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FOR 2013

Cambridge
IGCSE®

Business Studies

Fourth Edition

Karen Borrington
Peter Stimpson



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Introduction and guidance for students

Who is this book for?

This book has been written for all students of Cambridge IGCSE® Business Studies. It carefully and precisely follows the recently revised syllabus from Cambridge International Examinations. It provides the depth and practice that are needed by students to be successful in the examination of this specification. It will also prove to be of great use to students of Edexcel International GCSE, Cambridge O level and IGCSE Business Studies offered by other examining boards.

This book will prove to be valuable to students of Business Studies whether you are:

- studying the subject for the first time through your school or college and need a comprehensive and clearly written textbook
- revising the subject before your examinations and need a study guide to help refresh key definitions, techniques and examination advice
- learning the subject on your own through distance or open learning and need a complete programme of supportive questions, activities and suggested answers on-line.

Building on the successful formula of the three previous editions, this fourth edition explores all 21 topic chapters including selected material which will no longer be examined and adds new subject material with additional diagrams and new features.

How this book can help you

To make your study of Business Studies as rewarding and successful as possible, the Cambridge endorsed textbook offers the following important features in each chapter:

- an outline of the subject material to be covered and a checklist at the end to confirm what you should have learned and understood
- chapter titles and chapter section headings that completely match those of the Cambridge IGCSE® Business Studies syllabus
- extensive material presented in an informative yet lively way that allows for complete understanding of each topic to be gained
- numerous activities to support your learning and check your progress at each important stage of every chapter
- revision questions in the form of helpful 'Topic diagnosis' box highlights key topics and issues
- dilemmas of all types of business that might be examined
- case studies based on a range of international businesses
- examination-style questions at the end of each chapter to allow you to gain external practice in answering questions to Cambridge IGCSE® standard
- final case study plannings with questions at the end of each group of chapters covering a specific section of the curriculum content

- 'Tip-the-expert' tips to help you make key points when answering questions
- self-tests, inventories of activities for you to plot. These are focused on specific sections of the syllabus and will help you to develop your knowledge and application skills.

What is on the CD?

This is an illustration for the fourth edition. It contains:

- online answers to the exercises in each chapter
- sample answers to one of the examination-style questions from each chapter
- over 100 interactive multiple-choice questions, split into the chapters contained in the textbook, to allow further testing of your learning
- a review-question worksheet for each chapter – with online answers
- a glossary of all key words that have been defined in the textbook.

The information and details contained on the CD are as useful for your teacher as they are for you, so copy of the book – so that he or she can see the questions, worksheets and answers with you as they go through the course.

Is there a Teacher's CD too?

Yes! This is available separately (10000; 9780521178620) and provides the teacher:

- answers to all the remaining questions not given in the teacher's CD
- a syllabus of work
- teaching activities and worksheets
- sample examination questions with sample answers.

The Teacher's CD has not been through the Cambridge examination process.

Exam preparation and technique

Revision

You should be able to perform to the best of your ability if you:

- ensure that you have worked through all of the activities and examination-style questions in this book
- never disregard the following the examinations – allow plenty of time for this and avoid leaving it until the last minute.

You can also help yourself greatly if you take the following steps:

- Obtain a copy of the syllabus. You should also be able to obtain past examination papers and mark schemes. It is very important that you check the progress of your learning and revision by 'taking off' each copy against the syllabus criteria.
- Make sure that you know the number and length of each of the examination papers you will have to sit. The tasks and nature of the questions often differ between papers so you must be quite clear about the type of questions likely to appear on each paper.

For Cambridge IGCSE® Business Studies the examination papers are:

	Length	Type of paper	Type of assessment
Paper 1	1 hour 45 mins	Open book	Four short-response questions based on four different business. The questions are structured to test:
Paper 2	1 hour 30 mins	Open book	Two short-answer questions (3 p. in answer) all based on one topic.

In the examination

Make sure you check the instructions on the question paper, the length of the paper and the number of questions you have to answer. In the case of Cambridge IGCSE® Business Studies examinations you will have to answer three questions as there will be no choice.

Allocate your time equally between each question. Every year, good marks are often awarded by spending too long on some questions and too little time on one or all the others. You will be expected to spend longer writing an answer to a question worth 12 marks than two worth three words or answer with eight marks.

Remember that the same common 'prompt' words are 'Identify', 'Define' and 'Explain'. The following guide should help you:

Key examination prompt words you need to know

What is meant by

'This is asking you to clearly show the examiner that you know what a term means. A single sentence is usually always sufficient.'

Identify

'An "Identify" asks for one thing that could influence the price of a product.' Identify money written down, written explanation or discussion; the implied meaning of points.'

In the answers to the questions above might be:

- 1 Causes of inflation.
- 2 Price of component products.

Explain

'An "Explain" asks you to explain the broad-area level of problems.' This means 'using the figures provided, work out the following':

Calculate

'An "Calculate" asks you to calculate the broad-area level of problems.'

'More often than not it is asking you to give more detail than just identifying points. These answers must also be applied to the business in question – in this case, a hotel. No advertising on TV would not be appropriate for one hotel given the high cost of TV time. A better answer would be:

- 1 'The hotel could consider off-peak rates (lower than normal) at this hotel because it could offer these details at a special offer.'
- 2 'The hotel could also use a collection and delivery service to promote its services to customers who live far from the hotel's accommodation rooms.'

Examine

'An "Examine" asks whether the one manufacturer should reduce prices or increase demand.' This is asking you to show advanced skills. The best approach for answer this type of question is to explain the advantages and disadvantages of reducing one PESTO – using very clear material about the business to help you. You should then

weigh up their advantages and disadvantages applied to a car manufacturer and employ them before making a final conclusion.

Recommend

As in 'Recommended' which method of production the auto manufacturer should use? 'This is similar to *assess*'. A recommendation without explaining the advantages and disadvantages of different production methods will score you two marks. It is very important to have some recommendation on the right-hand portion given in the first part of your answer and to apply all of the points made in *advantages and disadvantages*. Your recommendation should also express why the other methods are less suitable.

Did you think that...

It is 'Do you think that [he/she] was right to choose the [the] correct business for the car show [and] justify your answer.'

You will notice the last three words of this question (justify your answer). You will earn one mark if you only answer to this question as 'Yes she/he was right'.

It sounds like this, you need to explain the advantages and disadvantages of choosing a chosen type of business given to you in the case. Finally, you should weight up the points for and against and come to a final decision, 'Yes' or 'No', based on your more important points.

Why have we included key statements in the examination above? This is because these statements are about the skill of application – linking your answer to the business in the form of case study. This is the easiest way to maximise your chances in an examination since you have drawn relevant knowledge. ‘Application’ is a very important skill for Business Studies students. Use all of the activities in this book and the examinations with questions to help you become an expert in applying answers to particular businesses.

Finally ...

Learning Business Studies should be both-exciting and challenging. We hope that this textbook and CIE IGCSE will help you overcome the challenges of the Cambridge IGCSE[®] exams so that you can achieve the success you are looking. In particular, we want the book to encourage you to develop a real interest in – even a passion for – finding out how all four areas of business really work. Business studies is so crucial to the future wellbeing of us all and is often given opportunities by all well educated students. Success in Cambridge IGCSE[®] Business Studies can help you take the first important steps towards playing a leading role in managing and directing business activity in your country. We are confident that this book will help support you during your exams.

Karen Brightman
Free Enterprise

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With the exception of *Brachydeuterus* which has been well preserved by the chalcid wasps of the genus *Aspicolpus*, these other four genera display no traces of winged apterous instars, save of those larger than the chalcidoids.

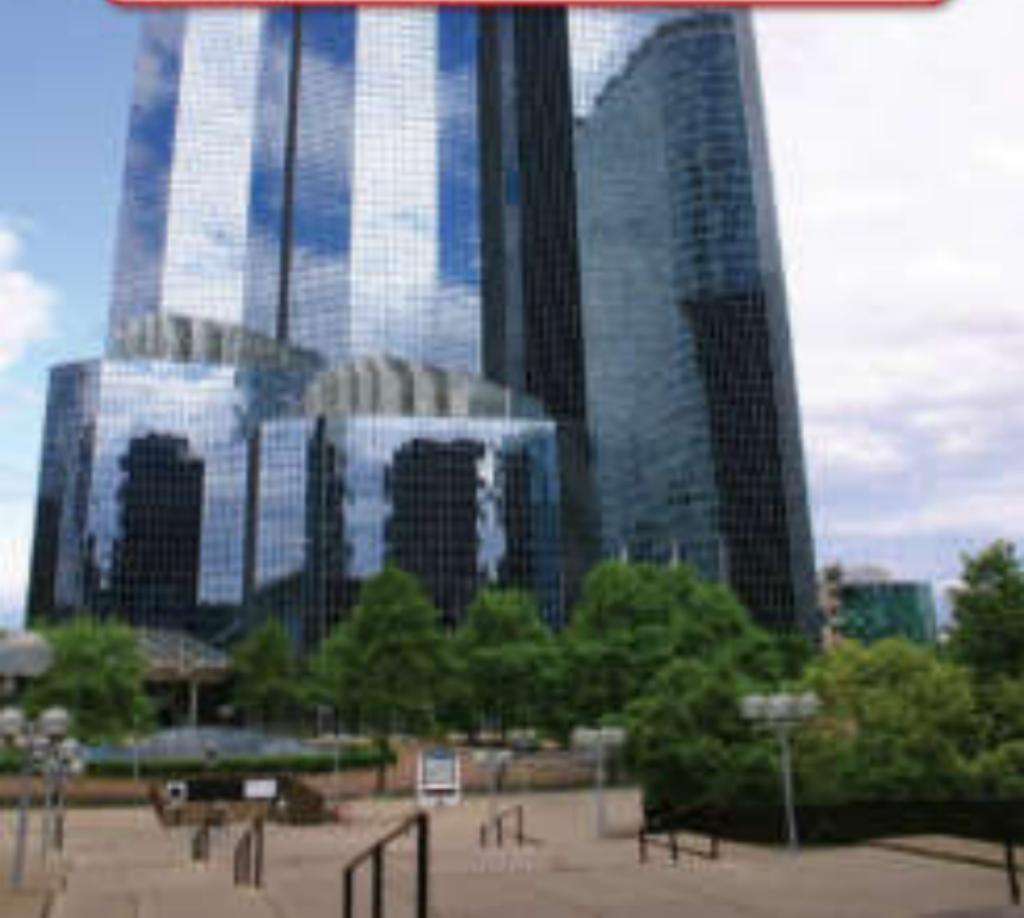
Section

1

Understanding business activity

Chapters

- 1 Business activity
- 2 Classification of businesses
- 3 Enterprises, business growth and size
- 4 Types of business organisation
- 5 Business objectives and sustainable objectives



Business activity

This chapter will explain:

- the concept of needs, wants, scarcity and opportunity cost
- the factors of production
- the development of economic activity and the use of specialisation
- the purpose of business activity
- the concept of added value

The economic problem: needs, wants and scarcity

Businessmen for business

A **need** is a general or absolute necessity for living.

A **want** is a general or variable-specific preference which has to be met, but which is not essential for living.欲求 wants are concerned.

The economic problem... these multi-dimensional wants had therefore been used to produce the goods and services to satisfy those wants. Why create scarcity?

Activity 1.1

Match these up:

- a) price needs - things you think are necessary for living.
- b) price wants - things you wouldn't be able to buy and live...

For example, an price needs lets you with probably include clean water, and an price wants let you think includes a luxury house.

What do you notice about your own list? Possibly the really important items are on the **needs** list - money, clothing, the warmth and protection, food and water from of housing or shelter. And on your **wants** list? That will be up to you and your resources and tastes, but you could probably have missed a tiny thing like that!

Do you already own all of the items on your wants list? If you do, then you must be very lucky and very rich! Most people in the world cannot afford to buy everything they need because our wants are unlimited. In many countries, some people cannot afford to buy the things they need, and they are likely to be very poor.

Why are there so many wants and needs than we can ever satisfy? Why are millions of people living in poverty in many countries around the world? About 1 billion people will answer these questions by saying, "Because there is not enough money!"

Is the real **economic problem** caused by a shortage of money? An example may help explain why your answer is not the answer to the problem of many people's wants and needs are being unsatisfied.

Case study: Venezuela

The Government of a what country is concerned about large numbers of people who cannot afford the basic needs of life. Even those citizens with more money are always complaining that the country is not producing enough of the basics that they want to buy. The Government decided to try to solve these problems by giving more basic foodstuffs to individual's incomes.

Has the Government solved the economic problem of this country? Not. Many more people go home for the people to sleep? More houses? More schools? Where can? basic needs standard of living off the production?

The answer to all of these questions is 'No'. Printing more money does not produce more goods and services. In fact price controls prices rising as basic goods cannot be afforded - one will pay more for the same amount of goods.

The economic problem – the root cause

The root cause of the shortage or scarcity of goods and services is that there are not enough **factors of production** to make all of the goods and services that the population wants and needs.

These are four factors of production:

- Land – this term is used to cover all of the natural resources provided by nature and include fields and forests, oil, gas, metals and other mineral resources.
- Labour – this is the number of people available to make products.
- Capital – this is the finance, machinery and equipment needed for the manufacture of goods.
- Enterprise – this is the skill and risk-taking ability of the person who brings the other resources or factors of production together to produce a good or service. For example, the owner of a business. These people are called entrepreneurs.

No-one country, and to the world as a whole, these factors of production are limited in supply. As there is limited supply of land, labour, capital or enterprise to produce all of the needs and different wants of a whole population, there is an economic problem of **WANTING**.



The root cause of the economic problem

Limited resources: the need to choose

We make choices every day. We have to, as we have limited resources but an insatiable desire. We therefore have to decide which wants we will satisfy and those which we will not. All choices involve giving something up – this leads to **opportunity costs**. Should I take a taxi to school or use the money for a taxi pass or train? Does business require travel? Do I buy a new pair of trainers to spend the money on a new mobile phone?

We do not have the resources to satisfy all our wants so the next best alternative that we give up becomes our opportunity cost. This problem of "what to give up" exists not only for consumers like us but for governments and businesses too. In making choices we need to consider carefully the opportunity cost to make sure it is the best choice to use than the ones we are having.

Key Resources

Key factors

Factors of production are those resources needed to produce goods or services. There are four factors of production and they are as follows:

Land is the area of sufficient size to produce the raw materials of the production.

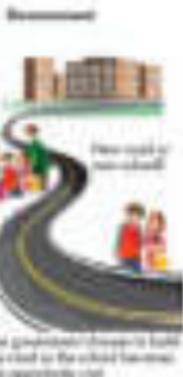
Key Resources and costs

Opportunity costs

Opportunity costs is the next best alternative given up by choosing another item.

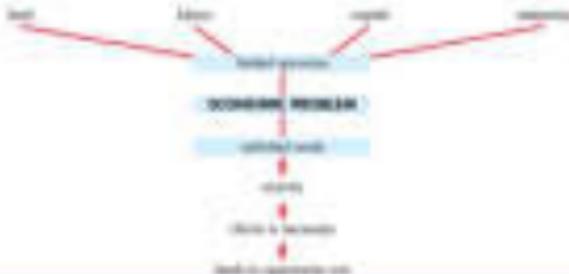
Opportunity cost
What are many
sacrifices of
the choices that
we make?

It is very
important that
you learn these
key terms for use in
your assessment
answers.



Examples of opportunity cost

Revision summary: the economic problem



Specialisation: the best use of limited resources

In all societies the factors of production are in limited supply. It is therefore important to use these resources in the most efficient way possible. The ways in which these resources are used have changed greatly in the last 200 years. Many few positions are now made just by the efforts and skills of one worker. Most of workers specialise in one skill and most businesses specialise in one product. **Specialisation** is now very common because:

- specialised machinery and technology are now widely available
- increasing competition means that businesses have to keep prices low
- more people recognise that higher living standards can result from being specialised

Definitions:

Opportunity cost

decisions where
parents and
businessmen
choose one
what does not
happen

Cross country comparison:

This is how Jack Morris, a carpenter, spent about half a day at work (pp. 11-12):



What do you notice about these methods of production?

- One did everything himself – increasing the cost of his product over the size-and-shape of the limited table.
- Production was very slow – only one table per week.
- Compare this with specialisation: production methods. This increased output rates, and therefore costs like family business. This is from production & equipment.

**Specialisation and the division of labour**

Jack Morris is using the principles of specialisation and **division of labour**. He is dividing up the making of tables into different jobs and making each worker a specialist at just one task. Division of labour has advantages and disadvantages.

Advantages**Disadvantages****Disadvantages****Advantages**

- Workers are more specialised and therefore efficient – this increases efficiency and reduces costs.
- It has been suggested that it increases productivity in production.

Disadvantages**Advantages****Disadvantages****Advantages**

- Workers are more specialised and therefore efficient – this increases efficiency and reduces costs.
- If one worker is absent, another can do the job, so continuity might be reduced.

Activity 1.1

- Using specific product for specific kind of job - picks, explores, with more than others - helps decision of labour or specialisation conditions used to make the product
- Keeping the possible widest range of products by using division of labour
- Specialisation of labour to the business operations

The purpose of business activity

We have described the following points:

- People have unlimited wants
- The four factors of production - the resources needed to make goods - are in limited supply
- Scarcity results from limited resources and unlimited wants
- Choice is necessary when resources are scarce. This leads to opportunity cost
- Specialisation improves the efficient use of resources

**Businesses are
there**

Businesses

Businesses help us to
make products
goods and
services which
satisfy people's
wants.

In this, we have briefly mentioned **businesses** and our aim is the purpose of this lesson:
Where does business activity fit into the ideas we have already looked at?

The purpose of all businesses is to continue the process of production to make products which will satisfy people's wants. These products can either be goods - physical items such as cars and televisions which we can touch and see - or they can be services, such as pensions, tourism or banking.

Businesses can be small - just one person, for example - or large. Some businesses employ thousands of people with operations in many different countries. Businesses can be privately owned or owned by the state. They can be owned by one person or by thousands of shareholders.

Wherever their size and wherever owners there, all businesses have one thing in common - they combine factors of production to make products which satisfy people's wants.



Agriculture

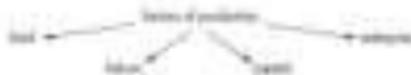


Office use



Industry

Businesses in all areas of industry produce goods and services by combining factors of production.



What would life be like without business activity? In simple, undeveloped societies, businesses do not exist. Everyone attempts to do everything for themselves – they are self-sufficient. With their own plot of land and by their own efforts, such as hunting, they attempt to acquire and produce enough for their own needs. This is a very basic existence and living standards are low.

By a slow process of specialisation, people began to concentrate on what they were best at. They then traded these goods or labour made by people who have different skills. In this way, business begins to be formed, and trade and exchange of goods expanded. In today's world, most people specialise in working in one job for a weekly wage. With this money, they are able to purchase a wide range of goods and services produced by many different businesses – specialising in different products.

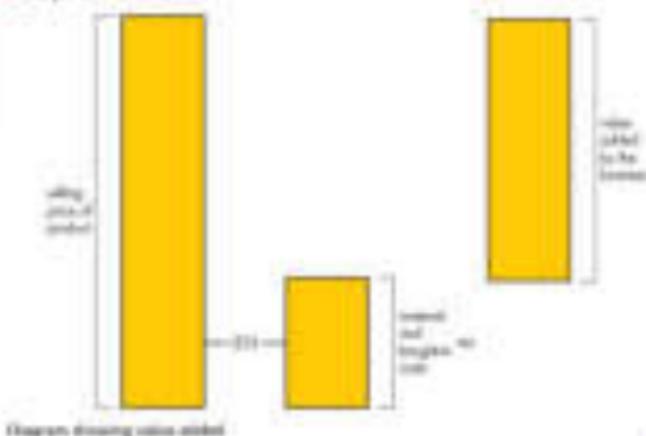
Businesses therefore:

- combine scarce factors of production to produce goods and services
- produce goods and services which are needed to satisfy the wants and needs of the population
- employ people as workers and pay them wages to allow them to consume products made by other people

Added value

This is a very important idea. All businesses attempt to **add value**. If value is not added to the materials and components that a business buys in raw:

- value cannot be paid for
- no profit will be made



Businesses in society

Added value is the difference between the selling price of a product and the cost of bought-in materials and components.

What is added value?

Added value is not just the cost of making something - it is also money business would have to pay to buy similar off-the-shelf items. Some businesses try to increase added value to get better returns. This means managing the product and increasing the price of this product over time to boost profit, perhaps from profit.

Why is added value important?

This section looks at how different ways of adding value can affect the business in the short term. A summary that is likely to add value to different ways for a food business or a soft drink manufacturer.

Example:

- The selling price of a locally built house is £100,000.
- The value of the bricks, mortar, wood and other materials was £15,000.
- The added value of the building firm was £85,000. This is not profit - just of the materials used plus wages and related costs too.

Why is added value important?

Added value is important because sales revenue is greater than the cost of essential inputs in the business. This means the business:

- can pay other costs such as labour costs, management expenses and costs such as advertising and power.
- may be able to make a profit if these other costs total less than the added value.

How could a business increase added value?

There are two main ways in which a business can try to increase its added value:

- 1 Increase selling price but keep the cost of materials the same. This might be possible if the business tries to create a higher quality image for its product or service. If consumers are convinced by this idea they might be prepared to pay higher prices just for the same quantity or below the average. A jewellery shop could employ very experienced and knowledgeable sales staff, display the ring in a very up-market way and use high quality packaging. Fewer storage costs might increase when trying to create this quality image.
- 2 Reduce the cost of materials but keep the price the same. If building firms could use cheaper wood, bricks and other materials when constructing a house or other item, the price charged to customers stays the same then a higher added value will be made. More though, lower priced materials might reduce the quality of the products. Will consumers be prepared to pay the same price for a product that they believe is of lower quality?

Revision summary: adding value

Case Study Example – McDonald's Bakery.

McDonald's offers a limited bakery within several dozen of its units. Its customers is just looking through menus to estimate 100,000+ meals. Just the idea of serving customers has until shifted all focus away from food that would be thrown away due to bakery shop. Customers will pay more for his meal's value and expect it to be well done with lots of coffee – just like a little talk. Standard thought consumer would expect higher prices and higher quality and taste. Customers had suggested. Increases right at base of his customers from very good to best and satisfied but also paid higher prices for the value and because those brought in they value increased themselves at store.

"Because most increased the value added to the food, sugar and butter he used to make bacon and meat bacon."

Activity 1.2

Refer to the McDonald's Bakery case study.

- If the food-selling ratio at this bakery is 80 cents worth of flour, sugar and butter and McDonald's sells each item for \$1, calculate the value added.
- If customers are prepared to pay up \$1.00 when this ratio is served on a plate of a meal, without the bakery, what is the value added (value added sales value)?
- Show the meaning of the meal-with-meal that helped most have increased the overall profit? Assume your answer.

International Business by Name: Overview of Issues in McDonald's

The running of business all McDonald's restaurant is business owned at the local, regional levels. These include advertising staff, pricing strategy, marketing Plan, risk and working hours. These regional units allow adapting to customer needs efficient and quick in their. All regions are given much freedom so that better that they will become profit at.

The similarities and differences of McDonald's member's choices that consumers do is served – very quickly with freshly cooked food. Costs are kept very low and the budget to make dinner time.

International fast-food have faced various risks often caused spread officials to reduce traps before entering to the countries.

Globalization process.

- Why do we think a large business such as McDonald's uses standardization?
- Think about terms like what happens do you eat by McDonald's if using international.
- If you owned a fast food restaurant, consider there must be which you must increase the value added to the food brought in to the consumers.



Exam-style questions – Paper 1

- 1 Giselle plans to start up her own business using her own savings. She wants to produce fashion clothes for women. She is a very good clothes designer but she does not like stitching clothes together. Some friends have offered to help Giselle. Also she has an experienced material supplier – this can cut lengths of material for clothes with very little wastage. After a quick of sewing:
- What is added value? [1]
 - Identify **fixed** factors of production that Giselle will need for her new business. [1]
 - Identify and explain **two** possible opportunity costs that Giselle may have from her decision to start her own business. [2]
 - Identify and explain **one** advantage and **one** disadvantage to Giselle's business of using chosen of labour in making clothes. [2]
 - Do you think that Giselle's business will be able to sell all of the clothes that it makes? Justify your answer. [1]
- 2 Mohammed runs a bakery. He makes bread and cakes. He employs three workers who help form the dough for the bread and cakes, put the dough into tins, bake the bread and cakes and serve customers. Mohammed has calculated that the 'added value' of his business is low. His customers complain when he tries to put up prices. 'They can buy the same bread and cakes at lower prices. They tell him':
- What is meant by 'added value'? [1]
 - Mohammed has just bought a new oven. Explain 'opportunity cost' to Mohammed. [1]
 - Identify and explain **two** benefits to Mohammed's business of all of his workers being able to do all of the jobs in the bakery. [2]
 - Identify and explain **two** ways in which Mohammed could increase the value added of his bakery business. [2]
 - As friend told Mohammed 'Your business would be more successful if you only worked in the shop and let your workers make the bread and cakes'. Do you agree? Justify your answer. [1]

Revision checklist

In this chapter you have learned:

- what the 'economic problem' means
- the difference between wants and needs
- why scarcity of resources results in choices and opportunity cost
- why specialisation is important
- the purpose and nature of business activity
- how businesses have to increase added value

Classification of businesses

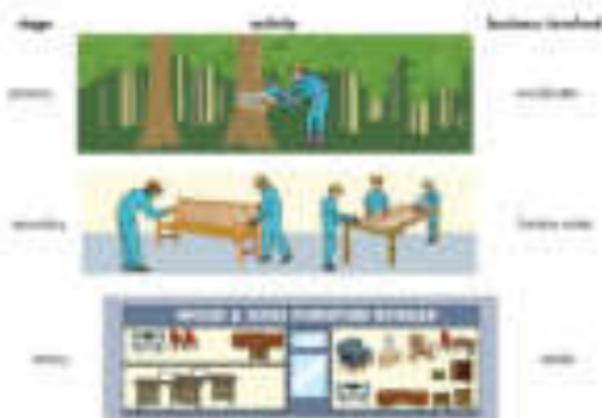
This chapter will explain:

- the differences between primary, secondary and tertiary production
- why the importance of these business activities varies between countries and over time
- the differences between public sector and private sector businesses in most economies

Stages of economic activity

As you read this book you are probably sitting at a desk. When desks are still made of wood, how many different types of businesses might have been involved in converting the wood into a finished desk ready to be sold to a final consumer? What stage of production has the wood passed through to arrive at the finished desk?

The diagram below shows the three likely stages in the production and sale of a wooden desk.



The stages in producing, making and selling a wooden desk

Businesses 101

Source

The **primary sector** of industry extracts and uses the natural resources of the earth to produce raw materials used by other businesses

You will notice that there are three main stages from the cutting down of the timber to the sale of the completed desk. These stages are typical of nearly all production and they are called the levels of economic – or business – activity.

Stage 1 is called the primary stage of production. This stage involves the earth's natural resources. Activities in the **primary sector** of industry include farming, mining, fishing and the extraction of natural resources, such as oil and copper ore.

Stage 2 is called the secondary stage of production. This stage involves taking the materials and resources provided by the primary sector and converting them into

Businesses by Name:

The **secondary sector** of industry manufactures goods using the raw materials provided by the primary sector.

manufactured or processed goods. Activities in the **secondary sector** of industry include building and construction, steel and oil manufacturing, aerospace, smelting, food packing.

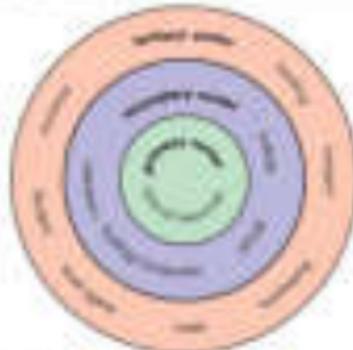


Businesses by Activity:

The **tertiary sector** of industry provides services to consumers and the other sectors of industry.

Examples of activities in the different sectors of industry:稻农 (rice farmer), 纺织业 (textile industry) and 零售业 (retail trade).

Stage 3 is called the tertiary stage of production. This stage involves providing services to both consumers and other businesses. Activities in the **tertiary sector** of industry include transport, banking, retail, insurance, finance and advertising.



The three types of business activity

Activity 3.1:

Copy this table. Indicate with a tick which sector of industry each business is in.

Business	Primary	Secondary	Tertiary
Postman			
Teacher			
Cashier			
Construction worker			
School teacher			
Driver			
Cleaner			

Relative importance of economic sectors

Which sector of industry is most important in your country? This depends on what is meant by "important". Usually the three sectors of the economy are compared by:

- percentage of the country's total number of workers employed in each sector
- or
- value of output of goods and services and the proportion this is of total national income

In some countries, primary industries such as farming and mining employ many more people than manufacturing or service industries. These would be countries - often called developing countries - where manufacturing industry has only recently been established. As more people shift from the rural areas with few services, there is little demand for services such as transport, health and education. The levels of both unemployment and wages in the primary sector in these countries are likely to be higher than in the other two sectors.

In countries which started up manufacturing industries forty years ago, the secondary and tertiary sectors are likely to employ many more workers than the primary sector. The level of output in the primary sector is often still composed of the other two sectors. In economically developed countries, it is now common to find that many manufactured goods are brought in from other countries. Most of the workers will be employed in the service sector. The output of the primary sector is often higher than the other two sectors combined. Such countries are often called the most developed countries.

Key words → classifying the three economic sectors: primary, secondary and tertiary.

The relative importance of the three economic sectors in India is very different to that in Britain. India does not have large reserves of arable land but Britain has some of the largest agricultural areas in the world. Increasingly, India's agriculture industry creates a huge contribution to its British economy.

India's rapidly rising service manufacturing industries are rapidly growing fast the secondary sector is becoming more and more processing and services are the most important secondary industries. In Britain, developed secondary industry includes engineering, energy and other services from the chemicals extracted from oil stores. Services production would increase. The tertiary sector is responsible for both countries' growth but is very important in Britain and accounting for between 60% and 70% in India's largest service industry.

% of total national output (2011)	Primary	Secondary	Tertiary
India	11	13	76
UK	14	21	65

Activity 2.2

Refer to the case study above.

- 1 Explain what tertiary production means by using examples from the case.
- 2 Identify and explain how secondary and tertiary sectors are relatively more important to Britain than India.
- 3 In 2011, it was estimated that India had 10% of India's workers in the primary sector – despite agricultural being one of the least important of the three in terms of output?
- 4 Discuss the likely impact on Britain if its diamond miners became exhausted (the diamonds run out).

Changes in sector importance

In the UK and other developed countries there has been a decline in the importance of manufacturing industry – to the secondary sector – since the 1970s. The tertiary sector at the UK age range will now 60 per cent of all workers. Many workers who have lost jobs in factory-based firms find it difficult to obtain work in the service industries. The decline in the manufacturing to secondary sector of industry is called **de-industrialisation**.

In China and India, the relative importance of the secondary sector has increased since the 1980s, compared to the primary sector. However, in both countries, many of the service sector increases are now occurring more rapidly than those in both the primary and secondary sectors. There are several reasons for changes in the relative importance of the three sectors over time:

- increases of some primary products, such as coal, oil and gas, become depleted. This has been true for Britain with the closing down of most of its pits.
- Most developed economies are taking opportunities in manufacturing to the newly industrialised countries such as Brazil, India and China.
- As a country's total wealth increases and living standards rise, consumers tend to spend a higher proportion of their income on services such as travel and recreation than on manufactured products produced from primary products.

Definitions to know

De-industrialisation
means when there is a decline in the importance of the secondary manufacturing side of industry in a country.

Topic for discussion

Was agriculture important in your local area? Do you have any knowledge of actual agriculture businesses, local or national? What do these businesses produce? Different patterns of ownership between family farms and business units, what business does this type of agriculture?

Case study: Bangladesh's agricultural sector

In 1950, Bangladesh (then known as East Pakistan) had an economy largely based on agriculture. A high proportion of the population worked in farming and its structure was far less efficient than it is today. Although 80 per cent of the agricultural staff works in agriculture, primary production of goods such as jute, tobacco and tea has fallen in recent years. Manufacturing industries – notably food processing and textiles – have expanded rapidly. Service sectors such as telecommunications, transport and finance now contribute approximately half of total national output.

Agriculture services in Bangladesh – World Bank estimates of % share of GDP

	Rice	Nonrice	Total
1950	55	15	70
2001	25	25	50

Activity 3.3

Refer to the case study above:

- Identify and explain three possible reasons why the relative importance of primary sector has fallen.
- Would workers who formerly worked in agriculture find it easy to obtain jobs in the secondary or tertiary sectors of industry? Explain your answer.
- What do you expect to happen to the relative importance of tertiary industries if income continues to rise in Bangladesh? Justify your answer.

Mixed economy

Mostly every country in the world has a **mixed economy** with a

- **private sector** – business not owned by the government. These businesses will make their own decisions about what to produce, how it should be produced and what price should be charged for it. These businesses in the private sector will aim to earn profitably. Since no there are likely to be some government controls over these decisions, and these are explained in other chapters in this book.
- **public sector** – government- or state-owned and controlled business and organisations. The government, or other public authority, makes decisions about what is produced and how much to charge consumers. These goods and services are provided free of charge to the consumer, such as state health and education services. The money for these comes from the tax but from the opposite direction of private-sector and public-sector business are often different (see Chapter 4).

Examination tip

A mixed economy has both a private sector and a public sector.

Which business activities are usually in the public sector?

In many countries the government controls the following important businesses or activities:

- health
- education
- defence
- public transport
- water supply
- electricity supply

Activity 3.1

For each of the examples of key industries or activities listed above, research how much revenue (i.e. the percentage of a country's total money) is spent and control they believe they receive.

Activity 3.2

Find out whether, in your own country, the government owns and controls the following businesses:

- railway system
- road traffic services
- water supply
- electricity supply
- TV and radio stations
- hospitals

Mixed economies – recent changes

In recent years, many governments have changed the balance between the private sector and the private sector in their economies. They have done this by selling some public sector businesses – owned and controlled by governments – to private sector businesses. This is called privatisation. In many European and Asian countries the water supply, electricity supply and public transport systems have been privatised.

Why have governments done this? In other words, do private-sector businesses act more efficiently than public-sector businesses? This might be because there is less competition in profits and decisions must be controlled. Also, private-sector owners might invest more capital in the business than the government can afford. Competitive businesses private-sector businesses can help to improve product quality.

However, a business in the private sector might make more workers unemployed than a public-sector institution in order to cut costs. A private-sector business is also likely to focus on profit objectives.

Definitions in bold

Capital is the money invested into a business by the owners.

Costs for business These will be the minimum for your business to stay competitive and the advantages and disadvantages of the private sector are useful to remember.

Type the question

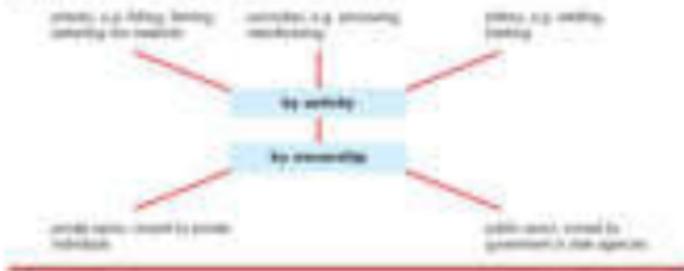
the state has a
privatised
organisation
with 'commercial'
a state trader
who is private.
Businesses compete
with traders and
private limited
businesses are
both examples
of privately-owned
businesses. True
or False?

Changed to the balance between the private sector and the public sector are likely to continue to many small economies.

Answers 2.4

Your Government is considering the privatisation of your country's postal service. You decide to write to the Government minister in charge, explaining your ideas on this matter and letting him/her know your letter of protest.

- an explanation of the difference between private sector businesses and public sector businesses;
- the positive benefits of this postal service being in the private sector;
- the possible disadvantages of the postal service being in the private sector;
- your recommendations on the monopoly or otherwise to keep the postal service as the public sector of not.

Revision summary: sectors of industry

International Business in Tourism: Mauritius

Mauritius is a small island in the Indian Ocean with a land area of just 3000 km². The Mauritian economy is dominated by the tertiary sector. In 2011, tourism, business and other services accounted for the one third of total national export trade elements produced in Mauritius. The secondary sector accounted for 28 per cent and primary industries – mainly sugar production – just 6 per cent. This diversification is planned for 2 million foreign visitors by 2015 and the number of tourists is increasing by 6 per cent per year. These tourists spend a great deal of money on food, drink, travel and holiday items.

All Mauritius is made of five businesses that have benefited greatly from the importance of tourism in the country. The article is partly concerned with the tourism and the Mauritius Government. It also looks at the Indian Ocean island nation's place and trend in tourist products.

All Mauritius has only been an independent country of six months back it also offers services to other nations according to the region's strengths. Mauritius' weaknesses such as Mauritius' language (AF). There are hundreds of tourists and guest houses in Mauritius and these compete against local markets. Some of the largest hotel groups in the world operate in Mauritius such as Radisson and ITC Hotels.



Discussion points:

- Why do you think the primary sector of the Mauritian economy is extremely small?
- Explain three ways in which service industries contribute to the Mauritian economy.
- Do you think after increasing numbers of tourists will bring only benefits to Mauritius?
- Why do you think the Mauritius Government will never leave off all Mauritius?

Exam-style questions – Paper 1

- 1** A state engineering company (AEC) makes parts for cars and trucks. These are sold to car manufacturers in many countries. The parts include metal brake components and rubber seals to fit various vehicles. AEC operates in Country X, which, until a few years ago, had an economy dominated by agriculture and coal mining. Over the last 20 years the relative importance of the primary sector has declined. To be successful AEC requires natural resources to make car parts and the services provided by other businesses. Consumer incomes are doing equally in Country X.
- a** What is meant by 'primary sector'? [1]
- b** Identify **two** examples of services that a business such as AEC requires. [2]
- c** Identify and explain **two** reasons why a business such as AEC could not be successful without other firms providing natural resources. [4]
- d** Identify and explain **two** likely reasons why the relative importance of the primary sector of Country X's economy has declined. [4]
- e** A government minister in Country X recently said: 'The secondary sector of industry will always be more important than the tertiary sector to our economy.' Do you agree with this view? Justify your answer. [6]
- 2** The Government of Country Y owns and controls many businesses. 'The public sector always produces goods and services more efficiently than privately owned businesses', a Government minister recently said. Other ministers disagree and want to privatise many state-owned businesses. The people voted in favour of Country Y's policies. It is per cent of total output – mainly in services such as transport, tourism and finance. The secondary sector of industry produces 30 per cent of total output.
- a** What is meant by 'public sector'? [1]
- b** Identify **two** industries in the secondary sector. [2]
- c** Identify and explain **two** reasons why the tertiary sector of industry is becoming more important in most countries. [4]
- d** Identify and explain **two** possible reasons why some ministers want to privatise some businesses in the public sector. [4]
- e** Do you agree with the Government minister's view that: 'The public sector always produces goods and services more efficiently than privately owned businesses'? Justify your answer. [6]

Revision checklist

In this chapter you have learned:

- the differences between the three sectors of an economy/business activity
- reasons why these sectors vary in importance between countries
- reasons why these sectors vary in importance over time
- the differences between the private sector and public sector in mixed economies
- arguments for and against privatisation.

EX 7B – test your understanding with the revision questions on the ECD-ROM.

Enterprise, business growth and size

This chapter will explore:

- the importance of enterprise to new businesses
- the key characteristics of successful entrepreneurs
- the importance of a business plan for an entrepreneur
- how to measure and compare the size of businesses
- how business can expand internally and by merger and takeover
- why some businesses remain small and why some businesses fail

Enterprise and entrepreneurship

Definitions and terms

Enterprise
the process
of creating
opportunities
and taking
risks for a
business venture

What will you do when you leave school or college? Maybe go to university or get a job. Some of you may decide to take the risk of setting up your own business – this could be full- or part-time. If you do decide to do this then you will become an **entrepreneur**!

What are the benefits – and possible disadvantages – to setting up your own business?

Benefits of being an entrepreneur	Disadvantages of being an entrepreneur
<ul style="list-style-type: none"> ■ independence – able to make money and money ■ able to put out their own products ■ may become famous and successful if the business grows ■ may be profitable and the income might be higher than working as an employee for another company ■ able to make use of unused resources and skills 	<ul style="list-style-type: none"> ■ risk – running your own business fails, especially if there's a poor planning ■ capital – will have to sell their own savings into the business and, possibly, they other sources of capital ■ lack of knowledge and experience in starting and managing a business ■ responsibility cost – bad business leads not being an employee of another business

For many successful entrepreneurs, setting up their own business has led to great wealth and fame. How many of these business leaders have you heard of? They all started out as entrepreneurs with their own business ideas.

Entrepreneur	Nationality	Most famous ventures
Mark Cuban	US	Major group of companies including Dallas, motorcycle and basketball
Shlomo Benyamin	India	Major group of companies including chemicals, IT and mining
Tan Sri	China	Properties
Harish Mehta	India, USA	Clothing
Mark Zuckerberg	US	Social networking site Facebook
Dave Thomas	US	Rapid food restaurant



Mark Zuckerberg



Sir Richard Branson



Steve Jobs

Tips for success

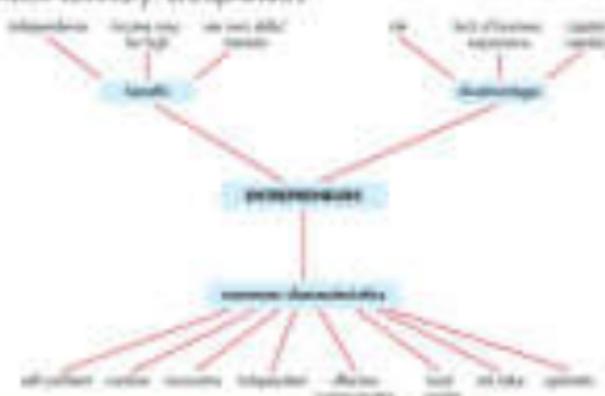
Think about why these 'successful' entrepreneurs are 'successful'. You will find they are based on: 1. Vision (able to see what others can't); 2. Persistence (able to keep going); 3. Creativity (able to think outside the box).

Characteristics of successful entrepreneurs

Would everyone make a good entrepreneur? Probably not - most people do not like risk or working independently - they might prefer to be an employee of a large business instead.

Characteristics of successful entrepreneurs	Reasons why important
Hard working	A long hard and often grueling life is typical for many entrepreneurs to help their business succeed.
Risk-takers	Starting a business is unusual (and can be seen) so being courageous is potentially risky.
Creativity	Older businesses need new ideas - novel products, services, new or exciting packaging - to make it stand out from other existing firms.
Opportunities	抓住 the moment is a better business approach - if you think only of future possibilities fails.
Self-confident	Being self-confident is necessary to convince others outside of your circle and to convince banks, other investors and customers that your business is going to be successful.
Resourceful	Money alone for start-up does not guarantee a successful and efficient company to start operations.
Independent	Entrepreneurs tend often have to work on their own before they can affect or please others. Entrepreneurs must be self-motivated and be able to work without a supervisor.
Effective communication	Writing clearly and concisely to family, other family, customers and government agencies about their new business will raise the profile of the new business.

Revision summary: entrepreneurs



Why governments support business start-ups

Most governments offer supports to entrepreneurs. The diagram shows six reasons why this support is given.

- Reduce unemployment - new businesses will often create jobs to help reduce unemployment.
- Increase competition - new businesses give consumers more choice and compete with already established businesses.
- Increase output - the economy benefits from increased output of goods and services.
- Benefit society - entrepreneurs may create social enterprises which offer benefits to society other than jobs and profit (for example, supporting disadvantaged groups in society).
- Encourage further - all large businesses were small ones! By supporting smaller ones the government may be helping some firms that grow to become very large and important in the future.

What support do governments often give to startup businesses?

Business start-up loans	Government often give support by:
Business idea competitions	Competing ideas and support schemes offered by government business people
Incentives	Enterprise zones - areas where tax rates are lower to attract investment
Research	Look for small businesses at low-interest rates Incentives if business starts in designated areas of high unemployment
Labour	Give £10,000 contributions to local unemployment and training agencies from productivity
Research	Encouraging universities to make their research facilities available to new business entrepreneurs

How a business plan assists entrepreneurs

A bank will always seriously ask an entrepreneur for a **business plan** before agreeing to a loan or overdraft to help finance the new business.

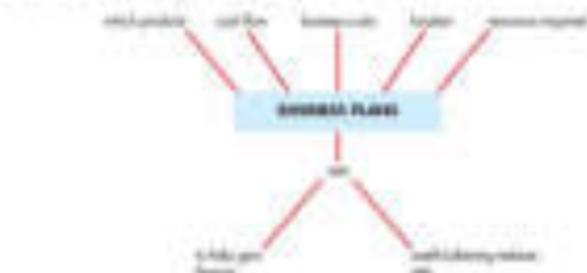
By completing a business plan, small firms are able to give business owners a really personal view to all that the entrepreneur is likely to think about and plan carefully for the first five years. The entrepreneur will have to consider:

- What products or services do I intend to provide and which consumers are I 'targeting' at?
- What will be my start costs and will enough profits be made to pay for them?
- Where will the firm be located?
- What machinery and how many people will be required to run the business?

Without this detailed plan the bank will be reluctant to lend money to the business. This is because the owners of the new business cannot show that they have thought seriously about the future and planned to meet its challenges that they will certainly face. Even with a detailed business plan, the bank might not offer a loan if the bank manager believes that the plan is not well completed (for example, poorly forecasted cash flow).

An example of a business plan is shown on the next page. It was completed by two entrepreneurs planning to open a *takeaway pizza restaurant*.

Revision summary: business plans



Why they succeeded:

They could be become what they wanted. The majority of a business ideas don't end like this, so it's especially nice to see that a particular business might actually work! Developing costs are low.

Business plan template – Business plan for Pizza Place Ltd

Name of business	Pizza Place Ltd
Type of organisation	Private limited company
Motivation (you)	To provide a high-class, affordable pizza service including home delivery.
Product	High-quality Italian pizzas
Price	Average price of \$10 with \$1 delivery charge
Market research for	Using Google and YouTube
Market research considerations and the results	Research in the area conducted using questionnaires, sites, research international trends in take-away sales and local competition. Results of all research in the appendix to this plan.
Business development plan	New staff (one person needed) for the early start to be arranged initially.
Details of business plan	Peter Young - Head of 25 year old experienced business plan - Strategic manager of a restaurant for three years.
Production details and financial costs	Main supplier - P&P Worldwide Fixed costs of business - \$1000 per year Variable costs - approximately \$1 per unit sold
Location of business	Blue Chip Shopping Street (Owner selected just prior from the local area).
What equipment required	Initial fixed equipment investment - \$9000. Second fixed investment - \$7000
Projected profits	See financial appendix to this plan. However, for the first year of operation this figure needs to be revised to be \$250000 with revenue of \$400000. Revised profits - \$300000 Loss off initial fixed costs - -\$200000 per year
Cash flow	See financial appendix to this plan. Due to the high initial fixed production costs there will be negative cash flows in the first year.
Finance	\$100000 invested to start off the business. Ability to finance not a further \$100000 plus an overstatement of \$100000 (if \$100000 isn't available).

Reviewing 3.1

Read the business plan for Pizza Place Ltd above. Explain why, if you were a bank manager reading this plan, each of the following would be important to you before you gave the entrepreneur a loan:

- local research results
- experience of business owners
- revised profits

Activity 3.1

Draw up another business plan. It should be based on your own idea for a business that is based on either your own interest or on page 60 (example: a pottery shop, craftswoman who sells things).

Activity 3.2

Research into the background and business activities of two micro-businesses appropriate to your area. Answer briefly the personal characteristics that you believe each entrepreneur has which have helped them to succeed. Write a brief report on each one and be prepared to present your findings to the rest of your class.

Comparing the size of businesses

Businesses can vary greatly in terms of size. On the one hand, firms can be owned and run by a single individual. At the other extreme, some businesses employ hundreds of thousands of workers all over the world. Some firms produce output worth hundreds of dollars a year, whilst the biggest businesses sell goods valued at billions of dollars each year.

Why would it be useful to compare the size of businesses?

- Investors – before deciding which business to put their savings into.
- Government – when there are different tax rates for small and large businesses.
- Competition – to compare their size and performance with other firms.
- Workers – to have some idea of how many people they might be working with.
- Banks – to see how important a factor the business is compared to its rivals size.

Business size can be measured in a number of ways. The most common are:

- number of employees
- value of output
- value of sales
- value of **capital employed**

They all have advantages and disadvantages.

Number of employees

This method is easy to calculate and compare with other businesses.

Some firms have production methods which employ very few people but which produce high output levels. This is true for automated factories which use the latest computer-controlled machinery. These firms are called capital intensive firms – they use a great deal of capital (high cost) equipment to produce their output. Therefore, a company with high output levels could employ fewer people than a business which produced less output. Another problem is should two part-time workers who work half of a working week each be counted as one employee – or two?

The Business in Depth

Capital employed
is the total value of capital used in the business.

Value of output

Calculating the value of output is a common way of comparing business size in the same industry – especially in manufacturing industries.

However, a high level of output does not mean that a business is large when using the value method of measurement. A firm employing five people might produce several very expensive components each year. This might give higher output figures than a firm selling cheaper products but employing more workers. The value of output in any case produced might not be the same if the value of some goods are not sold.

Value of sales

This is often used when comparing the size of retailing businesses – especially smaller selling outlets (for example, food supermarkets).

However, it could be misleading to use this measure when comparing the size of businesses that sell over millions products (for example, a market stall selling souvenirs and a retailer of luxury handbags or perfumes).

Value of capital employed

This measures the total value of capital invested into the business.

However, this has a similar problem to that of the 'number of employees' measure. A company employing many workers may use labour intensive methods of production. These give low output levels and use little capital requirement.

There is no perfect way of comparing the size of businesses. It is quite common to use more than one method and to compare the results obtained.



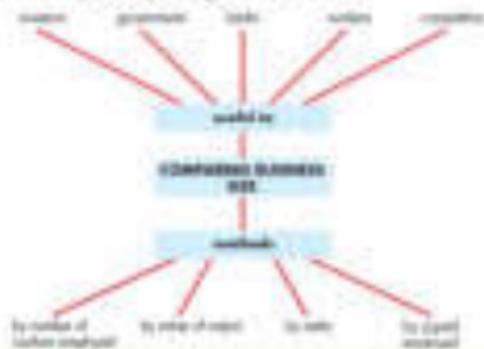
A capital intensive business and a labour intensive business



Activity 3.4 Comparing business size

You work for a small business, Company A, which makes cosmetics. You have been asked to write a brief report to the Marketing Director comparing the size of your company with three others in the same industry. Use the following information in your report. Show the advantages and disadvantages of each of the ways of comparing business size.

	Workers employed	Capital employed (£m)	Value of output (£m)
Company A	20000	50	100
Company B	3000	100	80
Company C	2000	30	60
Company D	15000	80	70

Revision summary: comparing business size**Why do owners often want their businesses to grow?**

The owners of businesses often want their firms to expand. What advantages will a business and its owners gain from expansion? There are some main benefits:

- the possibility of higher profits for the owners
- more money and prestige for the owners and managers – higher salaries are often paid to managers who control the bigger firms
- lower average costs (explained in Chapter 12, page 221, Economics of scale)
- larger share of its market – the proportion of total market value a market it grows. This gives a business more influence when dealing with suppliers and distributors and consumers are often attracted to the ‘big names’ in a industry.

Definitions of growth

External growth - occurs when a business expands its existing operations.

Internal growth - refers to a business adding more or changing parts of its existing business.

It is often called **expansion** or can also be integrated into existing core.

In **horizontal** it refers to the entry of two businesses agrees to join their resources to make their business.

A **merger** is where the owners of two businesses agree to join their resources to make their business.

An **acquisition** is when one business buys out the resources of another business without them.

Businesses part of the producer-business that they work together it is used.

Vertical integration - when one merged with another with sales over another level of the same industry of the same stage of production.

Horizontal integration - when one merged with another with sales over another level in the same industry but at a different stage of production.

Horizontal integration can be forward or backward.

Conglomerate integration - when one merged with another from a firm in a completely different industry. This is also known as **diversification**.

How can businesses grow?

Businesses can expand in two main ways:

- by **internal growth**, for example, a restaurant owner could open other restaurants in other towns - this growth is often paid for by profits from the existing business. This type of growth is often quite slow but easier to manage than external growth.

- by **external growth**, involving a **merger** or a **takeover** with another business.

Three examples of external growth are shown below:

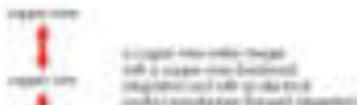
- Horizontal merger (or **horizontal integration**) - when one firm merges with or takes over another one in the same industry at the same stage of production.



An example of horizontal integration.

- Vertical merger (or **vertical integration**) - when one firm merges with or takes over another one in the same industry but at a different stage of production.

Vertical integration can be forward - when a firm merges with another firm which is at a later stage of production (i.e. closer to the consumer), or backward - when a firm merges with another firm at an earlier stage of production (closer to the raw material supplier, in the case of a manufacturing firm).



Forward vertical integration

Backward and forward integration

- Conglomerate merger (or **conglomerate integration**) - when one firm merges with or takes over a firm in a completely different industry. This is also known as **diversification**.



A business fulfilling business needs with a business making profits

You should notice that all three examples of integration are very different even though they all involve one business joining together.

The likely benefits of integration

Horizontal integration

- The merger reduces the number of competitors in the industry.
- There are (approximately) economies of scale (see Chapter 18).
- The combined business will have a bigger share of the total market than either firm before the integration.

Forward vertical integration

For example, a car manufacturer takes over a car trading business.

- The merger gives an assured source for their products.
- The profit margin made by the trader is absorbed by the expanded business.
- The supplier could be prevented from selling competing makes of car.
- Information about customer needs and preferences can now be obtained directly by the manufacturer.

Backward vertical integration

For example, a car manufacturer takes over a firm supplying car body panels.

- The merger gives an assured supply of important components.
- The profit margin of the supplier is absorbed by the expanded business.
- The supplier could be prevented from supplying other manufacturers.
- Costs of components and supplies for the manufacturer could be controlled.

Conglomerate integration

- The business now has activities in more than one industry. This means that the business has diversified its activities and this will spread the risks taken by the business. For example, suppose that a newspaper business took over a travel marketing company. If sales of newspapers fall due to changing consumer demand, sales from advertising on social networks may could be rising at the same time due to increased interest in this form of communication.
- There might be a transfer of value between the different sections of the business just through free exports in different industries. For example, an insurance firm buying an advertising agency could benefit from better promotion of its insurance services as a result of the agency's publicity.

Activity 1.5

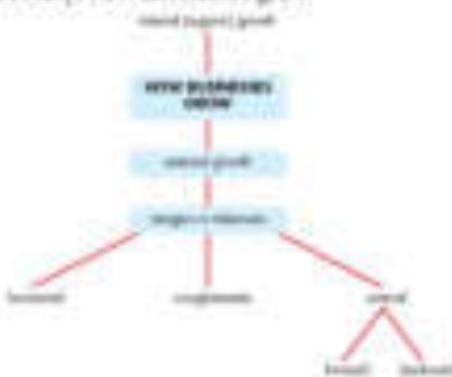
Identify five kinds of business growth which is used in each of these situations.

- 1 A garage expands to cover more customer spaces.
- 2 A single estate agent takes a three-storey building to run their business.
- 3 A business training plan takes place - expansion to plan with a business with retail shop specialising in educational goods.
- 4 A running firm takes over another manufacturing running business.
- 5 A corner coffee company buys a Holiday company.

Activity 1.6

In each of the cases in Activity 1.5, identify and explain how these reasons for the expansion

Revision summary: how businesses grow



Focus study 1: Market expansion of large Chinese-owned business

Haier is the largest 'brand-name' manufacturer in the world. The company needs the resources to expand into the EU (European Union) in Germany, China. This Chinese company makes washing-powder units. The turnover just 1000 million, it will take the same 10 years to sell its products in China. These places will be countries from the following three continents and expected that these might be less income of sales and profits than before the difference. Also, perhaps Haier might increase prices now that there will be less competition in the market and much higher.

Activity 3.7

Read this case study on the previous page:

- Is NCR's approach an example of 'horizontal' or 'vertical' integration? Explain your answer.
- Identify and explain three possible reasons why NCR took over Shutterfly USA company.
- Will you have confidence in NCR's soft-launch strategy? Assess NCR's future prospects.



A默沙东制药公司

Problems of business growth – and how to overcome them

Not all business expansions lead to success. There are several reasons why business expansions can fail to increase profit to achieve the original objectives and the managers:

Problem resulting from expansion	Possible management problem
Large business is difficult to control internally (see section of code, Chapter 16)	Oversee new business or small units – the ability of decentralisation
Large business fails to prove its competitiveness (see Chapter 16)	Identify risk factors in smaller units Use limited IT equipment and risk communication Have been placed on board problems
Businesses outside which the business is based off-shore	Identify local clients' requirements from doing expanding business in prep for further growth Ensure sufficient long-term finance is available (see Chapter 11)
Integrating with local business to make difficult than expected (e.g. different management styles or issues of entry foreign)	Considering a different style of management requires good communication with the resources – they will need to understand the reason for the change

Why do some businesses stay small?

Not all businesses grow. Some stay small, employing ten people and using relatively little capital. There are several reasons why more businesses remain small:

- the type of industry the business operates in
- the owners' size
- the owners' objectives.

The type of industry the business operates in

There are many examples of industries where most firms remain small: hairdressing, car repairs, window cleaning, maintenance work, plumbing, catering. Firms in these industries offer personalised services or specialised products. If they were to grow too large, they would find it difficult to offer the close and personal service demanded by customers. In these businesses, it is often very easy for competitors to keep up and stay competitive. This helps to keep existing firms relatively small.

Market size

If the market – that is, the total number of consumers – is small, the businesses will likely remain small. This is true for firms such as Jollibee, which operates in over 1,000 outlets from coast to coast in Asia alone, which produce goods or services of a specialised kind, which appeal only to a limited number of consumers, such as very expensive cars or expensive fashion clothing, remain small.

Owners' objectives

Small business owners prefer to keep their firm small. They would be more concerned in keeping control of a small business, having all of their staff and customers, than running a much larger business. Owners sometimes wish to avoid the extra job security of running a large firm.

Why some businesses fail

Not all businesses are successful. The rate of failure of newly formed businesses is high – in some countries, over 50 per cent close within five years of being set up. Even established businesses can close down because they make losses or run out of cash. The main reasons why some businesses fail are:

- **Poor management** – this is a common cause of new business failure. Lack of experience can lead to bad decisions, such as locating the business in an area with high costs but low demand. Failing businesses can fail because the sons and daughters of the founders of a business do not necessarily make good managers – and they might be reluctant to recruit professional managers.
- **Failure to plan for change** – the business environment is constantly changing – this happens to most of the best chapters. This adds to the risk and uncertainty of running a business. New technology, powerful new competitors and major economic changes are just some of the factors that can lead to business failure if they are not responded to effectively.

- **Poor financial management** - shortage of cash (lack of liquidity) means that workers, suppliers, landlords and government cannot be paid what they are owed. Failure to plan or forecast cashflows can lead to this problem and is a major cause of business failure at listing.
- **Over expansion** - as was seen above (page 31), when a business expands too quickly it can lead to big problems of management and finance. If these are not solved, the difficulties can lead to the ultimate business failing them.
- **Risks of new business start-ups** - many new businesses fail due to lack of financial and other resources and research. In addition, the owners of a new business may lack the organisational and decision-making skills of managers who work for larger businesses. This means that new businesses are nearly always more at risk of failing than existing, well-established businesses.

RESTRUCTURING BUSINESS TO SUCCEED: THE CASE OF NISSAN

The Nissan group is one of the largest companies in Asia measured by value of output. It had 100,000 employees in 2010 in many industries including electricity, steel, car chemicals, telecommunications - and cars!

Most of Nissan's growth has resulted from takeovers of other businesses. For example it bought out Mitsubishi (and therefore its South Korean and Japanese car divisions) in the 1990s. It also now makes many products, such as small and plastic components for other Nissan divisions.

Such a history of take-over and growth is often seen as problematic because it is hard to know if it is managed - this means more decisions are not taken centrally as these offices.

The purpose of Takeuchi's division is to spearhead innovation. This division failed in 2010 to produce a new model car. It's main problem seems to be organisational problems and model car development changing needs - and the business simply ran out of cash.

Discussion points

- What are some of the benefits to firms of being a 'takeover'?
- Why do you think Nissan's managers have used takeovers as a method of growth?
- If the NissanCar division was to introduce a fleet of hydrogen-fuelled cars, what form of innovation would it need? (Be sure there this would be a good idea!)



Nissan Leaf



Exam-style questions - Paper 1

- 1** Salma was forced out of her job in a clothing factory. Her main problem was fashion and she had always been good at selling since helping her father run his market stall. She encouraged her parents and some friends to invest in her idea for opening a shop selling good quality ladies' clothes. Salma, as the entrepreneur behind the idea, was pleased to make her own savings too. She had some worrying issues for the shop though and preservation of profits.
- What is meant by 'entrepreneur'? [1]
- Identify **two** benefits to Salma of starting her own business. [2]
- Identify and explain **two** characteristics that Salma seems to possess that might lead to success of her business. [4]
- Identify and explain **two** benefits to Salma of keeping her business small. [2]
- I think I should draw up a business plan before I start... said Salma to a friend. I think it would be best if you set that business up now – you don't need a plan as the shop will be so small, said the friend. Which view do you agree with? Justify your answer. [9]
- 2** TelCom makes a phone network and provides phone-network services to many companies. The business does not manufacture phones and it makes cash from retail stores selling them. Senior managers at TelCom are considering a takeover of another phone manufacturer as a chain of phone shops. TelCom employs 40000 workers and, last year, recorded total sales of £1000 million. In contrast, the largest manufacturer of mobile phones, Samsung, has 45000 workers and recorded total sales last year of £1200 million.
- What is meant by 'takeover'? [1]
- Identify **two** other ways a business might grow apart from takeovers. [2]
- Identify and explain **two** reasons why internal growth could be considered as increasing the size of businesses, such as TelCom. [4]
- Identify and explain **two** possible reasons why senior managers at TelCom want to expand the business. [4]
- How should TelCom manage – taking over a phone manufacturer or a chain of shops selling mobile phones? Justify your answer. [9]

Revision checklist

In this chapter you have learned:

- what an entrepreneur is and what characteristics successful entrepreneurs have
- the needs of a new business
- the importance of a business plan
- how big a business needs to grow
- the different ways in which a business can grow
- possible problems resulting from business growth
- reasons why some businesses remain small and why some businesses fail.

100/100 – are you familiarising with the revision questions on the CD-ROM?

Types of business organisation

This chapter will explain:

- the main forms of business organisation in the private and public sectors
- the advantages and disadvantages of each of these forms of business organisation
- how appropriate each of these forms are in different circumstances
- business organisations in the public sector

Business organisations: the private sector

There are three main forms of business organisation in the private sector. These are:

- sole traders
- partnerships
- private limited companies
- public limited companies
- co-operatives.

Sole traders

Sole trader is the most common form of business organisation. It is a business owned and operated by just one person – the owner is the sole proprietor. One of the reasons it is such a common form of organisation is because there are no legal requirements to set it up. The only legal requirements which must be followed are:

- the name must agree with, and sound similar to, the business's Tax Office number
- the name of the business is significant. In some countries the name must be registered with the Registrar of Business Names. In other countries, such as the UK, it is sufficient for the owner to put the business name on all of the firm's documents and to put a notice in the main office stating who owns the business
- in some industries, the sole trader must observe laws which apply to all firms in that industry. These include health and safety laws and cleaning standards, for example, as well as local law (e.g. a taxi).

What are the benefits and disadvantages to sole traders of running their own business rather than having other people look in with them? If you wanted to set up your own business, why might you choose to create a sole trader organisation? We can answer these questions by looking at the following case study.

Case-study example

Mike decided to start his own business. He set up the business as a sole trader. What are the advantages to Mike of being a sole trader?

Advantages of being a sole trader

- There are few legal requirements for him to worry about when he sets up his business.
- He is his own boss. He has complete control over his business and there is no need to consult with or take advice from decision-makers.
- He has the freedom to choose his own holidays, hours of work, prices to be charged and options to prioritise (if he finds that he could not do all the work by himself).

Small business for startups

Limited liability
means that
the liability of
shareholders is
restricted to
what they put
into the company.
professional funding

Alternative funding
options for a
business can be:
loan from bank or
other financial institution;
loan from friends or
family; angel investors;
equity crowdfunding;
crowdfunding.

- Mike has a clear contract with his own employees, like personnel with freedom of leaving for regular customers and the ability to demand rewards for their years of service.
- Mike has an incentive to work hard actively add to keep all of the profits when he stays here. He does not have to share these benefits.
- His client may have no prior information about his business or competitor - either than the fact it exists. He enjoys complete security in business decisions.



After organising the business for several months, Mike realised that there are often many unanticipated or forgotten costs involved. He made a list of them:

Disadvantages of buying a sole trader

- It has no income if the business stops trading, as I am the sole trader.
- It has no legal basis for the business or **legal protection**. If the business is my personal happenings, I am therefore fully responsible for any debts that my business may incur. **Liability** means that if the business cannot pay its debts, then the people I owe money to may
choose to force me to sell off my home possessions to settle my debts.
- I would be responsible for bringing up the trade skills - but I do not have enough money to do this. The cost of training for a sole trader are limited by the customer's earnings, which results in the business profit being lower. There are no other owners who can put capital into this business. Banks and other institutions do not lend money to individuals like me.
- My business is likely to require small business capital for expansion to be successful. My business is unlikely to be sold. Some businesses do well. I cannot offer much security in respect to this for my customers' future careers.
- If I am ill then I have no other jobs to take control of the business for me. I cannot pass on the business to my son - unless I die first because will legate can only pay taxes. This is because there is no continuity of the business after the death of the owner.

"These disadvantages are typical for a sole trader. Did Mike take the correct decision to set up a sole trader business? He still thought so. He would recommend a sole trader structure to people like:

- one setting up a new business
- do not need much capital to get the business going
- will be dealing mainly with the public, for example in running a premises like hairdressing - personal and direct contact between the customer and the owner is often very important for the success of these businesses.

But, as his business began to expand, Mike wondered if another form of business organisation would now be more suitable.

Typical reasons
if you think your
employees worth
protecting - but there
is only one person
that owns the
business

Ex-Business 101 Issue

Partnership is a
form of business
in which two
or more people
agree to jointly
run a business.
**A partnership
agreement** is
an agreement
between two
partners and
legal agreement
between business
partners. It is
not essential
for partners
to have such
an agreement,
but it is always
recommended.

Partnerships

A **partnership** is a group of associates of at least two people who agree to own and run a business together. In some countries, such as India, there is a maximum limit of 20 people. The partners will contribute to the capital of the business, will usually have a say in the running of the business and will share any profits made.

Partnerships can be set up very easily. Mike could give his colleague Joanne an interest in his business. This would be called a verbal agreement. Mike could be advised to create a written agreement with a partner called a **partnership agreement** or deed of partnership. Without this document, partners may disagree on who puts their capital into the business or who is entitled to most of the profit. A written agreement will settle all of these matters.

Case study exercise

Mike offered his friend, Gita, the chance to become a partner in his hair business. They prepared a written partnership agreement which contained the following points:

- my account of capital invested in the business by both partners
- my stake in the profits before any additional costs
- the steps to take if profits could be increased
- how long the partnership would last
- arrangements for decision, consent and how new partners could be admitted

The partners signed the agreement. After the partnership had been operating for some time, it became clear to Gita that it had several unanswered issues at stake.

Advantages of a partnership

- More capital could now be invested into the business from Gita's savings and this would allow expansion of the business. Established firms could not be purchased.
- The responsibilities of running the business were split among both partners, which specialised in the strengths and weaknesses of the business. Mike concentrated on marketing the success of the hair line and its styling. Advertisements had been used to target problems on one of the partners was often available.
- Both partners were motivated to work hard because they could both benefit from the profits. In addition, any losses made by the business could potentially shared by the partners. Although the local business expanded and became more busy, Gita became worried about what would happen if the business failed, perhaps because she realises how competitive were entering the market. She returned to Mike that although their partnership was working well, the form of business organisation still had a number of disadvantages.

Ex-Business 101 Issue

**No
unincorporated
businesses in one
particular
place as separate
legal entities.**
This is where sole
proprietorships and
unincorporated
businesses

Disadvantages of a partnership

- The partners do not have limited liability. If the business failed, their creditors could sue any of the partners to try and recover their debts.
- The business does not have a separate legal identity. If one of the partners died, then the partnership would end. Death acts triggers until partnerships are held to be **unincorporated businesses** because they do not have a separate legal identity from the members.
- Partners can disagree on business decisions and controlling all partners' salary line.
- If one of the partners is very inefficient or actively dishonest, then the other partners could suffer by losing money in the business.
- Most countries limit the number of partners (40) and this means that business growth could be limited by the amount of control that all partners could have.

Afrikah and Gilda discussed mixed partnerships-share success. They agreed that partnerships work very well in certain situations:

- when people without the form of business with others put together to avoid legal complications
- where the professional skills, such as medicine and law, are only offered professionally, separated from a partnership, 'not a company'
- where the partners are well known to each other socially in the same towns, and want a simple means of financing some or most of the running of the business.

Gilda and Afrikah made it clear that they wanted to expand the business further but wanted to reduce personal risk. They wanted to protect their own production from business creditors in the event of failure.



In particular, Afrikah said they often discuss important business issues together. They share their ideas and try to sort out the issues.

The controller advised them to consider forming a service limited company. He explained that this type of business organisation would be very different from a partnership and would have its own benefits and disadvantages.

Activity 8.1

Paul French, Apolis, is an internet e-commerce entrepreneur. His business website has a large customer base. He believes that he can run his own successful business. He has no experience of running a business. He has very few contacts. He needs skills in business.

Answer the following questions using business jargon. Write down your answers in a numbered document. Paul is friends with another 'boss' at the Agency World he knows well.

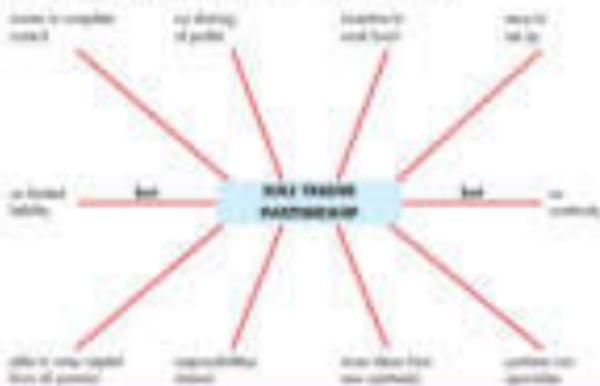
Answer the following questions whether he should buy up his first business part-share. Answer all six questions he doesn't choose. He asks for your help in these questions that are concerning him.

- **Is there a need and market for this business and does this business have an advantage over existing businesses? (Paul is working the idea of customer loyalty)**
- **Are you sure he should set up a sole trader business? Explain your answer.**
- **Who could he take as business partners in the business if he decides to go ahead? Identify and explain three advantages and three disadvantages to him of forming a partnership with his son.**

Limited partnerships

In many countries it is possible to create a Limited Liability Partnership. The advantages for the new form of legal structure is LLP. It offers partners limited liability but shares in risk business ratios can be bought and sold. This type of partnership is a separate legal unit which will never affect a partner's debts outside ordinary partnerships like and with the death of one of the partners.

Revision summary: sole traders and partnerships



Private limited companies

There is one essential difference between a company and an unincorporated business, such as a sole trader or partnership. A company is a separate legal unit from its owners – they are **unincorporated businesses**. This means that:

- a company exists separately from the owners and will continue to exist if one of the owners should die
- a company can make contracts or legal agreements
- company accounts are kept separate from the accounts of the owners

Companies are jointly owned by the people who have invested in the business. These people buy shares in the company and they are therefore called **shareholders**. These shareholders appoint a director to run the business. In a private limited company, the directors are usually the more important (or majority) shareholders. This is usually not the case in a public limited company, as we shall see in the next section.

Examination tip

Unincorporated businesses are companies that have separate legal status from their owners. **Shareholders** are the owners of a limited company. They have shares which represent part ownership of a company.

Case-study example

Mick and Tina used the internet to set up the business of running a private limited company.

Advantages of a private limited company

- Owners may be able to raise a larger amount of capital (in some circumstances there is a maximum limit). There would be likely to be financial institutions of SMEs and SISA – they would only invest if the owners put aside the personal profits. The sale of shares could help to raise larger sums of capital to invest in the business than the bank manager could consider to save themselves. The investors could therefore request more capital.
- All shareholders (over 50%) have liability covering its creditors. It means that it may personally fulfil some debts covering its creditors. But shareholders cannot be forced to sell their possessions to pay the debts. The shareholders could only lose their original

Investment in the project - there should be disclosure of the capital requirements. Shareholders have a continuing right over their own shares and partners' limited liability protects them from personal liability. Knowing what the partners' liability is, the maximum they could lose if the business is unsuccessful, is important so that the company can attract investors that deal with a private limited company. Since Ltd is not a sole trader or a partnership, however, the owners need to be aware that if the business fails, then they could not take legal action to demand payment from their partners. At this stage of privacy limited company status must still be chosen, as well as all other decisions in company law although over the UK, this title is awarded by 'Provisional control' at step 2.

- The partners who created the business - Miles and Gina in our example - are still in full control of it as long as they do not sell their shares to other people.

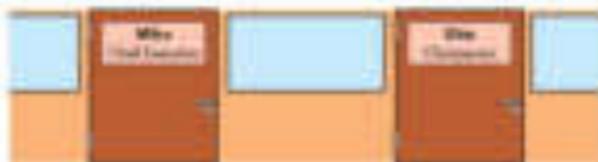
The partner was asked for Miles and Gina to know exactly what they would be committed to if they formed a private limited company. She also listed the disadvantages:

Disadvantages of a private limited company

- There are significant legal restrictions which have to be dealt with. Anytime a company can be formed, it must abide by the relevant factors in the Companies Act to the benefit of the Registrar of Companies.
- The Articles of Association - this controls the rules under which the company will operate - the rights and duties of all of its directors, rules concerning the election of directors and the holding of official meetings, and the procedures to be followed for the issuing of shares.
- The Minutes Book of Shareholders - these contain very important information about the members and the directors, the official name and the address of the registered office of the company must be stated. The minutes of the meeting must be stored as well as the record of where it is brought by each of the directors.
- Both of these documents are intended for legal compliance purposes and to ensure shareholders about the purpose and structure of the company. Once these documents have been signed by the Registrar of Companies, they will become of no importance until they are issued to allow the company to start trading.
- The creation of a private limited company cannot be sold or transferred to anyone else without the agreement of the other shareholders. This can create some problems when it comes to such a company because they may not be able to sell their shares quickly if they require their investment back.
- The exception of a company job has several flaws like unlike a sole trader or a partnership, bank accounts must be used for this Registrar of Companies and members of the public can request them. Miles and Gina have to be prepared to allow more information about their business to be known to other people.
- Most importantly for capital intensive businesses, the company cannot offer its shares to the general public. Therefore it will never possible to raise funds large sum of capital to invest back into the business.

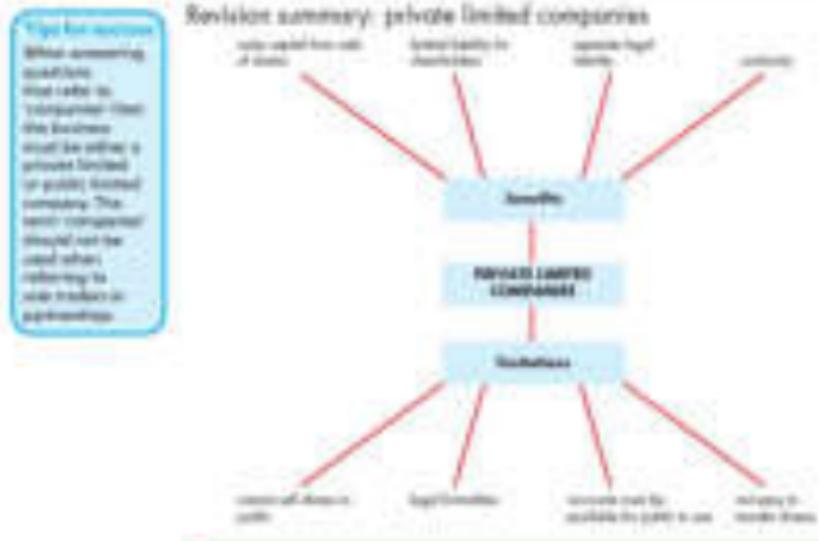
Private limited companies - how suitable is this form of organisation?

Miles and Gina were impressed by the benefits of a private limited company. Not all organisations that set up businesses use a very common form of organisation for family businesses or partnerships, when the owners wanted to expand their business. Further research revealed that the risk to their own capital. Private limited company status allows more capital to be raised - and this suffices sufficient for all but the largest businesses. The partners offered to hold shares and file for such the necessary legal forms in form that's business with a private limited company.



the division of the private former company from which your wife is your only responsible one.

Simultaneous subjects (first combination)



Public limited corporation

This form of business organization is most suitable for very large businesses. However, well-known franchises per se profit from companies as they have been able to raise the capital to expand nationally or even internationally.

Patients often take oral medications that provide benefit against

- 1 Public limited companies are not in the public sector of industry as they are not state-owned. They are not owned by the government but by private individuals and as a result they are in the private sector.
 - 2 The right given to public limited companies can cause confusion. This is why in the UK, public limited companies are given the prefix 'plc' after the business name, for example 'Unilever plc'. In other countries, the prefix 'Limited' is used. This must not be confused with the UK use of 'Limited' which refers only to private limited companies.

The table below might help.

Private versus public

	Private limited corporation	Public limited corporation
(a) Private limited company	Limited to 50 Non-trading (private) (Proprietary)	Unlimited

The next section shows the different forms used. In the Cambridge IELT™ examination, the questions will make it clear what type of company is being referred to.

Close closely held

Business Tools Ltd has been trading successfully for ten years. The two directors, Mike and Steve, each control most of the shares. They propose moving this from a close and family-owned business to a public one. It would be 20 shares. The shareholders' liability would now extend beyond the company's assets. The company's debts would now affect the personal assets of the shareholders. Many new risks would need to be considered. At huge cost, a large number of action-shareholders would be required. Although profitable, the private limited company could not afford this sort of money.

Mike and Steve want to use a specialist business financial consultant as a bridge bank. This consultant was impressed by the directors' sales projections (higher than company) into a public limited company. He explained the procedure for doing this and the benefits and drawbacks of this change.

Activity 4.2 Moving from a limited company

Read Activity 4.1 again. Steve decided not to form a partnership with his uncle. Instead, 2 years after starting up his business, he is thinking of forming a publicly-listed company. Steve doesn't yet know if this move corresponds to Steve's and Mike's needs but he wants to know more about it. However, he is very busy repairing computers and fixing home computer systems for his large number of customers. Steve therefore doesn't have time and likes the personal service his office. He wants to take another step for a bigger ownership and has been told his plan to employ all based less than 17 employees. Steve is also considering of employing a manager to help him deal with expansion and this accounting side of the business. Steve has been told that before he converts to a publicly-listed company his 'personal risk will be reduced from thirty to well over one thousand of the business'.

- Q1 Answer the questions below concerning the above situation.
- Q2 Give your think that a suitable financial consultancy is the appropriate form of organisation for Steve's business. Justify your answer.

A public limited company has certain advantages and disadvantages.

Advantages of a public limited company

- This form of business organisation will allow limited liability to shareholders.
- It is an incorporated business and it is a separate legal entity. Its accounts are kept separately from those of the owners and shareholders' interests should come before those of the shareholders.
- There is now the opportunity to raise very large capital sums to invest in the business. There is no limit to the number of shareholders a public limited company can have.
- There is no restriction on the buying, selling, or transfer of shares.
- A business trading as a public limited company usually has high status and should find it easier to attract suppliers prepared to sell goods on credit and banks willing to lend on to this type of business.

Disadvantages of a public limited company

- The legal formalities of having such a company are quite complicated and time consuming.
- There are many more regulations and controls over public limited companies in order to try to protect the interests of the shareholders. This includes the publication of accounts, which anyone can ask to see.
- Some public limited companies grow so large that they become difficult to control and manage.
- Selling shares to the public is expensive. The directors will often set up a specialist merchant bank to help them to do this. It will charge a commission for its services. The publication and printing of thousands of copies of the prospectus is an additional cost.
- There is a very real danger that although the original owners of the business might become rich by selling shares in their business that may have continued over a while as a 'going public'. This is an ungrateful point which we will investigate further.

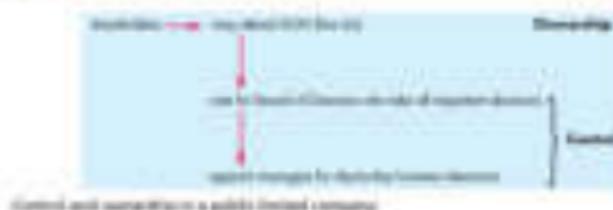
Control and ownership in a public limited company

In all privately owned businesses and partnerships the owners have control over how their business is run. They take all the decisions and try to make the business achieve the aims that they set. This is also the case in most private limited companies which have relatively few shareholders. The directors are often the majority shareholders as they can choose that they themselves possess at all ownership.

With a public limited company the situation is very different. There are often thousands of shareholders – even millions in the case of the largest companies. It is impossible for all these people to be involved in taking decisions – although they are all invited to attend the *Annual General Meeting* (AGM). The only decision that shareholders can have a real influence on at the AGM is the election of professional managers as company directors. They are given the responsibility of running the business and taking decisions. They will only meet with the other shareholders at the annual AGM. The directors cannot possibly control all of the business by themselves so they appoint other managers, who may not be shareholders at all, to take day-to-day decisions. The diagram below explains this situation.



Forms of business organisation



Shareholders in firms

Shareholders are people made to shareholders from the profits which had in a company. There are the people to shareholders for investing in the company.

So, the shareholders own, but also directors and managers control. Therefore, this is called the division between ownership and control.

Does this matter? It might be important for the shareholders. It means that the directors and managers run not the business to make their own objectives. These could be personal nature, growth of the business or simply higher management salary, or reducing shareholders to shareholders to put the expansion plan. The shareholders are not able to influence these decisions – other than to replace the directors at the next AGM. Doing this would give the company very bad publicity and force the business to be sensible as the new directors may be inexperienced.



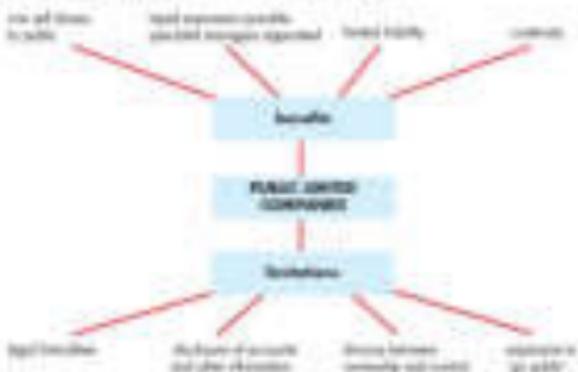
Mike and Spike's task was to explain the performance of the company to a large number of shareholders at the AGM.

Case study scenario

Mike and Spike had decided to concern the company with a public one. Express Deli and Deli, by selling shares to these customers, they had initially raised the capital they needed but they had also become very rich. They were asked at different at the first AGM for the new car. The requesters tried buying the unneeded bus company even successful – at first, drivers and busmen company salaries did not. However, after less transportation taking the night bus, Spike drivers, drivers charged 12.50. This accidently published last year showed the lowest profits for three years. Mike and Spike were forced off the board of directors. They no longer have a majority of the shares – which it has a private limited company they bought 50% out of the shares out. Other investors could – they invested only 25 per cent of the total shares issued. They may not control what have been their business. The new directors named new shares. They not dividends for shareholders and announced a price increase to increase profits.

Mike and Spike were not but these two helped controlled the business that had increased profit to these price raised being to control. He was thinking of getting his firm known by buying a factory house. He planned to operate as a sole trader.

Revision summary: public limited companies



Activity 6.2

- 1a) How does the existence of limited liability benefit an individual shareholder?
- 1b) Does limited liability make it easier or more difficult for companies to attract new shareholders? Explain your answer.
- 1c) Explain why a sole trader might not want to convert his business into a partnership.
- 1d) Is it possible to convert a public limited company back into a private limited company? Why or why not? Explain your answer. (Refer again to Michael Bloomberg and the several paragraphs with the blue boxes. After reading Michael and Alice have decided to do this with their business 'Fast and the part'.)

Risk, ownership and limited liability – summary

Business organisation	Risk	Ownership	Limited liability
Sole trader	Control by sole trader	One person	No
Partnership	Control by all partners	Several partners	No
Public limited company	Shareholders do not bear original investment	Shareholders – may be forced to resign due to decisions made by majority of the public	Yes
Individual trading	Shareholders do not bear original investment	Shareholders – may be compelled to	Yes

Other private sector business organisations

This section looks at some business types to meet a more specific organisational need.

Joint ventures

A joint venture is when two or more businesses agree to make a new project together, sharing the capital, the risks and the profits. Many European companies have set up joint ventures in China with Chinese businesses, as the local managers will have good knowledge of market needs and customer wants.

Advantages of joint ventures	Disadvantages of joint ventures
Sharing costs - can improve the business's products such as new specialities.	If the new project is successful, then the profits need to be shared with the joint venture partners.
Can increase the firm's sales because it already exists in the country.	Management costs required because high levels of control are required.
Risk is shared.	The firm may become over-reliant on foreign partners if it becomes difficult to control.

Focus study | Walmart's joint ventures in India

Walmart is the world's largest retail business. The company wanted to enter the Indian market for the first time in 2000. Walmart did not set up its own stores initially as it had little knowledge of the Indian market or Indian consumers. Walmart set up a joint venture with Bharti Enterprises, one of India's largest business groups. The joint venture set up a Indian-owned Bharti Walmart. Bharti Walmart controls 50 per cent of its operations and 49 per cent of its shares. Walmart might open more new supermarket stores in India - or it may leave completely.



Activity 6.4

Read the case study on page 46.

- What is meant by 'store capture'?
- Identify and explain three benefits to Walmart of setting up a new service to serve the Indian market.
- Identify what action has been taken that Walmart might have to take if it wants to enter India.

Franchising**The business of buying**

A franchise is a business-based ownership of a trading establishment or business. The franchisor buys the licence to operate this business from the franchiser.

This is now an extremely widespread form of business operation. The franchiser is a 'business with a product or service' that it can sell to others to expand its sales. It appears franchisors do not own the trade or product and so all is to consumers. Two of the best known international examples of a **franchise** are McDonald's restaurants and The Body Shop.

	No big franchisee	No big franchise
Advantages	<ul style="list-style-type: none"> • The franchised shop is always under the franchiser's control and is not independent. • Expansion of the franchised business is much faster than a new business that is wholly owned by the owner. • See Disadvantages of the owner is the responsibility of the franchiser. • No products can come from the franchiser. 	<ul style="list-style-type: none"> • The purchase of business takes far more effort than buying a well-known product or service. • The franchisor pays for advertising. • All supplies are obtained from a central source via the franchiser. • There are fewer decisions to make than with an independent business – giving you a broad product range of products without being decided by the franchiser. • Training for staff and management is provided by the franchiser. • Owners are often willing to lend to franchisees in relatively low risk.
Disadvantages	<ul style="list-style-type: none"> • Non-independent (if one franchisee makes a mistake that is a bad reputation for the whole franchise). • The franchised business needs to be run by the franchiser. 	<ul style="list-style-type: none"> • less independence than with operating a non-franchised business. • May be unable to make decisions that affect the franchisee – e.g. new products that are not part of the range offered by the franchiser. • Owner has more to pay for the franchise and possibly a percentage of the annual turnover.

Why buy a franchise?

There could be numerous reasons for buying a franchise. These include:

- Expanding your business
- Increasing your personal job satisfaction
- Starting a business in a field of expanding new retail services
- The continuation of a large well-known business
- Good knowledge of the franchisee can lead to very successful businesses



Franchised businesses give benefits to both the franchisee and the franchiser – but they must both co-operate too.

Business organisations in the public sector

The public sector is a very important part of the economy of all mixed economies. The term "public sector" includes all businesses owned by the state and local government; public services, such as hospitals, schools and the fire service, and government departments.

Public corporations

There are wholly-owned by the state or central government. They are usually businesses which have been nationalised. This means that they were originally owned by private individuals, but were purchased by the government. Examples of these in many countries include water supply and rail services. But, as we saw in Chapter 1, more of these businesses are now being privatised in many countries.

Public corporations are owned by the government, but it does not directly operate the business. Government ministers appoint a Board of Directors, who will be given the responsibility of managing the business. The government will, however, make clear what the objectives of the business should be. The directors are expected to run the corporation according to these objectives.

Advantages of public corporations

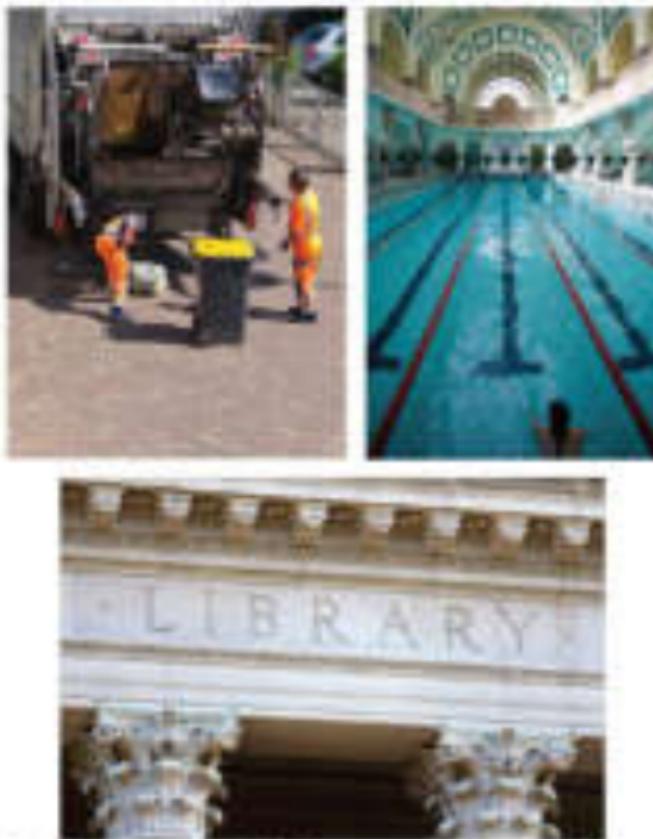
- Some industries are considered to be so important that government ownership is thought to be essential. This includes water supply and electricity generation in many countries.
- If businesses are controlled by management because it would be useful to have competition – one set of railway lines to a certain area, for example – then these natural monopolies are often owned by the government. It is argued that this will ensure that consumers are not taken advantage of by privately owned monopolies.
- If an unprofitable business is failing and likely to collapse, the government can step in to re-nationalise it. This will keep the business open and protect jobs.
- Important public services, such as TV and radio broadcasting, are owned in the public sector. Non-profitable but important programmes can still be made available to the public.

Disadvantages of public corporations

- There are no private shareholders to force the high profits and efficiency. The profit motive might not be as powerful as in private-sector industries.
- Governments without care lead to inefficiency as managers will always think that the government will help them. If the business makes a loss, it may take longer if the public corporation's manager is unlikely to prevent losses in the same industry due to cost.
- Other closely related consequences in the public corporations. There is therefore a lack of incentive to increase consumer choice and increase efficiency.
- Governments can use these businesses for political reasons, for example to create more jobs just before an election. This prevents the public corporation being regarded like other profit-making businesses.

Other public sector enterprises

Local government authorities or municipalities usually provide some trading activities. Some of these services are free in the case and paid for out of local taxes, such as street lighting and schools. Other services are charged for and expected to break even at least. These might include travel services, swimming pools and theatres. If they do not cover their costs, a local government authority is usually provided, to cover losses and reduce the burden on local taxpayers. An increasing range of services is now being privatised, as reducing the role of local government in providing goods and services.



Examples of other public sector enterprises

International business in India: private companies 'go public'

EDF Energie (France)-based EDF Energia was incorporated as a private limited company in India in 1999. It has since expanded its range of advanced electric generation. By 2012 the company owned three coal-fired sites:

- one hydro site;
- two oil & gas extraction sites (the latter in Indonesia).

The private shareholders decided to sell at least 25 per cent of their shares and convert the business into a public limited company. This decision raised the capital needed.

'Going public' makes modified requirements in law (Gupta 2011). The cost of going public is often described as 'public' (or value) capital for new projects - that is, external investment requirements. These are often increased from shareholders to firms by 100 per cent or more (from the new investment which will have shareholders to be repaid). Shareholders expect a higher rate of return for committing funds to public companies (in Australia, the ratio of shares can fluctuate from 10 to 100 times).

The owners of some existing businesses have decided against 'going public' because of the cost involved (the loss of control) and the need to make their information public.

International practice

- Do you think it would be better to leave a business such as EDF Energie as a private company or change to being a public limited company?
- Who are some business owners encouraged to convert their companies into public limited companies?



Many privately held companies want to go public.

Four-style questions - Paper 1

- 1** When Jacques left his job with a fruit and vegetable shop that closed down he decided to open his own shop. The first year's costs before he paid for supplies, turned half £10000 in savings to invest in the shop. He imagined this would be sufficient to start the business. He is an independent trader - he does not take the manager's orders in the food store. He wanted to operate his new business as a sole trader.
- a** Who is owned by sole trader? [1]
- b** Identify two other types of business organisation. [1]
- c** Identify and explain two benefits to Jacques of operating his business as a sole trader. [1]
- d** Identify and explain two drawbacks to Jacques of operating his business as a sole trader. [1]
- e** Do you think Jacques should open new branches of his business by taking part in it? Justify your answer. [3]
- 2** Austin and Hadine set up the A and H Partnership ten years ago. It specialises in household glassware. The business now employs around 20 people. Demand for their products is increasing rapidly. The partners need to invest much more capital in the business but they need to avoid a lot of risk as they both have families dependent on the income made from the business. Their main competitor is Glassworks plc., which has a much larger market share than A and H and can afford extensive advertising.
- a** Who is owned by partnership? [1]
- b** Identify two benefits to Austin and Hadine of the partnership legal structure. [1]
- c** Identify and explain two possible benefits to Glassworks plc. of being a public limited company. [1]
- d** Identify and explain two drawbacks of the partnership form of legal structure by Austin and Hadine. [1]
- e** If the A and H Partnership business continually reconsidered whether a private limited company is a suitable form of legal structure for the business, justify by considering the advantages and disadvantages of a private limited company. [3]

Revision checklist

In this chapter you have learned:

- the differences between sole trader and partnership organisations
- the differences between unincorporated businesses and limited companies
- the differences between private limited companies and public limited companies
- what franchising and joint ventures are
- the features of business organisations in the public sector
- how to recommend and justify suitable forms of business organisation to owners and managers in particular circumstances.

Business objectives and stakeholder objectives

This chapter will explain that:

- the need for and importance of business objectives
- objectives that can be set for a business in the private sector including social enterprises.
- business objectives in the public sector
- factors that influence which objectives are set
- different stakeholder groups with an interest in a business
- objectives of stakeholders
- potential conflict between objectives.

Business objectives – why set them?

Definitions are below

Business

objectives are the aims or targets that a business wants to achieve.

An **objective** is not just a target to work towards. All businesses should have objectives. They help an organisation succeed – although just setting an objective does not ‘guarantee success’. The benefits of setting objectives are:

- They give workers and managers a clear target to work towards and this helps motivate people.
- Taking objectives will be focused on – this will help achieve our objectives!
- Clear and measurable objectives help unite the whole business towards the same goal.
- Business managers can compare how the business has performed with their objectives – to see if they have been successful or not.

Setting objectives is very important for all businesses – small or large, newly formed, or well-established.

What objectives do businesses set?

Objectives are often different for different businesses. A business may have been formed by an entrepreneur to provide employment and income for the owner or family. It could have been created to make a big profit as possible for the owners. On the other hand, the business might have a more charitable aim in mind – many of the leading world charities are very large businesses indeed.

The most common objectives for businesses in the private sector are as follows:

- business survival
- profit
- revenue to shareholders
- growth of the business
- market share
- service to the community

Survival

When a business has recently been set up, or when the economy is moving into recession, the objectives of the business will be more concerned with survival than

anything else. Some companies can also make a loss but still have profits. The manager of a business threatened in this way could decide to lower prices in order to survive, even though this would lower the profits on each item sold.

Profit:

Businesses for
Assets:
Profits by itself

When a business is owned by private individuals rather than the government it is usually the case that the business is operated only the aim of making a **profit**. The owners will each take a share of their profits. Profits are needed to:

- pay a **wage** to the owners of the business for the capital invested and the risk taken
- provide finance for further investment in the business.

Without any profits at all, the owners are likely to close the business.

Will a business try to make as much profit as possible? It is often assumed that this will be the case. But there are dangers in this assumption. Suppose a firm puts up its price to raise profits. It may find that customers may leave them. Other people will be encouraged to set up in competition, which will reduce profits in the long run for the original business.

It is often said that the owners of a business will aim for a satisfactory level of profits which will avoid them having to work too many hours or putting too much in tax to the government.

Returns to shareholders:

Shareholders own business companies (see Chapter 4). The managers of companies will often set the objective of 'increasing returns to shareholders'. This is no encouragement shareholders from selling their shares and it helps managers to keep their jobs!

Returns to shareholders are increased in two ways:

- increasing profit and the share of profit paid to shareholders as dividends
- increasing share price : managers can try to achieve this aim partly by keeping profits low by putting plans in place that give the business a good chance of growth and higher profits in future.

Growth:

The owners and managers of a business may plan for growth in the size of the business - usually measured by value of sales or turnover - for a number of reasons:

- to make job more secure if the business is larger
- to increase the salaries and terms of managers as the business expands
- to open up new possibilities and help to expand the role of the business by creating more new products and new markets
- to obtain a higher market share than growth in sales
- to obtain some advantages called economies of scale. From business expansion. These are considered in more detail in Chapter 12.

Growth will only be achieved if the business's customers are satisfied with the products or services being provided. For this reason it might be important to prevent customers' spent at a very high priority.

Market share

Definitions: A) Markets

Market share is the proportion of total market sales achieved by one business.

A **social enterprise** has social objectives as well as aims to make a profit to reinvest back into the business.

If the total value of sales in a market is \$100 million in one year and Company A sold \$20 million, then Company A's **market share** is 20 per cent.

$$\text{Market share} = \frac{\text{Enterprise sales}}{\text{Total market sales}} \times 100$$

Increased market share gives a business:

- good publicity, as they could claim that they are becoming 'the most popular'
- increased influence over suppliers, as they will be very busy to sell to a business that is becoming relatively larger than others in the industry
- increased influence over customers (for example, in setting prices).

Providing a service to society

Social enterprises are sponsored by private individuals - they are in the private sector - but they do not just have profits as objectives. The people running the social enterprise often set their objectives for their business:

- social: to provide jobs and support for disadvantaged groups in society, such as the disabled or homeless
- environmental: to protect the environment
- financial: to make a profit to reinvest back into the social enterprise to expand the social work they perform

An example of a social enterprise is Kanganista in India. This helps very poor village communities develop skills to craft織織 and knitting products and helps them market their products at a fair price.



A display of Kanganista products. Kanganista's core value is 'respect for both the producer and customer'. These items are fair priced (in the period prior to covid) and are quality products for the market. Profits earned from sales go back to ensure a better life for these communities, as these producers are also the owners of Kanganista.

Why business objectives could change

It is more unusual for a business to have the same objective forever. There are some examples of situations in which a business might change its objectives:

- 1 A business set up recently has survived for many years and the owner can now work towards higher goals.
- 2 A business has achieved higher market share and now that the objective of getting higher market share is achieved.
- 3 A profit-making business operates in a country facing a serious economic recession so now has the short-term objective of survival.

Tips for success

- Do not suggest that 'making an initial profit as quickly as possible' is always the best short-term objective of a business. It might distract the business from long-term considerations and the strategic aims of the business. For example, this could have been more focused on helping owners to benefit from helping customers.

Activity 2.2 Which objectives for your business?

Here are ten brief details of four businesses:

- A small firm of builders which has started new business units to open the building markets.
- A recently-established business in the rapidly expanding computer industry, which is owned by two young and ambitious entrepreneurs.
- A large food company which dominates the market in soft drinks in your country.
- A group of people who are concerned about the lack of clean water provided by their communities.
- Charity and union - the most likely main objective of the managers of each of these businesses.
- To help complete, explain the decisions that would help the business to achieve these objectives.

Which stakeholder groups are involved in business activity?

The following groups of people are involved in business activity. Do you know who they are, or are affected by them?

Definitions to know

- **stakeholder:** A very person or group with a direct interest in the performance and outcome of a business.

- **shareholders**
- **customers**
- **workers**
- **government**
- **managers**
- **banks**
- **local community**

These groups are sometimes called the **stakeholders** of the business as they have an interest in how the business is run. Some of these groups are external to the business — they work for it or visit it — and others are internal — they are groups inside of the business.

Why are these groups of people important to business? How are they affected by business activity? Consider the table on page 80.

Business objectives and stakeholder objectives

Stakeholder group	Main features	Most likely interests for the stakeholder group
Shareholders	<ul style="list-style-type: none"> ► They put capital in to set up and expand the business ► They will take a share of the profits if the business succeeds ► If the business does not perform well, shareholders may lose their money they invested ► They are risk takers 	<ul style="list-style-type: none"> ► Ease of the profit they think puts a risk of failure in the future and not the business ► Growth of the business so that the value of their investment increases
Customers	<ul style="list-style-type: none"> ► They are employed by the business; they are also called employees ► They have to follow the instructions of managers and may need training to do their work effectively ► They may be employed on full or part-time contracts and can be terminated or permanent staff ► If there is insufficient work for all available, some may be made redundant (laid off/redundant) and sent to another business 	<ul style="list-style-type: none"> ► regular payment for their work ► contract of employment ► job security – i.e. position does not seem to last for very long ► job that gives satisfaction and security
Managers (internal)	<ul style="list-style-type: none"> ► They are also employees of the business and control the work of other workers ► They take important decisions ► Their successful decisions could lead to their business expanding ► A poor manager's decisions for the business could fail 	<ul style="list-style-type: none"> ► High priority decisions (if the important work stops) ► Job security – this depends on how successful they are ► growth of the business so that management can control a bigger and better business ► job gives them more control and power
Confidence (external)	<ul style="list-style-type: none"> ► They are important to every business. They find new groups, that the business produces in the services that the business provides ► Without enough customers, businesses will make losses and eventually fail ► The most successful businesses often find out what consumers want before making products or providing services – this is called market research 	<ul style="list-style-type: none"> ► sell and create products ► value for money ► good reputation/consistency of quality ► reliability of service and commitment
Government (internal)	<ul style="list-style-type: none"> ► They are important for the economy of the country ► They pass laws to protect workers and consumers 	<ul style="list-style-type: none"> ► need businesses to succeed in their country ► increased economy will create workers, jobs titles and increase the country's wealth ► ensure all firms do what within the law – less effect business operating
The wider community (external)	<ul style="list-style-type: none"> ► The community is greatly affected by business activity. For example, different positions might have the opposite effect to one person's job loss from a business closing, that may send an individual to unemployment and others might be employed by the community, such as charities or public transport 	<ul style="list-style-type: none"> ► job for the working population ► protection that takes care of the environment ► safe products that can't cause damage
Local (external)	<ul style="list-style-type: none"> ► They provide finance for the business expansion 	<ul style="list-style-type: none"> ► expect the business to be able to pay interest back money borrowed – business trust banks, funds

Objectives of public-sector businesses

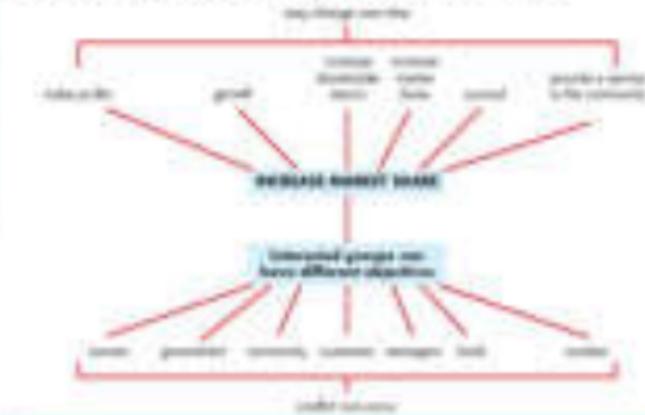
In Chapter 2 we explained that the government owns and controls many businesses and other activities in mixed economies. These were in the public sector. What are the likely objectives for public-sector businesses and organisations?

- **Distribution:** Many public agencies are 'by government' – meaning the profits it generates back to the business and/or other revenue it is handed over to the government is the 'reward' of this organisation.
- **Service:** Provide a service to the public and most public agencies are by government. For example, health services and education services will be measured as service targets laid down for them, and many owned trains and postal services will have reliability and punctuality targets.
- **Brand:** Projects an image or reputation in certain areas – especially poor regions with low-skill business employees.

Key terms

You should know
what each
means:
distribution (to sell
what you
make);
service (to help
people);
brand (the
image of
a product).

Revision summary: business objectives (private sector)



Activity 8.1: Business objectives

Intel-Digital's main objective is to increase its market share by increasing revenue to customers of the company – that is, its millions of shareholders. However, the managers believe that this can only be achieved if Intel-Digital needs three other objectives:

- Remove the country's largest software company by value of sales.
- Continue to satisfy customers with a competitive and closely examined product.
- Protect the environment of the local communities where they manufacture products and tools.
- Help all its staff think the senior managers believe that "increasing revenue is most important".

Activity 3.2 Stakeholder importance (continued)

- Explain why stakeholders have other objectives as well as returns to reward.
- By referring to the market in your local community, explain how local businesses achieve the aim of benefiting the world's largest soft drink company.



Conflict of stakeholders' objectives

In the previous section, we assumed that businesses could set one objective and aim for that. However, life is not that simple and most businesses are trying to satisfy the objectives of more than one group, as the diagram below shows.



Case study example – Business stakeholders

Given a large oil company operating in your country, the following stakeholder groups are interested in the work of this company:

- Owners of the company. They will likely want the business to work towards shareholder profitability.
- Directors, partners, managers of the company, represented by the board. They will be interested in growth of the business or their salaries and likely to demand oil price.
- Workers. They will want as many jobs as possible with security of employment.
- Local community. It will be concerned about job loss, but it will also be concerned about pollution from the oil refinery.
- Customers. They will expect reasonably priced products of acceptable quality – in this they may differ from consumers.

In practice, these stakeholder objectives could conflict with each other. For example:

- It could be that a major reduction of production increases profits but causes more pollution.
- A decision to expand the plant could lead to a better, longer term performance.
- A decision to increase local taxation could increase the costs of the refinery but lead to higher profits.
- Expansion could be expensive, reducing payments to owners, and this could reduce shareholder profits.

Managers therefore have to compromise when they need to decide on the best objectives for the business they are running. They would be foolish to ignore the real worries or aims of other groups with an interest in the operation of the business. Managers will also have to be prepared to change the objectives over time. Change could be the best option during a period of recession in the economy, but caused by cost cutting might be bad for the economy in its recession.

Activity 4.2

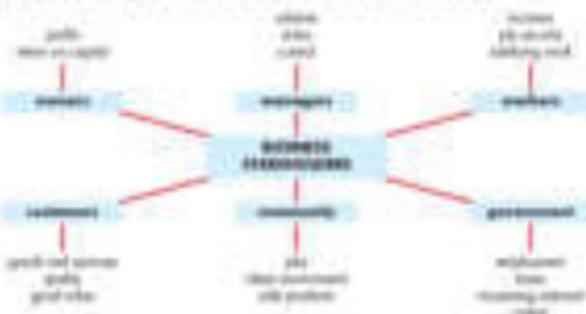
Read the case study on page 198

- What is meant by 'stakeholder group'?
- Identify and explain one other possible conflict of objectives between these stakeholders.

Tip for success

Be prepared to explain how a business objective might conflict with other stakeholders from time off.

Revision summary: business stakeholders and their aims



International business in focus Toyota makes clear its business objectives

The President of Toyota recently announced the targets for the business over the next few years. The key objective is sales growth. Sales of 10 million new and used trucks by 2014 is the main target. Toyota wants to achieve 10 per cent of these sales in the 'fast-growing' markets of Asia, Africa and South America.

Although profits are important, Toyota has set quite low earnings targets, considering it faces no pressure in a competitive market – especially at a time when the global economy is surrounded by client protection and fear of recession in some major countries. The company also has the aim of developing front-wheel-hybrid models over the next three years. Hybrid cars are promoted by several governments.

"Our two main pillars of growth in the future will be emerging markets and hybrid vehicles. We cannot sit on our hands in order to stay the number leader in hybrids," said Toyota's CEO.

Discussion points

- Why did the Toyota President think it necessary to set objectives for Toyota for the next five years?
- Why do you think sales growth and developing new models need to be more important than increasing car sales profits as priorities?
- Which stakeholder groups will be affected – positively or negatively – by Toyota achieving these objectives?



One of Toyota's objectives is to produce and sell more hybrid cars.

Knowledge questions - Paper 1

- 1** Sunita and her partner Kavita decided to start a business selling flowers called S and S Blooms. They agreed on the business objectives they should set. There are several other shops in their town, and there is much competition. Sunita and Kavita had very little cash to start their shop. However, four years after being set up, it is still open. Business objectives have changed. There are plans to open two or three more shops -- perhaps by taking over some of their competitors. This business now employs four workers and uses several local flower growers as suppliers.
- a** What is meant by 'business objectives'? [1]
- b** Identify **two** of S and S Blooms' stakeholder groups, other than workers and suppliers. [1]
- c** Identify and explain **two** likely business objectives for S and S Blooms when the business was first established. [1]
- d** Identify and explain **two** ways in which Sunita and Kavita have changed the business objectives of S and S Blooms. [1]
- e** Do you think that setting business objectives for S and S Blooms will make sure that the business is successful? Justify your answer. [1]
- 2** The Big KM Mining Company (BKM) owns and operates coal and gold mines in several different countries. It employs thousands of workers. Most of them work in very dangerous conditions for low pay. Ausbach, from the mines at Aitape, dumped its tail liquors, 'making higher profits and passing income to our shareholders are our most important objectives', said the Managing Director of BKM to his other senior managers recently. 'Shareholders are our most important stakeholder group,' he added.
- a** What is meant by 'stakeholders'? [1]
- b** Identify **two** objectives that the managers might set for BKM, apart from profits and returns to shareholders. [1]
- c** Identify and explain **two** possible reasons why BKM has profit as an objective. [1]
- d** Identify and explain how a decision to open a new BKM mine might affect **three** stakeholder groups. [1]
- e** Do you agree with the Managing Director -- when he said that shareholders are the most important stakeholder group? Justify your answer. [1]

Revision checklist

In this chapter you have learned:

- why a business needs objectives and the different objectives that can be set
- the objectives of public-sector organisations
- what stakeholder groups are and the objectives they have
- the potential for conflicts between objectives.

Now -- test your understanding with the review questions on the CD-ROM.

Understanding business activity: end of section case study (Paper 2 style)

A new business has been set up



David's idea of buying a franchise from a big racing team is to open his own racing team. David will take a £100 000 loan to start a suitable business with the help of his parents. Buying a franchise for a racing team will be expensive. However, the big racing company will help David sort out all the legal and practical problems of setting a suitable team.

David's idea is very good. However, he wants to run a larger motorcycle racing business that only race and service his motorcycles. David's idea was born from his passion and love for it. In 2005, he first started racing because he enjoyed winning and racing. He has never entered in other big races. His idea is to start by racing his own motorcycle racing at W circuit.

David is going to choose between continuing his idea or starting a small business. He needs to make a choice quickly.

Appendix 1: Letter to bank manager

Dear Mr/Mrs...

I am writing you as my bank manager. I have a business idea based on my business plan. I need additional funds. I have been provided business ideas.

The idea is to do an up-to-date motorcycle racing shop and for that I will need an additional £10 000 to buy equipment for the shop. I will require a loan.

The second idea is to buy a franchise for a motorcycle racing shop and for that I will need an additional £100 000. £100 000 will be needed to buy the franchise and £50 000 to start another business. I will need a loan.

I would like to give you some info to discuss my idea.

Yours faithfully,

David

- 1.11 Identify and explain four personal characteristics that David needs to be a successful entrepreneur.**

- 1.12** David has to decide which type of business organisation to choose if he sets up his own business. Consider the advantages and disadvantages of the following forms of business organisation. Research which one David should choose. (with power points)

- Sole trader
- Partnership
- Private limited company

- 1.13** Identify three contributions in David's new business. Explain why each contribution is important to his business.

- 1.14** Consider the advantages and disadvantages to David of buying a franchise from a big racing team business instead of setting up his own racing shop. Without giving any detail, he should prefer which one? (with power points)

10

11

12

13

14

Section

2

People in business

Chapters:

- 1 Motivating workers
- 2 Communication and management
- 3 Recruitment, selection and training of workers
- 4 Internal and external communication



Motivating workers

This chapter will explain:

- why people work and motivation (motives)
- what are the factors that motivate workers (financial and non-financial rewards)
- job satisfaction

Why people work

Motivations for work

Managers in business often encourage their workers to work hard and more effectively for the business.

People work for a variety of reasons. The main reason why most people work is because they need to earn money to buy food and the basic necessities for life. Other people work in voluntary paid work or part-time voluntary work. This chapter considers a wide range of **motivators** – the work and home items can make use of this knowledge to encourage their workers to work more effectively. High productivity in a business usually comes from a workforce that is motivated to work effectively and from this comes increased profits. It also considers leadership styles which might be used by managers, the effect of trade unions on the workers and legal considerations when employing workers.

The reasons why people work are summarised in the diagram below:



Of course, improved organisation in a business and/or the increasing use of new technology, especially where it replaces workers, result in productivity gains. However, businesses also need to recognise that the value of their employees' output, in terms of how much they produce and the quality of it, comes from how well motivated they are to work effectively. Employees are a firm's greatest asset!



Motivation theories

When people work for themselves they tend to work hard and effectively as they see the direct benefits of their labour. However, most people work for someone else who may not care how well work is effectively done. One of the tasks of management is to get their workers to contribute fully to the success of the business. To do this, many studies have been carried out to discover what makes employees work effectively. Three main theories are outlined on the following pages.

F.W. Taylor

Frederick Taylor worked for working life as a labourer in a factory in America in the 1800s. He rose to become chief engineer. During this time he conducted experiments at the steel company where he worked, to see how labour productivity could be increased. Taylor based his ideas on the assumption that all individuals are motivated by personal gain and pleasure. If they are paid more, they will work more effectively. He was looking at systems after worked in factories. He broke down each job into simple processes and then calculated how much output they should be able to do in a day. If they produced this target output, they would be paid more money. Taylor saw employees as like machines - when they were working hard, their productivity would be high and therefore their labour costs would be low. (But extra output would be worth more than the extra pay the workers received.)

Taylor's plan resulted in big productivity gains at the company where he worked, and many other businesses adopted his ideas. But there are several criticisms of Taylor's ideas:

- his ideas were too simplistic - employees are motivated by many things and can just money
- you can pay an employee more money, but if they are satisfied by their work or some other reason, they will be less interested in doing effectiveness at work and there will be no productivity gains
- a practical problem arises if you cannot easily measure an employee's output

Activity 4.1

- 1 From the following list of jobs, say what you could measure to flag out less effective workers. (How much output they are producing)
 - ◆ fire prevention officer
 - ◆ physio-therapist
 - ◆ teacher
 - ◆ cleaner
 - ◆ police officer
 - ◆ police
 - ◆ lawyer
- 2 Are there any jobs from the list for which output is difficult to measure? If so, why? Why is it difficult to measure their output in each case?
- 3 If you expand services workers' incomes, how can you give them more money if they work harder or more effectively?
- 4 Make this present project to your employer. Encourage him/her to measure the majority of the work force based on objective results.

Maslow

Abraham Maslow studied employee motivation. He proposed a hierarchy of needs, shown in this diagram.



Maslow's hierarchy of needs

- Businesses have begun to recognise that if employees are going to be motivated most effectively at the highest levels in the hierarchy must be available to them – money alone will not be the single route to increased productivity as was thought by Taylor. Evidence for the hierarchy can be seen in people who are unemployed. They can't fulfil their self-respect and self-esteem and may not have the feeling of belonging to society, which often comes from working.
- Maslow also suggested that each level in the hierarchy must be achieved before an employee can be motivated by the next level. For example, most social needs are met, this will no longer motivate the employee, how the opportunity to gain the respect of fellow workers and to gain esteem could motivate the employee to work effectively. If this is true, then there are important messages for managers in the way employees are managed.
- There are problems in that some levels do not appear to cover the various individuals, while some rewards appear to fit more easily than one level. For example, money allows basic needs to be purchased, but high pay can also be a status symbol or a indicator of personal worth.
- Managers must identify the level of the hierarchy that a particular job provides and then look for ways of allowing the employee to benefit from the next level up the hierarchy. For example, managers in agriculture who work on a temporary basis, when required, will probably have physiological needs fulfilled, but security needs may be lacking. If they were offered full-time jobs, they might feel more committed to the business and work more effectively for it.

Activity 4.2

- Miguel works as a barn labourer for a local landlord. He has a small house on the estate and is allowed to grow his own food on a plot of land next to his house. He grows enough food for himself and his family, and a plot of small crops, which pay for the office-needs of the family such as clothes, shoes and medicines.
 - Puerto works in a car factory during assembly time. He works in a team of other workers building the car body-chassis. In it also a mixture of live-working football fans. He is not paid any extra because all attend equal a free lunch.
 - Anna has a degree in Business Management and professional qualifications in human resources management. She is the Human Resources Manager of a large company. She has her own office with her name on the door and is in charge of the care of the human resources staff. She needs living people for this it is possible if the right employees are recruited by the processes.
- Identify points of Maslow's model and being satisfied in each of those employees. Then explain the point clearly.

Hierberg

Frederick Herzberg's motivation theories were based on his study of work on engineers and accountants in the USA. According to Herzberg, humans have two sets of needs: one is for the basic material needs, which he called "hygiene" (basic or needs), and the second is for a human being to be able to grow professionally, which he called "motivational" needs or "motivation".

Motivation
perfection
recognition
personal growth/development
achievement/achievement
task itself
Hygiene for Motivational Themes
salary
security
work conditions
company policies and procedures
interacting with co-workers
relationship with supervisor
rewards

Tips for success

Make sure you can explain each of these theories and the results. Then classification of them can help managers to improve the outcomes of the organization.

According to Herzberg, the "hygiene" factors must be satisfied, if they are not satisfied, they can act as disincentives to the worker. However, they do not act as motivators, unless satisfied the effects of them quickly wear off. These statements are found in other themes, as shown in the table above.

Case study: McDonald's

McDonald's is employing 1.9 million workers selling 100 million meals and making calls to potential customers. This company thinks it needs to reward them well. The efficient may decide to pay well for them (but that has been the salary or reward for the job in other similar jobs). The experienced are asking and being considering the needs of the employees. That workers are individual (so do we all have the opportunities, the perceptions, the choices) no recognition of workers' effort leads down well in those jobs. The management is described because the workers' decisions will be particularly happy and hard not increased their productivity. There is high labour turnover.

Acknowledgements

Read the case study above

- Why are you likely the product might not be happy in their job?
- Manager keeps the management might increase the motivation of their employees

People often say that money is the main motivator. It may not be. Surveys show that the other factors discussed above may be much more important to people than money alone. The bulk of these other motivators is where a reason why employees have a job and work complain about other but:

Bayisian summary: motivation theories**Motivating factors – financial rewards/motivators**

It is the responsibility of managers, and others the Human Resources Department, to motivate the workforce. A well-motivated workforce helps to raise productivity. Employees who are well motivated tend to have lower days off work and are less likely to leave promotion which result in better service.

The type can manage motivate their employees – whether it be to the value or not the factor of these? Then are there factors which can decrease employee:

- Financial rewards
- non-financial rewards
- encouraging work to give job satisfaction

Financial rewards

Pay may be seen as a major reason for working, but there are other reasons, as has been discussed in 'Motivation theories' on pages 68–69. However, pay does have to give incentives to employees to encourage them to work harder or more efficiently. Payment can take various forms, the most common of which are outlined below.

Wages

Wages are often paid every week, sometimes by cash and sometimes into a bank account.

- The worker gets paid on a regular basis and does not have to wait long for the wage money. Wages tend to be paid to manual workers, such as those who work in a warehouse.
- If the employee works longer than their normal hours, they are usually to paid overtime. This is extra regular amount per hour plus an extra amount. This is to incentive to work additional hours when required by the business.

However, there are some drawbacks:

- As the wages are paid weekly, they have to be calculated every week, which takes time and money.
- Wages (basic) are often employed to prevent staff sick.

When calculating the wages to be paid, they can be worked out in a number of different ways:

Time rate

This is payment by the hour (payment for a period of time). For example, if an employee is paid £10 per hour and they work the 40 hours, then they will be paid £400.

- This makes it easy to calculate the worker's wages and the worker knows exactly what they will be paid for working a certain period of time.

However, there are drawbacks:

- The hours worked are often recorded on a time sheet which must be filled in and used to calculate the wages for the business it represents. This system takes time.
- Good and bad workers get paid the same amount of money.
- Other incentives are needed to make the workers long-working and producing a good quality product. This is negative because other incentives are needed by the business.
- A clocking in system is needed to determine the number of hours worked by the employee.

Time rate is often used when it is difficult to measure the output of the worker, for example a bus driver or hairdresser.

Piece rate

This is where the workers are paid depending on the quantity of products made – the more they make, the more they get paid. A basic rate is usually paid with additional money paid according to how many products have been produced. Piece rate can be

Workhouse Job

Details

- Worker is assigned by society, cannot pass freely

Different types of bonus:

Performance-related pay: payment for work, quality and quantity.

Commission: a payment relating to the number of sales made.

Profit-sharing: a system whereby a proportion of the company's profits is paid out to shareholders.

Annual or per additional amount of payment above basic pay is received for good work.

Commission: **variable pay:** pay which is related to the achievement of the employee when their output can easily be measured.

Profit-sharing: a share in the company given to employees so that they become part owners in the company.

applied on business account where employees take produce away from a set range of output can be rewarded. There rates can only be used where it is possible to measure the performance of an individual or a team.

- The advantage with this bonus is that it encourages workers to work harder and produce more goods.

However:

- Workers may concentrate on making a large number of products and ignore quality, producing products that may not sell very well because they are not a poor quality. This usually requires a quality control system and this is expensive. If poor quality goods are produced, this could damage the reputation of the business.
- Workers who are caught at偷懒 will not earn as much as those who don't, which may not be seen as fair. Therefore business entrepreneurs may be forced to come well aware about their quality.
- If the machinery breaks down, the employees will earn less money. Because of this, workers are often paid a guaranteed minimum amount of money.

Salaries

Salaries are paid monthly, normally straight into a bank account. They are not paid in cash. It is usual for office staff or management (where salaried workers) to be paid salaries.

- A salary is calculated as an amount of money per year and is divided into 12 monthly amounts. This is easy to calculate when costs for the business.
- It is paid for the job and extra work is not usually paid for – it is counted as part of the salary.
- The employer has the money in their bank account for longer than if they were paying their workers wages, as salaries are paid only once a month.
- The person has to be satisfied with one a month instead of at least five times a month – as with wages.

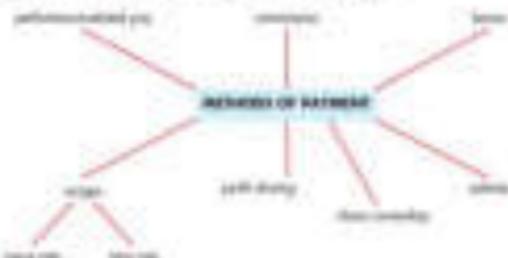
Salaries are usually a standard case (as we measure of money) but workers may get extra money if the following rewards are added to the basic salary: **commission**, **profit sharing**, **bonuses**, **per annum** and **annual pay**. These contribute to:

Commission:	Often paid to sales staff. The more sales they make the more money they are paid – unlike a piece rate. This encourages the sales staff to sell as many products as possible. This should be good for the business as sales may increase immensely, if the price isn't set very high. It also motivates people to buy quickly (they don't really know). Note: The business may not do a sales increase, even if the sales increase and then fall again as it gets a fixed percentage. It can be well considered for this-type of job because if they have a bad month, there may still fall.
Profit sharing:	Involves making a share of the profits as addition to their basic wages. This will increase the worker's income but it may not receive a share of the profits earned by the business. The sort of the profits will be paid as dividends to the shareholders or retained by the business. Profit sharing is often used in the service sector where it is difficult to clearly an individual employee's contribution to the increased profits, but helps pull all benefits from more productive work.
Bonus:	It is being awarded to workers when they happen around profit. It can be paid out as a part of the pay or at certain stages during the year.

Ex-Business Law

Key concept:
It is important
to measure the
effectiveness of an
employee.

Performance-based pay	Employees are linked to the effectiveness of their work. Many other variables need to be measured. For example, sales figures, customer satisfaction or health metrics. To assess their performance, businesses often use a system of appraisal . Appraisal is where an employee's manager observes their work, talks to the employee's colleagues and then ranks each of three main categories of work: quality, quantity and job enhancement. Training needs may be identified at the appraisal interview and the employee can improve the individual's effectiveness in the future.
Share ownership	Employees are given stock shares in the company. This should encourage them to work hard for the company's success. If the company does well, they share profit with investors. Share ownership is strong and active investors value their shares. May increase employee loyalty as they will have a greater sense of being part of the company.

Revision summary: methods of financial reward**Ex-Business Law**

Key concept:
Make sure you
prioritise the
various methods
of payment for
different jobs.

Motivating factors – non-financial rewards/motivators**Ex-Business Law**

Key concept:
Financial rewards
and non-financial
rewards given to
employees

In addition to financial rewards, firms may give non-financial rewards. Non-financial rewards vary according to the nature of the job. Business workers may get discounts on the firm's products, but this would not all turn a company car, whereas a senior manager may have several non-financial rewards, such as a bonus, a car and an expensive account. These are sometimes called perks or **fringe benefits** of a job. Non-financial rewards may include:

- company vehicles (car)
- discounts on the firm's products
- travel expenses paid for
- employer's education fees paid
- free accommodation
- staff options (where company shares are given to employees)
- generous expense accounts (for food and clothing)
- pension paid for by the business
- free days abroad/holidays

Activity 8.2

For the following jobs, use which method of reward (financial or non-financial) would be suitable and why. (Remember to consider whether it is easy to measure their output – that may affect how you decide to reward them differently.)

- job satisfaction-motives
- health management
- hospital
- shop-assistants
- managing disease
- fast-food

Job satisfaction**Motivation by needs**

Job satisfaction is like satisfaction from having things that you have done a good job.

Typical rewards

What are job satisfaction factors? Money, promotion, working conditions, financial rewards, job enrichment, job enlargement.

There are other ways that people can be motivated or be more committed to their job and work more effectively – they need to get satisfaction from doing their job. However, there are some factors that will make employees unhappy and those must be avoided before the employee can be motivated in a positive way. For example, if the management of the business is not good and the employees are treated really poorly then things themselves will probably not motivate them. If their rates of pay are perceived by the employees as being low relative to those of other similar workers, this will be a source of dissatisfaction to the employee. If there is a lack of dissatisfaction from being treated, for example if reasonable wage rates are paid and employees are treated fairly at work, then rather sources of job-satisfaction can motivate employees.

Simpler than different ideas about ideas related to job satisfaction. These include:

- pay – the amount of money paid to an employee (see pages 69–71)
- opportunities for promotion
- working conditions
- fringe benefits or non-financial rewards (see page 72)
- the way that the employee is managed or treated
- working hours
- colleagues
- the nature of the work itself
- level of responsibility
- the sense of achievement derived from the job
- recognition for good work
- chance for training
- sense of the job

Individual employees will have different ideas about which of these is the most important.

Imagine a worker with a machine operator in a factory. What do you think makes that job satisfying? Copy out the table below and list your ideas for each.

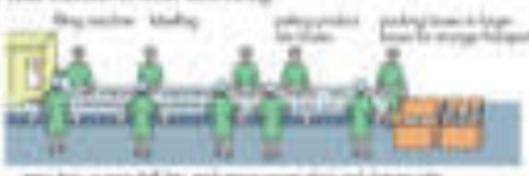
Worker	Machine operator

Some of the motivation theorists (particularly Elton and Herzberg) emphasise that the important aspects of jobs are those they should give recognition, responsibility and satisfaction to the people doing them and allow the employee to gain a sense of achievement from the work itself. Some jobs may seem dull and boring, but with a little thought and creativity they can be made more interesting and correspond to basic needs.

There are several ways in which a business can increase the job satisfaction of its employees:

Job rotation

Without it, a production line may carry out simple but different tasks. **Job rotation** involves the workers swapping round and doing each specific task for only a limited time (for example, for one hour) and then changing round again. This increases the variety in the work itself and also makes it easier for the manager to move workers around the factory if production is slow or jobs need altering. However, it does not make the tasks themselves more interesting.



Task enhancement and stretch

Task enhancement involves workers completing several tasks during each specific task for only a limited time and then changing round again.

Job enlargement is where extra tasks of a similar level of work are added to a worker's job description. The extra tasks should not add extra work or increased responsibility to the employee, but they should give greater variety to the work and therefore increase job satisfaction.

Job acknowledgement

Job recognition is where extra tasks of a similar level of work are added to a worker's job description. The extra tasks should not add extra work or increased responsibility to the employee, but they should give greater variety to the work and therefore increase job satisfaction.



Motivation in teams

Job enrichment
Involves making all jobs and adding tasks that require more skill and/or responsibility.

Job enrichment

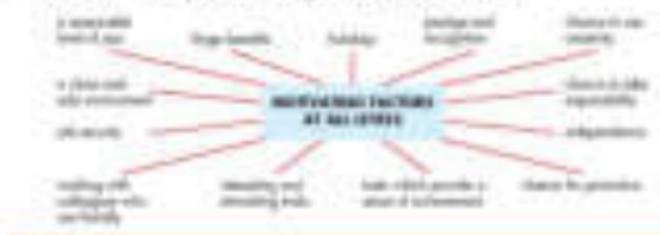
Job enrichment involves breaking up jobs and adding tasks that require more skill and/or responsibility. Additional training may be necessary to enable the employee to take on extra tasks. For example, employees may be given responsibility for a whole area of the work. If managers can change jobs so that they provide scope for fulfilling higher human needs, workers will often become more motivated because they get more satisfaction from their jobs, again raising productivity.

**Autonomous work groups or Teamworking**

This is where a group of workers is given responsibility for a particular process, product or development. They can decide as a group how to complete the tasks or improve the job. The workers can become more involved in the decision making and take responsibility for this process. This gives a feeling of control over the job/tasks and the atmosphere that makes committed, motivated and satisfied job satisfaction. An example of this type of organising employees is in a car production line where particular parts of the assembly line are given to one or more of the workers and they decide how to organise themselves. Often this leads to job content and job enrichment. Working as a group helps improve morale as well as giving a greater sense of belonging to the company.



A team of workers is responsible for a complete part of the assembly line. The team decides how its processes will be completed. The team is self-managing by team members – they make the decisions.

Revision summary: motivating factors at all levels

Topic for discussion

Make your post
as brief as possible
and refer to previous
classmate's posts on
discussing job
motivation for
different jobs.

Activity 3.3

- **Ramapati is a computer programmer.** He has a degree in Computer Science and learned his first programming in a class of 100-degree courses. He thought computer programming would be his ideal job. However, all he wants to write simple programs for small businesses, which often hire him for off-site projects.
- He is told what to do by his manager and is given little responsibility to make his own decisions. His team members and others try to limit the welfare of the business owner if it is limited. He is not held up for his training for another job.
- **King Aviation is a medium-sized airline.** The company has been looking after the changing needs of the airline customers like the changing routes and rules. The government officials are not going to let passengers board their flights if a company fails to meet these. Many are worried about cheap airfares, and stocks at the end of the year. Shareholders are also not happy due to the low passenger numbers in the past year and there is no change in the share price. The stock can be very volatile on some days and very busy on others. It costs more to park. It concerns that the right delivery is done given particularities like fuel, flight times etc.
- **Sun Micros is a computing factory.** The jobs paid the culture of the firm. The sort of the processes has created strict and certified work for online assignments. He has done this job for ten years now and gets very bad feedback about his working. He does not enjoy his work at all. Culture is slightly conservative, but it looks like a culture will lead choices. The culture disappears when work starts from the shift programme that the company has had.

These three situations are not happy in their work. Suggest how you would try to improve their job satisfaction. Explain the reasons for poor satisfaction. Other ways to suggest more than one day for each of the situations? Which job you think would be the best one to one and why?

Unintentional rewards in work—factors of job satisfaction among Playground managers



Unintentional rewards

- Why are the human resources?
- What could be implemented for improved motivation?
- Which methods to improve motivation would be most effective for humans and why?

A recent study reported that shortages of money in Malaysia are resulting in a mystery condition and job stress, which have also been linked to low job satisfaction. Reasons for the job include money, security and honour and personal reasons include stable, recognisable, personal and comfortable working environments. Reasons for money related factors include lack of recognition, no decision making, a poor relationship with management, low salaries and poor incentives, lack of job security and poor recognition. Job design factors to classify job content can be the job's main tasks.

Exam-style questions - Paper 1

- 1** Tom owns a business which produces wooden furniture. He employs 20 workers in the operations department and three workers in the office. One pays all his workers by piece rate but he is thinking of changing his piece rate. He has a high labour turnover from the factory as his workers are not well motivated.
- What is meant by 'piece rate'? [2]
 - Identify two examples of fringe benefits he could give to his employees. [2]
 - Identify and explain two reasons why employees might leave their job at the furniture company. [4]
 - Identify and explain two ways we can improve the job satisfaction of his employees. [3]
 - Do you think piece rate is a suitable method of payment for all staff employees? Justify your answer. [3]
- 2** Sophie is a hotel manager. She has 80 employees working for her in the following departments: kitchen; restaurant; hotel reception; housekeeping (maids). Sophie wants to increase the motivation of the employees and is thinking of introducing a bonus. She thinks it will make the hotel more profitable.
- What is meant by 'a bonus'? [2]
 - Identify two reasons why people work. [2]
 - Identify and explain three levels in Maslow's hierarchy of needs experienced by the hotel workers. [4]
 - Identify and explain two benefits to Sophie of having well-motivated employees. [3]
 - Do you think increasing the wage rate is the best way to increase the motivation of the employees at the hotel? Justify your answer. [3]

Revision checklist

In this chapter you have learned:

- about why people work and the importance of well-motivated employees
- about the different motivation theories
- about financial and non-financial rewards
- to identify when individualistic methods would be appropriate to use
- to select different methods to enhance job satisfaction for particular types of workers

SACM9 – test your understanding and the revised questions on the CD-ROM.

Organisation and management

This chapter will explain:

- organisational theory
- simple hierarchical structures
- the role of management
- the main leadership styles
- the benefits of membership of a trade union

What is organisational structure?

Definitions in focus

Organisational structure
As the leader of management and division of responsibilities between parts of organisation

Case study example

The CEO of the business Steve is owned and managed by SSI Holdings. It is a sole trader business. All tasks are completed. He works a long day - 12 hours usually. As he works alone, to the business he has to do all the jobs which are involved in running a busy construction firm. There is a lot of work off his hands.

- ordering raw materials
- employing workers
- going to the bank to pay in bills - he does this on Wednesday afternoons when the bank is closed
- arranging staff shifts
- keeping all the paperwork up to date. For example his health and safety acts provide him
- contacting the local newspaper to arrange an advertisement for the firm

Activity T.1

Read the case study above, and then other tasks that you think SSI has to do in order for the firm to run efficiently.

In Steve's business there is no need for an organisational structure because he works alone. There is no need to lay-out the responsibilities and duties of other employees or to indicate their links with other workers - because there aren't any! As he is the only manager, there can be no other management levels. This example shows the simplest form of business. What would happen to the organisation of SSI's business if it expanded?

Why does organisational structure change in a business enterprise?

Case study: Bill's Garage

Bill was exhausted. It was the end of another long day. He had decided during the day that he couldn't go longer on all of the work of running the business himself. He was going to add another car to his shop workforce. He thought carefully about what work he would want this additional technician. Bill immediately had his previous job, searching for a garage-type shop, that it was important to make clear. The tasks and responsibilities of employees. If this new car dealer from across town could help out with this same issue – and some were impressed with him as well.

He realized his initial car job descriptions had missed what his needs were as all the people who worked for the job. This would determine what the job would involve. Bill thought this would have more advantages:

- People applying for this job would see if they were suitable for the work involved of them.
- Once in the job, the new employee would know exactly what their duties and responsibilities were. These would clearly include helping Bill, not just repairing the car shop.

Bill wrote out the following job description:

Job description:

Shop Assistant

Main Tasks:

- To run this shop at the existing
- To be responsible for ordering all goods from supplier
- To arrange all staff displays
- To help serve customers
- To assist the manager in other areas directed by him

Working conditions:

- Five days a week
- Eight hours a day
- Free parking facilities – by negotiation. Just not as good free as the manager

Activity 1.1

Read the case study above.

- 1 Study the job description. Do you think Bill is looking to recruit or appointment this position? What evidence is there to support your answer?
- 2 Make a list of the important tasks and responsibilities Bill will have for his new recruit.

Bill's business now has a very simple organisational structure. There are now two people in the organisation and they are operating in different jobs.

Organisation charts

User study summary

Bill Mather's business had expanded rapidly. More employees had been appointed, but not many managed the links between bill and those links no office work. Group operating levels were designated. Eventually Bill decided not to run his further rooms in college towns. In response, Bill had Bill Williams created the advantages of limited liability status (see Chapter 4). At first, Bill and Bill Williams agreed to keep private and become one of the directors of the company. As the management grew, Bill decided it needed a clear structure. After discussions with his accountant and senior managers, he chose one that might look like:



In fact, Bill is a typical entrepreneur (not for long) and has the following:

- It is a hierarchy. This means that there are different levels in the organisation. Each level has a different degree of authority. People on the same level of hierarchy have the same degree of authority. There are five levels of hierarchy from chief executive down to shop worker.
- It is organised into departments. Each of these departments has a particular role or function.
- As there are different levels of management, there is a **chain of command**. This is where power and authority are passed down from the top to the lower levels in the organisation. Because Bill's company is still quite small (university), the chain of command is quite short (as there are not many levels of management). Bigger businesses are likely to have more, more formalised hierarchy and therefore a longer chain of command.

Bill decided to give a copy of this chart to all members of staff. He considered that there were several advantages to both constructing the organisation chart as a hierarchy and showing authority of it.

See Business in Brief

Levels of command is the structure in an organisation which allows different levels of power and control from senior management to junior (middle) management.

Advantages of an organisation chart

- The chart shows how everybody is linked together in the organisation. All employees are aware of which communication channel is used so much. This will strengthen and intensify.
- Every individual can see their own position in the organisation. They can identify who they are accountable to and who they have authority over. Employees can see who they should talk to them.
- It shows the links and intensity between different departments within the organisation.
- Efficiency is in a department and this gives them a sense of belonging.

Chain of command and span of control

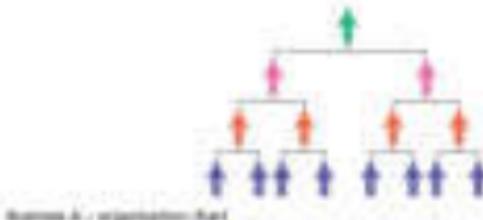
Look at the two organisational charts below. There are two essential differences between them:

- Business A has a tall structure and a long chain of command.
- Business B has a wide structure and a short chain of command.

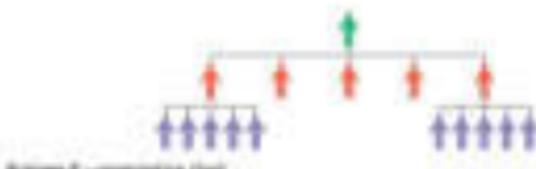
In terms of these two different structures, the **span of control** (the number of subordinates working directly under a manager) is wider in Business B than in Business A – in Business A, the number is restricted to Business B it is five.

There is therefore an inverse link between the span of control and the chain of command. The longer the chain of command, the 'wider' will be the organisational structure until the 'maximum' (the span of control).

When the chain of command is short, the organisation will have 'narrow' spans of control.



Business A - organisation chart



There is no perfect organisational structure. In recent years many organisations have made their structures "flatter" and with a shorter chain of command. In some cases, this has been done by increasing a third level of management – called *de-layering*. The classical advantages of different types of command are listed below.

Advantages of short chains of command

- Communication is quicker and more accurate. Each message has fewer levels to pass through before reaching the intended person.
- Top managers are less stressed than the lower levels of the hierarchy. Therefore managers should be more likely to trust people below them as there are fewer management levels to get in their way.
- Span of control will be wider. This means that each manager is responsible for more subordinates. Why is this an advantage?

Case study summary

What does this mean?
What does this tell us about
the organisation's structure?
For a participative
environment.

If expansion has more people to manage, it will encourage managers to delegate more. This is because, at their discretion, they can possibly do all the important work by themselves.

There will be less direct control of staff workers and they will feel more control. They will be able to take more decisions for themselves. They may often need job satisfaction.

However, with more of control, with more people to be directly responsible for, could mean that the manager has control of what their subordinates are doing. If they are poorly trained, the subordinates could lead more rebellion.

Case study example

Mohammed runs his business with his wife. He uses a telephone operator in a large telephone business firm. The operator receives calls from customers who want to use banking services that don't have time to call to a bank branch.

Mohammed works in a bank (called Team A), with other colleagues, Ibrahim and Asif. They were supervised by Asif who was under the authority of Mohammed. There were four other groups of telephone operators, Team B and Team C. These four teams used the same code as Team A. They also had their own supervisor who answers to Mohammed.

All calls were recorded and expenses were calculated so he made profit out of customers' bank and needed to customers. Telephone operators were fully allocated funds various tasks for customers. Other posts, such as transfers of large sums of money, had to be referred to a supervisor or manager. Telephone operator had to open up account 20-3000 British Pounds. Mohammed runs second post in world.

Thinking T.I.

Read the case study above.

- Why has the organisation changed the telephone business?
- What is the aim of control of the supervisor?
- What would be the advantages and disadvantages of removing the supervisor altogether? Then answer relevant questions referring to:
 - ◆ chain of command
 - ◆ delegation
 - ◆ span of control

Roles, responsibilities and inter-relationships between people in organisations

Case study example

The owners owned thousands of fine horses, all wanted to be sold as quickly as the first one, quickly increased and the business expanded in other ways, but not by selling others needed to cover the first costs of a foreign country, France. They had plans to open several more. The directors had also taken the idea of opening a food processing factory to provide some of the goods eaten by the fine horses. It was found to be difficult to produce these quickly than to buy their partly supplied.

These expansion ideas had required a great deal of capital. The business had been publicly owned for many years. The idea of closing the public sector the necessary finance. Mr. Bill was Chairman of the company as well as Chief Executive. He and his Board of Directors made programmes by mid-considerations. The management necessary before that was more and more complicated from when the business was smaller. The current implementation object is to increase sales.



Key features of the current organisation chart, which is typical of most large businesses, are as follows:

- It is built largely around functional departments, such as Finance and Marketing. These departments are responsible for one important part of the work of the organisation. This can result in difficulties if their goals and not often efficient as a result. However, businesses recognise in this approach that customers feel more loyalty to their department than to the organisation as a whole. There could be conflicts between departments. For example, Sales might try to prioritise new machinery, but Finance do not see the investment money available. Managers' authority to these departments are called **line functions**. They have the authority to give orders and to have their decisions put into effect in their department. These directly responsible subordinates are a clear form of authority.
- In addition to the functional departments, there is also a regional division responsible for the Gulf Cluster, shown in yellow. This department has the advantage of being able to use specialist knowledge to help manage the cluster closely. For instance, this department will be aware of which products are likely to be most popular in each country or will identify what to keep in stock.
- There are other departments which do not have a typical function and often operate separately in specialised areas. Examples from our business are the Research & Development department and the Information Technology department. Other examples include the Human Resources department (the purple area). These departments usually report to the Board of Directors. Some or all of the Board of Directors will be involved in the operational direction and may (if not Executive) be the sample of these departments are called **staff managers** because they are not operational and support the Board of Directors and/or the managers of the functional departments. Staff managers tend to be less well qualified experts. They often know more about their particular specialism rather than day-to-day running the business.

Activity 1.4

Read the case study above.

- What are the strengths and disadvantages of this tall organisation structure for the 1000 employees?
- Give three examples of conflicts which may arise from this structure.
- Do you think this organisation structure increases productivity? Give an argument.
- What are the benefits of having a regional division for the business?

The role of management

All organisations, including businesses, have managers. They may not be called managers because different ones can be used – leader, director, headteacher, and so on. Whatever their role, the roles of all managers are very similar, regardless of the organisation. If you are a student at a school or college or if you are in full employment, the managers of your organisation will, as soon-read, know to fulfil the following functions:

Planning

Planning for the future of the organisation involves setting aims or targets. For example, 'the school will aim to increase its sixth-form to over 200 students by next year's time' or 'we should plan to increase sales of our new fruit juice range by 50 per cent in three years'.

These aims or targets will give the organisation a sense of direction or purpose. There will be a common feeling in the organisation of having something to work towards. It is a good manager who uses these plans to the fullest at all.

In addition to these aims, a manager must also plan for the resources which will be needed. For example, 'to achieve our aim of increasing student numbers to the next form, we will need to build a new sixth-form centre' or 'increased advertising expenditure will be needed to increase sales of our fruit juices'. These are two examples of resources which are changed to help the organisation achieve the aims set for it.

Organising

A manager cannot do everything. Tasks must be delegated to others in the organisation. These people must have the resources to be able to do their tasks successfully. It is therefore the manager's responsibility to organise people and resources effectively.

An organisational chart can help us show who has the authority to do different jobs. It also helps us make sure that specialisation occurs and two people do not end up doing the same task. An effective manager will organise people and resources very carefully indeed.

Coordinating

Coordinating means 'bringing together'. A manager may be very good at planning and organising, but may have failed in 'bring[ing] people in the organisation together'. This is a real danger with the functional form of organisation. Different departments can be working away in their own specialist area without making contact with people from other departments. For example, there is no point in the Marketing department planning the launch of a new product unless they have worked with (coordinated with) the Operations department. It is the Operations department that will have to produce the product at the right time in the right quantities.

A good manager will therefore make sure that all departments in the organisation work together to achieve the planned organisation by the manager. In the example above, this could be done by regular meetings between people in the different departments. Alternatively, a project team could have been set up to develop and launch the new product. The team would be made up of people from different departments.

Commanding

Many people think that this is all managers do. In fact, the role of management is more concerned with guiding, leading and supervising people than just telling them what to do – although this may be important too. Managers have to make sure that

all departments and branches are keeping no targets and deadlines. Innovation and guidance must be provided by managers and it is also their responsibility to make sure that the tasks are carried out by people below them in the organisation.

Controlling

This is a never-ending task of management. Managers must try to measure and evaluate the work of all individuals and groups to make sure that they are in target. There is little point in planning and capturing if managers do not check that the original aims are being met. If it seems that certain groups are failing to do what is expected of them, then managers may have to take more corrective action. This is not necessarily disciplining staff – although that might be important. There might be other reasons for poor performances other than inefficient workers – it is the manager's job to find out why targets are not being met and then to correct the problem.

The first time I gave a lecture idea of what managers do if Management is not easy to define, then the list of tasks above help to demonstrate that varied and important work that good managers should be doing.

From reading the list of points on pages 84–86, it should also become clear what management is necessary to any organisation. Without clear and efficient management, a business is going to fail.

- a sense of control and direction
- coordination between departments, leading to integration of effort
- control of employees
- organisation of resources, leading to low wages and costs

In short, without management to take the business forward, the firm will sink and eventually fail.

Activity 1.8

Benito is a student at a local boys' college. He recently took part in a task shadowing exercise for their curriculum. It is likely to be a manager. Which shadowing means that a student follows a manager for a day or longer to experience the world they live in. Benito's 'shadowed' supervisor/teacher, who is the manager of a large supermarket chain, has a large responsibility. Complete the following map for one day.

- 08:00** Attended meeting with other departmental heads and Clerk Finance to agree targets for the last two years. Departmental heads told to plan their own changes to meet these goals.
- 09:15** Two staff members failed my last six key-word. Approx. asked other staff to cover these objectives by sending longer shifts today.
- 10:00** Meeting with Sales Manager from toy safety manufacturer. Subject discussed the range of goods this firm produces each year to meet the country targets.
- 11:00** Issue number of staff and non-staff with weekend purposes. When customer last gone, Salesman recorded the shop problems of the current position that should be followed. Sales worker shown to follow company policy in these matters.
- 12:00** Co-ordinated priorities of individual staff with figures were included. One worker to prioritise how held to meet sales targets and it was agreed with many that further product training was necessary.
- 13:00** Staff received form summary from manager. There was a problem with positive development selling clothing including sports clothes. It was now decided the customer to find the same goods in the store in their department as office and general. Salesman invited to meet the other departmental manager to agree on a common strategy for each of the tasks that Salesman carried out. Identify whether it was concerned with planning, organising, controlling, communicating or controlling.

Delegation

Delegation to others

Definition:
giving a subordinate the authority to perform particular tasks

Even though Bill's business is still very small it is possible to see that a very important idea is already being used. This idea is called **delegation**. This means giving a subordinate the authority to perform particular tasks. It is very important to remember that it is the manager who performs a task which is being delegated - see the final responsibility. If the job is done badly by the subordinate then it is the manager who has to accept the responsibility for this.

Advantages of delegation for the manager

- Managers cannot do every job themselves. As we have seen, it was becoming very difficult for Bill to control all of the running of Clean Linens by himself.
- Managers are less likely to make mistakes if some of the tasks are being performed by their subordinates.
- Managers can measure the success of their staff more easily. They can see how well they have done in performing the tasks delegated to them.

Advantages of delegation for the subordinates

- The work becomes more interesting and rewarding.
- The subordinate feels more responsible and believes that trust is being put in them to perform a job well.
- Delegation helps to train workers and they can then make progress in the organisation. It gives them career opportunities.

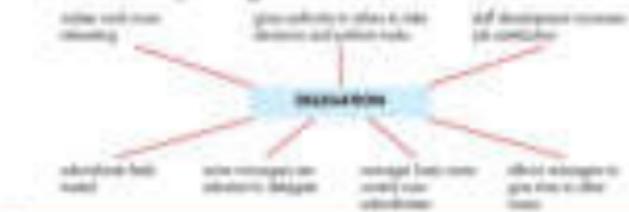
Why might a manager not delegate?

Despite the advantages of delegation, there are some managers who are reluctant to delegate. Some may be afraid that the subordinates might fail and the manager wants to control everything by themselves. Also, there is a risk that the subordinates might do a better job than the manager! This could make the manager feel very threatened.



Three reasons for not delegating or making a manager feel threatened

Revision summary: delegation



Different styles of leadership often call for different management styles. The way in which a manager deals with a situation can have a very important impact on people and how they react to the manager. It is important to remember here that a good manager will adapt the style of leadership that best suits each situation.

Revision summary: effective managers



Why is it important to have good management?

- To motivate employees
- To give guidance and advice to employees they manage
- To inspire employees they manage to achieve more than they thought possible
- To keep costs under control
- To increase profitability of the business

Leadership

Studies on leadership have emphasised the importance of good management in business and the need for leadership. There are many leaders in society – these politicians, religious leaders, captains of sports teams, or leaders of large businesses. Many people take on the role of being a leader and some are more effective than others. A good leader in a large business is someone who can inspire and get the best out of the workforce, giving plans to work towards a common goal.

Styles of leadership

There are different approaches to leadership that are adopted and these can be summarised into three main leadership styles:

- autocratic leadership
- democratic leadership
- laissez-faire leadership

Definitions of terms

Autocratic leaders are the ultimate decision-makers in directing their people where to go in a position of authority; autocrats; leaders here to dominate

Ex-Business 101 Board:

Autocratic leadership

is where the manager expects to be in charge of the business and no one has their own different viewpoints.

Decisions: made by the manager and other employees involved in the decision-making process.

Charismatic leadership

makes the broad objectives of the business known. To employees, decisions that are left to chance. Their ideas dominate and surprise their own work.

Autocratic leadership

Autocratic leadership is where the manager expects to be in charge of the business and no one has their own different viewpoints. They make decisions all the decisions and keep information to themselves. They tell employees only what they need to know. Communication in the business is mainly one way; that is, downward at top-down, and the workers have little or no opportunity to contribute or anything.

Democratic leadership

Democratic leadership will get other employees involved in the decision-making process. Information about future plans will be specific discussed factors the final decisions will be made, often by the leader. Communication will be both downward or top-down and opinion or bottom-up.

Charismatic leadership

Leaders plan to impress for their job. **Charismatic leadership** tends to make the broad objectives of the business known to employees, but there they are left to make their own decisions and regulate their own work. Communication can be difficult in this type of organisation as clear directions will not be given. The leader has such a very formal style, so will.

The style of leadership used by a manager can vary depending on the employees having direct work and the problems to be solved. Managers may not be successful leaders all of the time - it may be appropriate for them to be democratic over some issues, whereas other issues will need a decision-imposing on the workforce.

Equitable leaders

make sure you know that leadership styles and you can apply them to different work situations.



Activity 7.4

When Eric Clapton commenced his career it was small and did nothing. By the late 1980s, he had sold 100 million records by name. He could be considered a transformational style which involved making the members of the band feel brought along for the ride and encouraged them to better their skills across the business. The business has now grown into a large public limited company with many more executives.

Can you get this man to change his style and consider the different leadership styles might be suitable for him or his management to use?

Which do you think will be the best leadership style the Bill and Eric management to use? Explain your reasoning.

Trade unions

Differences to unions

- **Trade unions:** a group of workers who have joined together because their interests are protected.

Employees generally share many of the same interests, such as improving their pay, having a pleasant environment in which to work, being treated fairly by their employer, being given proper training and working in a safe environment. Forming a trade union is a way of helping employees to achieve improvements in these different aspects of their employment – a **trade union** is a type of pressure group.

Today, trade unions are found in many different countries around the world from the USA to Papua New Guinea.

Why do workers join a trade union?

When a person starts work they may be asked by someone who represents a trade union if they want to join. If the worker decides to join the trade union, they will pay an annual subscription (a trade fee).

The main benefits that the employee receive in exchange for paying their subscription to a trade union organisation, are generally included many of the following benefits:

- strength in numbers
- improved conditions of employment, for example, rates of pay, holidays and hours of work
- improved environments where people work, for example, health and safety, noise, lighting
- improved facilities for members who are not working because they are sick, cannot or have been made redundant (redundancy)
- improved job satisfaction by encouraging training
- advice and/or financial support, if a member thinks that they have been unfairly dismissed or made redundant (retrenched), have received unfair treatment, or have been asked to do something that is not part of their job
- benefits that have been negotiated on behalf of union members such as discounts in certain shops, provision of sporting facilities or clubs
- employment where there is a **closed shop**.

However, there are disadvantages to an employee of trade union membership:

- costs money to be a member
- may be required to take industrial action even if they don't agree

Trade unions also seek to:

- put forward their views to the media and influence government decisions, for example on minimum wage legislation and employment laws
- improve communication between workers and management

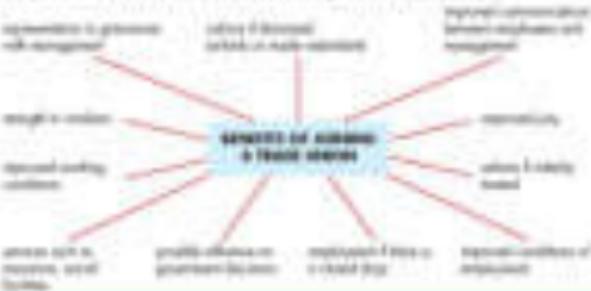
Differences to trade unions

- **Closed shop:** all employees must be a member of the same trade union.

The five reasons

- Make sure you can explain the advantages and disadvantages of trade union membership from both the employer and the employee viewpoints.

Revision summary: benefits of joining a trade union



Activity 1.7

Maria has just started work as an administrator, based out in a government department and has been asked if she wants to join the trade union that represents the workers in that department. She does not know what to do as she has no training about trade unions. Write her a letter, outlining the advantages and disadvantages of joining a trade union, before a recommendation to Maria as to whether to join the trade union or not.

Interest-based business in focus



Chelsea Football Club have just appointed a new manager. The club had not been winning many games and the owner decided to sack the manager and employ a new one. The original manager did not tell the players what he was going to do. He would ask them his final questions the game and who's players the captain thought should play in the next game.

"I am a professional footballer and I know what I am looking about", said one of the players.

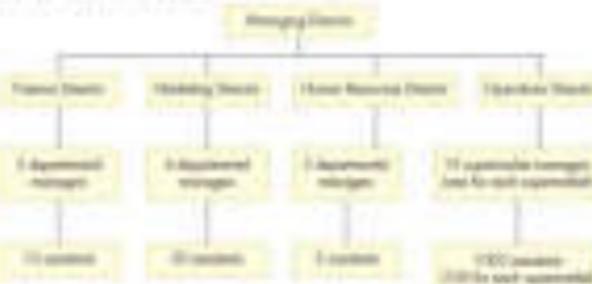
The owner decided to know for a more approach to managing and leading the players.

Discussion points

- What type of leadership style did the original manager use?
- Why does the owner need a new manager with a more leadership style?
- What might the players want the new manager?

Exam-style questions - Paper 1

- 1** Sasha works at a business which produces office furniture. She employs 1000 workers in the Operations department and 15 workers in the office. Sasha believes in a Democratic leadership style. Sasha says that being a good manager is very important to the success of the business. She sees no need for any of her workers to join a trade union.
- What is meant by a 'Democratic leadership style'? [1]
 - Identify **two** examples of other leadership styles Sasha could use. [2]
 - Identify and explain **two** methods Sasha could take as the manager of this business. [4]
 - Identify and explain **two** reasons why having good managers is important to this business. [4]
 - Do you think Sasha is right to say that her workers do not need to join a trade union? Justify your answer. [8]
- 2** The following organisation chart is for PPP Ltd. It is a private limited company which runs a chain of supermarkets. The organisation chart shows the hierarchical structure of the business.



- What is meant by the 'hierarchical structure of the business'? [1]
- Identify how many people are in the span of control for:
 - Operations director, and
 - Financial director. [2]
- Identify and explain the role of any **two** of the functional departments. [4]
- Identify and explain **two** disadvantages to this business of having a tall organisational structure. [4]
- Do you think more reorganisation would be a good idea for this business? Justify your answer. [8]

Revision checklist

In this chapter you have learned:

- to draw, interpret and understand simple organisational charts
- what is meant by hierarchical structures, span of control, chain of command and delegation
- about the roles, responsibilities and inter-relationships between people in organisations
- the role of management
- that there are different types of leadership that management might use
- why employees join trade unions

Test yourself - see your understanding with the revision questions on the E21-BCM3.

Recruitment, selection and training of workers

This chapter will explore:

- the role of the Human Resources department
- each stage of the recruitment and selection process
- benefits/limitations of part-time and full-time workers
- importance of training and different types of training
- why reducing the size of the workforce might be necessary
- recruit and justify which workers to recruit/retrain/reduce
- legal controls over employment issues

The work of the Human Resources department

Recruitment and selection are the most familiar roles of the Human Resources department, and this chapter will look at these roles in detail, and at another important area of human resources work – the training of employees. Redundancy and dismissal are also the responsibility of the Human Resources department and these are discussed too.



The responsibilities of the Human Resources department

Definitions for exam

Recruitment is the process that identifies that the business needs to employ someone for the next of which activities have planned at the business.

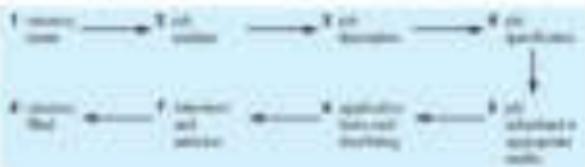
Recruitment and selection

When an employee leaves a job, when a new business is starting up or when a business is successful and must be expanded, the process of recruitment and selection starts. The business will first of all have to decide if the employee leaving a job needs to be replaced. The recruitment process also gives the business an opportunity to review the nature of people's jobs and consider human resource management.

In a large business this process of recruiting and吸引ing staff is usually undertaken by the Human Resources department. Small businesses do not recruit enough people to make it worthwhile having a separate Human Resources department – often the manager who will be supervising the employees will deal with recruitment for that department. For example, in a hotel a reception manager might recruit the waiters and waitresses.

The main stages in the job analysis (the most technical and serious stage), the most useful and time-consuming the recruitment and selection process will be:

The recruitment process is summarised in the diagram below:



The recruitment process

Job analysis and description

Definitions of terms

A job analysis identifies and records the responsibilities and tasks involved in a job.

A job description outlines the responsibilities and duties to be carried out by someone employed to do a specific job.

A job specification is a document which outlines the requirements, qualifications, experience, physical characteristics, and so on for a specified job.

The first stage of the recruitment process is to carry out a **job and role** to study the tasks and activities to be carried out by the new employee. If the business is increasing its employees to fill an existing post, for example if a supermarket had lost 500 bags of potatoes, an outline of the duties for the new employee will be relatively easy to draw up, and may even already exist. If the new employee is needed due to the business expanding, or because the business has identified skills that it needs but not one in the business has those skills, more thought will have to go into the analysis of the job.

Once all of these details about the job have been gathered, a **job description** will be produced, a job description has several functions:

- It is given to the candidate for the job so they know exactly what the job entails.
- It will allow a **job specification** to be drawn up, to see if the candidate 'match up' to the job, in that people with the right skills will be employed.
- Once someone has been employed, it will show whether they are carrying out job effectively. If any difficulties occur during their employment, it is something both the employer and the employee can refer to in order to settle any questions.

The exact content of a job description varies from business to business, but generally it will contain the following headings as outlined in the following case study:

Case study example:

Write a job description for a housekeeper in a hotel.

Job title:	Housekeeper
Requirements:	Housekeeping
Responsible to:	Hotel Manager
Responsible for:	✓ Guests, guest standards

Main purpose of the job:

- Responsible for domestic services at the hotel, with an aim to keeping accommodation clean and maintained to the highest grade.
- Responsible for the guests and room cleaning. To take a supervisory role.

Main duties:

- cleaning of public staff areas
- cleaning guest rooms
- washing and ironing laundry
- organising supply and replacement of consumable cleaning materials
- ensuring that all equipment used is kept in good condition
- ensuring that the rooms are ready to receive guests
- ensuring housekeeping rooms are ready for occupancy

Equipment/duties:

- equipment of house staff
- training new staff in their roles
- training new staff to use the equipment
- disciplining staff as and when required
- dismissing staff if necessary

Test for yourself:

Make sure you know the difference between a job description and a job specification, and what they are used for.

Job description often contains information about:

- the conditions of employment – salary, hours of work, pay rates, leave and staff welfare
- training that will be offered
- opportunities for promotion.

Job specification

Once a job description has been drawn up, the qualifications and qualities necessary to undertake the job can be specified. This list of desirable and essential requirements for the job is called a job, or person, specification. The listed requirements will usually include:

- the level of educational qualifications
- the amount of experience and type of experience
- special skills, knowledge or particular aptitude
- personal characteristics, such as type of personality.

Career vacancy example:

What is a job specification for a trainee manager at a hotel?

Job title:	Trainee manager
Desired outcome:	Train and develop
Details of post:	
<ul style="list-style-type: none"> ■ Responsibilities for cleaning areas in the hotel, including all accompanying accommodation areas and management by the head team ■ Responsible for cleaning and basic maintenance. To take a supervisory role. 	
Qualifications:	
Essential: GCSE English and Maths.	
Experience:	
Previous experience in a food environment or working in hotels.	
Skills:	
<ul style="list-style-type: none"> ■ Communication effectiveness with people ■ Ability to manage people 	
Personal characteristics:	
<ul style="list-style-type: none"> ■ Reliable ■ Honest and trustworthy ■ Friendly, helpful, approachable 	

Activity 4.1:

- Draw up a job description for one of the following:
 - Accountant
 - Sales Assistant
 - Hotel Manager
 - Teacher
- Research information to help you by writing sentences which describe the post or from internet information.
- Draw up a job specification for your chosen job. This should help you to complete your task. Write which are essential and which are desirable requirements for the job.
- Draw up a job description and a job specification to prove that someone suitable person for the job is recruited.

Advertising the vacancy

The next stage is to decide how the post will be filled.

Internal recruitment

The post could be filled from inside the organisation – **internal recruitment**. The vacancy may be advertised via a company newsletter or, if the business is large, via company intranet pages. This would be suitable for an employee who works predominantly within the business.

Advantages of internal recruitment

- It saves time and money, compared with recruiting someone from outside the business (advertising, advertising, etc.)
- The person is already known to the business and their reliability, ability and potential are known.

External recruitment
When a vacancy is filled by somebody who is new to the business.

- The person who knows the organisation's way of working and what is expected from employees.
- It can be very motivating for other employees to see that fellow workers being promoted - it motivates work harder.

Disadvantages of internal recruitment

- The same idea of experience comes into the business. Other companies may have different ways of working and these ways may be better to save resources, including making the business more efficient. Internal recruitment does not allow for these working practices to be tested.
- There may be jealousies and rivalry amongst existing employees.

External recruitment

Most vacancies are filled by **external recruitment**. This involves advertising the vacancy. There are several places the advertisement can be placed.

- Local newspapers.** These will usually be for clerical (office) or manual (factory) positions. These types of jobs do not require a high level of skill and therefore it is likely that many people locally would fill these vacancies.
- National newspapers.** These will usually be used for more senior positions where there may be less, if any, local people who have the right experience, skills and qualifications to do the job. The national newspapers will be read by more people who live in different parts of the country or sometimes by people who live in different countries. As the positions are senior, they will be highly paid and these people will be willing to move to another part of the country. Job vacancies in other countries are also sometimes advertised in national newspapers.
- Specialist magazines and journals.** These will usually be used for particular technical people such as scientists. These people will read the specialist magazines and use the advertisements. Again these can be for jobs in other towns or cities or abroad.
- Recruitment agencies.** These are specialists in recruiting employees. They will advertise and interview people for particular types of jobs. They keep details of qualified people on their 'books'. When a suitable vacancy arises, they will put forward candidates to be interviewed for the job. Agencies are often approached by companies who need to employ a particular type of skilled worker. The agency will send along those people they think will be suitable. This method is often used when particular workers need filling and where the vacancy is in another country.
- The use of recruitment agencies has increased in recent years. Some businesses are happy to leave the recruitment process to someone else because they have a wide range of candidates on their register. However, the services of an agent are expensive - they charge a fee for recommending the employee which is based on a percentage of the person's salary. If the person is successfully appointed to the job, it may cost 10% of the person's [net] salary. There are places where job vacancies can be advertised. Details of vacancies are given to a network of people. The vacancies are usually for unskilled and semi-skilled jobs.

Self-testimony: My answer

Internal recruitment:
when a vacancy is filled by employees who live in and/or working alongside and still can help to run the business.

Top tip: recruitment

What would be seen as good examples of jobs which could be advertised using each of the different methods?

Activity 8.2

In a large sheet of paper, copy out the table below and then add the pros and cons and advantages and disadvantages of the different methods of recruitment.

Method of recruitment	Advantages	Disadvantages	Examples of jobs suitable for this method of recruitment
Internal:			
Job advertisement (in company newsletter)			
External:			
Local newspaper			
National newspaper			
General magazine			
Industry magazine			
Recruitment agencies			
Community job centres			

Job advertisement

After the business has decided on advertising externally, the next step is to draw up the advertisement. When drawing up a job advertisement, the business will need to decide:

- what should be included in the advert
 - where the advertisement should be placed
 - from which the advertising will cost and if it is too expensive? (Can they afford it?)
- Answering the first question is straightforward – information about the job has to be included. This will usually be the duties involved, qualifications required, salary, conditions of employment, and information about the method of application (whether it is by letter of application and CV or should they complete and fill in an application form from the business).

Answers to the other two questions will depend on the vacancy being filled and whether it is a senior position or one which does not require any qualifications.

Case study example

Highly skilled engineering technician, £25,000 per annum, Head of R&D, Tel: 01702-011925, fax: 01702-011926, e-mail: hrd@headofrd.com, by 20/02/2000.

Industrial Engineering Technician

Multi-site role throughout the country based in New City. Competitive rate of pay with fringe benefits. Starting at £22k a leading manufacturer of industrial units from operating to 10 countries and a major supplier to the home market's foremost industry.

Applicants to highly-skilled professionals, responsibilities will include: part-time project management, customer analysis, project development and capital requirement appraisal. You will be a graduate of science, mathematics and IT, ideally with at least three years' experience in engineering.

Please send initial CV to: HR Dept, Head of R&D, Head of RD, New City, E10 5RQ.

Administrative Assistant required £15.00 per hour

Local office administration skills required to undertake a variety of duties within the organisation. Knowledge of MS Word as online package preferred. Standard rates. Please note for telephone for an application form to:

Mr G. J. Long, 2775 Park Road, Headstone, Walsall, WS10 8JG. Tel: 0885 333776.

Activity 8.7

Read the case study on the previous page.

- Which advert would have appeared in a national newspaper and which would have been in the local newspaper? Explain your choice.
- Imagine you were advertising for the job for which you drew up a job description and job specification (page 102). Where would you place this advertisement, and why?
- Comment on which parts of the other students' in your group's 'Which would be most likely to attract the best人选' are ready for this job and why?

Application forms and CVs/resumes

A job advertisement will require the applicant to apply by writing. This can either be by replying, and then filling in, an application form, or by writing a letter of application and attaching a curriculum vitae (CV) or resume. A CV or resume is a summary of a person's qualifications, experience and abilities, and is similar to a résumé.

A business will use the application form, or letter and CVs, to see which of the applicants match the job specification. The applicants who are the closest match are those who will be invited for an interview – the selection stage. A shortlist will be drawn up.

A curriculum vitae (CV) or resume must be well laid out so that it should usually contain the following details:

- name
- address
- telephone number
- date of birth
- nationality
- education and qualifications
- work experience
- positions of responsibility
- interests
- names and addresses of referees (for reference)

The letter of application should mention briefly:

- why the applicant wants the job
- why the applicant feels he/she would be suitable

Application forms are sometimes completed in place of the CV and usually ask for the same information. They may also include ask for other information that is specifically relevant to the job.

Activity 9.4

- Q** Read the job advertisement and the information from three applicants. From below, which of the three people could be most suitable for the job? Give reasons for your choice of the successful applicant, and say you would replace this offer from each one.

Position Advertised 2004

£20,000 to £25,000 per year

The General Manager at our busy City office requires an experienced and highly skilled financial administrator to complete support services to a large office base dealing with managing the General Manager's office, whilst processing a variety of documents, maintaining accounts, bank and loan portfolio customers, clients and insurance contracts. You will need to be able to demonstrate knowledge of SAP, knowledge of Microsoft Office and accounting programs, a good knowledge of customers and clients, and have previous experience in a similar role.

If you are applying for a difficult role, please send your CV to Human Resources, 1000 High Street, New York, NY 10075.

	Applicant 1	Applicant 2	Applicant 3
Name	Catherine Morris	Patricia Thompson	Jane McVey
Address	7 Old High Road, New York 10075	424 Long Street, New York 10075	666 Main Street, New York 10075
Age	35	35	35
Other relevant qualifications	B.A.(Hons), MTA (MBA) English, Maths and Computer Studies Administrative qualification Level 1 Level 2	B.A.(Hons) including English, Mathematics Computer Studies Administrative qualification Levels 1 & 2	B.Sc(Hons), Accounting and Finance, Administration qualification - Levels 1, 2 and 3
Previous experience	3 months at a time administrative assistant	2 years as office junior 2 years as reception 2 years as personal assistant	Unrelated roles - 2 years Business - 3 years General office roles - 6 years Role of administrator part-time - 10 years Financial controller - 1 year
Additional facilities	Having family - members of general local sports group travelling voluntary work with a youth group	Having members of local football team playing some with company	Having going to the gym regularly often

- Q** What additional questions do you think should have been on the application form? Who should they have been aimed at?

- Q** Design your own application form for the job for which you produced an advertisement on page 105.

Interviews

Two key reasons:
 Make sure you can impress
 the recruitment committee
 Interviewer might be asked about
 what respect &
 appreciation of your
 work expect to
 receive with
 an interview
 situation is being
 tested.

The applicants who are shortlisted and invited for interview will have provided their names and addresses of referees. These are people who will be asked to provide a reference (give their opinion on the applicant's character, honesty, reliability and their suitability for the job). References are usually confidential, which means the applicant does not know who has been chosen to do them. This should allow the person giving the references to be honest in their opinions. Sometimes an 'open' reference or 'unconfidential' will be given. These are not confidential, so when the applicant may bring these along themselves.

If the applicant is a school leaver, it is normal to give their school as a referee. If the applicant is older, usually a friend or colleague will be used.

Interviews are still the most widely used form of selection. However, interviews are not always the most reliable way of choosing the best person for the job. The main purposes of an interview are to assess, in the shortest possible time:

- the applicant's ability to do the job
- any personal qualities that are an advantage or disadvantage
- the general character and personality of the applicant — will they fit in?

Interviews can be one-to-one, two-to-one or a panel of people to interview the applicant. Panel interviews are usually used for more senior positions.

Some businesses include tests in their selection process, for example:

- Ability tests aim to show the ability of the candidate to carry out certain tasks.
- Aptitude tests aim to show the candidate's potential to gain additional skills. Either general intelligence tests or more specific tests are used to assess the candidate's ability to train for a particular job.
- Personality tests are used if a particular type of person is required for the job, if the job requires the ability to work with others or if the person will need to be in a part of a team of people.
- Group situations will give tasks to applicants to complete in group situations and the group is observed. Each applicant will be assessed on the way they work as a member of the team and the way they tackle the tasks themselves.

Again, a job that requires the applicant to work as part of a team, for example in retail, will often use this type of selection procedure during the selection process.

Two key reasons:
 Make sure you can impress
 the recruitment committee
 Roots these
 facts might
 be helpful to
 discussing recruitment
 requirements.

Activity 4.2

Imagine that you are about to interview candidates for the opening that you advertised in Activity 4.1. You have drawn up the following list of questions to ask the interviewees.

- What is it about the job that attracted you to apply for it?
- Tell us a bit about your hobbies and interests.
- Who do you feel are particularly suitable for the job?
- Where do you see yourself in three years' time?
- Do you have any questions?
- What is the purpose of each of these questions? What are you hoping to find out?
- Which other questions ought to be asked?
- Is there anything on your mind to apply for the job you have advertised and that may affect whether you would be good for the job?

Rejecting unsuccessful applicants

When the suitable applicant has been offered the job and has accepted it, the unsuccessful applicants should be informed that they have not got the job and thanked for applying.

Activity 8.8

- 1** An international corporation employing 100 staff from 20 countries has decided to build a plant in one African country. Who might the Human Resources department recruit the following workers for this project?
 - experienced managers
 - labourers
- 2** An international airline is expanding its operations in Latin America. It needs to recruit staff to fly this aircraft, as the flight-without-stop account that the airline's management and marketing teams need it can't be sustained.
 - airline pilots
 - cabin crew (air stewardesses and stewards)

Revision summary: the recruitment and selection process



The contract of employment

In many countries in the world it is a legal requirement for employers to provide a new employee with a contract of employment or letter. It will set out the terms of the relationship between the employer and the employee. It will usually be no more than one page and include the following:

- name of employer and name of the employee
- job title
- date when employment is to begin
- hours to be worked
- rate of pay and any other benefits such as bonus, sick pay, pension
- when payment will be made
- holiday entitlement
- amount of notice to be given by either the employer that the employee or the employee must give to end the employment.

Part-time and full-time contracts of employment

A **part-time worker** is someone who works fewer hours than a **full-time worker**. There is no specific number of hours that makes someone full- or part-time, but a full-time worker will usually work 35 hours or more a week. The number of hours which workers usually work in a week will vary from one country to another. The contract of employment will give a definite quantity of hours to show whether it is a part-time or full-time job. Employers can benefit from employing workers on a part-time contract rather than a full-time contract.

The advantages to the business of employing part-time workers are:

- more flexible in the hours of work
- easier to ask employees part-time work at busy times
- easier to extend business operating/reducing hours by working evenings or at weekends
- there is less risk taking place childcare and therefore employee is willing to accept lower pay
- less expensive than employing/using a full-time worker

The disadvantages to the employer are:

- less likely to be trained because the workers see the job as temporary or the employer thinks the employee will leave or won't train properly
- takes longer to recruit more part-time workers than one full-time worker
- can be less committed to the business/more likely to leave to get another job
- less likely to be promoted because they will not have gained the skills and experience as full-time employees
- more difficult to communicate with part-time workers when they are not at work

The advantages and disadvantages of full-time workers is the opposite to part-time workers (that is, the advantages of part-time workers are the disadvantages of full-time workers).

The Mathematics in Practice

Part-time employment & other contracts to be between 1 and 35-36 hours a week

full-time

employees will usually work 35 hours or more a week

(page 1)

Training

There should be clear objectives for training employees. Training is important to a business as it may be used for:

- introduce a new process or new equipment
- improve the efficiency of the workforce
- provide training for the qualified workforce to make them more valuable to the organisation
- decrease the supervision needed
- increase the opportunity for social promotion
- improve the chances of survival

Supervisors should be clear about the benefits of the training or they will not wish to build or take the training seriously.

Training covers many different needs. Some may be short-term, such as one-day courses on how to operate a new machine safely. Others may last a few days and others may be long-term where a programme of continuous training is involved, such as an ABB (Masters degree in Business Administration).

Training is usually trying to achieve one or more of the following:

- increase skills
- increase knowledge
- change people's attitudes/better behaviour, for example, customer service

There are three main types of training:

- induction training
- on-the-job training
- off-the-job training

Induction training

This is carried out when an employee is new to the post. What a new employee needs to do, what they will see/learn when starting in a job, people are on what to expect of them. The induction programme will vary somewhat for a day, nevertheless for several days - it depends on the company and the particular job. When a person starts a new school, they are shown around, introduced to students and told about what happens - that is the same type of induction you would need to know if you had just joined a new company.

The advantages of induction training are that it:

- helps new employees to settle into their job quickly
- may be a legal requirement to give health and safety training at the start of a job
- makes members feel likely to stick together

The disadvantages of induction training are that it:

- is time-consuming
- certain topics are paid for on work is being done by the worker
- takes the start of the employee concentrating their job.

Definitions of terms

Induction training
is an introduction
programme to a new
environment,
explaining the
firm's structure,
systems and
processes and
introducing them
to their fellow
workers.

Induction training
by watching a
more experienced
worker doing the
job.
Induction

Induction training
being explained
away from the
workplace, usually
by supervisor
or manager.

Core skills inventory

The following is an induction programme for a new worker:

20.00	Introduction
20.01	Company history Company culture Company structure
20.02	Authorisation details <ul style="list-style-type: none">■ Emergency procedures■ Health and safety in the workplace■ Policies
20.03	Health
20.04	Workplace <ul style="list-style-type: none">■ Map of the premises - offices of each■ Workstation■ Staff parking■ First aid points■ Fire exits■ Hazardous Materials Management
20.05	Conditions of employment <ul style="list-style-type: none">■ Work-life balance■ Health & safety■ Holidays and leave days■ Protection■ Disciplinary procedures■ Benefits■ Staff performance reviews
20.06	Training opportunities
20.07	Lunch
20.08	Off-training <ul style="list-style-type: none">■ Customer service■ Handling difficult behaviour of others■ Training goals■ Using low-risk words■ Training tips■ How to deal with difficult customers■ Security
20.09	Close

On-the-job training

This is where a person is trained by imitating a more experienced worker doing the job. They are shown what to do. This method of training is only suitable for routine and more skilled jobs.

The advantages of on-the job training are that:

- individual tuition is given and it is the workplace so the employee does not need to be sent away (costs money and requires time)
- it means there is more production from the worker while they are training
- it usually costs less than off-the-job training
- it is training to the specific needs of the business



The disadvantages of on-the-job training are that:

- the trainee will not be as productive as usual because they are learning the business what to do instead of giving time to their job
- the trainee may have bad habits and they may pass these on to the worker
- it may not necessarily be recognised training qualifications outside the business

Off-the-job training



This is where the worker goes away from the place where they work. This may be in a different part of the building or it may be at a different place altogether, such as a college or specialist training centre. The techniques used in these lessons are more varied and can involve more complex tasks. Off-the-job training often involves classroom learning, using terms, role play, case studies or computer simulations. This may be similar to how you are taught.

The advantages of off-the-job training are that:

- a broad range of skills can be taught using these techniques
- if these courses are taught in the evening after work, they are cheaper for the business because the employees will still carry out their normal duties during the day
- the business will only need to pay for the course and it will not also lose the output of the employee
- employees may be taught a variety of skills, they become multi-skilled and this makes them more valuable – they can be moved around the company where the need arises
- it often uses experts (teachers) who have up-to-date knowledge of business practices.

The disadvantages of off-the-job training are that:

- costs are high
- a certain length of paid leave is being taken by the worker
- the additional qualifications courses is a cost for the employer as time and fuel
- another job

Training is necessary for the success of your business. It is a form of investment, usually human capital not physical capital. Investment usually leads to greater output in the future and this is a sign of efficiency as well as machinery.

Task for revision

Make note how can managers profit from training and give examples of where on-the-job and off-the-job training is suitable for particular jobs.

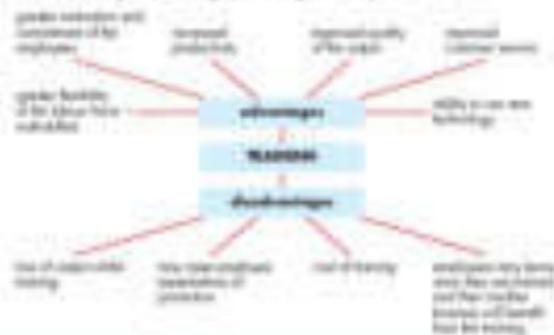
Acknowledgements

Copy out the table below and fill in the gaps.

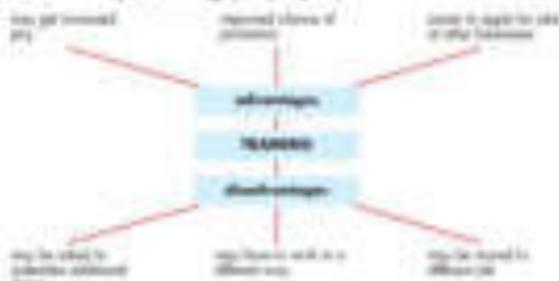
Advantages and disadvantages of methods of training

Method of training	Description	Advantages	Disadvantages
Induction training			
On-the-job training			
Off-the-job training			

Revision summary: training [management]



Revision summary: training [employees]



Activity 8.8

For each of the examples below, decide what type of training would be most appropriate and why.

- **SAR plc** has just introduced a new computer program into the accounts office. All the accounts employees will need to learn how to use this new software.
- **Gambley** has been given a role as a supplier manager with a large retail company. The business will last for about three years.
- **Jones** has just got a job as a travel agent. He has never done this type of task before. He is starting with high-level.

Situations in which downsizing of workforce is necessary

Illustration 8.9 裁员

Management summary & activities: In this section you will learn about the situations in which a business may need to reduce its workforce and the skills of employees required.

Resourcing planning is what the business will need to decide on the type and number of employees needed in the future. The resources required will depend upon the firm's sales forecasts, its future plans such as expansion or diversification, and its objectives, for example, introducing new types of products. Often businesses will require additional employees when they are expanding but sometimes they will need to decrease the workforce because the number of employees. This can be because of:

- introduction of automation
- falling demand for their goods or services
- factory/shop/office closure
- relocating their factory abroad
- a business has merged or been taken over and some jobs have become surplus to requirements in the newly combined business.

When it has been decided how many employees will be required and what their skills need to be, the Human Resources department can plan how this will be achieved by:

- laying off the skills of all the present employees
- sending out notice slips with the following note, for example, due to redundancy
- contacting with existing staff or ex-staff and would want to recruit to fill the new jobs
- preparing a recruitment plan to show how many new staff will be needed and how they should be recruited (internally or externally).

If a business needs to reduce the number of employees this can be done in one of three ways:

- **Dismissal**
- **Redundancy**

Workers may also leave their job because they:

- retire (they are getting older and want to enjoy working)
- resign (because they have found another job).

Dismissal

This is where a worker is told to leave their job because their work or behaviour is unsatisfactory. For example, an employee who was consistently late for work and who, despite being given warnings, continued to be late, would probably be dismissed. An employee who was caught reading or who was unable to do the job to a satisfactory standard would be dismissed. In some countries, an employee can take the business to

Illustration 8.10 裁员

Management summary & activities: In this section you will learn about the situations in which a business may need to reduce its workforce and the skills of employees required.

Typical questions

What laws provide protection against discrimination in the workplace?

Answer If there are laws that were unfairly discriminated. Therefore a business needs to make sure they have followed all the laws in their country when dealing with their employees.

Redundancy

There may be occasions when a number of employees will no longer be needed, through no fault of their own - for example, during a period of falling sales resulting from an economic recession.

When an employee is made redundant, that may be a place where strategy to compensate them for losing their job. In some countries this is laid down in law; for example, one week's wages for every year that the employee has worked for the business. The following factors help a business to decide which workers to make redundant and which to retain:

- Senior workers stay longer – because they may have identify with the company, stay longer in cases only or want to earn their own incomes.
- Length of time employed by the business – obviously those worked for the business for a long time are often retained. They will have the most experience and be the most expensive to make redundant, if redundancy payments are made.
- Workers with unusual skills that are needed by the business or unique skills could be invaluable to other departments are often retained.
- Employment history of the worker – whether they have a good/poor reputation, punctuality or appraisal record.
- Work dependencies of the business need to take workers and tasks need to remain working.

Legal controls over employment issues

In the UK, and several other countries, governments have passed laws that offer equal employment opportunities. The effects of these laws are that people should be treated equally in the workplace and when being recruited, and that they should be paid equal amounts for similar work.

This means that if a man and a woman are both equally well qualified for a job they should be treated equally. It should not be the case that one rather than the other is given the job simply because of their sex.

This is also true of people who have a disability, people from different races and people of different religions.

What does this mean for businesses?

- It means they have to be careful when making an advertisement for a job – for example, they cannot advertise for a woman – they issue any ‘position’.
- When advertising for employees for a job they must treat all applicants equally. If a business does not do this, then they would be prosecuted and fined.
- By following these laws carefully, businesses should recruit and promote staff on merit alone and this should help to increase motivation at work.

What laws are there in your country which might affect equal opportunities?

Employees are workers in a business. This section also covers the legal rights of those who wish to become employed and who apply for jobs.

Employers need permission to do the following tasks:

- against unfair discrimination at work and when applying for jobs.
- health and safety at work.
- against unfair dismissal.
- wage protection.

Protection against unfair discrimination

Discrimination means to make a choice. The discriminations we are concerned with here is about job access or unfair treatment. For example, some employers discriminate unfairly against women or people applying for jobs because they:

- are of a different race or colour
- belong to a different religion
- are of the opposite sex
- are considered too tall/young for the job
- are disabled in some way

In most countries many of these forms of discrimination are illegal. If they were not illegal, many workers of society would find it very difficult getting jobs or to achieve promotion at work. Businesses can discriminate by practising unfair discrimination. That could fail to select a very good worker just because they said one of the reasons above was the reason.

In addition to these laws, most employers have an equal opportunities policy. Employers who consider that they have been unfairly discriminated against can appeal to an equal opportunities committee.

Health and safety at work

Many years ago, most employers used to do the safety of their workers. Machines did not have safety cages. Working clothes were not issued. Conditions were often very hot or cold, noisy and unpleasant. The arguments often cited by employers to explain such conditions were that it would cost too much to make workplace safe, if the working workers did not like the conditions, then they could leave so there were many unemployed people who would do their work.

In our modern world such attitudes are no longer acceptable. Most employers care for their workers' safety. This means for doing that many laws have been passed that force them to improve health and safety at work. In most countries there are now laws which make sure that all employees:

- prevent accident from dangerous machinery
- provide safety equipment and clothing
- provide reasonable working temperature
- provide hygienic conditions and washing facilities
- do not make an unnecessary bring traffic and provide breaks to the work timetable

Are health and safety laws and controls ever 'business a good idea? Most managers think so. Workers are a great deal of profit and loss. It is worthwhile keeping them safe and healthy. Safe workers are likely to be better motivated, work more effectively and stay with the firm for a longer period of time.

For these reasons, some employers in countries where there are weak health and safety laws will still practise working conditions of a very high safety standard. The managers of these firms have taken an **optimal decision**. That means that they have a set of standards to a set of costs that prevent them from going to an unfair or dangerous way towards their workers. No firm manager makes better employed than workers would think so, and would be better motivated to work harder and stay with the business because of this.

Unfortunately, in some countries there are employers who will take advantage of workers. They may be no protection on the length of shifts and many millions of children can still be seen working in industries that offer little protection from danger.

Discussion 1a Topic

Global Approach – a Business Leader:
As a manager in a company because of the global code addressed by the UN.

and of health. In these countries workers are exploited and often paid low wages. Business costs are therefore very low. Should the rest of the world continue to buy products from these countries? What is your view?

Protection against unfair dismissal

Definition of Share.

Unfair dismissal is a legal protection which protects workers from being dismissed unfairly if the worker has certain basic rights or is absent from work, dismissed would be reasonable. The following examples of dismissal are unfair:

- for joining a trade union
- for being pregnant
- when no warnings are given before dismissal

In the UK, if a worker feels that they have been dismissed unfairly, then they can take their case to an **Industrial Tribunal**. This will hear both sides of the argument and may give the worker compensation if it believes that dismissal was unfair. Industrial tribunals are subject to statute of law and they can also be used to hear disputes between workers and employers on pay and race discrimination, sex redundancy.

Wage protection

Workers have a right to be paid for work they do for employers. There should be a written agreement between employer and employee - the **contract of employment** - which will contain details not only of the hours of work and the nature of the job but also of:

- the wage rate to be paid
- how frequently wages will be paid
- what deductions will be made from wages, for example, income tax

In some countries employees can pay whatever wage you like. If there is high unemployment or if unemployment benefits are low, workers may be offered very low wages. Workers could find it very difficult to live on those wages. Increasingly, governments are taking action against employers who pay low wages. This action often takes the form of a legal minimum wage. A minimum wage exists in parts of China, India and in the US. A minimum wage makes it illegal for an employer to pay at least one below the minimum rate. A legal minimum wage has a number of claimed advantages and disadvantages.

Advantages of a legal minimum wage

- It should prevent strong employers from exploiting unskilled workers who could not easily find other work.
- As more qualified workers will be covering higher wages, it might encourage employers to make them to make sure that they are more productive.
- It will encourage more people to seek work. There should be fewer shortages of workers.
- Low paid workers will earn more and will be able to afford to spend more.

Disadvantages of a legal minimum wage

- It increases business costs which will force them to increase prices.
- Some employers will not be able to afford these wage rates. They may make workers redundant instead. Unemployment may rise.
- Other workers receiving low rates risk becoming priced out the higher wages to keep the same differential between themselves and lower paid workers. Business costs will again increase.

Case study:

Make your own
use simple terms
communicate
information to
protect
employees. Also
make sure you can
explain how these
rules affect both
employers and
employees.

Activity 9.3

Discuss the way that Alice's human rights had been breached by her employer.

"She applied for a job as machine operator in a radio assembly factory. The employer interviewed her (and her son) and said that her 'workload of responsibility' would be kept to four after she finished school. Alice was promoted, started her 'regular' shift work, but was surprised to learn that her wage rate was much less than her supervisor. She was also working much less than other workers during the same week. There had been several difficulties, those low wage employees did not understand. She did not receive a contract of employment or had been promised".

Govern had complained to her supervisor that there were some basic electrical safety issues with machines but no action had been taken. This unusual 16-hour shift pattern was being imposed. She decided to tell a trade unionist but when the manager found about this the shift had been changed. She pointed out that their work was subcontracting part time work so longer hours didn't matter - reply stated this was the fact later clarified. She asked for a pay increase, as her legal advice on what she should do.

- Do you think that Alice's low wage really breached her employment law? Give reasons for your answer.
- Is it legal for Alice's employer, with a belief to the manager of the factory where she used to work, explain to the manager all of the points of law which you think the manager has breached.
- What might be the consequences for employees from hearing that staff will?

International Business in Kenya: Kenya Airways

Kenya Airways has used 40 newly recruited cabin crew for 'training in flight'. It was said that, "The costliest in Africa in one of the cheapest airfares, might easily improve." This training was intended as part of an expansion programme of 8 large aircraft. The programme is training local recruits from both poor and existing less privileged staff to positions to increase business of cabin crews. The airline looked abroad, as their domestic training facilities are saturated. The recruitment and selection process used by Kenya Airways for cabin crew is very intensive, "We are determined to offer the best standards of in-flight service," said the Operations Director.

Discussion points

- Why is high-quality training important to Kenya Airways?
- Why do you think that Kenya Airways did not use on-the-job training for the cabin crew?
- Suggest ways to recruit Kenya Airways cabin crew and cabin apprentices in Kenya.

Examiner-style questions – Paper 1

- 1** Sarah owns a business which manufactures musical instruments. There has been an increase in sales and profits over the last two years but there has been a fall in demand for some products. She employs 10 skilled production workers. She wants to recruit five more factory workers to make guitars but needs these workers to make guitars. She intends to carry out a job analysis for the factory workers after making guitars. Sarah uses her job analysis to make her planning decisions.
- What is meant by 'job analysis'? 12
 - Identify **two** suitable or suitable places Sarah could advertise the vacancies. 12
 - Identify **two** questions which Sarah could ask the job applicants at interview. Explain why each question is asked. 14
 - Identify and explain **three** advantages of pre-employment training for this business. 16
 - Sarah needs three skilled workers to make guitars. What do you think Sarah should do? Justify your answer. 16
- 2** Mr Patel owns an insurance company. He advises clients and finds insurance policies for customers and a fee is paid for his services. He employs full-time qualified workers. His business needs to recruit an extra five well-qualified workers and will need to draw up a job description and job specification. Mr Patel intends to use external recruitment to recruit these workers.
- What is meant by a 'job description'? 12
 - Identify **two** examples of requirements for people put in a job specification. 12
 - Identify and explain **two** reasons why Mr Patel needs to recruit well-qualified workers. 14
 - Identify and explain **two** items Mr Patel might put in an induction programme. 16
 - Do you think external recruitment a better than internal recruitment for Mr Patel? Justify your answer. 16

Business checklist

In this chapter you have learned:

- the role of the Human Resources department
- each stage of the recruitment and selection process
- how to draw up a job description
- how to draw up a job specification
- how to choose suitable ways of advertising a vacancy – either internally or externally
- how to draw up a CV and an application form
- how to draw up questions for interviews
- interviewing/recruiting of part-time and full-time workers
- the importance of training and different types of training, including how to design an induction programme
- the differences between on-the-job and off-the-job training
- how to analyse and evaluate the relevance of training to both the management and the employees
- why reducing the size of the workforce might be necessary
- what action to recruit/reduce redundant
- why government laws to protect employees.

Internal and external communication

This chapter will explore:

- the importance of effective communication to business
- the difference between internal and external, formal and informal communication
- the different methods of communication
- the barriers to effective communication and how they can be overcome

What is effective communication and why is it necessary?

Communication means when a **message** is transferred from one person to another, who understands the content of the message.

We all communicate with other people every day of our lives. We communicate with our families, at school or college, when we go shopping, or when chatting with friends. Communication with others is a natural part of life. Why do we need to study something which comes naturally to us? There is one important reason for this and this is communication must be effective. This means that the information or message being sent is received, understood and used quite as was intended. If it isn't, it will be annoying the us when we communicate with our family. For businesses, communication which is less effective, or communication which can have negative consequences.

Internal communication

Why do people within a business need to communicate with each other?

In all organisations, it is customary for people to communicate with each other in various ways. Without communication, we would all be working as individuals who talk with everybody else in the business we worked in. The tasks of managing, planning, innovating, training and encouraging workers would become impossible.

Here are some examples of common messages communicated within businesses (**internal communication**). The way in which each message is given is also shown:

- 'Please do you mind in this area.' (points on a table)
- 'How many hours did you work last week?' (manager asks a worker)
- 'There will be a Fire Drill at 11.00 today.' (notice on a board)
- 'The cutting machine has broken down. Can you send the engineer as soon as possible?' (telephone call)
- 'Sales has just reached a record level. You will need to increase wages so that we do not run out of resources.' (written memorandum to Operations Manager)
- 'Stop this done quickly as all others.' (written a check)
- 'You have been sacked because of frequent absences during work. Please acknowledge receipt of this letter.' (letter written to an employee)

Definitions to know:

Communication is the transferring of a **message** from the sender to the receiver who understands the message.

The receiver is the information or instructions being passed by the sender to the receiver.

Internal

Communication is between members of the same organisation.

- “The ability to set the agenda is our forte — this meeting gives all employees a chance to suggest ideas on how the problems can be reduced.” (Meeting with all shop workers by a manager)

This box could have been very long indeed, but these examples show the main range of topics which need to be communicated in business. Can you imagine the various problems that could occur if these messages were not communicated effectively to the people who need the information they contain?

Test your knowledge
When answering questions about communication, remember to state whether you are referring to internal or external communication.

Activity 1.1

- Suggest three more examples of internal communication within a business or your school or college.
- Give details of the message to be sent and the method you think should be used to send it.
- Identify why you have chosen these communication methods.

External communication

This occurs when messages are sent between one organization and another or between the organization and individuals outside that organization, for example customers. Some of the main examples of **external communication** are:

- selling for profit from supplier
- sending information or documents about prices and delivery times
- advertising goods or services (this is covered in detail in Chapters 14–16)
- taking measures to pay bills etc.

This type of communication is even more important than internal. It is just as important for a business to have good external communication as good internal communication. The key features of both types are the same. The methods of communication which can be used are also similar although the growth of social networking has transformed how a business can communicate with the “outside world”. The main difference between internal and external communication is who is being communicated with.

Why external communication has to work well

External communication is very important to the image and efficiency of a business. If a firm communicates inefficiently with suppliers, it may be using the wrong materials. If it sends inaccurate information to customers, they may buy a product from another firm.

Here are some more examples of external communication. You can imagine how serious it would be if communication was not effective in all of these cases.

- A Finance Manager writes a letter to the tax office asking how much tax must be paid this year.
- A Sales Manager sends a customer order value over the Internet for £29 hours to be delivered by next Wednesday.
- A business sells critical components which have to be dangerous. An email is sent to all customers who bought the product to tell them to return the item for a refund.

Exercise 4.1
Read

The **receiver** is the person who receives the message. Let's practice by sending the message.

The **medium** is the method used to send a message. For example, e-mail is a method of written communication and a meeting is a method of verbal communication.

The **sender** is the person who creates the message. Feedback is the reply from the receiver which shows whether the message has been fully understood and, if necessary, acted upon.

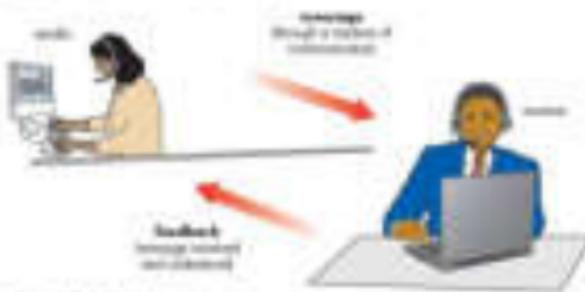
Activity 4.2

- 1) Prepare three more examples of verbal communication from a business or your school or college.
- 2) Give details of the message to be sent and the method you think should be used to send it.
- 3) Justify why you chose these communication methods.

The process of effective communication

Effective communication involves the following five stages:

- **A receiver of sender** – this is the person who wishes to pass on the information to others. This person has to choose the right person carefully in order to make total and communication success effective.
- **A medium of communication** – a method for sending the message, for example, a letter or telephone.
- **A creator of the information** – the person to whom the message should be sent.
- **Feedback**, where the receiver confirms that the message has been received and responds to it. This ensures that the information has been correctly received by the right person and, if necessary, acted upon.



The five stages of effective communication

Activity 4.3 Communicating with customers

Sales manager Barbara Morgan got this fax message from her boss. The manager was very concerned about this. She decided to write to every employee about \$80 in lost, for every hour of time wasted on filling out and sending fax messages. In this letter she asked for ideas on how to increase sales. Workers were asked to confirm that they had received this letter and had it may had any good ideas.

- 1) In this case study, identify:
 - the receiver of the message
 - the medium being used
 - the creator of the message
- 2) Did the communication involve feedback?
- 3) Do you think that the traditional way the manager is communicating with workers was the best way to do it? If yes, which method could have been more effective? Explain your answer.

One-way and two-way communication

One-way communication means that the sender of a message has no chance to reply or respond to the message. An example would be an instruction to 'Take these goods to the customer'. One-way communication does not allow the receiver to communicate its communication or to provide any feedback.

Two-way communication is where there is a reply or a response from the receiver. This could be an simple confirmation of receipt of the message or it could be a discussion about the message. Both people are directly involved in the communication process. This could lead to better and clearer information.

Activity 1.4

Refer to the list of messages on page 113–14. The textbook uses the word 'transmit' each message in this section. Which messages are most likely to lead to:

- one-way communication?
- two-way communication?

Any answers to your choice to each case.

The advantages of two-way communication

When the receiver has to, or decides to, give feedback to the sender of the message there are three main benefits:

- It should become relatively clear to the sender whether or not the person receiving the message has understood it and acted upon it. If they have not, then perhaps the message needs to be more specific or made clearer. Effective communication has now taken place until the message is confirmed by the sender.
- Both people are now involved in the communication process. The receiver feels more a part of this process. He or she can make a real contribution to the topic being discussed or communicated. This may help to increase the response.



The difference between one-way and two-way communication

Definitions to know

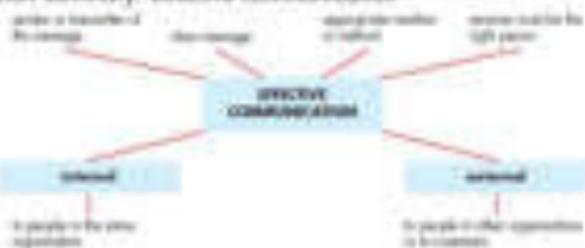
One-way communication: where the sender of a message has no chance to reply or respond to the message. An example would be an instruction to 'Take these goods to the customer'. One-way communication does not allow the receiver to communicate its communication or to provide any feedback.

Activity 1.4

Refer to the list of messages on page 113–14. The textbook uses the word 'transmit' each message in this section. Which messages are most likely to lead to:

- one-way communication?
- two-way communication?

Any answers to your choice to each case.

Revision summary: effective communication**Communication methods**

Information can be sent or received in a number of different ways – these are called the communication media.

- Most methods of communication involve the transfer of the message (writing is the exception).



- Written methods of communication include letters and emails; power (or messaging) involves the use of information technology (IT).



- Visual methods of communication include methods such as diagrams, charts and videos.



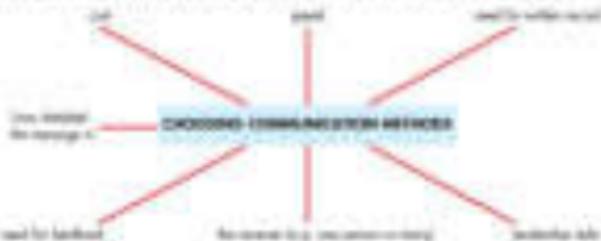
Who is the best way to communicate a message? There is no simple answer to this question. Awareness is a factor in our initial communication and on paper inclusion is essential to our written communication. Different messages require different methods of communication, so there is no hard method to of course.

Choosing the appropriate communication method

There are several factors that the sender of a message should consider before choosing the most appropriate method to use in communication with the receiver:

- Audience** - it is important that the receiver gets the information really quickly. For example, a message from a foreign client of a company must be laid about a controlled reading before he makes his flight.
- Cost** - is it important to keep costs down or is it more important to communicate effectively, regardless of cost? For example, consumers need to be informed about a sales offer position with a product.
- Message detail** - how detailed is the message? If it contains technical plans, figures and illustrations then, clearly, written and other visual forms of communication are likely to be essential.
- Feedback style** - is the leadership style a democratic one? If it is, then two-way verbal forms of communication, with questions we much more likely to be used than they would be by an "authoritarian leader".
- The receiver** - who is/are the "target" receivers? If just one person has to be communicated with, and they work in the user role, then one-to-one communication is likely to be used. However, this would be inappropriate if hundreds of workers needed to receive a message.
- Importance of a written record** - it is essential that a written record can be referred to at some time in the future, then, clearly, verbal communication would be inappropriate. For example, legal contracts or messages of some others from customers must have written records.
- Importance of feedback** - if it is essential that the sender receives feedback, perhaps very quickly, then a direct verbal method of communication might be most appropriate. For example, has the customer you leaving the shop paid the items you grade per?

Revision summary: how to choose communication methods



Verbal communication methods

Verbal, or oral, communication methods include:

- **face-to-face** (verbal) between the sender and the receiver
- **telephone conversations**
- **video conferencing**, where groups of people in different locations can talk to each other through a video link
- **voicemail and voice messaging**, which could involve lots of people

Advantages of verbal communication

- Information can be given out quickly. When this happens at big meetings, it is an efficient way of communicating with a large number of people.
- There is opportunity for immediate feedback and two-way communication.
- The message is often modified by using the speaker. The body language of the speaker, how they stand and their facial expressions, can help us put the message across effectively. This, of course, does not apply to telephone conversations.

Disadvantages of verbal communication

- In a big meeting, there is no way of telling whether everybody is hearing, or has understood, the message.
- It can take longer to use verbal methods when feedback occurs than written forms of communication.
- Where an urgent and permanent record of the message is needed, such as a warning to a worker, a verbal method is inappropriate.

Written communication methods including those based on information technology

Written methods of communication include:

- **Business letters** – used for either internal or external communication, they should follow a set structure
- **memos** (an abbreviation of memorandum) – written messages used internally. Many businesses now communicate to send these through the internal email system. An example of a memo sent by email is shown on the next page.

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Page 10

Journal of Oral Rehabilitation 2003 30: 103–109

The position of interrupted granite outcrops can however cannot be overlooked. It has been noted

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- reports—detailed documents about a particular issue or problem. These are often produced by experts working in the business. They can be sent to managers to read before a meeting to discuss the issue. Very often these reports are so detailed that they could not be understood by all employees.
 - notices pinned on boards—these are used to display information which is open to everyone. However, there is no certainty that they are read.
 - phone (telephone message) — written messages sent to other offices by telephone through the telephone lines
 - text messages—using cell (mobile) phones are a major part of popular forms. They allow the quick and convenient communication with others. One of the most used functions on the cell phone is text the phone. But the human still messaging—such as when organising a business meeting, at short notice, you take out your cell phone, open it in a quick, 'text me 40 E pkr' and press send. Text messaging is an easy and efficient way of communicating with others.
 - Text messaging allows the "sender" to communicate with others in situations where a face-to-face or phone conversation is not possible or appropriate. Also, a record exists of the communication—until this is deleted. However, there is no way of assessing the tone of the message or the "mood" of the sender and this can lead some difficulties in communication.
 - email and social networking sites and. Emailing and other forms of electronic communication using information technology—these have revolutionised communication in recent years. Written messages can be sent between two or more people with computing facilities. Pictures of messages can be obtained if a "Read copy" is received.

Business pounds may be required for all members in a business with income over \$10,000.

The system allows one and three-dimensional communication with customers and

Methodology

[Steps of the User-Data Pipeline by Jeffrey Green](#) ([Get ready to](#)

10 of 10

见于《新唐书·五行志》。

九章 七言 月夜雨 未完

The author of a *New Testament*

Advantages of written communication

- There is 'hard' evidence of the message which can be referred to in the future. This should help to reduce disagreements between the sender and the receiver about the content of the message.
- It is essential for certain messages involving complicated details which might be misunderstood if, for example, a telephone call was made. Also, the law in many countries requires certain safety messages to be written and displayed in offices and factories. It is no offence to tell people about safety measures – they could be dangerous.
- A written message can be copied and sent to many people. This could be more efficient than informing all of those people in person that the same message socially.
- Electronic communication is a quick and cheap way to reach a large number of people.

Disadvantages of written communication

- Direct feedback is not always possible, unless electronic communication is used. This can, however, lead to too many email messages being received and 'information overload', leading to people not being able to pick out the really important messages from the many that might be received. With written messages, in other forms, one-way communication is difficult.
- It is not so easy to check that the message has been received and acted upon as with verbal messages – although this can be done with email as a 'phone acknowledgement'. Evidence can be set up.
- The language used can be difficult for some receivers to understand. If the written message is over long it may be confusing and lose the intent of the reader.
- There is no opportunity for body language to be used to reinforce the message.

Visual communication methods

Visual methods of communication include:

- **Fliers, notices and brochures** – often used by businesses to help write new staff or to inform sales people about new products.
- **Posters** – can be used to explain a simple but important message by means of a picture or cartoon. For example, the dangers of operating an industrial machine or the risks of having higher alcohol use.
- **Charts and diagrams** – can be used in reports or interviews about numerical data or to simplify complicated ideas such as how the human heart works. Examples of these appear in other chapters of this book. Computers and software CD packages can be used to present data in a wide range of different tables, charts, graphs and diagrams. Printouts of these can then be included in a hard copy or added to reports and other documents.
- **Photographs and caricatures** – these can be used in aid writing, colour and business in a message – all of which can increase the chances of the communication being read and understood by the receiver.

Advantages of visual communication

- These methods can present information in an appealing and attractive way. People are often more prepared to look at them or process them to read letters or articles because of the interesting way they communicate messages.

Visual messages

Advantages: Visual messages can be used to send information quickly and effectively. It uses various forms of communication that communicate much more quickly than written communication. In other cases, for example when advertising a new product, communication with potential customers could be best achieved with visual visual methods.

- They can be used to make a better message clearer by adding a chart or diagram to illustrate the point being made.

Disadvantages of visual communication:

- There is no feedback, and the reader of the message may want to use other forms of communication to check that the message is understood. For example, written notes are often followed by a written test for the firm staff to check their understanding.
- Charts and graphs are difficult for some people to interpret. The overall message might be misunderstood if the receiver is unsure of how to read values from a graph or how to interpret a technical diagram.

Activity 1.3: Methods of communication

Fill out the table of communication methods. Under the headings of *method*, *written*, *voiced* and *feedback*, tick in the key advantages or disadvantages of each. Tick the ones that apply to you.

	Method	Written/voiced	Feedback
Letter	Written - takes time for reply letter with visual information per page	Written - recipient has the time to read the letter & reply to it back quickly	Only to be done via email or post as all
Telephone call			
Meeting with manager			
Local newsagent			
Staff newsletter			
Address book			
E-mail			
Website			
Point-to-point communication			
External website			
Post messages			

Revision summary: communication methods

Activity 9.4

Which communication method might be most appropriate for the following managerial activity you witness in each case:

- Staff should be on computer in the staff canteen.
- The management wants to inform all employees on their new computer system needs.
- Staffs of the firm's sales division that the last four years are having very no characteristics.
- The Finance Manager wants to remind the Operations Manager that they have arranged a meeting for next week.
- The Product Development Manager wants to inform division of the product research and development ideas, the hopes that they will agree to launch one of these products.
- The Office Manager wants to inform others from all office workers on how paper needs to be used.
- An experienced person to work for the last three or twelve weeks has left the work.
- Head of Marketing wants to be made available to all members.
- The Human Resources Manager wants to make an appointment for a job to an interview.
- The Operations Manager wants to warn this person has a new factory in the Manufacturing division, who is in a foreign business trip.
- Existing customers of a bank teller to be informed about a new type of bank account.
- A new contract needs to be agreed amongst between a farmer and the contractor who is to supply him.
- The Marketing Department of a company illustrate wants to launch a new perfume aimed at women with above average incomes.

Definitions 10**Formal**

Communication is
when messages
are sent through
standardised
channels using
formalised
language.

Informal

Communication is
when information
is sent and
received usually
with the use
of everyday
language.

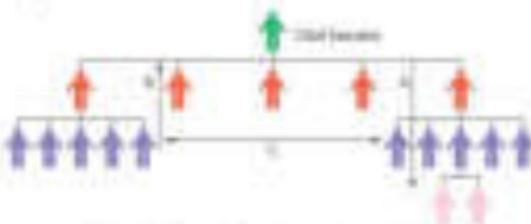
Formal and informal communication

If you are a school student or its equivalent, how do you receive messages which are important or vital? This may read notices on the noticeboard, receive reports, emails or memos or attend official meetings. These are all examples of **formal communication**. Are they the only way you hear about what is going on in your organisation? Almost certainly not.

You can also likely to receive messages through **informal channels**, such as one-to-one talks in common with colleagues or break times. These informal, or unstructured, meetings are sometimes referred to as the 'gossips'. Sometimes these informal channels can be used by managers to 'soft-sell' the receiver to new ideas, such as a new shift system in the factory, 'before communicating details of the new system formally. If the reaction to management from the employee is negative, they may not introduce the new idea at all. At other times, the informal channels can spread gossip and rumour, which is badlight to managers. Managers, however, cannot prevent the informal links existing between people in the organisation.

The direction of communications

A typical organisation chart for a business is shown below.



Look at the arrows. They indicate the direction of communication:

- **Arrow A:** shows downward communication. This is where messages are sent from manager to individual. It can be used for instructions or instructions on important business decisions. If done well, it will allow for feedback. If these messages have to pass through many levels of hierarchy, then the original meaning of the message could become distorted (see 'Communication barrier' below).
- **Arrow B:** shows upward communication. This is where a message or feedback is passed from subordinates to managers. As we have seen, such feedback can be an essential part of effective communication. Whether it is regular team touch or fully by being involved in the communication process. They should not be afraid of contributing to discussions or meetings. The organisation has itself to gain when the managers are prepared to listen to and act upon messages received from those lower down the organisation.
- **Arrow C:** shows horizontal communication (sometimes referred to as lateral communication). This occurs when people at the same level of an organisation communicate with each other. Information and ideas can be exchanged as freely formal and informal meetings. This can be a cause of conflict between departments; for example, if Marketing informs Operations that the quality of output is so poor that the customers are returning goods as faulty!

Communication barriers

As we saw on page 115, there are four parts to any successful communication – sender, receiver, medium and feedback. Communication can fail if any one of these four parts does not operate as it should. If one part fails, it would be called a **barrier to effective communication**. This would cause a breakdown in communication, which could lead to serious problems for the organisation.

The four common barriers to effective communication and ways to overcome them are listed in the table on the next page.

This is necessary
The sender of any message needs to be clear about what it is trying to say.

Difficulties in hearing
Communication barriers stop effective communication of messages.

Barriers to effective communication and how they can be overcome

Barrier	Description	How the barrier can be overcome
Gaps between sender and receiver	Language which is less difficult to understand. Technical or technical terms may not be understood by the receiver.	The sender should ensure that the message uses language which is understandable. Use language in terms which are non-technical enough to be understood.
	The sender uses technical terms of business language which quickly lose credibility if not being understood.	The sender should reduce the message as clear as possible. Examples should be added for to ensure the message is being understood.
	The sender communicates the wrong message or message to the wrong audience.	The sender must make sure that the right person is receiving the right message.
	The message is too long and has much detail prevents key points being understood. The content is often the fault of the sender.	The message should be short to ensure its able to make points to be understood.
Problems with the medium	The message may be lost as the receiver didn't read it.	It is important to check for feedback. If no feedback is received then the sender assumes the message was lost.
	The message is communicated in a less appropriate message than the audience which most people did not read.	The sender must check the appropriate channel for each message sent.
	If the message is well stated a loss of context, the original meaning of the message may be lost so could become distorted.	The standard pointer ellipsis should be used to avoid this problem.
	No feedback is received.	This could be because, e.g. an email goes back to working during the day. A feedback method like phone calls could help.
Problems with the receiver	Disinterest of the receiver, e.g. company issues or general topic.	Other forms of communication should always possible, ie. mobile available.
	The message can be lost by listening or reading attention.	The importance of the message should be emphasised. The receiver should be asked for feedback to ensure understanding.
Problems with feedback	The receiver may consider it was the sender. This may be something to consider on their message.	There should be trust between both the sender and the receiver as otherwise communication is unlikely to happen positive sender should be kind to the receiver.
	There is no feedback.	Feedback on feedback are added to. Perhaps the method of communication used does not allow for feedback.
	It is assumed one channel is the best. In addition, the original message perhaps the feedback is coming through an input device before being returned to the original sender of the message.	Different forms of communication (written, audio, video, etc.) messages could be used. More communication = more chance of success.

Practical exercise

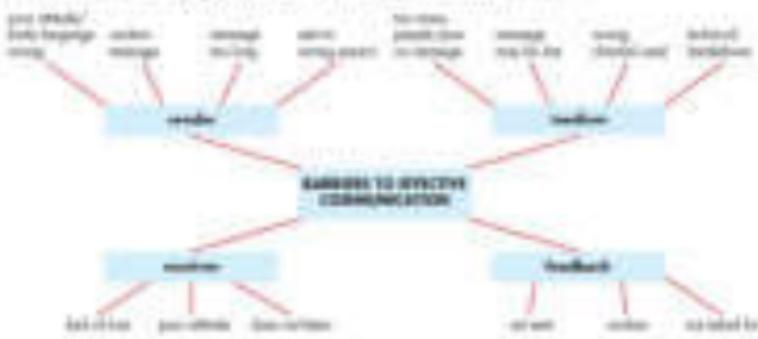
- (Qualified client communication)
Buyers often ask for suggestions about how to communicate with clients.
Failure can be presented as questions.

Activity 4.7: Reducing communication barriers

Harold is a successful business owner. He started his own business, ETC, importing tea and coffee four years ago. He now employs 40 people - 30 in his factory and 10 in his office. His products are very good, as he is very busy his factory has been running round the clock. He rarely has time to speak directly with his clients as place due his忙 schedule his free time. They are very unresponsive to his client needs. Some suppliers of tea and coffee tend not to like the way he runs his business and think he is very angry. He wants to sell his products and doesn't think they much dispersion. He wishes to have all his clients respond to him. He does not get any response.

- Identify three possible causes of communication barriers within ETC.
- Explain to Harold how he could overcome the three communication barriers that you identified in a.

Review summary: barriers to effective communication



[View additional treatments for breast cancer](#) from the National Institutes of Health.

This Euronext compilation is using a library of 10000 publications drawn from 100000 employees of the global business and academic elite based on Dow Jones' most innovative companies.

Almonds physical health of Human Resources (HR) at Encyclopaedia of Healthquarters in Atlanta, Georgia, says that Encyclopaedia can be one of the most respected companies in the physically healthy HRs due to its employees effort. The company knows how this will carry on advantage to all employees.

Characterizing TBI prognosis with last year's classification on five new principles which describe latent factors underlying the outcome for different patients according to their clinical presentation.

The seminar will be given for a week with one principle to discuss in each day—*control principles*, *space-things*—and another *space-principle* or *space-things* in the second week.

"With long-established principles (including its own unique, WPA) now generally accepted as superior, traditional usage has re-emerged for year-round-fish management activities at all three reservoir settings—an assessment and recommendation by Babbitt.

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- Response using Clean Breaks or DIF based initiatives, most effective measure since 2000 is improvements
 - The new Board must demonstrate a clear focus on customer outcomes of a service or system of service

Exam-style questions - Paper 1

- 1** Marwan is HR Manager for a large bank. His responsibilities include internal communication with individual workers and groups of workers. Sometimes he wants to send a message to all 15 000 workers employed by the bank. Some workers complain that unless they spend time reading emails, or email messages may fail to receive important information.
- **What is meant by 'internal communication'?**
- **Identify three benefits of using **notices** as a form of communication.**
- **Identify and explain **two** possible barriers to communication within the bank.**
- **Identify and explain **two** ways in which Marwan could communicate with individual workers about their pay and working conditions.**
- **Do you think that electronic forms of communication are always the best ones to use when communicating with large numbers of workers? Justify your answer.**
- 2** SEP manufactures electrical appliances such as cookers and kettles. One of Phil's responsibilities as Marketing Manager at SEP is to communicate with thousands of customers in many countries. Some of these customers are wholesalers but many are individual consumers who have bought products directly from the business. Phil is concerned that communication barriers sometimes prevent the message being received effectively.
- **What is meant by 'communication barriers'?**
- **Against these customers, identify **three** external factors SEP might need to communicate with.**
- **Identify and explain **two** types of **internal** communication with customers that Phil could use.**
- **Identify and explain **two** possible sources of communication barriers between Phil and SEP's customers.**
- **SEP has discovered a major safety problem with one of its products. It needs to communicate with customers quickly, explain the advantages and disadvantages of it informing all customers and tell nothing is aimed at them. Which method of communication is best in this case? Justify your answer.**

Revision checklist

In this chapter you have learned:

- **Why internal and external communication is important in different business situations**
- **How to select the best method of communication for different messages**
- **The most common reasons for communication failure – barriers to communication**
- **How businesses can overcome these barriers to communication**

ANSWER – see free download with the online questions at <http://E21-SHOW>

People in business: end of section case study (Paper 2 style)

The Lakeside Restaurant

The Lakeside Restaurant is owned by two brothers, Chris and Simon. They set up the restaurant ten years ago as a private limited company. It is located at the edge of a lake.



The business is split into two main dining areas. One area is for families and the other area serves more expensive meals for business people. The family dining area is large and is used for weddings and birthday parties. The other area is smaller for business customers.

Both sections of the restaurant are currently busy and fully booked on weekends. Chris and Simon want to expand their business. The managers cannot be expanded as it costs too much to hire buildings on one side and fit in staff to work there on the other side. Some ordinary car parking spaces will need to be converted into more expensive customer parking.

There are four options for the business to expand:

- Option 1 - Buy a shop and convert it into a floating restaurant next to the lake restaurant. The cost will be £100 000 to buy and convert it to a restaurant. The projected net profit is £20 000 per year. Unemployment in the area is high.
- Option 2 - Close the existing restaurant and relocate to a new building which is much larger and further the centre of the city. The additional cost of buying a new building is £200 000 and the projected net profit is £25 000 per year. Unemployment in the city centre is low.

Appendix 1

Recruit specifications for the post of manager of the Lakeside Restaurant

Name	Mr J. Patel	Ms B. Rajpal
Qualifications	GCSEs; 2 A levels; MBA (Master of Business Administration)	T/NCB; 2 A levels
Work experience required	2 years as General Manager of a small pub	2 years as Manager of a pub
Resumes	Cooking, foodstuff, supply industry	Floating, swimming, lifeguard. Searched online for accounts for w youth children's charity
Previous roles	Waitress, in a pub	Waiter, in a pub
Number of working hours at which they have worked	A minimum of 10 weeks such as their school holidays (20).	10 different restaurants for 20 weeks
Preferred management style	Authoritarian - follows the manager's instructions	Democratic - allows employees decide in which direction

Appendix 2

Mr. John Hastings

From: 436612@msn.com (uk)

Sent: 23 October 2003 23:42:07

To: Abdul (Abdul@gmail.com)

Subject:

RE: Abdul

We need to employ a new accountant manager. We had to discuss the best manager as he failed to increase employees - we do not want customers. We have open.

I hope someone who is careful with money pool will give a good service to the customers. They need to come up with ideas of how to increase the number of customers to the restaurant on weekends.

What do you think?

- 1. a) Identify and explain two reasons why multi-motivated employees are important for the restaurants. (10)
- b) Chris and Abdul have submitted a job instance for a recruitment manager. Look at Appendix 2, nominate the most appropriate and describe why you would choose for applying. Justify this decision for each choice. (10)
- c) The Lakeside Restaurant is expanding; identify and explain two reasons why an organisational chart would be helpful to the management of the restaurant. (6)
- d) The restaurant needs to communicate with its customer to update its weekly 'Food' requirements. Consider the advantages and disadvantages of using email, letter or telephone. Recommend which is the best method for Chris and Abdul to use. Justify your answer. (12)

Optional questions

- 1. a) The Lakeside Restaurant is located near to several restaurants which are competitors. Explain one advantage and one disadvantage in the business of being located near to competitors. (8)
- b) Consider the advantages and disadvantages of the two options for the customer business to expand. Recommend which option Chris and Abdul should choose. Justify your choice. (12)

**Section
3**

Marketing

Chapters:

- 10 Marketing, consumers and the customer
- 11 Market research
- 12 The marketing mix: product
- 13 The marketing mix: price
- 14 The marketing mix: promotion and technology in marketing
- 15 The marketing mix: place
- 16 Marketing strategy



Marketing, competition and the customer

This chapter will explore:

- the role of marketing
- why markets change in terms of consumer spending patterns and competition, and how businesses respond to these changes
- the difference between mass marketing and niche marketing
- how and why market segmentation is carried out

The Marketing department

Most businesses, whether they are very small, will have a Marketing department. In a large profit-making company, the Marketing Division will have people responsible for market research of new products, promotion (including public relations and advertising), distribution, pricing and sales.



The structure of a typical Marketing department

The bigger the company, the more people will be employed in the Marketing department and the more sections there are likely to be.

- The **Sales department** is responsible for the sales of the products. It will usually have agents across the distribution system in which the product is distributed. If the product is exported, there may also be an Export department.
- The **Market Research department** is responsible for finding out consumers' needs, market changes and the impact of competitors' actions. It will report on these to the Marketing Director and this information will be used to help make decisions about research and development of new products, pricing levels, sales forecasting and promotional strategies.
- The **Product Development department** deals with organising the advertising for products. It organises for advertisements to be produced. For example, adverts are filmed if they are to be on television, or designed if they are to be in newspapers. The department also decides on the types of promotion that will be included in campaigns. It will have a marketing budget – a fixed amount of money to spend. It has to decide which types of advertising media will be the most effective to use because there will only be a certain amount to spend; the department cannot spend what it likes!
- The **Distribution department** transports the products to the market.

Activity 1.3.1

To identify differentiation – **Define Market Research, Promotion or Distribution – do each of the following provide evidence?**

- Arrive quickly, many of the business's other competitors slowing the product to people who buy immediately for long-term gains.
- Differentiated products focus on quality of the product to be placed in international markets.
- Promote products of not time-varying, non-sophisticated.
- Many originalise the various rights for the products to prevent its been exploited abroad.

The role of marketing

Marketing is not just about advertising and selling a good or service, as can be seen by the different marketing activities found in a Marketing Department. The central role of marketing is to:

- **identify customer needs** by finding out what kind of products or services customers want, the prices they are willing to pay; where and how they want to buy these goods or services and what other sales services they might want.
- **satisfy customer needs** in order to achieve sales of their goods or services. Customers want the right products, in the right place and at the right price. Failure to do this, or to do it less well than competitor, will lead to the failure of the business.
- **maximise customer loyalty** by building customer relationships. Keeping old customers will help to reduce the costs of the business. If customers change their expectations of what they want from a good or service then the business should respond to more than one needs. This will be identified by maintaining close relationships with customers. It is very important involving existing customers (customer loyalty) and new customers in attracting new ones. It is much cheaper to keep existing customers (for example, with loyalty cards) than trying to gain new customers.
- **gain information about customers** so that their changing needs and expectations a long-term relationship with them. This is one of the most important roles of the Marketing department - work. Building a relationship with customers means that market research information can be used to understand why customers buy products and how they use them. This makes for better and therefore more effective marketing.
- **anticipate changes in customer needs** by identifying new trends in consumer demand or gaps in the market so that business can produce goods or services which are not currently available.

If the Marketing Department is successful in identifying customer requirements and predicting future customer needs, it should enable the business to meet one or more of the following objectives:

- gain competitive advantage of a product or service of the business
- increase sales revenue and profitability
- increase or maintain market share
- maintain or improve the image of products or a business
- target a new market or market segment
- enter new markets at home or abroad
- develop new products or improve existing products.

Definitions as Home

Market share: A percentage of total market sales made by one brand or business.

Case study: Pepsi-Europe

60 percent). Pepsi Worldwide, which manufactures Pepsi, Tropicana juice, Mountain Dew, Gatorade, Aquafina and Lipton, accounts for 20 per cent of the total non-carbonated drinks market in the Netherlands. It wants to expand its operations and increase its share of the carbonated soft drink market. The following discussion will be vital in deciding how this can be achieved.

Tip for success

When calculating market share, consider carefully what you are measuring for. Different producers may assume they carry equal shares of the market based on different figures.

Activity 1.2

Read the case study above.

- 1) Suppose Pepsi Worldwide could increase its market share. Which way do you think will be more effective: (a) buy your own market share; or (b) sell your products? Pepsi Worldwide should develop new varieties of drinks to suit its market. Explain your answer.
- 2) Identify who would be the main customers of Pepsi-Cola.
- 3) Explain what types of advertising and promotion might be effective in attracting these customers.

Understanding market changes

Styles of goods and services from particular businesses do not stay the same year after year or even month after month. Things don't stay the same forever! Some markets are changing at a rapid pace, such as mobile (cell) phones, whereas other markets, such as foodstuffs (cereals), don't change very quickly.

Why customer/consumer spending patterns change

- **Consumer tastes and fashion change** – fashion may change for clothes and as a consequence may mean different styles of clothes to those they wore last year.
- **Changes in technology** – with new processes being developed, such as iPads and smartphones, sales of traditional entrepreneurs have fallen as more executives' New products mean old customers/entrepreneurs do not have high sales anymore.
- **Change in incomes** – if an economy has high unemployment then many consumers will buy cheaper products. If the economy then grows and unemployment falls the sales of more expensive products will increase.
- **Ageing populations** – the age structure of the population in many countries is changing to a greater percentage of older people. This has changed the type of products we are increasing in demand, such as long-lasting flour products for instance.

The power and importance of changing customer needs

If businesses fail to respond to changing needs then they are likely to fail. Customers are 'King' because as their needs change, it is they themselves who research and know what these changes are, and respond to them, that will be the ones which are successful (see Case study Activity 3.1).

Why have some markets become more competitive?

- Globalisation of markets has meant that products are increasingly sold all over the world (see Chapter 2B).
- Transportation improvements have meant that it is easier to get products from one part of the world to another part of the world.
- Increased globalisation has meant that consumers can search for products and buy from overseas markets. Fewer value services such as insurance can be bought from businesses based in another country. Increased consumer information about products and the different international businesses that produce them makes a market much more competitive.

How can businesses respond to changing spending patterns and increased competition?

A business will focus on sales areas or markets in market share whenever there is growth amongst its competitors. This may also be necessary if the image of the business has been harmed by bad publicity in the newspapers or via television (for example, if a particular sex doll has had a child). In this case the business will need to find ways to continue customers that the product has been damaged. If it does not, then the sales revenue and profits will go down. Increasing or maintaining image is an important factor in improving or maintaining market share.

In order to remain successful, a business may need to:

- maintain good customer relationships – this has a key role in continuing to meet customer needs and it also provides market research information about customers. Marketing departments which 'listen' experts on customer needs will respond to these needs and maintain consumer loyalty. It has been shown that it is often cheaper to keep existing customers than gain new ones.
- keep improving its existing products – this is especially true if its competitors improve their products. By making the goods it sells very different from those produced by competitors the business will hopefully well known for differentiated products. Apple is a good example of a company that tends to increased competition by making ever more advanced products.
- bring out new products to keep customers' interest in their company rather than their competitors. This will help them to maintain, or even increase, their market share. An example of this would be McDonald's, which keeps on improving and introducing its existing products.
- keep costs low so maintain competitiveness – it should help keep low prices.

Case-study example

What happens when changes catch up with you?

The point is changing very fast. Big oil not just cost price issue. It will be the first leading the move? (Robert McDonald)

One of the few things that is certain is this world is changing. In a world where technology is advancing much much faster than change happens even more quickly. It is very important for companies to adapt to change as rapidly as they can.

This is an example of Kodak, which had the leadership in 1990 in cameras and prints, caused by point of failing some of its own strategies like the company has digital cameras now take over the market. Kodak, a pioneer in the photographic film business, has tried to revolutionise by buying a series of consumer products like cameras.

Consumer preference for digital cameras is on the rise in the last five years the digital cameras (around 40 million) as a category (according to NPD) and digital cameras are falling, what with additional features that allow users to record video, enhance connectivity such as being able to download and sharing their photos.

Activity 18.2

Read the case study above.

• Who has failed to take account of changes? Explain your answer.

• Suggest how business in closer contact with customer might have avoided this problem.

What is meant by a market?

A market for a particular good or service is made up of the total number of customers and potential consumers as well as sellers for that particular good or service. It can be measured by the total number of sales or by the value of the sales for that good or service by all suppliers in that particular good or service. These markets can be either mass markets or niche markets.

Mass marketing

If a producer has a very large number of sales it could be said to be sold on a **mass market** (many people in the population will buy this product, for example aspirin, washing powder or soap). Products are designed to appeal to the whole market and therefore advertising and promotions are intended to appeal to mass consumers. The advantages of selling in a mass market are:

- the sales are then cumulative - very large
- the firm can benefit from economies of scale (see Chapter 18)
- risks can be spread, as often the business will sell several different types of products to the mass market; and if one family of the product fails then the other products may still sell well
- opportunities for growth of the business due to large potential size

However, there are disadvantages:

- high levels of competition between firms
- high costs of advertising
- standardised products or services unpersonalised and so may not meet the specific needs of all consumers or potential customers, therefore leading to lost sales

Business for Exam

Mass market is where there is a very large number of sales of a product.

Niche marketing

Differentiation by brand

Niche-marketing is a small, clearly defined segment of a much larger market.

Target market

Market type plus
target market
the difference
between a mass
market and a
niche market
using examples of
products or services

However, some products, often specialised products, are sold only to a very small number of customers who form a very small segment of a much larger market. This is referred to as a **niche market**. These products are quite often sold by small firms as they have less fixed costs for large firms to handle with. For example, there is a niche market for food selling food products in one country. However, if there is a small group of migrant workers in that country then food shops selling specialised food for this group of people may be set up. Specialised products, such as health machines or dietary advice, are aimed at a small section of much larger markets.

Selling while or directly and supply a niche market has advantages:

- Small firms are able to sell to niche markets as large firms may not have diversified enough but concentrated on the main market instead. This may avoid competition from the larger business.
- The needs of consumers can be focused on and therefore satisfied by the firm in a niche market. This will give them an advantage over larger firms who aim to cover the needs of the mass market rather than the needs of these specific consumers.

However, there are disadvantages of supplying to a niche market:

- Niche markets are small and therefore have a limited number of sales, which means only small businesses can operate in these markets. If the business wants to grow it will need to look outside the niche market to find sales of other products.
- Often businesses in a niche market will specialise in just one product. This means that if the product is no longer in demand the business will fail as the business has no spread to risk. Producing several products cannot do one product alone but if one fails there are other products which are still in demand and the business carries on trading.

Market segments

The market for a particular good or service is made up of the total number of consumers and potential consumers for that particular good or service. Market segmentation recognises that all potential users of a good or service are not all the same, and what applies to one set of consumers may not apply to others.

Market segmentation is where a market is broken down into sub-groups which share similar characteristics. For example, consumers are split by young children, teenagers and adults of both sexes. Different brands of chocolate will appeal to these different groups of people. A Marketing department will divide the whole market into different groups and categories; these are called market segments.

Each segment is investigated to gain detail. When it comes to advertising, the Marketing department know the best places to advertise and the most likely place the particular market segment will see the advertisement. They will also know how to design the advertisement to appeal to the particular market segment they are aiming at. For example, might be teenagers buying clothes. They might be asked questions about which programmes they watch, which television programmes they watch, where mobile (cell) phone they buy and general questions about what they like. This will enable the Marketing department to select the best areas to advertise, if television advertisements are to be used, and the type of advert that will appeal to teenagers. They can advertise to teenagers that are unlikely used by teenagers to design a new app for free download.

Differentiation by brand

Market segments
are sub-groups of a
whole market to
which consumers
have similar
characteristics or
preferences.

Segmenting a market can help a business to:

- make marketing expenditure more efficient by producing a product which clearly meets the needs of these consumers and only targeting its marketing efforts on this segment;
- earn higher sales and profits for the business, because of cost-effective marketing;
- identify a market segment which is not being targeted fully yet, and therefore offers opportunities for increasing sales.

Some of the most common ways of how a market can be segmented are shown in the table below.

Ways of segmenting a market

Case study
Remember that consumers can be part of more than one segment. You should be able to mention how and why businesses segment a market and give examples to illustrate this.

By socio-economic group	most areas can be divided by income groups (by according to how much they eat past). For example, managers are usually paid more than office staff. Office staff are usually paid less than production workers. Unskilled workers will obviously be in the lower-income group. These income-based products are priced differently to target certain income groups. For example, car racing is top performance and high-end. Only someone on a high income could afford a Ferrari, but a person on a much lower income might prefer to buy a Fiat 500. Some products are sold to low-income groups; office cleaners are often marketed and are aimed at different income groups.
By age	This products bought by people in different age groups will reflect their values. Young people buy different clothes to elderly people. The most popular fast food will also differ from bought by older children, teenagers and adults. For example, teenagers like eating pizzas, while adults like eating sandwiches.
By geographical area	An ordinary supermarket country would have different physical characteristics, if there are any and every parts of the country have different conditions would be sold in the same part of the country, but not in the other part. If the product is required, then it may need to be changed slightly (for example, a different range of different packages) in order to appeal to the different people in other countries.
By gender	Some products are bought with the intent to only by men. For example, a racing car would normally be bought by a male, whereas a perfume would normally be bought by a female.
By size of the population	For example, cars can be used for customers for domestic use or for business use. The advertising media and promotional methods will still differ. Cost for business will have to be adjusted to smaller numbers and for domestic, whereas very big domestic spending includes fewer passengers. These last three are new models, but they will be marketed in a different way.
By lifestyle	For example, a single person living his/her income as a couple can be seen as different categories that require differently buying different products.

Decide the best place to advertise to increase sales

A marketing manager would take all these factors into account when deciding which segments might be more prevalent or important products. Therefore, once the segments have been identified, this will influence how the products are packaged and advertised. It will also affect the choice of where the products are sold in, in order to get maximum sales.

Potential benefits of segmentation to business

The business can use market segmentation to sell more products. This is done by making different brands of a product and then selling each brand in a different market segment. An easy to see example of this is the soap market. Before, a business would produce various brands of soap for mostly most of the market segments.

By looking over the different segments in a market, a business can potentially identify a segment whose needs are not being met (there is a gap in the market). Then, with their product a suitable provider to meet those unmet needs and again increase sales.

Key study outcome

What are examples of how the market for soap may be segmented?

Type of user	Characteristics of market segment
Beauty users	People who buy beauty soap will be people who want to keep their skin soft. They will therefore buy soap which contains moisturisers. This will be known as beauty soap.
Baby users	This is a baby soap which will have extra baby soap. This is used to bathe the baby's skin. This soap has the baby smell to it.
Handwash users	Handwash soap is sold to make hands clean. This soap is for the bathroom. It is for handwashing, both male and female.
Men's facial soap	This is a cleaning product which is for men's facial soaps. It is for personal use. This will probably be bought by parents for their children.

There may be other types of soap you can think of which are aimed at different groups. Some of these will be affected by factors such as gender and age.



Which type of soap will suit you best?

Activity 18.4

Read this case study scenario.

- 18.4.1** List five different brands of cars sold by your local dealers.
- 18.4.2** Search the website of the manufacturer of these brands at www.vauxhall.co.uk

Activity 18.5

Toyota produces a range of cars designed at different market segments. They seem to be a disparate company, but the Toyota range of cars are aimed at a particular market segment.



A Toyota Corolla



A Toyota Yaris



A Toyota Avensis



A Toyota RAV4

- Look at the photographs of the Toyota range of cars and identify what characteristics the consumers of these models put directly in front. The characteristics you identify might include: income, lifestyle, economic group, age, gender, use of the product. Example
- Explain the necessity for Toyota of producing a large range of cars aimed at different market segments.

Revision summary: ways of segmenting markets

Information technology has changed businesses and techniques



Marketing | Computer - mobile devices (cont) | **Mobile technology has taken many advances over the last twenty years:**

"The personal computer market has seen many changes over the last few years. The standard desktop computer is becoming a thing of the past in many offices, where a laptop has taken its place, or the home has also been true. However, the introduction of the smartphone has given rise to what has changed the market in leaps."

Analysts for the future of the personal computer market are predicting mobile devices will become market leaders in terms of global sales, followed by tablets and notebooks. Handheld computing are set to become a profitable and stable share of the global market.

Discussion points

- How has the market for personal computers changed?
- Why have these changes happened?
- How should businesses in the personal computer market respond to these changes?

Revision questions - Paper 1

- 1** D & F Limited own a number of farms which grow fruit. The fruit is sold to large supermarkets almost. They also grow coffee which is sold to companies that process and blend the coffee which is then sold by large supermarkets abroad. The world price of coffee has recently dropped by 20 per cent. There has been a growing demand for fruit from developing countries with rising incomes as well as an increasing demand from developed countries, which have seen a growing trend towards 'healthy eating', encouraged by government policies to tackle their obesity problem.
- What customer needs are being satisfied by D & F Limited? [2]
 - Identify two reasons why the price of coffee might be falling. [2]
 - Identify and explain two reasons why supermarkets are demanding more fruit. [4]
 - Identify and explain two ways the Directors of D & F Limited could respond to increased competition from farms which grow fruit instead of vegetables. [6]
 - Do you think D & F limited should change production from coffee to growing more fruit? Justify your answer. [6]
- 2** TGI is a public limited company which makes sports shoes (footwear). It makes a variety of designs for the mass market. The mass market is for young people who want fashionable sports shoes as well as those who play sport. The Directors recently decided to target a niche market which is for a particular market segment of customers who have a medical problem with their feet and need specially designed shoes.
- What is meant by a 'niche market'? [2]
 - Identify two examples of the different segments for TGI products. [2]
 - Identify and explain two reasons why TGI will focus on a niche market. [4]
 - Identify one advantage to TGI of segmenting the market for sports shoes. [6]
 - Do you think the Directors of TGI were right to target a niche market or should they have focused with just a mass market? Justify your answer. [6]

Revision checklist

In this chapter you have learned:

- the role of marketing - identifying and satisfying customer needs as well as maintaining customer loyalty
- why market changes occur, such as either (optimising patterns, change or there is increased competition, profit from business not respond to these changes)
- the difference between mass marketing and niche marketing
- what is meant by market segmentation and why market segmentation may be used
- to recommend and justify an appropriate method of segmentation in given circumstances.

NOW - test your understanding with the review questions on the CD-ROM.

This chapter will explore

- the importance of market research
- what is meant by primary research
- what is meant by secondary research
- other forms of data research
- why the information collected may not be accurate
- presentation and use of market research results.

Product-orientated and market-orientated businesses

Definition of a business
Markets
• product-orientated
Businesses in some industries tend to focus on the quality of their products rather than on the product itself.
market-orientated
Businesses in some industries put market research at the heart of their operations to ensure a constant flow of new products.
an entrepreneur
target area
Businesses plan the marketing of a product or product range for a target area which has been identified to contain the product or range, so that the Marketing department knows how much time and money to devote to the target area.

Some businesses produce the product first and then try to find a market for it. This is known as being **product-orientated**. This is not common today. Product-orientated businesses often produce basic necessities required for living, such as agricultural tools or basic foods. These products may not have done well before so limited (these issues will be discussed later in this chapter) and are general products that consumers need to buy. The manufacturer and supplier are mainly concerned with the price and quality of the product. Importantly when new technologies are being developed, due to close working from investigating possible markets. People may not see the product until it has been developed and advertising has promoted them so far off.

Businesses in these markets are successful as entrepreneurs cannot afford to produce products and hope that they will sell, without first carrying out market research to find out if the consumers will want the product. This is called being **market-orientated** and it means that the business must have a **marketing budget**. The business has to identify the wants and desires of consumers, track sales and in the future, in order to produce the right goods which will sell well and make a profit for the business.

Market-orientated businesses are better able to survive and to succeed because they are usually more prepared for changes in consumer tastes. They are able to take advantage of new market opportunities which may arise. New products are launched with more confidence when consumer needs have been identified before the product is communicated one to the market.

Case study example

India needs a new food by planting seeds. It is much easier to use than existing seeds because it has high manufacturing costs, needs a lot of water to water food.

Activity 1.1.2

Read the two bold boxes:

- Is Indian business product-orientated or market-orientated? Give reasons for your answer.
- What statistics and evidence do you believe to be before deciding the case test? Explain your answer.

Why is market research needed?

A business needs to find out how many people would want to buy the product it is planning to offer for sale. If there is not a very big market for the product, a great deal of money could be wasted producing something that not many people will buy. It could even cause the business to go bankrupt. Therefore, it is very important that **market research** is carried out accurately.

Market research is used to try to find out the answers to these questions:

- What colour of my product do people like or dislike?
- Would they be willing to buy my product?
- What price would they be prepared to pay?
- What would they be most likely to buy my product?
- What type of promotion would they like my product?
- What type of promotion would be effective with their type of customer?
- What is the competition like?

By carrying out market research, a business can identify consumer needs in a changing and competitive international environment. This is essential if a business is to remain competitive in the future.

Types of information

Market research can find out:

- quantitative information, which answers questions about this quantity of something, for example, 'How many spirit drinks were sold in the month of December?' or 'What percentage of children drink a certain soft drink?'
- qualitative information, which answers questions where an opinion or judgement is necessary, for example, 'What do consumers like about a particular product?' or 'Why do customers buy from one type of company's products?'

Both types of information can be performed as a result of:

- primary research, or field research
- secondary research, or desk research.

Primary research

Primary research, or field research, is the collection and collation of original data. It involves direct contact with potential or existing customers.

The research will usually have been planned and carried out by the people who hope to use the data, it is therefore, it can be an expensive way to gather information and will usually be for a specific purpose. For example, to use the market to see if a new product would be likely to succeed.

There are various types of primary research method:

- questionnaires
- interviews
- focus groups
- observation.

Surveys, Questionnaires, interviews and focus groups are all different types of survey.

Ex-Business 101 terms

Market research: A fine process of gathering, analysing and interpreting information about a market.

Primary research: Is the collection and collation of original data by direct contact with potential or existing customers, also called field research.

Secondary research

Information: Data or facts that are collected and is available for use by others, also called desk research.

Questionnaire: A set of questions to be answered as a means of collecting data for market research.

The process of primary research

To undertake primary research, a business will normally go through a series of stages, as illustrated in the diagram below.



The stages of primary research

Methods of primary research

Questionnaires

Questionnaires form the basis of most primary research. Questionnaires can be conducted face-to-face, for example at the supermarket, by post or via the internet.



Online surveys

Online surveys can be carried out via specialised websites. These allow the researcher to put a questionnaire on the website. The researcher will then email people or ask them to go onto the website and complete the questionnaire.

Developing better questions to ask is difficult if you want to be sure of getting accurate results. Some questions may not be very clear, others questions may lead the respondents to answer in a certain way which may not be what they really think. The researcher also needs to decide who to ask.

Advantages of questionnaires

- Detailed qualitative information can be gathered about the product or service.
- Consumers' opinions about the product or service can be obtained.
- They can be carried out online, which makes it cheaper and easier to collate/present the results.
- There can be follow-up phone-downs and prize draws/mailshots to encourage people to fill in the questionnaire.

Disadvantages of questionnaires

- If questions are not well thought out, the answers to them will not be very accurate. It may be very misleading for the business if it is thought that a product is liked by consumers, when in fact the respondent were only saying they thought the product was quite attractive but they would not actually buy it.
- Carrying out questionnaires can take a lot of time and money.
- Collating and analysing the results is also time-consuming.

Interviews

When interviews are used, the interviewer (the person asking the questions) will have ready prepared questions for the interviewee (the person answering the questions).

Advantages of interviews

- The interviewer is able to ask any questions that the interviewee does not understand.
- Detailed information about what the interviewee likes and dislikes about the product can be gathered.

Disadvantages of interviews

- Whether consciously or unconsciously, the interviewer could lead the interviewee into answering in a certain way, resulting in inaccurate results due to interviewer bias.
- Interviews are very time consuming to carry out and, therefore, they are often an expensive way of gathering information.

Surveys can be carried out with one person or they can be done in groups, where there is a single interviewer putting the questions to a group of people. This is less expensive than asking people individually, but it does eat the risk of the answer from people not being what they really think, for being influenced by what the others in the group say.

Samples

When deciding who to ask to fill in a questionnaire or 'Who to interview', a **sample** would have to be selected as it would be too expensive and impractical to try to include all the relevant population. This could be:

- A **random sample**. This means that every member of the population has an even chance of being interviewed. People are selected at random (either by computer). For example, every 1000th name in a telephone directory. The advantage is that everyone has an even chance of being picked, but not everyone in the population may be a consumer of the particular product being investigated.

1.1.1 Methods for surveys

A **sample** is the group of people who are selected to respond to a market research exercise, such as a questionnaire.

A **random sample** is where people are selected at random as a sample of respondents that represents a population.

Quota sampling

Definition of quota:
A quota sample is often based on specific characteristics such as age, gender or income, or a certain number of consumers that are required research. A **target group** is a group of people who are representative of the target market.

- **A quota sample:** This is when people are selected on the basis of certain characteristics, for example, age, gender or income. Researchers are given a quota. If they are carrying out street interviews, the researchers can choose who to interview, providing they ask a certain number of people with certain characteristics. For example, they may be required to interview 20 people from the age group 18–25, 20 people from the age group 26–45, and 20 people from the age group 46–65. The researcher can then find out the needs of those specific groups.

Focus groups

This is where groups of people (**focus groups**) agree to provide information about a specific product or service spending sometime with a panel of nine. This helps with development and sales. Groups may also eat test products and then discuss what they think of them, explaining why they like and what they didn't like about them.

Advantage of focus groups

- They can provide detailed information about consumers' opinions.

Disadvantage of focus groups

- They can be time-consuming, expensive and biased if some people in the panel are influenced by the responses of others.

Observation

This can take the form of:

- recording – for example, where you're based on whether which television channels are being watched;
- watching – includes such activities as counting how many different types of vehicles pass particular locations on a journey, recording how many different types of people go into a particular shop and also comparing buying brought waterfing;
- audio – for example, the recording of traffic to see which products have sold well.

Advantage of observation

- It is quite an inexpensive way of gathering data.

Disadvantage of observation

- The information only gives basic figures. It does not provide the business with reasons for consumer decisions.

Whether questionnaires, interviews, focus groups or observation are used to find out about a product depends very much on the type of product or service in question.

Type of research

Making sure you have selected a suitable method of primary research for particular products and services will help to ensure:

Activity 11.2

The following products require some primary research. Decide which type of research would be the most appropriate in each situation.

- 1 The number of people who use chocolate bars.
- 2 Whether to introduce a new style of sandwich which uses ham instead of bacon.
- 3 Whether to extend an existing fast-food menu to cater to more people.
- 4 The feasibility of opening a new restaurant.
- 5 Why the sales of a specific shoe are falling.

Secondary research

Secondary research, or desk research, is the use of information that has already been collected and is available for use by others. The information may be from prior internal sources or external sources.

Internal sources of information

A lot of information may be readily and cheaply available from the firm's own records. Internal quantitative information will be available from the sales department, which will hold detailed data on which branch of production have been selling well and to which area. The Finance department could give detailed information on the costs of manufacturing products or providing services.

Examples of internal sources of information include:

- Sales department sales records, pricing data, consumer records, sales reports
- Options of distribution and publicity relations personnel
- Finance department
- Customer service department.

External sources of information

This is where information is obtained from outside the company. External sources are many and varied and need to depend on the type of product that is being researched. Information from external sources is usually of a general nature as it is not being gathered for some purpose other than the research that is being conducted. The user can still be useful, as long as the limitations are taken into account.

- Government statistics are a detailed source of general information about such things as the population and its age structure. This is available in some countries.
- Newspapers can have useful articles, for example, about the general state of the economy and whether consumers are inclined to increase or decrease their spending in the near future.
- If there is a trade association for the industry, it often provides information for the businesses in that industry. For example, there might be an agricultural association which helps farmers who grow particular crops.
- Market research agencies are specialist agencies who carry out research on behalf of companies or others who commission them. They sometimes publish reports of their research on particular markets. However, while the reports contain very detailed information about the market, they are expensive to buy.
- The Internet provide an easily accessible source of a very wide range of information, including information on companies from their own websites, on government statistics, newspapers, etc. In fact, any paper-based source of information can often also be easily and quickly accessed through the internet. However, care must be taken to check information as it is not always accurate.

Tip for success

Make sure you can collect a suitable amount of secondary research for all the products and explore why it is important.

Secondary research is often a much cheaper way of gathering information as the research has already been done by others. It may be needed to help assess the total size of a market by finding out the size of the population and its age structure. Newspapers may carry vital economic forecasts if you are trying to assess when a recession might end and your sales increase again. This type of information could not be obtained by primary research.

**Activity 11.3**

Which of the following sources of information is generated by a business as primary data and which are secondary?

Data	Primary or secondary?
The chief financial officer's report on a company's new product	
Sales department's monthly sales figures	
An analyst's share price monitoring figures showing just which stocks were up or down yesterday	
A traffic count to see how many vehicles pass over a highway each day from 6 a.m. to 6 p.m.	
Annual government results monitoring information from previous years	
A market research agency's report on what customers like and dislike about your product	
Several government publications regarding:	
Some key customer complaints	

Business insights

From the previous five slides, you need to start writing a brief sketch of your industry. To help them assess the size of the market, you have been asked to think about the following information:

- size of total population
- how many possible buyers are in the age groups 11–18, 19–25 and 26–35 in your country
- how many different firms there are sold in your country (how many competitors there are)
- where these competitors come from — who they sell to and/or who they compete against

Activity 11.4

Read the case study below.

What other research could you advise the company to undertake before starting to sell to your country's tourists and citizens?

Who carries out market research?

Businesses can carry out their own research into different aspects of the market for their existing product or the potential market for a new product. Secondary research is often easier and cheaper to carry out, so primary research may be more expensive for the business to undertake itself.

The business can decide that it can afford to pay a specialist market research agency who will carry out whatever research it is asked to do. (These agencies also carry out opinion polls to see who they predict will win political elections.) They will find out consumers' spending habits as well as what their (and other individual business's) products and their competitors' positions. However, that is expensive to use.

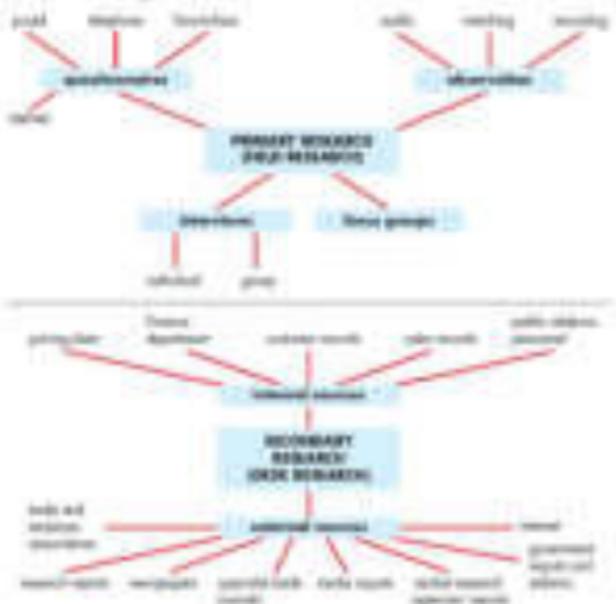
Accuracy of market research data

The reliability or accuracy of the data that has been collected depends largely on:

- how carefully the sample was drawn up
- the way in which the questions in the questionnaire were phrased to elicit honest responses
- the sample selected – it is sufficient to be truly representative of the total population, but it need not be as exact as is possible. If a specific sample is small, repeat that a random sample, or in order to get more accurate data
- the size of the sample – this is also important. It is not possible to ask everyone in a population, which is why a sample is used. The larger the sample, the more accurate the results are likely to be, but the greater expense will be the research. If only a small sample is taken, the results are unlikely to be an accurate. Therefore, the researcher needs to decide how many people will give them the accuracy they want and can afford
- well-phrased questions – trying out questionnaire on a small group of people before using them on a large sample can help to see if one of the questions could be misinterpreted. The questions can then be rephrased and the revised questionnaire carried out on the main sample
- who carried out the research – secondary research may not be as accurate as first thought because it was initially carried out for some other purpose and you would not have been the information was actually gathered
- bias – ask the interviewer sometimes have a bias and important information is left out deliberately
- age of the interviewer – interviewers can quickly become out of date, so images relating to current trends in consumers' buying habits, less reflecting when that need to be updated than money can.

There are two sorts of bias in the information collected from all sources, both primary and secondary, should be used with care. It should always be assessed thoroughly the information is correct.

Revision summary: methods of market research

**Activity 11.4**

Type out the table below and fit it to the frame.

Advantages and disadvantages of different types of market research

Method	Forces	Advantages	Disadvantages	Description of measurement issue	Why this situation may not be acceptable
Primary research	Questionnaire				
	Interview				
	Observation				
	Focus groups				
Secondary research	Internal sources				
	External sources				

How to design and use a questionnaire

Ask yourself the following questions:

- What do I want to find out?
- Who do I need to ask? (Age group, male/female, particular income or occupation?)
- Where will I carry out my questionnaire?

Questionnaire

Make sure you have thought these key points out in questionnaire design and analysis right from the start. It is important to get the process off to a good start.

Writing the questions

- When deciding what questions to ask, it is advisable to ask no more than 12 questions.
- Keep the questions short and sharp. It is a good idea to keep the answer simple; for example, ask for yes/no answers or provide a choice from which the respondents have to choose.
- If you want to know the age of the interviewees, give a choice of age groups, for example 25–49.
- Avoid unanswered questions unless people's opinions are sought.
- Be careful not to lead the interviewee into an answer that they feel forced to give by asking leading questions.
- Think about the order in which you ask the questions. Be logical!

Carrying out the questionnaire

Before going out and asking the questions, think about how you will ask the questions and how you are going to record the results. You may need to draw a grid to give the respondent "guidelines".

- How many people are you going to ask?
- At what time of the day are you going to carry out the questionnaire? Will this affect who will answer the questions?
- Where are you going to carry out the questionnaire? Will this have an influence on who you ask?

Case study: research

On the next page you can see the results of a questionnaire that was carried out to find out the feasibility of opening a fast food restaurant in a UK city. One hundred people were asked and 60% said they would visit this fast food restaurant. The size of the questionnaire can be directly linked to the market segment to be targeted in this promotional campaign.

continued

Case study responses (continued)

Q.	Responses to question X	Age group (years)	No. of persons
	Age: median of persons in this sample	40-49	0
		50-59	00
		60-69	00
		70-79	00
		80-89	00
		90+	0
Q.1	Responses to question X	Responses	No. of persons
	'How often do you eat out?'	Never	0
		Occasionally	00
		Several times	00
		More than once per week	00
		More than once per month	00
Q.2	Responses to question X	Responses	No. of persons
	'Where do you purchase fresh fruit and veg?'*	Local	00
		Café	00
		Supermarket	00
		Fruit/veg box scheme	00
Q.3	Responses to question X	Responses	No. of persons
	'How far do you usually travel when eating out?'	1 km	00
		1.1-20 km	00
		2 km	00
		2.1-10 km	00
		over 10 km	0

Activity 11.6

Analyse the results in the case study above and answer these questions:

- Which age group would be most likely to eat in fast food restaurants?
- How will this information affect where the business will advertise their restaurant?
- Why did the questionnaire contain this question? What effect do you predict it'll have?
- How will the responses to questions 1 and 3 be useful to the fast food restaurant?
- Suggest two additional questions that should have been included in the questionnaire. Explain why the information they provide would be useful to the business.
- Explain why the questionnaire results might not be very accurate.

Presentation of data from market research

When information has been gathered as part of market research, it may be difficult to make sense of what it means. The raw data will need to be converted into a form which is easy to understand. The significant points need to be made clear. For example, after conducting a questionnaire, it may not be clear which answer has the greatest number of 'yes' responses.

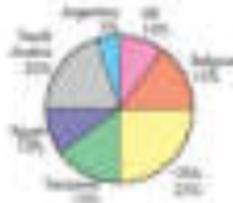
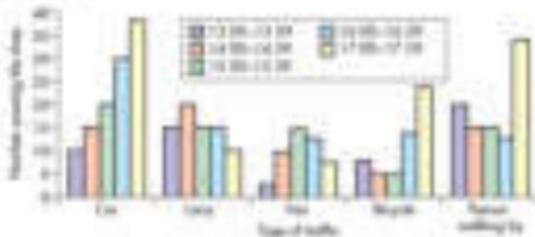
The type of data that has been collected and what it is to be used for will affect the form of presentation which will be used. Information can be displayed in the form of:

- a table or tally chart - results need to record the data in its original form, however, it is often better to convert this data into a chart or graph

An example of a tally chart

Type	Car	Lorry	Van	Motorcycle	Bus/truck selling by
11.00-12.00	00.00	00.00-00	00	00.0	00.00.00.00.00
12.00-13.00	00.00.00	00.00-00.00	00.00	00	00.00.00
13.00-14.00	00.00.00.00	00.00-00	00.00.00	00	00.00.00
14.00-15.00	00.00.00.00.00	00.00-00	00.00.00	00	00.00.00.00.00
15.00-16.00	00.00.00.00.00.00	00.00-00	00.00.00	00	00.00.00.00.00.00
16.00-17.00	00.00.00.00.00.00.00	00.00-00	00.00.00	00	00.00.00.00.00.00.00

- a chart - shows the total figures for each piece of data or the proportion of each piece of data in terms of the total numbers. For example, if a company sells six products in several countries, a chart can show at a glance which countries have the bigger percentage of sales and which have the lowest



A bar chart and a pie chart

- a graph – used to show the relationship between two sets of data. For example, how road cost changed over a number of years. The two variables are ‘road cost’ and ‘time’.



A line graph.

Revision summary: presentation of data from market research



Activity 11.2

You have been asked to carry out some research into the feasibility of opening a new restaurant in your local town. Design your own questionnaire to carry out a friends and family survey. Complete the following plan.

- 1 Design the questionnaire.
- 2 Decide who you are going to ask.
- 3 Decide how many people you are going to ask. Is it a good idea to carry out the questionnaire with friends and then put the results together or first put them in a general context (grouped).
- 4 Decide a summary sheet or chart to summarise the results.
- 5 Analyse the results.
- 6 Present the results to your friend.
- 7 Evaluate your findings. What does this tell you? Should a new restaurant be opened? If so, what type of restaurant would be successful?
- 8 Evaluate your questionnaire. How necessary were your questions? Should you redesign the questionnaire if you were carrying out the research again?

International business in mobile phone technology

Mobile phone companies are hoping to increase profits with the introduction of air-time which will allow the use of pay phones and pay walls. This will allow payments to be made at shops and restaurants, to be made using your mobile phone. Some of the experts believe that mobile phones will become the next big thing. Businesses, consumers, charities, banks and credit card companies have expressed some concern over the new technology, mainly over security.

Discussion points

- How could low-cost phone companies find out what consumers, retailers, banks and credit card companies think about the new technology?
- Do you think it is necessary, before launching this area, for the market research to be done?

Exemplar questions - Paper 1

- 1** T & T is a small business which sells many different types of garden tools. Sales of its products are growing very quickly. Its Managing Director (MD) feels that market research will be the most important factor contributing to the success of the business. However, the MD does not consider market research to be carried out before developing a new type of garden tool.
- a** What is meant by 'primary research'? [1]
 - b** Identify **two** methods of primary market research. [2]
 - c** Identify and explain **two** ways of presenting market research data on existing products that T & T could use. [4]
 - d** Identify and explain **two** factors which should be taken into account by T & T when trying to ensure the research information is accurate. [4]
 - e** Do you think market research is necessary before T & T develops a new product? Justify your answer. [6]
- 2** H & H have recently designed a new 'app' for the iPhone. Recipes in many different countries will be likely to want to download this app. The MD wants the Marketing department to carry out secondary research rather than primary research before launching this new 'app'.
- a** What is meant by 'secondary market research'? [1]
 - b** Identify **two** examples of secondary market research data which could be used by H&H. [2]
 - c** Identify and explain **two** advantages to H&H of using secondary market research. [4]
 - d** Identify and explain **two** reasons why accounts market research. [4]
 - e** Do you think the MD is right to want to only carry out secondary research? Justify your answer. [6]

Revision checklist

In this chapter you have learned:

- to identify which primary or secondary research would be suitable to gather data for a particular purpose
- how to conduct your own market research – primary or secondary (the steps to construct a questionnaire, carry out the questionnaire and analyse the data gathered)
- to evaluate whether data is accurate or biased
- how to present market research results

M397 - now test understanding with the review questions on the CD-ROM.

This chapter will explore

- the four elements of the marketing mix
- the role of product decisions in the marketing mix
- the costs and benefits of developing new products
- brand usage and how this can influence sales and customer loyalty
- the role of packaging
- the product life cycle
- how stages of the product life cycle can influence marketing decisions
- how the product life cycle can be extended

The marketing mix

The **marketing mix** is a term which is used to describe all the activities which go into marketing a product (remember that this includes goods and services).

The producer might want to find out through market research what consumers want from the product, but they may change the product to produce what consumers want. Once this is achieved, the producer has to convince the consumer that their product is the one that they want and that it meets their needs better than any of their competitors' products. This is done by branding their product. This involves giving a product a unique name and packaging. It is done deliberately to make consumers believe that it is different to any of the competitors' brands. The product also has to be sold in places that reinforce the brand image.

All of these activities are part of the marketing mix for a product. They are often summarised as the four Ps:

The four Ps of the marketing mix

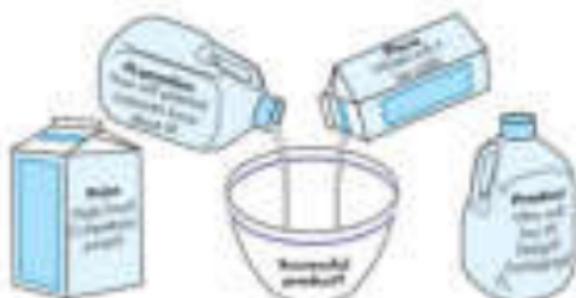
- **Product:** This applies to the product itself - its design and quality. How does the product compare with its competitor's products? What is the packaging like?
- **Price:** This is the price at which the product is sold. A comparison must be made with the prices of competitor's products. Price should, in the long run, cover cost (see Chapter 10).
- **Place:** That refers to the channels of distribution that are adopted. That is, what method of getting the product to the market is to be used? Will the manufacturer sell their product to shops who sell to the public, or to wholesalers, or direct to the consumer? (See Chapter 11.)
- **Promotion:** This is how the product is advertised and promoted. What type of advertising media will be used? It includes decisions that may be effected at other types of sales promotion, such as money off vouchers or free gifts (see Chapter 14).

Some people also talk about packaging as being a fifth P, but it can be included as part of both product and promotion.

**Marketing as
Action:**
**The marketing
mix:** It is a term
which is used to
describe all the
activities which
go into marketing
a product or
service. These
activities put effort
into marketing as
the four Ps - product,
price, place and
promotion.

Each part of the marketing mix has to be considered carefully to make sure that it all fits together and one part does not contradict the other. For example, a high-priced perfume should be wrapped in expensive-looking packaging and advertised to plutocratic women, but there is no need to sell it in small hand bags. If it were, the 'Prest' would not fit in with the other parts of the marketing mix.

Revision summary: the marketing mix



The role of product decisions in the marketing mix

The product will probably be the most important element in the marketing mix – without the product, the rest of the marketing mix is pointless. As discussed in Chapter 12, more businesses are product-oriented, that is, they will develop a product and then try to decide who might buy it. Today many companies are market-oriented when developing new products. They spend a lot of money 'researching consumers'. Hearing barks, then likes and dislikes, to see if they can design a product which people will want to buy. After deciding the market segment for the product, the other parts of the marketing mix – price, place and promotion – will be determined.

Large companies often have a department which spends all its time developing new products. It will also look at competitors' products to see what they are currently selling.

Types of product

There are several types of product. Some products are sold to consumers and some are sold to other businesses (that is, to other producers). In addition to goods, services may also add to consumers and to other producers. Products are usually grouped into the following types:

- **Consumer goods:** These are goods which are consumed by people. They can be goods that do not last long, such as fruit and cleaning materials. Some goods last a relatively long time and give enjoyment over a long time...such as fixtures and components.
- **Consumer services:** These are services that are produced for people. Examples include repairing cars, hairdressing and education.
- **Producer goods:** These are goods that are purchased for other businesses to use. They are bought to help with the production process. Examples include fixtures, machinery and components.
- **Producer services:** These are services that are produced to help other businesses. Examples include accounting, finance and advertising agencies.

Activity 1.1.1

Using the table and tick the correct box for each product

Product	Consumer good	Consumer service	Producer good	Producer service
Food or drink				
Bottle-washing machine				
Bank account				
Change of bank notes				
A. Accounting firm				
Project management of a partner				
Office cleaning				
Business training				
Business plan development				
Business programme				

Defining the type of product the business is producing is important when deciding how the product will be developed and marketed.

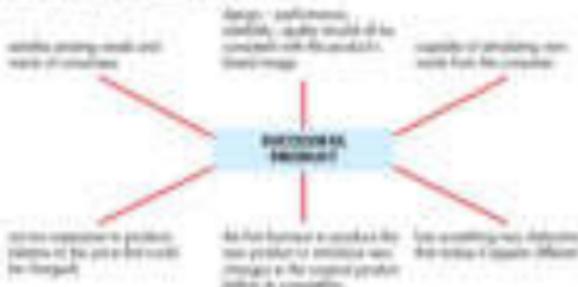
Determining of a producer good will be quite different to producing of a consumer good - this is illustrated in Chapter 14.

Producing the right product at the right price is an important part of the marketing mix.

- The product needs to satisfy consumer wants and needs. If it does not then it will not sell.
- The product also needs to be of the right quality so the price is what consumers are willing to pay.
- The costs of production must enable a price to be set that will produce a sustainable profit.

- Design of the product is obviously very important. How easily does the quality need to be appropriate for the target market (that is, high price for high quality, cheaper price for lower quality); but it also has to last a reasonable length of time. If the product is not reliable and breaks down, or breaks easily when it is purchased, then it will get a bad reputation and is unlikely to sell well. The product also needs to perform to a standard expected from it. For example, soap powder for washing clothes should lather effectively!

What makes a product successful?

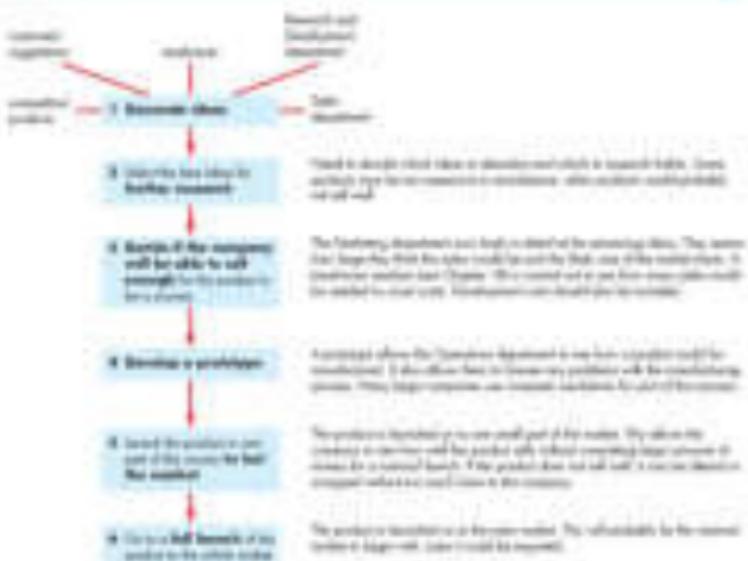


Activity 11.1

- Choose three products that you have bought.
- Has your choice been successful? Why?
- Try to produce the reasons off each product using the criteria in the diagram above. For example, does it have a good design? Is it reliable? Is it very distinctive from other products?

Product development

Large businesses are looking for new versions of old items. Smaller businesses are trying to stay competitive and therefore need to keep up with larger companies. When developing a new product, most businesses go through the process outlined on the following page.

**Activity 12.2**

You need to list a company's unique characteristics and strategy. You have been given the task of determining whether the company is a stick, a linked network or a lead (follower). Once this is done, keep your results to hand.

The costs and benefits of developing new products

There are various benefits for the business when developing new products. These are as follows:

- **customer黏着 (loyalty building factor)** will mean the business will be keeping the market with the new product
- **distribution** for the business, therefore giving it a broader range of products to sell
- it allows the business to expand into new markets
- it may allow the business to respond to changing markets

However, there are also costs for the business when developing new products. These are as follows:

- the costs of carrying out market research and analysing the findings
- the costs of producing trial products including the cost of wasted materials
- lack of sales if the target market is wrong
- loss of company image if the new product fails to meet customer needs

Differentiating by Market

The **USA** is the general term for a product that differentiates it from the products of competitors.

The importance of brand image

Definitions of brand

Brand name the unique name of a product (e.g. strawberries or blueberries)

Brand identity the overall perception a brand has among its target group (e.g. quality and appearance)

Brand image the image or identity given to a product's target group by a company to earn and distinguish it from its competition.

Brand image is an image or identity given to a product's target group by a company to earn and distinguish it from its competition.

Selling a product directly to the consumer makes it easy to inform the customer of the product's qualities and good points. The advertiser can persuade the consumer to buy the product. If a small business produced handmade jewellery and sold it on a street stall, it could be explained to customers how the jewellery was made and why it was a good product to buy.

Today, the manufacture of most products do not sell them directly to the customer – they are sold to other businesses or retailers, who will then sell on to the customer. This means that the producer's unique features and the reasons for buying it must be conveyed in a different way. This is done by creating a brand for the product. It will have a unique name, a **brand name**, and advertising will need to make consumers aware of the qualities of the product to try to persuade them to buy it. Branded products are generally sold as being of higher quality than unbranded products. It is the uniqueness of a branded quality that makes consumers confident to buy branded products.

Businesses use brands for their products to encourage consumers to keep buying their products and not those of their competitors. Businesses may have **brand loyalty**, which means they will keep buying the same brand of a product instead of trying other brands' products.

Brand image is important. If the brand is more than just an assurance of guaranteed quality, it will have a whole image which extends to and will be reinforced by advertising. Coca-Cola, for example, is sold throughout the world and has an image of being a superior quality soft drink which tastes better than its rivals' brands. Advertising shows people having fun where they think it and suggests that it is a fashionable drink for young people.

Tips for memory

Make sure you can define:
- packaging
- different products
- to ensure the
correct appeal for
the brand image
(target market).

Case study example

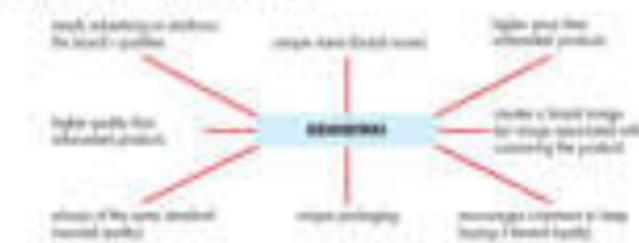


World manufacturer (Mondelez International) knew off their marketing team is difficult to sell products to young children. On the front of the packaging there is a picture of a smiling cartoon – called the Milkybar Kid. The advertising will let young children and the audience will favour the Milkybar kid – he looks like a friendly, blushing character. The image of the chocolate bar will be embedded in the Milkybar kid as he has been created to appeal to young children.

Discussion points

- Which consumers are the target market for Milkybar?
- Explain how the packaging appeals to the target market.
- Describe the brand image for Milkybars and explain how the packaging of Milkybars reinforces this brand image.

Revision summary: branding



Activity 13.4

Below are six statements that have been taken from the name of the product library.

- offer the customer(s) of the product are
- what it is that attracts them to the product
- what brand image the manufacturer is trying to create
- how the name and the packaging of the product help to reinforce that brand image
- where it is sold

The role of packaging

Giving the **packaging** rights is just as important as giving the other parts of the marketing mix rights. The packaging has two functions in particular:

It has to be suitable for the producer to be put in. Packaging has to give protection to the producer and not allow it to spoil. It also has to allow the producer to be used easily. It has to guard against being damaged in a city which will not allow the liquid to pass and easily. It has to be suitable for transporting the product from the factory to the shop, so protecting the packaging should not be too delicate or the product could easily get damaged.

Packaging is also used for presenting the producer. It has to appeal to the consumer; therefore the colour and shape of the container is very important. It is the packaging that catches the consumer's eye, not usually the producer inside! The brand image will be reinforced by the packaging in which the producer is sold. An expensive producer will have a luxurious-looking container, offer a gold colour. A low-cost producer may have basic simple packaging with plain colours.

The labels on products sometimes have to carry vital information about the product, such as how to use it or eat it and what ingredients it contains.

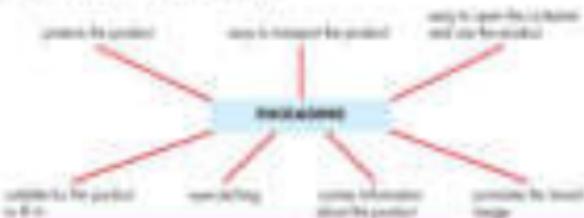
Definitions to know

Packaging is the physical container of something for a product. It is also used for protection and safety reasons.



Marketing communication based fact recall: The packaging used is bright and colourful and has the brand name clearly printed on it. There is also a small logo of a green bird printed on the side of the box. This keeps the message out of sight until you open the box. It also places the brand and product into contrasting terms being in colour. The side of the packed cereal box features about two nutritional qualities of the product. There is also promotional material often printed on the outside of the packet to encourage consumers to try the cereal. There are incentives linked with the product by ten points, collected and then sent off to receive a free gift. This additional product has been designed to keep the product moving on and that can be a marketing tool informed by the consumer.

Revision summary: packaging



Cross study example:



E&B Soft Drink Project E&B have decided to produce a new fruit flavoured soft drink especially for young children. The market research team expect the product to appeal to girls. The product is planned to be sweet, low calorie, healthy drink, which requires attractive packaging.

Activity 10.2:

Read the case study below.

- Which of the products shown above would you open first? Explain with details I expect your choice.
- Suggest another container that might be more suitable for the same soft drink.
- What visual identity does the container have? Explain your choice.
- Choose a brand name for the new soft drink. What image does this name give to the product?
- Design a label for the soft drink. Why do you think the design of the label will help the product to sell?
- What information will need to be put on the label?

The product life cycle

Products do not last forever. A typical cycle for a product is as follows.

- 1 First, a product will be developed. The prototype will be tested and market research carried out before the product is launched on to the market. There will be no sales at this stage.
- 2 It is then introduced or launched on to the market. Sales will grow slowly at first because most consumers will not be aware of its existence. Infiltrative advertising is used until the product becomes known. Price discounting (see Chapter 13) may be used if the product is a new development and there are no competitors. No profits are made at this point as development costs have not yet been covered.
- 3 Sales start to grow rapidly. The advertising is changed to persuasive advertising to encourage broad sales. Prices are reduced; a battle of price competition starts in the market and try to take more of these consumers. Profits start to be made as the development costs are covered.
- 4 Maturity: Sales now increase much more slowly. Competitive business (costs and pricing strategies are now competitive or promotional pricing (see Chapter 13). A lot of advertising is used to sustain sales growth. Profits are at their highest.
- 5 Sales have reached saturation point and decline as that happens. Competition is high but there are no new competitors. Competitive pricing is used. A high and steady level of advertising is used, but profits start to fall as sales are static and prices have to be reduced to be competitive.
- 6 Sales of the product will decline as new products come along or because the product has lost its appeal. The producer will usually be withdrawn from the market when sales become so low and prices have been reduced as far as it becomes unprofitable to produce the product. Advertising is reduced and then stopped.

This process of what happens to a product is called the **product life-cycle**. It is usually shown as a graph like the one below.



A typical product life cycle

The exact length of the life cycle, in terms of time, varies a great deal from product to product. It is affected by the type of product, for example, fashion items will go out of fashion quickly whereas basic products may last a very long time. The life cycle of some very popular brands, such as Coca-Cola, is many years, whereas the life cycle of fashionable clothes is often less than a year. New developments in technology will mean original products become old and their life cycle will shorten as new products are produced in preference to old technology.

How stages of the product life cycle influence marketing decisions

Knowing the stage of the life cycle gives a business ideas to use to help it make pricing and promotional decisions. These are likely to be higher in the growth stage than in the introduction or decline stage, when the business will want to try to stop sales declining. Spending on promotion will be higher at the introduction stage than in other stages as the business has to inform consumers of the product, establish a brand identity and encourage rapid purchases by sales. Advertising would probably be reduced in later stages.

Case study: Monopoly

Monopoly is a board game developed from a card game. It had been developed over several months before it was finally launched onto the market. Initially it was unsuccessful, during its first year it sold just 1000 copies. This seemed to be too low to pick the right strategy. It quickly became successful, a lot of advertising was used to promote the game and sales grew rapidly. One idea used here includes, more and more shops ordered copies of the game and consumers influenced their own friends. This helped offset the price of the game and the sales price to attract customers and caused the game to sell well. Sales grew steadily now, but as the first few copies of the game were sold, there were consumers who had purchased the game, the market was saturated and sales began to fall, even though prices became lower. The game was making little to no profit, but the company still continued to produce the game, from sales and considerations on what new games that they had introduced.

Activity 13A

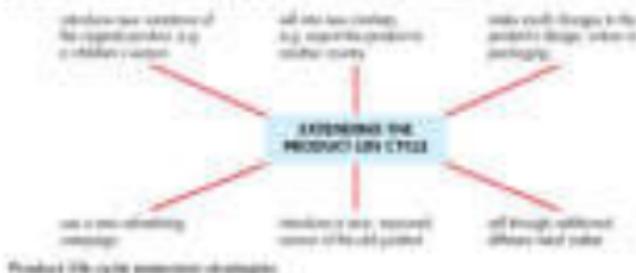
Read the case study above.

Draw the product life cycle for the game invented by Charles Darrow. Label the stages with the different stages that the game went through.

Tip for revision
Make sure you can identify the stages of the product life cycle for a particular product.

Extending the product life cycle

When a product reaches the maturity or saturation stage of its product life cycle, a business may stop sales moving so fast by adopting extension strategies. There are ways that sales may be given a boost. Some possible ways businesses might extend the life cycle of their products are shown in the diagram below:



Product planning
Market share
Sales can reflect
marketing effectiveness
Marketing
for particular
products

- If the marketing strategies are effective, the maturity phase of the product life cycle will be prolonged. An example of what might happen is shown in the diagram below.



The effect of extension strategies

Businesses will not usually consider just one product. They will have a range of products at different stages of the product life cycle. For example, a business will usually have products coming up from the growth phase in成熟期 (maturity) than are in decline.

Activity 1.3.7

Support students to model the product life cycles of the following products. These which extension strategies you would use for each product, and explain why you think it would be successful in increasing sales:

- A children's line which has been sold for many years in the same packaging and has had the same brand image. There are several competing brands of chocolate bars aimed at the market and sales have declined.
- A sports store that is well-known when playing a particular sport. This sport is no longer very popular with young people.
- The sales of a new model of a car have stagnated. The car is very well-made but has a relatively unique design.
- A children's toy which is only sold in toy shops and has steady growth in sales over time. The sales are stable and not increasing very much.

International business in Apple's smartphones



The iPhone® (iPhone), a smartphone, was first launched by Apple in January 2007 in North America and when it went on sale it quickly sold out. The production and sale of the iPhone® continued to have increasing growth, each year, until it is now dominant and sold all around the world. In 2012, it reached 100 million users worldwide. Apple's success has a range of performance and other reasons. Unlike the previous section, there is fierce competition from other smartphone manufacturers Microsoft and Android operating systems.

Discussion points

- What stage of the product life cycle do you think the iPhone® has reached?
- Why does Apple keep changing and improving the iPhone®?

Exam-style questions - Paper 1

- 1** ABC is a producer-centred company. It makes nuts and bolts, which are precision products, and they are sold to large car manufacturers. The sales of its products are at a high unit/casey level. The products are made to the exact specifications of the car companies and they are not sold to any other customers. Some other makers of nuts and bolts have developed new products using new technology materials.
- what is meant by the term 'precision product' [1]
 - ABC makes nuts and bolts. Identify two other examples of precision goods. [1]
 - Identify and explain two characteristics of the packaging of ABC's products. [1]
 - Identify and explain two reasons why ABC is only selling to large car companies. [1]
 - Do you think ABC should consider targeting just a few customers? Justify your answer. [1]
- 2** XYZ produces chocolate bars and sell them in supermarkets. In its advertising brand is ChocDesigner, it is put in expensive packaging and is sold as a luxury product. This best-selling chocolate bar has had high and steady sales for the last five years, but recently sales have started to fall as if this may reached the decline stage of the product life cycle.
- What is meant by a 'brand'? [1]
 - Identify two ways the business could used to increase sales of the chocolate bars. [1]
 - Identify and explain two characteristics of the packaging of the chocolate bars. [1]
 - Identify and explain two possible reasons why XYZ's chocolate bars are successful. [1]
 - Do you think giving the chocolate bar a brand name was necessary for its success? Justify your answer. [1]

Revision checklist

In this chapter you have learned:

- to identify the four elements of the marketing mix
- about the role of product decisions in the marketing mix
- what makes a product successful
- the costs and benefits of developing a new product
- what is meant by brand image and how this can influence sales and customer loyalty
- about the size of packaging
- to draw and interpret a product life cycle
- about the different stages of the product life cycle and how they can influence marketing decisions
- to suggest different ways to end a product life cycle

The marketing mix: price

This chapter will explain:

- the role of pricing decisions in the marketing mix;
- the main methods of pricing and the benefits and limitations of these methods;
- the difference between price-elastic demand and price-inelastic demand;
- the importance of price elasticity of demand in pricing decisions.

The role of pricing decisions in the marketing mix

When deciding a price for an existing producer or a new producer, the factors must be very careful to choose a price which will fit in with the rest of the marketing mix for the product. For example, if a new product is of high quality, it can be aimed at consumers who have a lot of money, or wrapped in luxurious packaging. If it has a low price, consumers will not think it is a good-quality product, and will see the low-quality products as sold in more competitive markets and prices will have to be set near to their competitors' prices. Other products are the only ones available in their market and consumers may be willing to pay a high price or have one of these products.



Example of a high-priced product and a low-priced product

Pricing strategies

If the product that a manufacturer can easily be distinguished from other products in the market then it is probably a branded product. If the product is branded, it will have a distinctive name and packaging, and be aimed at a particular part of the market. It will be important to set an appropriate price to complement the brand image; a value-for-money brand should have a low price. Today many products have a branded image. Firms will now just be determined by demand and supply in the market. The producer will have a lot of influence over the price of the product.

If a producer has a lot of competitors in its market, the price it charges will be very important. The business must carefully consider what its competitors are charging for their products to make sure its price remains competitive.

A business can adopt new pricing strategies for several reasons:

- to try to break into a new market;
- to try to increase its market share;
- to try to increase its profits;
- to make use of its costs or control and a particular profit is earned.

The business objective being sought will affect which of the pricing strategies the business decides to use. The price the business chooses to charge may not be related to the cost of manufacturing the product. Businesses may charge what they think the consumer will pay and this may be well above what a fair cost does to manufacture the product.

The main methods of pricing

Costplus pricing

Cost plus pricing involves estimating how many of the products will be produced, then calculating the total cost of producing this output and finally adding a percentage mark-up for profit.

- This method is easy to apply;
- You could base sales of the selling price at a bit higher than your competitor's price. For example, if the cost of making 2 000 biscuits has a £2 000 and you want to make a 10% gross profit on each biscuit, you would need to use the following calculation:

$$\frac{\text{£2 000}}{2\,000} + 10\% \times \text{£1.00 per biscuit} = \text{the selling price}$$

$$\text{£1} + 0.10 = \text{£1.10}$$

The calculation is that 10% profit of $\frac{\text{£1 000}}{2\,000}$ is £0.50.

$$\frac{\text{£2 000}}{2\,000} + \frac{\text{£0.50}}{2\,000} = 1 + \frac{10}{100} \times 0.50$$

$$\frac{\text{Total cost}}{\text{Capacity}} + \text{Markup} = \text{Mark up}$$

Competitive pricing

Competitive pricing involves pricing your items in line with your competitors' prices or just below them.

- Prices are likely to be high so your price is at a realistic level and the product is less popular or overpriced;
- In order to decide what the price should be, you would have to research what price other competitors are charging, and this cost time and money.

For example, a company wants to sell a line of sofa pillows. It needs to sell it at a similar price to all the other brands available or consumers will buy their competitors' brands.

For Business

For business

Cost plus pricing
at the cost of
manufacturing
the product plus
profit margin.

For Business

For business

Competitive pricing
is where
the product is
priced to fit with
the local business
competition's prices
to try to capture
more of the
market.

Differential pricing
Name
Psychological pricing is achieved by setting the price to reflect consumer's perceptions of the product.
It might involve charging a very high price for a high-quality product so that high-income customers will be prepared to pay a premium.
It could also involve charging a price for a product which is just below a whole number, for example, £99 is just below £100 and creates the impression of being much cheaper.
Supermarkets may charge low prices for products purchased on a regular basis and this will give consumers the impression of being good value for money.
It ensures that sales are made by reflecting consumers' perceptions of the product – this may be an image which the price creates.
Little sales revenue is lost by putting the price just below the price the business wants to sell the product for.
The consumers may do the same and notice its effect.

Psychological pricing

Psychological pricing is an approach where perceive situation it paid to the effect that the price of a product will have specific 'consumer' perceptions of the product.

- It might involve charging a very high price for a high-quality product so that high-income customers will be prepared to pay a premium.
- It could also involve charging a price for a product which is just below a whole number, for example, £99 is just below £100 and creates the impression of being much cheaper.
- Supermarkets may charge low prices for products purchased on a regular basis and this will give consumers the impression of being good value for money.
- It ensures that sales are made by reflecting consumers' perceptions of the product – this may be an image which the price creates.
- Little sales revenue is lost by putting the price just below the price the business wants to sell the product for.
- The consumers may do the same and notice its effect.

Penetration pricing

Penetration pricing would probably be used when trying to enter a new market. The price would be set lower than the competition's prices.

- It ensures that sales are made and the new product enters the market.
 - The product is sold at a low price and therefore the profit per item sold may be low.
- For example, a company launches a new chocolate bar at a price several cents below the price of similar chocolate bars that are already on the market. If this is successful, consumers will try the new bar and will become regular customers.

Price skimming

Price skimming, the product is usually a new invention, or a new development of an old product, and therefore it can be sold on the market at a high price until people will pay that high price because of the novelty factor. The producer will often have spent a lot in research and development, and these costs need to be recovered. Increasing the high price can be due to the high quality of the product.

- Skimming can help to establish the product as being of good quality.
- It may put off some potential customers because of the high price.

For example, a new computer game system is launched. It will be sold in the shops at a very high price, much higher than the existing computer game systems. Because it is new and has better graphics than the old systems, consumers will be willing to pay the high price. This way the business will earn high profits which will make the research and development costs worthwhile.

Professional pricing

Professional pricing would be used when you want to price the product at a low price for a set amount of time.

- It is useful for getting rid of unwanted stock that will not sell.
- It can help to ensure maximum profit if sales are falling.
- The sales revenue will be lower because the price of such items will be low.

For example, at the end of summer, a shop might have a lot of summer clothes left unsold. It might have a sale offering 'Buy one, get one free'. This will encourage customers to buy one item in order to get the second one free and it will clear the end-of-season stock. However, the shop will not make much, if any, profit on the clothes. But at least it will get some money the clothes that it thought no customer would be interested in will sell.

Dynamic pricing

Dynamic pricing happens when consumers are split into two groups and they are charged different prices for basically the same product or service because they have different demand levels. This is done because the price sensitivity of these two groups is different. Some consumers will be very price sensitive and firms will need to be careful not to set the price too high or they will lose customers. In contrast other consumers, often business consumers, are not price sensitive and firms can charge a higher price. For example, airlines regularly use dynamic pricing and charge different prices for flights to the same airport at different times of the day or different times of the year. This just means if the price of flights is the same during the school holidays as during term time.

Dynamic pricing can also be used to reflect the level of demand, i.e. if demand increases then the price will be raised and if there is low demand then the price will be reduced. For example, at American football games ticket prices often change to reflect the increased demand for tickets to popular games and when the game is less popular the price is reduced to encourage sales and fill the stadium seats.

Some effects of dynamic pricing are:

- increased sales revenue
- increased profits
- ensuring all seats are filled e.g. on airlines, football games
- legal use of constantly changing prices for business
- high cost for consumers in terms of time spent trying to find the best price

Pricing mistakes

Making sure you can select suitable pricing strategies for particular products and markets is important.

Cross subsidy

This refers to a large company that produces soft drinks. It has developed a new drink which contains an ingredient that gives people energy which they like in it. The company decided to target young people who like to go night racing. They put the drink in cans shaped like wheels which had bright colours on the outside so that it would be easily identifiable. The drink was advertised regularly on TV and was shown as a futuristic drink for young people. teenagers were drawn to it, they liked it and enjoyed it. The drink had a heavy sweetener because and sugar content a higher than than soft drink with similar fruit juice pastes alone.

The company had developed a clear brand image for the product and spent a lot of money advertising this drink. As the market saturated, businesses and others, it could charge a high price for it.

Giant Cola also manufactures a traditional soft drink, that is consumed mainly by children, looks like basic soft drinks, has more flavours of soft drinks becoming available. The company decided to reduce the price for it from £1.00 to 60 pence. The soft drink became less expensive.

The company has pricing strategies to target 17 different different price points at different times. The tactic will not succeed if there are very low prices when competing in new markets, until it is consolidated, where it might put prices similar to competitive prices for a while.

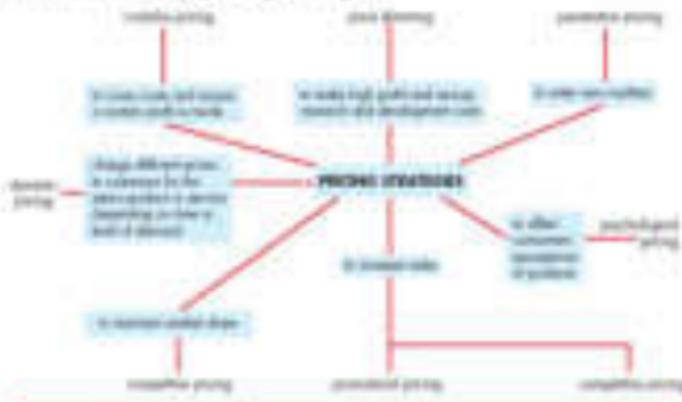
Activity 13.1

Read the case study on page 111.

Identify the different pricing strategies that T-Mobile uses and explain when it uses them.

There are several issues with using examples of dynamic pricing because thanks to new technology firms can track the buying history of customers and then charge higher prices for products when they buy them (these products include: This is compared to other consumers who appear to have lower income than their peers (using history), those consumers are charged lower prices for the same product).

Revision summary: pricing strategies



Activity 13.2

Define pricing strategy. Explain how probability is used for the following products? Explain price choices in each case.

- A service that is only suitable for older customers could be free (e.g. travel agency)
- A range of mobile phones that had been discontinued used to be sold higher quality than existing models (phones)
- A discounted car which had been on the market for several years and has no particular selling points (cars) which are competing with it.
- A store which sells books decides to give its money back on buying the book and makes no extra 10% profit on books
- A chain of fast food restaurants (where there are already many similar 'books' available)
- A trip costs just \$1,000
- A local supermarket sells holidays during the school holidays as well as other times of the year.

Activity 1.3.2

Copy out the table and fill in the blank boxes.

Pricing strategy	Examples and when they might be used	Advantages	Disadvantages
Cost-plus pricing			
Competitive pricing			
Penetration pricing			
Premium pricing			
Skimming			
Discriminational pricing			
Dynamic pricing			

Price elasticity of demand**Focus**

Price elasticity is a measure of the responsiveness of demand to a change in price.

Focus

When sales price is reduced, the difference between price elastic and price inelastic demand makes sure you can adjust your products and affect pricing decisions of businesses.

The greater the demand for a product is to changes in price is affected by how many close substitutes there are. If there are more close substitutes for the product, then, even if its price rises only a small percentage, consumers will respond by buying the substitute product and so demand for the original product will fall by a larger percentage. For example, if the price of a chewing gum rose by 5 per cent, some customers would buy alternative chewing gums and take might fall by 10 per cent. This practice would be said to have **price elastic demand** – the percentage change in quantity demanded is greater than the percentage change in price.

If price increases by 5% then sales decrease by 10% = falling revenue for the business. However, there are now really any substitutes for a product. For example, paint. Raise an increase in price of 10 per cent will not cause much of a fall in sales – perhaps 2 per cent – as most consumers will carry on buying the product at the higher price. Such products are said to have a **price inelastic demand** – the percentage change in quantity demanded is less than the percentage change in price.

Price increase by 10% then sales decrease by 5% = increasing revenue for the business.

The theory of the demand for the products of a business is price elastic then it is a good idea to raise prices as price theory has been strong over. If the price elasticity of demand is inelastic then businesses can increase revenue by decreasing prices.

International business in times of global pricing

Industries with competitors, such as Indian OEM Manufacturers, have raised profit margins by 10 per cent in response to a surge in global oil prices. Prices for oil have risen during rapidly in recent months due to several reasons. Not least oil, fossil fuels have increased rapidly. The oil of choice for the very majority of oil reserves are now quite rare because it will not be very responsive to rising oil prices. Elasticity of demand is said to be inelastic.

Discussion points

- Why have petrol prices risen?
- What effect do you think this increase in the oil price will have on the motorway trade by this oil company?

Exam-style questions - Paper 1

- 1 A & E is a private limited company. It produces a branded cereal which has a price elastic demand. The costs of producing each box of cereal is £1. The boxes are sold in shops at a price of £2 per box. The price of competitor cereals ranges from £1.50 to £2.50 a box. The Marketing Manager says 'we should change to psychological pricing strategy' to increase sales.
- Identify **two** elements of the marketing mix. **Identify two other elements.**
 - What is meant by 'price elastic demand'?
 - Identify and explain **two** reasons why demand for cereals might be price elastic.
 - Identify and explain **two** factors A & E should take into account when deciding which pricing strategy to use.
 - Do you think changing to psychological pricing strategy will increase sales? Justify your answer.
- 2 A & E have recently designed a new game for the Microsoft Xbox[®], a games console. People in many different countries have been waiting for this new game and they are willing to pay a high price to be some of the first people to play the game. 'The business can get back some of the development costs of the new game by using price skimming,' says the Marketing Manager. A & E have a product range of 200 games, some of which were developed several years ago.
- What is meant by 'price skimming'?
 - Identify **two** factors that affect the price of the new game for the Xbox[®].
 - Identify and explain **two** reasons why A & E might use price skimming for their new game.
 - Identify and explain **two** other pricing strategies A & E could use.
 - Do you think that just using the price skimming strategy for all the games produced by A & E is the best decision to 'take' quickly your answer.

EQUITY
PricingEQUITY
Pricing

Pricing

Revision checklist

In this chapter you have learned:

- the role of pricing decisions in the marketing mix
- about the different methods of pricing a business can use and their benefits and limitations
- how to select a suitable pricing strategy for a particular business situation/objective
- the difference between price-elastic demand and price-inelastic demand
- about the importance of price elasticity of demand in pricing decisions

NCF07 - one page understanding with the revision questions on the EQUITY PRICING

The marketing mix: promotion and technology in marketing

This chapter will explore:

- the role of promotional decisions in the marketing mix
- the aims of promotional
- different forms of promotion and how they influence sales
- when to use different forms of promotion
- the importance of the marketing budget in making promotion decisions
- how technology influences the marketing mix

The role of promotion decisions in the marketing mix

Promotions give the consumer information about the use of the marketing mix; without it, consumers would not know about the product, the price it will cost or the place where the product is sold. It includes through-the-point-of-purchase advertising and advertising the product, but it includes several different types of promotion as well as advertising.

It is difficult to think of products that are not advertised and promoted. Most products are produced for the mass market and therefore need advertising and promoting. Firms can spend money more easily by using representative existing channels but even these products are advertised in multi-channel, or feature few or no business advertising, there abouts the product.

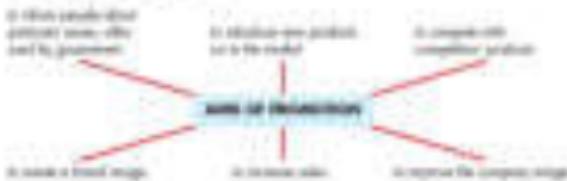
Promotion is essential when a brand image is being created for a product.

Promotion is part of the marketing mix because:

- advertising – plan involves ‘above-the-line’ promotion. These can take different forms, such as advertising on television, via the internet, in newspapers and magazines and other forms of advertising media
- sales promotion – also known ‘below-the-line’ promotion. These are often used to short periods of time or under as restricted as the above ‘above-the-line’ promotions. Examples include giving money off a product, free gifts, or product placements in television programmes or early release films.

The aims of promotion

As you can see, promotions include many activities that are undertaken by businesses. They all have one thing in common – their purpose, which is to raise awareness of the firm's products and encourage customers to make a purchase. The aims are summarised in the diagram below:



Advertising

Different types of advertising

Informational ad
Branding
Attention-grabbing advertising
attracts the attention of advertising at sales presentation will give first impressions about the product.
Reassurance advertising
is advertising or presentation which is nothing but reassures the customer that they really need the product and should buy it.

Advertising can be either **informative** or **persuasive** at times. Elements of books, 'I am rich' by Paul Balmer is an expensive advertisement. It is not sold by telling people off about what it will do for the skin. The advertising is made to make consumers think that when buying the advertised they will smell nice to the opposite sex and look more attractive. The advert for the phone book in magazine shows a picture of an attractive man, which is meant to persuade the reader to buy the telephone so that they will be attractive like the man in the advert.



Might consumers buy a laptop that has above its advert as being used by an attractive person, but will not receive information provided? Probably not. When buying a laptop, consumers want to know what speed it will run at and what memory it has. They want information about the product and its price.



The advertising process

When planning an advertising campaign, the business will need to go through the steps shown in six stages below:



The following table shows types of advertising media that businesses can use, together with the advantages and disadvantages of each and some examples of where they may be used.

Advertising media	Advantages	Disadvantages	Examples of suitable products/services to advertise using this method
Direct mail	<ul style="list-style-type: none"> The ad can be seen by millions of people. The product can be tested by a wide fanbase over marketing's most attractive period. It reaches the broadest number of consumers and can keep fit target audience for advertising all those who fit the consumer's needs. 	<ul style="list-style-type: none"> Very expensive. Cost of producing. 	<ul style="list-style-type: none"> Food products and items that are bought by individuals. Car ads bought for a large number of consumers. Unwanted products, e.g. door-to-door, that are bought by most of the population.
Media	<ul style="list-style-type: none"> Cheaper than television. Media reaches a large audience. Offered on a reasonable cost or basis so that the advert will be remembered. 	<ul style="list-style-type: none"> Careful and correct choice of message. Wide audience targeted to certain groups of advertising. The advert needs to be remembered by customers because food (e.g. fast food, coffee) is hard to copy off the advert. Sort of media can audience-specific. 	<ul style="list-style-type: none"> Local outlets or specific ads which are targeted on the particular local audience, e.g. local news, TV, billboards.
Newspapers classified as local	<ul style="list-style-type: none"> Newspapers are often bought by businesses, consumers and people for information on what the advertisement is trying to convey to a particular group of people. A large number of people will purchase and read classified newspapers. Local newspapers are usually cheap to place ads in and are a good alternative to national ones. Advertisers are permanent and can be run continuously. It is a lot of information can be put in the advert. 	<ul style="list-style-type: none"> Newspaper adverts can often only include short, brief and direct, one-line copy. There is a minimum printing area required. Advertisers need to be paid for their space, especially if the advert is placed. 	<ul style="list-style-type: none"> Local industry classifieds for local newspapers. Local, family & community newspapers.

Marketing media	Advantages	Disadvantages	Examples of suitable for particular businesses or advertising setting/like conditions
Print media	<ul style="list-style-type: none"> Magazines are reliable as specific types of products are mentioned, e.g. travel, restaurants, music, books. Magazines are more effective than word-of-mouth because they reach their target population if there are particular magazines which cover a particular product. Magazines usually are written by writers who have a high profile. 	<ul style="list-style-type: none"> Magazines are often only read once. Advertisers in magazines are often less responsive than other media. 	<ul style="list-style-type: none"> Reliable in providing important information. Good exposure for well-known products. Excellent exposure for established brands.
Point-of-purchase	<ul style="list-style-type: none"> Stay-at-home parents. Housewives. They are conveniently used to encourage extra purchases. 	<ul style="list-style-type: none"> Expensive to construct as possible per point of sale. Are difficult to maintain. 	<ul style="list-style-type: none"> Convenience. Product placement. It's a large surface of display space so products are seen by everyone passing the advertisement.
Clothing, prints and writing media	<ul style="list-style-type: none"> Can give visual image of the product and show the product in a positive way. Remembered. Can urge very effectively to buy because the user can relate particular items to their particular needs. 	<ul style="list-style-type: none"> Depend on style of clothing chosen. Depend on quality of prints and writing. 	<ul style="list-style-type: none"> Image effect. Not for important or serious.
Posters	<ul style="list-style-type: none"> Large investment of advertising. Shows can be discontinued to avoid waste of money. Show's result could be measured since it's simple to calculate a larger number of visitors. Showcases contain a take-away message to encourage the visitor to buy the exhibit. The address and telephone and fax numbers for future reference. 	<ul style="list-style-type: none"> May not be used. Show's had slow visitors (peak time) so advertising need some customers off during this period. 	<ul style="list-style-type: none"> Qualify and efficient to advertise local events. Good for giving last-minute information about what's coming up.

Downloaded

Advertising media	Advantages	Disadvantages	Importance of suitable advertising methods in advertising using other methods
Internet (using video, audio, text, images, etc.)	<ul style="list-style-type: none"> • It is large amount of information can be passed on to consumers, which can be sorted by a user's number of passes to forums and others. • Unlike print media, users can easily see the industry trends and can be sorted by them. 	<ul style="list-style-type: none"> • Internet connects every user together in the network and is constantly moving. • It has no constraints because it connects. • There is a lot of competition from other websites. • Security issues may hamper user privacy from business website. 	<ul style="list-style-type: none"> • Promotes best customers and already familiar with e.g. CEOs, journalists, public figures, business leaders, business itself as super informative, personalizing, and innovative, very user friendly.
Video content (YouTube)	<ul style="list-style-type: none"> • Very large field of advertising e.g. TV, different platforms. YouTube post or this video of being from others. 	<ul style="list-style-type: none"> • May not be seen by the advertisement's target market. 	<ul style="list-style-type: none"> • Shows on the large platforms with purchase by advertising their website. • Good job can increase user's response to advertisement.
Mobile communication (instant messaging, social media, and platforms for telephones, connected to mobile devices)	<ul style="list-style-type: none"> • Worldwide interconnected with the message to other programmes as forums. • Can highlight a company's audience after using the programme message or news video. 	<ul style="list-style-type: none"> • Can be expensive to pay for the placement of the promoted or the advertisements. • May cause negative effects on the audience if the message is off topic according to them. 	<ul style="list-style-type: none"> • Audiences, highly connected with each other via social media. • More than positive engagement and growth.

Case study overview



ING is a global institution of Dutch origin offering banking, investments, life insurance and retirement services. As they are a large international business, they can afford a large advertising budget. At times advertising over the internet, television, billboards, billboards, product placement and community.

Activity 14.1

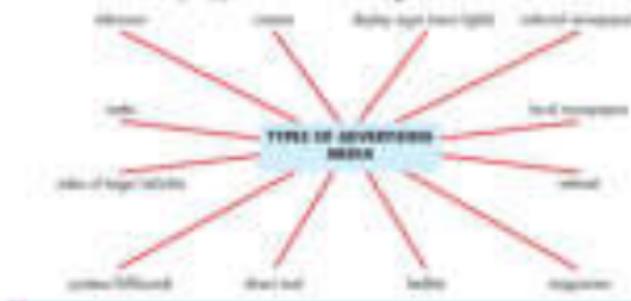
Read the case study above.

Discuss what you think about the ING case study. What do you think about the different methods of advertising and how effective do you think they are?

Type of media

Media are
the vehicles
which carry
advertisements
to a particular
audience and
person who they
are targeted.

Revision summary: types of advertising media



Activity 1.2

- a) Choose four products which you eat and pass Friends Day regularly. Collect examples of the advertising and note the media where the products are advertised. From now the table below and list in the table when you have all your responses.

Product	TV	Radio	Newspapers	Magazines	Cinema	Press cuttings	Local paper	Internet	Outdoor

After you have filled in in:

- which can you observe from your environment?
- for this place where the advert's are located a particular target audience for the product?
- is the target population a very large number or a relatively small number of people?
- do the places suggest the product is only sold locally or internationally?
- See under Marketing what you learned? Explain your answer.

Activity 18.2

For each of the following products, decide on the best advertising media to use. Explain your choice in each case.

- Milk, who produce an unsmoked blend of goats' dairy which is sold to consumers at a luxury price, need to promote their product with this consumer. This product is sold in certain areas of the country.
- A local hospital has been produced which is suitable for young men through school and the styling of its packaging.
- A local company's game has been discontinued.
- A local restaurant in a small town has opened.
- A famous brand of tea with local owners has expanded its range.
- A local business is launching a business.

Sales promotion

Different types of sales promotion

Promotion is used to support advertising and encourage new or existing consumers to buy the product. This is sometimes known as "below-the-line" advertising.

Point promotion is used in the short term to give a boost to sales, but it is not used over long periods of time. An example of this might be when a new chocolate bar has been introduced or as the summer and it being advertised on television. In the shops where the chocolate bars are to be sold, this template may be given out to encourage the customer to try the new chocolate bar and, if they like it, to become regular buyers.

There are several different types of sales promotion that can be used by businesses.

Price reductions



Example includes reduced prices to disrupt or specific times of the year and money-off coupons to be used when a product is being purchased. These can be issued to regular customers who purchase one more money-off coupon after they have spent a certain amount of money at the shop. Loyalty cards were discussed in Chapter 18. Money-off coupons are sometimes found on the bottom of leaflets, in newspapers or on the packet of the product itself, for example, '\$1.00 off your next packet'. This encourages the consumer to try the product and hopefully they will become a regular customer.

Definitions of terms
Sales promotion—
incorporates
such as special
offers or special
deals aimed at
encouraging
different levels of
increases in sales.

Gifts



Sometimes small gifts are placed in the packaging of a product to encourage the consumer to buy it. This is often used with products like breakfast cereals and the gifts are usually aimed at children. Sometimes consumers just eat the bulk of products and have to be enticed and influenced. When a specific number have been purchased they can be exchanged for a gift such as a book. If the item on offer is more expensive, the consumer may be exchanged for the item but a small additional charge may also have to be paid. Collecting campaigns require several packets of the product to be purchased before the gift can be claimed and so several packets of the product will be sold. The aim is thus the consumer may continue buying the product even after the promotion has ended.

BOGOF



This is where multiple purchases are encouraged (for example, 'Buy one and get one free').

Competitions



The packaging of a product may include an offer from which allows the consumer to enter a competition. The prize is often an expensive item, such as a car. This again obviously encourages the consumer to buy the product.

Point-of-sale displays and demonstrations



Point-of-sale is the place where the product is being sold – usually a shop.

In the shop, there may be a special display of the product. With some products it can be an advantage to show how they should be used and therefore a demonstration in the shop can be a good way of encouraging customers to buy.

After-sales service



With responsive policies, like care or complaint, providing an after-sales service can be a way of encouraging the consumer to buy. They can be reassured that, if the product goes wrong, in the first few weeks or months after they have bought it, there will be staff on hand to track and get it repaired with no additional charge or compensation. This may make the consumer feel more at ease than relies on other sales service policy from their competitors that treat them.

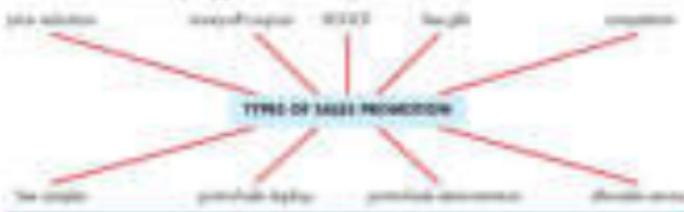
Free samples

Point for success:
When you give
out samples &
incentives,
remember:
Free products
products are
usually effective &
valuable.



This is most commonly used with products like food, shampoo and cleaning products. A free sample can be handed out in the shop to encourage the consumer to try the product and hopefully buy it. Free samples can be delivered to people's homes – although this would not be in every person's home, just the neighborhoods where the business thinks people will buy the product. Free samples can also be given away with other products. For example, some washing machines often come with a free sample of washing powder.

Revision summary: types of sales promotion



The advantages of sales promotion

- It can promote sales across all the categories which sales are traditionally low (off-water purchases).
- It encourages repeat purchases by existing customers.
- It encourages customers to try a new product.
- It encourages buying customers to buy a product more often or in greater quantities.
- It encourages customers to buy your product instead of a competing brand.

Activity 14.2

Discuss how products which you buy and sell (books, bags, regularly) (other examples of promotions that have been used for these products and explain why these methods of promotion were being used).

Activity 14.3

For each of the following five questions discuss who has control of promotion in each business (either the business itself or...

- A local management company at supermarket large
- A local chain of gas stations as each convenience store has its own fuel station.
- A company marketing a famous brand of football shirts seems to control sales.
- A pub that has been taken over by another pub owner who changed their name.
- A coffee shop has been taken over by a larger coffee chain which can be found in different countries which also change coffee when required.

Case study example



Haribo are a range of Haribo gummies for young children. These are sold through toy stores, where a special board is provided for the display of the gummies. The idea is that they are only to be eaten by children. A few Chinese stores, such as Super Express have been introduced. In these stores the gummy stuff used to target children, a representation of the character, a cartoon bear, which is designed to demonstrate the stuff and its properties. Also, with each purchase of the Haribo gummies there is a chance to enter a competition - the first prize is a trip to Germany.

Activity 14.4

Read the case study above.

Do you think all these ideas to promote the new range of Haribo gummies will be effective? Explain your answer.

The importance of the marketing budget

Marketing mix tools:

Marketing budget

Financial analysis by the marketing of a product or product range for a specified period of time.

When deciding which type of promotion (advertising and sales promotion methods) will be most suitable in one for a particular product than the marketing budget is perhaps the most important factor in making promotional decisions.

In, the size of the **marketing budget** is crucial. It specifies how much money is available to market the products or range, so that the Marketing department know how much they can spend. If the business cannot afford a very large budget... this will limit the places where the business can advertise. For instance, if the budget is small, television advertising will not be possible, and the number of times adverts appear in a magazine could be higher if the budget was larger.

The need for cost effectiveness in spending the marketing budget is very important. A business will need to compare the costs of advertising with the income it generates rates. It is not good to spend large amounts of money on an advertising campaign if there is only a small increase in sales.

Small firms will find it very difficult to compete with large ones because of the large marketing budgets available to them.

Which type of promotion should be used?

The following points also need to be considered when deciding on the type of promotion to use:

- **The stage of the product life cycle when it is being marketed.** Read Chapter 13, pages 188–189, to see which stages of the life cycle require different methods of promotion. If the product is new and has not been launched, the advertising may be more informative, but if the product is well established and is in maturity then the advertising may be persuasive.
- **The nature of the product itself.** If the product is a premium good, the type of promotion that would be used when promoting the product to other products will be quite different to the methods used with commodity goods. For example, money-off coupons would not be suitable, but discounts when goods are purchased in bulk would be appropriate. Premiums would not be influenced by collecting money-off coupons, but there will be large quantities and will be influenced by a discount. A product sold to other businesses, for example, a machine to help perfume, will not be advertised in the same way as the perfume itself, which will be bought by consumers. The advertising for the machine will be informative, while the advertising for the perfume will be persuasive.
- **The customer base received in international marketing.** If the product is to be sold abroad then different types of promotion may be appropriate. The advertising media used will be dependent on factors such as the number of televisions owned, literacy of the population, availability of radios and cinema. It is no use advertising in a national newspaper if none of the population has ever had or can buy off a newspaper. For example, computers, special offers, etc., will also have to be suitable for the culture of the population. In some countries it might not be usual to write composition and therefore this promotional issue would not act as an incentive to buy the product. The business might need to consider the types of promotion in terms of what it is suitable to people in the countries where the product is being sold. For instance, the use of money-off offers or the promotion of special offers would not be allowed in many parts of the world.

Effective promotion

Remember that advertising does not necessarily increase sales. Good products, if not promoted, can be spent on other things and may be ineffective. Advertising may increase sales, but if prices have been reduced and advertising expenditure increased then profits may not increase.

- The nature of the target market - whether it is local, national or international and so on - a local market will require different media for a national one or an international one. Is the product a specialist product such as motor oil or is it one that is sold to the majority of the population such as coffee.

Public relations/sponsorship

This is concerned with presenting a good image for the organization and/or its products. Public relations can take many forms, from sponsoring events such as football matches, to publicity events where journalists, or members of the public, take part in a sponsored activity for a good cause, or to raise awareness.



Another example is where companies donate some of their products to charity - for example when there has been a natural disaster, or paid for victims of a famine.

All these types of activity raise the public's awareness of the company and its products, and increase the likelihood of their choosing the products over its competitors.

How technology influences the marketing mix

New technology is becoming integrated into marketing decisions. It presents new opportunities for businesses to market their products and services and it means there are frequent changes to all four elements of the marketing mix.

The position part of the marketing mix may be changed to respond to new technology. For example, new features added to mobile (cell) phones. Social networking sites such as Facebook are changing the way businesses reach their potential customers. Twitter[®], pop-ups, sponsored links, paying search engines to put your website at the top of searches, own systems via websites, blogs, etc.

Facebook

Help people connect and share what matters most to you.

100

They are all new ways businesses are using to promote their business or to gather information on the Internet. The internet allows businesses to gather information about customer purchasing habits which means dynamic pricing can be used to save revenue. And finally, the internet has facilitated the widespread use of e-commerce (which is covered in Chapter 25).

Activity 14.1

Research the internet for four different types of business advertising (e.g. direct mail, telephone, email, a type of print media) and compare them.

• Write down a list of at least two different businesses or products that have tried out being advertised. (Try to include a variety of industries they can serve.)

• Indicate some effects of this activity if possible.

There are a number of benefits to a business of advertising via social networking sites such as Facebook:

- targets specific demographic group
- government target consumers; not always what they promote (Facebook)
- good in response to market changes – information can be updated regularly
- cheap to use – it has cost savings if later placing advertisements
- smaller groups that are difficult to recall may help

However, there are disadvantages too:

- can distract consumers if they find the adverts annoying
- hard to pay for advertising if using pop-ups
- lack of control of advertising if used by others
- may be altered or used to a bad way and forwarded on to others more giving the business bad publicity

If a business advertises via the media below it will enjoy the following benefits:

- no extra cost if own website is already set up
- control of advertising as it is on your website
- can change adver's quality and update products/prices, etc.
- interactive adver's can make the adver's more attractive than those in other forms of advertising, media such as magazines and posters
- can provide more information to adver's and link to other pages with further information and pictures.

However, there are disadvantages too:

- potential customers may not see the website as the page they come to is a long list of pages when using a search engine such as Google
- visitors not customers finding the website
- Average cost of the website may be high.

Activity 14.2

Look at the list above and produce a similar list of advantages and disadvantages for a business that is using the following to promote its products or services:

- Internet
- Email
- Applications need to be disseminated for the business/brand of products
- PR messages

Activity 14.8

For each of the following products, discuss three different ways to enter the market using the internet. Explain the advantages and disadvantages for each way. Then choose which you think is the best way, justify your choice and explain why it is better than the other two ways.

- **Reebok**, which produces an established brand of sports shoes that could be targeted at a niche shoe market to increase its market share.
- **McDonald's**, which could establish a new business with food carts which are sold in unoccupied or underutilized parts throughout Singapore.
- A new restaurant has opened in your nearest city centre.
- Your school is holding a charity fundraising event.



A company website

Unarmed Journalist Describes Us Attacks: Justin Shiner

Justin Shiner Shiner was born 1 March 1994 and is a Canadian unarmed long-distance runner and activist. He has showcased his 2000m 'Scream Dress' video series through effects on YouTube and later became his manager. Shiner is very popular particularly amongst younger age groups. He is pressuring to get rid of a nuclear war. The heat will cause a concern to being countries around the world and it is predicted that (unlike the big countries will be cold and very sparkly).

Discussion points

- Discuss the best way for this to be used as part of the content to the advertisement.
- If using another video and consider what other presentations could be used to promote them and their message.

Exam-style questions - Paper 1

- 1** An manufacturer operates economist's glasses. It sells no range of glasses through shops which sell ready-to-wear prescription designer clothes for women. Who needs to be aware of who our target market is? **Justify the Marketing Manager.**
- What is meant by 'target market'? [2]
 - Identify **two** examples of advertising TP could use. [2]
 - Identify and explain **two** reasons why it is important for TP to know its target market when deciding how to advertise the glasses. [4]
 - Identify and explain **two** possible ways for TP of using promotion. [6]
 - Do you think advertising is needed for this range of glasses? **Justify your answer.** [6]
- 2** HK is a partnership and it manufactures, styling glasses. Customers pay HK to put their own designs or messages on the outside of the glasses. These are often given as gifts at weddings, birthdays or other special celebrations. HK is thinking of starting to sell mass-produced plain glasses for everyday use. These glasses would be sold in supermarkets, but the specially designed glasses are ordered on the internet. HK only have a small advertising budget and so the owners will have to think carefully about where will be the best place to advertise the plain glasses.
- What is meant by an 'advertising budget'? [2]
 - Identify **two** places, other than the internet, where HK could advertise its glasses. [2]
 - Identify and explain **two** reasons for promoting the glasses. [4]
 - Identify and explain **two** methods of sales promotion HK could use to promote the plain glasses sold in supermarkets. [6]
 - Do you think the promotion of the plain glasses should be different to the promotion used for the specially designed glasses? **Justify your answer.** [6]

Revision checklist

In this chapter you have learned:

- about the role of promotion decisions in the marketing mix
- about the use of promotions
- to select appropriate types of sales promotion for different product/business objectives
- to select appropriate types of advertising by different product/business objectives
- the importance of the marketing budget in making promotion decisions
- how technology influences promotion decisions

QUIZ - test your understanding with the review questions on the E21-NCM1.

The marketing mix: place

This chapter will explain:

- the role of place decisions in the marketing mix
- the advantages and disadvantages of distribution channels
- e-commerce and its threats and opportunities to business and consumers.

The role of place decisions in the marketing mix

After deciding on the product and right price, the business has to get the product to the consumer. The product or service has to be available where and when consumers want to buy. Where consumers can buy the product will affect how well it will sell. Think of your local shop where you buy food. Would expensive luxury chocolates sell well? If many of the customers who use the shop are on low incomes then most luxury chocolates will be sold. If the product is not available when consumers want to buy it, and they have to go searching at different shops, then they may give up and buy a competitor's product. It is very easy for a business to get the place wrong and therefore lose sales, or even fail altogether.

How consumers get to know about the product through promotion is important, but there must also be ways to buy the products easily.

Distribution channels

Businesses have to decide where to sell their products. They also have to decide how to get the products to the customer; that is, what **distribution channel** to use.

The distribution channel can vary from being directly to the consumer to being via intermediary channels. The diagram below summarises the main distribution channels that are used.



Definitions in bold

A distribution channel is the route by which a product is passed from the place of production to the customer or retailer.

Distribution channel 1

Advantages

- This distribution channel is very simple. It involves manufacturers selling their products directly to the consumer.
- It is suitable for products, such as certain types of specialised products, which are expensive and unique from the firm.
- There is a lower price if sold directly to customer - no role wholesale/retailer.
- Products can be sold by mail-order catalogues or via the internet.

Disadvantages

- This is usually unsuitable for mass production because the consumers probably do not live next to the factory and could not get there to buy the product.
- This method may not be suitable for products which cannot easily be seen by price.
- It may be very expensive to send the products by post and therefore it will not be cost effective.

This channel is also common when selling directly from one manufacturer to another manufacturer. For example, car manufacturers sell directly to the car dealers.

Distribution channel 2

The second distribution channel is where the producer sells directly to small resellers and then they sell the products on to the consumer. This is more common where the retailer is large, such as a large supermarket, or where the products are expensive, such as furniture or jewellery.

Advantages

- Producer sells large quantities to resellers.
- Reduced distribution costs compared to distribution channel 1.

Disadvantage

- No direct contact with customer.

Distribution channel 3

This distribution channel involves using a distributor, who performs the function of breaking bulk.

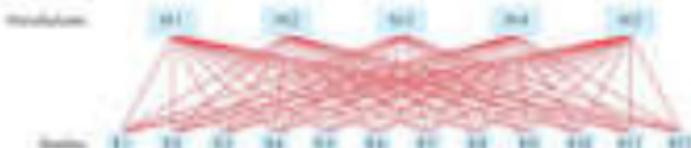
Breaking bulk is where a wholesaler buys products from manufacturers in large quantities and then divides up the stock into much smaller quantities for resellers to buy.

Advantages

- Wholesaler saves storage space for small resellers and reduced storage costs.
- Small resellers can purchase products in small quantities from wholesaler because they have a relatively short "shelf life" before they deteriorate.
- May give credit to customers so they can take the goods straight away and pay at a later date.
- Wholesaler may deliver to the small reseller thus saving on transport costs.
- Wholesaler can give advice to small resellers about what is selling well. They can also advise the manufacturer what is selling well.

Distribution

- May be more expensive for the manufacturer to buy from a wholesaler than if they bought straight from the manufacturer.
- Wholesaler may not have the full range of products to sell.
- Takes longer for both producer to reach the market and as it may not be at good quality.
- Wholesaler may be a long way from the end consumer.



Without a distributor, a manufacturer has to journey through several intermediaries.



With a distributor, a manufacturer has less paperwork.

Distribution channel 4

When products are exported, the manufacturer transaction costs are **higher** in the other country. The agent sells the products on behalf of the manufacturer. This can allow the manufacturer to have better control over the way the products are sold in a country. The agent will either pass on additional amount on the price in order that it receives or will receive a commission on sales.

Advantages

- Manufacturer may not know the best way to sell the product in other markets.
- Agents will be aware of local conditions and will be in the best position to select the most effective places to which to sell.

Disadvantages

- Loss control over the way the product is sold to consumers.

Case Study: Makro

Lokman Makro Holdings Ltd. Makro manufactures frozen and canned. It is located in Malaysia. It is famous for its healthy frozen meat products. The company sells its frozen and canned products in local shops because they sell by themselves. Different Makro Holdings Ltd. sites sell in local hypermarkets and supermarket outlets. Makro also sells its products in local grocery stores. Many large restaurants that specialize in supermarket, buy the frozen meat products to cook and prepares it directly from Makro. Makro Holdings Ltd. A variety of channels of distribution are used by the company depending on the customer and the quantity of increases and reduces purchases.

Methods of distribution

The methods of distribution used can include the following:

Method of distribution	Description
Distribution centre	A large store, usually in the centre of towns or cities, that sells a wide variety of products from a wide range of suppliers.
Chains	Two or more stores which have the same name and have no separate shareholders.
House brand	Brand which offers private label of products, mass branded products, or discount prices. Often the product resembles or contains parts of products, e.g. 'electrical goods'.
Superstore	Large single outlet which stocks a wide range of products.
Supersite	Small grocery stores with dairy products, frozen foods, packaged food and non-food departments.
Drop-shipping	Product can come directly from the manufacturer to the consumer (distance = 0).
Mail order	Consumers send through a catalogue of magazines and catalogues and letters, or place other forms of order by telephone or internet.
e-commerce	Process of buying or advertising, expression, selling the goods via the business website and then order to the internet or possibly by telephone or mail. Business can go through other specialist websites such as eBay and Alibaba.com.

**Distribution to
households:**
e-commerce:
the buying and
selling of goods
and services using
computer systems
linked to the
internet

e-commerce

What was the last time you purchased a product by computer or mobile phone linked to the internet? Some people will answer 'I never have' as the question has often will say 'the answer is no'. The growth of internet selling has been remarkable in recent years. Online retailing only started in the UK in 1992 – yet by 2012 internet sales in the UK alone was £788.217 billion!

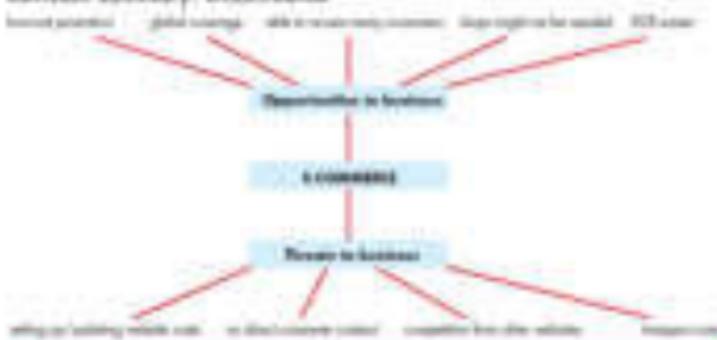
Consider these two instances by different marketing managers:

- Manager A: 'Since my company introduced a new perfume which allows e-commerce, sales have increased by 10 per cent including sales to customers we have never sold to before. We are now thinking about closing some of our retail shops.'
- Manager B: 'My company sells handbags with the men and women. We offer a personal service and customers visit us several times during the making of their bag to check for size and style. We use the internet only for gaining market research and dealing with suppliers.'

How can local managers be so convinced that e-commerce has the correct approach to e-commerce? The answer is ... they could be right! Not every product or every service will be especially sold by e-commerce. This means that we need to consider the different aspects that the Internet and e-commerce can have on business and consumers.

Top tips:
There are
several ways
you benefit
and threats of
e-commerce
to a particular
business.

Description of a consumer to business	Description of a consumer to consumer
Businesses can be used to increase the company and its products worldwide much easier through other forms of marketing, e.g. setting up firms in many countries.	We need to leave the house or go shopping – but the Internet is a major factor impacting the growth of e-commerce.
Orders can be taken via the computer and sent directly to company websites for delivery.	Comparisons between prices and availability of services offered can be easily made by visiting more websites to compare – or using price comparison websites.
Consumers might be encouraged to purchase convenience items that are delivered at different and easy to deliver locations – it is, getting take-away products that could be brought back to general stores.	Payments by credit or debit card is more easy.
Businesses can also easily make online purchases of supplies and materials than other businesses – this is called business-to-business (B2B) e-commerce.	Consumers can receive easier service products and services from businesses located abroad. This would be more difficult or expensive without e-commerce.
Businesses will be more competitive because consumers can get their products from anywhere.	Consumers' opinions come from the media must trust them they should be allowed the comparison of e-commerce, e.g. books, films and music on websites.
Threats of e-commerce to business	Threats of e-commerce to consumers
With so many businesses now offering e-commerce websites, competition between businesses is very high. If a business is changing cities across, consumers can switch from an alternative supplier.	Consumers' privacy needs to be protected. It is still the case that in many countries internet access is available for most younger consumers, in most parts.
Website design need to very clear, attractive and easy to use etc. Website designers can be expensive – and with others need to be updated, this will lead to further costs.	Computer systems fail to not detect connected computers can result in unauthorised users who spread viruses or penetrate systems from elsewhere.
Transport costs per product may well be higher than paid up through traditional routes. Goods have to be packaged and shipped separately. Shippers may have to pay extra costs to get insurance the business to compensate.	Products ordered to order, modified or based on booking. Not necessarily cost-effective because last-minute may be necessary (which is often inconvenient).
There may have to face issues with consumers, which can provide very poor feedback.	There is no back-to-back contact with sales staff as it is difficult to keep track of information about the goods and services being sold that that effects is provided on the website.
Consumers to have to trust that the information is kept private through a computer because they have to enter, download or enter the actual details. Web sites add to business costs.	Many companies are concerned about identity theft or fraud online (e.g. Credit cards). If they find people online, identity theft can be occurring but there are still some sites.
Although there might be benefits, a large amount of information needs control systems will be needed to meet consumers' safety, security and efficiency.	
e-commerce is not suitable for businesses that sell personal-care products as maintaining a database for personal-care highly personalises their data stored	

Revision summary: e-commerce**Activity 10.1**

Choose six different products that you or your family buy and find out what distribution channels are used to get the products from the manufacturer to you, the customer. Use the distribution channels used for each product assessment form given below.

Top tip:

Make sure you use different customers and products whenever they are distributed by a particular distributor or no distributor.

Case study example:

You have been asked to investigate how oil companies try to maximise their profits when it is subdivided to smaller producers. They originally manufactured just a few different types of fuel and sold them to a small number of large retailers. They have developed and are now selling many different types of fuel to a larger number of small retailers.

Activity 10.2

Read the case study above.

Write for the company writing down who you think it might be advantageous to use a wholesaler. They need persuading that a wholesaler will be beneficial, so give detailed recommendations for a wholesaler to support your answer.

Selecting the distribution channel to use

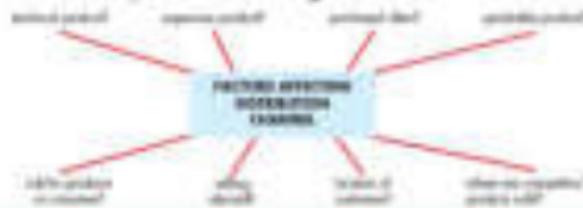
When deciding which distribution channel to use, manufacturers have to ask themselves a number of questions. This will help them to decide which channel will be the most successful for their products. There are ten types of questions that need to be answered.

- What type of product is it? Is it a sold-to-other product or an ordinary consumer product?
- Is the product very technical? If so, it should be sold to the customer by someone with technical knowledge who can explain how it works and what it will do. Direct selling from the manufacturer will probably be selected in this case. An example might be an airplane engine.
- How often is the product purchased? If it is bought once that, it will need to be sold in many retail outlets. An example would be a product like contraceptives which are purchased daily and are sold in many outlets. If they were one-month products, consumers might not bother to buy them at all.
- How expensive is the product? Does it have an image of being expensive? If the product is marketed as being expensive and of high quality, it will probably be sold through only a limited number of outlets. These shops will be inexpensive shopping areas. For example, if the product is an expensive watch, it is no good selling it in discount jewellery shops.
- How perishable is the product? If the product goes rotten quickly, such as fruit or bread, then it will need to be widely available in many shops so that it can be sold quickly.
- Where are the consumers located? If most of the customers are located in cities, it is no good selling the product in rural areas. If the customers are located in another country, then different retail routes might be appropriate. This factor might be used for online selling.
- Who are the competitors selling product? The usual outlets that competitors use will need to be considered. Each manufacturer will probably sell their products in the same outlets as their competitors so that they can compete directly for consumers.

Activity 10.1

Design a distribution channel for each of the following products. Encapsulate them in each case:

- Game trailers
- Children's clothes for sports
- Tea or coffee
- Motor-cross race suits

Revision summary: factors affecting distribution channels

International Business in India: Alibaba.com

Alibaba.com was founded in 1999 in China. It provided a central place for small businesses to sell their products. It has become a global source for selling cheaply made or more expensive items in China but also in the global market in countries such as India, Japan, Korea, France and the US. More and more businesses use this website to sell their products and it has encouraged an increasing number of customers to shop online.

Other suitable points

- Why do firms sell online? Is this an advantage?
- What advantages might there be in countries that use the website?
- If more consumers buy online, what will this mean to businesses which currently don't sell their goods online?

Exam-style questions - Paper 1

1	D & E manufacture footballs. The footballs are sold to sports shops throughout the world. The distribution channels D & E uses are to sell its footballs direct to visitors to sports centres and through an agent in other countries.	[1]
2	What is meant by the 'distribution channel'?	[1]
3	Identify two other examples of products which might be sold directly to retailing outlets than using a wholesaler.	[2]
4	Identify and explain two reasons why 'place' is an important part of the marketing mix for D & E.	[4]
5	Identify and explain two benefits to D & E of using an agent to distribute its products.	[3]
6	Do you think D & E would be better selling through a wholesaler? Justify your answer.	[3]
7	Protek is a retailer that selling children's clothes in its many small shops. It buys most of its products from wholesalers. Instead, the owner, see 1 above, now wants to sell on the internet.	
8	a) What is meant by a 'wholesaler'?	[1]
9	b) Identify three disadvantages to Protek of using a wholesaler.	[3]
10	c) Identify and explain two benefits to Protek of selling through several small shops rather than one large shop.	[4]
11	d) Identify and explain two factors which affect which distribution channel Protek should use.	[3]
12	e) Do you think Protek is right to want to sell on the internet? Justify your answer.	[3]

Revision checklist

In this chapter you have learned:

- the role of place decisions in the marketing mix
- about the different distribution channels and the advantages and disadvantages of each distribution channel
- what is meant by e-commerce and the threats and opportunities it offers to businesses and consumers
- to select the most suitable distribution channel for a given product

This chapter will explore:

- marketing strategies and how to develop an appropriate marketing strategy in given circumstances
- the nature and impact of legal contexts related to marketing
- the opportunities and problems of entering new markets abroad.

Marketing strategy

Marketing mix

A **marketing strategy** is a plan or outcome that right combination of the four elements of the marketing mix to achieve a particular marketing objective.

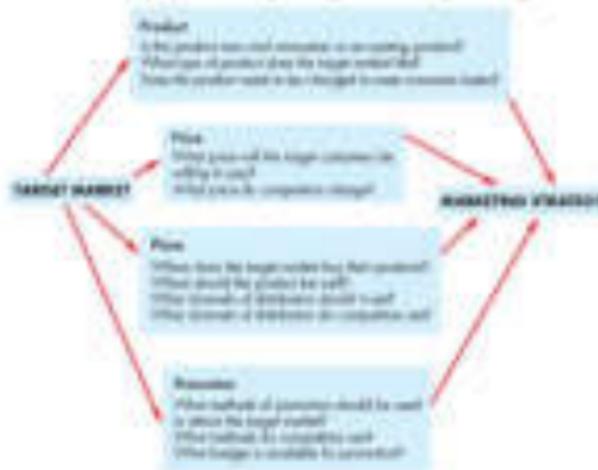
A **marketing strategy** is a plan to position the right combination of the four elements of the marketing mix for a product or service to achieve a particular marketing objective.

The marketing strategy developed by a business will differ depending on the size of the market and the number and type of competitors. It will need to achieve the marketing objectives of the business, the target market and the business available (this is called the marketing budget).

The marketing objective could include:

- increasing sales of an existing product/service by selling to new markets or selling more to the existing market
- increasing sales of new products or service by improving an existing product (extension strategy – see Chapter 22) or a totally new innovative product
- increasing market share which will include increasing sales for the existing market share from competitors
- maintaining market share if competition is increasing
- increasing sales in a mature market.

The different elements of the marketing mix are important in influencing consumer decisions when developing a marketing strategy aimed at a specific target market.



If the marketing message does not combine the four elements of the marketing mix correctly then the marketing objectives will not be achieved. For example:

- a product which meets customer needs but is priced at a suitable price which the target market is prepared to pay because the service or the product of them the two factors above is – that is, if the promotional methods are not suitable.
- a product which does not meet the needs of the target market but can still be price

Tip for success

Make sure you can describe a marketing message for a given product. The four elements of the marketing mix must all link together in order to be effective in attracting the target market to buy the product/service.

Case study: Nokia's Declining market share by Technology

For 14 years, Nokia was the world's biggest seller of mobile phones. It was overtaken by South Korea's Samsung in 2012 as the marketing with feature phones in developing and emerging markets. Apple's iPhone™ has now taken over in more competitive such North America being one of the basic phone market where it though there were 100 years of strong growth in manufacturing standards.

On Sunday 10th January 2013 Nokia's feature phone division, Nokia's mobiles unit has fallen from \$2.2 billion to \$1.1 billion in the last 12 months. Developed until in China, the world's largest mobile phone market. Its share of the market had fallen from 9% per year to 6.8% per year in 2011.

In addition its market share has also dropped to 11 and lower 10.9% in Brazil 6.6 per cent in 2010. In decreasing of the market's increased of its superior distribution on the European continent has this unit attributed more than 50% of its global sales revenue.

Nokia left the mobile market after the declining and inferior by 2010 developing a full touch-screen phone. The Kinsman Report in over three years ago, can Nokia still dominate our lives is uncertain, and then about 60 million of 4.23 billion.

So far through Nokia had a great reputation, their phones were popular comparatively very well with unprinted and were no longer one phone for consumers, consumers can't estimate its other functions, such as Samsung. Nokia mobile phones have failed to connect with the latest technology and consumer preferences. The "product" part of the marketing mix user's right and of relevance selling place where the other three elements of the marketing mix were right.

Activity 12.2

Choose a product which you think will have a lot of sales in your country (this could be a new product or an existing product such as breakfast cereal). Create a marketing strategy for this product by marketing against the following questions:

- Who is your target market? What are the characteristics of the consumer you think will buy your product? What is their market segment? Identify your audience.
- How does your product meet their needs? Why will consumers buy your product rather than a competitor's product? What is unique products' unique selling point (USP) that makes it different to your competitors' products? Identify your USPs.
- What price will this target market be willing to pay? Identify pricing strategy will you use? Justify your answer.
- Which methods of distribution should you use and why? These to suitable for your target market? Different methods of distribution disrupt competition and justify your answer.
- Which methods of promotion will you use? Promote from a limited budget amount of money to spend. Justify with evidence you will achieve good sales performance others may might not. Justify your answer.
- Justify for marketing why you think your new product will be successful.

Recommendng and justifying a marketing strategy in given circumstances

As time goes by the marketing mix will need to be changed. This may be because there are new competitors, the product goes to a different stage of its product life cycle, consumer tastes change or the business moves to enter a different market.

Activity 18.3

Copy out this table onto a large sheet of paper. Then add the correct answer from the following 10 facts page of the unit to the right of the table.

The answers for this table already have been filled in to get you started.

Note: You will need to recall Chapters 13 and 16 before completing this activity.

Strategy	Introductions	Growth	Maturity	Decline	Decision
New	low sales because the product is new	sales rise rapidly	sales increase more slowly	sales decline, off/on-church collections or returns	sales fall as other products become available or the product becomes old/fashioned
Price-cut policy					
Product-line advertising					
Public-sector issues					

Pricing policy

- Price discriminating to different consumers.
- Penetration pricing by competitors as if their competing products are introduced, small reduction in price to compete with those products.
- Competitive pricing by introducing an competitor's price.
- Price leadership by announcing sales as well as halving some competitors' price (the product).
- Competitive pricing prices are reduced to compete with existing competitors, no price competition under the method.

Product-line policy/timing

- Advertising focused on they were unique or unusual.
- Advertising advertising on the product it has, this example has to be drawn out to get consumers to buy it.
- A lot of advertising to encourage brand loyalty and for companies with other very competitive products.
- A large, steady level of advertising may be promoting new improved versions of the original product.
- Informational advertising changed to persuasive advertising to encourage brand loyalty. An area related to core identity.

Profitability

- Core model staying high discontinuous rents.
- Models fall as rents fall.
- Profits fall as costs are high and prices have been reduced.
- Profits cost to be made after development costs have been covered.
- Profits fall as fragmented as sales growth is high.

Legal controls on marketing

Consumers can be easily misled. It is quite easy to sell to today consumers' goods that are either unsuitable for the purpose intended or that fail or perform as the manufacturer claimed. This is not because consumers are stupid! It is because products are more complicated and technical than it is very difficult for a consumer to know how great they are or how they are likely to work. Also, untruthful advertising can be so persuasive that nearly all of us could be sold products, even if they were later discovered to be of poor quality or not as good as the adver claimed. Consumers need protection against businesses which could, intentionally, take advantage of the consumers' lack of knowledge and lack of access product information.

In the U.K., the laws on consumer protection are typical of those existing in most countries and include some of the following forms of consumer protection:

Trade Descriptions

Make sure you can explain why governments pass laws to protect consumers and what the laws mean for businesses when setting their goods or services.

Note: you will not be expected to know any law terms. Note the following Government [www.dca.gov.uk](#)

- **Weights and Measures.** Retailers and producers cannot be allowed if they sell underweight goods or if the weighing equipment they use is inaccurate.
- **Trade Descriptions.** It is illegal to give the customer misleading information about a product. For example, it is illegal to say that a pair of jeans is made of wool, when they are made of cotton. After facilities must therefore be established.
- **Half of Goods.** It is illegal to sell products which have certain flaws or problems, but if they are not of a substantial quality, products which are not fit for the purpose intended by the consumer, the customer if the consumer asks for a refund to make both to half and to half one which is only suitable for travel; products which do not perform as described on the label or by the maker. For example, if the label states "These shoes are completely waterproof" and they leak the consumer they are used.
- **Happy or Good and Service Act.** This act does the same the services as the Sale of Goods Act does for products. A service has got to be provided with reasonable skill and care.
- It is illegal for marketing pricing claims such as "£10 off the total cost only", when the product was also being sold for the same price the previous week. Most importantly, the law makes retailers and manufacturers liable – that is, responsible – for any damage which their faulty goods might cause. Anyone injured by faulty goods can take the supplier to court and ask for compensation.
- The Distance Selling Regulations allow consumers a cooling-off period of seven working days – this means they can change their mind about purchasing the good or service. For goods, this starts from the day after the goods are delivered and for services, it's seven working days from the contract being agreed. These regulations apply to all consumers-oriented retail over a distance as well as online transactions.

There are some examples of consumer protection laws from Pakistan and South Africa. Under Consumer Protection Act 2008, consumers have the right to file complaints with a consumer protection council or a consumer forum if they are dissatisfied with a product or service they have purchased and the business has not dealt with the complaint in a satisfactory way then the consumer can register a complaint with the council. It will hear the case and then decide who is at fault. They have remedial functions of cases – for example, recovering above control items, re-delivering statements to a shop keeper, repairing issues and prohibiting advertising.

Under the Consumer Protection Act 2008, in South Africa – here, consumers have up to six months to return faulty or small goods and that has a choice between the supplier repairing or replacing these, or refunding you in full. This only applies to general wear and tear of these appliances and are given negligence in their part. Also, if you

order online that the goods will have to be delivered at an agreed date, time and place. If not, you will be free to resign or cancel the agreement - it's your choice. Companies are also obliged to deliver goods that match the sample or description of the products. You have the right to examine your purchases before accepting them, and express them if you're not happy.



It is illegal in many countries to add items that do not fit up to the boxes made for them.

In all consumer protection a good idea! Most people would say that the consumer needs to be protected as much as possible. They believe that goods should be safe and available for the purpose intended as possible. However, some business managers believe that rules add to the costs of making and selling products and also increase the prices at the shop. What is your view?

Activity 18.5

Research three situations in which consumers might need some protection.

- 'These shoes are made of the finest leather' or fact they are made of plastic.
- A consumer buys one kilogram of potatoes and he weighs them at home. In fact, he has only 800 grams.
- A crooked seller for a long time 'drives through the red line' - takes his car off.

On the Web, why consumers need some legal protection in these cases? For each example, identify which part of the consumer protection laws have been broken by the business selling the goods.

Activity 18.6

Research the consumer protection laws in your country.

- What rights a consumer has if a product is faulty?
- What can a consumer do if a product does not do what it is advertised to do?
- Other consumer protection acts like consumer protection?

Entering new markets abroad

Opportunities

There are a large number of businesses both produce and sell in many different countries. Why has this been the trend towards more globalisation of business?

- Growth potential of new markets in certain countries. Countries in different parts of the world are now developing and seeing their population requiring rising incomes.

- This provides opportunities for entering new markets abroad.
- Home markets might be saturated and these new markets give the chance for higher sales.
- There is a wider choice of location for producing products and this encourages businesses as well as producers in these countries. The business will have more information about these markets and be better placed to sell its goods as well.
- Trade barriers there may be lower in many parts of the world making it easier and profitable to enter into these markets.

But there are problems when entering new markets abroad:

That's interesting

Make sure you can apply the implications and problems of entering new markets abroad for given circumstances

- **Lack of knowledge** – the business may not be aware of complications on the border of countries in those markets. For example where do most people do their shopping?
- **Cultural differences** – religion or culture may mean that some products won't sell in certain markets. For example, alcohol products will not be sold at many Muslim Kapoor's countries.
- **Exchange rate changes** (see Chapter 28) – if the exchange rate is not very stable then exchange rate changes can mean the price of imported goods change and the products can become less expensive or not fit the new market.
- **Imports restrictions** (see Chapter 28) – if there are tariffs or quotas on imported products then the price of those products may be higher than domestic produced goods – impacting sales or profits or both.
- **Increased cost of raw materials** – costs of production may be different in these new markets and it may be more difficult to be certain that producer the imported goods will be made.
- **Increased transport costs** – as products have to be transported over long distances then the costs of getting products to market will increase. However, there have been benefits from using containerised transports products and the container ships are getting bigger and all this has led to reductions in transport costs.

Methods to overcome the problems of entering new markets abroad

- **Joint ventures** (see Chapter 4) – for example McDonald's, Sainsbury's joint system with two Indian supermarket chains, Hardcastle restaurants and Gourmet Plus restaurants. This allows the business to gain important local knowledge so that values and customs can be adapted to enable a more successful entry into the new market.
- **Franchising** – this is where the business gives permission for another firm to the new market being allowed to produce the franchised or "parent" products under license. This means the products do not have to be physically transported to the new market which saves time, transport costs and can get round local restrictions.
- **International franchising** – this means that foreign franchises are used to operate a business's franchise abroad. For example Dunelm's Stores which is a UK-based homeware and coffee franchise sold the franchise to The United Arab Emirates, which operates all the markets. This means that again local knowledge is used to choose the best place to locate the Dunelm's Stores outside.
- **Localising existing brands** – there is a phrase "thinking global – acting local" which is being used by several global businesses. It means that there is still a company based image for the business but it has adopted cultural norms and cultures therefore increasing sales.

Case study: McDonald's enters African markets

McDonald's had developed a special menu for Black restaurants in India. This menu has more basic beef burgers, but does have chicken burgers known as 'Chicken McDonald's' and chickenburgers called Big Macs. Priced on the cheap. These products are suitable for the culture of India because as this country is of Hindus and Hindus consider meat unclean for religious reasons, also many do not consume fish and cheese.

Activity 12.2

Read the case study above:

- Why did McDonald's change its menu to Indian consumers?
- Why hasn't it done this in other countries?

International business in South East Asia

Yeo's is a food business which was set up in 1980 in China, originally as a small shop creating soy sauce. It moved to Singapore in the 1980s and started expanding. The business now creates a variety of food and drink, including juices, soya, protein, noodles and soups. Today this company sells across the world including Singapore, Malaysia, Indonesia, Hong Kong, India, Thailand and the UK.

The founders of Yeo's want to expand rapidly the European market. It selected several major European market (UK, France and Germany). European expansion helps to raise awareness of their products. The company plans to introduce the full range of its products into the European market.

Discuss possible:

- Why the you think Yeo's considered 'targeting' itself across European countries?
- Why did Yeo's introduce the full range of its products into the European market?
- What common problems do you think Yeo's might have had in entering the European market?

Examination questions - Paper 1

- 1** Way's are a franchise chain selling cakes, biscuits and coffee. The company wants to change its marketing strategy to increase its market share. It currently has 10 coffee shops in small towns and its target market are local people who shop and work in these towns. The profits are kept low because in these towns most people have low incomes. Way's want to start selling in city centres but the Marketing Director thinks they will need to change the decoration and furniture in the coffee shops to appeal to the higher income people in the city centres.
- a** What is meant by a 'marketing strategy'? [1]
- b** Identify **two** questions the Marketing Director will ask before deciding a new area for the coffee shops. [2]
- c** Identify and explain **two** reasons why Way's might need a new marketing strategy to increase market share. [4]
- d** Identify and explain **two** reasons why it is important for Way's to have an appropriate marketing strategy for a successful business. [4]
- e** Do you think the Marketing Director is right to say the decoration and furniture needs to be changed for the city centre coffee shops? Justify your answer. [6]
- 2** Klimatico manufactures make-up for business. The company sells its products across Europe but wants to start selling to African countries. The Marketing Director says "there are a lot of opportunities in these markets but also several problems. We are reaching saturation in the European markets and we need to increase sales in these markets."
- a** What is meant by 'reaching saturation' in the European markets? [1]
- b** Identify **two** ways a new market would be different to a home market. [2]
- c** Identify and explain **two** reasons why Klimatico might want to enter new markets abroad. [4]
- d** Identify and explain **two** possible problems for Klimatico of entering new markets abroad. [4]
- e** Do you think these problems can be easily overcome by Klimatico? Justify your answer. [6]

Revision checklist

In this chapter you have learned:

- How to develop an appropriate marketing strategy in given circumstances
- To explain the nature and impact of legal contexts relevant to marketing
- To explain the opportunities and problems of entering new markets abroad

20299 - test your understanding with the online questions at <http://C21-SM01>.

Marketing: end of section case study (Paper 2 style)

Chocolate

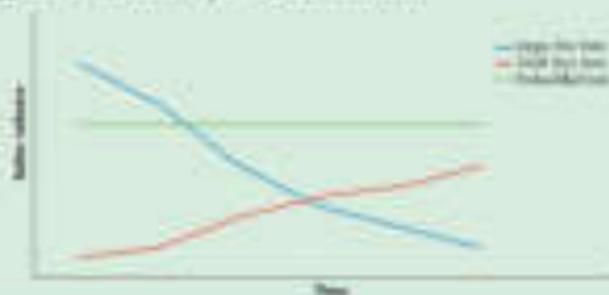


ChocolateCo has set up their own sign as a private limited company. The business plan consists of the marketing year's forecasted profits as the sole source of finance for expansion. The company has share capital of £10 million which is owned by its members of the Family Fund. Estimated turnover 2010-2011: £100 million (£10 million profit).

- Large chocolate bars' quality will be more.
- chocolates with protein filled centres clearly seem to receive.
- small chocolate bars consist like a chocolate minty will be chosen.

Marketing manager didn't work in the Marketing department. His department carries out market research and it also determines new products for the company to market. The Marketing Director signs off to one of the most important departments in the company. The Director of Chocolate want to expand the business.

Appendix 1: Sales for the products of ChocolateCo



1. Appendix 1 shows larger increase happens as the decline stage of the product life cycle, benefits and clearly how other stages of the product life cycle. (10)
2. ChocolateCo is considering what pricing strategy to use for the recently released (released) chocolate bars, however we're currently pricing strategies. It would depend on whether which one it should choose, clearly when someone buys a product they will. Merely and mainly have other ways that ChocolateCo could find the interest related to the success in the marketing of its products. (10)
3. The Marketing department is one of ChocolateCo most important departments. Chocolate's role model research is important to real success of ChocolateCo, marketing your products. (10)

Extended extra questions:

1. Identify and explain how each the role of the ChocolateCo company could be measured. (10)
2. Consider the alternative uses the directors could expect ChocolateCo. (10)

Section

4

Operations management

Chapters

- 17 Production of goods and services
- 18 Costs, costs of production and break-even analysis
- 19 Achieving quality production
- 20 Location decisions



Production of goods and services

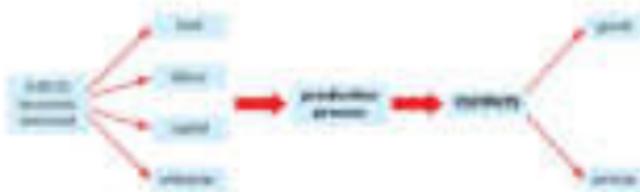
This chapter will explain:

- what is meant by production and processing
- the benefits of increasing productivity
- why businesses invest in technology (machines)
- lean production
- methods of production
- how technology has changed production methods.

Managing resources effectively to produce goods and services

Production is the provision of a product or a service to satisfy consumer wants and needs. The process involves first adding value to a product. As you learnt in Chapter 1, value added is the difference between the cost of inputs (raw materials or components) and the final selling price of the product or service.

The production process applies to manufacturing as well as service industries. In adding value, businesses combine the 'inputs' of a business (factors of production, such as land, labour, capital and equipment) to produce more valuable 'outputs' (the final good or service) to satisfy consumer wants or needs. However, these factors of production, also called economic resources, can be combined in different proportions – as inputs – in the production process, as shown in the diagram below.



For a business to be competitive it should combine these inputs of resources efficiently so that the business makes the best use of resources at its disposal to keep costs low and increase profits. In a developing country, where wages are low, it may be more efficient to use many workers and less machinery to produce goods – the production process is called "labour intensive". However, in developed countries where labour costs are high, then production is often "capital intensive", where businesses use machinery, robots and employ few workers.

Cook-happy example

A cook-happy customer like this 'fixes' or produces a meal from the ingredients:



Food ingredients are bought for £12.

Operations are conducted by buying £10 worth of ingredients.



Workers cook the food in a kitchen environment for customers.



Customer £20 for meal. Total added is £40.

The same process happens by manufacturing.

Operations department

The Operations department's role in a business is to take inputs and change them into outputs for customer use. Inputs can be physical goods or services.

The Operations Manager is responsible for making sure that the resources are provided and make the finished goods or services. The different sections of the department will vary depending on what the business produces. A typical manufacturing business will have:

- a Factory Manager who will be responsible for the quantity and quality of products coming off a production line. This will include the maintenance of the production line and other necessary repairs.
- a Purchasing Manager who will be responsible for providing the materials, components and equipment required for the production.
- a Research and Development Manager who will be responsible for the design and testing of new production processes and products.

In a retailing business this department will be smaller but the Factory Manager will be replaced by the manager for the shop. In a service business such as a hairdresser business the Operations department will include managers for each of the resources (see the organisation chart in Chapter 7).

Productivity

The level of production is the output of the business. This is different to **productivity**. **Productivity** is how a business can measure its efficiency. The productivity of a business can be measured by:

$$\text{Productivity} = \frac{\text{Quantity of Output}}{\text{Quantity of Inputs}}$$

Definitions to
Inputs

Productivity is the output obtained against the input used to create it.

Businesses often want to measure the productivity of one of the factors of production or inputs, usually labour. This is measured by dividing the output over a given period of time by the number of employees:

$$\text{Labour productivity} = \frac{\text{Output (over a given period of time)}}{\text{Number of employees}}$$

Productivity can either mean using fewer inputs to produce the same output or using the same inputs to produce a much greater output.

As employees become more efficient, the amount of output produced per employee will rise and therefore the costs of producing the product will fall.

Businesses strive to increase productivity in order to become more competitive.

Different levels of success in being productive reflects success for the different business clients' ability to be competitive, reduce trading and living off generated profits.

Tip for success

- Make sure you can discuss the effects of increased productivity on employees and shareholders. Show the effects differently!

Activity 13.3

Bitter Bakers produced cakes for local supermarkets. It has steadily increased the number of customers it employs. The owners, Bessie, Winnie and Helen, have been proud for the business to output has increased.

- a) Do you agree with the owners? Use the information below to justify your answer.

Year	Output (a number of cakes produced)	Number of workers	Output per worker
2012	10,000	200	
2013	20,000	400	
2014	30,000	600	

b) Suggest three ways Bessie could increase the productivity of Bitter Bakers.

c) Can Bessie measure the output of her office workers? If so, how?

There are a number of ways to increase productivity. These include:

- improving the layout of the machines in a factory to reduce travel time and therefore increase efficiency
- improving labour skills by training workers as they have more productive techniques of working
- streamlining processes.

Revision summary: ways to increase productivity



Benefits of increasing efficiency/productivity

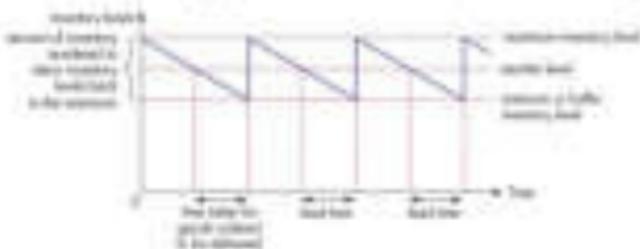
- Increased output relative to the inputs required
- Lower costs per unit (average cost)
- Fewer workers may be needed, possibly leading to lower wage costs.
- Higher wages for workers increase productivity.

Why businesses hold inventories (stock)

Have you ever gone into a shop and found that there was no one of what you wanted? If so, then the shop might have had higher sales than usual or slow delivery of stock might have been low. To ensure that there is always enough to meet demand, inventory levels must be carefully controlled.

Inventories can take various forms, including raw materials, components, partly-finished products, or finished products ready for delivery. It can even include memory of spare parts for machines in case of breakdowns.

When inventories get to a certain point (critical point), they will be replenished so being re-inventored back up to the maximum level again. The business must decide before inventories get too low to allow time for the goods to be delivered. If inventory levels get too low they might actually run out if there is an unexpectedly high demand for the goods. If we keep a level of inventory to hold steady this costs a lot of money, the business has brought the goods but they are not being paid and the owners could be put at danger. The following graph demonstrates how inventory levels can be managed.



Effectively managing inventory levels is very important to all types of business, especially manufacturing and retail businesses.

Lean production

Lean production uses a variety of techniques used by businesses to cut down on waste and therefore increase efficiency. It tries to remove the plan or waste that is possible to be developed and become available in the design for sale, so that it is as small as possible. Lean production can cut any waste which adds little value for the customer and this can apply to services as well.

There are seven types of waste that can occur in production and they are:

- overproduction – producing goods before they have been ordered by consumers. This results in high storage costs and possible damage to goods while in storage.

Examination tip

The factors

If you understand how to deal with constraints on production demand and the consequences of decisions, this question will be much easier.

Lean production is a fast, efficient technique used by businesses to cut down on waste and

therefore increase efficiency by

removing the waste it takes for a product to be developed and become available for sale.

- **waiting** – when goods are not moving or being processed in any way there tends to be waiting
- **transportation** – moving goods around unnecessarily wastes time and is not adding value to the product. Goods may also be damaged when they are being moved around
- **unnecessary inventory** – if there is too much inventory then the set-up times, may get in the way of production and costs change
- **motion** – all actions, including handling or retrieving components of the body of the employee takes time. It may also be a health and safety risk for the employee. This also applies to the movement of machines which may not be necessary
- **over-processing** – if complex machinery is being used to perform simple tasks then this is wasteful. Some action in producing the goods may not be necessary if the design of the product is poor
- **defects** – lots faults require the goods being fixed and time can be wasted improving the problem.

Activity 1.1.1

Identify a business activity with which you are familiar – it's a service, a restaurant, a shop or manufacturer – and identify examples of five main types of waste which might occur. What could those wastes be eliminated?

Benefits of lean production

Costs are saved through:

- less storage of raw materials or components
- quicker production of goods or services
- no need to repair defects or provide a replacement service for a dissatisfied customer
- better use of equipment
- training and reuse processes which speed up production
- less inventory built up in businesses
- improved health and safety leading to less time off work due to injury

Reduced costs can lead to lower prices for consumers, businesses being more competitive and possibly also increased profits.

Lean production might include using the following methods:

- **kaizen**
- **lean six sigma**
- **self-production**.

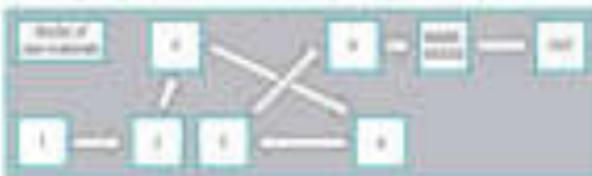
Definitions of kaizen

kaizen is a Japanese term meaning 'continuous improvement' through the elimination of waste.

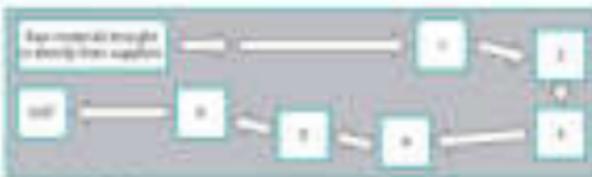
Kaizen

Kaizen means 'continuous improvement' in Japanese and its focus is on the elimination of waste. The improvements don't come from inventing new technology or equipment but through the ideas of the workers themselves. Small groups of workers meet regularly to discuss problems and possible solutions. This has proved effective because no one knows the problems that exist better than the workers who work with them all the time, so they are often the best ones to think of ways to overcome them.

Kanban eliminates waste, for example by getting rid of piles of inventories or reducing the amount of time taken by workers to walk between jobs so that they eliminate unnecessary movements. When Kanban is introduced, the factory floor is reorganized by repositioning machines slightly nearer to cells, in order to improve the flow of production through the factory. This flow will be open and marked with colour-coded lines which map out the flow of materials through the production process.



The factory effect: before



The factory effect: after

Activity 4.7.2:

Identify the changes that have taken place in the reorganization of the factory floor using Kanban processes.

The advantages of Kanban might be:

- increased productivity
- reduced amount of space required for the production process
- waste in progress is reduced
- improved focus of the factory floor may allow some jobs to be combined, thereby freeing up employees to carry out some other job in the factory

Just-in-time (JIT) inventory control

Just-in-time (JIT) is a production method whose focus is on reducing or virtually eliminating the need in held inventories of raw materials or components and on reducing work-in-progress and overstocks of the finished product. The raw materials or components are delivered just in time to be used in the production process; the making of any parts in production can go in time to be used at the next stage of production and the finished product is made just in time to be delivered to the customer.

- All this reduces the costs of holding inventory, as no raw materials and components are retained to keep in the warehouse just in case it is needed.

Definitions for Revision:

Just-in-time (JIT): is a production method that focuses on reducing the need to hold inventories of raw materials or components of the finished product. It applies strict just-in-time rules that are needed.

- Wasteful space is not needed, against reducing costs.
- The finished product is sold quickly and customers will come back to the business more quickly, helping its cash flow.

'So you put it down, investment of raw materials, work-in-progress and finished products are run down and no extra inventory is kept.' The business will therefore need very reliable suppliers and an efficient system of collecting raw materials or components.

Cell production

Cell production is where the production line is divided into separate, self-contained units (cells), each making up identifiable parts of the finished product; instead of having a long, linear production line. This method of production improves the quality of the employees and makes them work harder so they become more efficient. The employees that make up each cell are less likely to notice or cause disruptions.

Case study: KFC

This started its story by using business, like KFC's first food restaurants were very popular with the use of an excellent code of 'Fried Food'. The need to start creating chains of these foods and selling them by local people for dinner parties. This affected to the local newspaper and local food manufacturers to produce the food. Customers would ask for to cook a particular dish of fried chicken and the result would be especially fast from what they wanted to. The food was extremely popular and soon they had many more orders for dinner parties than the could cope with and had to turn away customers.

'To have decided to open a small factory just to satisfy who could get large orders. We researched and took our personal experience to help us. The number of orders increased immensely so we had to expand. We producing multiple food outlets. When market to wider target audiences of a particular dish and they worked well so by combining its unique combination of a fast-food chain which they could focus up on focus. In this case, chicken. This is still today slightly different. Now, instead of making one type of a particular dish, the company makes a larger quantity in one go and then divides it into larger portions ready to be eaten (not fast food). The power then makes a large quantity of chicken, just as in fast food the popularity of the food grows.'

'After, place business of expanding at the cost factory unit, this decided she could afford to do much larger companies and instead, it uses automated machinery to make the food. This demand was there, the food code is limited, healthy and nutritional food, as well as the original dishes. The fast food business produces special products particular dishes in some large countries, and would produce the same style, consistently.'

Activity 11.4

Read the two case studies.

- 1) What are the differences between cell production than firms used in fast food operations?
- 2) Why do you think the changed production methods in fast food businesses happened?

Methods of production

There are three main methods of production during the growth of the company:

- Job production
- Batch production
- Line production

Examination tip

Job production refers to a single product or made-to-order.

Job production

This is where products are made specifically to order. For example, a customer would order a particular cake and Tessa would make it. Each order is different, and time or cost can be expected. Other examples include specialist machinery manufacturers who will manufacture a machine for another business to meet a particular specification, bridges, ships, tanks to customer order, cinema films, or individual computer programs for particular specialised units.

Advantages of job production

- It is more suitable for personal services or 'hand-made' products.
- The product meets the many requirements of the customer.

- The workers often have more varied jobs (they don't carry out just one task).
- More typical work involves employee motivation – giving them greater job satisfaction.
- It is flexible and often used for high-quality goods and services, meaning that a higher price can be charged.

Disadvantages of job production

- Wasted labour is often used.
- The costs are highest because it is often labour intensive.
- Production often takes a long time.
- Products are specially made to order and so any errors can be expensive to correct.
- Materials may have to be specially purchased leading to higher costs.

Examination tip

Batch production is where a quantity of one product is made, then a certain number of another product is made, then a quantity of another item and so produced.

Batch production

This is where similar products are made in batches or batches. A certain number of one product is made, then a certain number of another product is made, and so on. Tessa made a batch of one type of cake and then made a batch of another type of cake, etc. Other examples include a small bakery making batches of bread, several houses built together using the same design, furniture

production (a certain number of tables are made, then a certain number of chairs), or clothing (a batch of a particular size of jeans is produced and then a batch of another size).

Advantages of batch production

- It is a flexible way of working and production can easily be changed from one product to another.
- It will give custom services to individual jobs.
- It allows mass variety to produce which would otherwise be abnormal. This gives more consumer choice (for example, different flavours of ready meals).
- Production may not be affected by any great change if machinery breaks down.

Disadvantages of batch production

- It can be expensive as semi-finished or finished products will need storing away.
- Machines have to be moved between production batches which means there is a delay in production and storage is lost.
- Warehouse space will be wasted for storage of semi-finished and components. This is costly.

Guidelines on Topic 4

Batch production is where large quantities of a product are produced in a continuous process. It is sometimes referred to as process production.

flow production



This is where large quantities of a product are produced in a continuous process. It is commonly referred to as mass production because of the large quantity of a standardised product that is produced.

It is called flow production because products flow as if they are flowing down the production line (they move continuously along a production line). The basic technique you can see is a queue in one part of the production line and then the products move down and more parts are added, and so on, until the product is finished and packaged ready for sale. Large quantities of identical products are made and the costs of production are low (the business will gain from economies of scale). Examples of products produced in this way include cars, cameras, televisions, packaged foods and dentures; in fact, very mass produced manufactured products which is sold to a mass market will be produced in this way.

Advantages of flow production

- There is a high output of a standardised product.
- Costs are kept low and therefore prices are also lower.
- It is easy for capital intensive production methods to be used – reducing labour costs and increasing efficiency.
- Capital intensive methods allow workers to specialise in specific, repeated tasks and therefore the business may only need relatively unskilled workers – skills training may be needed.
- It has benefits from economies of scale in purchasing.
- Low overhead costs and therefore low prices usually mean high sales.
- Automated production lines can operate 24 hours a day.
- Items are produced quickly and cheaply.
- There is no need to move goods from one part of the factory to another as with batch production, so time is saved.

Top Tip Section

Make sure you can discuss a suitable method of production for different products in a particular business.

Disadvantages of flow production

- It is a very tiring system for the workers, as there is little job satisfaction, leading to a lack of motivation for employees.
- There are significant storage requirements - costs of inventories of raw materials/ components and finished products can be very high.
- The capital costs of setting up the production line can be very high.
- If one machine breaks down, the whole production line will have to be halted.

Factors affecting which method of production to use

The factors which determine which method of production to use are as follows:

- The nature of the product. If a fairly unique product or an individual service is required (e.g. hair-care services are individual to the consumer and will be specifically tailored to their requirements), job production will be used. If the product can be more produced using an assembly production line than flow production will be used.
- The size of the market. If demand is higher and more products can be sold per year in very large quantities, batch production will be used. The products will be produced in a certain quantity to meet the particular order. Small local markets or niche markets will be served by businesses using job or batch production. Niche-market markets are served by businesses using flow production.
- The nature of demand. If there is a large and fairly steady demand for the product, such as soap powder, it becomes economical to set up a production line and continuously produce the product (flow production). If demand is less frequent, such as the furniture, then production may be more likely to be job or batch production.
- The size of the business. If the business is small and does not have the access to large amounts of capital then it will not produce on a large-scale using continuous production lines. Only large businesses can operate on this scale. Small businesses are more likely to use job or batch production methods.

Thinking ITQ

- Q** What method of production is used by each of the following businesses? Explain the reasons for your choices.

- Multi-national and domestic brands of tea leaves. These tea leaves are sold in many different shapes and often packed, and millions are sold a year.
- Alexander is a hairdresser. He styles men's hair and has a number of regular customers.

- Q** Holden painted have been in business for ten years manufacturing components for cars. They sell to several large car producers. Holden's clients want to receive just electrical parts/components for specific engines. They have decided to build a new factory abroad, near to where car manufacturers are manufactured. Some of the new components they plan to manufacture will be designed for only one type of engine, whereas most of the other components will be manufactured and used in several different models of engine. Holden Painted have chosen the name site for the factory but have not decided on the method of production to use. You have been asked to advise them on what to use. Explain your choice of the method(s) of production they should use.

How technology has changed production methods

Technological advances have allowed the mechanisation and automation of production methods in many industries. For example, the car industry is almost entirely automated. The use of automation, robotics and CAD/CAM keeps businesses ahead of the competition. Large-scale fitting, reduce costs and improve the product standard.

- **Automation** is where the equipment used in the factory is controlled by a computer to carry out mechanical processes, such as paint spraying in a car assembly line. The production line will consist mainly of machines and with a few people still be needed to oversee that everything proceeds smoothly.
 - **Mechanisation** is where the production is done by machines but operated by people. For example, a printing press. Before are machines that are programmed to do tasks, and are particularly useful for repetition, dangerous and difficult jobs. They are quick, very accurate and work non-stop 24 hours a day.
 - **CAD (computer aided design)** is computer software that allows users to design designs more quickly and allows them to be stored so it can be used in the next time off having to do it several times. It is used to design new products or to re-design existing products.
It is particularly useful for technical technical drawings.
 - **CAM (computer aided manufacture)** is where computers monitor the production process and control machinery or robots in the factory floor. For example on the production line of a car plant, computers will control the robots that spot-weld the car body together or the robots that spray paint the car.
 - **CDM (computer integrated manufacturing)** is the most integration of computer-aided design (CAD) and computer-aided manufacturing (CAM). The computers that design the products are linked directly to the computers that run the manufacturing process.
- Sufficiency has also improved productivity in shops with electronic payment methods and scanners at the till.
- **EPOS (electronic point of sale).** This is used in checkouts where the customer scans the bar code of each item individually. The price and description of the item is displayed on the check-out screen and printed on the till receipt. The inventory record is automatically changed to show one item has been sold and if necessary a low (or the reorder point) item more inventory can be automatically ordered.



- **CONTACTLESS PAYMENT:** (card swiped at point of sale). This is where the electronic card equipment is connected to the retailer's computer system and also to banks over a radio wave connection network. The shopper's card will be swiped at the till and the bank transaction will automatically be read from the card. The money will be directly debited from the customer's account plus they have signed for the dealer to be made to have entered their PIN (personal identification number). A message will be printed as confirmation that the payment has gone out of the customer's account.



Tip 10 - revision

Make sure you can discuss the effects of new technology on employees and customers. How are the effects different?

The advantages of new technology

- Productivity is greater as new production methods are used.
- Increased job satisfaction: repetitive routines, as cleaning and testing jobs are now done by machines.
- The types of jobs have changed as more skilled workers are needed to run the new technology. Businesses must offer training to existing workers to the use of new technology. The workers are more motivated and therefore improve the quality of their work.
- Better quality products are produced owing to better production methods and better quality control.
- More accurate customer service because firms can respond to individual customer needs.
- Quick and easy communication and reduced paperwork, owing to computers, lead to increased productivity.
- The influence that technology has on managers is much greater and this results in faster and quicker decision making.
- New products are introduced as new methods of production are introduced. The market and range of the consumer have changed.

The disadvantages of new technology

- Unemployment rates as machines/computers replace people on the factory floor and in offices.
- It is expensive to invest in, which also increases the risks as large amounts of produce need to be sold to cover the cost of purchasing the equipment.
- Employees are unhappy with the changes in their work practices when new technology is introduced.
- New technology is changing all the time and will often become outdated quite quickly and used to be replaced if the business is to remain competitive.

Activity 17.4

- i) Discuss a business that has introduced a product and find out what new technology equipment has been introduced in the Operations Department over the last five years.
- ii) What are the advantages and disadvantages of these changes?
- iii) How have these changes affected the business? (For example, environment, product, quality of the product?)

Activity 13.3

- Manage a business that produces a service and find out what new technology/equipment has been installed in the business over the last three years. (If the activity is to complete in small groups, nominate a reporter.)
- What are the advantages and disadvantages of these changes?
- How have these changes affected the business (for example, efficiency, profits, sales, quality of service?)

International business in focus: Technology in banking



Nigerian banks, for example, FID Bank, Hebborn Bank, Scotch Bank and some continental bank, have found that most Nigerians are gradually moving from cash-based personal and trade customers prefer round-the-clock efficient online banking facilities as they are not able to access it through banks. Increasing profits and increasing the number of customers is a major incentive to change the way they provide banking services.

The impact of technology in banking is leading to fewer branch banks with faster teller service as more branches offer account-opening services such as automated teller machines (ATMs), internet banking, usage of safe-holders (POS) and mobile bank phone banking. Using these technologies allows banks to attract customers of wealth as well as responding to customer preferences.

Discussion points

- Why are Nigerian banks changing the way they provide bank services?
- How is technology changing the way banks provide these services to customers?
- What benefits do the banks gain from introducing more technology into their business?

Case-style questions - Page 1

- 1** Carlos owns a private limited company called Biscuitabers (Ltd). It produces a variety of cakes which are sold in local shops. The method of production used by Biscuitabers is batch production. Carlos says, 'I have been told that lean production techniques in the bakery would help me to increase profits.'
- What is meant by 'lean production'?
 - Identify **two** ways lean production might be achieved.
 - Identify and explain **two** ways, other than lean production, Carlos could use to increase productivity.
 - Identify and explain **two** advantages to Carlos of using batch production.
 - Do you think Carlos should change his production methods to lean production in the bakery? Justify your answer.
- 2** Tim Patel owns a business which manufactures wooden furniture. He uses traditional labour intensive methods of production in the factory. The furniture made is to the exact requirements of the customer. Tim Patel is worried about productivity in his factory and wants to improve it. He is thinking of introducing new technology into his factory.
- What is meant by 'productivity'?
 - Identify **two** benefits to Tim Patel of increasing productivity.
 - Identify and explain **two** new technologies that change production methods for Tim Patel.
 - Identify and explain **two** disadvantages of using job production for Tim Patel.
 - Do you think Tim Patel should introduce new technology into his factory? Justify your answer.

Revision checklist

In this chapter you have learned:

- the difference between production and productivity and to identify factors that influence productivity
- why businesses hold inventories (stocks)
- to identify and explain ways of implementing lean production
- to identify and explain the method of production used in a given situation (job, batch or flow production)
- how technology has changed production methods

Now try... see page 106 regarding with the revision questions on the CD-ROM.

Costs, scale of production and break-even analysis

This chapter will explore:

- why managers need to know the costs of operating their business
- the different types of costs
- the concepts of economies of scale and diseconomies of scale
- how to construct, complete and interpret a break-even chart
- how break-even analysis helps managers make decisions

Business costs

All businesses require business costs of some sort. These costs cannot be ignored. For example, the manager of a business is planning to open a new factory making sports shoes. Why does his manager need to think about costs? Some of the reasons are explained below.

- The costs of operating the factory can be compared with the revenue from the sale of the sports shoes to calculate whether or not the business will make a profit or loss. This calculation is one of the most important ones in any business.
- The costs of two different locations for the new factory can be compared. This would help the owner make the best decision.
- To help the manager decide what price should be charged for a pair of sports shoes.

Business-cost calculations is therefore very important for managers.

Differences in costs

Fixed costs are costs which do not vary with the number of items sold or produced in that short time. These have to be paid whatever the business is producing and selling. They are often known as 'overhead costs'. Fixed costs are often seen as 'dead costs' because they do not increase or decrease as more items are produced.

Activity 18.1

There are seven of the costs involved in starting and operating a new sports shoe factory:

- cost of the factory
- insurance of the factory
- staff fees
- raw materials used
- management salaries
- advertising costs
- delivery costs

Add six other costs to this list that the manager would have to pay.

Fixed costs and variable costs

In calculating the costs of the business it is important to understand the difference between different types of costs. The main types of costs are **fixed costs** and **variable costs**. Examples of fixed costs include management salaries and rates paid for property. Even if output was zero, these costs would still have to be paid. Examples of variable costs include material costs and piece-rate labour costs. The more units that are produced, the higher these **variable costs** will be.

Tips for success
Based on making the mistake "fixed costs are not very useful".
Very useful fixed costs are not much because a business might expand by producing a lot more.
Fixed, factory or office fixed costs are a threat. Fixed do not very much the output of the business given the existing factory space or office buildings.

Revision summary: business costs



Activity 18.2:

Imagine the car factory is due to sell 1000 cars at an additional value of £1000 per car. Its total costs remain static. Furthermore you have put each car under either "Fixed cost" or "Variable costs".

Total cost and average cost

The **total** costs of a business, during a period of time, are all fixed costs added to all variable costs of production. This total figure can then be compared with the sales revenue for the period to calculate the profit or loss made.

An **average cost per unit** can be calculated from the total cost figure. Average cost is the total cost of production divided by total output. For a quick slow manufacturer, producing 100 000 pairs of shoes each year, this could be calculated as follows:

Stage 1

$$\text{Total cost of production} (\text{£100 000}) = \text{fixed costs} (\text{£60 000}) + \text{variable costs} (\text{£140 000})$$

Stage 2

$$\text{Average cost of production} = \frac{\text{Total cost of production (in a time period)}}{\text{Total output (in a time period)}}$$

$$= \frac{\text{£100 000}}{100 000} = 10 \text{ per pair}$$

If both the average cost of production and the level of output is known, then total cost can be calculated by multiplying average cost per unit by output.

$$\text{Total cost} = \text{average cost per unit} \times \text{output}$$

Activity 12.3 Calculating variable costs and average costs

Karen Jones' Petrolaser produces three models of printers, X, Y and Z. It has calculated the costs of these three products for her.

	X	Y	Z
Variable material costs (£ m)	£1	£1	£1
Variable labour costs (£ m)	£0.5	£0.5	£0.5
Variable overhead costs (£ m)	£0.5	£0.5	£0.5
Annual output of printers	8000	10 000	8000

The total variable cost of manufacturing model X is £12 million.

Total cost of manufacturing model Y = £11 million + £9 million = £20 million

$$\text{The average cost per unit is } \frac{\text{£20 000 000}}{10 000 \text{ units}} = \text{£2000 per vehicle}$$

- Calculate the total variable cost of manufacturing models Y and Z.
- Calculate the total cost of manufacturing models Y and Z.
- Calculate the average cost of manufacturing models Y and Z.
- Review and explain the possible uses of these results to managers of the organisation.

Using cost data

If a business has classified all costs into either fixed or variable, this information can be used to help make business decisions. There are three examples:

Type of cost data	Example	Explanation
Unitary pricing	Average cost of making a printer is £14. If the business wants to make £11 profit on each printer it sells, it must charge £25. See Chapter 13 for more examples of cost-based pricing.	If the average cost per unit has increased, the business could charge a price that leads to a loss being made on each item sold.
Unitary pricing applied to break-down costing	If the total annual cost of producing a printer is £20 000 but the cost associated with 8000 units, then the business is making a loss and could go bankrupt if it tries making the printer.	The business will continue to make losses from this decision so stop making the product until other decisions are made: <ul style="list-style-type: none"> ■ the product has been redesigned so the market – sales volume – increases or changes ■ the fixed costs will not have to be paid e.g. if the factory's leasing contract for the building is lost.
Deciding on the best location	Location A has a break-even point that needs costs of £100 000. Location B has a break-even point that needs costs of £105 000. On this basis alone, location A should be chosen.	Costs are not the only factor to consider – there might not be any point in choosing a low-cost location if the break-even point is in the middle part of town!

Economies of scale and diseconomies of scale

Look again at the definition of average cost above. It is the cost of producing one unit of output. Would we expect all businesses in the same industry to have the same average costs? This would be rather unlikely.

Key Business term

Economies of scale
where fixed costs
are reduced
as a reduction in
average cost as a
business increases
its size.

Case study exercise – cost of making brooms

Consider the average cost and total output of the following two businesses which make brooms:

	Business A	Business B
fixed cost (£1 unit)	£1 million	£1 million
variable cost (£1 unit)	£1000	£1000

The bigger company has much lower average costs than the smaller one. This cost advantage would allow the economies of being a large business. These are called the **economies of scale**.

Activity 1b-f

Read the case study above.

Explain three positive reasons why the unit cost of making brooms is lower for Business B than for Business A.

Economies of scale

There are five categories of scale.

Purchasing economies

When businesses buy large quantities of components, for example materials or spare parts, they are able to gain discounts for buying in bulk. This reduces the unit cost of each item bought and gives the firm an advantage over smaller businesses which buy in small quantities.

Marketing economies

There are several advantages for a large business when promoting its products. It might be able to afford to position its own vehicles to distribute goods rather than depend on other firms. Advertising costs in papers and on television do not go up in the same proportion as the size of an advertisement produced by the business. The business will not need twice as many sales staff to sell the product lines as a smaller firm needs to sell the same products.

Financial economies

Larger businesses are often able to raise capital more cheaply than smaller ones. Bank managers often consider that lending to large organisations is less risky than lending to small ones. A larger size of business is therefore often cheaper.

Managerial economies

Small businesses cannot usually afford to pay for specialist managers, for example marketing managers and qualified accountants. This reduces their efficiency. Large companies can afford specialists and this increases their efficiency and helps to reduce their average costs.

Technical economies

For the exam:
Businesses of
scale can more
economically
use certain
machines
and labour
than small ones.
It is likely to have
higher fixed costs
but a small over-
head means average
costs will be lower
than for small
businesses.

There are many of these, but a few examples will help to show how important they can be. Large manufacturing firms often use flow production methods (see Chapter 17). These apply the principle of the division of labour. Specialist machines are used to produce items in a continuous flow with workers responsible for just one stage of production. Small businesses cannot usually afford this expensive equipment. It could also be that they sell their products in small quantities and flow production could not be justified. The use of flow production and the latest equipment will reduce the average costs of the large manufacturing businesses.

In addition, some machinery is only used with a certain high output capacity. For example, an automatic welding machine can do 100 welds a minute. At small lots, if a business used a machine, could not keep the machine working all day and the average cost of using it would be high. This is because the machinery is set 'idle' more smaller capacity machines.

Dis-economies of scale

It is possible for a business to become so large that it becomes less and less efficient. In other words as economies of scale decline, growth suggests that very large businesses may become less efficient than the smaller ones and this could lead to higher average costs for big firms.

This is also possible! It could occur because of various **dis-economies of scale**.

Poor communication

The larger the organisation the more difficult it becomes to send and receive accurate messages. If there is delay in message transmission then actions mistakes can occur which lead to lower efficiency and higher average costs. Poor communication in a large business with many managers is also considered in Chapter 18.

Low morale

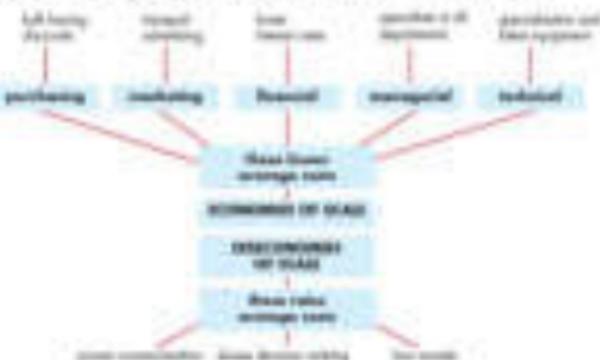
Large businesses can employ thousands of workers. It is possible that one worker will never see the top manager of the business. Workers may feel that they are unimportant and not valued by the management. In small firms it is possible to establish close relationships between workers and top managers. The lack of these relationships in a big firm can lead to low morale and low efficiency amongst the workers. This will result in push up average costs.

Slow decision making

It often takes longer for decisions made by managers to reach all groups of workers and this could mean that it will take a long time for workers to respond and act upon managers' decisions. The top managers will be so busy directing the affairs of the business that they may have no contact at all with the committee of the firm and they could become too removed from the products and services the firm operates on.

It is more difficult to 'prove' that these diseconomies exist in practice. However, many very large businesses are now breaking themselves up into smaller units which can increase efficiency and communicate more effectively. This trend is aimed at preventing diseconomies of scale from reducing efficiency and raising average costs.

Revision summary: economies and diseconomies of scale



Activity 14.4: Comparing costs: Company A vs Company B

The following cost data has been collected from two other manufacturing concerns.

	Company A	Company B
Annual profit... per unit of sales	\$1000	\$150 000
Variable cost per unit	\$5	\$10
Annual Fixed costs	\$1000 000	\$50 000

- Calculate the lower annual cost of manufacturing shoes for both businesses.
- Calculate the average cost per unit (per unit of sales).
- Identify and explain these reasons why the average total cost per unit for Company A is lower than for Company B.
- Identify and explain the benefits gained by Company B as a result of lower average cost per unit.

Feedback to learners

Break-even charts
are a very useful
way of showing
the quantity that must
be produced/sold
to avoid loss
and also know
an break-even
point.

Break-even charts: comparing costs with revenue

The concept of break-even

'Break-even' is a very ingenious idea for any business – especially a start-up business. The **break-even level of output or sales** indicates to the owner or manager of a business the minimum level of output that must be sold so that total

costs are covered. At this break-even level of output it is impossible to note that a profit is now being made – how can this be a break? This ‘problem’ is easily set up: businesses can reach break-even point (i.e. more likely to be no losses) – and yet not make a profit. If a business never reaches break-even point then it will always make a loss.

The break-even level of output can be worked out in three ways – by drawing a break-even chart or graph and by calculation.

Drawing a break-even chart

In order to draw a **break-even chart** we need information about the fixed costs, variable costs and **revenue** of a business. For example, if a factory that manufactures will ensure that:

- Fixed costs are \$10000 per year
- the variable costs of each pair of shoes are \$3
- each pair of shoes is sold for a price of \$18
- the factory can produce a maximum output of 20000 pairs of shoes per year

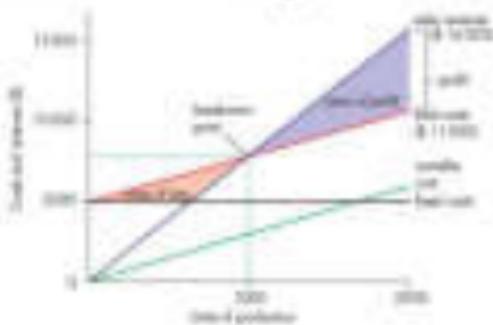
To draw a break-even chart it will help if a table, such as the one below, is completed. Take note of variable costs and revenue when no output is being produced. Clearly, there will be no variable costs as no shoes are being made and, as no shoes are being sold, there will be no revenue.

	break even @ 0	break even @ 1000	break even @ 20000 units
Fixed costs	10000	10000	10000
Variable costs	0	3000	60000
Total costs	10000	13000	110000
Revenue	0	18000	360000

When output is 20000 units, variable costs will be $20000 \times \$3 = \60000 .

Assuming all output is sold, total revenue will be $20000 \times \$18 = \360000 .

Make sure you understand how the above figures were arrived at before looking at how the data is used to construct a break-even graph.



Break-even chart

Break-even charts are graphs which show how costs and revenues of a business change with sales. They show the level of sales the business needs to make in order to break even.

The **revenue** of a business is the income resulting from the sale of items. The **rate of profit** is revenue minus costs.

Now we can plot the information on the graph. Note the following points:

- the 'y' axis (the vertical axis) measures money amounts - costs and revenue
- the 'x' axis (the horizontal axis) shows the number of units produced and sold
- the fixed costs do not change at any level of output
- the total cost line is the addition of variable costs and fixed costs.

What does the graph show?

Break-even point

The break-even point is the level of sales at which total costs = total revenue.

The break-even point of production is where total costs and total revenue meet. The business must therefore sell 18000 pairs of shoes in order to break even making a loss.

At production levels below the break-even point, the business is making a loss. At production above the break-even point, the firm makes a profit. Maximum profit is made when maximum output is reached and this is a profit level of \$16800.

Case study – in French Fries' breaking even!

French Fries produce motorcycle tyres. The following information about the business has been collected:

- Fixed costs are \$10 000 per year.
- Variable costs are \$3 per unit.
- Sale price is sold for \$10.
- Allowable overhead is 10% 000 tyres per year.

Case discussion

Remember that a break-even point is another term for 'breakeven point'. This is because it means that there will have to be sold further if the business wants to make a profit.

Activity 1.10

Read the case study above.

	Figure 1.10	Output = 10 000
Fixed costs	0	\$10 000
Variable costs	0	0
Total costs	0	0
Revenue	0	\$100 000

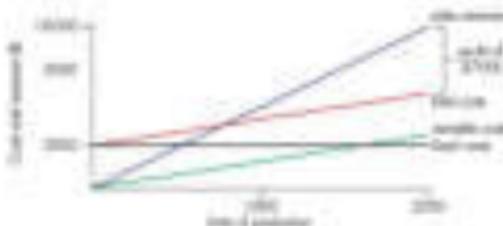
- Copy this table and fill in the missing figures.
- Draw a break-even chart from the information in the table.
- From your break-even chart identify:
 - the break-even level of output
 - the level of profit at maximum output

Uses of break-even charts

Again from the one we have already made of these graphs – identifying the break-even point of production and calculating maximum profit – there are other benefits of break-even charts.

Advantages of break-even charts

- Managers are able to read off from the graph the expected profit or loss to be made at any level of output.
- The impact on profit or loss of certain business decisions can also be shown by redrawing the graph. Consider again the quota-clearing business. What would happen to the break-even point and the maximum output level if the manager decided to increase the selling price to £59 per unit? This new situation can be shown on another break-even chart.

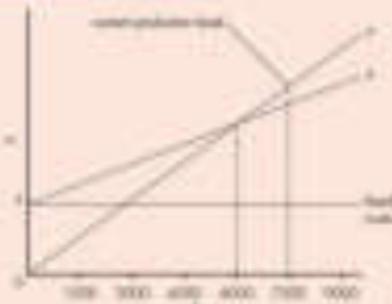


- Maximum revenue here is £11 800. The total cost of production falls to £8000 and maximum profit rises to £3800. Sounds like a win-win! However, the manager needs to consider competitor's prices too and he may not be able to sell at £5900 price at 89 each. This point is explained below.
- The break-even chart can also be used to show the safety margin – the amount by which sales exceed the break-even point. In the graph above, to the left of producing 1670 units, the safety margin is 167 units (1670 - 167).

Limitations of break-even charts

The break-even chart is therefore useful to managers, but the technique does have some limitations, as listed below. These must be considered by managers whenever they use these charts to help them take decisions.

- Break-even charts are constructed assuming that all goods produced by the firm are actually sold – the graph does not show the possibility that unsold items could build up if not all goods are sold.
- Break-even charts assume constant fixed costs of production does not change. For example, a firm's overheads concept is almost constantly going to increase fixed costs. In the case of the quota-clearing business, an increase in wages above £6000 will need a larger factory and more machinery.
- Break-even charts concentrate on the break-even point of production, but there are many other aspects of the operations of a business which need to be analysed by managers. For example how to reduce overheads or how to increase sales.
- The simple charts used in this section have assumed that costs and revenues can be drawn with straight lines. This will not often be the case, for example, increasing output to the capacity of a factory may involve paying overtime wages to extra production workers. This will make the variable cost line slope more steeply upwards as output increases. Also, in order to increase sales a business may need to offer discounts for large orders and this will cause the slope of the revenue line to be less steep.

Activity 8.2: Using break-even analysis

- Three cost lines break even graph and compare it with the following information:

Fixed costs = £4000

Variable costs per unit = 87

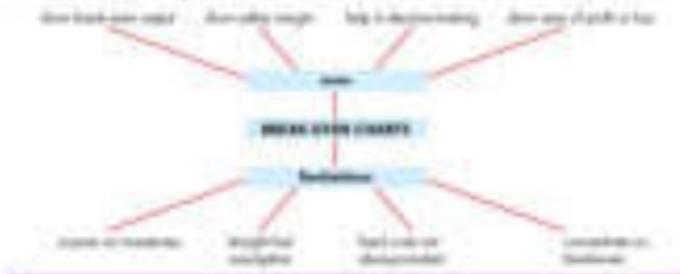
Selling price = 102

Label all of the lines/parts.

- Identify from your graph: the break-even level of output; the volume which exactly the level of profit at an output level of 9000.

- Explain what would happen to profit at an output of 10000 units and the break-even point of production if the selling price was increased to £105.

- Discuss why the business might decide not to increase price to £105.

Revision summary: uses and limitations of break-even charts

Break-even point: the calculation method

It is now obvious how necessary it is to draw a break-even chart in order to derive the break-even point of production. It is possible to calculate this. Study the following example:

Differences to Market

The contribution of a product is its selling price less its variable cost.

Case study: Restaurant

Cape Orange Ltd. makes sandwich-slabs. The selling price of each slab is \$100. The variable costs of ingredients and preparation labour are \$50. The weekly fixed costs are \$8000. Related to the fixed costs (break-even production)? It is necessary to calculate the **contribution per unit**. This is the selling price less the variable cost.

The calculation for the contribution of each slab is:

$$\text{Selling price} - \text{Variable cost} = \text{Contribution}$$

$$\$100 - \$50 = \$50$$

Each slab gives a contribution of fixed costs and profit of \$50. In order to break even each week, the business must make sufficient sales, contributing \$8000, to cover the fixed costs of \$8000.

The following formula should be used:

$$\text{Break-even level of production} = \frac{\text{Total fixed costs}}{\text{Contribution per unit}}$$

$$\frac{\$8000}{\$50} = 160 \text{ units per week}$$

Activity 18.8 Is the restaurant breaking even?

A fast-food restaurant sells meals for \$6 each. The variable costs of preparing and serving each meal are \$3. The monthly fixed costs of the restaurant amount to \$3000.

- How many meals must be sold each month for the restaurant to break even?
- If the restaurant sold 1000 meals in one month, what was the profit made in that month?
- If the cost of the food (ingredients) cost is \$3 per meal, what would be the cost to break even (level of production)?

(This question could be answered by using a break-even graph.)

International business in break-even graphs of car production

The French car manufacturer Renault and its distributor car dealer General Motors (GM) are attempting to form an alliance to build cars and components in Europe. This venture should be no clash of two units that manage from GM likely to be based upon in the business experience operated by the two companies. Characteristics in the automotive industry has led to price wars which have raised the break-even point of production (the point of these manufacturers' profit businesses registered a large loss in 2012).

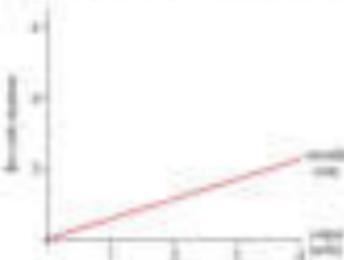
Another car maker, GM, is re-entering its operations in Mexico. It costs labour and land costs, compared to Europe, help GM's factories in Mexico operate at a lower break-even point of production.

Discussion points

- Discuss why it is important that the new European GM continued further will lead to more aggressive credit than existing factors.
- What ways can managers consider to lower their break-even points of production in order to increase profits?

Four-digit questions - Paper 1

1. Sadia runs a market stall selling jewellery. She makes most of the jewellery herself but she also buys it from large manufacturers. Her only other variable cost is the pay of her sales assistant who receives a small payment for each item she sells. Sadia wants to expand her business and has found out that there is an empty shop near her home. The fixed costs of the shop are three times greater than those of the market stall.
- a) What is meant by 'variable costs'? [1]
 - b) Identify **two** fixed costs that Sadia has. [1]
 - c) Identify and explain **two** ways in which Sadia could reduce the break-even point of sales from her market stall. [4]
 - d) Identify and explain **two** reasons why large jewellery manufacturers can produce jewellery at a lower average cost than Sadia can. [3]
 - e) Should you advise Sadia to close her market stall and open a shop instead? Justify your answer. [3]
2. Prosoft plc is one of the world's largest makers of soft drinks. Sales have increased in recent years but profits have not. Raising fixed and variable costs have meant that higher sales revenue has not led to higher profits. The Chief Executive recently said: 'Perhaps the company is just too big to manage efficiently'. A new factory is planned for Country 2. An incomplete break-even chart is shown.



- a) What is meant by the term 'fixed costs'? [1]
- b) Identify **two** variable costs that Prosoft plc has. [1]
- c) Identify and explain **two** reasons why having 'too big' can lead to higher overall costs. [4]
- d) Copy and complete the break-even chart by writing:
 - Fixed costs of £2 million
 - Total costs
 - Sales revenue assuming the drinks are sold at £1.00
 - The break-even point of production
 - Profit made at 4 million litres
- e) Explain **two** ways in which Prosoft plc could try to reduce the break-even level of output in the new factory. Recommend to the Chief Executive which one the company should use. Justify your answer. [3]

Revision checklist:

- In this chapter you have learned:
 - the differences between fixed costs and variable costs
 - why cost data is useful to business managers
 - to understand the main factors of economies of scale and diseconomies of scale
 - to understand what the break-even level of output means
 - how to use break-even charts to find the break-even level of output and other simple break-even charts
 - how to explain the uses and disadvantages of break-even analysis.

MCB807 – test your understanding with the revision questions on the ELE-B11A1

This chapter will explain:

- what is meant by quality and why it is important for all businesses
- the concept of quality control and how businesses implement quality control
- the concept of quality assurance.

What quality means and why it is important for all businesses

Imagine you went to the shop and bought a pair of jeans, took them home and found that they had a hole in them ... you would not be a very happy customer! The business would give a full replacement if this happened very often and would lose sales. You would probably take the jeans back to the shop and expect a replacement. If the shop refused to replace the jeans you would feel they were unfriendly towards you or even dishonest. They are likely to gain customers as other shops have to replace faulty products or reduce the price. A business needs to try to ensure that all the products or services it sells are free of faults or holes.

This will ensure that the business:

- establishes a good image
- builds brand loyalty
- will attract a good reputation
- will help to increase sales
- attracts more customers.

But if quality is not maintained the business will:

- lose customers to other brands
- have to replace faulty products or repeat poor service which costs extra for the business
- have customers who tell other people about their experience and this may give the business a bad reputation leading to lower sales and profits.

What does **quality mean?** Quality does not just mean producing a high-quality product or service...

Ask yourself this question - if you buy a low-priced remote-controlled toy car should you expect it to work as well as an expensive toy car? The answer will probably be no. But you do expect the low-priced product to be perfect and not have any faults.



Definitions of quality

Quality means the production of goods or a service which benefits customer experiences.

Top tip: Success
Remember that 'quality' does not only mean producing a high-quality product or service.

Activity 13.2

What do you, as a consumer, expect from the following products or services?

- A meal at McDonald's
- A meal at a restaurant or other fast food or take-away
- A hotel stay
- Takeaway meals from a coach at a local football club
- Football tickets from the coach at local amateur FC?



A manufacturing business needs a producer with a good design, that is made to ensure that it is manufactured without any faults and the product needs to satisfy the wishes of the consumer. A service providing business needs to match consumer expectations with its level of customer service, delivery times and convenience.

Therefore quality is a very important part of any business to both the manufacturing and service sectors. There are several ways businesses can ensure that they produce a good quality product or provide a good service.

Definitions to know

Quality control is the checking for quality at the end of the production process, whether it is the production of a product or service.

Quality control

A traditional way to make sure that packages were sent off accurately with no defects was on-base **Quality Control** departments whose job it was to take samples of original items to check for errors. Of course, as faulty were found than a whole batch of production might have to be scrapped or reworked. The Quality Control department would check that quality was being maintained during the production of goods, say, in a factory. If a batch then was sorted, and find any defective products before they went out of the factory to customers. A business may also set a 'quality standard' to see out the service to check if the quality is as expected.

Advantages include:

- tries to eliminate faults or errors before the customer receives the product or service
- less resulting rework for the workers.

However, there are drawbacks:

- expensive as employees need to be paid to check the product or service
- identifies the fault but doesn't find why the fault has occurred and therefore is difficult to source the problem.
- increased costs if products need to be scrapped or reworked or service reposed.

Quality assurance

QA-Business 101 Topic

Quality assurance is the checking for the quality standards. Unsuccessful QA contributes towards a reduction in the production of a product or service.

This takes a slightly different approach to quality. The business will make sure quality standards are set and then it will apply those quality standards throughout the business. The purpose of quality assurance is to make sure that the customer is satisfied, make the aim of achieving greater sales, increased added value and increased profits. To implement a **quality assurance** system, several aspects of production must be evaluated. Attention must be paid to the design of the product, the components and materials used, delivery schedules, after-sale service and quality control procedures. The business must support the use of this system or it will not be effective.

Advantages include:

- tries to eliminate faults or errors before the customer receives the product or service
- focus customer complaints
- reduced costs if products do not have to be scrapped or reworked or service reposed.

However, there are drawbacks:

- expensive as main employees to check the product or service
- roles of employee following introduction of standard set.

Total Quality Management (TQM) is one approach to implementing a quality assurance system.

Total Quality Management (TQM)

TQM-Business 101 Topic

Total Quality Management (TQM) is the continuous improvement of products and processes by focusing on quality at every stage of production.

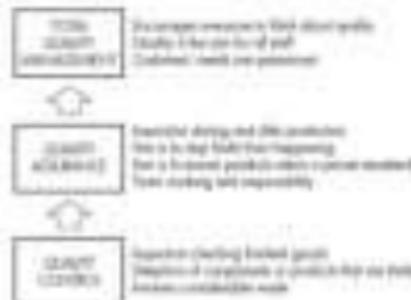
Again is a the influence of the Japanese that has changed the way quality is assessed in many businesses today. It is the idea of **Total Quality Management** (TQM) that is at the heart of many practices. TQM is the continuous improvement of products and processes by focusing on quality at each stage of production. It tries to get it right first time and not have any defects. There is no emphasis on ensuring that the customer is always satisfied, and the customer can be either people, organisations or the same business that you are competing with for, not just the final customer. This means that they are assessing each task for, not just the final customer. This means that they are assessing each stage throughout the business and so tasks should cover, as all employees are concerned with ensuring that a quality good or service is delivered. Right should mean that costs will fall. It is closely linked with Kaizen and the use of quality circles. Quality circles are small groups of workers who rapidly discuss problems and possible solutions. Workers are encouraged to suggest new ideas to reduce waste and increase sales volume.

Advantages to firms:

- quality is built into every part of the production of a product or service and becomes central to the value of all products
- customers often buy because they know that the product or service is to fit a 'tight time' approach
- no customer complaint and an ideal image is improved - leading to higher sales
- reduced costs as producers do not have to be scrapped or recalled or service repeated
- waste is reduced and efficiency increases

However, there are drawbacks:

- expensive to train employees to check the product or service
- jobs are repetitive following TQM ideology



Tools for success:

Making sure you can measure the different between quality control and quality assurance and what an organization must do to grow.

Case study: Airbus



Airbus France uses software as part of its Quality Management System to monitor and control quality. This program is a process that includes testing quality specifications. It uses engines and checks as being part of the production process and also an automated inspection to control such as various stages in the process. Both these ways of testing ensure quality, but in addition to this, it also has specially trained employees to carry out further checks on the engine to be certain of any defects.

Activity 18.2

Read this case study about:

- Why is producing a high-quality product important to Rolls-Royce?
- Do you think quality control would be a suitable method for ensuring quality artefacts? Explain your answer.

How can a customer be assured of a quality product or service?



If a customer wants to be sure that a product or service will have particular standards then they can look for a quality mark associated with the product or service. The business can apply to have this quality mark on their goods or services and then will have an official control body to be able to have this quality mark. An example is the ISO (International Organization for Standardization) which gives a business the right to use an ISO number in its business and advertising.

Ensuring a good customer service is also important to achieve success business. They may not usually use a quality mark to show that provide a good service, but by having a good reputation and communicating by satisfied customers they will keep repeat customers as well as gain new ones. Business marks, such as Triple-A, are useful ways for businesses to gain a good reputation if satisfied customers put positive reviews on the web. Of course bad reviews will give the business the opposite effect and there will have more potential customers as well as the dissatisfied customer who posted the review.



Some examples of quality marks

Activity 1.3

- 1 Look at products or services that are sold in your country. Do any of them have any marks on them to show that they are a quality product?
- 2 Use the Internet to find out what the International Organization for Standardization (ISO) is.
- 3 What does a business have to do to get ISO approved?
- 4 Show you that any other major standard bodies in your country or region.
- 5 Why do you think a business would want to obtain one of these quality marks?

International Business in Brief – quality at McDonald's



McDonald's restaurants focus a standard for employees to follow when serving customers. This is to ensure that all customers receive the same service regardless of where the business is located. McDonald's have found that ensuring the same quality standard is achieved by training employees to follow the set of rules or procedures of how to deal with the service of customers.

McDonald's process

- Identify which type of quality monitoring system McDonald's is using
- Decide whether this is the best approach for McDonald's in use
- Consider why McDonald's want to ensure a quality service to their customers.

Exam-style questions - Paper 1

- 1 L&H manufactures lots of plastic flip-flop shoes. It sells its flip-flops direct through supermarkets across the country to towns and cities. 'We need to use quality control when we manufacture the flip-flops to make sure they are good quality so our customers will not be happy', said the Customer Manager.
- What is meant by 'quality control'? [1]
 - Identify **two** other methods, apart from quality control, of ensuring quality flip-flops are manufactured. [1]
 - Identify and explain **two** benefits of using quality control to L&H. [2]
 - Identify and explain **two** possible disadvantages of using quality control to L&H. [2]
 - Do you think the owners of L&H should gain a quality mark, such as the BSI quality mark, for its flip-flop shoes? Justify your answer. [3]
- 2 L&H is a private limited company and it owns and operates three call-centre city centres. Customers expect the calls to provide a quality service and also be 'value for money'. There has been an increasing number of customer complaints and the owners of L&H are thinking of introducing quality assurance (QA) to their business. The city centre staff have a strong image of high quality and charge high prices.
- What is meant by a 'quality service'? [1]
 - Identify **two** possible reasons for an increasing number of customer complaints at the call-centres. [2]
 - Identify and explain **two** difficulties in introducing quality assurance into L&H. [2]
 - Identify and explain **two** reasons why the owners of L&H want to introduce quality assurance. [2]
 - Do you think the owners of L&H should charge higher prices in the jobs if quality assurance is introduced? Justify your answer. [3]

Revision checklist

- in this chapter you have learned:
- what is meant by quality and why it is important in all businesses
- about the concept of quality control and how businesses implement quality control
- about the concept of quality assurance

MCQs - test your understanding with the revision questions on the ECDL BLMs

This chapter will explain:

- what factors affect the location of manufacturing business
- what factors affect the location of a service sector business
- what factors affect the location of retailing business
- what factors a business may consider when deciding which country to locate operations in
- the role of legal contexts on location decisions.

Location of industry

The location of a business is usually considered critical when the business is first setting up or when its present location proves unsatisfactory for some reason. The business environment is constantly changing and a business's objectives, for example expanding its increasing profits, may result in a location no longer being suitable. The business may decide to look for an alternative site or may choose to set up additional factories/farms/warehouses in the home country or abroad.

Many businesses operate on a large scale and look at location on a world level; not just on a national or continental level. This is often termed globalisation because firms plan many aspects of their business, such as location decisions, marketing and sales, on a global scale.

Factors affecting where a manufacturing business chooses to locate will usually be different from those factors affecting where a service sector business will set up, and so these are discussed separately even though some factors will be common to both.

Factors affecting the location of a manufacturing business

Production methods and location decisions

The type of production methods used by a manufacturing business is going to have a significant influence on the location of that business.



An example of flow production

- If job production is used, the business is likely to be on a small scale and so the influence of the factors of production, for example, will be of less importance to the business than if flow production is used.

- If production is on a large scale, the location of component suppliers might be of greater importance because a large number of components will need to be transported and the cost will be high.

Affordability

Locating a factory near to the market for its products and so to be eligible for incentives where the product profit margin – when it becomes revenue and firm expenses to transport plus the raw materials/components. An example might be a drinks manufacturer, where the bottles and ingredients are lighter than the filled bottles and so the factory may have to be located close to the main markets for the products.

Today, because transport is much improved, being close to markets is of less importance, except for weight gaining or bulk-decreasing products. If the product processes quickly and needs to be fresh when delivered to the market, such as milk, bread or cakes, the factory might be located close to its retail outlets. However, ways of preserving food for longer have reduced the importance of this factor.

Raw materials/components

Similar to the weight gaining or bulk-decreasing products discussed above, the raw materials may be considerably heavier or more expensive to transport than the finished product. Where a material is produced locally they are, likely, still considerably more expensive than imported. It is often cheaper to process the raw material at the mining site than to transport it elsewhere.



If a particular process uses many different components, a business might look very carefully at its location. If many of these component suppliers are located near to one another, it might be preferable to locate near to these suppliers. This way often a factory can be cost-effective; other times different components are used in such a way, low-speed imported transport has lowered this influence.

If the raw material needs to be processed quickly while salt bricks, locating next to the raw material source is still important. An example is tomato refrigeration or canned fruits, which need to be processed quickly. There will also be a lot of waste generated which does not go into the packaging.

External economies of scale

In addition to component suppliers, firms which support the location in other ways might need to be located nearby. Support businesses which assist and improve a company may be better if nearby so that they can respond quickly to breakdowns.

The local education authorities, such as universities, might have research departments that work with the business on developing new products - being in close contact may help the business to be more efficient.

Availability of labour

To be able to manufacture products at low cost labour will be necessary, even if it is not a great number. If particular skilled labour is required, it may be easier and cheaper to move these employees if the business sets up in an area where people with the relevant skills live. If the manufacturing process requires a large number of unskilled workers, an area where there is high unemployment may be most suitable. Also, the wage rates paid to employees might vary and an area where wages are lower might be preferable.

Government influence

When a government wants to encourage businesses to locate in a particular area, it will often state-funded grants to encourage firms to move there. If an area has high unemployment, the government might give money to businesses who locate in that area. However, the government's influence might be negative in that there might be regulations or restrictions on what businesses can do. In fact, a government can refuse to allow a business to set up altogether. An example might be where the business produces a harmful waste product during the manufacturing process and the government will not want the waste produced, for example nuclear waste, to pollute the surrounding area.

Transport and communications



Businesses usually need to be near to a transport network, be it road, rail, inland waterway, port or airport. Where this produce is for export then the ability to easily get to a port will be important. A rapidly increasing air freight cost is speeding up the time spent delivering the products to market even when the market is quite a distance away.

Power and water supply

Today electricity is available in most places and therefore the availability of power is not so important. But no company having a reliable source of power, and therefore not regular power cuts, may be essential.

Case study resources

- Make sure you can choose:
- 吸引投资者
- 投资者和当地企业合作
- 为特定的行业或企业类型提供支持

The same could be said of water as for power – a reliable supply will be needed. If large supplies of water are needed as part of the manufacturing process, for example, the cooling processes will be power intensive, thus being near to a water supply, such as the sea or a river, will be important.

Climate

This will also influence many manufacturing businesses, but especially climate might be important. For instance, Silicon Valley in the US has a very dry climate which affects the production of silicon chips.

Revision summary: factors affecting the location of manufacturing businesses



Global market approach

Many MNCs manufacture close proximity. In order to cut costs it is better to make a product in one that can get important raw ingredients – usually freshly packed flour – to manufacture the flour biscuits. The flour comes from one particular region of the country. This requires quite a long way away from the main cities where much of the country's population live.

The production process is highly automated and requires only a few skilled workers to maintain the equipment. It uses a lot of water, so it rotates and also a fan to cool it until and the equipment every day to keep it clean.

The raw flour needs to go to domestic customers through supermarkets and other food stores. It is not sold abroad.

Activity 10.2

Read the last bullet above.

- Which factors affecting the location of manufacturing plants will be most important to the business when deciding where to locate? Explain why you think they will be important.
- Which do you think will be the most important factor and why?

Factors affecting the location of a service sector business

Customers

Locating a service sector business and its customers will be very important for certain types of services. These are usually services where direct contact between the business and the customer is required. If a quick response time is needed to serve the customer then the business needs to be located nearby. This would be true for plumbers and electricians who serve the local area in which they live. Other examples of personal services that need to be convenient for customers to use are hairdressers, beauticians, laundries, restaurants, coffee, gardens, florists, pet sellers.

Some services do not need to be near to customers. Many personal services is not necessary in these services can be received by telephone, post or the internet. These businesses can therefore be located in different parts of the country or in different countries to attract their customers. With the increasing use of IT and the Internet, more and more firms are becoming free from the need to locate near to their customers.

Personal preferences of the owners

The owners of businesses can influence where particular services choose to locate. They often locate their business near to where they live.

Technology



Technology has allowed some services to locate away from their customers. Some services may now be ordered by telephone or via the Internet and delivered to the business itself does not need to be near to customers, for example, website designers. These service locations can bring benefits and can therefore choose to locate on the outskirts of towns or even in remote areas (provided that the right employees are required), so that they can take advantage of cheaper rents.

Availability of labour

If a service business requires a large number of employees then it cannot 'move' to remote areas. It will need to locate near to a large town or city. If a particular type of skilled labour is required then it may also have to locate near to where this labour is found. However, it is more likely that the particular skilled labour will move near to the business for work rather than the other way round.

Climate



Tip for success:
What is your business
with reference to
location factors?
Are the most
important for a
particular service
sector business?

Climate will affect some businesses particularly if they are linked in some way. Hotels often need to book themselves when the climate is good and near to a beach.

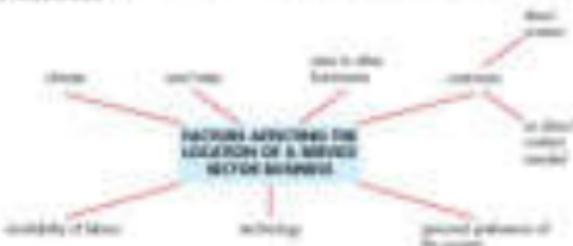
Near to other businesses

Some services serve the needs of local businesses, such as firms that service equipment owned by big companies. They will need to be nearby to respond quickly to a call to repair equipment. Not far enough away could be one factor away for the convenience of customers. However, internet banking has made this less important recently.

Bank/taxes

If the service does not need to be on the same street as a bank or tax centre, the example shows a distance between them that the business still focus on the number of users or benefit from lower taxes and rates.

Revision summary: factors affecting the location of a service sector business



Activity 20.2

For each of the scenarios below:

- 1) Answer these factors that you think are likely to affect its location.
- 2) Explain how you think each factor will influence the location decisions of:
 - McDonald's (fast food) restaurant chain
 - Computer software firm which writes computer games that are sold all over the world
 - Hotel firm that provides its rooms online and hires out motor-hiring equipment

Factors affecting the location of a retailing business

Based businesses set in the service sector has more specific business factors which apply to those types of business.

Shoppers

Most retailers will train an area which is popular, such as a shopping mall/centre. The type of shopper an area attracts will also influence the success/failure of the area to particular types of retailers. If the retailer sells expensive goods, it needs to be in an area where people can begin increasing wealth over time. If the goods are well-made products, the smaller Wright would be in an area visited by tourists.



Residential shops

Being able to locate near to shops/businesses which are visited regularly, such as a post office or popular fast-food outlet, will ensure that a lot of people pass your shop on the way to other shops and businesses and may go in to make a purchase. There may be many competing shops. You may think that this is bad for business, but it can also be a positive scenario. If the business sells clothes, then being located near to many other similar shops encourages people to visit the area as there is a lot of choice, therefore increasing business. If the location strategy is in a positive where there are no other nearby shops nearby, it may not attract people to visit the shop as there will be limited choice.

Customer parking available/nearby

Where parking is convenient and near to the shop, this will encourage shoppers to visit and therefore possibly increase your sales. Lack of parking may get people off visiting the area and sales will be lower.

Availability of suitable vacant premises

If a suitable vacant shop or premises is not available for purchase or rent, the business may not be able to locate to the area as wished.



Rent/leases

The more central the site of the premises, the higher the rents and rates will usually be. If a small area is popular, there will be a high demand for space in this area and therefore the cost of renting these areas will be higher. If the area is less popular, such as on the edge of towns, the demand and therefore the rents will be lower.

Access for delivery vehicles

Access for delivery vehicles might be a consideration. It is very difficult for them to gain access to the premises.

Security

High rates of crime such as break and enter/burglary may deter a business from locating in a particular area. Tenants/contractors may not want to locate the business if it is a

Quick fire review

- What is a service-based business?
- What are the factors that affect the location of a service-based business?
- What are the factors that affect the location of a retailing business?

in an area of high crime. A shopping centre which is positioned by goods, even though it will be more expensive to rent the premises, might prove preferable.

Logistics

In some instances there may be less maximizing the scaling or marketing of goods in particular areas.

Revision summary: factors affecting the location of retailing businesses



Case study example

W&G Limted are going to open a new shop selling fashion dresses. The chain are good quality and reasonable in pricing. W&G limited have narrowed down the choice of where to locate this new outlet for their retailing business.

	Site Y	Site Z
Population	50,000	10,000
% in age groups		
16-24 years	15	10
25-34	30	20
35-44	20	10
45-54	25	15
55+	5	5
Income per household	low	high
Customer base	low	low
Shopping centre	large - about 100 shops	small - about 20 shops
Parking facilities	large car parks for disabled bays and all bays filled	plenty of parking available - no problems at busy times
Types of shops in other shopping centres	clothes shops, food shops, banks, financial goods, food shops	food shops, financial goods, clothes shops, post office, banks

Activity 18.2

Read the case study on page 346.

- (a) Read the information on the two towns and then select which one will be the best location for the new shop, justify your choice.
- (b) What other information is needed to help make the final decision? Explain why the information is needed.

Sourcing in different countries

Multinational (transnational) companies have offices, factories, production operations in shops in many different countries. However, the rapid growth of newly industrialising countries, increasing international trade, improved global communications and improvements in transport have meant that more businesses can now consider where in the world to expand rather than just considering a single country; often called globalisation. Therefore this means that more firms businesses, other than multinationals, are considering moving to another country, either to expand their operations or sometimes to relocate entirely, away from developed countries to rapidly growing economies.

A number of factors will affect whether a business decides to relocate to another country and which country to choose when it does:

New market areas

When a business sees a steady increase in its sales overseas it may decide to relocate nearer to those markets rather than import its products from the existing manufacturing base as it may be more cost efficient. An example is JCB Construction equipment which has built additional factories in Brazil and China as well as keeping its existing factory in the UK.

If the business is in the service sector, slow growth over time can mean that it moves (for example Starbucks or UNICEF financial services). The better the demand for growth in these markets the more attractive the location for business.



Choosing or new sources of materials

If the raw material source is far away, a business may prefer bring in alternative suppliers from elsewhere or move to a new site in a country where you can easily obtain closer supplies. This is particularly true of mineral resources such as oil wells; these need to be in the country where the oil is found. This is might be cheaper to use the raw materials in their source rather than transport them to another country to process.

Difficulties with the labour force and wage costs

If the business is located in a country where wage rates keep on rising, there may come a point when the business decides it is more profitable to relocate overseas, particularly labour intensive businesses, to reduce wage costs. This has been true of many Western businesses moving their manufacturing plants to developing countries where the wages paid are much lower (for example, Vietnam for mobile phones). If particular types of skilled labour are needed in the business, the business might need to relocate to a different country where it can recruit the right type of labour. This has been true for businesses which employ software IT skills being attracted to India which has a large number of graduates from universities with IT related degrees.

Risks/Issues considerations

Warlike states such as Iran or Saudi Arabia (the profile of potential business) keep threatening the safety cause the business to relocate to countries where these sorts of issues are lower.

Availability of government grants and other incentives

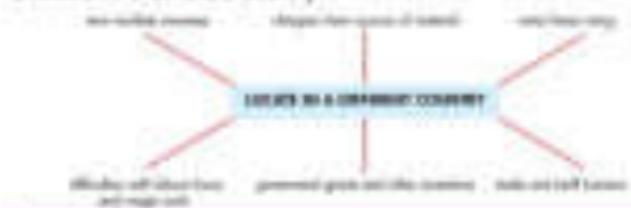
Governments may tried to encourage foreign businesses to locate in their country by listing in investment and job opportunities. They may be willing to give grants, loans and tax relief incentives to businesses to entice them to come to their country rather than go elsewhere. Some grants do this because the business will provide jobs and possibly teach new skills and improve their technology into the economy.

Trade and tariff barriers

If there are trade barriers, such as tariff (an tax on imported goods) or quotas (where a limit is placed on the quantity of imports of a particular good), then by locating in that country there will be no restrictions. An example of this is the invitation to Japanese car companies to Europe to either go against the European Union's strict quota for the import of cars.

Key to success:
Make sure you
only choose option
locations (country)
are the most
appropriate for a
particular business
depending which
industry it needs
operating in.

Revision summary: factors that influence a decision to locate in a different country



Case study: Nestlé

M&T Financials Limited wants to expand. Presently it is based in a small factory in the UK part of the city. New markets are opening up abroad and M&T has experienced a steady increase in its sales for the last five years. There is no room to build under the existing factory and many of the adjacent factories are for sale. The business has been forced to look for a new site of its own to grow.

Because price and some of the other non-legalised, it is considering whether to build a factory abroad or whether to build a larger factory in its home country. This following information has been gathered about two sites, one in M&T's existing factory and one abroad in the country where most of M&T's products are exported.

	Site A – is the location of the original base-to-marketing factor to Nestlé according	Site B – is the same market served
Market	large local market	large global market and growing
Infrastructure	good communications – easy road access to all parts of the country, port facilities, well developed infrastructure	good communications – road links connect to all parts of this economy and port are very close to the site
Raw materials/ components	local materials and components are close to the site – easy availability	far distance and components are far from the site – not easily available – road will need to be improved
Skilled labour	high	low – difficult to find skilled
Capital labour	high	very low skilled workers are needed
Unemployment	low	high
Business taxes	high	low
Government grants	no grants available	government grants available which is been company to setting up in this country

Activity 10.4

Read the case study on pages 202–203.

Study the information provided and then write a report to the Board of Directors of AMF Furniture Limited, outlining the advantages and disadvantages of each of the sites, including a recommendation of which one AMF should move to. Remember to give reasons for your choice.

The role of legal controls on location decisions

The decisions by firms about where to locate their business can have a very important effect on the local's profitability. Managers will want to locate their business in the best possible area, taking into account factors such as cost of land, proximity to transport links and customers, availability of workers, and so on. Weeds governments rely on influence these location decisions? Classify the two main reasons:

- to encourage businesses to set up and expand in areas of high unemployment – in some countries these are called development areas
- to encourage firms from locating in unpopulated areas in order which are taxed for their natural beauty

Two types of incentives are often used by governments to influence where firms locate:

- Planning regulations – will legally restrict the business activities that can be undertaken in certain areas. For example, a business planning to open a factory in an area of residential housing might be refused planning permission. It would then be illegal for the firm to build the factory on that site. In certain parts of rural countries, especially in particularly beautiful areas, it is not possible to establish any kind of business other than farming.
- Many governments provide grants or subsidies to businesses to encourage them to locate in underdeveloped parts of the country. This assistance could be in the form of financial grants, such as a non-refundable amount of money paid to the business to locate in a particular area or subsidies paid to businesses (for example, from local government). These development areas which receive government assistance usually have a very high unemployment rate and there is a great need for new jobs.

Take the test
Match each plus point against the government strategy mentioned in the location decisions of businesses.

Case study: recycling GEP Chemicals' new plant in Mexico and factory

Workers? Workers were assigned to issue notices of plants by 2011 (allowing to build a large new plant and American plant in the Southern province). Many of these products will be sold abroad. The factory will receive 100% new parts which were largely influenced by other leading countries. The new factory will receive materials, components and capacities from leading local firms, in a context that the Government is planning no other subcontracted grants to 2011 for investing in this area of high competitiveness.

However, it has emerged that in several months has started housing estates and schools. The government offered free equipment after 2011 to the public institutions as having central importance for them.

Local residents have raised feelings about this plant. One elderly woman pointed: "It will only bring more road traffic and lots of pollution. Don't forget that just 2007 alone in the World was destroyed by an explosion a few years ago, killing several workers". However, other local people welcomed the construction as will bring more businesses and wealth in the area.

Question 2.E

Read the case (2.E) above.

- Make a list of the stakeholders likely to be affected by GEP's plan to build a new chemical factory.
- For each of the groups that you have identified in all options why they are likely to be interested in an offer to support, have one point.
- Explain where resources are: in place consider, the Government might be involved in this decision.

International business in Spain – The supermarket chain company

The supermarket chain Carrefour, a UK company with its headquarters based in France, has decided to open a new factory in Spain for supply their growing American market for carrots. Being a large country with over 400 million people in America and 400 million households it's shopping centre have led to this decision. "In addition to cost considerations, to be successful in the American market, the American market we be able to produce and ship the carrots that can stay to meet the quickly changing demands for day-to-day", says Mr. Jim, the vice president of the company. Import tariffs are high for carrots mainly because being harvested from elsewhere.

International business

- Why has Mr. Jim chosen to build a new factory in America?
- What are the main difficulties that Carrefour might expect from the American?

Exam-style questions - Paper 1

- 1 ABC Limited produces fruit juice drinks. The fruit to produce the drinks is grown locally on nearby farms. However, the fruit can also be imported at a cheaper price, but the quality is not as good. When producing the fruit juice there is a lot of waste from the parts of the fruit which are not used to make the drinks. Land near to the firm is available at a fixed price and the company wants to find the land to expand rather than relocate the factory to another country. The market for fruit juices is both an elastic and inelastic.
- What is meant by 'relocate the factory'? [1]
 - Identify two reasons why ABC Limited might relocate from nearby farms. [2]
 - Identify and explain two factors which influenced the location decision of ABC Limited when choosing its original site. [4]
 - Identify and explain two reasons why ABC might want to buy land nearby to its existing factory to expand rather than relocate to another country. [3]
 - The Government is offering grants to relocate to another area of the country. Do you think the managers of ABC Limited should take advantage of these government grants? Justify your answer. [6]
- 2 Smith's is a chain of large clothes shops. The owners are looking for a location in the city centre for a new shop. The existing shops sell a range of clothes for men and women at low prices and are all located in busy shopping malls. There is a lot of competition from similar shops and the Managing Director thinks the new shop should not be located near to competitors.
- What is meant by 'competition'? [1]
 - Identify two advantages of a shop being located in a small town rather than the city centre. [2]
 - Identify and explain two ways that Government might influence the decision of where to locate the new shop. [4]
 - Identify and explain two ways in which the location chosen for the new shop might have an effect on its profitability. [4]
 - Do you think the Managing Director is right in not wanting to locate the new shop near to its competitors' shops? Justify your answer. [4]

Revision checklist

In this chapter you have learned:

- to identify the relevant factors that affect the location of a manufacturing business
- to identify the relevant factors that affect the location of a service sector business
- to identify the relevant factors that affect the location of a retailing business
- to identify the relevant factors that a business considers when deciding where to locate operations in
- about the role of legal controls in location decisions

REVIEW – test your understanding with the review questions on the CD-ROM.

Operations management: end of section case study (Paper 2 style)

Precision Suits

Sally runs a business called Precision Suits. It is a private limited company. The business makes ready-to-wear clothing which is precision-tailored and the production workers are paid an hourly wage. Sally employs 750 people who work in the production of suits, but has five managers who help her in the office but she only has one manager who is responsible for finance. Sally carries out all the other functions for the business.

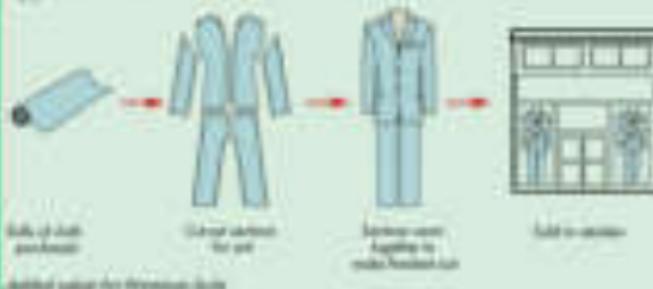


The business has grown steadily over the last two years. Sally expects to continue to expand the business and increase the sales of different suits by adding new colours, ranges of materials produced etc. There is a lot of competition for men's formal suits and this market is still growing. She has identified four main options for selling off excess stocks that have been produced. However, she is unsure which option to choose.

- ▲ Option 1 - She can start selling surplus suits that are not in much demand or high-quality material. These suits should be made to measure for each customer and individually designed. The market for these suits is a niche market. She would need to employ three skilled workers.
- ▼ Option 2 - She can start selling unsold suits to other men's markets. However, to do this she will likely need to invest in machinery to produce suits on a large scale. She could gain from economies of scale which could pay an advantage.

Sally can easily use search engines. However, if she decides to follow Option 1 she will use job advertisements and if she follows Option 2 she will use press publications.

Appendix 1: added value for Precision Suits



- 1.4** As Premium Suite grows bigger it could gain from economies of scale, costs will go down and customers will experience more value in the business. Explain how this can happen. (10)
- 1.5** Quality is important for Sally. Consider the advantages and disadvantages of quality control and quality assurance. Recommended include minimum batch size, use of process control tools and procedures. Justify your answer. (10)
- 1.6** Explain the main features of job costing system for Station 1 and the main features of process costing for Station 2. (10)
- 1.7** Sally believes that total machinery cost would increase faster than the business if she manufactures. Do you agree with Sally? Justify your answer. (10)

Marking guidelines

- 1.1** Premium Suite's chosen value for Sally's business intensity and explore how more sales could increase the added value for her suite. (10)
- 1.2** Sally runs two stations. Explain why a different marketing mix for Station 2 may affect you think well of the products of the competing company will be different for the two products in Station 1 and Station 2. Justify your answer. (10)
- Product
 - Price
 - Promotion
 - Place

-70,000 (-1.7%)

5

Financial information and financial decisions

Chapters

- 5.1 Business finance: assets and income
- 5.2 Cash flow forecasting and working capital
- 5.3 Income statements
- 5.4 Balance sheets
- 5.5 Analysis of accounts



Business finance: needs and sources

This chapter will explore:

- why businesses need finance
- the differences between short- and long-term finance
- the importance of money finance in developing economies
- the different sources of finance available to business
- how managers choose between different sources.

What do Finance departments do?

Finance departments fulfil a very important role in business. They have the following responsibilities:

- recording all financial transactions, such as payments and sales invoices
- preparing final accounts
- producing accounting information for managers
- forecasting cash flows
- making important financial decisions e.g. which source of capital to use for different purposes within the business.

Why do businesses need finance?

What is business finance? It's money. We all need money to purchase the goods and services we require – everyday goods. For food, but also more expensive items such as a house or car. Businesses need finance too – and this is often called 'capital'. Without finance they could not pay wages, buy materials or pay for assets. Here are three examples of why capital is needed:

- starting up a business
- expansion of an existing business
- increasing working capital

Starting up a business

When an individual plans to start their own business, they should consider all of the buildings, land and equipment they will need to buy in order to start trading. These are usually called fixed assets (see Chapter 24) and nearly all new businesses will need to purchase some of these. In addition, the owner of the firm will need to obtain finance to purchase other assets such as inventory, factors' goods, car or office furniture. The finance needed to launch a new business is often called **start-up capital**.

Expanding an existing business

The owners of a successful business will often take a decision to expand it in order to increase profits.

Additional fixed assets could be purchased – such as buildings and machinery. Another business could be purchased through a takeover.

Definitions for terms

Start-up capital

In this finance provided by a new business to pay for equipment, land and current assets before it can begin trading.



**Expenditure for
start**

Working capital
is the finance
needed by a
business to carry on
day-to-day costs.

**Capital
expenditure** is
expenses spent on
fixed assets which
will last for more
than one year.

**Revenue
expenditure** is
income spent on
day-to-day
expenses which
do not benefit
the running of a
long-term asset.
For example wages
or rates.

Other types of expenditure include developing new products or expanding markets. This form of growth could require substantial amounts of finance for research and development.

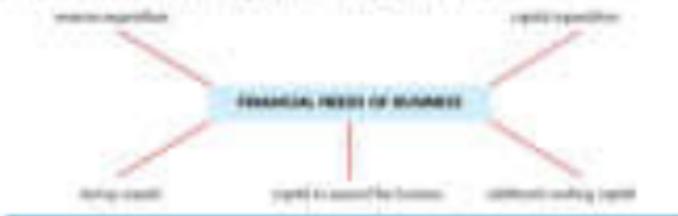
Additional working capital

Working capital is often described as the 'life blood' of a business. It is finance that is constantly needed by firms to pay for all their day-to-day expenses. They have to pay wages, pay for raw materials, pay electricity bills and so on. The money available to do this is known as the firm's working capital. It is vital to a business to have sufficient working capital at most of its requirements. Many businesses have stopped trading, not because they were unprofitable, but because they suffered from shortages of working capital.

In the final stage business need the finance to obtain some additional working capital.

In all these cases alone, business may need finance to pay for either **capital expenditure** or **revenue expenditure**. It is important to understand the difference.

- Capital expenditure is money spent on fixed assets such as buildings which will last for more than one year. These assets are treated as the 'heart' of a business and as it expands.
- Revenue expenditure is money spent on day-to-day expenses, for example wages or rates.

Revision summary: financial needs of business**Activity 11.1**

Look at the list below of expenses for a sports centre. Then put the table and try whether you can categorise each as either revenue expenditure or capital expenditure.

Purchase of building	Revenue expenditure	Capital expenditure
Rents (£400)		
Staff wages		
Office computers		
Car assessment		
Maintenance of equipment		

Activity 11.2 Paul's new business

Paul has decided to issue £10k to set up his own hair business.

- Ask yourself why he will need finance for his new business.
- Make a list of the main advantages of this business for its first month of operation.
- Which of these costs are revenue expenditure and which are capital expenditure?

Sources of finance

What you need to know:
internal finance
external finance
 Business cash flow
Financial finance
 is generated from
 sources outside of
 and separate from
 the business

There are many different sources of finance available. It is common to split them up, or classify them, into different groups. The two most common ways of doing this are:

- **Internal or external sources of finance**
- **Short-term or long-term sources of finance**

Internal finance

The most common sources of internal finance are as follows.

Retained profit

This is profit kept in the business after the owners have taken their share of the profit. It is often called ploughed-back profit, and has the following advantages:

- Retained profit does not have to be repaid quickly. For example, a loan.
- There is no pressure to pay—the capital is owned directly by the business.

There are disadvantages too:

- A new business will not have any retained profit.
- Many small firms' profits might be too low to finance the expansion needed.
- Keeping lower profits in the business reduces payments to owners, for example dividends or shareholders.

Sale of existing assets

Existing assets that could be sold are those items of value which are no longer required by the business, for example, redundant buildings or surplus equipment.

- This makes better use of the capital tied up in the business.
- It does not increase the debts of the business.

However:

- It may take time to sell these assets and the amount raised is likely to be less than what the asset is worth.
- This source of finance is not realistic for new businesses as they have no surplus assets to sell.

Sale of inventories to reduce inventory levels

- This reduces the opportunity cost and storage cost of high inventory levels.

However:

- It can be time costly to avoid disappointing customers if not enough products are kept in inventory.

Owners' savings

A sole trader or member of a partnership can put most of their savings into their entrepreneurial business. As we saw in Chapter 4, the returns of these firms are more secure than business and therefore such finance is called **internal**.

Advantages include:

- It should be available in the best quality
- No interest is paid.

However:

- Savings may be too low
- It increases the risk taken by the owners.

Revision summary: Internal sources of finance



Activity 11.1 Read and then read again

Paul wants to raise £1 million of finance before going ahead with his business plan. Identify (i) (ii). Explain your reasoning.

- (i) Personal savings are used for start-ups, a **business source of finance**.
- (ii) His savings will be likely to be an **important source of funds**.
- (iii) Selling off ownership is complex. **Trade and partners' current savings** is another source of finance to help Paul's business.

Tips for success

Remember that only limited companies can issue capital by issuing shares – and that only public limited companies can offer shares that can be sold to the public.

External finance

The more common forms of external finance are as follows.

Issue of shares

This source of finance is only possible for limited companies.

- This is a permanent source of capital which would not have to be repaid to shareholders.
- No interest has to be paid.

However:

- Dividends are paid after tax, whereas interest on loans is paid before tax is deducted.
- Dividends will be expected by the shareholders.
- The remaining value of the company could change hands if many shares are sold.

Bank loans

A bank loan is a sum of money obtained from a bank which must be repaid and on which interest is payable.

- These are usually quick to arrange.
- They can be for varying lengths of time.
- Large companies are often offered low rates of interest by banks if they borrow large sums.

However:

- A bank loan will have to be repaid eventually and interest must be paid.
- Security or collateral is usually required. This means the bank keeps loans that it has the right to sell some of the debt's property if it fails to pay interest or does not repay the loan. A note reader may have to put his or her own house up as security on a bank loan.

Selling shares

These are long-term loan certificates issued by listed companies.

- Debentures can be used to raise very long-term finance, for example, 25 years.
- However:
- As with loans, these must be repaid and interest must be paid.

Factoring of debts

A debtor is a customer who owes a firm money for goods bought. Debt factors are specialist agencies that "buy" the debts out of firms for a commission rate. For example, a debt factor may offer 90 per cent of an existing debt. The factor will then pay the buyer and the 10 per cent represents the factor's profit - when the factor collects payment from the debtor.

- Commission rate is made available to the business.
- The risk of collecting the debt becomes the factor's and not the business's.
- However:
- The firm does not receive 100 per cent of the value of its debts.

Grants and subsidies from outside agencies

Grants agencies include, for example, the government.

- These grants and subsidies usually do not have to be repaid.
- However:
- They are often given with 'strings attached'. For example, the firm must 'share' in a particular area.

Micro-finance

In many low-income developing countries, traditional commercial banks have been very unwilling to lend to poor people – even if they needed the finance to set up enterprises. Banks did not lend because:

- The size of the loans required by poor consumers – perhaps a few dollars – means that the bank could not make a profit from the loans.
- The poorest groups in society often have no assets to act as ‘security’ for loans – banks are usually not prepared to take risks by lending without some form of security (unless they can sell off the bad debts once repaid).

Extension 11**Assets**

Key message 4:
providing financial services – including small loans – to poor people
can serve the development needs of

Specialist institutions have been set up to meet the banking needs of poor people – especially poor entrepreneurs. The name known of these is the **Micro-Bank** in Bangladesh. These institutions, including postal savings banks, finance companies, credit unions and development banks, focus on lending small sums of money to people – hence the term **micro-finance** or **micro-credit**.

Case study – Micro-Banks: Microfin.org.lk

Microfin Bank is based in Sri Lanka. This has one million plus one user to date (including the head office). All it took to have Microfin the record was a £10 loan from the Kandy transaction. The loan officer had to start a feasibility meeting between pitch, feasibility test, etc. Since the day since a restaurant and a catering business that employs eight people. She has repaid the original loan and taken on a fifth微小企业 to pay for her children to go to high school and college. Microfin has changed my life! Thank you.

Activity 11.4

Read the case study above.

- Why are poor third world businesses unable to raise funds from the local business?
- Explain the benefits that this example of micro-finance has given to Microfin, her family and her business.

Revision summary: external sources of finance**Activity 11.5: Paul's business proposal**

Paul's local supermarket has run out of money representing their new stock. He wants to expand his business, so he and his wife are looking for a bank update.

- Explain to Paul the benefits of using his business profits to buy the new rather than taking out a bank loan.
- What would you advise Paul to take out a bank loan in respect to his business?

Short-term and long-term finance

Short-term finance

This provides the working capital needed by businesses for day-to-day operations.

Shortages of cash in the short term can be overcome in three main ways:

Overdrafts

These are arranged by a bank.

- The bank gives the business the right to 'overdraw' its bank account (that is, spend more money than is currently in the account).
- The firm credits the finance to pay wages or suppliers first; obviously, it cannot do this indefinitely.
- The overdraft will vary each month with the needs of the business - it is said to be a 'fluctuating' basis of borrowing.
- Interest will be paid only on the amount overdrawn.
- Overdrafts can turn out to be cheaper than loans in the short term.

However:

- Interest rates are variable, unlike most loans which have fixed interest rates.
- The bank can ask for the overdraft to be repaid at very short notice.

Bank credit

This is where a business borrows money by agreeing to supply, which leaves the business in a better cash position.

- It is money an business has lent to the business for the length of time that person is deemed fit.

However:

- The supplier may allow no gross discount or even refuse to supply if early payment is not made quickly.

Factoring of debts

(see page 261 under 'Financial Resources')

Long-term finance

This is finance which is available for more than a year – and sometimes for very many years. Usually this money would be used to purchase long-term fixed assets, or update or expand the business or to finance a takeover of another firm. The main sources of long-term finance are as follows:

Bank loans

These are payable over a fixed period of time. The advantages and disadvantages of loans have already been considered under 'External finance'.



Hire purchase

This allows a business to buy a fixed asset over a long period of time with monthly payments which include an interest charge.

- The firm does not have to find a large cash sum to purchase the asset.

However:

- A cash deposit is paid at the start of the period.
- Interest payments can be quite high.

Leasing

Leasing an asset allows the firm to use an asset but it does not have to purchase it. Monthly leasing payments are made. The business could decide to purchase the asset at the end of the leasing period. Some businesses decide to sell off some fixed assets for cash and lease them back from a leasing company. This is called sale and leaseback.

- The firm does not have to find a large cash sum to purchase the asset in case it fails.
- The care and maintenance of the asset are provided for by the leasing company.

However:

- The total cost of the leasing charges will be higher than purchasing the asset.

Issue of shares

An issue of new shares, also known as equity, is available only to limited companies. (See Chapter 4 for details of how sole traders and partnerships can convert to limited company status.) Shares are often referred to as equity – therefore the sale of shares is commonly called equity finance.

Public limited companies have the ability to sell a large number of shares to the general public. These new issues, as they are called, can raise very large sums of money but can be expensive to organise and administer. A right issue of new shares is a very common way for public limited companies to raise additional capital. This gives existing shareholders the right to buy new shares in proportion to their current holding. This avoids the problem of new shareholders changing the balance of ownership.

See page 242 for the advantages and disadvantages of selling shares to raise finance through loans or debt finance.

Loans differ from share capital in the following ways:

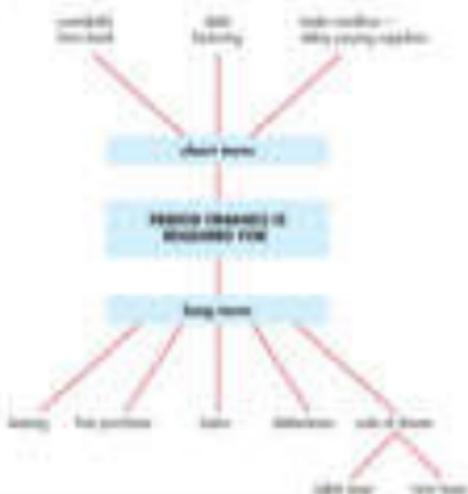
- Loan interest is paid before tax and is tax exempt.
- Loan interest must be paid every year but dividends do not have to be paid if, for example, the firm has made a loss.
- Loans must be repaid, as they are not permanent capital.
- Loans are often 'secured' against particular assets.

The advantages and disadvantages of loans have already been mentioned under 'External finance'.

Debentures

See page 242 under 'External finance'.

Revision summary: over what period of time is the finance required?



Activity 21.4

Consider all of the following sources of finance. Are they short-term or long-term sources of finance? Copy and fill in the short-term or the long-term column for each source.

Source of finance	Short-term	Long-term
Inventory		
Receivables		
Cost of finance		
Free cash flow from operations		
Trade credit		
Bank borrowing		

Sources of finance: how business makes the choice

We now know the main sources of finance available to firms. What factors do managers consider before deciding where to obtain finance from?

Purpose and time period

What is the business to be spent on? Is it to be used to put the fixed assets in or is it needed to pay for a short-term cash flow crisis?

The general rule is to match the source of finance to the use that will be made of it.

- If the use is long-term, for example the purchase of a fixed asset, the source should be long-term.
- If the use is short-term, for example the purchase of additional inventories to cover a busy period, the source should be short-term.

Think about the disadvantages of having additional inventories, which will only be needed for a few months, with a long-term bank loan. Can you see why this would be costly? What source of finance would be suitable for this?

Amount needed

Different sources will be used depending on the amount of money needed. A company would not go to the expense of arranging a new share issue if only £10000 of capital was needed for a short-term period.

Legal form and size

Companies, especially public limited companies, have a greater choice of sources of finance. Having shares or debentures is not an option the sole traders can't participate. These businesses, if they have plans to expand, may have to depend on the savings of their owners - personal capital. They also often have the disadvantage of having to pay higher interest rates to banks for loans than large and well-established companies.

CASE STUDY: COMPANY A—CHOOSING THE RIGHT SOURCE OF FINANCE

Company A sells fashion clothing, it needs £100 000 to accelerate its growth. A new issue of shares would be the easiest choice. This is because the issue of shares is comparatively inexpensive to arrange and would take a long time – the firm wants the high-decorated year.

Company B wants to be bidirectional. It plans to take over another manufacturer currently valued at £10 million. Company B already has a large bank loan.

Activity 11.1

Read the case study above.

- 1 Which company A or B, the source of finance that would be suitable?
- 2 Which company B is the source of finance that would be suitable?
- 3 In each case, which source of finance would be the most suitable in fact? Explain why you would choose that source rather than the other sources.
- 4 In each case, explain what other information would have been useful before giving your answer.

Control

Owners of businesses may lose control of their business if they sell their goods to investors in their firm. Owners do not decide what is more important, regarding the business or keeping control of it.

Risk and gearing – does the business already have issues?

An important point about how capital is used is will raise the gearing of the business – and this is a common measure of risk that the managers are taking. The gearing of a business measures the proportion of total capital raised from long-term loans. If this proportion is very high – say more than 60 per cent – the business is said to be highly geared. This is said to be a risk issue of financing a business.

This is risk because interest rates paid on the loans whether the business is making profits or not. When interest rates are high and business profits are low, the firm may well not be able to pay off all of the interests. The future of the business will be at risk. Therefore, banks are usually reluctant to lend to highly geared businesses which may have to use inflated versions of finance.

Teacher resource

'Which is the best source of finance for the business?' is a good question to ask to prepare to explain the advantages and disadvantages of the main sources of finance – and give a justified recommendation.

Case study: business

- It was trader would take on a private limited business as extra capital – but could their partner want to take important decisions without the original investor's permission?
- The directors of a private limited company should decide to 'go public' and sell shares in the audit. This could raise very large sums of money for the business but could the new shareholders make a controlling interest in the business?
- An existing plc could provide a new level of shares but could these be bought by just one or two other companies who may not be in a majority hold? These problems could all be overcome by using bank finance instead.

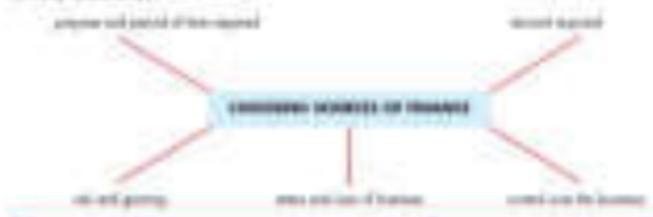
Activity 5.1.8

Read the case study above.

- 1 Would you advise each of these three businesses to use their capital instead of using the source of finance outlined above? Explain your answer.
- 2 Consider all of these following sources for a private limited company trading finance. State how this can be used, for what type of loan, P/L or the profit only.
 - 3 what you consider would be the most suitable source of finance
 - 4 the reason for your choice

Need for finance	Most suitable source	Reason for choice
Planned takeover of another business		
Temporary increase in investment over the coming year		
Purchase of new car for the chief executive		
Assumption and management of new activity – to complete the building in this year		
Growth of building modern factory requiring much less land than the present one		

Revision summary: choosing sources of finance – factors involved in the decision



Activity 11.3 *Share dilemma*

Joe Thompson has £100 000 to invest. He wants to buy shares in public limited companies because he has found that the most recent dividends were made at a capital gain if the share price fell, he has received dividends of 5 pps. That is an average of one cent of shares. The company seems to expand. He makes a note of the following information:

- The current share price is 200 pps and it had a high as £1.
- The average value of shares on the stock exchange has risen over the last year.
- The gearing ratio of the company is 22 per cent.
- Interest rates are likely to rise in the next month or two.
- The company is paying high dividends as its working shareholders.
- Considering all of the risks and possible gains, would you advise him to buy these shares or not?
- What other information would you be helpful in advising him?

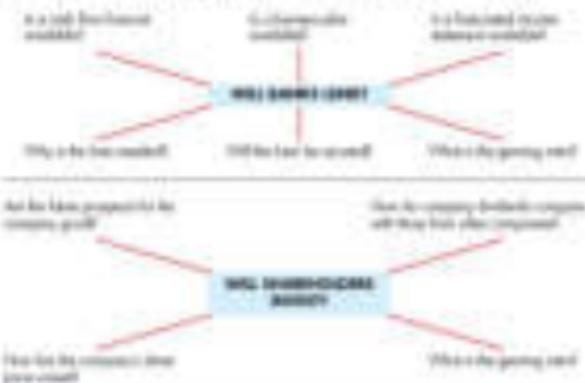
Will banks lend and shareholders invest?

A business can never be sure of finding suitable finance. Banks often refuse to lend to businesses – and shareholders may be reluctant to buy more shares. A business owner, especially of a new start-up business, will increase the chance of obtaining bank finance if the following is available:

- A cash flow forecast which shows why the business is needed and how it will be used.
- An income statement – for the last time period – and a forecast one for the year. These should show the chances of the business making a profit in future.
- Details of existing loans and sources of finance being used.
- Evidence that ‘willing’ is available to make the bank’s risk of lending.
- A business plan to explain clearly what the business hopes to achieve in the future and why the business is important to these plans.

Shareholders are more likely to buy additional shares when:

- the company’s share price has been increasing
- dividends are high – or profits are rising so dividends might increase in the future
- other companies do not quote such a good investment
- the company has a good reputation and has plans for future growth

Revision summary: finance from banks and shareholders**International Business by Home-Gating Properties**

Home-gating properties development company (Holding Properties) currently control over 1000 units without fees (the sale of more shares). The founders of this Malaysian based company owned nearly 80 per cent of the company (before the share sale) - but only 15 per cent after the share had been sold. The founders still control the rents, using share price (its own and the market) to encourage investors to buy these new shares in Gating Properties.

The company is expected to use this revenue related to leases (which have yet to begin) to help make fund for the long-term development of further properties.

Discussion points

- Explain what Home-gating Properties could benefit from an external/external from the sale of shares.
- Who do you think shareholders were at home to buy these new shares?
- Explain why this company succeeded in continue its bank loans.



Leasing fees (which is needed to pay the Home-gating properties).

Examination questions - Paper 1

- 1** Michelle lost her job when the sugar factory closed. She wanted to start her own business making and repairing clothes. All the main banks refused Michelle's request for a £1000 loan even though she had a business plan. Finally, a development bank specialising in micro-finance agreed to lend her the capital she needed. That year three years ago - she now employs three other people and is planning further expansion of her business.
- What is meant by micro-finance? [1]
 - Identify two reasons why Michelle needed £1000 to start her business. [2]
 - Identify and explain two likely reasons why the high street banks turned down Michelle's request for a loan. [4]
 - Michelle now expects to expand her business further, identify and explain two benefits of using external sources of finance to do this. [3]
 - Ten years after setting up her business, Michelle converted it into a public limited company to take financial Business expansion... Do you think she was right to do this? Justify your answer. [6]
- 2** Akrem owns a small farm. The income of the business varies greatly during the year. The farm makes a small profit but Akrem is ambitious. He wants to take over a neighbour's farm and however this farm is three times his size. He thinks that he needs long-term finance and plans to take out a bank loan to pay for the takeover. He has already informed the bank to buy a new tractor. A friend has advised him to form a company and sell shares.
- What is meant by 'long-term finance'? [1]
 - Identify two types of short-term finance Akrem could have when farm income is low. [2]
 - Identify and explain two forms of external finance Akrem could have used to buy the tractor. [4]
 - Identify and explain two pieces of information a bank would look at before granting a loan to Akrem. [6]
 - Do you think Akrem should take finance for the takeover by forming a company and selling shares? Justify your answer. [6]

Revision checklist

In this chapter you have learned to:

- recognise the different reasons why businesses need finance
- identify sources of finance as being either internal or external and also for the period of time for which they are available
- analyse and compare the advantages and disadvantages of different sources of finance
- analyse a firm's need for funds and make a reasoned choice between the different sources of finance available
- make decisions on whether finance should be provided to a business from the viewpoint of shareholders, banks and other creditors.

Cash flow forecasting and working capital

This chapter will explain:

- the importance of cash flow to business operations
- how a cash flow forecast is constructed and how it can be amended
- how firms can run short of cash and the likely consequences of this
- how a short-term cash flow problem can be overcome
- the importance of working capital

Why cash is important to a business

Investment in assets

The cash flow of a business is often called **cash inflows**, and cashflows over a period of time.

Cash inflows

are the sums of money received by a business during a period of time.

Cash outflows

are the sums of money paid by a business during a period of time.

Cash is a liquid asset. This means that it is immediately available for spending on goods and services.

Do you ever run out of cash? Have you ever been unable to pay for goods which you need at your particular time because you did not have enough cash? Have you ever borrowed money or borrowed bills which you cannot immediately pay? If you answered 'yes' to any of these questions, you have already experienced a **cash flow** problem! In business terms, cash flows measure the flow of money into and out of a business over a certain time period.

If a business has too little cash – or even more cash than it needs – it will face major problems:

- unable to pay workers, suppliers, landlords, government
- production of goods and services will stop – workers will not work for nothing and suppliers will not supply if they are not paid
- the business may be forced into 'liquidation' – selling up everything it owns at a price to settle debts.

What is meant by cash flows?

How can cash flow have a business **cash inflow**? There are five of the main common ways:

- the sale of products for cash
- payment made by clients – clients are customers who have already purchased products from the business but did not pay for them at that time
- increasing money flows an external source – this will lead to cash flowing into the business (or will there not be repaid eventually?)
- the sale of assets of the business, for example commercial property
- investment – the example above refers to the case of companies – putting more money into the business

How can cash flow out of a business **cash outflow**? Here are five of the most common ways:

- purchasing goods or materials for cash
- paying wages, salaries and other payments in cash

- purchasing fixed assets
- repaying loans
- by paying creditors of the business – either those who supplied items to the business but who were not paid immediately

Activity 10.1 Cash inflows or outflows?

Look at the table below. For each of the following transactions, indicate the correct column to indicate whether it represents a cash inflow or a cash outflow for Great House Enterprises Ltd.

Transaction	Cash inflow	Cash outflow
Purchase of new computer for cash		
Sale of goods to customers - no credit given		
Interest paid on bank loan		
Wages paid to employees		
Suppliers pay their bills		
Additional shares are sold to shareholders		
Creditors' cheques are cashed		
New equipment is used up		

Cash flow cycle

The following diagram will help to explain the link between some of the inflows and outflows mentioned above – the **cash flow cycle**. It explains why cash paid out is not released immediately in the business.



The cash flow cycle

The diagram shows how cash is used (1) to buy the essential materials and what costs (2) required to produce the product. Time is needed to produce the products (3). In fact they can be sold to customers (4). If these customers receive credit, they will not have to pay straightaway. When they do pay for the goods in cash (5), this money will be needed (6) to pay for buying further materials, etc. (1) and so the cycle continues.

The longer the time taken to complete these stages, the greater will be the firm's need for working capital (see below); and cash.

Definitions in focus:

Trade receivable
Shows the time gap between paying out cash for delivery materials, etc., and receiving cash from the sale of goods.

The diagram also helps us to understand the importance of planning for cash flow. What would happen if:

- A business did not have enough cash at stage 1? Then enough materials and other requirements could be purchased and so wages and sales would fall.
- A business insisted on its customer paying cash at stage 4 because the business had short of money? It might lose that customer to a competitor who could offer credit.
- A business had insufficient cash to pay its bills such as rates and electricity? It would be in a liquidity crisis and it might be forced out of business by its creditors.

These three examples illustrate the need for managers to plan ahead for their cash needs so that the business is not put at risk in these ways.

What cash flow is not

Cash flow is not the same as profit. This is an important distinction.

What is cash flow?

Profit is the surplus after total costs from being compensated from added revenue.

Cash flow = cash in less cash out (profit)

David Biggs Enterprises Ltd records the following transactions over the month of June:

Amount paid to customers	\$40 000	(Sales £400 000) less one month's credit
Cost of goods sold	\$21 000	(Paid for in cash)

- What was the gross profit in June?
Sales revenue - cost of goods sold = \$19 000
- Assuming the business reported the monthly profit as cash, how much cash did it have at the end of June? Ignore any other transactions.
Total cash flow = cash inflow - cash outflow
 $\$19 000$ cash inflow - $\$11 000$ = $\$8 000$.

There is a clear difference between the profit made by David Biggs Enterprises Ltd and the cash flow over the same period.

Q: Why is the cash figure lower than the gross profit?

A: Because, although all goods have been sold, cash payment has been received for only half of them. The customers buying the goods on credit will pay cash in four months.

This important example leads to further questions:

- Can profitable businesses run out of cash? Yes – and this is a major reason for insolvency failing. It is called **insolvency**.
- How is this possible? In a number of ways:
 - allowing customers to take a credit period, perhaps to encourage sales
 - purchasing too many fixed assets at once
 - expanding too quickly and keeping a high inventory level. This means that cash is used to pay the higher inventory levels. This is often called **overtrading**.

Cash-flow example

A business records the following transactions per year month:

Sales of goods	\$100,000 100% for cash, 80% on one-month credit.
Materials purchased and used	\$12,000 (all used) in cash during the month

Amounts not shown in parentheses.

Activity 12.2

- ① Expenses that give profit provide for the business in this month.
- ② Expenses that cost cash by this business in the cost of its goods because they have no cash at the start of the month.
- ③ Explain why the answers to ① and ② are different.

Revision summary: cash flow**Cash flow forecasts**

We have seen how important cash is to businesses. Without sufficient cash to pay bills and repay loans, a business may be forced to stop trading by its creditors and banks. It is therefore very important indeed for the manager of a business to know what cash will be available month by month. A **cash flow forecast** can be used to tell the manager:

- how much cash is available for paying bills, repaying loans or for buying fixed assets
- how much cash the bank might need to lend to the business in order to avoid 'insolvency'
- whether the business is holding too much cash which could be put to a more profitable use

Managers use cash flow forecasts to help them find out the future cash position of their business.

Uses of cash flow forecasts

Cash flow forecasts are useful to the following situations:

Business tip

Business tip
Forecast to go
estimate all future
cash inflows and
outflows of a
business capacity
as a monthly
income basis. This
then allows the
adjusted cash
balance at the end
of each month.

- setting up a business
- running an existing business
- keeping the bank manager informed
- managing cash flows

Differentiated by Market	
Operating cash flow from a business	
is the amount of cash held by the business at the start of the month.	
Net cash flows in the difference between receipts (inflows) and outflows.	
Working cash balance is the balance at the end of each month. This balance can be used to forecast operating cash flows.	

Cash flow statement

Cash flow forecast – Blue Wave Electronics Ltd – ending 31 August 2019 (£). Figures in brackets are negative.

	Balancing	Previous	Month
Cash inflows (B)	£1 000	£0 000	£0 000
Cash outflows (B)	£1 000	£0 000	£0 000
Opening bank balance (B)	£1 000	£1 000	£0 000
NET CASH FLOW (£) — A — B	£000	(£1 000)	£0 000
CLOSING BANK BALANCE (C = B)	£1 000	£000	£000

Spending the following month:

- a positive **net cash flow** will increase the opening bank balance
- a negative net cash flow has to be covered with reduced bank balance
- cash **outflow** should **balance** the **opening bank balance** for the next month
- no bank account will become overdrawn in February

Setting up a business

When planning to start a business, the owner will need to know how much cash will be needed in the first few months of operation. This is a very expensive time for new businesses as premises have to be purchased or rented, machinery must be purchased or hired, inventory must be built up and advertising and promotion costs will be necessary to make consumers aware of the product or service. Many new businesses fail because owners do not realize how much cash is needed in the first crucial months. A cash flow forecast should help to avoid these problems.

Keeping the bank manager informed

Banks provide loans to businesses. However, before bank managers will lend any money, they would like to see the firm's cash flow forecast. This is particularly vital if a new business, for example, is starting now. The bank manager will need to see how big a loan or overdraft is needed, when it is needed, how long the business is expected to last and when it might be repaid.

It is very rare for a bank to lend to a business unless a cash flow forecast is produced which shows their future.

Managing an existing business

In some firms earlier examples, it is not just newly started businesses which need to forecast cash flows. Any business can run out of cash and require an overdraft, perhaps because of an unexpected fixed asset being bought or a fall in sales. Monitoring cash flows is important so that the losses rates of interest can be arranged. Telling the bank earlier that a loan is needed, however, could lead to the bank either refusing the loan – because of poor business planning – or charging high

Test for success
There will be
slight variations
in the way
businesses buy and
sell cash flow.
However, the
examples used
in this chapter
will be the same
as every other
UK company in
manufacturing.

case of course. The bank will know that the business has little alternative but to pay these winter rates. If the business recoups the overhead losses from the bank without utilising the bank manager line, the bank could argue that the overdraft is repaid immediately and this could force the business to close.

Managing cash flow

This month's cash held in the bank account of a business known that this capital could be better used to reflect profit of the business. It is worth noting that the business is likely to have a very high bank balance; the accountant could decide to pay off loans to help to reduce another charges. Another option would be to pay creditors quickly to take advantage of payable discounts. These are examples of methods managing the cash flow of a business.

Activity 4.3: Using a cash flow forecast

Cash Flow Forecast for Derry Promotions (Co. January to April 2014 ££: Figures in thousands, all negative)

	January	February	March	April
Cash inflows:				
Cash sales	11 000	11 000	16 000	21 000
Payments from customers	3 000	3 000	7 000	8 000
Total cash inflows	14 000	14 000	23 000	29 000
Cash outflows:				
Manufacturing costs	9 000	9 000	13 000	10 000
Rent and other expenses	11 000	11 000	(15 000)	13 000
Total cash outflows	19 000	19 000	28 000	23 000
Starting bank balance	3 000	3 000	7 000	8 000
Net cash flow	2 000	-4 000	-5 000	11 000
Ending bank balance	5 000	-1 000	2 000	15 000

- ① Calculate values for 1, 2 and 3.
- ② Budgeted cash receipts after 'Manufacturing costs' are forecast to be as much higher in March and April than in the previous months.
- ③ In April, cash sales are more expected to be 10 per cent higher than March. Material and wages are expected to be 10 per cent higher than February. Amend the cash flow forecast for April and calculate the new closing cash balance.

Case study: Derry Promotions

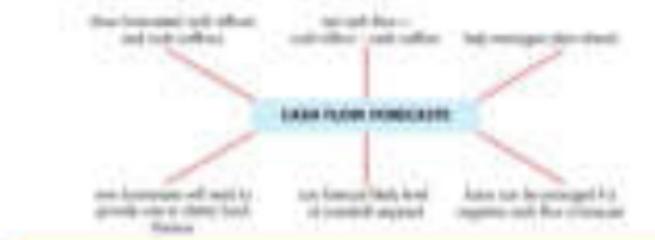
The manager of Derry Promotions Ltd wants to plan the cash flows of the business over the next four months. She asks for your help in making a cash flow forecast. She provides you with the following information:

- ④ Estimated sales are: January £22 000; February £21 000; March £24 000; April £22 000.
- ⑤ Manufacturing labour costs:
- ⑥ Materials are purchased each month and paid for in cash. This represents used materials are 10 per cent of sales receipts for that month.
- ⑦ Other cash expenses (salaries, rent, insurance, etc.) are forecast to be: January £4 000; February £3 500; March £3 000; April £3 500.
- ⑧ The starting cash balance is estimated at £5 000.

Activity 10.4 Creating a cash flow forecast

Read the case study on page 277.

- Return to the manager. (a) Explain what a cash flow forecast is.
 (b) Using the same structure as in that assessment answer, draw up a cash flow forecast for this business over the four months from January to April.
- What do you notice about the closing bank balance in April? What action could the manager of Super Works take now that she is aware of this problem?

Revision summary: cash flow forecasts**How can cash flow problems be overcome?**

There are several ways in which a short-term cash flow problem could be overcome. These are explained below – and the limitations of each method are outlined too.

Method of overcoming cash-flow problems	How it works	Limitations
Increasing bank loans	Bank issues additional cash into the business.	Increased overdraft fees; the self-service option.
Buying equipment on hire-purchase	Cash outflow will decrease in the short term.	Supplier credit influence supplier; higher costs; offer lower discounts for early payments.
Reducing overheads by way of temporary workers – or reducing my staff (cash buffer)	Cash outflow will increase in the short term.	Customers may take longer to pay; be smaller business than cash offers short-term financing – e.g. 4 weeks (variable).
Delaying or cancel purchases of capital equipment	Cash outflow for purchase of equipment will decrease.	The long-term efficiency of the business; costs increase without capital investment.

In the longer term, a business with cash flow difficulties will have to take other decisions to solve the problem. These could include:

- Advertising cuts temporary, for example by selling more temporary staff - how will this affect competitiveness of the business?
- Cutting costs and increasing efficiency - how will this be popular with employees and could product quality be affected?
- Developing new products that will attract new customers ... this could take a long time and could risk in the short term to pay the development.

Cash flow example – Management House

Manorial Business set up 20 business in a particular town over 10 days. It called its business 'Management houses'. Manorial designs and builds after the purchase of family offices and large private houses. The business it runs these in the letting, refurbishment and extension of lets out very short term contracts. Most employees are full-time employees. These employees have been with Manorial for the last four years. Management partners are not pleased with its financial performance. It has a small amount of local authority guarantees although these upgrade for more. Management houses charges about £5 per week of the property that it is capable to renovate. The cost of the business comes from profit of the price paid less expenses about every month.

Look at this cash flow forecast for the next financial year. There is a cash flow problem. You have been asked by Manorial to consider this problem and make recommendations as to what they can do to solve it.

Cash Flow Forecast for Management's houses (2010/11). All figures in thousands are rounded

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
Year 13													
Capital injections													
Equipment	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Land purchases													
Plant	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Working capital	10,000	0	0	0	0	0	0	0	0	0	0	0	0
Buildings	0	10,000	0	0	0	0	0	0	0	0	0	0	0
Marketing & advertising	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Staffing	0	0	0	0	0	0	0	0	0	0	0	0	0
Marketing & advertising	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Office equipment	0	0	0	0	0	0	0	0	0	0	0	0	0
Business service costs	100	100	100	100	100	100	100	100	100	100	100	100	100
Overheads	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Operating costs	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Marketing	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Working Capital	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Total Cash Flow	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000

Activity 12.3

- Why is cash-flow forecasting important to managers such as Maxwell?
- Why does apart from Maxwell, it's likely to be important to a cash-flow forecast for someone's personal financial health?
- Why do some firms stop this same cash control? (For example, to expand your services. Why do some firms very cash-control? One reason is to protect your services.)
- Maxwell has been informed that his supplier of credit and loans will increase its fee - 10 per cent in July 2010. Explain how this will affect him because the (Government) rules will be affected.
- Maxwell wants to improve the cash flow of his business. Suggest three ways to Maxwell of improving the cash flow of his business. Explain their advantages and disadvantages. Recommended answer may be required.

The importance of working capital

Definitions and terms:

Working capital is the capital available by a business in the short term to pay for day-to-day expenses

The term **working capital** refers to the amount of capital which is readily available in a business. That is, working capital is the difference between resources in cash or readily convertible form and total the short-term debts of the business. After reading Chapter 10, you will understand that:

Working capital = current assets - current liabilities

Working capital is the lifeblood of a business. Having enough working capital saves in taking the credit repayment of a business.

The business can more effectively withdraw a sufficient quantity of working capital. It is crucial to retain the right level of working capital.

A business enterprise with ample working capital is always in a position to take advantage of new favourable opportunities either to buy raw materials being offered at a discount or to implement a customer's special order.

Working capital may be held in different forms:

- Cash is needed to pay day-to-day costs and free inventories.
- The value of a firm's debtors is related to the volume of production and sales. To achieve higher sales there may be a need to offer additional credits facilities.
- The value of inventories is also a significant part of working capital. Not having enough inventories may cause production to stop. On the other hand, a very high inventory level may result in high opportunity costs.

The overall success of a business depends upon its working capital position. So, it should be handled properly because it affects the efficiency and financial strength of company.

International Business in Focus: Building A/B cash flow issues in different ways

Not all businesses in different industries have experienced problems with cash flow problems—in different ways. Kodak—formerly the world's largest supplier of cameras film—has since 2003 lost its dominance by 47.5% as demand for its traditional film collapsed as a result of the "digital revolution". It also incurred a \$800 million loss trading from 2003 to 2006 in its core business of digital prints.

Kim Group is a major construction company based in Thailand. The cost of the property sector after the financial crisis of 2008/2009 meant that construction companies had less work and were having to wait for payment from customers for longer. This started to damage its operations by increasing credit risk. The business has over 40 different capacities for a typical large building project. Kim Group has very low inventories and demands that all of its suppliers deliver goods and equipment on time. This was not possible at very short lead times. This means that variable costs are held up in inventories that will not be used for weeks.

**Discussion points**

- Explain why the following factors impact on cash flow:
 1. International change for Kodak
 2. Building of the company focus for Kim Group
- Explain the different ways these businesses tried to control a positive cash flow position.

Examiner-style questions - Paper 1

- 1** Bruno manages a hotel. About half the hotel bedrooms are occupied during the major tourist season, when hotel fix costs remain constant. The hotel's trade cash inflows are the same each month but food costs and some employee costs increase when there are more tourists. Bruno plans to base the hotel's cash forecast that he does not know whether the cost of this will mean the hotel receives its monthly rent. The hotel's bank account is overdrawn for several months at each year.
- (a) What is meant by "trade cashflows"? [1]
 (b) Identify three likely cash outflows for Bruno's hotel. [3]
 (c) Identify and explain two effects on Bruno's hotel if he often finds guests outside of one tourist following a stay in the hotel. [4]
 (d) Identify and explain three likely benefits to Bruno of preparing a cash flow forecast. [3]
 (e) Explain the advantages and disadvantages of any three ways in which Bruno could improve the cash flow position of his hotel, which may include you advise him to cash? [6]
- 2** Alibay Manufacturing produces wheels for cars. It holds high inventory levels of fast-moving parts from major car manufacturers can be sold quickly. The company's big car manufacturers demand long credit periods from their suppliers of three months. Bruno has prepared the following cash flow forecast for the next three months:

Month	July	August	September
Cash inflows			
Cash from customer payments	100	111	100
Sale of old equipment	0	0	100
Total cash in	100	111	100
Cash outflows			
Manufacturing purchased	100	111	100
Employee costs	100	100	100
Bank overdraft	0	100	0
Other costs	100	100	100
Total cash out	300	300	300
Demanding bank balance	200	(200)	100
New bank debt	0	(100)	0
Closing bank balance	0	100	0

- (a) What is meant by "net cash flow"? [1]
 (b) Identify three reasons why Alibay Manufacturing needs large amounts of cash in working capital. [3]
 (c) Calculate the values for x and y in the cash flow forecast. Show your working. [4]

- 6 Amend the cash-flow forecast for July assuming cash from stations and credit sales are going to be 10 per cent higher than originally forecast. Show your working.

[1]

- 7 Using the cash-flow forecast above, advise Hibbs Manufacturing on the best ways for the business to reduce its bank overdraft (negative cash balance). Justify your advice.

[1]

Revision checklist

In this chapter you have learned:

- the importance of cash to a business
- what is meant by cash flow, cash inflow and cash outflow
- the difference between the profits made by a business and its cash-flow position
- what the cash-flow cycle is and how it affects a business's cash-flow position
- understanding and creating a cash-flow forecast
- what working capital means and why it is important to a business

ANSWER - see your understanding with the review questions on the CD-ROM.

Income statements

This chapter will explain:

- why businesses need to keep accounting records such as income statements
- why profits are not the same as cash
- why profits are important
- the differences between gross, net and retained profit
- what the income statement contains

What are accounts and why are they necessary?

Objectives 14

Mark

Businesses are the financial records of a firm's transactions.

Accounts are the professionally qualified people who keep responsibility for keeping financial accounts and for producing the final **statements**.

Final statements are compiled at the end of the financial year and give details of the profits or losses made over the year and the worth of the business.

Clear visibility

Shaped Model has been in business for 10 months. He is a leather-making businessman and estimates he is a profit trader.

Imagine what would happen if the following happened. A written record of all business transactions can be communicated and used:

- He could sell goods on credit to customers without keeping a record of the sale. So a result, he might forget that customers still owe him money.
- He might order too many raw materials because no record was kept of previous orders.
- He might pay off the business costs, the telephone answering, raw materials and wages on the same day and then find out that there was no money in the bank.
- His profits or losses of this business could not be calculated.
- The government has collected money and the able to deduct from profit the business may could be charged if this fee is not paid.

Written written financial accounts, for business could assist in many trades.

The financial records of a business are called its **accounts**. They should be kept up to date and very great accuracy – this is the responsibility of the **accountant** working in the Finance department.

At the end of each financial year, the accountant will produce the **final accounts** of the business. These will reveal the main financial results over the year and the current worth or value of the business.

Listed companies are required by law to publish their final accounts and these are much more detailed than those required from non-listed businesses, such as sole traders and partnerships.

Recording accounting transactions

In most businesses, there are so many transactions each year that it would be very time-consuming to record them all by hand in accounting books. This is one reason why organisations now use computers. Computerized books record all the sales, purchases and other financial transactions made by a firm and the information can be extracted or printed out when required.

How a profit is made

Profit is an objective for most businesses. In simple terms, profit is calculated by:

$$\text{Profit} = \text{sales revenue} - \text{cost of making products}$$

This simple formula involves the idea that profit is a 'margin' that remains after business costs have been deducted. If these costs exceed the sales revenue, then the business has made a loss. The profit formula also suggests that this margin can be increased by:

- 1 increasing sales revenue by more than costs
- 2 reducing cost of making products
- 3 a combination of 1 and 2.

Why is profit important?

Profit is important to private sector businesses for several reasons:

Why profit is important	Explanation
Business for enterprise	Successful entrepreneurs need money (equity, supplies and equipment) and profit gives them a reason for doing business.
Business for risk-taking	Entrepreneurs and other investors take considerable risks when they provide capital to a business – profits reward them for taking those risks by offering returns if the results are successful or compensation if the venture fails.
Business of resources	These providers provide resources to business owners for free to help their business make money (products), so owners invest their capital into profitable businesses.
Business of success	Businesses that are successful can profit from their success. Other businesses can use entrepreneurs' and others' capital that investment into producing profitable products or services should be profitable. If all outcomes in an industry are unprofitable, this could try to be a profit target to set up in that industry.

In profit-making or asset-owned businesses, profit might also be important. The shareholders might set profit as one of the targets to be achieved for their business. These managers could also be used as a source of finance to develop the same owned business to make it more effective.

In social enterprises (see Chapter 4), profit also has an important role to play. Social enterprises cannot usually survive unless they make a surplus from their operations fast growth to run their units effectively. The managers of social enterprises will want to balance profits making with other goals such as protecting the environment and benefiting disadvantaged groups in society.

Difference between profit and cash

Do you recall from Chapter 12 that profit and cash are not necessarily the same?

See page 278.

Q: Why is it important to remember this difference when looking at a business's final accounts?



At least because a business records a profit when the revenue it has planned out is less than its costs. In fact, it could have no sales at all.

Arrange the following extract in columns, due you understand the important points.

Activity 12.1

Copy and complete the following table.

Business transaction	Pre-fit total	Impact on total
ad sells 1000 items for cash \$12. Each item cost the business \$11 so there has not yet paid its supplier.	\$10000 (\$4000 less than \$17,600)	
ad sells 21 000 items for profit \$1.50. Prod. cost is equivalent \$1 per item.		Additional \$315 000 added to credit balance spent with the supplier.
ad sells 1000 items for cash \$11. Inventory paid in cash \$11 per item.	\$11 000	

What's different about... profits

Ad's profit statement is a business tool. It shows the income of a business and all costs incurred to earn that income over a period of time. This helps managers decide if a profit over 100 percent.

A **gross profit** is made when sales revenue is greater than the cost of goods sold.

The **sales revenue** is the amount of a business during a period of time from the sale of goods or services. The **cost of goods sold** is the cost of producing or buying in the goods actually sold by the business during a time period.

Understanding income statements

Income statements (also known as profits and loss accounts) are longer than business accounts. They include no managers, business owners and other account totals, whether the business has made a profit or loss over a period of time. This can period is usually one year but income statements could be summarised monthly too. If the business is making a profit, managers will want to ask themselves:

- Is it higher or lower than last year?
 - Likewise, why is profit falling?
 - Is it higher or lower than other similar businesses?
 - Likewise, what just we do to become as profitable as other businesses?
- If the business is making a loss, managers will want to ask themselves:
- Is this a short- or long-term problem?
 - Are other similar businesses also making losses?
 - What decisions can be taken to turn losses into profits?

You can begin to realise why income statements are so important.

Gross profit

What information do income statements contain? Before we can answer this, we need to consider an important concept known as **gross profit** – which is profit calculated before fixed costs are considered. Here is an example:

If a business bought \$120 000 worth of goods during the year and sold them for \$180 000, the gross profit would be \$60 000.

$$\text{Gross profit} = \text{sales revenue} - \text{cost of goods sold}$$

It is important to note the following:

- Gross profit does not make any allowance for overhead costs or expenses.
- Cost of goods sold is not necessarily the same as the total value of goods bought by the business.

How is this information presented on an income statement?

The following table shows a simple example with some terms we explain each term. It is for a limited company, so there are the only business that has to publish their accounts.

Income statement for 2018 ended		The accounting year should be shown here
For the year ending 31 December	\$100	The time period covered by the income statement must be shown
Sales revenue	800	This is the value of goods sold during the year. For example \$800-\$100 leaves \$700 profit each
Cost of goods sold	500	This is the variable cost (variable and labour) for producing all finished goods sold. For example \$500-\$100 leaves profit of \$400
Gross profit	300	This is the profit made = \$800-\$500 = \$300 profit

Business for Review

- A business's gross profit is the profit of a business it generates.

This section of the income statement is often referred to as the **Trading account**. It shows the gross profit made from the normal trading activities of the business. Why do you think it is not a complete income statement? There are several important issues arising from this example:

- value costs of running the business apart from the variable labour and material costs, for example fixed costs
- value on profit paid by the company
- percentage of a share of the profits to managers/shareholders

Case Study Questions

The City-Cafe Co. buys cars on credit from a supplier for \$1 each. It sells them for \$2 each. They cycle 1000 cars per year with 500 cars in stock (opening inventory). It bought 1000 cars. At the end of the year 1000 cars were left (closing inventory).

How many cars did the business sell during the year?

What was the cost to the business of the goods sold?

What was the gross profit?

The answers to these questions are as follows:

total bought = the opening inventory + the new bought during the year:
 $1000 + 1000 = 2000 \text{ cars}$.

The business sold 1000 cars during the year. We know that it did not sell the majority itself because there were closing inventories of 500. Therefore, the business had sold 1500 cars.

Goods sold = opening inventory + purchases - closing inventory.

So the goods sold = all bought by the business for \$1 each. The cost of goods sold was \$1,500.

Remember:

Gross profit = sales revenue - cost of goods sold

In this example, sales revenue = \$2 x 1000 cars sold = \$2000

Gross profit = \$2000 - \$1500 = \$500

Tips for success

- You should be able to make suggestions on how a business might increase its gross profit.

Activity 13.3

Copy and complete the following table and figure in 3.

Sales revenue	Cost of goods sold	Gross profit
\$8 000	7000	
\$8 5000	7000	
\$8 5000		\$1 500
\$8	7000	\$1 000

Activity 13.4

Copy and complete this table.

Cost per unit	Beginning inventory	Purchases of goods	Ending inventory	Total cost of goods sold
\$1 21	1000	10000	100	98000
\$1 22	1000	10000	100	98000
\$1 23	100	1000	100	98000
\$1 24	1000	10000	100	98000

Case study scenario

This is an example of a general trading account section of an income statement:

Add (or) less year ending 31 December

Sales revenue	\$100 000
Gross margin	\$10 000
Net profit	\$1 000
Total inventory available	\$11 000
Less closing inventory	\$1 000
Total cost of goods sold	\$10 000
Gross profit	\$1 000

It is important to note that in a manufacturing business, unlike a trading one, the labour costs and production costs directly involved in making the products will also be deducted before arriving at the gross profit total.

The gross profit is then the total profit for the business because all of the indirect expenses have to be deducted. Costs such as salaries, lighting and rates of the buildings need to be deducted from gross profit.

Net profit (also known as 'profit before tax')

Net profit is calculated by deducting all expenses and overheads of the business from gross profit. Unlike gross profit, net profit will also include any non-trading income, such as the gain from an investment above a stage.

Case study example:

Macmillan Furniture Clearance Ltd. Income statement for year ending 31/3/2008/09

Gross profit	\$12000
Manufacturing income:	
Less expenses:	
Interest and salaries	\$12000
Electricity	\$1000
Rent	\$1000
Depreciation	\$1000
Marketing and advertising expenses	\$1000
	\$11000
Net profit	\$1000

Depreciation is the fall in the value of a fixed asset over time. This is included as an annual expense of the business. For example, a new truck bought by a building firm will fall in value with age and use. Each year, this fall in value or depreciation is recorded as an expense on the income statement.

Retained profit

The **retained profit** is the profit left, or unspent, back into the business after all payments have been deducted.

The income statement for listed companies will also contain:

- expenses not paid on the company's net profit
- dividends paid out to shareholders (in some years, dividends might be zero)
- the retained profit left after these two deductions
- cash from the previous year to allow for year comparisons.

Case study: Income statement

Here is a typical income statement for a small business (pvt). It is a simplified financial statement.

Income statement for Blue Skies Engineering pvt Ltd for the year ending 31/3/2013

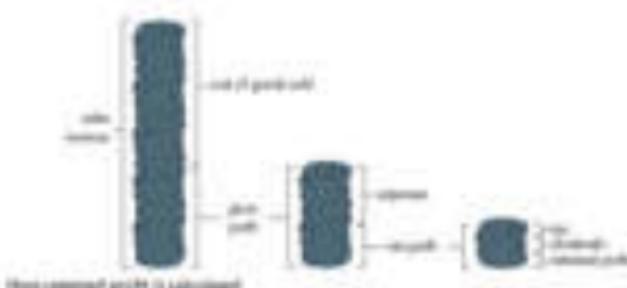
	2012	2013
Sales revenue	50000	55000
Cost of sales	35000	38000
Gross profit	15000	17000
Less depreciation expense	1000	1000
Net profit	14000	16000
Less corporation tax	3500	3500
Profit after tax	10500	12500
Dividend	1000	1200
Retained profit for the year	9500	11300

Activity 11.4: ABC's retained profits

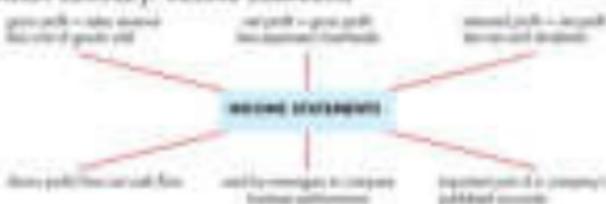
- (a) Using the same columns as the typical income statement shown above, calculate the retained profits of ABC pvt for the year ended 31/3/2013 from the following data (which is also in the correct order).

	2012
Sales revenue	10000
Dividend	1000
Less depreciation	1000
Cost of sales	5500
Gross profit	4500
Less corporation tax	1000
Profit after tax	3500
Dividend	1000

- (b) Explain why retained profits is important to ABC's future success.



Final outcome:
You must understand:
the concept of
differentiation,
revenue, gross
profit, net profit
and retained
profits.

Revision summary: income statements**Using income statements in decision making**

Managers can use the technique of income statement analysis to help them in making decisions based on profit calculations. If a manager has to choose which of two new products to launch, one way of making this calculation is to construct their financial income statements.

Case study example:

Jeff had his doubts on which location would be best for a new shop. He had undertaken market research and took away the costs of these two locations. The information he has collected is shown below:

Presented information for each place	Location A	Location B
Sale revenue	\$85 000	\$85 000
Cost of goods sold	\$55 000	\$54 500
Gross profit	\$30 000	\$30 500
Overhead	\$15 000	\$15 000
Net profit	\$15 000	\$15 500
Other expenses	\$10 000	\$10 000
Net profit	\$5 000	\$5 500

Case study example:

Jeff also considered other factors before making the final decision:

- Demand level at Location B is fixed (no risk involved), but only for the first year of operation.
 - A more promising product is planned to be built just six months away from Location B.
 - A domestic competitor has just opened a shop near Location B.
- Jeff finally selected Location A for the new shop.

Question 11.9

Read the case study above.

Do you think Jeff made the right decision? Justify your answer.

Case: youth entrepreneur – short-term profit statement

As is the case with most business at a point of 'take-ready' food stores, Mr. A is planning to introduce a new type of 'fast food' – a sandwich or a salad. He has high product margins but the customers can only afford his basic meal components and advertising materials because they are short-term.

Mr. A has undertaken some market research and formulated the basic costs for the fast-food products. He has asked you to help him complete the following income statement:

Revenue for one year	Gross margin	Operating margin
Sales revenue	100 000 units @ R 10	R 0 000 units @ R 20
Cost of goods sold	100 000 units @ R 1 each	100 000 units @ R 2 each
Net sales profit		
Administrative costs	R 15 000	R 1 000
Marketing advertising costs	R 10 000	R 1 000
Other expenses	R 11 000	R 1 000
Net profit		

Take-aways

Business managers often have to use calculations to sort out their choices about the efficiency of business operations. This book explores all of the calculations one will need to make – practice and put the concepts into action. Take a calculator with you!

Activity 33.4

Read the case study.

- 1. What are the main financial statements?
- 2. All in the budget for sales revenue and cost of goods sold.
- 3. Calculate the gross profit and net profit of both product options.
- 4. Identify and explain the other factors Mr. A should consider before making this decision.
- 5. Use these details to do the sum again. After each pass, try find a profit level from this generation a result. Answer them all.

Case: real estate in Mauritius – Business review and net profit flow

The successful Japanese hotel group in Mauritius has announced that sales figures and net profit growth had been robust last year. Total sales increased from R1 billion worth (other revenues up 10%) to R1.15 billion (up 5% in 2008). Gross profit went from R100 million (up 6% in 2008) to R120 million. However, this company has increased total revenues in 2009 – with an 8% rise in the opening of the latest Long Beach development. The company also says it expects net profit to increase. However, due to difficult times for the international tourism industry.

The financial crisis and falling tourist confidence in Europe have reduced tourist numbers. International hotel groups are increasingly using differentiated pricing of room types to offset a bigger share of the market for tourists, which is less profitable.

Discussion points

- 1. Why are profits important for a large company such as Sun Resorts?
- 2. Explain why the company's reported revenue is down by 20% but net profit is up.
- 3. Explain how Sun Resorts could try to increase its profits by future.

Exam-style questions - Paper 1

- 1 Brian is a franchisee. His sales revenue was £12 per unit higher this year than last year. He earned a total revenue of £300 000 last year. He charged an average of £3 for each customer last year and has not increased prices. His costs in materials such as ingredients and equipment have increased by an average of £1.20 for each customer. He estimates that his overhead expenses are £10 000 this year.
- What is meant by 'sales revenue'? [1]
 - Calculate Brian's sales revenue this year, three price marking. [1]
 - Identify two costs likely to be included in Brian's annual overhead expenses. [1]
 - Calculate Brian's net profit after overhauling your result from b. Show your working. [1]
 - Brian thinks that his net profit next year will be higher if he increases average prices to £6 per customer. Do you agree? Justify your answer. [3]
- 2 Sue develops new computer games. She has developed two new games but she only has the capital to launch one of these. Game A is aimed at young children – around 6–12 years old. Game B is targeted at teenagers – around 13–18 years old. She has calculated the following financial information:

Promised by next year	Game A	Game B
costs incurred	£100 000 + £11 000	£100 000 + £11 000
Cost of sales	£1.20 per unit	£1 per unit
Profits	£1000	£1000

- What is meant by 'cost of sales'? [1]
- Identify two reasons why retained profit of a company is not the same as its net profit. [1]
- Identify and explain two ways in which Sue could try to increase sales revenue for any one of her existing games. [1]
- Identify and explain two other pieces of information that Sue would find useful before making a choice between game A and Game B. [1]
- Advise Sue which game she should launch. Use calculations to support your answer. [6]

Revision checklist

In this chapter you have learned:

- what is relevant accounting information and why it is important
- why profit is important to businesses and investors – and if it is not the same as cost
- to explain the differences between four concepts of gross profit, net profit and retained profit
- what the main features of income statements are and how these statements can be useful to managers when taking decisions



This chapter will explain

- the basic structure of a balance sheet
- the main classifications of assets and liabilities
- how to use examples to illustrate these classifications
- how to interpret simple balance sheets and make decisions from them

Balance sheets**What business are we?**

The business assets
These are values of a business's assets at a particular time. Businesses referred to as 'businesses of thousands of thousands' because they are those items of value which are needed by the business. They may be fixed (machinery) or short-term current assets.

Liabilities are debts owed by the business

In the previous chapter, we learned how a manager can calculate whether the business is making a profit or a loss. This is clearly of great importance. However, for itself, the income statement does not tell us how much the business is worth. Business owners would be very interested to know how much their business is worth. This information, together with other details, is given on the **balance sheet**.

The balance sheet is very different from the income statement. The income statement records the income and expenses of a business, and the profit or loss it makes, over a period of time – usually one year. The balance sheet records the value of each of a business's asset categories in total – at the end of the financial year.

A potential balance sheet example will help to introduce the basic concept of the account.

Case study scenario – a potential balance sheet

Business owner for local hair salon. A government business adviser asked her 'How much money can you save from this business?' and suggested that, as a result, he did not make losses.'

'The adviser advised me to add an supplementary column of everything he needed including any bank accounts – as well as any debts or investments he had.'

Together, these made three test P&Ls:

All items owned by business	All debts owing to business
House \$100 000	Loans on house (mortgage) \$100 000
Car \$10 000	Bank loan for car \$10 000
Inventory \$1000	Trade creditor \$1000
Total assets \$101 100	Total debts \$101 100
Total \$101 100	

The adviser told Sandra: 'The total value of what you own is \$101 100 more than the value of what you owe. This difference is called "equity" and means that you could theoretically liquidate the assets of your hair salon after paying back business debts, leaving, in a nutshell, a sum free.'

Business balance sheets follow exactly the same principle. They list and give a value to all of the **assets** and **liabilities** of the business. It is important to understand these terms before the layout of the balance sheet is explained.

- Assets are those items of value which are owned by the business.

Land, buildings, equipment and vehicles are examples of non-current or fixed assets. They are likely to be kept by the business for more than one year. Non-fixed assets, apart from land, depreciate over time so the value of these will fall on the balance sheet over one year or the term. Intangible assets are those that do not have physical form but have a value – such as brand names, patents and copyrights.

Tip for success

You should label assets (fixed or easily moveable) as 'Assets owned by the business' & the liabilities as 'The costs of producing, or selling, the goods or services of a firm' (or something similar) as these two production expenses? In this case, shop fittings and delivery vehicles are both clearly fixed by name (part 2).

Bank, overdraft (money) and accounts receivable (debtors欠款) who owe money to the business) are only held for short periods of time and are called current assets.

- Liabilities are debts owed by the business. Again, there are two main types of these. Non-current liabilities (or long-term liabilities) are long-term (longer than 12 months) borrowings which do not have to be repaid within one year. Current liabilities are amounts owed by the business which must be repaid within one year, for example, bank overdraft and accounts payable (suppliers creditors) - owed money by the business.

What is the importance of these ratios? Banks again is the case study above giving details of 'business's most important financial ratios'. The value of his assets is greater than the value of his debts or liabilities, as he owns wealth. In the case of C's Business, the wealth belongs to the owners; as the case of companies, it belongs to the shareholders. This is why the balance sheet is an indicator to the owner of that company (the owners of the business). It shows how much wealth or equity the owners have invested in the business. They would obviously like to see this increase year by year.

Total assets = total liabilities + owners' equity (shareholders' funds) in a limited company)

Case study exercise – company balance sheet

This is a typical business sheet for Ltd. McDonald Ltd. The previous one is Figure 1 has already shown its values for every transaction. The terms that have not yet been explained are listed and its meanings below:

Re: Overheads costs incurred during the period

ASSETS	2014	2013
Non-current (fixed) assets		
Land and buildings	100	80
Equipment	100	90
	200	170
Current assets		
Inventories (stocks)	50	50
Accounts receivable (debtors)	50	50
Cash	50	50
	150	150
TOTAL ASSETS	350	370
LIABILITIES		
Current liabilities		
Accrued payable (creditors)	50	50
Bank overdraft	50	50
Cash	50	50
	150	150
TOTAL ASSETS = TOTAL LIABILITIES	350	370
Shareholders' equity		
Share capital	200	200
Profit and loss (Retained Profits)	200	200
TOTAL SHAREHOLDERS' EQUITY	400	400

Tip for success

Share is money
Bank overdraft
accounting term
used for trading
balance sheet
Name source of
money are given
in bracketed.
Companies can
be incorporated
internationally
international
accounting
can used in this
category – local may
give unfair service
try your best to understand

Non-current assets

Non-current assets
are items owned
by the business.
Non-current assets
include:

Current assets
are owned by a
business and used
within one year.

Revenues
Revenues are long-
term assets owned
by the business.

Current liabilities
are short-term
debts owned by the
business.

Explanation of balance sheet terms

- Non-current and current assets, revenues and non-current liabilities – see pages 290–4
- Total assets less total liabilities is always equal to total shareholders' funds or equity – otherwise the balance sheet would not balance!
- 'Shareholders' equity' (or shareholders' funds) is the total sum of money invested into the business by the owners of the company – the shareholders. This money is invested in two ways:
 - Share capital is the money put into the business when the shareholders bought shares.
 - Reserve capital for a number of reasons. Profits and loss reserves are retained profits from previous years. This profit is owned by the shareholders but has not been paid out yet either in the form of dividends. It is kept in the business as part of the shareholders' funds.

Activity 24.2: Interpreting balance sheets

A Managing Director of a company is trying to write out the balance sheet for the business. The following memo has been issued. You have been asked to help the Managing Director by putting these all under their correct heading. Copy out this table and put the content into the correct place.

	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Share capital	Reserves
Inventory						
Creditors to the business						
Bank overdraft						
Customer deposits						
Plant and equipment						
Buildings						
Less accumulated depreciation						
Less residual value						
Less insurance						
Less transport						
Less staff costs						
Less other expenses						
Less interest						
Less tax						
Less other						

Interpreting balance sheet data

- Stakeholders can see if 'their' stake in the business has increased or fallen in value over the last 12 months by looking at the 'total equity' figure in the statement.
- Stakeholders can also analyse how expansion by the business has been paid for - by increasing net-current liabilities (such as long-term leases, from retained profits or by increasing more capital (equity) of shares). If investments in assets have been paid off by providing capital, the business expansion shown will be clear by this figure appearing on the balance sheet.
- Working capital can be calculated from balance sheet data. This is a very important measure (see also Chapter 21). It is often known as net current assets. It is calculated by the formula:

$$\text{Working capital} = \text{current assets} - \text{current liabilities}$$

- The business can survive without working capital. It is cash or goods there are debts. If these debts cannot be paid because the business does not have enough working capital, the creditors could force the business to stop trading.
- Capital employed can also be calculated by using data from the balance sheet. The following formula is used:

$$\text{Capital employed} = \text{shareholders' funds} + \text{non-current liabilities}$$

This is the total long-term and permanent capital of the business which has been used to pay for the assets of the business.

- Balance sheet data can often be used to calculate ratios which can aid in assessing business performance - see Chapter 26.

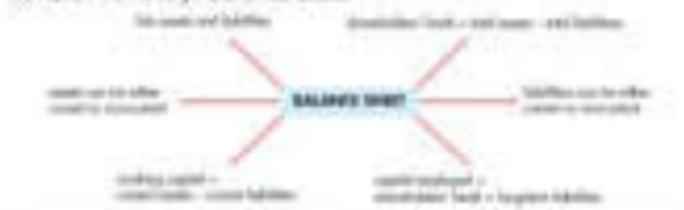
Case study example - reading balance sheets

Refer to the balance sheet for Ace Machines Ltd on page 100.

Ace Machines Ltd manufactures washing machines and vacuum-cleaners. Over the period shown by the balance sheet, the business invested heavily in fixed IT-based equipment for its production line. The increased capacity of this business has been reflected in recent years. Some acquisitions were made during the company's 2012/13 financial year and the following questions were raised:

- The business increased the value of fixed assets (net) from £1.0 million to £1.5 million. What happened to the value of these assets?
- The business increased its bank loans with local banks and retained profits within the business.
- The value of inventories increased by over 40% this year. At what speed?
- Profits rose by 10% resulting from cost savings, sales and a higher level of output in manufacture. These increases have to be £1.0 million (costs + sales) there is an opportunity cost to this. The money tied up in inventories could have been used to offset some of the business

Revision summary: balance sheet



Tip for success

A balance sheet is useful to many stakeholders because it lets them analyse the performance and financial strength of a business. This can also be compared with historical data from previous years or other businesses. See Chapter 23 for more detail of how business performance can be analysed.

Activity 14.2: Using balance sheet data

Please look at Macmillan Books' balance sheet page 299.

- Calculate the increase in investing capital between the two years shown.
- Comments on prior results.
- Which source of finance contributed more capital during 2013? Why? What was the reason for this?
- On what basis might this business should revalue the value of its inventories? Explain your proposal.
- On what basis the shareholders of Macmillan Ltd should be pleased with the balance sheet data? Explain your answer.

Activity 14.3: Comparing balance sheet data

Rs 250,000 and Rs 26,500 are two businesses that manufacture gifts bought by tourists – such as souvenirs and wooden carvings. The following table contains a summary of the two companies' balance sheets for the year ending 31/12/2013.

	Rs. Cr. 250,000	Rs. Cr. 26,500
Non-current assets:	50	120
Current assets:		
Stock	70	20
Accrued receivables	8	10
Cash	12	5
Total assets	130	135
Current liabilities:	10	15
Non-current liabilities	20	20
Total liabilities	30	45
Total assets - Liabilities	100	90
Non-current equity:		
Shareholders' funds		
Share capital	50	10
Reserve profit	10	5
Total shareholders' equity	60	15

- Explain the values for 2013-2012.
- Identify two types of investment made that these businesses are likely to make.
- Identify three items that are likely to be held as investments by these businesses.
- What competing assets is 2013 a stronger financial position? Give the reasons to support your answer.

International business from Mayday's balance sheet



Mayday Group PLC

10

HOME INVESTMENT GROUP INVESTMENT COMMENT



We drive a business portfolio spanning 12 diverse sectors of enterprise.

**Business
Sectors**
12 sectors
100+ companies



Mayday's diverse international portfolio is diversified by:

Geography: our operations are spread across 12 countries, including Sri Lanka, India, the Maldives, Thailand, Indonesia, the Philippines, the United Kingdom, the United States, Australia, New Zealand, South Africa and the Middle East. Our geographical diversification is reflected in our revenue streams, which are derived from 100+ companies.

Industry:

Mayday's diversified business portfolio spans 12 sectors, including:

Mayday is one of Sri Lanka's largest public limited companies. It is a well diversified business with interests ranging in agriculture, insurance, construction, retailing and aviation. The company has recently completed a contract to install lighting at Pamban Bridge-Cirikii Bima, it has rechristened the Delfin (Confidential) River and completed a project to generate power-electricity from biomass gasification. A summary of the Mayday Group business is shown below:

All Revenues in rupees, 1000.000	Rs. at 31/3/11	Rs. at 31/3/10
Non-current assets	231901	223850
Current assets	231218	271351
Total assets	463119	495201
Non-current liabilities	10288	17158
Current liabilities	204480	213564
Total liabilities	214768	221522
Net results of discontinued basis	24843	32160

Discussion points

- Triggered by non-current (fixed) assets that the financial division of Mayday is highly levered.
- Triggered by the company increasing non-current liabilities through items found in the current assets place.
- Because think what the consequence on Mayday would be passed with the 2011 balance sheet broken down.



Exam-style questions - Paper 5

5. An extract from Acme Builders Ltd's latest balance sheet is shown below. During the period shown the government increased interest rates – the cost of borrowing money. A competitor has offered a bid price. The owners have asked the directors of Acme Builders if they wish to buy the business for £4 million.

Extract from Acme Builders Ltd balance sheet

	As at 31/12/2012 (£m)	As at 31/12/2013 (£m)
Non-current assets	87	98
Current assets	21	25
Non-current liabilities	16	5
Shareholders' funds	87	90

- What is meant by 'non-current assets'? [1]
 - Identify two current assets likely to be held by Acme Builders Ltd. [1]
 - Identify and explain two possible reasons why the company increased its value of total equity (shareholders' funds) during the period shown. [4]
 - Identify and explain three ways in which the increase in non-current liabilities during the period might have been used by the company. [3]
 - Consider how useful the information above would be to the directors of Acme Builders Ltd when they decide whether or not to take over the competing business for £4 million. Justify your answer. [3]
6. An extract from Penning Garage plc's latest balance sheet is shown below. The garage company sells cars and repairs and services. It has many competitors.

Extract from Penning Garage plc balance sheet

All figures in £m	As at 31/12/2012	As at 31/12/2013
Non-current assets	96	96
Current assets	21	25
Non-current liabilities	55	40
Current liabilities	26	25
Shareholders' funds	96	90

- What is meant by 'total equity' (or shareholders' funds)? [1]
- Identify two current liabilities Penning Garage plc is likely to have. [1]
- Identify and explain two possible reasons why the value of current assets fell during the period shown. [4]
- Identify and explain the usefulness of these pieces of information, other than the data above, that a potential shareholder might need to analyse before investing in Penning Garage plc. [3]
- Do you think that the shareholders of Penning Garage plc would be pleased with the information shown above? Justify your answer. [3]

Revision checklist

In this chapter you have learned to:

- understand what is meant by accounting information and why it is particularly important to business managers
- list all of the users of a business's accounts and understand their need for accounting information
- explain the main business accounting records and trial balances
- explain the differences between such concepts as assets and liabilities; current and fixed assets.

SOCRIT : now test your understanding with the revision questions on the ICD-B11M.

This chapter will explain:

- How to interpret financial statements by calculating and comparing ratios.
- Profitability ratios: gross profit margin; net profit margin; return on capital employed.
- The concept of liquidity and liquidity ratios: current ratio and test.
- How accounts are used by which groups and their different needs.
- How assets of accounts can use ratio results to help make decisions.

Analysis of published accounts

The company's published or 'final' accounts contain a great deal of information. These published accounts of listed companies are made available to all those interested in the performance of the business. There are many stakeholders who will analyse company accounts. We must now look at how these accounts can be used and analysed to give the information these groups need.

Q: What is meant by 'analysis of accounts'?

A: It means using the data contained in the accounts to make some useful observations about the performance and financial strength of the business.

Without 'analysis of accounts' it is often impossible to tell whether a business is

- performing better than one than last year
- performing better than other businesses.

Case for analysis

You should be able to answer why you need to analyse certain areas from the accounts of a business to see if they have done well or poorly, and what influences its performance on final strengths of that business.

Answer study questions

Consider these results for two food retailing companies:

	Waitrose plc	Asda plc
Net profit (2010)	£300,000	£100,000

Other information can be derived from these figures:

- Is Waitrose plc more profitable than Asda plc? How may this be put from these figures?
- Is the net profit margin of Waitrose plc ten times more efficient than the management of Asda plc?
- Is Waitrose plc making more profit below cost of 16 weeks than its competition?
- If the profit margins make up each item's profit higher in one company than the other, further answers to these questions cannot be given until other information is considered.

Take for example, the value of **current assets** to start off these businesses:

	Waitrose plc	Asda plc
Current assets (2010)	£100,000	£40,000

Which company makes the best ready money efficiency out of the capital invested? We need to compare net profit margin with capital employed in each company.

Waitrose plc has made £300,000 with fixed asset investment of £400,000 and Waitrose only has made £100,000 profit from an investment of £100,000. So comparing these figures from the accounts, Waitrose plc appears to have achieved a better performance even though its overall level of profits is lower.



It is impossible to tell which of these businesses is more profitable without analysing their accounts.

Definition of assets

- Assets** is anything that is owned or controlled by a business.
- Capital employed** is shareholders' equity plus customer deposits and is the total long-term and permanent capital invested in a business.

This example shows how important it is to use ratios when you look from the outside when trying to judge how a business is performing. Comparing two supermarkets, the accounts in this way is called ratio analysis. This is a very important way of analysing the published accounts.

Ratio analysis of accounts

There are many ratios which can be calculated from a set of accounts. The chapter concentrates on five of the most commonly used. These ratios are used to measure and compare profitability (or performance) and liquidity of a business.

Profitability ratios

Three commonly used profitability ratios are:

- Return on capital employed (ROCE). This is calculated by the formula:

$$\frac{\text{Net profit}}{\text{Capital employed}} \times 100$$

Case study example

ABC Superstore Ltd made a net profit of £1 million in 2013 and its capital employed was £100 million. Its Return on Capital Employed in 2013 was:

$$\begin{aligned} \frac{\text{Net profit}}{\text{Capital employed}} \times 100 \\ = \frac{\text{£1}}{\text{£100}} \times 100 \\ = 1\% \end{aligned}$$

This means that in 2013, the company made a return on the capital employed in the business of 1% (£1 million). The higher this result, the more efficient the managed are in earning profits from capital used in the business. If this percentage increases over years, it means that the managers are getting the business more efficiently – making higher profits from each dollar invested in the business.

This result should never be compared with other years and other companies to see if the managers are running the business more efficiently or not.

3 Gross profit margin.

This is calculated by the formula:

$$\text{Gross profit margin (\%)} = \frac{\text{Gross profit}}{\text{Sales revenue}} \times 100$$

Case study: Analysis

ABC Company Ltd made a gross profit in 2013 of \$600 million. Total sales revenue was \$1 500 million.

$$\begin{aligned}\text{Gross profit margin} &= \frac{600}{1500} \times 100 \\ &= 40\%\end{aligned}$$

You know that for every \$1 worth of goods sold, the company made an average 40.0 cents gross profit. You might think this is better while previous hand book indicated an 18% gross profit margin. Again, this result needs to be compared with other years and other companies.

If this percentage increases next year it would suggest that:

- prices have been increased by more than the cost of goods type rises or falls;
- costs of goods bought in have been reduced. Possibly a new supplier is being used or inventory turns are reduced (lower stock levels).

4 Net profit margin (calculated as profit margin).

This is calculated by the formula:

$$\text{Net profit margin (\%)} = \frac{\text{Net profit}}{\text{Sales revenue}} \times 100$$

Case study: Analysis

ABC Company Ltd made a net profit of \$200m in 2013.

$$\begin{aligned}\text{Net profit margin} &= \frac{200}{1500} \times 100 \\ &= 13.3\%\end{aligned}$$

The company made 13.3 cents net profit on each \$1 worth of sales. You know that the gross profit margin leaves all other expenses including interest have been deducted from gross profit to arrive at net profit before tax. The higher this result, the more successful the management are in making net profit from sales. What would this result be compared with? Again, it should be compared with with other years and other companies.

Profitability ratios - what do they tell us?

Once profitability ratios result is not very useful. What a ratio result is compared with others, there some effective analysis can be done. There are some example values from the same business:

Ratio results	Description	Conclusion
Gross profit margin 2012 = 20% 2011 = 14%	100, means that the gross profit on each £1 of sales has increased.	The business is more successful at converting sales into profits. Since the price of goods has increased less than the cost of the cost of goods sold has fallen. This price has not been reduced at all or cut too severely.
Gross profit margin 2012 = 14% 2011 = 17%	The reverse than the net profit on each £1 of sales has fallen – even though gross profit margin has increased.	The business is less successful at converting sales into profits. The overhead fixed costs of the business must have increased significantly during the year – reducing the company's net profit compared to sales revenue.
Margin on capital employed 2012 = 10% 2011 = 2%	Net profit margin for each £1 invested in the business has risen.	This would be because either (a) assets have been revalued or (b) capital employed has increased. If capital employed has increased, this could mean that the manager of the business made investment, having to make higher profit to achieve

Activity 10.1 ABC Consulting Ltd - profitability

ABC Consulting Ltd - 2012 account statement	£m
Cash reserves	10.00
Gross assets	40.00
Net profit	2.00
Capital employed	30.00

- 1 Using the 2012 accounting information about ABC Consulting Ltd calculate
 - Net profit margin
 - Gross profit margin
 - Net profit margin
- 2 Refer to your results and the case studies on pages 203-4. Do you feel that the company performed better in 2012 or 2011? Give reasons for your answer.

Business in focus:**Wigold**

Wigold makes
flat panels and non-
metallic components
from steel.

The concept of liquidity

This measures a very important finance of a business. Liquidity is the ability of a business to pay back its short-term debts. If a business cannot pay its suppliers the materials that are important to production or if the business cannot repay its overheads when required, it is said to be **illiquid**. The business is then forced to stop trading and sell its assets so that its debts are repaid.

Liquidity ratios

Two commonly used liquidity ratios are:

1 Current ratio:

This is calculated by the formula:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Case study: Wigold

ABC Company Ltd had current assets valued at £125 million in 2013 and current liabilities of £100 million.

$$\text{Current ratio} = \frac{125}{100} = 1.25$$

What result means that the business could only just pay-off all of its short-term debts from liquid assets. This is an unacceptable result for a healthy business; liquidity ratios should be between 1.5 and 2. If the current ratio is less than 1, it would mean that the business could have had cash flow problems. It would not have left its short-term debts from current assets.

More effective analysis of liquidity is provided if we look at how previous years' sales allow us to measure the current ratio. If the current ratio is very high, say over 2.0, it could mean that too much liquidity is tied up in over-invested current assets.

The current ratio is unaffected if it is known that all current assets could be turned into cash quickly. This is most always the case. For example, it might be very difficult to sell an investment in a short period of time. But this reason a decent liquidity ratio is needed.

2 Acid test or liquidity ratio:

This is calculated by the formula:

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{Inventories}}{\text{Current liabilities}}$$

Case study: Wigold

ABC Company Ltd had £30 million of inventories at the end of 2013. Its acid test ratio can now be calculated:

$$\text{Acid test ratio} = \frac{125 - 30}{100} = 1.05$$

A result of 1 means that the company could just pay off its short-term debts from its most liquid assets. This is generally considered to be an acceptable acid test result. This result of 1.05 means that it passed the test. This might be concerning for the management and others may chose to be more sceptical of the liquidity of the business - for example consider the level of inventories by selling some for cash.

Liquidity ratios – what can they tell us?

One liquidity ratio analysis is less more useful. When a ratio trend is compared with others, then more effective analysis can be done. Here are some examples taken from the same financials:

Ratio results	Motivation	Analysis
Current ratio 1.25 – 2013 Current ratio 1.75 – 2012	The current ratio has been declining during 2013.	This could be because the business has bought more assets which require cash, but it may need less of them. It could also be because the business has used cash to pay for fixed assets. The business has low liquidity and needs to increase current assets or reduce current liabilities.
Current ratio 1.75 – 2012 Net fixed ratio 0.5 – 2012	The current ratio is acceptable and about 10% higher than the prior year sales.	The solid turnover suggests low cost base – the business might be at risk of not having the capacity to meet demands from its high sales – cash and accounts receivable difficulties. The poor relationship between the two models is because of a relatively high level of non-current assets.

Take the test now

You should be able to calculate why just one bank's analysis is not enough when analysing the performance of a business.

Activity 15.2 ABC Consulting Ltd – liquidity

ABC Consulting Ltd – 2013 accounts summary	\$m
Current assets	150
Inventory	40
Current liabilities	50

- (a) Using the information above for ABC Consulting Ltd, calculate the following ratios for 2013:

- Current ratio
- Net fixed ratio

- (b) The profit margin (the percentage) of ABC Consulting should be compared with the liquidity of the company's assets and current net fixed assets from all the 2013 results on page 388.

Uses and users of accounts

Who uses the accounts of a business? Which groups would analyse a company's accounts, such as by calculating ratios? As it is only the accounts of public limited companies that have to be published, we shall concentrate on the uses and users of these. The following groups have an interest in a public limited company's accounts and the ratios based on them:

Type of accounts	What they tell the account holder
<p>Messages they will be able to hear from well-respected and frequent accounting informants from one of the other groups:</p>	<p>They will use this account to help them keep control over the performance of each product or division of the business. Managers will be able to identify which parts of the business are performing well or poorly.</p> <p>Well-known staff will help in decision making, for example, in order to assess the business, change prices based on how diverse a product or division that it is not doing well.</p> <p>Managers will evaluate accountancy-related costs. Costs are less costly and it would allow the management to increase their company's profit performance and liquidity. This could help in comparison with:</p> <ul style="list-style-type: none"> ● other costs ● other businesses <p>It is important to compare accountancy data in these ways. This will not be the case in every firm. Consider the example of Standard Building Co., UK (figures are quoted in £'000s): 12% is the cost of a building. The percentage only has meaning if managers looking at profit margins and other companies. For example, here is some additional information:</p> <p>Standard Building Co. (average) no. of staff employed 2012 = 5,000 standard Building Co. 2012 (no. of staff employed 2007/08) = 4,000. Now the percentage of Standard Building can make sense.</p> <p>Competitors, when comparing its performance more effectively than in the previous year, have tried harder to improve because it is clear that performance, your profitability, of one of the competitors should have:</p>
<p>Good news: No other companies are owned by shareholders and they have a legal right to increase the published accounts output.</p>	<p>Good news: – anticipated revenue – want to know, ask the income statement, from day one until last the company made. The probability other results will be compared with turnover. The higher the probability other results are, the more likely unprofitable cash flow is caused by buying more shares in the company. They will have to know this from the balance sheet. If the balance sheet total is the sum of the user-faces it is at the beginning. They will also assess the liquidity of the business – i.e. cash. As well as to consider a company with revenue, cash or liquidity problems.</p>
<p>Caution: Results are often incomplete which have resulted partly to that company without yet disclosing a profit.</p>	<p>The balance sheet will indicate the creditors that total value (£'000s) that the company has to pay back over the cash position of the company.</p> <p>Usually, unless, especially when compared with the previous year, will indicate the ability of the company to service bank debt to creditors on time.</p> <p>If these results suggest the company has a liquidity problem, consider this notice by losses profit on costs.</p>
<p>Sorry: These may have been money to the business not a share in being returned.</p>	<p>They will use P&L account to examine why the business, if the business wants to be at risk of becoming liquid, it is unlikely that a bank will be willing to lend them.</p>
<p>Concerned:</p>	<p>The government and other officials will need to check on whether tax paid by the company, if this company is making a loss, this might be bad news for the government's control of the public economy, especially if it increases their spending, reducing tax base.</p>

continued



Uses of accounts	What they tell the account for
variable cost income statement	Business and trade owners will want to assess whether the future of the business is positive or not. In addition, if managers are aware that they cannot influence price, then a price fall, it would be useful for managers to look outside the income statement the profits of the company are increasing or not.
Other businesses - especially those in the same industry	The managers of other companies may be considering a bid to take over the business or they may just want to compare the performance of the business with that of their own. Other businesses will compare their performance with theirs with reference to same indicators

All of these uses of accounts used to consider does ratio analysis does not provide 'all the answers' as the many questions they have about the performance and financial strength of a business.

Limitations of using accounts and ratio analysis

- Managers will have access to all accounting data – but the external users will only be able to see the published accounts which contain only data required by law.
- Data are based on past accounting data and may not indicate how a business will perform in the future.
- Accounting data over time will be affected by inflation (rising prices), and compartmentalisation prevents them for evaluating.
- Different companies may use slightly different accounting methods, for example in valuing their fixed assets. These different methods could lead to different ratio results, therefore making comparisons difficult.

Revision summary: business accounts



Cash float management – using current banking services

Gloria Hotels is a public limited company that owns three hotels in the capital city. This would indicate to the reader it is a service but there are many competing hotel companies in the capital city. The company account has extracted the following table from their latest published accounts:

Banking浮動金額	£915	£912
Receivable capital amounts	115	118
Gross profit margin	25%	25%
Net profit margin	12%	10%
Current ratio	1.7	1.4
Acid test ratio	1.5	1.4

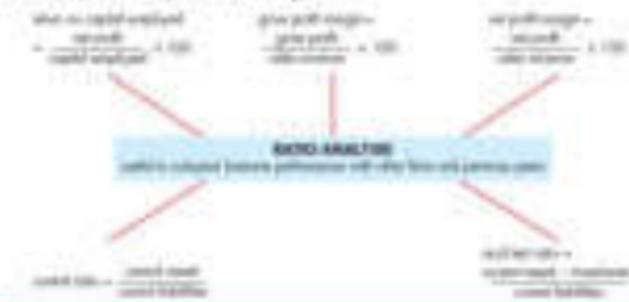
Activity 18.2

Read the case study above.

- Do you think the management of流动金額 should be watched over the profitability of this company? Justify your answer.
- Explain why comparing these ratios with other hotel companies would be useful for Gloria Hotels management.
- Do you think that taking浮動金額 bank overdraft should be watched with the liquidity of this company? Justify your answer.
- Suggest any changes here-area in which the management of Gloria Hotels could increase the profitability of this company. What's being asked (you're concerned already?)
- Assume and explain how easy it will be the management of Gloria Hotels could become the liquidity of the company. Which way would you recommend and why?

Revision summary: ratio analysis

Take the revision
Be presented
to students
why different
methodologies
gives and find
useful information
from a company's
published
accounts – and
offer advice will
help in the
analysis of these
accounts



International Business in Boxes: BP plc

BP is one of the world's largest oil companies. What is its measure of 'the most profitable'? A close analysis of the company's activities leads to some interesting results – which are compared with other businesses in this same industry sector.

In 2001 BP's sales on capital employed was 11.02% – substantially higher than the average for the sector of 7.12%. Their net profit margin was 8.86% which was a high result, again in 2001 and also slightly better than the rest of the main roads, Royal Dutch Shell which reported a net profit margin of 6.87%.

A BP's profitability at the end of 2001 (equity) is slightly higher to be the case. In 2001 the company had total assets (net value) of £2,821 and a current ratio of 1.13 – both higher results than those reported four years previously.

So BP has able to increase profitability and liquidity in terms of world economic problems persisting oil prices?

Discussion points

- Which group of BP's stakeholders would be interested in these ratio results and why?
- Explain why it is important to compare firms' results with those of other peers and other similar companies.

Exam-style questions - Paper 1

- 4 The table below is an extract from the accounts of 'Tinco Canning Ltd', a food canning and processing business. The company sells its products to the three main supermarket groups in the country.

	2011 £'000s	2012 £'000s
Gross profit	500	385
Net profit	120	140
Sales revenue	2000	2100
Capital employed	1000	900

- 44 What is meant by 'capital employed'? [1]
 45 Identify two possible reasons why sales revenue has increased. [2]
 46 Identify and explain two possible reasons why gross profit has increased. [2]
 47 Identify and explain two ways in which Tinco Canning management could increase net profit. [3]
 48 Do you think the management of Tinco Canning should be satisfied with the profitability of the company? Calculate the return on capital employed ratio for both years to support your answer. [3]
- 4 The table below is an extract from the accounts of 'H Factors Ltd'. This is a private limited company that sells quality fashion clothes. It purchases from some leading manufacturers, it recently started offering its customers two month's credit. However, sales have been falling due to increased competition. The bank manager is worried about the liquidity of H Factors Ltd.

	2011 (£'000s)	2012 (£'000s)
Cash assets	10	20
Inventories	40	30
Credit receivables	50	60

- 49 What is meant by 'liquidity'? [1]
 50 Identify two main current assets of H Factors, apart from inventories. [2]
 51 Identify and explain two possible reasons why the current liabilities of this business are increasing. [2]
 52 Identify and mention only two distributor groups, apart from the Park, which are interested in H Factors Ltd's accounts. [2]
 53 Do you think the bank is right to be worried about H Factors Ltd's liquidity? Give reasons to support your answer. [3]

Revision checklist

In this chapter you have learned:

- why ratios are important in analysing accounts
- how to calculate gross profit margin and understand the result
- how to calculate net profit margin and understand the result
- how to calculate return on capital employed and understand the result
- how to calculate the liquidity ratios—current ratio and acid test ratio—and understand the results
- which groups use analysis of financial accounts and ratio analysis, and how these can help make decisions

TEST – test your understanding with the review questions on the E21-06084.

Financial information and financial decisions: end of section case study (Paper 2 style)

Fruity Smoothies



Fruity Smoothies is a small, home-based business which produces a range of fruit smoothies. The business operates in many different countries across the world. Fruity Smoothies is a successful company but the Directors need to increase its market share of the fruit smoothies global market.

The following four ways of increasing market share have been identified:

- Option A: Increase sales of its most popular brand of smoothies by setting it up in five new countries. The investment required to get the smoothies launched into new markets is estimated to be \$800,000. This provides market research, advertising campaigns and licensing agreements to produce the fruits specified to the other countries.
- Option B: Take over a competitor's plant, who produces a range of brands of smoothies. The cost of the takeover is to buy all the shares in the company is estimated to be \$300 million.

Appendix 1

Summary of financial information for Fruity Smoothies (2010)

Existing Business	\$m per year
Cash employed	800
Sales revenue	1000
Gross profit	1200
Net profit	300
Option 1	\$m per year
Potential sales generated from the new countries	300
Fixed costs	100
Variable costs (\$m additional year)	220
Option 2	\$m per year
Purchased sales generated from competitor sales	400
Fixed costs	100
Variable costs of acquisition	300

Appendix 2

Information on County's Fixed Costing

	Expanding R	Contracting R
Average revenue per fixed	\$8000	\$800 000
Production	2000	2000
Contribution margin	\$200 per year (\$800 - \$600)	\$200 per year (\$800 - \$600)
Overhead	Revenue fixed in number used (\$600 x 4000)	Revenue fixed per hour used (\$600 x 400)
Average variable cost	\$12 per hour	\$12 per hour
Contribution margin rate	60%	60%
Margin	\$800	\$800

1. Identify and explain, with examples, the difference between 'fixed costs' and 'variable costs' for Prudy Investments.

(10)

2. Using the information in Appendix 1, consider the best options for increasing the revenue (loss) of Prudy Investments. Recommended plan/s of that best option(s) for Prudy should discuss justify your choice using appropriate calculations of profitability ratios.

(14)

3. Both Option 1 and Option 2 mention 'leverage' for the expansion. Identify and explain how variable revenue of Revenue the Dimension of Prudy Investments would rise.

(8)

4. If Prudy Investments might take over a competitor which sells fruit smoothies, discuss how important this competition? Balance sheet and income statement should be in helping that dimension of Prudy Investments decide whether to take-over the competitor. Justify your answer.

(12)

Optional questions:

1. a) The Dimension of Prudy Investments want to increase its market share, identify, and explain three actions along the dimensions right, focus for that business.

(10)

- b) If Prudy Investments try to sell their smoothies in small containers like cups will have a number of advantages in economics. Consider three questions for the business which among a can market is a sufficient revenue. Discuss each each of these problems can be easily anticipated & justify prior answer.

(12)

2. a) Prudy Investments with a wider range of 'balanced' smoothies, identify and explain how kept that Prudy Investments could make a better image for it's own fruit smoothies company.

(8)

- b) Prudy Investments is considering building a new factory to produce a sweet soft drink in one of the two locations shown in Appendix 2. Consider the advantages and disadvantages of that best-estimated, recommended which country they should choose to build the new factory, justify your choice.

(10)

External influences on business activity

Chapters

- 16 Government-economic objectives and policies
- 17 Environmental and ethical issues
- 18 Business and the international economy



Government economic objectives and policies

This chapter will explain:

- government economic objectives
- the main stages of the business cycle
- the tax and spending changes that governments can make
- the interest rate changes that governments can make
- the impact these changes have on businesses and how they can react to these changes

Government economic objectives

Most governments have the following economic objectives:

- low inflation
- low unemployment
- economic growth
- balance of payments: business imports and exports

low inflation

Inflation means when prices rise. Low inflation is an important objective. When prices rise rapidly it can be a burden for the whole country. Therefore if the government of a country will have it there is rapid inflation.

- Workers' wages will not keep up with rising prices as before. This means they probably will decrease real income. Real income is the value, or worth, of what can be bought, of an income – If a worker receives a \$1 per hour wage increase but prices rise by 10 per cent at the same time, then the worker's real income has fallen by 4 per cent. Workers may demand higher wages so that their real incomes increase.
- Prices of the goods produced in the country will be higher than those in other countries. People may buy foreign goods instead. Jobs in that country will be lost.
- Businesses will be unlikely to want to expand and employ more people in the near future. The living standards are likely to fall.

Therefore low inflation can encourage businesses to expand and it motivates a country to sell its goods and services abroad.



High rates of inflation reduce real income

Low unemployment

When people want to work but cannot find a job, they are unemployed. There are the problems unemployment causes:

- Unemployed people do not produce any goods or services. The total level of output in the country will be lower than it could be.
- The government pays unemployment benefit to those without jobs. A high level of unemployment will cost the government a great deal of money. This cannot be spent on other things such as schools and hospitals.

Therefore, low unemployment will help to increase the output of a country and improve workers' living standards.



High-unemployment reduces output and can reduce living standards

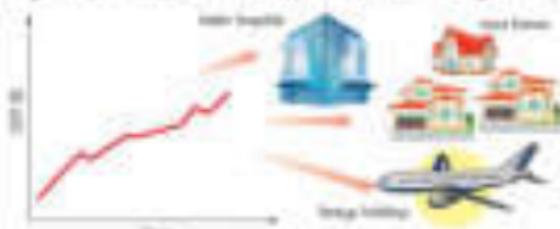
Economic growth

If an economy is said to grow when the total level of output of goods and services in the country increases. The total value of goods and services produced in a country in one year is called **gross domestic product (GDP)**. When a country is experiencing economic growth, the standard of living of the population is likely to increase.

When a country's GDP is falling there is no economic growth. The problems this causes are:

- As output is falling, fewer resources are needed and unemployment will occur.
- The average standard-of-living of the population – the number of goods and services they can afford to buy in one year – will decline. In effect, more people will become poorer.
- Business owners will not expand their firms as people will have less money to spend on the products they make.

Economic growth, however, makes a country richer and allows living standards to rise.



Economic growth will make a country richer and will allow living standards to rise.

Definitions for Matters

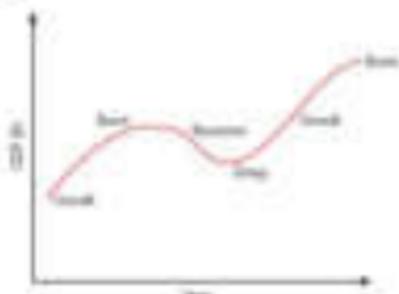
High Unemployment: **Fewer people** are available to work than there are **jobs** available.

Economic growth: **You will need to** answer questions about the **economy** of your own country. **Remember:** It is a general term to **describe** overall **economic** **conditions** and **unemployment** **rates** in your **country**.

The business cycle

Economies growth is not achieved steadily every year – there are often years where the economy does not grow at all or where the value of GDP actually falls. This pattern is shown below on the trade cycle diagram.

The business cycle (sometimes known as the trade cycle) has four main stages, as shown on the diagram:



A business cycle diagram:

- **Growth** – this is when GDP is rising, unemployment is generally falling and the country is enjoying higher living standards. More businesses will do well at this time.
- **Bust** – this is caused by too much spending. Prices start to rise quickly and there will be shortages of skilled workers. Business costs will be rising and firms will become uncertain about the future.
- **Recession** – often caused by too little spending. This is a period when GDP actually falls. Many businesses will experience falling demand and profits. Workers may lose their jobs.
- **Boom** – a strong and long upward trend. Unemployment will reach very high levels and prices may fall. Many businesses will fail at various times.

Clearly, governments will try to avoid the economy moving through a recession or a bust, but will also want to reduce the chance of a boom. A boom with rapid inflation and higher business costs can often lead to the conditions that result in a recession.

Balance of payments

Imports are goods and services sold by one country to people and businesses in another country. Thus bring money (foreign currency) into a country. **Exports** are goods brought in from other countries. These must be purchased with foreign currency so there lead to money flowing out of a country. **Trade balance** will aim to achieve equality of balance between these over a period of time. The difference between a country's exports and imports is called the balance of payments.

If the value of a country's imports is greater than the value of its exports then it has a balance of payments deficit.

There are three problems that could result:

- The country could 'run out' of foreign currencies and it may have to import less abroad.

EU Business Year

Recession – a period of falling Gross Domestic Product.

Exports are goods and services sold from one country to other countries. These are goods and services bought by one country in another country.

Dollars down the drain

The exchange rate is the price of one currency in terms of another, for example \$1 = £1.5.

Exchange rate depreciation is the fall in the value of a currency compared with other currencies.

- The price of one country's currency against other currencies - the exchange rate will fall by 50% to 60%. This is called **exchange rate depreciation**. The country's currency will now buy less abroad than it did before depreciation. Exchange rates are explained further in Chapter 18.



A balanced set of payments deficit can lead to major problems for a country.

Activity 28.1

- The GDP of Country A was \$1000 million in 2010. The population was 1 billion. The average income per person was therefore \$1000. In 2011, as a result of economic growth, GDP was \$1200 million. The population had also risen to 1.2 billion. What was the average income per person in 2011?
 - \$1000 / 1000 = \$1000 per person
 - \$1200 / 1000 = \$1200 per person
 - \$1200 / 1200 = \$1000 per person
 - \$1200 / 1200 = \$100 per person
 - \$1200 / 1000 = \$120 per person
- The real GDP of Country B fell by 10% last year in 2010. Inflation was 10% last year in 2010.
 - More output did not occur in 2010
 - Real GDP income rose by less than 10% last year because:
 - real GDP is measured in constant prices
 - real GDP is measured in constant prices
- Real GDP in Country A, initially equal to real GDP in Country B, fell by 10% in 2010. Real GDP in Country B fell by 10% in 2010. Real GDP in Country A fell by 10% in 2010.
 - more output did not occur in 2010
 - real GDP income rose by less than 10% last year because:
 - real GDP is measured in constant prices
 - real GDP is measured in constant prices

Revision summary: economic objectives of government



Government economic policies

Governments have a great deal of economic power. They can raise and spend like money on a wide range of services and public benefits. It is now unusual for governments to fully control over 40–50 per cent of a country's GDP through the

Evidence to hand:

Fiscal policy is any changes by the government to tax rates or public sector spending.

Issue they raise: Businesses use this power to try to achieve the objectives we have just looked at. The decisions made by governments can have a great effect on all businesses in a country. Business managers need to know how their firm could be affected by government economic decisions. The main tool is which governments can influence the economy - sometimes called economic policies - are:

- **Fiscal policy** - taxes and government spending
- **monetary policy** - interest rates
- **supply side policies**.

Fiscal policy: taxes and government spending

All governments spend money. They spend it on schools, hospitals, roads, defence, and so on. This expenditure is very important to some businesses. For example:

- construction firms will benefit from a new road building scheme
- defence industries will gain if the government increases the army
- bus manufacturers will benefit from government spending on public transport.

Q. Where do governments raise the money from?

A. largely from taxes on individuals and businesses

Q. What are the main types of taxes?

A. Direct taxes are the income of business and individuals and indirect taxes on spending.

Q. How do these taxes affect business activity?

A. In a number of different ways.

We will look at these effects by studying the impact of four common taxes:

- **income tax**
- **profits tax or corporation tax**
- **indirect taxes**, for example Value Added Tax (VAT)
- **import tariffs**.

Income tax

This is a tax on people's incomes. Usually, the higher a person's income the greater will be the amount of tax they have to pay to the government. Income tax is set at a certain percentage of income, for example 25 per cent of income. In many countries, income tax is progressive. This means that the rich pay tax at a higher rate than the poor.

How would businesses be affected by an increase in the tax of income tax? Individual taxpayers would have a lower **disposable income**. They would have less income to spend and save. Businesses would be likely to see a fall in sales. Managers may decide to produce fewer goods at a lower tax rate. Some workers could lose their job.

Evidence to hand:

Disposable income is the level of income a taxpayer has after paying income tax.

Businesses which produce luxury goods will be more affected by an increase in income tax rates. Businesses which produce basic necessities do not depend too much on the rich to buy their products. Businesses producing essential goods and services will be less affected. Consumers will still have to buy these products.

Which businesses are likely to be most affected by this increase in income tax rates? Businesses which produce luxury goods which consumers do not depend too much on the rich to buy their products. Businesses producing essential goods and services will be less affected. Consumers will still have to buy these products.

Case study: income tax

The government of Country A has set the following rates of income tax:

Income level	Tax rate paid by government
\$1,000 per year	10%
More than \$1,000 per year	20%

How much tax would John, earning \$10,000 per year, pay to the government? The answer is \$1,000. This is calculated as follows:

$$20\text{ per cent of the first } \$1000 = \$200$$

$$20\text{ per cent of the rest } \$900 = \$180$$

How much income has John left to spend or save after tax? The answer is \$8,000. This is called the taxpayer's disposable income, also known as 'disposable' as it is spent or saved at the taxpayer's discretion.

Tip for success

When a question asks about the impact of an increase or decrease on a business, think about the type of good or service the business produces.

Activity 10.2

These are eight products:

- bread
- butter
- TV
- storage business
- clothing shop
- publishing
- soft
- home computers

The sales of four of these products are likely to fall following an increase in income tax rates. Sales of the other four will not be much affected, meaning that four products likely to be most affected.

Profit tax (or corporation tax)

This is a tax on the profits made by business – usually companies.

Other taxes are passed on to the cost of corporation tax affect businesses. There would be two main effects:

- Businesses would have lower profits after tax. Managers will therefore have less money to finance or run their business (the firm). The business will find it more difficult to expand. New projects, such as additional factories or shops, may have to be cancelled.
- Lower profits after tax is also bad news for the owners of the business. They will be less willing to pay back to the owners who originally invested in the business. Fewer people will want to make their own business if they consider that the government will take a large share of any profits made. 'Computer' share price could fall.

Indirect taxes

Indirect taxes, such as Value Added Tax (VAT), are added to the prices of the products we all buy. They effectively make goods and services more expensive. We consumers contribute when paying those taxes on really essential items, such as food. However this would be considered unfair, especially to poorer consumers.

How would businesses be affected by an increase in an import tariff? Again, there would be two main effects:

- Prices of goods in the shops would rise. Consumers may buy fewer items at a time. This will reduce the demand for products made by businesses. Not all businesses will be affected in the same way however. If consumers used to buy a product such as a car battery for their alarm clock, then the price increase is unlikely to stop them doing so. However, there might buy fewer ice creams at their local news shop and that is surely essential in summer!
- As prices rise on the materials employed, businesses notice that their wages have risen in the shops. It is said that their real incomes have fallen! Businesses may be unable to pass on these wages, which will knock up the costs of making products.

Import tariffs and quotas

Definitions to learn

- Import tariff**
is a tax on
imported products.
Import quota
is a physical limit
on the quantity of
a product that can
be imported.

Many governments try to reduce the imports of products from other countries by putting tariff taxes on them. These are called **import tariffs** and they raise money for the government. Many international organisations, such as the World Trade Organisation, are trying to reduce the number of governments which do this.

How would businesses in a country be affected if the government put tariffs on imports from the country? There are three possible effects:

- Firms will benefit if they are competing with imported goods. There will now become more expensive, leading to an increase in sales of home-produced goods.
- Businesses will have higher costs of their factor or import raw materials or components that they were factors. These will now be more expensive.
- Other countries may now take the same action and introduce import tariffs too. This is called **reciprocity**. A business trying to export to these countries will probably sell fewer goods than before.

Afterwards a government can use its trade imports to introduce an **import quota** or physical limit on the quantity of a product that can be imported in. Quotas can be used selectively to protect certain industries from foreign competition that may be seen as unfair or damaging to jobs.

Changes in government spending

Governments in some countries spend the tax revenue they receive on programmes such as:

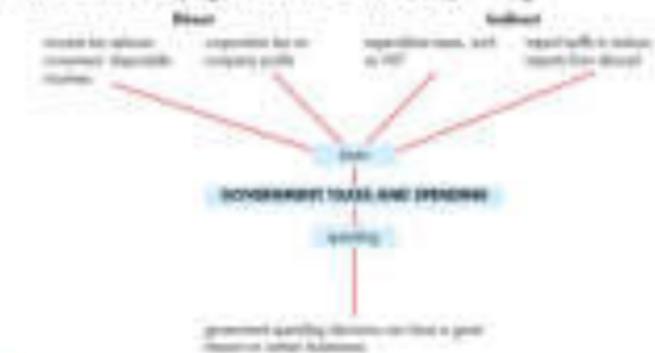
- education
- health
- defence
- law and order
- transport – roads and railways

When governments want to spur economic growth, they can increase their spending on these programmes. This will increase demand in the economy, more jobs and GDP will increase.

If governments want to save money – if they have extra borrowed for example – they will often cut government spending. This may could have a considerable impact on business activity. For example:

- purchase equipment for schools and hospitals and defence equipment
- build roads, bridges and railways

Revision summary: government taxes and spending



Monetary policy – interest rates

Definitions and terms

Monetary policy is a change in interest rates by the government or central bank, for example the Reserve Bank.

An interest rate is the cost of borrowing money. In most countries, the level of interest rates is fixed by the government or the central bank via monetary policy. In some countries, the charging and the payment of interest is agreed by markets and institutions of the population. In most countries, however, businesses and individuals can borrow money, from a bank for example, and they will have to pay interest on the loan.

The following are likely to be the main effects of higher interest rates:

- Firms with existing variable interest loans may have to pay more to borrow on the banks. This will reduce their profits. Lower profit margins are available to distribute to the owners and less is retained for business expansion.
- Mortgage lending allows businesses to expand their business after their success. New investments in business activity will be reduced. Fewer new factories and offices will be built. Entrepreneurs hoping to start a new business may now be able to afford to borrow the capital needed.
- Consumers have short term loans such as mortgages at high interest rates, when the higher interest payments will reduce their monthly income. Demand for all goods and services could fall as consumers have less money to spend.
- In addition to the power above, if the business makes expensive consumer items like cars or if they build houses then they will notice that consumer demand will fall for another reason. Consumers will be unwilling to buy expensive items if interest rates are higher. These businesses may have to reduce supply and make workers redundant.
- Higher interest rates in one country will encourage foreign banks and individuals to deposit their capital in that country. They will be able to earn higher rates of return on their capital. By resulting short money into this country's currency, they are increasing the demand for it. The exchange rate will rise - this is called **exchange rate appreciation**. This will limit the effects of making imported goods

Definitions and terms

Business cycle represents the time to top value of a economy, as opposed to other economies.

imports cheaper and exports will now be more expensive. The opposite effect, if the exchange rate of a currency strengthens, is called an exchange rate depreciation.

Revision summary: Inflation rates



Supply side policies

In recent years many governments have tried to make the economy of their country more efficient. They aim to increase the competitiveness of their industries against those from other countries. This would allow their businesses to expand, produce more and employ more workers. Some of the policies which have been used to achieve these aims are listed below – they are called supply side policies because they are trying to improve the efficient supply of goods and services.

- **Deregulation – privatisation** – privatisation is now very common. The aim is to set the public sector as competitive business efficiently.
- **Degree training and education** – governments plan to improve the skills of the country's workers. This is particularly important in those industries such as computer software which are often very short of skilled staff.
- **Business competition in all industries** – this may be done by reducing government controls over industry or by setting up competition.

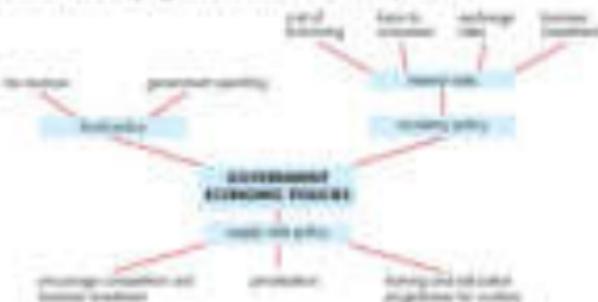
Activity 18.2 Impact of government policies

You are the Managing Director of the largest computer manufacturing company in your country. Your business sells products at home and in foreign markets. Markets are improving. You require hundreds of skilled workers to design, assemble and test the computers. Your objective is planning a major expansion programme.

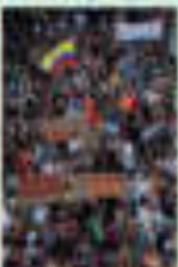
The government of your country has recently announced the following policies. Explain the likely impact of each of these policies on your business.

- a reduction in income tax rates on high-income earners
- trade negotiation tax rates
- higher import tariffs on all imports
- higher interest rates
- higher expenditure levels for public sector
- new training schemes to increase the supply of qualified workers
- more controls on commodity markets to encourage local businesses to be formed

Revision summary: government economic policies



Focus activity - 'Brazilian economy planned new 'economista' law'



Brazilian President Lula has taken steps to boost its people and business leaders' voice their opinion over the government's measures, policies. The Brazilian government has tried very hard to change so it is having to cut administrative spending and increase direct and indirect taxes. The country's GDP fell one year and is expected to decline again in 2013. Living standards are falling – especially amongst the growing numbers of unemployed. About 20 per cent of the total workforce are now unemployed.

Question 28-4

Read the case-study below.

- 1) Explain what is meant by 'the country's GDP had fallen'.
- 2) Explain how falling living standards might affect:
 - a factory producing soft drinks
 - a manufacturer of luxury leather goods
- 3) Identify and explain two reasons why the federal government might aim to reduce the level of unemployment.

How business might react to changes in economic policy

The following table explains how business might react to some major changes in government economic policy. The business decisions will often could be altered if the government decided to reduce tax- or interest rates.

Government policy change	Possible business response	Possibilities with ECo measure
Increased incentives... this reduces the achieved contribution from its spend	Lower prices on existing products to increase demand Provide cheaper products to allow for lower prices	Lower profits will likely result in lower future capital investment projects The financial image of a product might be damaged by using cheaper materials in it
Increased tariffs on imports	Focus more on their domestic market by locally produced goods over other countries Launch local-facing importers to reduce unit costs and commitments to world-produced costs	It might still be more profitable to import Change materials and components might be at higher quality
Increased environmental... this increases the cost of producing goods	Reduce environmental emissions through cost-cutting Meeting consumer pressures that consumers will be forced to adopt Sell products for use-in-reduce recycling projects	Other consumers might still buy as products of choice might be too Increase on the products that will be consumer duty to think that the quality and price increase are better The public might be reacted to these measures

You will notice that all of these business decisions could have both negative and positive effects. The overall impact of these decisions may depend on:

- how big the changes are in government policy;
- what action competitive rules impose to these policies.

International Business in focus: Sustainable accessibility: Recovery ready to greater effect



The rapidly developing countries including India, Bangladesh and China are a significant portion of the growing Asian market. Major stakeholders in this industry – manufacturers, transportation companies and dealers – want government policies that do little to encourage local manufacturing, so partners there want:

- import tariff on imported materials;
- more government spending on road and other infrastructure;
- low electricity fees on small firms.

These countries obviously have relatively low production costs (around \$1 per hour worked) due to low labor costs of \$1 million (USD 2012), however these cost factors, countries is growing its domestic economy to benefit from growth and rising income.

What can you gain?

- why is this demand for containerized shipping in Asia as local economies continue to grow?
- Explain how each of the government policy measures being mentioned would benefit the shipping industry.

Exam-style questions – Paper 1

- 1 The economy of Country A is growing rapidly. Unemployment is falling and the incomes of most consumers are rising. However, inflation increased to 8 per cent last year. Many business owners are worried that the government could increase interest rates.
a) What is meant by 'inflation'? [1]
b) Identify two likely economic objectives of the government of Country A. [2]
c) Identify and explain three types of taxes that a government can use to raise revenue. [3]
d) Identify and explain two ways in which an increase in interest rates could affect businesses in Country A. [2]
e) Do you think all increases add up to a country benefit when the economy grows? Justify your answer. [3]
- 2 The Government in Country B is planning to increase taxes. It will use the revenue raised to build more roads and airports in an attempt to reduce unemployment and increase economic growth. The rate of inflation was very high last year but it has now started to fall. ABC, a producer of luxury branded fashion goods, Management ABC are planning to respond to the government policy of higher taxes.
a) What is meant by 'economic growth'? [1]
b) Identify two effects on business of increased unemployment. [2]
c) Identify and explain three effects on businesses of high inflation. [3]
d) Identify and explain three ways in which a business producing luxury products could respond to higher taxes. [3]
e) Do you think that increased government spending on more roads and airports is a good idea? Justify your answer. [3]

Revision checklist

In this chapter you have learned:

- to explain the economic objectives of governments
- to understand the business cycle
- to understand the different types of government economic policy
- to explain the ways in which business activity might be affected by government economic decisions and how business might respond.

GCSE – see how well you’re doing with the revision questions via the Edexcel website.

This chapter will explain:

- How business activity can affect the environment and the concept of stakeholders
- What sustainable development means and how business can contribute to this
- How increasing concern for the environment and pressure groups are influencing business decisions
- How legal controls can be used to influence business decisions to protect the environment
- How official taxes might affect business decisions.

Business activity and the environment

Consider these two statements by different factory managers:

- Manager A: 'I know that my factory pollutes the air and the river with waste products but it is very expensive to use cleaner methods. We make a profit from making those products and others are still more expensive.'
- Manager B: 'We recently spent \$100 million on new low-energy technology producing 90 per cent less pollution than the old ones. We now recycle 75 per cent of our waste – consumers think that we care about their **sustainable development**'.

Business activity tries to **waste resources**, **impact** (or goods and services) – but it **effects** (or has impact) on the **environment**. The 'waste/resource' status on natural world. Here are some examples of how business activity impacts on the environment:

- Aircraft jet engine emissions damage the atmosphere
- Pollution from factory effluent reduces air quality
- Waste disposal uses police time and resources
- Transport of goods by ship and truck burns fossil fuels such as oil which creates carbon dioxide and may be linked to 'global warming' and climate change

The above negative impacts on the natural environment suggest many people believe they do – but other people think that all business should be worried about it, identifying opportunities to do things as cleanly as possible.

Did you find yourself agreeing with one of the two messages above? Whether business should be concerned about environmental issues is a major ongoing argument. Which side do you think dinner eat?



Air pollution damages the environment



Dirty rivers are expensive to clean up



Road transport causes noise and air pollution and adds to global warming

Types of issues

Why should business firms pay attention to social responsibility issues? Business firms are prepared to take on additional responsibilities because this increases their credibility and helps them to meet their social responsibilities as well.

Let's look at both sides of the argument:

Argument #1 Business should produce goods and services profitably and not worry about this consequence	Argument #2 Businesses have a social responsibility towards the environment and this can benefit society too
Protecting the environment can be expensive. Reducing waste, recycling waste and reducing pollution costs all cost businesses money and this reduces profits.	Social issues are global problems affecting all individuals. It is a social responsibility to reduce these problems.
Business might have to increase prices to pay for environmental friendly policies.	Giving social related decisions makes us more responsible – such as reducing business taxes etc. for future generations and lower prices.
They could make less profit if they had to pay more to follow environmental policies in other countries that do not environmentally friendly.	More costs will increase production costs than business activity can manage. The environment becomes a burden.
Consumers will face less if they have to pay higher prices.	Consumers will become more socially aware – this will encourage consumers to buy more environment friendly items and this can increase a company's profits.
If businesses do not pay, then governments would pay instead if it goes.	Businesses change the environment. One group could take action to help the environment and taxes.
Some business owners think there is no research just what business is doing to being economic growth to the environment.	

Externalities

Many business activities – such as locating a factory or producing goods and services – lead to many different costs and benefits. It is important to distinguish between private costs and benefits and external costs and benefits. The following case study explains these differences.

Businesses as firms

Private costs of an activity are the costs paid by the business.
Private benefits of an activity are the gains to a business.

Businesses as social members

A chemical firm pays for water to run its chemical factory. It has chosen a site which it believes is the most profitable one. In coming to this decision, the managers considered only financial and technical factors. These are called the **private costs and private benefits**. Please see table 1.

Private costs	Private benefits
Cost of land	The income made from the sale of the chemical products
Cost of labour	
Labour costs	
Cost of running the plant when it has been built	
Transport costs of raw materials and finished products	

Unluckily, the site chosen is near a housing estate. It is common part of a park used by local residents. Many problems from the factory affect happen to local flora or species.

(continued)

External costs and benefits

External costs are costs paid for by the user of a service rather than the producer, or a result of business activity.

External benefits are free gains to the rest of society rather than the business receiving from business activities.

External costs = external costs + private costs.
External benefits = potential benefits + public benefits.

For factory with costs & benefits of waste and illness. The area is one with a large load of manufacturing units – separate industries are below the national average.

...therefore applying uniform or market-based planning permission, the government also considers the external costs and external benefits – that is, the impact on the user of adding value from the industry itself.

External costs	External benefits
State industry will cause pollution	Industry will be funded
Local and national loss through loss of residents	Other firms may incur additional local & economic costs
Pollution victims may be caused by local residents	The national factory will pay taxes – government might increase spending on local projects e.g. more houses

The government will try to give a value to all of these costs and benefits. This is called social benefit calculations. This is not always simple. For example, when the cost of losing residents by migration is put at £100000 and wages and rents are added costs and benefits of the industry are added up:

- private costs, related to production costs, give a total **private cost**.
- private benefits, related to external benefits, give a total **social benefit**. Note: If the total social benefit is greater than the total private cost, the industry is likely to be accepted. If, however, the total social cost is greater than the total social benefit, the government will probably take no action.

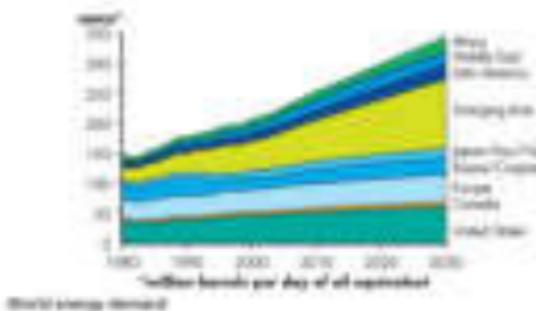
Activity 11.1

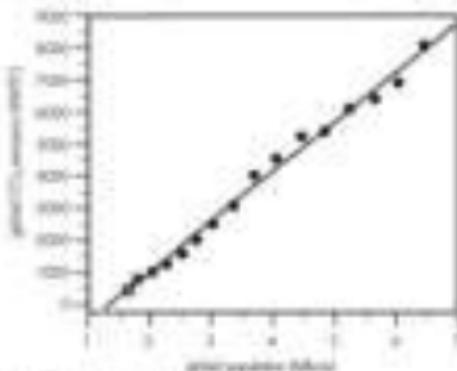
Read the case study above.

- 1) What is meant by the term 'external costs'?
- 2) Industrialists say that stakeholders groups will be worried about the external costs from a new chemical factory.
- 3) Explain why any industrial stakeholder group will benefit from the positive external benefits from the new chemical factory.
- 4) Assume you are the Environment Minister responsible for planning decisions. Would you allow the new chemical factory to be built or not? Explain your answer.

Sustainable development

Look at the following information about the world's demand for energy and carbon dioxide emissions:





Global population and人均国内生产总值 since 1900

What happens if...?

Non-renewable
resources
is depleting
which does not
put at risk the
living standards
of future
generations.

These people share some of the problems that both economic and population growth is causing us. Many economists and environmentalists agree that this rapid rate of energy use and pollution cannot continue if the world is to meet the same living standards as we have today. Using up more resources at a very fast rate will mean that there may be fewer living resources in the future. This means no health problems and bad air quality and climate problems that put at risk the welfare of millions of people.

Sustainable development means trying to achieve economic growth but without damaging the environment and society for future generations.

Sustainable development: what can business do?

- 1 Use sustainable energy - by fitting solar panels or buying energy that uses renewable sources such as wind or tidal power.
- 2 Recycle waste - by reusing water and other products that would otherwise be wasted or disposed of, waste use of resources is reduced.
- 3 Use fewer resources - less production (see Chapter 17) is about managing production so efficiently that the minimum amount of resources is used.
- 4 Develop new 'environmentally friendly' products and production methods - for example, replacing plastic cans and bottles with biodegradable packaging that will not damage the environment.

**Ex-Business 101
Issue:**

Fast fashion
production
involves very little
thought or consideration
of damage to the
environment.

By using these sustainable practices, individuals/businesses respond positively to environmental pressures and opportunities.

Case study - Facebook Hydrogen

This company used CSR first in Australia to develop the country's first Biomass-to-Electricity (BTE) plant. Examples of sustainable development initiatives at the 'Facebook site' are:

- Wind from geothermal in the surrounding process are recycled and used in sustainable microfarms.
- Natural gas is produced from waste using a biogasifier – the gas is used as energy within the plant.
- Waste water is used to irrigate trees in a newly constructed forest.

This creates cost savings which makes sustainable and green as a competitive edge! with the dual outcome of reduced costs.

Activity 17.2.

Read the case study above.

- 1 What is meant by the term 'sustainable development'?
- 2 Explain why the three initiatives taken by Facebook (above) make the business more sustainable.
- 3 Explain why the third initiative believe that the business has a 'competitive edge'.

Responding to environmental pressures and opportunities

How can society make business give the environment a higher priority? There are three main ways:

Pressure groups

Businesses feel worried if a firm is reported as destroying an important natural area or dumping waste in the sea. More sales increases will stop flooding, as products /or increasing proportion of consumers are becoming concerned about their environment. These already exist so will prove profitable. If sales of a product fall because consumers think it is harmful to nature, then the business does have to quickly change its products or its production methods.

Pressure groups are becoming increasingly powerful. They can take very effective action against businesses that are not socially responsible. Pressure groups such as Greenpeace and Earth First! have used so-called 'front' page press to expose corporate **irresponsibility**.

Pressure group activity is likely to change business actions when:

- they have popular public support and usually much media coverage
- economic pressure result in much reduced sales for the firm
- the group is well organised and funded

Pressure group activity is unlikely to result in a change in business actions when:

- what the firm is doing is unpopular but not illegal, such as testing drugs on animals
- the cost to the business of changing its methods is more than the possible cost of press image and lost sales
- the firm fails to reflect business rather than consumer – public pressure will be less effective

**Ex-Business 101
Issue:**

A pressure group is made up of people who want to change business for government decisions and they raise issues such as environmental protection, health and safety.

A consumer pressure group is when consumers decide not to buy products from businesses that do not act in a socially responsible way.

Laws passed by government

Governments can make business activities illegal. For example:

- hunting in conservation-area sensitive areas such as national parks
- dumping waste products into rivers or the sea – though it is often very difficult to prove which firm is responsible for this
- making products that cannot easily be recycled.



It is often difficult for governments to find out which firms are responsible for causing chemical waste.

Manufacturers often complain that laws, laws make it more expensive for them to produce. This makes prices more expensive. For this reason some governments do not pass strict laws on the environment, hoping that this will encourage firms to produce oil and money to create jobs. Do you think it is morally responsible for a business to focus on a country that does not have strict laws on protecting the environment?

Financial penalties, including pollution permits

Pollution permits are licenses to pollute up to a certain level. Governments can set a permit to a factory that produces pollution. If it produces more pollution than the permit allows, it must either buy more permits from "clean" firms or pay heavy fines. Either way, the costs of the business increase. Firms producing much less pollution can sell their permits to "dirty" firms. This encourages them to produce goods in the polluting ways. Other financial penalties could be additional taxes on growth or incentives like green subsidies.

These three types of controls help to explain why many businesses now regard as environmental processes. Being "environmentally friendly" can reduce a company's costs of a business and lead to opportunities for sustainable growth.

Environmentally conscious companies are becoming increasingly important in the marketplace

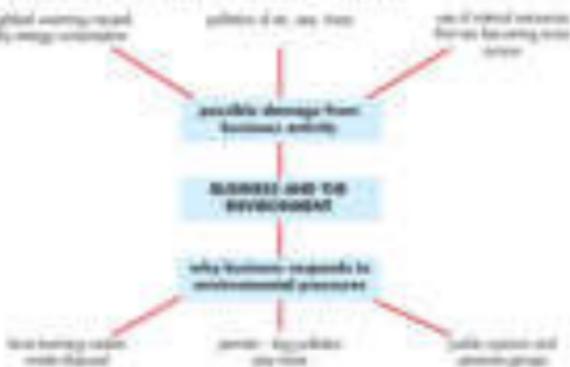
In Country X, there are very few government controls on business activity. The Government of Country X would be encouraged to encourage businesses to start up and grow. It believes that "greed" controls more pollution and disposal of waste and to increase costs. This will encourage competition in their industry. Country X sells many products made overseas, resulting in little investment in new local projects.

In Country Y, the Government has laws in place to control the ways in which businesses dispose of their waste, how much pollution they can produce and where new factories are located. It belongs to the Government to say, "We believe that businesses have a social responsibility to use community not to damage the environment. These have been encouraged businesses to use strict cleaner production methods. They have also developed products that pollute the environment less than traditional products. Many consumers in the world today will only buy environmentally friendly products."

Activity 11.5

Read this case study (page 214).

- What is meant by the term social responsibility?
- Identify and explain three reasons why the Government in Country X does not have environmental legislation that affects the environment.
- Identify and explain three ways in which business activity can damage the environment. This example from your own country.
- Do you think that the Government of Country X is right to implement laws against businesses that damage the environment? Justify your answer.

Revision summary: environmental constraints**Case study insight: Bunker-200 Companies**

For many years BP (UK) had been dumping waste products in the sea. The company argued that the monitoring was too costly and, until so far because of cost, it was a much cheaper method of getting rid of the waste than buying equipment to treat the waste. One night, though, the fire to keep them dry exploded.

Environmental pressure groups tried to ban their waste but it was ineffective. Then, one day, thousands of dead fish and sea birds started to be washed up on the sand bank, while investigations it was found that there had been dangerous levels off benzene (benzene is a oil derivative) and benzene oil spill from another firm's tank. Environmental pressure groups started to blockade BP's port of Milford Haven. The local press soon got风靡 from the public. Farmers asked for their crops removed to protect their soil. Environmental concerns were following this story closely.

The Chief Executive was suddenly summoned to a press conference and assessment for the following week. What do the company seem about to change its environmental policy after all?

Activity 17.2

Read the case study on page 303.

- 1 Define the basic producer group.
- 2 Why was Nestlé CEO consulting his manager to develop a policy after the fair and trade were reached agreement?
- 3 Explain how different producer groups might be successful in changing their business' behaviour in this case.
- 4 Do you think that Nestlé CEO should have developed a dumping policy and less engagement in market? Give reasons for your answer.

Ethical issues**Definitions in
black**

Ethical decisions
are decisions
by business
on moral
questions
referred to as
‘doing the right
thing’.

Should businesses always ‘do the right thing’? Should businesses always take decisions they are fair and moral?

Should businesses ever:

- take or offer bribes to government officials or people working for other firms, for example, to gain better information?
- employ child workers, even though it might not be illegal in some countries?
- buy its supplies from suppliers that damage the environment, for example those that pollute rivers causing disease, fish deaths?
- agree to ‘a high profit’ risk compromise?
- pay directors large bonuses and salaries of business large profit partners at the same time as reducing the workforce?

These are all examples of ‘ethical decisions’ that many businesses have to face up to very frequently. Firms can have very different answers to the questions above. This is because people have very different moral codes and therefore different ethical standards. The next section explores these and:

- 1 ‘the thing a business does not deliberately break the law that any decision is taken is acceptable. Business must make profits, after all’.
- 2 ‘Even if certain activities are not illegal, it is unethical and therefore wrong to do them despite any increase in profit that might occur’.

Impact on business of ethical decisions

Assume a large multinational clothing business – ‘Company X’ – bought clothes from a factory in a low-income country. The managers of Company X know that the factory employs child labour – it is not illegal to employ workers as young as 12 years old by the country it is based in.

Another business – Company Y – only buys clothes from suppliers who guarantee not to employ children and pay reasonable wages and offer good working conditions. Company Y managers check that suppliers being no from countries. What is the potential impact on Company Y of this policy decision?

Case discussion

Remember:
that there is no
right or wrong;
decisions made
reflecting what
the person or
business
is doing;
taking less on
more difficult in the
decisions making

Additional benefits of ethical marketing - Company Y	Additional costs of ethical marketing - Company Y
Customers may feel satisfied because they buy products made by companies who believe in sustainable development. Customers Y are pleased with products from Company Y.	Higher price - adult customers will be paid more than child customers and grown working children will be given less free food.
Good publicity about Company Y's ethical decisions will provide free promotion - Company Y has better brand position. Using new products of Company Y would increase sales.	Company Y's price might have to be set higher than those of Company X because of higher costs.
Shareholders and investors may want to be linked to an 'ethical' business - Company Y may find it easier to recruit the best workers and retain capital.	Company Y's branding costs will be higher if higher quality products are made - then sales of Company Y would fall.
There is less risk of legal action being taken against Company Y.	It could be argued that, in some countries, it is difficult to prove negligence in the outcome of an accident.

Case study: Who's to pay? UK supermarket price rises

The supermarket executive to the UK market around 800 major food stores (the average worker in these organisations) "Many people believe that this year price increases are acceptable and sustainable. These are not just arbitrary price rises that are unlikely to be sustainable and competitive. These are based on facts, such as economic growth in some key markets which is deserved, based on a sufficient level of investment in our businesses and other brands." The Chief Executive of Sainsbury's (Sainsbury's) in an interview, in a public role, has shown that he accepts that it is his company, he claims that this year price rises in other companies leads to low consumer morale and loyalty. In addition many consumers feel that they cannot trust their price and trust again because of excessive short-term cost increases. The Chief Executive of Ocado (Ocado) - the multichannelled food company recently had a 4% price increase in total product range - in the same year that the company invested over 100 million pounds in its UK operations in the UK market.

Many executives argue that it is essential for year-round high incomes for the best employees so that this company can be more successful in future. Executives, despite general concern of banks for the UK and Europe making decisive monetary fiscal and budgetary decisions, they were not yet fully prepared to take an alternative set of financial decisions at year-end.

Source: www.guardian.co.uk/business/2009/apr/28/supermarket-prices

Activity 10.2

Read the case study above.

- 1 What is meant by 'an unethical decision'?
- 2 How do you think ethical marketing policies are paid for if you consider all food companies?
- 3 Is it right that customers must be paid up to 800 times more than average workers? Explain your answer by considering the advantages and disadvantages of this situation.

International business: do business offices have environmental costs of air travel?



Protecting planes and people with aircraft

Airline industry has, like most of the world's largest manufacturers of passenger aircraft, a production of heavy-duty jet planes. These planes are made of different types of plastic needed in order to save fuel - they are 20 per cent more fuel-efficient. They are also much quieter than earlier models. Many airline want to buy these planes even though they are expensive. The airline will have fuel bill increase their image of 'fuel consumption'.

Airline industry will continue to be affected by long-distance passenger travel. This is important because their aircraft will cause 20 per cent of the world's air pollution by 2000. It is asking governments to put flight taxes on aircraft fuel to make air travel more expensive. Airlines hope that the rise of urban will reduce the need for air travel.

Unconscious possible:

- Does all business activity lead to environmental damage?
- Why do business offices need to seem to be 'socially responsible'?
- When should business respond to pressure from groups such as Greenpeace, Oxfam, etc?

Exam-style questions - Paper 1

- 1 Jean-Luc is the Chief Executive of a furniture factory. He認為 his business is supporting "sustainable development", as wood is better than plastic or metal for the environment. His company makes sustainable furniture that is used in many countries. Wood is bought from the cheapest source - Africa. Jean-Luc thinks it comes from rainforests that are being cut down, but he does not ask the suppliers about this. Furniture is transported by trucks and ships. Waste wood is burnt as fuel rather than sending it for processing into other products. Air quality in Jean-Luc's country is very poor but the government does not know which the major polluters are. Jean-Luc's business employs 2000 workers.
- What is meant by "sustainable development"? [1]
 - Identify two ways in which Jean-Luc's business impacts on the environment. [2]
 - Identify and explain two ways in which Jean-Luc's business might be encouraged to be more "environmentally friendly". [4]
 - Identify and explain two possible benefits to Jean-Luc's business of becoming more "environmentally friendly". [4]
 - Do you think it is right for Jean-Luc to promote his business as a supporter of "sustainable development"? Justify your answer. [5]
- 2 MDF is a large wood-making business. Sales and profits have fallen recently. The directors are under pressure from the owners to make the business much more profitable. One director has paid a bribe to a Government official to make sure MDF gained a Government contract. MDF has closed four local works this year and opened a huge new works in a low-income country. Pollution controls are very weak in this country. Workers are lone and some children are employed to do the work -- but at non-dangerous pay. Profits must be increased as a priority said Maria (the head of finance of MDF). "Retail decisions can increase sales".
- What is meant by "ethical decisions"? [1]
 - Identify two ways in which MDF could be said to be competing "unethically". [2]
 - Identify and explain two possible benefits to the company of operating in these ways. [4]
 - Identify and explain two possible improvements to MDF's actions by passing laws and amending statutes. [4]
 - Do you agree with Maria when she said "profits must be increased as a priority. Ethical decisions can increase sales"? Justify your answer. [5]

Revision checklist

In this chapter you have learned:

- how business activity can damage the environment and lead to alternatives
- ways in which businesses can respond to the threats and opportunities of environmental issues such as joining the "sustainable development"
- the role of pressure groups in influencing business decisions
- what ethical decision making means and why some businesses consider the environment

Now... test your understanding with the review questions on the E31-BOOK.

Business and the international economy

This chapter will explain:

- how globalisation creates threats and opportunities for businesses
- what multinationals are and the benefits to a business of becoming a multination
- the impact multinationals can have on the economies they operate in
- how exchange rate movements can have an impact on business decisions

Globalisation

Multinationals & markets

Globalisation is
the increasing
ability and
desire
to move
products and
capital around
the world.
Free trade
agreements help
allow countries to
trade
freely and
with no import
and export
barriers.

In many ways the world is becoming one large market rather than a series of separate national markets. The same goods and services can be found in every country throughout the world. Workers are moving to areas of more favourable economic and capital returns. It also means easier trade between countries. There are several reasons for this increase in global trade and movement of products, people and capital (globalisation).

- Increasing numbers of free trade agreements and economic unions between countries have reduced protection for industries. Countries can produce goods and services from other countries with low or no import controls such as tariffs.
- Improved and cheaper travel links and communications between all parts of the world have made it easier to transport products globally. In addition this increases allows every price comparison between goods from many countries. Online retailing is allowing sellers to be placed from anywhere in the world.
- Many 'emerging market countries' are industrialising very rapidly. Countries in SE Asia and China send no import duty of the goods they sell. New short-term manufacturing industries are on arriving first can compete in large quantities - at very competitive prices.

Globalisation – opportunities and threats

Increasing free trade and the rising mobility of labour and capital (for example the growth of multinational corporations) is having many effects on businesses all over the globe. Some of these effects are positive – opportunities – and some are potentially negative – threats.

Globalisation: potential opportunities for businesses

Opportunity	Impact on Business
Using existing assets in other countries - opening new foreign markets	This increases customer sales, but requires investment with local government officials. Online selling offers prospect for growth in the rest of these markets.
	Adds to cost for resources to set up and sell through intermediaries (logistics, power if there were no port, no roads).
Using internationalisation in other countries - diversify production	It would be cheaper to build closer proximity to other countries than UK factory.
	Test out the quality bar on yourself (global tests are an official reason to go, even price testing conditional). It is important to set up international offices in countries.
Export products from other countries to sell to customers in their country	With our world globalised it could be profitable to export goods and services from other countries and sell them domestically.
	Test the products will need translation and packaging, reasons - and then parts and support be available from the producers in the foreign country?
Export materials and components from other countries - do not produce final product in "their" country	It could be cheaper to purchase these materials from other countries - and then it is often easier to add value to reduce costs. Price supplier could be discounted further.
	Test out the products to understand what the price difference and cost would be throughout market.

Globalisation: potential threats to business

Threat	Impact on Business
Increasing imports into home market from "other" countries	It has a negative effect because production of higher quality was in local business might fail.
	Test the imported products could force the local business to become more efficient.
Increasing investment from multinationals - set up operations in "their" country	They will claim further expansion or put the multinationals may have economies of scale and the idea to defend they local companies.
	Test some big players could become very aggressive. These organisations and their ideas could increase competition.
Unfriendly crop based businesses that control and the same as most other international companies	Unfriendly politicians, inflation will take from health checks about where they could and for which business - businesses will have to move offices to leave their local employees.
	Test this might encourage local businesses to come alongside of multinationals methods to keep their workers.

Globalisation has led to more choice and lower prices for consumers. It has forced businesses to look for ways of increasing efficiency. Innovative producers have gone out of business. Many firms have merged with foreign businesses or made it easier to sell in foreign markets. This is one of the reasons behind the growth of multinational corporations.

This process of entry and exit by trade does lead to some problems. Many workers, often in the poorest countries, have lost their jobs owing to globalisation. Big foreign corporations can often purchase goods much cheaper and efficiently, so other countries' workers lose out. As governments can no longer "protect" their industries against foreign competition, the process can lead to serious economic and social problems.

Why some governments introduce tariffs and quotas

Manufacturers as buyers

Buy import quota

If a manufacturer can buy supplies of a product that can be imported.

Protectionism

Imports are controlled by governments. Protectionists believe that free foreign competition using tariff and quota

In Chapter 5b, import tariffs were explained as being one form of trade that governments can use to raise revenue. There is another important reason why governments might introduce tariffs and **quotas** on imports.

They are forms of **protectionism** – to protect domestic industries from competition that might otherwise close them down. Foreign competitors might be able to produce products much more cheaply and if they were allowed to import without any restrictions then local firms might be forced out of business. This would reduce employment and incomes.

This is a simple argument to understand – but many economists believe it is wrong. They believe it is better to allow local consumers to buy imported goods as cheaply as possible (so increase their living standards) and for local businesses to produce and export goods and services in which they have a competitive advantage. In this way, living standards across the globe can be improved. This is the free trade argument.

Case study: IBM's move offshore of production

IBM is one of the largest corporations in the world, manufacturing and selling computers, hardware and software. It has taken full advantage of the opportunities offered by globalisation, not only using its products around in nearly every country but it has invested in factories and offices everywhere. In 1995 IBM had 120,000 staff worldwide – with 70,000 in America. Most of the companies that it supplies to in the US use American-based companies. The company is well positioned to take advantage of demand in emerging market economies such as Brazil and Mexico. However, IBM faces tough competition. There is very fierce competition between IBM and its Chinese rivals. IBM cannot ask the US government to permit it to trade under such circumstances of free trade agreements.

Activity 18.1

Read the case study above

- Identify and explain the need for an IBM of protectionism.
- Identify and explain the potential risk to IBM from continued globalisation.

Multinational businesses

Definition of a business

- A **business** is an organisation which sells goods or services to customers.
- To be called a **multinational**, a business must produce goods or services in more than one country.

It is important to remember that a multinational business is not one which just sells goods in more than one country. To be called a multinational, a business must produce goods or services in more than one country.

Multinational businesses are some of the largest organisations in the world. They include:

- oil companies: Shell, BP, Exxon
- tobacco companies: British American Tobacco, Philip Morris
- car manufacturers: Toyota, Volkswagen

Activity 18.1

Make a list of at least four businesses operating in your country which are multinational. You can start this by writing your teacher or by contacting other businesses themselves and asking what other countries they operate in.

Why do firms become multinational?

There are some of the reasons why firms become multinational organisations:

- to produce goods in countries with low costs, such as low wages. For example, men's sports clothing is produced in the USA. American wages are lower than in Europe.
- to source raw materials which the firm may need for production or refining. For example, crude oil from Saudi Arabia is needed to supply oil refineries in the UK.
- to produce goods nearer the market to reduce transport costs. For example, oil and books are expensive to transport so the production of a factory near the market is another country.
- to avoid barriers to trade put up by countries to reduce the import of goods. For example, rules of origin made in Japan are relevant in Europe. Japanese manufacturers now make cars in Europe too.
- to expand into different markets, each in different parts. For example, if sales are falling in one country the business may move to a greater country where sales are strong.
- to remain competitive with local firms which may be expanding abroad.

But, there is no doubt that businesses gain from becoming multinational. But what is the impact on the countries that operate in? There are both advantages and disadvantages to the countries as a result of multinationals operating there.

Advantages of multinationals operating in a country

- jobs are created, which reduces the level of unemployment.
- New technology in buildings and machinery increases output of goods and services in the country. New technology can benefit the country by bringing in new ideas and methods.
- Some of the year's wages may be paid abroad, which will increase the exports of the country. This, in turn, may be reflected in more goods and services made in the country.
- Taxes are paid by the multinationals, which increases the funds to the government.
- There is more product choice for consumers and more competition.

Disadvantages of multinationals operating in a country

- The jobs created are often unskilled assembly line tasks. Skilled jobs, such as those in research and design, are not usually created in the 'host' countries receiving the multinationals.



- Local firms may be forced out of business. Multinationals use others more efficient and have lower costs than local businesses.
- Reputation of profits – profit motive often won't lead to a multinational's 'home' country and not legal in the country where they are based.
- Multinationals often bring up scarce and non-commodity primary resources to the home country.
- An industrialised business can very large size could have a lot of influence on both the government and the economy of the host country. They might ask the government for large grants to keep their operations in the country – threatening to leave the country with big job losses if these are not paid by the government.

Activity 26.2 Should we allow the XYZ Corporation to set up a factory in our country?

- The XYZ Corporation is requesting for permission to build a factory in your country. This factory is expected to be very profitable. One thousand new jobs should be created for people from your country. Many of the goods made could be sold abroad. Some of the supplies for the factory will come from your country.
- Local country unemployment is high, especially amongst skilled workers. The Government cannot afford any more building projects. These are causing local communities unending growth similar to the XYZ Corporation. Unemployment levels are very high. Land for new building is very limited. New developments would have to be built on beautiful mountains.
- Locally there are groups in your country who may benefit from allowing the XYZ Corporation to build the factory.
- Locally there are groups in your country who may lose from the building of the factory.
- Should you advise your Government to allow the new factory to be built? Explain your answer by using all of the evidence.

Revision summary: advantages and disadvantages of multinationals



Exchange rates

Definition of a exchange rate

The exchange rate is the price of one currency in terms of another, for example £1 = \$1.41.

If you have just travelled abroad then you will know that it is usually necessary to change your money into foreign currency. Your country has its own currency and to be able to buy things in other countries you have to use the local currency. How much of another currency do you get in exchange for your own country's currency? This will depend on the exchange rate between your currency and the foreign currency you wish to buy.

Assume that the exchange rate between the euro (€) and the US\$ is €0.85 / \$1.00. This means that for each €1 being changed into dollars, \$1.00 would be required in exchange. To clarify, the exchange rate is the price of one currency in terms of another.

How are exchange rates determined?

Most currencies are allowed to vary or float in the foreign exchange market according to the demand and supply of such currency. For example, if the demand for the Euro was greater than the demand for the £, then the price of the £ would rise. Compared to the exchange rate in the first example, the new exchange rate would be \$1.00 / £1.75. Each £ now buys more US dollars.

How are businesses affected by changing exchange rates?

Changes in the exchange rate affect business in several different ways.

Exporting businesses

In the following case study example, consider the impact of changing exchange rates on an exporting business – one which sells goods and services abroad.

Case study: Lox Trading Ltd

Lux Trading Ltd. produces washing machines. The current price of these machines is £800. The washing machines are imported to France and the price charged by Lux Trading Ltd. The current exchange rate is £1.00 / €1.00. The fixed cost per unit is £1000 less the machine in France (including additional distribution and marketing costs).

Assume that the exchange rate for £1 now rises compared to the euro and £1 is now worth €1.02. The Marketing Manager for Lux Trading notes that some export options:

- no increase in price in France at €800 – there will be more French wash machines in stock, depleting the supplies £1000 net £900 as previously
- no raise the price in France at €800 and continue to earn £800 from each machine. This higher price in France could result in fewer sales until exports to France are likely to fall.

Definition of a depreciation

Economic depreciation
depreciation of the value of a currency
relative to another

Economic depreciation
depreciation of a currency
relative to another
depreciation

The change in the exchange rate described in the case study above is called a £ appreciation because the value of the £ has increased. Exporters have a serious problem when the currency of their customers appreciates.

Case study: Marketing manager's choices

A business currently sells many units for \$1000. It also exports these to Japan. It sells them there for \$1000 just like the exchange rate is currently \$1 = 1000.

- The exchange rate for the £ now appreciated to £1 = 1000. The new £ selling price for the imports, assuming that the Marketing Manager wishes to earn the same amount of £ from each unit will be £1000
- Little importers like selling £1 if the exchange rate for £ falls. This is called a depreciation. The same £ price is £1.01 (and in 1000, assuming that the same amount of £ is earned from each unit will cost less per 1000).

Importing business

How consider how an importing business – one which buys goods and services from abroad – might be affected by changing exchange rates.

Case study

Martin Imports Ltd, based in the UK and buys 90% of its other countries to sell to supermarket chains. One tonne of bananas from abroad costs £200 and at the current exchange rate of \$1.60 it will cost Martin Imports £192.

If the value of the £ were to depreciate what would happen to Martin Imports' cost? Assume that the value of the £ goes from £1.60 to £1.50, how much will a tonne of bananas now cost? The answer is £212.50, which is an additional increase in cost for the importing firm.

Activity 10.2

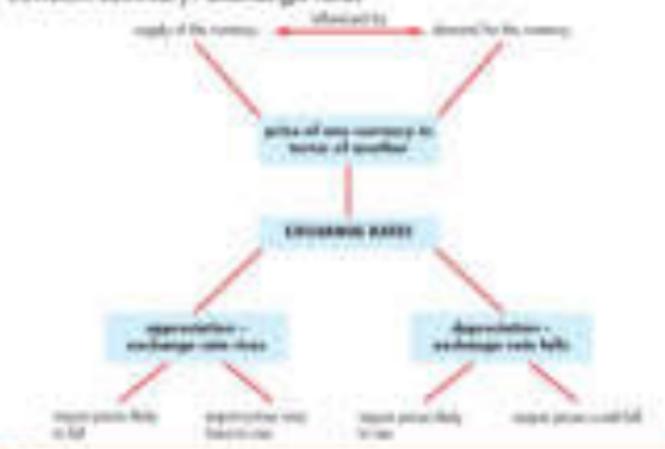
Read the case study above.

- What would happen to the cost of Martin's imports if the £ appreciated?**
- What would happen to the cost of Martin's imports if the £ depreciated?**

We have shown that an importing firm will have higher costs if the exchange rate of its currencies depreciates, but will have lower costs if the exchange rate appreciates, which an exporting firm will be able to reflect in prices. In general, if a currency depreciates, firms might have to raise prices with a currency appreciation.

You can now see how seriously businesses can be affected by exchange rate movements. This leads us to explore why some international organisations such as the European Union (EU) have tried to reduce exchange rate movements. In the case of the EU, it has introduced a common currency called euro which removes the need for separate currencies and exchange rates between member countries.

Revision summary: exchange rates



International Business in Brazil: Starbucks to change operations and culture?



Since opening in 2008, Starbucks has been opening new locations in Argentina at a rate of 10 per year. The company just opened its 100th location in Brazil, reflecting the shift of consumers to fast-growing, however, global brands. Starbucks' new business plan aims to double the number of locations to update its offerings to better serve local people in a growing, more-urban landscape; the growth of Starbucks' international business over recently global expansion has seen efforts of this expansion.

However, 11 Starbucks employees from an American customer service agent who seems a cheerful and helpful 20-year-old is actually nearly one hundred and sixteen years old using the correct machine. In the location of a Starbucks coffee house has to know competing coffee companies such as Nescafe,雀巢咖啡, and Caffitaly.

Argentina's 100th store has a distinct contrast to standard coffee culture, and Starbucks could broaden this. These are practically identical to Starbucks everywhere in the world, 100% roaster elements, such as tea investments, are taken outside of Argentina.

Discussion questions

- Apparently, Starbucks is considered as a institution?
- Would you prefer to eat a fast food or one operated by Starbucks? Did anything to arise from this question and what are the results are?
- Do Starbucks like you think the expansion of Starbucks is good for business with in Argentina?



Exam-style questions - Paper 1

- 1** PaintCo manufactures specialist paints for aircraft. It has taken advantage of globalisation. The research department recruits scientists from around the world every year. Up to 10 years ago it only had one large factory in Europe. Now PaintCo has two factories in European countries. Raw materials are imported and the paints are shipped to aircraft manufacturers in the US, Brazil and China.
- What is meant by "globalisation"? [1]
 - Identify **five** reasons for increased globalisation. [5]
 - Identify and explain **two** possible threats from globalisation to PaintCo. [2]
 - Do you think PaintCo should focus its next factory in Europe or in a non-EU country? Justify your answer. [4]
- 2** Beerna is a successful business that makes shoes in Country B. It imports some of the leather and the machines it uses until it reaches 50 per cent of its output. Recently the currency of Country B has fallen in value (depreciated). Beerna's managers are planning to open a second factory. This will be located in Country C, which already has several shoe manufacturers. Country C has just agreed to keep using protectionism by removing trade barriers such as import tariffs. Many of its importers are inefficient.
- What is meant by "exchange rate"? [1]
 - What is meant by "devalue"? [1]
 - Identify and explain **two** reasons why Beerna is planning to become a multinational business. [4]
 - Identify and explain **two** effects on Beerna of a depreciation of Country B's currency. [4]
 - Do you think the Government of Country C should encourage businesses such as Beerna to start operations in its country? Justify your answer. [4]

Revision checklist

In this chapter you have learned:

- to explain what globalisation is and why it is important
- to explain why multinationals businesses are created and understand the impact of them on the countries they operate in
- to understand what exchange rates are and how (changes in them can affect) businesses. Especially imports and exports.

GCSE – test your understanding with the revision questions on the CD-ROM.

External influences on business activity: end of section case study (Paper 2 style)

Floodelectricity

Floodelectricity is a large company that generates electricity. The company has been given permission to build a dam and hydro power station which will generate electricity. The location of the dam is to be a non-residential building a new power station near Maen-Clif.

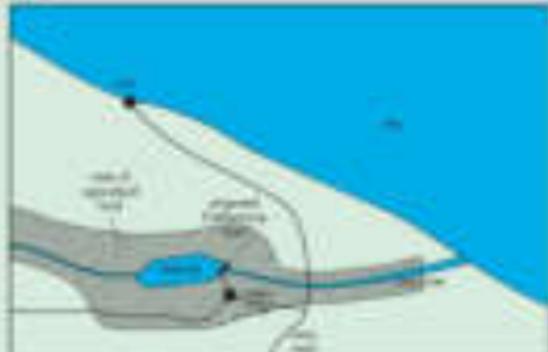
Maen-Clif is home to many oil industry workers. It has been proposed recently that the local oil plants at Maen-Clif have oil and existing industrial units inspected. The population of the village has grown as people from surrounding areas and villages have moved to Maen-Clif to work in oil jobs. Many oil refinery workers have been using their telephones for unauthorised workers at large. The supply of electricity has become a constant problem and many power cuts occur.

Floodelectricity is planning to build a dam across a wide river near the village. If it goes ahead there will be no electricity. It needs to create a reservoir of water. Electricity is made in the river passes through the dam. This new power station would provide all the electricity required by Maen-Clif and around the area.



The reservoir behind the dam, D'Vault, will be used by Floodelectricity to provide backup facilities for power from Maen-Clif. They are considering having either the loss of energy from a continuing facility or the reservoir.

Appendix 1:



Map of the proposed area for the dam.

Appendix 3.

Extract from: Mail City Times, 4 December 2013

WHD are benefit from the new power station?

Environmental groups have been pressuring on FiveElectricity plus to build a dam over the country's headwaters. If the decision fails then the environmentalists claim there will be more power cuts. Business says loss of power will prove if they can't meet their profit. Environmental groups claim the dam will destroy thousands of acres of cropland agricultural land and food supplies will be reduced. Food imports will increase and this will have a negative effect on Country 2's exchange rate.

Many people will be forced to leave their homes and move to another area. A Greenpeace spokesman said the future growth of the country could be affected if the move is too large. International companies may be put off investing in Country 2 if the power system is too fails.

- 1. At** mainly cost capture base-enterprise costs and helps ensure benefits of building the dam. **At** 10
2. At the local government should encourage the location of a multinational company in Country 2 to boost your areas. **At** 10
3. At identify and explain two effects of a business in Country 2 if no exchange rate has appreciated. **At** 10
4. At FiveElectricity is considering offering bonds to government employees to get permission to build the dam. Is this right? justify your answer. **At** 10

Optional questions:

- 1. At** FiveElectricity will need to recruit construction workers to build the dam. Outline four issues of the recruitment and retention process. Justify why you believe it will be difficult to employ these workers. **At** 10
2. At using all of the information available to you from the case study consider the advantages and disadvantages of building the dam. Recommend whether the dam will be beneficial for Country 2. Justify your answer. **At** 10
3. At Identify four multinational groups affected by the building of this dam. For each of the multinational group identified to (2) explain how they would be affected by the building of the dam. **At** 10
4. At FiveElectricity plan to issue the resources behind the dam bonds within the first 12 months/years by issuing bonds to the people of Mail City. Explain the advantages and disadvantages of unitary research and secondary research to find out which product will be the most popular. Recommend which research method they should use. Justify your choice. **At** 10

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