BUSINESS STUDIES AS LEVEL NOTES 9609

Contents

1. Business & Its Environment

1.1 Enterprise

1.1.1 The Nature of Business Activity

❖ *purpose of business activity*

- Use resources to meet the needs of customers by providing a product / service demanded
- Involves creating & adding value to resources (raw materials & semi-finished goods) & making them more desirable & valued by the final purchaser
- Use the scarce resources to produce goods & services that leads to a higher standard of living

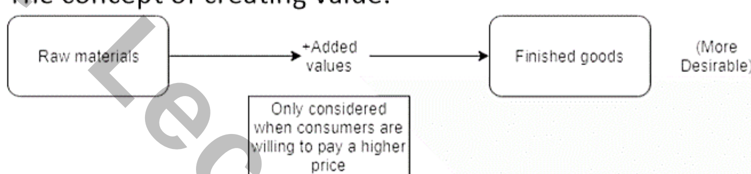
Without business activity -

- Dependent on the goods that we grow ourselves (native communities)
- Self-sufficient
- Lower living standard

❖ *the concept of creating value & adding value*

- (https://youtu.be/ihe0myow-II)
- **Creating value**: increasing the difference between the cost of purchasing bough-in materials & the price the finished goods are sold for.
- **Added value**: the difference between the cost of purchasing bought-in materials & the price the finished goods are sold for.
- **Value can be added by**:
  - Creating a brand
  - Advertising
  - Providing customised services
  - Providing additional features
  - Offering convenience

The concept of creating value:



- **The benefits of this is:**
  - Business can charge more to customers – increasing profitability
  - The product & business can differentiate themselves from competitors – brand & quality image
  - Helps cut costs in the long-run – customer loyalty & brand image

❖ *economic resources / factors of production*

- **Resources** – inputs used in the production process to produce goods & services (https://youtu.be/N09D87TK7HE)
  - **Capital** – finance needed to set up a business & pay for its operation, & the man-made resources e.g. Machinery & premises
  - **Enterprise** – entrepreneurs, who provide a driving force, combine the other factors of production into a unit that is capable of producing goods & services.
  - **Labour** – manual & skilled labour that makes up the workforce of the business
  - **Land** – land itself & all of the renewable & non-renewable resources of nature

❖ *the nature of economic activity*

- The item of lesser value is left out when making a choice (due to scarcity)
- It is the purpose of economic activity to provide for as many of our wants as possible, yet we are still left wanting more.

❖ *wants & needs*

- **Needs** – things that we cannot survive without. **The basic human needs can be classified as:**
  a. **Social** – entertainment
  b. **Physical** – food, warmth, shelter
  c. **Status** – sense of achievement, good job, large house, etc.
  d. **Security** – privacy, steady job, secure homes, etc.
- **Wants** – are the things that we can survive without e.g. Cell phones, radios, jewellery etc. Human wants are unlimited but the resources to satisfy them are limited in supply. This gives rise to the basic economic problem.

❖ *the problem of choice*

- (https://youtu.be/suecepimwre)
- **The economic problem** – there are insufficient goods to satisfy all of our needs & wants at any one time
- Shortage of products & resources = having to make choices.
- As we cannot satisfy all of our wants, then we must choose those which we will satisfy now & those which we will forgo. If we are careful & rational, we will choose those things that give us the greatest benefit, leaving out those things of less value to us.
- This need to choose is not exclusive to people as consumers. All economic units have to make choices – governments, businesses, workers, charities & so on.

❖ *opportunity cost*

- **Opportunity cost**: the benefit of the next most desired option which is given up.
- E.g. If a consumer chose to buy salad over fries, fries would be the opportunity cost
- In deciding to purchase one item, we must give up other goods as they cannot all be purchased.
- The next most desired product given up becomes the 'lost opportunity' / opportunity cost.
- This concept exists for all economic decision makers - consumers, businesses & government.

❖ *business environment is dynamic*

- Setting up a new business is risky because the business environment is dynamic (constantly changing)
- The risk of change can make the original business idea much less successful.
- New businesses may turn from successful to loss-making (fail) due to - **(let b)**
  - Competitors (other **b**usinesses)
  - **L**egal changes-outlaw products, e.g. Outlawing the product altogether
  - Market/customers has less to spend (**e**conomic)
  - Obsolesce (**t**echnological), the methods used become old-fashioned & expensive.

❖ *why many businesses fail early on*

- Lack of record keeping
- Lack of cash & working capital
- Poor management skills
- Changes in the business environment

- *what a business needs to succeed*

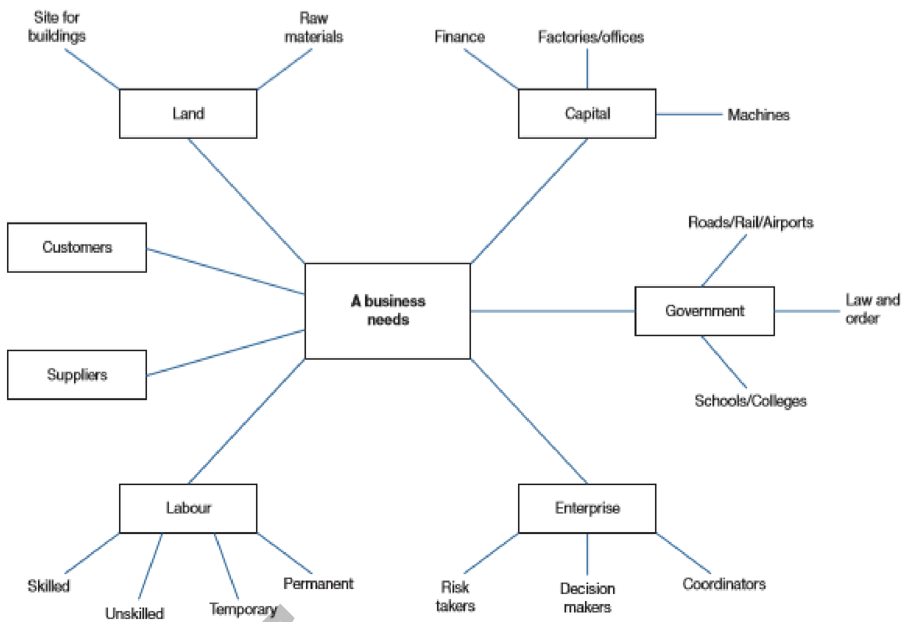


Figure 1.1 What businesses need

1.1.2 The Role of The Entrepreneur

(https://youtu.be/xzvjvdy-Dhk)

- *qualities of successful entrepreneur* ***(crilms)***
  - Commitment & self-motivation
  - Risk taking
  - Innovation
  - Leadership skills
  - Multiskilled
  - Self-confidence & an ability to bounce back

- *the role of the entrepreneur*
  - Have an idea for a new business
  - Invest some of their own savings & capital
  - Accept the responsibility of managing the business
  - Accept the possible risks of failure.

- *challenges faced by entrepreneurs*
  - (https://youtu.be/_o3fyhwx0ro)
  - Identifying successful business opportunities
  - Sourcing capital
  - Determining a location
  - Competition
  - Building a customer base

- *role of business enterprise in the economy of a country*
  - Provide employment
  - Pay taxes

- Increase the GDP of the country
- Satisfy the needs & wants of the people
- Bring foreign currency if the products are sold outside the country
- Reduce poverty levels
- Increase competition in the industry

❖ *types of entrepreneurial businesses*

- **Primary sector**
  - Fishing – e.g. A small boat owned by an entrepreneur
  - Market gardening – producing cash crops to sell at local markets.
- **Secondary sector**
  - Jewellery-making
  - Dress-making
  - Craft manufacture, e.g. Batik cloth
- **Tertiary/service sector**
  - Hairdressing
  - Car repairs
  - Cafés & restaurants
  - Child-minding.

1.1.3 Social Enterprise

(https://youtu.be/1h2wdzhne4c)

❖ *the range & aims of social enterprises*

- **Social enterprise**: a business w/ mainly social objectives that reinvests most of its profits into benefiting society rather than maximising returns to owners.
- **Most social enterprises have these common features:**
  - They directly produce goods / provide services.
  - They have social aims & use ethical ways of achieving them.
  - They need to make a surplus / profit to survive as they cannot rely on donations as charities do.

❖ *triple bottom line*

- **Triple bottom line**: the three objectives of social enterprises - economic, social & environmental.

a. **Economic** – make a profit to reinvest back into the business & provide some return to owners
b. **Social** – provide jobs / support for local, often disadvantaged, communities
c. **Environmental** – protect the environment & manage the business in an environmentally sustainable way.

1.2 Business Structure

1.2.1 Economic Sectors

❖ *primary, secondary & tertiary sector businesses*

- **Primary sector**: firms that extract natural resources to be used & processed by other firms.
  - E.g. Farming, fishing, oil extraction
- **Secondary sector**: firms that manufacture & process products from natural resources.
  - E.g. Computers, brewing, baking, clothes-making & construction
- **Tertiary sector**: firms that provide services to consumers & other businesses.
  - E.g. Retailing, transport, insurance, banking, hotels, tourism & telecommunications

❖ *the public & private sectors*

- (https://youtu.be/dr_ohenqugk)
- **Public sector**: comprises of organisations accountable to & controlled by central / local government (the state).
- **Private sector**: comprises businesses owned & controlled by individuals / groups of individuals.

❖ *changes in business activity*

- (https://youtu.be/fcqrc88tyse)
- **Industrialisation**: a growing importance of the secondary sector manufacturing industries in developing countries.
- The relative importance of each sector is measured in terms either of employment levels / of output levels as a proportion of the whole economy.

Advantages	Disadvantages
Total national output (GDP) increases and this raises standards of living	The chance of work in manufacturing can encourage a huge movement of people from the countryside to the towns, which leads to housing and social problems
Increasing output of goods can result in lower imports and higher exports of such products	
Value is added to the countries' output of raw materials, rather than just exporting these as basic, unprocessed products	Imports of raw materials and components are often much needed, which can increase the country's import costs
Expanding and profitable firms will pay more tax to the government	Much of the growth of manufacturing industry is due to the expansion of multinational companies
Expanding manufacturing businesses will result in more jobs being created	

- In developed economies, there is a decline in the importance of secondary-sector activity & an increase in the tertiary sector. **This process is termed deindustrialisation.**
  - Rising incomes due to higher living standards = consumers spend on services rather than more goods = growth in tourism, hotels & restaurant services, financial services, etc.
  - The rest of the world industrialises making manufacturing businesses in developed countries less competitive because developing countries are more efficient & use cheaper labour = rising imports of goods (smaller market for domestic secondary sector firms).

❖ *types of economies*

- **Economy**: the state of a country / region in terms of the production & consumption of goods & services, & the supply of money
- **Mixed economy**: economic resources are owned & controlled by both private & public sectors.

Advantages	Disadvantages
It has the advantage of taking the benefits of capitalist nature of private companies and socialist nature of government.	Since welfare of society is important in a mixed economy, it leads to lower than optimum use of the resources
Less inequality of income because government aims to have a balanced economic growth	Private enterprises have to face a lot of difficulty because of various government regulation
Individuals can run businesses and make profits	
Government can break up monopolies	

- **Free-market economy**: economic resources are owned largely by the private sector w/ very little state intervention.

Advantages	Disadvantages
A variety of goods and services produced	Businesses will only produce profitable goods
Businesses respond quickly to changes in consumer demand	Businesses will only sell products to customers who can afford to pay most for them
Businesses will innovate due to profit motive	Resources will only be employed if profitable
There is no taxation	Harmful goods may be produced if profitable
	Harmful effects of the products may be ignored
	Firms may dominate market supply of a product

- **Command economy**: economic resources are owned, planned & controlled by the state.

Advantages	Disadvantages
Prices are kept under control and thus everybody can afford to consume goods/services	Consumers cannot choose and only those goods and services are produced which are decided by the government
There is less inequality of wealth	
There is no duplication as the allocation of resources is centrally planned	Lack of profit motive may lead to firms being inefficient
Low level of unemployment as the government aims to provide employment to everybody	A lot of time and money is wasted in communicating instructions from the government to the firms
Elimination of waste resulting from competition between firms	

1.2.2 Legal Structures

❖ *different types of legal structure*

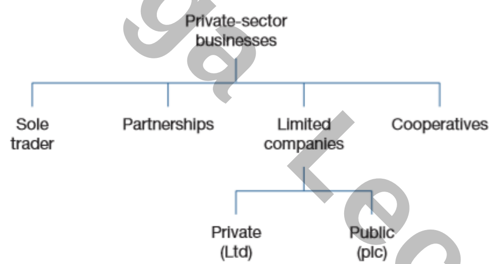


Figure 2.1 The private sector – legal structure

- **Unlimited liability**

a. **Sole trader**: a business in which one person provides the permanent finance &, in return, has full control of the business & is able to keep all of the profits (https://youtu.be/lljb9nb07xa)

Advantages	Disadvantages
Easy to set up – few legal formalities	Unlimited Liability
Owner has complete control	Long hours often necessary
Owner keeps all profits	Difficult to raise additional capital
Business can be based off of interests and skills of the owner, rather than working as an employee for a larger firm	Owner is unable to specialise in interesting areas of the business as they are responsible for all aspects of management
Able to choose times and patterns of working	Can face intense competition from bigger firms
Able to establish close relationships with staff and customers	Lack of continuity – there is no separate legal status so when the owner dies, the business will end too

b. **Partnerships:** a business formed by two / more people to carry on a business together, w/ shared capital investment &, usually, shared responsibility (https://youtu.be/LM1DvORE9KY)

Advantages	Disadvantages
Partners may specialise in different areas of business management	Lack of continuity – the partnership will have to be reformed in the event of a death of a partner
Shared decision making	Unlimited Liability for all partners
Additional capital injected by each partner	Profits are shared
Greater privacy than corporate organisations	Not possible to raise capital from selling shares
Easy to set up as less formalities than limited companies	All partners are bound by the decisions made by any one of them
Shared responsibility so business losses are shared between the partners	A sole trader, taking on partners, will lose independence of decision making
	Limited access to capital when compared to Limited companies
	Potential for conflict between partners

- **Sleeping partner**: a partner who usually supplies the business w/ capital, however they do not have an active role in running the business. These have limited liability.
- **Deed of partnership**: provides agreement issues, i.e. Voting rights, the distribution of profits, the management role of each partner & who has the authority to sign contracts.

- **Limited liability**

- **Separate legal identity:** the company is recognised in law as having a legal identity separate from that of its owners
- **Share**: a certificate confirming part ownership of a company & entitling the shareholder owner to dividends & certain shareholder rights
- **Shareholder**: a person / institution owning shares in a limited company
- **Limited companies**: incorporated business w/ limited liability, a separate legal personality & continuity of a business. In setting up, these must register w/ the registrar of companies at companies' house. **To do this they must complete:**
  - **Memorandum of association**
    - Name of the company
    - Address of the head office
    - Maximum share capital for which the company seeks authorisation
    - Companies declared aims
  - **Articles of association**
    - Internal workings of the business & control of the business e.g. It details the names of directors & the procedure to be followed at meetings

a. **Private limited companies**: an incorporated business that is owned by shareholders but does not have the legal right to offer shares for sale to the public (https://youtu.be/q6vnyff6p9y)

Advantages	Disadvantages
Shareholders have limited liability	Legal formalities involved in establishing the business
Separate legal personality	
Continuity in the event of a shareholder's death	Quite difficult for shareholders to sell shares
Able to raise capital from sale of shares to family, friends and employees	Capital cannot be raised by sale of shares to the general public
Original owner is still often able to retain control	End of year accounts must be sent to Companies House – available for public inspection there
Greater status than an unincorporated business	

b. **Public limited companies**: an incorporated business that has the legal right to offer shares for sale to the public. Shares of these companies are listed on the stock exchange (https://youtu.be/_Q7W_ruc024)

Advantages	Disadvantages
Limited Liability	Legal formalities in formation
Ease of buying and selling of shares for shareholders encourages investment	Cost of business consultants and financial advisers when creating such a company
Separate legal identity	Risk of takeover due to the availability of shares
Access to substantial capital sources due to the ability to issue a prospectus to the public and to offer shares for sale	Legal requirements concerning disclosure of information to shareholders and the public *e.g. annual publication of reports and accounts*
Continuity	Share prices subject to fluctuation – sometimes for reasons beyond business control
	Directors influenced by short-term objectives of major investors (Short-termism)

- **Other forms of business organisation**

a. **Cooperatives**: business organisations owned & controlled by a group of people to undertake an economic activity for mutual benefit (https://youtu.be/90FL_bBE4mw)

- **Consumer cooperatives:** members buy goods in bulk, sell them, & divide the profits between members
- **Worker cooperatives**: workers buy the business & run it; decisions & profits are shared by the members.
- **Producer cooperatives**: producers organise distribution & sale of products themselves

Advantages	Disadvantages
Good motivation for all members to work hard as they will benefit from shared profits	Poor management skills unless professional managers are employed
Working together to solve problems and take decisions	Capital shortages because no sale of shares to the non-member general public is allowed
Members share responsibilities, decision making	Slow decision making if all members are to be consulted on important issues
Bulk Buying	

b. **Franchises**: a business that uses the name, logo & trading systems of an existing successful business; based upon the purchase of a franchise licenser from the franchiser (https://youtu.be/kooewuilbng)

Advantages	Disadvantages
Fewer chances of new business failing as an established brand and product are being used	Share of profits or revenue has to be paid to franchiser each year
Advice and training offered by franchiser	Initial franchise license fee can be expensive
National advertising paid by franchiser	Local promotions may be paid by franchisee
Supplies obtained from established suppliers	No choice of supplies or suppliers to be used
Franchiser agrees not to open another branch in local area	Strict rules over pricing and layout of outlet reduce owner's control over their own business

c. **Joint ventures**: where two / more businesses agree to work closely together on a particular project & create a separate business division to do so.

Advantages	Disadvantages
Costs and risks of a new business venture are shared	Errors and mistakes might lead to one blaming the other for mistakes
Different companies might have different strengths and experiences and they therefore fit well together	The business failure of one of the partners would put the whole project at risk
They might have their major markets in different countries and they could exploit these with the new product more effectively than if they both decided to 'go it alone'	Styles of management and culture might be so different that the two teams do not blend well together

d. **Holding companies**: a business organisation that owns & controls a number of separate businesses, but does not unite them into one unified company. They often have separate businesses in different markets w/ diversified interests.

e. **Public corporations**: businesses enterprise owned & controlled by the state. They often do not have profit as a main objective.

Advantages	Disadvantages
Managed with social objectives rather than solely with profit objectives	Tendency towards inefficiency due to lack of strict profit target
Loss-making services might still be kept operating if the social benefit is great enough	Government may interfere in business decisions for political reasons
Finance raised mainly from the government	Subsidies can encourage inefficiencies

❖ *concept of limited liability & its importance*

- **Limited liability**: the only liability – potential loss – a shareholder has if the company fails is the amount invested in the company, not the total wealth of the shareholder. **This has two important effects:**
  - People are prepared to provide finance to enable companies to expand.
  - The greater risk of the company failing to pay its debts is now transferred from investors to creditors.
  - As a result, they are very interested in both checking whether the word 'limited' appears in the business name & scrutinising the company's accounts for signs of potential future weakness.

❖ *problems resulting from changing from one legal structure to another*

- **Changing from sole trader to partnership**
  - Sharing profits
  - Interference in decision-making
  - Bad decision of one partner affects all partners
- **Changing from partnership to limited company**
  - Owners may lose control
  - Legal work required
  - Financial accounts have to be made public
  - Decrease in privacy

1.3 Size of Business

1.3.1 Measurements of Business Size

❖ *different methods of measuring the size of a business (profit is not an acceptable measure of business size)* ***(comers)***

- (https://youtu.be/gqgarfdpx1c)
- **Capital employed** – generally the larger the business, the greater the value of capital needed. However, comparisons in different industries may be misleading e.g. A hair dresser & an optician
  - **Capital employed**: the total value of all long-term finance invested in the business
- **Other measure** – e.g. Occupied hotel rooms, number of shops, total floor space
- **Market capitalisation** – businesses w/ higher market capitalisation are generally larger, however it can only be used w/ businesses that have shares on the stock exchange. Due to the fluctuations, it can be very unstable to compare.
  - **Market capitalisation**: the total value of a company's issued shares
  - **Market capitalisation** = current share price × current no. Of shares
- **Number of employees** – a larger number of employees suggests a larger business. It is the simplest method & easy to understand, however it does not represent a business which requires little amounts of workers.
- **Revenue/sales turnover** – a larger sales turnover (revenue) represents a larger business. It is often used when comparing industry businesses. Less effective if in different industries e.g. High value production i.e. Previous jewels compared to low value production i.e. Cleaning services

- **Revenue**: total value of sales made by a business in a given time period.

- **Market share** – if a business has a high market share then it must be among the leaders in the industry / comparatively large. However, if the total size of the market is small, a high market share will not indicate a very large firm.
  - **Market share**: sales of the business as a proportion of total market sales
  - **Market share** = $\frac{total\ sales\ of\ the\ business}{total\ sales\ of\ the\ industry} \times 100$

❖ *why are businesses measured in size?*

- Investors can compare businesses & know which to invest in
- Governments can know where to put different tax rates
- Competitors can gain a competitive advantage
- Workers of the business can gain more confidence in financial situation
- Banks know how much loan they should lend to the business

1.3.2 Significance of Small Businesses

❖ *advantages & disadvantages of being a small business*

Advantages of Small Businesses	Disadvantages of Small Businesses
Can be managed and controlled by the owner	May have limited access to sources of finance
Often able to adapt quickly – meets changing customer needs	The owner may have to carry a large burden of responsibility if unable to afford to employ specialist managers
Can offer person service to customers	
Knows each worker and the business is more 'human' to employees	May not be diversified so greater risks with negative impact of external change

❖ *advantages & disadvantages of being a large business*

Advantages of Large Businesses	Disadvantages of Large Business
Can afford to employ specialist managers	Decision making can be slow
May benefit from economies of scale due to large scale production	May get diseconomies of scale with large scale production
May be able to set low prices that others have to follow	May be difficult to manage, especially if geographically spread
Usually can afford Research and Development and New Product Development	Poor communication can occur due to the large structure
Can diversify into several markets and products to spread risks	Can have a divorce between ownership and control that can lead to conflicting objectives
Have access to different forms of finance	

❖ *strengths & weaknesses of family businesses*

- **Family-owned businesses**: businesses actively owned & managed by at least two members of the same family

Advantages	Disadvantages
Commitment/dedication	Succession/Continuity problems
Reliability and pride	Informality in setting practices and procedures
Knowledge and Continuity; training provided from young age	Traditional/Lack of innovation
	Family Conflict

❖ *the importance of small businesses & their role in the economy*

- **Job creation** – small businesses usually employ a significant proportion of a working population
- **Entrepreneurs** – small businesses are normally run by entrepreneurs; creates variety & choice in the market
- **Competition** – more competition for larger businesses causes an increase in quality of goods
- **Specialist goods** – they may form niche markets
- **Lower average costs** – small firms do not have to pay as much as big firms to produce their products
- **Supplier to larger businesses** – small firms can supply goods to larger firms

- *government assistance for small businesses*
  - Reduced rate of tax on profits (corporation tax)
  - Loan guarantee scheme
  - Information, advice & support
  - Financing workshops e.g. Training, unemployment
  - Helping particular issues e.g. Specialist management expertise, start-up finance, marketing risks, finding the correct location

1.3.3 Internal Growth

- *why & how a business might grow internally*
  - **Internal growth**: expansion of a business by means of opening new branches, shops / factories (also known as organic growth).

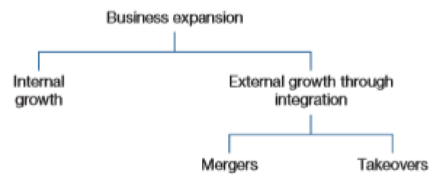


Figure 3.1 Different forms of growth

- *benefits of business growth*
  - **Increased profits** – expanding the business & achieving higher sales is one way of becoming more profitable.
  - **Increased market share** – this will give a business a higher market profile & greater bargaining power w/ both suppliers (e.g. Lower prices) & retailers (e.g. Best positions in the shop).
  - **Increased economies of scale**
  - **Increased power & status of the owners & directors** – e.g. The opportunities to gain publicity / influence government policy will increase if the business controlled by the owners / directors is large & well-known.
  - **Reduced risk of being a takeover target** – a larger business may become too large a target for a potential 'predator' company.

1.4 Business Objectives

1.4.1 Business Objectives in The Private Sector & Public Sector

- *the nature & importance of business objectives*
  - **Why set aims? (https://youtu.be/2x-equux-lq)**
    - They highlight key areas of development
    - They help businesses keep a focus upon key areas
    - They outline the 'destination' of where the company wants to reach
    - Provides a framework which strategies & plans can be drawn up
  - **Why set objectives?**
    - Objectives give the business a clearly defined target
    - Enables businesses to measure progress towards its aims
    - Can help motivate employees

- **Hierarchy of objectives**: the aims & objectives of a firm are placed in descending order of strategic importance. (https://youtu.be/bpasq6gv0r0)
  - **Aim** – where the business wants to go in the future; its goals.
  - **Mission** – the result that an organization is trying to achieve through its plans / actions
  - **Corporate objectives** – the long-term goals of the corporation that give focus & direction to the business. These form the foundation for the strategic plans for the business.

- **Smart**
  - **S – specific**: objectives should be focused on what the business does, applied directly & be specific to that business. A hotel may set an objective of 75% bed occupancy over the winter period.
  - **M – measurable**: objectives that have a quantitative value are likely to be more effective for employees to work towards. E.g. To increase sales in the south-east region by 15% this year.
  - **A – achievable**: setting objectives that are almost impossible in the time frame given will demotivate staff
  - **R – realistic & relevant**: objectives should be realistic when compared w/ the resources of the company & should be expressed in terms relevant to the people who have to carry them out. So, informing a factory cleaner about 'increasing market share' is less relevant than a target of reducing usage of cleaning materials by 20%.
  - **T – time-specific**: It will be impossible to assess if the objective has actually been met without a time limit

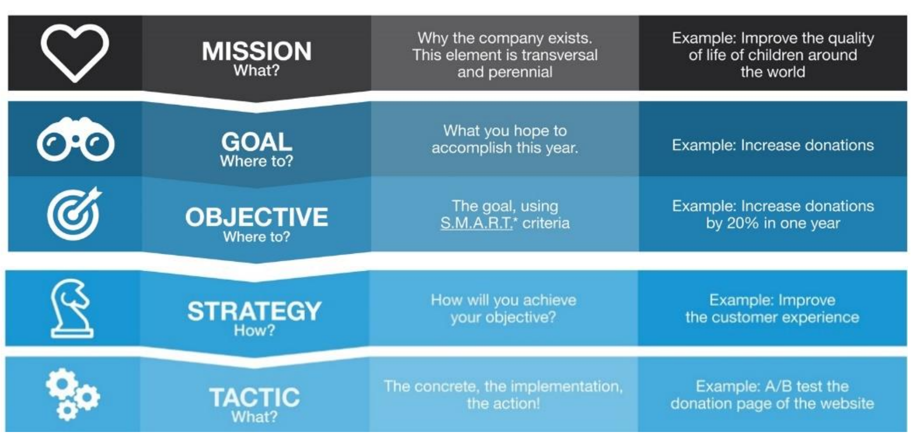
❖ *corporate social responsibility (CSR) as a business objective*

- **Corporate social responsibility**: the concept that accepts that businesses should consider the interests of society in their activities & decisions, beyond the legal obligations that they have.

Reasons for CSR	Reasons against CSR
Marketing and promotional advantage – good reputation	Cost involved in ensuring a socially responsible approach
Reduces the changes of breaking laws, avoiding bad publicity and heavy court fines	Reduction in Profits Distraction from main business activity
Long term financial gain – through increase in demand etc.	In developing countries, it is argued that economic growth is more important than CSR
Improvement in the number and quality of employee applications	Businesses just using it for publicity not actually doing it for society

❖ *relationship between mission statement, objectives, strategy & tactics*

- **Mission statement**: a statement of the business's core aims, phrased in a way to motivate employees & to stimulate interest by outside groups.



1.4.2 Objectives & Business Decisions

❖ *the different stages & the role of objectives in decision making*

- Effective decision-making requires clear objectives. Business managers cannot decide on future plans of action – strategies – if they are uncertain of which direction, they want to take the business in.
- **The stages in this decision-making framework are:**

1. Set objectives.
2. Assess the problem / situation.
3. Gather data about the problem & possible solutions.
4. Consider all decision options.
5. Make the strategic decision.
6. Plan & implement the decision.
7. Review its success against the original objectives

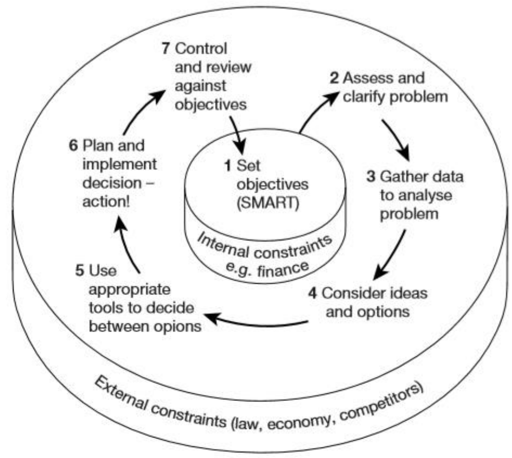


Figure 4.4 A decision-making framework

❖ *common corporate objectives*

- **Profit maximisation** – private sector firms want to gain the highest profit through increasing revenue & decreasing costs of production
- **Growth** – this is usually measured in terms of sales / value of output; growth can reduce risk of takeovers, appeal to new competitors, & motivate managers
- **Maximising shareholder value** – helps to direct management action towards taking decisions that would increase share price & returns to shareholders
- **Increasing market share** – indicates that the marketing mix of the business is proving to be more successful than that of its competitors. Becoming the 'brand leader' would make customers & retailers want to be more involved w/ this product over the competitors.
- **Maximising short-term sales revenue** – would benefit managers & staff when salaries & bonuses are dependent on sales revenue levels
- **Survival** – there is a high failure rate of new business, which means that to survive for the first two years of trading is a very important aim for entrepreneurs.
- **Profit satisficing** – aiming to achieve enough profit to keep the owners happy but not aiming to work flat out to earn as much profit as possible. Once a satisfactory level of profit has been achieved, the owners consider that other aims take priority – i.e. More leisure time.
- **Corporate social responsibility**

❖ *how objectives might change over time*

1. **Change in owners' priority** – the owners shift from one object to the next as time unfolds
2. **Change in market conditions** – in a recession the business may aim for survival
3. **Change in size of the business** – owners' objective could be growth in early stages & then profit maximisation as the business becomes well established
4. **Change in management** – the new management can introduce new changes & objectives
5. **Change in competitor behaviour** – the business can change its objectives in response to changes made by the competitors
6. **Change in legislation** – a change in government laws can force a business to come up w/ new objectives in a new environment

Figure 4.5 Influences on corporate objectives

❖ *translation of objectives into targets & budgets*

- **Management by objectives**: a method of coordinating & motivating all staff in an organisation by dividing its overall aim into specific targets for each department, manager & employee (https://youtu.be/a9m6K73Omsc)

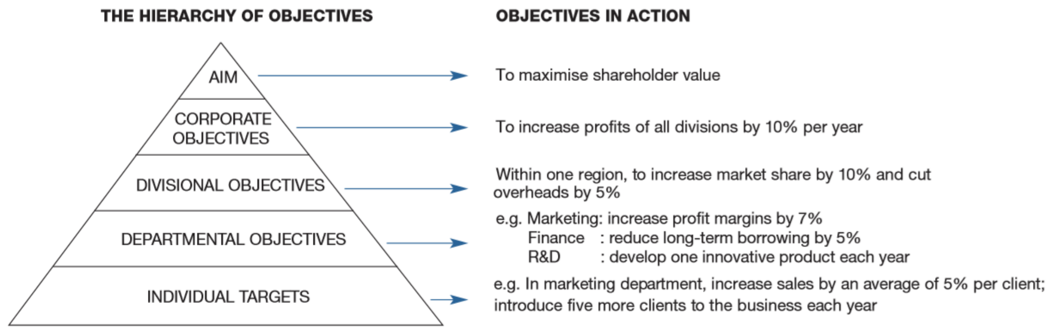


Figure 4.6 Management by objectives – how the corporate aim is divided at every level of the organisation

❖ *the communication of objectives & their likely impact on the workforce*

- If employees are unaware of the business objectives then how can they contribute to achieving them?
- Communication of corporate objectives – & translating these into individual targets – is essential for the effective setting of aims & objectives.
- If employees are communicated w/ – & involved in the setting of individual targets – **then these benefits should result in:**

- **Employees & managers achieving more** – through greater understanding of both individual & companywide goals.
- **Employees seeing the overall plan** – & understanding how their individual goals fit into the company's business objectives.
- **Creating shared employee responsibility** – by interlinking their goals w/ others in the company.
- **Managers more easily staying in touch w/ employees' progress** – regular monitoring of employees' work allows immediate reinforcement / training to keep performance & deadlines on track.

❖ *how ethics may influence business objectives & activities*

- **Ethical code** (code of conduct): a document detailing a company's rules & guidelines on staff behaviour that must be followed by all employees. (https://youtu.be/xntkjqxceie)
- **Ethics** – the moral guidelines that determine decision making

For:	Against:
Avoid court-cases & fines	Increases costs
Good PR & increased sales volume	Reduction in pester power
Attract ethical customers	No price fixing → reduction in prices & profits
Gov. Contract likely	Fair wages increase costs & reduces competitiveness
Attract well qualified staff	

1.5 Stakeholders in A Business

1.5.1 Business Stakeholders

❖ *individuals / groups interested in the activities of business*

- **Stakeholders**: people / groups of people who can be affected by – & therefore have an interest in – any action by an organisation.
- **Stakeholder concept**: the view that businesses & their managers have responsibilities to a wide range of groups, not just shareholders

❖ *roles, rights & responsibilities of stakeholders*
(https://youtu.be/t1m0zffibju)

	Roles	Rights	Responsibilities
Customers	• Purchase goods and services • Provide revenue	• Receive goods and services that meet local laws • Offered replacements, repairs, etc- as legally obligated	• Honesty • Not stealing • Not make false claims
Suppliers	• Supply goods and services	• On-time payment • Fair treatment	• Supply goods in time and condition already decided
Employees	• Provide manual and other labour services	• Treated within minimum legal limits • Employment contract payment and treatment • Join a trade union	• Honesty • Meet employment contract • Cooperate with management for reasonable requests • Observe Ethical code of conduct.
Local Community	• Provide local services and infrastructure	• Consulted about major changes • Not have lives badly affected	• Cooperate • Meet reasonable requests
Gov.	• Laws- restrain business activity • Law and order- allow activity to take place • Achieve economic stability	• Businesses to meet requirements	• Treat businesses equally • Prevent unfair competition • Good trading links internationally- allow international trade
Lender	• Provide finance in different forms	• Repaid on agreed dates • Paid finance charges	• Provide agreed finance on agreed date and time

1.5.2 The Importance & Influence of Stakeholders on Business Activities

❖ *impact of business decisions/actions on stakeholders, & their reactions*

Business decision/ activity	Possible impact on employees	Possible impact on local community	Possible impact on customers
Expansion of the business by building a new head office	■ more job and career opportunities ■ disruption during building and more complex lines of communication after expansion	■ more jobs for local residents and increased spending in other local businesses ■ disruption caused by increased traffic and loss of green fields for amenity use	■ better service provided by bigger business with more staff ■ larger business could be less personal and therefore offer inferior customer service
Takeover of a competing firm (horizontal integration)	■ the larger business may be more secure and offer career promotion opportunities ■ rationalisation may occur to avoid waste and cut costs – jobs might be lost	■ if the business expands on the existing site, local job vacancies and incomes might increase ■ rationalisation of duplicated offices or factories might lead to some closures and job losses	■ the larger business may benefit from economies of scale, which could lead to lower prices ■ reduced competition could have the opposite effect – less customer choice might result in higher prices
Significant application of IT into production methods	■ training and promotion opportunities might be offered ■ fewer untrained staff will be required and those unable to learn new skills may be made redundant	■ local businesses providing IT services could benefit from increased orders ■ specialist workers may not be available locally, so more commuting by staff in cars might be necessary	■ more efficient and flexible production methods might improve quality and offer more product variety ■ IT reliability problems could cause supply delays

Table 5.1 Impact of business activity on stakeholders

❖ *how & why a business needs to be accountable to its stakeholders*

Stakeholders	Benefits of accepting responsibility
Customers	- Consumer loyalty - Repeat purchases - Good publicity when customers give word of mouth recommendations to others - Good customer feedback - which helps to improve further goods & services.
Suppliers	- Supplier loyalty – prepared to meet deadlines & requests for special orders - Reasonable credit terms more likely to be offered.
Employees	- Employee loyalty & low labour turnover - Easier to recruit good staff - Employee suggestions for improving efficiency & customer service - Improved motivation & more effective communication.
Local community	- More likely to give planning permission to expand the business - More likely to accept some of the negative effects caused by business operations if they provide financial support for community groups & projects i.e. Children's playgrounds - More likely to give contracts to business
Government	- Success w/ expansion projects receiving planning permission - More likely to receive valuable government contracts - Requests for subsidies to expand are more likely to be approved by government - Licences to set up new operations are more likely to be awarded to businesses

2 People in Organisations

2.1 Management & Leadership

2.1.1 Management & Managers

❖ *the functions of management, including mintzberg's roles of management*

- **Manager**: responsible for setting objectives, organising resources & motivating staff so that the organisation's aims are met.
- **Mintzberg's management roles** (https://youtu.be/ngkqyrqxkts)

Role title	Description of role activities
1. Interpersonal roles: dealing w/ & motivating staff at all levels of the organisation	
Figurehead	Symbolic leader, takes on social / legal nature
Leader	Motivating subordinates, selecting & training staff
Liaison	Linking w/ managers & leaders of other divisions of the business & other organisations
2. Informational roles: acting as a source, receiver & transmitter of information	
Monitor (receiver)	Collecting data relevant to the business operations
Disseminator	Sending information collected from internal & external sources to the relevant people within the organisation
Spokesperson	Communicating information about the organisation, i.e. Current position & achievements, to external groups & people
3. Decisional roles: taking decisions & allocating resources to meet the organisations' objectives	
Entrepreneur	Looking for new opportunities to develop the business
Disturbance handler	Responding to changing situations that may put the business at risk, assuming responsibility when threatening factors develop
Resource allocator	Deciding on the spending of the organisation's financial resources & allocation of physical & human resources
Negotiator	Representing the organisation in all important negotiations

- **Functions of management:**
  - **Setting objectives & planning** – establishing of overall strategic objective translated into tactical objectives. Planning needed to put the objectives into effect also made.

- **Organising resources to meet the objectives** – recruitment, giving authority & accept accountability. Clear division of tasks for each section/dept. To work towards common objectives
- **Directing & motivating staff** – guiding, leading & overseeing employees to ensure organizational goals are met. Staff development included.
- **Coordinating activities** – ensure consistency & coordination between different parts of the firm. Establish common sense of purpose & ensure resources are used correctly.
- **Controlling & measuring performance against targets** – appraising performance against targets, take appropriate action & provide feedback.

2.1.2 Leadership

❖ *functions, roles & styles*

- **Leadership**: the art of motivating a group of people towards achieving a common objective.
- **Delegation**: passing authority down the organisational hierarchy
- **Empowerment**: allows workers some degree of control over how their task should be undertaken

❖ *the purpose of leadership*

- The purpose of leadership is to guide the people in an organization to work towards the attainment of common organizational goals. The leader brings the people & their efforts together to achieve common goals.

❖ *leadership roles in business (directors, managers, supervisors, worker representatives)*

- **Directors** – head of major functional department, elected senior members, objective meeting, communication
- **Manager** – manage people, resources, decision making. Direct, motivate & discipline.
- **Supervisor** – management appointed, responsible for goal achievement, work in a cooperative manner.
- **Worker representative** – worker elected, discuss concerns.

❖ *qualities of a good leader*

- Desire to succeed & natural self-confidence that they will succeed.
- Ability to think beyond the obvious – to be creative – & to encourage others to do the same.
- Multitalented, so that they can understand discussions about a wide range of issues affecting their business.
- Have an incisive mind that enables the heart of an issue to be identified rather than unnecessary details.

2.1.3 Choice of Leadership Style

❖ *leadership styles: autocratic, democratic, laissez-faire*

- (https://youtu.be/olmmdmm52pq)
- **Autocratic**: a style of leadership that keeps all decision making at the centre of the organisation. Lower levels of the hierarchy are given little delegated authority & communication is usually just one way.

Advantages	Disadvantages
Experienced leaders have full control of decision making	Demotivates staff who want to contribute and accept responsibility
Good in crisis situations	Decisions do not benefit from staff input

- **Democratic**: a style of leadership that allows the majority opinion of staff to influence decisions. It involves a great deal of participation from the workforce but can be time consuming.

Advantages	Disadvantages
Encourages participation in decision making	Consultation with staff can be time consuming
Two-way communication is used which allows feedback from staff	Issues may be sensitive to staff *e.g. job losses* or too secret for staff to be aware of

- **Laissez-faire**: a style of leadership that leaves much of the running & decision making of the business to the workforce. This may be appropriate in research & development departments staffed by skilled specialists that are self-motivated.

Advantages	Disadvantages
Gives employees as much freedom as possible	Lack of feedback may be demotivating
Managers communicate goals to employees but allow them to choose how they wish to work	Workers may not appreciate lack of structure and direction in their work

- **Paternalistic leadership**: a leadership style based on the approach that the manager is in a better position than the workers to know what is best for an organisation.

❖ *McGregor's leadership styles*

- **McGregor's theory x** – managers believe the workers dislike work, will avoid responsibility & are not creative
- **McGregor's theory y** – managers believe that workers can derive as much enjoyment from work as from rest & play, will accept responsibility & are creative
- **General view** – workers will behave as a result of management attitudes

Theory X managers believe that workers	Theory Y managers believe that workers
▪ dislike work ▪ will avoid responsibility ▪ are not creative	▪ can derive as much enjoyment from work as from rest and play ▪ will accept responsibility ▪ are creative

Table 10.3 Summary of Theory X and Theory Y management attitudes

❖ *the 'best' leadership style*

- **The style used will depend on many factors:**
  - The training, experience of the workforce & the degree of responsibility that they are prepared to take on.
  - The amount of time available for consultation & participation.
  - The attitude of managers, / management culture – this will be influenced by the personality & business background of the managers, e.g. Whether they have always worked in an autocratically run organisation.
  - The importance of the issues under consideration – different styles may be used in the same business in different situations. If there is great risk to the business when a poor / slow decision is taken, then it is more likely that management will make the choice in an autocratic way.

❖ *informal leader*

- **Informal leader**: a person who has no formal authority but has the respect of colleagues & some power over them.
- In an ideal business situation, where workers & employers work together in a trusting relationship, managers should attempt to work w/ the informal leaders to help achieve the aims of the business. This is best done by attempting to ensure that the aims of the informal leader & the group are common w/, / fit in w/, the aims of the business.

2.1.4 Emotional Intelligence/ Emotional Quotient (EQ)

❖ *Goleman's four competencies of emotional intelligence*

- **Emotional intelligence (EI)**: the ability of managers to understand their own emotions, & those of the people they work w/, to achieve better business performance. **This involves:**
  - Understanding yourself, your goals, your behaviour & your responses to people
  - Understanding others & their feelings.

- **Goleman's 4 main EI competencies:**
  - Self-awareness – knowing *what we feel is important* & using that to guide decision making. Having a *realistic view* of our own abilities & having self-confidence in our abilities.
  - Self-management – being able to recover quickly from *stress*, being *trustworthy & conscientious*, showing *initiative* & *self-control*.
  - Social awareness – sensing what others are feeling, being able to take their views into account & being able to *get along* w/ a wide range of people.
  - Social skills – handling emotions in relationships well & accurately understanding different social situation; using social skills to persuade, negotiate & lead.

2.2 Motivation

2.2.1 Motivation as A Tool of Management & Leadership

❖ *the need to motivate employees*

- **Motivation**: the internal & external factors that stimulate people to take actions that lead to achieving a goal.

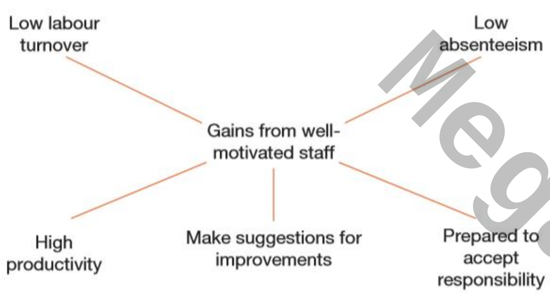


Figure 11.1 Gains from well-motivated staff

Absenteeism	deliberate absence for which there is not a satisfactory explanation; often follows a pattern
Lateness	often becomes habitual
Poor performance	poor-quality work; low levels of work or greater waste of materials
Accidents	poorly motivated workers are often more careless, concentrate less on their work or distract others, and this increases accidents
Labour turnover	people leave for reasons that are not positive; even if they do not get other jobs, they spend time in trying to do so
Grievances	there are more of them within the workforce and there might be more union disputes
Poor response rate	workers do not respond very well to orders or leadership and any response is often slow

Table 11.1 Some indicators of poor staff motivation

2.2.2 Human Needs

❖ *a simple explanation of human need*

- Elements required for life.
- Motivation theories assume individuals are motivated by the desire to fulfil their inner needs. These approaches focus on these human needs that energise & direct human behaviour & how managers can create conditions that allow workers to satisfy them

❖ *how human needs may / may not be satisfied at work*

2.2.3 Motivation Theories

❖ *ideas of the main content theorists & process theorists*

- **Maslow's – hierarchy of needs**
  - Abraham Maslow – his hierarchy of needs suggests that people have similar types of needs from low level basic needs to the need for achievement (https://youtu.be/pyk6e0ozgdu)
  - Needs start at a basic level.
  - After one need is satisfied - move on to the next.
  - Satisfied need will not motivate action
  - Reversion is possible - satisfaction can be withdrawn & level of need moved down

Figure 11.2 Maslow's hierarchy of needs

ADVANTAGES	DISADVANTAGES
• Useful summary of human needs. Applications in product design and positioning • Helps marketers focus advertisements on specific needs of the target market • Help decide rewards at each level and recognise potential. • Visual addressment of motivation	• Generalised • Practically difficult to identify which need is met. • Money can satisfy various levels • Self-actualisation is never permanently achieved

- **F.W. Taylor's scientific management**

- **F.W. Taylor** – he considered money to be the main factor that motivated workers, so he emphasised the benefits of piece work (https://youtu.be/wz5qfnajg9o)
- **Scientific management** – business decision making based on data that are researched & tested quantitatively in order to improve efficiency of an organisation. Higher efficiency would generate higher profits & thus higher wages to workers.
- **Division of labour** – breaking a job into small repetitive tasks, each of which can be done at a speed w/ little training
- **Piece work** – payment by results e.g. For every unit made they receive a certain amount of money
- **Tight management** – ensures workers concentrate on their jobs & follow the correct processes

- **Taylor's scientific approach:**

1. Select workers to perform a task.
2. Observe them performing the task & note the key elements of it.
3. Record the time taken to do each part of the task.
4. Identify the quickest method recorded.
5. Train all workers in this quickest method & do not allow them to make any changes to it.
6. Supervise workers to ensure that the 'best way' is being used & that the set time is not exceeded.
7. Pay workers on the basis of results

ADVANTAGES	DISADVANTAGES
• Sustainable productivity enhancement • Teamwork- modern bus sit. • Helps set up long-term plans	• Requires feedback • Participants could view work counters • Absence of evidence for the original study.

- **Elton mayo – the Hawthorne effect**

- **Elton mayo** – motivational theorist based on his studies known as the Hawthorne effect. (https://youtu.be/Zfq5lKBaUsQ) **He concluded that:**
  - Changes in work conditions & financial rewards had *little / no effect* on productivity
  - When management consulted workers & *took an interest*, motivation improved
  - *Team work* & developing team spirit can improve productivity
  - When some *control over* their own working lives *is given*, there is a positive motivational effect
  - *Groups can establish their own targets* / norms & these can be greatly influenced by informal leaders of the group

ADVANTAGES	DISADVANTAGES
• Enhanced Teamwork: cooperation between managers and workers • Increases speed of production • Higher productivity	• Industry specific • Lack of feedback can demotivate • Monotonous

- **Herzberg's two factor theory**
  - **Frederick Herzberg** – an American psychologist whose research led him to develop the two-factor theory of job satisfaction & dissatisfaction (https://youtu.be/nmfpar_N1Do)
  - **Motivating factors (motivators)**: aspects of a worker's job that can lead to job satisfaction.
  - **Hygiene factors**: aspects of a worker's job that have the potential to cause dissatisfaction.
  - **Conclusions:**
    - Pay & working conditions cannot motivate, only move.
    - Motivators can be adopted through job enrichment.
    - Hygiene factors get taken for granted & hence don't cause motivation in the long term.
  - **Job enrichment**: aims to use the full capabilities of workers by giving them the opportunity to do more challenging & fulfilling work.
  - **Can be achieved by:**
    - Complete units of work
    - Feedback of performance
    - Range of tasks

Motivators	Hygiene/Maintenance Factors
Sense of Achievement	Working Conditions
Recognition for effort and achievement	Supervision
Nature of the work itself	Pay
Responsibility	Interpersonal relations
Promotion and improvement opportunities	Company police and Admin *e.g. paperwork, rules*

- **David McClelland – motivational needs theory**
  - (https://youtu.be/vluy38yteng)
  - **Achievement motivation (n-ach)** – a person w/ a strong need to achieve goals & job advancement. There is a constant need for feedback & achievement (result driven).
  - **Authority/power motivation (n-pow)** – a person w/ a dominant need is 'authority motivated'. Desire to control others, be influential, effective & make an impact.
  - **Affiliation motivation (n-afill)** – a person w/ a need for affiliation, friendly relationships & interaction w/ other people. Good team members. Tend to be liked & popular.

- **Vector vroom – expectancy theory**
  - (https://youtu.be/Wm5ypcltyvI)
  - Individuals chose to behave in ways they believe will lead to outcomes that they value.
  - **Employees can be motivated if they believe that:**
    - There is a positive link between effort & performance
    - Favourable performance will result in desirable rewards
    - The reward satisfies an important need
    - Desire of need is enough to make the effort worthwhile.
  - **The theory is based on three beliefs:**
    - **'Valence'** – the depth of the want of an employee for an extrinsic reward, i.e. Money / an intrinsic reward i.e. Satisfaction
    - **'Expectancy'** – the degree to which people believe that putting effort into work will lead to a given level of performance
    - **'Instrumentality'** – the confidence of employees that they will actually get what they desire, even if it has been promised by the manager

motivational force = expectancy x instrumentality x valence

motivational force	expectancy	instrumentality	valence
extent to which a person is likely to engage in a certain course of action	belief that an increase in effort will result in an increase in performance	belief that increased performance will lead to certain outcomes	extent to which the outcome is desirable

2.2.4 Motivation Methods in Practice: Financial Motivators, Nonfinancial Motivators

❖ *different payment methods*

- (https://youtu.be/s5jxvb6evsg)
- **Wages**: payment to a worker made for each period of time worked, e.g. One hour
- **Commission**: a payment to a sales person for each sale made
- **Bonus**: a payment made in addition to the contracted wage / salary.
- **Salaries**: annual income that is usually paid on a monthly basis
- **Performance-related pay**: a bonus scheme to reward staff for above-average work performance.
- **Profit sharing**: a bonus for staff based on the profits of the business – usually paid as a proportion of basic salary
- **Piece rate**: a payment to a worker for each unit produced
- **Promotion** – where career prospects are enhanced as a result of efforts made
- **Share options** – where the employee is offered the opportunity to be a shareholder in the company
- **Time based wage rate**: payment to a worker made for each period of time worked, e.g. One hour.

Advantages	Disadvantages
It encourages greater effort and faster working.	It requires output to be measurable and standardised – if each product is different, then piece work is inappropriate.
The labour cost for each unit is determined in advance and this helps to set a price for the product.	It may lead to falling quality and safety levels as workers rush to complete units.
	Workers may settle for a certain pay level and will therefore not be motivated to produce more than a certain level.
	It provides little security over pay level, for example in the event of a production breakdown.
	Workers are discouraged from accepting change at work as this might result in loss of pay.

Table 11.4 Advantages and disadvantages of the piece rate pay system

Advantages	Disadvantages
It gives security of income. It gives status compared to time-rate or piece-rate payment systems. It aids in costing – the salaries will not vary for one year. It is suitable for jobs where output is not measurable. It is suitable for management positions where staff are expected to put in extra time to complete a task or assignment.	Income is not related to effort levels or productivity. It may lead to complacency of the salary earner. Regular appraisal may be needed to assess whether an individual should move up a salary band, although this could be an advantage if this becomes a positive form of worker appraisal.

Table 11.6 Advantages and disadvantages of a salary

Advantages	Disadvantages
Staff are motivated to improve performance if they are seeking increases in financial rewards.	It can fail to motivate if staff are not driven by the need to earn additional financial rewards.
Target-setting can help to give purpose and direction to the work of an individual.	Team spirit can be damaged by the rivalry generated by the competitive nature of PRP.
Annual appraisal offers the opportunity for feedback on the performance of an individual, but as it tends to occur only once a year this is not usually sufficient to achieve a key feature of job enrichment.	Claims of manager favouritism can harm manager–subordinate relationships. It may lead to increased control over staff by managers because of the danger that bonuses may not be awarded if workers do not conform.

Table 11.7 Advantages and disadvantages of performance-related pay

Advantages	Disadvantages
Potential conflict between owners and workers is reduced as everyone now has an interest in higher profits.	The reward offered is not closely related to individual effort – why should one worker put in greater effort when everyone will be benefiting?
They are designed to lead to higher worker effort levels and a greater preparedness to accept cost reduction measures and changes that benefit the business.	The schemes can be costly to set up and operate, especially in large firms with many employees.
The business is likely to attract better recruits drawn by the chance of sharing profits or owning shares in the firm.	Small profit shares paid at the end of the financial year are unlikely to promote motivation throughout the year.
As the bonuses are paid out of profits, the scheme does not add to business costs, unlike a normal increase in pay levels.	Profit-sharing schemes will reduce profits available to be paid to owners (reducing dividends) and to be reinvested in the business (retained earnings).
If successful in increasing motivation, then the schemes could lead to an increase in overall business profitability.	Worker share-ownership schemes can increase the total number of shares issued and dilute the value of existing shares.

Table 11.8 Advantages and disadvantages of profit sharing and worker share ownership

❖ *different types of non-financial motivators*

- (https://youtu.be/-dwvl93znzc)
- **Job rotation**: *increasing the flexibility* of employees & the *variety* of work they do by *switching from one job to another*.
  - Decrease in boredom
  - Increase in multiple skills
  - No authority / promotion
- **Job enlargement**: attempting to *increase the scope* of a job by *broadening the tasks* undertaken.
  - Increase in workload
  - Sense of responsibility
  - Increase in job satisfaction
- **Job enrichment**: use the full capabilities of workers by giving them more *challenging* & fulfilling work.
  - Increase in responsibility
  - Control over work
  - Decision-making authority
  - Feedback
  - Uses full capability of workers
  - Gives opportunity to do more challenging & fulfilling work
  - Decrease in direct supervision
- **Job redesign**: involves *restructuring a job* – usually w/ *employees' involvement & agreement – to make work more interesting, satisfying & challenging*.
  - Increase in chance of promotion
  - Increase in employee development
- **Training**: work-related education to increase workforce skills & efficiency.
- **Quality circles**: voluntary groups of *workers* who meet regularly to *discuss work-related problems* & issues.
  - Increase in voice for the workers
  - Hands on approach to solving problems
- **Worker participation**: workers are actively encouraged to become *involved in decision-making* within the organisation.
  - Increase in team-working, motivation & responsibility
  - Improved ideas
- **Fringe benefits**: benefits given, separate from pay, by an employer to some / all employees

- Target setting
- Delegation & empowerment
- **Team-working**: production is organised so that *groups of workers undertake complete units of work*.
  - Decrease in labour turnover
  - Increase in quality

Advantages	Disadvantages
■ Workers are likely to be better motivated as social and esteem needs (see Maslow) are more likely to be met. By empowering workers within teams, job enrichment can be achieved (see Herzberg). ■ Better-motivated staff should increase productivity and reduce labour turnover – both will help to reduce business costs. ■ Team-working makes fuller use of all of the talents of the workforce. Better solutions to problems will be found as those most closely connected with the work participate in suggesting answers. ■ Team-working can reduce management costs as it is often associated with delayering of the organisation – fewer middle managers will be required. ■ Complete units of work can be given to teams – a key feature of job enrichment.	■ Not everyone is a team player – some individuals are more effective working alone. When teams are formed, this point must be considered and training may need to be offered to team members who are not used to working collaboratively in groups. Some workers may feel left out of the team meetings unless there are good efforts to involve and encourage all team members. ■ Teams can develop a set of values and attitudes which may contrast or conflict with those of the organisation itself, particularly if there is a dominant personality in the group. Teams will need clear goals and assessment procedures to ensure that they are working towards the objectives of the organisation at all times. ■ The introduction of team-working will require training costs to be incurred and there may be some disruption to production as the teams establish themselves.

Table 11.9 Advantages and disadvantages of working in teams

❖ *ways in which employees can participate in the management & control of business activity*

- **Workshop/factory** – decisions on break times, job allocations to different workers, job redesign, ways to improve quality & ways to cut down wastage & improve productivity.
- **Strategic decision-making** – electing a 'worker director' to the board of directors / selecting worker representatives to speak for employees at works council meetings.

Benefits	Limitations
Job enrichment	Time-consuming
Improved motivation	Autocratic managers find it hard to adapt – they may set up a participation system but have no intention of actually responding to workers' input
Greater opportunities for workers to show responsibility	
Worker involvement – they have in-depth knowledge of operations	

2.3 Human Resource Management (HRM)

2.3.1 Purpose & Roles Of HRM

❖ *the role of HRM in meeting organisation objectives: recruitment, selection, training, induction, advice, guidance, workforce planning*

- **Human resource management (HRM)**: the strategic approach to the effective management of an organisation's workers so that they help the business gain a competitive advantage.
- The central purpose of HRM is to recruit, train & use the workers of an organisation in the most productive manner to assist the organisation in the achievement of its objectives.
- **The roles of HRM**
  - **Workforce planning** – planning the future workforce needs of the business.
  - **Recruitment & selection** – recruiting & selecting appropriate employees & inducting them into the business.
  - **Developing employees** – appraising, training & developing employees at every stage of their careers.
  - **Employment contracts** – preparing contracts of employment for all employees & deciding on how flexible these should be: permanent / temporary, full- / part-time.

- **Ensuring HRM operates across the business** – involving all managers in the development of their employees – emphasising that this is not just an HR responsibility.
- **Employee morale & welfare** – monitoring & improving employee morale & welfare including giving advice & guidance.

- **Incentive systems** – developing appropriate pay systems (& other incentives) for different categories of employees.
- **Monitoring** – measuring & monitoring employee performance

2.3.2 Recruitment & Selection

❖ *labour turnover, methods of recruitment & selection*

- (https://youtu.be/fb2d09xpvko)
- **Selection**: involves the series of steps by which the candidates are interviewed, tested & screened for choosing the most suitable person for vacant post.
- **Recruitment**: the process of identifying the need for a new employee, defining the job to be filled & the type of person needed to fill it & attracting suitable candidates for the job.
- **Labour turnover**: measures the rate at which employees are leaving an organisation.
- **Labour turnover =** $\frac{number\ of\ staff\ leaving\ in\ 1\ year}{average\ number\ of\ staff\ employed} \times 100$
- **Recruitment & selection will be necessary when:**
  - The business is expanding & needs a bigger workforce
  - Employees leave & they need to be replaced – this is called labour turnover.
- **Recruitment & selection process**
  1. Establishing the exact nature of the job vacancy & drawing up a job description
  2. Drawing up a person specification
  3. Preparing a person specification
  4. Drawing up a shortlist of applicants
  5. Selecting between the applicants
- **Recruitment methods**
  - **Internal recruitment**: when a vacancy is filled by someone who is an existing employee of the business

Advantages	Disadvantages
Managers know the internal candidates	Internal promotion leaves another job to be filled
Motivates staff as this can encourage promotion	
Shorter and less expensive than external recruitment	It can cause resentment among colleagues who are not selected
Internal candidates know the business and its objectives	

  - **External recruitment**: when a vacancy is filled by someone who is not an existing employee & will be new to the business.

Advantages	Disadvantages
External recruits bring in fresh ideas	External recruits usually need longer induction process
Larger pool of applicants to choose from	
They bring in experience from other organisations	Managers do not know the applicant
	It is usually a long and expensive process

2.3.3 Job Descriptions, Person Specifications, Job Advertisements

❖ *purposes of job descriptions, person specifications & job advertisements*

- **Job description**: a detailed list of the key points about the job to be filled – stating all its key tasks & responsibilities. It lists the tasks & responsibilities the person appointed will be expected to carry out. It may also state the job title, location, nature of the business & the salary & conditions.
- **Person specification**: a detailed list of the qualities, skills & qualifications that a successful applicant will need to have. It outlines the ideal profile of the person needed to match the job description. It may state qualifications, experience, interests & personality.
- The job advertisement needs to reflect the requirements of the job & the personal qualities needed.

2.3.4 Employment Contracts

❖ *main features of a contract of employment*

- **Employment contract**: a legal document that sets out the terms & conditions governing a worker's job.
- **A typical employment contract will contain the following features:**
  - Employee's work responsibilities & the main tasks to be undertaken.
  - Whether the contract is permanent / temporary
  - Working hours & the level of flexibility expected, e.g. Part time / full time, working weekends / not, the payment method to be used for the job & the rate for it (e.g. Hourly rate).
  - Holiday entitlement.
  - The number of days' notice that must be given by the worker (if they wish to leave) / the employer (if they want to make the worker redundant).

2.3.5 Redundancy & Dismissal

❖ *difference between redundancy & dismissal*

- **Dismissal**: being dismissed from a job due to incompetence / breach of discipline.
- **Redundancy**: when a job is no longer required, the employee doing this job becomes unnecessary through no fault of their own. This might be due to a fall in demand for a product/service / a change in technology. Redundancy might be voluntary / compulsory.

2.3.6 Staff Morale & Welfare

❖ *relationship between HRM, staff morale & welfare in a business including the concept of work-life balance*

- **Work–life balance**: a situation in which employees are able to give the right amount of time & effort to work & to their personal life outside work, e.g. To family / other interests.
- **This can be achieved by:**
  - **Flexible working**
  - **Teleworking** – working from home for some of the working week.
  - **Job sharing** – allowing two people to fill one full-time vacancy, although each worker will only receive a proportion of the full-time pay.
  - **Sabbatical periods** – an extended period of leave from work. This can be for up to 12 months. Some businesses do not pay employees during this period but guarantee to keep the job open for them on return, but some businesses do pay employees a proportion of their full-time salary.
- **Employee morale & welfare**

- Most HR departments will offer advice, counselling & other services to employees who are in need of support, perhaps because of family / financial problems. These support services can reflect well on the caring attitude of the business towards its workforce. When workers feel that the employer is concerned about their long-term welfare, then this is likely to lead to higher morale & a much stronger sense of loyalty & desire to do well for the business.

2.3.7 Staff Training

❖ *policies for diversity & equality*

- **Equality policy**: practices & processes aimed at achieving a fair organisation where everyone is treated in the same way & has the opportunity to fulfil their potential.
- **Diversity policy**: practices & processes aimed at creating a mixed workforce & placing positive value on diversity in the workplace.

❖ *the purpose of staff development/training as a means of securing required skills & motivating the workforce*

- (https://youtu.be/50pd35uhyb8)
- **Training**: work-related education to increase workforce skills & efficiency.
- **Induction training**: introductory training programme to familiarise new recruits w/ the systems used in the business & the layout of the business site.
- **On-the-job training**: instruction at the place of work on how a job should be carried out.
- **Off -the-job training**: all training undertaken away from the business, e.g. Work-related college courses.

Advantages	Disadvantages
Well qualified	Expensive
Accidents decrease	
Motivator (value increases in the job market)	Can be poached
Flexible	
Productivity increases	

3 Marketing

3.1 What Is Marketing?

3.1.1 Role of Marketing & Its Relationship w/ Other Business Activities

❖ *marketing – introduction*

- **Marketing involves –**
  - Market research
  - Product design
  - Pricing
  - Advertising
  - Distribution
  - Customer service
  - Packaging.
- **Related concepts** –
  - **Market**: place / mechanism where buyers & sellers meet to engage in exchange; the group of consumers that is interested in a product, has the resources to purchase the product & is permitted by law to purchase it.
  - **Human needs & wants** – a human need is a basic requirement that an individual wish to satisfy & wants are things we do not need for our survival as biological creatures, but they do satisfy certain requirements / individual needs of most human beings.
  - **Creating/ adding value**

- **USP – unique selling point:** the special feature of a product that differentiates it from competitors' products.
- **Product differentiation**: making a product distinctive so that it stands out from competitors' products in consumers' perception.

- **Value & satisfaction** –

Values:
- Customer value is the difference between the values the customer gains from owning and using a product and the costs of obtaining the products.
- Customers often do not judge product value and costs accurately or objectively. They act on perceived value.

Satisfaction:
- Customer satisfaction depends on a product's perceived performance in delivering value relative to a buyer's expectation.
- If the product's performance falls short of the customer's expectations, the buyer is dissatisfied.

❖ *coordination of marketing w/ other departments*

- **Marketing → finance**
  - Use sales forecasts to construct cash-flow forecasts & operational budgets.
  - Ensure that the necessary capital is available for the agreed marketing budget, e.g. For promotion expenditure.
- **Marketing → human resources**
  - Use the sales forecast to devise a workforce plan, e.g. Staff may be needed in sales & production.
  - Ensure the recruitment & selection of appropriately qualified & experienced staff
- **Marketing → operations**
  - Market research data will play a key role in new product development.
  - Use the sales forecasts to plan for the capacity needed, the purchase of machinery & the stocks of raw materials required for the new output level.

❖ *societal marketing*

- **Societal marketing**: this approach considers not only the demands of consumers but also the effects on all members of the public (society) involved in some way when firms meet these demands.
- **The societal-marketing concept has the following implications:**
  - Attempt to balance three concerns: company profits, customer wants & society's interests.
  - Societal marketing considers long-term welfare.
    - Short-term consumer wants = low prices
    - Long-term consumer & social welfare = protect the environment / pay workers reasonable wages
  - Business aims to identify consumer needs & wants & to satisfy these more efficiently than competitors do – but in a way that enhances consumers' & society's welfare.
  - Gives competitive advantage – many consumers prefer to purchase products from businesses that are seen to be socially responsible.
  - If successful, could lead to the firm being able to charge higher prices for its products as benefiting society becomes a USP.

❖ *the link between marketing objectives & corporate objectives*

- **Marketing**: the management task that links the business to the customer by identifying & meeting the needs of customers profitably – it does this by getting the right product at the right price to the right place at the right time.
- **Marketing objectives**: the goals set for the marketing department to help the business achieve its overall objectives.

- **Marketing strategy**: long-term plan established for achieving marketing objectives.
- The long-term objectives of the company will have a significant impact on both the marketing objectives & marketing strategy adopted. A business w/ clear short-term profit targets will focus on maximising sales at the highest prices possible. In contrast, a business w/ long-term objectives, which may include profitability as well as the achievement of goals of social responsibility, may adopt a 'societal marketing' approach.

❖ *marketing objectives*

- (https://youtu.be/_odiz0jrx2u)
- **Marketing objectives**: the goals set for the marketing department to help the business achieve its overall objectives.
- **To be effective, marketing objectives should:**
  - Fit in w/ the overall aims & mission of the business
  - Be determined by senior management
  - Be SMART
  - Be made through coordination w/ other departments
- **Examples of marketing objectives include an increase in:**
  - Market share – perhaps to gain market leadership
  - Total sales (value / volume / both)
  - Average number of items purchased per customer visit
  - Frequency that a loyal customer shops
  - Percentage of customers who are returning goods
  - Number of new customers
  - Customer satisfaction
  - Brand identity

3.1.2 Supply & Demand

❖ *factors influencing the supply & demand for the products/ services of a business*

- **Demand**: the quantity of a product that consumers are willing & able to buy at a given price in a time period. (https://youtu.be/Nc-cdcds1o0)
- **Supply**: the quantity of a product that firms are prepared to supply at a given price in a time period. (https://youtu.be/kzjysogjdf0)
- **Equilibrium price**: the market price that equates supply & demand for a product.

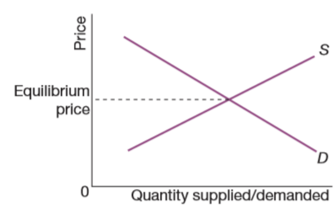


Figure 16.5 Equilibrium price is at the level that equates demand with supply

	Supply	Demand
Factors that influence	Selling price (POV of business)	Selling price (POV of customer)
	Costs of production, e.g. Change in labour / raw material costs	Changes in consumers' incomes
	Taxes imposed on the suppliers by government, which raise their costs	Changes in the prices of substitute goods & complementary goods
	Subsidies paid by government to suppliers, which reduce their costs	Changes in population size & structure
	Weather conditions & other natural factors	Fashion & taste changes
	Advances in technology to make cost of production lower.	Advertising & promotion spending.

❖ *interactions between price, supply & demand*

- As the price increases, the demand of a product decreases
- As the price increases, the supply of a product increases
- As the supply increases, the price decreases

- As the demand increases, the price increases

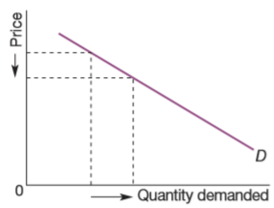


Figure 16.1 A normal relationship between price and demand for a product

Figure 16.2 New demand curve, D_1, caused by changes in the determinants of demand

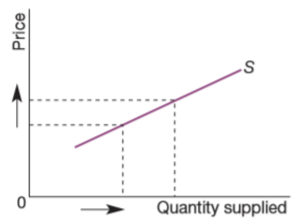


Figure 16.3 Supply increases when the price rises

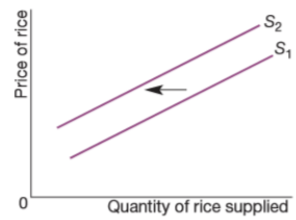


Figure 16.4 Supply of rice falls after a bad harvest

3.1.3 Features of Markets

❖ *how markets may differ: i.e. consumer/producer markets; national, regional & international markets*

- **Consumer markets**: markets for goods & services bought by the final user of them.
- **Industrial products** – goods & services sold to industry; market for products bought by other producers
- **National markets/ local markets** – they sell products to consumers in the area where the business is located; e.g. Laundries, florist shops, hairdressers & bicycle-repair shops.
- **Regional markets** – cover a larger geographical area & businesses that have been successful locally often expand into the region / country so that they can increase sales; e.g. Banking firms, supermarket chains & large clothing retailers.
- **International markets** – multinationals that operate & sell in many different national markets
- **Formal market** – a shop / financial market i.e. The stock exchange
- **Informal market** – selling goods from a street corner / an advert in a local newspaper

❖ *difference between product & customer (market) orientation*

Market Orientation	Product Orientation
Low Risk	R&D→ unique product
Longer Life Cycle	Quality is valued over market fashion
Constant Feedback	

- (https://youtu.be/raigxgxasjq)
- **Market orientation**: an outward-looking approach basing product decisions on consumer demand, as established by market research.
- **Product orientation**: an inward-looking approach that focuses on making products that can be made – / have been made for a long time – & then trying to sell them.
- **Asset-led marketing**: an approach to marketing that bases strategy on the firm's existing strengths & assets instead of purely on what the customer wants.

❖ *problems associated w/ measuring market share & market growth*

- **Market size**: the total level of sales of all producers within a market.

- The size of a market is important for three reasons:

1. A marketing manager can assess whether a market is worth entering / not.
2. Firms can calculate their own market share.

3. Growth / decline of the market can be identified.

- **Market growth**: the percentage change in the total size of a market (volume / value) over a period of time.
- The pace of growth will depend on several factors: overall economic growth, changes in consumer incomes, development of new markets, development of products that take sales away from existing ones, changes in consumer tastes, technological change, whether the market is 'saturated' / not.
- **Market share**: the percentage of sales in the total market sold by one business.
- **Market share** = $\frac{firm's\ sales\ in\ time\ period}{total\ market\ sales\ in\ time\ period} \times 100$

❖ *implications of changes in market share & growth*

- It is not always easy to measure market growth / market share in a reliable way. Different results may be obtained depending on whether the growth & share rates are measured in volume / value terms. E.g. If total sales in the market for jeans rose from 24 million pairs at an average price of $32 to 26 million pairs at an average price of $36, then market growth can be measured in two ways:
  - By volume – the market has risen from 24 to 26 million units, an increase of 8.33%.
  - By value – the revenue has risen from $768 million to $936 million, an increase of 21.88%.

❖ *competition*

- **Competitors** – businesses that sell similar / identical goods / services in the market
- **Direct competitor**: businesses that provide the same / very similar goods / services.
- **Indirect competitor** – businesses that are in a different market of sector i.e. A bus operator can experience indirect competition from rail transport operators.

3.1.4 Industrial & Consumer Markets

❖ *classification of products*

- **Consumer market** – a market whose customers are final users of the product i.e. Members of the public. They are ultimate/ final consumers who consume either by themselves / for family use. They do not buy a product to make another product for resale.
- **Industrial market –** a market for which customers are other businesses & they buy products as inputs to their own processes. It is also known as a business market. It consists of individuals / groups who purchase a specific kind of product **for any of the following purposes:**
  - Resale
  - Direct use in producing other products
  - General use in daily operation e.g. Lighting in schools, stationery for organisations' offices etc

3.1.5 Niche Versus Mass Marketing

❖ *reasons for & benefits/limitations of mass marketing & niche marketing*

(https://youtu.be/kraket_zgy8)

- **Niche marketing**: identifying & exploiting a small segment of a larger market by developing products to suit it.

Advantages	Disadvantages
Enables small firms to avoid competition from larger firms	It is not suitable for a business selling many products
Direct marketing is possible	It is more risk than mass marketing
There is little competition on those markets	Niche markets are small & can therefore only support a small business
Firms can focus on the needs of customers in these markets	

- **Mass marketing**: selling the same products to the whole market w/ no attempt to target groups within it.

Advantages	Disadvantages
Enables a firm to operate in a large scale & enjoy economy of scale	As direct marketing is not possible, mass marketing is likely to require very high advertisement, promotion & distribution cost & failure to succeed will be very costly.
It is less risk than niche marketing as the business will sell to a lot of consumers.	The business can lose customers who will be looking for specialised products.
A strong brand image & customer loyalty is reinforced & act as barriers to entry making it difficult for competitors.	There is a lot of competition as the needs & wants of the large market can be seen by many businesses.

3.1.6 Market Segmentation

❖ *benefits & limitations of market segmentation*

(https://youtu.be/bdqljax58f4)

- **Market segment**: a sub-group of a whole market in which consumers have similar characteristics.
- **Market segmentation**: identifying different segments within a market & targeting different products / services to them.

Advantages	Disadvantages
Defines target market more precisely	Extensive market research
Enables identification of a gap in the market	Danger of excessive specialisation
Small firms unable to compete in whole market so are specialised	Costs may be high – R&D, production and marketing (especially advertising)
Differentiated marketing strategies	
Price discrimination	

❖ *methods of market segmentation including geographic, demographic & psychographic*

- **Geographic differences**
  - Consumer tastes may vary between different areas so it may be appropriate to offer different products & market them in location specific ways
  - Different countries have different cultures so some forms of advertising are not going to be acceptable in different countries
- **Demographic differences**
  - The most common use for segmentation & helps organisations become more efficient
  - Demography is the study of the population data & identifies the following characteristics: age, income, sex, religion, ethnicity, social class
- **Psychographic differences**
  - Differences in consumers' lifestyles, personalities, values & attitudes. These can be influenced by the consumer social class.
- **Class system**
  - **A – upper class** – higher managerial, administrative & professional
  - **B – middle class** – managerial staff including professions
  - **C_1 – lower middle class** – supervisory, clerical / junior manager
  - **C_2** – skilled manual workers
  - **D – working class** – semi & unskilled manual workers
  - **E** – casual, part-time, workers & unemployed

3.2 Market Research

3.2.1 Primary & Secondary Research

❖ *purpose of market research in determining customer characteristics/ consumer profiles, wants & needs*

- **Market research**: this is the process of collecting, recording & analysing data about customers, competitors & the market.
- **Businesses need market research to:**
  - **Eliminate the risk associated w/ new products** – the company needs information about potential demand before launching a new product.
  - **Predict future changes in demand –** information which will enable the firm to predict all the likely changes in future demand.
  - **Help in decision making –** market research provides vital information needed for decision making
  - **Gain a competitive edge –** to assess the most popular designs, styles, brands, promotions & packages / trends
  - **Explain patterns in sales of existing products & market trends** – market research is required for both new & existing products. If the sales figures for an existing product are declining then marketing managers must implement new measures to reverse the negative trend.
- **Market research process**

1. Management problem identification

- Businesses need to have a clear idea of the purpose of the research on the problems needed to be investigated
- Examples can include: what size is the potential market? Why are our sales falling? How can we break into the market in another country?
- If the problem is not clear, there could be a high loss in money through wastage

2. Research objectives

- These objectives must obviously tie in w/ the original problem
- At the end of the research they will have needed to provide information to solve the problem
- Examples can include: how many people are likely to buy our products in country x? If the price of good Y is reduced, how much will this increase sales volume?

3. Sources of data

3.2.2 Methods of Information Gathering

❖ *primary & secondary research: distinctions*

- **Primary research**: the collection of first-hand data that is directly related to a firm's needs. (https://youtu.be/rjaopeilzc8)

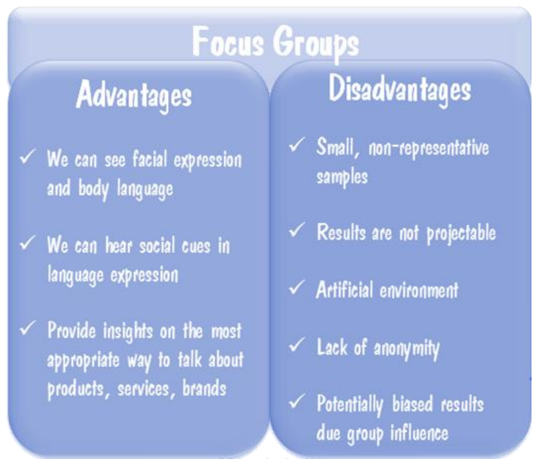
Advantages	Disadvantages
Relevant – collected for a specific purpose – directly addresses the questions the business wants	Costly – market research agencies can charge thousands of dollars for detailed customer surveys and other market research reports
Up to date and therefore more useful than most secondary data	Time-consuming – secondary data could be obtained from the internet much more quickly
Confidential – no other business has access to this data	Doubts over accuracy and validity – largely because of the need to use sampling and the risk thst the samples used may not be fully representative of the population

- **Secondary research**: collection of data from second-hand sources. (https://youtu.be/t6xs5yvgp1g)

Advantages	Disadvantages
Often obtainable very cheaply – apart from the purchase of market intelligence reports	May not be updated frequently and may therefore be out of date
Identifies the nature of the market and assists with the planning of primary research	As it was originally collected for another purpose, it may not be entirely suitable or presented in the most effective way for the business using it
Obtainable quickly without the need to devise complicated data-gathering methods	Data-collection methods and accuracy of these may be unknown
Allows comparison of data from different sources	Might not be available for completely new product developments

❖ *methods of primary research & their advantages & disadvantages*

- **Qualitative research**: research into the in-depth motivations behind consumer buying behaviour / opinions.
  - **Focus groups**: a group of people who are asked about their attitude towards a product, service, advertisement / new style of packaging.



- **Questionnaire design**
  - **Open questions**: those that invite a wide-ranging / imaginative response – the results will be difficult to collate & present numerically.
  - **Closed questions**: questions to which a limited number of pre-set answers is offered
- **Quantitative research**: research that leads to numerical results that can be statistically analysed.
  - **Observing & recording** – market researchers can observe how consumers behave i.e. How many people will look at a display in their shop,
    - However, results could be biased as people will behave differently if they are being watched
  - **Test marketing** – involves promoting & selling the product in a limited geographical area & then recording consumer reactions & sales figures.
    - The region selected must reflect the social & consumer profiles of the rest of the country.
  - **Consumer surveys** – involves directly asking consumers / potential consumers for their opinions & preferences.
    - The four important issues for market researchers to be aware of whilst conducting surveys are: who to ask? What to ask? How to ask? How accurate is it?

❖ *sources of secondary information*

- **Government publications** – population census, social trends, economic trends, annual abstract of statistics, family expenditure survey
- **Local libraries & government offices** – **for a small area:** local population census, number of households in the area, proportions of local population from different ethnic / cultural groups etc.
- **Trade organisations** – information regarding products can be collected from reports on the state of the markets their members operate in.
- **Market intelligence reports** – very detailed reports on individual markets & industries produced by specialist market research agencies.
- **Newspaper reports & specialist publications** – weekly advertising spend data, consumer 'recall of adverts' results, as well as regular articles on key industries & detailed country reports.

- **Internal company records** – customer sales records guarantee claims, daily/weekly/monthly sales trends, feedback from customers on product/service/delivery/quality
- **The internet** – has access to data that has already been collected from other sources (accuracy & relevance needs to be checked)

3.2.3 Sampling Methods

❖ *random, stratified & quota sampling; the appropriateness of each*

- **Sample**: the group of people taking part in a market research survey selected to be representative of the overall target market.
- **Probability sampling**
  - **Random sampling**: every member of the target population has an equal chance of being selected.
  - **Systematic sampling**: every nth person in the target population is selected.
  - **Stratified sampling**: this draws a sample from a specified sub-group / segment of the population & uses random sampling to select an appropriate number from each stratum.
  - **Quota sampling**: when the population has been stratified & the interviewer selects an appropriate number of respondents from each stratum.
  - **Cluster sampling**: using one / a number of specific groups to draw samples from & not selecting from the whole population, e.g. Using one town / region.
- **Non-probability sampling**
  - **Convenience sampling** – members of the population are chosen based on their relative ease of access.
  - **Snowball sampling** – the first respondent refers a friend who then refers another friend… & so the process continues.
    - This is a cheap method used by companies in the financial services sector, i.e. Insurance companies.
    - May lead to a biased sample, as friends are likely to have a similar lifestyle & opinions.
  - **Judgemental sampling** – the researcher chooses the sample based on who they think would be appropriate to study.
  - **Ad hoc quotas** – a quota is established (say 55% women) & researchers are told to choose any respondent they wish up to the pre-set quota.

❖ *limitations of sampling*

- Expensive
- May not represent target population
- Accuracy based on market research.

3.2.4 Market Research Results

❖ *the reliability of data collection*

- The reliability of data depends on the methods used to collect information**. Results will be less reliable if:**
  - Questions in questionnaire were difficult to understand / led respondents to give certain answers
  - Interviewers did not have enough training
  - Respondents purposely didn't give their real view / said what they thought others wanted to hear.
  - The sampling method failed to give a representative sample
  - Inappropriate analytical methods were used

❖ *analysis of results obtained from market research*

- **Averages**
  - **Mean**: calculated by totalling all the results & dividing by the number of results.

- **Mode**: the value that occurs most frequently in a set of data.
- **Median**: the value of the middle item when data have been ordered / ranked.
  - **Median** = $\frac{number\ of\ values}{2}$

- **Grouped frequency data**

- **Mean** = $\frac{\sum f}{f}$
- **Range**: the difference between the highest & lowest value.
- **Inter-quartile range**: the range of the middle 50% of the data.

Average type	Uses	Advantages	Disadvantages
Mean	▪ When the range of results is small, the mean can be a useful indicator of likely sales levels per period of time. ▪ Often used for making comparisons between sets of data	▪ It includes all of the data in its calculation ▪ It is widely used & easily understood	▪ It is affected by one / two extreme results ▪ It is commonly not a whole number.
Mode	▪ As the most frequently occurring, the result could be used for stock-ordering purposes. E.g. The shoe shop would need to hold more pairs of size 6 shoes than any other size.	▪ It is easily observed & no calculation is necessary ▪ The result is easily understood since it is a whole number	▪ The mode does not consider all of the data ▪ There can be more than one modal result which could cause confusion
Median	▪ Could be used in wage negotiations, e.g. 'half of our union members earn less than $xx per week.' ▪ Often used in advertising, e.g. 'the reliability records show that our products are always in the best-performing 50% of all brands.'	▪ It is less influenced by extreme results than the mean	▪ It cannot be used for further statistical analysis ▪ When there is an even number of items in the results, its value is approximated

❖ *interpretation of information*

- **Tables** – these allow ease of reference can be used to present a mass of data in a precise way.
- **Pie graphs/charts** – used to display data in which the proportions of the total need to be clearly shown. Each section of the sector shows how relatively significant that part of the data is of the whole. They allow easy comparison. This is calculated in the following way:

$$\text{Angle of sector} = \frac{value\ of\ one\ section}{total\ value\ of\ all\ sections} \times 360°$$

- **Line graphs** – most commonly used for showing changes in a variable, i.e. Sales over time in time-series graphs. The graph allows easy reference to trends & shows fluctuations clearly.
- **Bar charts** – these use bands of equal width but of varying height to represent values. They allow easy comparison over-time / between different items.
- **Histograms** – often confused w/ bar charts but the main difference is that the area of each bar represents relative values

3.2.5 Cost Effectiveness

❖ *factors affecting choice of the research method*

1. **Budget available** – high budget = primary research, limited budget = secondary research
2. **Accuracy required** – primary research data is more accurate than secondary research data.
3. **How fast the data is required** – limited time = secondary research, more time = primary research
4. **Accessibility to the sample** – no access to sample = secondary data/data from other organisations

❖ *factors to consider when deciding how much to spend on market research*

a. **Likely returns** – the marketing manager should consider the potential increase in sales / profits
b. **Method to be used** – more money is required if they are planning to use a primary research method.

c. **Budget available** – resources available can be a constraint to the amount of money a business can spend on market research.
d. **Emergence w/ which the data is required** – if the data is required quickly then more is required so that more data collectors can be hired.

3.3 The Marketing Mix

3.3.1 The Elements of The Marketing Mix (The 4Ps)

❖ *the 4ps: product, price, promotion, place (distribution channels)*

- **Marketing mix**: the four key decisions that must be taken in the effective marketing of a product.
- Consumers require the right **product**. This might be an existing product, an adaptation of an existing product / a newly developed one.
- The right **price** is important too. If set too low, then consumers might lose confidence in the product's quality; if too high, then many will be unable to afford it.
- **Promotion** must be effective – telling consumers about the product's availability & convincing them, if possible, that your brand is the one to choose.
- **Place** refers to how the product is distributed to the consumer. If it is not available at the right time in the right place, then even the best product in the world will not be bought in the quantities expected.

3.3.2 The Role of The Customer (The 4Cs)

❖ *the relationship between the customer & the business (the 4cs)*

- **Customer relationship management (CRM)**: using marketing activities to establish successful customer relationships so that existing customer loyalty can be maintained.
- **Customer solution** – what the firm needs to provide to meet the customer's needs & wants.
- **Cost to customer** – the total cost of the product
- **Communication w/ customer** – providing up-to-date & easily accessible two-way communication links w/ customers – to promote the product & gain back important consumer market research information.
- **Convenience to customer** – accessible pre-sales information & demonstrations, & convenient locations for buying the product.

❖ *ways in which customer relations can be improved*

- **Targeted marketing** – giving each customer the products & services they have indicated – from past purchases – they most need
- **Customer service & support** – essential to building customer loyalty
- **Informing customers as much as possible** – about product materials/quality/features & service levels
- **Using social media** – some CRM systems integrate social media to track & communicate w/ customers.

❖ *how the 4cs relate to the 4ps*
(https://youtu.be/rfi9oaewq8g)

4Ps	4Cs
Product	Customer solution
Price	Cost to customer
Promotion	Communication with customer
Place	Convenience to customer

Table 18.1 Linking the 4Ps and the 4Cs

3.3.3 Product

❖ *goods & services*

- **Product**: the end result of the production process sold on the market to satisfy a customer need.
- Products can be goods / services
- The term ‘product’ includes consumer & industrial goods & services.
- **Goods** have a physical existence, i.e. Washing machines & chocolate bars.
  - **Consumer goods –** these are the tangible goods which are sold to the general public.
    - Durable goods i.e. Machinery, garments & mobiles can last for a long time
    - Non-durable goods i.e. Edible things soon become damaged.
  - **Industrial/capital goods** – they are physical products, manufactured specifically to be sold to other industries for production of other goods & services like commercial vehicles.
- **Services** have no physical existence, but satisfy consumer needs in other ways − hairdressing, car repairs, child-minding & banking are examples of services.

❖ *recognising that products have a combination of tangible & intangible attributes*

- **Brand**: an identifying symbol, name, image / trademark that distinguishes a product from its competitors.
- **Intangible attributes of a product**: subjective opinions of customers about a product that cannot be measured / compared easily.
- **Tangible attributes of a product**: measurable features of a product that can be easily compared w/ other products.
- Why do consumers pay more for a well-known brand than a generic, non-branded, cheaper alternative? Consumer decisions are not always easy to weigh up / explain – which makes market research less accurate. However, marketing managers try to understand what ‘intangible features / attributes’ customers are looking for when purchasing products & the ‘tangible features / attributes’ they are likely to prefer. Meeting customers ‘intangible expectations’ for a product is most commonly achieved by effective branding.

❖ *the importance of product development*

- **New product development (NPD)**: the design, creation & marketing of new goods & services.
- Is crucial to the success of businesses centred in rapidly changing/dynamic markets, e.g. Smartphone markets.
- In other markets, it is possible to sell the same product for many years / to modify it slightly to meet changing tastes & to enter new segments, e.g. Sprite w/ sprite Waterlymon.
- Based on attempting to satisfy consumer needs that have been identified through research.
- Input from the marketing department is vital to ensure that the new product will be accepted & bought by the market.

Advantages	Disadvantages
Unique selling point (USP)	Expensive
Higher selling price	Time-consuming
Higher profits (due to higher selling price)	Not always successful – additional costs
Better publicity (due to USP)	Product developed may never reach market
Increased sales (due to publicity)	

❖ *product differentiation & USP (unique selling point)*

- **Product differentiation**: making a product distinctive so that it stands out from competitors’ products in consumers’ perception

- **Unique selling point (USP)**: a factor that differentiates a product from its competitors, i.e. The lowest cost, the highest quality / the first-ever product of its kind. A USP could be thought of as 'what you have that competitors don't'.

Advantages	Disadvantages
Effective promotion that focuses on the differentiating feature of the product / service.	It can be easy to set unrealistic expectations for a product.
Opportunities to charge higher prices due to exclusive design/service.	External sources can change procedures, which can alter your product development.
Free publicity from business media reporting on the USP.	Products can fail unexpectedly.
Higher sales than undifferentiated products.	Product testing can result in a failed idea.
Customers more willing to be identified w/ the brand because 'it's different'.	Changing consumer preferences can cause a valuable product to actually be seen as worthless

- **Product positioning**: the consumer perception of a product / service as compared to its competitors.

3.3.4 Product Life Cycle

❖ *how product life cycle stage influences marketing activities*

- (https://youtu.be/490Lqpl5FFQ)
- **Product life cycle**: the pattern of sales recorded by a product from launch to withdrawal from the market & is one of the main forms of product portfolio analysis.
- **Consumer durable**: manufactured product that can be reused & is expected to have a reasonably long life, i.e. A car / washing machine

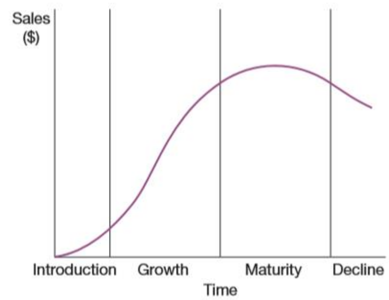


Figure 18.3 Product life cycle – the length of each stage will vary from product to product

❖ *product portfolio analysis as a way of achieving marketing objectives*

- **Product portfolio analysis**: analysing the range of existing products of a business to help allocate resources effectively between them.

- Whatever the marketing objective, the product portfolio needs to be understood & regularly analysed.
- In a highly competitive market, it is vital that the product mix is regularly considered.
- The aim is to review the 'optimal product mix' in the light of current marketing strengths, potential demand estimates, resource issues, & the general market environment.
- The benefits of product portfolio analysis are said to be the opportunity to identify market strengths, weaknesses, w/ a view to improve performance.
- Reference may be made to tools of analysis & should be rewarded as part of relevant analysis – but this is a question of why portfolio analysis rather than how

Phase of the product life cycle	Price	Promotion	Place (distribution outlets)	Product
Introduction	■ may be high compared to competitors (skimming) or low (penetration)	■ high levels of informative advertising to make consumers aware of the product's arrival on the market	■ restricted outlets – possibly high-class outlets if a skimming strategy is adopted	■ basic model
Growth	■ if successful, an initial penetration pricing strategy could now lead to rising prices	■ consumers need to be convinced to make repeat purchases – brand identification will help to establish consumer loyalty	■ growing numbers of outlets in areas indicated by strength of consumer demand	■ planning of product improvements and developments to maintain consumer appeal
Maturity	■ competitors likely to be entering market – there will be a need to keep prices at competitive levels	■ brand imaging continues – growing need to stress the positive differences with competitors' products	■ highest geographical range of outlets possible – developing new types of outlets where possible	■ new models, colours, accessories, etc. as part of extension strategies
Decline	■ lower prices to sell off stock – or if the product has a small 'cult' following, prices could even rise	■ advertising likely to be very limited – may just be used to inform of lower prices	■ eliminate unprofitable outlets for the product	■ prepare to replace with other products – slowly withdraw from certain markets

❖ *uses & limitations of the product life cycle*

- Assisting w/ planning marketing-mix decisions, i.e. New product launches & price / promotion changes.
- Identifying how cash flow might depend on the cycle.
- Recognising the need for a balanced product portfolio.
- **Limitations of the plc**
  - It is based on past / current data as such it cannot be used to predict the future
  - Some products can come back after the decline stage
  - Sales of some products continue to grow.

❖ *identifying how cash flow might depend on the product life cycle*

- **Development**: cash flow is negative as costs are high, but nothing has yet been produced / sold.
- **Introduction & growth** – heavy promotional expenses are likely to be incurred. In addition, there is likely to be much unused factory capacity, which will place a further strain on costs. As sales increase, then cash flow should improve – this depends on the length of consumer credit being offered.
- **Maturity** – most positive cash flow, because sales are high, promotion costs might be limited & spare factory capacity should be low.
- **Decline** – price reductions + falling sales = reduced cash flows. If a business had too many of its products either at the decline / the introduction phase, then the consequences for cash flow could be serious.

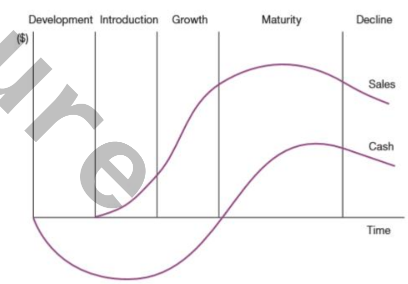


Figure 18.5 The link between cash flow and product life cycle

❖ *assisting w/ the planning of marketing-mix decisions*

- When would you advise a firm to lower the price of its product – at the growth / at the decline stage?
- In which phase is advertising likely to be most important – during introduction / at maturity?
- When should variations be made to the product – during introduction / at maturity?

❖ *decisions about extension strategies*

- **Extension strategies**: these are marketing plans to extend the maturity stage of the product before a brand new one is needed.
- **Extension strategies can include:**
  - **Redesigning the product** – new & improved
  - **Adding an extra feature** – colour, quality, etc.
  - **Changing the packaging & advertising to appeal to a new market segment**
  - **Providing a unique selling point**
  - **Advertising** – gain new audience / remind the current audience
  - **Price reduction** – more attractive to customers
  - **Adding value** – add new features to the current product
  - **Explore new markets** – selling the product into new geographical areas / creating a version targeted at different segments

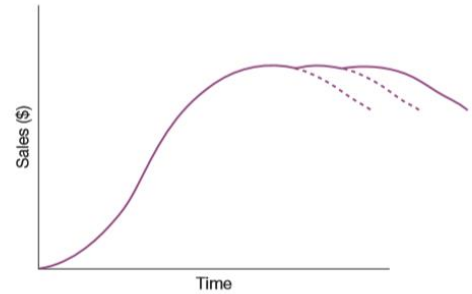


Figure 18.4 Product life cycle – showing the effect of extension strategies

3.3.5 Types of Pricing Strategies

❖ *use & value of alternative pricing*

- **The importance of pricing in the marketing mix:**
  - Impact the level of demand for the product
  - Determine the degree of value added by the business to bought-in components
  - Influence the revenue & profit made by a business due to the impact on demand
  - Reflect on the marketing objectives of the business & help establish the psychological image & identity of a product.
- **The main determinants of pricing decisions:**
  - Cost of production
  - Competitive conditions in the market
  - Competitors' prices
  - Business & marketing objectives
  - Price elasticity of demand
  - Whether it is a new / an existing product
  - **Competition amongst firms:**
    - Price wars to gain market share
    - Non-price competition
    - Collusion / agreements
- **Pricing methods – cost-based** (https://youtu.be/kmelsjcnbmo)

a. **Mark-up pricing**: adding a fixed mark-up for profit to the unit price of a product.

E.g. Total cost of bought-in materials = $40; firm wants 50% mark-up
therefore, selling price = $40 + (50% × $40) = $60

b. **Target pricing**: setting a price that will give a required rate of return at a certain level of output/sales.

E.g. Total costs for 10000 units = $400000; targeted rate of return = 20% of sales
therefore, selling price = $\frac{400\,000+(20\% \times 400\,000)}{10\,000}$ = $48

c. **Full-cost pricing**: setting a price by calculating a unit cost for the product (allocated fixed & variable costs) & then adding a fixed profit margin.

E.g. Fixed costs = $10000; variable cost for 5000 units = $25000; profit margin = 300%

therefore, selling price = $\frac{10\,000 + (5 \times 5000)}{5000} \times 3$ = $28

Advantages	Disadvantages
Suitable for firms that are 'price-makers' due to market dominance	Inaccurate for multi-product businesses where there is doubt over allocation of fixed costs
Easy to calculate for single-product firms where there is no doubt about fixed cost allocation	If sales fall, average costs often rise – this could lead to the price being raised using this method
Price set will cover all costs of production	Tends to be inflexible
	Doesn't consider market/competitive conditions

d. **Contribution-cost pricing**: setting prices based on the variable costs of making a product in order to make a contribution towards fixed costs & profit.

E.g. Variable cost = $2; total fixed costs = $40000; expects to sell 60000 units
if selling price = $3, $1 contribution covers fixed costs, plus makes $20000 profit

Advantages	Disadvantages
Variable costs covered and contribution to fixed	Fixed costs may not be covered
Suitable for firms producing several products – fixed costs do not have to be allocated	If prices vary too much – due to the flexibility– then regular customers may be annoyed
Price can be adapted to suit market condition	

e. **Competition-based pricing**: a firm will base its price upon the price set by its competitors.

Advantages	Disadvantages
Necessary for firms with little market power	Price set may not cover all of the costs
Flexible to market and competitive conditions	

f. **Price discrimination** – uses price elasticity knowledge to charge different prices. This takes place in markets where is possible to charge different groups of consumer's different prices for the same product. **Examples include:**

- Cheaper prices of travel for children & elderly
- Different prices for different export markets
- Higher priced goods in higher socio-economic areas
- Occupational discounts i.e. Teachers getting stationery cheaper

Advantages	Disadvantages
Uses PED knowledge to charge different prices in order to increase total revenue	Costs of having different pricing levels
	Customers may switch to lower-price rate
	Consumers paying higher prices may object

g. **Dynamic pricing**: offering goods at a price that changes according to the level of demand & the customer's ability to pay.

- **Pricing methods – new products**

a. **Penetration pricing**: setting a relatively low price often supported by strong promotion in order to achieve a high volume of sales.

b. **Market skimming**: setting a high price for a new product when a firm has a unique / highly differentiated product w/ low price elasticity of demand.

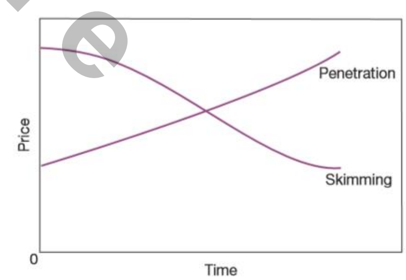


Figure 18.9 Market-skimming and penetration pricing strategies

Advantages	Disadvantages
Help establish a product in the market	Potential customers might be put off because of the high prices
Consumers may assume it is of good quality	

c. **Promotional pricing** – when the firm sets price lower for a set amount of time, in cases i.e.:

- Buy one get one free

d. **Loss leader** – involves the setting of very low prices for some products – possibly even below variable costs – in the expectation that consumers will buy other goods too.

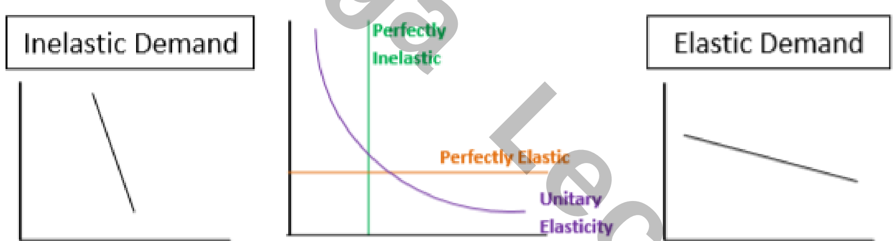
e. **Psychological pricing** – setting prices as appropriate for the quality of the good e.g. Perfume sold at a high price as to not effect perception of quality. This also refers to making prices appear lower than actually are e.g. $2.99 instead of $3.00

3.3.6 Price Elasticity of Demand

❖ *define, calculate & interpret price elasticity of demand & suitable prices*

- (https://youtu.be/7kkmamtcwoe)
- **Price elasticity of demand**: measures the responsiveness of demand following a change in price.
- **Price elasticity of demand =** $\frac{change\ in\ quantity\ demanded\%}{change\ in\ price\%}$

  Elastic demand – a change in price brings about a large change in the quantity demanded. These have a coefficient greater than 1
- **Inelastic demand** – a change in price brings about a small change in the quantity demanded. These have a coefficient between 0 & 1
- **Perfectly elastic** – a change in price brings about an infinite response (a tiny price change will cause a huge change in quantity demanded/supplied) giving a coefficient of infinity (∞)
- **Perfectly inelastic** – a change in price brings about no response (even if price drastically changes, QD/QS will stay the same) giving a coefficient of 0
- **Unitary elasticity** – this occurs when a percentage change in the price results in an equal change in demand giving a coefficient of 1



Value of PED (ignoring minus sign)	Classification	Explanation
Zero	Perfectly inelastic demand	■ The same amount is demanded, no matter what the price. In reality, there is no product that would have this PED.
Between 0 and 1	Inelastic demand	■ The percentage change in demand is less than the percentage change in price. If a firm faces this elasticity of demand, it can raise the price, not lose much demand and increase sales revenue. However, this cannot keep happening. As the price continues to rise, demand will become more elastic.
Unitary	Unit elasticity	■ The percentage change in demand is equal and opposite to the percentage change in price, so any price change will lead to an equal change in demand and the total sales revenue will remain constant. When PED = 1, sales revenue will be maximised.
Between 1 and infinity (∞)	Elastic demand	■ The percentage change in demand is greater than the percentage change in price. If a firm faces this elasticity of demand, then it can lower the price, pick up a lot more demand and increase sales revenue.
Infinity (∞)	Perfectly elastic demand	■ An infinitely large amount is demanded at one price and then demand falls to zero if the price is raised, even by the smallest amount. In reality, there is no product that would have this PED.

❖ *evaluation of price elasticity of demand*

- **Firms can use PED estimates to predict:**
  - The effect of a change in price on quantity demanded
  - The effect of a change in price on total revenue
  - The likely price volatility in a market following unexpected changes in supply
  - The effect of a change in indirect tax onto the consumer
  - Information on the price elasticity of demand can be utilized as part of a policy / price discrimination
  - To make more accurate sales forecasts & assist in pricing decisions
- **Is bad because:**
  - PED assumes nothing has changed in the market
  - PED can become outdated quickly
  - It is not always easy & indeed possible to calculate PED
- **Factors that affect price elasticity of demand**
  - **The number of substitutes** – goods that have a lot of substitutes have elastic demand e.g. Margarine. Those w/ very few substitutes have inelastic demand e.g. Pills to a patient
  - **The period of time** – in the short run the demand for goods is generally inelastic while it becomes elastic in the long run
  - **The proportion of income spent on the commodity** – products which take up a small proportion of an individual's income have inelastic demand e.g. Sweets. On the other hand, products which take up a larger fraction of a person's income have elastic demand e.g. Wardrobes
  - **The necessity of the product** – products that are basic necessities have inelastic demand while luxury products have elastic demand.

3.3.7 Promotion Methods

❖ *introduction to promotion*

- **Promotion**: the use of advertising, sales promotion, personal selling, direct mail, trade fairs, sponsorship & public relations to inform consumers & persuade them to buy. (https://youtu.be/54oxswv3rpi)
- **Promotion mix**: the combination of promotional techniques that a firm uses to sell a product.
- **Promotional objectives aim to:**
  - Increase sales by raising consumer awareness of a product
  - Remind consumers of an existing product & its 'unique' qualities
  - Increase purchases by existing consumers / attract new consumers to the brand
  - Demonstrate the superior qualities of a product compared w/ those of competitors – used when the product has been updated
  - Create / reinforce the brand image / 'personality' – this is increasing as it is often claimed that 'all products look the same'
  - Correct misleading reports about the product / the business & to reassure the consuming public after an accident involving the product
  - Develop the public image of the business – rather than the product – through corporate advertising
  - Encourage retailers to stock & actively promote products to the final consumer.

Stage of life cycle	Promotional options
Introduction	■ informative advertising to make consumers aware of the product's existence, price and main features ■ sales promotion offering free samples or trial periods to encourage consumers to test the product – incentives may need to be offered to the trade to stock the product
Growth	■ to continue some informative advertising, but the focus may now move to brand building and persuasive advertising ■ sales promotion to encourage repeat purchase ■ attempt to develop brand loyalty
Maturity	■ advertising to emphasise the differences between this product and competitors – may be needed to remind consumers of the existence of the product ■ sales-promotion incentives to encourage brand switching and continued loyalty
Decline – assuming no extension strategy	■ minimal advertising, apart from informing consumers of special offers ■ sales promotion – there may be little additional support for the product if the intention is to withdraw it

Table 19.3 How promotional strategies may vary over the life cycle of a product

❖ *above the line promotion*

- **Above-the-line promotion**: a form of promotion that is undertaken by a business by paying for communication w/ consumers.
- Advertising is sometimes referred to as 'above-the-line promotion'
- **Advertising**: paid-for communication w/ consumers to inform & persuade. Advertising is communicating information about a product / business through the media, i.e. Radio, tv, newspapers, internet, magazines, outdoor (billboards & posters) & cinema. **There are two types:**
  - **Informative advertising** – adverts that give information about a product
  - **Persuasive advertising** – adverts trying to create distinct image/brand identity for products
- **Advertising agencies** – firms who advise businesses on the most effective way to promote products – useful to business that do not have their own marketing experts / might be entering a new market for the first time. **These agencies will – for substantial fees – undertake the following stages in devising a promotional plan:**
  - Research the market, establish consumer tastes & preferences & identify the typical consumer profile.
  - Advise on the most cost-effective forms of media to be used to attract these potential consumers.
  - Use their own creative designers to devise adverts appropriate to the media to be used.
  - Film / print the adverts to be used in the campaign.
  - Monitor public reaction to the campaign & feed this back to the client to improve the effectiveness of future advice on promotion.
- **Factors contributing towards determining advertising media**
  - Cost
  - Size of audience
  - Profile of target audience in terms of age/income levels/interests etc.
  - Message to be communicated
  - Other aspects of the marketing mix
  - Legal & other constraints

Advantages	Disadvantages
Improves image of the business	Leads to higher prices
Increase in sales & profitability	Encourages impulse buying
Fights competition	Adverts interrupt tv & radio programmes
Enables consumers to make informed decisions	
Informs customers about promotions & sales taking place	

- *below-the-line advertising*
  - **Below-the-line promotion**: promotion that is not a directly paid-for means of communication, but based on short-term incentives to purchase.

a. **Sales promotion**: incentives i.e. Special offers / special deals directed at consumers / retailers to achieve short-term sales increases & repeat purchases by consumers. They include:

- **Price deals** – a temporary reduction in price
- **Loyalty reward programmes** – consumers collect points on purchases & redeem them for rewards
- **Money-off coupons** – redeemed when the consumer buys the product
- **Point-of-sale displays in shops**
- **BOGOF** – 'buy one, get one free'
- **Games & competitions** – e.g. On cereal packets.
- **Money refunds** – these are offered when the receipt is returned to the manufacturer.

- **Sales promotion can be directed either at:**
  - **The final consumer** – to encourage purchase (pull strategy)
  - **The distribution channel** – e.g. The retailer, to encourage stocking & display of the product (push strategy).
- **Limitations of sales promotion methods:**

Sales promotion method	Limitations
Price deals	▪ Reduced gross profit ▪ Negative impact on the brand's reputation
Loyalty rewards	▪ Reduced gross profit ▪ There are administration costs to inform consumers of loyalty points earned ▪ Loyalty cards have become common, so their loyalty impact is reduced.
Money-off coupons	▪ They may simply encourage consumers to buy what they would have bought anyway. ▪ Retailers may be surprised by the increase in demand & not hold enough stocks, leading to consumer disappointment. ▪ The proportion of consumers using the coupon might be low if the reduction it offers is too small.
POS displays	▪ The best display points are usually offered to the market leaders – products w/ high market share. ▪ New products may struggle for best positions in stores – unless big discounts are offered to retailers.
BOGOF	▪ Reduction in gross profit margin. ▪ Consumers may consider are they paying a 'normal' price that is too high? ▪ Is the scheme being used to sell off stock that cannot be sold at normal prices – impact on reputation? ▪ Future sales could fall as consumers have stocked up on the product.
Games & competitions	▪
Money refunds	▪ These involve the consumer filling in & posting off a form, & this might be a disincentive. ▪ Delay before a refund is received may act as a disincentive.

b. **Personal selling**: a member of the sales staff communicates w/ one consumer w/ the aim of selling the product & establishing a long-term relationship between company & consumer.

- Personal selling is often used for expensive industrial products – & this is often one of the key differences between consumer marketing & business marketing.

c. **Direct mail/marketing** – directs information to potential customers who have a potential interest in a type of product e.g. Junk mail, pop-up ads, mail shots

d. **Trade fairs & exhibitions** – these are used in marketing to other businesses to sell products to the 'trade', i.e. Retailers & wholesalers.

e. **Sponsorship**: payment by a company to the organisers of an event / team/individuals so that the company name becomes associated w/ the event/team/individual.

f. **Public relations**: the deliberate use of free publicity provided by newspapers, tv & other media to communicate w/ & achieve understanding by the public.

❖ *marketing / promotion expenditure budgets*

- **Marketing / promotion budget**: the financial amount made available by a business for spending on marketing/ promotion during a certain time period. **These are set number of different ways:**
  - **Competitor-based** – setting the budget based on competitor's budget. When two / more firms are of roughly the same size in terms of sales, it is possible that they will attempt to match each other in terms of spending which can lead to a spiralling of promotion costs.
  - **Objective-based** – analysing what sales are required to meet objectives, then assess how much support spending is required
  - **Percentage of sales** – expenditure will vary depending on sales
  - **What the business can afford** – many managers adopt a view that marketing is a luxury & may not provide a large amount of budget towards it
  - **Incremental** – what was set last year, adding a percentage for inflation of different sales targets

Benefits	Drawbacks
It informs people about new products and thus helps increase competition between firms	Waste of resources – could be used to lower prices instead
By helping create mass markets, promotion can assist in reducing average cost per unit	Promotion is powerful – could encourage purchases that are unwanted
Generates income for TV, radio, and newspaper businesses	Promotes consumerism – people are judged by the amount they own
	Encourages consumption – environmentalists argue that it's against conserving resources

❖ *the role of packaging in promotion*

- Protect & contain the product
- Give information to consumers about contents, ingredients, cooking instructions, assembly instructions, etc.
- Support the image of the product created by other aspects of promotion
- Aid the recognition of the product by the consumer.

❖ *branding as part of product/promotion*

- **Branding**: the strategy of differentiating products from those of competitors by creating an identifiable image & clear expectation about a product. (https://youtu.be/izahynsz2_4)
  - **The aims of branding products include:**
    - Aiding consumer recognition
    - Making the product distinctive from competitors
    - Giving the product an identity / personality that consumers can relate to.
  - **An effective brand identity will have the following benefits for businesses:**
    - Increase the chances of brand recall by consumers, e.g. When shopping in a supermarket & there are several product options available.
    - Clearly differentiate the product from others.
    - Allow for the establishment of a 'family' of closely associated products w/ the same brand name.
    - Reduce price elasticity of demand as consumers have been shown to have preferences for well-known brands.
    - Increase consumer loyalty to brands, which is a major marketing benefit.

3.3.8 Channels of Distribution

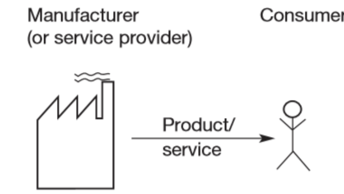
❖ *choosing between alternative types of channel of distribution*

- **Channel of distribution**: this refers to the chain of intermediaries a product passes through from producer to final consumer. (https://youtu.be/5nslbxbosd8)
- **Why the distribution channel choice is important:**
  - Consumers may need easy access to a firm's products to allow them to try them & see them before they buy, to make purchasing easy & to allow, if necessary, for the return of goods.
  - Manufacturers need outlets for their products that give as wide market coverage as possible, but w/ the desired image of the product appropriately promoted.
  - Retailers will sell producers' goods but will demand a mark-up to cover their costs & make a profit, so, if price is very important, using few / no intermediaries would be an advantage.
- **Factors influencing choice of distribution channel include:**
  - **Industrial products tend to be sold more directly** – w/ fewer intermediaries than consumer goods.
  - **Geographical dispersion of the target market** – if the target market is large but widely dispersed throughout the country, then the use of intermediaries is more likely.
  - **Level of service expected by consumers** – e.g. After-sales servicing of a car, means that internet selling is not appropriate for most manufacturers.
  - **Technical complexity of the product** – e.g. Business computers are sold directly as they require a great deal of technical know-how among the sales staff & a supporting service team.
  - **Unit value of the product** – it may be worth employing sales staff to sell directly to individual customers if the unit cost of, e.g. A luxury yacht is $5 million, but not worthwhile if items of jewellery are being sold for $5.
  - **Number of potential customers** – if the number of potential customers is few, direct selling might be used, but larger businesses – w/ their customers worldwide – would use intermediate channels to distribute their products.
- **Recent trends in distribution channels in recent years include:**
  - Increased use of the internet
  - Large supermarket chains perform the function of wholesalers as well as retailers, holding stocks in their own warehouses.
  - Some businesses are increasingly using a variety of different channels, e.g. An ice cream manufacturer may have their own ice cream vans to sell directly as well as supplying retailers.
- **The most common intermediaries**
  - **Wholesalers**
    - Breaks down bulk & buys from producers & sell small quantities to retailers
    - Provides storage facilities
    - Reduces contact cost between producer & consumer
    - Wholesaler takes some of the marketing responsibility e.g. Sales force, promotions
  - **Agents**
    - Mainly used in international markets, however control is difficult due to cultural differences
    - Commission agent – does not take the title of the goods
    - Stockist agent – hold 'consignment' stock
    - Training, motivation etc. Is expensive
  - **Retailer**
    - They have a much stronger personal relationship w/ the consumer
    - Holds a variety of products & builds retailer 'brand' in the high street
    - Offers consumers credit
    - Promote & merchandise products prices the final product

- **The most common channels of distribution**

a. Direct selling to consumer

- Direct selling: no intermediaries. Can be referred to as 'zero-intermediary' channel.
- E.g. Mail order from manufacturer
- E.g. Airline tickets & hotel accommodation sold over the internet by the service providers
- E.g. Farmers' markets – selling produce directly to consumers

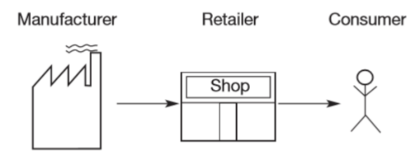


Direct selling to consumer

Advantages	Disadvantages
No mark-up or profit margin by other businesses	Producer must pay for storage and stock costs
Producer has full control over marketing mix	May not be convenient for consumer
Quicker than other channels	Limits chance for consumers to see and try good
May lead to fresher food products	No promotion paid for by intermediaries
Direct contact with consumers offers research	Can be expensive to deliver goods to consumers

b. Single-intermediary channel

- One-intermediary channel. Usually used for consumer goods but could also be an agent for selling industrial products to businesses.
- E.g. Holiday companies selling holidays via travel agents
- E.g. Large supermarkets that hold their own stocks rather than using wholesalers
- E.g. Where the whole country can be reached using the one-level route, e.g. A small country

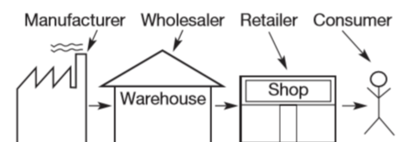


Single-intermediary channel

Advantages	Disadvantages
Retailers pay for stock and storage	Intermediary takes a profit mark-up
Retailer has product displays	Producers lose some control over marketing mix
Retail locations convenient for consumer	Retailers may sell competitor's goods too
Producers can focus on production	Producer has delivery cost to retailer

c. Two-intermediaries channel

- Two-intermediaries channel. Wholesaler buys goods from producer & sells to retailer.
- For instance, in a large country w/ great distances to each retailer – many consumer goods are distributed this way, e.g. Soft drinks, electrical goods & books



Two-intermediaries channel

Advantages	Disadvantages
Reduces stock-holding costs	Another intermediary takes profit mark-up
Wholesaler pays for transport costs to retailer	Producer loses most control over marketing mix
May be best way to enter foreign markets where producer has no direct contact with retailers	Slows down distribution chain

3.3.9 Using the Internet for the 4Ps/4Cs

❖ *online advertising, catalogues, sales, dynamic pricing, distribution (download of digital products), social media, viral marketing, e-commerce*

- **Internet (online) marketing**: refers to advertising & marketing activities that use the internet, email & mobile communications to encourage direct sales via electronic commerce.
- **E-commerce**: the buying & selling of goods & services by businesses & consumers through an electronic medium.

- **Marketing over the internet can involve several different marketing functions which impact on the 4cs:**
  - Selling directly to consumers (b2c) / businesses (b2b) – orders are placed online through the company website / an online retailer, known as e-commerce **(convenience).**
  - Online & mobile advertising by using the company's website, 'pop-up's & by using social media, targeted at potential consumers & can lead to viral marketing (**communication**).
    - **Viral marketing** – the use of social media / text messages to increase brand awareness / sell products
  - Sales contacts are established by visitors to a site leaving their details & then the company emails them / calls on them to attempt to make a sale (**communication**).
  - Collecting market research data by encouraging visitors to the website to answer questions that can provide important consumer data to aid the development of new products (**customer solution**).
  - **Dynamic pricing** – using online data about consumers to charge different prices to different consumers over the internet, often these prices are much lower **(cost to customer).**

Advantages	Disadvantages
Relatively low cost	Some countries have low-speed or no internet
Worldwide audience	Cannot touch/feel/smell/try-on products
Access to consumers information for research	Product returns may increase
Convenience of the internet	Cost and unreliability of postal service
Lower fixed costs	Must be kept up to date (particularly for apps)
Dynamic Pricing	Worries about internet security

3.3.10 Consistency in The Marketing Mix

❖ *the need for the marketing mix to be consistent w/ the business, the product type & the market*

- **Integrated marketing mix**: the key marketing decisions complement each other & work together to give customers a consistent message about the product.
- The impact a product has on consumers is explained by human psychology – as complex beings we are influenced by a range of different messages before we decide on buying a product.
- Confused consumers will steer clear of the product & this will result in lower long-term sales than if a clear message about the product is conveyed through all aspects of the mix – although everyone can be misled once.
- The best-laid marketing plans can be destroyed by just one part of the marketing mix not being consistent / working w/ the rest. The most effective marketing-mix decisions will, therefore, be:
  - Based on marketing objectives & affordable within the marketing budget
  - Integrated & consistent w/ each other & targeted at the appropriate consumers.

4 Operations & project management

4.1 The nature of operations

4.1.1 Inputs, outputs & the transformation process

❖ *operations encompass products & services*

- Essentially, operation managers are aiming to produce goods & services *of the required quality, in the required quantity, at the time needed, in the most effective way.*
- '**Operations**' / '**operations management**' is concerned w/ the use of resources called inputs – land, labour & capital – to provide outputs in the form of goods & services.
- Operations managers must be concerned w/:
  - **Efficiency of production** – keeping costs as low as possible which give a competitive advantage

- **Quality of product** – the good / service must be suitable for the purpose intended
- **Flexibility & innovation** – the need to develop & adapt to new processes & new products is increasingly important in today's dynamic business environment.

❖ *process: from idea/need to final product/service*

Figure 22.1 The transformation process

❖ *resources: land, labour, capital (including intellectual capital)*

- **Raw materials** – the basic materials that can be used to make / create something e.g. Wheat in bread
- **Land** – the site on which production takes as well as all the free gifts of nature e.g. Minerals, climate
- **Labour** – the physical & mental effort put into the production process. There are three types of labour - unskilled labour, semi-skilled labour & skilled labour
- **Capital** – the tools, machinery, computers & other equipment as well as finance that businesses use to produce goods & services
- **Intellectual capital**: intangible capital of a business that includes human capital (well trained & knowledgeable employees), structural capital (databases & information systems) & relational capital (good links w/ supplier & customers).

4.1.2 Effectiveness, efficiency & productivity

❖ *difference between effectiveness & efficiency*

- **Efficiency**: producing output at the highest ratio of output to input.
- **Effectiveness**: *meeting the objectives* of the enterprise by using inputs productively to produce outputs that meet customers' needs.

❖ *productivity: measuring efficiency*

- **Production**: converting inputs into outputs.
- **Level of production**: the number of units produced during a time period.
- **Productivity**: the ratio of outputs to inputs during production, e.g. Output per worker per time period.
- **Productivity** = $\frac{output\ (in\ a\ given\ time)}{the\ resource(s) employed}$

- **Productivity can be raised by**: (https://youtu.be/i5l8yx0j2iy)
  - **Training the staff to raise skill level** – employees w/ relevant skills are more productive
  - **Improve worker motivation** – use financial & non-financial motivators to encourage staff to work harder.
  - **Purchase more technologically advanced equipment** – the firm can introduce new machinery & latest production systems i.e. Robot-controlled production systems.
  - **More efficient management** – good leadership improves the overall efficiency of the business

4.1.3 Value added

❖ *how 'value added' is linked to marketing & operations process & decisions*

- **Added value**: the difference between the cost of purchasing raw materials & the price the finished goods are sold for – this is the same as creating value.
- The degree of value added will depend on:

- Design of the product
- Impact of the promotional strategy
- Efficiency w/ which the input resources are combined & managed

- **The production process involves the following stages:**
  - Converting a consumer need into a product that can be produced efficiently
  - Organising operations so that production is carried out efficiently – e.g. Ordering stocks to arrive on time
  - Deciding on suitable production methods
  - Setting quality standards & checking they are maintained.

4.1.4 Capital versus labour intensity

❖ *benefits & limitations of capital- & labour-intensive processes*

(https://youtu.be/erjeq0ozjxw)

- **Labour intensive**: involving a high level of labour input compared w/ capital equipment.
  : labour-intensive methods of production might be most appropriate, e.g.
  For a furniture company that specialises in making reproduction furniture by hand.

Benefits	Limitations
Can produce one-off unique products	Cannot produce large-scale output quickly
Well suited to deliver personal services	Limited economies of scale
Lower productions costs especially when labour is cheaper in that area	Employees can disrupt production easily due to industrial action / absence
Relatively easy to vary labour force (recruit/ retrench)	Legal constrains may make it difficult to vary labour force
Low start-up costs	Training costs may be very high

- **Capital intensive**: involving a high quantity of capital equipment compared w/ labour input.
  : capital-intensive methods of production might be used in industries that supply mass-produced goods due to the nature of the production process

Benefits	Limitations
Mass production requires large scale output using repeated task. Machine can deliver this much more quickly than labour	Machine break down can be a big challenge to the business
Skills level may be lower so costs are less & it is easier to recruit employees.	High start-up costs. Cost of capital may be too high for a business to buy machinery
Increased labour productivity	Difficult to deliver personal services
Enables the business to enjoy economies of scale	Difficult to produce a range of varied one-off products
	Employees using machines can be bored

Job production = labour intensive | **Flow production** = capital intensive

⇩

Economies of scale

= *decreased* average costs from *increased* production

4.2 Operations planning

❖ *operations decisions*

❖ *define operations decisions & list the factors that influence operations decisions*

- **Operations planning**: preparing input resources to supply products to meet expected demand.

- **Operations decisions** – decisions taken by operations managers that have a significant impact on the success of the business.
- The role of operations decisions is to achieve a desired value added, in terms of productive efficiency in reducing unit costs (minimising inputs in relation to outputs) & in terms of financial value (sales revenue & profit).
- **These decisions are often influenced by:**
  - **Marketing factors** – planning future production levels requires estimated / forecast market demand
  - **Availability of resources**
  - **Technology** – e.g. The availability of CAD/CAM

❖ *influence of marketing, availability of resources & technology on operations decisions*

- **CAD – computer aided design**: the use of computer programs to create two- / three-dimensional (2D / 3D) graphical representations of physical objects.

Benefits	Limitations
Lower product development costs	Complexity of the programs
Increased productivity	Need for extensive employee training
Good visualization of the final product & its constituent parts	Large amounts of amount of computer processing power required & this is can be expensive.
Faster time-to-market	
Improved product quality	
Great accuracy, so errors are reduced	
Easy re-use of design data for other product applications.	

- **CAM – computer aided manufacturing**: the use of computer software to control machine tools & related machinery in the manufacturing of components / complete products.

Benefits	Limitations
Integrated w/ CAD, CAM allows more design variants of a product to be produced, which means that niche products can be produced as well as mainstream mass market products. This increased customisation increases the competitiveness of businesses in both small & large market segments.	Cost of hardware, programs & employee training – these costs may mean that smaller businesses cannot access the benefits of CAM – although technology is becoming cheaper
Precise manufacturing & reduced quality problems – compared to production methods controlled by people	Hardware failure – breakdowns can & do occur & they can be complex & time-consuming to solve
More flexible production allowing quick changeover from one product to another	
Faster production & increased labour productivity	

4.2.2 Flexibility & innovation

❖ *the need for flexibility w/ regard to volume, delivery time & specification*

- **Operational flexibility**: the ability of a business to vary both the level of production & the range of products following changes in customer demand.
- The level of demand is not constant, it may increase / decrease. Thus, the business must be able to respond quickly to changes in demand.
- This flexibility can be achieved in a number of ways:
  - **Increase capacity by extending buildings & buying more equipment** – this is an expensive option
  - **Hold high stocks** – but these can be damaged & there is an opportunity cost to the capital tied up
  - **Have a flexible & adaptable labour force** – using temporary, part-time contracts reduces fixed salary costs but may reduce worker motivation
  - **Have flexible flow-line production equipment** – mass customisation

❖ *process innovation*

- **Process innovation**: the use of a new / much improved production method / service delivery method.
- Some recent examples will help to show the extent & importance of some of these new methods:
  - Robots in manufacturing.
  - Faster machines to manufacture microchips for computers.
  - Computer tracking of inventories, e.g. By using bar codes & scanners, to reduce the chances of customers finding businesses out of stock.
  - Using the Internet to track the exact location of parcels being delivered worldwide & improve the speed of delivery.

4.2.3 Operations methods: job, batch, flow & mass customisation

❖ *differences between methods – advantages & disadvantages of each method*
(https://youtu.be/ZQ0m2dmLLcM)

- **Job production**: producing a one-off item specially designed for the customer (https://youtu.be/2OIRKD_Gua8)

Advantages	Disadvantages
Able to undertake specialist projects or jobs, often with high value added	High unit production costs Time-consuming
High levels of worker motivation	Wide range of tools and equipment needed

- **Batch production**: producing a limited number of identical products – each item in the batch passes through one stage of production before passing on to the next stage. (https://youtu.be/mwzf6pxs3ms)

Advantages	Disadvantages
Some economies of scale	High levels of stocks at each production stage
Faster production with lower unit costs than job production	Unit costs likely to be higher than with flow production
Some flexibility in design of product in each batch	

- **Flow production**: producing items in a continually moving process. (https://youtu.be/izlq609hc9a)

Advantages	Disadvantages
Low unit costs due to constant working of machines, high labour productivity and economies of scale	Inflexible – often very difficult and time-consuming to switch from one type of product to another Expensive to set up flow-line machinery

- **Mass customisation**: the use of flexible computer aided production systems to produce items to meet individual customers' requirements at mass-production cost levels (https://youtu.be/4h6adna8d84)

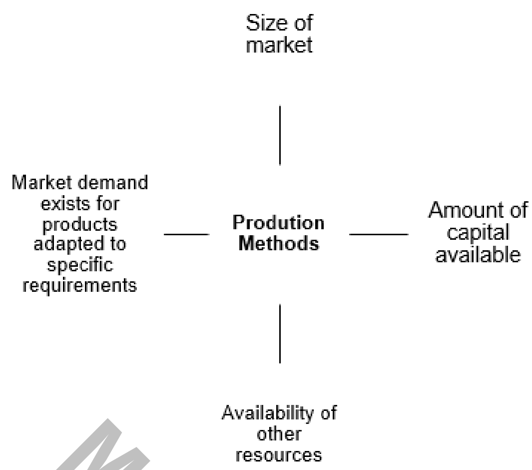
Advantages	Disadvantages
Combines low unit costs with flexibility to meet customers' individual requirements	Expensive product redesign may be needed to allow key components to be switched to allow variety Expensive flexible capital equipment needed

❖ *problems of changing from one method to another*

- **Job to batch:**
  - Cost of equipment needed to handle large numbers in each batch.
  - Additional working capital needed to finance stocks & work in progress.
  - Staff demotivation – less emphasis placed on an individual's craft skills.

- **Job / batch to flow:**
  - Cost of capital equipment needed for flow production.
  - Staff training to be flexible & multiskilled – if this approach is not adopted, then workers may end up on one boring repetitive task, which could be demotivating.
  - Accurate estimates of future demand to ensure that output matches demand.

❖ *how the right production method is chosen?*



4.2.4 Location

❖ *factors that determine location & relocation*

- **Location decisions**
  - Factors affecting location decisions:
    - Site & capital cost
    - Labour costs
    - Transport costs
    - Sales revenue potential
    - Government grants
  - Quantitative factors:
    - Profit estimate
    - Investment appraisal – return on capital employed
    - Breakeven analysis
  - Qualitative factors:
    - Safety
    - Further expansion
    - Management preferences
    - Ethical considerations
    - Environmental concerns
    - Infrastructural
  - Other location issues
    - The pull of the market
    - Planning restrictions
    - External economies of scales
- **Relocation decisions**
  - Reasons why a business may want to relocate
    - Infrastructural development in other locations
    - Cheaper labour costs in other locations
    - Changing objectives & strategies
    - Changing of location of suppliers / customers
    - Change in government policies
  - Changing location may involve costs i.e.:
    - Finding & training new employees
    - Finding new customers & suppliers
    - Administrative costs of the change
    - Redundancy payments
    - Adjusting to the new set-up

❖ *differences between local, regional, national & international location decisions*

- Reasons for an international location
  - To reduce costs
  - To access global (world) markets
  - To avoid protectionist trade barriers
  - Other reasons – (substantial government financial support to relocating businesses, good educational & highly qualified staff, & avoidance of problems resulting from exchange rate fluctuations).
- Issues & potential problems w/ international location:
  - Language & other communication barriers
  - Cultural differences
  - Level-of-service concerns
  - Supply-chain concerns
  - Ethical considerations

4.2.5 Scale of operation

❖ *factors that influence the size of a business*

- **Owners' objectives** – they may wish to keep the business small & easy to manage
- **Capital available** – if this is limited, growth will be less likely
- **Size of the market the firm operates in** – a very small market will not require large-scale production
- **Number of competitors** – the market share of each firm may be small if there are many rivals
- **Scope for scale economies** – if these are considerable, as in water supply, each business is likely to operate on a large scale.

❖ *causes & examples of internal/external economies / diseconomies of scale*

- **Economies of scale**: reductions in a firm's unit (average) costs of production that result from an increase in the scale of operations. (https://youtu.be/ka0ymhaw1k8)

a. **Internal Economies of Scale** – average costs per unit decrease as scale of production is increased within a firm
  - **Purchasing Economies** – suppliers generally offer price discounts for bulk purchases as delivery is cheaper.
  - **Marketing Economies** – larger marketing costs can be spread over high levels of sales of large firms
  - **Financial Economies** – large firms can generally borrow money at lower interest rates as banks view them as less risky than small firms.
  - **Technical Economies** – large firms generally have sufficient finance for investment in new machinery, training/recruiting skilled workers, & research & development.
  - **Managerial Economies** – larger firms are able to employ specialist managers who should operate more efficiently than general managers & make fewer mistakes due to training
  - **Risk-bearing Economies** – as larger firms tend to have more customers; they are safe from being too reliant on one customer. Diversification allows large firms to spread their risk over a range of products

b. **External Economies of Scale** – when the expansion of an entire industry benefits all firms within that industry
  - **Access to a skilled workforce** – Large firms may have access to a skilled workforce because they can recruit workers trained by other firms within the industry
  - **Ancillary firms** – firms which develop & locate near large firms in particular industries to provide them w/ specialised equipment & services
  - **Joint Marketing Benefits** – firms locating in the same area well known for producing high quality produce may benefit from reputation
  - **Shared infrastructure** – the growth of one industry may persuade firms in other industries to invest in new infrastructure

- **Diseconomies of scale**: factors that cause average costs of production to rise when the scale of operation is increased. (https://youtu.be/Fhziks6AJho)

a. **Internal Diseconomies of Scale** – average costs per unit increase as scale of production is increased within a firm

- **Managerial Diseconomies of Scale** – monitoring the productivity & quality of output from thousands of employees in big corporations is imperfect & costly.
- **Administrative Diseconomies of Scale** – instructions from the top management may be partly / completely distorted if they are to follow a long channel of communication.
- **Over-specialisation** – workers in large firms my feels a sense of alienation & subsequent loss of morale causing their productivity may fall leading to wastage of factor inputs & higher costs.

b. **External Diseconomies of Scale** – refers to a rise in the average costs due to the growth of the whole industry when too many firms have located in one area.

- **Shortage of Labour** – firms have to bid wages higher to attract & retain new workers as the wage rises due to labour shortages, the cost of production to all firms in an industry will increase
- **Formation of Trade Unions** – growth of an industry may lead to the formation of industrial unions which may ask for higher wages for their members which then increases the production costs.
- **Pressure on Raw materials** – increased demand on raw materials & other components
- **Disposal of Waste material becomes costly** – when the industry grows, dumping sites may be shifted to the outskirts, firms can also be forced to acquire more advanced equipment to reduce & dispose waste / the government can also increase pollution taxes as the industry grows

❖ *links between economies/diseconomies of scale & unit costs*

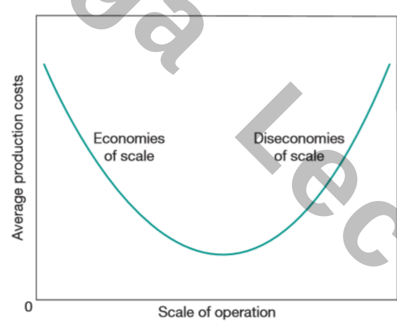


Figure 23.1 The impact of economies and diseconomies of scale on average costs

4.3 Inventory management

4.3.1 Purpose, costs & benefits of inventory

❖ *purpose of inventory within a business*

- **Inventory (stock):** materials & goods required to allow for the production & supply of products to the customer.
- **Raw materials** – the basic materials from which a product is made & they are usually bought from outside.
  - These inventories can be drawn upon at any time & allow the firm to meet increases in demand by increasing the rate of production quickly.
- **Work-in-progress** – unfinished project that is still being added to / developed / partially completed goods
- **Finished products** – goods that have completed the manufacturing process
  - These inventories can be displayed to potential customers & increase the chances of sales.

- They are also held to cope w/ sudden, unpredicted increases in demand so that customers can be satisfied without delay.
- Firms will also stock completed goods to meet anticipated increases in demand as w/ seasonal goods / products, i.e. Toys at festival times.

❖ *costs of holding inventory*

- (https://youtu.be/nsfh8__RZI0)
- **Opportunity cost** – working capital tied up in goods in storage which could be put to another use, i.e. Pay off loans, buy new equipment / pay off suppliers early to gain an early-payment discount.
- **Storage costs** – the overhead costs of storing inventories in secure warehouses.
- **Risk of wastage & obsolescence** – goods often become damaged while held in storage / while being moved – they can then be sold only for a much lower price.

❖ *cost of not holding enough inventory*

- **Lost sales** – if a firm is unable to supply customers from goods held in storage, then sales could be lost to firms that hold higher inventory levels.
- **Idle production resources** – if inventories of raw materials run out, expensive equipment & labour will be left idle, of which the costs could be considerable.
- **Special orders could be expensive** – if an urgent order is given to a supplier to deliver additional materials, then extra costs might be incurred
- **Small order quantities** – the firm may lose out on bulk discounts, & transport costs could be higher as so many more deliveries have to be made.

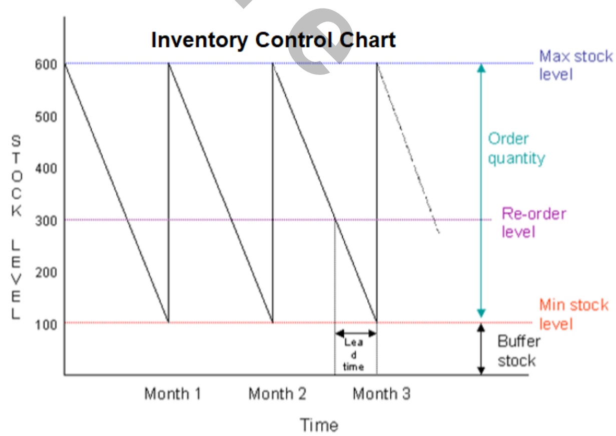
❖ *why inventories need to be managed effectively*

- There might be insufficient inventories to meet unforeseen changes in demand.
- Out-of-date inventories might be held if an appropriate rotation system is not used, e.g. Fresh foods / fast-changing technological products, i.e. Tablet computers.
- Inventory wastage might occur due to mishandling / incorrect storage conditions.
- Very high inventory levels may result in excessive storage costs & a high opportunity cost for tied up capital.
- Poor management of the supplies purchasing function can result in late deliveries, low discounts from suppliers / too large a delivery for the warehouse to cope w/.

4.3.2 Managing inventory

❖ *buffer inventory, reorder level & lead time*

- **Buffer inventories**: the minimum inventory level that should be held to ensure that production could still take place should a delay in delivery occur / should production rates increase.
- **Re-order quantity**: the number of units ordered each time.
- **Lead time**: the normal time taken between ordering new stocks & their delivery (https://youtu.be/nsfh8__RZI0)



❖ *optimum inventory size & economic order quantity*

- **Optimum stock level** – refers to the right quality & quantity of stocks to be kept at the business to promote the smooth running of production.

- **Economic order quantity**: the optimum / least-cost quantity of stock to re-order taking into account delivery costs & stock-holding costs.
- EOQ depends on
  - Interest on credit
  - Storage costs
  - Wastage costs
  - Insurance costs

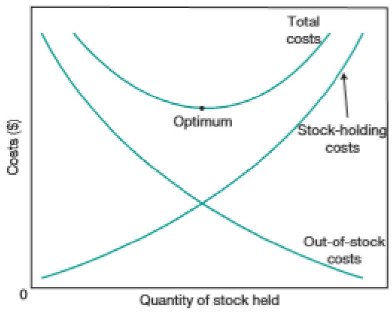


Figure 24.1 Total inventory-holding costs

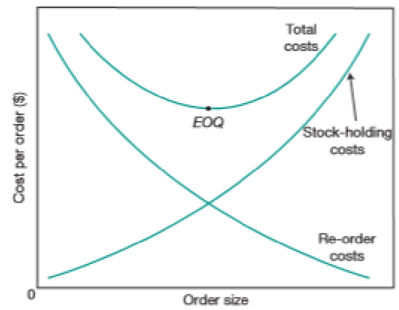


Figure 24.2 Factors influencing the economic order quantity

❖ *inventory control methods including buffer inventory & just in time (JIT)*

- **Just-in-time**: this inventory-control method aims to avoid holding inventories by requiring supplies to arrive just as they are needed in production & completed products are produced to order (https://youtu.be/AH5Bn8iguNM)
- **The factors that influence the success of JIT stock control**
  - **Employee flexibility** – employees should be multi-skilled & able to switch jobs quickly so that excess stocks of raw materials won't build up.
  - **Flexibility of machinery** – modern, computerised machinery is required to produce a wide range of products just by changing a single software
  - **Excellent relationships w/ suppliers** – it should be possible for suppliers to be able to supply raw materials at short notice.
  - **Accurate demand forecast** – enables the business to produce a reliable production schedule used in the calculation of precise number of goods to be produced over a certain time
  - **Extensive use of IT** – computerised records of sales & stock levels would allow minimum stocks to be held & e-communication w/ suppliers would enable accurate delivery of supplies
  - **Strict quality control/zero defect** – as there are no spare stocks, goods have to be produced correctly the first-time otherwise customer orders will not be completed on time.
- **The appropriateness of JIT stock control in given situations**
  - The costs resulting from production being halted when supplies do not arrive may far exceed the costs of holding buffer inventories of key components.
  - Small firms could argue that the expensive IT systems needed to operate JIT effectively cannot be justified by the potential cost savings.
  - In addition, rising global inflation makes holding inventories of raw materials more beneficial as it may be cheaper to buy a large quantity now than smaller quantities in the future when prices have risen. Similarly, higher oil prices will make frequent & small deliveries of materials & components more expensive.

Advantages	Disadvantages
Capital invested in inventory is reduced and the opportunity cost of inventory holding is reduced	The multi-skilled and adaptable staff required for JIT to work may gain improved motivation
Costs of storage and inventory holding are reduced. Space released from holding of inventories can be used for a more productive purpose	Delivery costs will increase as frequent small deliveries are an essential feature of JIT
	Order-administration costs may rise because so many small orders need to be processed
The greater flexibility that the system demands leads to quicker response times to changes in consumer demand or tastes	There could a reduction in the bulk discounts offered by suppliers because each order is likely to be very small
Any failure to receive supplies of materials or components in time will lead to expensive production delays	The reputation of the business depends significantly on outside factors such as the reliability of supplying firms
Much less chance of inventories becoming outdated or obsolescent. Fewer goods held in storage also reduces the risk of damage or wastage	

5 Finance & accounting

5.1 The need for business finance

5.1.1 Start-up capital, capital for expansion

❖ *why businesses need finance to start up & to grow*

- **Start-up** – initial purchase of capital, land & payments for marketing, production, etc
- **Working capital** – day-to-day finance to pay for bills, stocks, etc
- **Expanding capital** – new premises / takeover, etc
- **Special situations** – decline in sales, economic downturn

❖ *how the purpose of finance affects the source of finance chosen*

5.1.2 Working capital

❖ *the meaning & significance of working capital as a source of finance*

- **Working capital**: the capital needed to pay for raw materials, day-to-day running costs & credit offered to customers. In accounting terms working capital = current assets – current liabilities.

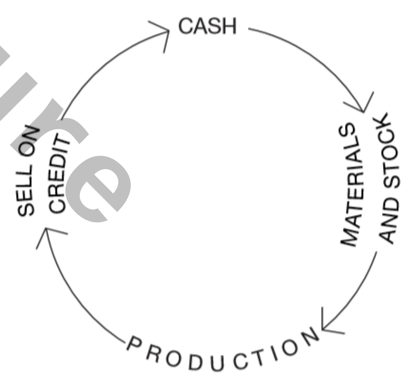


Figure 28.1 The simple working capital cycle – the longer this cycle takes to complete, the more working capital will be needed

❖ *significance of the distinction between revenue expenditure & capital expenditure*

- **Capital expenditure**: the purchase of assets that are expected to last for more than one year, i.e. Building & machinery.
- **Revenue expenditure**: spending on all costs & assets other than fixed assets, includes wages, salaries & materials bought for stock.

5.2 Sources of finance

(https://youtu.be/jsifwhdpkro)

5.2.1 Legal structure & sources of finance

❖ *the relationship between the legal structure of a business & its sources of finance*

- Share issues can only be used by limited companies – & only public limited companies can sell shares directly to the public. Doing this runs the risk of the current owners losing some control – except if a rights issue is used.
- If the owners want to retain control of the business at all costs, then a sale of shares might be unwise.

5.2.2 Short term finance & long-term finance

❖ *distinction between short- & long-term sources of finance*

Short-term finance	Long-term finance
Within a year	More than a year
Used to meet working capital needs	Used to acquire fixed assets
Bank overdraft, debt factoring, trade credit	Share issue, debentures, long-term loan, grants

5.2.3 Internal sources

❖ *internal sources of finance*

- **Internal Sources of Finance** – internal money raised from the business's own assets / from profits left in the business (ploughed-back / retained earnings)

Source of Finance	Explanation	Advantage	Disadvantage
Retained profit	Earned profit that is not taken as tax / used to pay owners / shareholders	Once invested back into the business the retained earnings will not be paid out	Newly formed companies / ones trading at a loss will not have access
Sale of Assets	Use of assets that are no longer fully employed to raise cash	Assets can be sold to leasing company & leased back	Opportunity cost of selling assets that could be used in the future
Reductions in Working Capital	Money raised through selling assets / reducing debt		Firm's liquidity may be reduced to risky level

5.2.4 External sources

❖ *debt finance / equity capital?*

Debt finance	Equity capital
Lenders have no voting rights at the annual general meetings.	It never has to be repaid; it is permanent capital.
Loans will be repaid eventually (apart from convertible debentures), so there is no permanent increase in the liabilities of the business.	Dividends do not have to be paid every year; in contrast, interest on loans must be paid when demanded by the lender.
As no shares are sold, the ownership of the company does not change / is not 'diluted' by the issue of additional shares.	
Interest charges are an expense of the business & are paid out before corporation tax is deducted, while dividends on shares have to be paid from profits after tax.	
The gearing of the company increases & this gives shareholders the chance of higher returns in the future.	

❖ *external sources of finance*

- **External Sources of Finance** – external money raised from sources outside the business.

Source of Finance		Explanation	Advantage	Disadvantage
Short term	**Bank overdraft**	Bank agrees to a business borrowing up to an agreed limit as & when required.	Amount raised can vary from day-to-day	Often High Interest Rates, Bank can 'call in' overdraft – force firms to pay back
Short term	**Debt factoring**	Selling of claims over trade receivables to a debt factor in exchange for immediate liquidity – only a proportion of the value of the debts will be received as cash.	Any debts to the business can be received immediately	Only a proportion of the value of the debts will be received as cash
Short term	**Trade credit**	Delaying the bills for goods & services to suppliers / creditors	Extra existing finance, no interest rates must be paid for this 'loan'	Supplier confidence lost; quick payment discounts lost
Medium term	**Leasing**	Obtaining the use of equipment / vehicles & paying a rental / leasing charge over a fixed period. This avoids the need for the business to raise long-term capital to buy the asset. Ownership remains w/ the leasing company.	Avoids raising long-term capital to buy assets, leasing company repairs/upgrades	Periodic payments may total more than one payment, asset returned after use
Medium term	**Hire purchase**	An asset is sold to a company which agrees to pay fixed repayments over an agreed time period – the asset belongs to the company	The asset belongs to the company, purchase made over time	Periodic payments may total more than one payment
Medium term	**Medium-term loan**		Bank can supply large sum quickly	Interest rates must be paid back to bank, collateral must be provided
Long term	**Share issue / equity finance**	Permanent finance raised by companies through the sale of shares.	Nothing needs to be paid back	Ltd. Cannot sell shares publicly, expensive to join stock exchange, risk of takeovers, some loss of ownership
Long term	**Long-term bonds / debentures**	Bonds issued by companies to raise debt finance, often w/ a fixed rate of interest	Usually not secured on an asset, convertible debentures can be turned into shares overtime so the company issuing them will not have to pay it back	Company must pay fixed rate of interest each year up to 25 years, if secured on an asset & the firm ceases trading the investors may sell the asset
Long term	**Long-term loan**	Loans that do not have to be repaid for at least one year	Bank can supply a large sum quickly that does not have to be paid back for awhile	Interest rates must be paid back to bank, collateral must be provided
Long term	**Mortgage**	A legal agreement by which a financer, lends finance by taking title of the debtor's property.		
Long term	**Grants**	Money donated to the business by outside agencies	Do not have to be repaid if conditions are met	Difficult to receive – the business has no choice over who gets the grants
Long term	**Venture capital**	Risk capital invested in business start-ups / expanding small businesses that have good profit potential but do not find it easy to gain finance from other sources.	They usually invest in small to medium-sized businesses & risky businesses (technology / research) that may find it difficult to raise capital from other sources	Venture capitalists generally expect a share of the future profits / a sizeable stake in the business in return for their investment.

- **Finance for unincorporated businesses**

  • **Microfinance**: providing financial services for poor & low-income customers who do not have access to banking services, i.e. Loans & overdrafts offered by traditional commercial banks.
  • **Crowd funding**: the use of small amounts of capital from a large number of individuals to finance a new business venture. In business ventures that are successful, the crowd funding investors will receive either:
    ▪ Their initial capital back plus interest – this is sometimes known as peer-to-peer lending
    ▪ An equity stake in the business & a share in profits – when these are eventually made!

5.2.5 Factors influencing the sources of finance

❖ *factors influencing the choice of sources of finance in a given situation*

- Use of finance
- Size of existing borrowing
- Flexibility of firm's need for finance
- Legal structure & desire to retain control
- Amount required
- Cost of debt
- Time period for which finance is required
- Existing assets of the firm

5.2.6 Selecting the source of finance

❖ *the appropriateness of each possible source in a given situation*

5.3 Costs

5.3.1 Cost information

❖ *the need for accurate cost data*

- Accurate profits / losses will allow a business to take effective & profitable decisions, i.e. Where to locate.
- Cost data are useful to other departments, e.g. Marketing managers will use cost data to help inform their pricing decisions.
- It allows comparisons to be made w/ past periods of time & the efficiency of a department / the profitability of a product may be measured & assessed over time.
- They can help set budgets for the future which will act as targets to work towards for the departments concerned & actual cost levels can then be compared w/ budgets.
- Comparing cost data can help a manager make decisions about resource use, e.g. If wage rates are very low, then labour-intensive methods of production may be preferred over capital-intensive ones.
- Calculating the costs of different options can assist managers in their decision-making & help improve business performance.

❖ *types of costs: fixed, variable, marginal; direct & indirect*

- **Direct costs**: these costs can be clearly identified w/ each unit of production & can be allocated to a cost centre.
- **Indirect costs**: costs that cannot be identified w/ a unit of production / allocated accurately to a cost centre.
- **Fixed costs**: costs that do not vary w/ output in the short run.
- **Variable costs**: costs that vary w/ output.
- **Marginal costs**: the extra cost of producing one more unit of output.

❖ *problems of trying to allocate costs in given situations*

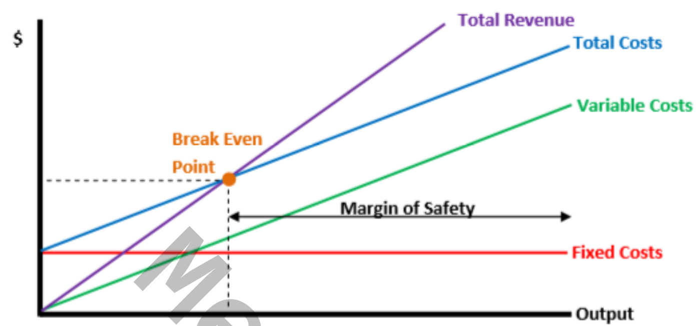
- **Time** – allocations take a lot of time for big complex organizations, this drags out the time for financial close, which is so critical for timely internal & external reporting.
- **Accuracy** – without Reciprocal Allocation & without sufficient flexibility, allocations are not as accurate as they should be.
- **Transparency** – it is difficult to understand where allocations come from & how they are derived.
- **Trust** – sometimes people take the position that cost figures are not accurate so there is no point in making decisions based on cost. Neither attitude is helpful in a corporate setting.

5.3.2 Uses of cost information

- *cost information for decision making purposes, e.g. average, marginal, total costs*
- *how costs can be used for pricing decisions*
- *how costs can be used to monitor & improve business performance, including using cost information to calculate profits*

5.3.3 Break-even analysis

- *determining the minimum level of production needed to break-even / the profit made*
  - **The graphical method** (https://youtu.be/pnsuwxt4ene)



  - **The equation method** (https://youtu.be/578qm7sxo_M)
    - **Contribution per unit:** selling price less variable cost per unit.
      Contribution = $selling\ price\ -\ total\ variable\ cost$
    - **Break-even level of output** = $\frac{fixed\ cost}{contribution\ per\ unit}$

- *define, calculate & interpret the margin of safety*
  - **Margin of safety**: the amount by which the sales level exceeds the break-even level of output.
    - **Margin of safety** = $current\ output\ in\ units\ -\ break\text{-}even\ output$

- *uses & limitations of break-even analysis*

Advantages	Disadvantages
Charts are relatively easy to construct and interpret.	Assumption that costs and revenues are represented by straight lines is unrealistic.
Analysis provides useful guidelines to management on break-even points, safety margins and profit/loss levels at different rates of output.	There is no allowance made for inventory levels on the break-even chart. It is assumed that all units produced are sold. This is unlikely to always be the case.
Comparisons can be made between different options by constructing new charts to show changed circumstances.	It is unlikely that fixed costs remain unchanged at different output levels up to maximum capacity.
Break-even analysis can be used to assist managers when taking important decisions.	Not all costs can be conveniently classified into fixed and variable costs *e.g. electricity*
The equation produces a precise breakeven result.	

5.4 Accounting fundamentals

5.4.1 Income statement

❖ *contents of an income statement*

- (https://youtu.be/2hku45vfd5e)
- **Income statement**: records the revenue, costs & profit (/ loss) of a business over a given period of time.
- **Revenue (formerly called sales turnover)**: the total value of sales made during the trading period = selling price × quantity sold.
- **Cost of sales (/ cost of goods sold)**: this is the direct cost of the goods that were sold during the financial year.
- **Gross profit**: equal to sales revenue less cost of sales.
- **Operating profit (formerly referred to as net profit):** gross profit minus overhead expenses.
- **Profit for the year (profit after tax):** operating profit minus interest costs & corporation tax.
- **Dividends:** the share of the profits paid to shareholders as a return for investing in the company.
- **Retained earnings (profit):** the profit left after all deductions, including dividends, have been made, this is 'ploughed back' into the company as a source of finance.

	Revenue	3,060	
(minus)	Cost of sales	(1,840)	Trading account
(equals)	Gross profit	1,220	
(minus)	Overheads/expenses	(580)	Profit and loss section
(equals)	Operating profit (formerly net profit)	640	
(minus)	Interest	(80)	
(equals)	Profit before tax	560	
(minus)	Tax @ 20%	(112)	
(equals)	Profit for the year	448	
(minus)	Dividends to shareholders	200	Appropriation account
(equals)	Retained earnings	248	

Table 30.4 Income statement for Energen plc for the year ended 29 March 2013

5.4.2 Statement of financial position

❖ *contents of a statement of financial position*

- **Statement of financial position (balance sheet):** an accounting statement that records the values of a business's assets, liabilities & shareholders' equity at one point in time.
- **Shareholders' equity**: total value of assets – total value of liabilities.
- **Non-current assets**: assets to be kept & used by the business for more than one year. Used to be referred to as 'fixed assets'.
- **Current assets**: assets that are likely to be turned into cash before the next balance-sheet date.
- **Current liabilities**: debts of the business that will usually have to be paid within one year.
- **Accounts payable (creditors):** value of debts for goods bought on credit payable to suppliers; also known as 'trade payables'.
- **Working capital**: the capital needed to pay for raw materials, day-to-day running costs & credit offered to customers.
  - **Working capital** = current assets – current liabilities.
- **Non-current liabilities**: value of debts of the business that will be payable after more than one year.
- **Intellectual capital / property:** the amount by which the market value of a firm exceeds its tangible assets less liabilities – an intangible asset.
- **Goodwill:** arises when a business is valued at / sold for more than the balance-sheet value of its assets.

	$m	$m	Notes
ASSETS			
Non-current (fixed) assets:			
Property	300		
Vehicles	45		
Equipment	67		
Intangible assets	30		
	442		
Current assets:			
Inventories	34		
Trade receivables (formerly debtors)	28		
Cash	4		Also called 'cash and cash equivalents'.
	66		
TOTAL ASSETS		508	This total will balance with equity and liabilities – hence the original term 'balance sheet'.
EQUITY AND LIABILITIES			
Current liabilities:			
Accounts payable (or creditors)	42		
Short-term loans	31		These loans will include the company's overdraft with the bank. Other current liabilities might include provisions to pay tax and dividends.
	73		
Non-current liabilities:			These used to be referred to as 'long-term liabilities'.
Long-term loans	125		Other non-current liabilities might include debentures issued by the company.
	125		
TOTAL LIABILITIES	198		If these actually equalled total assets, there would be no shareholders' equity in the company at all.
Shareholders' equity:			
Share capital	200		
Retained earnings reserve	110		The cumulative value of the company's annual 'retained earnings/profits'.
	310		
TOTAL EQUITY AND LIABILITIES		508	This does balance with total assets!

Table 30.5 Example of a Statement of financial position with some explanatory notes

5.4.3 Liquidity ratios

❖ *acid test ratio, current ratio*

- **Current ratio** = $\frac{current\ assets}{current\ liabilities}$ (https://youtu.be/lkwoqypqnw0)
- **Acid-test ratio** = $\frac{liquid\ assets}{current\ liabilities}$ (https://youtu.be/ekcwyaelrxu)

5.4.4 Profitability ratios

❖ *gross profit margin, profit margin*

- **Gross profit margin %** = $\frac{gross\ profit}{revenue} \times 100$ (https://youtu.be/hh9-xlrj0hc)
- **Operating profit margin %** = $\frac{operating\ profit}{revenue} \times 100$ (https://youtu.be/z82e4z1zfoy)

5.4.5 Practical use of ratio analysis

❖ *how each of these ratios is used?*

- Profit margin ratios are used to assess how successful the management of a business has been at converting sales revenue into both gross profit & operating profit. They are widely used to measure the performance of a company – &, therefore, by implication, the performance of the management team too.
  - **Gross profit margin**: This ratio compares gross profit (profit before deduction of overheads) w/ revenue.
  - **Operating profit margin**: This ratio compares operating profit (formerly known as net profit margin) to revenue.
- Liquidity ratios assess the ability of the firm to pay its short-term debts. They are an important measure of the short-term financial health of a business. They are not concerned w/ profits, but w/ the working capital of the business.
  - **Current ratio** – compares the current assets w/ the current liabilities of the business. The result can either be expressed as a ratio (2:1, for example) / just as a number (for example, 2). Many accountants recommend a result of around 1.5–2.
  - **Acid-test ratio / quick ratio** – a stricter test of a firm's liquidity. It ignores the least liquid of the firm's current assets – inventories (stocks), which have not yet been sold & there can be no certainty that they will be sold in the short term. Results below 1 are often viewed w/ caution by accountants.

❖ *ways that businesses might try to improve ratio results, including reducing working capital problems*

Method to increase profit margins	Examples	Evaluation of method
Increase gross and operating profit margin by reducing direct costs	1 Using cheaper materials, e.g. rubber not leather soles on shoes. 2 Cutting labour costs, e.g. relocating production to low-labour-cost countries, such as Dyson making vacuum cleaners in Malaysia. 3 Cutting labour costs by increasing productivity through automation, e.g. Hyundai's production line uses some of the most labour-saving robots in the world. 4 Cutting wage costs by reducing workers' pay.	1 Consumers' perception of quality may be damaged and this could hit the product's reputation. Consumers may expect lower prices, which may cut the gross profit margin. 2 Quality may be at risk; communication problems with distant factories. 3 Purchasing machinery will increase overhead costs (gross profit could rise but operating profit fall), remaining staff will need retraining – short-term profits may be cut. 4 Motivation levels might fall, which could reduce productivity and quality.
Increase gross and operating profit margin by increasing price	1 Raising the price of the product with no significant increase in variable costs, e.g. Mauritius Telecom raising the price of its broadband connections. 2 Petrol companies increasing prices by more than the price of oil has risen.	1 Total profit could fall if too many consumers switch to competitors – this links to price elasticity. 2 Consumers may consider this to be a 'profiteering' decision and the long-term image of the business may be damaged.
Increase operating profit margin by reducing overhead costs	Cutting overhead costs, such as rent, promotion costs or management costs but maintaining sales levels, for example: 1 Moving to a cheaper head office location. 2 Reducing promotion costs. 3 Delayering the organisation.	1 Lower rental costs could mean moving to a cheaper area, which could damage image. 2 Cutting promotion costs could lead to sales falling by more than fixed costs. 3 Fewer managers – or lower salaries – could reduce the efficient operation of the business.

Table 30.6 Evaluation of ways to increase profit margins

Method to increase liquidity	Examples	Evaluation of method
Sell off fixed assets for cash – could lease these back if still needed by the business	▪ Land and property could be sold to a leasing company.	▪ If assets are sold quickly, they might not raise their true value. ▪ If assets are still needed by the business, then leasing charges will add to overheads and reduce operating profit margin.
Sell off inventories for cash (note: this will improve the acid-test ratio, but not the current ratio)	▪ Stocks of finished goods could be sold off at a discount to raise cash. ▪ JIT stock management will achieve this objective.	▪ This will reduce the gross profit margin if inventories are sold at a discount. ▪ Consumers may doubt the image of the brand if inventories are sold off cheaply. ▪ Inventories might be needed to meet changing customer demand levels – JIT might be difficult to adopt in some industries.
Increase loans to inject cash into the business and increase working capital	▪ Long-term loans could be taken out if the bank is confident of the company's prospects.	▪ These will increase the gearing ratio (see Chapter 35). ▪ These will increase interest costs.

Table 30.7 Evaluation of ways to increase liquidity

5.4.6 Main users of accounts

❖ *comparison of ratios results between businesses*

❖ *limitations of these accounting ratios*

- The four ratios studied give an incomplete analysis of a company's financial position.
- One ratio result on its own is of very limited value – it needs to be compared w/ results from other similar businesses & w/ results from previous years to be more informative.
- Comparing results w/ those of other businesses should be done w/ caution. Different businesses may have slightly different ways of valuing assets & some accounts may have been window-dressed.
- Poor ratio results only highlight a potential business problem – they cannot by themselves analyse the cause of it / suggest potential solutions to the problem.
- As noted earlier in the chapter, financial statements can only measure quantitative performance & this is true of the ratios based on them. Other information of a qualitative nature is necessary before the full picture of a company's position & performance can be fully judged.

❖ *identification of the kind of information that individual stakeholder groups might seek*

Stakeholders	Use of accounts
Business managers	- To measure the performance of the business to compare against targets, previous time periods & competitors - To help them take decisions, i.e. New investments, closing branches & launching new products - To control & monitor the operation of each department & division of the business - To set targets / budgets for the future & review these against actual performance.
Banks	- To decide whether to lend money to the business - To assess whether to allow an increase in overdraft facilities - To decide whether to continue an overdraft facility / a loan.
Creditor	- To see if the business is secure & liquid enough to pay off its debts - To assess whether the business is a good credit risk - To decide whether to press for early repayment of outstanding debts.
Customers	- To assess whether the business is secure - To determine whether they will be assured of future supplies of the goods they are purchasing - To establish whether there will be security of spare parts & service facilities.
Government & tax authorities	- To calculate how much tax is due from the business - To determine whether the business is likely to expand & create more jobs & be of increasing importance to the country's economy - To assess whether the business is in danger of closing down, creating economic problems - To confirm that the business is staying within the law in terms of accounting regulations.

Investors	- To assess the value of the business & their investment in it - To establish whether the business is becoming more / less profitable - To determine what share of the profit's investors are receiving - To decide whether the business has potential for growth - If they are potential investors, to compare these details w/ those from other businesses before making a decision to buy shares in a company - If they are actual investors, to decide whether to consider selling all / part of their holding
Workforce	- To assess whether the business is secure enough to pay wages & salaries - To determine whether the business is likely to expand / be reduced in size - To determine whether jobs are secure - To find out whether, if profits are rising, a wage increase can be afforded
Local community	- To see if the business is profitable & likely to expand, which could be good for the local economy - To determine whether the business is making losses & whether this could lead to closure.

5.4.7 Limitations of published accounts

❖ *limitations of the usefulness of published accounts:*

- Historical – may not reflect the future, may be out of date
- Does not reflect qualitative aspects of a business
- Information not in published accounts:
  - Details of the sales & profitability of each good / service produced by the company & of each division / department
  - The research & development plans of the business & proposed new products
  - The precise future plans for expansion / rationalisation of the business
  - The performance of each department / division
  - Evidence of the company's impact on the environment & the local community
  - Future budgets / financial plans
- Possibility of '**window dressing**' – presenting the company accounts in a favourable light – to flatter the business performance. Common ways of window dressing include:
  - Selling assets at the end of the financial year then lease them back
  - Reduce the amount of depreciation of fixed assets; increase profits & asset value
  - Ignoring some trade receivables
  - Giving stock levels a higher value than what they are worth
  - Delaying the payment of bills / incurring expenses until after they have been published
- May not have details of the performance of individual parts of a business

5.5 Forecasting & managing cash flows

5.5.1 Purposes of cash flow forecasts

❖ *difference between cash & profits*

- Profit does not pay the bills & expenses of running a business – but cash does. Of course, profit is important – especially in the long term when investors expect rewards & the business needs additional finance for investment.
- Cash is always important – short & long term. Cash flow relates to the timing of payments to workers & suppliers & receipts from customers.
- If a business does not plan the timing of these payments & receipts carefully it may run out of cash even though it is operating profitably. If suppliers & creditors are not paid in time, they can force business owners into liquidation of the business's assets if it appears to be insolvent.

5.5.2 Cash flow forecasts in practice

❖ *uses of cash flow forecasts*

- (https://youtu.be/pdfwspxnx5e)
- Preparing for areas of negative cash-flow – new business start-ups are often offered much less time to pay suppliers than larger, well-established firms – they are given shorter credit periods
- Required for investors & banks – banks & other lenders may not believe the promises of new business owners as they have no trading record, they will expect payment at the agreed time
- Planning to reduce negative cash-flow – finance is often very tight at start-up, so not planning accurately is of even more significance for new businesses.

❖ *construction of cash flow forecasts, including recognising the uncertainty of cash flows*

- Limitations of cash flow forecasts:
  - Mistakes can be made in preparing the revenue & cost forecasts / they may be drawn up by inexperienced entrepreneurs / staff.
  - Unexpected cost increases can lead to major inaccuracies in forecasts. Fluctuations in oil prices can lead to the cash-flow forecasts of even major airlines being misleading.
  - Wrong assumptions can be made in estimating the sales of the business, perhaps based on poor market research, & this will make the cash inflow forecasts inaccurate (https://youtu.be/77drcnsnbbq)

CASH INFLOWS	All figures in $000	APRIL	MAY	JUNE	JULY
	Owners' capital injection	28	0	0	0
	Cash sales	6	8	12	9
	Payments by trade receivables (e.g. credit card companies)	0	2	2	3
	Total cash in	34	10	14	12
CASH OUTFLOWS					
	Lease	18	0	0	0
	Rent	2	2	2	2
	Clothes purchases	6	4	3	4
	Labour	3	3	4	3
	Other costs	6.5	2	2.5	1.5
	Total cash out	35.5	11	11.5	*y*
NET CASH FLOW	**Net monthly cash flow**	**x**	**(1)**	**2.5**	**z**
	Opening balance	0	(1.5)	(2.5)	0
	Closing balance	(1.5)	(2.5)	0	1.5

❖ *interpretation of simple cash flow forecasts from given data*

❖ *amendment of cash flow forecasts in the light of changes in business circumstances*

5.5.3 Methods of improving cash flow

❖ *how reducing costs / improving the management of trade receivables & trade payables can improve cash flow*

(https://youtu.be/fwltate_vve)

Particular	How it can be managed
Trade receivables	- Not extending credit to customers – / extending it for shorter time periods - Selling claims on trade receivables to specialist financial institutions acting as debt factors - By being careful to discover whether new customers are creditworthy - By offering a discount to clients who pay promptly
Trade payables	- Increasing the range of goods & services bought on credit - Extend the period of time taken to pay
Inventory	- Keeping smaller inventory levels - Using computer systems to record sales & inventory levels – thus ordering as required - Efficient inventory control, inventory use & inventory handling so as to reduce losses through damage, wastage & shrinkage - Just-in-time inventory ordering – by producing only when orders have been received, working capital tied up in inventories will be minimised.
Cash	- Use of cash-flow forecasts – as identified above, these can help the management of cash flows & working capital needs - Wise use / investment of excess cash - Planning for periods when there might be too little cash & arranging for overdraft facilities from the bank to avoid a liquidity crisis.

❖ *further methods of improving cash flows: debt factoring, sale & leaseback, leasing, hire purchase*

Method	How it works	Possible drawbacks
Overdraft	Flexible loans on which the business can draw as necessary up to an agreed limit.	■ Interest rates can be high – there may be an overdraft arrangement fee. ■ Overdrafts can be withdrawn by the bank and this often causes insolvency.
Short-term loan	A fixed amount can be borrowed for an agreed length of time.	■ The interest costs have to be paid. ■ The loan must be repaid by the due date.
Sale of assets	Cash receipts can be obtained from selling off redundant assets, which will boost cash inflow.	■ Selling assets quickly can result in a low price. ■ The assets might be required at a later date for expansion. ■ The assets could have been used as collateral for future loans.
Sale and leaseback	Assets can be sold, e.g. to a finance company, but the asset can be leased back from the new owner.	■ The leasing costs add to annual overheads. ■ There could be loss of potential profit if the asset rises in price. ■ The assets could have been used as collateral for future loans.
Reduce credit terms to customers	Cash flow can be brought forward by reducing credit terms from, say, two months to one month.	■ Customers may purchase products from firms that offer extended credit terms.
Debt factoring	Debt-factoring companies can buy the customers' bills from a business and offer immediate cash – this reduces risk of bad debts too.	■ Only about 90–95% of the debt will now be paid by the debt-factoring company – this reduces profit. ■ The customer has the debt collected by the finance company – this could suggest that the business is in trouble.

Table 31.2 Ways to increase cash inflows and their possible drawbacks

Method	How it works	Possible drawbacks
Delay payments to suppliers (creditors)	Cash outflows will fall in the short term if bills are paid after, say, three months instead of two months.	■ Suppliers may reduce any discount offered with the purchase. ■ Suppliers can either demand cash on delivery or refuse to supply at all if they believe the risk of not being paid is too great.
Delay spending on capital equipment	By not buying equipment, vehicles, etc. cash will not have to be paid to suppliers.	■ The efficiency of the business may fall if outdated and inefficient equipment is not replaced. ■ Expansion becomes very difficult.
Use leasing, not outright purchase, of capital equipment	The leasing company owns the asset and no large cash outlay is required.	■ The asset is not owned by the business. ■ Leasing charges include an interest cost and add to annual overheads.
Cut overhead spending that does not directly affect output, e.g. promotion costs	These costs will not reduce production capacity and cash payments will be reduced.	■ Future demand may be reduced by failing to promote the products effectively.

Table 31.3 Ways to reduce cash outflows and their possible drawbacks

- *recognition of situations in which the various methods of improving cash flow can be used & working capital*
  - There is no 'correct' level of working capital for all businesses. Business requirements for working capital will depend on a number of factors, especially the length of the working capital cycle. For example, supermarkets can manage on a much lower level of working capital than a shipbuilding business.
  - Too much liquidity is wasteful.
  - Too little liquidity can lead to business failure.
  - Managing working capital is not just about looking after cash. Clearly the timings of cash received & spent are important but other features of management are important too – efficient operations management will reduce wastage of resources (& money) & cut inventory levels. Efficient marketing will help to speed up the sale of goods – &, therefore, the cash inflows from this.
  - When businesses expand, they generally need higher inventory levels & will sell a higher value of products on credit. This increase in working capital is likely to be permanent, so long-term / permanent sources of finance will be needed, i.e. Long-term loans / even share capital.

Revision and How to Answer Questions

A Level Exam Skills – (https://www.youtube.com/playlist?List=plcwpawknioickpefyygfu3abljf-fsrqh)

5 Topics in 5 Minutes Revision – (https://www.youtube.com/playlist?List=plcwpawknioid2y62ja15h_ZN3vM53kFUR)

Credits

- **Z Notes – Business 9609 AS Level** - https://znotes.org/caie/as/business-9609/theory
- **Cambridge International AS and A Level Business**: Coursebook with CD-ROM Third Edition
  Publisher: Cambridge University Press
  Author: Stimpson, P and Farquharson, A
  ISBN: 9781107677364
- **CIE Notes** - https://www.cienotes.com/as-and-a-level-business-studies-notes-9609/
- **Notes for CIE** - https://sites.google.com/site/notesforcie/as/business-studies
- **Compiled by:** Vishakha Mirchandani (mirchandanivishakha@gmail.com)