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EDEXCEL INTERNATIONAL GCSE (9–1)

eBook included

BUSINESS

Student Book

Rob Jones

Pearson

PEARSON EDEXCEL INTERNATIONAL GCSE (9–1)

BUSINESS

Student Book

Rob Jones

Published by Pearson Education Limited, 80 Strand, London, WC2R 0RL.

www.pearsonglobalschools.com

Copies of official specifications for all Pearson qualifications may be found on the website: https://qualifications.pearson.com

Text © Pearson Education Limited 2017
Edited by Jeremy Toynbee
Designed by Cobalt id
Typeset by Cobalt id
Original illustrations © Pearson Education Limited 2017
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Cover design by Pearson Education Limited
Picture research by: Ann Thomson
Cover photo/illustration © alamy.com: David Noton Photography / Alamy Stock Photo
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First published 2017

20 19 18 17
10 9 8 7 6 5 4 3 2

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN 978 0 435188 63 4

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ABOUT THIS BOOK

This book is written for students following the Pearson Edexcel International GCSE (9–1) Business specification and covers both years of the course.

The course has been structured so that teaching and learning can take place in any order, both in the classroom and in any independent learning. The book contains five units that match the five areas of content in the specification: Business Activity and Influences on Business, People in Business, Business Finance, Marketing and Business Operations.

Each unit is split into multiple chapters to break down content into manageable chunks and to ensure full coverage of the specification.

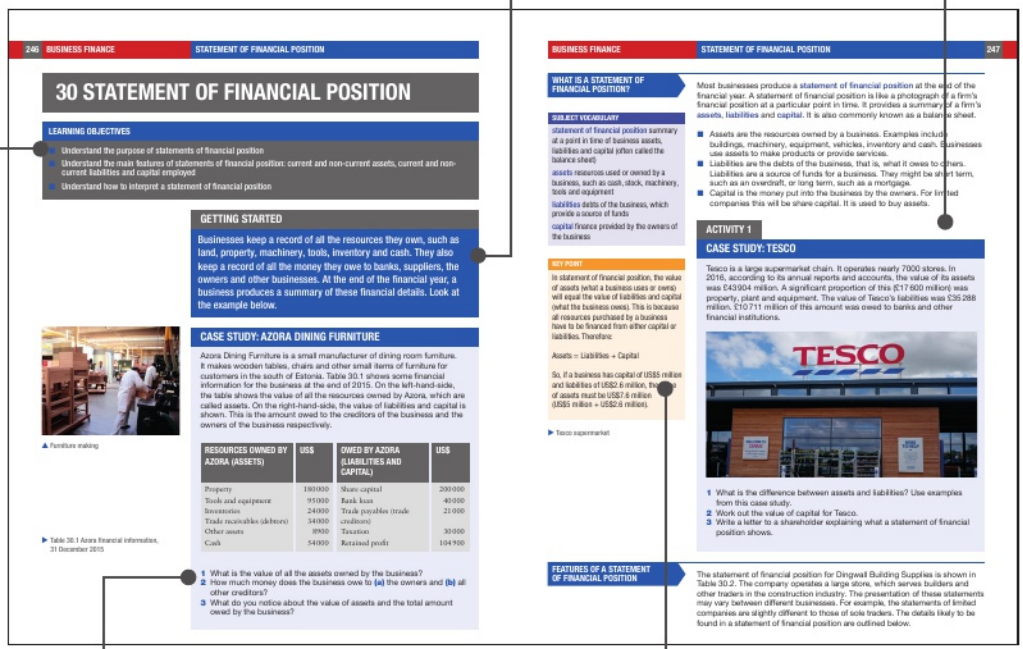
Each chapter features a mix of learning and activities. Global case studies are embedded throughout to show a range of businesses within the context of the chapter. Summary questions at the end of each chapter help you to put learning into practice.

The content for all five units is applicable for both exam papers. Paper 1 is Investigating small businesses and Paper 2 is investigating large businesses. Knowing how to apply your learning to both of these will be critical for your success in the exam. To help with this, relevant chapters feature a section on how the content applies to both large and small businesses. There are also exam-style questions at the end of each unit and two full practice exam papers at the end of the book.

Learning objectives
Each chapter starts with a list of what you will learn from it. They are carefully tailored to address key assessment objectives central to the course.

Getting started
An introduction to the chapter, letting you think about the concepts you will be introduced to. Questions are designed to stimulate discussion and use of prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

Activity
Each chapter includes activities to embed understanding through case studies and questions.


246 BUSINESS FINANCE STATEMENT OF FINANCIAL POSITION

30 STATEMENT OF FINANCIAL POSITION

LEARNING OBJECTIVES

- Understand the purpose of statements of financial position
- Understand the main features of statements of financial position: current and non-current assets, current and non-current liabilities and capital employed
- Understand how to interpret a statement of financial position

GETTING STARTED

Businesses keep a record of all the resources they own, such as land, property, machinery, tools, inventory and cash. They also keep a record of all the money they owe to banks, suppliers, the owners and other businesses. At the end of the financial year, a business produces a summary of these financial details. Look at the example below.

CASE STUDY: AZORA DINING FURNITURE

Azora Dining Furniture is a small manufacturer of dining room furniture. It makes wooden tables, chairs and other small items of furniture for customers in the south of Estonia. Table 30.1 shows some financial information for the business at the end of 2015. On the left-hand-side, the table shows the value of all the resources owned by Azora, which are called assets. On the right-hand-side, the value of liabilities and capital is shown. This is the amount owed to the creditors of the business and the owners of the business respectively.

▲ Furniture making

RESOURCES OWNED BY AZORA (ASSETS)	US$	OWED BY AZORA (LIABILITIES AND CAPITAL)	US$
Property	180 000	Share capital	200 000
Tools and equipment	95 000	Bank loan	40 000
Inventories	24 000	Trade payables (trade creditors)	21 000
Trade receivables (debtors)	34 000	Taxation	30 000
Other assets	8900	Retained profit	104 900
Cash	54 000		

▶ Table 30.1 Azora financial information, 31 December 2015

1 What is the value of all the assets owned by the business?
2 How much money does the business owe to (a) the owners and (b) all other creditors?
3 What do you notice about the value of assets and the total amount owed by the business?

BUSINESS FINANCE STATEMENT OF FINANCIAL POSITION 247

WHAT IS A STATEMENT OF FINANCIAL POSITION?

Most businesses produce a statement of financial position at the end of the financial year. A statement of financial position is like a photograph of a firm's financial position at a particular point in time. It provides a summary of a firm's assets, liabilities and capital. It is also commonly known as a balance sheet.

- Assets are the resources owned by a business. Examples include buildings, machinery, equipment, vehicles, inventory and cash. Businesses use assets to make products or provide services.
- Liabilities are the debts of the business, that is, what it owes to others. Liabilities are a source of funds for a business. They might be short term, such as an overdraft, or long term, such as a mortgage.
- Capital is the money put into the business by the owners. For limited companies this will be share capital. It is used to buy assets.

SUBJECT VOCABULARY

statement of financial position summary at a point in time of business assets, liabilities and capital (often called the balance sheet)

assets resources used or owned by a business, such as cash, stock, machinery, tools and equipment

liabilities debts of the business, which provide a source of funds

capital finance provided by the owners of the business

KEY POINT

In statement of financial position, the value of assets (what a business uses or owns) will equal the value of liabilities and capital (what the business owes). This is because all resources purchased by a business have to be financed from either capital or liabilities. Therefore:

Assets = Liabilities + Capital

So, if a business has capital of US$5 million and liabilities of US$2.6 million, the value of assets must be US$7.6 million (US$5 million + US$2.6 million).

▶ Tesco supermarket

ACTIVITY 1

CASE STUDY: TESCO

Tesco is a large supermarket chain. It operates nearly 7000 stores. In 2016, according to its annual reports and accounts, the value of its assets was £43 904 million. A significant proportion of this (£17 600 million) was property, plant and equipment. The value of Tesco's liabilities was £35 288 million. £10 711 million of this amount was owed to banks and other financial institutions.

1 What is the difference between assets and liabilities? Use examples from this case study.
2 Work out the value of capital for Tesco.
3 Write a letter to a shareholder explaining what a statement of financial position shows.

FEATURES OF A STATEMENT OF FINANCIAL POSITION

The statement of financial position for Dingwall Building Supplies is shown in Table 30.2. The company operates a large store, which serves builders and other traders in the construction industry. The presentation of these statements may vary between different businesses. For example, the statements of limited companies are slightly different to those of sole traders. The details likely to be found in a statement of financial position are outlined below.

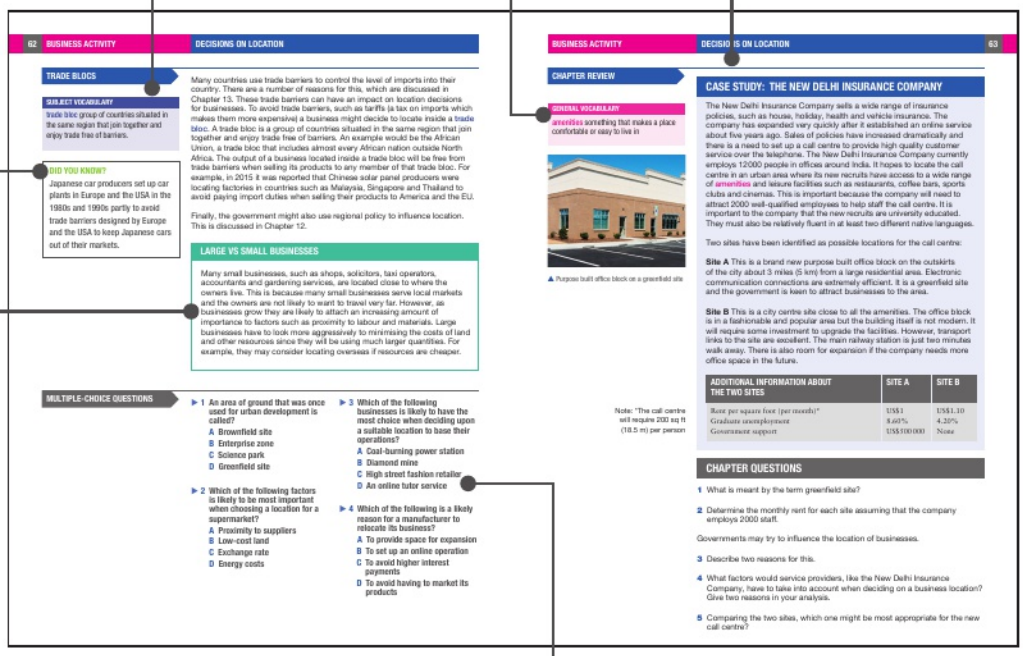
Case study
Getting started, Chapter review and Activities are all based around case studies. They are drawn from a range of large and small businesses from around the world and will help you see learning applied to real-world contexts.

Key point
Easy to understand, core information to take away from sections.

Did you know?
Interesting facts to encourage wider thought and stimulate discussion.

Subject vocabulary and General vocabulary
Useful words and phrases are colour coded within the main text and picked out in the margin with concise and simple definitions. These help understanding of key subject terms and support students whose first language is not English.

Chapter review and Chapter questions
A summary case study and associated questions at the end of each chapter to consolidate your learning.



62 BUSINESS ACTIVITY DECISIONS ON LOCATION

TRADE BLOCS

SUBJECT VOCABULARY
trade bloc group of countries situated in the same region that join together and enjoy trade free of barriers.

DID YOU KNOW?
Japanese car producers set up car plants in Europe and the USA in the 1980s and 1990s partly to avoid trade barriers designed by Europe and the USA to keep Japanese cars out of their markets.

Many countries use trade barriers to control the level of imports into their country. There are a number of reasons for this, which are discussed in Chapter 13. These trade barriers can have an impact on location decisions for businesses. To avoid trade barriers, such as tariffs (a tax on imports which makes them more expensive) a business might decide to locate inside a trade bloc. A trade bloc is a group of countries situated in the same region that join together and enjoy trade free of barriers. An example would be the African Union, a trade bloc that includes almost every African nation outside North Africa. The output of a business located inside a trade bloc will be free from trade barriers when selling its products to any member of that trade bloc. For example, in 2015 it was reported that Chinese solar panel producers were locating factories in countries such as Malaysia, Singapore and Thailand to avoid paying import duties when selling their products to America and the EU.

Finally, the government might also use regional policy to influence location. This is discussed in Chapter 12.

LARGE VS SMALL BUSINESSES

Many small businesses, such as shops, solicitors, taxi operators, accountants and gardening services, are located close to where the owners live. This is because many small businesses serve local markets and the owners are not likely to want to travel very far. However, as businesses grow they are likely to attach an increasing amount of importance to factors such as proximity to labour and materials. Large businesses have to look more aggressively to minimising the costs of land and other resources since they will be using much larger quantities. For example, they may consider locating overseas if resources are cheaper.

MULTIPLE-CHOICE QUESTIONS

▶ 1 An area of ground that was once used for urban development is called?
A Brownfield site
B Enterprise zone
C Science park
D Greenfield site

▶ 2 Which of the following factors is likely to be most important when choosing a location for a supermarket?
A Proximity to suppliers
B Low-cost land
C Exchange rate
D Energy costs

▶ 3 Which of the following businesses is likely to have the most choice when deciding upon a suitable location to base their operations?
A Coal-burning power station
B Diamond mine
C High street fashion retailer
D An online tutor service

▶ 4 Which of the following is a likely reason for a manufacturer to relocate its business?
A To provide space for expansion
B To set up an online operation
C To avoid higher interest payments
D To avoid having to market its products

BUSINESS ACTIVITY DECISIONS ON LOCATION 63

CHAPTER REVIEW

GENERAL VOCABULARY
amenities something that makes a place comfortable or easy to live in

▲ Purpose built office block on a greenfield site

CASE STUDY: THE NEW DELHI INSURANCE COMPANY

The New Delhi Insurance Company sells a wide range of insurance policies, such as house, holiday, health and vehicle insurance. The company has expanded very quickly after it established an online service about five years ago. Sales of policies have increased dramatically and there is a need to set up a call centre to provide high quality customer service over the telephone. The New Delhi Insurance Company currently employs 12000 people in offices around India. It hopes to locate the call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre. It is important to the company that the new recruits are university educated. They must also be relatively fluent in at least two different native languages.

Two sites have been identified as possible locations for the call centre:

Site A This is a brand new purpose built office block on the outskirts of the city about 3 miles (5 km) from a large residential area. Electronic communication connections are extremely efficient. It is a greenfield site and the government is keen to attract businesses to the area.

Site B This is a city centre site close to all the amenities. The office block is in a fashionable and popular area but the building itself is not modern. It will require some investment to upgrade the facilities. However, transport links to the site are excellent. The main railway station is just two minutes walk away. There is also room for expansion if the company needs more office space in the future.

ADDITIONAL INFORMATION ABOUT THE TWO SITES	SITE A	SITE B
Rent per square foot (per month)*	US$1	US$1.10
Graduate unemployment	8.60%	4.20%
Government support	US$100 000	None

Note: *The call centre will require 200 sq ft (18.5 m) per person

CHAPTER QUESTIONS

1 What is meant by the term greenfield site?

2 Determine the monthly rent for each site assuming that the company employs 2000 staff.

Governments may try to influence the location of businesses.

3 Describe two reasons for this.

4 What factors would service providers, like the New Delhi Insurance Company, have to take into account when deciding on a business location? Give two reasons in your analysis.

5 Comparing the two sites, which one might be most appropriate for the new call centre?

Large vs small businesses
As one exam paper focuses on large businesses and the other on small businesses, this feature details how the content of the chapter may apply differently to large and small businesses.

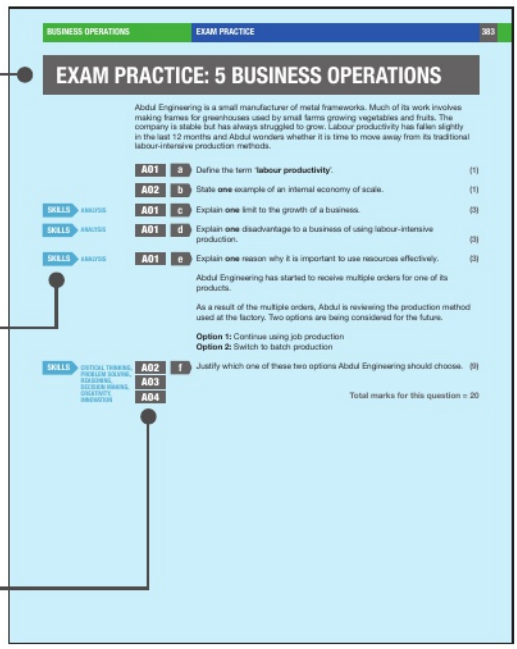
Multiple-choice questions
Question 1 in both exam papers features multiple-choice questions. These will help you prepare this section of the exams.

Preparing for your International GCSE Business examination
A full practice exam for both Paper 1 and Paper 2 at the back of the book helps you prepare for the real thing.

Exam practice
These exam-style questions are found at the end of each unit. They are tailored to the Pearson Edexcel specification to allow for practice and development of exam writing technique. They also allow for practice responding to the command words used in the exams.

Skills
Relevant exam questions have been assigned the key skills that you will gain from undertaking them, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.

Assessment objectives
Questions are tagged with the relevant assessment objectives that are being examined.



BUSINESS OPERATIONS EXAM PRACTICE 383

EXAM PRACTICE: 5 BUSINESS OPERATIONS

Abdul Engineering is a small manufacturer of metal frameworks. Much of its work involves making frames for greenhouses used by small farms growing vegetables and fruits. The company is stable but has always struggled to grow. Labour productivity has fallen slightly in the last 12 months and Abdul wonders whether it is time to move away from its traditional labour-intensive production methods.

AO1 a Define the term 'labour productivity'. (1)

AO2 b State one example of an internal economy of scale. (1)

SKILLS ANALYSIS AO1 c Explain one limit to the growth of a business. (3)

SKILLS ANALYSIS AO1 d Explain one disadvantage to a business of using labour-intensive production. (3)

SKILLS ANALYSIS AO1 e Explain one reason why it is important to use resources effectively. (3)

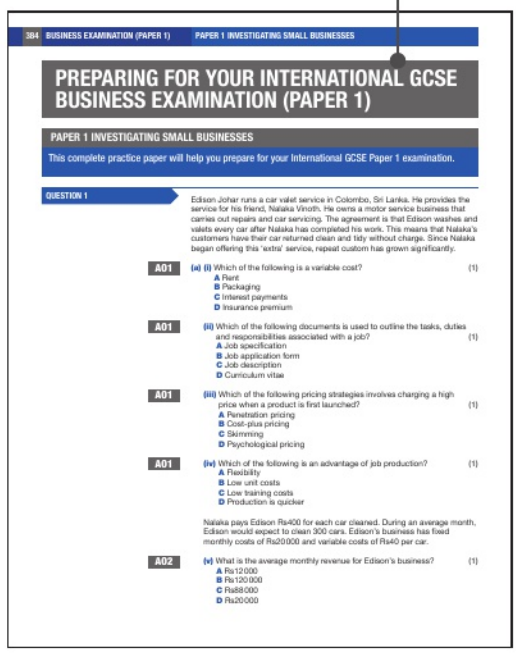
Abdul Engineering has started to receive multiple orders for one of its products.

As a result of the multiple orders, Abdul is reviewing the production method used at the factory. Two options are being considered for the future.

Option 1: Continue using job production
Option 2: Switch to batch production

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, ORIENTATION AO2 AO3 AO4 f Justify which one of these two options Abdul Engineering should choose. (9)

Total marks for this question = 20



384 BUSINESS EXAMINATION (PAPER 1) PAPER 1 INVESTIGATING SMALL BUSINESSES

PREPARING FOR YOUR INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 1)

PAPER 1 INVESTIGATING SMALL BUSINESSES

This complete practice paper will help you prepare for your International GCSE Paper 1 examination.

QUESTION 1

Edison Johar runs a car valet service in Colombo, Sri Lanka. He provides the service for his friend, Nalaka Vinoth. He owns a motor service business that carries out repairs and car servicing. The agreement is that Edison washes and valets every car after Nalaka has completed his work. This means that Nalaka's customers have their car returned clean and tidy without charge. Since Nalaka began offering this 'extra' service, repeat custom has grown significantly.

AO1 (a) (i) Which of the following is a variable cost? (1)
A Rent
B Packaging
C Interest payments
D Insurance premium

AO1 (ii) Which of the following documents is used to outline the tasks, duties and responsibilities associated with a job? (1)
A Job specification
B Job application form
C Job description
D Curriculum vitae

AO1 (iii) Which of the following pricing strategies involves charging a high price when a product is first launched? (1)
A Penetration pricing
B Cost-plus pricing
C Skimming
D Psychological pricing

AO1 (iv) Which of the following is an advantage of job production? (1)
A Flexibility
B Low unit costs
C Low training costs
D Production is quicker

Nalaka pays Edison Rs400 for each car cleaned. During an average month, Edison would expect to clean 300 cars. Edison's business has fixed monthly costs of Rs20000 and variable costs of Rs40 per car.

AO2 (v) What is the average monthly revenue for Edison's business? (1)
A Rs12000
B Rs120000
C Rs88000
D Rs20000

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE	MARK	TIME	AVAILABILITY
INVESTIGATING SMALL BUSINESSES Written exam paper Paper code 4BS1/01 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	June exam series First assessment June 2019
PAPER 2	**PERCENTAGE**	**MARK**	**TIME**	**AVAILABILITY**
INVESTIGATING LARGE BUSINESSES Written exam paper Paper code 4BS1/02 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	June exam series First assessment June 2019

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN INTERNATIONAL GCSE
A01	Recall, select and communicate knowledge and understanding of business terms, concepts and issues	27–28*%
A02	Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts	38–39%
A03	Select, organise and interpret business information from sources to investigate and analyse issues	22–23%
A04	Evaluate business information to make reasoned judgements and draw conclusions	11–12%

* A maximum of 15 per cent of total qualification marks will assess knowledge recall.

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	AO1	AO2	AO3	AO4
PAPER 1	13.7%	19.4%	11.3%	5.6%
PAPER 2	13.7%	19.4%	11.3%	5.6%
TOTAL FOR INTERNATIONAL GCSE	27–28%	38–39%	22–23%	11–12%

ASSESSMENT SUMMARY

PAPER 1	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
INVESTIGATING SMALL BUSINESSES PAPER CODE 4BS1/01	**Structure** Paper 1 assesses 50% of the total Business qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short-answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives: AO1 – 13.7% AO2 – 19.4% AO3 – 11.3% AO4 – 5.6%
	Content summary This paper will draw on topics taken from the whole of the subject content. The question scenarios are based on a small business – those with up to 49 employees.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		

PAPER 2	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
INVESTIGATING LARGE BUSINESSES PAPER CODE 4BS1/02	**Structure** Paper 2 assesses 50% of the total Business qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short-answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives: AO1 – 13.7% AO2 – 19.4% AO3 – 11.3% AO4 – 5.6%
	Content summary This paper will draw on topics taken from the whole of the subject content. The question scenarios are based on a large business – those with more than 250 employees.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		


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1 BUSINESS ACTIVITY AND INFLUENCES ON BUSINESS

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

This section looks at the nature of business activity and the types of organisations that conduct business, both domestically and internationally. It also covers some of the key factors that might influence business decision making, such as external factors, the government, exchange rates and interest rates. Finally, the ways in which business performance is measured and the possible causes of business failure are addressed.

1 WHAT IS BUSINESS ACTIVITY?

LEARNING OBJECTIVES

- Understand the nature of business activity and the reasons why businesses exist
- Understand the role played by different stakeholders
- Understand that businesses operate in a changing business environment

GETTING STARTED

Some people try to make money by setting up a business. They might do this because they want to work for themselves. Or they think they can make more money than working for someone else. Or perhaps they have been made redundant and cannot find another job. Running a business is hard work but the rewards can be worth it. Look at the example below.



▲ Maintaining and repairing old bicycles is hard work

GENERAL VOCABULARY

tool a piece of equipment that is useful for doing your job

SUBJECT VOCABULARY

premises buildings and land used by a shop or business

CASE STUDY: THE KANDY CYCLE SHOP

In 2015, Tharanga Perera opened a second-hand bicycle shop in the city of Kandy in Sri Lanka. He had always wanted to run his own business because he wanted to be his own boss. He worked for 12 years in a tea factory and saved LKR 100 000. Tharanga had a passion for bicycles and spent a lot of his spare time as a hobby restoring old bicycles and selling them to local people. The shop, located in a Kandy backstreet, had a small garage at the rear where he carried out repairs. Tharanga employed his younger brother as a shop assistant while he spent most of the time repairing, maintaining and restoring old bicycles. Before the shop was opened Tharanga had to:

- obtain a LKR 300 000 loan from his grandmother
- buy some new tools and equipment
- find suitable premises, ideally with somewhere to carry out repair work
- refurbish the premises
- find a reliable supplier of spare parts for his repair and restoration work
- learn how to keep financial records
- advertise the shop.

Tharanga worked very hard. However, it was worth it because in 2016 the Kandy Cycle Shop made a profit of LKR 900 600. Tharanga thought he might start to sell new bicycles in the future if he could get a bank loan to buy some stock.

In groups, discuss the following:

1 Why do you think Tharanga opened a second-hand bicycle shop?
2 What are three resources used by Tharanga when setting up his business?
3 Why do you think businesses exist?

BUSINESS ACTIVITY

SUBJECT VOCABULARY

business organisation that produces goods and services

organisation group, such as a club or business, that has formed for a particular purpose

goods physical products, such as a mobile phone, a packet of crisps or a pair of shoes

services non-physical products, such as banking, car washing and waste disposal

output amount of goods or work produced by a person, machine or factory

human resources in some businesses, the department that deals with employing, training and helping people

A **business** is an **organisation** that provides **goods** and **services**. The Kandy Cycle Shop example illustrates many features of business activity.

1. Business activity produces an **output** – a good or service. Tharanga is selling second-hand bicycles (goods) and offering a repair and maintenance service.
2. Goods and services are consumed. Customers buy the second-hand bicycles or consume the repair and maintenance service provided by Tharanga.
3. Resources are used. Spare parts (such as tyres, wheels and chains), oil, tools, equipment and electricity are just a few of the resources used by the Kandy Cycle Shop. Money, such as the LKR 300 000 loan from his grandmother and his LKR 100 000 savings, is also a resource. The resources used by businesses are often called the *four factors of production* – these are explained in Chapter 44, pages 368-374.
4. A number of business functions may be carried out. Production, marketing, **human resources** and financial control are examples of these functions. Production in the case of the Kandy Cycle Shop involved the sale of second-hand bicycles and a repair and maintenance service. Marketing involved advertising the shop in the local area.
5. External factors affect businesses. Things that they cannot control have an impact on businesses, such as government laws, changes in consumer tastes and the actions of competitors. The Kandy Cycle Shop has to compete with similar shops in the area.
6. Businesses aim to make a profit. Most people setting up a business do so as they wish to make money for themselves. In this case, the Kandy Cycle Shop made a profit of LKR 900 600 for Tharanga in 2016.

GOODS AND SERVICES

SUBJECT VOCABULARY

consumer goods goods and services sold to ordinary people (consumers) rather than businesses

producer goods goods and services produced by one business for another

Businesses provide a wide range of goods and services. Some are produced for consumers – ordinary people. These are called **consumer goods**. Products sold by one business to another are called **producer goods**. Examples are shown in Table 1.1. Some businesses serve both consumers and producers. For example, the Taj Mahal hotel in Mumbai serves both tourists and business people.

▶ Table 1.1 Consumer and producer goods

CONSUMER GOODS		PRODUCER GOODS	
GOODS	SERVICES	GOODS	SERVICES
Smartphone	Health care	Delivery van	Market research
Magazine	Banking	Office furniture	Insurance
Crisps	Air travel	Tools	Software design
Handbag	Education	Sugar cane	Industrial cleaning
Computer game	Garden design	Tractor	Printing

SATISFYING NEEDS AND WANTS

SUBJECT VOCABULARY

needs basic requirements for human survival

wants people's desires for goods and services

Businesses have to satisfy people's **needs** and **wants**.

Needs are the requirements for human survival. Some are physical such as water, food, warmth, shelter and clothing. If these needs cannot be satisfied humans will die.

SUBJECT VOCABULARY

infinite without limits in space or time

finite having an end or a limit

scarce resources with limited availability

Humans also have other desires. These are called wants and include holidays, a better house, a bigger car, a better education and a cleaner environment. These wants are infinite. Most people want more than they already have. It is human nature. Unfortunately, the resources available to businesses are finite. This means there is a limited amount. Economists say such resources are scarce.

THE PURPOSE OF BUSINESS ACTIVITY

Businesses exist to provide goods and services. However, different types of organisation provide goods and services for different reasons. Each type of organisation has a different purpose.

SUBJECT VOCABULARY

private sector business organisations owned by individuals or groups of individuals

public sector business organisations owned by central or local government

DID YOU KNOW?

In the UK there are over 5.4 million privately owned businesses. Most of these are small (10–49 employees) or medium (50–249 employees) in size, they make up 99% of all businesses.

KEY POINT

Many goods and services provided in the public sector are free at the point of use. They are paid for through tax revenue.

- **Private enterprise**: Most businesses are owned privately by individuals or groups of individuals. They are private sector businesses. The objective of a private enterprise is often to make money – a *profit* for the owners. The objectives of private sector businesses are discussed in Chapter 2, pages 11–18.
- **Social enterprise**: Some organisations in the private sector are non-profit making. Organisations, such as charities, pressure groups, clubs and societies exist for reasons other than profit. For example, charities, such as UNICEF, exist to raise money for 'good' causes. Clubs and societies, such as youth groups and sports clubs, provide opportunities and facilities for people with common interests. Social enterprises are discussed in Chapter 3, pages 19–26.
- **Public enterprise**: Some goods and services are provided by organisations owned by central or local government. These are public sector organisations. In many countries public sector organisations often provide health care, education, mail delivery, policing, the fire service and environmental services. The main purpose of a public enterprise is to provide the goods and services that private enterprise fails to provide adequately. Public enterprises are discussed in more detail in Chapter 5, pages 35–43.

ACTIVITY 1

CASE STUDY: GULF CONFECTIONERY AND BISCUIT CO.

The Gulf Confectionery and Biscuit Co. (LLC) manufactures high quality sweets such as toffees and lollies. It has a factory that employs sophisticated, up-to-date technology and it is committed to the production of high quality products.



▲ Some products produced by the Gulf Confectionery and Biscuit Co.

1 Does the Gulf Confectionery and Biscuit Co. supply products that satisfy needs or wants?
2 The Gulf Confectionery and Biscuit Co. is a private enterprise. What does this mean?

BUSINESS STAKEHOLDERS

SUBJECT VOCABULARY

stakeholder an individual or group with an interest in the operation of a business

Any individual or group that has an interest in the operation of a business is called a stakeholder. Owners have a financial 'stake' in the business. This is because they have invested some of their own money and usually a lot of their time. Some stakeholders, such as employees, rely on the success of a business for the income to meet their needs and wants. Figure 1.1 shows the different business stakeholders.



▶ Figure 1.1 Business stakeholders

SUBJECT VOCABULARY

entrepreneur person who takes risks and sets up businesses; individual who organises the other factors of production and risks their own money in a business venture

OWNERS

A business belongs to its owners. Many small businesses are owned by individuals, families or small groups of people. These people are often called entrepreneurs. They are responsible for setting up and running the business. Larger businesses, such as limited companies (see Chapter 4, pages 27–34), are owned by *shareholders*. Shareholders invest money in a business and get a share of the profit called a dividend.

CUSTOMERS

Customers buy the goods and services that businesses sell. Most customers are consumers who use or 'consume' goods and services. However, some may be other businesses. Customers want good quality products at a fair price. If they do not get them; they will spend their money elsewhere.

EMPLOYEES

Employees work for businesses. They depend on businesses for their salary. However, they have other needs. They will require training so that they can do their jobs properly. They want good working conditions, fair pay and benefits, job security and opportunities for promotion.

GENERAL VOCABULARY

dispute serious argument or disagreement
motivate encourage someone to do something

MANAGERS

Managers help to run most businesses. They are often employed to run the different departments in businesses, such as marketing, production, finance and human resources. Managers have to lead teams, solve problems, make decisions, settle disputes and motivate workers. Managers are likely to help

plan the direction of the business with its owners. They also have to control resources, such as finance, equipment, time and people. Managers are also accountable to the owners. This means they have to take responsibility if things go wrong.

FINANCIERS

Financiers lend money to a business. They may be banks but could be individuals, such as family members, or private investors, such as *venture capitalists* (see Chapter 25, pages 210–217). Clearly these stakeholders have a financial interest in a business and will be keen for it to do well.

SUPPLIERS

Businesses that provide raw materials, parts, commercial services and utilities, such as electricity and water, to other businesses are called *suppliers*. Relations between businesses and their suppliers must be good because they rely on each other. Businesses want good quality resources at reasonable prices. In return suppliers will require prompt payment and regular orders.

THE LOCAL COMMUNITY

Most businesses are likely to have an impact on the local community. A business may employ a lot of people who live in the local community. If the business does well the local community may benefit. There may be more jobs, more overtime and possibly higher pay. In contrast a business may be criticised by the local community. For example, if the owners of a noisy factory decide to introduce night shifts, there may be complaints from local residents.

THE GOVERNMENT

The government has an interest in all businesses. They provide employment, generate wealth and pay taxes. Taxes from businesses and their employees are used to finance government spending.

THE CHANGING BUSINESS ENVIRONMENT

All businesses operate in a changing business environment. This means that they may be affected by external factors that are likely to change over time. Such factors include the strength of competition, the economic climate, government legislation, population trends, demand patterns, world affairs and social factors.

To survive, businesses must produce goods and services that satisfy people's needs and wants. They must have clear objectives and be aware that the changing environment can bring new opportunities and impose new limitations.

DID YOU KNOW?

In 2008/09 there was a global recession. In some countries the recession lasted for many years. This meant that many businesses had to deal with very difficult trading conditions. Many adapted by freezing wages, closing down unprofitable divisions, reducing staff numbers and improving efficiency.

ACTIVITY 2

CASE STUDY: STAKEHOLDERS



▶ Different stakeholders in a store

1 What is meant by the term business stakeholder?
2 Name the two groups of stakeholders in the photograph.
3 The goods sold in the store above are bought from suppliers. What are the possible needs of suppliers.

MULTIPLE-CHOICE QUESTIONS

▶ **1 Which of these products is designed to satisfy a need?**
- A Potato crisps
- B Cricket bat
- C Bread
- D Smartphone

▶ **2 Which of the following is a business stakeholder?**
- A Lawyer
- B Tax collector
- C Customer
- D Police officer

▶ **3 Which of the following business activities is a service?**
- A House construction
- B Dental treatment
- C Coconut farming
- D Gold mining

▶ **4 An example of a producer good is:**
- A Tractor
- B Newspaper
- C Package holiday
- D Meal at a restaurant

CHAPTER REVIEW

GENERAL VOCABULARY

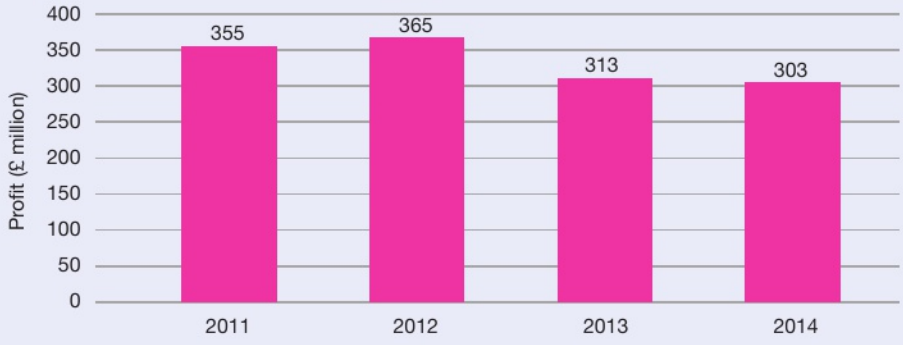
machinery equipment with moving parts that uses power, such as electricity, to do a particular job

SUBJECT VOCABULARY

EBITDA earnings before interest, tax, depreciation and amortisation

CASE STUDY: JCB

JCB, a private sector business, was formed in 1945 and produced trailers for use on farms. Today, it is one of the top three manufacturers of construction equipment in the world and produces a wide range of **machinery**, such as engines, diggers and forklift trucks. The business employs around 11 000 people in locations over four continents and sells its products through more than 750 dealers worldwide. Figure 1.2 shows the earnings before interest, tax, depreciation and amortisation (EBITDA) made by JCB between 2011 and 2014. During this time, the construction industry has performed poorly in many countries.



▶ Figure 1.2 JCB earnings before interest, tax, depreciation and amortisation (EBITDA), 2011–14



▶ An example of a machine (digger)

CHAPTER QUESTIONS

1. JCB makes producer goods. What is meant by the term producer goods?
2. What is meant by the term private sector?
3. Name two possible stakeholders in JCB.
4. Describe the role played by managers in a business such as JCB.
5. JCB operates in a changing business environment. What does this mean?
6. Assess whether the owners of JCB would be happy with the financial performance of the business between 2011 and 2014.

2 BUSINESS OBJECTIVES

LEARNING OBJECTIVES

- Understand the financial aims and objectives of businesses: survival, sales, profit, market share and financial security
- Understand the non-financial aims and objectives of businesses: social objectives, personal satisfaction, challenge, independence and control
- Understand why business objectives change in response to market conditions, technology, performance, legislation and internal reasons

SUBJECT VOCABULARY

objectives goals or targets set by a business

GETTING STARTED

Businesses exist to produce goods and services for consumers and other businesses. However, the owners of businesses will want to achieve certain objectives. Most business owners want to make a profit. They risk their own money when setting up or buying a business and aim to make a financial return. However, there are other objectives that businesses might try to achieve. Look at the example below.

SUBJECT VOCABULARY

executives managers in an organisation or company who help make important decisions

diversify if a business, company or country diversifies, it increases the range of goods or services it produces

CASE STUDY: MICROMAX

In 2015, Micromax overtook Samsung to become India's leading smartphone brand. However, about 12 months later Micromax had lost half of its market share and a number of its top executives had left. India is the world's fastest growing market for smartphones. Initially, this encouraged a number of local operators to thrive, with Micromax leading the way. However, energetic competition from Samsung and low-cost Chinese manufacturers has forced Indian suppliers to rethink their strategies. Chinese producers are also squeezing their competitors by joining with e-commerce operators, such as Amazon, to sell their products online.

Micromax also went through a period of change as they employed new executives to help manage its growth. It has been argued that tension between managers resulted in a loss of finance crucial to the development of the company. As its market share continued to fall, Micromax responded by shifting production from China to India. Industry analysts suggested that to survive in the future Micromax needed to diversify geographically and develop new products, such as tablets and televisions.

▶ Micromax handsets



1 What are two reasons why Micromax is starting to struggle?
2 What do you think is the main aim of Micromax at this time?
3 What measures might Micromax take in order to achieve this aim?
4 In groups, produce a spider diagram to show the different possible objectives a business might have. Present your ideas to the rest of the class.

THE IMPORTANCE OF CLEAR OBJECTIVES

Businesses are more likely to be successful if they set clear objectives. Businesses need to have objectives for the following reasons.

- Employees need something to work towards. Objectives help to motivate people. For example, sales staff might get bonuses if they reach certain sales targets.
- Without objectives owners might not have the motivation needed to keep the business going. Owners might allow their business to 'drift'. This might result in business failure.
- Objectives help to decide where to take a business and what steps are necessary to get there. For example, if a business aims to grow by 10 per cent and its home market is crowded, it may decide that launching products overseas might be the best way to achieve this.
- It is easier to assess the performance of a business if objectives are set. If objectives are achieved it could be argued that the business has performed well.

FINANCIAL OBJECTIVES

In the private sector, where individuals or groups of individuals own businesses, financial objectives are particularly important. This is because most business owners in the private sector want to make money. The main financial aims and objectives are outlined below.

- **Survival**: All businesses will consider survival as important. However, from time to time survival may be the most important objective. For example, when a business first starts trading it may be vulnerable. The owners may lack experience and there may be a shortage of resources. Therefore, an objective for a new business may be to survive in the first 12 months. The survival of a business might also be threatened when trading conditions become difficult or if a strong competitor emerges. In 'Getting started' above, it was suggested that Micromax was starting to struggle owing to

SUBJECT VOCABULARY

financial return monetary return

profit maximisation making as much profit as possible in a given time period

shareholders owners of limited companies

dividends share of the profit paid to shareholders in a company

profit satisficing making enough profit to satisfy the needs of the business owner(s)

competition from Samsung and low-cost Chinese producers. As a result of this its key short-term business objective may have been survival.

- **Profit**: Most businesses aim to make a profit because their owners want a financial return. Some businesses try to reach profit maximisation. This means they make as much profit as they possibly can. For example, companies, which are owned by shareholders, may try to maximise profits. This is because shareholders often put pressure on companies to pay out large dividends.
- **Sales**: Some owners want their businesses to grow their sales. This is because businesses with large volumes of sales may enjoy a number of benefits. For example, they:

  1 may enjoy lower costs
  2 have a larger market share
  3 enjoy a higher public profile
  4 generate more wealth for the owners.

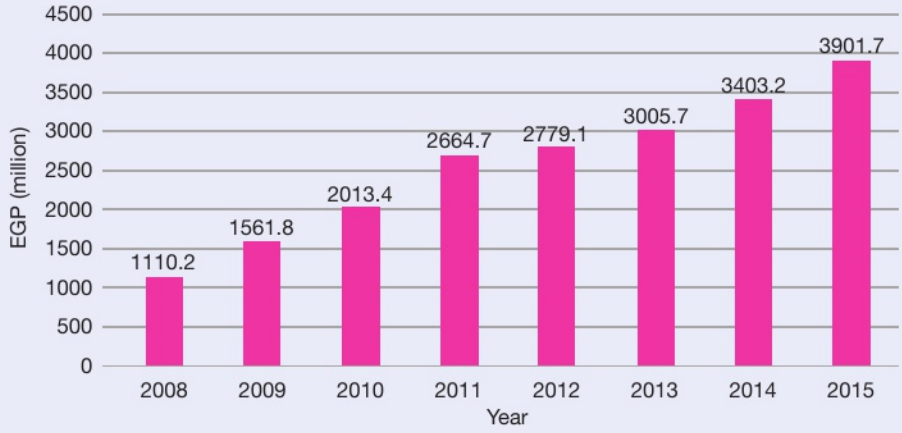
  The growth of a business might also benefit a wide range of stakeholders linked with the business. For example, employees are likely to benefit from the growth of a business because their jobs will be more secure.
- **Increase market share**: Businesses often want to build a larger market share. They may be able to do this if they can win customers from competitors. Businesses with a large market share may be able to dominate the market. They may be able to charge higher prices, for example. Businesses with a large market share also have a higher profile in the market. This might mean it is easier to launch new products.
- **Financial security**: Some business owners do not aim for profit maximisation. Instead, they might aim to make enough profit to give them financial security. This is sometimes called profit satisficing. One reason why some owners do not seek to maximise profits is because they do not want to take on the extra responsibility of expanding their business – which is often required to make more profit. Also, some entrepreneurs run 'lifestyle' businesses. This involves running a business that generates enough profit and financial security to provide the flexibility needed to allow a particular lifestyle. This type of business allows owners to spend more time on their other interests or with family. For example, a couple running a busy hotel in the summer might shut down for four months in the winter so that they can go abroad and relax in a warmer climate. However, to do this they first need financial security. This can be an important business aim.

ACTIVITY 1

CASE STUDY: CAIRO FOOD SUPPLIES

Cairo Food Supplies (CFS) make a wide range of canned and packaged food products. It is a large company and employs 4100 people in its factory based near Kirdasah, Egypt. CFS has markets in a number of African states and has been popular with investors for a number of years. This is probably owing to its dividend policy, which is very generous. Figure 2.1 shows the profits made by CFS between 2008 and 2015.

▶ Figure 2.1 Cairo Food Supplies profits, 2008–15



1 What evidence is there to suggest that CFS aims to maximise profits?
2 Who is likely to benefit most from such an objective?

NON-FINANCIAL OBJECTIVES

Some businesses may have non-financial objectives. These are objectives that are not connected with money. Whether owners have such objectives often depends on the nature of the business. Some business owners might have both financial and non-financial objectives.

SOCIAL OBJECTIVES

- In the public sector, where the government owns businesses, social objectives are important. Social objectives are designed to improve human well-being. In the public sector most businesses aim to provide a public service and the objectives will be linked to quality of service and reducing costs. Examples might include reducing response time by the emergency services or increasing rates of recycling.
- Some businesses operate as social enterprises, not-for-profit organisations, such as charities and cooperatives (see Chapter 3, pages 19–26), and also aim to improve human and environmental well-being. They usually have a clear social or environmental mission. For example, a business may gather used textbooks and distribute them to schoolchildren in developing countries. Their aim might be to help improve the quality of education in these countries.

Finally, in recent years, some businesses have attempted to improve their social responsibility. One way of doing this is to take into account the needs of a wider range of stakeholders, such as customers, the local community and employees. For these businesses, social objectives might include providing employment for local people, reducing pollution or making contributions to the local community, such as visiting schools or sponsoring local events.

PERSONAL SATISFACTION

Many business owners set up a business because they think they will be happier and feel more satisfied in their work environment than when working for an employer. Such owners are likely to enjoy taking risk and seeing their idea succeed. Some owners have developed their hobby into a business. For example, a fitness enthusiast might become a personal trainer or someone who likes baking might start a business making wedding cakes. Investing money in your own business idea and seeing it develop into a successful business is likely to be very satisfying and a matter of great pride.

GENERAL VOCABULARY

negotiation official discussions between the representatives of opposing groups who are trying to reach an agreement, especially in business or politics
outcome result of an action

DID YOU KNOW?

Many businesses set SMART objectives. This means that their objectives should be:

- Specific – stating clearly what is to be achieved
- Measurable – an outcome that can be measured in numbers
- Achievable – possible to complete by the people involved
- Realistic – able to be achieved with the resources available
- Time specific – stating a period of time in which to achieve it.

An example of a SMART objective might be for a business to increase its revenue by 8 per cent in the next 12 months.

CHALLENGE

Some people are motivated by challenges and starting a business can be very challenging. To be successful in business people need to be committed, hardworking and multi-skilled. For example, business owners need skills in organisation, financial management, communication, decision making, negotiation, IT and people management. Even if a business becomes successful, owners might set new challenges for their business. For example, they may decide to grow by selling overseas or invest in developing new products. Running a business can often provide endless challenges.

INDEPENDENCE AND CONTROL

Some people want to be 'their own boss' – they want to be in control. This is an important non-financial objective for many business owners. These entrepreneurs are driven by the desire to be independent and to take control of their own futures. The freedom to make all the decisions when running a business is very appealing. Some people often dislike being told what to do at work. According to an article and poll by Startups.co.uk, having the independence to make your own decisions is considered the key benefit of being an entrepreneur. Nearly 90 per cent of the people surveyed said this was very important. In practice this independence may be limited: work has to be done; taxes have to be paid; those financing the business, such as a bank giving a loan, need to be satisfied that the business is doing sufficiently well. However, those who own their own business, in general, do have more independence than those who work for an employer.

ACTIVITY 2

CASE STUDY: DOHA AIRLINE MEALS

DAM (Doha Airline Meals) supplies ready-made meals for a number of airlines operating out of Doha airport, Qatar. Omar Hassan set up the business in 2009. Previously, Omar worked for a large hotel working in the kitchen. However, he did not like following instructions and being told what to do all day. He set up in business mainly because he valued independence. He wanted to take complete control of his life and also thought he could improve on some of the 'inflight' meals offered by airlines.

The business was successful right from the start. Omar was very happy being in control and after breaking even in the first year started to make a profit. In 2013, the success attracted interest from a much larger catering company. The company made a very generous offer to buy the business and employ Omar as the managing director. However, Omar declined, he wanted to keep control. This was very important to him.

In 2016, the business made a record profit of US$1.2 million. Omar said: 'one of the main reasons for our success is setting clear and achievable objectives which employees understand'. One example of an objective set by DAM in 2015 was to increase sales from 2.4 million units to 2.8 million units in 12 months. Omar said: 'I agreed this objective with my sales team. There is no point in setting objectives which are unrealistic and unachievable for staff.'

1 Why is independence and control an important objective in this case?
2 What is meant by a SMART objective? Use information in this case as an example.
3 Why is it important for objectives to be achievable and realistic?



▲ A typical meal served on board an aircraft

WHY MIGHT OBJECTIVES CHANGE AS BUSINESSES EVOLVE?

As a business develops and evolves over time, its aims and objectives are likely to change. This is usually because businesses have to respond to events or changes in circumstances. Some of the main examples are outlined below.

GENERAL VOCABULARY

evolve to develop and change gradually over a long period of time
sustained continued for a long time
legislation law or set of laws
emissions gas or other substances that are sent into the air

MARKET CONDITIONS

Businesses operate in dynamic markets. This means they have to deal with regular changes. For example, a new entrant may appear in the market, a rival might introduce a new product or the economy may start to decline. When market conditions change, it may be necessary to set new objectives. For example, if trading becomes difficult as a result of changing market conditions, a profit-seeking business may decide that survival is more important until the market 'settles down'.

SUBJECT VOCABULARY

automation use of computers and machines instead of people to do a job
economies of scale financial advantages (falling average costs) of producing something in very large quantities

TECHNOLOGY

As the pace of technological development increases businesses may have to adjust their objectives. For example, a manufacturer that introduces more automation into production may decide to switch its objective to sales growth. This might be necessary to lower costs. A business may be under pressure to sell more in order to exploit economies of scale (see Chapter 40 pages 336–343). Alternatively, a business might decide to win a larger share of the market after introducing online selling technology.

PERFORMANCE

The performance of a business is not likely to stay constant. Periods of sustained profitability may be interrupted by less successful periods. The performance levels of businesses may have an impact on their objectives. For example, a business that has been growing sales for several years might decide to focus more on profitability. This might be because sales growth has been achieved by lowering prices and the owners are unhappy with the negative impact this has had on profits.

LEGISLATION

New legislation might have an impact on the objectives of a business. In recent years, many businesses have become more socially responsible. This might be a reaction to new environmental, employment or consumer legislation. For example, in 2013, EU regulations for the construction industry were tightened to reduce energy use in order to help protect the environment from carbon dioxide emissions from the generation of power. This meant that

businesses in the industry had to construct buildings that were more energy efficient. In general, much of the new legislation aimed at businesses is putting pressure on them to consider the needs of a wider range of stakeholders and behave in a more socially responsible way.

INTERNAL REASONS

The reasons outlined above for a business changing its objectives are mainly owing to external factors: things beyond the control of businesses. However, sometimes a business might change its objectives for internal reasons. For example, there may be a change in ownership or a change in the senior management team. In such circumstances the objectives might change. For example, new owners might want to maximise profits so that higher dividends can be paid to shareholders.

SUBJECT VOCABULARY

large business a business that employs more than 250 people

small business a business that employs fewer than 50 people

LARGE VS SMALL BUSINESSES

The objectives of a large business and a small business may differ. For example, many small businesses may be content to stay small. The people who own them may just want to make enough money to support their families and lifestyles. They may want to avoid the responsibility that may come with growth, for example. Small businesses may also be more interested in some of the non-financial objectives, such as personal satisfaction and independence. It might also be argued that large businesses are more interested in financial objectives. Large businesses may aim to grow even larger and try to maximise profits for their owners. However, most businesses will aim to make some profit – whether they are large or small.

MULTIPLE-CHOICE QUESTIONS

SUBJECT VOCABULARY

revenue money from the sale of goods and services

▶ 1 Which of the following is a non-financial business objective?

A Increase market share
B Independence and control
C Profit maximisation
D Survival

▶ 2 Which of the following is a financial business objective?

A Improve customer service
B Independence and control
C Sales growth
D Improve social responsibility

▶ 3 Which of the following might cause business objectives to change over time?

A Technological development
B A rise in the price of shares
C Following the introduction of a new accounting system
D A change in weather patterns

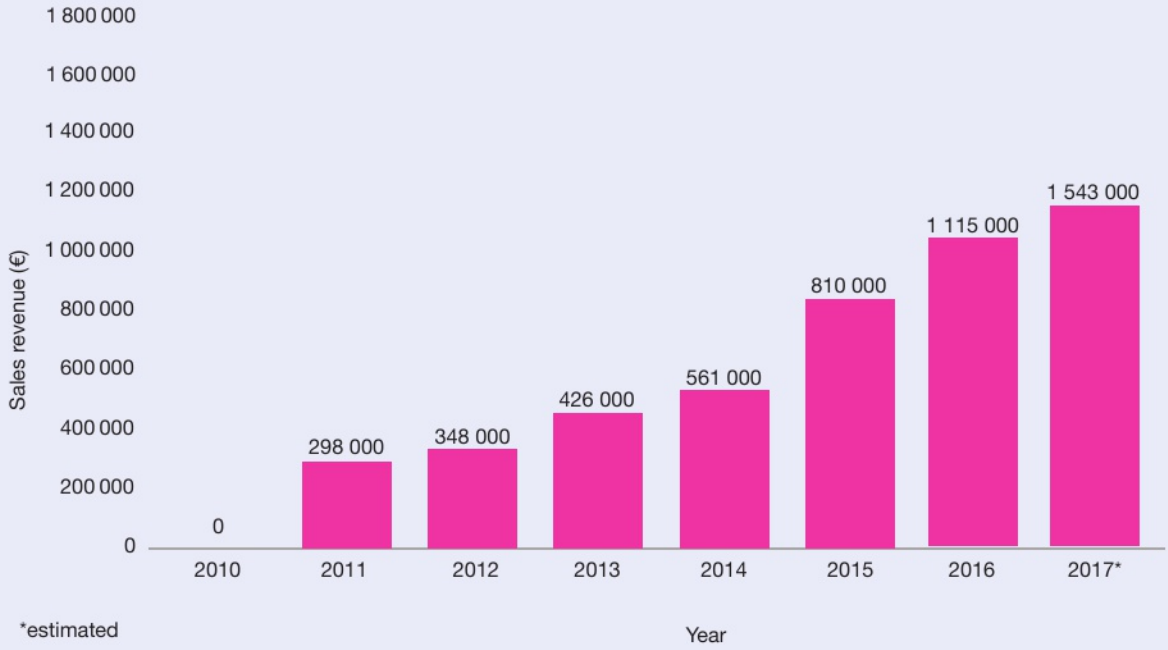
▶ 4 Which of the following is likely to be an objective of a public sector organisation?

A Increase profit by 5 per cent in the next financial year
B Survival
C Increase revenue by 20 per cent over a three-year period
D Improve the quality of customer service

CHAPTER REVIEW

CASE STUDY: SUPERSKISWISS.COM

SuperSkiSwiss.com is an online retailer of ski equipment and accessories. It is based in Basel, Switzerland and has recently branched into relatively expensive outdoor fashionwear. It targets skiers and young fashion-conscious consumers. It sells a combination of own-label and branded products. The company has grown rapidly since it was set up in 2000. Its ambitious aim is to be Europe's number one online shopping site for skiers. Figure 2.2 shows the growth in sales revenue between 2010 and 2017. SuperSkiSwiss.com hopes to achieve sales of €3 000 000 by 2020.



▲ Figure 2.2 SuperSkiSwiss.com sales revenue for 2010 to 2017

SuperSkiSwiss.com also claims that it wants to grow in a sustainable way. As a result, for example, the business is committed to the protection of the environment. The biggest environmental impacts from SuperSkiSwiss.com are carbon emissions from the distribution of goods, the running of buildings and waste from packaging. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used.

CHAPTER QUESTIONS

1. What is meant by a business objective? Use this case as an example.
2. Some businesses have non-financial objectives. Name two examples of non-financial business objectives.
3. Work out the change in sales revenue between 2010 and 2017.
4. Describe one benefit to SuperSkiSwiss.com of sales growth.
5. SuperSkiSwiss.com may be concerned about social responsibility. What evidence is there in the case study to support this view?
6. How might a company like SuperSkiSwiss.com change its objectives as it evolves? Provide two reasons in your analysis.

3 SOLE TRADERS, PARTNERSHIPS, SOCIAL ENTERPRISES AND FRANCHISES

LEARNING OBJECTIVES

- Understand the features of sole traders, partnerships, social enterprises and franchises
- Understand the advantages and disadvantages of sole traders, partnerships and franchises
- Understand the concepts of risk, ownership, sources of finance and use of profit for the different types of business

GENERAL VOCABULARY

legal status position defined by law

GETTING STARTED

There are several different types of business organisation. They vary according to size, type of ownership and legal status. Look at the examples below.

CASE STUDY: MARIANA BELLO

Mariana Bello owns a café in Seville, Spain, which she calls Mariana's. She set up the business in 2012 using €20 000 of her own savings and a €10 000 bank loan. After a slow start, the business picked up when she began to target health conscious customers. She developed a range of drinks from freshly sourced fruit and vegetables and used organic ingredients to make home-made snacks. Mariana now employs six part-time staff and in 2016 made a profit of €46 000.



▶ Mariana Bello's café



▲ Inside the Hatta Dental and Implant Clinic

CASE STUDY: THE HATTA DENTAL AND IMPLANT CLINIC

The Hatta Dental and Implant Clinic is an established dental practice in Dubai, UAE, which was set up by experienced dentists Khalid Said and Ismail Mansour in 1997. The practice employs seven other people including dental hygienists and administrative staff. It carries out a range of dental work including cosmetic dentistry, such as replacing missing teeth and repairing badly damaged teeth. Khalid specialises in dental implants while Ismail is responsible for a range of routine dental work. When the clinic was set up, both partners each contributed AED 200 000 from personal savings.

1 Who owns the businesses in the above two case studies?
2 Discuss one advantage and one disadvantage of owning a business with a partner.

Business owners have to take risks.

3 What risks are taken in the above case studies?
4 Discuss in groups whether you would be prepared to take the risk to set up in business. List your reasons for and against and present to the rest of the class.

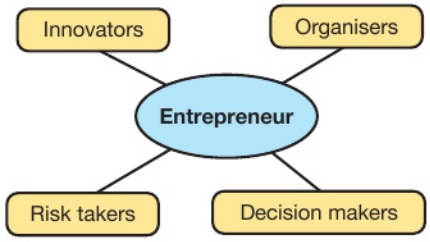
ENTREPRENEURS

SUBJECT VOCABULARY

innovator someone who introduces changes and new ideas

labour people employed in a business/ used in production

People who set up businesses are called entrepreneurs. They are the owners and without them businesses would not exist in the private sector. The roles played by entrepreneurs in business are summarised in Figure 3.1.



▲ Figure 3.1 Roles of the entrepreneur

- Entrepreneurs are **innovators** because they try to make money out of a business idea. Such ideas might come from spotting a gap in the market, a new invention or market research. However, many people set up a business by copying or adapting what another business does.
- Entrepreneurs are responsible for *organising* other factors of production. They buy or hire resources, such as materials, **labour** and equipment. These resources are used to make their products. Organising involves giving instructions, making arrangements and setting up systems.
- Since entrepreneurs are the owners, they have to make all the key decisions. They may make decisions on how to raise finance, product design, choice of production method, prices, recruitment (see Chapter 18) and wages.
- Entrepreneurs are risk takers. This is because they risk losing any money they put into the business, and possibly more, if it fails. However, if the business is successful, they will be rewarded with profit.

UNINCORPORATED AND INCORPORATED BUSINESSES

SUBJECT VOCABULARY

unincorporated businesses where there is no legal difference between the owner and the business

incorporated business that has a separate legal identity from that of its owners

Businesses vary according to the legal form they take.

- **Unincorporated**: These are businesses where there is no legal distinction between the owner and the business. Everything is carried out in the name of the owner. These businesses tend to be small and owned by one person, or a small group of people.
- **Incorporated**: An incorporated business is one that has a separate legal identity from that of its owners. In other words, the business can sue, be sued, taken over or *liquidated*. Incorporated businesses are often called *limited companies* and the owners are shareholders. This is discussed in Chapter 4, see pages 27–34.

FEATURES OF A SOLE TRADER

SUBJECT VOCABULARY

sole trader or sole proprietor business owned by a single person

unlimited liability owner of a business is personally liable for all business debts

A **sole trader or sole proprietor** is the simplest form of business organisation. It has one owner but can employ any number of people. Sole traders may be involved in a wide range of business activity. In the primary sector, they may be farmers or fishermen. In the secondary sector, they may be small builders or manufacturers. However, most sole traders are found in the tertiary sector. Many are retailers running small shops. Others may offer services such as web design, tutoring, hairdressing, taxi driving, garden maintenance and so on.

Setting up as a sole trader is simple because there are no legal requirements. However, all sole traders have **unlimited liability**. This means that if the business fails a sole trader can lose more money than was originally invested. This is because a sole trader can be forced to use personal wealth to pay off business debts. The advantages and disadvantages of operating as a sole trader are summarised in Table 3.1.

▶ Table 3.1 Advantages and disadvantages of being a sole trader

ADVANTAGES OF A SOLE TRADER	DISADVANTAGES OF A SOLE TRADER
The owner keeps all the profit.	Have unlimited liability.
They are independent – owner has complete control.	May struggle to raise finance – considered too risky by those that lend money.
It is simple to set up with no legal requirements.	Independence may be too much of a responsibility.
Flexibility – for example, can adapt to change quickly.	Long hours and very hard work.
Can offer a personal service because they are small.	Usually too small to exploit economies of scale.
May qualify for government help.	No continuity – the business dies with the owner.

FEATURES OF A PARTNERSHIP

SUBJECT VOCABULARY

partnership business owned by between 2 and 20 people

deed of partnership binding legal document that states the formal rights of partners

A **partnership** exists when between 2 and 20 people own a business together. The owners will share responsibility for running the business. They also share the profits. Professions such as accountants, doctors, estate agents and solicitors are often partnerships.

There are no legal formalities to complete when a partnership is formed. However, partners may produce a **deed of partnership**. This is a legal document that states partners' rights in the event of a dispute. It states:

- how much capital each partner will contribute
- how profits (and losses) will be shared among the partners
- the procedure for ending the partnership
- how much control each partner has
- rules for taking on new partners.

The advantages and disadvantages of partnerships are summarised in Table 3.2.

GENERAL VOCABULARY

legally binding agreement has been made, and certain actions are now either required or prohibited by law

ADVANTAGES OF PARTNERSHIPS	DISADVANTAGES OF PARTNERSHIPS
Easy to set up and run – no legal formalities.	Partners have unlimited liability.
Partners can specialise in their area of expertise.	Profit has to be shared.
The job of running a business is shared.	Partners may disagree and fall out.
More capital can be raised with more owners.	Any partners' decision is **legally binding** on all.
Financial information is not published.	Partnerships still tend to be small.

▶ Table 3.2 Advantages and disadvantages of partnerships

LIMITED PARTNERSHIPS

It is possible to have a **limited partnership**. This is where some partners provide capital but take no part in the management of the business. Such a partner will have **limited liability** and can only lose the original amount of money invested. This type of partner is called a *sleeping partner*. However, even with a limited partnership there must always be at least one partner with unlimited liability.

SUBJECT VOCABULARY

limited partnership partnership where some partners contribute capital and enjoy a share of the profit but do not take part in the running of the business

limited liability business owner is only liable for the original amount of money invested in the business

audits official examination of a company's financial records in order to check that they are correct

KEY POINT

In 2000, the law changed in the UK so that limited liability partnerships could be formed. This is where all partners have limited liability. However, to set up a limited liability partnership, the business has to **comply** with a number of legal requirements such as sending annual accounts to the Registrar of Companies (more commonly known as Companies House).

GENERAL VOCABULARY

comply to do what you have to do or are asked to do

ACTIVITY 1

CASE STUDY: KISULI, OKUMA AND OWINO

Kisuli, Okumu and Owino is a firm of chartered accountants based in Mombasa, Kenya. It employs, in addition to the three partners, 16 other staff and provides a range of financial services for local clients. A deed of partnership was drawn up when the business was established in 2010. To raise finance for the business, each partner contributed KES 2 000 000. One of the strengths of the business was that each of the partners was a specialist in a particular field. Michael Kisuli was a corporate tax specialist, Edwin Okumu was an investment analyst and Joseph Owino was in charge of **audits**.



▶ One of the partners at work

1 Why do you think Kisuli, Okumu and Owino drew up a deed of partnership?
2 How does this case study illustrate one of the main advantages of partnerships?

FEATURES OF FRANCHISES

SUBJECT VOCABULARY

franchise structure in which a business (the franchisor) allows another operator (the franchisee) to trade under their name

merchandise goods that are being sold

One approach to running a business is to buy a franchise. This may suit someone who wants to run a business but does not have their own business idea. Owners of franchises are called *franchisors*. They have developed a successful business and are prepared to allow others, the *franchisees*, to trade under their name. Franchisees pay fees to the franchisor. Examples of some international franchises are McDonald's, Subway and Avis, the car rental business.

What does the franchisor offer the franchisee?

- A licence to trade under the recognised brand name of the franchisor.
- A start-up package including help, advice and essential equipment, usually including branding materials.
- Training in how to run the business and operate the systems used by the franchise.
- Materials, equipment and support services that are needed to run the business.
- Marketing support that is organised on behalf of all franchisees.
- An exclusive geographical area in which to operate. This means that the business will not face competition from other franchisees in the same franchise group.

In return for these services the franchisee has to pay certain fees.

- A one-off start-up fee.
- An ongoing fee (usually based on sales).
- Contribution to marketing costs.
- Franchisors may make a profit on some of the materials, equipment and merchandise supplied to franchisees.

▼ Table 3.3 Advantages and disadvantages to franchisees and franchisors of franchising

The advantages and disadvantages of franchises to both franchisees and franchisors are shown in Table 3.3.

ADVANTAGES TO THE FRANCHISEE	DISADVANTAGES TO THE FRANCHISEE	ADVANTAGES TO THE FRANCHISOR	DISADVANTAGES TO THE FRANCHISOR
Less risk – a tried and tested idea is used.	Profit is shared with the franchisor.	Fast method of growth.	Potential profit is shared with franchisee.
Back-up support is given.	Strict contracts have to be signed.	Cheaper method of growth.	Poor franchisees may damage brand's reputation.
Set-up costs are predictable.	Lack of independence – strict operating rules apply.	Franchisees take some of the risk.	Franchisees may get merchandise from elsewhere.
National marketing may be organised.	Can be an expensive way to start a business.	Franchisees more motivated than employees.	Cost of support for franchisees may be high.

FEATURES OF SOCIAL ENTERPRISES

SUBJECT VOCABULARY

social enterprise business that aims to improve human or environmental well-being, charities for example

cooperative company, factory or organisation in which all the people working there own an equal share of it

consumer cooperative cooperative that is owned by its customers

retail cooperative cooperative of retail members, who often work together to assert their purchasing power

worker cooperative cooperative that is owned by its employees

charities organisations that give money, goods or help to people who are poor, sick or in need

GENERAL VOCABULARY

accountable responsible for the effects of your actions and willing to explain or be criticised for them

transparent language or information that is clear and easy to understand

Some businesses operate as **social enterprises**. These aim to improve human and environmental well-being rather than make a profit for owners. They are sometimes referred to as not-for-profit or non-profit organisations. Generally, social enterprises:

- have a clear social and/or environmental mission
- generate most of their income through trade or donations
- reinvest most of their profits
- are majority controlled in the interests of the social mission
- are **accountable** and **transparent**.

Social enterprises may take a variety of forms.

Cooperatives usually operate as **consumer cooperatives** or **retail cooperatives**. They are owned and controlled by their members. Members can buy shares which entitle them to elect directors to make key decisions. Any profit made by the cooperative is given to members.

Worker cooperatives are businesses in which its employees share ownership. Examples might be a wine growing or milk producing cooperative. Workers will contribute to production and be involved in decision making, share in the profit and provide some capital when buying a share in the business.

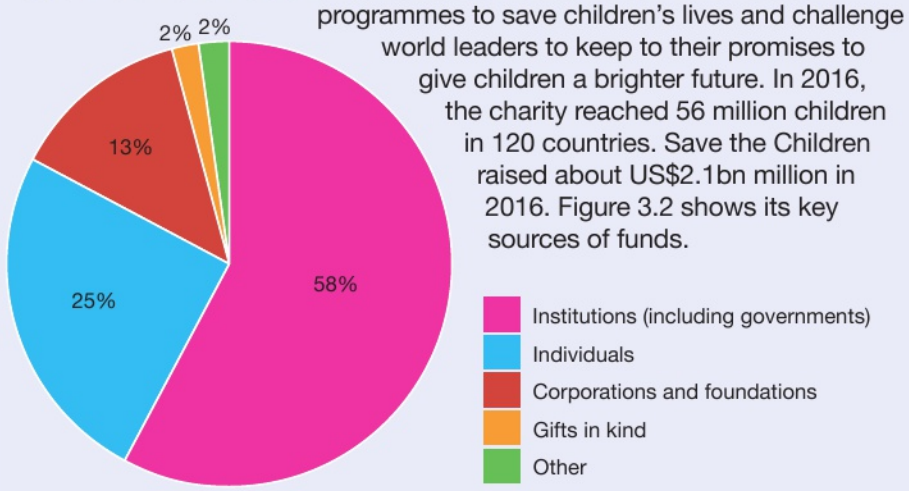
Charities exist to raise money for 'good' causes and draw attention to the needs of disadvantaged groups in society. For example, Age UK is a charity that raises money on behalf of senior citizens. It also raises awareness and comments on issues, such as cold weather payments (payments made to elderly people in the UK for heating during cold weather). Charities rely on donations for their revenue.

They may also organise fundraising events such as cake sales, sponsored activities and selling greetings cards. Some run business ventures such as charity shops.

ACTIVITY 2

CASE STUDY: SAVE THE CHILDREN

Save the Children is a charity that raises money to run world-class programmes to save children's lives and challenge world leaders to keep to their promises to give children a brighter future. In 2016, the charity reached 56 million children in 120 countries. Save the Children raised about US$2.1bn million in 2016. Figure 3.2 shows its key sources of funds.



▶ Figure 3.2 Save the Children global income by source of funds

1 What are the features of a social enterprise? Use this case as an example.
2 How might charities such as Save the Children raise money?

LARGE VS SMALL BUSINESSES

The types of business organisation described in this chapter are most likely to operate as small businesses. In many economies the majority of businesses are sole traders. In certain fields, such as the professions, partnerships are common. However, they are often small. Most franchisees are small businesses but franchisors may be large – McDonald's, for example. Many social enterprises are small but some charities, such as UNICEF and Oxfam, are very large since they have an international presence.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an advantage of a sole trader?
- **A Limited liability**
- **B More capital can be raised than a partnership**
- **C Unlimited liability**
- **D Independence for owners**

▶ 2 Having a clear social and/or environmental mission is a feature of which business structure?
- **A Franchise**
- **B Sole trader**
- **C Social enterprise**
- **D Partnership**

▶ 3 A fast method of growth is a key advantage for which business structure?
- **A Franchisor**
- **B Partnership**
- **C Franchisee**
- **D Social enterprise**

▶ 4 Taking risk in business is a key role of which of the following?
- **A Accountant**
- **B Entrepreneur**
- **C Company director**
- **D Marketing manager**

CHAPTER REVIEW



▲ A Husse delivery van

CASE STUDY: HUSSE

Husse (pronounced hoo–say) is a Swedish franchising operation established in 1987. It delivers pet products to customers in over 50 countries around the world. Husse has around 1000 franchisees delivering a range of luxury pet food products, accessories, health and cleanliness products for cats and dogs, and care products for horses. It can cost franchisees up to £13 900 to obtain a Husse franchise in the UK. Some of the benefits provided by the Husse franchisor (for the £13 900 premium package) include:

1. a stock of dry food worth £2000 for resale
2. additional materials worth £2000 (including items such as a Husse tent, signs for a van, catalogues, two-day in-house training, social media set up and uniforms)
3. exclusive territory with 55 000 households
4. regular money for marketing (in first six months)
5. support including a range of advisory services and development manager
6. free training, workshops and seminars
7. an operational manual.

Husse UK is an associate membership of BFA (British Franchise Association).

CHAPTER QUESTIONS

Franchisees are entrepreneurs.

1. What is meant by the term entrepreneur?

2. What is meant by the term franchisor?

3. What are the four roles of an entrepreneur?

Franchisees are likely to have unlimited liability.

4. What is meant by unlimited liability?

5. Assess the advantages to a franchisee of taking out a Husse franchise.

4 LIMITED COMPANIES AND MULTINATIONALS

LEARNING OBJECTIVES

- Understand how a limited company is formed
- Understand the features of private limited companies, public limited companies and multinationals
- Understand the advantages and disadvantages of operating as a private limited company and a public limited company
- Understand the ownership, control, sources of finance and use of profits for limited companies

GETTING STARTED

Limited companies have different features to sole traders and partnerships. They have different types of owners and raise capital in different ways. They are also set up and run differently. Look at the examples below.

CASE STUDY: QUBIT DIGITAL LTD

Four ex-Google employees set up Qubit in 2010. Its technology helps retailers get the best out of their websites. For example, its tools track what people look at on web pages and why they leave a website. Some of its high profile customers include Topshop, Emirates and Thomas Cook. Qubit is led by one of the people who originally formed the business, Graham Cooke, and has offices in the USA and Europe. It has raised over £50 million from share sales since it was set up and some of its shareholders include Goldman Sachs and venture capitalists Sapphire Ventures and Accel Ventures. In 2016, Qubit employed over 200 people.

SUBJECT VOCABULARY

venture capitalists specialist investors (individuals or companies) who provide money for business purposes, often to new businesses

CASE STUDY: HYUNDAI LTD

Hyundai is a huge South Korean motor corporation. It is led by Chairman Mong-Koo Chung and a team of eight senior directors. The company is listed on the London Stock Exchange and is owned by shareholders. In 2014, it had a 10.5 per cent share in the global motor car market and has factories in the USA, China, Russia, Turkey, Czech Republic, Brazil and India, in addition to those in South Korea. Hyundai's sales revenue for the period 2011 to 2015 is shown in Figure 4.1.

1. Who owns limited companies?
2. Who runs limited companies? (Use examples from the case studies.)
3. Comment on the size of limited companies, such as those above, compared to sole traders and partnerships.
4. In groups, make a list of 20 companies that you know about. Try to decide whether they are large or small.

▶ Figure 4.1 Hyundai sales revenue, 2011–15



FEATURES OF LIMITED COMPANIES

GENERAL VOCABULARY

sue to make a legal claim against someone, especially for money, because they have harmed you in some way

SUBJECT VOCABULARY

limited companies business organisations that have a separate legal identity from that of their owners

limited liability shareholders are legally responsible for the debts of a company according to how many shares they own

chairperson someone who is in charge of a meeting or directs the work of a committee or organisation

Limited companies are incorporated. This means that they have a separate legal identity from their owners. They can own resources, form contracts, employ people, sue and be sued. The other main features of limited companies are as follows.

- The owners have limited liability. If a limited company has debts, the owners can only lose the money they originally invested. They cannot be forced to use their own money to pay debts run up by the business.
- The business raises capital by selling shares. Each shareholder owns a number of these shares. They are the joint owners of the company. They are entitled to vote on important matters such as who should run the company. They also get a dividend paid from profits. Those with more shares will have more control and receive more money in dividends.
- The shareholders elect directors to run the company. The board of directors, headed by a chairperson, is accountable to shareholders. The chairperson should run the company as the shareholders wish. If the company performs badly, directors can be voted out at an annual general meeting (AGM).
- Whereas sole traders and partnerships pay income tax, companies pay corporation tax on profits.
- To form a limited company, it is necessary to follow a legal procedure. This is outlined below.

FORMING A LIMITED COMPANY

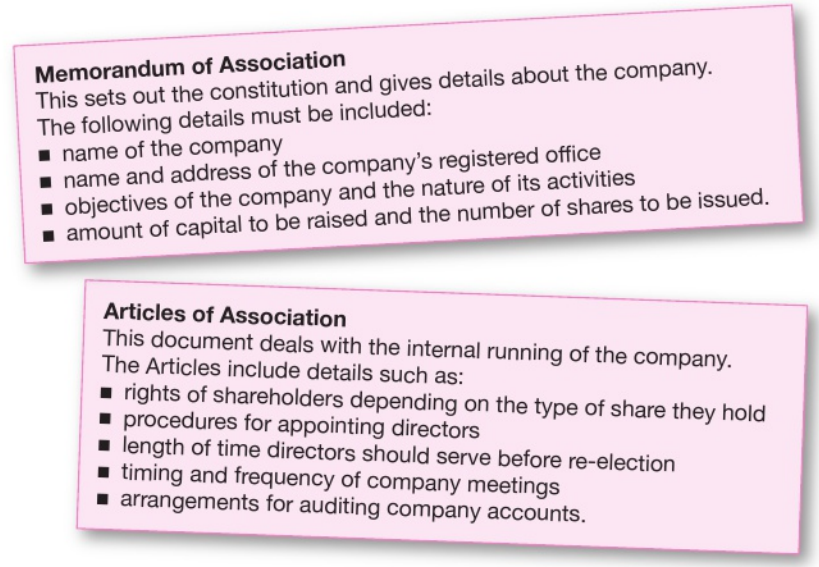
SUBJECT VOCABULARY

certificate of incorporation document needed before a new company can start doing business

A limited company must have a minimum of two members, but there is no upper limit.

Some important documents must be sent to the Registrar of Companies before a limited company can be formed. The two most important ones are the memorandum of association and the articles of association (see Figure 4.2).

If these documents are acceptable, the company will get a certificate of incorporation. This allows it to trade as a limited company. The shareholders have a legal right to attend the AGM and must be told of the date and venue in writing.



▶ Figure 4.2 Memorandum of association and articles of association

PRIVATE LIMITED COMPANIES

Most **private limited companies** tend to be small or medium sized. However, a small minority are large. Some features of private limited companies are as follows.

- Their business name ends in Limited or Ltd.
- Shares can only be transferred 'privately' (from one individual to another). All shareholders must agree on the transfer and they cannot be advertised for sale. Shares in private limited companies cannot be traded on the **stock market**.
- They are often family businesses owned by family members or close friends.
- The directors of these firms tend to be shareholders and are involved in the running of the business.

SUBJECT VOCABULARY

private limited company (Ltd) in the UK, a private company limited by shares, which means the liability of the shareholders to creditors of the company is limited to the capital originally invested, a shareholder's personal assets are protected, and with Ltd or Limited after its name; other countries have similar arrangements with different letters after the company name: German GmbH, Polish sp. z o.o., Czech s.r.o., Italian s.r.l. and Slovak s.r.o.

stock market market for shares in PLCs

ADVANTAGES OF PRIVATE LIMITED COMPANIES	DISADVANTAGES OF PRIVATE LIMITED COMPANIES
Shareholders have limited liability.	Financial information has to be made public.
More capital can be raised.	Costs money and takes time to set up.
Control cannot be lost to outsiders.	Profits are shared between more members.
Business continues if a shareholder dies.	Takes time to transfer shares to new owner.
Has more status – for example, than a sole trader.	Cannot raise huge amounts of money, like PLCs.

▶ Table 4.1 Advantages and disadvantages of private limited companies

ACTIVITY 1

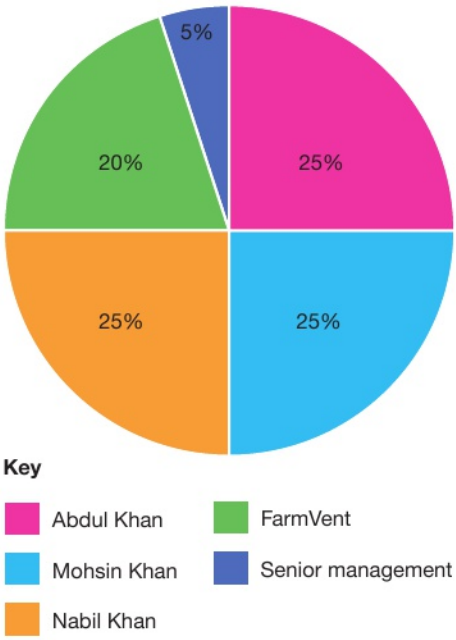
CASE STUDY: KHAN SUGAR MILLS

The Khan Brothers own and run a sugar mill near Multan in Pakistan. Khan Sugar Mills Ltd was first opened in 1984 when the business was set up. However, it was upgraded and modernised in 2001 after the brothers obtained some funding from a Karachi-based venture capitalist, FarmVent. The upgraded plant now has a sugarcane processing capacity of about 12 000 tonnes per day. The business employs more than 350 people in the mill.

The family business operates as a private limited company and made a profit of PKR 543.5 million in 2015. The three brothers own the majority of the business but in 2001 FarmVent took a stake in exchange for their funding. Some of the senior managers also own a small stake. Figure 4.3 shows the stakes of each shareholder in Khan Sugar Mills Ltd.

GENERAL VOCABULARY

stake if you have a stake in a business, you have invested money in it



▲ Figure 4.3 Khan Sugar Mills Ltd shareholders



▲ A sugar mill

1 Name the documents needed to set up a limited company.
2 Who controls Khan Sugar Mills Ltd?
3 What are the advantages to Khan Sugar Mills of operating as a limited company. Provide two advantages in your analysis.

PUBLIC LIMITED COMPANIES

Public limited companies (PLCs) tend to be larger than private limited companies. Their shares can be bought and sold by the public on the stock exchange. Any person or organisation can buy shares in a PLC.

SUBJECT VOCABULARY

public limited company (PIC) in the UK, a limited company whose shares are freely sold and traded, with a minimum share capital of £50 000 and the letters Plc after its name; other countries have similar arrangements with different letters after the company name: German AG (Aktiengesellschaft), Czech a.s., Italian S.p.A. and Spanish, French, Polish, Greek and Romanian S.A.

prospectus document produced by a company that wants the public to buy its shares

regulatory control official power to control an activity and to make sure that it is done in a satisfactory way

flotation process of a company 'going public'

'Going public' can be expensive because:

- the company needs lawyers to ensure that the **prospectus** is 'legally' correct
- the prospectus has to be printed and circulated
- a bank may be paid to process share applications
- the company must insure against the possibility of some shares remaining unsold, therefore, a fee is paid to an underwriter who must buy any unsold shares
- there are advertising and administrative expenses
- the PLC must have a minimum of £50 000 share capital.

ADVANTAGES OF PUBLIC LIMITED COMPANIES	DISADVANTAGES OF PUBLIC LIMITED COMPANIES
Large amounts of capital can be raised.	Setting up costs can be very expensive.
Shareholders have limited liability.	Outsiders can take control by buying shares.
PLCs can exploit economies of scale.	More financial information has to be made public.
May be able to dominate the market.	May be more remote from customers.
Shares can be bought and sold very easily.	More **regulatory control** owing to Company Acts.
May have a very high profile in the media.	Managers may take control rather than owners.

▶ Table 4.2 Advantages and disadvantages of public limited companies

KEY POINT

When 'going public' a company is likely to publish a prospectus. This advertises the company to potential investors. It has to be examined by lawyers to ensure that it is not presenting any misleading information about the business. It also invites investors to buy shares before a **flotation**.

FEATURES OF MULTINATIONALS

SUBJECT VOCABULARY

multinational company large business with significant production or service operations in at least two different countries

Multinational organisations have become very important in recent history. A **multinational company** is a large business with significant production or service operations in at least two different countries. Examples include McDonald's, Toyota, British Petroleum, Microsoft and Coca-Cola. Some of the key features of a multinational include:

- **huge assets (land, buildings, plant, machinery and money, for example) and turnover**: multinationals are extremely well-resourced and can often afford to take on large-scale contracts and projects that many other firms could not cope with
- **highly qualified and experienced professional executives and managers**: multinationals can afford to hire the very best people from anywhere in the world
- **powerful advertising and marketing capability**: they can invest huge amounts of money in impressive advertising campaigns to outcompete smaller rivals
- **highly advanced and up-to-date technology**: multinationals can afford to keep right up to date with technological developments so that they always have the most efficient factories, machinery and equipment that can help to lower costs
- **highly influential both economically and politically**: they can be very powerful and even influence government decision making

DID YOU KNOW?

The biggest multinational company in the world in 2015 was the US company Wal-Mart. The giant supermarket chain had sales revenue of US$4 857 000 million.

- **very efficient since they can exploit huge economies of scale**: because multinationals are so large, they have the ability to reduce their costs significantly – they can buy huge quantities of raw materials more cheaply, for example
- **ownership and control is centred in the host country**: the control of multinationals is nearly always held in the country where the company was first established. This means that profits are always returned to this country.

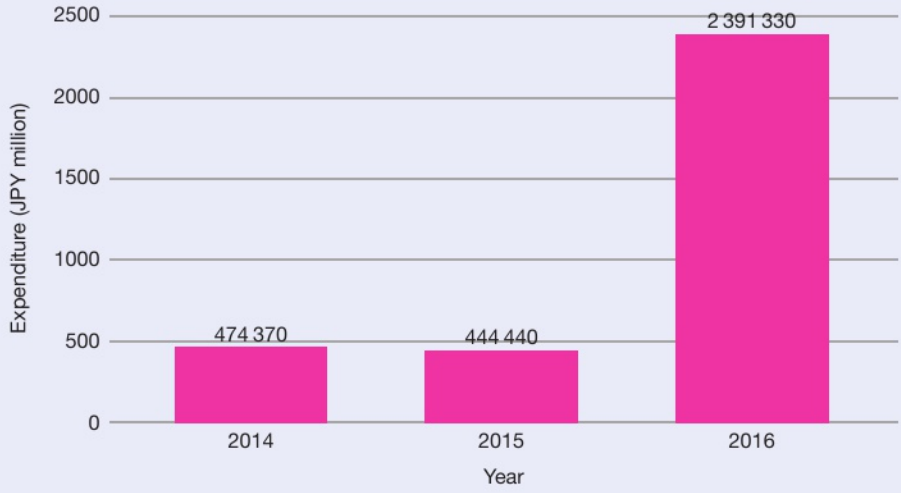
The growth and importance of multinationals is discussed in detail in Chapter 10, pages 72–80.

ACTIVITY 2

CASE STUDY: SONY

Sony is a huge Japanese-based multinational. It manufactures and markets a range of electronic goods including televisions, digital cameras, video cameras, Blu-ray Disc™ players and recorders, video games, semiconductors and other electronic components. In 2016, Sony employed over 125 000 people across the world and enjoyed sales of about US$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, the USA and India. The value of Sony's assets at the end of June 2016 was US$159 450 million.

Sony is a highly recognisable global brand. The strength of the brand has been developed over many years of successful trading. However, to support the brand Sony continues to invest heavily in global advertising. Figure 4.4 shows the amount of money Sony spent on worldwide advertising between 2014 and 2016.



▶ Figure 4.4 Sony expenditure on advertising worldwide, 2014–16

1. What is meant by the term multinational?
2. What evidence is there to suggest that Sony is a multinational?
3. Describe two features of multinationals. Use examples from the case study.

LARGE VS SMALL BUSINESSES

Quite a number of small- and medium-sized businesses operate as private limited companies. They are often family businesses and ownership may be shared between members of the same family. Many public limited companies are large and some, like multinationals, are very large indeed. However, there may be exceptions. For example, Dell the giant US computer company is privately owned by Michael Dell.

MULTIPLE-CHOICE QUESTIONS

SUBJECT VOCABULARY

issue (shares) sale of new shares

▶ 1 Which document would be issued to a limited company giving it permission to trade?

A Memorandum of association
B Articles of association
C Certificate of incorporation
D Prospectus

▶ 2 Which item of information would be contained in the memorandum of association?

A Rights of shareholders
B Name of the company
C Price of the shares to be issued
D Procedures for appointing directors

▶ 3 Selling shares to the public for the first time to raise capital for a company is called a:

A Flotation
B Prospectus
C Joint venture
D Venture capital

▶ 4 Which of the following is a disadvantage of a private limited company?

A Shareholders have limited liability
B Owners have to share the profits with 'outsiders'
C It can take time to transfer shares to a new owner
D Control could be lost to 'outsiders'

CHAPTER REVIEW

CASE STUDY: HKOFFICESUPPLIES.COM

Lee Kwok Hung is the majority shareholder in Kwok Hung Office Supplies Ltd. The three other shareholders are family members who all work in the business. The company is based in Kowloon and serves the whole of Hong Kong. It delivers a wide range of office supplies, including stationery (such as pens, paper and staplers), office equipment, office furniture and other office accessories. Lee started the business in 2004 when he operated as a sole trader supplying just stationery. However, in 2009, he invited family members to take a stake in the business and formed Kwok Hung Office Supplies Ltd, a private limited company. They contributed some capital and the business expanded.

▶ Example of an advert for office supplies



The family is now considering raising more money by 'going public'. Lee wants to expand the business further and needs HK$200 million. This will be used to:

- develop an online business
- build a large distribution centre
- purchase delivery vehicles to serve the wider South China area
- buy stock to supply a complete range of office supplies and accessories.

The company also plans to change its name to HKofficesupplies.com.

CHAPTER QUESTIONS

1 What is meant by the term private limited company?

When Kwok Hung Office Supplies Ltd was formed, Lee had to produce a memorandum of association.

2 What information would this document contain?

3 What is the purpose of a prospectus?

Share issues have to be underwritten.

4 What does this mean?

5 Why is going public expensive?

6 Discuss whether Lee should convert his business to a public limited company. Make a clear judgement at the end of your evaluation.

5 PUBLIC CORPORATIONS

LEARNING OBJECTIVES

- Understand the features of public corporations
- Understand the ownership, control, sources of finance and use of profits for public corporations
- Understand the reasons for and against public ownership
- Understand the nature of, and reasons for, privatisation

GETTING STARTED

In most countries around the world, some business activity is undertaken by government-controlled organisations. They are not owned by individuals and often have different objectives. In many countries, public services, such as health care, transport and education, are provided by public corporations. In others, commercial goods and services, such as banking, oil production and energy, are also provided. Look at the example below.

CASE STUDY: THE UGANDAN NATIONAL WATER AND SEWERAGE CORPORATION

Water and sewerage services in Uganda, like many other countries in the world, are supplied by a government-owned organisation. The Ugandan National Water and Sewerage Corporation (NWSC) is owned 100 per cent by the Ugandan government. Its mission is 'To sustainably and equitably provide cost effective quality water and sewerage services to the delight of all stakeholders while conserving the environment.' The organisation is run by a board of directors which is accountable to a government minister.

NWSC has enjoyed a successful period in recent years. Its turnover in 2017 was UGX320 billion. NWSC now has a presence in 218 towns, a large increase from only 24 towns in 2011. It has increased account holders from 58 260 in 1998 to 530 000 in 2017. NWSC employs over 2800 people and has also improved its productivity. For example, in 1998, it took 36 staff to make 1000 connections; in 2017, this was reduced to 6 staff per 1000 connections.

NWSC is committed to providing good quality customer service. It aims to supply everyone with clean, safe water within 200 metres of all towns and urban centres (coverage is currently 78 per cent). It links up with customers and local communities through NWSC Water Communication Clubs. On the NWSC website it states that 'The Customer is the reason we exist. We do everything to the delight of our customer.' According to annual surveys carried out by NWSC, 90 per cent of its customers are satisfied with the service provided.

SUBJECT VOCABULARY

productivity rate at which goods are produced, and the amount produced, especially in relation to the work, time and money needed to produce them

▶ Bringing water to the people



1 Who owns and runs the Ugandan National and Water Sewerage Corporation?
2 Suggest what the objectives of the NWSC might be.
3 Why do you think the government gets involved in business ownership?

FEATURES OF PUBLIC CORPORATIONS

SUBJECT VOCABULARY

public corporations business organisations owned and controlled by the state/government

- **State owned**: The government owns public corporations. This means that the government appoints the people who run the organisations, often a board of directors. The government is also responsible for the corporation's policies.
- **Created by law**: Public corporations are created by an act of parliament. The powers and duties of each organisation are specified clearly in the act.
- **Incorporation**: Public corporations are incorporated businesses. This means they have a separate legal identity. They can sue, be sued and enter into contracts under their own name.
- **State-funded**: The government provides the capital needed by public corporations. The money comes mainly from tax. All the assets and liabilities of public corporations belong to the state, but corporations can also borrow money and are free to re-use revenue from the sale of any goods or services.
- **Provide public services**: Most, but not all, public corporations do not aim to make a profit. Their main objective is to provide a public service. For example, Air India provides international air transport in India, Televisión Española (TVE) provides a national broadcasting service in Spain and the NHS provides free health care in the UK. Profit is not usually the driving force behind public corporations.
- **Public accountability**: Public corporations have to produce annual reports, which are submitted to the government minister in charge of the particular corporation. Ultimately, they are accountable to taxpayers because state-owned corporations are accountable to the public. If a public corporation makes a profit, the money will either be reinvested in the business or handed over to the government.

SUBJECT VOCABULARY

portfolio collection (of business interests or products)

DID YOU KNOW?

Some large public corporations are part owned by the private sector. For example, the government owns about 60 per cent of the State Bank of India and private individuals, financial institutions, foreign institutions and other private investors own the rest.

The nature and number of public corporations around the world can vary in each country. Although a great number of public corporations around the world exist to provide a public service, there are many that operate commercially with the aim of making a profit. In the UAE, the government owns a number of large businesses that aim to make a profit – Emirates Airline and Dubai World, a holding company that manages and supervises a portfolio of businesses and projects for the Government of Dubai, are examples.

ACTIVITY 1

CASE STUDY: SNCF GROUP

SNCF Group is a global company that provides passenger and freight transport services. It consists of three enterprises: SNCF, SNCF Réseau and SNCF Mobilités. SNCF Réseau is France's state-owned railway company. Under French law, SNCF Réseau is an établissement public industriel et commercial – a public service company with a commercial and industrial mission, owned by the French state. Its mission is to provide a nationwide railway network. SNCF Réseau is committed to customer satisfaction and makes social progress a priority. It aims to promote regional growth and development throughout France. It has recently launched a range of projects to:

- improve punctuality for people travelling to work
- make fares easier to understand
- make the rail system more accessible for all.

These projects include a programme to gradually improve stations and trains, and to develop services for people with disabilities.

SNCF Group generated revenues of €32 273 million in 2016, which was 2.8 per cent higher than the previous year, and made a net profit of €567 million. This is a significant improvement as despite investing over €4000 million in infrastructure and making productivity gains, SNCF Group made a net loss of €12 228 million in 2015.

SUBJECT VOCABULARY

infrastructure basic systems and structures that a country or organisation needs in order to work properly



▶ SNCF has made huge investments in infrastructure

1 Using this case as an example, describe three features of a public corporation.
2 Who will take financial responsibility for the losses made by SNCF in 2016?

REASONS FOR THE PUBLIC OWNERSHIP OF BUSINESSES

The amount of business activity taking place in the public sector has fallen in many countries in recent years. However, public corporations, and other public sector organisations, still provide a wide range of important services. What are some of the main reasons for public ownership?

GENERAL VOCABULARY

duplication repeat of something
provision providing something that someone needs now or in the future

SUBJECT VOCABULARY

natural monopoly market where it is more efficient to have just one organisation meeting total market demand

- **Avoid wasteful duplication**: In some industries, a natural monopoly exists. This means it is more efficient to have just one business providing a service for the whole market. Such industries include rail transport and public utilities where a large infrastructure is needed before trading can begin. It would be a waste of resources if, for example, two or more water companies built their own system of pipes to distribute water to all households in an area.
- **Maintain control of strategic industries**: It may be argued that it is better for industries that are vital to the nation's security, such as energy production and water supplies, to be owned by the government. This would prevent 'outsiders' from another country taking them over and exploiting the nation. If the provision of a particular service is vital to the well-being of the nation, it is considered desirable for the government to maintain control so that a reliable supply and quality can be guaranteed.
- **Save jobs**: In some cases, businesses have been taken into public ownership to save jobs. A government might take control of a failing private sector business if it employs very large numbers of people. It might be preferable to allow a business to carry on trading even though it is losing money if it prevents mass unemployment. For example, one of the reasons why Prestwick Airport, Glasgow was taken into public ownership in 2013 was to save 1400 jobs (3200 jobs linked to the airport were also saved).
- **Fill the gaps left by the private sector**: In some markets, the private sector will not make an adequate provision to meet the market's needs. For example, it is desirable that everyone gets an education because it benefits society as a whole. However, the private sector would only provide school places for those who are prepared to pay. Consequently, a large number of children would be left inadequately educated because their parents either could not afford to pay or would choose not to pay.
- **Serve unprofitable regions**: In some markets, the private sector would not deliver important services to unprofitable regions. For example, the cost of providing electricity to a remote farm many miles away from the main power lines would be too high for a private sector operator. However, a public corporation may be prepared to meet this cost because profit is not a key objective.

REASONS AGAINST THE PUBLIC OWNERSHIP OF BUSINESSES

It is argued by some that the government should not run businesses. This is because public ownership has some drawbacks.

SUBJECT VOCABULARY

subsidise paying part of the costs (often by the government in business)

- **Cost to government**: A number of public corporations make losses. These losses have to be met by the taxpayer. For example, in Activity 1 above, SNCF, the French rail transport provider, made a loss of €2176 million in 2015. If losses get bigger, and more frequent, taxpayers might object to the financial burden. Also, any money used to subsidise public corporations cannot be used for more attractive alternatives, such as improving international security.
- **Inefficiency**: Public corporations are often criticised for their low productivity and inefficiency. For example, public sector rail providers are often criticised for the poor reliability and regular lateness of trains. The cause of such inefficiency is often blamed on a lack of competition, the absence of profit as an objective and the knowledge that they cannot 'go

bust' because losses will be met by the government.

- **Political interference**: Public corporations often suffer owing to government interference. This may occur because different governments have different views about the way public corporations should operate. As a result, corporations are subject to policy changes every time a new government is elected. For example, a new government may decide that public corporations should raise prices to generate more revenue.
- **Difficult to control**: Some public corporations are very large. They may employ many thousands of workers spread across a wide geographical area and own huge quantities of physical assets. This might make it difficult to co-ordinate different parts of the business and run it effectively. For example, the NHS in the UK employs about 1.5 million people. It is one of the biggest employers in the world. With such a large workforce, and so many different operational locations, managing the organisation can be very challenging.

PRIVATISATION

SUBJECT VOCABULARY

privatisation transfer of public sector resources to the private sector (business)

In many countries, the number of public corporations has been reduced. For example, in the UK, industries such as rail transport, water provision, electricity generation and distribution, and telecommunications have been transferred to the private sector. Many Eastern European countries have also transferred a lot of government-run businesses into the private sector following the break-up of the Soviet Union. The process of transferring public sector resources to the private sector is called privatisation. Privatisation can take a number of forms.

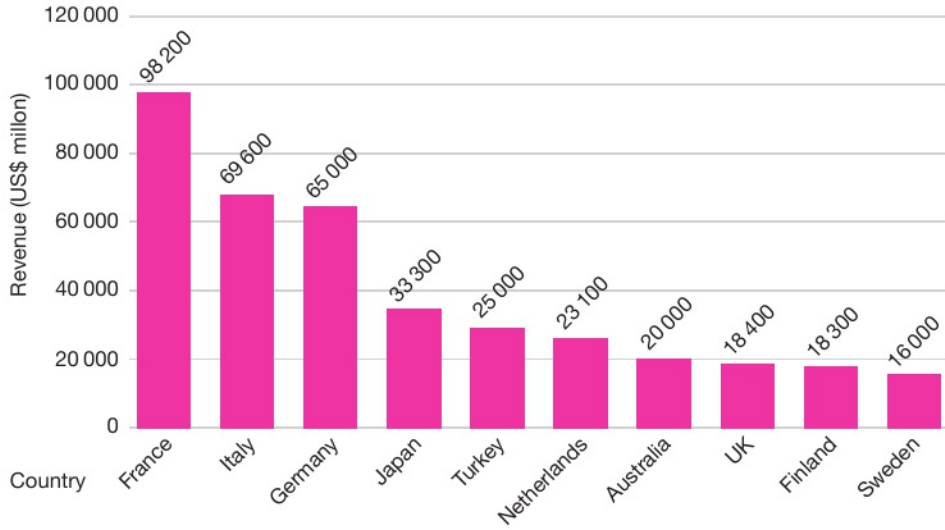
- **Sale of public corporations**: The sale of public corporations has been a popular way of transferring business activity from the public to the private sector. One way of doing this is to sell shares in the business to anyone that wants them. In some cases, governments have sold off parts of state-owned businesses over a period of time. For example, in 1997 the Australian government sold off the first third of the telecommunications business Telstra for A$13 700 million. Sales of the second and third thirds followed in 1999 and 2006.
- **Deregulation**: This involves lifting legal restrictions that prevented private sector competition. For example, in the UK the deregulation of the communications market has allowed companies such as Sky to compete with British Telecom.
- **Contracting out**: Many government and local authority services have been 'contracted out' to private sector businesses. This is where contractors are given a chance to bid for services previously supplied by the public sector. Examples include the provision of school meals, hospital cleaning and refuse collection.
- **The sale of land and property**: One example of this in the UK was the sale of council-owned properties to the tenants. They were given generous discounts, if they agreed to buy.

WHY DOES PRIVATISATION TAKE PLACE?

Different reasons have been put forward for the privatisation of government-owned resources.

- **To generate income**: The sale of state assets generates income for the government. Figure 5.1 shows the money raised by OECD countries between 2000 and 2007. These countries have raised very large amounts of money.
- **To reduce inefficiency in the public sector**: Many public corporations lacked the incentive to make a profit and often made losses. It was argued that in the private sector they would have to cut costs, improve services and return profits for shareholders. They would also be more accountable.

- **As a result of deregulation**: Legal barriers were removed that allowed new businesses in some markets, such as bus and coach services. Existing firms were privatised so that new firms could be encouraged to join the market.
- **To reduce political interference**: In the private sector, the government could not use these organisations for political aims. They would be free to choose their own investment levels, prices, product ranges and growth rates, for example.



▶ Figure 5.1 Privatisation revenues – top ten OECD countries, 2000–07

ACTIVITY 2

CASE STUDY: AIRPORT PRIVATISATION

Historically, governments have preferred to keep ownership of businesses operating airports. They were seen as very important to the nation and therefore in need of close state control. Even as recently as 2006, only about 2 per cent of the world's airports were owned or managed by the private sector. However, in recent years there has been a rapid growth in the privatisation of airports and airport facilities. For example, in 2014, the Indian Aviation Authority went ahead with plans to sell off Sardar Vallabhbhai Patel International Airport in Ahmedabad. Brazil has also opted to privatise airports. In 2013, the Brazilian Government raised US$9100 million by privatising two major airports ahead of the 2014 World Cup. More recently, in 2016, it was reported that Brazil wanted to raise a further US$1400 million by selling stakes in five of its airports. The money is needed by the Brazilian government to help reduce its budget deficit. (The government is spending more than it earns from tax revenues.)

One of the motives for privatisation is that airports are likely to be run more efficiently in the private sector. According to Ahmed Bukalla, director of operations at the Department of Civil Aviation, Sharjah International Airport, UAE, 'When privatisation comes, there will be pressure for further productivity gains, and airport operators will need to be even more innovative and adopt new technologies to stay competitive.'

▶ Airports – attractive targets for privatisation?



1 What is meant by the term privatisation?
2 Why were governments keen to maintain state control of airports until recently?
3 Describe two possible reasons why governments should want to privatise airports.

MULTIPLE-CHOICE QUESTIONS

▶ **1** An industry where efficiency is improved if there is just one operator is which of the following?
- A Segmented industry
- B Saturated industry
- C Natural monopoly
- D Oligopoly

▶ **2** Which of the following is a feature of a public corporation?
- A It is owned by the board of directors
- B It is funded by the government
- C It aims to maximise profits
- D It is not accountable to anyone

▶ **3** The transfer of public sector resources to the private sector is called what?
- A Nationalisation
- B Rationalisation
- C Segmentation
- D Privatisation

▶ **4** Which of the following is a reason against the public ownership of businesses?
- A Public corporations may be too large and difficult to control
- B Public corporations cannot raise enough funding
- C The government cannot employ businesspeople
- D Public corporations cannot employ overseas employees

CHAPTER REVIEW

CASE STUDY: AUSTRALIAN BROADCASTING CORPORATION

The Australian Broadcasting Corporation (ABC) is Australia's national public broadcaster. It is established under the Australian Broadcasting Corporation Act. The ABC is funded by the Australian taxpayer via an appropriation from the Commonwealth Government of Australia. By law and convention, the ABC remains independent of the government, political, sectional and personal interests. The Charter of the ABC sets outs its functions to, amongst other things, provide broadcasting services (TV and radio) and digital media services within Australia and overseas, and to promote Australia's musical, dramatic and other performing arts. A board of eight directors led by a chairperson is responsible for the ABC's operations. They must ensure that the independence and integrity of the ABC is maintained and that the corporation is run efficiently with maximum benefit to the Australian people.

The ABC's aim is to serve the Australian people. In particular, it is 'focused on keeping audiences at the centre, providing high-quality programming, independent news and information and content that enriches Australian communities'. The ABC does appear to be meeting the needs of its customers.

In the 2016 annual Newspoll ABC Appreciation Survey, support for the corporation was strong. In the survey:

- around 86 per cent of Australians believed that the ABC performs a valuable role
- a large majority believed it provides quality content
- a majority said it was doing a 'good job' meeting its media obligations.

In addition, respondents were very positive about the ABC's online output. Figure 5.2 shows the satisfaction levels relating to ABC's provision of online content.

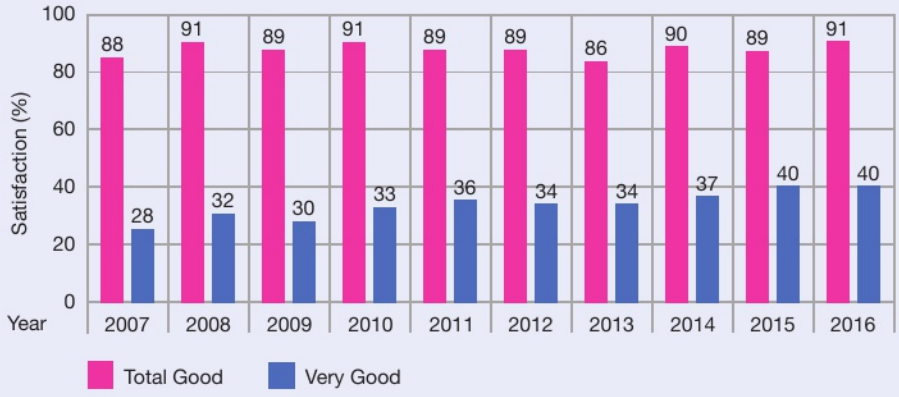


Figure 5.2 ABC Online: satisfaction with content quality

Note: 'Total good', those responding 'good' or 'very good'.

However, the arrival of digital technology has had a huge impact on the media. Competition from new media companies and platforms is increasing at an astonishing rate. To add to these difficulties, the Australian government has begun a round of cuts to the corporation's funding. By 2018/19, the ABC will lose a total of A$254 million. In light of these developments, some have argued that the ABC would perform more effectively in the private sector.

One argument in favour of privatising the ABC is that it does not provide a universal service. According to one survey, over one year 40.1 per cent of those questioned did not watch the ABC at all. The government would also save money if it were transferred to the private sector. The government currently provides over A$1000 million in funding. Many say that this money could be used to reduce government debt or cut taxes. Finally, some people also think that the ABC favours left-wing political parties. In 2016, the ABC's new managing director, Michelle Guthrie, said that the ABC 'can do better' at presenting a broader range of political views.

Opponents to the privatisation of the ABC say that the move would be unpopular with the public and lead to a huge reduction in current affairs, drama and children's programming. Mark Scott, managing director of the broadcaster in 2013, shared this view. It is also suggested that radio and other ABC-like services would not be broadcast to remote regions if the ABC were transferred to the private sector.

CHAPTER QUESTIONS

1. What is meant by the term public corporation?
2. Describe two features of public corporations. Use the ABC as an example.
3. Why might organisations like ABC operate as public corporations? Give two reasons in your analysis.
4. Assess the case for privatising the ABC.

6 APPROPRIATENESS OF DIFFERENT FORMS OF OWNERSHIP

LEARNING OBJECTIVE

- Understand the factors that affect the appropriateness of different forms of business ownership

GETTING STARTED

The type of organisational structure that owners choose for their business will depend on a number of factors. For example, there is a relationship between the objectives of a business and the type of business organisation. Generally, as a business grows, the legal status of the business changes. Look at the examples below.

CASE STUDY: WU YANG

Wu Yang runs a small business supervising tour parties around Lantau Island in Hong Kong. She acts as a tour guide and takes tourists to the Giant Buddha Exhibition Hall at Po Lin (Precious Lotus) Monastery. She also drives groups around the beaches, fishing villages, green valleys and massive mountains on the island. Wu Yang owns a tour bus and meets tour groups at the ferry port. She operates as a sole trader and made a profit of HK$420 000 in 2016. Wu Yang is happy with her current business situation and does not want to expand. She enjoys meeting new people every day and operating as a sole trader. She is making sufficient profit to fund a comfortable lifestyle. As long as she can maintain her current market share, she is happy with her business. She does not want to take on the extra responsibility that growing the business might bring.



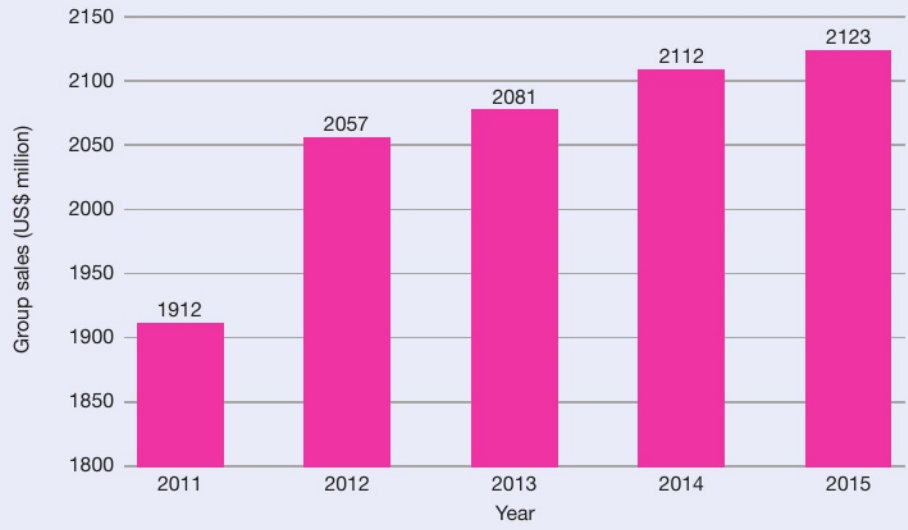
▶ Giant Buddha at Po Lin Monastery, Lantau Island, Hong Kong

CASE STUDY: SHANGRI-LA HOTELS AND RESORTS

Shangri-La Hotels and Resorts is a Hong Kong-based luxury hotel group. The first hotel opened in 1971 and Shangri-La now operates over 98 hotels across Europe, Asia, China, North America and Australia. It also offers a range of hotel management and related services. Some of its brand names include Shangri-La, Hotel Jen, Traders, and Kerry hotels.

Since the company was established, it has grown significantly. For example, in 2015, the group opened nine new Shangri-La hotels. It also launched the modernised Shangri-La's Le Touessrok Resort & Spa, Mauritius, and rebranded four properties to Hotel Jen.

Figure 6.1 shows the sales revenue for the group between 2011 and 2015.



▶ Figure 6.1 Shangri-La group sales, 2011–15



▶ Shangri-La Hotel, Qaryat Al Beri, Abu Dhabi

Wu Yang is happy operating as a sole trader.

1. Suggest two reasons why she might be happy.
2. Why could Shangri-La not realistically operate as a sole trader?
3. What evidence is there to suggest that Shangri-La is a growing company?
4. Why might businesses in general be forced to change their legal status as they grow?

FACTORS AFFECTING THE APPROPRIATENESS OF DIFFERENT FORMS OF OWNERSHIP

DID YOU KNOW?

Some business activity, such as oil processing and chemical manufacturing, requires large-scale production. Sole traders or partnerships could not manage this effectively.

- **Growth**: Many businesses start small and gradually get bigger. Most businesses change their legal status as they grow. This is because they need to raise more capital. For example, sole traders often find it difficult to raise additional finance. However, by taking on a partner, or becoming a private limited company, they can raise more money. This is because more owners can generate more capital and limited companies have access to a wider range of finance options. Similarly, if the owners of a private limited company want to raise even larger amounts of capital they may consider becoming a public limited company.
- **Size**: Many small businesses are sole traders or partnerships. Public limited companies are much larger with thousands of employees and huge turnovers. It could be argued that a very large business could only be run effectively if it were a limited company, although, of course, there are exceptions.
- **The need for finance**: Finance is one of the main reasons why owners change the legal status of their businesses. Quite often the only way to get more money is to change the type of organisation (see Growth above).
- **Control**: Some owners like their independence. They like to have complete control of their business. This is why many owners remain as sole traders. Once new partners or shareholders join the business, some control is lost because it is shared with the new partners or owners. It is possible to keep control of a limited company by holding the majority of shares. However, even if one person holds 51 per cent of shares in a limited company, the wishes of the holders of the other 49 per cent cannot be ignored.
- **Limited liability**: Owners can protect their own personal financial position if the business is a limited company. Sole traders and partners have unlimited liability. Because of this, they could be forced to use their own money to meet business debts. Therefore, some owners become limited companies to give themselves more financial protection.

OTHER FACTORS

DID YOU KNOW?

Entrepreneurs such as Richard Branson (Virgin) and Alan Sugar (Amstrad) have changed the legal status of their organisations from public limited companies back to private limited companies. After operating as PLCs for some time, they found that they did not like sharing control. Their own objectives may have been different from those of the other shareholders. However, doing so requires a lot of money in order to buy enough shares to take back control.

- The type of business activity may influence the choice of legal status. For example, services such as plumbing, decorating and gardening tend to be provided by sole traders, while professional services such as accountancy, legal advice and architectural design are usually offered by partnerships. Relatively small manufacturing and family businesses tend to be private limited companies and large banks, retail chains and manufacturers are usually public limited companies (PLCs). It must be remembered that there are many exceptions to these general examples.
- The way in which a business plans to use its profits may be important. For example, PLCs usually pay dividends to their shareholders. Therefore, a growing business that prefers to reinvest a lot of its profit may choose to remain as a private limited company.
- Finally, the different stakeholders such as employees and shareholders might influence the choice of organisation. For example, leading employees in a private limited company might discourage the shareholders from going public. They may argue that the company operates more effectively without external owners.

OBJECTIVES AND THE TYPE OF ORGANISATION

It is likely that the different types of business organisation will have different objectives. Some examples are given below.

- Small sole traders might be happy to make a modest amount of profit – just enough to fund a comfortable lifestyle. They may not want the responsibility associated with other objectives such as growth. This is sometimes called *profit satisficing*.
- Family businesses and other medium-sized private limited companies often do not wish to go public because they are afraid of losing control to outsiders. As a result, their growth might be limited and other objectives are more important.
- Most multinationals want to grow. Their aim is often to get bigger and bigger so that they can dominate global markets. For example, McDonald's is one of the biggest multinationals in the world. However, in 2016, it announced that it wanted to open another 1250 outlets in China plus another 250 in Hong Kong and South Korea.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following business activities is likely to be operated by a sole trader?

A Motor car manufacturing
B Chemical processing
C Banking
D Gardening service

▶ 2 What is the most appropriate form of business for a multinational operator?

A Partnership
B Public corporation
C Public limited company
D Social enterprise

▶ 3 What is an appropriate form of business for a self-employed taxi driver?

A Multinational
B Public limited company
C Sole trader
D Cooperative

▶ 4 Which of the following is most likely to affect the appropriateness of a particular form of business?

A The rate of inflation in the economy
B Geographical location
C The financial risk owners are prepared to take
D The views of employees

CHAPTER REVIEW

CASE STUDY: ESHANIBABYGEAR.COM

Eshani Atapattu has run her retail operation selling baby clothes and accessories as a sole trader, then as a partnership and now as a limited company. Set up in 1986, the business first traded from her home in Colombo, Sri Lanka, by mail order. But now it has a shop and a growing Internet business. Eshani said: 'When I started, I started small, operating from home, and never needing outside funding, so being a sole trader seemed the simplest option.'

Three years later, Eshani decided to open a shop. However, she needed money for premises, stock and marketing. After a few months, there was a strain on her cash resources. Therefore she decided to take on her best friend as a partner. This helped to share the burden of running the business and raised LKR 6 million in much needed cash. However,

after 18 months, Eshani fell out with her partner. Her partner wanted to take more profit from the business whereas Eshani wanted to use it for expansion. The break-up of the partnership was bitter and Eshani ended up having to pay her friend off. Eshani said: 'I was a fool really. I should have drawn up a deed of partnership in case we disagreed.'

Immediately after the break-up, Eshani formed a private limited company. Eshani had 70 per cent of the shares because she wanted control. Her mother bought 20 per cent and she allowed two of her staff to buy the remaining 10 per cent. She wanted to reward them for their loyalty and also keep them motivated. Some of the money raised from selling the shares was used to set up an online business. This is now expanding fast and Eshani thinks she could develop a small chain of shops. A major retailer has recently offered a number of stores for sale. However, to buy, convert and stock them would cost LKR 400 million. The only way she could raise this money is by going public.



▶ Baby clothes and equipment are big business across the world

CHAPTER QUESTIONS

1 Why was a sole trader organisation most appropriate for Eshani's business when she first started?

2 Discuss why Eshani formed a partnership.

Eshani formed a private limited company after the break-up of the partnership.

3 Do you think it was appropriate?

4 Assess whether Eshani should form a public limited company to buy the shops.

7 CLASSIFICATION OF BUSINESSES

LEARNING OBJECTIVES

- Understand that business activity falls into three different sectors – primary, secondary and tertiary
- Understand the changes in sectors that have occurred over time

GETTING STARTED

Businesses operate in different sectors. In developed countries, such as the USA and Germany, most businesses provide services. They may be fitness centres, insurance brokers and retailers, or provide services for businesses such as market research or IT support. In some countries, such as China, there are large numbers of manufacturers. Finally, in less developed countries many businesses will concentrate on producing agricultural goods. Look at the businesses below.



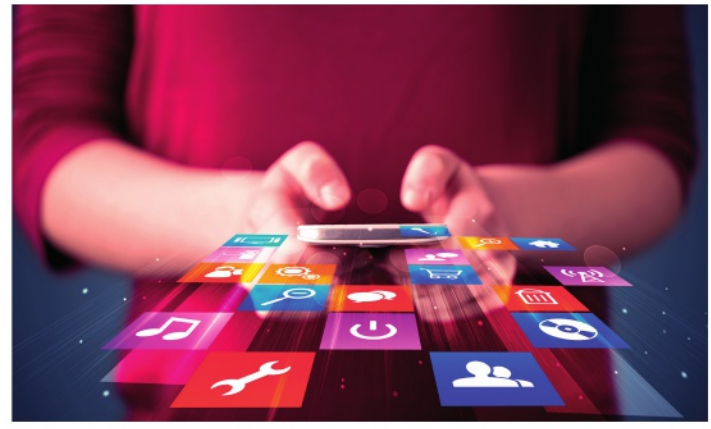
▲ Rail transport in India



▲ Growing crops in Africa



▲ Food processing



▲ App design for smartphones

1 Which of the businesses shown on the previous page are concerned with **(a)** agriculture, **(b)** manufacturing or **(c)** services?
2 Which of these businesses are **most likely** to employ large numbers of people in a developing nation? Explain your answer.
3 In pairs, draw up a list of 20 businesses in your area and decide whether they are agricultural, manufacturers or service providers.

PRIMARY SECTOR

SUBJECT VOCABULARY

primary sector (industry) production involving the extraction of raw materials from the earth

Business activity is classified into three sectors. In the primary sector business activity involves extracting raw materials from the earth. Here are some examples.

- **Agriculture** involves a range of farming activities. It is probably the most important primary sector activity for most countries. Most agriculture is concerned with food production. However, other examples include decorative or exotic products such as cut flowers, nursery plants and tropical fish.
- **Fishing** involves netting, trapping, angling and trawling for fish. It also includes catching or gathering other types of seafood, such as mussels, prawns, lobsters, crabs, scallops and oysters. China is the world's largest fish producer.
- **Forestry** involves managing forests to provide timber for wood products. Modern forestry also involves protecting the natural environment, providing access and facilities to the public and managing areas for wildlife.
- **Mining and quarrying** is the extraction of raw materials such as coal, iron ore, copper, tin, salt and limestone from the ground. This sector also includes the extraction of oil and gas. Saudi Aramco, the largest oil producer in the world, is an example of a business that extracts oil.

SECONDARY SECTOR

SUBJECT VOCABULARY

secondary sector (industry) production involving the conversion of raw materials into finished and semi-finished goods

assembly plant factory where parts are put together to make a finished product

In the secondary sector, business activity involves converting raw materials into finished or semi-finished goods. All of manufacturing, processing and construction lie within this sector. Secondary sector business activities include metalworking, car production, textile production, chemical and engineering industries, aerospace manufacturing, energy utilities, engineering, food processing, construction and shipbuilding.

Some businesses focus on the production of semi-finished goods (sometimes called intermediate goods or producer goods). These goods are sold to other businesses and used as inputs for the production of final goods, which are then sold to consumers. Examples of semi-finished goods might include the parts used in assembly plants to make motor cars, such as steering wheels, car seats, brakes, light fittings, engines, electric cables, switching mechanisms and exhaust systems. A single car may use around 30 000 different parts in assembly.

In many developed countries the secondary sector has declined in recent years. This is discussed in more detail below.

TERTIARY SECTOR

SUBJECT VOCABULARY

tertiary sector (industry) production of services in the economy

The tertiary sector involves the provision of a wide variety of services, such as:

- **commercial services**: freight delivery, debt collection, printing and employment agencies
- **financial services**: banking, insurance, investment advice and pensions
- **household services**: plumbing, decorating, gardening and house maintenance

- **leisure services**: television, tourism, hotels and libraries
- **professional services**: accountancy, legal advice and medical care
- **transport**: train, taxi, bus and air services.

ACTIVITY 1

CASE STUDY: AGRICULTURAL EMPLOYMENT

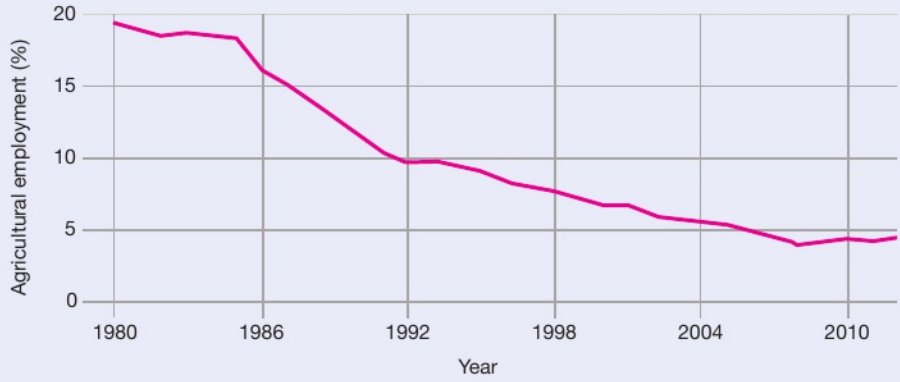
The largest olive growing region in the world is Andalucía, southern Spain. Many of the growers in this region are owned and run by small family businesses. The Casillas family grow olives on their farm near Cordoba. Each year they sell their harvest to a local business, which process the olives into oil, much of which is exported. Harvest time between November and March is a very busy time for the family. They usually employ about 15 villagers to help out. However, Marco Casillas has recently thought about investing in some harvesting machinery to reduce labour costs and remain competitive.



▲ The olive harvest



▶ Processing olives for oil



▶ Figure 7.1 Agricultural employment in Spain (as a percentage of the total employed), 1980–2013

Source: http://www.tradingeconomics.com

1 What is the difference between the primary and the secondary sectors? (Use examples from this case study.)

Look at Figure 7.1.

2 What has happened to the number of people employed in agriculture in Spain since 1980?
3 Describe one possible reason for the pattern described in question 2.

INTERDEPENDENCE

Businesses in each of the three sectors above are likely to be *interdependent*. This means that they rely on each other. For example, in the primary sector cereal farmers rely on bakers in the secondary sector for their sales of wheat. Bakers may depend on advertising agencies in the tertiary sector to produce newspaper adverts for their products. The transport industry in the tertiary sector relies on the oil industry in the primary sector to provide fuel for its vehicles. Workers in both the secondary and tertiary sectors rely on the primary sector for their food. In modern developed economies, this interdependence is huge.

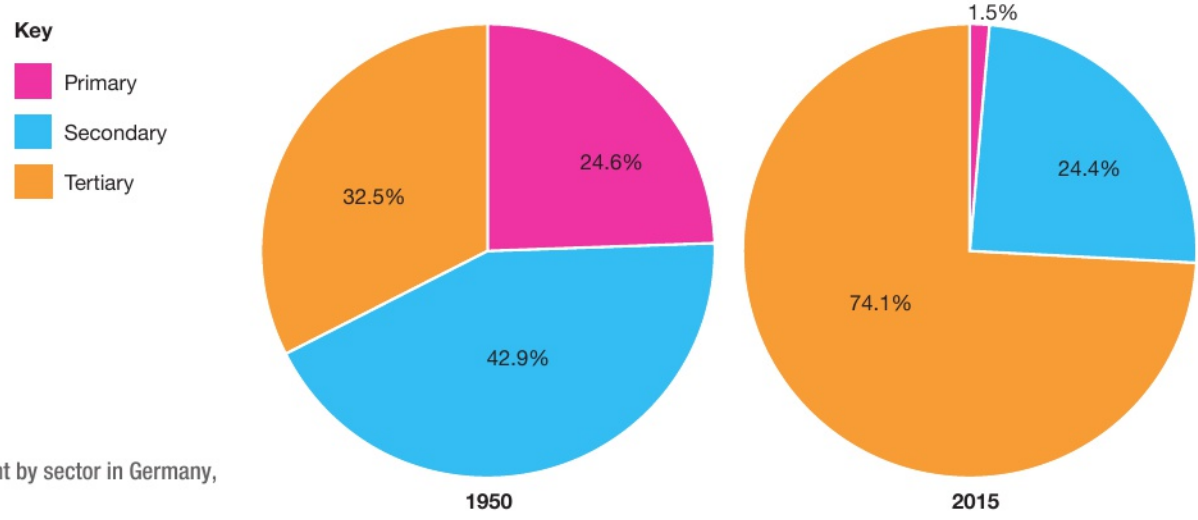
CHANGES IN SECTORS

The number of people employed in each sector does not stay the same. Different sectors grow and decline over time. In the UK, before the Industrial Revolution began in the late 18th century, most production was in the primary sector. During the 19th century, secondary production expanded rapidly as manufacturing grew during the Industrial Revolution.

SUBJECT VOCABULARY

de-industrialisation decline in manufacturing

However, in the last 60 years the tertiary sector has started to expand at the expense of both agriculture and manufacturing. The decline in manufacturing is called **de-industrialisation**. Figure 7.2 shows the pattern of employment in the primary, secondary and tertiary sectors in Germany between 1950 and 2015. Similar patterns can be identified in other developed nations.



▶ Figure 7.2 Employment by sector in Germany, 1950 and 2015

Source: https://www.destatis.de

Why has manufacturing declined in developed countries while services have grown?

- People may prefer to spend more of their income on services than manufactured goods. There has also been a decline in demand for the goods produced by some of the traditional industries in manufacturing, such as shipbuilding and textiles.
- There is fierce competition in the production of manufactured goods from developing countries such as India, China and Brazil.
- As countries develop, the public sector grows. Since the public sector mainly provides services, this adds to the growth of the tertiary sector.
- Advances in technology mean that employment in manufacturing falls because machines replace people.

LARGE VS SMALL BUSINESSES

Both large and small businesses can be found operating in all three of the different business sectors. However, it could be argued that in many countries businesses in agricultural are generally small (although there are many exceptions). In the secondary sector, the size of manufacturers can vary considerably from giant car producers, such as Ford, to carpenters producing furniture operating as sole traders. Again, in the tertiary sector there are millions of examples of small service providers in a wide range of fields. However, at the same time there very large multinationals, such as banks and insurance companies.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Gold mining in South Africa is an example of business activity in which sector?

A Primary sector
B Secondary sector
C Tertiary sector
D None of the above

▶ 2 Which of the following businesses operate in the secondary sector?

A Santander Bank
B Qatar Airways
C Ford Motor Company
D McDonald's

▶ 3 Which of the following countries has most likely seen the sharpest decline in employment in the primary sector in the last 50 years?

A USA
B Uganda
C Bangladesh
D Chad

▶ 4 The table below shows the value of exports in different industry sectors for a country.

EXPORT	VALUE (US$ MILLION)
Air transport	700
Education	200
Manufactured goods	400
Oil	1300
Other services	800
Processed food	500
Shipping	500

What is the total value of exports from the primary sector?

A US$900 million
B US$1300 million
C US$1800 million
D US$2200 million

CHAPTER REVIEW



▲ Products made by Hisense

GENERAL VOCABULARY

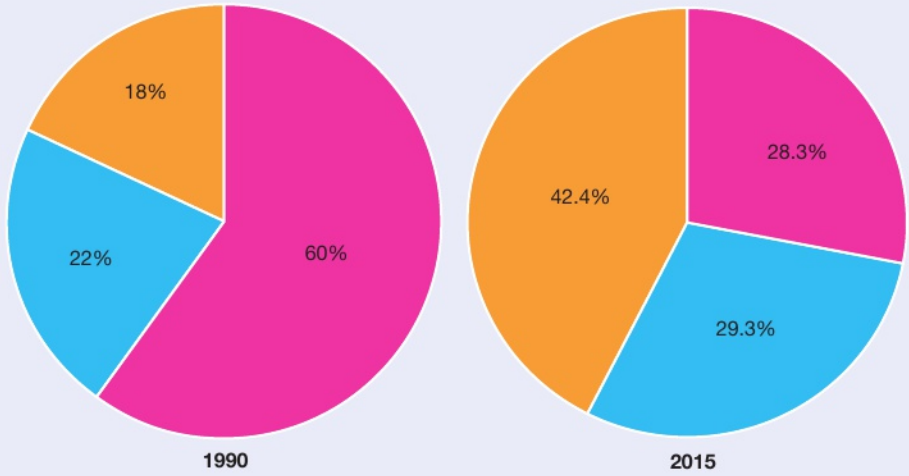
proportion part of a number or an amount, considered in relation to the whole

CASE STUDY: HISENSE

China is well-known for its manufacturing capabilities. The country has many thousands of manufacturers that make a wide range of goods, which are sold all over the world. China has enjoyed a competitive edge in manufacturing in the last 30 years or so owing to its cheap and large supply of labour. However, producers in other parts of the world are now taking market share away from China as wages in the country are starting to rise.

One very large Chinese manufacturer is state-owned Hisense. It makes white goods, such as refrigerators and washing machines, as well as electrical goods, such as televisions, laptops and mobile phones, and many other related products. Hisense has a large number of factories in both in China and overseas. However, Hisense also provides a range of services, such as product design, information technology services and property management. Hisense has recently opened two new research and development centres to help speed up product development.

In common with many other countries in the world, the pattern of business has changed in China over time. Figure 7.3 shows the **proportion** of people in China employed across the primary, secondary and tertiary sectors in 1990 and 2015.



▶ Figure 7.3 Employment by sector in China, 1990 and 2015

Source: https://www.destatis.de

CHAPTER QUESTIONS

1 What is the difference between secondary and tertiary production? Use examples from the case study.

Look at Figure 7.3.

2 What evidence is there to suggest that China's economy has become more balanced since 1990?

3 Discuss the interdependence that exists between the different sectors of business activity.

4 What is meant by de-industrialisation?

5 Assess the main causes of de-industrialisation.

8 DECISIONS ON LOCATION

LEARNING OBJECTIVE

Understand the factors that influence the location and relocation of businesses:

- proximity to market, labour, materials and competitors
- nature of the business activity
- the impact of the internet on location decisions: e-commerce and/or fixed premises
- legal controls and trade blocs

GETTING STARTED

Businesses have to decide from where to operate. Should they choose a site in the town centre, on an industrial or business estate, close to a motorway, by a port or in the countryside? Businesses may be located in a wide range of different places and the changing business environment will influence the choice of location. Look at the examples below.

CASE STUDY: NUCLEAR POWER STATIONS



▲ Nuclear power stations need stable ground and plenty of space for their construction

Nuclear power stations are used to generate electricity. Today, around 11 per cent of all electricity globally is generated by nuclear power. Globally, there are over 400 nuclear power stations with a further 67 planned for the future. People are likely to worry about the location of nuclear power plants because of the risk they potentially carry. Some people still remember the impact and harm caused when nuclear materials escaped from plants in Chernobyl, Ukraine (then USSR), in 1986 and Fukushima, Japan, in 2011.

Nuclear plants cannot be built without a lengthy consultation process involving the local and national authorities, local communities and power companies. There are legal restrictions on their location. Nuclear plants also need solid ground and plenty of space. Most plants also need access to a water source such as a lake or river and access to a large workforce. The construction of nuclear plants may need around 2000 people and a further 500 or so to operate them. Many nuclear plants around the world are built just outside small- or medium-size towns and on the coast. However, despite the potential risk of such sites, they cannot be too remote because the electricity produced has to be fed in to the electricity distribution system to reach the final users.

CASE STUDY: ONLINE BUSINESSES

Many thousands of new businesses operate online. Some high profile examples include Facebook, Amazon and Twitter. However, many other service providers operate as retailers, consultants, bloggers, web designers, information providers and teachers. The one thing they all have in common is that they use the Internet to trade. One of the main advantages of these businesses is flexibility of location. Most traders can locate their base anywhere in the world as long as they have access to the Internet. However, some large online retailers may need to locate their operations close to good transport networks; this will help them to distribute their products effectively and efficiently.



▶ Online businesses can be located anywhere in the world with an Internet connection

1. What are four factors that must be taken into account when locating a nuclear power station?
2. Describe how the changing business environment has affected the location of many service providers such as retailers.
3. In groups, consider where you might locate **(a)** a banana plantation, **(b)** a large car factory and **(c)** a new shopping centre or mall. Give at least two reasons for each answer.

FACTORS INFLUENCING THE LOCATION AND RELOCATION OF BUSINESSES

Historically, many manufacturers were located near to the sources of power and raw materials. Steel and chemical heavy industries were located close to power sources, such as coal, and raw materials, such as water and iron ore. The steel industry was successful in the Ruhr and Rhine valleys in Germany because all these resources were available in the locality. Today, electricity and gas can be supplied to most places, therefore manufacturers may not have to be located close to power sources. They are more likely to consider other factors such as those below (although there are exceptions).

PROXIMITY TO MARKET, LABOUR, MATERIALS AND COMPETITORS

PROXIMITY (CLOSENESS) TO THE MARKET

- Businesses that make large or heavy products may be located close to their customers to keep transport costs down. For example, Renault located a factory in Tangier, a port in North Africa with proximity to the

DID YOU KNOW?

In the car industry, firms making components such as braking systems, light fittings, car seats and other parts may locate close to a car assembly plant. The use of just-in-time production (see Chapter 42) has encouraged this trend. It is easier for suppliers to make several deliveries per day, for example, if they are located 'next door' to their main customer.

GENERAL VOCABULARY

relocated moved to another place

DID YOU KNOW?

In India, Bangalore has a reputation for good IT professionals. Firms in Bangalore employ about 35 per cent of India's 1 million IT professionals and as a result many multinationals have IT operations there.

GENERAL VOCABULARY

fracking the process of injecting liquid at high pressure into subterranean rocks, boreholes etc. so as to force open existing fissures and extract oil or gas

SUBJECT VOCABULARY

brownfield sites areas of land that were once used for urban development

greenfield sites previously undeveloped areas of land, usually on the outskirts of towns and cities

European market (see Activity 1). The manufacturers of parts often locate close to their customers where components are assembled into final products.

- Many service providers have to locate their premises close to their markets. This is because many services are sold direct to consumers. For example, restaurants, cafés, shops, hair salons, taxis and dry cleaners have to be located in towns and cities because this is where the majority of customers live, work and shop.

PROXIMITY TO LABOUR

Businesses needing large numbers of workers have to consider wage costs and labour skills. Wage rates may vary in different regions and large companies may also consider locating in countries where labour is very cheap. Also, labour skills are not evenly distributed throughout a country. If a firm needs a particular type of skilled labour, certain locations may be more suitable than others. A number of manufacturers in the USA and Europe have relocated production operations to Mexico and the Far East because labour is relatively cheap.

PROXIMITY TO MATERIALS

- Businesses that use large amounts of raw materials that are difficult to transport may choose to locate their premises very close to their sources. For example, some types of business activity use up large quantities of water and therefore might choose to locate close to rivers, lakes or the coast. Some manufacturers, such as chemical processors, still use large amounts of energy. Consequently, they may look for locations where cheap energy sources are available. For example, in 2014, German company BASF, the world's largest chemical producer, said that it would expand production overseas rather than in Germany where energy costs were rising. The USA has become a popular location for this reason. Here energy prices have been falling owing mainly to an increase in supply of oil and gas resulting from fracking.
- Some businesses, such as large supermarkets and manufacturers, require large areas of land to locate buildings, staff car parks and other facilities. As a result, they look to minimise land and property costs. For example, they may set up in areas where:
  - premises are cheap – perhaps in a business park or on an industrial estate; these are often located away from expensive residential areas
  - business rates (a tax paid by businesses to the local authorities) are low
  - land has been allocated for business development such as brownfield sites or greenfield sites.

PROXIMITY TO COMPETITORS

- Most service providers will prefer to locate where competition is minimised. For example, an entrepreneur opening a hair and beauty salon may avoid locations where such businesses already exist. However, in contrast, some business deliberately choose locations where competitors are closely concentrated. This might be important in industries where comparison shopping is popular. It might also be possible to catch the excess demand from existing businesses, particularly if premises are located in a restaurant and entertainment area.

ACTIVITY 1

CASE STUDY: RENAULT

A number of high profile manufacturers have started to locate plants in Morocco. One such company is Renault, the French motor car manufacturer. Renault has a factory in Tangier where it makes two of its low-cost brands, Dacia and Renault. The plant can produce up to 150 000 cars per year. What might have attracted Renault to Morocco?

1. In North Africa where political disturbances are not uncommon, Morocco is seen as a politically stable location.
2. Tangier is a busy port and just 10 miles (16 km) away from the large European market. This was important to Renault since most of the factory's output in Tangier is intended for export.
3. Economic growth in Morocco is currently high, around 5 per cent in 2016. Increasing numbers of Moroccans can now afford to buy cars.
4. Morocco has improved its infrastructure in recent years. For example, motorways and railways effectively link Tangier to industrial parks. Indeed, Renault has its own direct rail link to the port.
5. Morocco provides a strategic geographical location for manufacturers. It is at the crossroads of the world's most important sea links.
6. French is the commercial language of Morocco.

Renault must be happy with its decision to locate factories in Morocco as the company is now looking to increase its use of local suppliers in Morocco from the current 40 per cent to 65 per cent by 2023.

▶ Inside the Renault plant in Morocco



1. Discuss the possible reasons for Renault's decision to locate a factory in Tangier.

2. What are two possible benefits to Morocco of Renault's decision to locate a factory in Tangier?

Adapted from http://www.just-auto.com/regions/morocco_cid144

THE NATURE OF BUSINESS ACTIVITY

GENERAL VOCABULARY

congestion problem of too much traffic in a place
refineries factories where something such as oil or sugar is made purer
fertile land or soil is able to produce good crops

SERVICES

Increasingly, when choosing a suitable location, businesses have to take into account the ease of access and parking facilities. Traffic congestion is a growing problem in many parts of the world and businesses need to choose locations where there is less chance of delays. It is particularly important for customers since they will try to find alternatives if they cannot park conveniently. Some service businesses, particularly fast-food providers, are developing 'drive-through' facilities to help overcome parking problems.

Some service providers locate in specialist shopping areas such as retail parks, centres or malls. These are usually designed for easy access and contain very large numbers of outlets. They can attract many thousands of visitors per day.

OFFICE-BASED BUSINESSES

In some fields of business, such as creative marketing, consultancy, financial services and customer service provision, business activity is office based. If large numbers of people have to be employed in offices, businesses may need to ensure that there are sufficient facilities such as restaurants, cafés and hotels, nearby. Many businesses locate their head offices in large and popular cities. This gives employees, customers and other visitors access to a wide range of other facilities, such as theatres, cinemas, museums, night clubs, bars and sports stadiums. Locating in a high profile city such as London, Paris, Dubai or New York can also improve the image of a business. Although some office-based businesses still prefer to locate where costs are lower.

MANUFACTURING AND PROCESSING

The locations chosen by manufacturers may vary. This is because different types of manufacturing have different needs. For example, manufacturing that is labour intensive will need to locate where there is a good supply of skilled and relatively cheap labour. Coal-fired power generators are likely to be located very close to coal mines or access to coal imports (for example, a shipping terminal) to keep transport costs down. Oil refineries are often located on the coast for the same reason: oil can be transferred straight from ships to the refining plants if they occupy coastal locations. Manufacturers that need very large areas of land may choose locations where land is relatively cheap and there is lots of space on the edge of towns and cities, for example.

AGRICULTURE

Most farmers require large areas of land for their businesses. However, not all land is the same and some farming activity needs a particular type of land. For example, dairy farmers need land where grass can grow effectively so that cows can get access to a good food source. Growers of vegetables generally need quite fertile land whereas cereal crops can be grown on slightly less fertile land. Fruit growers producing apples, pears, plums and strawberries, for example, need land that is sandy and well drained. And tropical fruits, such as bananas and mangoes, can only be grown in tropical regions.

In the fishing industry, businesses will tend to be located on the coast. However, different types of fish and shellfish live in different environments. For example, someone keen to develop a business catching oysters would have to locate close to an oyster reef, which are often found where rivers meet the sea.

ACTIVITY 2

CASE STUDY: RESTAURANT LOCATIONS

Abdullah Jaffer plans to open a seafood restaurant in Manama, the capital of Bahrain. He wants to target business customers working in the financial quarter of the city. He has raised some money and has found a specialist seafood chef who has agreed to lead the team in the kitchen. Abdullah has also been spending some time trying to find the perfect location for his business. He wants to find premises that are already suitable for opening a restaurant. He is considering a location close to where a number of other restaurants operate. Premises occupied by a recently failed restaurant have become available. However, he is concerned about the competition in the area.



▶ There are benefits and risks in locating a restaurant close to competitors

1. What factors will Abdullah need to take into account when deciding where to locate his seafood restaurant? Give two factors in your analysis.
2. Why might businesses, such as Abdullah's seafood restaurant, deliberately choose to locate close to competitors?

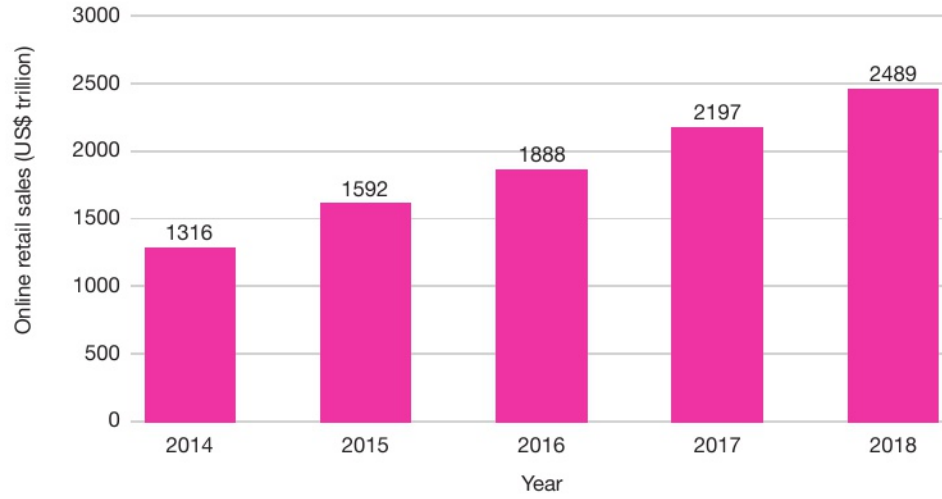
THE IMPACT OF THE INTERNET ON LOCATION DECISIONS

Many people are switching to the Internet when shopping rather than going to stores. There has been a huge growth in e-commerce, which has had a massive impact on business locations. Figure 8.1 shows the estimated growth in global online retail sales between 2014 and 2018. The development of online businesses means that many entrepreneurs have a lot more flexibility when choosing a location. This means that retailers, for example, can serve national markets and operate in premises far away from the actual customers. For example, an online clothes retailer could operate from a warehouse near a motorway and serve a national market.

Also, businesses do not need to have fixed premises. They could run their business from anywhere where they can get an Internet connection. For example, an online business offering advice on personal investment and personal financial management could be located anywhere in the world and still serve a global market.

▶ Figure 8.1 Estimated growth in online retail sales, 2014–18

Source: http://www.invespcro.com



GENERAL VOCABULARY

connectivity ability of computers and other electronic equipment to connect with other computers or programs

As the importance of electronic data continues to grow, businesses will require greater network speeds and capacity in order to operate effectively. Many businesses operate in an increasingly global economy, which means that access to continuous communication systems is vital. These growing requirements have made **connectivity** a major concern for many office-based businesses. Some locations have better connections and faster electronic communication links than others.

INFLUENCE OF LEGAL CONTROLS AND TRADE BLOCS ON LOCATION

LEGAL CONTROLS

Governments, both local and national, may try to influence location decisions for several reasons.

GENERAL VOCABULARY

petrochemical any chemical substance obtained from petroleum or natural gas
consultation discussion in which people who are affected by or involved in something can give their opinions

SUBJECT VOCABULARY

assisted areas areas that are designated by a government as having economic problems and are targeted to receive support in a variety of forms
viability studies careful study of how a planned activity will work, how much it will cost, and what income it is likely to produce

- To avoid congestion where there is already enough or too much development. This will reduce the strain on existing infrastructure such as roads, schools and hospitals.
- Minimise the impact businesses might have on local communities. For example, most people would object if a business opened a noisy night club in a highly residential area or if a large **petrochemical** company established a refinery in a national park.
- To encourage manufacturers to locate where unemployment is high. This will help to improve the distribution of jobs around a country.
- Government often use financial incentives to influence business choice of location. For example, the government can offer low rates, tax breaks and low rents if they locate in areas preferred by the government (**assisted areas**).
- To attract foreign manufacturers into the country. Many countries rely on inward investment to help create employment and work for domestic suppliers.

The easiest way to control the location of business is to apply strict planning controls. This means that a business will need to gain official permission from the authorities before it can begin trading in a particular location. In some countries there is a complete ban on development in certain regions; such bans usually exist to protect the environment. Finally, the location of some large-scale business operations, such as airports, power stations and chemical processing plants, requires lengthy periods of **consultation** and **viability studies** before planning permission is finally given. This may mean many years of delay for businesses.

TRADE BLOCS

SUBJECT VOCABULARY

trade bloc group of countries situated in the same region that join together and enjoy trade free of barriers.

DID YOU KNOW?

Japanese car producers set up car plants in Europe and the USA in the 1980s and 1990s partly to avoid trade barriers designed by Europe and the USA to keep Japanese cars out of their markets.

Many countries use trade barriers to control the level of imports into their country. There are a number of reasons for this, which are discussed in Chapter 13. These trade barriers can have an impact on location decisions for businesses. To avoid trade barriers, such as tariffs (a tax on imports which makes them more expensive) a business might decide to locate inside a trade bloc. A trade bloc is a group of countries situated in the same region that join together and enjoy trade free of barriers. An example would be the African Union, a trade bloc that includes almost every African nation outside North Africa. The output of a business located inside a trade bloc will be free from trade barriers when selling its products to any member of that trade bloc. For example, in 2015 it was reported that Chinese solar panel producers were locating factories in countries such as Malaysia, Singapore and Thailand to avoid paying import duties when selling their products to America and the EU.

Finally, the government might also use regional policy to influence location. This is discussed in Chapter 12.

LARGE VS SMALL BUSINESSES

Many small businesses, such as shops, solicitors, taxi operators, accountants and gardening services, are located close to where the owners live. This is because many small businesses serve local markets and the owners are not likely to want to travel very far. However, as businesses grow they are likely to attach an increasing amount of importance to factors such as proximity to labour and materials. Large businesses have to look more aggressively to minimising the costs of land and other resources since they will be using much larger quantities. For example, they may consider locating overseas if resources are cheaper.

MULTIPLE-CHOICE QUESTIONS

▶ 1 An area of ground that was once used for urban development is called?

A Brownfield site
B Enterprise zone
C Science park
D Greenfield site

▶ 2 Which of the following factors is likely to be most important when choosing a location for a supermarket?

A Proximity to suppliers
B Low-cost land
C Exchange rate
D Energy costs

▶ 3 Which of the following businesses is likely to have the most choice when deciding upon a suitable location to base their operations?

A Coal-burning power station
B Diamond mine
C High street fashion retailer
D An online tutor service

▶ 4 Which of the following is a likely reason for a manufacturer to relocate its business?

A To provide space for expansion
B To set up an online operation
C To avoid higher interest payments
D To avoid having to market its products

CHAPTER REVIEW

GENERAL VOCABULARY

amenities something that makes a place comfortable or easy to live in



▲ Purpose built office block on a greenfield site

CASE STUDY: THE NEW DELHI INSURANCE COMPANY

The New Delhi Insurance Company sells a wide range of insurance policies, such as house, holiday, health and vehicle insurance. The company has expanded very quickly after it established an online service about five years ago. Sales of policies have increased dramatically and there is a need to set up a call centre to provide high quality customer service over the telephone. The New Delhi Insurance Company currently employs 12 000 people in offices around India. It hopes to locate the call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre. It is important to the company that the new recruits are university educated. They must also be relatively fluent in at least two different native languages.

Two sites have been identified as possible locations for the call centre:

Site A This is a brand new purpose built office block on the outskirts of the city about 3 miles (5 km) from a large residential area. Electronic communication connections are extremely efficient. It is a greenfield site and the government is keen to attract businesses to the area.

Site B This is a city centre site close to all the amenities. The office block is in a fashionable and popular area but the building itself is not modern. It will require some investment to upgrade the facilities. However, transport links to the site are excellent. The main railway station is just two minutes walk away. There is also room for expansion if the company needs more office space in the future.

ADDITIONAL INFORMATION ABOUT THE TWO SITES	SITE A	SITE B
Rent per square foot (per month)*	US$1	US$1.10
Graduate unemployment	8.60%	4.20%
Government support	US$500 000	None

Note: *The call centre will require 200 sq ft (18.5 m) per person

CHAPTER QUESTIONS

1 What is meant by the term greenfield site?

2 Determine the monthly rent for each site assuming that the company employs 2000 staff.

Governments may try to influence the location of businesses.

3 Describe two reasons for this.

4 What factors would service providers, like the New Delhi Insurance Company, have to take into account when deciding on a business location? Give two reasons in your analysis.

5 Comparing the two sites, which one might be most appropriate for the new call centre?

9 GLOBALISATION

LEARNING OBJECTIVES

- Understand the concept of globalisation
- Understand the threats and opportunities of globalisation for businesses

GETTING STARTED

In recent decades, economies all over the world have become more open. For example, since the break-up of the Soviet Union, a large number of countries, such as Estonia, Poland, Ukraine, Latvia and many others, have started to trade with other nations. This has led to more trade, more cooperation, more communication between countries and more movement of resources, such as labour and capital. Look at the example below.

CASE STUDY: THE GLOBAL MARKET FOR CARS

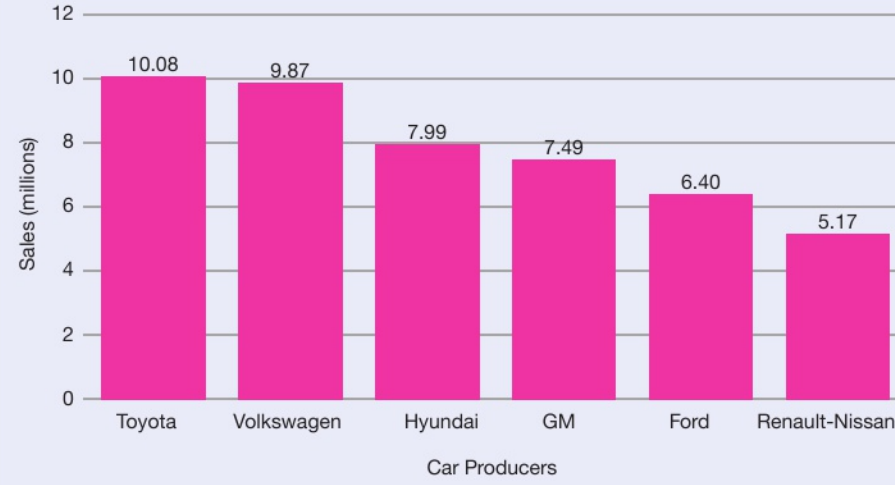
SUBJECT VOCABULARY

emerging economies rapidly growing economies (for example, Brazil) – emerging economies have huge growth potential but also pose significant risks

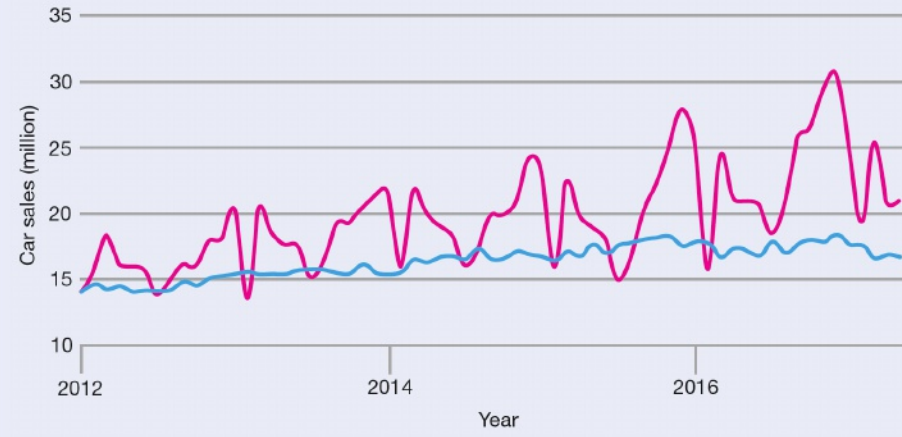
A few large firms, such as Toyota, General Motors (GM), Ford, Volkswagen, Hyundai and Nissan dominate the global car industry. Each of these firms produced over 6 million cars in 2015. Three of them – Toyota, Volkswagen and GM – produced over 9 million cars each. Many of these firms sell their cars in global markets and have factories and suppliers in many countries. For example, Ford has factories in Australia, Brazil, France, Portugal, Spain, Thailand, the USA, the UK and many other countries. These companies have a global outlook. They will sell their products anywhere and operate production plants and other facilities wherever costs can be minimised. Fifty years ago, US producers, such as GM, Ford and Chrysler, dominated the world car industry. However, from the 1980s, their market share fell as Japan made an entrance into the global market. The market shares of the US producers have declined dramatically as new and more efficient producers like Toyota have entered the market.

As shown in Figures 9.1 and 9.2, the global demand for cars is growing. In 2015, global sales reached 72.37 million. It is expected that total sales in 2016 will reach the 75 million mark. In particular, demand for cars is growing fast in emerging economies. Sales in China, for example, were around 25 million in 2015.

▶ Figure 9.1 Major global car producers by annual sales, 2015



▶ Figure 9.2 Car sales in China and the USA, 2013–15



1 What do you think is meant by a global market?
2 Comment on the pattern of global demand for cars.
3 Work out the global market share of the major car producers shown in Figure 9.1.
4 Why do you think Japanese car manufacturers have started to dominate the world market?

THE CONCEPT OF GLOBALISATION

SUBJECT VOCABULARY

globalisation growing integration of the world's economies

Many of today's markets are global. This means that some firms expect to sell their products anywhere in the world. Today, a firm could have a head office in London, borrow money from a bank in Japan, manufacture products in China, deal with customers from a call centre in India and sell goods to countries all over the world. Firms and people are behaving as though there is just one market or one economy in the whole world. This development is called **globalisation**. It is often defined as the growing integration of the world's economies. Some of the key features of globalisation are outlined below.

- Goods and services are traded freely across international borders. There are no government laws to prevent firms from selling goods in overseas markets. This means that a firm such as Coca-Cola can sell its products as easily in Qatar as in the USA.
- People are free to live and work in any country they choose. This has resulted in increasingly multicultural societies where people from many different nations live and work in the same city, for example.

SUBJECT VOCABULARY

intellectual property people's knowledge or creative ideas that have commercial value and are protectable under different forms of copyright.

- There is a high level of interdependence between nations. This means that events in one economy are likely to affect other economies. For example, the financial crisis in the USA in 2008 had an impact in many economies all over the world.
- Capital can flow freely between different countries. This means that a firm or consumer in Australia can put their savings in a bank in the USA. This also means that investors can buy shares in foreign companies and firms can buy companies that operate in other countries. For example, in 2016, Dutch multinational Randstad Holding NV, a human resource consulting firm, bought Monster Worldwide, Inc., a US employment website, for around US$429 million.
- There is a free exchange of technology and **intellectual property** across borders. This means, for example, that patents granted in the USA are recognised in other countries.

DID YOU KNOW?

It should be noted that the process of globalisation is not complete. This is because some restrictions still exist. For example, it may not always be possible to live and work in any country in the world. Many countries, such as Australia and the USA, restrict the number of immigrants entering the country. There are also some trade barriers that make it more difficult to sell goods in some countries.

REASONS FOR GLOBALISATION

There is a general agreement that modern globalisation began in the 1980s and has grown rapidly. There are a number of reasons for this trend.

SUBJECT VOCABULARY

monetary system system of money in a particular country or the world as a whole, and the way that it is controlled by governments and central banks

saturate (market) to offer so much of a product for sale that there is more than people want to buy

- Developments in technology have helped globalisation to gather pace. Modern computing allows firms to transfer complex data instantly to any part of the world. It also means that more people can work at home, or any other location that they choose. Many people do not have to be office-based to do their jobs. This makes it easier for firms to have operations all over the world. The Internet also allows consumers to gather information and buy goods online from firms located in different parts of the world.
- International transport networks have improved in recent years. In particular, the cost of flying has fallen and the number of flights and destinations flown to has increased. This means that people can travel to business meetings more easily and goods can be transported more cheaply.
- There has been a huge amount of deregulation. Privatisation has allowed more competition in many industries. Also, a lot of the barriers to trade have been removed. An increasing number of economies are more open, and more and more countries have stopped protecting domestic industries. Many countries have also simplified their **monetary system** and legal system to make international trading easier.
- An increase in tourism has also helped globalisation to thrive. Consumer tastes have changed as a result of their experiences when travelling abroad. People are more willing to try goods and services produced in other countries. For example, many people are happy to fly with a Middle Eastern Airline, drive a car made in South Korea, eat at a Bangladeshi restaurant and dress in clothes made in China.
- Many firms want to sell abroad, perhaps because domestic markets have become **saturated**. Some markets are dominated by large multinationals, which have a global outlook. They benefit considerably from having international markets and producing goods anywhere in the world where costs can be minimised.

GOVERNMENT AND GLOBALISATION

Globalisation can only flourish if governments are committed to it. For example:

- countries cannot trade if the government keeps international borders closed
- international trade will be very limited if governments put up trade barriers
- people cannot be free to live and work in overseas countries unless borders are kept open
- firms cannot develop their businesses overseas if planning permission is denied.

Governments can aid globalisation by relaxing laws and regulations that prevent, restrict or complicate trade and business.

ACTIVITY 1

CASE STUDY: GLOBALISATION AND AIRLINES

One industry that has benefited from globalisation is the airline industry. The numbers of people using air transport have grown significantly. Figure 9.3 shows the growth in passengers carried between 1980 and 2015. Air travel has risen for a number of reasons. These include an increase in tourism, more business travel and the arrival of budget airlines around the world. For example, in India, airlines such as Indigo, GoAir, JetLite and Simplify Deccan, have emerged and all offer cheap air travel in the country.



▶ Figure 9.3 Global air transport – passengers carried, 1980–2015

Source: http://data.worldbank.org

1. Work out the percentage increase in passengers carried between 1980 and 2015.
2. Describe two features of globalisation that have supported the growth of the airline industry.
3. What are the reasons for the development of globalisation? Provide two reasons in your analysis.
4. Produce an illustrated poster that shows what is meant by globalisation.

OPPORTUNITIES OF GLOBALISATION FOR BUSINESSES

The common view is that globalisation has a range of benefits. In general, globalisation results in more free trade, higher levels of employment, increased incomes and improved living standards for huge numbers of people. However, there are some specific opportunities opened up by globalisation that many businesses may be able to exploit.

ACCESS TO LARGER MARKETS

One of the most important benefits to business of globalisation is access to huge markets. Clearly global markets are considerably larger than domestic markets. If a business has access to several billion customers rather than, say, 40 million, this provides huge opportunities to increase sales. Therefore, access to global markets provides growth opportunities for businesses. This should result in higher sales revenue and an increase profits.

LOWER COSTS

If businesses are able to grow by selling more output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow. Economies of scale are discussed in detail in Chapter 40. With lower costs businesses will become more competitive. This might help them to win a larger share of the market, increase sales and raise profit margins.

ACCESS TO LABOUR

One of the benefits of globalisation is the free movement of labour. This means that people are free to move around the world and find employment in other countries (subject to border controls that still exist in some countries). As a result businesses will have access to a larger pool of labour. This is important for a number of reasons.

- If a business is growing fast there may be a shortage of domestic labour. Globalisation means that workers from overseas can help to boost the labour supply. It also means that businesses have more people to choose from when recruiting. As a result they may be able to recruit better quality workers, which should help to improve productivity. A shortage of labour can restrict the development of a business.
- A rising labour supply might help to prevent wages from rising. It is often said that the arrival of larger numbers of foreign workers hold wages down – particularly in markets where unskilled labour is needed. Lower wages will help businesses to lower their costs.
- Globalisation means that businesses can recruit highly skilled staff from anywhere in the world. In some countries there are skills gaps, which means that there is a shortage of workers with specific skills. For example, in the USA in 2014 it was reported that there was a shortage of computer systems analysts, web developers, line managers in retailing, software engineers, market research analysts, human resource and training specialists, mechanical engineers and many more areas of expertise. Again, if a business cannot recruit people with the skills it needs, business development will be slowed.

DID YOU KNOW?

Some businesses take the opportunity to locate their operations in countries where there is less regulation. This means that they may be able to avoid strict employment regulations and environmental legislation, for example. Developing countries, such as Bangladesh, Vietnam and many African states, are likely to have less regulation targeted at businesses. Globalisation has helped to increase access to some of these countries. However, many would argue that such a practice is controversial since it might result in exploitation.

REDUCED TAXATION

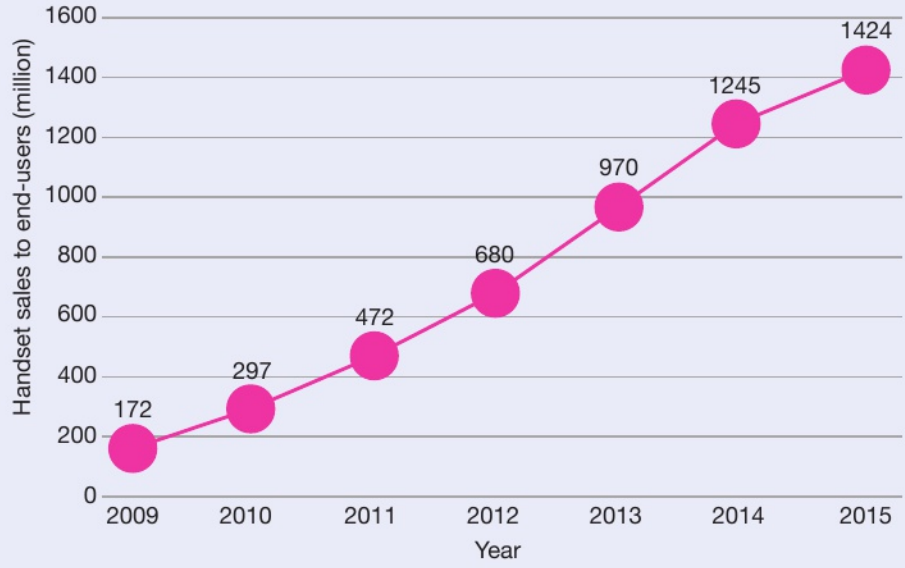
One benefit of globalisation is that businesses can choose where to locate their base. Consequently, they can reduce the amount of tax they pay by locating their head office in a country where business taxes are low. Ireland has proved a popular destination for businesses in recent years since its rate

of corporation tax is just 12.5 per cent (on trading income). This is well below other rates in the world, which are generally higher than 20 per cent.

ACTIVITY 2

CASE STUDY: MOBILE PHONES

Global sales of smartphones have grown sharply in recent years. The growth in sales of handsets between 2009 and 2015 is shown in Figure 9.4. The global market is dominated by three large multinational corporations: Samsung, Apple and Huawei with shares of 21.4 per cent, 13.9 per cent and 8.7 per cent, respectively. However, in recent years, market leaders Samsung and Apple have lost market share to emerging competitors, such as those from China.



▶ Figure 9.4 Global mobile phone sales, 2009–15

1. Work out the number of mobile phones sold by Samsung in 2015, assuming it had a market share of 21.4 per cent.
2. What opportunities might globalisation provide for mobile phone producers such as Samsung, Apple and Huawei? Give two opportunities in your analysis.

THREATS OF GLOBALISATION TO BUSINESSES

Despite the benefits and opportunities that increasing globalisation brings to a business, there are a number of threats that they might have to deal with. Some examples are outlined below.

COMPETITION

Businesses will face increased competition as a result of globalisation. As more companies around the world try to sell their goods and services in an increasing number of countries, some businesses will have their survival threatened. Often, the companies that are able to exploit globalisation are strong, well-resourced and influential. They can use their resources, by investing heavily in marketing, for example, to move into new markets and put pressure on existing firms in the industry. In some cases, whole industries have been 'wiped-out' by overseas competitors. For example, the growth in Chinese

SUBJECT VOCABULARY

predator business that tries to use another's weakness to get advantages

hostile takeover takeover that the company being taken over does not want or agree to

bid offer to pay a particular price for something (for example, a business)

manufacturing has resulted in the decline of manufacturing in a wide range of countries in the West. As the pace of globalisation accelerates, the prospect of increased competition is the most worrying threat for most businesses, both large and small.

INTERNATIONAL TAKEOVERS

With the free movement of capital that globalisation brings, it is possible for a business in one country to take over a business in another. Consequently, companies may feel more vulnerable to a takeover since there are a larger number of **predator** businesses. Some experience a **hostile takeover**, when a company is taken over against its will. For example, in 2016 the Paris-based company Sanofi made a hostile **bid** for US biotech firm Medivation.

INCREASED RISK OF EXTERNAL SHOCKS

The interdependence that results from globalisation could pose a threat to businesses. This means that events in one economy are likely to affect other economies. For example, the UK leaving the EU is likely to have an impact on other countries in the future. Immediately after the UK voted to leave the EU, in June 2016, stock markets around the world fell quite sharply at first. In the future, when the UK finally leaves the EU, some businesses may feel a negative impact. For example, German car manufacturers may face trade barriers when trying to sell their products in UK markets and vice versa.

LARGE VS SMALL BUSINESSES

It might be argued that large businesses are likely to gain the most from globalisation since they have the resources to exploit global markets. And it is true to say that large multinationals profit considerably from making and selling products all over the world. However, small businesses are also likely to benefit. For example, small online businesses can sell their products globally without any significant increase in cost. Also, many small producers supply larger organisations, so they may benefit from the increase in global trade. In contrast, some small businesses might feel more threatened than larger ones from the threats and competition resulting from globalisation. They are likely to be more vulnerable.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which is a reason for increasing globalisation?

- **A** Lower exchange rates
- **B** Decreased regulation, such as privatisation
- **C** An increase in environmental legislation
- **D** An increase in the world's population

▶ 2 Which of the following is a feature of globalisation?

- **A** The free flow of goods and services across international borders
- **B** Rising unemployment in the EU
- **C** Higher rates of inflation in Africa
- **D** Greater standardisation of goods and services

▶ 3 Which of the following is an opportunity for businesses that might result from globalisation?

- **A** Lower costs resulting from economies of scale
- **B** Protection from international takeovers
- **C** Lower levels of inflation
- **D** An improvement in product quality

▶ 4 Which of the following might be a threat to businesses that could result from globalisation?

- **A** Lower interest rates
- **B** Increased competition
- **C** More health and safety legislation
- **D** A lack of diversification opportunities

CHAPTER REVIEW

GENERAL VOCABULARY

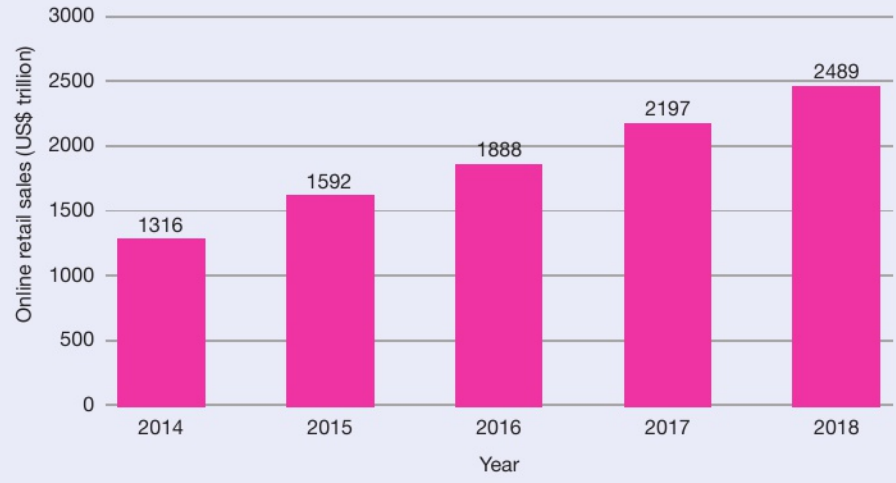
auction site online website where products are sold to the person who offers the most money for them

CASE STUDY: THE GLOBAL ONLINE RETAIL MARKET

The global market for online retail sales is estimated to grow significantly over the next few years. Figure 9.5 shows the estimated sales levels between 2014 and 2018. A wide range of goods and services can be purchased online including cars, clothes, books, computers, insurance, web development and financial services.

As a result of increasing globalisation, many online retailers have extended their services overseas. For example, ASOS, the UK online clothes retailer for 20 to 30 year olds, has launched new sites for Russia and China; eBay, the online **auction site** has set up operations in Brazil; and HP and Lenovo, which are online computer retailers, have both moved into the Indian market. Improvements in online payment systems, shipping, local transport providers, warehousing and the removal of trade barriers have all contributed to the growth in global online sales.

It is also estimated that around 40 per cent of the global online retail market will in the future be dominated by just three huge organisations – Amazon, eBay and Alibaba. This might suggest that smaller operators will find it difficult to survive in the market.



▶ Figure 9.5 Estimated global online retail sales, 2014-18

CHAPTER QUESTIONS

1. What is meant by the term globalisation?
2. Work out the percentage increase in estimated online retail sales between 2014 and 2018.
3. Suggest two ways in which a government can help to support the process of globalisation.
4. Describe how interdependence might affect online retailers such as Amazon, eBay and Alibaba in the future.
5. Assess the opportunities that globalisation might bring to online retailers in general.

10 THE IMPORTANCE AND GROWTH OF MULTINATIONAL COMPANIES

LEARNING OBJECTIVES

- Understand the importance and growth of multinationals
- Understand the benefits to a business of becoming a multinational
- Understand the benefits to a country/economy where a multinational is located
- Understand the possible drawbacks to a country/economy where a multinational is located

GETTING STARTED

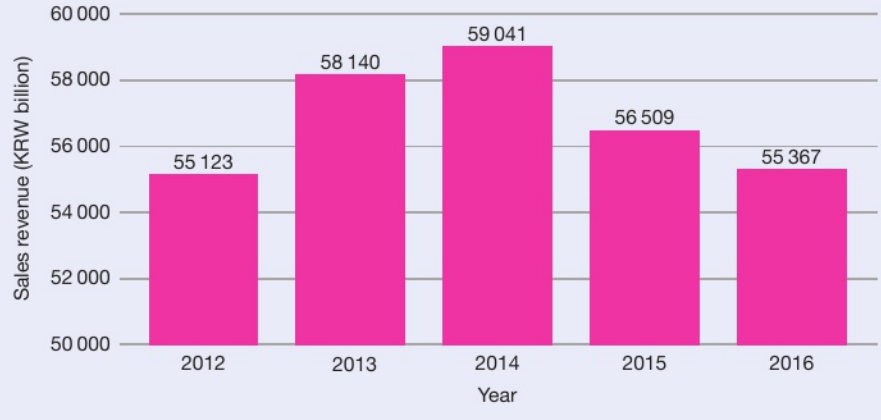
In the last 40 years or so, some businesses have developed large operations in many different countries. They serve global markets and provide jobs and other benefits for the countries in which they locate. They are called multinationals. Look at the example below.

CASE STUDY: LG ELECTRONICS

One of the largest business corporations in South Korea is LG Electronics. In 2016, it had 125 global operations and employed 77 000 people. LG's product range is grouped into four divisions.

1. **Home entertainment** – including televisions, sound systems and gaming monitors.
2. **Mobile communications** – including smartphones, tablets and wearable technology.
3. **Vehicle components** – including infotainment systems, electronic safety systems and other electronic components.
4. **Home appliances and air solutions** – including washing machines, microwave cookers, vacuum cleaners, air conditioning units and water purifiers.

▶ Figure 10.1 LG Sales revenue, 2012–16



LG enjoys huge global revenues. Figure 10.1 shows the revenues generated by the company between 2012 and 2015.



▶ LG's product range is grouped into four divisions covering a large range of goods

1 What evidence is there to suggest that LG is a multinational company?
2 Why are multinationals important for the global economy?
3 Suggest one possible reason why a company might become a multinational.
4 In groups, draw up a list of ten businesses that you think might be multinationals. Then do some online research to see if you are right.

DID YOU KNOW?

In 2016, it was reported by IDA Ireland that in Ireland about one in five private sector workers were employed by multinationals in the private sector. This amounts to 318 000 people in total.

THE IMPORTANCE AND GROWTH OF MULTINATIONALS

Multinationals contribute about 10 per cent to world GDP and about 66 per cent to global exports. They have a significant and increasing role in the world economy.

DID YOU KNOW?

The importance of multinationals is growing in developing countries. It was reported that the growth rate of emerging multinationals from developing countries was three times that of those in developed countries in the five years to the end of 2014. Rising demand from middle-class consumers, whose incomes have risen, is the main driver of this growth.

The number of multinationals in the world has increased from about 7000 in 1970 to about 78 000 in 2005. Between them they employ over 70 million workers, that is, around 3 per cent of the global workforce. The role played by multinationals in the global economy is likely to remain important well into the future.

Table 10.1 provides a summary of information about the world's five largest multinationals at the end of 2015. Interestingly, four from the top five operate in the oil and gas industry.

COMPANY	SECTOR	REVENUE (US$ MILLION)	BASE
1 Walmart	Retailing	482 130	USA
2 State Grid	Oil and Gas	329 601	China
3 China National Petroleum	Oil and Gas	299 271	China
4 Sinopec Group	Oil and Gas	294 344	China
5 Royal Dutch Shell	Oil and Gas	272 156	UK/ Netherlands

▶ Table 10.1 Five largest multinational companies, 2015

HOW HAVE MULTINATIONALS DEVELOPED?

SUBJECT VOCABULARY

commodities products that are bought and sold (in business often refers to things like oil, gold, iron ore, rice, wheat and meat)

patents legal documents giving a person or company the right to make or sell a new invention, product, or method of doing something and stating that no other person or company is allowed to do this

ventures new business activity that involves taking risks

GENERAL VOCABULARY

superiority quality of being better, more skilful, more powerful than other people or things

ECONOMIES OF SCALE

Many companies have developed into multinationals because larger companies enjoy lower costs. This is because they can exploit economies of scale (see Chapter 40). Businesses that sell to global markets will produce more than those who just sell to domestic markets. Therefore their costs will be lower. Multinationals are powerful and can put pressure on suppliers to lower their prices. Also, multinationals have access to cheap global resources, such as labour, capital and commodities.

MARKETING

Some firms have become multinationals by relying on effective marketing. Firms such as Starbucks and McDonald's are good examples. These are low-tech firms that have developed a successful brand at home and then exploited it globally. Both companies face fierce competition in their markets. However, they have protected their brand with patents and use heavy advertising and innovative marketing to attract customers globally.

TECHNICAL AND FINANCIAL SUPERIORITY

Most multinationals have developed into large businesses over a period of time, enjoying superiority. They have developed advanced technologies and built a huge bank of knowledge. They can also afford to invest heavily in research and development. They are experienced and can afford to employ the most talented people available. They also have the resources to take risks and diversify. As a result, they can explore business ventures that small firms could never dream of.

BENEFITS TO A BUSINESS OF BECOMING A MULTINATIONAL

Owing to their size, multinational companies generally enjoy higher revenues and lower costs. Some of the specific benefits of becoming a multinational are outlined below.

LARGER CUSTOMER BASE

Multinationals will have access to a much wider market than companies that focus entirely on domestic markets. Multinationals can boost their sales revenues by selling to global markets. This will help to increase profits and win market share from competitors.

LOWER COSTS

Since multinationals are large companies they can exploit economies of scale and enjoy lower costs. They can buy resources at lower prices and borrow money at cheaper rates, for example. Many will also reduce transport costs. This is because they are likely to set up factories in new countries so that the distance from the production site to the market is reduced. This is particularly important with difficult to transport products like motor cars. Reducing costs will help them gain a competitive edge and put pressure on their rivals.

HIGHER PROFILE

If a business is able to develop as a multinational it will enjoy a higher profile in the market. Large companies with strong brand names are recognisable and may become household names. This helps to encourage existing customers and attract new ones. For example, multinationals like Google, McDonald's, Microsoft, Apple and Coca-Cola are known to nearly everyone in the world.

AVOIDING TRADE BARRIERS

One of the benefits of becoming a multinational is that trade barriers can be avoided. Since multinationals are prepared to set up operations in other countries, they can bypass trade barriers by establishing operations in those countries that have barriers in place. Once inside a foreign country, a multinational will be subject to the same trading rules and regulations as domestic producers. One of the reasons why Japanese car producers, such as Honda, Nissan and Toyota, located factories in the UK was to avoid EU trade barriers.

LOWER TAXES

Multinationals can reduce the amount of tax they pay on their profits by basing their head offices in countries where taxes are lower. Some of the lowest rates of corporation tax are to be found in Ireland, Cyprus, Lichtenstein and Gibraltar where rates are all 12.5 per cent, or lower. By minimising taxes, higher dividends can be paid to shareholders.

ACTIVITY 1

CASE STUDY: NIKE

NIKE, Inc. is a well-known multinational and a strong brand. It is involved in the design, development, manufacturing and global marketing of footwear, clothing, equipment, accessories and services. It is one of the world's largest producers of sports clothing and equipment. In 2016, the company employed 70 700 people in hundreds of factories in over 40 countries around the world. In 2015, NIKE, Inc. made a profit of US$785 million. This was an increase of 20 per cent on the previous year. Its revenue was up 4 per cent to US$7700 million. It was reported in 2016 that NIKE, Inc. spent US$804 million on advertising. This was a 10 per cent increase on the previous year.

1. What are the benefits to NIKE, Inc. of operating so many factories around the world?
2. How important is a strong brand name to a multinational like Nike?
3. How does Nike remain a high profile company?

BENEFITS OF MULTINATIONALS TO A COUNTRY/ECONOMY

SUBJECT VOCABULARY

currency reserves money in foreign currency held by a country and used to support its own currency and to pay for imports and foreign debts

human capital people and their skills

enterprise the activity of starting and running businesses

INCREASE IN INCOME AND EMPLOYMENT

When multinationals set up operations overseas, income in those countries rises. Multinationals create new jobs in developing countries. In 2010, there were more than 80 000 multinationals worldwide employing over 80 million people.

Local suppliers are also likely to get work when a multinational arrives. The extra output and employment generated by multinationals will increase economic growth and raise living standards for people in these countries.

INCREASE IN TAX REVENUE

The profits made by multinationals are taxed by the host nation. This increases tax revenue for the government in that country and this can be used to improve government services. Although sometimes tax revenue may be lost by governments if multinationals locate their base in 'tax havens'.

INCREASE IN EXPORTS

The output produced by a multinational in a particular country is recorded as output for that country. Therefore, if this output is sold out of the host country, it is counted as an export. This helps countries to increase their foreign currency reserves.

TRANSFER OF TECHNOLOGY

Multinationals often provide foreign suppliers with technical help, training and other information. They may also help local suppliers to purchase resources and modernise production facilities.

IMPROVEMENT IN THE QUALITY OF HUMAN CAPITAL

Multinationals provide training and work experience for their workers. In less developed countries such training may otherwise be unavailable. Furthermore, governments in less developed countries will often spend more on education to improve the countries human capital to attract multinationals. This happened in India where the government invested heavily in IT education and training.

ENTERPRISE DEVELOPMENT

The arrival of multinationals has encouraged more people to set up businesses in less developed countries. Multinationals may have provided the skills and motivation needed for enterprise. For example, the arrival of a new multinational may encourage local people and companies to supply services such as transport, accommodation, maintenance, cleaning and leisure activities.

ACTIVITY 2

CASE STUDY: MARS

Mars, the giant US confectionery multinational, is planning to open its first factory in India. Mars wants to produce some of its high profile brands, such as Snickers and Galaxy, in a new factory in Pune the construction of which will cost of US$160 million. The investment is expected to create 200 new jobs. However, a further 1000 jobs are expected to be created indirectly. The factory will boost the global production capacity of Mars and help to meet the growing demand for chocolate in India.

According to M.V. Natarajan, general manager, Mars International India, 'The chocolate industry in India is growing at nearly 20 percent every year and we see this as a huge opportunity to expand our chocolate portfolio in the country in the coming years.'



▶ According to industry experts, annual growth in the chocolate industry in India is at 20 per cent

1 How might: **(a)** the local Pune community and **(b)** the Indian government benefit from Mars' investment in Pune?

POSSIBLE DRAWBACKS OF MULTINATIONALS TO A COUNTRY/ ECONOMY

GENERAL VOCABULARY

environmentalists those concerned with protecting the environment
extraction industries industry where materials, such as oil and coal, are obtained from under the ground in drilling, mining and quarrying

SUBJECT VOCABULARY

exploitation situation in which you treat someone unfairly by asking them to do things for you, but give them very little in return

ENVIRONMENTAL DAMAGE

Many environmentalists are suspicious of multinationals because they may cause environmental damage. One reason is because multinationals are heavily involved in the extraction industries, such as coal, oil and gold mining. Mining is often destructive.

EXPLOITATION OF LESS DEVELOPED COUNTRIES

It is sometimes argued that multinationals bring exploitation to developing nations.

- Some multinationals may encourage developing countries to rely on producing primary products. This is risky because the prices of primary products can change sharply, which causes variations in income. Relying on one industry also makes developing nations vulnerable. It also limits their own independent development if they concentrate on meeting the needs of multinationals at the expense of developing their own secondary and tertiary industries.
- Multinationals often pay low wages. They may also employ child labour and the working conditions in their factories are often very poor.
- Taxes paid to the host nation are often minimal.
- As little as possible is put back into the country because this would reduce the amount of profit made by the multinational.

However, although such exploitation does occur, many multinationals have good records when developing business interests in less developed countries.

SUBJECT VOCABULARY

repatriation (of profit) where a multinational returns the profits from an overseas venture to the country where it is based, typically from a developing country to a developed country (not often the other way around)

livelihood way you earn money in order to live

REPATRIATION OF PROFITS

The profits made by multinationals abroad are often repatriated. This means that profits are returned to the country where the multinational is based and has its headquarters. As a result, the host country loses out. It can be argued that multinationals bring more benefits to developed countries than to their less developed host countries.

LACK OF ACCOUNTABILITY

Some argue that because multinationals are so large and powerful they lack accountability. This means they may be able to evade the law, especially in countries where the government is weak or corrupt. Also, multinationals may be keener to operate where regulation is insufficient or non-existent. However, pressure groups may monitor multinationals. This helps improve accountability.

GENERAL VOCABULARY

evade to avoid paying money that you ought to pay, for example, tax

corrupt using your power in a dishonest or illegal way in order to get an advantage for yourself

pressure group group or organisation that tries to influence the opinions of ordinary people and persuade the government to do something

monitor to carefully watch and check a situation in order to see how it changes over a period of time

DID YOU KNOW?

In one high profile example of the impact of multinationals, oil spills and waste dumping have seriously damaged agricultural land in the Niger Delta in Nigeria. According to Amnesty International, this has taken away the livelihood of many locals in the area.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a benefit to a business of becoming multinational?

A The ability to offer a more personal service
B Diseconomies of scale
C Improved cash flow
D Access to wider markets

▶ 2 Which of the following is a benefit to a nation that hosts a multinational?

A Higher tax revenues
B Higher interest rates
C Lower levels of government spending
D Less competition

▶ 3 Which of the following is a possible disadvantage to a nation that hosts a multinational?

A The transfer of technical knowledge
B Higher inflation
C Less competition
D The possible exploitation of workers

▶ 4 Which of the following is a means by which some multinationals may avoid accountability?

A Ignore the wishes of their shareholders
B Attempt to evade or manipulate the law
C Spend less on marketing
D Reduce their prices to exploit their power

CHAPTER REVIEW

CASE STUDY: MCDONALD'S

McDonald's is a very well-known global brand. It is the world's largest restaurant chain selling a range of fast food products, such as hamburgers, hotdogs, chicken nuggets, cheeseburgers, French fries, soft drinks, coffee and milkshakes. The box below gives some key facts about the chain.



▶ McDonald's is one of the world's best-known brands

KEY FACTS ABOUT MCDONALD'S

- It has around 34 000 outlets.
- It employs around 1.8 million people.
- It has outlets in over 100 countries; even in India, where most people do not eat beef or pork, there are about 180 restaurants.
- It is estimated that each day over 60 million people worldwide purchase something from McDonald's.
- They sell more than 75 hamburgers per second.
- McDonald's has employed around one in eight workers in the USA.
- A significant proportion of McDonald's outlets (70 per cent in the UK) are franchises.

Although McDonald's already has a huge global presence, it still wants to keep growing. In 2016, it was reported that the company planned to open 1250 more outlets in China. This would make China the second largest market after the USA. There were also plans to open 250 more restaurants in Hong Kong and South Korea. McDonald's is looking to franchise most of its Asian stores and hopes that 95 per cent of its outlets will operate as franchises in the future.

Although McDonald's helps to create employment as it expands its global operations, the giant multinational has been the target of criticism over the years. Recently, it has been attacked for paying its workers low wages.

GENERAL VOCABULARY

solidarity loyalty and general agreement between all the people in a group, or between different groups, because they all have a shared aim

In 2014, it was reported that thousands of fast-food workers around the world stopped work or held protests against McDonald's and other fast-food suppliers. Employee action has been ongoing since 2012 in the USA where workers are demanding US$15 per hour pay rates and the right to join a trade union. Indeed, around 200 workers went on strike in New York. Also, in Brazil, McDonald's has encountered trade union protests because of wage theft, poverty-level pay and the poor treatment of pregnant workers. Protests against McDonald's took place in Japan, South Korea and Brazil in 2014. South Korean labour leader, Cheong Ok-soon said: 'Everywhere you go in the world, fast-food workers are suffering with low wages, long hours and unstable employment. They can't live a normal life under the working conditions they face now, so they have no option but to fight in **solidarity**.'

However, McDonald's claims that it always pays above the legal minimum wage. For example, a report in the US in 2015 said that from 1 July the starting wage will be $1 above the local legal minimum. McDonald's also said that all employees up to restaurant managers will receive a pay rise. In addition, the company claimed that there would be other perks for employees. For example, McDonald's would provide financial help to employees who attend classes to obtain a high-school diploma and assist with college credits and other tuition. Finally, the company said it would provide free language classes for non-English speaking employees.

In 2015, McDonald's reported a profit of US$1310 million, or US$1.40 a share, up from US$1070 million, or US$1.09 a share the previous year. Sales revenue was US$6620 million.

CHAPTER QUESTIONS

1 Suggest two features of a multinational. Use this case study as an example.

McDonald's has become a multinational through effective marketing.

2 What does this mean?

3 What are the benefits to McDonald's of operating as a multinational? Give two benefits in your analysis.

4 Assess the benefits to a country/economy when McDonald's locates outlets in that country.

11 INTERNATIONAL TRADE AND EXCHANGE RATES

LEARNING OBJECTIVES

- Understand the nature of international trade (exports and imports)
- Understand the purpose of exchange rates and exchange rate calculation
- Understand the impact of changes in the exchange rate on importers and exporters
- Understand the impact of changes in the exchange rate on international competitiveness

GETTING STARTED

Businesses operate in an international environment. For example, many businesses sell their products overseas. They may also buy resources from abroad. Trade between nations has grown a lot in recent years. One reason for this is because many countries have become more open. There has also been a growth in the size and number of multinationals. Look at the example below.

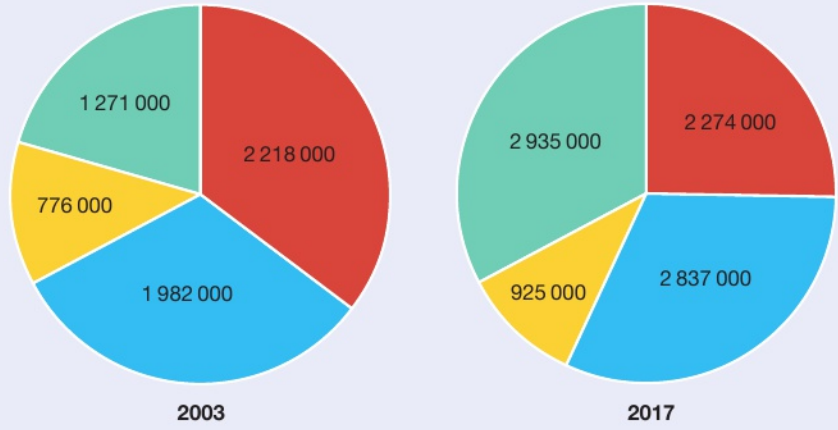


▲ Toyota is one of the world's largest multinationals

CASE STUDY: TOYOTA

Toyota, the Japanese car manufacturer, is one of the world's largest multinationals. It is one of Japan's major exporters but also has factories and other operations overseas. Toyota employs around 340 000 people in assembly plants and component manufacturing – in over 50 different worldwide locations.

The giant corporation has grown steadily since it was set up in 1937. In 2017, Toyota's global sales of cars were 8.97 million and its revenue was 1 994 372 million yen. Figure 11.1 shows the number of cars sold by Toyota in different regions around the world in 2003 and 2017.



▶ Figure 11.1 Toyota sales (units) by region, 2003 and 2017, thousands

Note: many of these sales are from factories based outside Japan

'Others' includes Asia, Central and South America, Oceania, Africa, Middle East. Since 2013 Toyota have separated these geographies out into individual regions in their financial reports.

Look at Figure 11.1.

1 What are the key changes in Toyota's regional sales between 2003 and 2017?
2 Why is international trade important to Toyota?
3 How might international trade help a business like Toyota to grow?
4 In groups discuss how international trade might affect you. For example, think about the products you buy and where they come from.

INTERNATIONAL TRADE

International trade benefits the world. It creates opportunities for business growth, increases competition and provides more consumer choice. Specifically international trade:

- allows countries to obtain goods that cannot be produced domestically
- allows countries to obtain goods that can be bought more cheaply from overseas
- helps to improve consumer choice
- provides opportunities for countries to sell off **surplus** commodities.

SUBJECT VOCABULARY

surplus amount of something that is more than what is needed or used

VISIBLE AND INVISIBLE TRADE

Goods and services sold overseas are called **exports**. Those bought from other countries are called **imports**. A distinction is made between **visible trade** and **invisible trade**.

SUBJECT VOCABULARY

exports goods and services sold overseas

imports goods and services bought from overseas

visible trade trade in physical goods

invisible trade trade in services

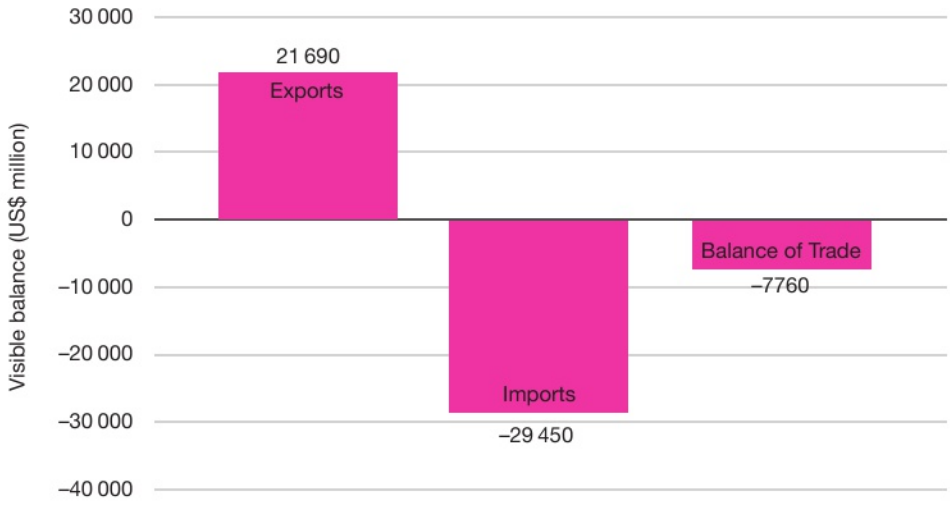
balance of trade (or visible balance) difference between visible exports and visible imports

Visible trade involves trade in physical goods. For example, India sells textiles, leather goods, precious stones and jewellery overseas. These are visible exports for India. India buys oil, fertiliser and chemicals from overseas. These are examples of visible imports for India. The difference between total visible exports and imports is called the **visible balance** or the **balance of trade**. Figure 11.2 shows India's visible trade to the year July 2016. The balance of trade is:

– US$7760 million (US$21 690 million – US$29 450 million)

This shows that India has imported more goods than it has exported.

Invisible trade involves trade in services. For example, the money India gets from tourists is recorded as an invisible export. In contrast, India pays foreign carriers to transport goods to other countries. Payments for this service are recorded as invisible imports.



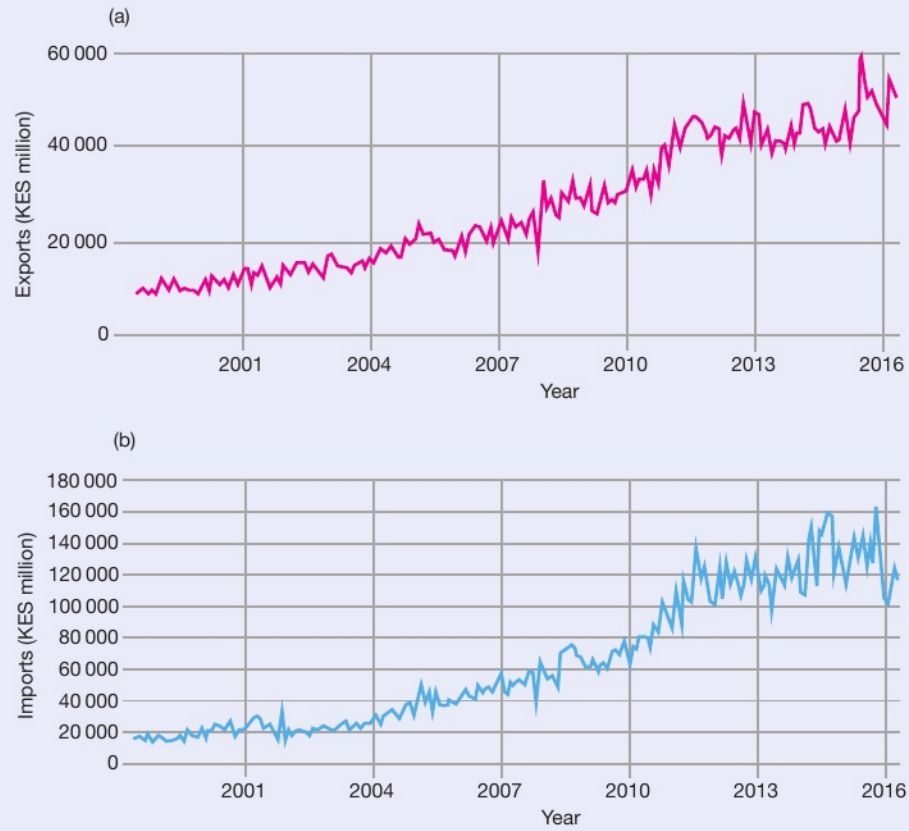
▶ Figure 11.2 India's visible balance (year to July 2016)

Source: http://www.tradingeconomics.com

ACTIVITY 1

CASE STUDY: IMPORTS AND EXPORTS IN KENYA

In common with many African states, Kenya relies heavily on the sale of primary goods for its exports. Its most important exports are agricultural products and tea. However, goods such coffee, tobacco, iron and steel products, textiles, petroleum products and cement from Kenya are also sold abroad. Some of Kenya's customers for its exports are the Netherlands, Pakistan, Tanzania, Uganda, the UK and the USA. In contrast, Kenya imports products like machinery and transportation equipment, motor vehicles, iron and steel, and plastics. Kenya's international suppliers are located mainly in China, Japan, Saudi Arabia, South Africa, the UAE and the USA. The pattern of Kenya's trade between 1998 and 2016 is shown in Figure 11.3.



▶ 11.3 Kenya's (a) exports and (b) imports, 1998–2016

Note: KES 1 million = US$9600 (February 2017).

Source: http://www.tradingeconomics.com

1 Using examples from the case, distinguish between exports and imports.
2 Describe the pattern of international trade in Kenya over the period shown.
3 Why do you think Kenya relies heavily on primary goods for its exports?

WHAT IS AN EXCHANGE RATE?

SUBJECT VOCABULARY

transactions business deals or actions, such as buying or selling something

exchange rate value of one currency in terms of another

Most countries in the world do not use the same currency. For example, China has the yuan, India has the rupee, America uses the US dollar and Britain has the pound sterling. When countries use different currencies, **transactions** between people and firms in different countries are affected. For example, an Indian visitor to the USA cannot use rupees when making payments. The Indian visitor would have to buy some US dollars.

How many dollars could the visitor get for 20 000 rupees? This depends on the **exchange rate** between the rupee and the dollar. If it were US$1 = Rs50 the visitor would get US$400 (Rs20 000 ÷ Rs50). The exchange rate shows the price of dollars in terms of rupees. When businesses buy goods from other countries, payments are often made in another currency. Some more examples are given in the box.

Example 1 How much will it cost a French firm to buy goods from a British firm that cost £400 000 if £1 = €1.20? The cost to the French firm in euros is given by:

£400 000 × 1.2 = €480 000

Example 2 How many US dollars will be needed by an Italian firm buying €55 000 of goods from an American firm if €1 = US$1.10? The cost to the Italian firm in US dollars is given by:

€55 000 × 1.10 = US$60 500

Example 3 How much will it cost a UAE firm in dirhams to buy US$300 000 of goods from a US firm if AED 1 = US$0.30? The cost in dirhams is given by:

US$300 000 ÷ 0.3 = AED 1 000 000



▲ Agricultural machinery

ACTIVITY 2

CASE STUDY: RONNIE MACKAY

Glasgow-based Ronnie Mackay Plc manufactures machines for the agricultural industry. About 40 per cent of its output is sold to American farmers. However, Ronnie Mackay buys materials and components from Germany and Spain. In July 2016, there were three important international transactions:

- a US firm bought machines from Ronnie Mackay costing £3 600 000
- Ronnie Mackay bought components from a German firm for €2 500 000
- Ronnie Mackay bought materials from a Spanish firm for a sterling price of £200 000.

1. Work out the price in US dollars of the machines sold by Ronnie Mackay to the US firm (assume £1 = US$1.50).
2. Work out the amount paid in pounds by Ronnie Mackay for the €2.5 million components bought from Germany (assume £1 = €1.10).
3. Work out the amount in euros received by the Spanish supplier for the £200 000 of materials sold to Ronnie Mackay (assume £1 = €1.10).

THE IMPACT OF CHANGES IN THE EXCHANGE RATE ON IMPORTERS AND EXPORTERS

FALL IN THE EXCHANGE RATE

Changes in the exchange rate can have an impact on the demand for exports and imports. This is because when the exchange rate changes, the prices of exports and imports also change. Look at what happens when the exchange rate falls from £1 = US$1.50 to £1 = US$1.20.

- **Impact on exports**: If a UK firm *sells* goods worth £2 million to a US customer, the dollar price at the original exchange rate is US$3 million (£2 million × US$1.50). When the exchange rate falls, the dollar price of the goods also falls to US$2.4 million (£2 million × US$1.20). This means that demand for UK exports is likely to rise because they are now cheaper than they were before the change in exchange rate.
- **Impact on imports**: If another UK firm *buys* goods worth US$600 000 from a US supplier, the price in pounds at the original exchange rate is £400 000 (US$600 000 ÷ US$1.50). When the exchange rate falls, the sterling price to the importer rises to £500 000 (US$600 000 ÷ US$1.20). This means that demand for imports is likely to fall because they are dearer.

When the exchange rate falls there is said to be a depreciation in the exchange rate.

RISE IN THE EXCHANGE RATE

A rise will have the opposite effect to a fall on the demand for exports and imports. Look at what happens when the exchange rate rises from £1 = US$1.50 to £1 = US$2.00.

- **Impact on exports**: If a UK firm sells goods worth £2 million to a US customer, the dollar price at the original exchange rate is US$3 million (£2 million × US$1.50). When the exchange rises, the dollar price of the goods also rises to US$4 million (£2 million × US$2.00). This means that demand for UK exports is likely to fall because they are now dearer.
- **Impact on imports**: If another UK firm *buys* goods worth US$600 000 from a US supplier, the price in pounds at the original exchange rate is £400 000 (US$600 000 ÷ US$1.50). When the exchange rate rises, the sterling price to the importer falls to £300 000 (US$600 000 ÷ US$2.00). This means that demand for imports is likely to rise because they are cheaper.

When the exchange rate rises there is said to be an appreciation in the exchange rate. The effects of changes in the exchange rate on the demand for exports and imports are summarised in Table 11.1.

▶ Table 11.1 Effects of exchange rate on demand for exports and imports

EXCHANGE RATE	PRICE OF EXPORTS	DEMAND FOR EXPORTS	PRICE OF IMPORTS	DEMAND FOR IMPORTS
Falls	Falls	Rises	Rises	Falls
Rises	Rises	Falls	Falls	Rises

INTERNATIONAL COMPETITIVENESS AND EXCHANGE RATES

KEY POINT

It costs money to switch from one currency to another. There is a usually a commission charge of around 2 per cent. This represents a cost to importers and therefore reduces profit.

SUBJECT VOCABULARY

commission extra amount of money that is paid to a person or organisation according to the value of the goods they have sold or the services they have provided

GENERAL VOCABULARY

uncertainty when you feel doubt about what will happen

The examples above show what happens to the prices of imports and exports when exchange rates rise and fall. Sometimes these changes will benefit a business, other times they will not. For example, if the value of the rupee falls, Indian exporters will benefit because the price of exports falls and demand should increase. However, Indian importers will lose out because their purchases will be more expensive.

Sustained changes in the exchange rate can have an impact on the international competitiveness of a country. If the exchange falls sharply for a long period of time, this means that all exporters in the country can sell their goods more cheaply abroad. This can have a positive impact on the economy of that country. Higher export sales means more employment, income and tax revenues for that country. For example, since 2010, the value of the South African rand has fallen very sharply against most other currencies in the world. One of the results of this was an increase in the number of tourists visiting the country. Many EU tourists, for example, saw the exchange rate between the euro and the rand double. It went from €1.00 = ZAR 8.75 in 2010 to €1.00 = ZAR 18.28 in 2015.

However, a lower exchange rate means that import prices will rise. This means that consumers will have to pay more for overseas goods and holidays abroad and businesses have to meet the rising cost of imported raw materials and components.

Finally, constantly varying exchange rates cause uncertainty. Businesses do not know what is going to happen to exchange rates in the future. This means that it is difficult to predict demand for exports and the cost of imports. This makes planning and budgeting more difficult for businesses.

LARGE VS SMALL BUSINESSES

It could be argued that large businesses are likely to be more affected by changes in the exchange rate than small ones. This is because large businesses are more likely to be selling goods abroad, for example. However, small businesses can also be affected. This is because many of the resources they use are imported. For example, many small retailers sell goods that have been imported and when the exchange rate falls these goods become more expensive.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of visible trade?

A Banking products
B Manufactured aircraft components
C Tourism
D Training services

▶ 2 Which of the following is an example of invisible trade?

A Insurance
B Machinery
C Coal
D Electronic components

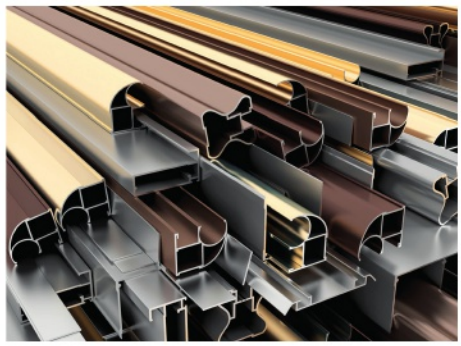
▶ 3 If US$1.00 = €1.20, the cost in euros to a German business buying US$6 700 000 of goods from the USA will be?

A €6 700 000
B €5 583 333
C €8 040 000
D €1 200 000

▶ 4 Which of the following will improve the international competitiveness of a country?

A A sustained rise in the exchange rate
B A sustained fall in interest rates
C Higher rates of inflation in that country
D A sustained fall in the exchange rate

CHAPTER REVIEW



▲ Examples of products made using aluminium extrusion

CASE STUDY: ALUMBURG

South Africa has benefited from international trade since its economy became more open in 1994. It has lots of mineral resources and is a major exporter of gold, platinum, coal and diamonds. South Africa also has a growing tourist industry. In 2015, South Africa exported US$81 500 million worth of goods and services. South African imports include machinery, foodstuffs, chemicals, petroleum products and scientific instruments.

Alumburg is a growing producer of aluminium products based near Johannesburg. It uses a production process called extrusion. Extrusion shapes material, such as aluminium, by forcing it to flow through a shaped opening in a die. Extruded material emerges as a lengthened piece with the same shape as the die opening. Extruded products have numerous applications and are found in almost every industry and market. They are in homes, cars, offices, planes, trucks, trains and boats; in airports, factories, machines and power stations. Alumburg has been trading for 40 years and is beginning to grow sales overseas, particularly in Europe.

CHAPTER QUESTIONS

1 Suggest two reasons why nations trade. Use examples from this case study.

2 What is meant by an invisible export? Use an example from this case study.

3 Describe two benefits of international trade to Alumburg.

4 **(a)** How might Alumburg be affected by exchange rates?

(b) If €1 = ZAR 10, how much would a European customer have to pay in euros for an order worth ZAR 124 million?

(c) If the exchange rate rose to €1 = ZAR 18, how might Alumburg be affected?

5 Discuss how the international competitiveness of a country could be affected by changes in the exchange rate.

12 GOVERNMENT OBJECTIVES AND POLICIES

LEARNING OBJECTIVES

- Understand how the government uses spending and taxation to provide public services
- Understand why the government might constrain public spending
- Understand how governments can affect business activity through infrastructure provision, legislation and trade policy
- Understand the effect of interest rates on businesses and consumer spending

GENERAL VOCABULARY

legal framework structure of a society, or a legal or political system
constraint something that limits your freedom to do what you want

GETTING STARTED

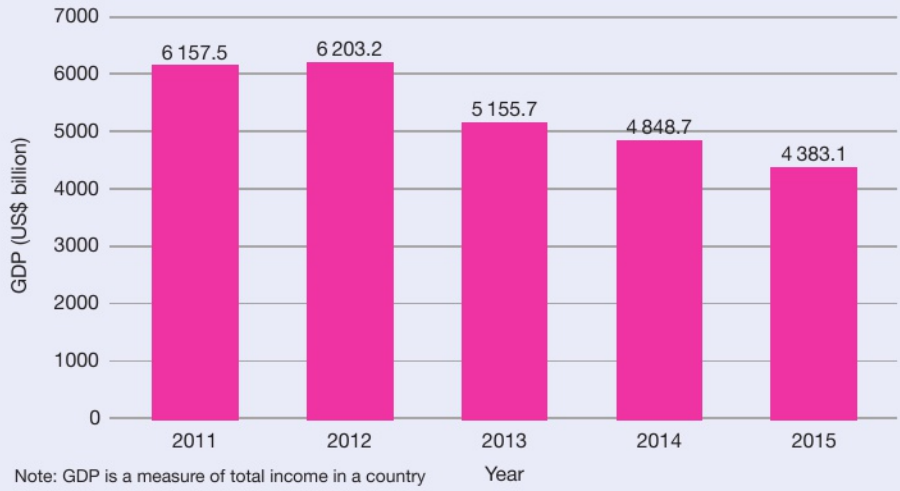
Governments are responsible for providing a legal framework in which businesses can operate. They are also in charge of running the economy. This means that prices should not be rising too quickly, unemployment should be low and the economy should be growing steadily. Governments use a range of policies, such as spending and taxation, to help meet these responsibilities. Such policies can provide opportunities for, and impose constraints upon, businesses. Look at the example below.

CASE STUDY: BOOSTING THE JAPANESE ECONOMY

For 20 years or more, the Japanese economy has been fairly 'flat'. This means that it has not grown much. Very few new jobs have been created and people's incomes have barely risen. Many businesses have also been very cautious when investing and planning to grow. At the end of 2012, a new prime minister was elected – Shinzo Abe. He took three key measures to help boost the Japanese economy.

- In 2013, he began to increase government spending. Abe's government spent US$210000 million over a period of three years on infrastructure projects, such as bridges, tunnels and earthquake resistant roads.
- He injected cash into the banking system to encourage them to lend more money. This forced interest rates down to extremely low levels so that borrowing was very cheap.
- Some regulations aimed at controlling businesses were reduced or removed. For example, it became easier for businesses to 'hire and fire' labour, and many rules and regulations aimed at controlling the energy, agriculture, environment and health care sectors were relaxed meaning that it was easier for businesses in these markets to operate. Taxes on business profits were also cut.

▶ Figure 12.1 Japanese GDP, 2011–15



Note: GDP is a measure of total income in a country

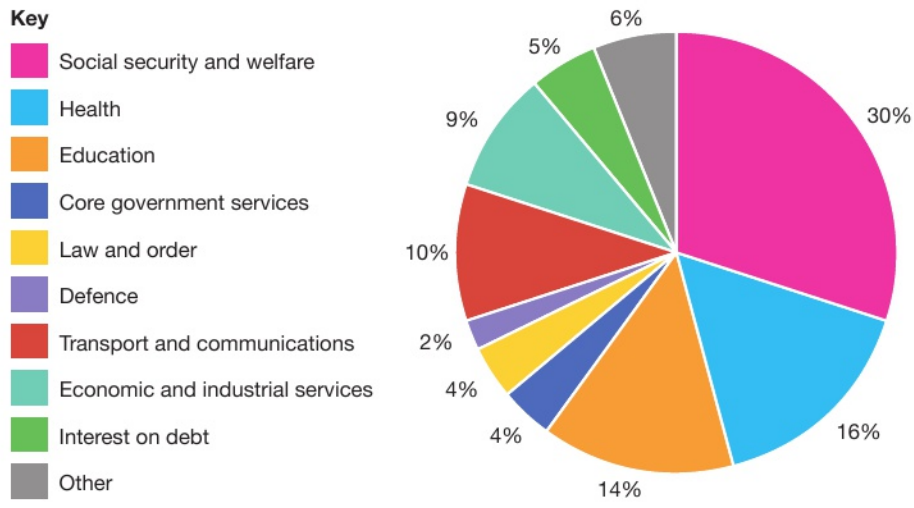
1 What evidence is there to suggest that Japan's economy is still performing weakly?
2 How might the construction industry benefit from the measures taken by Shinzo Abe?
3 How might lower interest rates benefit businesses?
4 How might businesses in general benefit from the changes in taxation made by Shinzo Abe?

GOVERNMENT SPENDING

One of the roles of most governments is to provide a range of public services. These might include health care, education, defence, care for the elderly, child protection, policing, refuse collection, a judicial system and transport networks. The amount of money spent by governments on these services will vary enormously. For example, in less developed countries, governments will tend to spend less because they are relatively poor. Sweden, however, has a reputation for very high levels of government spending. Figure 12.2 shows the different categories of government spending in New Zealand for 2015. The government spent a total of NZ$94 272 million.

▶ Figure 12.2 Categories of government spending in New Zealand, 2015

Source: http://www.treasury.govt.nz



Government spending levels will influence businesses. Generally, higher levels of spending will be welcomed by businesses. However, it often depends where the money is spent. For example, if a government decides to build a new motorway, businesses in the construction industry are likely to benefit the most. Spending on infrastructure is discussed below.

TAXATION

SUBJECT VOCABULARY

fiscal policy using changes in taxation and government expenditure to manage the economy

KEY POINT

Generally, lower taxes are better for businesses than higher taxes. This is because high taxes will reduce demand and discourage work and enterprise.

The money raised from taxation is used by a government to help fund its spending on public services. Businesses and individuals pay taxes. Some taxes are direct, which means they are charged on income. Examples include income tax, which is paid on personal income, and corporation tax, which is paid on company profits. Some taxes are indirect, which means they are levied on spending. Value Added Tax (VAT), which is paid when buying goods and services, is one. Governments may change levels of government spending and taxation to influence total demand in the economy. This is called fiscal policy and is likely to have an impact on businesses. Below are some examples.

- If income tax were lowered, there would be more spending in the economy. Businesses may respond by increasing production and expanding. In some countries, income tax rates may be cut to help the low paid. For example, in the Philippines in 2016, President Rodrigo Duterte promised to cut income taxes for the low paid in his first speech after being elected.
- Businesses may respond to higher corporation tax by cutting investment or reducing dividends. However, in recent years a number of governments have cut corporation tax rates. Examples include Croatia, Denmark, Egypt, Estonia, Finland, Latvia, Lesotho, New Zealand and Norway. One reason why governments are cutting rates of corporation tax is to attract foreign businesses to locate operations in their countries. This will help to create jobs and improve living standards.

CONSTRAINTS ON PUBLIC SPENDING

SUBJECT VOCABULARY

lay off (staff) make employees redundant

social security payments money taken by the British government from people's wages to pay for the system of payments to people who are unemployed or ill

In recent years, some governments have tried to constrain levels of public spending. One reason for this was because some countries built up massive debts as a result of the financial crisis in 2008. The effects on businesses of such constraints can be severe. Some examples are below.

- Public sector organisations that supply services directly may get their funding cut. For example, hospitals, schools, universities, social service providers and libraries may be forced to lay off staff to cope with funding cuts. This will affect businesses because those people laid off in the public sector will have lower incomes. Therefore, demand will fall and businesses will not need to produce as much.
- Private sector businesses that rely on public sector contracts for part, or all, of their business will be hit. For example, private sector construction companies that carry out government infrastructure work will lose revenue if the government cancels projects, such as road and rail construction, house building and maintenance work. Some countries have cut defence spending. This will negatively affect businesses that produce military goods.
- Cuts in pensions and other government payments. In some countries, government payments, such as pensions and social security payments have been frozen or cut. For example, in 2015 the Australian government cut the amount it spent on Family Tax Benefits. Businesses are affected by such cuts because people who rely on state benefits will have their spending power reduced, which lowers demand in the economy.

ACTIVITY 1

CASE STUDY: THE GREEK ECONOMY

Since 2008, Greece has suffered more than most countries as a result of the financial crisis. However, the problems faced by Greece were made worse because of the amount of money owed by the government. Years of overspending, together with the impact of the financial crisis, meant that Greece needed money from the EU. For example, in 2015, Greece owed a total of €323 000 million and had received around €240 000 million in 'bail outs' from the EU. In return for the money, Greece had to raise taxes and cut public spending. Examples of cuts included:

- 20 per cent cut in public sector wages
- 30 per cent cut in wages paid to workers in state-owned enterprises
- lower spending on education, defence, health care and public investment
- lower pensions and social security payments.



▶ Figure 12.3 Debt as a percentage of GDP – a selection of countries, 2014

1 Why has the Greek government been forced to constrain its spending?
2 How might a government constrain public spending? Give two ways in your analysis.

Kostas Samaras runs a private fitness centre in Athens.

3 Discuss the possible impact public spending constraints might have on his business.

HOW CAN GOVERNMENTS AFFECT BUSINESS ACTIVITY?

The government can affect business activity in a number of ways. It can:

- change the law
- influence the rate of interest and exchange rates in the economy
- change levels of government expenditure and taxation
- introduce polices that have a direct impact on businesses such as giving subsidies to farmers.

Three specific approaches are outlined below.

INFRASTRUCTURE PROVISION

In most countries, the government is responsible for developing and maintaining the nation's key infrastructure. This includes building schools, hospitals, roads, bridges, dams, railway systems, power generators and government offices. These projects can be very expensive, often costing millions or even billions of dollars. For example, in 2015, the Ugandan government announced that infrastructure investment was its top medium-term economic priority. A 10-year US$11 000 million spending programme was planned involving upgrading transport networks and increasing electricity generating capacity. Heavy expenditure on large-scale projects like this can have big benefits for businesses. This is because private sector businesses are likely to get most of the work. Construction companies, and their suppliers, are likely to benefit most. However, there will be a multiplier effect. This means that employees will spent some of the money received by these businesses from the government. This will boost demand for all types of businesses. In the Ugandan example, it was expected that the 10-year spending programme would have positive effects on agriculture, manufacturing and trade.

SUBJECT VOCABULARY

anti-competitive practices (restrictive trade practices) attempts by firms to prevent or restrict competition

barriers to entry restrictions that mean it is difficult for new firms to enter a market

GENERAL VOCABULARY

government intervention government becoming involved in an argument, fight or other difficult situation in order to change what happens

fit for purpose usable (by a consumer) for the purpose for which it was intended

compensate to replace or balance the effect of something bad

KEY POINT

Some examples of UK consumer legislation are:

- Sale of Goods Act 1979: This states that products sold by businesses must be of an appropriate quality and fit for the purpose. For example, customers cannot be sold paint that peels off in the sun after one month or a waterproof coat that lets in the rain.
- Food Safety Act 1990: This law means that food should be fit for human consumption and comply with safety standards. For example, a business should not sell frozen food if it has defrosted and been refrozen or fresh produce that is decaying.

LEGISLATION

Without **government intervention**, some businesses may not meet the needs of certain stakeholders. Some might go further and exploit vulnerable stakeholders. One of the roles of the government is to provide a legal framework in which businesses can operate and ensure that vulnerable groups are protected. Three areas where legislation has a particular impact on businesses are outlined below.

Consumer protection

Consumers want to buy good quality products at a fair price and receive good customer service. They want information about products that is accurate and clear. They do not want to buy goods that may be dangerous, overpriced or sold to them on the grounds of false claims. Without government regulation, some firms may exploit consumers by using **anti-competitive practices** or **restrictive practices**. These might include:

- increasing prices to higher levels than they would be in a competitive market
- price fixing, where a number of firms agree to fix the price of a product to avoid price competition
- restricting consumer choice by market sharing
- raising **barriers to entry** by spending huge amounts of money on advertising, which smaller companies could not match, for example.

Some countries have a lot of consumer legislation. Such legislation covers a variety of consumer issues and aims to protect consumers from some of the practices mentioned above. Figure 12.4 shows some examples. Legislation exists to prevent businesses from making false claims about the performance of their products, selling goods that are not fit for human consumption and selling goods that are not **fit for purpose**. If businesses break consumer laws, they may be fined and have to **compensate** consumers for any loss.



▶ Figure 12.4 Consumer issues covered by legislation

Competition policy

Governments should try to promote competition. This helps to prevent anti-competitive practices and consumer exploitation. How might they do this?

- **Encourage the growth of small firms**: If more small firms are encouraged to join markets there will be more competition. With more small firms the market is less likely to be dominated by one very large firm.
- **Lower barriers to entry**: If barriers to entry are lowered or removed then more firms will join a market. This will make it more competitive. For example, in some countries public transport was provided only by the public sector. However, laws have been changed to allow private companies to provide public transport services.
- **Introduce anti-competitive legislation**: Many countries have laws that help to encourage competition. Such laws are often designed to protect consumers from exploitation by monopolies, mergers and restrictive practices. Some countries have special bodies or agencies that are responsible for managing all policy relating to competition and consumer protection. They may also carry out enquiries into mergers, takeovers and anti-competitive practices.

SUBJECT VOCABULARY

merger two or more businesses joining together to form one new firm

Environmental legislation

Business activity can have a negative impact on the environment. For example, water pollution may be caused by businesses dumping waste into rivers, streams, canals, lakes and the sea. Air pollution may be caused by businesses releasing waste or gases into the air. Also, some businesses waste resources.



▶ Pollution from industry can damage the environment

For example, many argue that some of the packaging used by businesses is unnecessary and that insufficient use is made of recycled materials.

One approach used by many governments is to pass new laws to minimise the damage done by businesses to the environment. Much of the pressure for environmental legislation has emerged owing to the growing concerns about global warming. If businesses fail to comply with environmental laws they may be fined or forced to close until the problem is solved.

SUBJECT VOCABULARY

protectionism use of trade barriers to protect domestic producers

infant industries new industries that are yet to be established

dumping where a business sells goods in another country often below cost

trade barriers measures designed to restrict trade

quota physical limit on the quantity of imports allowed into a country

subsidy financial support given to a domestic producer to help compete with overseas firms

TRADE POLICY

Despite the benefits of international trade, governments sometimes believe that it is in the nation's interests to restrict trade. This is called protectionism and might be used to:

- protect jobs if foreign competitors threaten the survival of domestic producers
- protect infant industries (new industries that are yet to get established)
- prevent dumping (where foreign producers sell goods below cost in a domestic market)
- raise revenue from tariffs.

Governments can use trade barriers to restrict trade.

- **Tariffs**: a tax on imports, which makes them more expensive.
- Quota: a physical limit on the amount allowed into the country.
- Subsidy: the giving of financial support, such as grants or tax breaks, to exporters or domestic producers that face fierce competition from imports.
- **Administrative barriers**: the use of strict health and safety or environmental regulations and specifications to make importing more awkward.

Governments can also influence businesses by forming a trade bloc. This is where a group of countries in the same geographical region sign a trade agreement to reduce or remove trade barriers. The main benefits to businesses of trade blocs include:

- the opportunity to specialise in the production of those goods and services which they can produce more expertly or at a lower cost
- access to wider markets
- lower costs, if economies of scale can be exploited when sales and output rise
- protection from large predatory multinationals from outside the bloc.

However, trading blocs do have disadvantages. For example, they might protect inefficient businesses or lead to conflict and tensions if the benefits are not shared out fairly between countries.

EFFECTS OF INTEREST RATES ON BUSINESSES

SUBJECT VOCABULARY

interest price of borrowed money (and the reward to savers)

monetary policy using changes in interest rates and the money supply to manage the economy

Interest is the cost of borrowing money and the reward to savers. Interest rates are usually controlled by the authorities and can therefore change. The use of interest rates to help control the economy is called monetary policy. Higher interest rates mean that it is more expensive to borrow money so demand in the economy is likely to fall. In contrast, lower interest rates will increase demand in the economy because it will be cheaper to borrow. Changes in the interest rate can influence businesses. Generally, high interest rates are bad for businesses for the following reasons.

- When the interest rate rises, costs will increase for any business that has already taken out a loan. The majority of businesses have loans, mortgages or overdrafts (see Chapter 25) to help fund their activities. Higher interest rates will therefore reduce profits. This will cut the rewards of business for the owners and shrink the funds available for new investment. Lower levels of investment could reduce the growth of businesses.
- The purchase of capital goods funded by borrowing is discouraged because it is more expensive. This means that businesses will be reluctant to invest in new machinery, equipment and research and development. If businesses postpone or cancel investment, they may fail to keep up with changes in technology. This could affect their competitiveness and their ability to grow.
- Higher interest rates usually mean that demand in the economy falls. This is because consumers are less willing to borrow money to fund spending. This will clearly have an impact on businesses. However, certain industries are likely to be affected more than others. Businesses that produce goods bought with borrowed money, such as cars, houses and consumer durables, are likely to suffer the most.

Finally, changes in the interest rate will have a bigger impact on those businesses that have lots of debt. It must also be remembered that lower interest rates can have a very positive effect on businesses. When borrowed money is cheap businesses are likely to invest more and grow faster.

▶ Interest rate changes affect business



EFFECTS OF INTEREST RATES ON CONSUMER SPENDING

Changes in the interest rate can have a significant effect on consumer behaviour. Generally higher interest rates are bad for consumers BUT not all of them.

- House-owners with mortgages will be affected negatively when interest rates rise. This is because most people's mortgage payments rise. As a result, they will have less disposable income (income remaining after taxes and bills are paid for) to spend. Obviously, people with larger mortgages will be hit harder than those with smaller ones. The cut in consumer spending that results from higher mortgage payments will clearly be more severe for businesses. The construction industry and the housing market will be hit hard because most people buy houses using a mortgage.

- Demand for goods bought with borrowed money will fall when interest rates rise. Many people use loans, overdrafts and credit cards to fund their spending. When interest rates rise, funding expenditure with borrowed money becomes less affordable; consequently their demand for certain goods and services is likely to fall. They are likely to spend less on non-essential items such as jewellery, new clothes, holidays and entertainment. They may also reduce demand for expensive items like cars, furniture and white goods.
- Savers will be hit if interest rates are low. This is because they will earn less interest on their savings. Consequently, consumers that rely heavily on income from savings, such as the retired community, will have less to spend. As the global population ages, the impact of lower interest rates on savings will be felt more.

Since the beginning of the financial crisis in 2008, interest rates in many countries have been very low as governments tried to stimulate more demand to encourage firms to employ more people, invest more and grow. Figure 12.5 shows the interest rate in the EU between 2006 and 2016.

▶ Figure 12.5 EU interest rate, 2006–16



LARGE VS SMALL BUSINESSES

All businesses can be influenced by government objectives and policies. For example, if the government allows interest rates to rise, both large and small firms are likely to feel the impact. Both will pay more interest on loans and overdrafts for example. However, some of the laws passed by the government may not always apply to small businesses. Sometimes new business laws only apply to firms above a certain size. Finally, large firms might feel the impact more of some changes in government spending. For example, a cut in spending on the infrastructure in a country is likely to hit large firms more. This is because it is mainly large firms that take on government contracts.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a trade barrier?

A Interest rates
B VAT
C Corporation tax
D Tariff

▶ 2 Which of these effects are likely to result from lower interest rates?

A Savings will increase
B Inflation will fall
C Consumer spending may rise
D Less business investment

▶ 3 Which of these measures might help a company manufacturing power boats?

A Lower levels of corporation tax
B Higher VAT
C Higher income tax
D Higher interest rates

▶ 4 Which of the following is likely to rise when taxation is decreased?

A Unemployment
B Business investment
C Average costs
D Tariffs

CHAPTER REVIEW

SUBJECT VOCABULARY

budget an official statement that a government makes about how much it intends to spend and what the rates of taxes will be for the next year or six months.

tax allowances part of income that is not taxed

CASE STUDY: GOVERNMENT INFLUENCES ON BUSINESSES

Most governments set a budget each year, which outlines their spending plans for the future. It also states how revenue is to be raised from taxes. In 2016, a government budget planned some constraints on spending. For example, expenditure on roads and motorways was to be cut by 20 per cent. There would also be a freeze on public sector pay for three years. However, there were a number of measures to help businesses. Some examples are outlined below.

- Tax allowances on investment were increased (this makes investment cheaper).
- Interest rates would be held at their current low levels for several years.
- Corporation tax would be reduced from 25 per cent to 20 per cent.
- Tariffs would be introduced for a range of imported shoes, clothes and fashion accessories.
- Some out of date consumer legislation would be cut.
- Negotiations would begin to join an established trading bloc.



▶ Cuts in spending on roads and motorway construction

CHAPTER QUESTIONS

1 What is meant by the term tariff?

2 Suggest two practices that consumer legislation might attempt to prevent.

3 Describe one possible impact on businesses of the 20 per cent planned spending cuts on roads and motorways.

SUBJECT VOCABULARY

budgetary measures actions taken by the government to influence business and the economy

4 Why do businesses prefer lower interest rates? Give at least two reasons in your analysis.

5 Assess the possible impact of the **budgetary measures** designed to help businesses.

13 EXTERNAL FACTORS

LEARNING OBJECTIVES

- Understand the nature of external factors
- Understand how social, technological, environmental and political factors affect business decisions

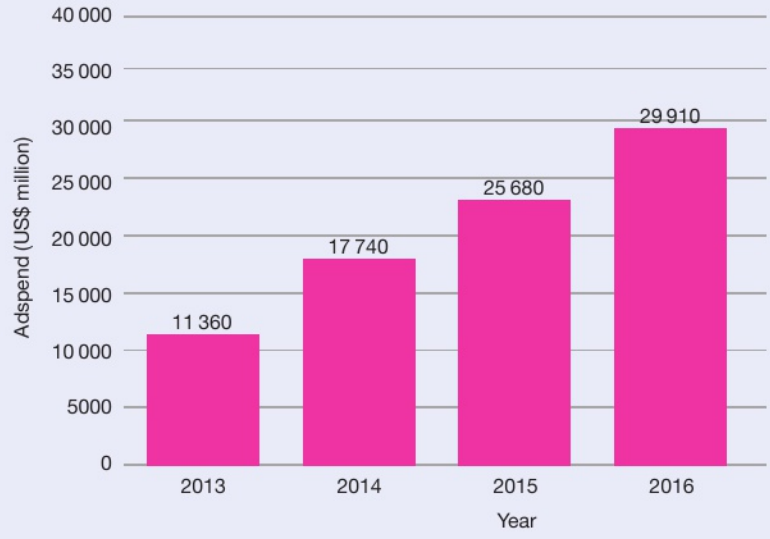
GETTING STARTED

Business decisions are influenced by external factors other than those determined by the government. These include environmental, social, technological and political factors. Over time, these change and create opportunities and constraints for businesses. Look at the example below.

CASE STUDY: SOCIAL MEDIA AND BUSINESS

One of the most revolutionary external factors to affect businesses in recent years is social media. Social media is the use of web-based platforms, such as Facebook, Twitter, YouTube and Instagram, to exchange news, information, ideas, photographs and other images. Electronic devices, such as smartphones and tablets, enable people to exchange this wide range of data instantly and globally. Social media has become a powerful phenomenon and it is no surprise that businesses are making increasing use of it – particularly for marketing their products.

In 2016, it was reported that every day around 500 million tweets were posted on Twitter, 4500 million 'Likes' were expressed on Facebook and 95 million photos were uploaded onto Instagram. Businesses can use social media to gather huge amounts of data about their customers, such



▶ Figure 13.1 Global adspend by businesses on social media

as their profiles, their preferences and what they think of products. This is a valuable resource. Businesses have set up links to some of these social media platforms, which allows them to tell people about their products and listen to their views. Businesses can use social media to raise and strengthen brand awareness, run targeted adverts with real-time results, increase traffic on their own websites and find out what competitors are doing.

▶ Business and social media



1 Why is social media so important to businesses?
2 How might businesses use social media?
3 In groups, discuss your own experiences of interacting with businesses on social media. Make a list of the possible benefits of such interaction and present the information to the rest of the class.

THE NATURE OF EXTERNAL FACTORS

Sometimes businesses have to deal with events and issues that are completely beyond their control. These external forces can impact on businesses unexpectedly and usually mean that businesses have to make changes to the way they operate. The effects of external factors can be both positive and negative.

For example, in 2014, the global price of oil fell by more than 50 per cent. The speed and extent of the fall was unexpected and had both positive and negative effects. Companies in the oil industry were hit hard; their revenues fell sharply and many were forced to reduce their exploration activities, for example. However, in complete contrast, businesses in the transport industry, such as delivery contractors, benefitted because their fuel costs fell significantly. This would have provided a welcome boost to profits.

External factors may fall into a number of different categories, which are outlined below.

SOCIAL

Businesses have to adapt to any changes that occur in society. Some examples of changes that have occurred in recent years are outlined below.

SUBJECT VOCABULARY

urbanisation process of constructing more and more buildings on rural land

- **Increased consumer awareness**: Consumers have higher expectations than ever before. They have easy access through the Internet to lots of information about products and are more aware of their rights. As a result, many businesses have become more customer-focused.
- **Changing demand patterns**: Changes in society bring about changes in demand for products. For example, modern lifestyles mean many people expect goods to be delivered to their doors. Consequently, there has been a growth in home delivered goods, such as takeaway food and a whole range of personal, domestic and other services. The rapid growth in online businesses has also led to changes in these demand patterns.
- **Increased numbers of women at work**: In many countries, more and more women have abandoned the traditional childcare role and have combined family life with employment and running businesses. This has increased the supply of labour and helped to increase the number of new businesses.
- **More part-time workers**: In many countries there has been a huge increase in the number of people taking on part-time work. This has helped to improve flexibility in business organisations because part-time labour is more adaptive.
- Urbanisation: In some countries, such as Brazil, India and China, very large numbers of people have left rural areas to live in towns and cities. This has provided businesses with more labour and created additional markets to which goods and services can be supplied.

TECHNOLOGY

The development of new technology continues to have a huge impact on businesses. New technology results in new products, which in turn provide new market opportunities. Also, new technology means production becomes more capital-intensive and costs are reduced.

SUBJECT VOCABULARY

capital-intensive use of relatively more machinery than labour in production

- In the primary sector, the use of tractors, mechanical harvesters, grain-drying machines and automatic feeding systems have helped to lower costs in agriculture. Chemicals and pesticides have also helped to increase crop yields.
- In the secondary sector, the introduction of robots on production lines has reduced costs. They are cheaper to employ than people because they can work 24/7. In some factories, production is entirely automated. Computers are used to design products and the information is then fed into CNC (computer numerically controlled) machines that can carry out tasks such as cutting, milling, sewing, moulding and welding.
- The use of technology in service industries has reduced costs. For example, the use of automatic check-in facilities in some hotels has reduced labour costs in the hotel industry. Internet banking has also helped to reduce banking costs because customers can manage their accounts online. A whole new online retail industry worth billions of dollars has emerged and looks set to continue its growth.
- The use of IT has helped to reduce administration and communication costs in business. For example, computers can carry out many routine tasks quickly. Huge amounts of data can be gathered, processed, analysed, stored and accessed using computer databases. A wide range of different information can be sent electronically anywhere in the world instantly.

The rate of technological change seems to increase all the time. Businesses usually welcome technological developments because they often provide new product opportunities or help to improve efficiency.

- Changes in technology can shorten the amount of time products can be marketed for. This is because new products are quickly developed to replace ones that use old technology.
- Developments in technology often mean that businesses can replace labour with capital. This is welcomed because human resources are often said to be the most difficult to manage. New technology also lowers unit costs.
- The development of social media has helped to improve communications between businesses and customers. This allows businesses to remain aware of changing consumer needs.

The impact of technology in marketing and in production is discussed in detail in Chapters 34 and 43, respectively.

ACTIVITY 1

CASE STUDY: 3D PRINTING

3D printing is a rapidly developing new technology. Chuck Hull invented it in 1986. However, only in recent years have businesses really started to exploit the new technology on a commercial scale. Between 2016 and 2022, the 3D printing market is expected to grow to US$30 190 million although other forecasts are less optimistic.

3D printing involves producing a physical object from a 3D digital design made on a computer. The physical object is produced by laser printers that build up a model by printing very thin layers on top of each other repeatedly over a period of time – perhaps several hours. However, 3D printers do not use ink because it would never build up enough volume. Instead, the printer deposits layers of liquid plastic and sticks them together with a type of glue or ultraviolet light.

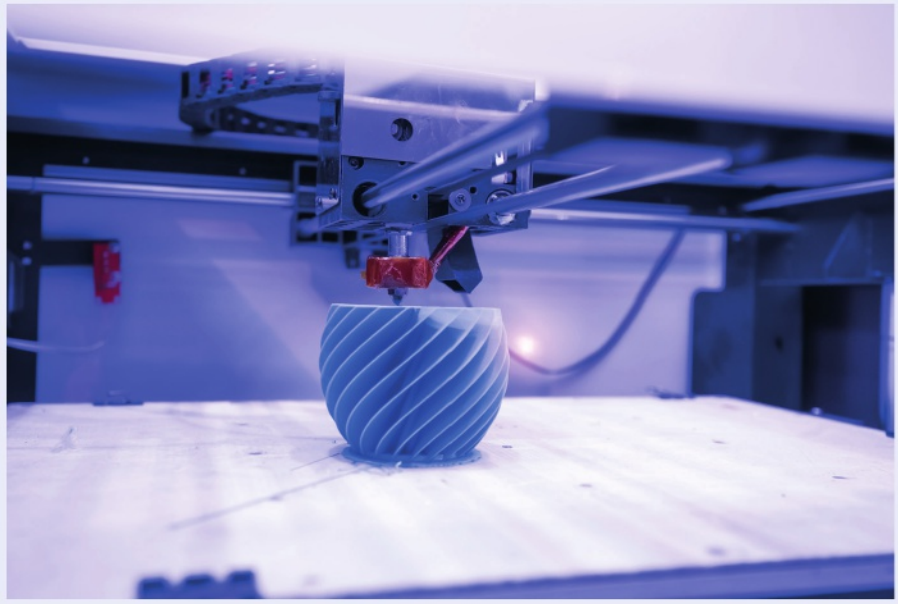
3D printers reduce the need to produce hand-built models. They are said to be around ten times faster than other methods of model production and five times cheaper. This means that models of new products can be produced in hours rather than days. This will help to speed up product development.

Another attraction of 3D printing is its wide range of applications. The technology can be used to:

- make components for cars, aeroplanes and spacecraft
- produce prosthetics (artificial body parts) for the medical industry
- provide models and shapes that can be used in education
- produce a range of personalised products such as jewellery, fashion accessories and toys.

3D printers do have some disadvantages. They may cost between US$25 000 and US$50 000, although this is less than the more sophisticated rapid prototyping (RP) machines, which can cost between US$100 000 and US$500 000. The surface on the models is also a little rough compared with production using RP machines. Models can only be made from one or two materials and there are only two colours.

▶ 3D printing



1 Assess the possible benefits to businesses of new technology like 3D printers. Make a clear judgement in your evaluation.

ENVIRONMENT

Evidence suggests that as economies grow environmental damage increases. Businesses are often blamed for pollution and congestion. Some examples of other environmental issues are outlined below.

GLOBAL WARMING

Many governments are becoming increasingly concerned about global warming, which may be affecting weather patterns and climates. Some of the greenhouse gases, such as carbon dioxide, which contribute to global warming, come from factories. Also, economic development means that car ownership and air travel increases. The emissions from cars and aircraft also add to global warming.

HABITAT DESTRUCTION

Some business development destroys wildlife habitats and spoils the natural environment. For example, around one-half of the forests that once covered the planet are now gone. Forests are important for the survival of the planet. At least 120 out of 620 living primate species will be extinct in the next 10 to 20 years. Many other species are under threat, such as tigers, mountain gorillas and pandas.

RESOURCE DEPLETION

In addition to the loss of forests, many other resources are at risk of running out.

- Oil, coal, gas and minerals are non-renewable resources and, therefore, cannot be replaced. Because of this, as business development gathers pace, these resources are depleted.
- Fish stocks are falling. The world's marine catch increased from 18.5 million tonnes in 1950 to 82.5 million tonnes in 1992. This huge growth is threatening millions of people who depend on fishing for their livelihoods.

SUBJECT VOCABULARY

sustainable development idea that people should satisfy their basic needs and enjoy improved living standards without compromising the quality of life of future generations

- Fertile soil, which is needed to grow food, is being lost. The loss is caused by deforestation, poor farming practices, over-grazing, the increasing size of urban areas and land pollution.

SUSTAINABLE DEVELOPMENT

Many governments are promoting the idea of **sustainable development**. This means that people should satisfy their needs and enjoy better living standards without doing so in ways that will reduce the quality of life of future generations. Business development that denies future generations of resources is not sustainable. This means that the use of resources by businesses and consumers needs to be reduced. If businesses take a sustainable approach, they will also find it easier to comply with regulations, reduce costs, improve their image and increase profits.

Businesses may respond to environmental issues in a number of ways. For example to help reduce resource depletion businesses could:

- design packaging that can be reused or recycled
- use more energy-efficient equipment or renewable energy sources
- explore ways of selling waste to other businesses as a by-product
- reduce business travel and use video conferencing for meetings.

ACTIVITY 2

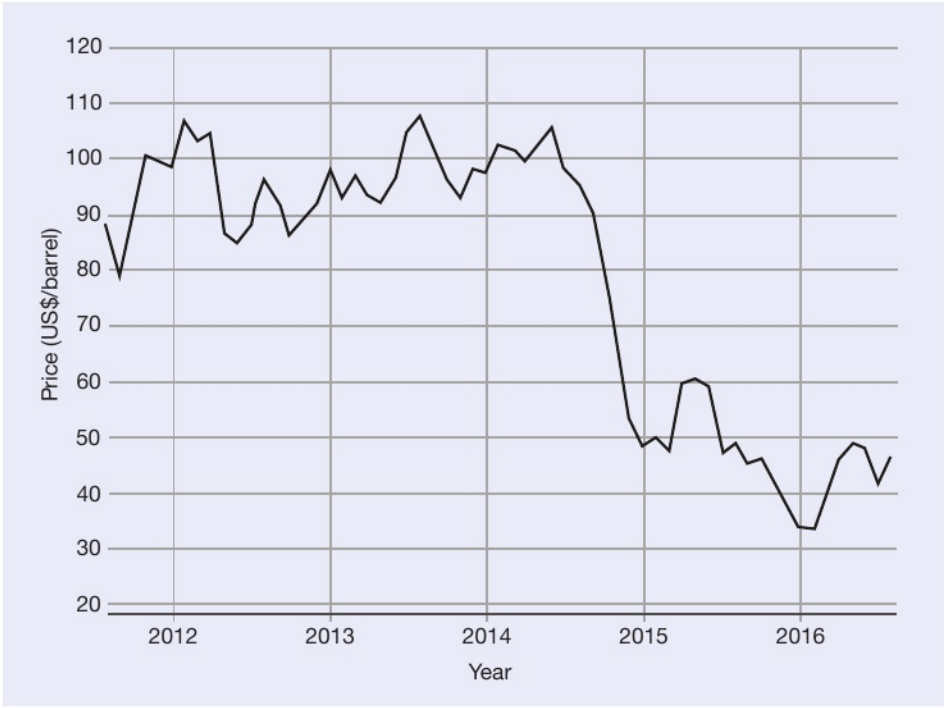
CASE STUDY: ELECTRIC VEHICLES

Most car manufacturers are either developing, or have already launched, alternatives to petrol-fuelled vehicles. This is mainly because of the damage done by cars to the environment and the pressure on governments to reduce emissions as part of global agreements. Evidence suggests that car makers are focusing on electric vehicles (EVs). For example, in 2015, Volkswagen decided to speed up the development of EVs after the emission scandal (Volkswagen was caught changing test results to deceive consumers). Hyundai-Kia plans to launch eight EV models by 2020 and Ford has invested US$4500 million in EVs and plans to launch 13 models by 2020.

Consumers can already choose from the Nissan Leaf range of EVs that produces zero emissions. The car can use a battery that will recharge in four hours and give drivers a range of 107 miles (about 170 km) on one charge. EVs are very cheap to run compared to petrol-fuelled cars: fuel may only cost US$0.04 per mile (US$0.06 per kilometre), at least 20 times less.

Another reason why car manufacturers thought that EVs would be popular was because of high oil prices. However, in the last couple of years global oil prices have been low. Figure 13.2 shows the global oil price between 2012 and 2016.

1. Describe two external factors that have contributed to the development of EVs.
2. What are the advantages of EVs for consumers? Give at least two advantages in your analysis.
3. Assess the impact global oil prices might have on the plans of car manufacturers in the future.



▶ Figure 13.2 Global oil prices, 2012–16

Source: http://www.nasdaq.com

POLITICAL

GENERAL VOCABULARY

unstable likely to change suddenly and become worse
pressure groups group or organisation that tries to influence the opinions of ordinary people and persuade the government to do something

Some parts of the world are politically **unstable**. Businesses need to be cautious if they develop interests in such countries. For example, few businesses would have considered setting up operations in Syria, Western Turkey, Iraq and Libya in 2016 owing to severe political instability. However, political factors can also influence businesses in stable, democratic countries. The activities of **pressure groups** can also play a role in influencing business activity. Some examples of political factors may include the following.

- In 2015, some felt that Greece might leave the EU. This could have disrupted financial markets and created a great deal of uncertainty in the Eurozone.
- In 2016, the UK voted to leave the EU. Not many people would have predicted this and the effects of Brexit, as it became called, are still to be determined. However, one immediate outcome was a fall in the exchange rate. The value of sterling fell by more than 10 per cent against most currencies after the Brexit vote.
- The issue of national security has become a priority for many governments. If measures designed to improve national security restrict the movement of goods, people and capital, this could have a negative impact on businesses.
- Pressure groups, such as ASH, which aims to eliminate the harm done by smoking, can affect businesses. For example, it might post some information on its website that further discourages people to smoke. This could clearly affect the tobacco industry.
- A new government might be elected which is very pro-business. This might encourage more people to become entrepreneurs. It might also mean that more foreign investment may be attracted.

LARGE VS SMALL BUSINESSES

Businesses of all sizes can be affected by external factors. For example, the unexpected fall in oil prices in 2014 might have benefitted a wide range of businesses from taxi drivers operating as sole traders to a multinational chemical processor using oil as a raw material. However, it might be argued that large firms might be in a better position than small firms to cope with the negative effects of external factors. This is because they might make detailed contingency plans and because they have more resources to fall back on.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of these external factors is likely to help reduce production costs?

A Social
B Political
C Environmental
D Technological

▶ 2 Which of the following is a possible social factor that might affect businesses?

A Attitude towards saving
B Industrial action by employees
C Global warming
D The development of water powered cars

▶ 3 The formation of a pressure group campaigning for manufacturers to use less sugar in products is an example of which type of factor?

A Technological
B Environmental
C Ethical
D Political

▶ 4 A rise in the number of retired people making themselves available for work is an example of which factor?

A Political
B Environmental
C Social
D Human

CHAPTER REVIEW

CASE STUDY: ATERRO RECYCLING

Aterro Recycling was set up when its founder, Rohan Gupta, wanted to throw away an old laptop without harming the environment. He realised that India did not have a system to deal with the vast quantities of electronic waste (e-waste) that was building up around the country. Computers, laptops, television sets, mobile phones and electronic office equipment are examples of e-waste. In one Indian city, Bangalore, e-waste amounts to 18000 tonnes per year and is still growing 20 per

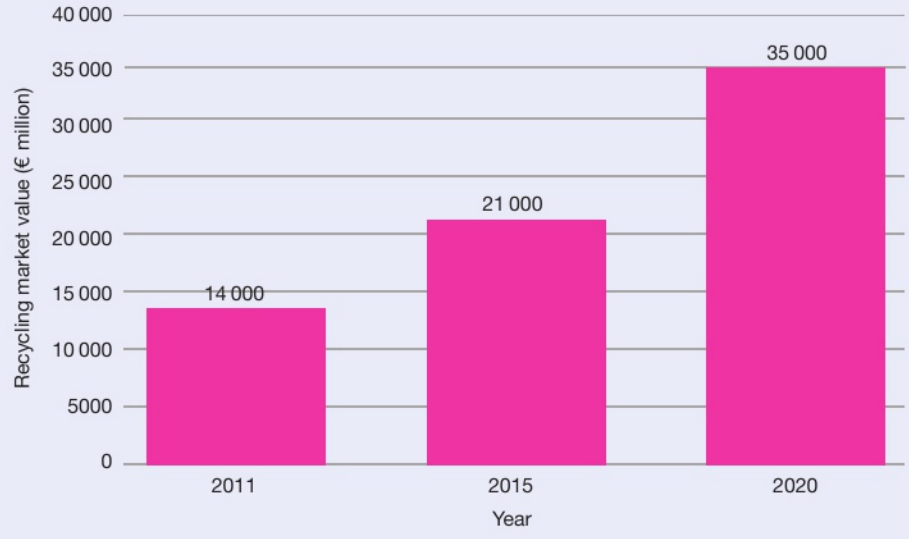


▲ Example of e-waste

cent annually. The growth is driven by rapid developments in technology with the frequent arrival of new, updated and attractive electronic products. E-waste is now the world's fastest growing and most toxic waste material.

Rohan and his brother wrote a business plan, managed to raise US$6 million from some venture capitalists and built a smelting factory to process e-waste in Roorkee, a city in the state of Uttarakhand. The business now collects and processes about 1000 tonnes of e-waste a month from over 500 cities in India. The factory uses processes to extract precious metals like platinum, gold and selenium from the e-waste. Revenue is growing rapidly and in 2013 reached US$15 million.

Aterro Recycling is now expanding and has processing plants in Mexico and Ireland. Provided e-waste continues to build up and new entrants do not monopolise the recycling industry, the future is bright for Aterro.



▶ Figure 13.3 Projected size of the global recycling market by 2020

CHAPTER QUESTIONS

1 What is meant by external factors?

2 How will Aterro Recycling help to reduce resource depletion?

3 How might developments in technology have impacted on Aterro Recycling?

Businesses may be affected by political factors from time to time.

4 Discuss how political factors can affect business decisions.

5 Assess whether Aterro Recycling will thrive in the future.

14 MEASURING SUCCESS IN BUSINESS

LEARNING OBJECTIVES

Understand the measures of success such as:

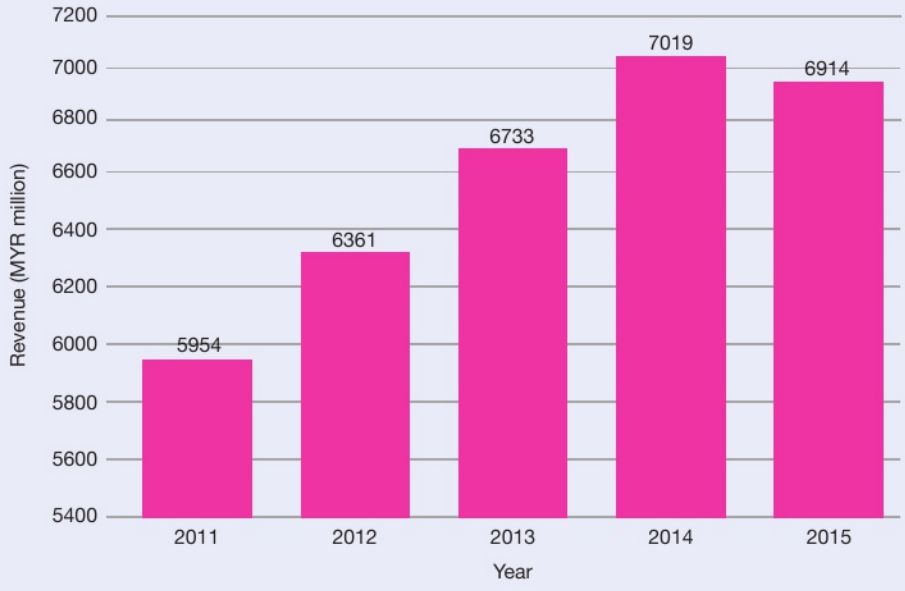
- Revenue
- Market share
- Customer satisfaction
- Profit
- Growth
- Owner/shareholder satisfaction
- Employee satisfaction

GETTING STARTED

Business owners want their businesses to be successful. However, how can owners measure that success? A lot depends on the objectives of the business. For example, if a company's main objective is to maximise profit, the amount of profit made by a business can be used to measure its success. Look at the example below.

CASE STUDY: DIGI.COM BERHAD (DIGI)

Malaysian-based DiGi is a global telecommunications provider. It has around 12 million customers in Malaysia and provides them with mobile voice, Internet and digital services. In 2015, DiGi won an award for the 'Best Managed Public Company in Asia' (in its category). It is a successful company and the information in Figures 14.1 and 14.2 tends to support this view.



▶ Figure 14.1 DiGi revenue, 2011–15



▶ Figure 14.2 DiGi profit after tax, 2011–15

1 What evidence is there to suggest that DiGi is a successful business?
2 In pairs, discuss what other information might be helpful to measure the success of DiGi. Draw up a list and present the information to the rest of the class.

MEASURES OF SUCCESS

The success of a business can be measured in different ways. Several approaches are outlined below.

REVENUE

The amount of revenue generated by a business is a guide to its success. If revenues increase each year, most business owners would feel that they were making a success of their venture. In 'Getting started' above, DiGi's revenue rose from MYR 5954 million to MYR 6914 million over five years. This is an increase of 16.1 per cent. Whether this can be regarded as a success depends on DiGi's sales objectives, trading conditions over the time period and the revenues received by rivals in the industry. Look at the examples below.

- If DiGi had set an objective of increasing its revenue by 15 per cent over the five-year period, then success can be claimed since the target has been exceeded.
- If trading conditions had been very difficult between 2011 and 2015, then again DiGi might claim that it had been successful.
- If other companies in the same industry had seen their revenues increase by, say, 80 per cent, then DiGi's 16.1 per cent increase does not look so impressive.

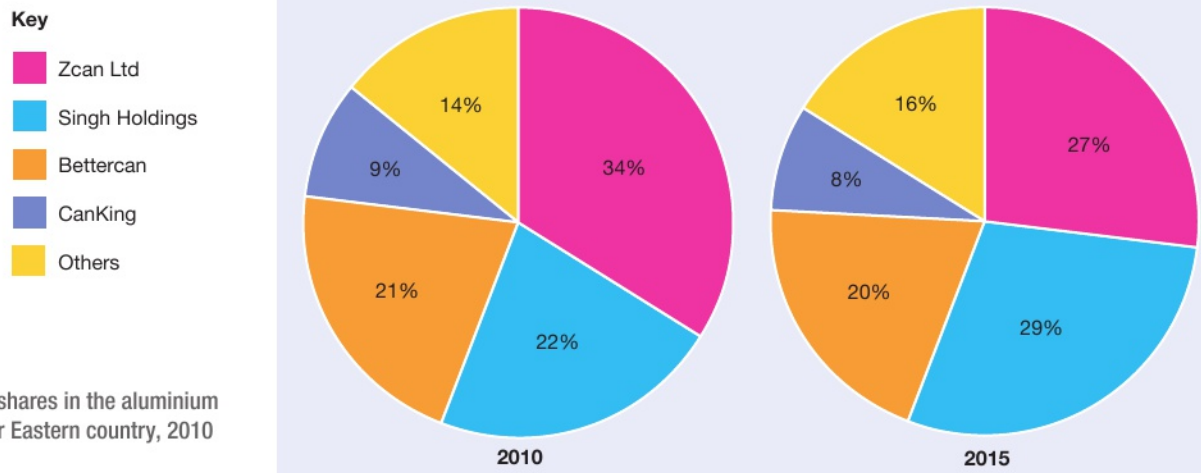
MARKET SHARE

Some businesses aim to increase their market share each year. It is better for a business to have a larger market share than a smaller one. With a large market share a business might be able to dominate the market; this will raise the profile of the business and perhaps allow it to charge a higher price. Therefore, if a business were continually increasing its market share, it would be considered as successful because it is winning sales from its rivals. However, measuring market share might be challenging. Information would be needed about the size of the total market and the revenues of the main suppliers in that market. Some of this information might be difficult to obtain. Therefore, using the value of market shares to measure success may not be easy, as it needs to reflect the market context.

ACTIVITY 1

CASE STUDY: ALUMINIUM CANS

Aluminium can production in a Far Eastern country is dominated by four businesses: Zcan, Singh Holdings, Bettercan and CanKing. Figure 14.3 shows the market shares in the industry for 2010 and 2015. In 2010, the total market was worth US$450 million. By 2015, the market had grown to US$560 million.



▶ Figure 14.3 Market shares in the aluminium can industry in a Far Eastern country, 2010 and 2015

1 What is the change in CanKing's revenue between 2010 and 2015?
2 Do you think CanKing has been successful over the time period?
3 Which company has been most successful over the time period? Explain your answer.
4 Why might it be difficult to measure success using market share?

CUSTOMER SATISFACTION

Many businesses will look at how consumers' needs and wants have been satisfied when measuring success. If its customer service is good, a successful business will find that it has loyal customers and a growing customer base.

Many businesses are becoming more customer-focused and make efforts to get feedback from their customers. They may monitor customer complaints very carefully. They might do this by having a formal complaints procedure or monitoring comments on social media. This should encourage customers to record complaints without them feeling uncomfortable or threatened. Many businesses recognise that it takes a lot of effort for customers to complain. Therefore, the subject of any complaint should be taken seriously and action should be taken to make improvements.

An increasing number of businesses use customer surveys to gather information about customer satisfaction. For example, Booking.com, the online hotel booking company, send emails to customers after every booking made to ask for feedback. The information they gather can be analysed and used to assess customer satisfaction levels. If customer satisfaction levels rise over a period of time then the company will consider it is being successful.

PROFIT

Most private sector businesses aim to make a profit. Therefore rising profits should signal improving success. However, a number of factors have to be taken into account.

- It is possible to make higher profits if there is no competition in the market. Therefore, profits made by a monopoly are not as impressive as profits made in a competitive market.
- The amount of profit made by a business will often depend on its size. For example, a large multinational company is likely to make more profit than a sole trader. It is possible to take into account the size of a business when measuring profit. One approach is to compare the profit to the amount of money invested in the business by calculating the *return on capital* employed. Another is to compare the profit with the size of turnover by calculating the *profit margin*. Both of these approaches are discussed in detail in Chapter 31.
- Profit should also be compared with that made by other businesses in the same industry. This will provide a better measure of success because different industries often expect different profit levels. For example, it may not be appropriate to compare the profit made by a farmer with that made by an insurance company.
- Profit can only be used to measure success if the objective of the business is to maximise profit. For example, some small business owners are often content to make a 'modest' amount of profit. They may not want the responsibility or hard work that often comes with striving for higher profits.

GROWTH

Many businesses aim to grow, therefore the size of the business is important when measuring success. However, there are several different ways of measuring size. The main ones are listed below.

- **Turnover or revenue**: The revenue of a business could be used to measure size. For example, Lenovo, the Chinese computer company, is a large business. Its revenue in 2015 was over US$46 300 million.
- **The number of employees**: A business with thousands of employees may be considered large. For example, Ford, the US car giant, employed over 199 000 people in 2015.
- **Market share**: It could be argued that a business with a 43 per cent market share is more successful than one that has a 9 per cent market share in the same industry. Coca-Cola, for example, had a 29.5 per cent share of the global soft drinks market in 2011.
- **The amount of capital employed**: Capital employed is the amount of money invested in a business. The more money invested the larger the business.
- **EU definitions of size**: The EU defines the size of firms according to turnover, the number of employees and the capital employed. The definitions are summarised in Table 14.1.

SUBJECT VOCABULARY

capital employed amount of money invested in a business

▼ Table 14.1 EU definitions of firm size

	MICRO	SMALL	MEDIUM-SIZED	LARGE
Turnover	Less than €2 million	Less than €10 million	€10 million to €50 million	Greater than €50 million
No. of employees	Less than 10	Less than 50	50 to 249	Greater than 249
Capital employed	Less than €2 million	Less than €10 million	€10 million to €43 million	Greater than €43 million

SUBJECT VOCABULARY

overtrading taking on more work than a business can afford to fund effectively

DID YOU KNOW?

In 2015, Ergon Energy, the Australian energy company, employed 4447 people. In contrast, Kresta Holdings, the Australian window and soft furnishings company, employed 570 people. Clearly, Ergon is the larger business if size is measured by the number of people employed. However, according to EU definitions of size both would be regarded as large companies.

A growing business is likely to be considered successful, particularly if growth is sustained over a period of time. However, occasionally businesses try to grow too quickly and suffer as a result. They may get caught out overtrading, which means they run out of resources trying to meet rapidly rising orders. This is discussed in more detail in Chapter 15.

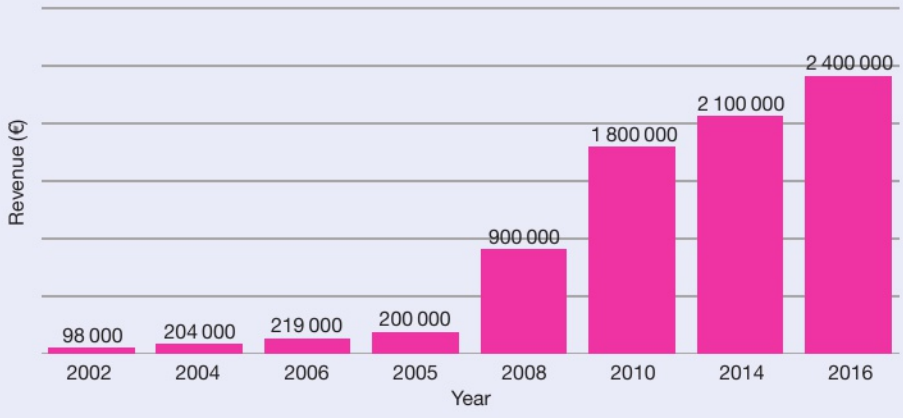
ACTIVITY 2

CASE STUDY: LOSADA PAELLA

Marta Losada owns Losada Paella, a food processing business in Murcia, Spain. She manufactures a range of ready-made paella meals – a traditional Spanish dish made from rice and a selection of seafood and chicken. She uses secret recipes handed down by her great grandmother. The business was set up in 2002 but has grown sharply since 2008 when she designed her own website. A growing proportion of sales are now generated online.



▶ Paella is a Spanish speciality



▶ Figure 14.4 Losada Paella revenue, 2002–16

1 What was the size of Losada Paella in 2016 according to EU definitions?
2 In what year did the size of Losada Paella change?
3 Do you think Losada Paella has been successful?

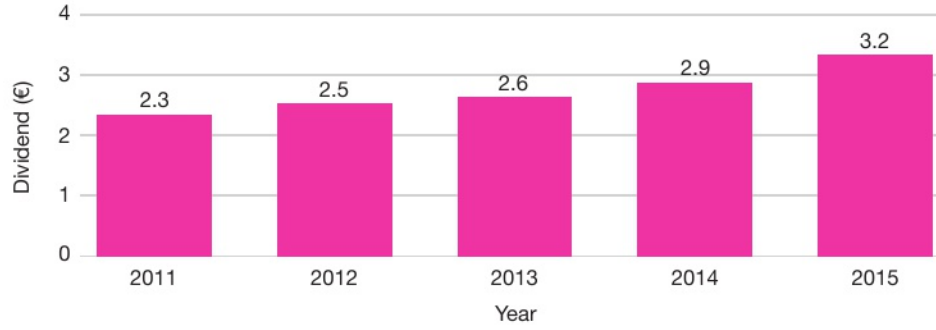
OWNER/SHAREHOLDER SATISFACTION

How do shareholders judge the success of a business? Most shareholders in public limited companies have bought shares with the aim of making some money; consequently they will focus on dividend payments and share prices. Over time, shareholders would want both dividend payments and share prices to rise. In many countries, large financial institutions, such as insurance providers, pension funds and investment companies, own shares. These groups tend to be very focused on short-term returns. They like to see regular dividend growth and if dividend payments were frozen or cut they might see this a sign of failure or weakness. In their opinion, successful companies are those that increase dividends each year.

Figures 14.5 and 14.6 show the dividend payments and share price, respectively, of BMW, the German car maker. It might be argued that BMW shareholders would consider that the company is successful. Its dividends per share have risen steadily from €2.30 in 2011 to €3.20 in 2015. This is an increase of 39 per cent over the time period. The share price has also increased from around €55 in 2012 to just under €80 in 2016. However, the price did reach €120 in 2015. Shareholders might be a little disappointed that this price was not sustained.

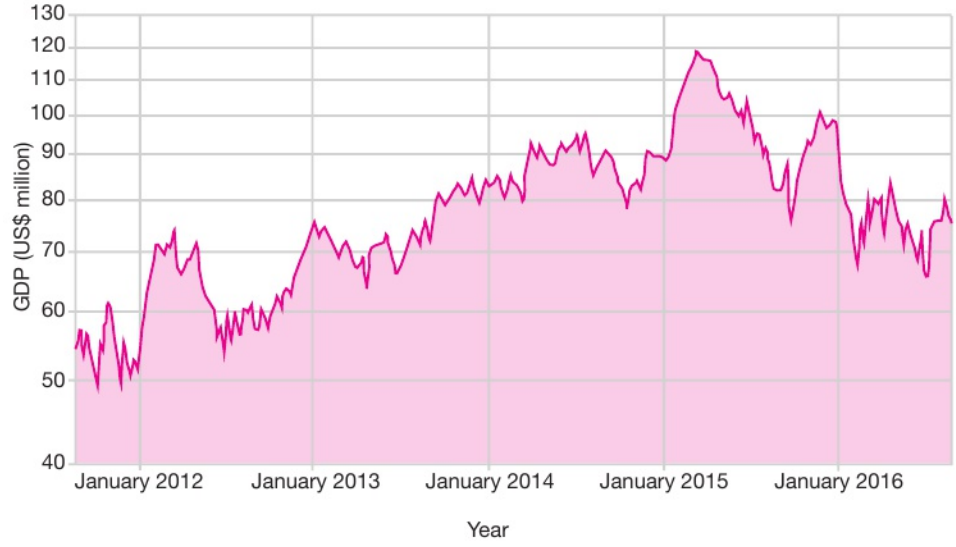
▶ Figure 14.5 BMW dividends per share, 2011–15

Source: http://markets.ft.com



▶ Figure 14.6 BMW share price, 2012–16

Source: https://uk.finance.yahoo.com



Shareholders in private limited companies may have a slightly different view of success than those of public limited companies. Private limited companies tend to be owned by families or groups of people that are known to each other. They are also likely to be fully involved in the running of the business. Success to them might mean survival in the market, rising salaries or business growth.

Small business owners may also measure success differently. For example, they may feel that a business is successful if it continues to provide financial security.

EMPLOYEE SATISFACTION

The needs of employees in a business are likely to be different from those of shareholders or other owners. Employees depend on businesses for their livelihood. Most employees have no other sources of income and rely on wages. Like the owners, employees want the business to be successful. If a business is growing and profitable, employees are likely to get higher wages, more benefits and perhaps a bonus. They will also feel more secure in their jobs. However, employees have other needs, which must be met. They will need to be trained so that they can do their jobs properly. They want good working conditions, opportunities to interact with other employees, fair and honest treatment, and opportunities for promotion. Safety at work is also important, as are issues to do with equal opportunities. Generally, employees will want to maximise their financial rewards and welfare. If their employer is able to satisfy all, or most of these needs, then in their opinion the business will be considered as successful.

Making a business more profitable may not always mean success from an employee's perspective. For example, if a business is laying off workers to cut costs in order to drive up profits, those workers who are made redundant are not likely to consider that the business is successful.

THE IMPORTANCE OF TARGETS WHEN JUDGING SUCCESS

Many owners set objectives (targets) when running their businesses. This makes it easier to measure success. For example, a business might plan to grow its market share by 5 per cent. If, by the end of the trading year, market share has grown by 6.5 per cent, the business would be considered successful. Targets might also be used to motivate staff. If targets are met or exceeded staff may receive bonuses. Another advantage of setting targets is that they can be adjusted to take into account the current circumstances of the business. For example, during a period of strong market growth a business might set more challenging targets.

LARGE VS SMALL BUSINESSES

Large businesses, particularly public limited companies, have to meet the demands of their shareholders. Consequently, their performance is likely to be measured by the size of the dividends shareholders receive and by how much the share price has increased. Therefore the performance of large companies is usually measured by profits and growth. Smaller firms may have slightly different objectives, such as personal satisfaction. Therefore, their success can be measured by looking at whether these objectives have been met.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is most likely to be used by shareholders to measure the success of a business?

A Revenue
B Dividend growth
C The quality of customer service
D Social impact

▶ 2 Which of the following might be used by a business to help measure customer satisfaction?

A Online survey
B Labour turnover
C Sales forecasts
D Cash flow forecast statement

▶ 3 Employees might measure the success of a business by looking at?

A Dividend growth
B Turnover
C Job security
D Net profit margin

▶ 4 What must be taken into account when using profit to measure the success of a business?

A Labour productivity
B The location of the business
C Product mix
D The size of the business

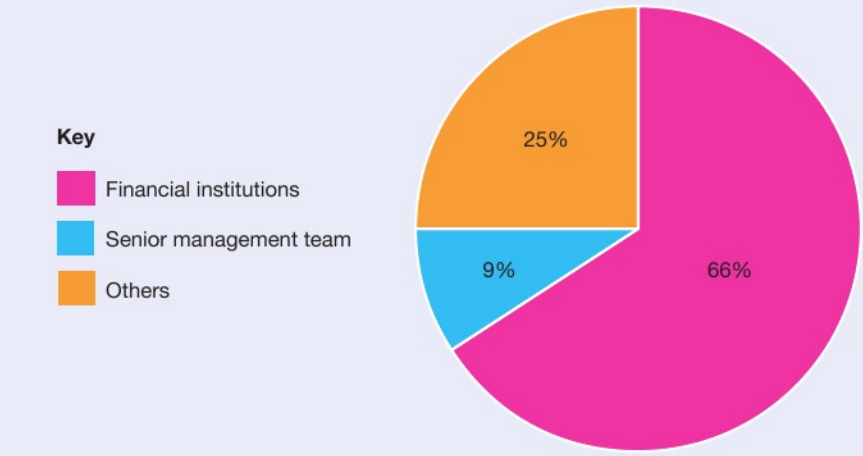
CHAPTER REVIEW

CASE STUDY: QETIC LATEX PLC

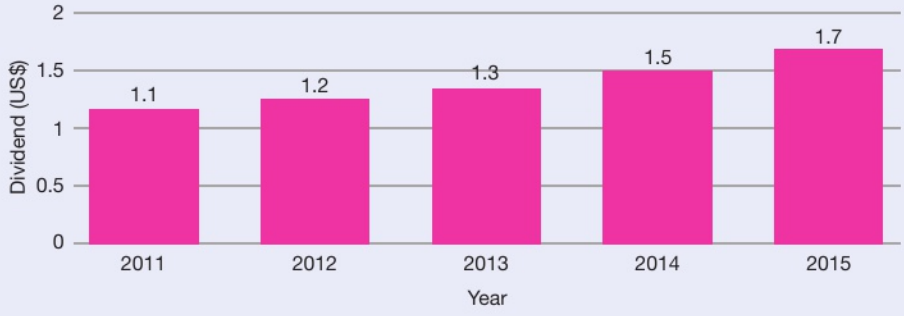
Qetic Latex Plc manufactures a range of rubber products, such as concentrated latex. It also markets latex examination gloves to medical professionals, high-pressure water hoses, injection plastic and rubber moulded parts and escalator handrails. In 2016, the company won two high profile industry awards for the quality of its latex products. This was the result of its commitment to product development and investment in a US$50 million research centre in 2015.

However, in the middle of 2016, Qetic faced some internal problems. In order to improve productivity, one of the moulding sections was to be converted to automation. This meant that 180 staff would be laid off – 16 per cent of the total workforce. The announcement of the job cuts was received very badly by the employees. Two workers protested by chaining themselves to the main gates to prevent the movement of suppliers' vehicles. A week later, the situation became more severe when a representative of the workers said that they would 'bring the company to its knees' if the workers were not given roles in another part of the organisation or paid reasonable compensation for their loss of employment. Some ugly scenes at the main plant were broadcast on television and it was reported that shareholders were very worried about the continuing conflict. This concern was reflected in the share price, which fell 12 per cent on the day after the broadcast.

▶ Figure 14.7 Qetic Latex shareholdings



▶ Figure 14.8 Qetic Latex dividend per share 2011-15



CHAPTER QUESTIONS

1. Work out the total number of people employed by Qetic Latex.
2. Is Qetic a small, medium-sized or large business?
3. Discuss how consumer satisfaction might be used to measure the success of a business like Qetic Latex.
4. Describe how shareholders might measure the success of a business.
5. Assess the success of Qetic Latex. Make a clear judgement in your evaluation.

15 REASONS FOR BUSINESS FAILURE

LEARNING OBJECTIVE

Understand the reasons for business failure:

- cash-flow problems
- lack of finance
- not competitive
- failure to adapt to changes in the market

GETTING STARTED

Unfortunately, when entrepreneurs set up a business the chances of failure are far greater than those of success. For example, in 2009 in the UK, 236 000 new businesses were started. By 2013, only 98 000 of these were still trading. This means that 58 per cent of them had failed within four years. Businesses can fail for a variety of reasons. For example, they run out of cash, they are unable to raise finance, they lack a competitive edge or they fail to adapt to changes in the market. Look at the example below.

CASE STUDY: THE PEPPERTAP

SUBJECT VOCABULARY

inventory stocks of goods

Navneet Singh established the PepperTap in India in 2013 using a simple business idea. By using an app on a mobile phone, people could order food from local shops and get it delivered very quickly. Navneet and his team were convinced that the simplicity of the idea, which provided shoppers with a speedy and convenient delivery service, would be a success – by 2015 the business was thriving. The PepperTap was operating in 17 different cities and enjoying daily orders of 20 000 – it was one of the top three food delivery services in India. However, in 2016 it closed down. There were three key reasons for the failure.

First, some local shops struggled to provide accurate information, about their stock range for example, to the app. In some cases, essential items were missing. It was often a struggle to persuade the smaller stores to adopt electronic **inventory** management and billing systems. There was no problem with larger stores because it was possible to link up with electronic systems that they were already using. However, the failure to provide customers with up-to-date information was a serious weakness.

Second, the PepperTap began to use generous discounts (around 20 per cent) to attract new customers and keep existing ones loyal. The idea was to invest in heavy discounts in the early stages of trading and then recover some of these costs later when a large bank of loyal customers had been established. However, the discounts were proving expensive.

Third, was the cost of maintaining high staffing levels to meet delivery commitments. The PepperTap promised to deliver food within two



▲ Using an app for food shopping

hours of an order being placed. This was far quicker than any rivals. However, Navneet and his team felt that they had an advantage over their competitors in making their delivery operation more efficient. This is because some of them had previously worked in this area, and costs would eventually fall.

Navneet identified these problems but the PepperTap tried to solve all three problems at the same time by closing down operations in some of the smaller cities. Even though orders rose to around 30 000 a day, losses were being made on most deliveries and cash was disappearing fast. The PepperTap was forced to close down because it could not operate competitively in the market.

1 Why did the PepperTap fail?
2 What measures might have been taken to avoid failure?
3 In pairs, make a list of things that you think might cause a business to fail. Try to decide which one of these is most likely to be a threat.

BUSINESS FAILURE

The precise rate of business failure across the world is difficult to identify. In 'Getting started' above, it was stated that 58 per cent of new businesses in 2009 in the UK had failed within only four years. More recently, in 2015, the US Census Bureau reported that 400 000 new businesses were set up in the USA during 2015 but 470 000 businesses failed. One thing is certain from these statistics: the failure rate is high. Businesses fail for a variety of reasons – one of the common reasons is money. Many businesses fail because they run out of cash, even when they are potentially profitable. Others fail because they did not raise enough finance before trading began, or they could not attract crucial funding at a later date. Effective financial planning in business is crucial. Entrepreneurs need to ensure that the business has enough money exactly when it is needed.

CASH FLOW PROBLEMS

Many businesses fail because they run out of cash. Some entrepreneurs focus too much on profit and forget about the importance of cash. There are a number of reasons why a business runs short of cash.

SUBJECT VOCABULARY

fixed assets resources that are used repeatedly for a period of time by a business such as property, tools, vehicles and machinery

OVERTRADING

Young and rapidly growing businesses are particularly at risk of overtrading. This occurs when a business is attempting to fund a large volume of production with insufficient cash. This can happen even if a business is profitable. The problem is that cash runs out while it is spending money on resources to meet a rising number of orders. Established companies trying to expand too quickly can also face this problem.

INVESTING TOO MUCH IN FIXED ASSETS

When businesses first start trading, funds are limited. Spending large amounts initially on equipment, vehicles and other capital items can quickly use up resources. It may be better to lease some of these fixed assets to protect cash reserves.

GENERAL VOCABULARY

lease legal agreement that allows you to use an asset such as a building, vehicle or machine, for a period of time, in return for rent

ALLOWING TOO MUCH CREDIT

A great deal of business relies on credit. This means that goods are sold and the customer pays for them at a later date – perhaps after 3 months. One of

the dangers is that businesses allow their customers too long for payment. This means that they are waiting for money and may actually be forced to borrow during this period.

OVER-BORROWING

Businesses may borrow to finance growth. As more loans are taken out, interest costs rise. To avoid over borrowing, a business may try to raise more capital from the owners – perhaps by selling shares.

SEASONAL FACTORS

Sometimes trade varies for seasonal reasons. In agriculture, cereal farmers have a large cash inflow when their harvest is sold. For much of the year, though, they have to pay expenses without any cash flowing in. This situation requires careful management, although it is possible to predict these changes.

UNEXPECTED EXPENDITURE

Businesses need to be prepared for any unforeseen expenditure. Equipment breakdowns, tax demands, strikes and bad debts are common examples. In the early stages of business development, owners are often hit by unforeseen expenditure. This might be caused by lack of experience or poor planning.

SUBJECT VOCABULARY

downturn period or process in which business activity, production, etc. is reduced and conditions become worse

EXTERNAL FACTORS

Sometimes events that are outside the control of the business cause cash flow problems. Examples include changes in consumer tastes, changes in legislation or a **downturn** in the economy. For example, when the global price of oil fell in 2014/15, many businesses in the oil and gas industry started to struggle.

POOR FINANCIAL MANAGEMENT

Inexperience in managing cash or a poor understanding of the way cash flows into and out of a business may lead to cash flow problems. For example, if a business plans to spend heavily just before they receive large amounts of cash from customers that have bought on credit, it is likely to face problems. It is careless to spend cash when it is not definitely there.



▲ A wooden house under construction

ACTIVITY 1

CASE STUDY: VALTREX CONSTRUCTION

In 2016, Valtrex Construction, a specialist in the design and construction of 'wooden homes', collapsed owing money to more than 300 suppliers. Up to 2014, the business had grown to US$30 million sales and was trading profitably. The directors decided to grow the business further after several new opportunities arose and during 2014 the business recorded sales of US$45 million. However, it appeared that the company was growing too quickly and resources became strained. Valtrex was unable to raise the money to needed fund the new business. Banks refused to extend overdraft lending and this resulted in serious cash flow problems. The failure of the business resulted in the redundancy of 85 staff and debts of around US$12 million.

1 What is meant by overtrading?
2 How is it possible for a profitable business, like Valtrex Construction, to fail?

LACK OF FINANCE

SUBJECT VOCABULARY

undercapitalised starting a business with insufficient capital

Both new and established businesses may fail if they cannot attract funding. Established businesses may fail to get funding because their track record is poor and they therefore present too much of a risk for investors. New businesses often struggle to attract funding because they do not have a trading history and, again, they are too risky for investors. Some business owners think they can survive with limited amounts of capital by being cautious. This means they might be **undercapitalised**. If a business does not raise enough money before trading begins it will risk failure. Arguably this is a preventable problem. However, some entrepreneurs are so keen to get started that they underestimate the importance of starting with sufficient capital.

One industry that often struggles owing to a lack of finance is the restaurant industry. Owners frequently underestimate the cost of setting up a restaurant and fail to raise enough money before they open. It takes time for a restaurant to become established and in the early stages of trading restaurants often 'burn cash'. Consequently, many restaurant ventures are short lived – a lot fail in the first year.

NOT COMPETITIVE

Some businesses fail because they are unable to compete effectively in the market. There could be a number of reasons why businesses eventually lose out to their rivals.

NEW ENTRANTS

A business may begin successfully and then fail because a new rival enters the market and takes away their trade. Many small businesses collapse because they are 'overrun' by larger competitors in the market. Competitors might:

SUBJECT VOCABULARY

outcompeted perform more effectively in a particular field

- bring out superior products – for example, the mobile phone maker Nokia failed because Apple and Android came along with better products
- read market conditions more effectively – for example, some businesses fail because they bring out products that are unpopular in the market
- charge lower prices because their costs are lower – for example, in recent years many manufacturers in the West have been **outcompeted** by low-cost producers from China and other emerging nations where labour costs are lower
- use 'destroyer pricing' (very high discounting), if they are a powerful company, to drive smaller rivals out of the market – this might happen when a company 'dumps' a cheap product in a foreign market.

INEFFECTIVE COST CONTROL

In some cases, businesses cannot keep their costs down. If costs are too high then a business needs to charge more to make a profit. This might result in a loss of trade to low-cost competitors. A firm's costs might be higher than rivals for a number of reasons.

- They may be too small to exploit economies of scale. Larger rivals that produce much more output enjoy lower unit costs – perhaps because they can buy enormous quantities of raw materials at lower prices.

- They may be wasteful. For example, a business that does not have an effective budgeting system may lose control of its costs as certain departments over spend. Some senior members of staff may spend unnecessarily when travelling on business, such as directors claiming US$5000 for a flight in business class when the economy fare is only US$300.
- It is possible that a business is paying too much for some of its resources. It may not be spending enough time researching suppliers in the market. For example, a dairy farmer might be buying large quantities of cattle feed from a local supplier when the same feed could be bought at a cheaper rate from an overseas producer.
- In some circumstances, a business might not be minimising labour costs. For example, it might be possible to relocate production to a country where wages are lower – such as Bangladesh or Vietnam.
- Costs might also rise owing to external factors. For example, if the exchange rate falls, the cost of imported raw materials and components rise. This could disadvantage a business that relies heavily on imports.

INEFFECTIVE MARKETING

Businesses may struggle to compete if their marketing is weak. Below are some examples.

- A business might launch a new product, which fails to take off. For example, Colgate, the toothpaste producer, once launched a line of convenience foods. The product was a complete failure. However, Colgate does continue to make toothpaste.
- A business might use inappropriate pricing strategies, which could mean that prices are too high or too low. If prices are too high, customers will switch to a rival. If they are too low, customers might think that the quality of the product is poor.
- A business might invest too heavily in overpriced or inappropriate marketing campaigns. Some businesses invest huge amounts of money in advertising and promotion and it does not always pay off.
- A business might use an inappropriate marketing strategy. An example might be using expensive television advertising when social media would have been more cost effective.

LACK OF BUSINESS SKILLS

Some businesses lack competitiveness and fail because their owners are not sufficiently skilled. Running a business is challenging and requires many skills. Entrepreneurs have to be creative, good with numbers, motivational and good decision makers. They also need skills in communication, IT, marketing, negotiating, financial management and, probably, many more areas. It is perhaps not surprising that willing entrepreneurs sometimes lack the skills required to be successful.

POOR LEADERSHIP

There have been cases where senior managers and business leaders have brought bring down companies by their actions. A business might lose its competitive edge in the market because the leader makes a mistake. This could be the result of poor decision making or a failure to make urgent changes. For example, it was argued that one of the main reasons why the UK chain store BHS collapsed in 2016 was down to Dominic Chappell's poor leadership.



▲ In 2009, Kingfisher was the market leader

GENERAL VOCABULARY

discretionary not controlled by strict rules, but decided on by someone in a position of authority

ACTIVITY 2

CASE STUDY: KINGFISHER AIRLINES

In 2012, Kingfisher Airlines, the debt-laden Indian airline, ceased trading. The company collapsed owing around 7000 crore (1 crore = Rs 10 million). It started operating flights in 2005 and in 2009 it was the market leader. It also acquired another Indian Airline, Air Deccan, to help boost its market share. A range of factors contributed to the failure of the company.

It has been suggested that poor management was one reason. The company lacked a strong leader. There was a frequent change of personnel at the top that meant the business was unstable. The owner of the airline, Vijay Mallya, never took an active role in running the business and eventually the airline was given to his son, Siddharth Mallya, as an 18th birthday present. It was alleged that Siddharth did not have the experience to run such a large and complex business organisation. One option would have been to make Gopinath (ex-founder of Air Deccan) the CEO. However, this opportunity was missed and generally the company lacked the expertise and experience of a specialist manager in the airline industry.

Another possible reason for Kingfisher's collapse was high operating costs. Kingfisher chose to offer customers some high quality inflight entertainment, which was not usual for domestic flights. For example, a deal with DishTV to provide live inflight entertainment meant that 50 or so customised dishes had to be installed on each aircraft. Passengers were also offered free headphones. In addition, Kingfisher invested in some very expensive advertising campaigns, featuring Deepika Padukone, one of the highest paid actors in the world. It also offered passengers access to exclusive lounges and luxury meals. These costs, and others, made it very difficult for Kingfisher to make a profit.

There were also some factors beyond the control of Kingfisher that contributed to the failure. Economic conditions were poor for several years after 2008 and the airline was caught out by high fuel prices and some discretionary taxes.

1. What was the value of Kingfisher's debt in US dollars when it collapsed in 2012 (assume US$1 = Rs 66)?
2. How might: **(a)** poor management and **(b)** high costs have contributed to the failure of Kingfisher Airlines?
3. Describe one external factor that might have contributed to the downfall of Kingfisher.

FAILURE TO INNOVATE

Some businesses collapse because they fail to innovate – they do not change with the times. They may have failed to adopt new technology or to develop new products. Some are not prepared to take the risk and invest money – they are too cautious. As a result they lose out to their more innovative rivals.

Relying on 'old' products can lead to the collapse of a business. Many people like new, innovative and up-to-date products. In recent years, Blackberry, the mobile phone and communication company, has started to struggle for its survival. In the third quarter of 2013, it announced a huge loss of US$4400 million; it also

axed several thousand jobs. After enjoying success in the 2000s, it failed to innovate by introducing new products with touchscreens.

Some businesses struggle because they fail to adopt the latest available technology in their operations. Businesses that do not install the latest and more efficient production technology will tend to have higher costs and lose out to rivals that do invest in new technology. For example, some high profile retailers have collapsed because they failed to adopt online technology. An increasing number of people do their shopping online and a failure to recognise this and provide an online service can result in a huge loss of sales. For example, one of the reasons why Comet, an electrical goods chain store in the UK, failed was because it did not adopt online retailing. It continued to trade from stores when online sales started to boom.

LARGE VS SMALL BUSINESSES

Businesses of all sizes can fail. The causes of failure can affect both large and small businesses. For example, large PLCs and small sole traders can experience cash shortages. However, it might be argued that when trading conditions become difficult, large firms are less likely to fail than smaller ones because they have more resources. Also, smaller firms are more likely to fail because the owners may have less to lose and can 'bounce back' more quickly.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a possible cause of business failure owing to ineffective marketing?

- **A** Charging a price that is too high
- **B** Investing too much in fixed assets
- **C** Over borrowing
- **D** Relocating production to a country where wages are lower

▶ 2 What term describes a business that begins trading with insufficient capital?

- **A** Overtrading
- **B** Undercapitalised
- **C** Overdrawn
- **D** Insolvent

▶ 3 Which of the following is most likely to cause a cash flow problem?

- **A** Obtaining a bank overdraft
- **B** Investing too little in innovation
- **C** Spending too much on expensive fixed assets
- **D** A weak marketing strategy

▶ 4 Overtrading might occur if a business tries to do which of the following?

- **A** Expand too quickly
- **B** Take over a rival
- **C** Sell in overseas markets
- **D** Outsource production

CHAPTER REVIEW

CASE STUDY: DANDENONG SOFT FURNISHINGS

Dandenong Soft Furnishings began trading in 1965 when Charlie Dandenong opened a furniture store in Melbourne, Australia. The business became a success and expanded rapidly. By 1998, a chain of 87 stores was trading in Victoria, New South Wales, South Australia and Queensland. In 2001, the business made a profit of A$3.3 million. However, from that year on, things started to go wrong.



▲ Soft furnishings

Charlie retired from the business and appointed his daughter, Agnes, as CEO. She had a degree in business management and had spent five years working in accounts at the business. However, although Agnes impressed on the 'academic stage', she struggled to run a multi-million pound business. She lacked a strong personality and had poor leadership skills. She also made a number of bad mistakes. One was to buy rival chain, Marigold Furnishings, for A$6.3 million. The price was far too high and Dandenong already had stores competing successfully with Marigold in more than half of the locations. Another error was to invest heavily in a national television advertising campaign just after the purchase. This stretched the company financially, forcing them to borrow A$10 million. However, worse was to come.

Between 2002 and 2008, the company 'bumped along', just about breaking even. The interest payments were eating into profits and sales were starting to fall. The marketing manager wrote a report for Agnes explaining the importance of online selling and that Dandenong should consider very seriously setting up an online facility. However, Agnes was strongly opposed to this. She thought that the main strength of Dandenong's business model was the quality of customer service given in the stores. Dandenong had always invested heavily in specialised customer service training.

In 2010, the company had started to lose money owing to falling sales. Agnes thought that the way to improve performance, and prevent cash flow problems, was to open stores in Western Australia, a region in which Dandenong was not represented. This strategy needed investment of A$5 million. Agnes drew up a business plan and approached a number of lenders for finance. However, not a single bank or investor was interested. They felt that online selling was the way forward and Dandenong had 'missed the boat'. Too many businesses were running successful online businesses offering quality furniture at much lower prices than Dandenong.

In September 2014, Dandenong closed down owing banks A$12.5 million. Agnes told a reporter that the business had failed owing to a lack of finance. However, in a television interview for a local Queensland media company, the marketing manager said the failure to innovate was the real reason for the collapse.

CHAPTER QUESTIONS

1 Suggest two possible causes of cash flow problems.

2 How can rising debt affect a business like Dandenong Soft Furnishings?

3 Assess the reasons why Dandenong Soft Furnishings failed. Make a clear judgement in your evaluation.

EXAM PRACTICE: 1 BUSINESS ACTIVITY AND INFLUENCES ON BUSINESS

Ismail Omar, a sole trader, owns a retail outlet in a shopping mall in Bahrain. He sells jewellery that he imports from overseas. In 2014, the business was struggling to survive owing to strong competition from other retailers inside the mall. However, one of his main rivals closed down in 2015 and now his business is increasing its sales.

AO2 **a** State **one** non-financial aim of a business. **(1)**

AO2 **b** State **one** way of measuring the success of a business. **(1)**

SKILLS ANALYSIS **AO1** **c** Explain **one** way in which a fall in the exchange rate might affect a business. **(3)**

SKILLS ANALYSIS **AO1** **d** Explain **one** disadvantage of operating as a sole trader. **(3)**

Ismail read in a newspaper that interest rates in Bahrain were likely to rise in 2017.

SKILLS ANALYSIS **AO1** **e** Explain **one** possible effect on a business of an increase in interest rates. **(3)**

In 2017, Ismail was informed that his rent in the shopping mall would double. As a result of the news, Ismail was considering two options:

Option 1: Move his shop to a Bahraini side street where rent is very cheap.
Option 2: Cease trading from a shop and set up an online business selling jewellery.

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION **AO2** **AO3** **AO4** **f** Justify which one of these two options Ismail should choose. **(9)**

Total marks for this question = 20



2 PEOPLE IN BUSINESS

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

The people employed by a business are crucial to its performance. This section explores the types of employment that businesses use and the way they recruit, select, train and motivate employees. It also covers the methods of communication used by businesses and the possible barriers to communication. Finally, the way in which businesses organise themselves into different departments is addressed, as are the different roles and responsibilities of employees.

16 THE IMPORTANCE OF GOOD COMMUNICATION IN BUSINESS

LEARNING OBJECTIVES

- Understand the nature of communication
- Understand the difference between internal and external communication
- Understand the importance of good communication
- Understand the different methods of communication, their benefits and their limitations

SUBJECT VOCABULARY

overdue money that has not been paid by the time expected

GENERAL VOCABULARY

communication sending and receiving of messages

GETTING STARTED

People in businesses exchange information all the time.

- A sales manager may telephone the production manager to ask if a customer's order is ready.
- A credit controller may write to a customer explaining that their account is overdue.
- An operative may ask a technician to repair a fault with a machine.

Look at the examples of communication below.

CASE STUDY: BUSINESS PRESS CONFERENCE

From time to time, companies will address the media. They may want to make an important announcement. For example, they may want to launch a new product, announce a takeover or give out information about the performance of the business. Below the board of directors are presenting information about the financial performance of the company for the year.



▶ A company press conference

CASE STUDY: INTERNAL EMAIL

▶ Figure 16.1 An internal email

12.4.16

Dear Celia,

Please could you send me a copy of the sales report you wrote for the marketing manager last month?

Thank you very much.

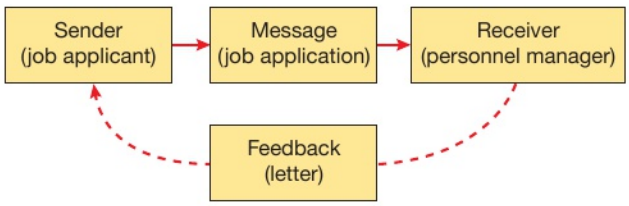
Kind regards
Deepika Mendis
Head of Finance
Portland Carriers plc

1 Name the **(a)** sender, **(b)** receiver(s) and **(c)** message in the two examples of communication shown in the photograph and Figure 16.1.
2 Produce an illustrated poster that shows the different ways you communicate with your friends.

WHAT IS COMMUNICATION?

Communication is about sending and receiving information. Figure 16.2 shows how communication might work in business. It shows who is involved, the message and the feedback. Communication begins with a *sender*. In Figure 16.2, the sender is an applicant for a job. The *message* being sent is a job application form for a clerical assistant. The *receiver* is the personnel manager. The *feedback* is a letter inviting the applicant for an interview. Note that the personnel manager becomes the sender when the interview invitation is sent back. Therefore, the applicant now becomes the receiver.

▶ Figure 16.2 The process of communication



HOW DOES COMMUNICATION TAKE PLACE?

SUBJECT VOCABULARY

communication channels routes along which information might travel in a business

downward communication passing messages from the top of the organisation to those at the bottom

GENERAL VOCABULARY

subordinates people in the hierarchy who work under the control of a more senior worker

Inside a business, messages can be passed vertically (upwards or downwards) and horizontally (from side to side). These routes are called communication channels.

Downward communication usually involves managers giving information or instructions to their subordinates. Downward communication is important because:

- subordinates look to their managers for leadership and guidance
- it allows the decisions made by management to be carried out by employees
- it allows managers to command, control and organise.

SUBJECT VOCABULARY

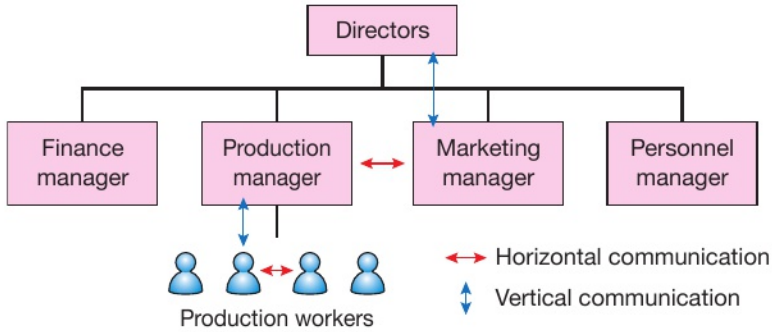
upward communication passing messages from the bottom of an organisation to those at the top

horizontal communication exchange of information between parties on the same level in an organisation's hierarchy

Upward communication often involves workers giving feedback to managers. However, it might also involve requests by workers. They may need more resources, for example. Upward communication is helpful because it:

- helps managers to understand the views and needs of subordinates
- may make managers aware of problems
- helps staff to feel that they are valued
- provides managers with information to help make decisions.

Horizontal communication occurs when workers on the same level in the organisation exchange information. Horizontal communication is common within a department. For example, operatives are likely to discuss their work with each other.



▶ Figure 16.3 Vertical and horizontal communication

ACTIVITY 1

CASE STUDY: ELMART

Roberto Navarro is the Regional Manager of ELMart, a Spanish supermarket chain. He is responsible for the performance of six stores in southern Spain. Table 16.1 contains financial information about the performance of the stores in May 2016. The table has been sent to the finance director who is writing a report for a board meeting.

▼ Table 16.1 ELMart regional store performance

	MALAGA	MADRID	CADIZ	JEREZ	NERJA	SEVILLE	TOTAL
Turnover	98 500	133 400	87 600	94 900	76 900	83 400	574 700
Profit	23 200	34 600	21 400	19 700	–1200	16 800	114 500

1 Who is the sender of the information in this example?
2 What is meant by vertical communication? (Use an example from the case study.)
3 What sort of information is being sent in this example?
4 Why is upward communication helpful?

INTERNAL AND EXTERNAL COMMUNICATION

SUBJECT VOCABULARY

internal communication communication between people inside the business

external communication communication between the business and those outside such as customers, investors or the authorities

Internal communication takes place inside a business between employees. Examples include:

- a manager giving a warning to a subordinate for repeated lateness
- a board meeting where directors are discussing a possible merger.

External communication occurs when businesses exchange information with people and organisations outside the business. Examples include:

- a statement from a credit card company
- a focus group where people from the marketing department discuss a product with members of the public.

FORMAL AND INFORMAL COMMUNICATION

SUBJECT VOCABULARY

formal communication use of recognised channels when communicating

informal communication use of non-approved channels when communicating

Formal communication in business is when people use recognised channels. **Informal communication** is through non-approved channels. Most informal communication is done 'on the grapevine'. This means that unofficial information is passed on through gossip and rumours. It can be both helpful and unhelpful. Information on the grapevine may become confusing and misleading.

Communication often takes place between groups. These can be both formal and informal. *Formal groups* are those set up by the business. They are often shown on organisation charts as departments. Examples of *informal groups* might be:

- employees who meet outside work at sports clubs, local churches or social clubs
- families and very close friends who work in different departments
- groups of workers that started together or trained together.

Communication between informal groups is helpful if it keeps people informed and encourages cooperation. However, it can also be a problem. One reason for this is because leaders of informal groups often have influence than those of formal groups. Therefore, when formal communication and informal communication channels give different messages, staff may not trust the formal communication.

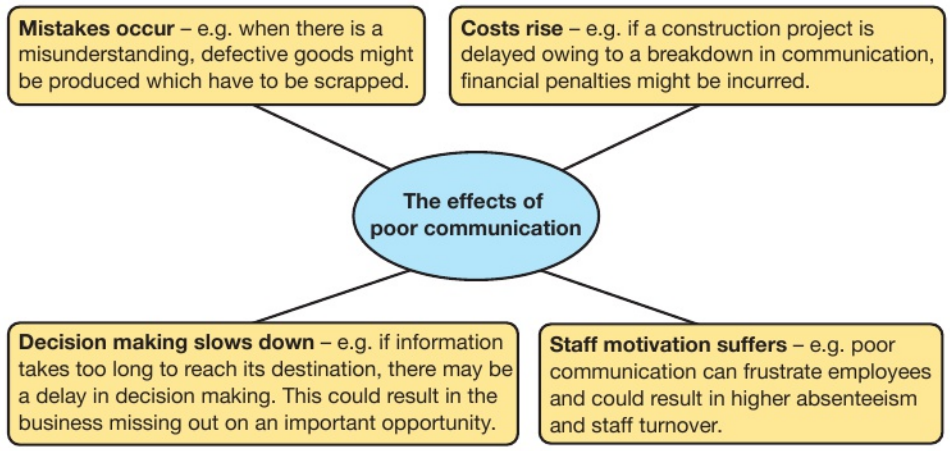
DID YOU KNOW?

The grapevine can be used by management to find out what people 'feel'. Some firms 'leak' information on the grapevine to see what reaction it gets. The reactions might then affect management decisions.

THE IMPORTANCE OF GOOD COMMUNICATION IN BUSINESS

If internal communication is poor, problems can arise. As a result, efficiency and profitability may suffer. Poor communication can lead to mistakes, wasted resources and confusion. It can lead to workers not understanding what they have to do, poor motivation and to some work being accidentally repeated. Poor external communication can make the business look foolish and may cost it money. For example, if prices on a company's website are set too low by mistake, this could lead to a flood of online orders. These may have to be accepted at a loss. Poor communication with outsiders could also damage the image of the company. The main effects of poor communication on a business are summarised with examples in Figure 16.4.

▶ Figure 16.4 Effects of poor communication



METHODS OF COMMUNICATION

FACE-TO-FACE COMMUNICATION

This takes place when spoken information is exchanged by people who can see each other. Face-to-face communication is effective. The advantages and disadvantages are shown in Table 16.2. Some examples of face-to-face communication include:

- an interview where a candidate is being interviewed for a job
- at a training session where people are being taught new skills
- dealing with customers, either from behind a counter or in reception
- at a presentation to investors and the media reporting the financial progress of a company.

▶ Table 16.2 Advantages and disadvantages of face-to-face communication

ADVANTAGES	DISADVANTAGES
Allows immediate feedback	Negative body language may create a barrier
Encourages cooperation	A record of the message may not be kept
Allows new ideas to be generated	Non-relevant information may be included
Saves time	In a meeting, some people may not listen
	Limits to the number reached, for example, by the capacity of largest meeting room

WRITTEN COMMUNICATION

Businesses communicate written information using a variety of methods. Each of them has their own advantages and disadvantages.

- **Letters** are a common way to send written information. They are flexible because they can be sent to a variety of different people, such as customers, employees and suppliers. The information in each letter can be expressed so that the recipient can understand it. Letters can also be used for private information and provide a record of the communication. However, letter writing can take time and effort and some employees may have relatively poor written skills.
- **Reports** are used to communicate important information in a formal manner. They may be short, or complex and detailed. However, reports should be concise and carefully structured and presented. Reports can contain numerical data and graphics. The main disadvantage of reports is that they take time to research and write.

- **Memorandums** (short written notes) are used for internal communications only. They contain brief messages and are flexible. They are often used to remind people of events, confirm telephone conversations or pass on simple instructions.
- **Forms** are used to communicate routine information. Application forms are used to collect information for jobs, loans or licences. Claim forms for expenses and other allowances, order forms and timesheets are all examples of different types of form. However, forms may be inflexible and can become out of date.
- **Noticeboards** are cheap to use and can pass on information to a large number of people. However, they can become untidy, are open to abuse and are often overlooked.

ACTIVITY 2

CASE STUDY: STAFF COMMUNICATION

Yuri Kutepov is in charge of a section at a call centre that provides customer support for an insurance company. He is responsible for 50 staff and wanted all of them to attend a very short meeting at the end of work on Thursday evening. He used the section noticeboard to inform staff of the meeting. He thought that if people did not see the notice, which was pinned to the board on Monday, at least they would hear about it 'on the grapevine'.

When the meeting took place, 11 members of staff were absent.



▶ Noticeboards can be a good way to communicate but not in all cases

1 Is this case an example of internal or external communication?
2 What is meant by 'on the grapevine'?
3 Do you think using a noticeboard was an appropriate method of communication in this case?

ELECTRONIC COMMUNICATION

Most businesses use electronic communications. It is possible to deliver messages instantly, all over the world and to a number of people at the same time using electronic methods.

- **Email**: Email is one of the most common methods of electronic communication. It allows businesses and individuals to communicate by sending text or images instantly via a computer. One of the problems with emails might be that they get ignored. People at work often get so many emails that they do not have the time or the motivation to read/answer every single message.
- **Internet**: The Internet can be used for internal and external communication. Many businesses use their own website to provide a wide range of information. The Internet can be used to:
  - market products by displaying them on shopping sites
  - allow customers to buy products with credit and debit cards
  - provide general information about the history and nature of the business
  - advertise jobs to people inside and outside the business
  - obtain information about other companies and products for market research
  - obtain information about potential suppliers
  - deal with customer queries online.
- **Mobile phones**: These are a valuable method of communication for businesses. They are useful when employees work away from the office or move around frequently. Text messages can also be sent from a mobile phone. This is cheap and can be used for sending short memos. Modern mobile phones can be used to access the Internet and send images. This makes them even more useful.
- **Social media**: Businesses rely heavily on the use social media platforms, such as Facebook and Twitter, to communicate. Businesses can use social media to communicate with customers. For example, they can gather information from customers all over the world to find out what they think of a new product. The information is up to date and can be sent instantly. More details about the use of social media to communicate in business are detailed in the chapter review case study below. Social media might also be used internally so that employees can communicate information. For example, Nokia, the mobile phone manufacturer, uses three specific social media tools called BlogHub, VideoHub and Infopedia to encourage information sharing among its 125 000 workers. BlogHub can be used by staff for horizontal communication, to raise awareness of what individual staff members are working on, for example.
- **Intranets**: An Intranet is where all the computers in a particular department or organisation are linked together. This enables users to access common information. An advantage is that changes made to information such as timetables, staff diaries, stock lists, prices and company events can be updated instantly and be available to everyone.
- **Videoconferencing and teleconferencing**: Videoconferencing allows people in different locations to have face-to-face meetings. Individuals or groups of people in different parts of the world can be linked at the same time by using a system of cameras, computers and telephones. Teleconferencing is similar but the participants in the conference call are all linked by telephone. Each person can talk to all the others as though they were together.

KEY POINT

Online communication is not without problems.

- In some areas, it is not possible to get a broadband connection.
- Connections can be lost when using the Internet.
- Email inboxes get filled with electronic junk mail or spam.
- Computer viruses can result in the loss of files.
- Computer hackers may get hold of sensitive and confidential information.

- **Public address (PA) systems**: These are often used in factories, hotels and large stores to pass on information to staff or customers. Messages are broadcast over the loudspeaker system for everyone to hear.
- **Electronic noticeboards**: These perform a similar function to PA systems except that written messages, pictures, videos and sound are used. They communicate information to employees and visitors via visual display units located around the business, such as in reception. Other examples of electronic noticeboards are departures and arrivals boards at train stations and airports.

LARGE VS SMALL BUSINESSES

In small businesses, a great deal of communication is likely to be informal. This is because the owner of the business is likely to be working very closely with employees. It will be relatively easy to pass on instructions, get feedback and discuss work issues with employees that are likely to be working in the same physical space. However, as businesses get larger there will be a need for formal communication systems. There may be quite a physical distance, for example, between the owners of the business and the employees – particularly in large PLCs. Also, some large businesses employ thousands of people and without formal communication systems, communications are likely to break down and result in numerous difficulties.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of external communication?

A Sending a customer information about a special offer
B A departmental staff meeting
C A training session for a new recruit
D A presentation by the chairman to the senior management team

▶ 2 Which of the following is a disadvantage of face-to-face communication?

A It takes too much time
B It fails to encourage cooperation
C Negative body language may create a barrier
D Only a minority of staff are able to use this method

▶ 3 Which of the following is an example of upward communication?

A The board of directors addressing the shareholders
B The board of directors addressing all employees
C A supervisor asking an operative if they can work overtime
D A purchasing officer teaching a new recruit how to complete a requisition form

▶ 4 Which of the following is most likely to require written communication?

A Informing staff of an end-of-month party
B Inviting a job applicant for an interview
C A job interview
D Asking a colleague for a very urgently needed piece of information

CHAPTER REVIEW

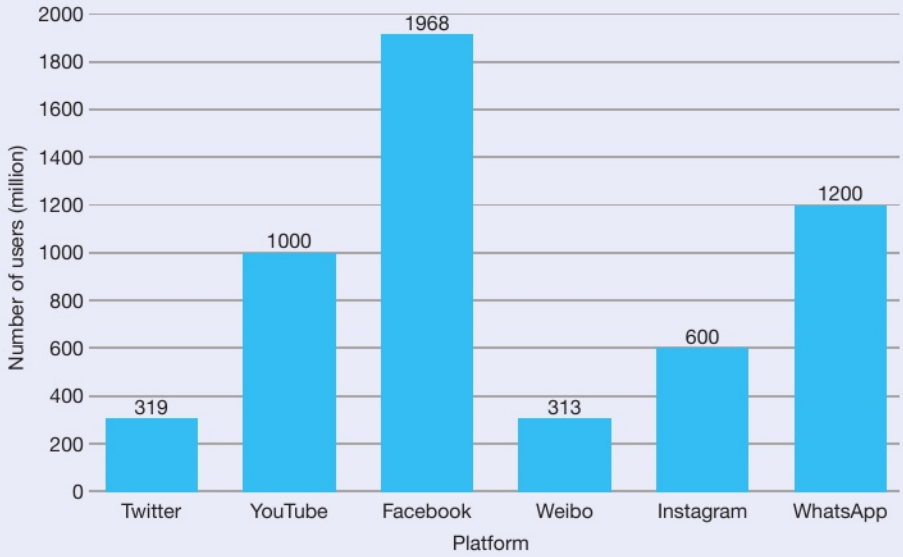
CASE STUDY: CHOCCOMATE

Ju Kin Fung is the marketing manager of Hong-Kong-based ChoccoMate, a sweet manufacturer serving customers in Hong Kong, China and other Far Eastern countries. In 2016, he wanted to persuade the board of directors that the company should make use of social media to help market its products. He had been to a marketing conference in California where the benefits of using social media in marketing had been the topic of debate. Ju Kin Fung was extremely enthusiastic about using social media since it was a means of gathering up-to-date feedback from customers. The board of directors agreed to attend a 30-minute presentation by Ju Kin Fung. The main benefits of using social media that he discussed in the presentation are outlined below.

- Businesses can gather personal data from huge numbers of people. They can find out who they are, what they like and what they think of ChoccoMate's products. Customer feedback can be obtained instantly from all over the world and all this is free! The graph in Figure 16.5 shows the huge numbers of users of different social platforms.
- Businesses are using social media to connect and engage directly with their customers. For example, 65 per cent of small or local businesses said they used social media to communicate with customers, 50 per cent of Facebook users under the age of 35 responded to recommendations about products online and 51 per cent of Facebook users and 64 per cent of Twitter users are more likely buy products they see advertised on their social media platforms.
- ChoccoMate could run targeted adverts. For example, with a Facebook advert, ChoccoMate could target customers based on location, age, interests, behaviours and connections. It would also be possible to track and measure the performance of adverts on social media.
- ChoccoMate could provide better customer service. Around 67 per cent of customers use social media to get their customer service. People expect to be able to contact a business 24/7. A study by Aberdeen Group, an IT research company, shows that businesses offering customer service using social media enjoyed bigger annual financial gains (7.5 per cent growth) vs those without (2.9 per cent).
- It would be possible to increase website traffic by directing interested customers from a social platform using a link.
- ChoccoMate could monitor the behaviour of competitors. For example, tools are available that allow a business to 'flag-up' key words used on social media such as 'new chocolate bar'.

To maintain balance in the presentation, Ju Kin Fung also planned to draw attention to the possible disadvantages of using social media. For example, he would point out that any negative feedback would be there for all to see. So, while social media can be an extremely powerful tool for building the reputation of the business, it can also damage the reputation of a business. It also takes time to develop a presence on social media. ChoccoMate would have to decide which employees would be involved in monitoring comments and recording, gathering

and presenting the huge amount of data that would be generated. There would also be a need to decide what information and other content should be fed onto the social media stream. Finally, although it is free at the very basic level, costs would be incurred, such as the time it takes staff to manage the company's media presence and gather and present data in a meaningful way.



▶ Figure 16.5 A sample of social media platforms and their number of users (minimum), 2017

CHAPTER QUESTIONS

1 What is meant by the term external communication?

2 Describe one benefit of using a presentation as a means of communication in this case.

3 Why is good communication important in business? Give at least two reasons in your analysis.

4 Assess the benefits to ChoccoMate of using social media as a means of communication.

17 BARRIERS TO COMMUNICATION IN BUSINESS

LEARNING OBJECTIVES

- Understand how communication barriers arise
- Understand the problems of ineffective communication
- Understand how communication barriers can be removed

GETTING STARTED

It is not uncommon for communication to break down when people exchange information. For example, messages might get misunderstood or they might be delayed. Sometimes an organisation might develop a reputation for poor communication. In business, the cost of ineffective communication can be expensive. Look at the example below.

CASE STUDY: PARAPOWERCORP



▲ Customer service staff at ParapowerCorp

ParapowerCorp supplies electricity to around 3 million users in a Far Eastern country. In 2015, it was heavily criticised in the media for the poor quality of its customer service. A report, which appeared in a national newspaper, revealed a number of specific problems that thousands of customers had identified.

- It could take up to 20 minutes to get a telephone call through to the organisation.
- Emails would often go unanswered.
- Staff had poor knowledge of customer details and often blamed computer problems for their lack of information.
- Some staff were rude when talking to customers.

The report claimed that around 39 per cent of the customers they spoke with when gathering information for the report had now switched suppliers. A spokesperson for ParapowerCorp said: 'We are aware of a small number of communication problems. We take customer dissatisfaction seriously and hope to find resolutions to these problems very quickly indeed.'

1. Describe the communication problems ParapowerCorp customers are experiencing.
2. Discuss the impact these communication problems might have on ParapowerCorp.
3. Suggest how these communication problems might be overcome.

4 In groups, try to think of some examples where a breakdown in communications between you and your friends or family has caused problems.

BARRIERS TO COMMUNICATION

Communication is only effective if the receiver understands the message sent. Things that get in the way of good communication are called **communication barriers**. Some examples are given below.

GENERAL VOCABULARY

communication barriers obstacles that prevent effective communication between the sender and the receiver

LACK OF CLARITY

If a message is not clear, it may be misunderstood or ignored. Unclear communication may be the result of poorly written or poorly expressed messages. For example, instructions may be given to an employee that do not contain enough detail. How might a sewing machinist in a clothes factory respond to an instruction that states 'You need to clean up your act.'? More information is needed. Does it mean that the machinist needs to work more tidily, make less mess, work more accurately or improve personal presentation before arriving at work?

TECHNOLOGICAL BREAKDOWN

A lot of business communication is done electronically. If technology is faulty, communication may become unclear or break down. For example, emails cannot be sent if broadband connections are lost. Mobile telephone conversations can often be unclear because of a weak signal or unavailable because there is no signal. Since the use of, and reliance on, electronic communication is increasing all the time, technological breakdowns are becoming a more serious issue. For example, company websites sometimes crash if there is a large volume of traffic. This can happen when tickets go on sale for a major concert or sporting event, or when special offers are announced. More recently, the websites of some businesses have been taken out of service by computer hackers.

POOR COMMUNICATION SKILLS

Some people may have poor communication skills. Here are some examples.

- When communicating verbally, some people may have a limited vocabulary or may not be able to make themselves understood. They make speak with very strong accents or use informal language. Customers sometimes complain that they cannot understand people when they are put through to staff working in an overseas call centre; this may be owing to the customers' unfamiliarity with the accent.
- Some people may be poor listeners and may 'switch off' during the communication process. They may only be able to concentrate for short periods or may be too impatient. Some employees at meetings do not have the will to participate actively. They may 'daydream', distract themselves (with their smartphones perhaps) or even fall asleep! This is more likely to happen when meetings are attended by large numbers of staff.
- Written messages may contain poor spelling or weak grammar, errors that can make a message appear untrustworthy. Some messages might be completely ignored if they are poorly written. For example, a poorly written bid for a contract may be simply deleted. Some types of written messages may be too long. If a business report is too long, for example, the reader may overlook some of the important issues.

- Sending messages in anger is an example of poor communication and can act as a barrier. For example, an angry person at the end of a phone line may be ignored. Switching off the phone may be a natural reaction to an angry caller. The use of threatening messages may also act as a barrier. People often act very negatively to threats. For example, sending a threatening message to a customer asking for payment is likely to result in a further delay. The customer may avoid paying as a response to the unpleasant message they have received.

JARGON

Sometimes people use jargon when communicating. Jargon is vocabulary that is used and understood by people in a specific group; however, outside that group it may be meaningless. Clearly, jargon should not be used when communicating with people outside the group. Customers sometimes get frustrated when employees start to use company, industry or technical jargon.

DISTRACTIONS

Communications may break down if there are distractions in the communication process. An obvious distraction is noise. In a factory or on a construction site, for example, the noise from machinery may prevent messages from being communicated effectively. Distractions may also occur if people are under stress as they may be insufficiently focused on their jobs as a result.

BUSINESS CULTURE

Some businesses may develop a culture of poor communication. This can be quite a serious issue and occurs when there is a general lack of communication throughout the whole organisation. If a business fails to keep its employees fully informed of important events, it can lead to doubt and uncertainty. This may result in rumours, gossip, suspicion and anger. This is all negative and encourages a mentality in which staff become isolated and fail to share information with colleagues.

LONG CHAIN OF COMMAND

If there are too many layers of management in the organisation, the chain of command will be longer. This means messages take longer to pass through the chain and may become unclear or inaccurate on the way. This is more likely to happen in large organisations where thousands of staff are employed.

USING THE WRONG MEDIUM

The different methods by which messages can be sent are called communication media (these are discussed in Chapter 16). However, if the sender uses an inappropriate medium, an important message may be missed. Quite often the same information can be sent using different methods of communication, or by more than one method. A business must use the most appropriate method. Generally, methods should be used that minimise costs. Some examples of appropriate use of communication media are shown in the box opposite.

- Confidential information, such as people's personal details, should be communicated securely – using a letter, for example.
- Sensitive information, such as a staff disciplinary matter, should be communicated face to face.
- Some communication, such as a job offer, must be supported by a document such as a letter.

DID YOU KNOW?

In some Middle Eastern countries, it is polite to spend time discussing trivial matters before a business meeting gets under way. But Western colleagues may see this as a waste of time.

- If immediate feedback is required, verbal communication will be needed.
- Standard information is best communicated using forms.
- Complex and detailed information is best communicated in a report.

DIFFERENT COUNTRIES, LANGUAGES AND CULTURES

In multinational companies people may be working in different countries where languages and cultures vary. Such differences may make communication more challenging. Employees may be in different time zones from one another, which can delay responses or make real time communication by telephone or video call difficult.

KEY POINT

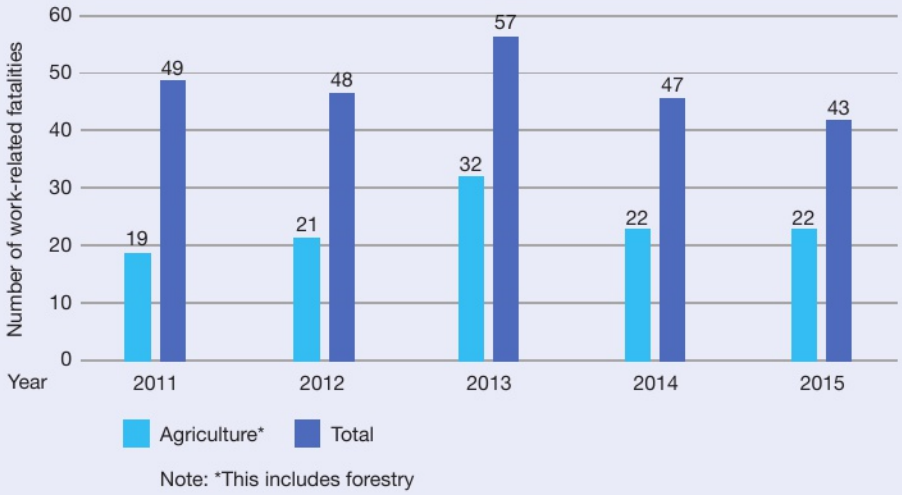
Information is more likely to be understood if:

- there is not too much information
- clear and precise language is used
- it is delivered at a reasonable pace
- the receiver is familiar with the sender and method of communication
- the message only contains relevant information.

ACTIVITY 1

CASE STUDY: WORK-RELATED FATALITIES

Clear communication in a business can help reduce the number of accidents and deaths at work. In New Zealand, a few people each year are killed as a result of work-related quad bike accidents. In addition, around 60 people each year are seriously injured. Most of these accidents happen on farms where quad bikes are used when working with livestock. A spokesman for a Health and Safety Agency said: 'The problem is people just don't understand how dangerous these bikes are. The message just hasn't got across. Far too many people ride these bikes without helmets. This is so dangerous. These bikes also have limitations – they can't go everywhere. We need to improve communications here and make sure everyone knows the dangers before they ever take off on one.'



▶ Figure 17.1 Number of work-related fatalities in New Zealand, 2011–15

Source: http://www.business.govt.nz

1. Work out the percentage of work-related fatalities in agriculture as a proportion of the total in 2015.
2. Why is clear communication very important on a farm?
3. Discuss the possible barriers to communication on farms. Include at least two barriers in your analysis.

THE PROBLEMS OF INEFFECTIVE COMMUNICATIONS IN BUSINESS

Ineffective communication in business can result in expensive problems. Higher staff turnover, more staff absences, poor customer service, more work-related injuries, difficulties making changes, higher legal costs and lower profits are all possible examples. Ineffective external communications can damage relations with customers and suppliers. In the case of customers, poor communications can result in misunderstandings, misinformation and poor-quality customer service. If communication problems cannot be solved, customers may find alternative shops or suppliers, which will result in lost revenues and lower profits. If communications break down with suppliers, production may be halted because crucial supplies have failed to arrive.

Ineffective internal communication can result in low motivation, disengaged workers, conflict, mistakes and injuries. The list below shows data relating to poor internal communications in US companies in 2014.

- Companies with good internal communications enjoyed 47 per cent better financial returns (over the last five years).
- Each employee that switches from being uncommitted to committed in their work as a result of better internal communication adds US$13 000 to annual profit.
- In the USA, 70 per cent of employees are not engaged in their work.
- Disengaged employees cost US$450 million to US$550 million per year in lost productivity.
- Communication barriers can cost around US$26 000 per worker owing to lost productivity.
- A business with 100 employees might expect to spend 17 hours per week merely clarifying communication.
- Of employees 71 per cent think that managers do not spend enough time communicating goals and plans.
- Two-thirds of employees do not receive enough information when experiencing corporate change.

SUBJECT VOCABULARY

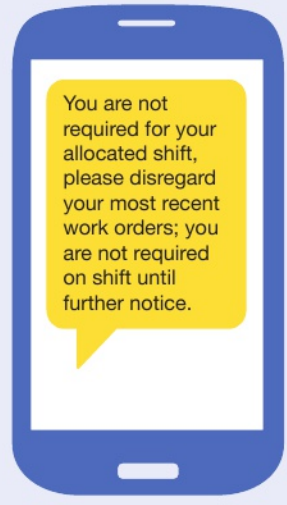
redeployment moving someone or something to a different place or job

ACTIVITY 2

CASE STUDY: POOR COMMUNICATION

In 2015, around 40 workers in Brisbane received a text message from their employer, Hutchinson Ports Australia, telling them that they had been dismissed. Figure 17.2 shows some of the wording of the text. The text directed the dismissed workers to a company email that gave further details. Extracts from the email revealed that 'The intended last day of your employment will be Friday 14 August 2015' and that there would be 'no **redeployment** opportunities.'

In response to the text, angry workers set up barriers stopping some movements at ports in Brisbane and Sydney. Two weeks later, a late night court sitting gave the workers their jobs back. Justice Darryl Rangiah agreed to grant a temporary order to stop Hutchinson Ports



▶ Figure 17.2 A text allegedly sent to workers by Hutchinson Ports Australia in August 2015

Australia from going through with the sackings until a full hearing the following month.

1 Discuss the appropriateness of the method used by Hutchinson Ports Australia to communicate the information stated in the case.
2 Describe the possible impact on the business of this method of communication.

HOW CAN BARRIERS TO COMMUNICATION BE REMOVED?

RECRUITMENT

Businesses should recruit staff with good communication skills. The quality of people's written communication in job applications may provide a guide to their ability. Also, people's verbal communication skills can be assessed in interviews. If a job applicant is unable to communicate effectively during an interview, they should not be likely to get the job. In some cases, businesses might use formal tests to assess the communication skills of potential recruits.

TRAINING

Businesses must overcome barriers to communication. One way is to train staff in communication. For example, staff can be trained to improve verbal communication skills when dealing with customers on the telephone. They can attend specialised courses to improve verbal communication, learn a language, improve written skills and develop presentation skills. Many businesses introduce new recruits to formal communication systems at the start of their employment.

WRITTEN COMMUNICATION

One way of removing the barriers created by poorly written communication is to provide standard company letters, which can be used by all staff. Templates can be stored easily in IT systems for letters to customers, suppliers and other regular receivers. A business might also use forms to gather information. This helps to present written information in a structured and clear way. Forms will also prevent employees from including written information that is not required.

TECHNOLOGY

If communication barriers result from faulty technology, a business may have to repair or replace equipment. The pace of technology is very fast and businesses will be under competitive pressure to keep up to date with new developments. Barriers sometimes exist because some employees do not understand how IT systems work, or they are not aware of the systems' full capabilities. If this is the case, then training should be supplied. Modern IT systems should improve communication in business, not create barriers.

CHAIN OF COMMAND

If this is too long, a business may decide to remove some of the management levels in the organisation. A shorter chain of command means that information can pass through an organisation more quickly. Flatter organisations might also lead to more upward communication, which means that managers might have a better understanding of employee ideas and morale.

SOCIAL EVENTS

Internal communication may improve if social events are organised for staff. These provide opportunities for workers from different departments to come

together, which may be helpful. Getting to know colleagues at social events might help people to bond and develop working relationships and thus help to improve communications.

CULTURE CHANGE

If a business has a culture of poor communication, it will be important to make changes. A business might need to introduce some formal communication systems. It might need to remove physical barriers, such as partitions between workstations, provide larger and more open work spaces, end the separation of workers according to job status and perhaps introduce an 'open door' policy, through which staff are encouraged to communicate with their seniors. A business must also avoid withholding important information and encourage upward communication. Generally, a business will need to work towards a climate of openness and trust.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is the **most appropriate** method of communication for requesting an **urgent** delivery of components?

A Business report
B Telephone call
C Email
D Letter

▶ 2 Which of the following communications needs to be supported with a document?

A An online job advert
B A request to an employee to stay an extra 10 minutes to complete an order
C A job offer
D A presentation to potential customers

▶ 3 Which of the following is **most likely to be** a barrier to communication?

A Barriers to entry
B The use of jargon
C Employing a flat organisational structure
D Heavy reliance on electronic means of communication

▶ 4 A business with a flatter organisation will experience

A Slower communication through the chain of command
B Quicker communication through the chain of command
C The development of poor communication skills among senior management
D Difficulties in training staff in communication skills

CHAPTER REVIEW

CASE STUDY: MENDIS HOLDINGS

Mendis Holdings is a shipping agent based in Colombo, Sri Lanka. It employs 190 people and is starting to suffer from a rise in staff turnover and staff absence. Problems started to develop when a number of important clients complained that some of the staff had poor communication skills. For example, two clients mentioned that some of the reports it was receiving were too long and contained what they considered to be too much jargon. Another said that sometimes staff appeared angry and under stress when speaking over the telephone. One client tried to contact a manager at the company several times to discuss the contents of a report but she was always unavailable.

Staff at Mendis Holdings are overworked and motivation is suffering. In particular, they are worried about losing their jobs. This is because there

are rumours that Mendis Holdings is going to merge with a shipping broker in Chennai and the Colombo office will be shut down. However, there has been no information whatsoever to either confirm or deny that this is the case.

A spokesperson for the employees said: 'Communications problems here go much deeper than "wordy reports" and "edgy telephone conversations". The communication culture at the business is depressing. There is no formal upward communication channel, the chain of command is too long, the senior management team is secretive and fails to make goals and plans clear and people are developing a silo mentality. The office layout does not help communication either – everyone works in their own little "cubby hole".'



▶ Mendis employees at their partitioned workstations

CHAPTER QUESTIONS

1 Describe what is meant by a barrier to communication.

2 Suggest two examples of barriers to communication at Mendis Holdings.

3 Discuss how Mendis Holdings might improve the communications skills of its staff.

4 Assess the measures Mendis Holdings might take to improve the communications culture at the business. Make a clear judgement in your evaluation.

18 RECRUITMENT AND SELECTION

LEARNING OBJECTIVES

- Understand the different types of employment – full time, part time, job share, casual, seasonal and temporary
- Understand the different recruitment documents – job description, job specification, application form and curriculum vitae
- Understand internal and external recruitment – job advertisement, short listing and interviewing

GETTING STARTED

When businesses hire new employees they need to attract the best people – those with the right skills and experience. This is called recruitment and selection. There are several different stages in the recruitment process. Two of these are outlined in the examples below.

CASE STUDY: ANKARA HAULAGE COMPANY (AHC)

Ankara Haulage Company provides a distribution service for manufacturers across Turkey. The company owns 130 vehicles and is looking to recruit 12 more drivers to increase capacity. The advert in Figure 18.1 was placed online, designed to attract HGV 1 drivers.

▶ Figure 18.1 Job advert for HGV 1 drivers

ANKARA HAULAGE COMPANY

We are an established haulage company with a 34-year trading history. We are currently going through a period of expansion following the award of a new contract. We now require 12 new drivers to help meet our delivery commitments. We can offer:

- TRY 500 per week
- TRY 30 overnight payment
- 5 weeks annual holiday (with full pay)
- Company pension scheme
- Life cover insurance
- Satnav fitted as standard

We require experienced Class 1 HGV drivers. You must be prepared to travel overseas, work weekends (1 in every 3), stay out 3 nights in 5, speak some English and preferably have some forklift truck driving experience. Please contact Emine Erkam (HR Director) on 0090 06885 329861.

CASE STUDY: KARACHI COATINGS

Karachi Coatings, a painting and coating company, recruits a lot of its managers internally. This means they try to promote people who already work at the company. Umar Iqbal, the human resources manager, said: 'We have recruited internally for many years. There are some clear

advantages. For example, promoting from within is safer. We know what these people are like and what their potential is. They are proven workers. It is also cheaper and quicker to recruit in this way.'

▶ Coating plant



1 What is the purpose of the Ankara Haulage Company advert?
2 What sort of person is the business trying to attract?
3 How much pay is the company offering successful applicants?
4 How does Karachi Coatings recruit many of its managers?
5 Suggest two advantages of recruiting managers in this way.

TYPES OF EMPLOYMENT

When a business takes on workers it can choose between different types of employment. For example, a small retailer may want to employ someone to help out on busy weekends, a farm manager may want to employ 20 people for one month to help pick fruit during the harvest and a large steel producer may need to recruit 55 more people full time because the factory is expanding. The different types of employment are outlined below.

FULL-TIME EMPLOYMENT

This is where a business takes on an employee who is expected to work the full working week – usually five days. The number of hours may vary in different countries. For example, in the EU a full-time worker is not expected to work for more than 48 hours per week. Full-time workers may be entitled to certain benefits and rights in addition to pay, including health insurance or overtime pay.

PART-TIME EMPLOYMENT

Part-time workers will work fewer hours than full-time colleagues. There is no specific number but it might be less than 30 hours, for example. Part-time employment is a helpful arrangement for businesses because it gives them some flexibility. This means that workers can be employed for short periods of time, for example, at weekends when a business is at its busiest. It might also mean that a business can stay open for longer hours – if part-time workers are employed during the evenings perhaps. Part-time work might also suit certain employees. Many students, for example, cannot work full time because they are committed to their studies, or parents may wish to work during the school day.

JOB SHARE

A minority of businesses provide opportunities for job sharing. This is where two part-time workers share the work and pay of a single full-time post. This arrangement might suit employees who want to reduce their work hours, to provide more leisure or family time, for example. However, the two people sharing will have to work as a team and interact effectively. For a business, job sharing means that it has the ideas and enthusiasm of two people rather than one. They may also be better motivated and less stressed since they have themselves chosen to reduce the amount of work they have to do.

OTHER TYPES OF EMPLOYMENT

A number of other employment arrangements exist. These are likely to provide businesses with more flexibility and may help to improve efficiency since people are only employed when needed.

- **Casual employment:** Casual workers do not get any guarantees of work from their employer. Their hours of work are often variable and uncertain. Some are 'on-call', which means that an employer can ask them to work at very short notice. This provides a great deal of flexibility for businesses but casual workers may lack the commitment of their full-time or part-time colleagues. Casual work is often used in the hospitality industry where people are required to help staff at specific events, such as the India Premier League.
- **Seasonal employment:** Some businesses need workers at particular times of the year. The work is regular and full time but short lived. A ski resort may require hotel workers in the winter, a farm manager may need extra workers during the harvest period and in the UK postal delivery workers are needed before Christmas to help out with the heavy volume of cards and parcels. Seasonal employment is usually full time but still provides businesses with flexibility since seasonal workers are laid off when the season ends. Some people prefer seasonal work because it suits their lifestyle. It may also appeal to people who like to travel. For example, a hotel chef might work in a Parisian hotel during the busy summer holidays and then transfer to a hotel in a French ski resort during the busy winter period.
- **Temporary employment:** Sometimes businesses need to take on staff for a short period of time to cover for absent workers, for example, such as those on paternity leave or long-term sickness. The work is likely to be full-time but the length of the contract may vary – perhaps between 3 and 12 months (but not strictly). Temporary work might be taken by job seekers to earn some income while they look for a permanent post. Also, a temporary post might provide a 'doorway' into a permanent position.

GENERAL VOCABULARY

hospitality industry when companies entertain clients or take them on trips in order to get business
maternity leave time that a mother is allowed to spend away from work when she has a baby
paternity leave time that a father is allowed to spend away from work when his baby has been born

RECRUITMENT

In a large business, the human resources department is responsible for employing staff. A business may need new staff because:

- the business is expanding and more labour is needed
- people are leaving and they need to be replaced
- positions have become vacant owing to promotion
- people are required for a temporary period to cover staff absence owing to maternity leave or paternity leave, for example.

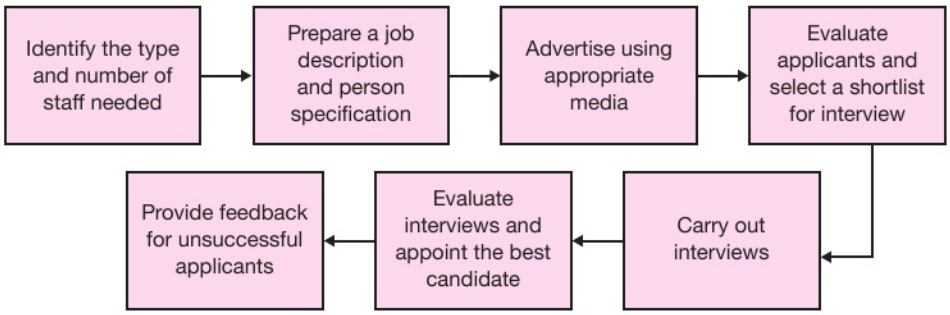
STAGES IN THE RECRUITMENT PROCESS

The whole recruitment process may be broken down into a number of stages. These are shown in Figure 18.2.

GENERAL VOCABULARY

job description document that shows clearly the tasks, duties and responsibilities expected of a worker for a particular job
person specification personal profile of the type of person needed to do a particular job
job application form standard document used to collect information from a job applicant
curriculum vitae document used by a job seeker that lists personal details, qualifications, work experience, referees and other details
shortlist list of the most suitable people for a job, chosen from all the people who were first considered
induction introduction of someone into a new job, company, or official position

- The first stage is to identify the number and type of staff that need to be recruited. For example, if the business is planning to expand, larger numbers of applicants will need to be attracted. A business may also need to choose between full-time, part-time, temporary and permanent workers.
- The right people are more likely to be selected if a **job description** and **person specification** are created.
- Advertising costs money, so businesses must place job advertisements in places where they are likely to attract sufficient interest from the 'right' sort of applicants.
- Job seekers are likely to apply for a job by completing a **job application form** or sending an employer a copy of a **curriculum vitae** (CV). A business must sort through all the applications and produce a **shortlist**.
- Shortlisted applicants will be invited for an interview.
- After the interviews, the interviewers must decide who to appoint. Sometimes there are more than one round of interviews. In many cases, candidates are told the outcome of the interview by post. This gives the business more time to evaluate the performance of the candidates. A business might also check references before making a final decision.
- The recruitment process ends when a job offer has been made and accepted. It is also polite to provide feedback to the unsuccessful candidates.



▶ Figure 18.2 Stages in the recruitment process

KEY POINT

Recruitment is important because if the wrong people are selected it can be expensive. If new recruits leave, all the costs of advertising, interviewing, **induction** and training will have to be repeated.

RECRUITMENT DOCUMENTS

During the recruitment process, a range of information has to be exchanged between applicants and the business. A number of widely recognised documents are used for this purpose, which helps improve the efficiency of the whole process.

JOB DESCRIPTION

A job description states the title of the job and outlines the tasks, duties and responsibilities associated with that job. If a new job is created, a new job description may have to be prepared. If a business is replacing someone who is leaving, the job description may be the same. However, when the holder of the post leaves the job description may be updated.

GENERAL VOCABULARY

appraisal meeting between an employee and a manager to discuss the quality of the employee's work, and areas for future progress

The main purpose of a job description is to show clearly what is expected of an employee. Extracts from it are likely to be used in a job advert. It might also be used during **appraisal** to see how well an employee has performed in relation to what was expected of them. Figure 18.3 shows an example of a job description.

PERSON SPECIFICATION

This provides details of the qualifications, experience, skills, attitudes and any other characteristics that would be expected of a person appointed to do a particular job. It is used to 'screen' applicants when sorting through the

applications; applications that do not match the person specification can be ignored. It is common to state on the specification whether a particular requirement is 'essential' or 'desirable'. An example of a person specification is shown in Figure 18.4. The styles of both job descriptions and person specifications are likely to vary between different businesses according to their specific needs.

Job title
Accounts Clerk

General role
To join the accounting team in the recording of financial transactions and the handling of financial information.

Responsibilities
- Matching, batching and coding invoices.
- Matching invoices to purchase orders.
- Arranging payments through cheques and BACS.
- Allocating items of expenditure to cost centres.
- Dealing with internal expense claims.

Salary
AED 60 000–85 000 depending on experience.

Hours and conditions of work
- 40 hours per week (7.30 am–4.30 pm)
- 5 weeks' holiday a year

▶ Figure 18.3 Job description for an accounts clerk with Dubai Construction, UAE

	ESSENTIAL	DESIRABLE
Qualifications and education	3 A levels GCSE Grade 1 Maths and English Full driving licence Design or web-related qualification	A level IT A management qualification
Experience	Sound knowledge of HTML Skilled in the use of Adobe Photoshop Proficient in Microsoft Office Knowledge of current legislation	Awareness of dynamic languages
Communication skills	Excellent oral communication skills Report-writing skills Foreign language	Spanish
Other skills	Team player Ability to work flexibly Excellent organisational skills	Ability to negotiate
Personal attributes	Self-motivated Willing to travel abroad	Creative

▲ Figure 18.4 Person specification for a web production manager for a UK IT company

APPLICATION FORM

Many businesses use application forms to gather information from job applicants. It is a standard form and every applicant will be expected to submit a list of information on the form. One advantage is that is ensures the same data is collected from each applicant, which makes comparisons between them easier. The following list includes the most common information requested:

- full name and address and other contact details
- personal or tax identification numbers such as a National Insurance number
- details of education
- employment history
- other relevant experience and qualifications
- a statement from the applicant as to why they applied for the post and the reasons why they should be appointed

- hobbies and interests
- names and addresses of two referees
- a declaration of any health issues that might impede the fulfilment of an applicant's duties.

It is also common for a business to ask applicants to support their application form with a cover letter – perhaps inviting them to add any further information they think might be relevant to their application.

CURRICULUM VITAE (CV) OR RÉSUMÉ

This is similar to an application form. However, a CV is not a standard document. It contains most of the information given in a job application form but it is produced by the job seeker and is therefore personalised. The use of a CV allows the job seeker to express their individuality. It is likely to have a more professional look and can be sent speculatively to a range of employers when seeking a job. For an employer, it is one way to assess the applicant's presentation skills and the quality of their work through their use of structure, layout, spelling, grammar and content.

ACTIVITY 1

CASE STUDY: NUJUMBA CEMENT

GENERAL VOCABULARY

forklift truck vehicle with special equipment on the front for lifting and moving heavy things

Nujumba Cement is a large cement manufacturer based in Nagpur, India. The company needs to recruit seven new employees to work in production. The job, production worker, involves heavy manual work and some knowledge of cement manufacturing. The workers will be expected to handle heavy machinery, drive a forklift truck, clean machinery and equipment and work in a team. The job will involve heavy lifting in a noisy and dangerous working environment. The wage is Rs400 per hour and the working week is 40 hours long. Workers will be entitled to 4 weeks' holiday, free protective clothing and free lunches.



▶ Inside a cement factory

1 Draw up a job description for the production worker jobs at Nujumba Cement.
2 Discuss two reasons why a business draws up a job description.

Nujumba Cement uses application forms in its recruitment process.

3 Discuss one advantage to the business of using job application forms.
4 Imagine that you are applying for a part-time job at a local shop. Draw up a CV to help support your application.

INTERNAL AND EXTERNAL RECRUITMENT

One way of recruiting staff is to appoint someone who already works for the business. This is called internal recruitment. A business might do this by advertising the post internally or appointing someone who is thought to be suitable. The advantages of internal recruitment are that:

- it is cheaper because it saves on advertising
- internal recruits are familiar with company policy and working practices
- staff may be more motivated if they know there is a chance of promotion
- the ability, personality, attitude and potential of the person appointed will be more predictable.

SUBJECT VOCABULARY

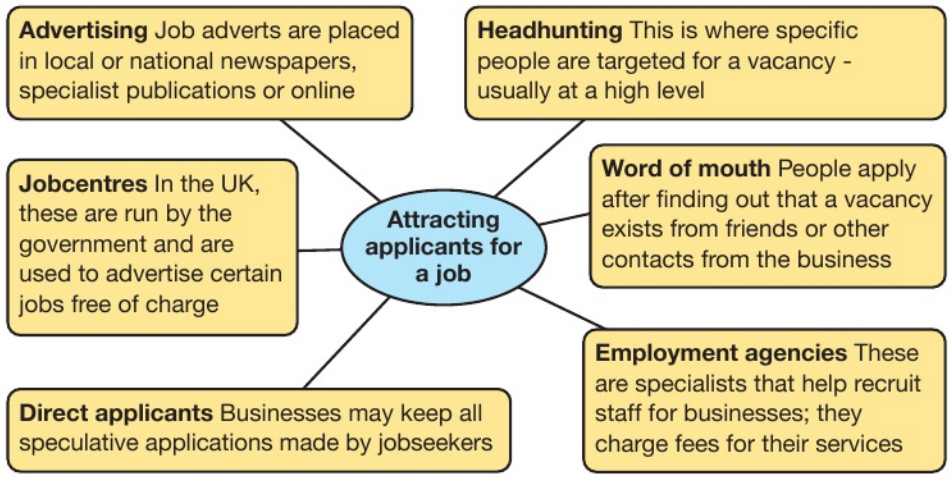
internal recruitment appointing workers from inside the business

external recruitment appointing workers from outside the business

All businesses have to use external recruitment. This is where new staff are recruited from outside the business. The advantages of this are that:

- a business will have a much larger pool of potential employees to choose from
- a new person may be very talented and have some have fresh ideas, which could help the business become more competitive.

A number of different methods might be used to attract applicants from outside the business. Some of the main ones are shown in Figure 18.5.



▶ Figure 18.5 Methods of attracting job applicants

JOB ADVERTISEMENTS

A perfect job advertisement would stand a good chance of attracting a small number of perfectly suitable candidates for the job. However, it is not always possible to design such perfect advertisements. Some of the important pieces of information that are likely to be included in a job advert are:

- job title
- name, address, email and telephone number of employer
- brief details of the job description
- skills, qualifications and work experience required for the job
- salary and other benefits
- method of application.

A business has to choose which media to use when placing the advert. The choice will depend on the area the business plans to target and the type of worker needed. For example, if a business wants to recruit a local labourer from a town or city, it may place the advert in a local newspaper or a job centre. If a higher-grade worker is required, such as a manager, adverts might be placed in a national newspaper or online. The use of specialist online sites for advertising jobs is now common; advertising online is fairly cheap and can be used to attract applicants from all over the world if necessary.

SHORTLISTING

Once the deadline has been reached for receiving application forms, the next stage in the recruitment process is to select a small group of candidates suitable for interviewing – this is called shortlisting. This involves sorting through all the application forms or CVs and choosing those applicants that best match the person specification. This can be a time-consuming task if hundreds of people have made an application. The main advantage of using application forms in recruitment is because the skills and experience of the applicants can be compared very quickly. It speeds up the process to read and analyse information from a large number of different sources if it has been presented in a standard way.

INTERVIEWING

Job applicants that have been shortlisted will be invited for an interview. This is where interviewers can find out more about the applicants by asking direct questions face to face. It also gives candidates the opportunity to provide more detailed information and to ask questions about the job and the business. Interviewing is often best done by people who are experienced or have been trained in interviewing. For many jobs, more than one person carries out the interviews. This provides an opportunity for a discussion about the performance of candidates in their interviews.

Interviews are likely to be more effective if they have been carefully planned. To provide a fair interview, all candidates should be asked the same questions and probably in the same order. Also, some people find interviews stressful so measures should be taken to try to make candidates feel more at ease. This is because people are likely to give a fuller and more accurate account of themselves if they are comfortable.

Interviews can be used to:

- help clarify information on the application form (or CV)
- assess personality, motivation, attitude, commitment and communication skills
- challenge candidates by asking searching questions such as how they might deal with a specific work-related problem.

Candidates should be encouraged to talk by asking open questions, such as ‘What is your opinion on…?’ or ‘Tell me about your responsibilities in your last job.’ Finally, candidates should be given the opportunity to ask their own questions about the role or business.

GENERAL VOCABULARY

personnel manager manager who is in charge of taking care of a company's employees, organising recruitment, training and so on

ACTIVITY 2

CASE STUDY: PALLABI GARMENTS LTD

Pallabi Garments Ltd, based in Dhaka, Bangladesh, makes women's clothes for a number of European customers. The company is expanding fast and has taken on new staff regularly over the last three years. The **personnel manager** has been asked to recruit seven new machinists and a purchasing manager – all to start in 10 weeks. The machinists will be recruited externally but the purchasing manager will be recruited from the existing purchasing team; it is expected that three suitable people from the department will apply.



▶ Machinists at work

1 What are the advantages to the business of recruiting internally for the job of purchasing manager?

During interviews at Pallabi Garments Ltd, open questions are used.

2 What is meant by an open question?
3 What is the main advantage of using open questions in interviews?
4 Discuss how the vacancies for the machinists might be advertised.

LARGE VS SMALL BUSINESSES

Both small and large businesses are likely to recruit new workers and both are likely to use a variety of the different types of employment. Small businesses may use informal methods of recruitment, such as asking an existing employee if they can recommend anyone for a new vacancy. Many small business owners are unlikely to use job descriptions and job specifications. However, as businesses grow, there is a need for more formal methods of recruitment and selection. In large organisations there is likely to be a separate department (human resources) that takes responsibility for this important task.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of an open question in an interview?

A Have you worked for a manufacturing company before?
B Did your last employer use just-in-time manufacturing?
C What is your opinion on the use of just-in-time manufacturing?
D Have you ever driven a forklift truck?

▶ 2 Which of the following information is **likely** to appear on an application form?

A Applicant's gender
B Name of two referees
C Applicant's marital status
D Applicant's political preferences

▶ 3 The process of sorting through application forms to select a small group of candidates suitable for interview is:

A Selection
B Shortlisting
C Testing
D Prioritising

▶ A catering company has got a contract to provide a food service at a weekend What type of employee might be recruited for one weekend only to help out?

A Part-time worker
B Casual worker
C Seasonal worker
D Full-time worker

CHAPTER REVIEW

CASE STUDY: ONLINE JOB ADVERTISEMENT

The job of sales and marketing director for a travel tour operator was advertised online (Figure 18.6).

▶ Figure 18.6 A job advert on popular job website

◂ Back to results | Email me jobs like these | Send to a friend | Print | Save

Sales and Marketing Director UK
Video Games Developer, Cambridge

Salary: Up to £65 000 + benefits
Working hours: Full-time
Job type: Permanent
Industry sector: Media & Entertainment

APPLY NOW

Successful candidates will:
Develop and implement a strategic sales and marketing plan to drive growth with a focus on creating and developing brand awareness.
Oversee all activities to fulfil strategic objectives to agreed budgets, sales targets, values, product mix and timescales.
Carry out competitor analysis, market and customer research to analyse market trends and uncover new opportunities and revenue streams.
Provide monthly management reports on activities, analysing past performance and proposing future activities and direction.
Lead business meetings, delivering sales presentations and product launches professionally.
Lead, direct and motivate to build the overall strength and performance of the sales and marketing teams.

Successful candidates will possess:
Degree or equivalent industry qualifications
Experience in a similar role within the games industry or similar field
Strong financial and analytical skills
Ability to develop team while maintaining focus and achieving goals
Ability to travel regularly and be able to work in the UK

CHAPTER QUESTIONS

1 What type of employment will be used to fill the vacancy advertised?

2 Draw up a simple person specification for the job of sales and marketing director. (You do not need to show whether details are essential or desirable).

3 How might a business use a person specification?

4 Suggest two important details that should be included in any job advertisement.

Applicants for the job shown have to apply with a CV.

5 What is meant by a CV?

6 Assess whether the business was right to recruit externally for this post.

19 LEGAL CONTROLS OVER EMPLOYMENT

LEARNING OBJECTIVES

- Understand the nature of equal opportunities legislation (gender, race, disability, religion, sexual preference and age) and its impact on businesses
- Understand the nature of minimum wage legislation and its impact on businesses

GENERAL VOCABULARY

exploitation situation in which you treat someone unfairly by asking them to do things for you, but give them very little in return

discrimination favouring one person over another, for example, in the EU it is unlawful to discriminate on grounds of race, religion, gender, age, sexual orientation and disability

SUBJECT VOCABULARY

unfair dismissal when a worker is dismissed illegally by a business

ombudsman someone who deals with complaints made by ordinary people against the government, banks, insurance companies and so on

GETTING STARTED

People at work often need legal protection. This is because some businesses may treat their workers poorly, or even exploit them. Employees need protection from dangers in the work environment, exploitation, unfair dismissal and discrimination. This chapter focuses on legal protection from discrimination in the workplace. Consider at the example below.

CASE STUDY: AGE DISCRIMINATION IN A RESTAURANT

In 2014, two Thai restaurants near Brisbane, Australia, were found guilty of age discrimination in the workplace. The court fined the restaurants' owners around A$30 000 for their treatment of an employee. The employee, despite having a perfectly good employment record, was told on his 65th birthday that he would no longer be allowed to work full time. He was also told, after returning from long-term leave in 2011, that the company did not employ people over the age of 65. However, he was offered a part-time post. Fair Work Ombudsman, Natalie James, said that the court ruling should discourage other businesses from age discrimination in the workplace. She said that age discrimination should be taken very seriously and that the ombudsman would act on any reported incidents. She also encouraged people to come forward and make reports if they experienced any such conduct.

1 How does this case illustrate the need for protection at work?
2 What do you think is meant by age discrimination?
3 How might laws aimed at preventing age discrimination affect a business?

LEGAL CONTROLS OVER EMPLOYMENT

Governments often pass legislation to protect people at work. Without such protection, some businesses would exploit their workers. They might pay low wages, make them work long hours, deny them employment rights, expose them to danger, discriminate against certain groups or dismiss them unfairly. This chapter looks at the legal protection against different types of discrimination in the workplace, and the impact that such legislation might have on businesses.

WHAT ARE EQUAL OPPORTUNITIES?

Businesses have to make a choice when recruiting staff or selecting employees for promotion or training. Choosing one person rather than another based on characteristics is known as discrimination. If a business chooses a person because they are more skilled and better qualified than another, this would be legal. However, it is illegal in most countries to discriminate on the grounds of gender, race, disability, sexual preference, religion or age. When employing and promoting people, employers must base their decisions on the ability of candidates, and not whether they are male or female, for example. Many countries have legislation to protect groups from discrimination.

GENDER

Gender discrimination (sometimes called sex discrimination) usually, though not exclusively, occurs when a woman in the workplace does not receive equal treatment because she is female. Women now form a significant proportion of the working population. For example, in 1972 in the USA around 38 per cent of employees were female. In 2014, women comprised 47 per cent of the total. However, there is still some evidence to suggest that equal opportunities do not exist for women. For example, there are still differences in earnings. In the USA, average earnings for women in 2014 were US$39 621 per annum, significantly lower than the US$50 383 men received. In the UK, a survey in 2014 found that more than one-quarter of women at work felt they were the victims of gender discrimination. For example, out of 1500 office workers, 26 per cent felt that motherhood had limited their career development.

In many countries, laws have been passed to help deal with the problem of gender discrimination. Two UK laws are shown in the box on this page. Legislation like this is likely to have an impact on businesses. Some examples are outlined below.

- Advertisements for jobs must not specify a particular gender. A business is not allowed to target job adverts at either a man or a woman. Both genders must have equal opportunity in appointments.
- References to work titles in job adverts must be genderless. For example, a business could not advertise for a 'policeman' or a 'saleswoman' – the job titles must be 'police officer' or 'salesperson'.
- Promotion must not be made on the basis of gender and people cannot be dismissed because they are male or female.
- Wages for staff occupying the same position must be the same for both men and women.
- Businesses will have to take more care when designing internal documents, such as a person specifications and job descriptions. This is to ensure that jobs do not limit applicants from a particular gender.

The **Sex Discrimination Act 1975** states that a person must not be discriminated against because of their gender. For example, adverts for jobs and job titles must be 'genderless'. Recruitment and selection must not favour a particular gender. People should be promoted on grounds of ability not gender.

The **Equal Pay Act 1970** states that an employee doing the same or 'broadly similar' work as a member of staff of the opposite sex is entitled to equal rates of pay and working conditions.

DID YOU KNOW?

- After African-Americans, Hispanic people are the second most discriminated against ethnic group in the USA.
- In 2011, a survey found that 22 per cent of Hispanic/Latino people complained of discrimination at work compared with just 6 per cent of white people.
- Hispanic families earn just 54 per cent of what a white family would earn.

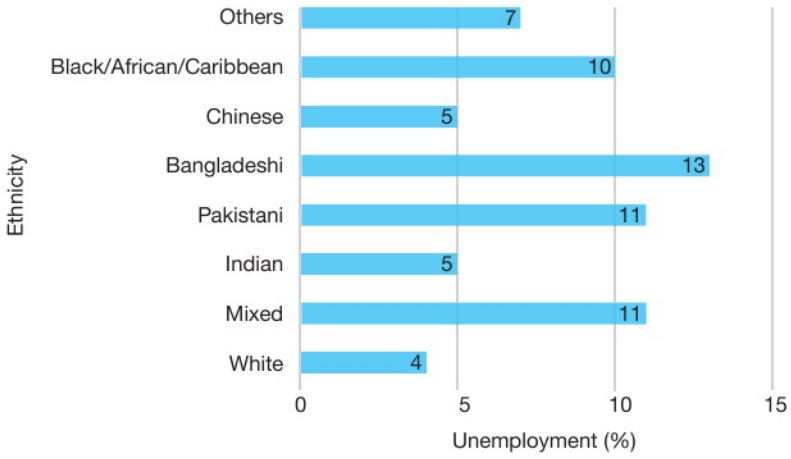
GENERAL VOCABULARY

ethnic origin the birthplace of a group of people of a different race from the main group in a country
harassment when someone behaves in an unpleasant or threatening way towards you

RACE AND RELIGION

Businesses must ensure that they do not discriminate on grounds of colour, race, ethnic origin, religion or nationality. However, some evidence suggests that this does happen. Figure 19.1 shows unemployment rates according to ethnicity in the UK in 2015. Clearly ethnic groups suffer higher levels of unemployment than whites. Governments around the world are aware of such discrimination and have passed laws to reduce the imbalance. The box below gives an example of such an act in the UK. Some examples of the effects of race legislation on businesses may include the following.

- Businesses cannot prevent employees from wearing ethnic or religious dress, such as Sikhs wearing turbans or Muslims wearing the burka.
- The use of selection tests must be monitored to ensure that their styles do not discriminate against people from minority backgrounds.
- Businesses must take into account the religious holidays of ethnic groups. For example, a business cannot insist that certain religious groups work on a day of worship or on a day of religious celebration, such as Eid al-Fitr.
- Businesses cannot refuse to employ people from particular ethnic or religious groups.
- Workers must receive awareness training to encourage equality of treatment and prevent racial harassment.



▶ Figure 19.1 Unemployment by ethnicity in the UK, 2015

The **Race Relations Act 1976** makes it illegal to discriminate on grounds of race. This means that a business cannot appoint someone who is white in preference to someone who is from an ethnic minority. (NB. This was changed in 2002 and 2003 to include a wider range of organisations and groups.)

ACTIVITY 1

CASE STUDY: WORKPLACE DISCRIMINATION

In 2014, the BC Human Rights Tribunal in Canada ruled that the co-owners of Khaira Enterprises Ltd illegally discriminated against 55 African tree planters at a work camp in Golden, Canada. The owners of the company were ordered to pay each of the employees CAN$10 000 plus

CAN$1000 for every month that they had worked at Khaira. The total payment came to around CAN$600 000. The 55 workers, who came from Democratic Republic of Congo, Burundi, Guinea and Rwanda, were treated extremely poorly compared with their non-African colleagues. For example, the bathroom facilities at the campsite were terrible. One worker described the conditions as being similar to those on ships transporting slaves. No toilet paper was provided and most of the 55 workers were subjected to racial insults. There was also evidence that wages were not given to the African workers while South Asian and Caucasian workers were paid in full.

▶ Tree planting



1 What is meant by racial discrimination?
2 Describe the possible evidence that suggests racial discrimination has taken place in this case.
3 How does this case illustrate the protection given by the law against discrimination?
4 Design a poster that could be used in the workplace to warn employees that racial discrimination is forbidden.

DISABILITY

Protection in the workplace exists in many countries for people with disabilities. Unemployment rates for people with disabilities around the world tend to be higher than those without disabilities. For example, in Germany in 2012, the general unemployment rate was 6.8 per cent. However, for the people with disabilities, unemployment was more than double that at 14.8 per cent. Many countries now have legislation to help improve the rights of people with disabilities at work. The box gives one example. Employers are now obliged to make reasonable adjustments to their working practices and work environment to help accommodate disabled employees. Some examples are shown below.

GENERAL VOCABULARY

accommodate to adapt an environment for someone in order to meet their needs

- Improve access to the workplace by widening doors and providing ramps for wheelchairs.
- Allow disabled workers time to attend medical appointments, such as physiotherapy sessions.
- Alter equipment such as telephones and computers (software and hardware) to accommodate those with sight or hearing difficulties.
- Allow more time for training.

The **Equality Act 2010** says 'a disability is a physical or mental impairment which has a substantial and long-term adverse effect on your ability to carry out normal day-to-day activities'. The Act makes it unlawful for a business to discriminate on the grounds of disability.

ACTIVITY 2

CASE STUDY: DISABILITY DISCRIMINATION

In 2016, US-based café chain Starbucks was found guilty of disability discrimination. Starbucks accused one of their employees, Meseret Kumulchew, of falsifying documents. One of Meseret's duties during her shift was to record the temperature of fridges and water at specific times. However, she was accused of falsifying the documents after mistakenly entering wrong information. Meseret, who has dyslexia, said that she had always made it known to her employer that she had difficulties reading, writing and telling the time and had to be shown how to do tasks.

GENERAL VOCABULARY

tribunal type of court that is given official authority to deal with a particular situation or problem

Following the accusation made by Starbucks, Meseret was given a less important job at her branch and told to retrain. She was left feeling very depressed, potentially suicidal. According to the **tribunal**, Starbucks had not made reasonable adjustments for Meseret's disability, and had discriminated against her because of the effects of her dyslexia. Starbucks said they were now having discussions with Meseret about making adjustments to help her cope. Starbucks also made a statement which said the company was committed to having a 'diverse and inclusive workforce' that make people 'feel welcome and comfortable in our stores'.



▶ Employees at Starbucks

1 How was the employee in this case a victim of disability discrimination?
2 Describe the possible measures businesses like Starbucks might have to take to help avoid disability discrimination.

SEXUAL PREFERENCE

Discrimination against people on grounds of their sexual preference is illegal in some countries. This is because laws have been passed to protect their rights. For example, in South Africa in 1998 laws were passed to protect lesbian, gay, bisexual, transsexual and intersex (LGBTI) citizens from employment discrimination. However, it must be remembered that in many countries the laws may be different. For example, homosexuality is a criminal offence in 38 out of 55 African states.

Most cases of sexual preference discrimination result from harassment or bullying. However, businesses must take care to avoid sexual preference discrimination in recruitment, pay, terms and conditions of employment, promotion and training opportunities and dismissal.

AGE

The example in 'Getting started' above highlighted a case of age discrimination. Age discrimination in the workplace occurs when a business decision is made on the grounds of a person's age. For example, a person aged 32 is given promotion because another person, aged 66, was considered too old – even though the 66-year-old was equally qualified and more experienced. In many countries, the unemployment rate of the over-50s is higher than the average. Also, older workers are more likely to take up part-time work and receive less training.

Many countries do not have specific age discrimination legislation but protection is still provided under laws that make discrimination of all types illegal. For example, in New Zealand, the Human Rights Act 1993 has been updated to provide protection against age discrimination. Examples of the possible effects on businesses of such legislation are given below.

- It would be illegal to not to offer a job to someone on the grounds of age.
- Businesses should take measures to prevent older workers from being harassed in the workplace.
- Businesses cannot refuse promotion or training on the grounds of age.
- In interviews, assumptions cannot be made about the ages of candidates or their suitability for a job on grounds of age.
- A business cannot state that a specific number of years' experience is needed to apply for a job. This might disadvantage younger applicants.

Finally, it is in the interests of businesses to follow laws designed to prevent discrimination in the workplace. If they fail to do so businesses may:

- be involved in expensive legal battles
- fail to recruit or promote the best staff for the post
- demotivate certain sections of the workforce
- create unnecessary tension or conflict between employees.

MINIMUM WAGE LAWS

SUBJECT VOCABULARY

minimum wage minimum amount per hour, which most workers are entitled to be paid

apprenticeship system of training new entrants to a trade or profession, often, but not always, younger workers, mostly on-the-job training but often with some college attendance

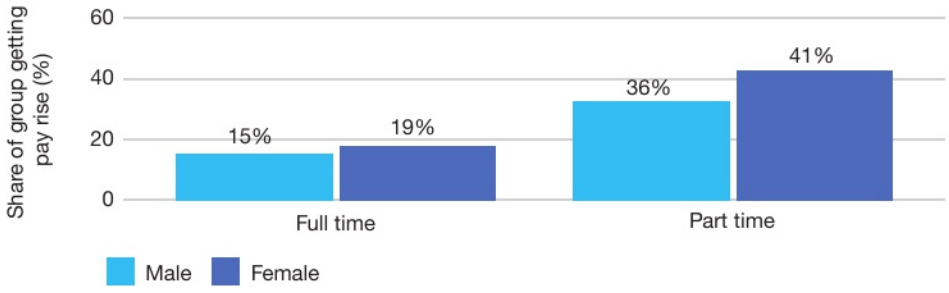
arrears money that you owe someone, or is owed to you, because you have not made, or have received, regular payments at the correct intervals or amounts

Generally, owners are free to set levels of pay in their businesses. However, in some countries governments have introduced a legal **minimum wage**. This involves passing legislation that means no employer is allowed to pay their workers an hourly rate below the limit set. A minority of workers might be excluded from the minimum wage, such as very young workers or those on an **apprenticeship** scheme. Employers face a penalty if they pay wages that are lower than the national minimum wage. Also, workers will be entitled to have **arrears** of wages repaid at current rates. There are three main reasons why governments set legal minimum wages.

- **To benefit disadvantaged workers:** It is argued that people such as women, ethnic minorities and low-income families benefit from minimum wages. For example, it is estimated that if the UK introduces a mandatory national living wage (very similar to a minimum wage) female workers will benefit more. This is shown in Figure 19.2.
- **To reduce poverty:** In many countries, minimum wages are often part of a broad strategy to end poverty. In the USA, increasing numbers of poor families have to rely on their earnings from low-paying jobs. Therefore, a minimum wage increase will help reduce poverty. The minimum wage raises the wages of low-income workers in general, not just those below the official poverty line. Many families move in and out of poverty, and therefore near-poor families will also benefit.
- **To help businesses:** A minimum wage should promote greater equality and fairness among workers. As a result, workers will be better motivated. This should reduce staff turnover and absence and raise productivity.

One of the advantages of minimum wages is that low paid people receive more money. This means that governments do not have to pay out as much in benefits to the poor. The extra money low paid workers receive comes from firms who have to pay the higher wages. This reduces the cost to the taxpayer.

▶ Figure 19.2 Estimated gains by male and female employees from an increase in the minimum wage, UK, 2015



EFFECTS OF MINIMUM WAGE LAWS ON BUSINESSES

If a business employs very large numbers of people on wages that are below the minimum wage, clearly their wage bill will rise if a minimum wage is introduced. Also, most governments increase the minimum wage every year, therefore businesses employing people on the minimum wage will have to match this increase. Some people argue that the introduction of a minimum wage will result in job losses. In theory, if the price of labour rises, demand for it will fall. However, in 2016, 14 US cities saw significant increases in the minimum wage, yet in July, one month after the increases, employment went up by 237 000 across the country. If a business is doing well, they are not likely to lay people off, even when wages go up, if they are needed to meet rising customer demand.

It is also suggested that higher wages encourage businesses to replace labour with capital and outsource production to countries where labour is cheaper. However, this may not be possible for many sorts of businesses. For example, fast food chains cannot outsource production because they are a service industry. Neither can they easily replace customer service workers with machines.

There may be some benefits of minimum wages to businesses.

- People on low pay may be better motivated and more productive when they receive a pay rise resulting from the introduction of a minimum wage.
- Low wage earners across the nation will have more disposable income so demand for many goods and services will rise. This will help drive up sales and profits for some businesses.
- Businesses may experience lower rates of staff absence and better reliability. This might be because low paid workers, who often have to have more than one job to survive, will be more committed to a single employer.

LARGE VS SMALL BUSINESSES

Firms of all sizes should avoid all types of discrimination. However, some small firms might be exempt from certain details in discrimination laws. For example, a business that employs just one single employee cannot have a gender balance. If only one employee is needed and a female is employed, the business could not be accused of having a gender imbalance in its workforce – even though 100 per cent of its employees were female. However, a business that employs 500 people, all of which were female, could be accused of having a gender imbalance.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a possible benefit to a business of the introduction of a minimum wage?

A A business will be able to employ more women
B There will be less administration when taking on an employee
C Worker motivation might improve since workers will be better paid
D Business taxes will be lower

▶ 2 According to the graph in Figure 19.1, which of the following ethnic minorities suffers the highest levels of unemployment in the UK?

A Pakistani
B Black African/Caribbean
C Chinese
D White

▶ 3 Which of the following is a motive for the introduction of a minimum wage?

A Reduce poverty
B Encourage the employment of more female workers
C Encourage the employment of more workers from ethnic minorities
D Improve the productivity of workers

▶ 4 In a job advert, a business states that applicants must have at least 10 years' work experience. This is an example of discrimination on the grounds of which characteristic?

A Gender
B Age
C Race
D Sexual preference

CHAPTER REVIEW

SUBJECT VOCABULARY

FTSE 100 index that measures the share prices of the top 100 companies in the UK

GENERAL VOCABULARY

gender imbalances where there is unnaturally more of one gender than the other in a particular group of people



▲ Women were a minority in the boardroom – it's still the case today

CASE STUDY: GENDER DISCRIMINATION AND THE MINIMUM WAGE

Gender discrimination in the workplace is a much discussed issue. Even with legal protection some evidence suggests that gender discrimination still takes place. For example, the following are true of the UK.

1. Despite the Equal Pay Act, there is an 18 per cent pay gap between males and females.
2. Women are more likely to be employed in low paid jobs. For example, 80 per cent of the people working in the low paid care and leisure sector are women.
3. Less than 10 per cent of executive directors at the top FTSE 100 companies are female.
4. In 2013, it was estimated that around 50 000 women lost their jobs as a result of pregnancy discrimination.

The cause of the gender imbalances listed above may be partly or entirely owing to discrimination. However, other reasons may also explain the gender 'gaps'. For example, one of the reasons why there are so few women on the board of directors of PLCs is because the number of women available to take up such posts is very small. Another reason is that women at the level below the board may not be as well-connected as men at this level. This might be because talented females tend to stay with the same employer for longer. Consequently, they do not get the chance to meet as many different business professionals. Also, once women leave corporate life to have children, they are sometimes not readily welcomed back. Plus, many very talented women become disappointed with companies and prefer to start their own businesses. Finally, it may be that male-dominated boards like to recruit men like themselves for image reasons.

CHAPTER QUESTIONS

1. What is meant by the term equal opportunities?

2. Discuss two measures a business might have to take to ensure that gender discrimination is avoided in the workplace.

3. Assess whether discrimination is the reason for so few women sitting on the board of directors at top companies.

A business pays 1340 of its employees US$9 per hour. Each of these employees works 40 hours per week and is paid for 52 weeks of the year.

4. Work out the financial impact on the business if the government introduces a minimum wage of US$14 per hour.

5. Assess the likely impact on businesses, such as the case in **4**, of the introduction of a minimum wage.

20 TRAINING

LEARNING OBJECTIVES

- Understand the importance of training to a business and its workers
- Understand the different types of training and their main purpose: induction, on-the-job and off-the-job training
- Understand the role of training in compliance with health and safety laws
- Understand the benefits and limitations of training

GETTING STARTED

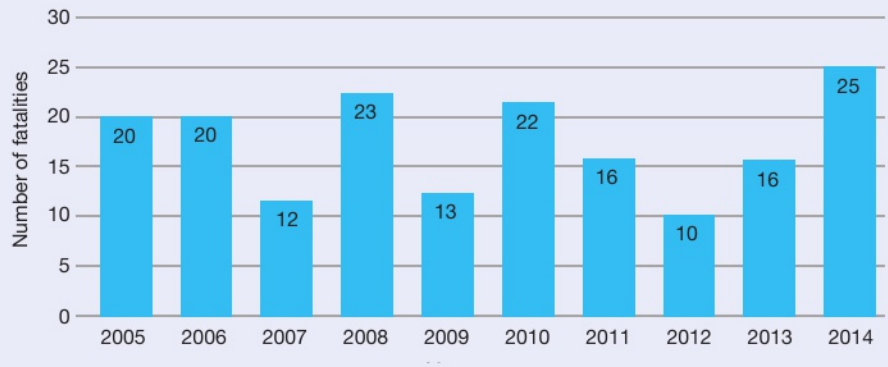
Most businesses have to train their workers. This means employees have to be taught how to do their jobs. If workers are trained, they will be more productive. However, there are different ways in which workers can be trained. Look at the example below.

CASE STUDY: ALBERTA FARMING CORPORATION (AFC)

In 2015, ten young people started work at the Alberta Farming Corporation (AFC), Canada. AFC is a large cereal producer with 180 employees spread over different farm locations in the region. The new recruits had just graduated from agricultural college and were keen to get started on their first real job. However, before they were allowed to begin they had to attend an intensive training course at the farm's own training centre. Most of the training focused on:

- understanding the company's working practices
- learning how to operate the different machines on the farm
- health and safety.

Training in health and safety is taken very seriously at AFC. Employees caught breaking AFC's health and safety regulations are sacked without warning. Figure 20.1 shows the number of fatalities in agriculture in Canada between 2005 and 2014. Of these fatalities 70.9 per cent involved machinery and of those fatally injured, 91.6 per cent were male.



▶ Figure 20.1 Fatalities in agriculture in Canada, 2005–14

Source:
http://www.abfarmsafety.com



▲ Farm machinery

1 Work out the average annual fatality rate in agriculture in Canada between 2005 and 2014.
2 Why is training in health and safety is so important to AFC?
3 Suggest three other reasons for training at AFC.
4 Carry out some research (online if possible) to see what training is offered by some large businesses in your area. Try to decide which business offers the best 'training package'.

THE IMPORTANCE OF TRAINING

SUBJECT VOCABULARY

training process that involves increasing the knowledge and skills of a worker to enable them to do their job more effectively

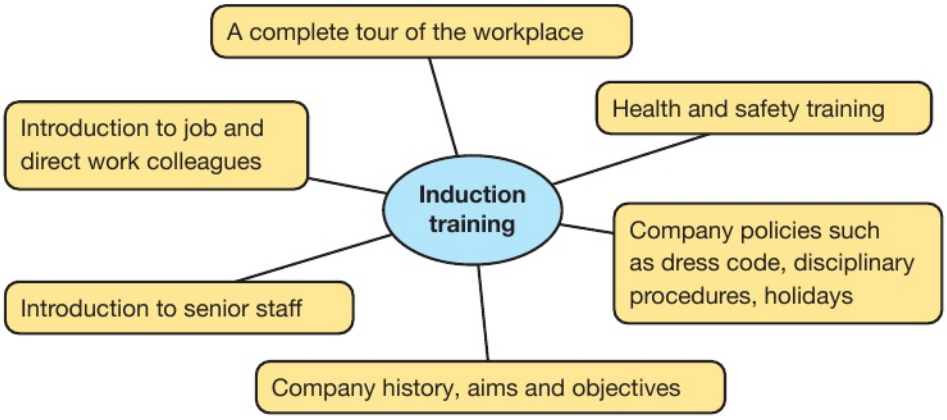
It is unlikely that an employee would go through their working life without some form of **training**. Training is important and involves increasing the knowledge and skills of workers so they can do their jobs more effectively. Training is important because it allows employees to acquire new skills, improve existing ones, perform better, increase productivity and be better leaders. It also helps to improve employee motivation so productivity will be higher. It is also important since part of training involves teaching new recruits how to work safely in their new environment. However, training can be expensive and in some cases the cost discourages investment in training. This may result in lower productivity and a loss of competitiveness. A lack of training might also endanger workers.

INDUCTION TRAINING

SUBJECT VOCABULARY

induction training training given to new employees when they first start a job

When people start a new job they are likely to receive some **induction training**. This helps new recruits settle in and become familiar with their new surroundings. If firms fail to provide adequate induction training, staff may feel anxious. This might lead to poor productivity. At worst, staff may leave because they have not settled. The nature of induction training will vary between businesses but Figure 20.2 shows what it might involve.

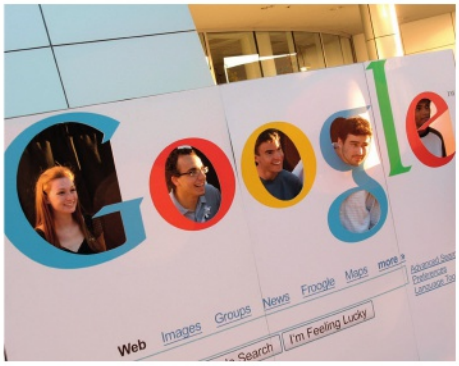


▶ Figure 20.2 Features of induction training

ACTIVITY 1

CASE STUDY: GOOGLE

New software engineers at Google are called Nooglers. All Nooglers attend an induction programme designed to introduce new recruits to the 'Google Way'. On the first day, Nooglers are given a temporary badge, a security card, a laptop, other equipment and a special Noogle hat. They have their photos taken and are assigned to a Noogler group. The



▲ Nooglers

2-week induction and programme starts with a series of lectures and presentations about things like Google's culture, mission and products. Most of the information given out is highly confidential and the importance of secrecy and sensitive treatment of information is emphasised. The importance of change is also a priority at Google. All employees are expected to be excited by change since much of their work is involved in future technology and new products. Senior members of the organisation deliver lectures and presentations.

On their first day, Nooglers are also involved in a 'get-to-know-you' exercise and get to meet their working team. They are also shown to their workstations and become familiar with their new working environment. On the second day, Nooglers get involved in technical exercises designed to teach recruits about developing at Google. Google uses training tutorials called Codelabs. These teach recruits about internal technologies that help employees do their jobs. Examples include Bigtable, Megastore, Protocol Buffers and Unit Testing. These tutorials last for about a week. There will also be large group exercises, which continue into the third day.

1 What is the purpose of induction training?
2 Describe what new recruits might learn during the induction programme at Google.
3 Discuss why induction training is so important to businesses like Google.

ON-THE-JOB TRAINING

One of the most common methods of training is **on-the-job training**. This means that workers are trained in the workplace while they are doing their job. A number of different approaches might be used by a business.

WATCHING ANOTHER WORKER

On-the-job training by an existing member of staff is a common method. It involves a new recruit watching and copying (shadowing) the actions of an experienced and competent employee. This method can work well if the existing member of staff is a good and committed teacher. If not, the quality of training might be poor.

GENERAL VOCABULARY

on-the-job training training that takes place while doing the job

mentoring where people with a lot of experience and knowledge advise and help other people at work or young people preparing for work

supervision when you supervise someone or something

job rotation where employees alternate between different jobs during the course of their employment

MENTORING

Mentoring is where a trainee is paired with an experienced member of staff for a given period. The trainee is put to work on their own without direct **supervision** where employees alternate between different jobs during the course of their employment but can call on the mentor for advice and guidance. Mentoring may be used to help train teachers.

JOB ROTATION

Job rotation may involve a new recruit spending a period of time in several different departments at a business. By working in a range of departments, or at different tasks, the employee will learn the different skills required and will gain a broad knowledge of how the business works. This approach will also improve the flexibility of the business.

The advantages and disadvantages of on-the-job training are summarised in Table 20.1.

▶ Table 20.1 Advantages and disadvantages of on-the-job training

ADVANTAGES	DISADVANTAGES
Output is being produced	Output may be lost if workers make mistakes and through the time diverted to showing the new recruit how to do things
Relevant because trainees learn by actually doing the job	May be stressful for the worker – particularly if working with others
Cheaper than other forms of training	Staff may get frustrated if they are 'unpaid' trainers
Can be easy to organise	Could be a danger to others, for example, surgeon or train driver

SUBJECT VOCABULARY

off-the-job training training that takes place away from the work area

OFF-THE-JOB TRAINING

Some employees receive training away from the normal work area. This is called **off-the-job training**. For example, it might involve workers going to college once a week. Alternatively, it might involve a small group of managers travelling overseas to learn about new management techniques. The advantages and disadvantages of off-the-job training are summarised in Table 20.2.

▶ Table 20.2 Advantages and disadvantages of off-the-job training

ADVANTAGES	DISADVANTAGES
Output is not affected if mistakes are made	No output because employees do not contribute to work
Learning cannot be distracted by work	Some off-the-job training is expensive if provided by specialists
Training could take place outside work hours if necessary	Some aspects of work cannot be taught off-the-job
Customers and others are not put at risk	It may take time to organise

ACTIVITY 2

CASE STUDY: EMIRATES

The UAE airline, Emirates, has a specialised cabin crew training facility where new recruits are given 7 weeks of initial training before they start work. The training course provides a mixture of both theoretical and practical elements. To make the practical training realistic, it takes place in machines that simulate the movement of all aircraft types. This helps to give new recruits a taste of the experience required to deliver the best possible customer service to passengers. The training course addresses a range of work related issues such as:

- safety and emergency procedures (SEP)
- first aid
- service
- Emirates cabin crew image and Emirates cabin crew uniform
- fitness and nutrition
- security procedures.

In addition to this intensive training programme before work begins, Emirates employees also get annual refresher safety and emergency and first aid training.

▶ Emirates cabin crew



1 What is meant by the term off-the-job training?
2 Describe the method of training used at Emirates.
3 Discuss two benefits to Emirates of using off-the-job training.

TRAINING IN HEALTH AND SAFETY

In many occupations the workplace can be a dangerous environment. Because of this potential danger, governments aim to protect workers with legislation that forces businesses to provide a safe and healthy workplace. Some of this legislation addresses training in health and safety. For example, employees will need to learn about:

- using and maintaining safety equipment and protective clothing, such as fire extinguishers, protective overalls, hard hats, ear plugs and safety goggles
- the importance of a hygienic environment, for example, one that is safe for food production
- the dangers from hazardous substances, such as acids and glues
- the protection needed from violence, bullying, threats and stress in the workplace.

In many countries legislation exists to protect people at work. This might require businesses to prepare a written statement of their general policy on health and safety and ensure that all employees are aware of its existence.

Businesses will have to provide training, information, instruction and supervision to ensure the health and safety of workers. Many businesses also follow codes of practice to meet health and safety standards at work. Finally, health and safety inspectors have the right to enter business premises to ensure that health and safety measures are in place and are being carried out by businesses and employees.

THE BENEFITS OF TRAINING

The main reason for training is to provide workers with the skills and knowledge needed to do their jobs effectively. As a result, their productivity will increase. However, there are several other reasons.

KEEPING WORKERS UP TO DATE

Workers will need training if there are changes that might affect their jobs. Some examples might include:

- new health and safety procedures
- new technology
- after a takeover
- new working practices
- new legislation.

IMPROVING LABOUR FLEXIBILITY

Some businesses train their workers in a range of different jobs so that they are multi-skilled. This provides businesses with added flexibility.

IMPROVING JOB SATISFACTION AND MOTIVATION

Workers will feel more secure if they have been trained to do their job effectively. Not being able to do a job properly will be a source of anxiety, frustration and dissatisfaction for workers. The company has invested in those workers, and to replace them would require more expense, this may make employees feel more secure. It is also argued that training can be used to motivate staff.

NEW JOBS IN THE BUSINESS

Sometimes, owing to expansion, new products or new technology, new jobs are created. This often means that some staff will need retraining.

TRAINING FOR PROMOTION

Training is usually needed when workers are promoted. At each stage of the promotion process staff will need to learn new skills and methods. This allows them to handle the different duties and new responsibilities.

THE LIMITATIONS OF TRAINING

Some businesses are unwilling to invest heavily in training because of its limitations and costs. Some of the main ones are outlined below.

HIGH COST OF TRAINING COURSES AND OTHER RESOURCES

Training can be very expensive. Businesses will have to pay training providers if they use external training. Even internal training can be expensive if specialist training staff and equipment is needed.

GENERAL VOCABULARY

simulation activity of producing conditions that are similar to real ones, especially in order to test something, or the conditions that are produced

LEARNING BY DOING

Some businesses might argue that training is limited because workers do not really start learning how to do the job until they arrive at their workstations. In some jobs the actual work environment, with all its stresses and distractions, cannot be easily taught through simulation.

LOSS OF OUTPUT

If workers are involved in off-the-job training they will not be producing anything. This will result in lower output levels. Even if workers are trained on the job there may be a loss of output owing to mistakes and slow work associated with 'learners'. The time of those carrying out the training may need to be considered, if it takes them away from the their normal duties and therefore has an effect on production.

EMPLOYEES LEAVING

Businesses are likely to get very frustrated if employees leave and join a rival company after they have invested in training them. Some businesses actually target workers that have already been trained by others to avoid such costs.

LARGE VS SMALL BUSINESSES

Businesses of all sizes are likely to offer training of some description. It is unreasonable to expect a new recruit to start work with no training. However, the amount and quality of training is likely to vary considerably. It might be argued that larger firms can offer better quality training because they have more resources. There will inevitably be exceptions to this. For example, a very experienced worker in a small business may provide a very rich mentoring experience to a young recruit. Finally, large businesses will have to provide formal training to all employees if they employ very large numbers of workers. Failure to do so could result in 'chaos'.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a benefit of on-the-job training?

A Training can take place outside of work hours
B Simulations can be used
C It is cheaper than most other types of training
D Trainees will not be distracted by the work itself

▶ 2 Which of the following is an example of on-the-job-training?

A Mentoring
B Simulation
C Correspondence course
D Job analysis

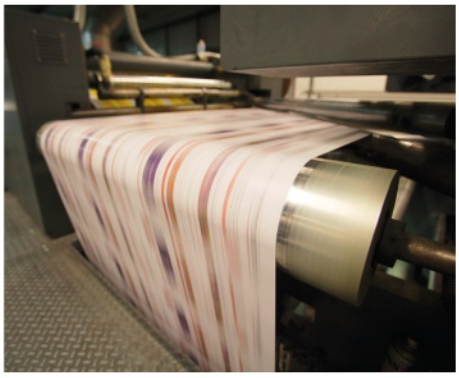
▶ 3 Which of the following is a benefit of training?

A It is cheap
B Workers always enjoy training
C Workers skills can be updated
D Business cash flow improves

▶ 4 An induction course may be used in which situation?

A Train workers in new skills
B Provide workers with a new qualification
C Deal with an employee grievance
D Introduce works to company policies and regulations

CHAPTER REVIEW



▲ Digital printing technology

CASE STUDY: PESHAWAR PRINTWORKS

Peshawar Printworks is one of the biggest printing companies in Pakistan. It is a growing business and has contracts with the government and some of the country's key publishers. The company has recently invested in some highly advanced digital printing technology. However, the introduction of the new technology has not been without problems. The conversation below took place between Kamran Irfan, the production manager, and the chief executive officer (CEO) of the company.

CEO: 'Another US$120 000 on training is too much. It is double the annual training budget.'

Kamran: 'But without the training it will take at least another 6 months before the new system is up and running.'

CEO: 'I know that training is necessary but it's so expensive. Plus, what happens when the trained workers leave and go and work for someone else?'

Kamran: 'I appreciate that, but we often get workers that have been trained elsewhere.'

CEO: 'How many need to be trained?'

Kamran: 'About 15 – but if we trained all 30 staff we get more flexibility and won't have to spend on training again for quite a while.'

CEO: 'Look – here's the deal. You can have US$60 000 for on-the-job training. I don't want workers going off on one of these "training holidays" for two weeks. We lose too much production and I would rather staff were trained on our system – not some simulator.'

CHAPTER QUESTIONS

1 Why is training needed at Peshawar Printworks?

2 Discuss two reasons why businesses like Peshawar Printworks may be reluctant to spend on training.

3 What are the advantages of on-the-job training to Peshawar Printworks? Discuss two advantages in your analysis.

4 Assess the benefits of training to Peshawar Printworks.

21 THE IMPORTANCE OF MOTIVATION IN THE WORKPLACE

LEARNING OBJECTIVES

- Understand the nature of motivation at work
- Understand the importance of motivation at work for attracting employees, retaining employees and productivity
- Understand the motivational theories of Herzberg, Maslow and Taylor

GETTING STARTED

Worker productivity can vary, which means that some workers produce more than others. There are several reasons for this: some people are more capable, some are more experienced and others have received more training. However, another reason is that they are better motivated; in other words, they have more drive and are more willing to work harder. Look at the example below.

CASE STUDY: ANJU SHARMA AND JAYA DHAR



▲ Bank work

Anju Sharma and Jaya Dhar are employed by a major bank and have been with the company for six years. Both women were recruited from a local university on the same day in September 2009. They trained together and started on the same salary. Anju is a highly motivated worker: she is always on time, reliable and enjoys solving problems. She is also happy to give up her own time to help new recruits. Anju always wanted to work in finance. She enjoys her job and has recently been promoted. Anju now earns 20 per cent more than Jaya.

In contrast, Jaya is poorly motivated. She has become unreliable, lacks drive and is often late for work. She has also developed a reputation for being un-cooperative and difficult to work with. Jaya has never really been happy working in a bank. Her ambition was to go to medical school but she failed the entrance exam. Jaya has been looking for another job for 18 months.

1 Suggest two possible reasons why Jaya is poorly motivated.
2 Why is motivation important to businesses?
3 In pairs, discuss whether you are a well-motivated individual. Provide a list of evidence to support your view.

GENERAL VOCABULARY

motivation desire to achieve a goal

WHAT IS MEANT BY MOTIVATION?

Motivation is the desire to achieve a goal. Some people are self-motivated. This means they have the drive to achieve goals on their own; they do not need any encouragement. However, others need to be motivated. They need a push, pressure or rewards. For example, some students are self-

motivated. They aim to achieve good results. They will attend all lessons, meet coursework deadlines and study hard. In contrast, some students lack the drive to achieve goals. These students will need encouragement, such as rewards for good attendance or praise for meeting deadlines.

WHY IS EMPLOYEE MOTIVATION IMPORTANT IN BUSINESS?

If a business has a well-motivated workforce, it will perform better. People will be happier in the workplace, the working environment will be more agreeable and labour productivity will be higher. Therefore, business profits are likely to be higher. Three specific reasons can be identified for why motivation is important in the workplace.

EASIER TO ATTRACT EMPLOYEES

Businesses need to attract the best possible workers available. If a business can recruit highly capable and reliable workers, it might gain a competitive edge on its rivals. If employees are motivated, the working environment and atmosphere is likely to be pleasant. Workers are more likely to be cheerful, polite, supportive and positive. This is important when interviewees are being shown around the work environment. Good candidates will be more likely to accept the job if they are impressed with what they see and feel about the workplace. A business might also develop a good reputation for employing a happy and well-motivated workforce. This will encourage people to apply for jobs in the first place. It might also attract good employees from rivals.

EASIER TO RETAIN EMPLOYEES

It is important for a business to keep hold of its workers. If they are well motivated, they are less likely to leave their jobs. This means that staff turnover (the rate at which people leave their jobs) will be lower. This is good because if staff turnover is high, recruitment, selection and training costs will be higher. A high labour turnover can also be troublesome for managers trying to organise business activities and/or other workers. Once good quality workers have been recruited and trained, it is important for businesses to keep them highly motivated. If they can do this, the business is more likely to be profitable.

HIGHER LABOUR PRODUCTIVITY

Well-motivated employees will work harder. They are likely to take more pride in their work, complete tasks quickly and feel that their jobs are important. As a result, they will produce higher levels of output. Businesses also need workers to cooperate. For example, more and more businesses organise their staff into teams. Therefore, if workers do not cooperate with each other, teamwork will be disrupted. At worse, conflict might result if a team member is uncooperative. However, well-motivated employees are likely to be cooperative, so a good team spirit is likely to develop, which will help to raise productivity.

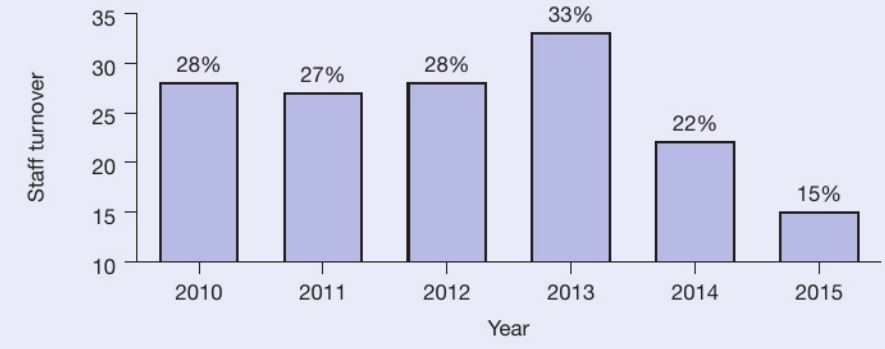
Poorly motivated staff are more likely to take time off. They may also become depressed, use minor illness as an excuse for missing work or simply take time off. This is bad for business because production will be lost, costs will rise and profits will fall.

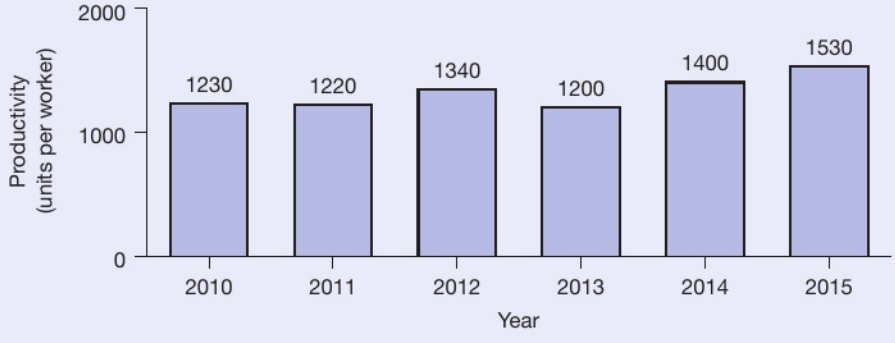
ACTIVITY 1

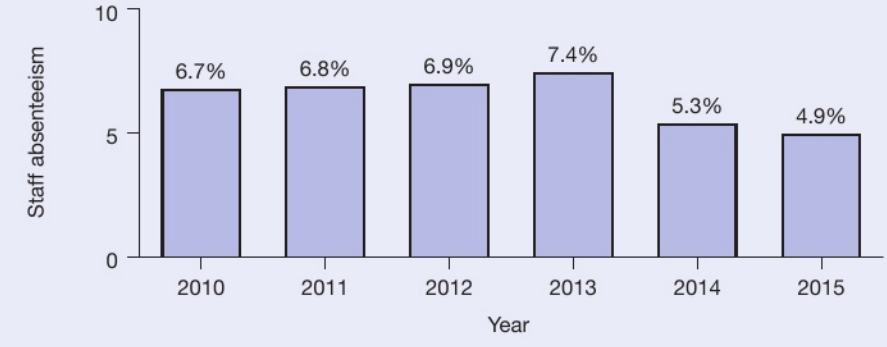
CASE STUDY: ANDRIS ZJUZINS

Andris Zjuzins is a Latvian company that manufactures electric motors. Two years ago, the company faced a staffing crisis because too many staff were leaving. It was becoming increasingly difficult to attract and retain staff in the business. The production manager had told the board repeatedly that worker morale was low and motivation poor. He thought the main reason for this was because the machinery was out-of-date and frequently broke down. As a result, earnings were being reduced owing to so much 'downtime' as workers were being paid piece rates. Eventually, in 2013, the board agreed to completely re-equip the factory.

1. What is meant by a well-motivated employee?
2. What evidence in Figure 21.1 suggests that workers were poorly motivated?
3. Describe the possible effect on the working environment if workers are not motivated.







▶ Figure 21.1 Staff information at Andris Zjuzins



▲ Manufacturing electric motors

HOW CAN BUSINESSES INFLUENCE MOTIVATION?

Businesses can change the motivation of workers because they have the opportunity to provide for a number of human needs. These needs may be physiological, social, or concern safety and security. Businesses can meet these needs by providing adequately paid, challenging and creative work, for example. A number of theories have been developed that suggests how businesses can motivate workers by satisfying human needs.

GENERAL VOCABULARY

social needs human needs to communicate, develop friendships and belong

DID YOU KNOW?

Businesses often organise their workers into teams. This is because teams of workers are more productive. It also helps to satisfy social needs because people are given the chance to form closer ties with people who have a common aim. Belonging to a team gives people a sense of identity and they may feel more secure.

HERZBERG TWO-FACTOR THEORY

Psychologist Frederick Herzberg discovered in the 1960s that certain factors at work would help to give employees job satisfaction. He called these motivators. He also found that other factors could leave workers dissatisfied. He called these hygiene factors. Examples of these are shown in Table 21.1

▶ Table 21.1 Herzberg's motivators and hygiene factors

MOTIVATORS	HYGIENE FACTORS
Achieving aims	Pay
Chance of promotion	Working conditions
Responsibility	Job security
Interesting work	Quality of supervision
Recognition	Staff relationships
Personal development	Company policy

SUBJECT VOCABULARY

job satisfaction pleasure, enjoyment or sense of achievement that employees get from their work

hygiene factors (Herzberg's) things at work that result in dissatisfaction

motivators (Herzberg's) things at work that result in satisfaction

job enrichment making a job more challenging and interesting

Maslow's hierarchy of needs order of people's needs starting with basic human needs

Herzberg said businesses must find ways of giving workers job satisfaction to motivate them. For example, they would have to ensure that jobs were interesting and that workers' achievements were recognised. Workers must also be given the chance to perform exceptionally well and win promotion. As a result, job enrichment could be used to motivate workers. Furthermore, Herzberg said that hygiene factors would not motivate workers. But if hygiene factors, such as pay, working conditions and the quality of supervision were insufficient, workers would develop poor motivation.

MASLOW'S HIERARCHY OF NEEDS

Psychologist Abraham Maslow recognised, in 1943, the needs of employees but arranged them into a hierarchy showing that some needs are more important than others. Maslow's hierarchy of needs is usually presented in a pyramid (shown in Figure 21.2).

GENERAL VOCABULARY

physiological needs basic needs of humans for their survival

PHYSIOLOGICAL NEEDS

Physiological needs are the basic human needs and are at the bottom of the pyramid. They include food, drink, shelter, warmth and rest. Humans also need protection from physical and physiological threats. If these needs are not met, humans cannot survive. Work provides the means to satisfy these needs. By going to work, people can earn money to buy food, clothes and safe shelter.

SAFETY AND SECURITY

People need protection from any form of danger, and from physical and psychological threats. They also need routine and familiarity.

SOCIAL NEEDS

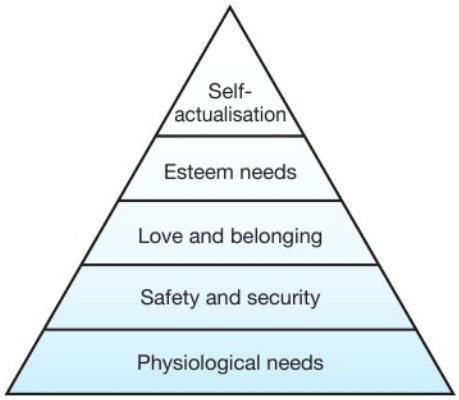
People are social animals. This means that they have social needs. People like to communicate and make friends. People also like to be cared for, to care and to belong to groups. Work can satisfy social needs. This is because people often work with others. This provides opportunities for people to meet and develop friendships and relationships.

ESTEEM NEEDS

People need to be recognised and respected and their achievements praised. They also want self-respect and self-esteem.

SELF-ACTUALISATION

A lot of people want to develop skills and also develop as people. Also, many people want to reach their full potential. For example, they may want to create something or stand out in some way. These needs are at the top of the pyramid.



▲ Figure 21.2 Maslow's hierarchy of needs

Table 21.2 shows how the needs in the hierarchy can be satisfied at work.

▶ Table 21.2 How work can satisfy people's needs

NEED	WORK CAN PROVIDE
Physiological	Adequate pay – subsidised meals and accommodation
Safety and security	Job security and safe working conditions
Love and belonging	Teamworking, good communication systems and social facilities
Esteem	Praise for doing a good job; awards and rewards for achievement
Self-actualisation	Opportunities to be challenged, be creative, solve problems and make decisions

Maslow also said that when businesses try to motivate workers by satisfying their needs, they should recognise the following.

- Once one set of needs have been satisfied they are no longer a motivator. Workers can only be motivated by achieving the next set of needs in the hierarchy. Therefore, if a worker has enough pay and feels secure at work, raising pay levels would not motivate that worker. A business would have to find ways of satisfying higher needs.
- If lower needs are not met, workers cannot be motivated if a business tries to meet higher needs. For example, if pay were insufficient, workers would not be motivated if a business was giving workers the chance to be creative.
- If a business fails to meet a particular need, workers are not likely to be motivated. For example, if a worker is overlooked for promotion, that worker may start to work less hard or look for another job.

ACTIVITY 2

CASE STUDY: INCHCAPE

Inchcape is an international car dealer and sells models such as Audi, Mercedes-Benz, Jaguar and Land Rover. Set up over 170 years ago, the business now employs over 5000 people in 25 different countries. Inchcape has a very good reputation as an employer; employees are particularly impressed by the benefits offered to them. Some examples include the following.

- Holiday benefits – staff get more holidays the longer they work at the company.
- Save as you earn scheme – earnings can be invested in discounted company shares.
- Customer introduction award – cash rewards are given to staff if they introduce a customer to the salesroom who then buys a car.
- Advantage scheme – Inchcape has ties with over 3000 retailers selling groceries, petrol, clothing, holidays, flights and mobile phones, for example, where staff can get discounts.
- Childcare vouchers – staff can claim childcare vouchers, which make a contribution to childcare costs.

Inchcape also encourages employees to take part in charity events. One employee, Rachael Mullard, said: 'The charity work is lovely. Last year we did the Three Peaks Challenge. It's a change, and nice to know you are doing something good. We were in a minibus for three days with the general manager, bundled up, freezing cold, aching and stinking, but we felt the love.'

▶ Car dealership



1 What is meant by hygiene factors in Herzberg's two-factor theory?
2 Describe some examples of Herzberg's hygiene factors offered by Inchcape.
3 Assess whether Inchcape manages to meet the social needs of staff, as described by Maslow.

TAYLOR'S THEORY OF SCIENTIFIC MANAGEMENT

One of the first motivational theories to emerge was that of Frederick Taylor in 1911. Taylor said that workers were motivated by money. After observing workers in manufacturing, Taylor recognised that many employees were inefficient and not working to their full potential. He also thought that the pay systems were not motivating them to work. After making a close examination of working practices, he recommended that jobs should be broken down into simple tasks and that workers should:

- use specialist tools and equipment
- follow a strict working procedure
- receive proper training
- get breaks to recover from the physical strain of work
- be paid according to what they produce.

Once a business had determined the most efficient way to carry out tasks and organise the workforce, Taylor felt that employees should get a 'fair day's pay for a fair day's work'. This meant that pay should be linked to output in order to motivate workers.

LARGE VS SMALL BUSINESSES

Businesses of all sizes will probably recognise the importance of employee motivation. Poorly motivated workers can have a negative impact on both large and small businesses. In a small business, workers might be better motivated because they work more closely to the owner. This might put workers under a little more pressure to work hard. They may also benefit from the owners natural enthusiasm and have more say in the running of the business. They may also get more responsibility and a wider range of tasks to complete. In large organisations though, training might be better and there may be more scope for team working, job rotation and promotion, for example. This would help to improve motivation.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Better motivation at work is likely to increase what?

A Staff turnover
B The cash flow
C Labour productivity
D Hygeine factors

▶ 2 Which of the following is an example of a motivator according to Herzberg?

A An increase in salary
B More responsibility at work
C Better job security
D Improved working conditions

▶ 3 According to Taylor, which of the following would motivate workers?

A More pay
B More recognition
C The opportunity to work in teams
D More responsibility

▶ 4 Which of the following would help to satisfy esteem needs at work?

A Higher pay
B Opportunities to be creative
C Improve supervision
D More praise from senior staff

CHAPTER REVIEW

CASE STUDY: CHESS

Chess is an IT and communications services provider. It has won a number of awards for its record and reputation as a good employer. For example, it won Employer of the Year in Cheshire in 2016. CEO, and founder of Chess, David Pollock said: 'It is with great pride that Chess has been named as Employer of the Year, we continually strive to create a happy working environment where everyone can progress their career, develop knowledge and skill, gain reward and recognition and maximise their potential.' There is support for this claim since only 12 per cent of staff decided to leave their positions at the company last year. This is a low staff turnover rate.

Chess is committed to its customers, employees and the environment. It invests heavily in specialist customer service training. For example, in 2016, Chess launched a customer service school for new recruits. It also delivered customer passion training that teaches Chess teams how to deal with different customer personality types. Each team has an appointed knowledge champion who has 'expert' knowledge in specialist areas. Teamwork is important at Chess and in a staff survey 92 per cent of employees said that teammates were helpful.

Chess also offers opportunities for creativity and recognises the value of praise in the workplace. For example, it holds monthly 'ideas lunches' where employees meet, chat, bond and eat together. Staff have a 'gimme 5 praise page' on a website, which enables them to award each other virtual thanks. Employees are also encouraged to vote for each other to win employee of the month.

Employees recognise Chess's genuine commitment to the environment. Evidence of this commitment is seen clearly in the work environment, which is well designed with plenty of space, light, plants and fish tanks. Chess has also won awards for its waste, recycling and energy saving achievements.



▶ Chess employees at an awards ceremony

Another feature of Chess's culture is its involvement in charity work. Every single employee is entitled to take a day off each year (on full pay) to participate in any charity event such as skydives, runs, theme days and car rallies. Chess will also match any money raised for charity by an employee up to a limit. Chess is also involved in a mentoring scheme in partnership with The Princes Trust, which allows managers to assist disadvantaged youngsters in the workplace.

Finally, Chess encourages its staff to interact socially. For example, the company's summer conference closed with a sociable evening out and last September Chess included employees' families and friends in festivals with a barbecue, bouncy castle and football-focused entertainment.

CHAPTER QUESTIONS

1. Why do people need to work?
2. Discuss two reasons why staff motivation is important to businesses such as Chess.
3. Suggest two examples of Herzberg's motivational factors as used at Chess.
4. Assess whether Chess satisfies any of the employees' needs outlined by Maslow's hierarchy. Make a clear judgement in your evaluation.

22 METHODS OF MOTIVATION AT WORK

LEARNING OBJECTIVES

- Understand the financial methods of motivation: remuneration, bonus, commission, promotion and fringe benefits
- Understand the non-financial methods of motivation: job rotation, job enrichment and autonomy

GETTING STARTED

Most people go to work to earn money. However, businesses may use different payment systems to reward their staff. For example, factory workers might be paid an hourly rate, which means they get paid so much per hour for every hour they work. Some businesses try to motivate workers by giving them non-financial rewards. All reward systems have advantages and disadvantages. Look at the examples below.

CASE STUDY: GVS LIFE ASSURANCE

Nasir Gul works for GVS Life Assurance selling life insurance policies. He earns a basic salary of US$400 per month. However, for every policy he sells, he receives another US$200. Nasir is well motivated and hard working. He is happy with the payment method and can earn up to US$3500 a month. Some of his colleagues are less happy. They lack Nasir's charm and skills and are often under a great deal of stress trying to earn a living.



▲ Businesses often motivate their salespeople with financial incentives

CASE STUDY: THE HERNING CARE HOME

The Herning Care Home, based in Herning, Denmark, is one of many care homes run by a large Scandinavian health care group. Johanna Jensen, the manager at Herning Care Home, is a talented care worker with excellent organisational and communication skills. In 2015, she met with a senior manager to explain that she was getting bored with her job. She felt unfulfilled and was thinking of leaving. The group was extremely keen to retain Johanna so it promised to make her job more interesting. Johanna was allocated time in her schedule to:

- organise monthly meetings with other care home managers in the group to discuss good practice and possible solutions to common problems
- report to the senior management team after each meeting
- design a formal induction programme for all new care home recruits in the group
- represent the group by attending international care conferences.

▶ Care work



1 Work out how much Nasir would earn if he sold 11 insurance policies during a month.
2 Suggest one advantage and one disadvantage of the payment system used by GVS Life Assurance.
3 Describe the method used to motivate Johanna at the Herning Care Home.
4 Describe one possible disadvantage of this method.
5 In pairs, decide what would motivate you to work harder at school. Draw up a list of these things in order of priority.

REMUNERATION

Remuneration is the money paid to employees for their work or services to an organisation. Taylor said that people only work because of the money they earn. Also, according to Maslow, money is needed by workers to help satisfy their physiological needs. There are different methods of remuneration, each of which has advantages and disadvantages.

SUBJECT VOCABULARY

remuneration money paid to employees for their work or services

time rate payment system based on the amount of time employees spend at work

gross pay pay before deductions, such as tax

net pay take home pay, that is, pay after deductions, such as income tax pension contributions or student loan repayments

overtime rate of pay above the normal rate to compensate employees for working extra hours

TIME RATES

Many workers are paid according to the amount of time they spend at work. This payment system is called a time rate. It is a common system and involves paying workers so much per hour or per week. Therefore, someone who earns US$20 an hour and works 37 hours a week will receive US$740 (US$20 × 37). This is gross pay, that is, pay before deductions. A worker's net pay is what they take home. It is gross pay minus deductions such as:

- income tax
- national insurance contributions
- pension contributions
- contributions to an employer savings scheme
- repayments for education or training loans
- trade union membership fees.

Workers may be paid overtime. This means they get a higher hourly rate for working extra hours. For example, workers might get paid time and a half for working after the normal working day, at weekends or during public holidays. Therefore, if the hourly rate were US$20 an hour, the overtime rate at time and a half would be US$30 (that is, US$20 × 1.5).

KEY POINT

Time rates are a suitable method of payment when it is difficult to measure the output of workers. They are also appropriate if the work involves a high degree of skill, care or accuracy. Rushing such work may be dangerous or result in costly errors. However, one problem with time rates is that productivity is not rewarded. With time rates, people are paid for their attendance at work. Disciplined and productive workers get the same as those who try to avoid work.

Some employees are paid a **salary**, which is expressed in annual terms and paid monthly. Salaries are usually paid to *non-manual* workers. Salaried workers are not always paid overtime. For example, teachers receive a salary and are expected to work as long as it takes to do their jobs.

PIECE RATES

Some workers are paid according to how much they produce: a **piece rate**. An example would be an employee picking grapes being paid US$0.50 per kilogram. The main benefit of this system for businesses is that it rewards productive workers. Workers who are lazy or slow will not earn as much as those who are disciplined and productive. This system helps to motivate workers and businesses are likely to get more out of their employees. However, piece rates do have problems.

- Piece rates cannot be used if work cannot be measured. For example, it is very difficult to measure the output of a hotel receptionist or a research scientist.
- The quality of output may suffer if people work too fast. They may take short cuts and make mistakes. In the above example, a labourer picking grapes may damage some of the fruit when picking too quickly.
- Workers might use dangerous practices trying to work too fast. For example, machinists may remove protective guards to speed up production and therefore risk injury.

SUBJECT VOCABULARY

salary pay, usually to non-manual workers, expressed as a yearly figure but paid monthly

piece rate payment system where workers receive an amount of money for each unit produced

performance-related pay payment system designed for non-manual workers where pay increases are given if performance targets are met

PERFORMANCE-RELATED PAY

Performance-related pay (PRP) may be used to motivate non-manual workers. PRP is designed specifically to reward workers whose output is difficult to measure. PRP works best if businesses use an *appraisal* system to evaluate staff performance. This involves meeting with individual workers every year to:

- discuss progress at work
- assess whether targets have been met
- set new targets for the next year.

If targets have been met or exceeded, workers would get paid more. Businesses like PRP because it links pay to performance and only workers who perform well will be paid more. However, the system does have problems.

- Some workers feel that it is unfair because appraisers may be inconsistent. For example, pay awards may be given to certain workers because they have close friendships with their managers. This may demotivate staff and cause conflict.
- The financial **incentives** may not be high enough to motivate workers to improve their performance.
- Some workers may feel that the performance targets set are too demanding.
- Some workers may blame other factors if targets are missed. For example, there may have been problems with computer systems that affected performance.

GENERAL VOCABULARY

incentives something that encourages you to work harder

ACTIVITY 1

CASE STUDY: TOP RANK SERVICE CENTRE

The Top Rank Service Centre carries out maintenance, servicing and repair work on taxis in New Mexico. The company employs one manager, nine mechanics, one labourer and a receptionist. The mechanics are paid US$20 per hour and time and a half for every hour they work over 35 hours during a week. The manager is paid a salary of US$62 000 per year with no overtime payments.



▶ Taxis

One of the mechanics worked 50 hours during a busy week in September.

1. Work out the gross pay earned by this mechanic.
2. What is meant by the term salary?
3. Describe **one** possible reason why the Top Rank Service Centre chooses not to use piece rates as a method of remuneration.

SUBJECT VOCABULARY

bonus systems payment in addition to the basic wage for reaching targets or in recognition for service

commission payment based on the value of sales, usually a percentage of sales made

DID YOU KNOW?

Some businesses pay their staff *loyalty bonuses*. These are usually paid annually. Such bonuses are not necessarily linked to productivity. They are designed to reward workers for their loyalty.

BONUS PAYMENTS

Some firms have **bonus systems**. Bonuses are paid in addition to the basic wage or salary. They are usually paid if targets are met. For example, machinists may be paid a bonus if they reach a weekly production target. Bonuses can also be paid to groups of workers. For example, a sales team may get a bonus if the whole team meets a sales target. The main advantage to businesses of bonus payments is that they are only paid if targets are met. This means that money is only paid if it has been earned. Bonus payments may help to motivate workers as they work hard to reach a target to earn their bonus.

COMMISSION

Commission is a payment for reaching a target. This method is often used to reward sales staff. A salesperson may be paid entirely on the basis of their sales record. This means that their income is nothing if no sales are made. However, a more common approach is to pay a salesperson a relatively low basic salary and top it up with commission payments. This is the method used by GVS Life Assurance in 'Getting started' at the beginning of this chapter (see page 183). Taylor might approve of this method of payment as a means of motivating workers.

PROMOTION

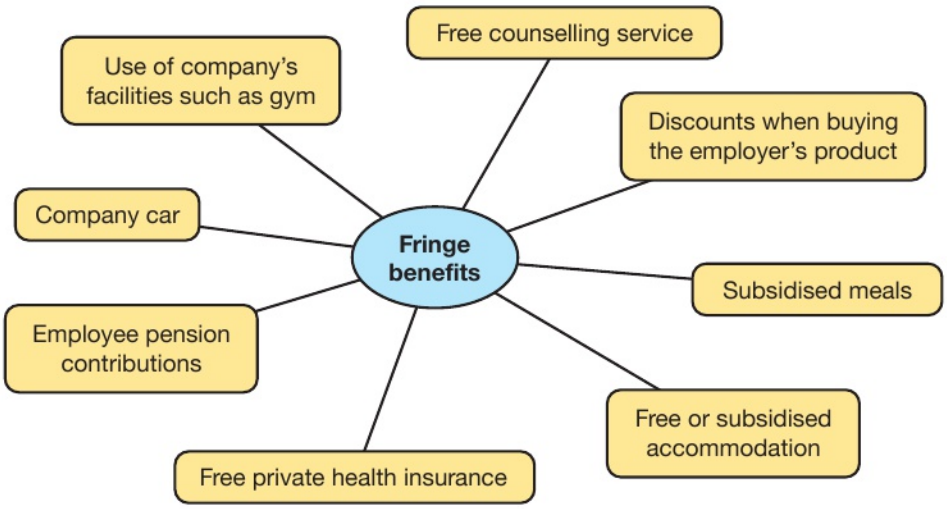
Many people want to develop a career at work. This means they want to improve their skills, learn new ones and try to get promotion. A business can reward workers if there is a clear route to the top. The chance of promotion at work will help to motivate workers; this may be because promotion nearly always comes with higher pay. The higher pay rates are to reward employees for taking on additional responsibilities. For example, if an employee is promoted from assistant manager to manager, that employee will be responsible for the performance of the whole department or area of work. If a business wants to use promotion as a means of motivation, it must be prepared to use internal recruitment. According to Herzberg, the chance of promotion is a motivator.

FRINGE BENEFITS

SUBJECT VOCABULARY

fringe benefits 'perks' over and above the normal wage or salary

Some employees receive **fringe benefits** in addition to their normal pay. They are often described as the 'perks' of the job. They might be used to help satisfy Maslow's physiological needs. Examples of fringe benefits are shown in Figure 22.1.



▶ Figure 22.1 Examples of fringe benefits

There are some good reasons for rewarding workers with fringe benefits.

- It may be cheaper to give employees US$2000 of fringe benefits than US$2000 in cash. Employees **may** also pay less tax if they take fringe benefits instead of cash.
- Productivity may improve because there is less staff absence. Workers may be healthier owing to private health care and having use of the company gym, sports facilities or counselling services.
- Some benefits help to attract and retain better-qualified employees for a business.
- Many benefits provide protection and security for workers and their families. This might help to improve worker satisfaction, such as free private health insurance, particularly in a country with poor or no nationwide health care system.
- Some fringe benefits are performance related. This will help to motivate staff. Some fringe benefits are only available to senior staff. This might encourage employees to aim for promotion.

Herzberg would argue that fringe benefits cannot be used to motivate workers since they are hygiene factors.

NON-FINANCIAL REWARDS

Businesses use non-financial rewards for a number of reasons.

- Some people are not motivated by money.
- Some workers attach more importance to non-financial rewards.
- Since more and more people work in teams, individual financial rewards are less appropriate.
- Some of the motivational theories, such as those of Maslow and Herzberg, suggest that non-financial rewards are a valuable means of motivation at work.

JOB ROTATION

One way to make work more interesting is to allow employees to change jobs from time to time. This will give workers more variety and help to avoid feeling bored. This is called job rotation. In a supermarket, job rotation might mean that staff switch between shelf-filling, order-picking for online orders, trolley collection, customer services and the checkout. Job rotation should help motivate workers and provide a business with more flexibility. For example, if there is a rush of customers waiting to check out, some employees can be temporarily switched from shelf-filling to operate the tills. This will avoid keeping customers waiting. One possible disadvantage of this method of motivation is that training costs will rise. Another is that the benefits of specialisation may be lost.

JOB ENRICHMENT

Herzberg said that if jobs were more interesting workers would be better motivated. He identified job enrichment as a possible motivator in his two-factor theory. Job enrichment means that jobs should be made more challenging and rewarding. Workers should be given tasks that require more responsibility and creativity if a business wants to motivate them. Job enrichment gives employees the opportunity to develop unused skills. Developing such skills and taking on more challenging tasks should make work more interesting. It might also encourage staff to aim for promotion and they may feel valued.

In 'Getting started' above (see page 183), the Herning Care Home used job enrichment to motivate Johanna Jensen. She was bored and unfulfilled in her managerial post and was thinking about leaving. However, her employers decided to make her job more interesting and challenging. She was asked to organise monthly meetings with other care home managers in the group and report back to the senior management team. She was also asked to design a formal induction programme for new recruits and represent the group at international care conferences. This is an example of job enrichment.

One of the problems with job enrichment is that if employees are forced to take on extra work without resources and training, some of them may be displeased. This could have a negative impact on labour productivity.

ACTIVITY 2

CASE STUDY: TATA STEEL

Tata Steel is part of the giant Indian-based Tata Group. The company is committed to employee development and growth and uses a concept of learning and development called 70:20:10. Tata believes that 70 per cent

of learning and development takes place on the job, 20 per cent through coaching and guidance and 10 per cent from the classroom. Therefore Tata uses a range of methods to ensure that employees are trained, coached and mentored in a systematic manner. This approach helps workers to acquire the knowledge, skills and attitude required to do their jobs and to develop a meaningful career path.

One of the methods used by Tata is job rotation. This is used to help avoid some of the dull repetitiveness of factory work. It is also used to equip staff with a wider range of skills and provide them with more learning opportunities. Job rotation, along with other working practices, helps Tata to raise and retain the technical capabilities of staff in the business.

▶ Steel worker



1 What is meant by the term job rotation?
2 Discuss one possible advantage of job rotation to **(a)** Tata Steel and **(b)** its employees.

AUTONOMY

GENERAL VOCABULARY

autonomy giving workers the authority to make choices and decisions about the way they work (sometimes called empowerment)

Some businesses allow its workers more autonomy to improve motivation (autonomy may also be referred to as empowerment). This means that they are given the authority to make more choices and decisions about the way they work. Workers with autonomy are set a goal or task by management and then left to decide for themselves the best way to achieve the goal. This gives workers control and suggests that they can be trusted. It might also give employees more self-confidence and is a way of recognising their achievements. This should help to motivate workers. Businesses will benefit from this practice because productivity will be higher and there may be opportunities to reduce the number of managers and supervisors. This is because once workers are given autonomy; the need for managers and supervisors is reduced because workers are trusted. However, some workers may respond negatively to being given autonomy – especially if they do not receive extra pay. They may think that it is just a way of laying off managers and 'squeezing' more out of workers. Also, some workers may not be confident taking on more responsibility.

LARGE VS SMALL BUSINESSES

It could be argued that many of the owners of small businesses are not aware of the motivational theories that link rewards to workers and their levels of motivation. However, owners may know from experience that certain incentives, such as giving employees more responsibility, can motivate people. In large businesses, where specialist human resources managers are employed, the motivational theories are more likely to be well understood. Consequently, a great deal of thought may be given to the various methods which are used to motivate workers in the job roles specific to that organisation.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is a disadvantage of job rotation?

A Employees may get bored
B Training costs are likely to be higher
C Managers' jobs will be at risk
D Work timetables will be more difficult to prepare

▶ 2 A payment in addition to the basic wage for reaching targets or in recognition for service is called?

A Salary
B Commission
C Bonus
D Piece rate

▶ 3 An example of a non-financial reward used to help motivate workers is?

A Job enrichment
B Job analysis
C Job description
D Job specification

▶ 4 Factory workers at an assembly plant get Rs100 per hour for a 35-hour week and Rs150 per hour overtime. A worker working a 50-hour week would receive how much?

A Rs3500
B Rs5000
C Rs5750
D Rs8500

CHAPTER REVIEW

CASE STUDY: SANTIAGO DISEÑO

Santiago Diseño is a design company located in Santiago, Chile. The company employs over 100 staff and has clients all over South America. In 2011, the company employed a consultant to investigate why motivation was poor and make recommendations for improvement. Their general conclusion was that staff needed more autonomy. As a result, Santiago Diseño made the following changes, which were put in place by the end of 2012.

- The designers were split into eight design teams. Each team specialised in the design of a particular product group.
- Each team was responsible for carrying out their work in any way they chose. Their only aim was to meet the design briefs they were given.
- Each team was free to order resources, choose their method of work and communicate with clients directly.
- A bonus would be paid to all team members if the design briefs were met within an agreed time period.

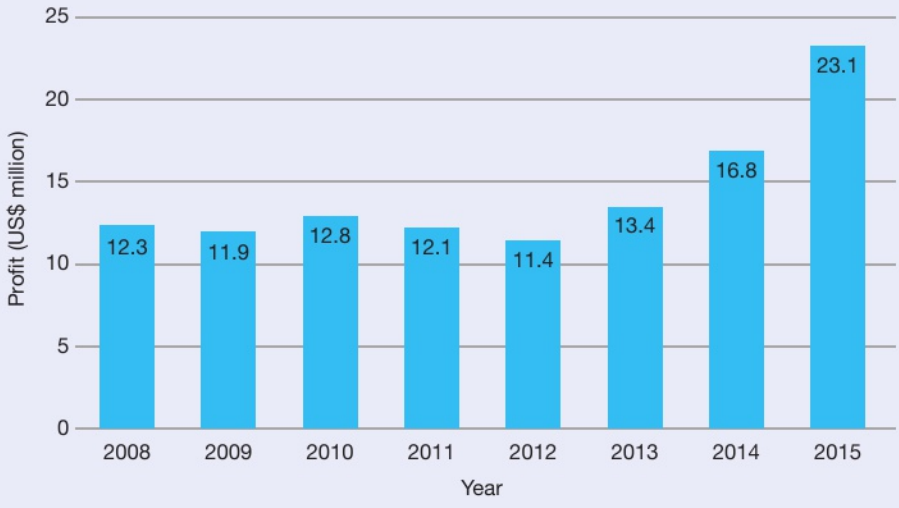
SUBJECT VOCABULARY

design brief set of instructions about what a new product should look like or what features it should have

In 2012, Santiago Diseño also introduced a range of fringe benefits to reward existing workers and help attract and retain talented new designers. These included:

- an attractive company pension scheme
- a free canteen
- free bicycles to encourage employees to cycle to work
- subsidised in-house childcare – Santiago Diseño opened a specialist childcare unit so that employees could bring their young children to work and leave them in safe care on site
- free health insurance.

In 2015, Santiago Diseño made a record profit and won two high-profile design awards for industry. Figure 22.2 shows the profit of the company from 2008 to 2015.



▶ Figure 22.2 Santiago Diseño profit, 2008–2016

CHAPTER QUESTIONS

1 What is meant by the term bonus?

2 How might bonus payments benefit Santiago Diseño?

3 Describe how giving workers more autonomy might motivate workers at Santiago Diseño.

4 Discuss two benefits to Santiago Diseño of giving staff fringe benefits.

5 Assess whether the use of non-financial methods of motivation such as autonomy were effective at Santiago Diseño. Make a clear judgement in your evaluation.

23 ORGANISATION STRUCTURE AND EMPLOYEES

LEARNING OBJECTIVES

- Understand organisational charts for different types of businesses: hierarchical and flat, and centralised and decentralised
- Understand the roles and responsibilities of employees in terms of compliance and accountability: span of control, chain of command and delegation

GETTING STARTED

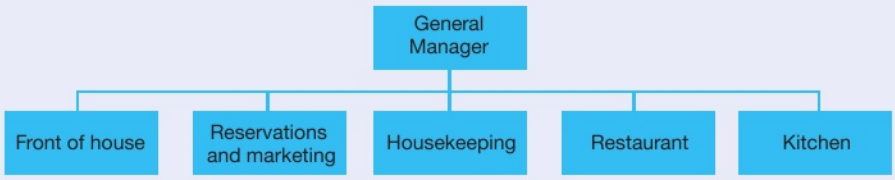
As businesses grow they need to be formally organised. This means that workers must be placed into groups, teams or departments. Each group must have a leader, who is responsible for the whole group and is able to control its activities. Every person in the business must understand their role in the organisation and be accountable to someone. Look at the example below.

CASE STUDY: THE ZETA HOTEL

The Zeta Hotel, Nepal, is one of 68 hotels owned by an international hotel chain. The hotel staff work in one of five departments. These are shown in an organisational chart in Figure 23.1.

- **General manager:** Anil Karmi is responsible for running the hotel. He is accountable to an area manager and submits a weekly sales report to head office. He also holds regular team meetings with the other heads of department to discuss progress and resolve problems.
- **Front office:** Trishna Rawal runs the reception area at the hotel. She leads a team of six staff and is responsible for ensuring that the guest check-in process runs smoothly. Receptionists also deal with guests' queries throughout their stay and process payments when they leave.
- **Reservations and marketing:** Kajal Verma runs this department. Its aim is to sell all the rooms each night at the best possible price. Bookings can be made online, by telephone, by a travel agent or in person. Nine people are employed in this department, which is also responsible for maintaining the hotel's website and promoting the hotel. A simple form is used to gather feedback from customers before they leave.
- **Housekeeping:** this department employs 12 people and it is run by Pradeep Pulami. It is responsible for the cleanliness of the hotel's public areas and servicing the guests' rooms every day. Pradeep is also in charge of keeping records of all the hotel's supplies and equipment.

- **Restaurant:** Indu Chand is the restaurant manager. She is responsible for managing 13 staff in the restaurant. She works very closely with the executive chef in the kitchen.
- **Kitchen:** Aarif Vesawkar is the executive chef and responsible for designing menus, purchasing food and supervising the 22 staff of chefs and other kitchen workers. He works very closely with Indu, the restaurant manager, and Basanta, the head chef.



▶ Figure 23.1 Organisational chart for the Zeta Hotel, Nepal

1 Who is in control of the Zeta Hotel?
2 Describe briefly how the Zeta Hotel is organised.
3 What is Kajal's role in the organisation?
4 To whom is (a) Basanta (b) Pradeep accountable?

ORGANISATIONAL CHARTS

Running a business involves planning, decision making, co-ordination and communication. These tasks are easier if workers are organised into a structure made up of different functions or departments. The internal structure of a business is known as its formal organisation.

SUBJECT VOCABULARY

formal organisation internal structure of a business as shown by an organisation chart

organisational chart diagram that shows the different job roles in a business and how they relate to each other

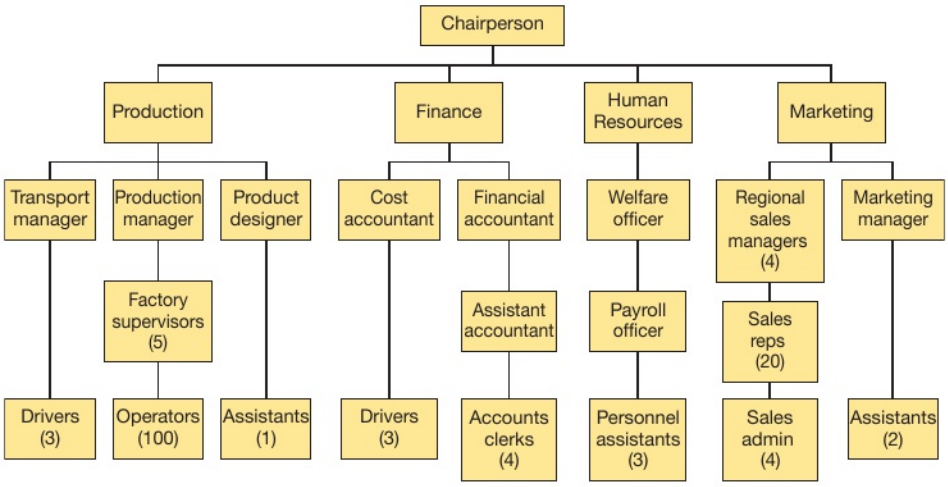
The formal organisation can be represented by an organisation chart, which shows:

- how the business is split into functions or departments
- the roles of employees and their job titles
- who has responsibility
- to whom people are accountable
- communication channels
- the relationships between different positions in the business.

GENERAL VOCABULARY

hierarchy order or levels of responsibility in an organisation from the lowest to the highest

An organisation chart for Denham Plc, a manufacturer, is shown in Figure 23.2. It is a traditional organisation chart and the person in charge is the chairperson. The chairperson, at the top of the hierarchy, is accountable to the shareholders. The roles played by all other employees in the chart are outlined below.



▶ Figure 23.2 Organisation chart for Denham Plc

EMPLOYEE ROLES AND RESPONSIBILITIES

The roles played by employees vary depending on the size and type of business. The roles outlined here refer to the chart in Figure 23.2.

GENERAL VOCABULARY

authority right to command and make decisions

DIRECTORS

Directors are appointed by the owners to run the business. Together with the chairperson, they form the board of directors. They make all the important decisions in the business. Figure 23.2 shows that Denham Plc is divided into four departments: Production, Marketing, Human Resources and Finance. A director runs each of these departments. These four directors are accountable to the chairperson. They also have **authority** over the managers in the layer below them.

MANAGERS

Managers have a number of *functions*. They are responsible for planning, controlling, organising, motivating, problem solving and decision making. However, their overall role is to achieve the objectives of the owners. They are employed to 'get things done' using the resources of the business as effectively as possible. They are also leaders and help to guide and shape the business. The manager in each department is accountable to the departmental director. In Figure 23.2, there are several managers in each department.

SUBJECT VOCABULARY

payroll officer someone who is responsible for the administration of workers' pay in an organisation

- The production department has a transport manager and a production manager. There is also a product designer who has the same *status* as a manager in the chart. They are on the same level in the hierarchy.
- In the finance department, the cost and financial accountants both have managerial status; this is because they are responsible for the work of others.
- The welfare officer in the personnel department also has managerial status. He or she is responsible for the work of the **payroll officer** and three assistants.
- The sales department has four regional sales managers and a marketing manager. Each regional manager has five sales staff working for him or her.

SUPERVISORS

Supervisors monitor the work in their particular area. They have authority over operatives and general workers. At Denham Plc, five factory supervisors are employed in the production department. Each of them has authority over 20 operatives. Supervisors may carry out managerial duties, but at a lower level. For example, Figure 23.2 shows that the assistant accountant, the payroll officer and the sales reps are all at the same level in the hierarchy.

OPERATIVES

Operatives are skilled workers. They are involved in the production process. For example, they may operate machines, assemble products, work with tools or carry out maintenance. In Figure 23.2, 100 operatives are employed in the production department. They are accountable to supervisors or managers. They are shown near the bottom of the hierarchy in Figure 23.2. However, they may have more status than general staff because they are often skilled.

GENERAL STAFF

Businesses often employ staff that do not have any specific skills. However, with training they can perform a variety of tasks and gain promotion to other positions. Examples of general staff in Figure 23.2 include drivers, assistants,

SUBJECT VOCABULARY

accounts clerk someone who keeps records or accounts in an office

accounts clerks and people with administration jobs. They are shown at the bottom of the hierarchy in Figure 23.2. General staff do not have any authority.

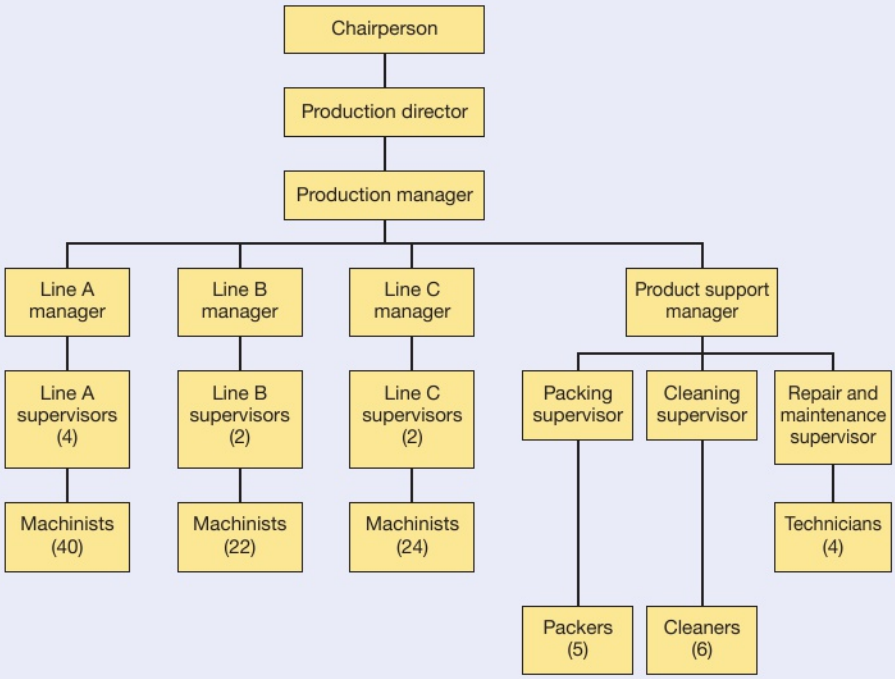
PROFESSIONAL STAFF

Professional staff are skilled and highly trained. Examples include lawyers, accountants, doctors, pilots and dentists. In places where lots of professionals are employed, organisation charts may be different.

ACTIVITY 1

CASE STUDY: YU XIAOTING MOTORS

The Taiwanese company, Yu Xiaoting Motors, makes three types of electric motor. The company employs 300 staff and supplies refrigerator manufacturers in the Far East. The factory operates three production lines – A, B and C – for each of the three electric motors produced. Figure 23.3 shows part of the company's organisation chart.



▶ Figure 23.3 Chun-ching Motors – organisation chart for production

1. Name two examples of operatives at Yu Xiaoting Motors.
2. What is meant by the terms **(a)** formal organisation **(b)** hierarchy?
3. Describe the roles of **(a)** the production director **(b)** line supervisors at Yu Xiaoting Motors.

FEATURES OF ORGANISATIONAL STRUCTURES

GENERAL VOCABULARY

chain of command route through which orders are passed down in the hierarchy

CHAIN OF COMMAND

Organisation charts show the **chain of command** in a business. This is the route through which orders are passed down in the hierarchy. In Figure 23.2, each layer in the hierarchy is like a link in a chain. Orders will pass down through the layers from the top to the bottom. Information may also flow back from the bottom to the top. If the chain of command is too long:

GENERAL VOCABULARY

subordinates people in the hierarchy who work under the control of a more senior worker

delegation authority to pass down work from superior to subordinate

SUBJECT VOCABULARY

span of control number of people a person is directly responsible for in a business

centralised type of organisation system where most decisions are made at the top of the organisation and then passed down the chain of command

decentralised type of organisation system where decision making is pushed down the chain of command and away from the top

- messages may get lost or confused as they pass up and down the chain
- changes might not be accepted lower down the chain.

Therefore, if there are lots of links in the chain, the risk of instructions not being implemented is higher.

SPAN OF CONTROL

The number of people, or **subordinates**, a person directly controls in a business is called **the span of control**. For example, in Figure 23.2, the finance director is responsible for two people – the cost accountant and the financial accountant. Therefore, the director's span of control is two. In the sales department, each regional manager is responsible for five sales reps. Their span of control is five.

If a business has a *wide* span of control it means that a person controls relatively more subordinates. Someone with a *narrow* span of control controls fewer subordinates. If the span of control is greater than six, difficulties may arise, for example, managers may not be able to monitor effectively the performance and behaviour of more than six subordinates.

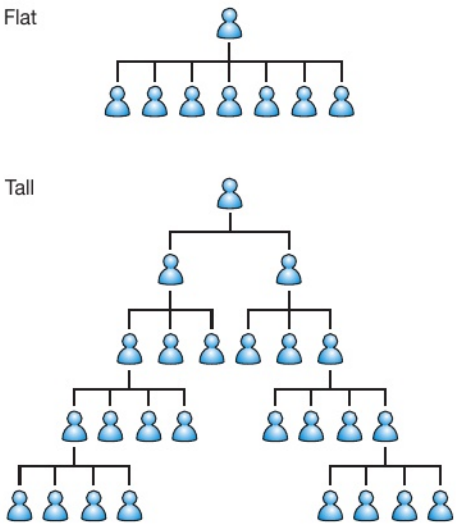
FLAT AND HIERARCHICAL (TALL) STRUCTURES

Organisation structures may be flat or tall. Examples are shown in Figure 23.4. A flat structure means there are a fewer layers in the hierarchy. In Figure 23.4, the flat structure only has two layers in the hierarchy. The chain of command is short but the span of control is wide. With flat structures:

- communication is better because the chain of command is short
- management costs are lower because there are fewer layers of management
- control may be friendly and less formal because there is more direct contact between layers.

With hierarchical (tall) structures:

- communication through the whole structure can be poor because there is a long chain of command
- management costs will be higher
- there may be a clear route for promotion that might help to motivate staff
- control tends to be more formal and less friendly because of all the layers in the hierarchy.



▲ Figure 23.4 Flat and hierarchical (tall) organisational structures

KEY POINT

One change in recent years has been a switch to flatter structures. This has helped to cut managerial costs. It has also given more responsibility to other workers, which may help to motivate them.

DELEGATION

In some situations, a manager may hand a more complex task to a subordinate. This is called **delegation**. The manager will still have responsibility for the overall task. However, time can be saved if a subordinate completes the task. Sometimes delegation can motivate workers because they feel as though they are being trusted to carry out more difficult work. However, if employees think that 'extra' work is being given to them without any reward, they may be dissatisfied. The extent to which delegation takes place will often depend on whether decision making is **centralised** or **decentralised**. This is discussed next.

CENTRALISATION AND DECENTRALISATION

If employees do not have any authority at all in a business, then decision making is centralised. In contrast, if control in a business is completely

decentralised, this means that every employee has the authority to take decisions. In most businesses, some decision making is delegated down the hierarchy. This is because there are limits to the amount of work the senior management team can do. However, the extent to which businesses are decentralised may depend on the view senior managers hold about the advantages and disadvantages of each structure. The following bullet lists summarise the advantages and disadvantages of each.

Centralised – advantages

- Senior management has complete control over resources.
- Senior managers are trained and experienced in decision making.
- It prevents parts of the business (such as different departments) acting independently.
- Coordination and control is easier.

Centralised – disadvantages

- Employees may be demotivated without any authority.
- It brings less creativity and fewer ideas.
- Procedures may be needed to make decision making easier.
- People at the top may be out of touch with the needs of customers served by more local employees.

Decentralised – advantages

- Workers have autonomy and may be better motivated.
- It speeds up decision making.
- It takes pressure off senior managers by reducing their workload.
- Workers get the opportunity to be creative and share their ideas.
- It provides more promotion opportunities at the different managerial levels.

Decentralised – disadvantages

- Senior managers may lose control of resources.
- Costs may be higher owing to less standardisation and more variability in decision-making processes.
- Some employees may not have the ability to make decisions.
- Some employees may not welcome the extra responsibility.

ACTIVITY 2

CASE STUDY: MPHASIS

Mphasis is an IT solutions provider based in Bangalore, India. It is a large company with over 30 000 employees (including contractors). In 2015, it began the process of decentralisation. It wanted to give more control to executives placed onsite (that is, on the customers' premises). One of the main reasons for the move to decentralisation was to speed up decision making. The plan was to allow 17 executives in a management layer lower down in the hierarchy to make decisions without approval from a higher level. These people would have the power to make more decisions relating to the customer. Ganesh Ayyar, then Mphasis CEO, said that the decentralisation programme would be expanded in the future but a time frame for the process had not been outlined.

1 What is meant by the term decentralisation?
2 Discuss **(a)** one benefit and **(b)** one disadvantage of decentralisation to Mphasis.

LARGE VS SMALL BUSINESSES

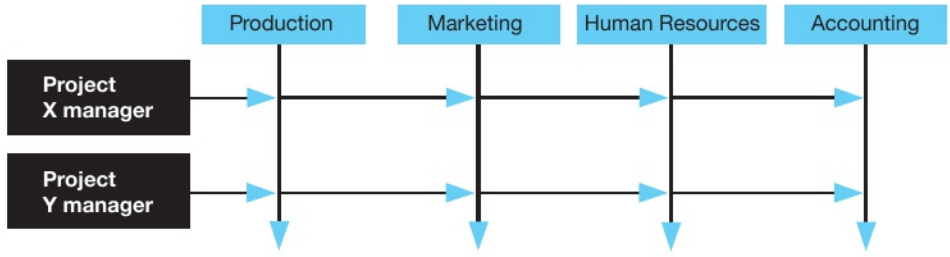
Small businesses rarely need a formal organisation. This is because the workforce is small and everyone will know what the others are doing. They will all be accountable to the same person – probably the owner. However, large businesses that employ thousands of people, need a formal organisation. Without it, the business would be difficult to control. Communications may break down, mistakes might occur and staff may become confused about their roles.

ORGANISATIONAL CHARTS AND GROWTH

As businesses grow, the formal organisation is likely to change.

[M23NP23.2]

- Most businesses, because they start small, have an *entrepreneurial structure*. This means that decisions are made centrally – by the owner or 'key' workers.
- As businesses grow, they may introduce a traditional structure. This is where the structure is based on a hierarchy and decision making is shared throughout the business. The chart in Figure 23.2 is an example.
- In some businesses, a *matrix structure* is favoured. This is where employees are put into teams that cut across departmental roles. They may work together on a specific project – designing a new product, for example. This is shown in Figure 23.5.



▶ Figure 23.5 Matrix structure

MULTIPLE-CHOICE QUESTIONS

▶ **1 The route through which orders are passed down the hierarchy is called?**
A Span of control
B Delegation
C Chain of command
D Authority

▶ **2 Granting workers the power to make decisions means they have been given?**
A Authority
B Delegation
C Responsibility
D A job title

▶ **3** With a flatter organisational structure, which is true?

A Management costs will be higher

B Communication will be better because the chain of command will be shorter

C The span of control will be lower

D Control tends to be more formal

▶ **4** Which of the following is an advantage of centralisation?

A Less control by the senior management team

B More motivated workforce

C Fewer procedures may be needed, making decision making more efficient

D Co-ordination and control is easier

CHAPTER REVIEW



▲ Medical supplies

CASE STUDY: TAUKIR MEDICAL SUPPLIES

Amjad Taukir is the chairman of Taukir Medical Supplies. It is a growing company and distributes a range of medical equipment and dressings to hospitals and clinics in the UAE. It has a traditional structure and the following information is given about the finance department.

- The finance director is in charge of the finance department.
- The department is divided into four sections, each of which is run by a manager. These managers are the financial accountant, the cost accountant, the purchasing manager and the credit controller.
- The financial accountant has two assistant accountants, each of which have three accounts clerks working for them.
- The cost accountant has one assistant cost accountant but no clerks.
- The purchasing manager has one supervisor and two purchasing clerks.
- The credit controller has no supervisor or assistant but does have two clerks.

CHAPTER QUESTIONS

1 Draw an organisational chart for the finance department at Taukir Medical Supplies.

2 What is the span of control for (a) the credit controller (b) the cost accountant?

3 What is meant by the chain of command? Use this case study as an example.

The financial accountant often delegates work to the assistant accountants.

4 What is meant by delegation?

The HR manager has suggested to the board that Taukir Medical Supplies would benefit from having a flatter organisation structure.

5 Discuss the benefits of a flatter organisation structure. Give at least two benefits in your analysis.

24 DEPARTMENTAL FUNCTIONS

LEARNING OBJECTIVES

- Understand the human resources function – workforce planning, recruitment and selection, training, health and safety, staff welfare, employment issues, industrial relations, disciplinary and grievance procedure, dismissal, unfair dismissal and redundancy
- Understand the finance function– wages/salaries, cash-flow forecasting, budgets and accounting
- Understand the marketing function – market research, product planning, pricing, sales promotion, advertising, customer service, public relations, packaging and distribution
- Understand the production function – manufacturing the product, designing new products, quality control and stock control

GETTING STARTED

The way businesses are divided into departments will vary according to the size and needs of the business. For example, a small engineering business might have just two departments: production and sales. However, as businesses grow, many are likely to divide their organisation into four traditional departments: production, marketing, human resources and finance. Employees working in each of these departments will specialise in a particular range of tasks. Look at the example below.

GENERAL VOCABULARY

grievances belief that you have been treated unfairly, or an unfair situation or event that affects and upsets you

SUBJECT VOCABULARY

trade unions organisations, usually in a particular trade or profession, that represent workers, especially in meetings with employers



▲ Induction training at Zuzzy Solutions

CASE STUDY: ZUZZY SOLUTIONS

Zuzzy Solutions is a marketing agency based in Paris. It employees 150 staff and is divided into six departments: human resources, finance, advertising, graphic design, social media and public relations. Patricia Renard is head of the human resources department; her job is to supervise the recruitment and selection process and ensure that employees' welfare needs are met. She also meets with other heads of department on a regular basis and is responsible for the six staff that work in her department.

Andre Duval works in the human resources department. Examples of the tasks carried out by Andre include the following.

- Organising and delivering induction training.
- Helping Patricia with interviews and selection.
- Dealing with staff grievances.
- Liaising with trade unions.

1 Describe the role of the human resources department at Zuzzy Solutions.
2 Discuss in groups why it might be an advantage to divide a business like Zuzzy Solutions up into different departments. Produce a poster showing your ideas and present them to the rest of the class.

Traditionally, a business may be divided into four departments: human resources, finance, marketing and production.

HUMAN RESOURCES (HR) DEPARTMENT

The human resources (or personnel) department is responsible for the welfare of employees. The main tasks completed by the department include the following.

GENERAL VOCABULARY

departments sections in a business where all employees have similar skills and specialise in particular activities

- **Workforce planning:** This involves calculating the number and types of staff that will be required by the business. In a small business, this would not take up too much time. However, when a business employs thousands of people, workforce planning is an important job. If a business is short of particular types of staff, it may not be able to meet customer orders.
- **Recruitment and selection:** The HR department will help plan the numbers and types of workers needed, place job adverts, and provide application forms. The selection of appropriate candidates for interview, interviewing of candidates and selection of the best employees for the job may also be carried out by HR, or by the managers in the departments they will join.
- **Training:** The HR department is likely to organise induction and most other training that employees will need during their employment.
- **Health and safety:** Businesses have to comply with health and safety legislation, which is designed to protect employees from dangers in the workplace. The HR department will have to ensure that staff are fully trained in health and safety, and issue all employees with the required safety equipment and protective clothing.
- **Staff welfare:** The HR department is responsible for meeting the welfare needs of employees. They may have to monitor the working environment to ensure that it is as comfortable as possible. Employees are also entitled to toilets, washing facilities, fresh drinking water, and somewhere clean, hygienic and comfortable to take a break. There should also be a means of heating food or water for hot drinks.

SUBJECT VOCABULARY

contracts of employment written agreements between an employer and an employee in which each has certain obligations

unfair dismissal when worker is dismissed illegally by a business

employment tribunal court that deals with cases involving disputes between employers and employees

- **Employment issues:** The HR Department has to draw up contracts of employment for employees. They must explain the contents and ensure that both the employer and the employee sign copies. It is also important to clarify the pay, hours and place of work, job descriptions, holiday allowances, non-financial incentives and any other conditions of service for new employees.
- **Industrial relations:** The HR department may have to maintain good communications with trade unions. They may also have to organise, and be involved in, negotiations between employers and employees.
- **Disciplinary and grievance procedures:** Sometimes workers may have to be disciplined owing to poor conduct, or they may have a problem with a work issue. The HR department will have to provide information to employees on procedures in such matters and deal with the whole process.
- **Dismissal:** The HR department is responsible for giving formal warnings to workers and dealing with any legal requirements when laying off staff. Workers may be forced to leave a job through dismissal or redundancy. Sometimes an employee may have grounds to claim unfair dismissal. For example, if a worker is dismissed for joining a trade union or because they are considered too old, they may take their employer to an employment tribunal where the case will be heard. The HR department would be involved in this process.
- **Redundancy:** If a business has to make people redundant, a strict formal procedure has to be followed before they can be laid off. For example, employees must be given written notice and may be entitled to redundancy pay. The HR department will handle this.

FINANCE DEPARTMENT

The finance department is responsible for administering and monitoring all financial transactions carried out by the business. In a large business, the following tasks may be carried out.

- **Recording transactions:** Details of every single purchase and sale must be recorded by a business. These records are used to produce important financial statements.
- **Wages and salaries:** This involves processing wages and salaries for all workers. The department will provide workers with wage slips, ensure that payment is made on time, deal with wage queries and make payments to the tax authorities.
- **Credit control:** This involves monitoring the amount of money owed by customers. It often requires staff to chase outstanding debts.
- **Cash flow forecasting and budgets:** The finance department is responsible for controlling the firm's money. Such control is aided by producing *budgets* and *cash flow forecasts*. Cash flow forecasts are discussed in Chapter 26 (see pages 218–224).
- **Accounts:** One important job done by the finance department is producing the business's accounts. These are financial statements that show how well the company has performed. They include the *statement of comprehensive income* and the *statement of financial position (balance sheet)*. These are discussed in Chapters 29 and 30 (see pages 238–253).

MARKETING DEPARTMENT

Most businesses today are market orientated. This means that the main focus for businesses is the customer. Consequently, marketing has grown in importance. In addition to selling products, the marketing department may be involved in the following activities.

SUBJECT VOCABULARY

market orientated where a business focuses on the needs of consumers when developing products

- **Market research:** People may be employed gathering, processing and presenting data about customer needs, markets and competitors. Increasingly, a lot of this sort of information is being gathered using social media. This information will be used by the business to help make decisions. For example, it may use the information to improve existing products or create new ones.
- **Product planning:** This involves deciding which products should be marketed. For example, should old products be relaunched or withdrawn and replaced with new ones?
- **Pricing:** The marketing department has to decide what prices should be charged for the range of products sold by the business. Costs, competitors, the state of the market and the type of product will influence these decisions.
- **Sales promotion:** People working in this area have to develop interesting and effective methods of promotion. Examples might be free gifts, coupons, discounts, buy-one-get-one-free offers, competitions and loyalty cards.
- **Advertising:** Businesses have to create innovative and effective adverts. People in this area might also be employed to buy advertising space from the media. The marketing department might also make a significant contribution to the company website where goods might be advertised.
- **Customer service:** An increasing number of businesses focus on the importance of providing good quality customer service. It is a way of gaining a competitive edge and involves providing assistance and advice to people who buy or use a firm's products. This service is likely to be provided before, during and after a product has been purchased.
- **Public relations:** Communication between the company and the general public, including shareholders and potential investors, is known as public

SUBJECT VOCABULARY

wholesalers persons or businesses that buy goods from manufacturers and sell them in smaller quantities to retailers

relations (PR). PR links to advertising but is separate from it, as PR is about managing the company's image and dealing with any issues affecting reputation, rather than marketing specific products. PR can be under the umbrella of the marketing function or, if the company is large, it may be a separate department. Alternatively, a company may outsource their PR to an external agency.

- **Packaging:** The marketing department will play a key role in the design of packaging. Packaging is important because it often says a great deal about the product itself.
- **Distribution:** Marketing people will be employed to make sure that products are made available to customers in the right place at the right time. This may involve organising transportation and securing contracts with retailers and wholesalers, for example.

ACTIVITY 1

CASE STUDY: MARKETING AND PR

Monica works in the marketing department for a large Brazilian soft drinks producer. She is responsible for public relations (PR). This involves:

- dealing with the media by answering questions and providing company information
- organising company presentations to shareholders, potential investors and customers.

Monica is also employed to negotiate sponsorship deals on behalf of the company. For example, she recently negotiated a contract for her company to sponsor a national football competition in Brazil.



▶ Football in Brazil

1 Describe two other activities that might be carried out in the marketing department.

Marketing departments play an increasingly important role in businesses today.

2 What might have caused this development?
3 Describe Monica's role in the marketing department.

PRODUCTION DEPARTMENT

Production involves making goods and providing services. In many businesses, the majority of workers are employed in the production department. In the primary sector, they may be tractor drivers, shepherds and miners. In the secondary sector, they may be machine operators, packers, assembly workers, welders, printers or managers. In the tertiary sector, they may be receptionists, shop workers, sales assistants, porters, nurses, teachers, police offices, hairdressers, mechanics and solicitors. Other activities that may be carried out in the production department are shown in Figure 24.1.

▶ Figure 24.1 Other production department activities

- **Design:** Some firms design products for individual customers. Others are continually innovating by designing new products to meet changing customer needs.
- **Purchasing:** This involves buying the resources needed by the business, such as raw materials, components, energy, tools, equipment and packaging.
- **Stock control:** This involves storing, controlling, supplying and handling stocks of resources and providing information about stocks. There will be close links between purchasing and stock control.
- **Maintenance:** Some production departments have a team of maintenance workers. They might be responsible for cleaning and the maintenance of machinery and business property.
- **Research and development (R&D):** In some industries, such as pharmaceuticals, automotive, electronics and computers, firms have large R&D centres. They are responsible for the investigation and discovery of materials, processes and products.

SUBJECT VOCABULARY

pharmaceutical relating to the production of drugs and medicines

automotive relating to cars

RELATIONSHIPS AND INTERDEPENDENCE BETWEEN DEPARTMENTS

It is very important for departments to work together. They are interdependent, which means that they rely on each other for their success. There must be good communication between departments to ensure that the business runs effectively. Some examples of relationships and interdependence between different departments are given below.

- The production department may have to meet with the marketing department to discuss changes to a customer's order.
- The welfare officer from the human resources department may have to meet the sales director to discuss customer complaints about one of the sales people.
- The HR department will need to communicate regularly with the finance department to discuss wages and salaries.
- The finance department may have to communicate with the production department to ensure that designs for a new product are profitable.

There are many more examples of the interdependence between departments in a business. A business may struggle if there is no cooperation between departments.

LARGE VS SMALL BUSINESSES

Most small businesses can operate without being divided into departments. This is because they are often run informally and cannot really afford to employ specialists such as accountants and human resource managers. However, larger organisations, ones that employ tens of thousands of people, for example, need to be broken down into smaller units. Each department in a business will specialise in one particular function. Everyone in a department will focus on a narrower range of activities and have a common purpose.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which department is likely to be responsible for dealing with an employee's contract of employment?

A Production
B Marketing
C Human resources
D Finance

▶ 2 Which task is likely to be completed by the finance department?

A Plan a sales promotion
B Provide customer service
C Deal with a staff grievance
D Produce a cash flow forecast

▶ 3 Why are businesses likely to be divided into functional departments?

A To provide opportunities for specialisation
B To help deal with export orders
C To improve cash flow in the business
D To help improve the business culture

▶ 4 Which of the following tasks is likely to be carried out in the production department?

A Product planning
B Product placement
C Product design
D Workforce planning

CHAPTER REVIEW

CASE STUDY: JAKAC

JakAC makes air conditioning units and is based in Jakarta, Indonesia. The business is organised into four traditional departments with a senior manager and two deputy managers in each department.
The chairman, Marek Arland, is becoming concerned about the sales trend for AC Power, one of its leading products. The sales figures for this product are shown in Figure 24.2. Marek also believes that the production department and the finance department are not working well together because the production department is overspending on its labour budget. The production department argues that more skilled labour is needed to maintain quality. However, the finance department argues that expenditure budgets should not be exceeded. Communication between the two departments has almost broken down and the production department has not provided some important data needed for a financial report.



▲ Production of AC units

CHAPTER QUESTIONS

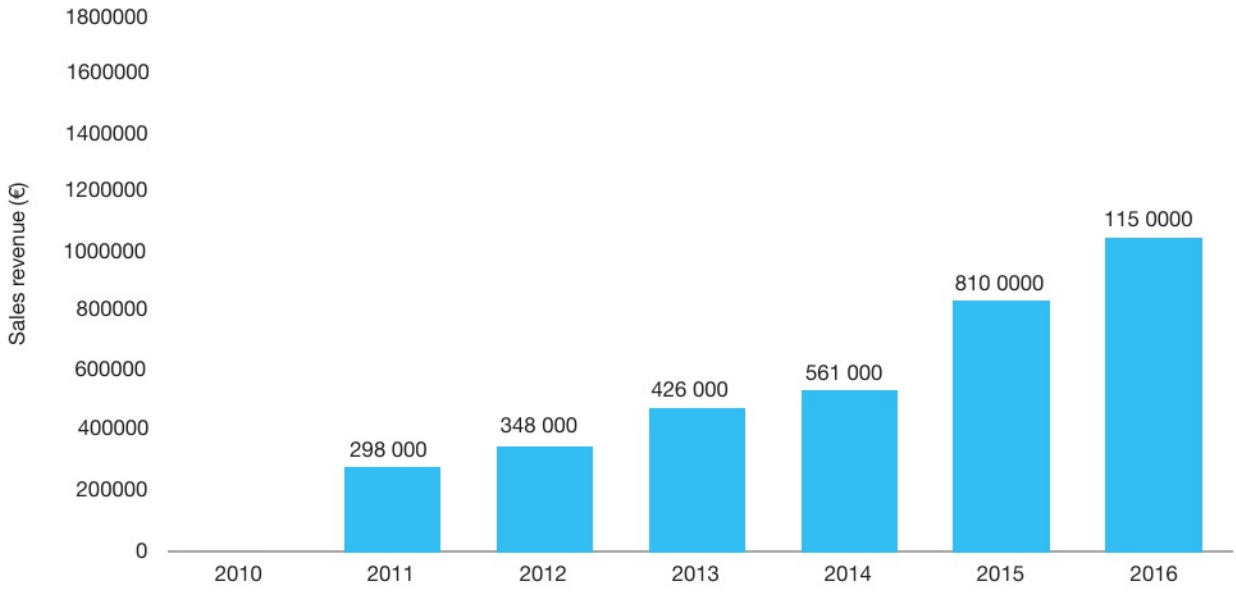
1 Draw a simple organisation chart for the management team at JakAC.

2 Which departments at JakAC would be responsible for the following activities?
- **a** Chasing customers for late payment.
- **b** Dealing with the dismissal of an employee with a very poor attendance record.
- **c** Using social media to get customer feedback on a new maintenance service.
- **d** Setting output targets for production lines.

3 How might the marketing department find out the reasons for the trend in sales of AC Power?

4 Discuss two possible functions of the JakAC production department in addition to making AC units.

5 Discuss the importance of interdependence between departments in a business. Use examples from this case study in your analysis.



EXAM PRACTICE: 2 PEOPLE IN BUSINESS

Skyscanner is a travel comparison website with offices in Edinburgh, Singapore, Beijing and Barcelona. The company's 500 employees said they are happy at work in 2016. High-performing staff can choose to spend 30 days every two years in one of its offices around the world. Employees can also request to work from their country of origin for three weeks each year as part of Skyscanner's culture of trusting people to give their all. Staff appear to be well motivated and only 10 per cent of the workforce left voluntarily in 2015.

AO1 **a** Define the term '**fringe benefit**'. **(1)**

AO2 **b** Outline **one** reason why motivation in the workplace is important **(2)**

AO2 **c** Outline **one** legal control over employment that may affect Skyscanner. **(2)**

Skyscanner advertises jobs online.

SKILLS: PRODUCTIVITY

AO2 **AO3** **d** Analyse the benefit to Skyscanner of advertising jobs online. **(6)**

Skyscanner is committed to equipping their staff with new skills. To help with staff training, Skyscanner offers a range of 200 courses to help promote the transfer of knowledge in its organisation. The CEO delivers a five-week programme for high-potential employees, educating them on how to think like an entrepreneur.

Many businesses face two key options when training their staff:

Option 1: On-the-job training
Option 2: Off-the-job training

SKILLS: CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO2 **AO3** **AO4** **e** Justify which of these two options Skyscanner should choose. **(9)**

Total marks for this question = 20


%
£
400
300
200
10,500,000
?
4,367
?
185,000

3 BUSINESS FINANCE

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

All businesses need financial management. This section identifies the different sources of finance available to businesses and looks at the importance of cash flow and how cash flow forecasts are interpreted. The nature and calculation of costs and revenue is addressed along with how cost and revenue functions are used in break-even analysis. Finally, the section looks at the two main types of accounts produced by businesses and how they are used to analyse its financial position and performance.

25 SOURCES OF FINANCE

LEARNING OBJECTIVES

- Understand the need for finance: short-term needs, long-term needs, and to start up or expand
- Understand internal sources of finance: personal savings, retained profit and selling assets
- Understand external sources of finance: overdraft and trade payables, loan capital, share capital, including stock market flotation (public limited companies), venture capital and crowd funding

GETTING STARTED

Money is needed to set up a business and to keep it running. It is also needed to help a business expand. When raising money, businesses have to decide which source of funds is best for their needs. They often have to choose between long-term and short-term sources. Also, most businesses are likely to use several different sources. Look at the example below.

CASE STUDY: MAURICE OBUYA

Maurice Obuya set up an airport taxi service in Kenya in 2016 with a KES 2 million five-year bank loan and KES 2 million of his own savings. Maurice had spent 20 years driving taxis for other taxi firms to help generate his savings. The interest on the bank loan was fixed at 8 per cent per annum and he was required to repay the loan plus the interest in 60 monthly instalments.

Maurice used the money to buy a vehicle, pay for insurance and obtain some adverts in various taxi directories. He planned to operate a luxury service between Nairobi and Jomo Kenyatta International Airport.

SUBJECT VOCABULARY

instalment one of a series of regular payments made until all the money owed has been repaid



▶ Airport taxis

CASE STUDY: TRIBAL GROUP

Tribal Group is a leading global provider of technology-based education services. In 2015, its revenue fell to £106.7 million, down from £123.7 million in 2014. The group also made losses of £47.3 million and £6.3 million in 2015 and 2014, respectively. In 2016, the company decided to raise more money to reduce its debt and provide some financial stability for the future. It planned to sell 94.8 million new shares to existing shareholders at 22p each. The company also sold its Synergy business to Servelec Group for £20.3 million in cash. Synergy supplies management software to children's services departments of local authorities.

1. What are the sources of finance used by **(a)** Maurice Obuya and **(b)** Tribal Group?
2. Work out the monthly instalment Maurice would have to make in order to repay the five-year bank loan (including interest).
3. Work out the amount of money raised by Tribal Group by selling shares to existing shareholders.
4. Why did Tribal Group need to raise more money?

THE NEED FOR FUNDS

SUBJECT VOCABULARY

short-term finance money borrowed for one year or less

long-term finance money borrowed for more than one year

capital finance provided by the owners of a business

SHORT-TERM NEEDS

Once a business starts trading it will earn revenue. This money can be used to meet the day-to-day running costs of the business, such as wages, raw materials, components, and premises and utility bills. However, sometimes the revenue from sales may not cover all expenditure. This is when a business will need to borrow money. The finance needed to fund day-to-day expenditure is usually called **short-term finance**; this is because it is usually repaid within one year.

LONG-TERM NEEDS

Businesses often raise money and take much longer than one year to repay what is owed. This is called **long-term finance**. Some long-term finance comes from the owners. This is called **capital** and often remains in the business permanently or until the business stops trading. Other long-term sources may be borrowed from financial institutions, such as banks. Long-term sources of finance are often used to buy resources that will be used repeatedly by the business for long periods of time. Examples would be machinery, tools equipment, property and office furniture. In 'Getting started' above, the vehicle bought by Maurice Obuya for his airport taxi service would be such an example.

KEY POINT

Most entrepreneurs risk their own money when starting a business. However, this money is rarely enough. They need to find finance from other sources. Also, businesses often struggle to find start-up capital and may start trading with insufficient funds.

START-UP CAPITAL

Funds are most needed when first setting up a business. This is because a lot of resources are needed before trading can begin. Some of these resources are 'one-off' items. For example, a new restaurant would need to buy cookers, refrigerators, utensils, furniture, glassware and other equipment including knives, forks and plates. Once these 'one-off' costs have been met, they may not be repeated for many years. Other start-up costs might include research, converting premises, legal fees, website design and marketing.

EXPANSION

Once a business is established, the owners often want to expand. They may want to:

- expand capacity to meet growing orders
- develop new products
- branch into overseas markets
- diversify.

Businesses often need to raise finance to help fund their expansion plans; this is because expansion usually requires heavy expenditure.

INTERNAL SOURCES OF FINANCE

SUBJECT VOCABULARY

internal finance finance generated by the business from its own means

retained profit profit held by a business rather than returning it to the owners and which may be used in the future

assets resources used or owned by a business, such as cash, stock, machinery tools and equipment

Sources of finance may be internal or external. **Internal finance** comes from inside the business and can only be used when the business is established. This is because new businesses are usually short of finance. There are three main internal sources of finance.

PERSONAL SAVINGS

When a business is set up the owners are usually required to contribute some finance. It would be rare for an entrepreneur to set up a business in which all the money needed to get started came from an external source. For many small businesses, the capital provided by the owners comes from personal means. Entrepreneurs might use redundancy money, loans or gifts from relatives and friends, the sale of personal belongings or personal savings. Personal savings is likely to be the most common source. Some entrepreneurs have saved for many years in the hope that one day they might have enough money to start their own business. In 'Getting started' above, Maurice Obuya used KES 2 million of his personal savings to help start his airport taxi business.

RETAINED PROFIT

Retained profit is profit that has not been returned to the owners. It is retained by the business. It is an important source of finance for a business because it is cheap. There are no charges involved, such as interest, dividends or administration. However, if profit is used by the business, it cannot be returned to the owners. Some owners might object to this. Retained profit is also a flexible source of finance. It can be built up by a business and kept in a bank account earning interest. A business can then use this source at a later date.

SELLING ASSETS

An established business may be able to sell some unwanted **assets** to raise finance. For example, machinery, land and buildings that are no longer required could be sold off for cash. Large companies can sell off parts of their organisation to raise finance. In 'Getting started' above, Tribal Group sold off Synergy for £20.3 million cash. Synergy was part of the Tribal Group selling software to children's services departments of local authorities. It is also possible to sell off assets that are needed by the business and then lease them back.

Finally, given the choice, most businesses would prefer to use internal sources when raising funds. This is because they are cheap and more readily available.

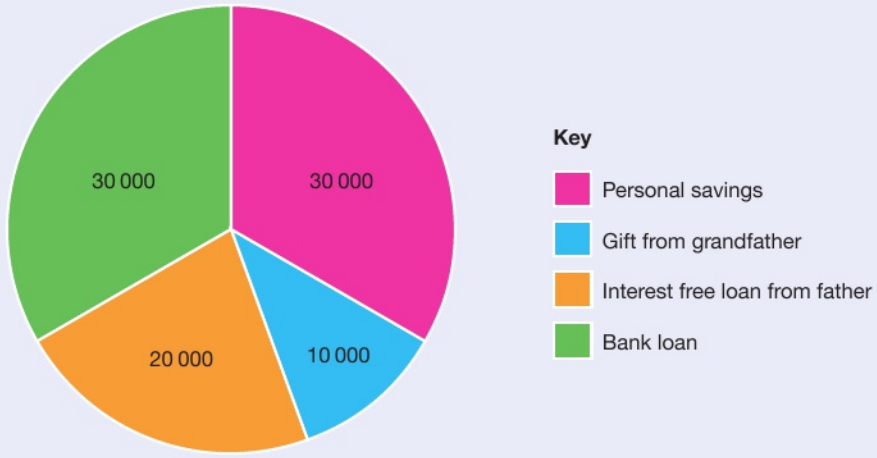


▲ A Hindu wedding

ACTIVITY 1

CASE STUDY: WEDDING PLANNING

In 2014, Nikki Rani set up a wedding planning business in Pune, India. She had to raise almost Rs100 000 to get started. The money was needed to buy a small vehicle, a smartphone contract, a laptop and to pay for some advertising in some wedding magazines. Nikki had very good negotiating skills which she thought would help her get better prices when negotiating for wedding venues, cakes, flowers, music and hot food, for example. Raising the money to get started was not easy. She approached a local bank in Pune but was told that they would only lend her some of the money needed. She would have to provide the majority of the capital herself. After 12 months of investigating many sources, she eventually drew up her financing plan. Figure 25.1 shows the different sources used by Nikki.



▶ Figure 25.1 Sources of finance for Nikki Rani's business, Rs

1 Work out the percentage of the funding provided by the bank.
2 What is meant by internal sources of finance?
3 Describe one advantage to Nikki of using an internal source of finance.

EXTERNAL SOURCES OF FINANCE

SUBJECT VOCABULARY

external finance finance obtained from outside the business

External finance comes from outside the business. There is a wide variety of both short-term and long-term external sources of finance. Short-term sources, where money is borrowed for less than one year, may be needed for the following reasons.

- Some businesses have seasonal trade. A farmer, for example, may need to borrow money for a few months until revenue comes in from selling the harvest.
- A manufacturer may need finance to pay for raw materials and wages to meet a large order.
- A firm might be short of money because it is waiting for a customer to pay.
- A business may need to meet emergency expenditure. For example, if a machine breaks down unexpectedly, the repair costs might have to be met by a short-term loan.

SUBJECT VOCABULARY

bank overdraft agreement with a bank where a business spends more money than it has in its account (up to an agreed limit)

trade payables buying resources from suppliers, such as raw materials and components, and paying for them at a later date (sometimes called trade credit)

mortgage long-term loan secured with property

repossess to take back cars, furniture or property from people who had arranged to pay for them over a long time, but cannot now continue to pay for them

Three main sources of short-term finance are outlined below.

BANK OVERDRAFT

This is a common source of finance for most businesses. A **bank overdraft** means a business can spend more money than it has in its account. In other words, they go *overdrawn*. The bank will set an overdraft limit and interest is only charged when the account is overdrawn. Bank overdrafts are simple and flexible. However, the bank has the right to call in the money owed at any time. It may do this if it thinks the business is struggling. A business may use bank overdrafts as a short-term source of finance.

TRADE PAYABLES

Businesses often buy resources and pay for them at a later date, usually within 30 to 90 days. This is called **trade payables** (or trade credit) and is a cheap way of raising finance. It means a business holds on to its cash for longer. However it has its downsides:

- many suppliers encourage early payment by offering discounts
- the cost of goods is often higher if firms buy on credit
- delaying payment may upset suppliers.

CREDIT CARDS

Credit cards are popular because they are convenient, flexible and avoid interest charges if accounts are settled within the credit period. Executives can use them to meet expenses when travelling on company business. Small businesses use credit cards to buy materials from suppliers. However, interest rates on credit cards are very high if accounts are not settled within the credit period, usually 56 days.

Sometimes a business will need to borrow money for much more than a year. This is called long-term finance and some examples are discussed below.

LOAN CAPITAL

A loan is a fixed agreement between a business and the bank. The amount borrowed, and interest, must be repaid in regular instalments over a fixed period. Bank loans can be short-term or long-term sources of finance. The main advantage of a bank loan is that a business will know exactly what it has to pay every month. Maurice Obuya used a bank loan in 'Getting started' above.

Unsecured bank loans

Some bank loans are unsecured. This means that the bank lends money without the security of having a claim on your assets if you do not pay it back. Therefore, if the business collapses, the bank might not get its money back. Consequently, banks would prefer to make secured loans. Some businesses may find it difficult to get an unsecured bank loan. This is because they present too much risk for banks. Interest rates are higher for unsecured loans compared to secured loans.

Mortgages

A **mortgage** is a long-term loan and the borrower must use land or property as security. This means that if the borrower fails to make the repayments, the lender can **repossess** the property. Mortgages are popular because the interest rates are usually lower than those on unsecured bank loans. Mortgages may be taken out for up to 25 years.

SUBJECT VOCABULARY

debenture long-term security yielding a fixed rate of interest, issued by a company and secured against assets

hire purchase buying specific goods with a loan, often provided by a finance house

rights issue sale of new shares to existing shareholders at a discount

Debenture

Another form of loan is a **debenture**. Debenture holders are creditors of a company, not owners. Debenture holders are entitled to a fixed rate of return, but have no voting rights. They must also be repaid on a set date – when the debenture matures. Public limited companies (PLCs) use this long-term source of finance.

Hire purchase

Another type of loan is a **hire purchase** (HP) agreement. Businesses may use HP to buy tools, equipment, vehicles and machinery. The features of a HP agreement are:

- the business usually makes a down payment
- the remaining fee is paid in monthly instalments
- the goods bought do not legally belong to the buyer until the very last instalment has been paid
- if the buyer falls behind with the repayments, the goods can be repossessed
- HP agreements can be short term or long term.

The main problem with HP is that it is usually more expensive than a bank loan. This is because lenders are not as strict when checking the risk posed by borrowers.

DID YOU KNOW?

Share capital is *permanent* capital. This means that it is not repaid (as long as the company is still trading).

SHARE CAPITAL

For limited companies, share capital is an important source of external finance. The sale of shares can raise very large amounts of money. When limited companies are formed, shares are issued to raise start-up capital. However, limited companies can raise more money by selling more shares in the future. A **rights issue** may be used to raise more share capital. This is where a company gives the existing shareholders the right to buy the new shares at a discount. The main advantage of selling shares to raise capital is that interest payments are avoided. However, shareholders will expect to be paid dividends if the business is successful. The main disadvantage of issuing shares to raise capital is the cost of administration. The whole flotation process, where shares are sold to raise money when setting up a company, is discussed in Chapter 4 (see pages 27–34).

SUBJECT VOCABULARY

venture capitalists specialist investors (individuals or companies) who provide money for business purposes, often to new businesses

VENTURE CAPITAL

Venture capitalists are specialists in the provision of funds for small- and medium-sized businesses. They may invest in businesses after the initial start-up and often prefer technology companies with a high growth potential. They prefer to take a stake in the company, which means they have some control and are entitled to a share in the profit. Venture capitalists raise their funds from institutional investors, such as pension funds, insurance companies and wealthy individuals. They are also likely to exit after about five years.

Some venture capitalists are individuals and may be called business angels. They may invest between £10 000 and £100 000, sometimes more, usually in exchange for a stake in a business. Most investments are in start-ups or early stage expansions. The problem with this source of finance for businesses is finding a suitable 'angel'. Since angels normally take a stake in the business, the angel and the current business owners must have shared interests and want the same for the future of the business. Finally, business owners have to be comfortable with sharing profits with the angel for as long as they are involved. Businesses often turn to venture capitalists for funding when they have been refused by other sources.

SUBJECT VOCABULARY

crowd funding where a large number of individuals (the crowd) invest in a business venture using an online platform and therefore avoiding using a bank

CROWD FUNDING

Crowd funding is a relatively new source of finance for businesses. It is similar to peer-to-peer funding (where banks are excluded and individuals can lend money via the Internet to others without previous knowledge of them). However, the fundraisers tend to be businesses or groups who are involved in a particular venture, such as putting on a concert, building a school or setting up a community project. The lenders or investors will be a large number of individuals who together represent 'the crowd'. Transactions are conducted online. Specialist websites allow those seeking finance to publish details of their business idea, or project, including how much cash they need, how they will use it and how investors stand to profit (if at all) in future. Some of the sites carry out checks on the fundraisers but not all of them. In most cases the investors, who can usually put in as little as £10 per venture, are offered shares in a business.

ACTIVITY 2

CASE STUDY: CROWD FUNDING

Crowd funding has started to grow as a source of business finance in Korea. According to the Financial Services Commission, some 2300 people have invested a total KRW 5740 million in 72 companies through crowd funding platforms since April 2016. This is up from KRW 1870 million since the end of February.

Marine Techno, a small biotechnology firm based in Yeosu, South Korea, needed some finance to help fund further product development. The business produces innovative make-up made from recycled marine by-products. However, the company was struggling to get the finance it needed. According to the CEO, this was because most of the finance available to businesses ends up in Seoul or the surrounding Gyeonggi province. When the CEO heard about a new crowd-funding site he thought it might be worth a try.

The business was successful. It aimed to raise KRW 80 million (US$70 000) and by the end of the first day this target was achieved. By the end of the week, a total of KRW 127 million had been raised through crowd funding.

1 What is meant by the term crowd funding?

Crowding funding is an external source of finance.

2 What is meant by this?
3 Discuss why Marine Techno used crowd funding to raise finance.

LARGE VS SMALL BUSINESSES

Sole traders and other small businesses are limited in their choices of finance. For example, long-term sources may be mortgages and perhaps the introduction of some personal capital. Public and private limited companies can usually obtain finance from many different sources. In addition, because of their size and added security, they can often demand lower interest rates from lenders.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of these sources of finance is internal?
- A Retained profit
- B Mortgage
- C Venture capital
- D Crowd funding

▶ 2 Which of these is a short-term source of finance?
- A Mortgage
- B Share capital
- C Venture capital
- D Bank overdraft

▶ 3 Trade payables is a suitable source of finance to fund the purchase of what?
- A A new delivery vehicle
- B Inventories
- C Property
- D Direct labour

▶ 4 A rights issue involves the sale of what?
- A New shares on the stock market
- B Fixed assets
- C New shares to existing shareholders
- D Part of the business

CHAPTER REVIEW



▲ Manufacturing motor scooters

CASE STUDY: BLAKELY MOTOR SCOOTERS

Blakely Motor Scooters make affordable motor scooters in a factory on the outskirts of Bangkok, Thailand. The company is successful and uses a variety of different sources of finance. For example, it makes regular use of a bank overdraft, which provides the business with a great deal of financial flexibility. It also uses another short-term source of finance, trade payables. This source is used to obtain a range of components and other parts from local suppliers.

In 2016, the company had ambitious plans to go 'up market'. It wanted to launch a more modern and 'trendy' scooter to aim at a growing body of wealthier young consumers in the market. The design process had been completed and the next stage was to build a production line where the new model would be assembled. However, it needed to raise TNB 700 million to fund the construction of the plant and fit it out with state-of-the art technology. Blakely was always keen to use retained profit to help fund new projects. However, this time the most they could use would be TNB 200 million. Therefore, the other TNB 500 million would have to be raised externally. Two options were being considered:

- issue some new shares to existing shareholders
- take out a 25-year mortgage.

CHAPTER QUESTIONS

1 What is meant by short-term finance?

2 Why is retained profit an internal source of finance?

Blakely Motor Scooters often uses retained profit to fund business activity.

3 What is the main reason for using this method of financing?

Blakely Motor Scooters uses trade payables to buy components and parts.

4 Discuss one advantage and one disadvantage of trade payables as a source of finance.

5 Assess whether Blakely Motor Scooters should fund the new factory through share capital or a mortgage. Make a clear judgement in your evaluation.

26 CASH FLOW FORECASTING

LEARNING OBJECTIVES

- Understand the importance of cash to a business: to pay suppliers, overheads and employees and to prevent business failure (insolvency)
- Understand the difference between cash and profit
- Understand how to prepare and interpret cash flow forecasts
- Calculate: cash inflows, cash outflows, net cash flow, and opening and closing balances

SUBJECT VOCABULARY

cash flow flow of money into and out of a business

GETTING STARTED

The flow of money into and out of a business is called cash flow. Cash flows out of a business when payments are made for resources, such as materials and labour. Cash flows into a business when customers pay for goods and services. Cash also flows in when other income is received, such as interest. Look at the cash flows in the example below.



▲ Brick making in Kenya

CASE STUDY: AGA BRICK MAKING

Hiren and Thomas Aga run a small brick manufacturing business near Mombasa, Kenya. They set up in 2012 when it was apparent that the real estate market in the country was growing rapidly. Hiren went on a brick making training course and then bought a brick-making machine with some financial help from his brother Thomas.

In June 2016, the business received KES 155 000 cash from customers. Also, in that same month, the business paid KES 43 000 for raw materials, KES 20 000 rent, KES 12 000 for fuel and KES 11 000 for other expenses. Hiren and Aga also took out KES 20 000 each for their own personal use.

1. Suggest ways in which cash is flowing into and out of the Agas' brick-making business.
2. Work out the net cash flow (cash inflows – cash outflows) for Aga Brick Making.
3. What does the answer in question 2 show?

THE IMPORTANCE OF CASH

SUBJECT VOCABULARY

liquid asset that is easily changed into cash

Cash is the most liquid of all business assets. Cash is the notes and coins a business keeps on the premises and any money it has in the bank. Without cash a business cannot trade. It is reckoned that poor cash flow is the reason why many businesses eventually fail. Even when trading conditions are good, businesses can fail. If a business does not have enough cash to pay its immediate bills, it cannot trade. Businesses need cash for the following reasons.

SUBJECT VOCABULARY

overheads money spent regularly on rent, insurance, electricity and other things that are needed to keep a business operating

insolvent inability to meet debts

cash flow forecast prediction of all expected receipts and expenses of a business over a future time period, which shows the expected cash balance at the end of each month

TO PAY SUPPLIERS, OVERHEADS AND EMPLOYEES

A business always needs cash to pay important bills. Suppliers have to be paid for the materials and components that have been purchased. A lot of purchases made from suppliers will have been made using trade payables (trade credit). This means that goods are bought and delivered and then payment is made at a later date, perhaps 30 to 90 days later. However, eventually, suppliers have to be paid. Failure to pay suppliers on time may mean that they will refuse to trade in the future. Businesses also need cash to pay for **overheads**, such as rent, electricity, insurance and telephone charges. Businesses will often get bills for the services that they have already used. Again, if these bills are not paid there is a risk that such services will be cut. Finally, employees have to be paid every week or every month. If a business cannot pay its employees, it would not be very long before they walked out.

TO PREVENT BUSINESS FAILURE

If a business runs out of cash, it may become **insolvent**. This means that the business cannot pay its debts. This would usually result in the business closing down. This is the worst that can happen. Unfortunately, unless a business can raise cash immediately to pay the most pressing debt, the business will collapse. Therefore, it is important that a business continually monitors and controls its cash flow. A business will have better control over its cash flow if it:

- keeps up-to-date records of financial transactions
- always plans ahead by producing accurate **cash flow forecasts**
- operates an efficient credit control system, which prevents slow or late payment.

THE DIFFERENCE BETWEEN CASH AND PROFIT

It is important to recognise that cash and profit are different. At the end of a trading period, the value of profit will not be the same as the cash balance. Some of the reasons for this are outlined below.

KEY POINT

It is possible for a business to trade for several years without making a profit. Provided it has enough cash, it can carry on trading. However, if a business runs out of cash it will collapse.

- Some goods are sold on credit (trade payables). So, at the end of the period, some customers will still owe money. Therefore, profit is greater than cash. Similarly, a business may receive cash at the beginning of the trading period from credit sales made in the previous period. This would increase the cash balance, but not affect profit.
- Sometimes owners might put more cash into the business. This will increase the cash balance, but have no effect on the profit made. The effect will be the same if a business borrows some money.
- Purchases of fixed assets, such as machinery or equipment, will reduce cash balances, but have no effect on the profit a company makes. This is because the purchase of assets is not included for the purpose of calculating profit.
- The amount of cash at the end of the period will be different from profit because at the beginning of the year the cash balance is unlikely to be zero.

CASH INFLOWS AND OUTFLOWS

SUBJECT VOCABULARY

cash inflow flow of money into a business

CASH INFLOWS

The money entering a business is called a **cash inflow**. Cash flows into a business when income is received. Examples of cash inflows are sales revenue, loans, fresh capital from the owners, interest and the sale of assets. The expected cash inflows for Salah Motor Services (Cairo, Egypt) in June 2015 are shown in Figure 26.1.

SUBJECT VOCABULARY

cash outflow flow of money out of a business

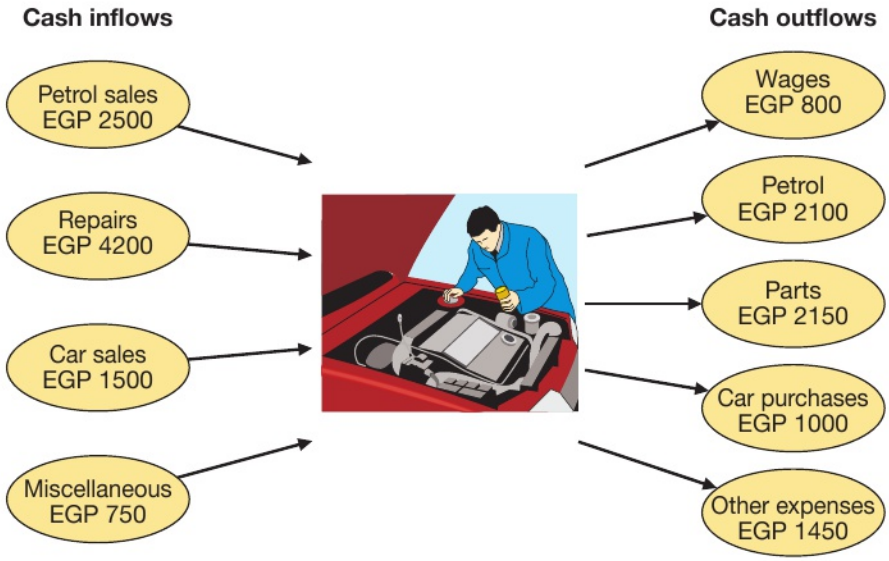
CASH OUTFLOWS

The money going out of a business is called a **cash outflow**. Cash flows out of a business when payments are made. This might include wages, materials, utilities, machinery, rent and tax. Expected cash payments for Salah Motor Services in June 2015 are shown in Figure 26.1.

NET CASH FLOW

The difference between cash inflows and cash outflows is called the **net cash flow**. A business will hope that for most of the time the net cash flow is positive. This means that more cash flows in than flows out. However, there will be times when the net cash flow is negative. This means that a business may have to borrow some money. The net cash flow for Salah Motor Services in June 2015 is EGP 1450 (EGP 8950–7500).

▶ Figure 26.1 Forecast cash inflows and outflows for Salah Motor Services



ACTIVITY 1

CASE STUDY: CASH FLOWS

Abdul Hassan runs a commercial laundry operation in Abu Dhabi, UAE. Most of his customers are city hotels so the laundry operation involves collecting large quantities of bedding each day and returning it clean and pressed the next day. He offers two payment systems: if customers pay cash on the day he returns the clean laundry, they get a 10 per cent discount. However, most of his customers prefer to pay 60 days later with no discount.

▶ Table 26.1 Monthly forecast payments

	US$
Wages	2500
Cleaning materials	400
Motor expenses	700
Utilities	400
Advertising	100
Other overheads	500
Drawings	1000

SUBJECT VOCABULARY

drawings money taken out of the business by the owner for personal use

In July 2016, Abdul forecast that cash receipts would be US$1400 and payments from customers taking trade credit would be US$5400 (this was payment for laundry done 60 days ago). Table 26.1 opposite shows the forecast payments for the month.

1 Suggest one example of a **(a)** cash inflow and **(b)** cash outflow, for Abdul Hassan's laundry.
2 Work out the net cash flow for July 2016 for the laundry business.
3 Why might the net cash flow above not represent the value of profit made in July?

CASH FLOW FORECASTS

SUBJECT VOCABULARY

closing cash balance amount of cash that the business expects to have at the end of each month (takes into account the cash inflows and cash outflows)

Most businesses produce a regular cash flow forecast. This is a financial document and shows the expected cash inflows and cash outflows over a future period. It also shows the closing cash balance at the end of each month. All the figures in the forecast are estimated because they are in the future. The forecast shows the planned cash flow of the business month by month. A cash flow forecast is shown for Salah Motor Services in Figure 26.2. It is a three-month forecast drawn up in May.

The forecast shows that the cash position is expected to improve over the three months. At the end of June, the business expects to have a closing cash balance of EGP 1900. By the end of August, the cash balance is expected to be EGP 3150. However, there is a negative net cash flow in August owing to the extra money the business plans to spend buying cars for resale.

Total cash inflow
This is the total amount of cash Kamal Motor Services expects to generate during the month, i.e. EGP 8950 during June

Total cash outflow
This is the total amount of cash Kamal Motor Services expects to pay out during the month, i.e. EGP 7500 during June

Closing balance
This is the opening balance plus the net cash flow for the month. For June it is EGP 1900 (EGP 450 + EGP 1450). The closing balance for June is also the opening balance for July

	June	July	August
Cash inflows			
Petrol sales	2500	2600	2700
Repairs	4200	4000	4500
Car sales	1500	2000	1500
Miscellaneous sales	750	750	800
Total cash inflows	**8950**	9350	9500
Cash outflows			
Wages	800	800	800
Petrol	2100	2100	2300
Parts	2150	2200	2400
Car purchases	1000	1000	3000
Other expenses	1450	1500	1500
Total cash outflows	7500	7600	10000
Net cash flow	1450	1750	–500
Opening balance	450	1900	3650
Closing balance	1900	3650	3150

Net cash flow
This the difference between the total cash inflow and the total cash outflow. For June it is EGP 1450 (EGP 8950 – EGP 7500)

Opening balance
The amount of cash the business has at the beginning of the month, i.e. EGP 450 at the beginning of June

▲ Figure 26.2 Cash flow forecast for Salah Motor Services

ACTIVITY 2

CASE STUDY: CASH FLOW FORECASTS

Priscila Landa owns a bookshop near the University of Madrid, Spain. She sells educational books to students but also has a large stock of fiction books. Unfortunately, the business has been struggling in recent months. She thinks that many students are sharing books and therefore sales are suffering. Table 26.2 shows a cash flow forecast for the bookshop at the beginning of 2016. It is incomplete.

▶ Table 26.2 Cash flow forecast, January–March 2016

	JAN	FEB	MAR
Cash inflows			
Book sales	3000	3500	3100
Fresh capital			2000
Interest		150	
Total cash inflows	3000	3650	5100
Cash outflows			
Stock	1700	1790	1900
Casual labour	500	500	500
Rent	1000	1000	1000
Other expenses	230	240	230
Total cash outflows	?	?	?
Net cash flow	?	?	?
Opening balance	230	?	?
Closing balance	?	?	?

1 Complete the cash flow forecast for Priscila Landa's bookshop to show:
- **a** the total cash outflows for each month
- **b** the net cash flows for each month
- **c** the closing balance for each month
- **d** the opening balance for February and March.

It is suggested that Priscila Landa's bookshop is struggling.

2 What evidence is there in the forecast to support this view?

WHY ARE CASH FLOW FORECASTS IMPORTANT?

Businesses draw up cash flow forecasts to help control and monitor cash flow. What are the advantages of doing so?

IDENTIFYING CASH SHORTAGES

A forecast can help to identify in advance when a business might need to borrow cash. The forecast clearly shows how much cash is left at the end of each month. This will help to identify when, or if, a bank overdraft will be needed.

SUPPORTING APPLICATIONS FOR FUNDING

When trying to raise finance, lenders often insist that businesses support their applications with a cash flow forecast. This will help to show the future outlook for the business.

HELP WHEN PLANNING THE BUSINESS

Careful planning in business is important. It helps to clarify aims and improve performance. Producing a cash flow forecast is a key part of the planning process.

MONITORING CASH FLOW

A business should compare the predicted figures in the cash flow forecast with those that actually occur. By doing this, it can find out where problems have occurred. It could then try to investigate the reasons why the figures were different.

LARGE VS SMALL BUSINESSES

Businesses of all sizes have to monitor their cash flow carefully. Both large and small businesses will collapse if they run out of cash. Sometimes large businesses cause small businesses cash flow problems. This is because they may 'bully' small businesses by delaying payment for the goods or services they have bought from them. Since they are larger and more powerful, it is difficult for smaller businesses to demand payment. In some countries, governments have taken measures to limit this practice.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of a cash inflow?

- **A** Wages
- **B** Cash sales
- **C** Rent
- **D** Interest paid

▶ 2 Which of the following is an example of a cash outflow?

- **A** Interest received
- **B** Cash from trade payables
- **C** Fresh injection of capital
- **D** Payment for raw materials

▶ 3 The opening cash balance for a business was US$35 700 and the net cash flow was negative US$11 500. The closing balance is:

- **A** US$24 200
- **B** US$11 500
- **C** US$37 200
- **D** None of the above

▶ 4 When a business cannot pay its debts it is said to be?

- **A** Liquid
- **B** Insolvent
- **C** Overtrading
- **D** Overheating

CHAPTER REVIEW

CASE STUDY: LINARI GARDEN DESIGN

Sara Linari set up her own garden design business in 2015. She put in some of her own capital and persuaded a bank to lend her more. By February 2015, Sara had found several customers who promised her some work. The table shows the predicted revenue for the first nine months of trading. The following financial information was also gathered.

- A bank loan of €3000 would be needed in April.
- Sara would contribute €2000 of her own savings as capital in April.
- A van for €2000 would be purchased in April.
- Tools and equipment for €3400 would be purchased in April.
- A laptop computer with specialist design software for €600 would be purchased in April.
- A business directory listing will cost €100 in May.
- General overheads will be €400 per month.
- Advertising will be €100 in alternate months starting in May.
- Sara would take out €800 per month as drawings for personal use starting in June.
- Loan repayments will be €200 per month from April.

CHAPTER QUESTIONS

▶ Table 26.3 Predicted revenue for Linari Garden Design, April–December 2015

	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Predicted revenue (€)	2000	2100	2000	2500	2500	2000	1000	500	0

1. Describe what a 'cash flow forecast' shows.
2. Prepare a nine-month cash flow forecast for Linari Garden Design. (Use a spreadsheet if possible.)
3. Comment on the cash position of the business during the nine-month period.
4. What would you expect to happen to the cash position of the business in early 2016?

27 COSTS

LEARNING OBJECTIVES

- Understand the concept and calculation of fixed costs, variable costs and total costs
- Understand the concept and calculation of revenue
- Understand the concept and calculation of profit and loss

SUBJECT VOCABULARY

costs expenses that must be met when setting up and running a business

GETTING STARTED

Businesses have to pay for the resources they use. These expenses might include wages, raw materials, components, energy and machinery. They are called costs. However, there are different types of business costs. Some costs stay the same when a business produces more output, but others go up when more is produced. Look at the example below.



▲ Construction at a building site

CASE STUDY: AMPAT CONSTRUCTION

Ampat Construction is a specialist house builder in the USA. It is an established family business with a successful 79-year trading history. The company buys plots of land and builds residential properties, which it markets to individuals. Like any other business, it incurs a wide range of costs. Some examples of costs incurred in the construction of the house below include bricks, sand, cement, timber, pipes, glass, electrical wire, glass, plastic window frames and insulation materials. Other costs include: labour; machinery, such as cement mixers, lifting gear, vehicles; tools and equipment, such as spades, trowels, wire cutters, saws, power tools; protective clothing; computers; smartphones and office furniture at the company office.

Ampat Construction employs 140 people and builds about 350 houses each year. In 2016, its total costs were US$56 450 200 and total revenue from selling houses was US$64 340 700.

1. Suggest four costs incurred by Ampat Construction that will rise when more houses are built.
2. Suggest four costs incurred by Ampat Construction that remain unchanged when more houses are built.
3. Work out the profit made by Ampat Construction in 2016.

WHY DOES PRODUCTION GENERATE COSTS?

The production of goods and provision of services uses up resources. For example, tyre production uses resources such as rubber, synthetic fabrics, steel bands, machinery, a factory, labour and energy. These resources represent some of the costs generated during tyre production. Other costs will also be incurred. In this example, the selling of tyres will incur marketing,

SUBJECT VOCABULARY

fixed costs costs that do not vary with the level of output

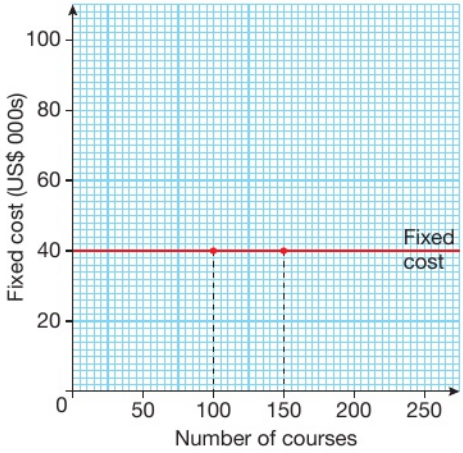
variable costs costs that change when output levels change

distribution and administration costs. Also, if the business has borrowed any money, there will be interest to pay on the loan. All these costs, and many others, can be classified according to how they behave when output changes: they are fixed or variable.

FIXED COSTS

Some production costs remain the same whatever the level of output. These are called **fixed costs**. Examples of fixed costs include rent, business rates, advertising, insurance premiums, interest payments and research and development costs. These costs will not increase even if a firm produces more output. However, fixed costs will still have to be met if the firm produces nothing. Fixed costs are sometimes called *overheads*.

Fixed costs can be shown on a graph. Figure 27.1 shows the fixed cost for Frampton Training. This business provides training courses for HGV drivers. The business incurs fixed costs of US$40 000 p.a. The graph shows that fixed costs stay the same at all levels of output. If the business provides 100 training places, fixed costs are US$40 000. If the number of places rises to 150, fixed costs are still US$40 000.



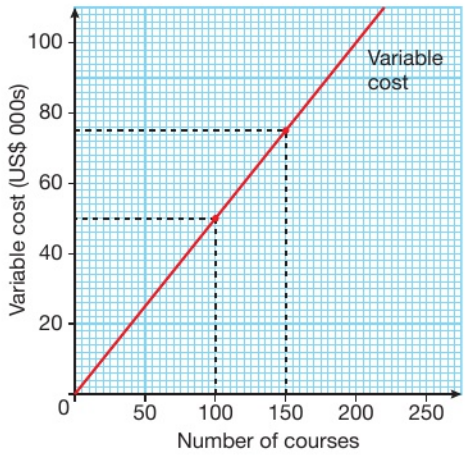
▲ Figure 27.1 Fixed costs for Frampton Training

VARIABLE COSTS

Production costs that change when the level of output changes are called **variable costs**. If a firm produces more output, variable costs will increase. Similarly, if output levels are cut, variable costs will fall. Examples of variable costs include raw materials, packaging, fuel and labour. If a firm produces nothing, variable costs will be zero.

Figure 27.2 shows variable costs for Frampton Training. The business has variable costs of US$500 per course. If 100 courses are provided, the variable costs will be US$50 000 (100 × US$500). If 50 extra courses are provided, variable costs rise to US$75 000 (150 × US$500). The graph shows that variable costs change whenever output changes.

▶ Figure 27.2 Variable costs for Frampton Training

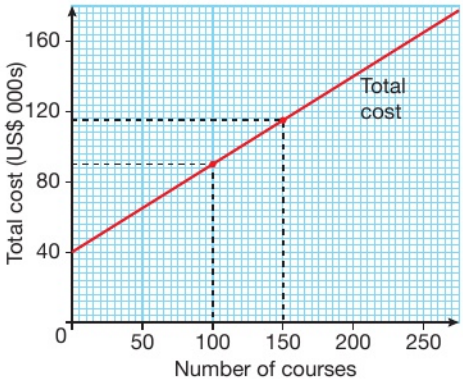


TOTAL COSTS

SUBJECT VOCABULARY

total costs fixed cost and variable cost added together

The cost to a firm of producing all output over a period is called **total cost**. Total cost (TC) can be calculated by adding fixed costs (FC) and variable costs (VC) together.



▲ Figure 27.3 Total costs for Frampton Training

Total cost = Fixed costs + Variable costs

If Millhouse Training provides places for 100 training courses, total costs will be:

TC = US$40 000 + (100 × US$500)
= US$40 000 + US$50 000
= US$90 000

The total cost graph in Figure 27.3 shows that total cost increases from US$90 000 to US$115 000 when the number of courses provided rises from 100 to 150.

ACTIVITY 1

CASE STUDY: KANDASAN CRICKET BATS

Kandasan Cricket Bats manufactures high quality cricket bats. The company, which is based in Colombo, Sri Lanka, employs six skilled craftsmen. Table 27.1 shows some cost information for the business in 2015.

▶ Table 27.1 Kandasan Cricket Bats costs

Rent	LKR 50 000 pa
Business rates	LKR 5000 pa
Other fixed costs	LKR 25 000 pa
Wood	LKR 30 per bat
Other raw materials	LKR 10 per bat
Labour	LKR 50 per bat
Other variable costs	LKR 10 per bat



▶ Making cricket bats

1 What is meant by fixed costs? Use examples from the case study in your explanation.

In 2015, Kandasan Cricket Bats produced 4800 bats.

2 Work out the total cost of production.

In 2016, the rent increased to LKR 60 000 and 6000 bats were produced.

3 Work out the effect of this increase on total costs.

AVERAGE COSTS

The average cost (AC) of production is the cost of producing a single unit of output. The formula for calculating average cost is given by:

$$\text{Average cost} = \frac{\text{Total cost}}{\text{Quantity produced}}$$

So, for example, the average cost of a training course provided by Millhouse Training, if 100 places (quantity = Q) were provided, would be:

$$AC = \frac{TC}{Q} = \frac{US\$90\,000}{100} = U\$900$$

This means that each course provided to trainee HGV drivers costs Millhouse Training US$900.

TOTAL REVENUE

SUBJECT VOCABULARY

total revenue money generated from the sale of output. It is price multiplied by quantity

The amount of money a firm receives from selling its output is called **total revenue**. Total revenue (TR) can be calculated by multiplying the price of each unit by the number of units sold:

Total revenue = Price × Quantity

If Millhouse Training, in the earlier example, charged US$1500 for its HGV training courses, the total revenue from the sale of 100 courses is given by:

TR = US$1500 × 100 = US$150 000

This means that Millhouse Training generated US$150 000 of revenue from providing 100 places on its HGV driving course.

CALCULATING PROFIT

One of the main reasons why firms calculate their costs and revenue is to work out *profit* or *loss*. Profit is the difference between total revenue and total costs.

Profit = Total revenue – Total cost

The profit made by Millhouse Training from providing 100 places is given by:

Profit = US$1500 × 100 – (US$40 000 + US$50 000)
= US$150 000 – US$90 000
= US$60 000

It is possible to calculate the profit for a firm at any level of output using this method. If total costs are greater than total revenue, then a loss is made.

ACTIVITY 2

CASE STUDY: JENKINS LTD

Jenkins Ltd manufactures electronic control systems that open and shut swing gates. Its most popular product is the underground system, which sells for US$250. The systems are assembled in a factory using components supplied by firms nearby. In 2015, Jenkins sold 4500 systems. Total fixed costs for the year were US$160 000 and variable costs were US$120 per system.

In 2015, Jenkins produced and sold 4500 control systems.

1 Work out the total cost.
2 Work out the total revenue.
3 Work out the profit.

In 2016, fixed costs and the price charged remained the same. However, variable costs rose to US$140 per system.

4 Work out the profit made in 2016 if 5200 systems were sold.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which is an example of a fixed business cost?
- **A** Raw materials
- **B** Interest payments
- **C** Packaging
- **D** Wages to production workers

▶ 2 If total cost is US$35 000 000 and output is 100 000 units, what is average cost?
- **A** US$100 000
- **B** US$35
- **C** US$350
- **D** US$3500

▶ 3 If variable cost is £10 per unit and fixed costs are £400 000, what is the total cost of producing 50 000 units?
- **A** £900 000
- **B** £450 000
- **C** £4 000 000
- **D** £500 000

▶ 4 Which one of the following expressions is true?
- **A** Profit = TC + TR
- **B** Average cost = FC ÷ Q
- **C** TR = P x FC
- **D** Profit = TR – TC

CHAPTER REVIEW

CASE STUDY: MODAL METAL PRODUCTS

Modal Metal Products is a medium-sized engineering company. In the last six years, the business has begun to specialise in the production of signage, particularly road signs. Around 80 per cent of its business comes from government contracts. Modal Metal Products has benefitted from government investment in road building in India. One of its recent orders was for 1000 speed limit signs. Table 27.2 shows some variable cost information for the order.

The fixed costs for the order were expected to be Rs600 000. Most of this cost was to pay for a specialist machine. The price of each sign would be Rs2500.

▶ Table 27.2 Variable costs

VARIABLE COSTS PER SIGN	Rs
Sheet metal	200
Metal pipe	500
Clips and fastenings	200
Paint	100
Labour	300
Other variable costs	100

▶ Road signs



CHAPTER QUESTIONS

1 What is meant by variable costs?

2 For the new order, work out **(a)** total variable cost and **(b)** total cost.

3 Plot fixed cost, variable cost and total cost on a graph. Use a range of output of 0 to 1000 units.

4 Work out the profit made on the order.

5 Work out the average cost of each sign.

Six months later, Modal Metal Products gets another order for 1500 speed limit signs. The variable costs remain the same but fixed costs are only Rs200 000. However, the government will only pay Rs1500 for each sign.

6 Assess whether Modal Metal Products should accept the order. Show all your calculations. Make a clear judgement in your evaluation.

28 BREAK-EVEN ANALYSIS

LEARNING OBJECTIVES

- Understand the concept of break-even, the calculation of break-even and the break-even level of output
- Understand how to interpret break-even charts: the impact of changes in revenue and costs
- Understand the limitations of break-even charts

GETTING STARTED

In business, it is crucial to know how much output needs to be sold to cover costs. If costs are not covered by revenue, the business will make a loss. If revenue is greater than costs, the business will make a profit. If costs are exactly the same as revenue, the business will break even. Look at the examples below.

CASE STUDY: UNIVERSAL MUSIC GROUP

Universal Music Group (UMG) is a US global music corporation owned by the French media group Vivendi. It is one of the three largest record labels in the world and some of the high profile bands/artists signed up to UMG include ABBA, Dizzee Rascal, Madonna, U2, Taylor Swift, Lady Gaga and Lana Del Rey. In 2016 UMG generated revenues of €5.26 billion. Its total costs for the year (before interest, tax and amortization) were €4.616 billion.



▶ Luxottica eyewear

SUBJECT VOCABULARY

Amortization is a cost associated with the falling in value of certain types of asset.

CASE STUDY: CONE STREET CYCLES

Cone Street Cycles assemble bicycles in a factory in Islamabad, Pakistan. In 2015:

- fixed costs were Rs20 000 000
- variable costs were Rs2000 per bicycle
- 100 000 bicycles were made and sold, so its total variable costs were Rs20 000 000 (Rs2000 × 10 000).
- the total revenue resulting from the sale of 10 000 bicycles was Rs40 million.

1 Show whether the firms in the above examples are making a profit, loss or breaking even.

THE CONCEPT OF BREAK EVEN

SUBJECT VOCABULARY

break-even point level of output where total costs and total revenue are exactly the same: neither a profit nor a loss is made

A business will break even if its total costs (TC) and total revenue (TR) are exactly the same. This is called the **break-even point**. At this point, the business does not make a profit or a loss. For example, if a business produces 40 000 units and sells them for €5 each, total revenue will be €200 000 (€5 × 40 000). If fixed costs are €100 000 and variable costs are €2.50 per unit, total costs will also be €200 000 (€100 000 + €2.50 × 40 000). Here, the business is breaking even and 40 000 units is the break-even point.

CALCULATING THE BREAK-EVEN POINT

DID YOU KNOW?

Selling price – variable costs is known as the contribution.

To calculate the break-even point, the following information is needed:

- fixed cost
- variable cost per unit
- selling price per unit.

The following formula can be used to calculate the break-even point:

$$\text{Break-even point} = \frac{\text{Fix cost}}{\text{Selling price} - \text{Variable cost per unit}}$$

Ed Winchester has a contract with a house builder to install fire alarms in state-owned council houses. Ed charges US$25 for each installation. Fixed costs are US$20 000 p.a. and variable costs are US$5 per installation. How many alarms have to be installed before the business breaks even?

$$\text{Break-even point} = \frac{\text{Fixed cost}}{\text{Selling price} - \text{Variable cost per unit}}$$

$$= \frac{\text{US\$20 000}}{\text{US\$25} - \text{US\$5}}$$

$$= \frac{\text{US\$20 000}}{\text{US\$20}}$$

$$= 1000 \text{ units}$$

So, Ed has to fit 1000 fire alarms to break even.

ACTIVITY 1

CASE STUDY: GALLE ICE CREAM

Galle Ice Cream Ltd makes ice cream that is sold to retailers and restaurants in Sri Lanka. Its standard ice cream product sells for Rs100 a kilogram. The fixed costs in standard ice cream production are Rs100 000. Variable costs of production are Rs50 a kilogram.

1. How many kilos of ice cream must the business sell to break even?
2. What is total cost and total revenue at the break-even point?
3. What would happen to the break-even point if fixed costs were reduced to Rs80 000?



▶ Ice cream

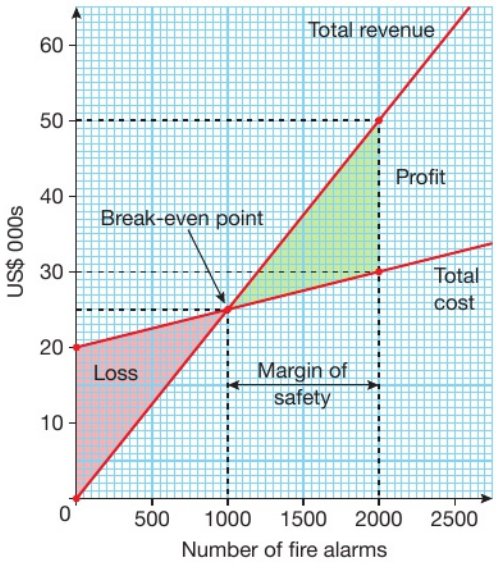
BREAK-EVEN CHART

SUBJECT VOCABULARY

break-even chart graph that shows total cost and total revenue; break-even point is where total cost and total revenue intersect

margin of safety amount of output available to be sold above the break-even point where the business makes a profit

The break-even point can be shown on a graph. The **break-even chart** in Figure 28.1 shows total cost and total revenue for Ed Winchester's business in the previous example. Output is measured on the horizontal axis and revenue, costs and profit are measured on the vertical axis. What does the break-even chart show?



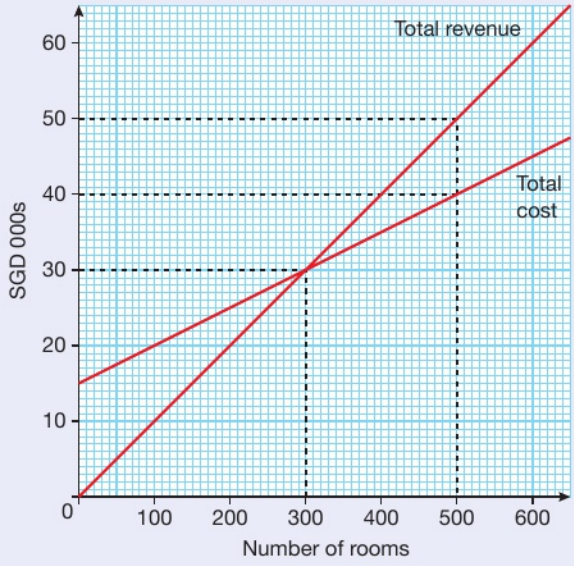
▲ Figure 28.1 Break-even chart for Ed Winchester

- The break-even point is where total cost and total revenue meet or intersect. In this example, the business breaks even when 1000 fire alarms are fitted. At this point, total cost and total revenue are both US$25 000.
- At any level of output below the break-even point the business makes a loss.
- At any level of output above the break-even point the business makes a profit. For example, if Ed Winchester fits 2000 fire alarms, the business will make a profit of US$20 000. (Total costs are US$30 000 and total revenue is US$50 000.)
- If Ed Winchester fits 2000 alarms, the **margin of safety** is 1000 units. This is the range of output over which the business can make a profit (the difference between current output and the break-even level of output).
- Some break-even charts show fixed cost. In this example, a horizontal line at US$20 000 would show fixed cost.

ACTIVITY 2

CASE STUDY: THE GRAND HOTEL

The Grand Hotel, Singapore, has 600 rooms. The price charged (on average) by the hotel for a room is SGD 100. Figure 28.2 shows a break-even chart for the hotel.



▶ Figure 28.2 Break-even chart for The Grand Hotel, Singapore

1. What is the value of fixed cost for the Grand Hotel?
2. How many rooms need to be occupied to break even?
3. What is total revenue at the break-even point?
4. What is total cost at the break-even point?
5. If 500 rooms are occupied, what is the **(a)** amount of profit and **(b)** margin of safety?

CONSTRUCTING A BREAK-EVEN CHART

Following the steps below will guide you through drawing a break-even chart.

Nanjing Holdings assembles circuit boards to go inside electronic devices. Fixed costs are US$10 000, variable costs are US$10 per circuit board and the assembled boards are sold for US$20 each.

Step 1: It is useful to know the break-even point before constructing the chart. This helps to check that your chart is correct. Calculate the break-even point using the formula given earlier. In this example, the break-even point is 1000 units (US$10 000 ÷ US$20 – US$10).

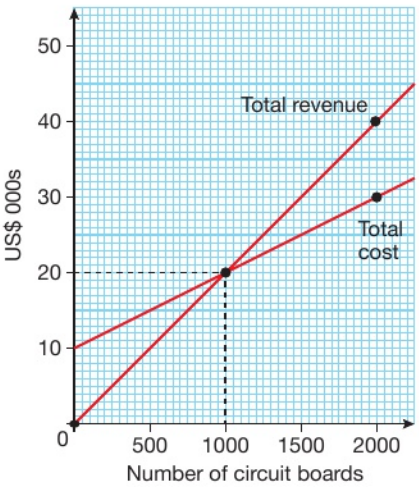
Step 2: Since both total cost and total revenue are straight lines, two sets of points (or co-ordinates) on the graph are needed to construct the lines. It is necessary to choose two levels of output and work out the total cost and total revenue at each level.

- Choosing 0 as one level makes the calculations easier. If output is 0, TC will be US$10 000 (remember that fixed costs are still incurred even when nothing is produced).

- When output is 0, TR will also be 0 (there are no sales if nothing is produced).
- When choosing the second level of output, choose a value that is double the break-even point. This means the break-even point will appear right in the middle of the chart. Therefore, the second level of output will be 2000 (2 × 1000).
- When output is 2000, TC = US$10 000 + (US$10 × 2000) = US$30 000.
- When output is 2000, TR = US$20 × 2000 = US$40 000.
- The values for TC and TR at each level of output are summarised in Table 28.1.

▼ Table 28.1 Total cost and revenue

OUTPUT	TC	TR
0	US$10 000	US$0
2000	US$30 000	US$40 000



▲ Figure 28.3 Break-even chart for Nanjing Holdings

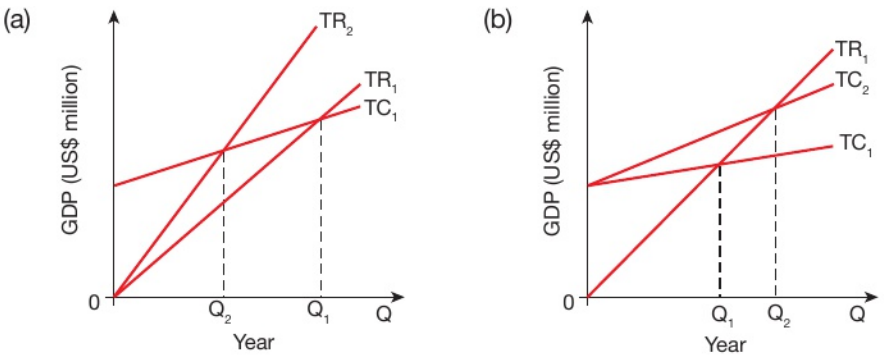
Step 3: The values shown in the table represent two sets of co-ordinates, which can be used to plot TC and TR for the break-even chart.

- Output is measured on the horizontal axis and goes up to 2000.
- Costs, revenue and profit are measured on the vertical axis and go up to US$40 000.
- TC can be drawn by placing the co-ordinates (0, US$20 000) and (2000, US$30 000) on the chart and joining them with a straight line.
- TR can be drawn by placing the co-ordinates (0,0) and (2000, US$40 000).
- The chart is shown in Figure 28.3.

EFFECT OF CHANGES IN PRICE AND COSTS ON THE BREAK-EVEN CHART

The break-even chart can be used to show the effects on the break-even point when there are changes in costs and price.

- If price is higher, TR will be steeper and the break-even point will shift to the left. This is shown in Figure 28.4(a).
- If price is lower, the TR will be flatter and the break-even point will shift to the right.
- If FC is higher, TC will move upward with the steepness unchanged and the break-even point will shift to the right.
- If FC is lower, TC will move downward with the steepness unchanged and the break-even point will shift to the left.
- If VC is higher, TC will be steeper and the break-even point will shift to the right. This is shown in Figure 28.4(b).
- If VC is lower, TC will be flatter and the break-even point will shift to the left.



▶ Figure 28.4 Effect of changes in price and variable cost on the break-even point

THE LIMITATIONS OF A BREAK-EVEN CHART

SUBJECT VOCABULARY

bulk buying buying goods in large quantities, which is usually cheaper than buying in small quantities

stockpile large supply of goods and so forth that are being kept for use or possible use in the future

A break-even chart shows:

- how much output a business has to produce in order to break even
- the costs, revenue and profit at different levels of output
- the margin of safety.

However, the chart does have some limitations.

- The TC and TR are shown as straight lines. In practice, they may not be straight lines. For example, a business may have to offer discounts on large orders, so total revenues fall at high outputs. In this case, the total revenue line would rise and then eventually fall. A business can lower costs by **bulk buying**. So costs may fall at high outputs and total cost will be curved.
- It is assumed that all output is sold and no stocks are held. Many businesses hold stocks of finished goods to be able to cope with changes in demand. There are also times when firms cannot sell what they produce and choose to **stockpile** their output to avoid laying off staff.
- The accuracy of the break-even chart depends on the quality and accuracy of the data used to construct total cost and total revenue. If the data is poor and inaccurate, the conclusions drawn on the basis of the data will be wrong.

LARGE VS SMALL BUSINESSES

Both large and small businesses should be interested in break-even. For example, when an entrepreneur starts a small business, an initial objective might be to break even in the first year of trading. This means that the entrepreneur would have to compare total revenue at the end of the year with total costs. If they are the same then the business will have achieved its objective. Many small business owners may not be aware of the mathematical interpretations of break-even but they are likely to fully understand the concept. Larger businesses, with their specialists in the finance department, may use break-even analysis more formally. For example, they may calculate the break-even point of a particular business venture or a new product.

MULTIPLE-CHOICE QUESTIONS

▶ 1 A business that breaks even has total revenue of US$5 600 000 and fixed costs of US$2 000 000. Therefore the value of variable costs is?

A US$2 000 000
B US$5 600 000
C US$7 600 000
D US$3 600 000

▶ 2 A business charges US$25 per unit for its output. Fixed costs are US$1 million and variable costs are US$5 per unit. How much should the business produce and sell to break-even?

A US$50 000
B US$20
C 20 units
D 50 000 units

▶ **3** **A business breaks even when 5000 units are produced. If price = US$20 and fixed costs are US$20 000, then variable cost per unit is?**

A US$16 per unit
B US$50 per unit
C US$20 per unit
D US$4 per unit

▶ **4** **An increase in fixed cost will do which of the following?**

A shift the break-even point to the left
B Make the total cost function steeper
C Shift the break-even point to the right
D Make the total cost function flatter

CHAPTER REVIEW



▲ A fibreglass sailing dinghy

CASE STUDY: GRAFTON DINGHIES

Grafton Dinghies manufacture fibreglass sailing boats. The standard model produced by the business sells for €3000. The variable costs incurred in the manufacture of one dinghy are shown in Table 28.2. Fixed costs for 2015 were €400 000.

▼ Table 28.2 Variable costs for dinghy production

VARIABLE COSTS PER DINGHY	€
Fibreglass	400
Labour	600
Sail fabric	300
Components	400
Other variable costs	300

CHAPTER QUESTIONS

1 Construct a break-even chart for Grafton Dinghies.

2 **a** What is the break-even point for Grafton Dinghies?

b What is the total cost and total revenue at the break-even point?

Grafton plans to make 600 dinghies during the year.

3 How much profit will be made?

4 Describe what would happen to the break-even point for Grafton Dinghies if variable costs were to increase.

5 What are the limitations of break-even analysis to Grafton Dinghies? Discuss at least two limitations in your analysis.

29 STATEMENT OF COMPREHENSIVE INCOME

LEARNING OBJECTIVES

- Understand the purpose of statements of comprehensive income
- Understand the main features of statements of comprehensive income (sales, cost of sales, gross profit, expenses, operating profit)
- Understand the use of statements of comprehensive income in decision making
- Understand the nature of profit and its importance

GETTING STARTED

Most business owners want to make a profit – it is the main reason why they start a business. At the end of the financial year, businesses produce a statement of comprehensive income. This shows the income and costs for a business and is used to calculate profit. It can also be used to help make decisions such as how much the business might invest in the future. Look at the example below.



▲ Grocery store

CASE STUDY: DOHA FOOD STORE

The Doha Food Store sells a wide range of groceries. It is located in a suburb of Doha in Qatar and serves local residents. Musab Assad and his family own the business and his three sons are employed in the store. Table 29.1 shows the statement of comprehensive income for the business in 2015.

▶ Table 29.1 Doha Food Store statement of comprehensive income, year ending 31 May 2015

	US$
Revenue	256 400
Cost of sales	137 100
Gross profit	**119 300**
Expenses	77 900
Operating profit	**41 400**
Finance costs	600
Profit for the year	**40 800**

1 What do you think is meant by the terms **(a)** cost of sales and **(b)** finance costs?
2 Suggest three possible expenses that the Doha Food Store might incur.
3 How might Musab Assad use the statement of comprehensive income?

THE PURPOSE OF A STATEMENT OF COMPREHENSIVE INCOME

SUBJECT VOCABULARY

statement of comprehensive income financial document showing a firm's income and expenditure in a particular time period

profit money left over after all costs have been subtracted from revenue

gross profit sales revenue less cost of sales

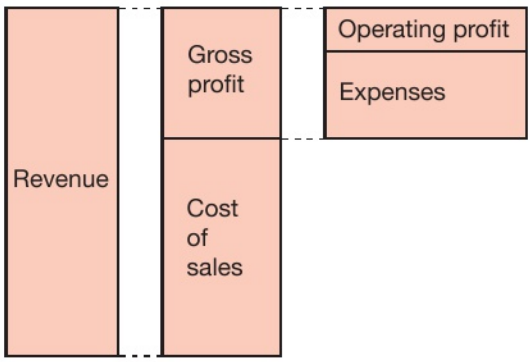
operating profit gross profit less expenses.

Businesses use the **statement of comprehensive income** to calculate the **profit** at the end of the financial year. The financial year is a 12-month trading period and can vary from the calendar year, for example, it might be from 1 June 2015 to 31 May 2016. A business normally calculates its profit using two steps. First, it calculates **gross profit**. This is the profit made before expenses or overheads are subtracted. It is found by calculating:

Gross profit = revenue – cost of sales

Then it calculates **operating profit**. This is profit after expenses and is found by:

Operating profit = gross profit – expenses



▶ Figure 29.1 Calculating gross profit and operating profit

RETAINED AND DISTRIBUTED PROFIT

SUBJECT VOCABULARY

distributed profit profit that is returned to the owners of a business

retained profit profit held by a business rather than returning it to the owners and which may be used in the future

dividend share of the profit paid to shareholders in a company

Some of the profit made by a business at the end of the year is used to pay taxes. Sole traders and business partners may pay *income tax* whereas limited companies may pay *corporation tax*. The profit after tax can be **distributed profit** or **retained profit**. Some of the profit is likely to be distributed to the owners of the business. For example, limited companies may return some of the profit to shareholders. They are paid a **dividend**. Any undistributed profit is retained by the business. This may be invested in the business. This means it may be used to help fund investment projects. It may also be kept as a reserve in case trading conditions become difficult in the future or to help fund expansion.

ACTIVITY 1

CASE STUDY: FORMAT 66

Format 66 produces software for automated production lines. In 2015, its turnover was US$12.56 million. Its cost of sales was US$7.6 million and expenses were US$2.56 million.

1 Work out **(a)** gross profit and **(b)** operating profit.

Format 66 distributes US$0.8 million to shareholders.

2 How much profit is retained?
3 What is likely to happen to the profit retained by the business?



▶ An automated production line

THE STATEMENT OF COMPREHENSIVE INCOME

The statement of comprehensive income shows the income and expenses of a business during the financial year. Up until recently, the statement of comprehensive income was called the profit and loss account and many accountants still use this term. The layout of the statement is important. Information must be presented in a standard way. Table 29.2 shows the statement of comprehensive income for Walnut Soaps, a manufacturer of soap products and other toiletries.

▶ Table 29.2 Walnut Soaps statement of comprehensive income, year ending 31 May 2016

	2016 US$000	2015 US$000
Revenue	5400	4900
Cost of sales	3500	3100
Gross profit	**1900**	**1800**
Administration expenses	750	700
Other operating expenses	160	150
Operating profit	**990**	**950**
Finance costs	100	100
Profit for the year	**890**	**850**
Taxation	160	150
Profit for the year after taxation	**730**	**700**

The statement of comprehensive income contains the following information.

REVENUE

Revenue is the money the business receives from selling goods and services. Revenue must not include VAT. This is because VAT does not belong to the business. The revenue for Walnut Soaps in 2016 was US$5 400 000.

COST OF SALES

For a manufacturer, cost of sales would include costs such as raw materials and the wages of factory workers. For a retailer, the cost of sales would be the cost of buying inventory (stock) for resale. For a service provider, such as a taxi service, it would be the costs associated with the actual delivery of the service such as fuel and the drivers' wages. In the case of Walnut Soaps, the cost of sales would be the cost of chemicals, other raw materials, energy and wages paid to factory workers. In 2016, the cost of sales for Walnut Soaps was US$3 500 000.

GROSS PROFIT

Gross profit is calculated when the cost of sales is subtracted from the revenue. This is the profit made before the subtraction of general expenses or overheads. The gross profit made by Walnut Soaps in 2016 was US$1 900 000 (US$5 400 000 – US$3 500 000).

ADMINISTRATIVE EXPENSES

Administrative expenses are the general overheads or expenses of the business. Examples might include office salaries, expenses claimed by senior staff, stationery supplies, IT expenses, accountancy fees and telephone bills. Walnut Soaps incurred US$750 000 of administrative expenses in 2016.

OTHER OPERATING EXPENSES

Any expenses not included in administrative expenses above may be called other operating expenses. Examples might include small irregular expenses such as subscriptions, stationary, postage and office supplies. Other operating expenses for Walnut Soaps in 2016 were US$160 000.

SELLING EXPENSES

A business may incur a range of expenses that are directly related to the selling of its products. Examples might include sales commissions, advertising, distribution and promotional expenses. There is no entry for selling expense in the statement for Walnut Soaps.

OPERATING PROFIT

If the administrative costs and other operating expenses are subtracted from gross profit we get the operating profit. The operating profit is the profit generated from the firm's main activities. It does not include any income from financial investments made by the business. Walnut Soaps made an operating profit of US$990 000 in 2016.

SUBJECT VOCABULARY

finance cost interest paid on loans

finance income interest received by the business on deposit accounts

FINANCE COSTS

If a business borrows money it will have to pay interest to the lender. The amount paid will be entered in the income statement as a finance cost. However, a business may also receive interest if it has money in deposit accounts. This will appear as finance income in the account. In 2016, Walnut Soaps paid US$100 000 in interest.

PROFIT FOR THE YEAR

If the cost of finance is subtracted from the operating profit, the profit for the year is determined. This is the profit before taxation (sometimes called net profit before tax). In 2016, Walnut Soaps made US$890 000 profit for the year in 2016.

PROFIT FOR THE YEAR AFTER TAX

This is the amount of money that is left over after all expenses, including taxation, have been subtracted from revenue. It is often referred to as the 'bottom line'. The money belongs to the owners of the business. In the case of a limited company, it belongs to the shareholders. However, it may not necessarily be distributed to the shareholders. Some of it may be retained. In 2016, Walnut Soaps made US$730 000 profit for the year after tax.

The statement of comprehensive income for Walnut Soaps on page 240 shows figures for both 2016 and the previous year. This is standard practice and helps to make comparisons over time. For example, the performance of Walnut Soaps has improved over the two years. Its profit for the year after tax (the 'bottom line') has increased from US$700 000 to US$730 000 over the two years.



▲ Computer game players

ACTIVITY 2

CASE STUDY: SANCHEZ SUPERSOFT

Sanchez Supersoft produces software for computer games. It employs 230 staff and operates from Bermuda. The business has started to struggle a little owing to the slowdown in global economic growth. Table 29.3 shows the statement of comprehensive income for Sanchez Supersoft in 2016. Some of the figures are missing.

▶ Table 29.3 Sanchez Supersoft statement of comprehensive income, year ending 31 May 2016

	2016 US$ million	2015 US$ million
Revenue	26.9	29.2
Cost of sales	17.4	?
Gross profit	9.5	11.1
Expenses	4.4	4.8
Operating profit	?	6.3
Finance cost	1.8	1.5
Profit for the year	3.3	4.7
Taxation	1.1	1.6
Profit for the year after taxation	2.2	?

Look at the statement of comprehensive income for Sanchez Supersoft.

1 Work out the missing values for **(a)** cost of sales in 2015, **(b)** profit for the year after tax in 2015 and **(c)** the operating profit for 2016.
2 Comment on the performance of the business over the two years.

HOW MIGHT THE STATEMENT OF COMPREHENSIVE INCOME BE USED IN DECISION MAKING?

The statement of comprehensive income shows business owners and managers the amount of profit made by a business in a financial year. However, the information contained in the statement might be used to help make some important decisions. Some examples are outlined below.

INVESTMENT DECISIONS

A business might use the statement of comprehensive income to decide how much money to invest in the business. For example, if the statement shows that profits are rising, this might encourage decision makers to use more funds for investment. In contrast, if the statement shows that the business is struggling, investment plans might be postponed in the hope that the business will pick up in the near future.

COST ANALYSIS

The statement of comprehensive income will show what has happened to costs during the year. It might show, for example, that the cost of sales has increased sharply. As a result, a business can identify reasons for this and take measures to bring costs under control. A business might decide that cheaper suppliers of raw materials must be found or that the wages of production workers must be brought under control.

BASIS FOR FUTURE FORECASTS

Many businesses like to forecast the future performance of a business. Most public limited companies are expected to give shareholders some idea of what earnings to expect in the future. Businesses can therefore use the statement of comprehensive income as a basis on which to make forecasts. For example, if profit for the year has increased by 5 per cent, a business might tell shareholders that next year earnings are expected to rise by 7 per cent if the economy continues to improve.

MAKING COMPARISONS

Investors may use the statement of comprehensive income when deciding where to invest their funds. For example, if a financial institution was looking to invest some money in the motor car industry, it might look at the statements of different car manufacturers to help decide which one looks the most attractive. The use of the statement of comprehensive income for assessing the performance of a business is discussed in more detail in Chapters 31 and 32 (see pages 254–268).

THE NATURE AND IMPORTANCE OF PROFIT

Profit is the driving force in most businesses. There are few, if any, which attach no importance to profit, the exceptions perhaps being charities. Profit has a number of functions. It is the prospect of making a profit that motivates many people to set up a business. Without profit, there would be little incentive for individuals to risk their time and money in a business venture.

Economists often refer to normal profit. This is the minimum financial reward an entrepreneur must receive in order maintain interest in a business. If a business does not earn this amount, an owner will pull out.

SUBJECT VOCABULARY

normal profit minimum profit a business needs to make to retain the interest of the owner(s)

Profit levels affect the flow of money into and out of different industries. Money will flow into expanding industries where profits are rising and out of declining industries where profits are falling. This is a natural process and helps resources in an economy to be used more efficiently. For example, money

has been flowing into expanding industries, such as social media, air travel, smartphones and foreign holidays, in recent years. In contrast, money has been flowing out of declining industries such as newspaper publishing, mills, DVDs and production of film for traditional cameras.

Profit is also important as a measure of business performance. Businesses that supply quality products that are produced efficiently and sold at prices which are attractive to consumers, will generally make the most profit.

LARGE VS SMALL BUSINESSES

A significant number of small businesses, such as sole traders, may not produce a formal statement of comprehensive income. They may pay an accountant to calculate the amount of taxable income (profit) for the year. They may use this as a measure of performance and to work out how much tax needs to be paid. However, limited companies in most countries are required by law to produce a set of accounts, which includes a statement of comprehensive income. Business owners and managers are like to use the statement for the purposes described above.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Wages paid to production workers is an example of which of the following?

A Current asset
B Finance cost
C Business expense
D Cost of sales

▶ 2 A business has revenue of US$239 500, cost of sales of US$154 000 and expenses of US$65 000. Therefore, the value of operating profit is?

A US$20 500
B US$85 500
C US$393 500
D US$239 500

▶ 3 A statement of comprehensive income might be used to do which of the following?

A Calculate labour turnover
B Help make investment decisions
C Measure the value of assets in a business
D Calculate the liquidity ratio

▶ 4 Which of the following is a function of profit?

A A measure of global economic success
B Used to calculate the break-even point
C Measure of business performance
D Measure of labour productivity

CHAPTER REVIEW

CASE STUDY: ROLLS-ROYCE

Rolls-Royce is a global specialist in the supply of power and propulsion solutions. Rolls-Royce design, develop, manufacture and service integrated power systems for use in the air, on land and at sea. They build some of the world's most efficient aero-engines, eco-friendly ships, power nuclear submarines and enable land-speed records. Table 29.4 shows an extract from its statement of comprehensive income for 2015. (The figures shown in brackets are subtracted in the statement.) The figures for taxation and gross profit in 2015 are missing.

▶ Table 29.4 Rolls-Royce statement of comprehensive income (extracts), year ending 31 December 2015

	2015 £m	2014 £m
Revenue	13 725	13 736
Cost of sales	(10 459)	(10 533)
Gross profit	**????**	**3203**
Other operating income	10	10
Administrative expenses	(1059)	(1124)
Research and development costs	(818)	(793)
Income from joint ventures	100	94
Operating profit	**1499**	**1390**
Adjustments	2	8
Finance costs	(1456)	(1452)
Finance income	115	121
Profit for the year	**160**	**67**
Taxation	??	(151)
Profit for the year after taxation	**84**	**(84)**

SUBJECT VOCABULARY

adjustments includes adjustments for the profits made on the disposal of assets

CHAPTER QUESTIONS

1 What does a statement of comprehensive income shows?

2 Work out **(a)** taxation and **(b)** gross profit for 2015.

3 What is meant by operating profit?

4 Describe two ways in which the statement of comprehensive income might be used by a business like Rolls-Royce.

5 Assess the performance of Rolls-Royce over the two years. Make a clear judgement in your evaluation.

30 STATEMENT OF FINANCIAL POSITION

LEARNING OBJECTIVES

- Understand the purpose of statements of financial position
- Understand the main features of statements of financial position: current and non-current assets, current and non-current liabilities and capital employed
- Understand how to interpret a statement of financial position

GETTING STARTED

Businesses keep a record of all the resources they own, such as land, property, machinery, tools, inventory and cash. They also keep a record of all the money they owe to banks, suppliers, the owners and other businesses. At the end of the financial year, a business produces a summary of these financial details. Look at the example below.



▲ Furniture making

CASE STUDY: AZORA DINING FURNITURE

Azora Dining Furniture is a small manufacturer of dining room furniture. It makes wooden tables, chairs and other small items of furniture for customers in the south of Estonia. Table 30.1 shows some financial information for the business at the end of 2015. On the left-hand-side, the table shows the value of all the resources owned by Azora, which are called assets. On the right-hand-side, the value of liabilities and capital is shown. This is the amount owed to the creditors of the business and the owners of the business respectively.

RESOURCES OWNED BY AZORA (ASSETS)	US$	OWED BY AZORA (LIABILITIES AND CAPITAL)	US$
Property	180 000	Share capital	200 000
Tools and equipment	95 000	Bank loan	40 000
Inventories	24 000	Trade payables (trade creditors)	21 000
Trade receivables (debtors)	34 000		
Other assets	8900	Taxation	30 000
Cash	54 000	Retained profit	104 900

▶ Table 30.1 Azora financial information, 31 December 2015

1 What is the value of all the assets owned by the business?
2 How much money does the business owe to **(a)** the owners and **(b)** all other creditors?
3 What do you notice about the value of assets and the total amount owed by the business?

WHAT IS A STATEMENT OF FINANCIAL POSITION?

SUBJECT VOCABULARY

statement of financial position summary at a point in time of business assets, liabilities and capital (often called the balance sheet)

assets resources used or owned by a business, such as cash, stock, machinery, tools and equipment

liabilities debts of the business, which provide a source of funds

capital finance provided by the owners of the business

KEY POINT

In statement of financial position, the value of assets (what a business uses or owns) will equal the value of liabilities and capital (what the business owes). This is because all resources purchased by a business have to be financed from either capital or liabilities. Therefore:

Assets = Liabilities + Capital

So, if a business has capital of US$5 million and liabilities of US$2.6 million, the value of assets must be US$7.6 million (US$5 million + US$2.6 million).

Most businesses produce a **statement of financial position** at the end of the financial year. A statement of financial position is like a photograph of a firm's financial position at a particular point in time. It provides a summary of a firm's **assets**, **liabilities** and **capital**. It is also commonly known as a balance sheet.

- Assets are the resources owned by a business. Examples include buildings, machinery, equipment, vehicles, inventory and cash. Businesses use assets to make products or provide services.
- Liabilities are the debts of the business, that is, what it owes to others. Liabilities are a source of funds for a business. They might be short term, such as an overdraft, or long term, such as a mortgage.
- Capital is the money put into the business by the owners. For limited companies this will be share capital. It is used to buy assets.

ACTIVITY 1

CASE STUDY: TESCO

Tesco is a large supermarket chain. It operates nearly 7000 stores. In 2016, according to its annual reports and accounts, the value of its assets was £43 904 million. A significant proportion of this (£17 600 million) was property, plant and equipment. The value of Tesco's liabilities was £35 288 million. £10 711 million of this amount was owed to banks and other financial institutions.



▶ Tesco supermarket

1. What is the difference between assets and liabilities? Use examples from this case study.
2. Work out the value of capital for Tesco.
3. Write a letter to a shareholder explaining what a statement of financial position shows.

FEATURES OF A STATEMENT OF FINANCIAL POSITION

The statement of financial position for Dingwall Building Supplies is shown in Table 30.2. The company operates a large store, which serves builders and other traders in the construction industry. The presentation of these statements may vary between different businesses. For example, the statements of limited companies are slightly different to those of sole traders. The details likely to be found in a statement of financial position are outlined below.

SUBJECT VOCABULARY

non-current assets assets that last for more than one year

NON-CURRENT ASSETS

Details of a firm's non-current assets are given at the top of the statement of financial position. Non-current assets are those that last for more than one year. They are the most productive resources of a business. Dingwall Building Supplies has two main non-current assets – property, and fixtures and fittings, such as doors, windows and flooring (Table 30.2). The total value of these non-current assets at 31 December 2015 was US$440 000.

▶ Table 30.2 Dingwall Building Supplies statement of financial position, 31 December 3015

	US$000
Non-current assets	
Property	340
Fixtures and fittings	100
	440
Current assets	
Inventories	150
Trade receivables	78
Cash	56
	284
Current liabilities	
Trade payables	112
Taxation	12
	124
Net current assets	160
Non-current liabilities	
Mortgage	(60)
Net assets	540
Shareholders' equity	
Share capital	100
Retained profit	395
Other reserves	45
Capital employed	540

SUBJECT VOCABULARY

current assets assets likely to be changed into cash within a year

liquidity ease or speed with which assets can be sold for cash

trade receivables amounts of money that are owed to a company by its customers

CURRENT ASSETS

Current assets are assets that will be changed into cash within one year. They are *liquid* assets. The liquidity of an asset is how easily and how quickly it can be changed into cash. Examples might include the following.

- Inventories of raw materials, semi-finished goods and finished goods. Dingwall Building Supplies holds large inventories of building supplies in its store. These are valued at US$150 000.
- Trade receivables – customers that owe money to the firm. In this case, Dingwall Building Supplies is owed US$78 000 by customers.
- Cash 'in hand' or in the bank. The statement shows that Dingwall Building Supplies has US$56 000 in cash.

SUBJECT VOCABULARY

current liabilities debts that have to be repaid within a year

net current assets current assets minus current liabilities, also known as working capital

non-current liabilities debts that are payable after 12 months

net assets value of all assets less the value of all liabilities; total at the bottom of the first part of the balance sheet

CURRENT LIABILITIES

Current liabilities are business debts, which must be repaid within 12 months. They might include the following.

- Trade payables – money owed to suppliers. Dingwall Building Supplies owes US$112 000. This money might be owed to manufacturers of building supplies, utility providers or any other business supplying commercial services to Dingwall.
- Taxation is money owed by the business to the tax authorities. This might include tax on company profits, VAT or tax that has been deducted from employee wages that must be passed on to the authorities. Dingwall Building Supplies owes US$12 000 to the tax authorities.
- Leases and hire purchase are other forms of borrowing.
- Short-term loans and overdrafts are money owed to banks repayable within 12 months.

Dingwall Building Supplies does not have any lease, hire purchase, short-term loans or overdrafts.

NET CURRENT ASSETS

The table shows that Dingwall Building Supplies has US$160 000 of net current assets. It is calculated by subtracting current liabilities from current assets (US$284 000 – US$124 000). This is an important figure in the statement of financial position. It shows the amount of working capital a business has available. Working capital is the value of liquid resources that can be used to meet the running costs of a business. If a business is short of working capital, it could have cash flow problems.

NON-CURRENT LIABILITIES

Any money owed where repayment is not due for more than one year is called a non-current liability. Examples could include the following.

- A mortgage is a long-term secured loan usually taken out to buy property. It is secured against the value of property so that if the borrower cannot repay the loan, the lender can repossess the property. Dingwall Building Supplies has a US$60 000 mortgage. The value is shown in brackets, which means that it is subtracted (from net current assets in this case).
- Other borrowings is any money that has been borrowed for more than 12 months. Examples might be long-term bank loans, long-term leases or long-term hire purchase agreements. Dingwall Building Supplies does not have any other borrowings.

NET ASSETS

Net assets are the total at the bottom of the first part of the statement of financial position. It is the value of all assets less the value of all liabilities. To calculate net assets add net current assets to non-current assets and then subtract non-current liabilities. The value of net assets for Dingwall Building Supplies is US$540 000.

SHAREHOLDERS' EQUITY

The bottom section of the statement of financial position shows the capital of the business. This is all the money that is owed to the owners. It may also be called shareholders' funds or capital and reserves. It is likely to include the following.

- Share capital is the amount of money that shareholders have put into the business. In this case, shareholders of Dingwall Building Supplies have put in a total of US$100 000.
- Retained profit is the amount of profit that has been kept in the business. It belongs to the shareholders but is not likely to be returned to them while the business is still trading. It may be used in the future to help fund investment. Dingwall Building Supplies had US$395 000 of retained profit in 2015.
- Other reserves includes any other amounts owing to the shareholders not listed in the other two categories. Dingwall Building Supplies has US$45 000 of reserves.

Finally, the very bottom line in the statement of financial position shows the capital employed by the business. This is the amount of money that the owners have invested in the business. For Dingwall Building Supplies it is US$540 000 and is exactly the same as the net assets. In most statements the figures for two years will be given. This helps to make immediate comparisons.

ACTIVITY 2

CASE STUDY: QETTER TOYS

Qetter Toys is a Chinese toy manufacturer. It makes a wide variety of plastic toys, many of which are sold to Western Europe. Table 30.3 shows the statement of financial position for the company. There are three missing figures for 2016.

1. What is the value of **(a)** net current assets, **(b)** share capital and **(c)** plant and equipment for 2016?
2. What is meant by the term inventories in the statement of financial position?
3. What is the difference between current assets and non-current assets?

	2016 US$ MILLION	2015 US$ MILLION
Non-current assets		
Factory	34.65	36.44
Plant and equipment	????	7.34
	43.77	43.78
Current assets		
Inventories	4.56	4.33
Trade receivables	6.99	4.34
Cash	2.11	4.19
	13.66	12.86
Current liabilities		
Trade payables	6.77	6.21
Taxation	2.50	3.00
	9.27	9.21
Net current assets	???	**3.65**
Non-current liabilities		
Mortgage	(5.00)	(5.00)
Net assets	**43.16**	**42.43**
Capital and reserves		
Share capital	????	10.00
Retained profit	33.16	32.43
Capital employed	**43.16**	**42.43**

▶ Table 30.3 Qetter Toys statement of financial position, 31 May 3016

INTERPRETING THE STATEMENT OF FINANCIAL POSITION?

A statement of financial position will show the financial position of a business at a given point in time and can be used to evaluate its performance and potential. It shows the:

- value of all business assets, capital and liabilities
- asset structure of a business, which means how the money raised by the business has been spent on different types of asset
- capital structure of a business, which is an analysis of the different types of funding the business has used
- value of net current assets, which is how much working capital a business has – indicating whether a business has enough liquid resources to pay its immediate bills.

SUBJECT VOCABULARY

goodwill value that a company has because it has a good relationship with its customers and suppliers

A statement of financial position may provide a guide to the value of a business. Generally, the value of the business is represented by the value of net assets. However, this is an approximate value because assets are difficult to value exactly. Also, some businesses have non-physical assets such as goodwill. This is the amount a buyer would be prepared to pay for a business in addition to the net assets.

LARGE VS SMALL BUSINESSES

Many small businesses would not produce a statement of financial position. Indeed, some small business owners may struggle to understand some of the information it contained. However, in most countries very large businesses and limited companies are required to produce a statement of financial position by law. Shareholders and managers may use the statement for the purposes described above.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of a non-current asset?

A Inventories
B Mortgage
C Property
D Cash

▶ 2 If a company's liabilities are £2 399 000 and its assets are £5 800 000. The value of capital will be?

A £5 800 000
B £3 401 000
C £8 199 000
D £8 199 000

▶ 3 Which of the following is an example of a current liability?

A Trade payables
B Trade receivables
C Mortgage
D Cash

▶ 4 The working capital of a business is given by:

A capital employed
B net assets
C non-current assets
D net current assets

CHAPTER REVIEW

CASE STUDY: HASHAN BATHROOM SUPPLIES

Hashan Bathroom Supplies is a chain store operation that sells a wide variety of bathroom fixtures, fittings and accessories in Texas, California and New Mexico. It has several hundred stores and has operated successfully for nearly 50 years. However, in 2016, the business started to run short of working capital. Inventories have built up and the amount owed by customers has risen sharply (more than doubled). Its cash position has also worsened. The statement of financial position for Hashan Bathroom Supplies is shown in Table 30.4.

▶ Table 30.4 Hashan Bathroom Supplies statement of financial position, 31 December 2016

	2016 US$000	2015 US$000
Non-current assets		
Stores	450 000	410 000
Fixtures and fittings	120 000	110 000
	570 000	520 000
Current assets		
Inventories	459 000	299 000
Trade receivables	230 300	109 200
Cash	67 000	166 700
	756 300	574 900
Current liabilities		
Trade payables	560 000	333 300
Taxation	230 000	210 000
	790 000	543 300
Net current assets	(33 700)	31 600
Non-current liabilities		
Borrowings	(300 000)	(350 000)
Net assets	236 300	201 600
Shareholders' equity		
Share capital	100 000	100 000
Retained profit	136 300	101 600
Capital employed	236 300	201 600



▲ Bespoke bathroom in one of Hashan's showrooms

CHAPTER QUESTIONS

1. What is meant by the term capital employed?
2. What is meant by borrowings in the statement of financial position?
3. What is the difference between current assets and current liabilities in the statement of financial position?
4. What is the approximate value of Hashan Bathroom Supplies?
5. Describe two uses that a statement of financial position might have to Hashan Bathroom Supplies.
6. Assess the main financial changes that have taken place over the two years at Hashan Bathroom Supplies.

31 RATIO ANALYSIS

LEARNING OBJECTIVES

- Understand how to calculate and analyse accounting ratios: gross profit margin, operating profit margin, mark-up, return on capital employed (ROCE), current ratio and the acid test ratio
- Understand the concept and importance of liquidity
- Understand how to make comparisons with previous years and/or with other business organisations using ratios

GETTING STARTED

The statement of financial position can show the financial position of a business and the statement of comprehensive income can show how well it has performed. For example, the statement of comprehensive income shows how much profit a business has made and the statement of financial position shows whether a business can pay its bills. Look at the example below.

CASE STUDY: ORIENT PLUS

Orient Plus is a specialist producer of high quality children's clothes. At the end of 2015, the business started to struggle following the arrival of a new competitor. The impact was severe and at the end of 2016 Orient Plus announced that 12 of its 32 design and production staff would be made redundant.

1. What evidence is there to support the view that Orient Plus is starting to struggle?
2. How might the redundancies improve financial performance at Orient Plus?

▼ Table 31.1 Orient Plus statement of comprehensive income, year ending 31 August 2016

	US$ 2016	US$ 2015
Revenue	890 600	1231 500
Cost of sales	302 100	334 100
Gross profit	**588 500**	**897 400**
Administration expenses	254 700	298 700
Other operating expenses	276 400	325 600
Operating profit	**57 400**	**273 100**
Finance costs	59 800	34 000
Profit for the year	(2400)	239 100
Taxation	0	80 500
Profit for the year after taxation	**(2400)**	**158 600**

▼ Table 31.2 Orient Plus extracts from statement of financial position, year ending 31 August 2016

	US$ 2016	US$ 2015
Current assets		
Inventories	129 600	111 400
Trade receivables	412 400	445 200
Cash	12 000	128 900
	554 000	685 500
Current liabilities		
Trade payables	539 700	446 200
Net current assets	**14 300**	**239 300**

WHAT IS RATIO ANALYSIS?

SUBJECT VOCABULARY

ratio analysis mathematical approach to investigating accounts by comparing two related figures

It is possible to look at a statement of financial position and the statement of comprehensive income and to draw some conclusions about the financial position of a business. However, a more precise way is to use ratio analysis. This involves taking key figures from the accounts and calculating financial ratios. There are different types of financial ratios. Two groups that will be examined in this chapter are below.

- **Profitability ratios** measure the performance of the business and focus on profit, revenue and the amount invested in the business.
- **Liquidity ratios** measure how easily a business can pay its short-term debts, such as wages or suppliers.

GROSS PROFIT MARGIN

SUBJECT VOCABULARY

gross profit margin (or mark-up) gross profit expressed as a percentage of turnover

Table 31.3 shows some financial information that has been taken from the accounts of Ecohomes, a builder of environmentally friendly homes in Sweden. The information will be used in this chapter to calculate a number of useful ratios.

The gross profit margin shows the gross profit made on sales revenue. It is calculated using the following formula:

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Revenue}} \times 100$$

For Ecohomes in 2016, gross profit was US$11 000 000 and turnover was US$23 500 000.

$$\text{For 2016, gross profit margin} = \frac{\text{US\$11 000 000}}{\text{US\$23 500 000}} \times 100 = 46.8 \text{ per cent}$$

$$\text{For 2015, gross profit margin} = \frac{\text{US\$8 300 000}}{\text{US\$18 400 000}} \times 100 = 45.1 \text{ per cent}$$

KEY POINT

To increase the gross profit margin, revenue must be increased or cost of sales reduced. The gross profit margin will be different for different industries. For example, firms that sell inventories quickly, such as supermarkets, can operate with lower gross profit margins.

The gross profit margin in 2016 was 46.8 per cent. This means that gross profit was 46.8 cents on sales of US$1. Higher gross margins are better than lower ones. The gross profit margin for Ecohomes has improved slightly over the two years from 45.1 per cent to 46.8 per cent.

▶ Table 31.3 Extracts from the accounts of Ecohomes, 2016

	2016 US$000	2015 US$000
Revenue	23 500	18 400
Cost of sales	12 500	10 100
Gross profit	11 000	8300
Operating profit	4600	3200
Current assets	13 600	11 900
Inventories	4900	5000
Current liabilities	8700	7800
Capital employed	20 000	18 000

OPERATING PROFIT MARGIN

SUBJECT VOCABULARY

operating profit margin operating profit expressed as a percentage of turnover

KEY POINT

Higher margins are better than lower ones. Operating profit margins over 10 per cent would be regarded as very good. The operating profit margin for Ecohomes has improved over the two years. This suggests that the business kept control of expenses more effectively in 2016 than in 2015.

The **operating profit margin** helps to measure how well a business controls its expenses and cost of sales. If the difference between the gross profit margin and the operating profit margin is small, this suggests that expenses are low. The operating profit margin can be calculated by:

$$\text{Operating profit margin} = \frac{\text{Operating profit}}{\text{Revenue}} \times 100$$

For Ecohomes in 2016, operating profit was US$4 600 000 and revenue was US$23 500 000.

$$\text{For 2016, operating profit margin} = \frac{\text{US\$4 600 000}}{\text{US\$23 500 000}} \times 100 = 19.5 \text{ per cent}$$

$$\text{For 2015, operating profit margin} = \frac{\text{US\$3 200 000}}{\text{US\$18 400 000}} \times 100 = 17.4 \text{ per cent}$$

ACTIVITY 1

CASE STUDY: SANTOS METAL PRODUCTS

Santos Metal Products makes metal scaffolding and metal components for the construction industry. In 2013 and 2014, the company received a flood of orders to supply scaffolding to firms involved in construction work for the Rio Olympics in Brazil. Table 31.4 provides a summary of their profits for 2010 to 2014.

▶ Table 31.4 Santos Metal Products operating profit, 2010–14

BRL MILLION	2010	2011	2012	2013	2014
Revenue	12.4	13.8	14.9	19.8	24.1
Gross profit	4.9	5.6	6.1	9.8	12.3
Expenses	3.9	4.4	4.8	7.7	9.7
Operating profit	1	1.2	1.3	2.1	2.6

Look at the revenue figures for Santos Metal Products between 2010 and 2014.

1. How has the company performed?
2. What impact has the flood of orders had on Santos Metal Products?
3. Work out for both years **(a)** gross profit margin and **(b)** operating profit margin.
4. Discuss possible reasons for the changes in question 3 between 2010 and 2014.



▶ Scaffolding

MARK-UP

Some businesses are interested in the profit made per item sold. This is called the mark-up and is calculated by:

$$\text{Mark-up} = \frac{\text{Profit per item}}{\text{Cost per item}} \times 100$$

If Ecohomes sells one of its properties for US$236 000 and the cost of building it was US$200 000, the profit made on the sale would be US$36 000 (US$236 000 – US$200 000). The mark-up is given by:

$$\text{Mark-up} = \frac{\text{US\$36 000}}{\text{US\$200 000}} \times 100 = 18 \text{ per cent}$$

Mark-up is used by some businesses to set its prices. One of the main reasons is that it is a price that guarantees to recover all the costs of production and also generate a profit. For example, if Ecohomes decided that it wanted to make 25 per cent profit (the mark-up) on each property, the price it would have to charge is given by:

Price = cost + (cost × mark-up)

= US$200 000 + (US$200 000 x 25%)

= US$200 000 + US$50 000

= US$250 000

CONCEPT AND IMPORTANCE OF LIQUIDITY

Liquidity is a very important issue for businesses. Liquidity refers to the ease and speed with which assets can be converted into cash. Non-current assets, such as property, plant, machinery and tools are not liquid assets. This is because they cannot be converted into cash very quickly. It may take several months, for example, to sell property. In contrast, current assets are liquid, although some are more liquid than others. Cash is totally liquid and trade receivables are fairly liquid – this is because cash from customers who have bought goods on trade credit is expected to be paid within 90 days. Inventories are the least liquid current asset. This is because the sale of inventories, such as finished goods, cannot be guaranteed by a business, although the expectation is that they will be sold.

If a business does not have enough liquid assets, it may not be able to raise enough cash to pay its immediate bills. A serious lack of liquidity could mean that a business collapses. Two ratios can be used to assess the liquidity of a business: current ratio and acid test ratio.

SUBJECT VOCABULARY

current ratio assesses the firm's liquidity by dividing current liabilities into current assets

CURRENT RATIO

The **current ratio** is a liquidity ratio and focuses on current assets and current liabilities. It is calculated using the formula:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

For Ecohomes, current assets were US$13 600 000 in 2016 and current liabilities were US$8 700 000.

$$\text{For 2016, current ratio} = \frac{\text{US\$13 600 000}}{\text{US\$8 700 000}} = 1.56$$

$$\text{For 2015, current ratio} = \frac{\text{US\$11 900 000}}{\text{US\$7 800 000}} = 1.53$$

SUBJECT VOCABULARY

acid test ratio similar to the current ratio but excludes stocks from current assets (sometimes called the quick ratio)

The current ratio for Ecohomes rose very slightly from 1.53 in 2015 to 1.56 in 2016. It is suggested that a business will have enough liquid resources if the current ratio is between 1.5 and 2. If the ratio is below 1.5, it might be argued that a business does not have enough working capital. This might mean that a business is running short of liquid assets. Operating above 2 may suggest that too much money is tied up unproductively.

ACID TEST RATIO

The **acid test ratio** is a more severe test of liquidity. This is because inventories are not treated as liquid resources. It is not certain that inventories will be sold. Therefore, they are excluded from current assets when calculating this ratio.

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$$

$$\text{For 2016, acid test ratio} = \frac{\text{US\$13 600 000} - \text{US\$4 900 000}}{\text{US\$8 700 000}} = 1$$

$$\text{For 2015, acid test ratio} = \frac{\text{US\$11 900 000} - \text{US\$5 000 000}}{\text{US\$7 800 000}} = 0.88$$

Over the two years, the acid test ratio for Ecohomes has improved slightly from 0.88 in 2015 to 1 in 2016. If the acid test ratio is less than 1, it means that current assets (less inventory) do not cover current liabilities – this might be a problem. However, as with the current ratio, the acid test ratios of businesses in different industries tend to vary. For example, retailers that receive cash for all their sales can often operate effectively with much lower acid test ratios than, say, manufacturers that offer trade credit to customers.

ACTIVITY 2

CASE STUDY: COMPARING ASSETS AND LIABILITIES

Patel's operates a national car dealership in India. It has over 60 outlets, mainly in southern and central India. UZZY Plastics manufactures over 300 000 tonnes of polythene products, including plastic bags and bottles, a year. Table 31.5 shows current assets and current liabilities for the two companies.

▶ Table 31.5 Comparison of assets and liabilities

	PATEL'S		UZZY PLASTICS	
	2016 Rs MILLION	2015 Rs MILLION	2016 Rs MILLION	2015 Rs MILLION
Inventories	42 481	81 559	59 500	55 300
Other current assets	20 074	49 615	60 500	64 100
Total current assets	62 555	131 174	120 000	119 400
Current liabilities	53 757	136 531	68 300	75 500

1 Calculate for both companies and for both years the **(a)** current ratios and **(b)** acid test ratios.
2 Which is the more liquid of the two companies?

RETURN ON CAPITAL EMPLOYED (ROCE)

SUBJECT VOCABULARY

return on capital employed (ROCE) profit of a business as a percentage of the total amount of money used to generate it

One of the most important profitability ratios is the **return on capital employed (ROCE)**. It compares the profit (return) made by the business with the amount of money invested (its capital). The advantage of this ratio is that it links profit to the size of the business. ROCE can be calculated using the formula:

$$\text{ROCE} = \frac{\text{Operating profit}}{\text{Capital employed}} \times 100$$

The operating profit for Ecohomes in 2016 was US$4 600 000. Capital employed was US$20 000 000. (If not stated directly, the capital employed of a business is the value of capital and reserves plus any non-current liabilities.)

$$\text{For 2016, ROCE} = \frac{\text{US\$4 600 000}}{\text{US\$20 000 000}} \times 100 = 23 \text{ per cent}$$

$$\text{For 2015, ROCE} = \frac{\text{US\$3200 000}}{\text{US\$18 000 000}} \times 100 = 17.8 \text{ per cent}$$

The ROCE will vary between industries. Over the two years, Ecohomes has seen its ROCE increase from 17.8 per cent to 23 per cent. These are good returns on capital if compared with the rate of interest at this time. Rates were often less than 1 per cent on bank deposits in 2016. However, it must be remembered that investing money in business is more risky compared with leaving it in a bank.

USING RATIOS TO MAKE COMPARISONS

Ratios can be used to assess the performance and the liquidity of a business at a particular point in time. They can also be used to monitor the progress of a business over time. The statement of comprehensive income and, the statement of financial position, both show the figures for the current financial year and the previous financial year. This means that ratios can be calculated and compared immediately. For example, the ROCE for Ecohomes, calculated above, in 2015 is 17.8 per cent in 2015 and 23 per cent in 2016. This shows immediately that performance has improved significantly. It is also possible to track the historic performance of a business over a period of time, for example, by comparing the ratios over, say, five years. Financial analysts looking to invest funds in companies might do this.

Ratios can also be used to make comparisons between businesses in the same industry. This will help to judge the performance of a business compared to its closest rivals. For example, in 2015 the operating profit margins for Ford and Honda were 6.8 per cent and 5 per cent, respectively. This suggests that in 2015 Ford performed better than Honda according to this particular measure of performance. However, care is required when using ratios to compare the performance of different companies at a particular point in time. There may be a number of reasons why the ratios are different. For example, Ford and Honda might have quite different product lines, they might have invested very different amounts in research and development in that particular year or they may have spent a huge amount launching a new car in a new market.

LARGE VS SMALL BUSINESSES

Most small business owners are unlikely to use ratio analysis. They may not be aware of the method and they may not have access to the information needed to perform ratio analysis (for example, they may not produce accounts for their business). However, many small businesses will understand how profit margins can be applied. Small businesses might have specific margins that they want to achieve, for example. Finance departments in larger businesses are likely to use ratio analysis. They may be required to analyse the performance and financial position of the business in much more detail on behalf of the shareholders, for example.

MULTIPLE-CHOICE QUESTIONS

1 Gross profit is equal to which of the following?
- A Operating profit + Revenue
- B Revenue – Cost of sales
- C Revenue – Operating profit
- D Revenue + Cost of sales

2 A business is likely to have sufficient working capital if the current ratio lies between which of the following?
- A 0 and 1
- B 1 and 2
- C 1.5 and 2
- D 2 and 3

3 If revenue = US$500 000 and operating profit = US$100 000, the operating profit margin will be?
- A 20 per cent
- B 10 per cent
- C 5 per cent
- D 500 per cent

4 The ROCE is given by which formula?
- A Gross profit ÷ Revenue × 100
- B Operating profit ÷ Capital employed × 100
- C Operating profit ÷ Revenue × 100
- D Current assets ÷ Current liabilities

CHAPTER REVIEW



▲ A ship transporting oil

CASE STUDY: AL-DHABIT SHIPPING

The Al-Dhabit family in Oman owns Al-Dhabit Shipping. Its main business is the transportation of oil. In 2014, a drop in demand hit the company when the price of oil fell very sharply. The owners injected US$2 million to help the business survive. Some financial information for the company is shown in Table 31.6.

	2013 US$ MILLION	2014 US$ MILLION	2015 US$ MILLION
Revenue	12.5	9.6	11.9
Operating profit	1.13	0.34	1.17
Current assets	3.21	2.59	3.99
Current liabilities	2.16	2.55	2.43
Capital employed	10	12	12

▶ Table 31.6 Al-Dhabit Shipping financial information, 2013–15

CHAPTER QUESTIONS

The return on capital employed is a performance ratio.

1 What is meant by this?

2 Work out **(a)** operating profit margin **(b)** current ratio **(c)** ROCE for Al-Dhabit Shipping in each of the three years.

3 Discuss the benefit of using ratios to compare the performance of a business over a period of time.

4 Assess the performance of the Al-Dhabit Shipping between 2013 and 2015. Make a clear judgement in your evaluation.

32 THE USE OF FINANCIAL DOCUMENTS

LEARNING OBJECTIVES

- Understand how to use financial documents to assess the performance of a business
- Understand how to use financial documents to inform decision making

GETTING STARTED

One reason why businesses produce financial documents is because they provide useful information to help assess business performance. Documents can also be used to help make decisions. A company's stakeholders might use the documents. However, different stakeholders may look at the documents for different reasons. For example, a bank may look at accounts when deciding whether or not to lend a business some money. Employees may look at accounts to see whether a business can afford a pay rise. Look at the examples below.

CASE STUDY: O'JAR BUILDING SUPPLIES

O'Jar Building Supplies produces building materials for the construction industry. In 2016, the company began looking for a new supplier of calcium silicate, an important raw material. A suitable supplier was found but the supplier would not supply goods on credit until it had looked at the company's accounts. The new supplier was particularly interested in the amount of working capital (net current assets) O'Jar Building Supplies had. The Table 32.1 shows some financial information for the business between 2012 and 2015.

▶ Table 32.1 O'Jar Building Supplies financial information, 2012–15

	2012 €	2013 €	2014 €	2015 €
Current assets				
Inventories	128 500	132 900	123 700	121 200
Trade receivables	78 500	86 400	78 500	65 800
Cash	12 800	13 900	4800	300
Total	219 800	233 200	207 000	187 300
Current liabilities				
Trade payables	132 100	134 300	143 100	165 400
Other creditors	22 100	14 300	25 200	27 600
Total	154 200	148 600	168 300	193 000

CASE STUDY: PARK FARM FOODS

Park Farm Foods is a small chicken meat company in South Africa. Marcus van Zyl owns the company, which supplies restaurants and retailers. However, owing to increasing competition from cheap imports, profit has fallen in recent years. He has decided that if the farm does not make a profit of ZAR 500 000 in 2016, he will retire from farming. Table 32.2 shows the statement of comprehensive income for the business in 2016.

▶ Table 32.2 Park Farm Foods statement of comprehensive income, year ending 30 June 2016

	2016 ZAR	2015 ZAR
Revenue	4 568 000	4 718 000
Cost of sales	3 118 000	3 193 000
Gross profit	**1 450 000**	**1 525 000**
Administrative expenses	769 000	761 000
Other operating expenses	230 000	220 000
Operating profit	**451 000**	**544 000**
Finance costs	250 000	200 000
Profit for the year	**201 000**	**344 000**

1. Which stakeholder is interested in the financial information in Table 32.1?
2. What conclusion might the stakeholder in question 1 draw from the information shown in the statement?
3. How will Marcus van Zyl use the statement of comprehensive income shown in the statement of comprehensive income to make an important decision?
4. Obtain the accounts of two large businesses in your area and compare their performance. (The accounts of PLCs can be obtained very quickly online.)

USING FINANCIAL DOCUMENTS TO ASSESS THE PERFORMANCE OF A BUSINESS

One of the main reasons why businesses produce accounts is to assess business performance. A number of stakeholders may be interested in the statement of financial position and the statement of comprehensive income. However, their interest may be for slightly different reasons.

MANAGERS AND EMPLOYEES

Managers will want to assess the performance of the company. The profit made by the business will be a reflection of their own performance. For example, if the company does well they may be in a position to ask the owners for higher rewards. Managers might also make comparisons with competitors to see how their performance compares with that of rivals. Managers might be more motivated if they see that their company is performing better.

Employees might need financial information during wage negotiations. Information about profit and the prospects of the business could be used to decide whether it can afford to meet a wage claim. For example, if the statement of comprehensive income shows that profits have increased significantly, employees will be in a stronger position to demand a wage increase. They may also look at accounting information to see whether their jobs are secure.

OWNERS AND SHAREHOLDERS

Owners of small businesses will obviously be interested in the performance and the financial position of the business. For example, a sole trader might look at the profit to see if targets have been met for the year. In 'Getting started' above, Marcus van Zyl used the statement of comprehensive income to decide whether it was worth continuing with the business. He set a profit target that the business needed to meet in order to retain his interest.

Shareholders in limited companies will also be interested in the performance of the business. They may look at the size of dividends. They may use ratio analysis to see how their investment is performing and make comparisons with other companies in which they could invest. The financial documents will also show whether the business has grown. Investors often prefer to invest in growing companies.

EXTERNAL STAKEHOLDERS

Banks need up-to-date financial information when deciding whether to lend money to a business. Banks will look at the accounts to see whether a business can repay the loan with interest. They will tend to focus on the amount of working capital a business has and whether it already has any large debts. Banks often want to look at accounts from several years of trading. They may look for patterns and trends in a firm's trading history.

Suppliers will want to assess the creditworthiness of businesses that buy resources from them using trade credit. A supplier is likely to carry out a credit search before granting such credit. Suppliers can use accounts to see whether new customers are a good risk. In 'Getting started' above, Cork Building Supplies wanted to buy some goods on credit. However, the supplier wanted access to financial information to look at the firm's ability to pay its debts before making any deliveries.

The accounts of public limited companies are published and help to inform shareholders about the progress and performance of the company. They are also used by potential investors and financial analysts to help make decisions when buying shares. Financial institutions, such as insurance companies and pension funds, invest huge amounts of money in shares so they are likely to examine financial documents very carefully.



▲ Lab work at a pharmaceuticals company

ACTIVITY 1

CASE STUDY: BIBBLINGTON PHARMACEUTICALS

Bibblington Pharmaceuticals produce drugs and medicines for the South East Asian markets. The shareholders expect a 10 per cent return on capital employed. They use the accounts each year to check whether this target has been achieved. Table 32.3 shows some financial information for Bibblington Pharmaceuticals, which has been taken from the accounts.

	2013	2014	2015	2016
Revenue (US$ million)	45.66	47.85	79.41	47.11
Operating profit (US$ million)	3.98	4.12	4.1	3.16
Return on capital employed (%)	11.10	11.40	10.90	8.30

▶ Table 32.3 Bibblington Pharmaceuticals financial information, 2013–16

1 What is the main reason why the owners of Bibblington Pharmaceuticals use accounts?
2 Discuss whether Bibblington Pharmaceuticals has reached the targets set by the shareholders over the time period shown.

USING FINANCIAL DOCUMENTS TO INFORM DECISION MAKING

SUBJECT VOCABULARY

quantitative information information expressed in numbers

Businesses will make better-informed decisions if they have access to financial documents. Since financial documents contain quantitative information, they can be very helpful in the decision-making process. For example, managers may need up-to-date financial information to help run the business and make key decisions, such as those outlined below.

FUNDING DECISIONS

Access to relevant financial information can help to predict when more money will be needed by a business. For example, details of current assets and current liabilities can be used to calculate liquidity ratios to see whether the business needs to raise short-term funding to boost working capital. Also, if the business is planning to expand, it can use the statement of financial position to see which type of funding might be most appropriate. For example, if the statement of financial position shows that the business already has high levels of non-current liabilities, it may be more appropriate to raise funds by selling more shares. Alternatively, if there are high levels of cash resulting from the build up of retained profit, this might be used to fund expansion.

REDUCING COSTS

A business might use the statement of comprehensive income to analyse costs. For example, by comparing the gross profit margin and the operating profit margin over a time period, a business can assess whether costs are under control. If the gross profit margin is rising and the operating profit margin is falling, this would suggest that business expenses are increasing. Therefore, managers might examine the different costs to help identify problems.

INCREASING PROFITABILITY

It may be possible to use the accounts to help find ways of making more profit. For example, if the gross profit margins are small in relation to competitors, it may be because prices are too low or cost of sales is too high. Therefore, prices can be raised or new suppliers might be found for raw materials and other key resources. Perhaps wage costs need to be controlled more tightly. Profitability might also be improved if revenues are falling behind those of competitors. For example, perhaps a business should try to find new markets to help increase sales – overseas, for example.

INVESTMENT DECISIONS

Investment decisions are risky and uncertain because a business can never know for sure whether an investment project will generate returns in the future. The future is very difficult to predict. However, information in financial documents might help managers to assess whether a business is strong enough to take risks. For example, if the statement of financial position shows that a business has high levels of cash and modest levels of debt, this suggests that investing in new ventures might be appropriate.

OTHER USERS OF FINANCIAL DOCUMENTS

SUBJECT VOCABULARY

excise duties taxes on selected goods, such as those on petrol and tobacco in the UK

auditing accounting procedure that checks thoroughly the accuracy of a company's accounts

GOVERNMENT

Many governments gather business and financial information. This is made available to the public. Some of the data is taken from accounts. The government uses the information to monitor the progress of the economy and help evaluate the success of its economic policies. People doing research may also use the information.

COMPETITORS

Limited company accounts are available to the public. Therefore, competitors can analyse them to make comparisons. Also, if a competitor is thinking about a takeover, it can use the information to help make a decision.

THE MEDIA

Television, online media companies and radio often produce reports on business and commerce. There are also specialists that focus on business information, for example, the *Financial Times* newspaper in the UK.

TAX AUTHORITIES

The tax authorities may require details of income when working out how much tax businesses and their owners must pay. Accounts can be used to provide details of income. The authorities may require access to business accounts when calculating VAT and **excise duties** owed by businesses.

AUDITORS

Every year, the accounts of limited companies have to be checked by an independent firm of accountants and registered auditors. The process of checking the accuracy of accounts is called **auditing**.

REGISTRAR OF COMPANIES

In many countries, limited companies have to register with a registrar of companies. One of the conditions of registration is that they submit a copy of their final accounts every year. These accounts are available to the general public.

LARGE VS SMALL BUSINESSES

Many small businesses do not produce, and very small companies are exempt from producing, a full set of accounts so they would not be available for use. To assess the performance of their business, a small business owner may look at the amount of profit made for the year, which can be calculated accurately by an accountant. However, once a business is large enough to produce accounts (or if it trades as a limited company when they are required), the documents are likely to be used for the purposes described above.

MULTIPLE-CHOICE QUESTIONS

▶ 1 The owners of a business may use financial documents to assess a company's?
- A Current assets
- B Profitability
- C Market share
- D Cash flow position

▶ 2 A bank may use a company's financial documents to help assess?
- A Labour turnover
- B Growth potential
- C Creditworthiness
- D Product quality

▶ 3 The authenticity of financial documents is checked by?
- A Suppliers
- B Shareholders
- C Auditors
- D Local authorities

▶ 4 Financial documents might be used to help a business make decisions about which of the following?
- A Funding
- B Marketing strategies
- C Remuneration methods
- D Effect of changes in exchange rates on the business

CHAPTER REVIEW

CASE STUDY: VARL TOWN POOLS

Varl Town Pools is a swimming pool construction and maintenance company based in Queensland, Australia. Although the company is well established, it has started to struggle as a result of new competition in the area. In an effort to improve competitiveness, Varl Town Pools has lowered the prices of its maintenance services and taken on some construction work at a loss in 2016. Tables 32.4 and 32.5 show the statement of comprehensive income and statement of financial position, respectively, for Varl Town Pools.

▶ Table 32.4 Varl Town Pools statement of comprehensive income, year ending 31 December 2016

	2016 A$000	2015 A$000
Revenue	45 600	49 800
Cost of sales	25 100	21 400
Gross profit	**20 500**	**28 400**
Administrative expenses	18 700	15 700
Other operating expenses	3200	2700
Operating profit	**(1400)**	**10 000**
Finance costs	2000	1500
Profit for the year	**(3400)**	**8500**
Taxation	100	1600
Profit for the year after taxation	**(3500)**	**6900**



▲ Swimming pool

▶ Table 32.5 Varl Town Pools statement of financial position, year ending 31 December 2016

	2016 A$000	2015 A$000
Non-current assets	2300	2300
Property	4800	5000
Plant and equipment	7100	7300
Current assets		
Inventories	3800	3000
Trade receivables	4800	4600
Cash	1200	5300
	9800	12 900
Current liabilities		
Trade payables	5100	4300
Taxation	100	1600
	5200	5900
Net current assets	**4600**	**7000**
Non-current liabilities		
Borrowings	(1900)	(1000)
Net assets	**9800**	**13 300**
Shareholders' equity		
Share capital	3000	3000
Retained profit	6800	10 300
Capital employed	**9800**	**13 300**

CHAPTER QUESTIONS

1. Describe one reason why employees at Varl Town Pools might be interested in the financial documents shown in the tables above.
2. Discuss two ways in which Varl Town Pools might use financial documents to make decisions.
3. Assess the performance of Varl Town Pools between 2015 and 2016. Make a clear judgement in your evaluation.

EXAM PRACTICE: 3 BUSINESS FINANCE

West Point Pty. Ltd manufactures a range of beds, which it sells to retailers in New South Wales, Australia. An extract from its statement of comprehensive income is shown in the table below.

	A$000s
Revenue	14 200
Cost of sales	9000
Gross profit	5200

AO1 **a** Define the term '**cost of sales**'. **(1)**

AO2 **b** Calculate the gross profit margin for West Point in 2016. **(2)**

AO2 **c** Outline **one** reason why West Point might produce a statement of comprehensive income. **(2)**

SKILLS PRODUCTIVITY

AO2 **AO3** **d** Analyse the importance of cash to West Point. **(6)**

West Point has experienced financial difficulties in recent months and wants to improve its cash flow. Two options have been identified.

Option 1: Take out a bank overdraft
Option 2: Make more use of trade payables

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO2 **AO3** **AO4** **e** Justify which one of these two options West Point should choose. **(9)**

Total marks for this question = 20


6
5
3
2

4 MARKETING

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

The success of a business can be influenced by the quality of its marketing and how elements in the marketing mix are combined. In this section, the purpose and methods of market research are explored. The importance of responding to changes in the market, how businesses use segmentation to target customers and how products are developed and managed are addressed. There is also coverage of the pricing strategies used by businesses, how they organise distribution and the various ways in which different businesses promote their products and organisations.

33 MARKET RESEARCH

LEARNING OBJECTIVES

- Understand the purpose of market research: to identify and understand customer needs, to identify gaps in the market, to reduce risk and to inform business decisions
- Understand the methods of primary market research: survey, questionnaire, focus group, observation and test marketing
- Understand the methods of secondary research: Internet, market reports and government reports
- Understand the use of data in market research: qualitative and quantitative data, the role of social media in collecting market research data and the importance of the reliability of market research data

GETTING STARTED

Marketing involves a range of activities that help businesses to sell products. One of the most important marketing activities is gathering information. Businesses have to find out what customers need and want. This will help them to design products that people will buy. Information is also needed about the market. Businesses need to find out about their competitors, what sorts of people buy the product and the size of the market. Look at the example below.

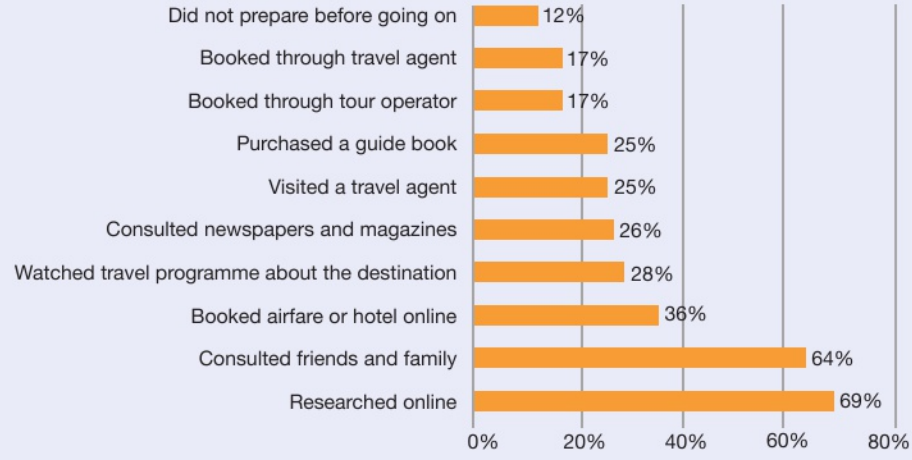
CASE STUDY: TOURISM IN SRI LANKA

A 26-year civil war, which finally ended in 2009, and the huge destruction of the 2004 Tsunami have had a negative impact on the numbers of tourists visiting Sri Lanka. Recently though, Sri Lanka has recovered as a tourist destination and, in 2015, a total of 1 798 410 tourists visited the country. The tourism industry has been growing fast and Sri Lanka is regarded as a top 'up-and-coming' destination. Figure 33.1 shows the number of tourist arrivals in Sri Lanka in 2015 and 2016.



▶ Figure 33.1 Tourist arrivals in Sri Lanka, 2016 and 2017

As a tourist destination, Sri Lanka provides a diverse range of attractions. It offers beautiful beaches, a rich culture, an interesting history, a wide range of different accommodation, a vibrant city in Colombo and unique dining experiences. Sri Lanka also appeals to those seeking adventure with its jungle, rich biological diversity and wildlife (Sri Lankan fauna includes leopards and elephants). A survey shows that adventure travel has been growing at over 65 per cent a year since 2009. It is now a US$263 000 million industry worldwide, and still growing. Figure 33.2 shows how adventure seekers prepared for their last trip.



▶ Figure 33.2 How adventure travellers prepared for their last trips

1 What was the size of the Sri Lankan tourist market in 2015?
2 What is expected to happen to the size of this market in 2016?
3 How might a tour operator selling adventure holidays in Sri Lanka use the information in Figure 33.2?
4 In groups, discuss what other information might be useful to a European tour operator selling holidays to Sri Lanka. List your results on a poster and present them to the rest of the class.

PURPOSE OF MARKET RESEARCH

SUBJECT VOCABULARY

market research collection, presentation and analysis of information relating to the marketing and consumption of goods and services

GENERAL VOCABULARY

consumption act of buying and using products
durability staying in good condition for a long time, even if used a lot

Market research involves gathering, presenting and analysing information regarding the marketing and **consumption** of goods and services. Market research can be expensive but businesses are prepared to meet the cost because of the benefits it brings. What are the main purposes of market research?

TO IDENTIFY AND UNDERSTAND CUSTOMER NEEDS

A business will be more successful if it can supply products that meet customers' needs. This means that a business has to gather information to identify these needs. For example, a vacuum cleaner manufacturer will need to find out which product features are important to potential customers. These might include:

- model design and style
- colour
- **durability**
- efficiency/performance
- ease of handling
- ease of storage.



▲ A vacuum cleaner

GENERAL VOCABULARY

anticipate to expect that something will happen and be ready for it

SUBJECT VOCABULARY

untapped supply, market or talent that is available but has not yet been exploited

Once this data has been gathered, a business can design a product that meets the specific needs of customers. The data gathered by market researchers needs to be as detailed as possible.

If possible, businesses need to **anticipate** customer needs. This means they try to predict what customers want in advance and respond to changes very quickly. Businesses operate in a rapidly changing environment and have to keep up with the latest trends, fashion, technology and design.

TO IDENTIFY GAPS IN THE MARKET

If a business can spot a gap in the market it is likely to gain a competitive edge for a while. It may be able to generate higher levels of revenue and profit before a competitor arrives. Finding **untapped** markets is not easy but gathering information from people might help. For example, market research data might identify a problem that sufficient people are having that requires a solution in the form of a new product. People will nearly always look for better, faster and smarter ways to complete everyday tasks. New apps might fill such gaps. For example, mapping apps help to solve the problem of finding your way in unfamiliar areas. Many apps are designed to speed up access to a range of services. This saves time for people, which is valued.

TO REDUCE RISK

Setting up a business or launching a new product is risky. As markets get larger, and as competition gets fiercer, launching new products becomes even riskier. The likelihood of failure is high but investment in effective market research can help reduce the risk of failure. There are many examples of costly product failures that may have resulted from misreading the market or failing to carry out effective market research. One such product is the Amazon Fire Phone. Amazon, which has a very powerful brand name, launched the Fire Phone in 2014. However, about a year later it was removed from the market. Sales did not meet expectations and it cost the company at least US$170 million. The mobile phone market is highly competitive, making it difficult for new products. Some customers also felt that the phone's design was too focused on the sale of Amazon's own services and that the price was wrong.

TO INFORM BUSINESS DECISIONS

Businesses have to make countless decisions and generally the quality of decision making can be improved if managers have access to meaningful information. Market research can provide a wide range of information that could be used to improve decision making – particularly when making marketing decisions. For example, one of the most important decisions made by a business is what price should be charged for a product. Look at the example in the box.

PRICING DECISION

A business was considering a price cut to boost sales volume and revenue. The current price was US$10 per unit and current sales were 1 500 000 units. It carried out some research to find out how consumers would react to a 20 per cent reduction in price to US$8 per unit. After interviewing a sample of 1000 customers, it discovered that sales would increase by 12 per cent. The effect on total revenue of the planned price cut is shown below.

When P = US$10, TR = US$10 × 1 500 000 = **US$15 000 000**

When P = US$8, TR = US$8 × 1 680 000 (1 500 000 + 12 per cent) = **US$13 440 000**

Consequently, the business found out through market research that the planned price reduction would reduce revenue from US$15 000 000 to US$13 440 000. As a result, the plan was abandoned and a drop in price avoided.

METHODS OF PRIMARY RESEARCH

Businesses use primary or field research to gather information that does not already exist. It involves collecting new information from new sources. Primary data is usually gathered by asking questions or observing people's behaviour. The main advantage of primary research is that it is original and the information gathered can be adapted to the needs of the business. However, conducting primary research is often time consuming and expensive. Some businesses employ a *market research agency* to carry out research. Agencies are experts in gathering, presenting and analysing information. However, they may be too expensive for many businesses. Some of the main methods of gathering primary data are discussed briefly below.

SUBJECT VOCABULARY

primary or field research gathering of 'new' information that does not already exist

QUESTIONNAIRES

A questionnaire is a list of written questions. They are very common in market research and are used to record the views and opinions of *respondents*. A good questionnaire will have the following features.

- A balance of *open* and *closed* questions. Closed questions allow respondents a limited range of responses. An example would be: 'How many times have you flown with Emirates this year?' The answers to closed questions are easier to analyse mathematically. Open questions let people say whatever they want. They do not have to choose from a list of responses. Open questions are best used if there is a large number of possible responses. An example would be: 'How would you improve the quality of the service provided by Emirates?'
- Contain clear and simple questions. Questions must be clear, avoiding the use of jargon, poor grammar and bad spelling.
- Not contain leading questions. Leading questions are those that 'suggest' a certain answer. They should be avoided because otherwise the results will be biased. An example of a leading question would be: 'Do you have any problems with this product?'
- Be short. If questionnaires are too long people may be reluctant to answer them, or may stop part way through.

GENERAL VOCABULARY

jargon words and expressions used in a particular profession or by a particular group of people, which may be difficult for other people to understand

Questionnaires can be used in different situations.

- **Postal surveys:** Questionnaires are sent out to people by letter and they are asked to complete them in their own time. They may be more convenient for people but the majority of questionnaires are never returned. This means that resources are wasted.
- **Telephone interviews:** The main advantage of interviewing people over the telephone is that it is cheaper. A wide geographical area can also be covered. However, some people do not like being phoned by businesses.
- **Personal interviews:** These are often carried out in the street or on the doorstep, and the interviewer fills in the answers. The advantage is that

questions can be explained if a respondent is confused. It may be possible to collect more detailed information. However, many people do not like being approached in the street.

- **Online surveys:** As access to computers increases around the world, so does the use of online surveys. These are similar to postal surveys except respondents may be directed to a questionnaire, after receiving an email confirming an online transaction, for example.

SUBJECT VOCABULARY

consumer panels groups of customers are asked for feedback about products over a set period

FOCUS GROUPS OR CONSUMER PANELS

If a business wants very detailed information from customers it might use *focus groups* or consumer panels. A focus group is where a number of customers are invited to attend a discussion led by market researchers. The group must be representative of the whole population and be prepared to answer detailed questions. This is a relatively cost-effective method of collecting information but the group may be small so generalising from the results may not be reliable.

DID YOU KNOW?

Online surveys may be more sophisticated because they can use a wider range of images. They are cheaper to administer and can be made available to respondents 24/7. However, many people still ignore them.

OBSERVATION

This is where market researchers 'watch' the behaviour of customers. This approach might be used in retail outlets. Observers might record the amount of time customers spend looking at particular products and displays in the store. However, because there is no feedback using this method a lot of questions may go unanswered. The observers do not ask customers to explain reasons for their behaviour

TEST MARKETING

This involves selling a new product in a restricted geographical area to test it and sales levels before a national launch. After a set period, feedback is gathered from customers. The feedback is used to modify the product before the final launch. This reduces the risk of failure.

GENERAL VOCABULARY

random happening or chosen without any definite plan, aim or pattern

ACTIVITY 1

CASE STUDY: MANZINI SAFARI TOURS

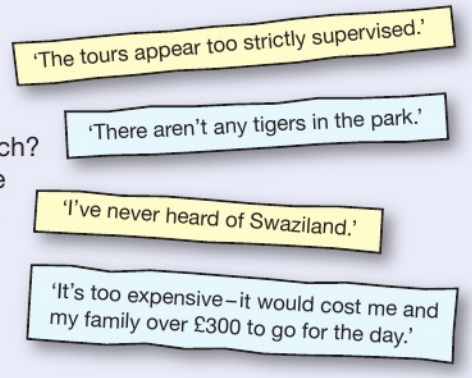
Manzini Safari Tours supervises trips around the Mlilane Wildlife Sanctuary in Swaziland. Animals found in the park include antelope, crocodile, giraffe, hippo, zebra and a variety of birdlife. Walking, cycling and horse riding is allowed in the reserve and there are many vehicle and walking trails. However, visitor numbers to the park fell from 21 400 in 2014 to 9400 in 2015. A survey was carried out by Manzini Safari Tours using telephone interviews. One thousand telephone numbers were chosen at random from a list of potential customers provided by a research agency. Figure 33.3 shows the answers to five key questions from the survey and Figure 33.4 shows a selection of comments made by the people interviewed.

1. Have you ever been on a Manzini Safari Tour?
   YES 7% NO 93%
2. Have you ever been on any other safari tour?
   YES 61% NO 39%
3. Would you go on a Manzini Safari Tour if it was cheaper?
   YES 44% NO 56%
4. Have you seen any adverts for the Manzini Safari Tours?
   YES 7% NO 93%
5. Would a holiday in Swaziland appeal to you?
   YES 46% NO 54%

▶ Figure 33.3 Answers to five questions from the survey

Figure 33.4 Comments made by some of the people surveyed

Manzini Safari Tours has used primary research to gather information.



1. What is meant by primary research?
2. Describe one advantage and one disadvantage of using telephone surveys.
3. What is the difference between open questions and closed questions in a survey?
4. Look at the data for Manzini Safari Tours and suggest reasons why the number of visitors has fallen in recent years. Give at least two reasons in your analysis.

METHODS OF SECONDARY RESEARCH

SUBJECT VOCABULARY

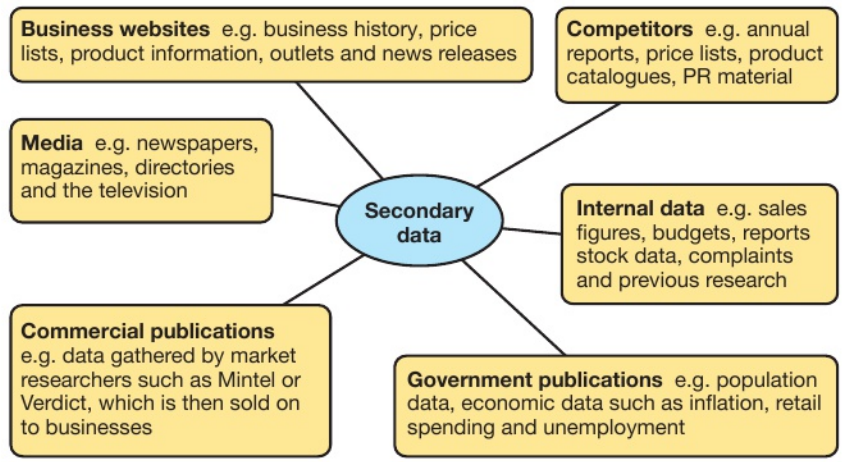
secondary or desk research collection of data that already exists

qualitative data information about attitudes, beliefs and intentions, usually written in words

Businesses use **secondary or desk research** to collect information that already exists. It has been collected by someone else and may be available for other users. The information collected may be *internal*, which means that it already exists inside the business. It may also be *external*, which means it exists outside the business. Figure 33.5 shows some different sources of secondary data.

Secondary research is quicker and easier to gather. For example, internal data may be immediately available on internal company networks. Also, a lot of external data is available online. However, the main problem with desk research is that the data collected might not be exactly what the business needs. It may also be out of date and therefore inaccurate.

Figure 33.5 Different sources of secondary data



QUALITATIVE AND QUANTITATIVE DATA

Some of the data gathered by market researchers is **qualitative data**. This means that the information is about the attitudes, beliefs and intentions of consumers. It is usually written down in words or recorded – in a video clip, perhaps. Focus groups, interviews and social media can be used to gather qualitative data. Consumer messages on social media about a new product in the market would be an example of qualitative data. Although qualitative data can be quite detailed, which is useful, it is also open to many different

SUBJECT VOCABULARY

quantitative data information that can be quantified, that is, expressed in numbers

interpretations. This means that there may be disagreements within a business about the usefulness of qualitative research. It is less easy to analyse statistically than quantitative data.

Quantitative data is expressed in numbers and can be measured. This usually means that market researchers collect statistical data, such as sales figures and market share. Surveys and government publications are common sources of quantitative data. Quantitative data is often easier to gather, process and present to readers. It is also regarded as being open to less interpretation than qualitative data.

ROLE OF SOCIAL MEDIA IN COLLECTING MARKET RESEARCH DATA

Social media is playing an increasing role in marketing. Businesses use social media platforms and blogs to gather information. Social media can provide a cheap way of gathering information about a firm's customers, market, brand appearance and other market issues. For example, most social media platforms offer numerous ways to analyse trends and conduct market research. By searching the latest posts and popular terms, it is possible to gain some understanding of emerging trends and see what customers are talking about in real time. One example of this is conducting hashtag searches. By setting up a few searches with hashtags related to a specific brand, industry or product, instant notifications can be received when customers, clients or competitors use key terms. Quite often the interaction is not led by businesses; they can simply observe or join in as an equal. This can result in a variety of answers and discoveries that might have remained hidden using other research methods. Table 33.1 summarises the advantages of using social media for market research.

▶ Table 33.1 Advantages of using social media for market research

Broad reach	It can reach millions of people all around the world.
Ability to target	It allows specific groups of people to be targeted.
Free or low-cost	It may be free for business and paid options are usually cheap.
Personal	It allows communication on a personal basis with individual customers and groups.
Fast	Information can be collected very quickly from large numbers of people.
Easy	High-level IT skills and complex equipment are not needed.



▲ Nescafé products

ACTIVITY 2

CASE STUDY: NESCAFÉ

Nestlé is a very large multinational company based in Switzerland. It sells over 2000 brands in 189 different countries and employs 335 000 people in 436 factories. One of its high profile brands is Nescafé, the instant coffee. In 2015, Nescafé became the first global brand to transfer all of its websites to the Tumblr platform. Tumblr, which employs around 400 people, is a microblogging and social media platform that allows users to share information. People can post text, photos, quotes, links, music and videos from their phones, laptops, tablets and email, and from wherever they may be. Tumblr claims that it hosts around 353.3 million blogs and 150 300 million posts a year.

One of the main reasons for the switch was to build stronger relationships with younger consumers. Using the Tumblr platform will allow Nescafé to develop consumer-led communications and gather useful information about the attitudes, beliefs and intentions of customers. Over the last six months, Nescafé says the Tumblr websites have generated an extra US$200 000 in sales. Users can make instant purchases by clicking on to 'buy now buttons'. Also, total monthly visits have risen by 29 per cent and users are now staying 18 per cent longer per visit.

Nescafé uses Tumblr to gather qualitative data.

1 What is meant by qualitative data?
2 Assess the benefits to Nescafé of using social media to help gather information from consumers.

IMPORTANCE OF THE RELIABILITY OF MARKET RESEARCH DATA

Although carrying out market research can reduce the risk of products failing in the market, it is important to ensure that the data gathered is reliable. If market research data is inaccurate or out of date, any decisions based on the data are likely to be unsound. The reliability of market research data often depends on the number of people questioned and whether they represent the views of everyone. Ideally, information could be gathered from every single person in a market. However, this would take too long and cost too much money. To overcome this problem, businesses use a sample of people. A sample is a much smaller group, however, so the behaviour and views of the sample must be representative of all the people in the market, otherwise the data will be biased and unreliable.

SUBJECT VOCABULARY

sample small group of people, which must represent a proportion of a total market when carrying out market research

A business should also appreciate that human behaviour is unpredictable. Although people may indicate their intentions in a questionnaire, what they do in reality might be quite different. People might change their minds or misunderstand the question. They might also give answers that they think the interviewers wanted to hear. Finally, if questionnaires are poorly designed or interviewers have not been trained, the quality of the research carried out might be poor. These issues must be addressed to ensure the reliability of data.

LARGE VS SMALL BUSINESSES

Market research may be important for businesses of all sizes. However, small businesses are likely to use cheaper methods of research or carry out the task informally – such as 'chatting to customers'. Large businesses may spend considerably more on market research. This may be because they have more resources or they need to access to some important and specific information. Large businesses also have more to lose if they 'misread' the market.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of quantitative data?

A Our market share is 14 per cent
B I like the product because it is reliable
C The product is packaged very attractively
D I would buy the product if it was available online

▶ 2 One purpose of market research is to do which of the following?

A Cut the cost of advertising
B Exploit economies of scale
C Reduce the risk in business
D Lower the barriers to communication

▶ 3 Selling a new product in a restricted geographical area to test it before a national launch is called?

A Sampling
B Promotion
C Surveying
D Test marketing

▶ 4 Which of the following is an example of internal secondary data?

A Historic sales figures
B Government statistics
C A market research report from a specialist agency
D A press release by a competitor

CHAPTER REVIEW

CASE STUDY: FORD

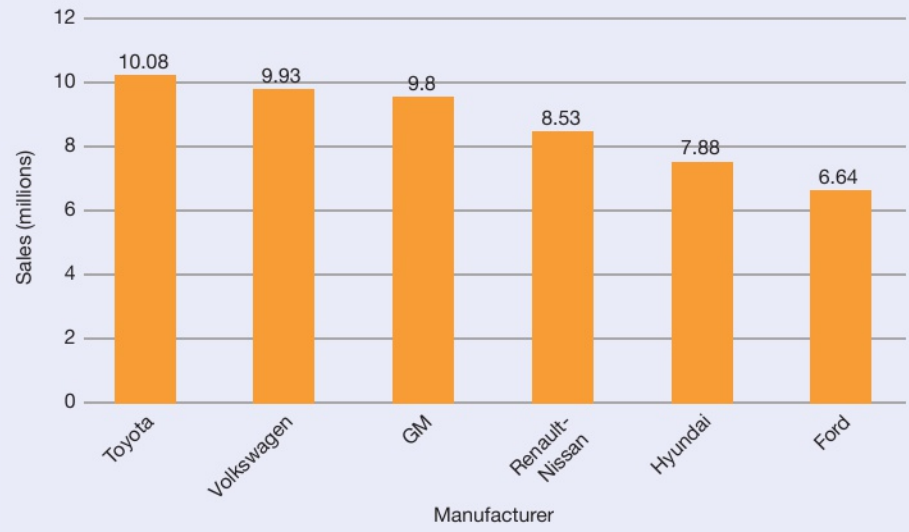
In 2015, 72.37 million cars were sold around the world. Ford, the US-based global car manufacturer, enjoyed global sales of 6.64 million cars. Ford is one of the world's major car producers and customers can choose from 22 different models. Ford is a company that listens carefully to the views of customers. It conducts market research online and in person, and is always improving and creating new research methods. The information gathered by Ford influences both product development and marketing campaigns. The company interacts with consumers through the use of focus groups and one-on-one interviews before any new product is launched. Ford also conducts online searches for consumer comments in auto sites, chat rooms and blogs.

Gordon Platto, Ford chief designer, says that the company is very influenced by the data gathered from market research. He said: 'We go to customer immersion events and spend time with customers in their homes to understand how they use their vehicles. It enables us to better meet the customer needs. You can see the influence in our new vehicles.'

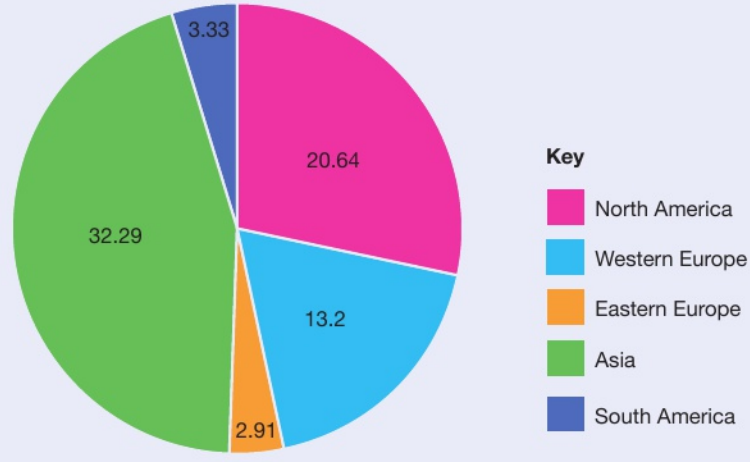
Ford also interacts with customers using social media. This gives them opportunities to share their attitudes, beliefs, opinions and intentions. Ford has its own social media website that allows customers and Ford employees to discuss Ford vehicles including feedback on products, recommendations for new products, and experiences people have had with Ford vehicles.

Finally, Ford recognises the importance of the reliability of market research data. For example, Ford recognises the difficulty in judging the accuracy and authenticity of people's online comments. This is particularly the case when many admit that they lie on their social media profiles to make themselves appear better than they are. Therefore, Ford has established social media guidelines to ensure that its employees are truthful and realistic when discussing the company on social media.

▶ Figure 33.6 Sales of cars by the major global car producers, 2015



▶ Figure 33.7 Global sales of cars by geographical region (millions)



CHAPTER QUESTIONS

1. Using the data in Figure 33.6, calculate Ford's share of the global car market in 2015.
2. Describe two benefits of using online surveys to gather information from customers.
3. Discuss the importance of the reliability of market research data to a company like Ford.
4. Discuss the possible benefit to Ford of the information in Figure 33.7.
5. Assess the possible benefits to Ford of using market research before launching new products.

34 THE IMPORTANCE OF MARKETING

LEARNING OBJECTIVES

- Understand the importance of marketing: satisfying customer needs, building customer relationships, keeping customer loyalty, market orientation and product orientation, market share and analysis and niche and mass marketing
- Understand how businesses respond to changes in the market: changing customer needs, changing customer/consumer spending patterns and increased competition

GETTING STARTED

Most businesses operate in competitive markets. Customers will only buy products if they:

- meet their needs
- are fairly priced
- are conveniently located
- are brought to their attention.

Businesses are aware of this and understand that to be successful their products have to be marketed effectively. There are different ways of doing this. Look at the example below.



▲ Indian cuisine

CASE STUDY: HASAN'S

Aftab Hasan owns a restaurant serving Indian cuisine. The business is very successful and it is almost impossible to get a table at weekends without booking well in advance. The success is owing to the reasonably priced high-quality food served in the restaurant and the excellent customer service provided by Hasan and his family. About 80 per cent of Hasan's customers are regulars. Aftab says: 'I am lucky to have a successful business. But I have worked very hard to build a relationship with my customers. I treat them all like my personal friends. I cater for their needs whatever the cost. It's all about satisfying customer needs. For example, my normal opening hours are from 5.30pm to 10.30pm but every Thursday night I stay open until 2.00 am. I have about 12 customers that finish their night shift in a local factory and come straight here for something to eat. They have been coming here for 11 years. This sort of customer loyalty is typical of what we have here.'

1 Why is Hasan's a successful business?
Aftab says 'I have worked very hard to build a relationship with my customers.'
2 What is meant by this?
3 Describe the benefit to Hasan's of having loyal customers.

MARKETS AND MARKETING

Goods and services are sold in a market. A market exists when buyers and sellers communicate and exchange goods for money. Historically, markets were places where buyers and sellers would meet to exchange goods. Today, it is possible to trade goods without buyers and sellers actually meeting up in person. For example, trading can be done over the telephone, using newspapers, through mail order or on the Internet. Some examples of markets are given below.

SUBJECT VOCABULARY

market set of arrangements that allows buyers and sellers to communicate and trade in goods and services

marketing identifying customer needs and satisfying them profitably

- Consumer goods markets – where products such as food, cosmetics, furniture and magazines are sold.
- Markets for services – these are varied and could include services for individuals, such as banking, or business services, such as cleaning.
- The housing market – where people buy and sell properties.
- Commodity markets – where raw materials such as oil, copper, wheat and coffee are traded.

Marketing involves a range of activities that help a business to sell its products. However, marketing is not just about selling, it involves:

- identifying the needs and wants of consumers
- designing products that meet these needs
- understanding the threat from competitors
- telling customers about products
- charging the right price
- persuading customers to buy products
- making products available in convenient locations.

Marketing can be defined as 'a management process involved in identifying, anticipating and satisfying consumer requirements profitably'.

SATISFYING CUSTOMER NEEDS

Businesses have to satisfy customer needs and wants. This means that they have to produce goods and offer services that customers are prepared to buy. Businesses identify customer needs by carrying out *market research*. Market research is one of the most important marketing activities; it is the first step in satisfying customer needs. Market research is discussed in Chapter 33 (see pages 272–281). If a business can gather reliable information from customers, they may be able to identify their needs and wants. If they do this accurately and design products that meet those needs, they are more likely to be successful.

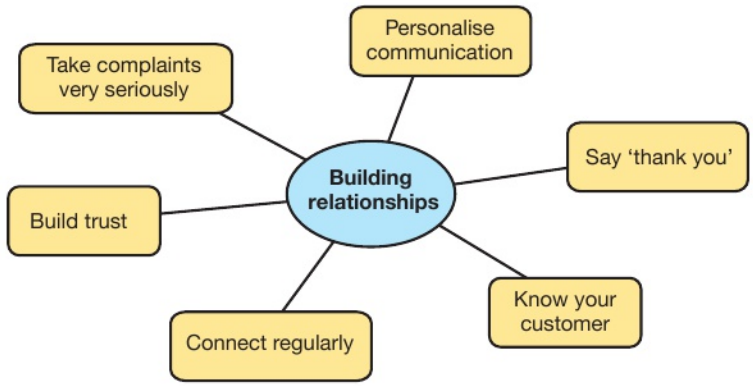
If possible, businesses need to anticipate customer needs. This means they try to predict what customers want in advance and respond to changes very quickly. Businesses operate in a changing competitive environment and have to keep up with the latest designs, trends, fashions and technology.

BUILDING CUSTOMER RELATIONSHIPS

Many businesses try to build relationships with their customers. This means that they try to establish a bond with them through effective communication and do everything possible to meet their needs. Businesses can adopt a number of practices to help build customer relationships. These are summarised in Figure 34.1.

Increasingly, businesses are using social media to build customer relationships. Many are switching from the historic practice of broadcasting marketing messages to having conversations with customers. Businesses

are likely to be more successful if communication is two-way. This is because an increasing number of customers do not take kindly to messages that are 'pushed' in order to sell products. Businesses are learning quickly the value of using social media platforms to build relationships with customers. In a recent social media study, 87 per cent of satisfied customers said their online interaction with the company increased the probability that they would make a purchase from that company.



▶ Figure 34.1 Building relationships with customers

KEEPING CUSTOMER LOYALTY

GENERAL VOCABULARY

retain to keep something or continue to have something

Once a business has attracted a customer, it is important to retain their loyalty so that they continue to make purchases in the future. Many previous studies have concluded that the cost of retaining a customer is about 10 per cent of the cost of acquiring a new one – in other words, finding new customers costs a business ten times the amount it costs to maintain existing customer loyalty. To retain existing customers, a business must continue to satisfy their needs by developing new products, providing first-class customer service, maintaining effective communication links, delivering reliability and responding to any changes in the market. It is also easier to keep customers loyal if a business can develop a strong brand name. Branding (see Chapter 36) and its importance are discussed in Chapter 39 (see pages 322–332). Finally, one of the best ways to retain customers is to reward their loyalty. Some examples of customer loyalty schemes are outlined below.

REWARD CARDS

Some businesses, such as supermarkets, cafés and airlines, reward customers every time they make a purchase. In the case of supermarkets, customers are awarded points according to the amount they spend. Customers then receive money-off vouchers, which they can use at the store.

FREE GIFTS

Loyal customers may receive free gifts from a business. For example, Amazon allows their customers to download a free Kindle book as a reward for making purchases to a certain value. Amazon notifies customers of the normal price to highlight the fact that it's a real reward and not just a worthless gesture. According to a survey, nearly 90 per cent of free gift receivers said they were 'somewhat likely' to buy more frequently from an online retailer after receiving a gift.

CHARITABLE DONATIONS

One approach to rewarding customer loyalty is for a business to make donations to charity as a result of a customer purchase. The size of a donation may be linked to the value of the purchase. According to a study by Cone

Communication and Echo Research, around 47 per cent of consumers worldwide said they would be more loyal to a company if it supports social or environmental concerns.

PARTNERSHIP DEALS

Some businesses set up deals with other businesses to share the cost and benefits of rewarding customer loyalty. For example, American Express linked up with the social media platform Twitter, so that customers could link their credit cards to Twitter and get discounts on certain items by way of special offers sent out on the social network. More recently, the two companies set up a joint venture so users can buy certain items simply by hashtagging tweets.

ACTIVITY 1

CASE STUDY: INTERCONTINENTAL HOTELS GROUP

Intercontinental Hotels Group is a multinational hotel chain with well-known brands, such as Holiday Inn, Crowne Plaza, Intercontinental and Candlewood Suites. The group operates about 4600 hotels in over 100 different countries. It offers a customer loyalty scheme called the IHG Rewards Club. Some of the benefits include:

- the accumulation of points or miles, which can be exchanged for bookings
- exclusive rates when staying in a hotel
- extended checkout times
- dedicated customer service phone assistance
- no restrictions when booking reward nights
- free Internet during stays.

The IHG Rewards Club also has different membership levels through which customers can progress. The higher levels offer more attractive rewards. For example, members with elite status are entitled to complimentary upgrades at hotels.

1. What is meant by a customer loyalty scheme?
2. Describe one important benefit to IHG of using the IGH Rewards Club.
3. In pairs, design a customer loyalty scheme for a small guest house. Present your ideas on a poster to the rest of the class.

PRODUCT AND MARKET ORIENTATION

SUBJECT VOCABULARY

product orientated where a business focuses on the design and manufacture of the product itself rather than the needs of customers

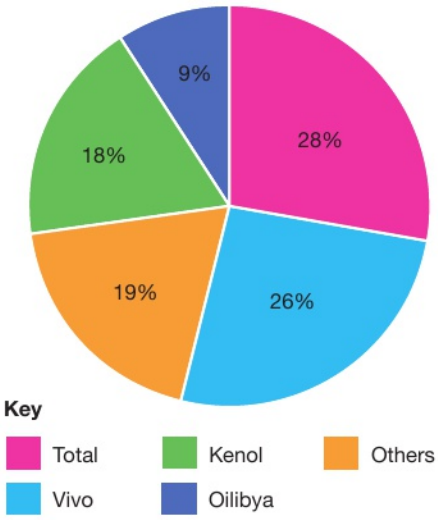
market orientated where a business focuses on the needs of consumers when developing products

In the past, many businesses were **product orientated**. This meant that businesses were more concerned about the quality of their products. Their efforts concentrated on the design and manufacturing of the product itself. They then tried to persuade people to buy it. Some businesses today are still product orientated. For example, in the pharmaceuticals industry, companies such as Pfizer and Bayer focus most of their attention on the development of new drugs and medicines. They already know that a need exists.

In contrast, most firms today are **market orientated**. They are led by the market and their focus is on the customer. They do not make products until they know what people want. Market-orientated firms spend a lot of their

time and resources on identifying, reviewing and analysing the needs of customers. As a result, they attach a lot of importance to market research. This is discussed in Chapter 33.

MARKET SHARE AND MARKET ANALYSIS



▲ Figure 34.2 Petrol stations in Kenya – 2015 market share

Businesses are often interested in their **market share**. This is the share of the total market that a particular business or product enjoys. The pie chart in Figure 34.2 shows the market shares for petrol distributors in Kenya. Just three large suppliers, Total, Vivo and Kenol, dominate the whole market. Between them, they supply 72 per cent of the market. The fourth largest supplier in the market is Oilibya with a 9 per cent share. Businesses often aim to increase their market share at the expense of rivals. If a firm can dominate the market, it may be able to charge a higher price. The formula below can be used to calculate the market share of a business or product:

$$\text{Market share} = \frac{\text{Total product or business sales}}{\text{Total sales in the whole market}} \times 100$$

A business might be more successful if it carries out **market analysis**. This involves finding out about the features or characteristics of a market. A business may gather both quantitative and qualitative information when assessing the market. For example, it will be useful if a business can find out:

- the size of the market
- the current growth rate in the market and the potential for future growth
- the number and size of businesses currently operating in the market
- the factors that might influence possible changes in the market – these might include social, political, technological, environmental and economic factors
- the possible costs and potential profitability in the market
- opportunities for segmenting the market (market segmentation is discussed in Chapter 35 (see pages 292–297)
- the way consumers behave in the market, such as where they like to buy products and how they like to use them.

Ideally, market analysis should be ongoing. Markets are dynamic, which means they are changing all the time. A business must keep in touch with market developments and respond to them appropriately. For example, in the market for motor cars, an increasing number of people are switching from petrol-fuelled cars to electric powered cars. This change is being driven partly by fears about global warming. Manufacturers in the industry will have to ensure that more of their models can run on electricity in the future.

SUBJECT VOCABULARY

market share proportion of sales in a total market that a business or product enjoys

market analysis quantitative and qualitative assessment of a market

mass markets very large markets in which products with mass appeal are marketed

niche market smaller market, usually within a large market or industry

NICHE MARKETING AND MASS MARKETING

Some businesses sell their products to **mass markets**; this is when a business sells the same products to all consumers and markets them in the same way. Fast-moving consumer goods, such as crisps, breakfast cereals, confectionery and soft drinks, are sold in mass markets. The number of customers in these markets is huge. This means that businesses can produce large quantities at a lower unit cost by exploiting economies of scale (see Chapter 40, pages 336–343). This might result in higher sales and higher profits. However, there is often a lot of competition in mass markets and therefore businesses may need to spend a lot of money marketing these products.

A **niche market** is a small market segment (see Chapter 35) – a segment that has sometimes not been serviced by larger businesses. Niche marketing is the complete opposite of mass marketing. It involves selling to a small

customer group, sometimes with specific needs. Small firms can often survive by supplying niche markets. They can often avoid competition. It is also a lot easier to focus on the needs of the customer in a niche market. Examples of niche markets might include graduation gifts, dog training, wedding planning and BBC Radio 3 (which mainly broadcasts classical music).

ACTIVITY 2

CASE STUDY: FERRARI



▲ Ferrari customers value performance, quality and exclusivity

Ferrari manufactures high performance luxury supercars. Although there are few people in the world who can afford to buy a Ferrari, it is a famous global brand name. In 2015, it produced 7664 cars and made a record profit. Few people buy Ferraris as a means of transport. Most Ferrari owners have several cars and as a brand Ferrari is a status symbol. Ferrari is targeted at a niche market – the prestige segment of the car market where performance, quality and exclusivity are highly valued. Prices of Ferraris range from US$200 000 to US$400 000.

Enthusiasts say that Ferrari is a special car because it has a soul. Red stands for passion and the horse logo represents aggression. It is said that Ferrari symbolises power, strength, speed, confidence and boldness.

In 2015, 72.37 million cars were produced globally.

1 Work Ferrari's share of the global market.
2 What is meant by a niche market? Use this case study as an example.
3 Describe one advantage of operating in a niche market.

RESPONDING TO CHANGES IN THE MARKET

Most markets do not remain the same over time – they are not likely to be static. They are dynamic, which means they may grow, shrink, break-up and emerge. Some markets can completely disappear. For example, in the USA, the market for frozen concentrated orange juice has almost collapsed. One reason is because Americans are drinking less orange juice. However, another is because those that continue to drink orange juice prefer freshly squeezed juice. At the beginning of the 1980s, the two forms of juice were drunk in roughly equal quantities. Today, Americans drink 1.4 million gallons of frozen concentrate per month compared with 19.1 million gallons of fresh juice.

CHANGING CUSTOMER NEEDS

One of the reasons why markets change is because the needs of customers change. These needs change for a number of reasons.

- Consumers' incomes change so they choose different products. For example, there is rapidly growing demand for cars in China and India as people become wealthier.
- Consumers become better educated and more sophisticated. Owing to improvements in communications and the greater availability of knowledge, people are more aware of opportunities and have developed more sophisticated tastes. For example, many consumers prefer to buy expensive smartphones that can meet a wide range of needs.

- Consumers are influenced by changes in social habits. For example, more people are concerned about the environment and resource depletion and therefore want to recycle their waste.
- Fashions change over time. For example, the clothes worn by some people this year, or even season, will be unwanted and replaced by new designs next year.
- New technologies result in different needs. For example, people now want access to music, television and films streamed online, so they can enjoy these services in different locations.

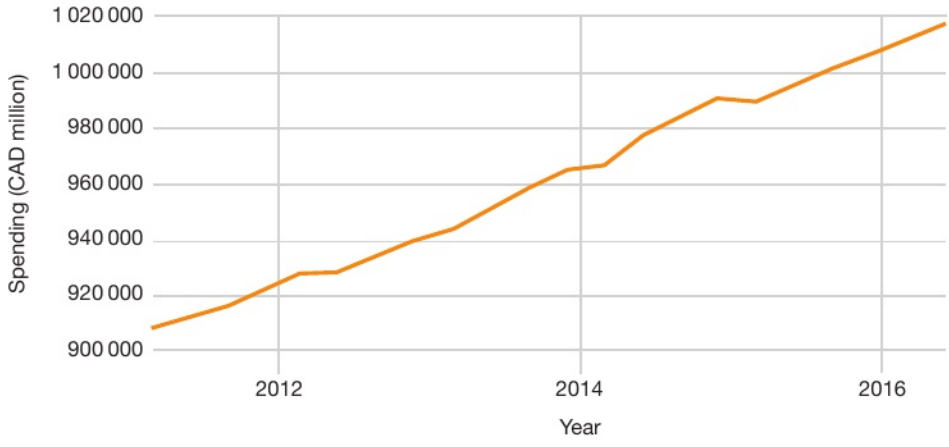
GENERAL VOCABULARY

responsive reacting quickly, in a positive way

Businesses must monitor markets, identify changes in customer needs and be prepared to develop new products or services in order to meet these new needs. Failure to do so may mean that market share is lost to more responsive rivals.

CHANGING CUSTOMER/CONSUMER SPENDING PATTERNS

Businesses can gather information about spending patterns in markets. They can carry out their own research, use statistics generated by the government or purchase market research reports from specialist market research agencies, such as Mintel. Businesses are most likely to be interested in spending patterns in those markets in which they operate. However, they may also be interested in global spending patterns or spending trends in a particular country. Figure 34.3 shows that consumer spending in Canada has risen steadily in the last five years by about 10 per cent. A business that was considering entry into the Canadian market is likely to be encouraged by such information.



▶ Figure 34.3 Consumer spending in Canada, 2011–16

Source: http://www.tradingeconomics.com

INCREASED COMPETITION

Competition is the rivalry that exists between businesses in a market. It would be rare for a business to operate in a market where there was no competition. The behaviour of competitors in the market needs to be monitored very carefully. For example, the arrival of a new competitor could have a dramatic effect on sales if their products are more advanced or more effectively marketed.

COMPETITION PUTS BUSINESSES UNDER SOME PRESSURE

The pressure from competition means that businesses have to encourage customers to buy their products in preference to those of rivals. They will use a range of methods to attract customers, such as:

- lowering prices
- making their products appear different to those of rivals
- offering better quality products
- using more powerful or attractive advertising or promotions
- offering 'extras' like high quality customer service.

All of these methods cost money and generally reduce the amount of profit a business can make. However, businesses have to use such methods in order to survive in the market. Finally, if businesses do not respond to market changes, they are likely to lose market share. At worst, they could collapse. A couple of years ago, it was reported that Tesco, the UK supermarket chain, was losing market share to other supermarkets. There were a number of reasons for this but several reports suggested that they were failing to meet customer needs. They were losing market share to the cheaper stores, such as Aldi and Lidl. There was a need for Tesco to adapt quickly, or risk losing more of their market share. Tesco responded by investing £1000 million in refitting some of its stores, increasing staff numbers to improve customer service and cutting the prices of more than 30 important goods.

LARGE VS SMALL BUSINESSES

Marketing is important to business of all sizes. Failure to recognise the importance of marketing may mean that a business struggles in relation to its rivals. A business may even fail owing to poor marketing. However, larger businesses, with their depth of resources, are likely to invest more in activities such as market analysis and market research. Some large businesses may employ specialist companies, such as market research agencies, to carry out work on their behalf.

MULTIPLE-CHOICE QUESTIONS

▶ 1 A business has a 35 per cent share in a market worth US$38 000 000. The value of this market share is?

A US$35 000 000
B US$38 000 000
C US$13 300 000
D US$1 330 000 000

▶ 2 The process of gathering quantitative and qualitative information about the features and characteristics of a market is called?

A Marketing
B Market analysis
C Market orientation
D Market forces

▶ 3 One advantage of a niche market is that it is easier to do which of the following?

A Identify customer needs
B Distribute products to customers
C Keep production costs down
D Manage cash flow

▶ 4 Which of the following is a marketing activity?

A Reducing waste in production
B Improving cash flow
C Increasing the rate of return on a product
D Identifying the needs and wants of consumers

CHAPTER REVIEW

CASE STUDY: THE GLOBAL MARKET FOR OIL

The market for oil is global. It is a mass market with supply being dominated by the USA, Saudi Arabia and Russia. Figure 34.5 shows the contributions made by the main oil producing countries to total global production. In 2014, the price of oil fell quite sharply, from around US$115 per barrel in 2014 to just US$45 in 2016. Individual suppliers in the market have no control over the price. It is determined by global market forces and all suppliers receive roughly the same price per unit.

The price fall has been caused by a number of factors. One of the main ones is the fall in global demand. A slowdown in the growth of the Chinese economy, and flat economic growth in the EU, has resulted in weaker demand as less energy is required for production. Demand has also fallen in the USA. However, this is because the USA is now producing more of its own energy. The USA has started to enjoy the benefits of large-scale shale gas production. This has had a huge impact on the energy market in the USA.

In addition to the fall in demand for oil, there has also been a rise in supply. US production has nearly doubled recently, which means that the US's suppliers, such as Saudi Arabia, Nigeria and Algeria, are trying to sell more of their oil in Asian markets. Canadian and Iraqi oil production is also rising and the Russians are also managing to maintain high production levels.

Businesses in the oil industry have been hit hard. Revenues and profits have fallen (after experiencing record profits in recent years). This has resulted in many bankruptcies and forced oil companies to cease

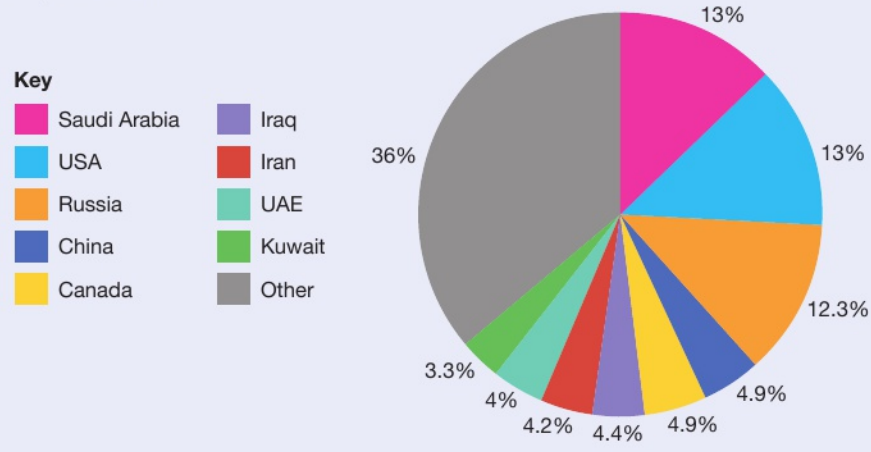
▼ Figure 34.4 Oil price, 2012–16

Source: http://moneyweek.com



operation at more than two-thirds of their production facilities. Companies have also cut investment in exploration and production quite sharply. It is estimated that 250 000 oil workers – roughly one-half in the USA – have lost their jobs.

There is not a great deal that oil companies can do to influence the market for oil. It is not possible to develop the product, firms have no control over price and the promotion of oil as a product is not really appropriate. The only way businesses can respond to changes in the market is to cut costs and hope that the price recovers in the future. However, one possibility is for oil companies to diversify. For example, some large oil companies have started to invest in wind farms, electric battery storage systems and carbon capture and storage (CCS) to generate new revenue streams. One of the world's largest oil producers, Saudi Arabia, has said that it will sell off part of its large state-owned oil business and diversify its economy away from oil.



▶ Figure 34.5 Market share of the major oil producing countries

CHAPTER QUESTIONS

1 What is meant by the term mass market?

The global price of oil fell from around US$115 a barrel in 2014 to US$45 in 2016.

2 Work out the percentage change in the price between 2014 and 2016.

3 Do you think the oil industry is product or market orientated?

4 Discuss one important change that has occurred in the global oil market.

5 Assess the importance to businesses of responding to changes in the market.

35 MARKET SEGMENTATION

LEARNING OBJECTIVES

- Understand how businesses use market segmentation to target customers
- Understand the different methods of segmentation: location, demographics (including income and age) and lifestyle

GETTING STARTED

Many businesses aim their products at a particular part of the market. For example, Rolex, the watch manufacturer, aims its products at the prestige segment of the watch market. Some businesses produce several products and target (aim) them at different customer groups in the same market. Look at the example below.



▲ A dining room at Raffles Singapore

CASE STUDY: ACCOR

Accor is a large international hotel chain. Based in Paris, the chain has 19 different hotel brands that serve different customer needs. Examples of the different levels of service offered by some of the different brands are outlined briefly below.

- Hotel F1 is a one-star hotel and offers two- and three-person rooms starting at €19 per night. This is France's leading low-cost hotel chain. All rooms are equipped with Wi-Fi, flat-screen television, a 'quick wash' corner and a desk.
- The Mercure brand with 738 hotels in 51 different countries offers warm, personalised contemporary rooms. They are welcoming, perfectly clean with high quality furniture. Prices per room start at around €60 per night depending on location.
- Pullman is the modern brand. It is targeted at well-connected and sophisticated travellers. Pullman has 100 four- and five-star hotels across Europe, Africa, the Middle East, Asia-Pacific and the Americas. Prices per room will start at around €120, however, they could be a lot higher depending on the location.
- Raffles is Accor's top brand and is described as an oasis for the well travelled, offering emotional luxury. There are just 12 Raffles hotels and each one is unique in style. The brand also offers several special features including the famous Long Bar and Writers Bar (which come from the original Raffles in Singapore), Raffles Patisserie and Raffles Spa. A room in Raffles, Singapore costs €800 upwards.

1 How has Accor divided the market in this case?
2 Discuss how Accor might benefit from having many different hotel brands.

WHAT IS MEANT BY MARKET SEGMENTATION?

Markets can be divided into different sections or market segments. Each segment is made up of consumers that have similar needs. Businesses recognise this and target particular market segments with their products.

SUBJECT VOCABULARY

market segments part of a whole market where a particular customer group has similar characteristics

- Some businesses concentrate on producing one product for one particular segment. For example, Rolls Royce Motor Cars, which produces luxury cars, targets a very wealthy market segment in the car market.
- Some businesses produce a range of different products and target them at several different segments. In the 'Getting started' example, Accor targets different market segments with its different hotel brands. Each brand meets the needs of a particular customer group.
- Some businesses aim their products at nearly all consumers. For example, large food manufacturers, such as Heinz, are likely to target their brands at everyone.

However, by dividing markets into segments, businesses can more easily supply products that meet customers' needs.

METHODS OF MARKET SEGMENTATION

LOCATION (GEOGRAPHICAL) SEGMENTATION

Different customer groups are likely to have different needs depending on where they live. For example, groups living in very hot climates, such as the Middle East, will have different needs from those living in cooler climates, such as Germany. There might also be differences between groups living in different parts of the same country. For example, in India, different regions have slightly different tastes in cuisine. Also, the needs of rural people might be different from those living in the city. For example, waterproof boots might be targeted more at rural people whereas compact furniture might be targeted at those living in cities in accommodation with less space.

GENERAL VOCABULARY

social class divisions by which individuals and groups are classified on the basis of esteem and prestige acquired mainly through economic success

DEMOGRAPHIC SEGMENTATION

It is common for businesses to divide markets according to the age, gender, income, social class, ethnic origin or religion of the population.

SUBJECT VOCABULARY

socio-economic groups division of people according to social class based on employment status

- **Age:** Infants, teenagers, young adults and the over-65s are all likely to have different needs because of their age. Quite a lot of products are targeted to different consumer groups on the grounds of age. For example, clothes are produced in different sizes and styles for people in different age groups; and different types of holidays are likely to be sold to different age groups.
- **Gender:** Businesses are likely to target male and female consumers with different products. For example, producers of clothes, cars, magazines, perfumes and drinks target different products to different genders.
- **Income:** Incomes in most countries vary considerably. As a result, businesses target products at certain income groups. For example, Chanel, maker of luxury handbags (among other products), targets very high-income groups. In contrast, Lidl, the low-cost European supermarket chain, targets lower-income groups.
- **Social class:** Businesses pay a lot of attention to different socio-economic groups. Such groups are usually based on occupations. These can be used by businesses to target products. For example, sports cars might be targeted at young professionals. Table 35.1 overleaf shows a commonly used measure of social class: socio-economic groups.
- **Ethnic origin:** Many countries in the world are becoming more cosmopolitan, with populations made up of different ethnic groups. This is important for businesses because different ethnic groups are likely to have different needs owing to their varying cultures.

DID YOU KNOW?

In Canada, where there are over 200 different ethnic groups, Chinese consumers are likely to spend more on leather goods, furniture, appliances and electronic equipment.

- **Religion:** It is not uncommon for different religious groups to have different needs. For example, Muslims do not eat pork or drink alcohol. In the USA, the market for Kosher food is thought to be worth US$100 000 million a year.

▼ Table 35.1 Socio-economic groups

SOCIAL GRADE	SOCIAL STATUS	HEAD OF HOUSEHOLD OCCUPATION	PERCENTAGE OF UK POPULATION (APPROX.)
A	Upper middle	Higher managerial, administrative or professional – doctors, lawyers and company directors	4
B	Middle class	Intermediate managerial, administrative or professional – teachers, nurses and managers	12
C1	Lower middle class	Supervisory or clerical and junior managerial, administrative or professional – shop assistants clerks and police constables	22
C2	Skilled working class	Skilled manual workers – carpenters, plumbers, cooks and train drivers	33
D	Working class	Semi-skilled and unskilled manual workers – fitters, window cleaners and storekeepers	19
E	The poor	State pensioners or widows, casual or lower grade workers or long-term unemployed	10

ACTIVITY 1

CASE STUDY: TOYOTA

Toyota is the largest car manufacturer in the world. It currently produces 18 models in many different countries. In 2015, the company sold 10.15 million vehicles. Four of Toyota's models are described below.

- **Prius £24 115.** The Toyota Prius has become well-known among eco-conscious drivers. It is a hybrid car, which means that it runs on both electricity and petrol. It is considered environmentally friendly because it does not use as much petrol as other similar cars. It has very low CO^2 emissions. Many car manufacturers are launching hybrids but Toyota was the first.
- **Proace £18 669.** The Proace is the new replacement for the Hiace commercial vehicle. It has twin sliding side doors, is well equipped and offers Bluetooth. It also very stylish and comfortable on the motorway with a good driving position.
- **AYGO £8995.** The AYGO is small, low-priced and described by Toyota as the ultimate city car. It is agile, easy to handle and made for narrow gaps and tight parking. It is also very economical – achieving over 74 miles per gallon.
- **Land Cruiser £37 230.** The Land Cruiser is a 'sporty' four-wheel drive vehicle. It can be driven 'off-road' and is said to offer special levels of comfort. Toyota claims that the Land Cruiser has led the way in 4 × 4 technology for around 60 years.

There are many different segments in the market for cars.

1 What is the main reason for this?

2 Describe the market segment that Toyota is likely to target with the vehicles described here.
3 Assess if these products are likely to be targeted at particular **(a)** geographical areas and **(b)** income groups.
4 Choose another well-known multinational car manufacturer and look at the range of models it is marketing (online if possible). Decide which market segment each model is being aimed at. Record your results on a poster and present to the rest of the class.

LIFESTYLE (OR PSYCHOGRAPHIC) SEGMENTATION

Using geographic and demographic segmentation may have limitations. For example, young women aged between 18 and 30 living in Berlin share the same gender, age and location. However, their spending patterns could be quite different. Therefore, an alternative way of grouping customers is through lifestyles, as with the examples below.

- Television broadcasters may target sports channels at sports lovers.
- Fine dining restaurants will target customers with a passion for sophisticated menus, high-quality locally produced foods and a taste for fine wines.
- Adventure holidays may be targeted at 'outdoor types', who like to try new things and take risks.
- Organic foods might be targeted at people who care more about the environment (organic foods are produced without chemical pesticides and fertilisers that can damage the environment).

BENEFITS OF MARKET SEGMENTATION

It is easier for a business to meet the needs of different customer groups if the market is segmented. However, some specific advantages include the following.

- Businesses that produce different products for different market segments can increase revenue. This is because some businesses can charge higher prices to different customer groups. In the airline industry, many airlines offer three different levels of service – economy, business class and first class. The price of an economy ticket from London to Dubai might be around £450, however, the first class price might be over £3000.
- Customers may be more loyal to a business that provides products that are designed specifically to them. For example, tailors in Savile Row in London, UK, make made-to-order suits for wealthy customers. They often remain loyal because each suit is unique and created specifically for them.
- Businesses may avoid wasting promotional resources if they only target their adverts at those people who are really interested in the product.
- Some businesses can market a wider range of goods to different customer groups. For example, in 'Getting started' above, Accor, the hotel chain, has 19 different brands that are targeted at different customer groups. This helps the business to generate much higher levels of revenue.

LARGE VS SMALL BUSINESSES

Market segmentation is important for both large and small businesses. For example, small businesses may target their products solely at a specific market niche. In contrast, a large business may look at a market and decide to target several segments with specifically designed products – like Accor and Toyota in the above examples.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following products is likely to be targeted at a particular market segment?

A Biscuits
B A golfing magazine
C Bread
D Petrol

▶ 2 Which of the following is an advantage of market segmentation?

A There will be less waste in promotion and advertising
B Cash flow will improve
C Customers will be more loyal
D Product development is cheaper

▶ 3 Skilled manual workers belong to which socio-economic group?

A C1
B C2
C D
D A

▶ 4 Airlines offering first-class accommodation on long haul flights segment the market according to which characteristic?

A Gender
B Ethnic origin
C Age
D Income

CHAPTER REVIEW

CASE STUDY: JQBC

JQBC is an independent Japanese satellite broadcasting company. It has been broadcasting for 19 years and in 2017 made a profit of JPY12 billion on a revenue of JPY140 billion. Most of the broadcaster's revenue is generated from subscription fees and advertising. In order to increase the number of subscribers, and reduce its 'churn rate' (the annual percentage rate at which customers stop subscribing to a service), subscription fees have been lowered recently. This has helped to increase the revenue from advertisers because the number of subscribers has risen. However, the company is worried that an increasing amount of advertising expenditure by its main customers is being directed towards social media.

The broadcaster provides a number of specialist channels aimed at different market segments. This helps to boost advertising revenues since adverts can be better targeted. Three of the company's eight channels are described briefly below.

JQBC Sport

This channel is aimed at sports enthusiasts. It provides live coverage of a number of key sports events around the world such as golf, association football, auto racing and baseball. It also covers sumo wrestling, martial arts, figure skating and rugby union in depth. 78 per cent of JQBC Sport viewers are male and large advertising revenues are attracted from

car manufacturers, sports equipment companies and gaming-related businesses.

JQBC Kidz

This channel targets the 3–10-year-old age group. It provides a range of cartoons, children's films and learning programmes. The schedule aims to follow the mood and energy levels of young children throughout the day. For example, JQBC Kidz features stimulating and upbeat shows in the morning, followed by programmes with learning themes, activities and story-telling during the day. Over the lunch hour, the broadcaster shows programmes for adults to co-view with their children and perhaps participate in activities. In the afternoons, the focus switches to giving children a chance to relax and have fun. Then in the evening, the mood changes as programmes are designed to wind down young viewers with calming stories before bedtime. Some of the popular advertisers on this channel include the producers of toys, soft drinks and confectionery, trainers and children's fashion-wear, children's films and computer games.

JQBC Fem

This is an important channel for the broadcaster since it attracts the most advertising revenue. It is aimed at female viewers and offers a wide range of programmes including films, lifestyle series, quiz and panel shows, drama series, reality series and talk shows on varying topics including cooking, travel, cars, relationships and sports. Advertising revenue is attracted from a large number of businesses and increasingly from businesses that save time for busy families. For example, online grocery retailers are currently targeting working parents who have increasingly less time for family grocery shopping trips.

CHAPTER QUESTIONS

1. What is meant by market segmentation?
2. How does JQBC segment the market for television according to **(a)** age, **(b)** lifestyle and **(c)** gender?
3. Discuss how a business might benefit from using the socio-economic table in Figure 35.1
4. Assess the possible benefits to JQBC of using market segmentation.

36 PRODUCT

LEARNING OBJECTIVES

- Understand what is meant by the marketing mix
- Understand the development of a new product/service
- Understand the difference between goods and services
- Understand the role played by packaging and its importance
- Understand the product life cycle – main phases and extension strategies
- Understand how the product portfolio is managed and reviewed (Boston matrix)

GETTING STARTED

The goods or services sold by a business have to be designed, developed, named and packaged. Products also have to be modified, improved and possibly replaced. This may be because some products have a limited life cycle or need to achieve higher sales after they are relaunched. Look at the example below.

CASE STUDY: PRODUCT DEVELOPMENT AT BESTHOME

BestHome is a German multinational group that designs and sells a very wide range of affordable household goods such as furniture, soft furnishings, appliances and other domestic products. It operates around 430 large stores in 43 different countries. In 2017, BestHome made a profit of €2.98 billion on revenue of €23.7 billion.
The company stocks about 8000 different product lines in its stores and each year around 1500 new or modified products are introduced. Lena Huth is the head of design at BestHome and she is responsible for a team of 23 designers. BestHome claims that it has a thorough approach to product development. Some features of this approach are outlined briefly below.

- Designers visit people's homes to discuss the current and future needs of homeowners.
- The design process is carried by a number of teams. In addition to designers, each team contains a materials analyst, a product developer and a technician or engineer.
- Each team works transparently so that everyone can see what everyone else is doing. Design work is carried out in a huge converted aircraft hangar in Frankfurt. Work is undertaken openly where all projects and prototypes can be seen. This encourages designers to share information and ideas.
- The design facility has a prototype shop with craftsmen providing a wide range of skills and a 3D printing facility.
- Designers are encouraged to travel and work with foreign designers to learn new techniques and get fresh ideas. They are also required to attend all major international trade fairs to observe developments in the market and explore the activities of competitors.

Design is also heavily influenced by costs, according to Lena Huth. For example, designers would change the materials and dimensions of a product by very small amounts if money could be saved and passed on to consumers in the form of cheaper prices.

1 What is meant by product development?
2 Describe BestHome's approach to product development.
3 Discuss why BestHome brings out so many new products each year.

THE MARKETING MIX

A good marketing strategy is one that meets customers' needs. This means that a business must:

- design and produce high quality *products*
- charge a *price* that is acceptable to consumers
- let consumers know about products through *promotion*
- make products available in the right *place* at the right time.

This is called the **marketing mix** and is usually referred to as the four Ps. To achieve marketing objectives, a business must find the right balance or mix between product, price, promotion and place. This chapter focuses on the importance of the product in the marketing mix.

SUBJECT VOCABULARY

marketing mix elements of a firm's marketing that are designed to meet the needs of customers (often called the 4Ps, they include product, price, promotion and place)

PRODUCT DEVELOPMENT

Product development is a continuing process for many businesses. New products are needed to replace those that are out of date. They are also needed to gain a competitive edge in the market. In some industries, product development is a very lengthy process. For example, in the pharmaceuticals industry some products have taken many, many years to develop. When product development takes a long time, it is very risky for a business. This is because money is being spent on research and development, and the size and timing of the return is not known. In some cases, product development may result in no return at all. New products may pass through a number of different stages while they are being developed.

GENERATING IDEAS

Ideas for new products may come from business owners, customers, competitors, staff, and research and development. Ideas might also result from time spent analysing the products of rivals. A business might try to copy, adapt or improve upon the best features of a rival's product.

ANALYSIS

Once a list of product ideas has been drawn up, there is a need to analyse each one closely. A business must decide whether products are marketable, technically possible, a suitable fit with the current portfolio and legal.

DEVELOPMENT

This might be a lengthy stage and could involve carrying out experiments, using simulations, building models, producing samples and initial testing. Frequent changes and modifications in designs might be a necessary part of this process.

TEST MARKETING

This stage involves testing the product in a small section of the total market. The sample used must be representative of the whole market. Test marketing is used to gather information about what consumers think of the product.

COMMERCIALISATION AND LAUNCH

During this stage, a business puts the 'final touches' to the product. Any problems identified during the test marketing stage can be resolved by making changes or modifications. A marketing strategy will be designed that will begin with the national launch of the new product. Some businesses organise a high profile press conference to launch their products.

Finally, at each stage of the development process, a number of product ideas are likely to be rejected. However, the number of rejections will tend to fall sharply at each stage.

GOODS AND SERVICES

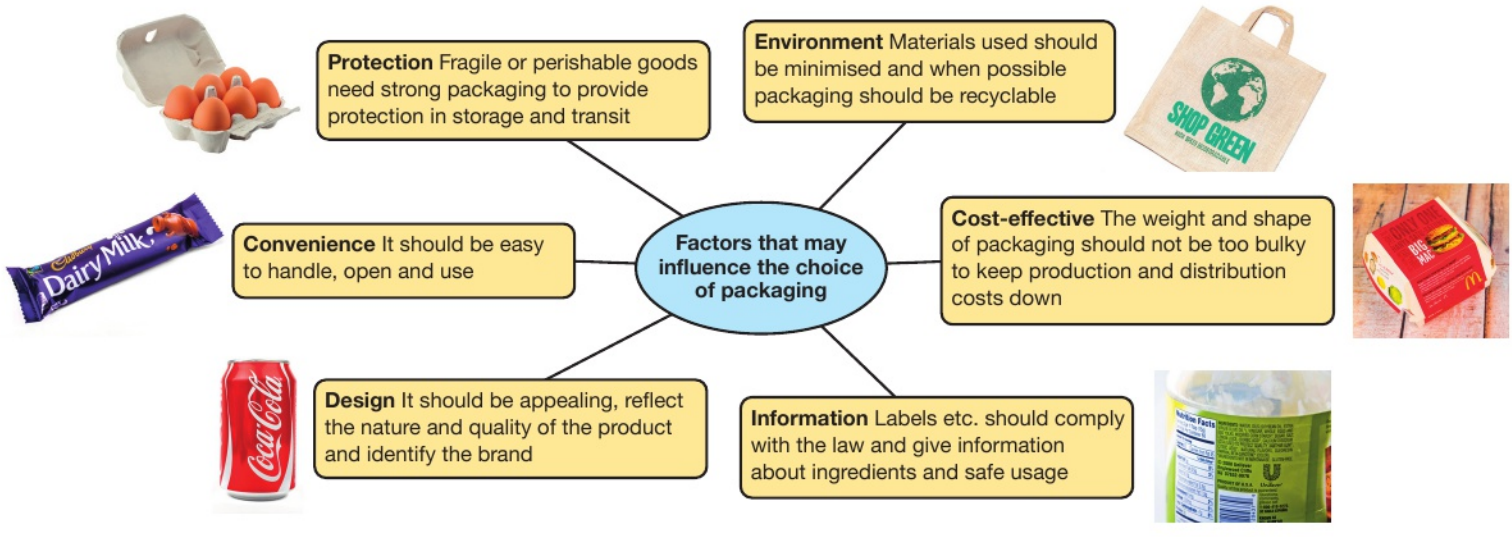
The goods and services produced by businesses are called *products*. These products can be split into different categories. For example, some businesses supply *consumer goods*, such as clothes, food, mobile phones and motor cars. However, an increasing number of products are services. These might include telecommunications, holidays, banking, financial advice, health care, transport, restaurants, domestic services (cleaning, gardening, car washing and catering) child minding, laundry and lifestyle management.

Many business supply *producer goods*, such as machines, tools and equipment. These are sold to other businesses. Specialist services such as accounting, maintenance, printing, debt collecting, consultancy and business insurance are also examples of producer gods. The nature of goods and services is also discussed in Chapter 1 (see pages 4–10).

PACKAGING

One aspect of the product is its packaging. Businesses should consider packaging carefully. This is because consumers often link the quality of packaging with the quality of the product itself. With some products, such as perfume, confectionery and make-up, packaging is vital because it seems to say a lot about the product. It also helps people to recognise it when placed next to rival products. Figure 36.1 summarises the factors that may be considered when a business designs its packaging.

▼ Figure 36.1 Factors which may influence the choice of packaging



ACTIVITY 1

CASE STUDY: PACKAGING





▶ Different package designs

1 What is the main role played by packaging in the images?

Businesses might need to change their packaging when selling goods abroad.

2 Discuss why this might be necessary.

PRODUCT LIFE CYCLE

SUBJECT VOCABULARY

product life cycle level of sales at the different stages through which a product passes over time

skimming or creaming setting a high price initially and then lowering it later

penetration pricing setting a low price to start with in order to get established in the market; price may be raised once established

Marketing may be more effective if businesses understand the **product life cycle**. This shows the level of sales at the different stages through which a product passes over time. Figure 36.2 shows that a product might pass through five stages over its life.

DEVELOPMENT

During the development stage sales are zero. This is because the product is being researched, designed and tested. It is not yet on the market. This may be an anxious time for businesses because many products do not make it beyond this stage, and consequently, money invested in product development is lost. Development costs are also high and can damage the cash flow of a business.

INTRODUCTION

Businesses often introduce new products with an official *launch*. There may be a presentation or a party to give a new product good promotion when it is launched. Costs will continue to be high. New production facilities may be needed and spending on promotion will be high. The price charged by a business when a product is first introduced will vary. Some may start with a high price (**skimming**). Others may start with a low price (**penetration pricing**) to get established in the market. Pricing strategies are discussed in detail in Chapter 37.

GROWTH

If a product is successful, sales will start to grow. If the line on the product life cycle is very steep, this shows that sales are growing sharply. The business will now get increased revenue and begin to recover the costs of development. Costs are likely to fall and the product may start to make a profit. Towards the

end of this stage, sales may start to grow less quickly. This may be because competitors are starting to launch their own versions of the product.

SUBJECT VOCABULARY

extension strategies methods used to lengthen the life of a product

MATURITY AND SATURATION

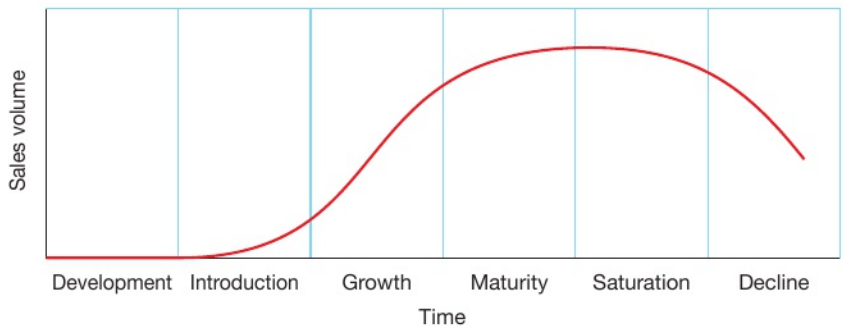
Eventually, sales will start to level off. Development costs will have been recovered and the product will be making a profit. Cash flow will also be improving. As more businesses enter the market, it will become saturated and some businesses will be forced out. The price is likely to fall and promotion methods may change. Some businesses will try to extend the life of the product before it declines. They use **extension strategies**, which are discussed below.

DECLINE

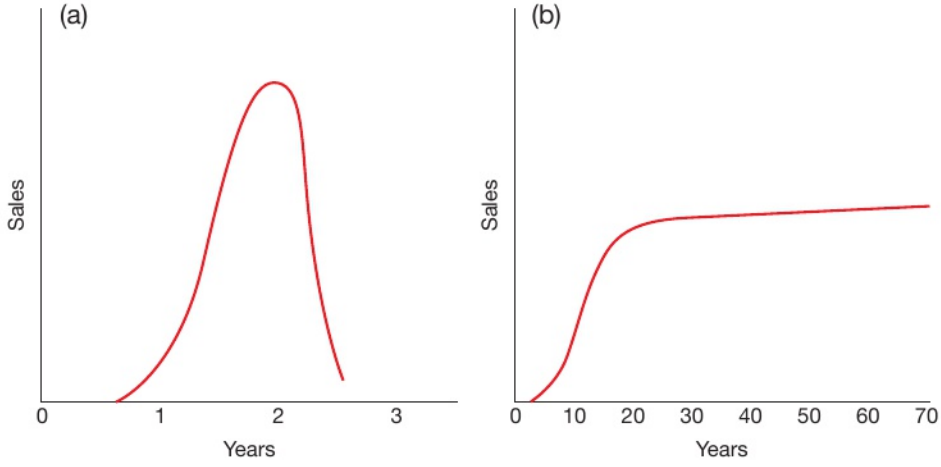
Sales of many products decline and they are eventually taken off the market. This is because consumer tastes change, new technology emerges or new products appear in the market. Where possible, a business will replace declining products with new ones. Volkswagen, the global car producer, introduced the Golf to replace the Volkswagen Beetle, which was withdrawn from the European market (although the Beetle was reintroduced at a later date). Examples of products that are on the decline include CDs, cheques and fax machines.

Finally, different products will have different length cycles. For example, some products have very short life cycles. These may be called *fads* – (a) in Figure 36.3. The slope of the introduction and growth periods will be very steep. However, the decline will be very sharp and sales will fall to very low levels perhaps after a couple of years. Fads are common in the toy industry and some examples might be Tamagotchis (a virtual pet) and Beanie Babies (soft toy animals). In contrast, some products have very long product life cycles and have been around for many decades. Coca-Cola, Heinz canned foods, Kellogg's Corn Flakes and Cadbury's Dairy Milk are examples – (b) in Figure 36.3.

▶ Figure 36.2 Product life cycle



▶ Figure 36.3 Product life cycles for (a) 'fads' and (b) long established products, such as Kellogg's Corn Flakes



EXTENSION STRATEGIES

Extension strategies, which lengthen the life of a product before it starts to decline, are popular with businesses because the costs of product development are high and extension strategies help a product to generate more cash. They may be introduced before the product starts to seriously decline. If a product can be successfully refreshed, sales levels, along with revenues, may start to recover or even grow.

Examples of extension strategies include the following.

- Finding new markets for the product – for example, selling abroad.
- Finding new uses for a product – for example, Ralph Lauren extending its Polo brand for clothes into towels and bedding.
- Modifying the product. Volkswagen has done this many times with the Golf GTI since it was launched in 1975.
- Develop the product range – for example, a crisp manufacturer bringing out new flavours.
- Change the appearance or packaging – for example, Coca-Cola selling coke in cans, glass bottles and different sized plastic bottles.
- Encourage more frequent use of the product – for example, Kellogg's persuading people to eat Corn Flakes for supper as well as for breakfast.

Another benefit of lengthening the life cycle of products with effective extension strategies is that competitors will find it more difficult to enter the market. If a business is able to keep updating and modifying a product to make it even better and more appealing, competitors know that they will have to bring out something really special to make an impact in the market. Apple has managed to do this with continual updated versions of the Apple iPhone.

ACTIVITY 2

CASE STUDY: MICROSOFT



▲ Windows 10

Microsoft® Windows is a well-known global brand. Microsoft's computer operating software is to be found on a large number of computers around the world. The first version, introduced in 1985, was called Windows 1. It had a colour 16-bit interface and was less than 1 MB in size. Many of the basic programs used in today's systems, such as Paint, Notepad, Clipboard and Write, were present in Windows 1. The most recent version is Windows 10. Launched in 2015, this version has two ways of operating – one for touch-controlled tablets, and one for PCs with mice and keyboard. Table 36.1 shows the launch dates of the different versions of Windows since 1985.

Note: Microsoft did launch other versions of the systems listed in the table but they are not included here.

WINDOWS VERSION	LAUNCH DATE
Windows 10	2015
Windows 8	2012
Windows 7	2009
Windows Vista	2006
Windows XP	2001
Windows ME	2000
Windows 2000	2000
Windows 98	1998
Windows 95	1995
Windows 3	1990
Windows 2	1987
Windows 1	1985

▶ Table 36.1 Windows versions and launch dates

1 What is meant by an extension strategy? Use examples from this case study in your explanation.
2 Discuss benefits to Microsoft of using extension strategies. Give at least two benefits in your analysis.

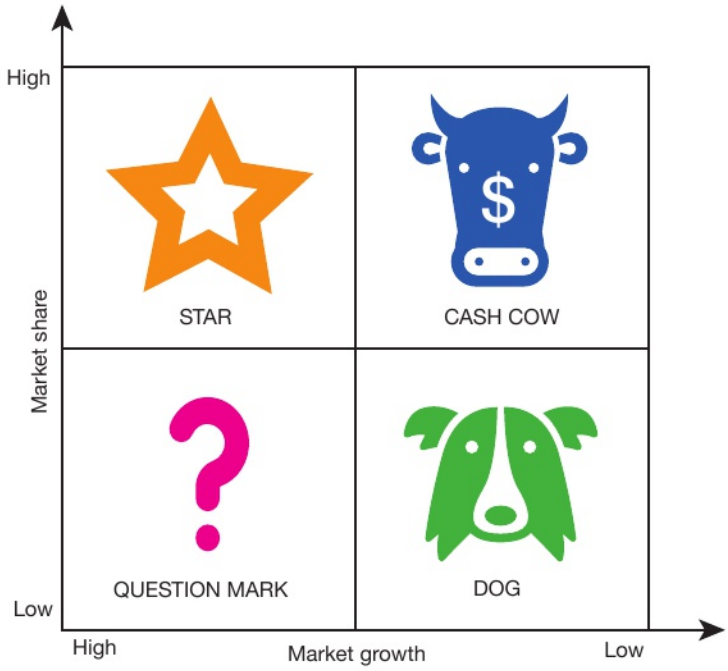
MANAGING AND REVIEWING THE PRODUCT PORTFOLIO

SUBJECT VOCABULARY

product portfolio (product mix) range of products a business is currently marketing

Boston matrix 2×2 matrix that describes products according to the market share they enjoy and whether the market has any potential for growth

The range of products that a business currently has available on the market is called the **product portfolio**. Over a period of time, the different products that make up the portfolio are likely to change. Old products decline and get replaced, while others might be modified and extended. A business has to manage the portfolio by constantly reviewing each product and making changes whenever necessary. The **Boston matrix** may be used to help analyse the products marketed by a business. The matrix enables a business to place their products into different categories according to their market share and position in the life cycle. There are four positions in the matrix where products might be placed. The matrix is shown in Figure 36.4.



▶ Figure 36.4 The Boston matrix

The Boston matrix puts products in four categories.

- **Stars** are valuable products for a business. They have a high market share but also the potential for growth. They are likely to be profitable.
- **Cash cows** are mature products. They have a high market share but the market is not likely to grow very much. Cash cows generate a steady flow of income for the business.
- **Question marks** are products with a low market share but the market is growing. If the right marketing action is taken these products could do well. They have potential.
- **Dogs** are at the end of their life cycle. They have a low market share and the market is not likely to grow any more. Dogs are likely to be replaced with new products.

When managing its product range, a business must try to make sure it has the 'right balance' of products. This means that it must avoid having too many dogs and try to increase the number of stars and cash cows. Some of the income from cash cows might be invested in new product development.

LARGE VS SMALL BUSINESSES

The marketing mix is important to all businesses regardless of their size. If businesses ignore certain elements of the marketing mix they may not perform as effectively as their competitors. However, some aspects of the marketing mix may be more important to larger firms. For example, large businesses are more likely to invest heavily in product development. One reason is because they have more resources. Also, if a large business discovers a brand new product or material, the rewards for investment in product development can be huge.

MULTIPLE-CHOICE QUESTIONS

▶ 1 The first stage in the product life cycle is called?
- **A Introduction**
- **B Growth**
- **C Saturation**
- **D Development**

▶ 2 In the Boston matrix, a product with a low market share but a high potential for growth is called what?
- **A Dog**
- **B Star**
- **C Question mark**
- **D Cash cow**

▶ 3 Which of the following is an example of a service sold to businesses?
- **A Smartphones**
- **B Office cleaning**
- **C Machinery**
- **D Fuel for lorries**

▶ 4 Which of the following is an element of the marketing mix?
- **A Profit**
- **B Cash**
- **C Price**
- **D Money**

CHAPTER REVIEW

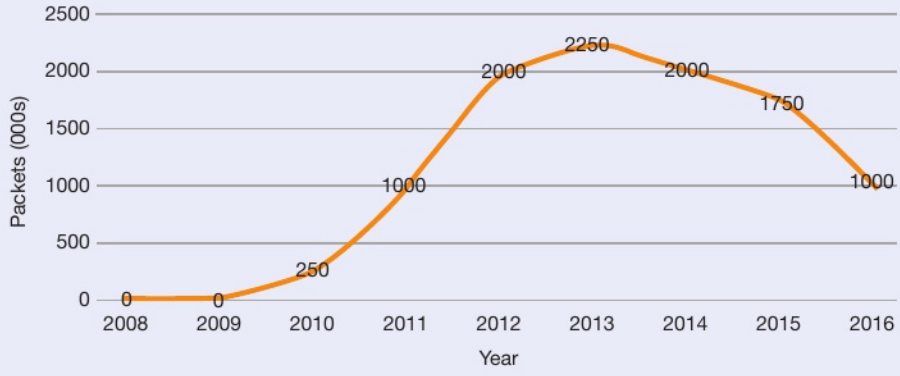
CASE STUDY: CHEESY SNAX

Cheesy Snax is a producer of cheese-flavoured snacks. It focuses heavily on the quality of the product in its marketing mix. The business currently markets four different products. Two of these, Cheesy Crackles and Cheesy Pops, are established in the market. They are the company's cash cows, enjoying annual sales of around 30 million packets each. Both products were introduced in the late 1990s and aimed at the mass market. Another product, Cheesy Puffs, was introduced in 2014 and targeted at children. It has a low market share but is showing some potential. It sold 5 million packets in 2015. The marketing manager thinks that with the right sort of promotion the product will flourish. However, the cost of this promotion is likely to be US$2.5 million.

The fourth product, Cheesy Nuts, is in decline. Figure 36.5 shows the product life cycle for Cheesy Nuts. It was launched in 2009 and never really succeeded even though quite a lot of money was spent on its development. One view is that the product should be relaunched with

a change in packaging and targeted more aggressively at adults. However, the cost of this strategy would be about US$1.5 million and another view is that this is just 'a waste of money'.

Finally, Cheesy Snax has another product, Blue Cheesy Crackles, under development. The product is close to the test marketing stage. However, there is a worry with this new product: although Blue Cheesy Crackles have a pleasant taste, their bright blue appearance was unpopular with some consumers during development.



▶ Figure 36.5 Product life cycle of Cheesy Nuts

CHAPTER QUESTIONS

1. What is meant by the term marketing mix?
2. What are the features of a cash cow in the Boston Matrix?
3. What is the position of Cheesy Puffs in the Boston Matrix?
4. Discuss how Cheesy Snax might use the Boston matrix in the management of its product portfolio.
5. Describe the main features of the product life cycle for Cheesy Nuts.
6. Assess whether Cheesy Nuts should be replaced with Blue Cheesy Crackles in 2017. Make a clear judgement in your evaluation.

37 PRICE

LEARNING OBJECTIVE

Understand the main pricing strategies and when they might be applied:

- cost plus
- competition
- promotional
- penetration
- skimming

GETTING STARTED

Setting the price of a product is a vital marketing decision. If the price is set too high customers may not buy the product. Conversely, if it is too low this might suggest that the product is of a poor quality; the business might also struggle to make a profit. Businesses can use a number of methods to set their prices. Look at the examples below.

SUBJECT VOCABULARY

early adopters consumers who are keen to buy new products as soon as they are launched



▲ Granite Tecco games can be played on mobile phones

CASE STUDY: GRANITE TECCO

Granite Tecco is a high tech gaming company. When it launches a new game it is usually very expensive. For example, it recently launched a game called 'Airdust', a game with a space wars theme. When it was first launched in India it cost RS3600. However, ten months later it was selling for Rs2600. This is about 28 per cent cheaper than the original launch price.

Selling new products at a high price when they are first launched is a common pricing strategy for some businesses – particularly those in the technology industry. The idea is to generate high levels of revenue by selling to **early adopters**. These are people who attach a great deal of value to buying new technology when it first comes out. They are prepared to pay the higher prices to be the 'first' with the new technology.



▲ Kowloon market, Hong Kong

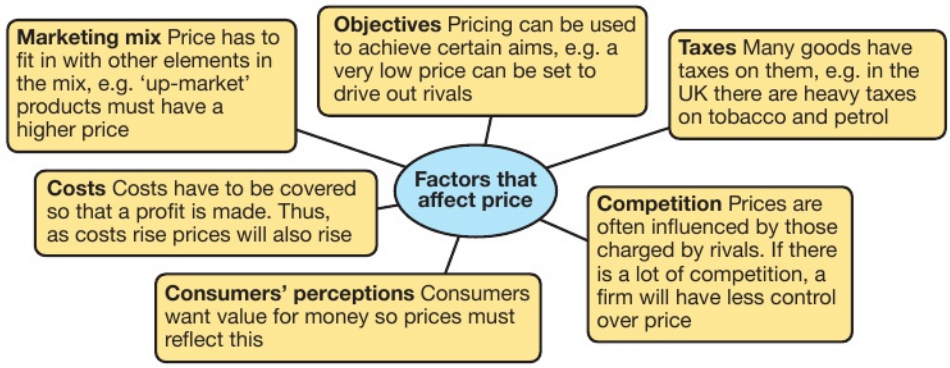
CASE STUDY: KOWLOON GIFT SHOP

Yvette Cheng owns a gift shop in Kowloon market, Hong Kong. She uses a very simple method to calculate the prices of all products sold in the shop: she adds 20 per cent to the cost of buying them in. So, for example, a product that cost HKD 100 is sold for HKD 120 (100 + [20% × 100]).

1. How are prices set in the above examples?
2. Describe one possible advantage of using the pricing method in each case.
3. In groups, discuss the factors that might influence the price charged for **(a)** a carton of milk and **(b)** an air ticket to a far-away place. Record your ideas on a poster and present them to the rest of the class.

PRICING

Pricing is another element in the marketing mix. It is important to get the price right otherwise people will buy goods and services elsewhere. Businesses have to take into account a number of factors when setting the price of products. Some of the important factors are summarised in Figure 37.1.



▶ Figure 37.1 Factors that affect the price charged by a business

Businesses can choose from a range of different *pricing strategies* when setting prices. A pricing strategy is a set of plans designed to meet a specific marketing aim.

COST-PLUS PRICING

Businesses have to set prices that generate a profit. One method, which ensures that all costs are covered, is **cost-plus or cost-based pricing**. It is simple and involves adding a **mark-up** to total costs. For example, the cost to a manufacturer of making a bicycle is €60. The manufacturer adds a mark-up of 25 per cent to get the price. Therefore, the price of the bicycle is €75 (€60 + [25% × €60]). This method is common with retailers. However, one of the disadvantages of this method is that it ignores market conditions. For example, the €75 price set by the cycle manufacturer may be far too high in relation to the prices of other bicycles in the market. This might result in low sales.

PENETRATION PRICING

SUBJECT VOCABULARY

cost-plus or cost-based pricing adding a percentage (the mark-up) to the costs of producing a product to get the price

mark-up percentage added to costs that makes a profit for a business when setting the price

penetration pricing setting a low price to start with in order to get established in the market; price may be raised once established

Sometimes a business will introduce a new product and charge a low price for a limited period. This is called **penetration pricing**. The aim of this strategy is to get the product established in the market. Once this objective has been achieved the price slowly increases to higher levels. There are two main reasons why a business might use this strategy.

1. It is hoped that consumers get into the habit of buying the product when the price is low. Then, when the price starts to rise, people continue to buy the product.
2. Large retailers and other bulk buyers are more likely to show an interest in a product if it is generously priced. This will help a business using penetration pricing to sell larger quantities of the new product and get established in the market.

A number of industries favour this strategy – particularly those that sell into mass markets. Therefore, businesses selling certain fast-moving consumer goods, such as confectionery, canned drinks, shampoos and detergents, may use penetration pricing. However, the cost of this pricing strategy can be high since profit margins will be squeezed. There is also the danger of a negative response from consumers when prices start to increase after the introductory offer.

COMPETITION-BASED PRICING

SUBJECT VOCABULARY

competition-based pricing pricing strategies based on the prices charged by rivals

destroyer or predatory pricing setting a low price until rivals have gone out of business

GENERAL VOCABULARY

differentiate to recognise or express the difference between things

Some businesses take a close look at what their rivals are charging when setting their prices. This is called **competition-based pricing** and is likely to be used by businesses operating in very competitive markets. One approach is to charge the same price as competitors. The advantage of this strategy is that a price war is likely to be avoided. It is considered to be a safe pricing strategy. Another approach is for the market leader to set the price and all others follow. This is called price leadership. The leader is likely to be the largest or most dominant firm in the industry. It may also be the lowest-cost producer. Businesses that 'follow the leader' may have higher costs and therefore have to accept lower profit margins.

In competitive markets where prices are all very similar, businesses are more likely to engage in non-price competition. This might involve special promotions or strategies designed to **differentiate** the product.

Finally, a business might lower its price for a temporary period to drive out competition. This is called **destroyer or predatory pricing**. The aim is to lower prices for a period of time to make it difficult for rivals to compete. If the strategy worked, some rivals would eventually leave the market and allow the 'predator' to raise prices again. However, the predator will now have a larger market share.



▲ Coffee making

ACTIVITY 1

CASE STUDY: COFFEE SHOPS

Eduardo Urondo runs a busy coffee shop in the centre of Rosario, Argentina. However, in 2015, a multinational coffee chain opened a branch opposite Eduardo's shop. The thing that upset Eduardo the most was the pricing policy of the new rival. The prices charged by the multinational were half of what Eduardo was charging. Naturally, customers started to fall. Eduardo said 'I know what will happen. Eventually I will be forced out of business. And then, when I'm gone, their prices will rise. I can't win. The multinational has huge resources and can afford to trade at a loss until I leave the market.'

1 Describe the pricing strategy being used by the multinational.
2 How can the new rival afford to trade at a loss?

SKIMMING

SUBJECT VOCABULARY

skimming or creaming setting a high price initially and then lowering it later

Some businesses may launch a product into a market charging a high price for a limited time period. This is called **skimming or creaming**. The main objective is to generate high levels of revenue with a new product before competitors arrive on the scene. In 'Getting started' above, this is the pricing strategy often used by Apple when launching new products, such as the iPhone 6. In the market for some goods, there is a group of consumers called early adopters. These people are prepared to pay higher prices because they like to be the first to buy the product. It has been suggested that early adopters are younger, have a higher social status with a better education than late adopters. They may also have higher levels of income and be more socially forward. It is reckoned that about 13 per cent of consumers are early adopters in such markets.

Pharmaceutical companies also use skimming. They sell new drugs for high prices when they are first launched. However, when their patents expire, competition emerges and prices fall. Charging a high price initially helps such companies recover high research and development costs.

PROMOTIONAL PRICING

Promotional pricing usually involves lowering the price of a product for a short period of time to draw in customers. Prices might be cut for a number of reasons:

- to get rid of old stock (before the start of a new selling season perhaps)
- to generate some cash quickly to help solve a cash flow problem
- to generate renewed interest in an existing product
- to attempt to win a larger share of the market by encouraging brand switching.

There are a number of different approaches to promotional pricing. Some examples are outlined below.

SUBJECT VOCABULARY

patents legal documents giving a person or company the right to make or sell a new invention, product, or method of doing something and stating that no other person or company is allowed to do this

loss leader product sold below cost to draw in customers

DISCOUNTS AND SALES

Businesses often cut prices for a short period. They have *sales* where goods are sold below the standard price. Some of these sales are seasonal. For example, in some countries, sales may occur at particular times of the year. For example, in the USA many retailers discount their products on 'Black Friday'. This is the day after Thanksgiving Day and signals the start of the Christmas shopping season.

PSYCHOLOGICAL PRICING

One common pricing strategy is to set the price slightly below a round figure – charging £99.99 instead of £100. This is called *psychological pricing*. Consumers are 'tricked' into thinking that £99.99 is significantly cheaper than £100. Of course it is not but this psychological effect often works for businesses.

LOSS LEADERS

Some products are sold at a price lower than cost. These are called a loss leader and are popular with supermarkets. The objective of this strategy is to draw customers into a store where they will buy the loss leader. Once in the store, it is hoped that customers buy other products. Overall, this will generate a profit.

ACTIVITY 2

CASE STUDY: PHARMACEUTICAL COMPANIES



▲ Research and development

In the pharmaceutical industry, businesses spend a lot of money on research and development. For example, in 2014, Pfizer, the US drugs company, spent US$7200 million on R&D. In order to encourage research on this scale, pharmaceutical companies can obtain a patent when they launch a new drug. This is a license that protects companies from competition for a period of time. This means they can charge very high prices until the patent runs out. When the patent runs out, competitors are allowed to produce generic (non-branded) versions of the drug and compete with the original. This competition nearly always results in lower

prices. For example, Atorvastatin (40 mg), a drug produced by Pfizer to help reduce the risk of heart attacks, was selling for US$191 per month in the USA just after the drug went generic. In contrast, a generic producer of Atorvastatin (40 mg) was selling it for US$160 per month. Another generic brand, Lovatstatin (40 mg), was selling for just US$51 per month (although this was not exactly the same chemical composition as Atorvastatin).

1 Name the pricing strategy used by Pfizer for Atorvastatin.
2 Discuss the main advantage to Pfizer of this pricing strategy.

LARGE VS SMALL BUSINESSES

All businesses have to make pricing decisions. One important difference between large and small businesses with regard to pricing is that larger businesses often have more control over what price they charge. Large firms are more dominant in the market. Consequently, they tend to set the price and smaller businesses follow their example. It might be argued that small businesses often use cost-plus pricing. This may be because it is easy to use and ensures that a profit is made. Sometimes suppliers have to accept the prices that much larger businesses offer them. They may not be in a position to negotiate higher prices.

MULTIPLE-CHOICE QUESTIONS

1 The pricing strategy that involves setting a very high price initially (when a new product is launched) is called?
- A Penetration pricing
- B Cost-plus pricing
- C Promotional pricing
- D Skimming

2 Which pricing strategy involves adding a mark-up to the costs of the product?
- A Penetration pricing
- B Cost-plus pricing
- C Promotional pricing
- D Skimming

3 Which of the following factors might affect the price charged by a business?
- A Competition
- B Income elasticity of demand
- C The statement of comprehensive income
- D Quotas

4 Which of the following is an example of promotional pricing?
- A Cost-plus pricing
- B Skimming
- C Price leadership
- D Loss leaders

CHAPTER REVIEW

CASE STUDY: NASSAR'S

Nassar's is a high street retailer of fashionable menswear. The business has 23 stores in the UAE and a few in neighbouring middle-eastern countries. For 56 years, the business has used cost-plus pricing in its shops. It is a simple pricing method, all staff understand it and it ensures that profits are made. For most lines bought in by the chain, a mark-up of 40 per cent is applied to the cost to get the selling price.



▲ Fashionable UAE menswear

In 2014/15, the business started to feel the impact of online competition. Although the business was keen to hold on to its traditional methods, the owners understood that if they failed to meet customer needs sales would decline. As a result, an online operation was set up. However, the online operation had problems with distribution and was taking time to get established. The business was also running short of cash. It was suggested by one of the managers that perhaps promotional pricing could be used to generate sales quickly. This was discussed at a meeting and the managing director suggested that a trial should be undertaken at one of the stores. The plan was to use psychological pricing for a selection of four items on a one-month trial basis. Table 37.1 shows the sales of the four items in the month before the trial and Table 37.2 shows the sales of the same four items in the month of the trial.

▼ Table 37.1 Sales in month before trial

ITEM	COST (AED)	COST + PRICE (AED)	SALES	REVENUE (AED)
1	200	280	100	
2	800	1120	50	
3	400	560	80	
4	120	168	200	

▼ Table 37.2 Sales during one-month promotional pricing trial

ITEM	COST (AED)	PSYCH. PRICE (AED)	SALES	REVENUE (AED)
1	200	239	150	
2	800	899	65	
3	400	519	140	
4	120	159	300	

CHAPTER QUESTIONS

1 What is meant by cost-plus pricing?

2 Work out the price Nassar's would charge for an item costing AED 240.

3 Discuss one advantage and one disadvantage of cost-plus pricing.

4 What is meant by psychological pricing?

5 **(a)** Complete the tables by calculating the revenue before and after the price change and **(b)** then assess whether the sale using psychological pricing was effective for Nassar's.

38 PLACE

LEARNING OBJECTIVES

- Understand the role of distribution channels
- Understand the different methods of distribution
- Understand the role played by e-commerce (e-tailing) in distribution

GETTING STARTED

One important activity in the marketing mix is making sure that products are in the right place at the right time. Consumers are more likely to buy products if they are available in convenient locations. Businesses can distribute their products using a number of methods. Look at the examples below.

CASE STUDY: UNILEVER

Unilever is a giant multinational company selling around 400 different brands of food, drinks, cleaning agents and personal care products. In 2015, the company enjoyed sales revenue of €53 300 million. Products are sold in as many outlets as possible. Unilever has its own sales force but also uses independent brokers, agents and distributors. Unilever sells to chain stores, wholesalers, cooperatives, independents, food service distributors and institutions. Products are transported through a network of distribution centres, warehouses, company-operated and public storage, and other facilities. Their popular brands can be bought in a very wide range of retail outlets from small independents to giant supermarkets, all over the world.



▶ Unilever offices in London

1 What is meant by distribution in business?
2 Describe the method of distribution used by Unilever.
3 Discuss one reason for Unilever's approach to distribution.
4 In groups, make a list of all the different types of outlet where a Magnum ice cream might be purchased. Compare your results with other groups. Which group has the longest list?

WHAT IS PLACE?

Place is one of the 4Ps in the marketing mix (see page 299). It refers to the location where people can buy products. If businesses cannot get products in the right place at the right time they are not likely to be successful. If products are not available in convenient locations, consumers may not have the time to search for them. For example, if motorway service stations were located two or three miles from the motorway, they may struggle to survive. Also, food producers in many countries would have limited sales if they did not make groceries available in supermarkets.

DISTRIBUTION CHANNELS

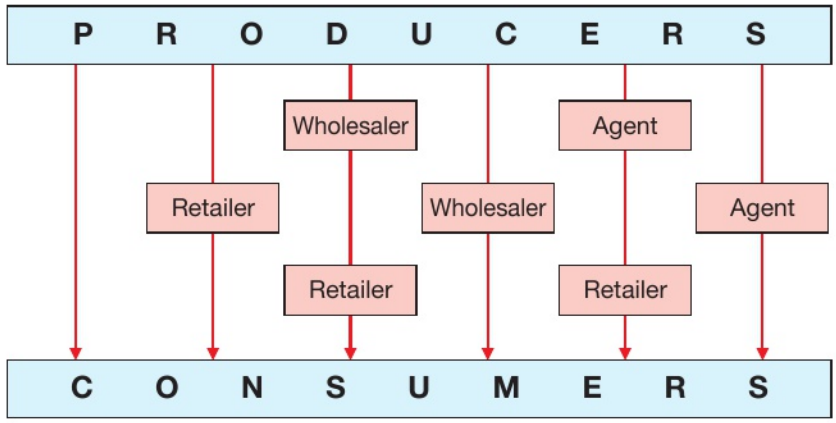
SUBJECT VOCABULARY

distribution channel route taken by a product from the producer to the customer

intermediary person or organisation that helps to arrange agreements or business deals between other people or organisations

wholesalers persons or businesses that buy goods from manufacturers and sell them in smaller quantities to retailers

The route taken by a product from the producer to the customer is called a **distribution channel**. Businesses can choose from a number of different distribution channels. Some of the main ones used for consumer goods are shown in Figure 38.1. One approach is to sell goods directly to consumers but others involve using an **intermediary**, such as retailers and **wholesalers**. These are businesses that provide links between producers and consumers. The diagram shows that some producers may use more than one channel of distribution.



▶ Figure 38.1 Distribution channels for consumer goods

RETAILING

SUBJECT VOCABULARY

retailers businesses that buy goods from manufacturers and wholesalers and sell them in smaller quantities to consumers

bulk breaking dividing a large quantity of goods received from a supplier before selling them on in smaller quantities to customers

Figure 38.1 shows that most distribution channels use **retailers**. These are businesses that buy goods from manufacturers or other suppliers and sell them straight to consumers. Retailers provide manufacturers and other sellers with some key services.

- They buy large quantities from manufacturers and wholesalers and sell small quantities to customers. This is called **bulk breaking**.
- They sell in locations that are convenient to consumers. Most supermarkets, for example, are conveniently located and have good parking facilities.
- They may add value to products by providing other services. These might include help with packing, delivery, repair services, information about products, guarantees and gift wrapping.

Businesses can choose from among a wide range of different retailers when selling their products. The main features of some common retailers are outlined below.

INDEPENDENTS

These tend to be relatively small outlets, although there are exceptions. Examples include newsagents, general stores, greengrocers, delicatessens and specialists, such as those selling bicycles, jewellery or toys. Many are owned by sole traders and may be found in a variety of locations such as on high streets, in shopping centres or malls, in small villages and in towns.

SUPERMARKETS

Supermarkets are usually large stores selling up to 20 000 product lines including groceries, fresh food, greetings cards, clothes, electrical goods, books and household goods. They are usually cheaper than independents selling the same sorts of products because they can afford to buy in bulk from manufacturers. Many supermarkets are located on the outskirts of towns and cities where land may be relatively cheap and is more readily available. They usually offer free parking and meet the needs of consumers who prefer 'one-stop-shopping'.

DEPARTMENT STORES

These are large stores split into distinct selling departments, such as menswear, nightwear, cosmetics, food, gifts and children's clothing. They usually aim to provide good quality products with high levels of customer service. For example, sales staff may receive training in the different products sold in their particular department. Department stores are often found in city centres. One example of a famous department store is Harrods of London, UK.

MULTIPLES OR CHAIN STORES

One approach to retailing is to develop a chain of stores. This is where one owner opens multiple stores selling the same range of goods in many different locations. Each store in the chain will look very much the same and be under the control of a central office. Stores will usually have a standardised:

- product range
- pricing strategy
- store fronts
- store layout
- staff uniform (if appropriate)
- staff training, wages and conditions of work.

Chain stores may specialise in all sorts of product lines such as menswear, children's clothes, ladies clothes, shoes, food products, domestic appliances, sportswear, books or toiletries. They bulk buy direct from manufacturers so their cost of sales are low. However, their ranges of goods are often limited and staff may be poorly motivated because they are not usually given incentives.

SUPERSTORES OR HYPERMARKETS

These are very large stores, usually located on the outskirts of towns and selling a wide range of goods under one roof. They sometimes feel like giant warehouses when moving around inside. Hypermarkets offer an approach to shopping without any non-essential services. Goods are not likely to be displayed attractively, there are likely to be fewer staff to help out and they tend to lack atmosphere. However, they are generally cheaper than supermarkets and have a wider product range.

KIOSKS AND STREET VENDORS

These are very small outlets selling a limited range of goods. They may be found in airports at bus and train stations, in streets and the cinema, for example. Many of them sell fast food, confectionery, newspapers and a limited range of clothes perhaps. They generally operate with low set-up costs and minimal overheads, but this depends on the location (for example, renting a location inside a major airport would actually be quite expensive).



▲ Market traders in a souk

MARKET TRADERS

These are usually small time businesses selling goods from market stalls. They are common in many parts of the world. They have low overheads and are often cheaper than other retailers. Some market traders move from one market to another and set up a stall each time they relocate. However, in other markets, such as souks, market traders may sell their goods from the same permanently located stall.

ONLINE RETAILERS

Businesses, such as Amazon, that buy goods from manufacturers and sell them online to customers. These are discussed in more detail below.

E-TAILING (E-COMMERCE)

The most important new trend in distribution in recent years is probably the development of online distribution. It is often called **e-commerce or e-tailing** because it involves the use of electronic systems to sell goods and services. There are two main types.

SUBJECT VOCABULARY

e-commerce or e-tailing use of electronic systems to sell goods and services

business to consumers (B2C) selling of goods by businesses to consumers

BUSINESS TO CONSUMERS

Business to consumers (B2C) is the selling of goods and services by businesses to consumers. Most e-tailing involves ordering goods online and taking delivery at home. However, new 'click and collect' services are being developed where people order goods online and then pick them up from a store or a central hub. In London, UK, underground stations are being used as sites for hubs. Most large retailers now have online services. Other examples of B2C e-commerce include:

- tickets for air, rail and coach travel
- tickets for sports events, cinemas, theatres and theme parks, such as Alton Towers in the UK
- holidays, weekend breaks and hotel rooms
- access to online audio and film broadcasts
- a wide range of goods on eBay and other auction sites
- agent or broker intermediary that brings together buyers and sellers
- financial services such as banking and insurance.

BUSINESS TO BUSINESS

Business to business (B2B) involves businesses selling to other businesses online. Businesses can also use specialist software to purchase resources. The software helps to find the cheapest supplier and carries out all the paperwork.

The benefits to consumers and businesses of online distribution are summarised in the two boxes opposite.

Benefits to consumers of online distribution

- It is cheaper because online retailers often have lower costs
- Consumers can shop 24/7
- There is generally a huge amount of choice
- People can shop from anywhere if they have access to the Internet

Benefits to businesses of online distribution

- E-tailers may not have to meet the costs of operating stores
- Lower start-up costs – both fixed and variable costs are lower
- Lower costs when processing transactions – many systems are automated
- Less paper is needed for documents such as invoices and receipts
- Payments can be made and received online using credit cards or online payment systems
- B2C businesses can offer goods to a much wider market – for example, global
- Businesses can serve their customers 24/7
- Businesses have more choice when locating their operations

Despite the advantages to both consumers and businesses of online distribution, there are some disadvantages.

- Businesses will face increasing competition since selling online is a relatively cheap method of distribution and can be organised from any location in the world. Consequently, businesses will face more competition from overseas.
- There is a lack of human contact, which might not suit some customers. There is also a heavy dependence on delivery services where e-tailers often lack control on the quality of delivery.
- There may be technical problems online. For example, websites may crash. The site may be affected by malware and Internet connections can go down.
- There is a security risk as computer hackers might gain access to sensitive information.
- Consumers cannot touch or look at goods before purchase and people may have problems taking delivery of goods if they are out.
- Customers may experience poor aftersales service.
- Customers without Internet access and credit cards may be excluded.
- Fake traders may be more difficult to identify online.

OTHER DISTRIBUTION METHODS

SUBJECT VOCABULARY

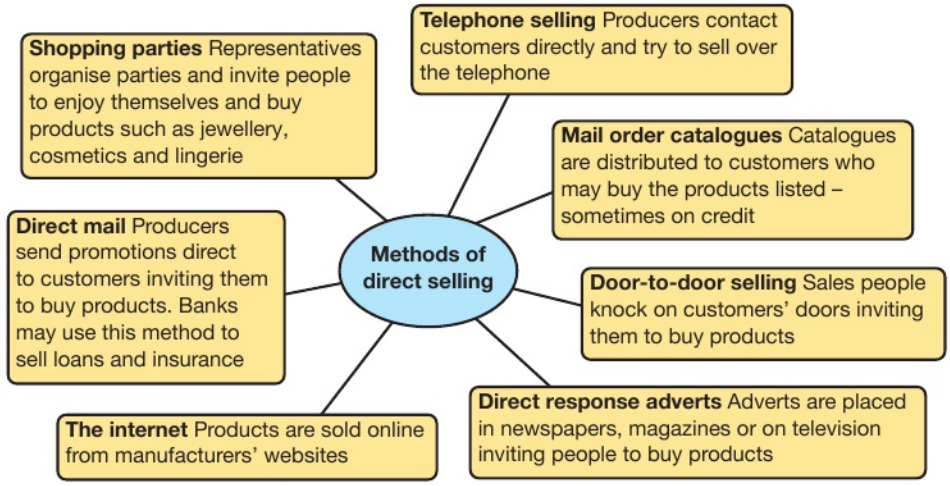
direct selling where businesses sell their products directly to consumers

DIRECT SELLING

Some producers market their products directly to consumers. **Direct selling** can take a number of forms, as summarised in Figure 38.2.

WHOLESALING

Some producers use wholesalers to help distribute goods. Wholesalers usually buy from manufacturers and sell to retailers. Some wholesalers are called cash and carry stores. This is because customers can come to the store, buy goods, pay cash and take goods away with them. Wholesalers may break bulk, repack



▶ Figure 38.2 Methods of direct selling

SUBJECT VOCABULARY

agent or broker intermediary that brings together buyers and sellers

KEY POINT

Manufacturers may use agents when exporting. Agents can reduce the risk of selling overseas. This is because they have knowledge of the country and the market.

goods, redistribute smaller quantities, store goods and provide delivery services. A wholesaler stocks goods produced by many manufacturers. Therefore retailers get to select from a wide range of products.

AGENTS OR BROKERS

The role of an agent or broker is to link buyers and sellers. They are used in a variety of markets. For example, travel agents sell holidays and flights for holiday companies, airlines and tour operators. Estate agents sell properties on behalf of vendors. Agents are also used to sell insurance, mortgages and other financial products.

ACTIVITY 1

CASE STUDY: BATA



▲ A Bata store

Bata is the largest retailer and the leading footwear manufacturer in India. It has a global operation employing 30 000 people in over 70 different countries. It serves 1 000 000 customers every day and generated revenue of Rs24 813.43 million in 2016. In 2015, it was recognised as 'India's most trusted brand'. Bata's stores can be found in convenient locations, such as in metro stations and towns. Bata aims to provide better quality products than its rivals and hopes to offer a high-quality shopping experience to its customers.

In addition to its 5000 stores, Bata has 26 manufacturing units in 18 different countries and a wholesaling operation distributing products through 30 000 dealers.

1 What is the difference between retailers and wholesalers?
2 Describe two features of a chain store like Bata.
3 Discuss the main advantage to Bata of manufacturing shoes and selling them through its own chain stores.

CHOOSING APPROPRIATE DISTRIBUTION CHANNELS

THE NATURE OF THE PRODUCT

Different types of products may require different distribution channels. Some examples are given below.

- Most services are sold directly to consumers. It would not be appropriate for window cleaners, gardeners and hairdressers, for example, to use intermediaries.
- Fast-moving consumer goods, such as breakfast cereals, confectionery, crisps and toilet paper, cannot be sold directly by manufacturers to consumers. Wholesalers and retailers play an important role in the distribution of these goods because they break bulk.
- Businesses producing high-quality 'exclusive' products, such as perfume and designer clothes, will choose their outlets very carefully. The image of their products is important so they are not likely to use supermarkets, for example.
- Some products need explanation or demonstration.

COST

Businesses will choose the cheapest distribution channels. They will also prefer direct channels. This is because each time an intermediary is used they will take a share of the profit. Large supermarkets will try to buy direct from manufacturers. This is because they can bulk buy and get lower prices. Independents are more likely to buy from wholesalers and so have to charge higher prices as a result because the intermediary needs to take a 'cut', or a payment for their service, and the independent needs to recover that cost. Many producers now sell direct to consumers from their websites, which helps to keep costs down.

THE MARKET

Producers selling to mass markets are likely to use intermediaries. In contrast, businesses targeting smaller markets are more likely to target customers directly. For example, a building contractor in a small town will deal directly with customers. Producers selling in overseas markets are likely to use agents because the agents will know the market better. Businesses selling goods to other businesses are likely to use more direct channels.

CONTROL

For some producers, it is important to have complete control over distribution. For example, producers of exclusive products do not want to see them being sold in 'down market' outlets because this might damage their image.

ACTIVITY 2

CASE STUDY: ROLEX

Rolex designs, manufactures and markets high-quality wristwatches for the prestige market. Rolex watches are made in Switzerland and distributed through a small network of specialists. Voted the world's most reputable company in 2016, for the second year running, Rolex is one of the world's top brands and, in keeping with its image, the watches can only be purchased from official Rolex retailers. Rolex watches are only available in a select number of official Rolex retailers. It is important

that each outlet has the skills and technical know-how to guarantee the authenticity of each and every part of a Rolex watch. Staff will also help customers to choose the right model that will last a lifetime. This helps to control the environment in which they are sold and to avoid the sale of fake watches. Genuine Rolex watches cannot be purchased online.

▶ An example of a Rolex showroom



1 Describe the method of distribution used by Rolex.
2 Discuss one possible reason why Rolex watches cannot be purchased online.

LARGE VS SMALL BUSINESSES

The distribution of goods is important to both large and small businesses. However, it could be argued that it may be more important to very large businesses, such as manufacturers, because they have greater quantities of produce to move. Choosing the best method of distribution will help them to keep costs down and make goods available in the 'right place at the right time'. Recent developments in distribution, such as online selling, have benefitted both large and small businesses. Indeed, small businesses may have benefitted the most. This is because small businesses will find it easier to sell to global markets. Before online selling, global markets may have been out of the reach of many small businesses.

MULTIPLE-CHOICE QUESTIONS

▶ **1 Which of the following is a service provided by retailers?**
A Wholesaling
B Market research
C Bulk-breaking
D Advertising

▶ **2 Which of the following is a feature of a chain store?**
A Usually located on brownfield sites
B Offer a very wide range of products
C Staff are highly trained
D Offer a standardised product range

▶ 3 Door-to-door selling is an example of which type of selling?
- A Direct selling
- B Wholesaling
- C Retailing
- D e-tailing

▶ 4 Which of the following is a benefit to consumers of e-tailing?
- A Low start-up costs
- B Consumers can shop from any location if they have access to the Internet
- C Businesses have more choice when locating their operations
- D Consumers receive excellent after sales service

CHAPTER REVIEW



▲ A Neiman Marcus department store

CASE STUDY: NEIMAN MARCUS

Neiman Marcus is an established US luxury department store. It belongs to the Neiman Marcus Group and operates stores in about 40 locations, five of which are in South Florida. Founded in 1907, the stores sell women's and men's clothing, accessories, jewellery and dinnerware. Neiman Marcus stocks high-profile brands, such as Chanel, Gucci and Prada, alongside up-and-coming designers. Its target market is people who can afford and value high-fashion. According to a recently published prospectus, Neiman Marcus said 'Our customers are educated, affluent and digitally connected.' Seventy per cent are women and about 38 per cent have a median household income of US$200 000. The average customer is 51 years old; 48 per cent are aged 50 or younger.

In common with many other retailers, Neiman Marcus has an online selling operation. Indeed, online sales are becoming more important to the business. Neiman Marcus's chief operating officer Don Grimes said that the company sold US$1300 million online in 2015, an increase of 13 per cent. Web sales made up 25.5 per cent of the company's 2015 sales of US$5095 million, up from 23.9 per cent a year earlier. The success of its online operation was explained by investment in technology and the provision of a personalised shopping facility.

CHAPTER QUESTIONS

1 What is meant by the term distribution channel?

2 Describe one factor that might affect the choice of distribution channel for a business.

3 Describe two features of a department store.

4 Discuss the possible reasons for the growth in online sales for retailers such as Neiman Marcus. Give at least two reasons in your analysis.

5 Assess the benefits of e-tailing to Neiman Marcus.

39 PROMOTION

LEARNING OBJECTIVES

- Understand above the line and below the line promotion techniques
- Understand public relations – improving company image/brand
- Understand how technology is used in promotion: targeted advertising online, viral advertising, social media and e-newsletters
- Understand the importance of a brand
- Understand promotion strategies for different market segments: advertising, sponsorship, product trials, special offers, branding

GETTING STARTED

Businesses have to make consumers aware of their products. They have to give them details about the features of the product, its price and where it can be purchased. However, many businesses go further than this. They use a variety of methods to encourage people to buy their products. Look at the examples below.



▲ Sky studios

CASE STUDY: SKY TELEVISION

Sky claims to be Europe's leading entertainment and communications business. It is a satellite television broadcaster but also provides contract-free streaming services (NOW television and Sky Online). In some countries, it also provides broadband, talk and line rental services. It has over 22 million customers. In 2015, Sky generated revenue of £11 283 million and made an operating profit of £1400 million, up 5 per cent and 18 per cent, respectively.

CASE STUDY: BLAKE STREET BLINDS

Blake Street Blinds is a small family business that manufacturers and fits blinds (window shades). It serves a small town with a population of 50 000. In 2016, it placed the advert shown Figure 39.1 in a local weekly newspaper for 4 weeks. The cost of the advert was £45.

1 Describe the methods used by Sky and Blake street Blinds to promote their products.
2 Describe one possible advantage of each method.



▶ Figure 39.1 An advert in a local newspaper

3 Discuss why Blake Street Blinds is likely to use a different method to Sky when advertising.
4 Design a poster that could be used to advertise a satellite television broadcaster.

WHAT IS PROMOTION?

SUBJECT VOCABULARY

above-the-line promotion placing adverts using the media

below-the-line promotion any promotion that does not involve using the media

merchandising the way in which goods are arranged and placed in a store

coupons printed piece of paper given to customers by the seller of a product, allowing the customer to pay less than usual for the product when they next buy it, or to get a free gift

direct mail advertisements that are sent to people in the post, often people who have been chosen because they might be interested in the product

Businesses have to communicate with their customers. They use two different methods of promotion to draw attention to their products.

- **Above-the-line promotion** involves advertising using the media. Advertising in newspapers and magazines, advertising on the television and the radio and banner adverts on websites are all examples.
- **Below-the-line promotion** is any other form of promotion that does not involve using the media. Examples might include press releases, point of sale displays, **merchandising**, **coupons** and **direct mailing**.

Generally, businesses use promotion to obtain and retain customers. However, promotion is likely to be used to achieve some specific aims.



▶ Figure 39.2 Why business use promotion

SUBJECT VOCABULARY

advertising communication between a business and its customers where messages are placed in the media to encourage the purchase of products

ABOVE-THE-LINE PROMOTION

Above-the-line promotion involves **advertising** in the media. Businesses pay television companies or newspapers, for example, to have their adverts broadcast or printed. Table 39.1 shows the advantages and disadvantages of the main media.

▼ Table 39.1 Advantages and disadvantages of main media

MEDIA	ADVANTAGES	DISADVANTAGES
Television	Huge audiences can be reached The use of products can be demonstrated Creative adverts can have great impact Opportunity to target groups with digital television	Very expensive Message may be short lived Some viewers avoid television adverts Delay between seeing adverts and shopping
Newspapers and magazines	National and local reach Reader can refer back Adverts can be linked to articles and features Opportunity to target with specialist magazines Relatively cheap	No movement or sound Individual adverts may be lost in a sea of adverts Rivals' products may be advertised as well
Cinema	Big impact with a big screen Can be used for local and national advertising Specific age groups can be targeted Sound and movement can be used	Limited audience Message may only be seen once Message is short lived

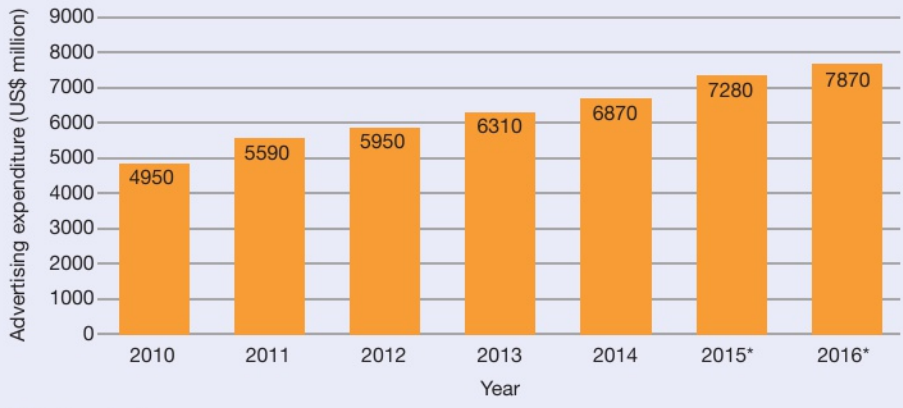
Radio	Sound can be used Minority audiences allow targeting Cheap production Can target youngsters	Not visual May be ignored May lack impact Can be irritating for listeners
Posters and billboards	Can produce national campaigns Seen repeatedly Good for short sharp messages Large posters can have big impact	Posters can get damaged by vandals Only limited information can be shown Difficult to evaluate effectiveness
Internet	Can be updated regularly Can be targeted Hits and response can be measured Cheap and easy to set up	Some adverts such as pop-up adverts are irritating Possible technical problems

ACTIVITY 1

CASE STUDY: TELEVISION ADVERTISING

The amount of money spent on advertising is huge. In 2016, total global advertising expenditure was set to reach US$579 000 million according to media research agency Zenith Optimedia. This was 4.9 per cent higher than in 2015. A significant proportion of this goes on television advertising. However, in many countries television advertising by businesses, as a proportion of the total, is falling.

In China, television advertising is still growing and is expected to continue growing into the near future. China has a rapidly growing economy and an increasing number of foreign businesses are trying to break into the Chinese market.



▶ Figure 39.3 Television advertising expenditure in China, 2010–16

* Estimated

1. What is meant by above-the-line promotion?
2. Work out the percentage increase in television advertising expenditure in China between 2010 and 2016.
3. Suggest one possible reason that might account for the growth calculated in (2).
4. Discuss two benefits to businesses of using television advertising.

BELOW-THE-LINE PROMOTION

Below-the-line promotion is usually designed and produced by a business 'in-house'. It refers to any form of promotion that does not involve advertising. A variety of different promotions might be used.

Sales promotions

These are incentives to encourage people to buy products. They are used to boost sales in the hope that if new customers are attracted they will continue to buy the product. Sales promotions can include the following.

- **Free gifts:** Businesses might give free gifts to customers when they buy the product. For example, computer companies often give away free software.
- **Coupons:** Money-off coupons, or discount codes, can be used by businesses to attract customers. They may be attached to products, appear in newspaper adverts or pushed through letterboxes. A number of specialist coupon websites have emerged in recent years. People can logon to the sites and print-off coupons entitling them to discounts on a wide range of products.
- **Loyalty cards:** Some businesses reward customers according to how much they spend. Points are collected and then exchanged for cash, vouchers or free goods. Loyalty cards are popular with supermarkets, credit card companies and stores.
- **Competitions:** People may be allowed free entry into a competition when they a buy a particular product. An attractive prize is offered to the winners.
- **BOGOF offers:** This stands for Buy One Get One Free. These are popular with many businesses such as supermarkets, transport services and restaurants.
- **Money off deals:** Businesses may offer customers discounts such as '30% off' or 'an extra 20% free'. These are similar to BOGOF deals and are used by a range of suppliers.

DID YOU KNOW?

Sales promotions are popular. They might be used to break into a new market or encourage new customers to try the product. They may also be used to reward loyal customers and allow businesses to measure the impact of promotion (by counting the number of returned coupons, for example).

Merchandising and packaging

Some businesses may arrange the point of sale so that it is interesting and eye catching and likely to encourage sales. This is called merchandising. Some examples are outlined below.

- **Product layout:** The layout of products in a store is often planned very carefully. This is to encourage shoppers to follow particular routes and look at certain products. Products that stores want you to buy are placed at the most visible locations, such as at the end of shelving units and at eye level.
- **Display material:** Posters, leaflets and other materials may be used to display certain products with the aim of persuading customers to buy. Lighting and other special effects might be used to improve the environment. Window displays are considered important to retailers; they are used to draw in customers.
- **Stock:** Businesses must keep shelves well stocked because empty shelves create a bad impression. Also, if items are out of stock, customers may shop elsewhere.

Direct mailing

Direct mailing is where businesses send households leaflets or letters. Sometimes personal letters are used. They may contain information about new products or details of price changes, for example. Increasingly, email is being used to contact consumers rather than the postal system. The development of IT and use of customer databases has resulted in more use of personalised marketing.

Direct selling or personal selling

Direct selling or personal selling might involve a salesperson calling at households or businesses hoping to sell products. It could also be a telephone call from a call centre, where a large sales team is employed to sell over the telephone. One advantage of this approach is that the features of the product can be discussed. However, people are often irritated by this approach because the sales staff have not been invited to call.

Exhibitions and trade fairs

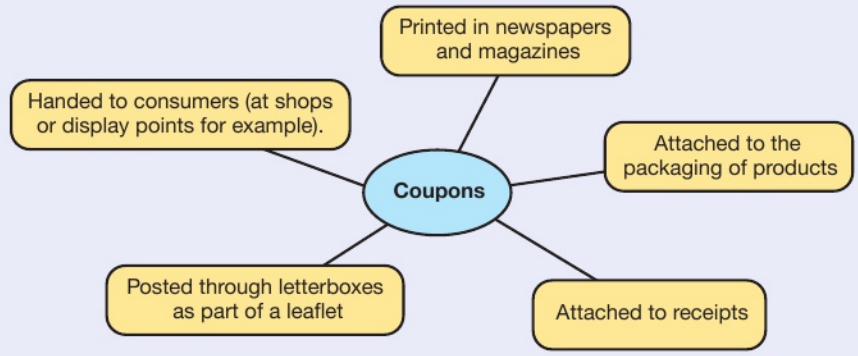
Some businesses attend trade fairs or exhibitions to promote their products. Businesses set up a stand and promote their products face to face. Commercial buyers or consumers, or both, may attend trade fairs. In the UK, some popular exhibitions are the Motor Show, the Ideal Home Exhibition and the Boat Show. The main advantages of this method are outlined briefly below.

- Products might be tested out on consumers before a full launch.
- Some exhibitions are overseas and can be used to break into foreign markets.
- Products can be physically demonstrated and questions can be answered.
- Exhibitions often attract the media.
- Customers can speak to business owners or senior personnel face to face.

ACTIVITY 2

CASE STUDY: COUPONS

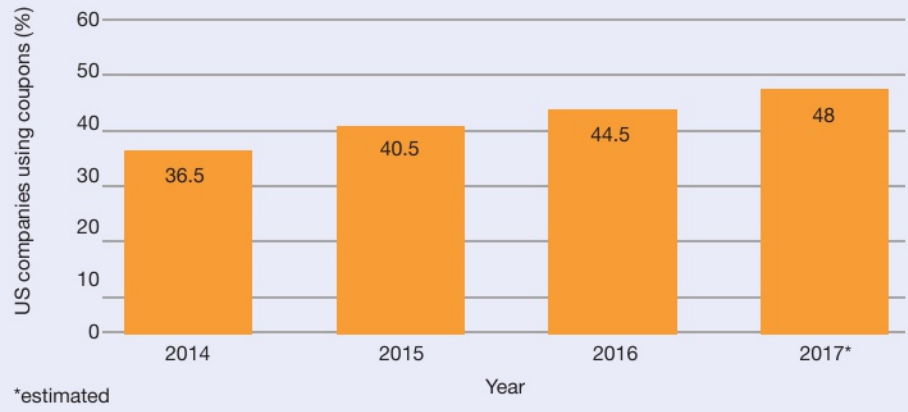
Coupons, which entitle the holder to discounts off specified goods and services, can be found in a variety of places.



▶ Figure 39.4 Coupon distribution

However, in recent years they have started to appear on specialist coupon websites. These are websites that offer consumers coupons and discount codes that can be used to get money off a wide range of products and services. Examples of these websites include Brad's Deals, Coupon Cabin, Hip 2 Save, Promocodes.com, The Krazy Coupon Lady and Savings.com.

Most online retailers make use of coupons. For example, Figure 39.5 shows the proportion of US companies using mobile coupons for marketing between 2014 and 2017. One of the main advantages of coupons is that they draw in price-conscious consumers who would otherwise go elsewhere. Coupons can also be targeted at those markets where price competition is most intense.



▶ Figure 39.5 Proportion of US companies using mobile coupons

1 What is meant by below-the-line promotion?
2 Discuss the benefits to businesses of using online coupons.

PUBLIC RELATIONS

Some businesses communicate with stakeholders using public relations (PR). The main purpose of PR is to increase sales by improving the image of the business and reinforcing an established brand. A number of approaches might be used by businesses to attract publicity.

SUBJECT VOCABULARY

public relations attempt by a business to communicate with interested parties

PRESS RELEASE

Some information about the business may be presented to the media. This might be used to write an article or feature in a television programme. For example, a business might announce that it is to create 2000 new jobs. Such positive news would be of interest to the media and they might want more information.

PRESS CONFERENCE

This is where representatives face the media and present information verbally. This allows for questioning and other feedback. The press might be invited to a new product launch, for example.

GENERAL VOCABULARY

sponsorship making a financial contribution to an event in return for publicity

SPONSORSHIP

Many companies attract publicity by linking their brands with sporting events through sponsorship. For example, Samsung, Coca-Cola, Omega, Bridgestone, McDonald's, Visa and Panasonic were some of the businesses that sponsored the Rio Olympic Games in 2016 in return for publicity at the event. The sponsoring of television programmes is also becoming popular. One of the key advantages of sponsorship is that the name of the brand can be projected globally on the television or in print media without paying broadcasters or publishers. This is because most of the major events targeted by sponsors are televised or covered in the press.

DONATIONS

Donations to charities and the local community might be used by businesses to improve their image. A large donation from a business is likely to be reported in the media if the identity of the donor is revealed.

The main advantage of PR to businesses is that it is often a cheap method of promotion. Some businesses have been known to deliberately seek bad publicity by being controversial. This can raise the profile of a business very quickly, sometimes at no cost, but can be extremely risky.

USING TECHNOLOGY IN PROMOTION

Many businesses are keen to exploit new technology when marketing their products. The development of online businesses, mobile devices and social media platforms have all contributed to many businesses re-allocating their advertising expenditure in favour of the new technological methods. Some of the common methods used by businesses are outlined below.

ONLINE TARGETED ADVERTISING

Some of the traditional methods of advertising often meant that adverts were directed at a lot of people who would never buy the product. For example, a television advert promoting a four-wheel drive car would only appeal to a minority of viewers. Therefore, much of the money spent on the advert would appear to be wasted. New technology means that adverts can now be more targeted. This means that adverts are only directed at people who are likely to be interested in the product. This is possible because businesses can use browsing habits and other data collected from online users to make adverts more personalised. This means for example, if someone has been browsing websites to book a flight from Mumbai to Colombo, several hours or days later they might see adverts for such flights while looking at a completely unrelated website, such as the weather. Marketing companies like DoubleClick compile records of users' browsing habits, which are then sold on to businesses. This information is then used to tailor advertising to specific customers and therefore avoids the waste of misdirected adverts.

SUBJECT VOCABULARY

viral advertising direct marketing technique in which a company persuades Internet users to forward its publicity material in emails or via social media (usually by including jokes, games, video clips, etc.)

exposure advertising and publicity that is used to sell a product or service

VIRAL ADVERTISING

Advertising using the Internet has provided the opportunity for **viral advertising**. This involves any strategy that encourages people to pass on messages to others about a product or a business electronically. It creates the potential for exponential growth in the **exposure** of a message. Like a virus, these strategies exploit the process of rapid multiplication that results from people sending messages to family, friends and colleagues, who then send them on again. Not only can people send text relating to a marketing message, but they also can send images, such as photographs and video clips. One example of a successful viral advertising campaign was produced by Disney, which showed a film clip of Disney characters interacting with shoppers in the USA.

SOCIAL MEDIA

The use of social media platforms, such as Facebook, Twitter, Instagram and Tumblr, in advertising is growing at a rapid rate. In 2015, the Internet had 3170 million users. There are 2300 million active social media users and 91 per cent of retail brands use two or more social media channels. Internet users have an average of 5.54 social media accounts and social media users have risen by 176 million in the last year. Figure 39.6 shows that the amount spent by businesses on digital advertising will soon be greater than the amount spent on television advertising.

Social networks gather lots of information about users, which allows businesses to target their adverts more effectively. When people use the Internet, every click, every view and every sign-up is recorded somewhere. This behaviour is collected, processed and eventually ends up with

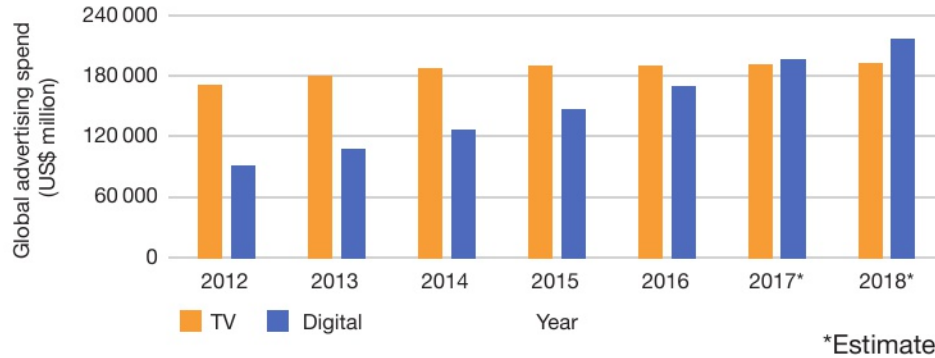
businesses. Some of the advantages of using social media in advertising are as follows.

- It is relatively cheap compared with other methods of advertising.
- Businesses can respond immediately to developments in the industry.
- The quality of customer service can be improved because it is possible to communicate instantly with customers.
- The method has a huge reach – billions of people.
- Adverts can be accurately targeted.
- Links can be used to draw traffic into company websites.

E-NEWSLETTERS

Some businesses send customers e-newsletters. These are documents sent electronically to interested parties. They contain a range of content that is not just related to shopping. Companies might include everything from industry news, to interesting statistics, and 'tips' on how to improve one's lifestyle, for example. E-newsletters are only sent to customers who have already purchased some goods or services or have expressed an interest in the company. They may also be personalised, which means that they are less likely to be treated like 'spam'. Provided that they are not too long and contain information of interest, they can help develop relationships with customers and bring to their attention new buying opportunities.

▶ Figure 39.6 Global spending on television and digital advertising, 2012–18



*Estimated

BRANDING

The aim of many businesses is to build a powerful brand. Branding involves giving a product a name, term, sign, symbol, design or any feature that allows consumers to instantly recognise the product and differentiate it from those of competitors. Some brand names are very well known and worth a great deal of money. Table 39.2 shows the top ten most valuable global brands in 2016 according to brand consultancy Millward Brown's annual BrandZ rankings. Branding is used to:

- differentiate the product
- create customer loyalty
- help recognition
- develop an image
- raise prices when the brand and image becomes strong.

▶ Table 39.2 Top ten most valuable global brands, 2016

RANK	BRAND	VALUE (US$ MILLION)
1	Google	229 200
2	Apple	228 500
3	Microsoft	121 800

RANK	BRAND	VALUE (US$ MILLION)
4	AT&T	107 400
5	Facebook	102 600
6	Visa	100 800
7	Amazon	98 900
8	Verizon	93 200
9	McDonald's	88 600
10	IBM	86 200

THE USE OF PROMOTION STRATEGIES IN DIFFERENT MARKET SEGMENTS

In this chapter, we have discussed a wide variety of different promotion methods. Many businesses use a range of different approaches to promotion and the methods chosen by businesses will vary according to the nature of the market segment being targeted. Some examples are outlined below.

ADVERTISING

Some form of advertising is likely to be used in most market segments. However, the type of advertising used in certain market segments is likely to differ. For example, in mass markets a large business may use television advertising or social media. This will help to reach large audiences. In niche markets different approaches will be used. For example, businesses selling prestige cars might use more targeted advertising such as specialist magazines or specialist websites, where wealthier consumers may be reached.

SUBJECT VOCABULARY

product positioning way that people think about a product in relation to the company's other products and to competing products, or the way that the company would like them to think about it

subscription pricing amount of money you pay regularly to receive a newspaper, magazine, or broadcasting or telephone service

SPONSORSHIP

Sponsorship might be used in markets where image or **product positioning** is important. For example, Rolex, the luxury watchmaker, sponsors golf tournaments around the world. This may be because golf has a certain prestigious and sophisticated image with which Rolex wants to be associated. Some businesses sponsor certain events because their products can be a targeted directly at the people attending, or more importantly, watching the event on television. In sport, many businesses sponsor high profile individuals. This means they pay them for wearing clothing or using certain equipment. Nike uses this approach.

PRODUCT TRIALS

In some market segments product trials are popular. This is where people are encouraged to try a product for a trial period at a reduced rate before fully committing to it. For example, gyms and fitness centres and other businesses using **subscription pricing** use this approach. A customer may be offered membership to a fitness centre at half price for three months. Such offers allow them to trial the product and see if it meets their needs. If they like the centre, they might then take out a full membership.

SPECIAL OFFERS

Price discounts and other special offers are common in many market segments. However, they are particularly popular with the selling of fast moving consumer goods. They can be used in different ways. For example, supermarket might use price reductions on a limited range of lines to draw people into stores. The store will hope that customers make additional purchases once they have taken the trouble to find the lines on special offer.

Special offers might also be used to clear old stock, generate quick cash flow and create interest in a new product.

BRANDING

Since there are significant advantages to building a strong brand name, branding will be popular in virtually all market segments. If a business can establish a name for itself or its products in a particular market segment, the brand can then be 'stretched' and perhaps used in other segments. Virgin has managed this by building a brand in the music industry and then exploiting it in air travel and rail transport, among other things.

LARGE VS SMALL BUSINESSES

All businesses are likely to spend some money on promotion. However, the methods used by different businesses may depend on their size. For example, most small businesses could not afford television advertising. Also, many small businesses aim their adverts at local markets. This is because they can survive by attracting a much smaller number of customers from the local area. Large businesses have much more choice when selecting methods of promotion. This is mainly because they have more resources. Furthermore, they may have to promote a range of different products in a number of different market segments. Finally, both large and small businesses are making increasing use of social media in promotion.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an example of above-the-line promotion?
- A Radio advert
- B Merchandising
- C Sponsorship
- D Free gifts

▶ 2 Which of the following is an example of public relations?
- A Television advert
- B Coupons
- C Merchandising
- D Press conference

▶ 3 A business targeting a mass market is **most** likely to use which method?
- A Sponsorship
- B Television advertising
- C e-newsletters
- D Trade fairs

▶ 4 Which of the following is an aim of promotion?
- A Improve productivity
- B Reduce labour turnover
- C Inform customers about a new product
- D Reduce costs

CHAPTER REVIEW

CASE STUDY: THE INDIAN PREMIER LEAGUE

The Indian Premier League (IPL) is the most important domestic cricket tournament in the world. This Twenty20 cricket league was run for the ninth time in 2016 with eight franchised teams representing Indian cities. The IPL is the most attended cricket league in the world and ranks sixth among all sports leagues. It is broadcast live on YouTube; the brand value of IPL was estimated to be US$4500 million in 2015. It is a huge 'money-

making' event and according to the Indian cricket authorities, the IPL contributed US$182 million to the Indian economy in 2015.

The IPL is sponsored by some high profile businesses, such as Vodafone, Yes Bank, CEAT Tyres, Tata Sky, Coca-Cola, Amazon and OPPO. In 2016, the Chinese company, Vivo Electronics, became the title sponsor. Therefore, the league is officially known as the Vivo Indian Premier League. Each sponsor is given advertising boards around the edges of the pitch. They also get their logos during pre- and post-match interviews and free tickets to each match. They are also likely to get priority on television adverts during matches to give them maximum exposure.

Although staged in India, the IPL attracts the best players from around the world and has global television audiences of around 361 million viewers, according to Sony Pictures Networks India, the official broadcasters. It was reported that 10-second television spots to advertisers were being sold for Rs550 000–700 000 (around US$105 000). Despite these high rates, companies were happy to invest in television advertising. The total advertising space for the tournament was sold out well before it began. One advert by smartphone maker Reliance Retail went viral on social media. It featured Bollywood actress Kangana Ranaut and cricketers M.S. Dhoni, Virat Kohli and Ravichandran Ashwin.

The tournament generates an enormous amount of social media activity. The 2016 Twenty20 generated close to 9 million Tweets, an increase of 122 per cent in Tweets-per-match from 2015. Social media followers can go onto the IPL website and connect to a 'social' tab. This shows all online conversations and features a leaderboard for Tweets relating to each cricket team and the tournament in general.



▲ An IPL match in progress

CHAPTER QUESTIONS

1 What is meant by sponsorship?

2 Describe two advantages to sponsors of their involvement in the IPL.

3 What is meant by viral advertising? Use an example from this case study in your explanation.

4 Discuss one benefit to businesses of establishing a brand name.

5 Assess the benefits to a business of using social media in advertising.

EXAM PRACTICE: 4 MARKETING

Sony is a large Japanese multinational company. It is a diversified corporation with interests in consumer and professional electronics, gaming, entertainment and financial services. In 2014, Sony enjoyed revenues of US$69 050 million and spent US$2350 million on worldwide advertising.

AO2 **a** Calculate the amount of money Sony spent on advertising as a percentage of its revenue in 2014. **(2)**

For some of its products, such as the Sony Playstation, Sony uses a skimming pricing strategy.

SKILLS PRODUCTIVITY

AO2 **AO3** **b** Analyse the benefit to Sony of using a skimming pricing strategy. **(6)**

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO1 **AO2** **AO3** **AO4** **c** Evaluate the importance of market research to Sony. **(12)**

Total marks for this question = 20


2,512.9
3,31

5 BUSINESS OPERATIONS

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

This section explores the different methods of production used by businesses and the role played by modern approaches, such as lean production and kaizen. The range of resources used by businesses, the balance between the use of labour and capital in production and the behaviour of average costs as output increases are also covered. Finally, the concept and importance of quality is addressed showing how quality can be used to gain a competitive advantage in the market.

40 ECONOMIES AND DISECONOMIES OF SCALE

LEARNING OBJECTIVES

- Understand internal and external economies of scale
- Understand diseconomies of scale
- Understand the limits of growth

SUBJECT VOCABULARY

scale size of a business

GETTING STARTED

Setting up a business and ensuring it survives is challenging. However, once a business is established, the owners often want it to grow. They want to increase the scale of the business. This means that they want to increase its size. One of the benefits of increasing the scale of operations is that certain costs start to fall. Look at the examples below.

CASE STUDY: GILLY'S SNACK SHACK

Gilly's Snack Shack sells sandwiches and other snacks from a kiosk by Grant Park, in central Chicago, Illinois, USA. It serves office workers, shoppers and tourists. Gilly's Snack Shack sells about 900 sandwiches per week. Gilly, the owner, buys sandwich ingredients from supermarkets and wholesalers. For example, the business buys about 20 loaves of bread per day at a cost of US$1.80 each. Tomatoes cost US$2.50 per kilogram and cheese is US$7.00 per kilogram. Most of their sandwiches sell for US$2.00. The business has a US$5000 loan, which was taken out to help set up the business. An interest rate of 8.9 per cent is paid on the loan.



▲ Sandwich production

CASE STUDY: GRANT FINCH FOODS

Grant Finch Foods is a large catering company based in Chicago. It supplies sandwiches to supermarkets and sells about one million sandwiches per week. Grant Finch Foods employs 110 workers and buys ingredients direct from farmers and manufacturers. For example, it buys tomatoes from a local farm for US$1.50 per kilogram and cheese for US$5.00 per kilogram. It buys thousands of loaves of bread from a Chicago baker for US$1.10 each. It sells sandwiches at an average price of US$1.40 per packet. GF Foods pays 7.5 per cent interest on a US$1 000 000 loan.

1. Which of the two businesses is the largest?
2. Which business has the lowest costs?
3. Which firm is likely to be the most efficient?
4. How might Grant Finch Foods benefit from its cost advantage?

ECONOMIES OF SCALE

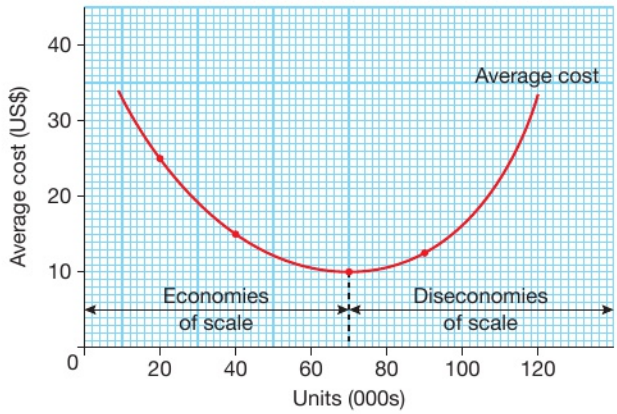
SUBJECT VOCABULARY

economies of scale financial advantages (falling average costs) of producing something in very large quantities

diseconomies of scale rising average costs when a firm becomes too big

Large firms can usually produce goods more cheaply than small firms. The size of a firm has an important effect on the average costs of production. As a firm increases its size, average costs start to fall. This is because of **economies of scale**, as is shown in Figure 40.1. When the business is producing 20 000 units of output, the average cost is US$25. If it raises output to 40 000 units, average costs fall to US$15. The firm could carry on expanding and lower its average costs until it is large enough to produce 70 000 units. At this level of output, average costs are minimised at US$10 per unit. It is the ideal size because average costs are at an absolute minimum. If the firm grows beyond 70 000 units, average costs will start to rise. For example, if the firm increases its size and produces 90 000 units, average costs will now rise to US$12.50 per unit. This is owing to **diseconomies of scale**, which occur because of inefficiency.

▶ Figure 40.1 Economies and diseconomies of scale



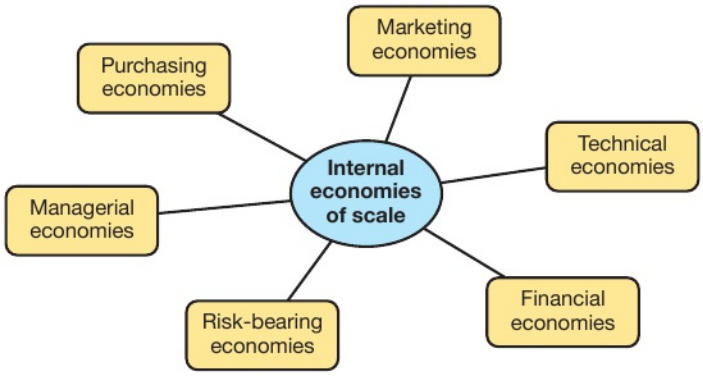
INTERNAL ECONOMIES OF SCALE

SUBJECT VOCABULARY

internal economies of scale cost benefits that an individual firm can enjoy when it expands

Internal economies of scale are the cost benefits that an individual firm can enjoy when it grows. The reasons why costs fall are summarised in Figure 40.2.

▶ Figure 40.2 Sources of internal economies of scale



PURCHASING ECONOMIES

Large firms that buy lots of resources get cheaper rates. Suppliers offer discounts to firms that buy raw materials and components in bulk. This is similar to consumers buying multi-packs in supermarkets – they are better value for money. Bulk buying is a purchasing economy. In 'Getting started' above, GF Foods was able to buy bread for US$1.10 a loaf. However, Gilly's Snack Shack was having to pay US$1.80 because it was buying smaller quantities. In fact, all the purchases made by GF Foods were cheaper than those of Gilly's Snack Shack for the same products.

MARKETING ECONOMIES

A number of marketing economies exist. For example, it may be cost effective for a large firm to run its own delivery vehicles. For a large firm, with lots of deliveries to make, this would be cheaper than paying a distributor. Marketing economies can occur because some marketing costs, such as producing a television advert, are fixed. These costs can be spread over more units of output for a larger firm. Therefore, the average cost of the advert is smaller for a large firm.

TECHNICAL ECONOMIES

Technical economies occur because larger plants are often more efficient than smaller ones. There can be more specialisation and more investment in machinery. One example of a technical economy is the way a large firm will make better use of an essential resource than a smaller firm. For example, a small engineering company may buy some CAD (computer aided design) software for US$1000. It is needed by the business but is only used for one day a week. A much larger engineering company may buy the same software but use it every day of the week. Clearly, the larger company is making better use of the software and therefore its average cost will fall.

FINANCIAL ECONOMIES

Large firms can get cheaper money. They also have a wider variety of sources to choose from. For example, a large limited company can raise money by selling shares. This option is not available to a sole trader. Large firms can put pressure on banks when negotiating the price of loans. Banks are often happier lending large amounts to large companies at lower interest rates. In 'Getting started', GF Foods was paying 7.5 per cent to borrow US$1 000 000. In contrast, Gilly's Snack Shack was paying 8.9 per cent to borrow just US$5000.

MANAGERIAL ECONOMIES

As firms expand they can afford specialist managers. A small business may employ a general manager responsible for finance, human resources, marketing and production. The manager may find this role demanding and may be weak in some areas of the job. A large firm can employ specialists. As a result, efficiency is likely to improve and average costs fall.

RISK-BEARING ECONOMIES

Larger firms are more likely to have wider product ranges and sell into a wider variety of markets. This reduces the risk in business. For example, many supermarkets have extended their product ranges to include household goods, consumer durables, books, a café, financial services, garden furniture, pharmaceuticals and clothes.

ACTIVITY 1

CASE STUDY: DIB (DO-IT-BETTER)

DIB is a large US hardware store with 212 branches right across the whole of the USA. Many of its product lines are manufactured by its own factories. One of the reasons for its success has been the ability to keep costs down in manufacturing. DIB is very large and generated sales revenue of US$24.5 billion in 2017. As a result of its size, it is able to exploit economies of scale.



▲ The garden department inside a large DIB store

On the technical side, DIB benefits from specialisation. It employs specialist workers in all of its factories to produce different products and components. This division of labour allows average costs to be reduced since specialists are more efficient. DIB also invests heavily in research and development. This allows the business to develop cost effective products and money-saving production techniques.
DIB also exploits risk-bearing economies. Although the business first began trading in painting and decorating materials in the 1970s, DIB is now involved in a much wider range of markets. These include fitted kitchens, garden furniture, other garden products, timber, tools, light machinery and building supplies. It also operates restaurants and food markets with many stores serving food throughout the day. It also provides childcare with some stores offering properly supervised play areas. This growth in the business means that DIB can benefit from boom periods in different markets. It can also cope with seasonal changes and difficult trading conditions in one market by relying on sales in others.

1 Discuss how DIB is exploiting **(a)** technical economies of scale and **(b)** risk-bearing economies of scale.

EXTERNAL ECONOMIES OF SCALE

SUBJECT VOCABULARY

external economies of scale cost benefits that all firms in the industry can enjoy when the industry expands

GENERAL VOCABULARY

vocational training, guidance, course and similar that teaches you the skills you need to do a particular job
ancillary (services) connected with something but less important than the main part of it

Sometimes all firms in an industry can enjoy falling average costs as the whole industry grows. This is called external economies of scale. External economies are more likely to occur if an industry is concentrated in a particular region.

SKILLED LABOUR

If an industry is concentrated in one area, there may be a build-up of labour with the skills and work experience required by that industry. As a result, training costs will be lower when workers are recruited. It is also likely that local schools and colleges will provide vocational courses that are required by local industry.

INFRASTRUCTURE

If a particular industry dominates a region, the roads, railways, ports, buildings and other facilities will be shaped to suit that industry's needs. For example, a specialised industrial estate may be developed to help a local IT industry.

ANCILLARY AND COMMERCIAL SERVICES

An established industry in a region will encourage ancillary suppliers in that industry to set up close by. Specialist marketing, cleaning, banking, waste disposal, distribution, maintenance and components suppliers are likely to be attracted to the area. All firms in the industry will benefit from their services, like the car industry in the Midlands in England, for example.

COOPERATION

When firms in the same industry are located close to each other they are likely to cooperate with each other so that they can all gain. For example, they might work together to share the cost and benefits of a research and development centre, as high-tech businesses do in Silicon Valley, California, USA.

DISECONOMIES OF SCALE

GENERAL VOCABULARY

bureaucracy system of administration that uses a large number of departments and officials
coordinate to organise people or things so that they work together well

Figure 40.1 shows that if a firm continues to expand beyond a certain point, average costs eventually rise. This is because the firm suffers from diseconomies of scale. Average costs start to rise because aspects of production become inefficient. Why might this happen?

BUREAUCRACY

Larger business rely more on **bureaucracy**. If a business becomes too bureaucratic, it means that too many resources are used in administration. Too much time may be spent filling in forms or writing reports. Also, decision making may be too slow and communication channels too long. If resources are wasted in administration, average costs will start to rise.

LABOUR RELATIONS

If a firm becomes too big, relations between workers and managers may deteriorate. Management may fail to understand workers and they may become demotivated. As a result, conflicts may occur and resources may be wasted resolving them.

CONTROL AND COORDINATION

A very large business may be difficult to control and **coordinate**. Thousands of employees, billions of pounds and dozens of plants all over the world can make running a large organisation demanding. There may be a need for more supervision, which will raise costs.

ACTIVITY 2

CASE STUDY: VOLKSWAGEN

In 2015, Volkswagen (VW), the very large German car manufacturer, was caught falsifying emissions data on its diesel cars. VW had been fitting some special software in its diesel vehicles called a 'defeat device'. This fine-tunes the engine's performance so that nitrogen oxide emissions are limited when being tested. However, when the cars return to the road, the emissions levels rise again. This meant that the cars would pass the strict emissions test.

It appears that around 11 million cars were fitted with this device and since its discovery VW has suffered badly. For example, the value of the company fell by around €30 000 million following a flood of bad publicity across the world. A number of theories have been suggested to explain why this scandal was allowed to happen. Some analysts have suggested that the company is now too big and suffering from diseconomies of scale. Giant companies like VW, which employs over 500 000 employees, become huge bureaucracies rather than commercial organisations. Controlling and monitoring such vast operations, with factories, offices, warehouses and other operational facilities all over the world, becomes a very serious challenge for managers.

Although economies of scale are crucial in the mass production of motor cars, some people think that a number of companies are beginning to experience diseconomies of scale – particularly when managing information in the organisation.



▲ A VW vehicle being tested for emissions

It has been claimed that the CEO of VW did not know about this activity. In such a large organisation, this might be true. It is unlikely that any CEO, however capable, committed and well organised, could be in complete control of such a huge quantity of resources that are widely dispersed all over the world.

To conclude, as businesses grow, at some point, the disadvantages of being big eventually become greater than the benefits. These disadvantages include:

- loss of control
- communications problems
- the need for more supervision and extra layers of management
- the increasing tendency for delegation
- the geographical spread of resources
- the near impossibility of establishing a common business culture
- employing a fully integrated IT system.

This may have been the cause of VWs current problems.

1 What is meant by diseconomies of scale?
2 Assess whether VW has experienced diseconomies of scale in its organisation.

OTHER LIMITS TO GROWTH

Diseconomies of scale are likely to discourage businesses from growing too big. However, there are a number of other barriers that might prevent a business from growing in size.

LACK OF FINANCE

Some businesses would like to grow but are not able to raise the finance needed to expand. Growth usually requires investment in new resources, such as property extensions, new machinery, equipment and more labour. Unfortunately, some businesses are not able to convince moneylenders that if the company grows it will be more successful and the finance will be repaid. Many small businesses that want to grow are still seen as too risky by lenders.

NATURE OF THE MARKET

Some markets are too small to sustain very large companies. For example, the market for luxury yachts is limited. Only a relatively small number of very wealthy people can afford to buy a luxury yacht. Therefore, businesses in this market will struggle to grow into very large organisations.

LACK OF MANAGERIAL SKILLS

Some businesses may be prevented from growing because the owners do not have the managerial skills required to run a large business operation. For example, the skills needed to run a grocery store are not exactly the same as those required to run a large chain of grocery stores. To run a very large business, owners need vision, good leadership skills, highly effective communication skills and the ability to take a lot of the responsibility. This is particularly the case if owners are reluctant to delegate.

LACK OF MOTIVATION

Some business owners do not want to grow their businesses. They may be happy running a small business. They may be making enough profit to satisfy their needs and do not want the responsibility of taking on more workers, expanding operations and borrowing more money, for example. Also, some businesses are 'lifestyle' businesses. This means that the owners have interests other than their businesses and they need the time and flexibility to pursue them. As a result, such businesses are likely to remain small.

LARGE VS SMALL BUSINESSES

Small businesses cannot benefit from economies of scale. This is because, by definition, a business has to produce large amounts of output to enjoy the lower costs that result. Similarly, a small business cannot experience diseconomies of scale for the same reason. Some small businesses may want to grow so that they can enjoy economies of scale. However, they may be prevented from doing so by the limits to growth, which are explained above.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Employing a specialist cost accountant in a growing business is an example of which type of economy?

A Technical economy
B Risk-bearing economy
C Managerial economy
D Marketing economy

▶ 2 What impact will internal economies of scale have on costs?

A Total costs will fall
B Average costs will rise
C Variable costs will rise
D Average costs will fall

▶ 3 Which of the following is an example of an external economy of scale?

A Increased cooperation and information sharing between businesses
B Rising costs of inputs
C Lower costs owing to bulk buying
D Better efficiency resulting from the specialisation of labour

▶ 4 Which of the following is a possible limit to business growth?

A Fall in the exchange rate
B Government restrictions
C Marketing constraints
D Lack of finance

CHAPTER REVIEW

CASE STUDY: FLAMBOYANCE

Flamboyance is a clothes chain based in Singapore. It sells high-quality clothes, shoes and fashion accessories. It has an excellent reputation for good customer service and operates 21 shops in Singapore and a further 52 in other Asian countries. In 2012, Flamboyance employed a specialist marketing manager. The new manager raised the profile of the Flamboyance brand right across Singapore. As a result, the company grew quickly and became very profitable. Flamboyance buys most of its clothes and shoes from China.



▶ Inside a high-quality clothes store

In 2015, Flamboyance bought a clothes chain in the Middle East. It was thought that the company could further exploit economies of scale and make even more profit. However, there were some problems. Communications became difficult owing to language and cultural difficulties. There was also a lack of employee understanding. Many of the staff did not seem to care whether the company succeeded or not. Some of the store managers also complained that the company was becoming too bureaucratic.

CHAPTER QUESTIONS

1 What is meant by the term scale in business?

2 Describe the effect that economies and diseconomies of scale are likely to have on Flamboyance's average cost.

3 Why is employing a specialist marketing manager an economy of scale?

4 Assess whether Flamboyance has benefited from purchasing economies of scale.

5 To what extent has Flamboyance experienced diseconomies of scale?

41 PRODUCTION AND PRODUCTIVITY

LEARNING OBJECTIVES

- Understand the different types of production processes: job, batch and flow
- Understand labour and capital-intensive production
- Understand the impact of different types of production
- Understand how to calculate productivity
- Understand the impact of productivity improvements

GETTING STARTED

Businesses can use different production methods when making products. For example, the method used by a jeweller is different from that used by a computer manufacturer. There may also be differences in the same industry. For example, some furniture is mass produced in large factories while smaller producers make furniture by hand. Look at the production methods used in the examples below.

CASE STUDY: M.K. SIDDIQI

M.K. Siddiqi produces handmade suits for men of all ages. He learnt the trade from his father and has been making suits in the same workshop in Chittagong, Bangladesh, for 43 years. M.K. Siddiqi has an excellent reputation for quality and can make a suit in less than 48 hours. He offers customers a massive choice in terms of different fabrics, designs and styles. Each suit is made to the needs and desires of each individual customer. M.K. Siddiqi says: 'I really enjoy my time at work. Every job is different. I like the variation in customer demands. I think I have made nearly 10 000 suits since I started and every one has been different to some extent.'



▶ Tailor at work



▲ Production of chocolate bars

CASE STUDY: MARS, INCORPORATED

Mars is a multinational producer of confectionery, pet foods and other foods. Some of its well-known brands include Mars, Bounty, Snickers, Milky Way, Galaxy, Wrigley's, Starburst, Pedigree Chum and Whiskers. Mars employs around 80 000 people in 78 factories all over the world. It produces millions of units of chocolate bars and other products to allow the 200 million transactions Mars conducts with customers each day. In 2015, the family-owned business generated US$33 000 million in revenue.

1 Compare the two production methods used in the above examples.
2 Describe two reasons why the two businesses use different production methods.

BATCH PRODUCTION

SUBJECT VOCABULARY

production transformation of resources into a final product

job production method of production that involves employing all factors to complete one unit of output at a time

Production involves converting resources into goods or services. These goods and services are provided to satisfy the needs and wants of people. Some examples of production would be:

- a baker using flour, yeast, salt and water to make bread
- a large manufacturer using people to assemble components to make laptop computers
- a dentist using dental instruments to extract a diseased tooth
- a taxi driver using a car and petrol to transport a family from their home to an airport.

When making products businesses may use different production methods. One of these is called **job production**. This is where a business produces one product from start to finish before moving on to the next. Each item produced is likely to be different. Job production is used when orders are small, such as 'one-offs'. Examples might include the construction of an office block, the making of a wedding dress, the drawing up of a person's will or the design of a television advert.

JOB PRODUCTION

SUBJECT VOCABULARY

batch production method that involves completing one operation at a time on all units before performing the next

GENERAL VOCABULARY

specification detailed description of how something should be designed or made

Job production is suitable when demand is relatively low. However, when demand grows and orders for multiple units are placed, a business might switch to **batch production**. This is where a business makes a number (a batch) of products to the same design or **specification** and then changes production to another product with different specifications. When products are made in batches, production is usually divided into a number of operations or *processes*. The table below gives an example of batch production for an armrest for an aircraft seat. An engineering company uses batch production to make the metal structure for an armrest in an aircraft seat. Armrests are made from 1.5 mm aluminium sheet. The operations needed on each unit in a batch of 2000 are summarised in Table 41.1.

▶ Table 41.1 Batch production stages

OPERATION	DESCRIPTION
Laser cutting	The correct shape is cut from the metal sheet
Part marking	The armrest is marked with a number for identification
Punching	Holes are made in the armrest to make it lighter
Folding	The armrest is folded into the correct shape
Assembly	Components and fasteners are put together
Plating	The armrest is coated in zinc plating
Packaging	The armrests are packed into cases to be transported

Many products are made using batch production, particularly in engineering, the clothes industry and food processing. For example, in a canning plant, a firm may can several different batches of soup, each batch being a different recipe. Products can be produced in large or small batches depending on the level of demand. Larger production runs tend to lower the *unit* or average cost of production.

FLOW PRODUCTION

SUBJECT VOCABULARY

flow production large-scale production of a standard product, where each operation on a unit is performed continuously one after the other, usually on a production line

process production form of flow production where materials pass through a plant where a series of processes are carried out in order to change the product

GENERAL VOCABULARY

conveyer belt long continuous moving band of rubber and metal, used in a place such as a factory or an airport to move things from one place to another

Flow production may be used when a business can sell huge quantities of output into a mass market. Flow production results in lower unit costs. It is organised so that different operations can be carried out, one after the other, in a continuous process. Products move from one operation to the next, often on a **conveyer belt**. The main features of flow production are:

- large quantities are produced
- a standardised product is produced
- a semi-skilled workforce, specialising in one operation only is employed
- large amounts of machinery and equipment are used.

Flow production is used in the manufacture of products as varied as newspapers, food and cement. *Repetitive flow production* is the manufacture of large numbers of the same product, such as plastic toy parts or metal cans. **Process production** is a form of flow production that is used in the oil or chemical industry. Materials pass through a plant where a series of processes are carried out in order to change the product. An example might be the refining of crude oil into petrol.

LABOUR-INTENSIVE AND CAPITAL-INTENSIVE PRODUCTION

SUBJECT VOCABULARY

labour-intensive production production methods that make more use of labour relative to machinery

capital-intensive production production methods that make more use of machinery relative to labour

Businesses have to manage resources effectively. They have to choose a suitable combination of materials, tools, equipment, machinery and labour for production. Some businesses use **labour-intensive production**. This means that they use relatively more labour than capital. Labour-intensive production is common in Far Eastern countries, such as China where labour is cheap.

In contrast, some businesses use **capital-intensive production** methods. This means that production relies more on the use of plant and machinery. Production in the West tends to be more capital intensive. The use of labour and capital intensive methods is discussed further in Chapter 44 (see pages 368–374).

THE IMPACT OF USING DIFFERENT TYPES OF PRODUCTION

The adoption of the different types of production outlined above will have different impacts on a business. The impact will be on the workers, the costs of production, the nature and quality of output, the use of resources and the production environment. Each method has its own advantages and disadvantages.

JOB PRODUCTION

The quality of output from job production is usually very high. This is because skilled craft workers often carry out work. Workers are likely to be motivated because the work is varied. Also, each worker is likely to be involved in completing the whole job from start to finish. One key advantage to a businesses using job production is that products can be custom made. In 'Getting started' above, M.K. Siddiqi has made nearly 10 000 suits during his life and each one was different. Some customers are prepared to pay more if their product is unique.

GENERAL VOCABULARY

lead time time it takes to prepare, make or deliver something

Although production might be easier to organise when using job production, production may be slower and **lead times** longer. This is because craft workers take longer than machines to carry out their tasks. Job production is also likely to be more expensive than other methods. This is because the wages of craft workers will be higher and specialist tools might be needed.

BATCH PRODUCTION

Unit costs are likely to be lower when batch production is adopted. This is because output is higher, workers can be more specialised and more use is made of machinery. Production is also flexible because orders with different measurements, styles or specifications can still be met. However, planning and co-ordination may be more difficult. For example, if a particular operation takes longer than all others in the production process, it is important that resources employed on other operations are not kept waiting. Another possible disadvantage is that the work may be less interesting for workers because of specialisation. Also, if batches are small then unit costs may still be quite high. More money may also be tied up in work-in-progress as it moves between different operations.

FLOW PRODUCTION

Flow production can reduce unit costs significantly. Output can be produced very quickly and the speed of production can usually be varied to deal with changes in demand. Also, some modern technology is so sophisticated it is possible to produce quite flexibly. For example, car manufacturers can build a car with many different specifications on the same production line. However, the set-up costs can be very high for flow production and employee motivation may be low because of the repetitive nature of production line work. Products also tend to be more standardised. And if production stops, owing to a breakdown on part of the line, delays can be very expensive for the business.



▲ Flow production at an oil refinery

ACTIVITY 1

CASE STUDY: SAUDI ARAMCO

Oil refining involves processing crude oil into several different products. It often starts with a fractional distillation column. Crude oil is heated and the different products are collected at different temperatures. For example, lubricating oil, used for motor oil, grease and other lubricants, boils at a temperature between 572 to 700°C. After this, chemical processes are used to remove impurities. A system of pipes is used to link all the different processes so that refining continues uninterrupted.

Saudi Aramco is the largest oil corporation in the world and is involved in all stages of oil production. It manages over 100 oil and gas fields in Saudi Arabia. It employs over 65 000 people and is capable of refining around 2 million barrels per day. In 2015, the company was generating about US$1000 million of revenue per day.

1 What is meant by flow production? Use this case study as an example in your explanation.
2 Assess the advantages and disadvantages to Saudi Aramco of flow production. Make a clear judgement in your evaluation.

PRODUCTIVITY

SUBJECT VOCABULARY

productivity rate at which goods are produced, and the amount produced, especially in relation to the work, time and money needed to produce them

labour productivity output per worker in a given time period

Businesses will want to use their resources as efficiently as possible. Output can be increased if **productivity** is raised. Productivity is the amount of output that can be produced with a given quantity of resources. It is common to measure the productivity of specific resources. For example, a business may measure **labour productivity**, that is, output per worker. It can be calculated by:

$$\text{Labour productivity} = \frac{\text{Total output}}{\text{Number of workers}}$$

An example involving the calculation of labour productivity is shown in the following box.

A factory producing racing cycles employed 20 workers in 2015. During the year, a total of 12 000 cycles were produced. In 2016, four more workers were employed and total production rose to 15 000. What has happened to labour productivity over the two years?

$$\text{2015 labour productivity} = \frac{12\,000}{20} = 600 \text{ cycles per worker}$$

$$\text{2016 labour productivity} = \frac{15\,000}{24} = 635 \text{ cycles per worker}$$

Over the two years, labour productivity has increased at the cycle factory from 600 cycles per worker to 625 cycles per worker.

A business could also measure the productivity of its capital by calculating how much each unit of capital produces. This is called capital productivity. It can be calculated by:

$$\text{Capital productivity} = \frac{\text{Total output}}{\text{Capital employed}}$$

ACTIVITY 2

CASE STUDY: HUBER

In 2015, Huber, a German-based container manufacturer, decided that it must cut capacity owing to a fall in demand. The directors said it would shut one of the four factories operated by the company. They plan to close the factory with the lowest labour productivity. Table 41.2 shows the output and number of people employed in each of the four factories.

▶ Table 41.2 Huber's output and number of employees by factory

FACTORY	OUTPUT	NUMBER OF EMPLOYEES
India	28 500	150
Germany	54 000	270
China	79 050	310
Brazil	46 000	200

1 Calculate the labour productivity in each of the four factories.
2 Which factory is Huber likely to close down?

3 Imagine that you are an employee working in the factory that is due for closure. Write a letter to the directors giving possible reasons why it should not be closed. (Hint: consider non-financial reasons.)

Businesses will try to increase productivity because they will lower costs and make more profit. Firms may increase productivity in a number of ways.

INCREASING LABOUR PRODUCTIVITY

SUBJECT VOCABULARY

flexitime system in which people work a fixed number of hours each week or month, but can change the times at which they start and finish each day

Labour productivity can be improved in the following ways.

- The government invests more in education by providing more equipment for schools and improving the quality of teaching, for example. Also, businesses can provide more training and improve the quality of existing methods.
- People are better motivated at work. This might be achieved by using financial incentives such as piece rates, performance-related pay and profit sharing. However, some workers may respond better to non-financial incentives, such as job rotation or team working.
- Labour is organised and managed more effectively. For example, it may be possible to change the factory layout by repositioning workstations or reorganising the flow of production.
- Labour is more flexible. One approach is to train workers to do different jobs so they can switch at short notice. Some firms use **flexitime**, where workers can choose their hours of work (within limits). This might help a business to extend its opening hours.

INCREASING CAPITAL PRODUCTIVITY

SUBJECT VOCABULARY

downsizing process of reducing capacity, usually by laying off staff

outsourcing contracting out of work that might otherwise have been performed within the organisation to other businesses

Capital productivity usually increases when new technology is introduced. This is because new technology is more efficient. Productivity is also likely to increase if production becomes more capital intensive. The impact of technology on business is discussed in detail in Chapter 44 (see pages 368–374).

DOWNSIZING

Some firms have tried to improve efficiency by **downsizing**. This involves reducing capacity, that is, laying off workers and closing unprofitable divisions. Advantages of downsizing include cost savings and increased profit, and a leaner, more competitive operation with profitable parts of the business that do not subsidise unprofitable ones.

RELOCATION

Businesses often relocate their operations to improve efficiency. By relocating, firms can take advantage of cheaper resources, such as lower rent, lower wages or lower transport costs. For example, a number of multinational companies have located call centres in India to take advantage of cheap skilled labour. Also, a number of firms have located factories in China for similar reasons.

DID YOU KNOW?

In the car industry, manufacturing of most components is now outsourced. The big car makers are often just giant assemblers.

OUTSOURCING

It may be possible to improve efficiency by **outsourcing** specific business activities. This means that work currently done by a business is given to specialists who can do the same work at a lower cost. For example, a manufacturer may decide to outsource its distribution operation. A transport company may take on a contract do this.

LEAN PRODUCTION

Another modern approach to improving productivity in a business involves reducing the amount of resources used. This is called lean production and is discussed in detail in Chapter 42 (see pages 353–359).

THE IMPACT ON BUSINESS OF PRODUCTIVITY IMPROVEMENTS

When a business tries to improve productivity, there is likely to be an impact on the business. A number of effects are likely to occur.

FINANCIAL IMPACT

If a business is able to improve productivity, there should be a positive financial impact on the business. For example, if more output is produced with the same resources costs will be lower. This should improve the profitability and provide greater returns for the owners. However, some of the measures used to improve productivity may cost money. For example, a business may invest in new technology. This may mean that the business has to borrow money or use some retained profit. This could have an impact on the cash flow or put the business into more debt, or both.

COMPETITIVENESS

If a business can improve productivity it will be more efficient. This will help the business to secure a competitive edge. As a result, the business might increase its market share and enjoy a higher profile in the market. It might start to attract new customers – from overseas perhaps.

WORKFORCE

If a business introduces measures to improve labour productivity, clearly the workers are likely to be affected. However, the nature of the impact will depend on the particular measure introduced. For example, if financial incentives are introduced to improve motivation, workers may benefit from higher earnings. If non-financial incentives are used, workers' jobs may become more interesting. However, some measures might have a negative impact. For example, if new machinery is introduced, or some production is outsourced, some workers might lose their jobs. This could have a negative impact on the business, particularly if workers take industrial action. The morale of workers who remain may fall. Workers are also likely to feel a negative impact if a business uses downsizing or relocation to improve productivity.

CUSTOMERS

Customers are likely to benefit if a business tries to improve productivity. This is because lower costs could result in lower prices. Also, some measures designed to improve productivity might result in a better product or service for customers. For example, if customer service staff at a call centre receive more training, customers might experience a faster and more effective service when contacting a business to deal with an issue. Also, if new technology and lean production methods are introduced, the quality of manufactured products is likely to improve.

LARGE VS SMALL BUSINESSES

The methods of production used by large and small businesses may differ. For example, large businesses are far more likely to use flow production than smaller ones. This is because they will be producing much larger quantities of output, which is a requirement when switching to flow production. However, many large businesses will also use job production owing to the nature of the industry. For example, large construction companies would use job production when building an office block.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an advantage of job production relative to other production methods?

A Unit costs will be lower
B Production speeds are faster
C Workers may be better motivated
D Fewer resources are needed

▶ 2 Dental treatment is provided using which form of production?

A Flow production
B Batch production
C Job production
D Capital-intensive production

▶ 3 A manufacturer employs 18 machinists in a workshop. During a single week, 1440 pairs of jeans are produced. Therefore, labour productivity per worker for the week was how many pairs of jeans?

A 80 pairs
B 25 920 pairs
C 1440 pairs
D 18 pairs

▶ 4 Which of the following products is likely to be made using batch production?

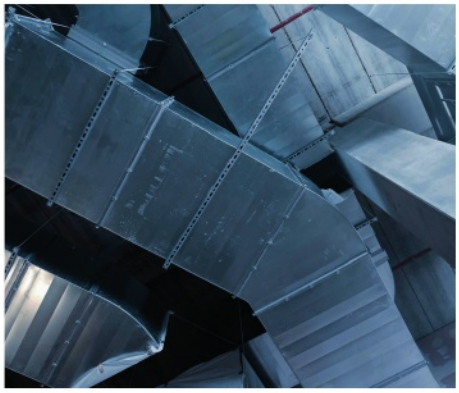
A Mobile phones
B Toilet paper
C Petrol
D Clothes

CHAPTER REVIEW

CASE STUDY: GHF LTD

GHF Ltd was established in 1999 and manufactures air conditioning units. To begin with, the business began by selling design services to architects and developers planning noise reduction systems. It also supplied and installed finished systems. The manufacturing of units, however, was outsourced. In 2009, although the company was profitable, it opened a new factory to make silent fan units and steel ducts. The main reason for this was to reduce reliance on subcontractors and switch from job production to batch production. This would help to raise profit margins by moving from costly 'one-off special-project work' to reproducible standard products.

M. Patel, the production manager, had identified problems with the special one-off projects. They often involved research, design and installation costs that did not carry over into another project. For example, one job for a large clothes retailer involved lots of design work. In addition, some of the key parts of the system had to be outsourced to another business. The job was a one-off with little that could be reused for the next job.



▲ Steel duct for an air conditioning system

Between 2009 and 2012, GHF Ltd reduced the amount of special project work from 80 per cent to 10 per cent. Producing standard systems in batches filled the gap. This approach allowed GHF Ltd to cut costs and become more competitive. However, the switch from job to batch production required a significant amount of investment as the business began to use more capital-intensive methods of production. GHF Ltd had to borrow £900 000.

Before the change, M. Patel had noticed that production was inefficient. For example, workers sometimes moved from one job to another (if there was a delay in the supply of a component for example). This slowed down production as employees had to make adjustments to their pattern of work – catch up with what others had been doing, rethink what they were doing and often switch tools and equipment. Once batch production was adopted with the introduction of a small production line, efficiency improved.

It took a while for the factory to adjust to these changes in working practices, but even in the first year the company made a small profit. This was largely down to an order for 85 standard silent fans. In the next year, GHF Ltd started producing batches of ducts using their new production system – a system so flexible that 60 000 variations were possible.

In the future, GHF wants to make further improvements to productivity. It hopes to make further investments in new technology and introduce some non-financial methods of motivation for the workforce.

CHAPTER QUESTIONS

1. What is meant by the term capital-intensive production?
2. Why was job production inefficient at GHF Ltd?
3. Why are unit costs likely to fall when using batch production?
4. Discuss one possible impact on workers of making further improvements in productivity at GHF Ltd.
5. Assess the benefits to GHF Ltd of switching from job to batch production.

42 LEAN PRODUCTION

LEARNING OBJECTIVES

- Understand the principles of lean production: just-in-time and kaizen
- Understand the importance of using resources effectively

GETTING STARTED

In recent years, a number of Japanese production techniques have been introduced by businesses to improve productivity. This has helped businesses to reduce the amount of resources used up in production. It has also improved the quality of products. Look at the example below.



▲ Gym equipment

CASE STUDY: GOLDSTONE HOLDINGS

Goldstone Holdings make equipment for gyms and fitness centres. It has two plants and employs 94 people. To improve performance, Goldstone introduced some Japanese production methods.

- It standardised some procedures and changed the factory layout. This led to a 17 per cent gain in production space.
- Goldstone recognised that improvements required staff involvement. Therefore, more training was organised and workers were given more authority to make their own decisions and solve problems.
- Goldstone gave staff time to 'tidy up' the work environment. They removed all the clutter, such as old tools, spoilt work and items of unnecessary stock that had built up over time. It also reduced inventory levels and reduced stock handling.

As a result of these measures, turnover increased by 50 per cent and production set-up time was reduced by 74 per cent. Also, machine down time was cut by 73 per cent, delivery targets were increased by 21 per cent and product rejection fell by 50 per cent. Investment in staff training also improved staff motivation.

1 How important was staff involvement at Goldstone when trying to make improvements?
2 Discuss the possible benefits to Goldstone from introducing Japanese production methods.

WHAT IS LEAN PRODUCTION?

SUBJECT VOCABULARY

lean production approach to production aimed at reducing the quantity of resources used

GENERAL VOCABULARY

defective product that has not been made properly or is not working properly

Lean production is an approach to production developed by Toyota, the Japanese car manufacturer. Its aim is to use fewer resources in production. Lean producers use less of everything. This includes factory space, materials, stocks, suppliers, labour, capital and time. As a result, lean production:

- raises productivity
- reduces costs and cuts lead times
- reduces the number of **defective** products
- improves reliability and speeds up product design.

Lean production involves using a range of practices designed to reduce waste and to improve productivity and quality. Some of these are discussed in this chapter.

JUST-IN-TIME PRODUCTION

SUBJECT VOCABULARY

just-in-time production technique that is highly responsive to customer orders and uses very little stock holding

If a business holds stock, money is tied up and therefore wasted. For example, if a business has US$1 million of stock in a warehouse, that US$1 million cannot be used for anything else. The money is unproductive. To overcome this problem, many businesses have adopted **just-in-time** (JIT) production. This means that a business does not:

- hold any stock of raw materials or components – suppliers have to deliver resources straight to the production line at regular intervals (this might be several times a day)
- produce any goods unless they have been ordered – this avoids the need to hold stock of finished goods.

The advantages and disadvantages of JIT are shown in the Table 42.1.

▶ Table 42.1 Advantages and disadvantages of just-in-time production

ADVANTAGES	DISADVANTAGES
Cash flow is improved	Higher ordering and administration costs
No waste, out-of-date or damaged stock	Relies hugely on suppliers' reliability
Space is released	Advantages of bulk-buying may be lost
No stock holding costs	Hard to cope with changes in demand
Stronger links with suppliers	Vulnerable to a break in supply
Fewer suppliers	



▲ Dell computers ready for delivery

ACTIVITY 1

CASE STUDY: DELL

Dell is a privately owned US computer manufacturer. In 2015, it became the world leader in PC monitor sales by volume. It also launched a brand new tablet range called Dell Venue. The design for this range was heavily influenced by customer feedback. Much of Dell's success results from its unique manufacturing approach. Dell was the first in the market to make computers according to precise customer specifications. Dell used direct selling and all its products were sold online. A customer would place an order on Dell's website listing the various specifications that were required.

SUBJECT VOCABULARY

tailor-made where a product has been designed so that it is exactly right for someone's needs

stockpile large supply of goods and so forth that are being kept for use or possible use in the future

Dell would then make that computer and deliver it to the customer very rapidly.

This approach allowed Dell to deliver a tailor-made product at a lower cost. By manufacturing to order, Dell was able to avoid the cost of buying too many components and having to store them. It also meant that they did not have a stockpile of waiting to be sold. This enabled Dell to put together and deliver products very quickly. This saved time and allowed Dell to pass on the savings to their customers.

Dell also developed special relationships with its suppliers. It persuaded them to hold inventories of raw materials and components and deliver them very quickly as and when they were needed. This was key to Dell's approach as Dell was passionate about minimising stock levels and relied heavily on suppliers to bear the burden of inventory holding and meeting very demanding lead times.

1. Describe how Dell adopted just-in-time methods.
2. Describe the benefits to Dell of using a just-in-time approach to production.
3. Carry out some research to identify another business that uses just-in-time methods. Produce a poster to show how it is used and how the company has benefitted. Present your findings to the rest of the class.

KAIZEN

There is a strong link between lean production and kaizen. Kaizen is a Japanese word and refers to the practice of continuous improvement. There is a belief in Japan that everything can be improved. Even at work, the Japanese believe it is possible to make small improvements continuously. This means that workers are always coming up with ideas to improve quality, reduce waste or increase efficiency. The improvements may be very small but over a long period of time they have a huge impact. In many Japanese companies workers are familiar with coming up with ideas: it has become part of their culture. However, when kaizen is adopted in other countries, workers have to be trained. Training plays a key role in kaizen because, evidently, workers in the West do not possess the same cultural characteristics of the Japanese.

The elimination of waste in business is an important part of kaizen. Firms that adopt kaizen train workers to continually search for waste and suggest how it might be avoided. This is why kaizen has a strong link with lean production. Examples of waste may be:

- time wasted while staff wait around before starting tasks, such as waiting for materials to arrive
- time wasted when workers move unnecessarily in the workplace, such as walking to a central point in the factory to get tools
- the irregular use of a machine, such as one that is only used once a month.

Kaizen is about building a culture in which all employees are actively involved in suggesting and implementing improvements to the company. In truly lean companies, it becomes a natural way of thinking for both managers and factory workers. Focus on customer needs is also a crucial element.

GENERAL VOCABULARY

sustain to manage to make something continue to exist over a long period of time
empowerment when workers in a company are given more responsibility by being allowed to organise their own work and make decisions without asking their managers

One of the key drivers in kaizen is 'good housekeeping'. A clean and well-organised working environment is needed for continuous improvement to flourish. The Japanese use a method called 5S to ensure that this is achieved. What does 5S stand for?

- **Sort** – get rid of the clutter in the workplace. Only necessary items such as tools should be stored at a workstation. All other items such as excess inventory should be removed.
- **Set in order** – organise the work area, so that it is easy to find what is needed.
- **Shine** – ensure work area and equipment are clean. Make them 'shine'.
- **Standardise** – once the most effective working practices have been identified everyone in the workplace should adopt them.
- Sustain – adopt systems to lock the other 4Ss into the way people work at all times on a permanent basis.

Once kaizen is adopted it is likely to be supported by a wide range of techniques, principles and practices. Some of these are outlined below.

STANDARDISATION

Standardisation means carrying out every business activity according to established formulae. These formulae may be printed out and hung in the workplace for all to see. They develop into standards for the best, most efficient and safest way to complete a job. In this way, quality is assured and customer expectations are met. It is management's task to make sure these standards are maintained. Managers must get involved if standards are not maintained and also make adjustments to methods to avoid future failures to produce to the standard.

TEAMWORKING

This involves dividing the workforce into small groups. Each team will focus on a particular area of production and team members will have the same common aims. Both the business and workers might benefit from teamwork.

- Workers should develop a 'team spirit'. This may improve motivation and productivity.
- Flexibility might improve. For example, team members might be more willing to cover for an absent colleague.
- Teams might plan their own work schedules, share out tasks and solve their own problems. This should lead to quicker decision making and more ideas.
- Communication and labour relations might also improve.

EMPOWERMENT

Empowerment gives employees more control over their own work. In the past, most workers have followed the instructions given to them by managers. They were rarely required to think for themselves. However, if workers are empowered, they are given the authority to make decisions, solve problems and work creatively. As a result, the business benefits from more workers realising their full potential. Also, motivation is likely to improve since workers feel trusted and their work may be more interesting.

SUGGESTION SCHEMES

Suggestion schemes encourage workers to suggest ideas to improve production or reduce costs. A simple scheme involves workers writing their

SUBJECT VOCABULARY

quality circles small group of factory workers who meet regularly to discuss ways to improve working methods and to solve problems

GENERAL VOCABULARY

multi-skilled workers who are trained in more than one skill, which enables them to do a range of jobs



▲ Encouraging teamwork has benefits for the company

ideas down and putting them into a suggestion box. When a worker's idea is adopted, they should be rewarded – with cash or a prize. Suggestion schemes are often a feature of kaizen.

QUALITY CIRCLES

Quality control circles or quality circles are small groups of workers in the same area of production who meet on a regular basis to solve production problems. Quality circles give employees an opportunity to make improvements in their jobs and therefore support kaizen. It is important that meetings are in work's time and have the support of both workers and managers.

MULTI-SKILLING

If workers are trained in a variety of skills, they are said to be multi-skilled. Multi-skilled workers are more useful to a business because they provide more flexibility. For example, workers can cover for absent colleagues in different work areas more easily. Workers might also be better motivated if they are allowed to do a range of different jobs. It might help to make their work more interesting.

THE IMPORTANCE OF USING RESOURCES EFFECTIVELY

When businesses adopt lean production, resources are used more effectively. This is because the key aim of lean production is to use less of everything. This includes factory space, materials, inventory, suppliers, labour, capital and time. This is important because the benefits of using resources effectively are numerous.

FINANCIAL BENEFITS

Clearly, if fewer resources are used, business costs will be lower. For example, if JIT manufacturing is adopted there will be lower inventory levels. This will reduce stock holding costs. If costs are lowered, then businesses will make more profit. This will increase returns for the owners and provide cheap funds for investment in the future.

IMPROVED COMPETITIVENESS

Lean producers will have a competitive edge in the market. Businesses that use their resources effectively will be able to lower prices. In Activity 1, Dell was able to lead the market in computer sales for a period of time because it had lower costs. Also, Toyota, one of the developers of kaizen, eventually took market shares away from the large US car makers. It is now the world's leading car manufacturer.

POSITIVE ENVIRONMENTAL EFFECTS

If a business makes more effective use of resources, it will be making a positive contribution to the protection of the environment. For example, if a business uses less energy, such as electricity, it will help reduce emissions. Also, if a business uses recycled resources this will help to reduce resource depletion. If customers recognise that a business is adopting environmentally friendly production methods, this might also improve its image.

IMPROVED CUSTOMER SERVICE

Customers are likely to benefit if a business makes more effective use of resources. For example, lean production often results in shorter lead times. This means that customers will get their products more quickly. Also, some aspects of lean production result in better quality products. For example, some kaizen practices focus on customer needs, therefore customers are likely to get a better service.

LARGE VS SMALL BUSINESSES

There is no reason why businesses of all sizes should use lean production in their operations. However, it could be argued that larger businesses are more likely to adopt lean production methods. This may be because they have a lot more to gain since they produce much larger levels of output. Also, some lean production methods may not be suitable for small operators. For example, if a business only employs one other worker, team working and quality circles are not really appropriate.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Which of the following is an advantage of just-in-time manufacturing?
- A Labour productivity is increased
- B Stock holding costs are significantly reduced
- C Lead times are lengthened
- D Dependence on the reliability of suppliers is increased

▶ 2 Lean production focuses on which of the following?
- A Increasing labour productivity
- B improving cash flow
- C Using fewer resources
- D Making production more capital intensive

▶ 3 What does kaizan mean?
- A Continuous improvement
- B Agile manufacturing
- C Multi-skilling
- D Market orientated

▶ 4 Which of the following is a practice associated with kaizen?
- A Extension strategies
- B Skimming
- C Product differentiation
- D Empowerment

CHAPTER REVIEW

CASE STUDY: HERMAN MILLER

Herman Miller manufactures office chairs in the USA. Their Aeron chair is one of its most popular lines. Herman Miller runs a modern and efficient production operation and has seen some impressive improvements in productivity in recent years. Much of this improvement has resulted from the use of kaizen, which they began using when the company brought in a kaizen expert working for Toyota.

One of the first steps in the process of change was to empower the workforce. Employees in the factory were asked to suggest small changes that could help to improve the speed or ease of working practices around their workstations. The employees noticed that they could break down their current working practices into 1200 tasks and that they had remained unchanged for many, many years.



▲ A Herman Miller chair

One example of a small change that was suggested was the position of a bin containing metal rings. By moving it slightly, employees reduced the amount of reaching required by 6 inches. Another was the adjustment in the height of the assembly line. It was changed slightly so that workers did not waste a few moments bending over. Such changes are extremely small but this is what kaizen is all about. If small changes like this are made continuously, over a period of time, significant improvements in efficiency can be made.

Training is a very important element of kaizen at Herman Miller. One programme included a one-day introduction, a five-day boot camp and a 12-week bridge programme. This helped Herman Miller to develop a more scientific approach to problem solving. Also, numerous standardised factory procedures have improved at Herman Miller over the course of the past decade. These changes and many others have led to the following improvements:

- a new Aeron chair now comes off the production line every 17 seconds, compared with 82 seconds 13 years ago
- production time has been reduced from 600 seconds to 340 seconds
- measures of safety have improved by a factor of six
- quality indicators have improved by a factor of ten
- the factory is ten times smaller
- the labour time needed to make a single chair is one-fifth of what it used to be
- customer lead times have fallen from two months to ten days
- product range has increased from five standard designs to 17
- no inventory of finished products is held
- reliability is now 99.4 per cent
- product faults have been reduced to less than 0.1 per cent.

Despite this impressive list of benefits, Herman Miller is still achieving improvements of one-quarter to one-half of a second at a time, month by month as the practice of kaizen continues.

CHAPTER QUESTIONS

1 What is meant by kaizen?

Kaizen is usually driven by ‘good housekeeping’.

2 What does this mean?

3 Discuss one advantage to Herman Miller of empowering workers.

4 Assess the benefits to Herman Miller of implementing kaizen and making more effective use of resources.

43 TECHNOLOGY IN PRODUCTION

LEARNING OBJECTIVES

- Understand the impact of technology in production
- Understand the use of robotics in production
- Understand the importance of balancing cost, productivity, quality and flexibility when using technology

GETTING STARTED

Many businesses introduce new technology to help improve productivity. New technology also results in new products that provide new market opportunities for businesses. It also helps to make work a lot easier for many people. Look at the example below.

CASE STUDY: DRIVERLESS TRACTORS (ROBOTRACTORS)

By 2050, the world's population is expected to grow to around 9000 million. In order to feed this rapidly growing number of people, significant improvements in productivity will be required in agriculture. One way of improving productivity is to use less labour. This could be achieved by employing driverless tractors.

In 2016, Case IH, a producer of agricultural machinery and other farming implements, revealed its Case IH Autonomous Concept Vehicle. It was presented at the Iowa Farm Progress Show. The tractor is pre-programmed and then remotely controlled by an operator from a desktop computer or a mobile device.



▶ Driverless tractor

The tractor uses radar, on-board cameras and LIDAR (light imaging, detection and ranging) to find and update its path when moving. If it detects a barrier in its path, it will stop automatically until an operator reprograms the machine. The tractor will also stop if the GPS signal is lost. These features make the vehicle safe. The machine can take on the traditional land work of tractors, such as tillage, planting, spraying and harvesting. According to a spokesman for Case IH, a farm manager can supervise several machines using a mobile device while tending to other tasks or even operating another machine. Driverless tractors can be put to work in groups or individually, and in separate fields. Each machine will be pre-programmed with maps and instructions. Therefore, it is possible to have one tractor pulling a plough followed closely by another one operating a planter.

Case IH say that the machine will be able to cut costs and help farmers that struggle to find skilled drivers during busy periods such as at harvest time.

1 Describe the new technology outlined in the case above.
2 Describe the possible benefits of the new technology to **(a)** farmers and **(b)** consumers.
3 In pairs, carry out some research to find out how genetically modified crops are being used in agriculture. Find out the advantages and disadvantages of their use and present your results to the rest of the class using a poster.

THE IMPACT OF NEW TECHNOLOGY IN THE PRIMARY SECTOR

Advances in technology gather pace all the time. All business sectors have enjoyed the benefits of new technology. In the primary sector, the use of tractors, mechanical harvesters, grain-drying machines and automatic feeding systems have helped to raise productivity in agriculture. Technological development in agricultural has significantly reduced the need to employ large numbers of workers on farms.

Chemicals and pesticides have also helped to increase crop quantities and biological research has developed plants that are less likely to suffer from diseases. Developments in genetically modified (GM) crops, where useful genes are introduced from different living sources into plants, are beginning to have an impact. Initially, GM crops were developed mainly to reduce the harmful effects of pests and diseases. However, the new generation of GM crops aims to increase the nutritional value of plants. Consumers are likely to benefit more directly from this. For example, it may be possible to develop rice with a higher content of iron and vitamins, potatoes with more starch, healthier oils from soybean and canola, and allergen-free nuts. The use of GM crops is well established in some countries around the world. For example, in the USA, 88 per cent of corn, 93 per cent of soybean, 94 per cent of cotton seed and 75 per cent of Hawaiian papaya is genetically modified.

Another technological development in agriculture is the application of drones. They can be used to help farmers with water and disease management, and to develop better planting strategies. The use of drones can also provide information about the progress of crops – even in different parts of the same field.

In the mining industry, new cutting machinery has raised productivity and improved the health and safety of workers. In 2016, some new technology was launched in Canada. MineSense Technologies Ltd has a product suite called the MineSense Solution. The technology is designed to decrease the energy,

water and chemicals used in the extraction and analysis of materials from the ground. It is believed that the technology will improve the recovery of usable materials by 25 per cent.

THE IMPACT OF NEW TECHNOLOGY IN THE SECONDARY SECTOR

Production has become more capital-intensive in many industries. This means that more machinery is used in production instead of other resources such as labour. New technology is flexible, sophisticated and highly efficient. Some examples of new technologies in the secondary sector are outlined below.

ROBOTS

Robots feature largely in assembly and on production lines. They usually have a mechanical arm that moves according to instructions given by a computer. Robots are used in welding, assembly and in the movement of components on a production line. Robots in manufacturing can be divided into three categories.

- **Material handling robots** are usually employed in the transport of goods, parts or stock from one place to another, most often within the same factory or plant. Automated warehouses are an example of this.
- **Processing operations robots** generally perform a specific task, such as spot welding or spray painting. These robots are fitted with a specialised tool to perform the programmed task.
- **Assembly line robots** usually perform a single task on assembly lines such as fitting a cap on a bottle. Inspection robots are used to check a finished part or product for faults. They may use a range of tools, such as lenses and scanners.

All manufacturing robots perform repetitive and sometimes dangerous work involving heavy machinery, industrial pollutants, poisonous chemicals or other hazardous materials. They are also accurate, perform at a constant rate and can operate 24/7. Disadvantages are that some staff may lose their jobs, robots can be expensive to introduce and products may have to be standardised.

COMPUTER AIDED DESIGN

Before products are manufactured they have to be designed. The whole design process has been improved by the introduction of computer aided design (CAD). This allows a business to produce accurate drawings, which can be viewed in 3D and altered cheaply and quickly. Designs can be accurately measured and tested on computers for faults, such as unsuitable dimensions or components. In many cases, CAD also removes the need to build models and prototypes because they can be replaced by 3D computer-generated images. CAD can also identify the best or 'optimal' design solutions because it can analyse a range of alternatives.

DID YOU KNOW?

CAD has a wide range of applications but is common in the design of vehicles, plastic containers, furniture and clothing.

COMPUTER NUMERICALLY CONTROLLED MACHINES

Computer numerically controlled machines (CNCs) machines can be programmed by computer to carry tasks such as cutting, milling, drilling, welding, sewing and printing. They can produce both uniform and irregular shapes, and cut quickly and accurately. They can also carry out repetitive tasks without human error. This reduces waste and the need for rework. Some CNC machines use instruments and co-ordinate measuring machines (CMMs). These can make simple or complex measurements and check batches or components. They can measure several variables, such as dimensions, weight and temperature.

SUBJECT VOCABULARY

computer aided design (CAD) use of computers to design products

computer numerically controlled machines (CNCs) machines that carry out the instructions fed by computers

SUBJECT VOCABULARY

computer aided manufacturing (CAM) where computers link and control the design and production of goods in manufacturing

computer integrated manufacturing (CIM) use of computers to control the entire production process

DID YOU KNOW?

Car manufacturers, such as Volkswagen, use robots to paint car bodies. The robots each have their own set of paint cans and can spray paint cars different colours according to customer orders. Using the robot means that customers demanding less popular colours can be satisfied without having to clean the pipes of the main painting operations.

DID YOU KNOW?

CAM is used by Lego in the manufacture of plastic bricks and other Lego components and by McCain foods to make pizzas.

COMPUTER AIDED MANUFACTURING

If computers are used in both design and production, the two processes can be linked. If this approach is used the whole of production can become automated. This is called **computer aided manufacturing (CAM)**, which may also refer to the use of a computer to assist in all production operations including planning, management, transportation and storage. CAM speeds up production and minimises waste. This is because CAM only uses the exact amount of raw material needed and less energy.

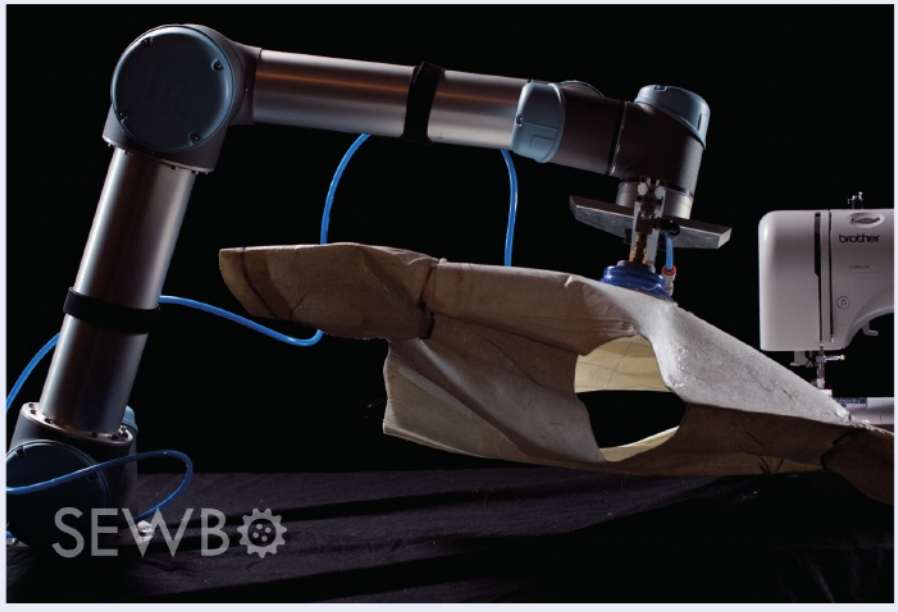
COMPUTER INTEGRATED MANUFACTURING

Computer integrated manufacturing (CIM) involves using computers for the entire production process. In a CIM system, functional areas such as design, planning, purchasing, cost accounting, stock control and distribution are linked through the computer with factory floor functions such as materials management providing direct control and monitoring of all processes. People are only used for supervising, monitoring and maintenance work.

ACTIVITY 1

CASE STUDY: ROBOTS IN PRODUCTION

The use of robots in production is quite common in certain industries, such as motor car production and electronics. However, in the clothing industry, the role of robots has until now mainly been only cutting. They were not able to sew because soft fabric is very difficult for robots to handle. It requires a great deal of accuracy to feed a piece of soft material through a sewing machine to create a straight join. Consequently, the job has always been done manually. However, in 2015, an inventor called Jonathan Zornow developed a technique that allowed a robot, called Sewbo, to sew effectively. It involved using a water-based plastic to coat the fabric that made it stiff, rather like cardboard. Following the application of this coating, robots were able to handle the cloth more easily. Once the Sewbo has completed a sewing task, the coated material is immersed in water and the cloth returns to its normal state.



▶ A robot sewing

Sewbo can make a shirt in about 30 minutes. Once the cost of the technology has been met, Sewbo can work continuously for virtually nothing. If the technology becomes established, the textiles industry could see some great changes. A large proportion of garment manufacturing is undertaken in places like China, Bangladesh and Thailand. In much of the industry, workers are treated poorly and receive relatively low wages. Eliminating the exploitation of these of these workers would be a positive move. However, the many thousands of people working in the industry might struggle to find alternative employment once the technology is introduced.

1. What is the difference between material handling robots and processing operations robots?
2. Describe the new technology invented by Jonathan Zornow in this case.
3. Discuss the possible disadvantages of introducing Sewbo into the textiles industry.

THE IMPACT OF NEW TECHNOLOGY IN THE TERTIARY SECTOR

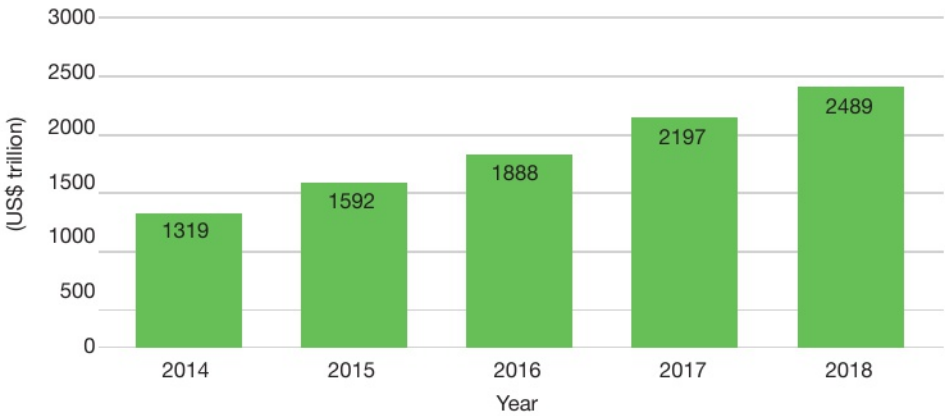
In the past, the provision of services has been mainly labour intensive. This is because supplying services often requires direct and personal contact with customers. However, new technologies are being rapidly adapted for use in the tertiary sector. Some examples are outlined below.

- In **financial services**, such as banking, many transactions can be carried out online. Automatic teller machines (ATMs) have been common for many years and can be used to withdraw cash 24/7. Money can be transferred from one account to another electronically from anywhere with a smartphone reception, even internationally. The development of electronic funds transfer at point of sale (EFTPOS) means that plastic cards and other electronic methods reduce the need for cash.
- In **marketing**, the use of information technology (IT) has made market research easier. The gathering, processing and presentation of market research data are cheaper using IT. Data can also be gathered online. This is more convenient for consumers and therefore more data is likely to be gathered.
- In **advertising**, television adverts use the latest film technology and special effects to make adverts more exciting and entertaining. The Internet is used to promote products. Many businesses have their own websites where information about products is posted and updated regularly – this is discussed in more detail below.
- In **retailing**, there have been a number of technological developments. EFTPOS is a well-established example. EPOS refers to technologies that record the sale of goods or services to the customer at the point where they are purchased. In stores, goods are likely to be scanned into a machine by cashiers, or increasingly by the consumer themselves in supermarkets. Information from bar codes on packaging is recorded and used to generate a range of information, such as till receipts, stock details and customers' purchases. EPOS saves time and reduces queues at the checkout. It also improves stock control and automatically orders new stock. The data gathered from customers about their purchases might be used for marketing purposes. There has also been a huge growth in online shopping – this is discussed below.

- In the **leisure industry**, technology allows people to travel without a ticket. For example, flights can be booked using the Internet or the telephone and a credit card. A boarding pass can be printed at home. It is also possible to store boarding passes electronically and use a smartphone to board a flight. Bookings for hotels, holidays or the theatre can be made online, which reduces administration costs.
- The use of IT has helped to reduce **administration** and **communication** costs in business. For example, a computer can carry out many routine tasks quickly. These may include customer invoicing or billing. Huge amounts of data can be gathered, processed, edited, stored and accessed using computer databases. A wide range of different information can be sent electronically anywhere in the world instantly.
- **e-commerce** involves the use of electronic systems to buy and sell products. Most e-commerce takes place online. There are two main types. First, business to consumers (B2C) involves the selling of goods and services by businesses to consumers. Some e-commerce is done entirely electronically. For example, an individual can make a payment, download some music and listen to it on their laptop, MP3 device or smartphone. However, a great deal of e-commerce still involves trading in physical goods, such as clothes and consumer durables. This is called **e-tailing** and involves ordering goods online and taking delivery at home. The growth in online shopping is shown in Figure 43.1. Second, business to business (B2B) involves businesses selling to other businesses online. In some cases, the services sold to consumers are also available to businesses. E-commerce is discussed in more detail in Chapter 38 (see pages 313–321).

▶ Figure 43.1 Estimated growth in online retail sales, 2014–18

Source: http://www.invespcro.com



THE COSTS AND BENEFITS OF NEW TECHNOLOGY

Table 43.1 provides a summary of the main benefits and costs of introducing new technology in business.

▶ Table 43.1 Benefits and costs of new technology

BENEFITS	COSTS
New products provide more choice	High set-up and purchase costs
Higher productivity and lower costs	Technology breakdowns can be expensive
Less waste of resources	Job losses may cause conflict and distress
Improved health and safety	Existing staff may need to be retrained
Tasks are easier for workers	Reduced motivation for machine workers
Improved communications	Loss of flexibility

BALANCING THE COST, PRODUCTIVITY, QUALITY AND FLEXIBILITY OF TECHNOLOGY

The decision of when or whether to introduce new technology into production is often a difficult one for businesses. The financial cost of purchasing, installing and maintaining technology can be very high. Robots, CNC machinery and other high-tech equipment are often very expensive and businesses often need to borrow or raise funds to make the investment. There is also the human cost to consider. Introducing new technology often means making people redundant; this is also expensive and can disrupt the workforce. Senior management have to be sure that the cost of the technology is lower than the value of the productivity gains. The productivity gains may only be achieved if large quantities of output can be sold. Therefore, a business must be confident about selling much larger quantities.

Decision makers also have to consider the impact that technology will have on the quality of the product. For example, historically, mass produced products were often seen as lower in quality than those that were handmade. Also, some customers are actually happy to pay higher prices for handmade products. This might be the case in the clothing industry, for example. Another issue is the flexibility of new technology. When production processes are automated, it often means that a business can only produce standardised products. This reduces the choice for customers.

However, many would argue that that most technology is so sophisticated today that quality and flexibility are not compromised. For example, production lines in the motor industry can deliver flexibility. This is because it is possible to produce cars to many different specifications on the same line. To conclude, investing in new technology is risky and businesses have to evaluate the costs, productivity gains, the impact on quality and the loss of flexibility (if any) before going ahead.

LARGE VS SMALL BUSINESSES

It might be argued that larger businesses are more likely to use new technology in their operations. This may be because larger businesses produce more output and the fixed costs of using new technology can be spread over more units if output so the average cost is lower. However, there will be exceptions to this. For example, many dentists operating as sole traders or partnerships use very up-to-date technology when repairing or replacing patients' teeth. Also, small businesses might get access to new technology by leasing it rather than purchasing it outright.

MULTIPLE-CHOICE QUESTIONS

▶ 1 Robots that perform a specific task, such as spot welding or spray painting, are called what?

- **A** Assembly line robots
- **B** Processing operations robots
- **C** Mechanical robots
- **D** Handling robots

▶ 2 Which of the following is an advantage of using technology in production?

- **A** Higher labour turnover
- **B** Lower fixed costs
- **C** Improved communications between employees
- **D** Improved productivity turnover

▶ 3 Which of the following is used to design products?

- **A** CAD
- **B** CAM
- **C** CIM
- **D** CNC

▶ 4 Which of the following is a problem with new technology in production?

- **A** Machines are difficult to operate
- **B** High initial cost
- **C** Poor communications
- **D** Machines waste resources

CHAPTER REVIEW

CASE STUDY: ALLIANCE GROUP

Alliance Group is a farmers' cooperative in New Zealand. It is owned by farmers and operates a red meat processing plant. In 2015, the group generated NZ$1500 million revenue from the sale of around 1600 different products processed from lamb, mutton, beef and venison.

In 2016, the group invested NZ$16 million in new technology. It purchased a state-of-the-art robotic bone removal machine and a new thermoplastic packaging system. Two robots were installed at the group's Smithfield processing plant in Timaru. These machines were responsible for cutting cow breast meat and evisceration (the removal of internal organs such as the heart and lungs). These two fully automated robots work safely in the same areas as workers in the plant. They take on the difficult and potentially dangerous roles in meat processing and contribute to improvements in quality and hygiene.

A new robotic cutting machine for sheep meat was also due to be installed at Alliance Group. The purpose-built boning machinery uses an x-ray unit to analyse each sheep carcass and instruct the cutting machines where to cut. The machine then divides the carcase into back, middles and forequarter cuts. Finally, a robot middles machine separates middles into other sections such as racks, loin, flap or saddle. The new technology reduces waste in the process and improves hygiene because the machine has circular blades rather than band saws. This machine also improves health and safety in the plant and reduces some stress for workers.

In another of the firm's plants, at Invercargill, a new plastic packing machine has been installed. This machine ensures that no air was in contact with the meat after the packaging process. It can offer a longer shelf-life for products, which is appealing to Alliance's large number of retail customers. It also has a much larger capacity, which makes the packaging process more cost effective.

Alliance Group aim to improve operational efficiency as a result of the investment. Senior managers believe that the company will gain a competitive edge in the market since Alliance is an early adopter of some of this technology.

CHAPTER QUESTIONS

1. Describe one disadvantage to Alliance Group of introducing the new robotic technology into its plants.

2. What are the benefits to Alliance Group of introducing new technology in its plants. Give at least two benefits in your analysis.

3. Assess the importance to businesses of balancing cost, productivity, quality and flexibility when introducing new technology.

44 FACTORS OF PRODUCTION

LEARNING OBJECTIVES

- Understand the four factors of production
- Understand the difference between capital-intensive and labour-intensive activities
- Understand the changing relationships between enterprise, capital, land and labour

GETTING STARTED

Businesses use a range of resources to make goods or deliver services. Examples include raw materials, components, buildings, energy, tools, equipment, machinery and people. Businesses will try to make the best use of these resources to improve efficiency. For example, workers often specialise in one task so that they become highly skilled in that task. Look at the resources used in the example below.



▲ Banana farming in Uganda

CASE STUDY: BANANA FARMING IN UGANDA

Robert Oloya runs a banana farm in the Insigiro district of Western Uganda. He was raised on a banana farm during his childhood where he learnt lots of valuable skills. However, after his schooling he left home to work in the city in financial services. At the age of 42, he returned to the farm and took over from his aging parents. He used some of his savings to buy some more land next to his parents' farm and expanded the business. He employs six local people to help out on the farm and is starting to export some produce to South Sudan.

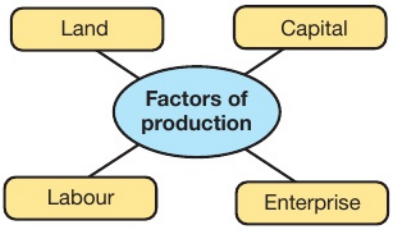
1 Describe three possible resources used by Robert Oloya on his banana farm.
2 How might the use of machinery (to prepare the land, for example) impact on Robert's banana farm?

FOUR FACTORS OF PRODUCTION

SUBJECT VOCABULARY

factors of production resources used to produce goods and services – including land, labour, capital and enterprise

Production involves converting resources into goods or services. These goods and services are provided to satisfy the needs and wants of people. In 'Getting started' above, Robert Oloya used resources, such as land, workers and tools, to grow bananas, which he has begun exporting to Sudan. The resources used by businesses, such as Robert Oloya's banana farm, are called the four **factors of production**. They are summarised in Figure 44.1.



▲ Figure 44.1 The four factors of production

KEY POINT

- Some land resources are non-renewable. This means that once they have been used they cannot be replaced. Examples include coal, oil, limestone and iron ore.
- Renewable land resources are those like fish, forests and water, which are replaced by nature. These resources should not run out. However, there is a risk that if they are overexploited and are not protected they could disappear.

SUBJECT VOCABULARY

labour people employed in a business/ used in production

fixed capital stock of human-made resources, such as machines and tools, used to help make goods and services

entrepreneur individual who organises the other factors of production and risks their own money in a business venture

GENERAL VOCABULARY

split shifts working shift comprising two or more separate periods of duty in a day

LAND

Businesses will need a 'plot of land' to locate their premises. For example, the developers of a large shopping centre or mall may look for one or more hectares of land on the outskirts of a town to locate the stores and car parking facilities. However, land also includes natural resources, such as coal, oil, iron ore, rainwater, forests, rivers and fertile soil.

LABOUR

The workforce in the economy is the labour. Manual workers, skilled workers and managers are all part of a nation's workforce. The quality of individual workers will vary considerably. Each worker is unique and has a different set of abilities, characteristics, skills, knowledge, intelligence and emotions.

CAPITAL

Capital is often said to be an artificial resource because it is made by labour. There are two types of capital.

- Working capital or circulating capital refers to stocks of raw materials and components that will be used up in production. It also includes stocks of finished goods that are waiting to be sold.
- Fixed capital refers to the factories, offices, shops, machines, tools, equipment and furniture used in production. Fixed capital is used in production to convert working capital into goods and services.

ENTERPRISE

An entrepreneur is responsible for setting up and running businesses. Without them production would not take place. What is the role of entrepreneurs?

- They come up with a *business idea*. This might involve the production of a completely new product. However, this is unusual. Most new businesses supply goods or services that are currently produced by others.
- They are business *owners*. They usually provide some money to help set up a business and are responsible for its direction.
- Entrepreneurs are *risk takers*. For example, they risk their own money in the venture. If the business collapses they may lose some or all of the money. However, if the business is successful they may make a lot of profit. But when they start up they do not know what will happen – they are taking a risk.
- Entrepreneurs are responsible for *organising* resources. They have to buy and hire resources, such as raw materials, tools, equipment and labour. Entrepreneurs need to use skills such as decision making, people management, time management and financial judgment to organise resources effectively.

ACTIVITY 1

CASE STUDY: ANGELA'S BAKERY

Angela Collier runs a small bakery in Gijon, northern Spain. She learnt her baking skills working as a patisserie chef making high quality cakes and desserts in Madrid, Spain. However, she did not like working split shifts in a large hotel so she purchased some property and built a bakery in an old outhouse at the back. She invested €40 000 of her own money and started by supplying cafés, hotels and small shops with a range of home-made cakes.

After setting up a website, she started to get orders for birthday and wedding cakes which were custom made. After three years, Angela was established in the area and recruited three staff to help her out in the bakery. In the future, she hoped to open her own retail outlet – perhaps even a chain.



▶ Working in a bakery

1 Suggest two examples of capital that Angela will use.

Angela Collier is an entrepreneur.

2 What evidence is there in this case study to support this view?

SPECIALISATION AND THE DIVISION OF LABOUR

GENERAL VOCABULARY

specialisation in business, the production of a limited range of goods

SUBJECT VOCABULARY

division of labour specialisation in specific tasks or skills by an individual

One feature of modern business is specialisation. This is the production of a limited range of goods by an individual, business, region or nation. For example, Coca-Cola specialises in soft drinks, Toyota makes cars and Emirates provides air travel. Specialisation inside a business is also common. Departments specialise in different activities such as marketing, production, finance, personnel (human resources) and purchasing.

Workers will also specialise in certain tasks and skills. This is called the division of labour. It allows people to concentrate on a limited range of tasks. For example, in construction, an architect will draw up plans, a bricklayer will build walls, a roofer will lay the roof and so on. The division of labour will increase productivity for the following reasons.

- Workers concentrate on the task that they do best.
- Workers' skills improve as they regularly repeat the same task.
- Time is saved because workers are not switching from one task to another.
- The organisation of production is easier.

Although specialisation is likely to improve productivity, it does have disadvantages. For example, work can become tedious and boring because of repetition. Also, when one stage of production depends on another, there may be delays if one stage breaks down or is delayed.

LABOUR-INTENSIVE AND CAPITAL-INTENSIVE PRODUCTION

Businesses have to manage resources effectively. They have to choose a suitable combination of materials, tools, equipment, machinery and labour for production. Some businesses use labour-intensive production, which means that they use relatively more labour than capital. Labour-intensive production is common in Far Eastern countries, such as China and Vietnam, where labour is cheap and plentiful. In contrast, some businesses use capital-intensive production methods. This means that production relies more on the use of plant and machinery. Production in the West tends to be more capital intensive. The best resource mix between labour and capital depends on the following factors.

THE TYPE OF PRODUCT

Mass produced fast-moving consumer goods are likely to be produced in huge plants using large amounts of machinery. However, in many Western economies, most production is focused on providing services that are often very labour intensive. For example, the provision of financial services uses large amounts of labour relative to capital.

GENERAL VOCABULARY

morale confidence, enthusiasm and discipline of a person or group at a particular time

THE RELATIVE PRICES OF THE TWO FACTORS

If labour costs are rising, a business may be encouraged to employ more capital. In countries like China and India, where labour is relatively cheap, labour-intensive production methods are likely to be preferred. However, in much of Western Europe and the USA, where labour is more expensive, a great deal of manufacturing is capital intensive.

▼ Table 44.1 Advantages and disadvantages capital- and labour-intensive production

The advantages and disadvantages of labour and capital intensive approaches to production are summarised in Table 44.1.

CAPITAL-INTENSIVE PRODUCTION		LABOUR-INTENSIVE PRODUCTION	
ADVANTAGES	**DISADVANTAGES**	**ADVANTAGES**	**DISADVANTAGES**
Generally more cost effective if large quantities are produced	Huge set-up costs	Generally more flexible than capital – can be retrained, for example	People are more difficult to manage – they have feelings and reactions
Machinery is often more precise and consistent	Long delays may occur when there is a breakdown	Cheaper for small-scale production	People can be unreliable – they may be sick or leave suddenly
Machinery can operate 24/7	May be inflexible – a lot of machinery is highly specialised	Cheaper for large-scale production when labour is cheap	People need breaks and holidays
Machinery is easier to manage than people	May leave the workforce facing redundancy and effect morale	People are creative and can solve problems and make improvements	People sometimes need to be motivated to improve performance

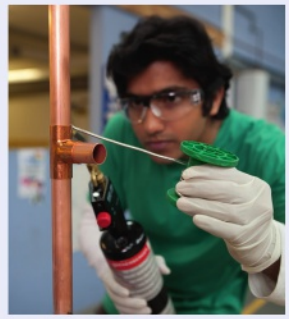
ACTIVITY 2

CASE STUDY: MOON BROTHERS CONSTRUCTION COMPANY

The Moon Brothers Construction Company is based in Ireland. It has 37 employees, eight of whom are general labourers. The others are skilled workers. Details of three of the employees are outlined below.







▶ Employees of the Moon Brothers Construction Company

Brendan O'Hagan is 26 years' old and has worked for the company since leaving school. He is a bricklayer and learnt his trade from one of the experienced bricklayers in the company.

Mary O'Mara is 27 years' old and has only just started working for the company. She is a qualified electrician. She spent three years at college and has a vocational qualification in electrical installation.

Ahab Patel is a self-taught plumber. He spent time working with his father and then became self-employed. However, after doing some contract work for Moon Brothers Construction Company, he was invited to join them full time.

1 What is meant by the division of labour? Use examples from the case study in your explanation.
2 Discuss how specialisation might benefit Moon Brothers Construction Company.

THE CHANGING RELATIONSHIPS BETWEEN ENTERPRISE, CAPITAL AND LABOUR

DID YOU KNOW?

Modern production techniques often require workers to be more flexible. They may be expected to learn a variety of skills, work in different parts of the organisation, make decisions for themselves and solve problems.

Over time, the types of resources used by a business, and the way they are used, is likely to change. For example, rapid advances in technology have resulted in more capital-intensive production worldwide. Fifty years ago, computers were undeveloped and not widely used. In contrast, workers in a wide range of different jobs are likely to use computers today. There is also more large-scale production because it is more efficient. This often results in more capital-intensive methods and a greater division of labour. Even in China, where historically production has been labour intensive, factories will become more capital intensive as the economy develops and manufacturing becomes more specialised. For example, China is beginning to attract investors from Western companies who are building factories in China to give them access to the Chinese market. Many of these factories are using capital-intensive production techniques. In 2014, Jaguar Land Rover Limited opened a £1000 million plant at Changshu with its Chinese partner, Chery Automobile, and was expected to produce up to 130 000 vehicles a year. This factory contained state-of–the-art technology.

LARGE VS SMALL BUSINESSES

As businesses get larger and the scale of production increases, they often use more capital relative to labour. One reason for this is because it is often necessary to produce and sell large quantities of output to make investment in capital worthwhile.

MULTIPLE-CHOICE QUESTIONS

1 Which of these products is most likely to be produced using labour-intensive production methods?

A Biscuits
B Motor bikes
C Smartphones
D Wedding gowns

2 Which of these is an example of land as a factor of production?

A Water
B Tractor
C Machinist
D Robotic welder

3 Which of these is an advantage of labour-intensive production?

A More flexibility
B Lower unit costs
C More consistent in production
D People are easier to manage than machines

4 Which of the following is a role of an entrepreneur?

A Producing final accounts to measure performance
B Organising
C Specialising
D Training

CHAPTER REVIEW

CASE STUDY: TOOTING TOYS

Tooting Toys, a Chinese company, manufactures plastic toys such as pedal tractors. The business was set up in 1994 by Yang Chen. He invested CNY 70 000 of his own money and started by producing small plastic toy tractors using a simple shaping machine. The business was successful but a breakthrough came in 2010 when he was asked to produce a pedal tractor that a child could actually drive. A retailer placed a very big order and in 2012 the business was forced to move to a larger factory near Shanghai. The workforce increased from 12 to 160 in just a few years. Production is labour intensive. Machines can mass produce the plastic components but they have to be assembled by hand.

In 2016, Yang Chen planned to introduce a new product. It is a large plastic pedal sports car. He has had a great deal of interest from large retailers and one has placed a initial order for 100000. However, to produce such large quantities he would need to consider automating a significant proportion of production. Investment in new technology would cost CNY 14 million. The business would have to borrow over CNY 7 million and Yang Cheng is worried about the financial burden that such a loan would impose.



▶ Child's plastic pedal car

CHAPTER QUESTIONS

1 What is meant by the term capital intensive production?

2 Suggest two examples of land used in production at Tooting Toys.

Yang Chen is an entrepreneur.

3 Discuss his role at Tooting Toys.

4 Assess whether Yang Chen should switch to more capital intensive production methods. Make a clear judgement in your evaluation.

45 QUALITY

LEARNING OBJECTIVES

- Understand the concept of quality
- Understand the importance of quality in the production of goods and the provision of services
- Understand quality control
- Understand total quality management (TQM)
- Understand how quality can give a business a competitive advantage



▲ Figure 45.1 Sample menu from The Albannach Hotel

GENERAL VOCABULARY

Michelin star worldwide recognition of quality in the restaurant industry

GETTING STARTED

Businesses must produce good quality products. This means products have to be well designed, perform the function for which they were intended, look good and be safe to use. Businesses that fail to produce quality products are likely to lose out to competitors. For most businesses, quality really matters. Also, if a business can gain a competitive edge by offering quality, it may be able to charge a higher price. Look at the example below.

CASE STUDY: QUALITY AT THE ALBANNACH HOTEL

The Albannach Hotel is located in a wild and remote coastal corner of the northwest Scottish Highlands. It is a stylish hotel set in a characterful 200-year-old house. It has a reputation for serving high-quality meals. The hotel is also listed in the Good Hotel Guide 2017. The hotel is run by self-taught chef/proprietors Lesley Crosfield and Colin Craig. They are now entering their 26th year and The Albannach has held a Michelin star since 2009. Many of their guests return on a regular basis to enjoy the food, accommodation and friendly service.

The accommodation in the hotel is luxurious. The owners have put an enormous amount of effort into renovation – paying respect to the charm and history of this old highland house. The couple also rely heavily on locally produced food to keep quality standards high in the kitchen. For example:

- white fish and shellfish are caught and landed in Ullapool and Lochinver or dived for by friends
- organic vegetables and free-range eggs are produced by local farmers
- a free-range farm in Morayshire supplies beef and lamb
- game, other than barn-reared fowl, is wild and seasonal.

1 Discuss the importance of quality to The Albannach?
2 What evidence is there in the case to suggest that The Albannach provides a quality experience for guests and diners?

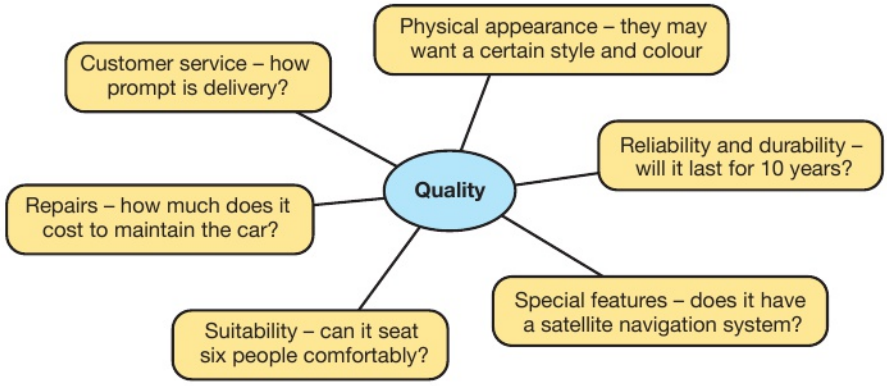
3 Suggest two possible advantages to The Albannach of providing high quality service.
4 Can you think of four businesses that have a reputation for offering good quality products? Carry out research if necessary. Give reasons for your selection and present your ideas to the rest of the class.

WHAT IS QUALITY?

SUBJECT VOCABULARY

quality features of a product that allow it to satisfy customers' needs

When consumers are shopping, they may consider **quality** when choosing products. Quality could be described as those features of a product or service that allow it to satisfy customers' wants. For example, a family buying a new car may consider some of the features in Figure 45.2.



▶ Figure 45.2 Features of quality

THE IMPORTANCE OF QUALITY

Quality is more important than ever. Consumers are more aware, they get information through the media and the Internet, and as a result they have higher expectations than ever before.

- Increased competition has forced firms to improve quality. Consumers do not need to buy products from businesses that fail to deliver quality.
- Government legislation designed to protect consumers has forced firms to improve quality. For example, the production of food products has to be carried out in a hygienic environment and comply with health and safety legislation.
- Faulty products are costly for a business. Machinery that breaks down or constantly needs to be repaired will also be expensive. Late delivery and productivity that results from poor quality in production can harm a business's reputation.

Quality matters to a business because sales will be higher if they can deliver quality products. Poor quality is likely to result in lost customers. The case study in Activity 1 shows what can happen if quality is poor.

ACTIVITY 1

CASE STUDY: SAMSUNG

When there is a serious problem with a product, a business might need to issue a product recall. This happened to Samsung in 2016. Samsung launched its Galaxy Note 7 smartphone in August 2016 in an effort to challenge Apple in the market. Unfortunately, Samsung had to recall all



▲ A safety notification at Eindhoven Airport

sets and halt production owing to a problem with the batteries. This followed a series of incidents, some examples of which are:

- 4 October – in the USA, a user suffered lung damage when a Galaxy Note 7 released smoke in his bedroom
- 5 October – a handset caught fire on a Southwest Airlines flight over the USA
- 7 October – a user in Taiwan noticed smoke emerging from her pocket where her handset was
- 7 October – a young girl in the USA suffered a burn on her thumb when a set became extremely hot
- 9 October – another US man reported that a set left on a bedside table caught fire.

The Galaxy Note 7 was officially recalled in the USA by the Consumer Product Safety Commission in September. It advised owners of the handsets to shut down and cease all usage, and return them for a replacement. However, even replacements had problems, therefore in October Samsung stopped production of the sets. Samsung instructed customers to return the sets in kits containing special packaging. The kits consisted of an antistatic bag (for the phone) and three layers of wrapping, one of which was made of a fireproof material. Samsung issued a statement saying: 'We remain committed to working diligently with the CPSC, carriers and our retail partners to take all necessary steps to resolve the situation.'

The impact on Samsung of this problem with product quality could have a long-term effect. Immediately after the first announcement, around US$14 000 million was lost from the value of the company as its share price fell dramatically. Also, hundreds of Koreans have threatened to sue Samsung for compensation. They wanted to recover the costs of visiting shops to exchange their phones, for the time they spent transferring data and for the psychological harm inflicted from handling a hazardous product.

1 What is meant by a product recall?
2 Why is quality so important for products like the one in this case study?
3 Discuss how Samsung may be affected by this product recall.

TRADITIONAL QUALITY CONTROL

SUBJECT VOCABULARY

quality control making sure that the quality of a product meets specified quality standards

Traditionally, production departments were responsible for ensuring quality. Their objectives might have been to make sure that products:

- satisfy consumers' needs
- operate in the way they should
- can be produced cost effectively
- can be repaired easily
- meet safety standards set down by legislation and independent bodies.

Quality control in the past often involved quality controllers or quality inspectors checking other people's work and the product itself after production had taken place. By today's standards, this is not quality control. This is a method of finding a poor quality product before it is sold.

QUALITY ASSURANCE

SUBJECT VOCABULARY

total quality management (TQM) managerial approach that focuses on quality and aims to improve the effectiveness, flexibility and competitiveness of the business

quality assurance working methods that take into account customers' wants when standardising quality – it often involves guaranteeing that quality standards are met

Today inspection is carried out during the production process. This means that poor quality production can be prevented before production is complete. Such a preventive approach has been used by Japanese businesses and is known as **total quality management (TQM)**. **Quality assurance** is a commitment by a business to maintain quality throughout the organisation. The aim is to stop problems before they occur rather than finding them after they occur. Quality assurance also takes into account customers' views in the production process.

TOTAL QUALITY MANAGEMENT

TQM is designed to prevent errors, such as poor quality products, from ever happening. What are the features of TQM?

- **Quality chains**: Every worker in a business is like a link in a chain and every worker is both a customer and a supplier. This is because a worker on a production line will only receive (as a customer) and pass on (as a supplier) semi-finished work if it has reached specified quality standards. This avoids faulty products ever being made. The chain also includes customers and suppliers outside the business.
- **Everyone is involved**: Every department, activity and worker is organised to take into account quality at all times. TQM must start from the top with the chairperson and spread throughout the business to every employee.
- **Quality audits**: Statistical data is used to monitor quality standards. These checks or audits aim to reduce variation, which is the cause of most quality problems. Variations in products, delivery times, materials and worker performance often occur. Such variations can be easily identified if statistical data is used.
- **Teamwork**: TQM stresses that teamwork is the most effective way of solving problems. This is because teams have more skills, knowledge and experience than a single person.
- **Customer focused**: Firms using TQM are committed to their customers. They respond to changes in people's needs and expectations.
- **Zero defects**: Many quality systems have a zero defect policy. This aims to ensure that every product that is manufactured is free from defects.

Table 45.1 summarises some of the advantages and disadvantages of TQM.

▶ Table 45.1 Advantages and disadvantages of total quality management

ADVANTAGES	DISADVANTAGES
Focus is on customer needs	High training and implementation costs
Quality improved in all aspects of business	Will only work if everyone is committed
Waste and inefficiencies removed	May be bureaucratic (lots of documents)
Helps develop ways of measuring performance	Focus is on processes not product
Improves communication and problem solving	

ACTIVITY 2

CASE STUDY: SANTA CRUZ GUITAR COMPANY

The Santa Cruz Guitar Company is a small manufacturer of handmade guitars. The company is passionate about quality. It only makes around 500 instruments per year but they are made to demanding quality standards and are expected to last for more than a lifetime. The company does not have a written quality policy. Neither does it formally apply the principles of TQM. However, the way production is organised does suggest that TQM methods and principles are in use.

The company aims to avoid errors in production at all costs. It employs a number of highly skilled craftsmen called luthiers and organises employees around six different workstations. After work on a guitar is completed at one workstation, the job is then passed on to the next. However, each workstation is under the supervision of a senior luthier (someone who builds stringed instruments) and no guitar passes on to the next stage without a thorough quality check – usually by two luthiers. Although production is organised like an assembly line, each workstation operates like a link in a chain – they are both customers and suppliers.

To ensure that quality standards are maintained, the company will only recruit people that are committed to team working and have a genuine interest in guitars. This helps to ensure that workers are highly motivated. Workers are also encouraged to attend training courses and have permission to build two guitars each year for themselves. The company is also customer focused. Each guitar is made to precise customer specifications and the company has a website where guitar owners can communicate directly with the manufacturer. The success of the company is reflected by its long list of customer orders.



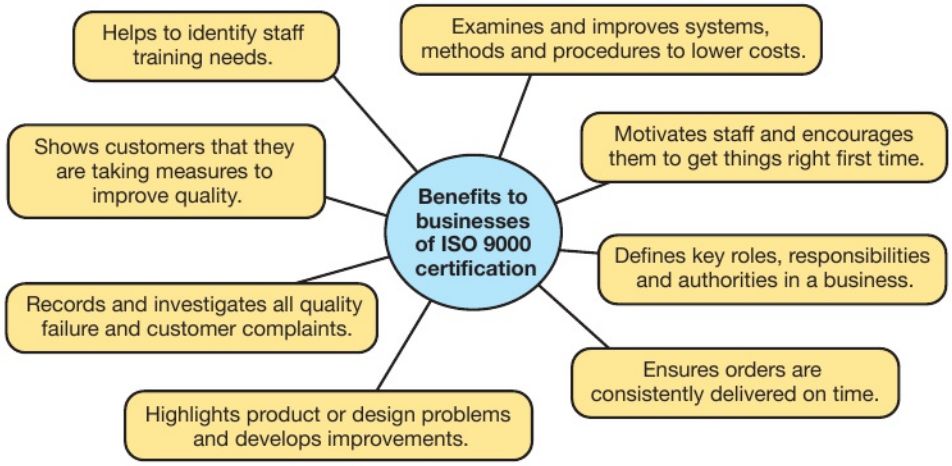
▶ Example of a guitar produced by the Santa Cruz Guitar Company

1 Describe two features of total quality management that are used by the Santa Cruz Guitar company.
2 Explain one advantage to the Santa Cruz Guitar company of using TQM principles.

QUALITY STANDARDS

Businesses can earn a reputation for quality by following a code of practice or gaining quality awards. Recognition for quality in business may be awarded by a number of organisations. One important example is the British Standards Institution (BSI). This is an independent organisation that sets quality standards in industry. One internationally recognised standard is the ISO 9000. Firms that achieve and maintain a certain standard can carry the BSI kitemark. The kitemark tells the customer that BSI quality standards are consistently achieved by the business. The benefits to a business of ISO 9000 certification are summarised in Figure 45.3.

▶ Figure 45.3 Benefits of ISO accreditation



QUALITY AND COMPETITIVE ADVANTAGE

SUBJECT VOCABULARY

unique selling point (USP) feature of a product that no other similar products have, used in advertising to try to persuade people to buy it

Businesses that produce high-quality products may gain a competitive edge in the market. Some businesses have a reputation for producing high-quality products all over the world. For example, it might be argued that the following businesses are recognised for the quality of their products globally.

- **Prada** – an Italian luxury fashion house specialising in leather handbags, travel accessories, shoes, eyewear and perfumes.
- **Versace** – an Italian fashion company making and selling a wide range of clothing and fashion accessories for men and women.
- **Rolls Royce** – a manufacturer of jet engines but possibly more famous for its Rolls Royce luxury cars.
- **Rolex** – famous for its high-quality luxury wristwatches.
- **Lego** – a global supplier of toys made famous by its large plastic building bricks.

Quality can be important to both large and small businesses. If any business can develop and produce high quality products, this could serve as a unique selling point (USP). This will help give the business a competitive edge in the market. Also, people are often prepared to pay higher prices for quality products so profit margins can be increased.

Developing a reputation for quality and gaining a competitive edge in a market may take time. A business needs to understand how customers view quality in their market and adopt strategies to meet or beat customer expectations. This might mean adopting TQM, buying better quality resources, employing more skilled and experienced staff and implementing an effective marketing strategy. However, the effort and cost may well be worth it.

LARGE VS SMALL BUSINESSES

Quality will be an important issue for most businesses whether they are large of small. Most business owners will appreciate the benefits of offering quality goods and services and even small businesses can gain ISO certification. However, it might be argued that large businesses are more likely to adopt quality control procedures such as TQM because of their high cost.

MULTIPLE-CHOICE QUESTIONS

1 Which of the following is a feature of TQM?
- **A** Quality chains
- **B** Product differentiation
- **C** Cash flow forecasting
- **D** Labour intensive production methods

2 A commitment by a business to maintain quality throughout the organisation is called what?
- **A** Quality circles
- **B** Quality chain
- **C** Quality assurance
- **D** Quality control

3 Which of the following is a possible disadvantage of TQM?
- **A** Waste and inefficiencies rise
- **B** It is expensive to implement
- **C** It is not recognised globally
- **D** It is unclear

4 Teamwork is an important feature of which of the following?
- **A** Quality assurance
- **B** TQM
- **C** Delayering
- **D** Labour-intensive production

CHAPTER REVIEW

CASE STUDY: ASHWIN DATA SYSTEMS (ADS)

ADS produces data management software for businesses. One of its products, DataCare, helps businesses to manage large customer databases. ADS is committed to quality assurance and has been awarded ISO 9001, the internationally recognised standard for the quality management of businesses. Some of the basic requirements of certification include:

- a set of procedures that cover all key processes in the business
- monitoring processes to ensure they are producing quality products
- keeping records

- checking for defects, with action to correct problems where necessary
- regularly reviewing the quality system itself
- ensuring continual improvement.

Regular monitoring ensures that these standards are maintained and that ADS remains worthy of its title as a certified ISO 9001 provider.

▶ Business software: DataCare



CHAPTER QUESTIONS

1 How does ADS ensure quality in its business?

2 Why does quality matter so much to a business like ADS?

ADS has been awarded the ISO 9001 certificate.

3 Discuss two benefits from winning this award.

ADS is considering the introduction of TQM.

4 Will this benefit the company? Make a clear judgement in your evaluation.

EXAM PRACTICE: 5 BUSINESS OPERATIONS

Abdul Engineering is a small manufacturer of metal frameworks. Much of its work involves making frames for greenhouses used by small farms growing vegetables and fruits. The company is stable but has always struggled to grow. Labour productivity has fallen slightly in the last 12 months and Abdul wonders whether it is time to move away from its traditional labour-intensive production methods.

AO1 **a** Define the term '**labour productivity**'. **(1)**

AO2 **b** State **one** example of an internal economy of scale. **(1)**

SKILLS ANALYSIS **AO1** **c** Explain **one** limit to the growth of a business. **(3)**

SKILLS ANALYSIS **AO1** **d** Explain **one** disadvantage to a business of using labour-intensive production. **(3)**

SKILLS ANALYSIS **AO1** **e** Explain **one** reason why it is important to use resources effectively. **(3)**

Abdul Engineering has started to receive multiple orders for one of its products.

As a result of the multiple orders, Abdul is reviewing the production method used at the factory. Two options are being considered for the future.

Option 1: Continue using job production
Option 2: Switch to batch production

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION **AO2** **AO3** **AO4** **f** Justify which one of these two options Abdul Engineering should choose. **(9)**

Total marks for this question = 20

PREPARING FOR YOUR INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 1)

PAPER 1 INVESTIGATING SMALL BUSINESSES

This complete practice paper will help you prepare for your International GCSE Paper 1 examination.

QUESTION 1

Edison Johar runs a car valet service in Colombo, Sri Lanka. He provides the service for his friend, Nalaka Vinoth. He owns a motor service business that carries out repairs and car servicing. The agreement is that Edison washes and valets every car after Nalaka has completed his work. This means that Nalaka's customers have their car returned clean and tidy without charge. Since Nalaka began offering this 'extra' service, repeat custom has grown significantly.

AO1

(a) (i) Which of the following is a variable cost? **(1)**

A Rent
B Packaging
C Interest payments
D Insurance premium

AO1

(ii) Which of the following documents is used to outline the tasks, duties and responsibilities associated with a job? **(1)**

A Job specification
B Job application form
C Job description
D Curriculum vitae

AO1

(iii) Which of the following pricing strategies involves charging a high price when a product is first launched? **(1)**

A Penetration pricing
B Cost-plus pricing
C Skimming
D Psychological pricing

AO1

(iv) Which of the following is an advantage of job production? **(1)**

A Flexibility
B Low unit costs
C Low training costs
D Production is quicker

Nalaka pays Edison Rs400 for each car cleaned. During an average month, Edison would expect to clean 300 cars. Edison's business has fixed monthly costs of Rs20 000 and variable costs of Rs40 per car.

AO2

(v) What is the average monthly revenue for Edison's business? **(1)**

A Rs12 000
B Rs120 000
C Rs88 000
D Rs20 000

SKILLS INTERPRETATION — A02

(vi) How much profit would Edison's business make in an average month? **(1)**

A Rs12 000
B Rs120 000
C Rs88 000
D Rs20 000

A01 **(b)** Define the term **'average cost'**. **(1)**

A01 **(c)** Define the term **'liquidity'**. **(1)**

A02 **(d)** State **one** example of a stakeholder in Edison's business. **(1)**

A02 **(e)** Calculate the number of cars Edison's business would have to clean to break-even in a month. You are advised to show your working. **(2)**

SKILLS ANALYSIS — A03 **(f)** Explain **one** advantage of customer loyalty to a business. **(3)**

Edison Johar operates as a sole trader.

SKILLS ANALYSIS, PRODUCTIVITY — A03 A02 **(g)** Analyse the advantages to Edison of operating as a sole trader. **(6)**

QUESTION 2

Edison wants to buy some new car-cleaning equipment. A new state-of-the-art pressure washer will cost Rs100 000 and will involve borrowing about Rs50 000. The rest of the cost will be met from retained profit.

A02 **(a)** State **one** possible source of finance that Edison might use to raise Rs50 000. **(1)**

A02 **(b)** State **one** example of a cash outflow that might appear in a cash flow forecast. **(1)**

SKILLS ANALYSIS — A01 **(c)** Explain **one** advantage to a business of using retained profit as a source of finance. **(3)**

SKILLS ANALYSIS — A01 **(d)** Explain **one** benefit of using new technology in a business. **(3)**

SKILLS ANALYSIS — A01 **(e)** Explain **one** possible financial aim that a business might have. **(3)**

Edison wants to measure the success of his business.

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION — A02 A03 A04 **(f)** In order to measure the success of his business, Edison is considering the following two options:

Option 1: Profit.
Option 2: Owner satisfaction.

Justify which one of these methods Edison Johar should use. **(9)**

QUESTION 3

Edison Johar and Nalaka Vinoth have decided to join forces in a new venture called *Quickwash*. They want to form a partnership and set up a purpose-built car washing/valeting centre in Mount Lavinia, Colombo.

AO1 **(a)** Define the term '**labour intensive**'. (1)

AO2 **(b)** Outline **one** disadvantage for Edison and Nalaka of forming a partnership. (2)

In preparation for their new venture, Edison and Nalaka prepare a cash flow forecast. At the end of the first trading period, the following figures were identified.

Opening cash balance Rs1 000 000
Cash inflow Rs3 600 000
Cash outflow Rs4 900 000

AO2 **(c)** Calculate the closing cash balance. (2)

When Edison and Nalaka opened *Quickwash* they used penetration pricing.

SKILLS PRODUCTIVITY

AO2 AO3 **(d)** Analyse the possible reasons why Edison and Nalaka used penetration pricing. (6)

Edison and Nalaka want to promote *Quickwash*, but have a limited amount of money.

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO2 AO3 AO4 **(e)** In order to promote the new venture Edison and Nalaka are considering two options:

Option 1: Take out a full-page advert in a local newspaper every day for 2 weeks.
Option 2: Offer a coupon with a 20 per cent discount for a full car service at Nalaka's motor service centre.

Justify which one of these options Edison and Nalaka should select. (9)

QUESTION 4

At the end of the first year, *Quickwash* made an operating profit of Rs2 200 000. Its capital employed was Rs18 000 000.

AO2 **(a)** Calculate the return on capital employed for *Quickwash*. (2)

To cope with rising demand, *Quickwash* needs more staff.

SKILLS PRODUCTIVITY

AO3 **(b)** Analyse the benefit to *Quickwash* of employing part-time staff. (6)

In the future, if *Quickwash* continues to be successful, Edison and Nalaka hope to set up a franchise operation. They believe that this would be the best way to grow the business.

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO1 AO2 AO3 AO4 **(c)** Evaluate the future growth options for *Quickwash*. (12)

PREPARING FOR YOUR INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 2)

PAPER 2 INVESTIGATING LARGE BUSINESSES

This complete practice paper will help you prepare for your International GCSE Paper 2 examination.

QUESTION 1

Coca-Cola is one of the most widely recognised brands in the world. There are few countries where one of the company's products cannot be purchased. Its global sales generate huge revenues. Coca-Cola uses a number of methods to promote its products. Some evidence suggests that in 1886 Coca-Cola was the first company to use coupons. Between 1886 and 1914, one in ten cokes were given away free. Coca-Cola also use sponsorship. For example, Coca-Cola was one of the sponsors of the 1928 Olympic Games in Amsterdam. It has supported every single Olympic Games since then.

AO1

(a) (i) Which of the following is an example of a current asset? **(1)**

A Trade payables
B Property
C Bank overdraft
D Cash

AO1

(ii) Which of the following means that business owners can only lose the original amount of money they invested in the business if it collapses? **(1)**

A Certificate of Incorporation
B Unlimited liability
C Limited liability
D Patent

AO1

(iii) Which of the following businesses is likely to pursue objectives other than profit maximisation? **(1)**

A Multi-nationals
B Private limited companies
C Public limited companies
D Social enterprises

AO1

(iv) Which of the following is an example of an internal economy of scale? **(1)**

A Risk-bearing economies
B Improved infrastructure
C The availability of specialist financiers
D The availability of a well-qualified and experienced pool of labour

In 2015, Coca-Cola's revenue was US$44 294 million. Five years before, in 2010, it was US$35 119 million.

AO1

(v) The percentage increase in revenue over that time period is: **(1)**

A 26.1 per cent
B 9175 per cent
C 20.7 per cent
D about 10 per cent

At the end of the 2015 financial year, Coca-Cola's current assets were US$33 395 million. Its current liabilities were US$26 930 million.

SKILLS INTERPRETATION — A02

(vi) Which of the following is the current ratio for Coca-Cola? **(1)**

A 1.5
B 1.24
C 0.81
D US$6465 million

A01 **(b)** Define the term **'brand'**. **(1)**

A01 **(c)** Define the term **'promotion'**. **(1)**

A02 **(d)** State **one** possible example of a current liability for Coca-Cola. **(1)**

A coupon entitles the holder to 20 per cent off a case of 12 bottles of cola. The case costs US$8.00.

A02 **(e)** Calculate the amount of money saved per bottle if the coupon is redeemed. **(2)**

SKILLS ANALYSIS — A01 **(f)** Explain **one** benefit to a business of using internal methods of recruitment. **(3)**

SKILLS ANALYSIS, PRODUCTIVITY — A02, A03 **(g)** Analyse the importance of sponsorship to Coca-Cola. **(6)**

QUESTION 2

Coca-Cola has many factories all over the world. In 2015, the company opened a US$20 million factory in partnership with a group of Palestinians. The factory, located in the Gaza strip, will employ 250 people and support another 1000 families or more. The factory was a welcome investment since the unemployment rate in Palestine is over 40 per cent, according to the World Bank.

A02 **(a)** State **one** type of employment the Coca-Cola factory might use when recruiting workers. **(1)**

A02 **(b)** State **one** financial method of motivation that might be used in the Coca-Cola factory. **(1)**

SKILLS ANALYSIS — A01 **(c)** Explain **one** benefit to a business of a falling exchange rate. **(3)**

SKILLS ANALYSIS — A01 **(d)** Explain **one** disadvantage to a business of an increase in the national minimum wage. **(3)**

SKILLS ANALYSIS — A01 **(e)** Explain **one** benefit to a country of being the location for a multinational a factory. **(3)**

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION — A02, A03, A04 **(f)** When developing new factories overseas, Coca-Cola can choose between two approaches to production:

Option 1: Labour-intensive production.
Option 2: Capital-intensive production.

Justify which one of these two options Coca-Cola should choose. **(9)**

QUESTION 3

An extract from Coca-Cola's statement of comprehensive income is shown in the table below.

	2015 (US$ MILLION)
Revenue	44 294
Cost of sales	17 482
Gross profit	26 812
Administrative expenses	16 427
Other operating expenses	1657
Operating profit	8728

AO1 **(a)** Define the term '**cost of sales**'. (1)

AO2 **(b)** Outline **one** role of the finance department at Coca-Cola. (2)

AO2 **(c)** Calculate the operating profit margin for Coca-Cola in 2015. (2)

SKILLS PRODUCTIVITY

AO2 AO3 **(d)** Analyse the benefit to Coca-Cola of using financial ratios. (6)

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO2 AO3 AO4 **(e)** When selling products in a new overseas country, Coca-Cola may have two options:

Option 1: Set up a factory inside a trade bloc.
Option 2: Supply the new country from an established factory outside the trade bloc.

Justify which of these options might be best for Coca-Cola. (9)

QUESTION 4

In 2016, Coca-Cola (UK) launched its biggest new product campaign in ten years. The product, Coca-Cola Zero Sugar, was a new and improved sugar-free brand of Coca-Cola. As part of the promotion, people in London were able to try the drink at a pop-up 'Coca-Cola Zero Sugar photo booth' at Camden Beach Bar. The company planned to give away over 4 million drinks during the summer.

The new drink was marketed in smaller 250 ml cans compared with the standard 355 ml cans used by the company.

AO2 **(a)** Calculate the potential savings in materials costs for Coca-Cola as a percentage. (2)

SKILLS PRODUCTIVITY

AO2 AO3 **(b)** Analyse the benefit to Coca-Cola of using extension strategies for its products. (6)

A study conducted by ICM Research, found that 20 per cent of a sample (comprising 180 agencies and brands) said Coca-Cola was 'one of the brands doing social media particularly well'.

SKILLS CRITICAL THINKING, PROBLEM SOLVING, REASONING, DECISION MAKING, CREATIVITY, INNOVATION

AO1 AO2 AO3 AO4 **(c)** Evaluate the possible benefits to Coca-Cola of making increasing use of social media in marketing. (12)

COMMAND WORDS

The table below lists the command words that may be used in question papers for the Pearson Edexcel International GCSE in Business, it also gives an outline of what each type of question requires students to do.

COMMAND WORD	THIS TYPE OF QUESTION WILL REQUIRE STUDENTS TO:
(MULTIPLE-CHOICE QUESTION)	select one or more correct answer from a choice of answers. These questions test recall of knowledge from the specification content or require a calculation to reach the correct answer
DEFINE	define a term from the specification content
GIVE	give an answer testing recall of knowledge from the specification content
STATE	give an answer, no longer than a sentence, referring to apiece of contextual information from which they must select the answer
IDENTIFY	select the correct answer from reading a graph or table of data
CALCULATE	use mathematical skills to reach the answer, based on given data. Calculators may be used and workings should be given
COMPLETE THE TABLE	work out the values missing from the presented table of data
OUTLINE	give two linked points about a business concept or issue, placed in context in the question
EXPLAIN	give a statement of fact, with two further expansion points. These may expand on each other, or both from the same fact. There is no context in these questions
ANALYSE	write an extended answer, requiring expansion and exploration of a business concept or issue. The answer will be placed in context by the question
JUSTIFY	write an extended answer, using information provided in order to recommend one of two options to a business
EVALUATE	write an extended answer, using knowledge of specification content to reach a supported conclusion about a business situation.

Examples of how these command words are used in Paper 1 and Paper 2 are given in the Pearson Edexcel International GCSE in Business Sample Assessment Materials for this qualification.

GLOSSARY

above-the-line promotion placing adverts using the media

accounts clerk someone who keeps records or accounts in an office

acid test ratio similar to the current ratio but excludes stocks from current assets (sometimes called the quick ratio)

adjustments includes adjustments for the profits made on the disposal of assets

advertising communication between a business and its customers where messages are placed in the media to encourage the purchase of products

agent or broker intermediary that brings together buyers and sellers

anti-competitive practices (restrictive trade practices) attempts by firms to prevent or restrict competition

apprenticeship system of training new entrants to a trade or profession, often, but not always, younger workers, mostly on-the-job training but often with some college attendance

arrears money that you owe someone, or is owed to you, because you have not made, or have received, regular payments at the correct intervals or amounts

assembly plant factory where parts are put together to make a finished product

assets resources used or owned by a business, such as cash, stock, machinery, tools and equipment

assisted areas areas that are designated by a government as having economic problems and are targeted to receive support in a variety of forms

audit official examination of a company's financial records in order to check that they are correct

auditing accounting procedure that checks thoroughly the accuracy of a company's accounts

automation use of computers and machines instead of people to do a job

automotive relating to cars

balance of trade (or visible balance) difference between visible exports and visible imports

bank overdraft agreement with a bank where a business spends more money than it has in its account (up to an agreed limit)

barriers to entry restrictions that mean it is difficult for new firms to enter a market

batch production method that involves completing one operation at a time on all units before performing the next

below-the-line promotion any promotion that does not involve using the media

bid offer to pay a particular price for something (for example, a business)

bonus systems payment in addition to the basic wage for reaching targets or in recognition for service

Boston matrix 2×2 matrix that describes products according to the market share they enjoy and whether the market has any potential for growth

break-even chart graph that shows total cost and total revenue; break-even point is where total cost and total revenue intersect

break-even point level of output where total costs and total revenue are exactly the same: neither a profit nor a loss is made

brownfield sites areas of land that were once used for urban development

budget an official statement that a government makes about how much it intends to spend and what the rates of taxes will be for the next year or six months

budgetary measures actions taken by the government to influence business and the economy

bulk breaking dividing a large quantity of goods received from a supplier before selling them on in smaller quantities to customers

bulk buying buying goods in large quantities, which is usually cheaper than buying in small quantities

business organisation that produces goods and services

business to consumers (B2C) selling of goods by businesses to consumers

capital employed amount of money invested in a business

capital finance provided by the owners of a business

capital-intensive production production methods that make more use of machinery relative to labour

capital-intensive use of relatively more machinery than labour in production

cash flow flow of money into and out of a business

cash flow forecast prediction of all expected receipts and expenses of a business over a future time period, which shows the expected cash balance at the end of each month

cash inflow flow of money into a business

cash outflow flow of money out of a business

centralised type of organisation system where most decisions are made at the top of the organisation and then passed down the chain of command

certificate of incorporation document needed before a new company can start doing business

chairperson someone who is in charge of a meeting or directs the work of a committee or organisation

charities organisations that give money, goods or help to people who are poor, sick or in need

closing cash balance amount of cash that the business expects to have at the end of each month (takes into account the cash inflows

and cash outflows)

commission extra amount of money that is paid to a person or organisation according to the value of the goods they have sold or the services they have provided

commission payment based on the value of sales, usually a percentage of sales made

commodities products that are bought and sold (in business often refers to things like oil, gold, iron ore, rice, wheat and meat)

communication channels routes along which information might travel in a business

competition-based pricing pricing strategies based on the prices charged by rivals

computer aided design (CAD) use of computers to design products

computer aided manufacturing (CAM) where computers link and control the design and production of goods in manufacturing

computer integrated manufacturing (CIM) use of computers to control the entire production process

computer numerically controlled machines (CNCs) machines that carry out the instructions fed by computers

consumer cooperative cooperative that is owned by its customers

consumer goods goods and services sold to ordinary people (consumers) rather than businesses

consumer panels groups of customers are asked for feedback about products over a set period

contracts of employment written agreements between an employer and an employee in which each has certain obligations

cooperative company, factory or organisation in which all the people working there own an equal share of it

cost plus or cost-based pricing adding a percentage (the mark-up) to the costs of producing a product to get the price

costs expenses that must be met when setting up and running a business

coupons printed piece of paper given to customers by the seller of a product, allowing the customer to pay less than usual for the product when they next buy it, or to get a free gift

crowd funding where a large number of individuals (the crowd) invest in a business venture using an online platform and therefore avoiding using a bank

currency reserves money in foreign currency held by a country and used to support its own currency and to pay for imports and foreign debts

current assets assets likely to be changed into cash within a year

current liabilities debts that have to be repaid within a year

current ratio assesses the firm's liquidity by dividing current liabilities into current assets

de-industrialisation decline in manufacturing

debenture long-term security yielding a fixed rate of interest, issued by a company and secured against assets

decentralised type of organisation system where decision making is pushed down the chain of command and away from the top

deed of partnership binding legal document that states the formal rights of partners

demographic segmentation dividing a market according to the type of people that make up a particular group, in particular their age, sex and income

design brief set of instructions about what a new product should look like or what features it should have

destroyer or predatory pricing setting a low price until rivals have gone out of business

direct mail advertisements that are sent to people in the post, often people who have been chosen because they might be interested in the product

direct selling where businesses sell their products directly to consumers

diseconomies of scale rising average costs when a firm becomes too big

distributed profit profit that is returned to the owners of a business

distribution channel route taken by a product from the producer to the customer

diversify if a business, company or country diversifies, it increases the range of goods or services it produces

dividends share of the profit paid to shareholders in a company

division of labour specialisation in specific tasks or skills by an individual

downsizing process of reducing capacity, usually by laying off staff

downturn period or process in which business activity, production, etc. is reduced and conditions become worse

downward communication passing messages from the top of the organisation to those at the bottom

drawings money taken out of the business by the owner for personal use

dumping where a business sells goods in another country often below cost

e-commerce or e-tailing use of electronic systems to sell goods and services

early adopters consumers who are keen to buy new products as soon as they are launched

economies of scale financial advantages (falling average costs) of producing something in very large quantities

emerging economies rapidly growing economies (for example, Brazil) – emerging economies have huge growth potential but also pose significant risks

employment tribunal court that deals with cases involving disputes between employers and employees

enterprise the activity of starting and running businesses

entrepreneur person who takes risks and sets up businesses; individual who organises the other factors of production and risks their own money in a business venture

exchange rate value of one currency in terms of another

excise duties taxes on selected goods, such as those on petrol and tobacco in the UK

executives managers in an organisation or company who help make important decisions

exports goods and services sold overseas

exposure advertising and publicity that is used to sell a product or service

extension strategies methods used to lengthen the life of a product

external communication communication between the business and those outside such as customers, investors or the authorities

external economies of scale cost benefits that all firms in the industry can enjoy when the industry expands

external finance finance obtained from outside the business

external recruitment appointing workers from outside the business

extraction industries industry where materials, such as oil and coal, are obtained from under the ground in drilling, mining and quarrying

factors of production resources used to produce goods and services – including land, labour, capital and enterprise

finance cost interest paid on loans

finance income interest received by the business on deposit accounts

financial return monetary return

finite having an end or a limit

fiscal policy using changes in taxation and government expenditure to manage the economy

fixed assets resources that are used repeatedly for a period of time by a business such as property, tools, vehicles and machinery

fixed capital stock of human-made resources, such as machines and tools, used to help make goods and services

fixed costs costs that do not vary with the level of output

flexitime system in which people work a fixed number of hours each week or month, but can change the times at which they start and finish each day

flotation process of a company 'going public'

flow production large-scale production of a standard product, where each operation on a unit is performed continuously one after the other, usually on a production line

formal communication use of recognised channels when communicating

formal organisation internal structure of a business as shown by an organisation chart

franchise structure in which a business (the franchisor) allows another operator (the franchisee) to trade under their name

free trade trade between nations that is completely without government restrictions

fringe benefits 'perks' over and above the normal wage or salary

FTSE 100 index that measures the share prices of the top 100 companies in the UK

globalisation growing integration of the world's economies

goods physical products, such as a mobile phone, a packet of crisps or a pair of shoes

goodwill value that a company has because it has a good relationship with its customers and suppliers

greenfield sites previously undeveloped areas of land, usually on the outskirts of towns and cities

gross pay pay before deductions, such as tax

gross profit sales revenue less cost of sales

gross profit margin (or mark-up) gross profit expressed as a percentage of turnover

hire purchase buying specific goods with a loan, often provided by a finance house

horizontal communication exchange of information between parties on the same level in an organisation's hierarchy

hostile takeover takeover that the company being taken over does not want or agree to

human capital people and their skills.

human resources in some businesses, the department that deals with employing, training and helping people

hygiene factors (Herzberg's) things at work that result in dissatisfaction

imports goods and services bought from overseas

incorporated business that has a separate legal identity from that of its owners

induction training training given to new employees when they first start a job

infant industries new industries that are yet to be established

infinite without limits in space or time

informal communication use of non-approved channels when communicating

infrastructure basic systems and structures that a country or organisation needs in order to work properly

innovator someone who introduces changes and new ideas

insolvent inability to meet debts

instalment one of a series of regular payments made until all the money owed has been repaid

intellectual property people's knowledge or creative ideas that have commercial value and are protectable under different forms of copyright

interest price of borrowed money (and the reward to savers)

intermediary person or organisation that helps to arrange agreements or business deals between other people or organisations

internal communication communication between people inside the business

internal economies of scale cost benefits that an individual firm

can enjoy when it expands

internal finance finance generated by the business from its own means

internal recruitment appointing workers from inside the business

inventory stocks of goods

invisible trade trade in services

issue (shares) sale of new shares

job enrichment making a job more challenging and interesting

job production method of production that involves employing all factors to complete one unit of output at a time

job satisfaction pleasure, enjoyment or sense of achievement that employees get from their work

just-in-time production technique that is highly responsive to customer orders and uses very little stock holding

kaizen Japanese term that means continuous improvement

labour people employed in a business/used in production

labour productivity output per worker in a given time period

labour-intensive production production methods that make more use of labour relative to machinery

large business a business that employs more than 250 people

lay off (staff) make employees redundant

lean production approach to production aimed at reducing the quantity of resources used

liabilities debts of the business, which provide a source of funds

limited companies business organisations that have a separate legal identity from that of their owners

limited liability business owner is only liable for the original amount of money invested in the business; shareholders are legally responsible for the debts of a company according to how many shares they own

limited partnership partnership where some partners contribute capital and enjoy a share of the profit but do not take part in the running of the business

liquid asset that is easily changed into cash

liquidity ease or speed with which assets can be sold for cash

livelihood way you earn money in order to live

long-term finance money borrowed for more than one year

loss leader product sold below cost to draw in customers

margin of safety amount of output available to be sold above the break-even point where the business makes a profit

mark-up percentage added to costs that makes a profit for a business when setting the price

market analysis quantitative and qualitative assessment of a market

market orientation where a business focuses on the needs of consumers when developing products

market research collection, presentation and analysis of information relating to the marketing and consumption of goods and services

market segments part of a whole market where a particular customer group has similar characteristics

market set of arrangements that allows buyers and sellers to communicate and trade in goods and services

market share proportion of sales in a total market that a business or product enjoys

marketing identifying customer needs and satisfying them profitably

marketing mix elements of a firm's marketing that are designed to meet the needs of customers (often called the 4Ps, they include product, price, promotion and place)

Maslow's hierarchy of needs order of people's needs starting with basic human needs

mass markets very large markets in which products with mass appeal are marketed

merchandise goods that are being sold

merchandising way in which goods are arranged and placed in a store

merger two or more businesses joining together to form one new firm

minimum wage minimum amount per hour, which most workers are entitled to be paid

monetary policy using changes in interest rates and the money supply to manage the economy

monetary system system of money in a particular country or the world as a whole, and the way that it is controlled by governments and central banks

mortgage long-term loan secured with property

motivators (Herzberg's) things at work that result in satisfaction

multinational company large business with significant production or service operations in at least two different countries

natural monopoly market where it is more efficient to have just one organisation meeting total market demand

needs basic requirements for human survival

net assets value of all assets less the value of all liabilities; total at the bottom of the first part of the balance sheet

net cash flow difference between the cash flowing in and the cash flowing out of a business in a given time period

net current assets current assets minus current liabilities, also known as working capital

net pay take home pay, that is, pay after deductions, such as income tax pension contributions or student loan repayments

niche market smaller market, usually within a large market or industry

non-current assets assets that last for more than one year

non-current liabilities debts that are payable after 12 months

normal profit minimum profit a business needs to make to retain the interest of the owner(s)

objectives goals or targets set by a business

off-the-job training training that takes place away from the work area

ombudsman someone who deals with complaints made by ordinary people against the government, banks, insurance companies and so on

on-the-job training training that takes place while doing the job

operating profit gross profit less expenses

operating profit margin operating profit expressed as a percentage of turnover

organisation group, such as a club or business, that has formed for a particular purpose

organisational chart diagram that shows the different job roles in a business and how they relate to each other

outcompeted perform more effectively in a particular field

output amount of goods or work produced by a person, machine or factory

outsourcing contracting out of work that might otherwise have been performed within the organisation to other businesses

overdue money that has not been paid by the time expected

overheads money spent regularly on rent, insurance, electricity and other things that are needed to keep a business operating

overtime rate of pay above the normal rate to compensate employees for working extra hours

overtrading taking on more work than a business can afford to fund effectively

partnership business owned by between 2 and 20 people

patents legal documents giving a person or company the right to make or sell a new invention, product, or method of doing something and stating that no other person or company is allowed to do this

payroll officer someone who is responsible for the administration of workers' pay in an organisation

penetration pricing setting a low price to start with in order to get established in the market; price may be raised once established

performance-related pay payment system designed for non-manual workers where pay increases are given if performance targets are met

pharmaceutical relating to the production of drugs and medicines

piece rate payment system where workers receive an amount of money for each unit produced

portfolio collection (of business interests or products)

predator business that tries to use another's weakness to get advantages

premises buildings and land used by a shop or business

primary or field research gathering of 'new' information that does not already exist

primary sector (industry) production involving the extraction of raw materials from the earth

private limited company (Ltd) in the UK, a private company limited by shares, which means the liability of the shareholders to creditors of the company is limited to the capital originally invested, a shareholder's personal assets are protected, and with Ltd or Limited after its name, other countries have similar arrangements with different letters after the company name: German GmbH, Polish sp. z o.o., Czech s.r.o., Italian s.r.l., Slovak s.r.o. and UAE LLC.

private sector business organisations owned by individuals or groups of individuals

privatisation transfer of public sector resources to the private sector

process production form of flow production where materials pass through a plant where a series of processes are carried out in order to change the product

producer goods goods and services produced by one business for another

product development identifying opportunities and ideas for new products and converting those ideas into marketable goods or services

product life cycle level of sales at the different stages through which a product passes over time

product orientation where a business focuses on the design and manufacture of the product itself rather than the needs of customers

product portfolio (product mix) range of products a business is currently marketing

product positioning way that people think about a product in relation to the company's other products and to competing products, or the way that the company would like them to think about it

production transformation of resources into a final product

productivity rate at which goods are produced, and the amount produced, especially in relation to the work, time and money needed to produce them

profit maximisation making as much profit as possible in a given time period

profit money left over after all costs have been subtracted from revenue

profit satisficing making enough profit to satisfy the needs of the business owner(s)

prospectus document produced by a company that wants the public to buy its shares

protectionism use of trade barriers to protect domestic producers

public corporations business organisations owned and controlled by the state/government

public limited company (Plc) in the UK, a limited company whose shares are freely sold and traded, with a minimum share capital of £50 000 and the letters Plc after its name, other countries have similar arrangements with different letters after the company name: German AG (Aktiengesellschaft), Czech a.s., Italian S.p.A. and Spanish, French, Polish, Greek and Romanian S.A.

public relations attempt by a business to communicate with interested parties

public sector business organisations owned by central or local government

qualitative data information about attitudes beliefs, and intentions, usually written in words

quality features of a product that allow it to satisfy customers' needs

quality assurance working methods that take into account customers' wants when standardising quality – it often involves guaranteeing that quality standards are met

quality circles small group of factory workers who meet regularly to discuss ways to improve working methods and to solve problems

quality control making sure that the quality of a product meets specified quality standards

quantitative data information that can be quantified, that is, expressed in numbers

quantitative information information expressed in numbers

quota physical limit on the quantity of imports allowed into a country

ratio analysis mathematical approach to investigating accounts by comparing two related figures

redeployment moving someone or something to a different place or job

regulatory control official power to control an activity and to make sure that it is done in a satisfactory way

remuneration money paid to employees for their work or services

repatriation (of profit) where a multinational returns the profits from an overseas venture to the country where it is based, typically from a developing country to a developed country (not often the other way around)

repossess to take back cars, furniture or property from people who had arranged to pay for them over a long time, but cannot now continue to pay for them

retail cooperative cooperative of retail members, who often work together to assert their purchasing power

retailers businesses that buy goods from manufacturers and wholesalers and sell them in smaller quantities to consumers

retained profit profit held by a business rather than returning it to the owners and which may be used in the future

return on capital employed (ROCE) profit of a business as a percentage of the total amount of money used to generate it

revenue money from the sale of goods and services

rights issue sale of new shares to existing shareholders at a discount

salary pay, usually to non-manual workers, expressed as a yearly figure but paid monthly

sample small group of people, which must represent a proportion of a total market when carrying out market research

saturate (market) to offer so much of a product for sale that there is more than people want to buy

scale size of a business

scarce resources with limited availability

secondary or desk research collection of data that already exists

secondary sector (industry) production involving the conversion of raw materials into finished and semi-finished goods

services non-physical products, such as banking, car washing and waste disposal

shareholders owners of limited companies

short-term finance money borrowed for one year or less

skimming (or creaming) setting a high price initially and then lowering it later

small business a business that employs fewer than 50 people

social enterprise business that aims to improve human or environmental well-being, charities for example

social security payments money taken by the British government from people's wages to pay for the system of payments to people who are unemployed or ill

socio-economic groups division of people according to social class based on employment status

sole trader or sole proprietor business owned by a single person

span of control number of people a person is directly responsible for in a business

stakeholder individual or group with an interest in the operation of a business

statement of comprehensive income financial document showing a firm's income and expenditure in a particular time period

statement of financial position summary at a point in time of business assets, liabilities and capital (often called the balance sheet)

stock market market for shares in PLCs

stockpile large supply of goods and so forth that are being kept for use or possible use in the future

subscription pricing amount of money you pay regularly to receive a newspaper, magazine, or broadcasting or telephone service

subsidise paying part of the costs (often by the government in business)

subsidy financial support given to a domestic producer to help compete with overseas firms

surplus amount of something that is more than what is needed or used

sustainable development idea that people should satisfy their basic needs and enjoy improved living standards without compromising the quality of life of future generations

tailor-made where a product has been designed so that it is exactly right for someone's needs

tariff tax on imports to make them more expensive

tax allowances part of income that is not taxed

tertiary sector (industry) production of services in the economy

time rate payment system based on the amount of time employees spend at work

total costs fixed cost and variable cost added together

total quality management (TQM) managerial approach that focuses

on quality and aims to improve the effectiveness, flexibility and competitiveness of the business

total revenue money generated from the sale of output. It is price multiplied by quantity

trade barriers measures designed to restrict trade

trade bloc group of countries situated in the same region that join together and enjoy trade free of barriers

trade payables buying resources from suppliers, such as raw materials and components, and paying for them at a later date (sometimes called trade credit)

trade receivables amounts of money that are owed to a company by its customers

trade unions organisations, usually in a particular trade or profession, that represent workers, especially in meetings with employers

training process that involves increasing the knowledge and skills of a worker to enable them to do their job more effectively

transactions business deals or actions, such as buying or selling something

undercapitalised starting a business with insufficient capital

unfair dismissal when worker is dismissed illegally by a business

unincorporated businesses where there is no legal difference between the owner and the business

unique selling point (USP) feature of a product that no other similar products have, used in advertising to try to persuade people to buy it

unlimited liability owner of a business is personally liable for all business debts

untapped supply, market or talent that is available but has not yet been exploited

upward communication passing messages from the bottom of an organisation to those at the top

urbanisation process of constructing more and more buildings on rural land

variable costs costs that change when output levels change

venture capitalists specialist investors (individuals or companies) who provide money for business purposes, often to new businesses

ventures new business activity that involves taking risks

viability studies careful study of how a planned activity will work, how much it will cost, and what income it is likely to produce

viral advertising direct marketing technique in which a company persuades Internet users to forward its publicity material in emails or via social media (usually by including jokes, games, video clips, etc.)

visible trade trade in physical goods

wants people's desires for goods and services

wholesalers persons or businesses that buy goods from manufacturers and sell them in smaller quantities to retailers

worker cooperative cooperative that is owned by its employees

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ANSWERS

*Please note: questions without answers are 'open' and designed for group or class activities.

CHAPTER 1

CASE STUDY: THE KANDY CYCLE SHOP

1 ▶ Why do you think Tharanga opened a second-hand bicycle shop?

Tharanga had always wanted to run a business because he wanted to be his own boss. He also had a passion for bicycles and spent a lot of his spare time restoring old bicycles and selling them on to local people as a hobby. He probably felt he could make a living by exploiting this hobby. He may also have been motivated by the prospect of making some money.

2 ▶ What are three resources used by Tharanga when setting up his business?

Tharanga when setting up his business used a range of resources. For example, he needed premises, tools and equipment, such as spanners, pliers, screwdrivers and wrenches, spare bicycle parts, lubricants, business stationery, electricity and a mobile telephone. He also employed his younger brother as a shop assistant.

3 ▶ Why do you think businesses exist?

Businesses exist to provide goods or services. In this example, Tharanga sold second-hand bicycles and carried out a repair and maintenance service for bicycle owners. In the private sector these goods and services are sold in the hope that a profit is made for the business owners.

ACTIVITY 1

CASE STUDY: GULF CONFECTIONERY AND BISCUIT CO.

1 ▶ Does the Gulf Confectionery and Biscuit Co. supply products that satisfy needs or wants?

The Gulf Confectionery and Biscuit Co. manufactures high-quality toffees, sweets and lollies. These products are designed to meet consumers' wants, not their needs. They are non-essential products. They are not required for human survival. People can live without toffees, sweets and lollies, so they are not designed to meet their needs.

2 ▶ The Gulf Confectionery and Biscuit Co. is a private enterprise. What does this mean?

Individuals or groups of individuals own most businesses privately. They are private sector businesses. The Gulf Confectionery and Biscuit Co. is a private enterprise that makes toffees, sweets and lollies. The owners hope that the business is successful and is able to make a profit.

ACTIVITY 2

CASE STUDY: STAKEHOLDERS

1 ▶ What is meant by the term business stakeholder?

A stakeholder is an individual or a group that has an interest in the operation of a business. Some stakeholders, such as owners, have a financial interest in the business.

2 ▶ Name the two groups of stakeholders in the photograph.

Customers and employees are the two groups of stakeholders in the photograph.

3 ▶ The goods sold in the store above are bought from suppliers. What are the possible needs of suppliers?

Businesses that provide raw materials, parts, commercial services and utilities to other businesses are called suppliers. In this case, suppliers provide the store with the stock that is sold on to consumers. Relations between businesses and their suppliers must be good because they rely on each other. Businesses want good quality resources at reasonable prices. In return suppliers will require prompt payment and regular orders. If suppliers do not receive prompt payment from their customers, this may cause them problems. For example, they may not have enough money to pay their own bills.

MULTIPLE-CHOICE QUESTIONS

1C, 2C, 3B, 4A

CHAPTER REVIEW

CASE STUDY: JCB

1 ▶ JCB makes producer goods. What is meant by the term producer goods?

Products sold by one business to another are called producer goods. JCB designs and manufactures a wide range of machinery for the construction industry. These are producer goods because they are sold to other businesses, not consumers.

2 ▶ What is meant by the term private sector?

Business organisations owned by individuals or groups of individuals operate in the private sector.

3 ▶ Name two possible stakeholders in JCB.

Any two from: shareholders, suppliers, employees, customers, the local community or the government.

4 ▶ Describe the role played by managers in a business such as JCB.

Managers help with the running of a business. They are often employed to run the different departments in businesses such as marketing, production, finance and human resources. Managers have to show leadership, solve problems, make decisions, settle disputes and motivate workers. Managers are likely to help plan the direction of the business with its owners. They also have to control resources, such as finance, equipment, time and people. Managers are also accountable to the owners. This means they have to take responsibility if things go wrong.

5 ▶ JCB operates in a changing business environment. What does this mean?

Most businesses operate in a changing business environment. This means that they may be affected by external factors that are likely to change over time. Such factors include the strength of competition, the economic climate, government legislation, population trends, demand patterns, world affairs and social factors. In this case, JCB

might be affected by a decline in the construction industry, for example. This might happen if there is a recession or a reduction in government expenditure on building projects. To survive, businesses such as JCB must produce goods and services that satisfy customer needs. They must have clear objectives and recognise that the changing environment can bring both new opportunities and impose limitations.

6 ▶ Assess whether the owners of JCB would be happy with the financial performance of the business between 2011 and 2014.

The owners of most businesses hope to make a profit. This is one of the main reasons why people get involved in business ownership – they hope to make some money. In this case, the graph in Figure 1.2 shows that JCB saw profits fall from £355 million in 2011 to £303 million in 2014. This is a 14.6% fall over the time period. Generally, owners would prefer profits to rise over a period of time as their business grows. However, sometimes this may not be possible. Businesses may struggle due to internal factors, such as poor management, or external factors, such as emerging competition or poor trading conditions. In this case, information suggests that the construction industry has struggled between 2011 and 2014 in some parts of the world. Consequently, since this is an external factor, JCB owners might be fairly satisfied with the financial performance of the business. At least it hasn't started to lose money.

CHAPTER 2

CASE STUDY: MICROMAX

1 ▶ What are two reasons why Micromax is starting to struggle?

Micromax was a successful company in 2015 where it had overtaken Samsung as market leader in the sale of smartphones in India's rapidly growing market. However, a year later the business started to struggle. There were two main reasons for this: stiff competition from Samsung offering a new range of cheaper sets and Chinese low cost producers entering the market. The second reason appears to be an internal problem. Tensions between established managers and new executives are causing conflict and instability. For example, it appears that a funding deal fell through which was crucial to the development of the company.

2 ▶ What do you think is the main aim of Micromax at this time?

At the moment, Micromax is struggling to face up to threats from strong rivals in the market. It has also got internal problems that are damaging the progress of the company. Consequently, it could be argued that the main objective of the business at the moment is to survive. If Micromax cannot overcome the threat from strong competition and deal with its internal issues, the business may eventually fail.

3 ▶ What measures might Micromax take in order to achieve this aim?

In order to survive in the future, Micromax needs to employ measures designed to make the business stronger. Industry analysts have suggested that Micromax needs to diversify geographically and develop new products such as tablets and televisions. This means that it must find new markets for its products and also develop new ones. Relying only on smartphones is likely to make the business vulnerable. Micromax has also decided to shift production of its smartphones from China to India. This might help to cut costs and make the business more profitable. Finally, Micromax needs to sort out its internal problems so that established managers and new executives work together more effectively.

4 ▶ In groups, produce a spider diagram to show the different possible objectives a business might have. Present your ideas to the rest of the class.

ACTIVITY 1

CASE STUDY: CAIRO FOOD SUPPLIES (CFS)

1 ▶ What evidence is there to suggest that CFS aims to maximise profits?

The information shown by the graph in Figure 2.1 suggests that profit is very important to CFS. Between 2008 and 2015 profits have grown from around EGP1110.2 million to EGP 3901.7 million. This is a huge growth in profits – over 250 per cent during the time period. The company also has a strong dividends policy which suggests that the shareholders' value high returns on their investments. Therefore, it is reasonable to conclude that CFS is a business that aims to maximise its profits.

2 ▶ Who is likely to benefit most from such an objective?

The profit from business activity belongs to its owners. In this case the owners of CFS are the shareholders. Since CFS has a strong dividends policy the shareholders will benefit particularly from profit maximisation and the rapid growth in profits between 2008 and 2015. However, some employees may also benefit. For example, senior executives are likely to get bonuses which are related to profits. Also, profitable businesses can afford to reinvest some of their profits to help develop new products. This may benefit consumers if attractive new products eventually reach the market.

ACTIVITY 2

CASE STUDY: DOHA AIRLINE MEALS

1 ▶ Why is independence and control an important objective in this case?

Some people want to be 'their own boss' – they want to be in control. This is an important non-financial objective for many business owners, such as Omar Hassan. These entrepreneurs are driven by the desire to be independent and to take control of their own futures. The freedom to make all the decisions when running a business is very appealing. Some people often resent being told what to do at work. Omar was employed by a large hotel working in the kitchen. However, he did not like following instructions and being told what to do all day. He set up in business mainly because he valued independence very highly. He wanted to take complete control of his life and also thought

he could improve on some of the inflight meals offered by airlines. Omar also had an offer to sell his business – he would also be kept on as the managing director. However, Omar declined; he wanted to keep control because it was very important to him.

2 ▶ What is meant by a SMART objective? Use information in this case as an example.

SMART business objectives should be **Specific**. This means that the objective should state clearly what is trying to be achieved. They should be **Measurable,** which means the outcome must be able to be measured in numbers. They should be **Achievable** meaning that people involved should be able to complete them and **Realistic**, which means that they can be achieved given the resources available. Finally, SMART objectives also need to be **Time specific**. This means that they state a period of time to achieve the objective. In this case, DAM set SMART objectives in 2015. DAM aimed to increase sales from 2.4 million units to 2.8 million units in 12 months.

3 ▶ Why is it important for objectives to be achievable and realistic?

DAM's managing director, Omar Hassan, said that there is no point in setting objectives that are unrealistic and unachievable by staff. In fact, setting unachievable objectives may have a negative effect on business performance. This is because staff might become demotivated knowing that a particular objective is impossible to achieve. Similarly, if there are not enough resources available to a particular objective, it makes the objective unrealistic and could discourage workers. In this case, Omar said that the key objective was agreed with the sales team. This suggests that the sales objective was both achievable and realistic. Consequently, the objective should help to motivate staff to achieve it.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

CHAPTER REVIEW

CASE STUDY: SUPERSKISWISS.COM

1 ▶ What is meant by a business objective? Use this case as an example.

The objectives of a business are the goals or targets which the business wants to achieve. In this case one of SuperSkiSwiss.com's objectives is to grow the business. This is suggested by the fact that the company has grown sales revenue from 0 in 2010 to an estimated €1 543 000 in 2017. SuperSkiSwiss.com also aims to be Europe's number one online shopping site for skiers. SuperSkiSwiss.com hopes to achieve sales of €3 000 000 by 2020.

2 ▶ Some businesses have non-financial objectives. Name two examples of non-financial business objectives.

Examples of non-financial business objectives include social objectives, personal satisfaction, challenge and independence and control.

3 ▶ Work out the change in sales revenue between 2010 and 2017.

For this amended question the answer will be:

$$\frac{€1\,543\,000 - €240\,000}{€240\,000} \times 100 = \frac{€1\,303\,000}{€240\,000} \times 100$$

$$= \textbf{542.9 per cent}$$

4 ▶ Describe one benefit to SuperSkiSwiss.com of sales growth.

Many owners aim to grow their businesses. This usually means they want to increase sales revenue. It is a common business objective because growth has a number of benefits. For example, as a business grows it will usually gain a larger market share. As market share grows businesses enjoy a higher profile and eventually may be able to have an influence in the market. For example, it may be able to charge higher prices. Other benefits include lower costs, more profits and more security.

5 ▶ SuperSkiSwiss.com may be concerned about social responsibility. What evidence is there in the case study to support this view?

In recent years a growing number of businesses have been keen to improve their social responsibility. For example, SuperSkiSwiss.com appears to consider the needs of the environment when making business decisions. The biggest environmental impacts from SuperSkiSwiss.com are carbon emissions from the distribution of goods, the running of buildings and waste from packaging. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions, and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used. This suggests that SuperSkiSwiss.com wants to foster a good public image. If a business has a bad image or poor reputation it may lose customers.

6 ▶ How might a company like SuperSkiSwiss.com change its objectives as it evolves? Provide two reasons in your analysis.

Over a period of time, as businesses like SuperSkiSwiss.com evolve, aims and objectives are likely to change. This is usually because businesses have to respond to certain events or changes in circumstances. For example, businesses like SuperSkiSwiss.com operate in dynamic markets. This means they have to deal with regular changes. For example, a new entrant may appear in the market, a rival might introduce a new product or the economy may start to decline. When market conditions change it may be necessary to set new objectives. In this case the fashion industry is highly competitive. For example, if trading becomes difficult as a result of more intense competition, SuperSkiSwiss.com may decide that survival is more important than rapid growth until the market 'settles down'.

New legislation might also have an impact of the objectives of a business. In recent years many business have become more socially responsible. This may be a reaction to new environmental, employment or consumer legislation.

In this case, SuperSkiSwiss.com claims that it wants to grow in a sustainable way. As a result, for example, the businesses is committed to the protection of the environment. This might be the result of a growing body of legislation passed to help protect the environment. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions, and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used. These results suggest that SuperSkiSwiss.com may have modified its objectives as a result of environmental legislation.

Finally, the reasons for a business changing its objectives are often due to external factors. These are factors which are beyond the control of businesses. However, sometimes a business such as SuperSkiSwiss.com might change its objectives for internal reasons. For example, there may be change in the senior management team. In such circumstances the objectives might change. For example, new senior managers might want to pursue profit maximisation so that higher dividends can be paid to shareholders. However, there is no evidence in this case to suggest that SuperSkiSwiss.com has made any such changes.

CHAPTER 3

CASE STUDY: MARIANA BELLO

CASE STUDY: THE HATTA DENTAL AND IMPLANT CLINIC

1 ▶ Who owns the businesses in the above two case studies?

Mariana Bello is the sole owner of Mariana's. Khalid Said and Ismail Mansour own the Hatta Dental and Implant Clinic – they are business partners.

2 ▶ Discuss one advantage and one disadvantage of owning a business with a partner.

One advantage of owning a business with someone else is that more money can be raised when setting up. Khalid and Ismail both put in AED 200 000 when they set up the Hatta Dental and Implant Clinic. The challenge and responsibility of running the business can also be shared. One major disadvantage is that the profits have to be shared. Owners may also disagree and fall out.

Business owners have to take risks.

3 ▶ What risks are taken in the above case studies?

In both these cases, the owners had to risk their own money when setting up and running the business. Mariana Bello used €20 000 of her own savings when she set up her café in Seville. Similarly, Khalid and Ismail both put AED 200 000 into their dental practice when setting up.

4 ▶ Discuss in groups whether you would be prepared to take the risk to set up in business. List your reasons for and against and present to the rest of the class.

ACTIVITY 1

CASE STUDY: KISULI, OKUMA AND OWINO

1 ▶ Why do you think Kisuli, Okumu and Owino drew up a deed of partnership?

When a group of people form a partnership, they often agree to draw up a deed of partnership. This is not a legal requirement, but it does help to make the rights of each individual partner clear in the event of a dispute. The deed of partnership is a legal document and covers issues such as how much capital each partner has contributed, how profits (and losses) will be shared, the procedure for ending the partnership, how much control each partner has and the rules for taking on new partners. Without a deed of partnership disputes may be more difficult to resolve.

2 ▶ How does this case study illustrate one of the main advantages of partnerships?

One of the main advantages of a partnership is that partners are likely to have different skills and by specialising they can offer clients a wider range of services. The partners in this business each specialise in a different specific area of finance or accountancy. Michael Kisuli is a corporate tax specialist, Edwin Okumu is an investment analyst and Joseph Owino specialises in external audits. Specialisation also helps to improve the efficiency of a business because specialists are generally more skilled in their field of expertise.

ACTIVITY 2

CASE STUDY: SAVE THE CHILDREN

1 ▶ What are the features of a social enterprise? Use this case as an example.

Social enterprises aim to improve human and environmental well-being rather than make a profit for owners. Generally, social enterprises have a clear social and/or environmental mission. They generate most of their income through trade or donations and reinvest most of their profits. They are majority controlled in the interests of the social mission and are accountable and transparent. In this case, Save the Children aims to improve the well-being of children across the world. In particular, Save the Children raises money to run world-class programmes to save children's lives and challenge world leaders to keep to their promises to give children a brighter future.

2 ▶ How might charities such as Save the Children raise money?

Most charities rely on gifts and donations to fund their social activities. In this case Save the Children raises very large amounts of money globally. In 2015, it generated around US$2100 million. According to the pie chart in Figure 3.2 a large proportion of this money came from institutions and governments – 58 per cent. The next largest source was from individual donations – 25 per cent. Individuals are often generous when giving to causes that protect the interests of children. Corporations and foundations are another important source. This might be companies and special charitable foundations. Save the Children is a large international charity. Smaller charities

might organise fund-raising events such as cake sales, sponsored activities and selling greetings cards. Some also run business ventures, such as charity shops.

MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3A, 4B

CHAPTER REVIEW

CASE STUDY: HUSSE

Franchisees are entrepreneurs.

1 ▶ What is meant by the term entrepreneur?

Entrepreneurs are the business owners and without these people businesses would not exist in the private sector. They come up with a business idea, invest their own money and get a business started.

2 ▶ What is meant by the term franchisor?

In a franchising operation the franchisor is the owner of the franchise. Franchisors receive money when they allow others to take out a franchise and trade under their name.

3 ▶ What are the four roles of an entrepreneur?

Innovation

Decision making

Organising

Risk taking

Franchisees are likely to have unlimited liability.

4 ▶ What is meant by unlimited liability?

Many small business owners, such as sole traders and franchisees, have unlimited liability. This is very important because it says something about the risk they take. It means that if the business collapses the franchisee is liable for all business debts. The franchisee can be forced to meet these debts from personal wealth. It means that a person can actually lose more than was originally invested in the business. In this case, a Husse franchisee could lose more than the original £10 000 paid to the franchisor before trading began.

5 ▶ Assess the advantages to a franchisee of taking out a Husse franchise.

Taking out a franchise may suit someone who wants to run a business but does not have his or her own business idea. The Husse franchisor grants the franchisee a licence to trade under the *brand name* of Husse. In return for £10 000 the Husse franchisee gets a range of benefits and support. Husse offers benefits such as £2000 of stock for resale, additional materials worth £2000, which includes items such as a Husse tent, signs for a van, catalogues and a two-day in-house training course. Husse franchisees also get an exclusive territory with around 55 000 households. Regular money for marketing is provided, in the first six months, and so is support such as advisory services and a development manager. All these benefits are key advantages of operating as a franchisee. There is also less risk when taking out a franchise. Entrepreneurs have to risk their own money to get started. In this case it costs up to £13 900 to take out Husse franchise. This is less risky than starting a business alone because the franchisee has the advantage of trading under an established and successful brand name. In this case, Husse is established in over 50 countries worldwide. Many pet owners will be aware of the 'tried and trusted' brand name. This gives the franchisee a head start and reduces the risk of failure – a huge advantage. However, there are disadvantages when taking out a franchise, such as Husse. In some franchise agreements profit is shared with the franchisor. For example, in addition to the original fee it may be necessary to pay and annual commission. There is also a lack of independence. Franchisors often require strict operating conditions. For example, a Husse franchisee may not be allowed to trade outside the agreed territory. Finally, it can be an expensive way to start a new business. For example, it may be cheaper to set up a pet food delivery service without the use of Husse. To conclude, taking out a franchise may benefit those who are struggling to come up with their own idea, those who want to reduce some of the risk in business and those who are happy to sacrifice some independence.

CHAPTER 4

CASE STUDY: QUBIT DIGITAL LTD

CASE STUDY: HYUNDAI LTD

1 ▶ Who owns limited companies?

Shareholders own limited companies. For example, in the Qubit case study, it is likely that the four ex-Google employees who founded the company in 2010 will own shares. In addition, information in the case study says that some of Qubit's shareholders include Goldman Sachs and venture capitalists Sapphire Ventures and Accel Ventures. These investors bought shares when they contributed some of the £50 million capital to the business. These are the current owners of Qubit. Hyundai is also owned by shareholders. Hyundai's shares are listed on the London Stock Exchange. This means that anyone can buy them and become a part owner of the company.

2 ▶ Who runs limited companies? (Use examples from the case studies.)

Limited companies are run by a board of directors headed by a chairperson. A team of eight senior directors led by Chairman Mong-Koo Chung runs Hyundai, the huge South Korean motor corporation. The team running Qubit is likely to include some, or all, of the original founders – the four ex-Google employees.

3 ▶ Comment on the size of limited companies, such as those above, compared to sole traders and partnerships.

Evidence in the case studies suggests that limited companies are significantly bigger than sole traders and partnerships. For example, Qubit employs 200 people. Most sole traders and partnerships would employ much smaller numbers of people – perhaps less than 10 in the majority of cases.

For example, Qubit Digital Ltd turned over £11 million in 2016 and employed over 200 people. Not many sole traders would enjoy revenue as high as this and employ so many workers. Hyundai is very large – its turnover in 2015 was KRW 91 959 000 million. It also has factories all over the world including the USA, China, Russia, Turkey, Czech Republic, Brazil and India in addition to those in South Korea.

4 ▶ In groups, make a list of 20 companies that you know about. Try to decide whether they are large or small.

ACTIVITY 1

CASE STUDY: KHAN SUGAR MILLS

1 ▶ Name the documents needed to set up a limited company.

Two key sets of documents are needed before a business can trade as a limited company. These include the memorandum of association and the articles of association.

2 ▶ Who controls Khan Sugar Mills Ltd?

Khan Sugar Mills Ltd is a private limited company. It is a family business and is owned by three brothers, a venture capitalist called FarmVent and some of the senior managers. Three quarters of the company is owned by the Khan brothers – Abdul, Mohsin and Nabil; they each own 25 per cent of the shares. FarmVent own 20 per cent of the company while senior managers have a small 5 per cent interest. Since the three brothers own three-quarters of the company, together they have complete control over the company.

3 ▶ What are the advantages to Khan Sugar Mills of operating as a limited company. Provide two advantages in your analysis.

Private limited companies, such as Khan Sugar Mills Ltd, enjoy a number of advantages. One significant advantage is that the company cannot be taken over by outsiders. This is because the shares are not on open sale. Shares in private limited companies cannot be transferred without the permission of the other shareholders. They cannot be bought on the stock market. This is because only shares in PLCs can be traded on the stock market. Therefore, Khan Sugar Mills Ltd is safe from an unwanted takeover.

Another advantage is that all of the shareholders have limited liability. This means that they can only lose the amount of money they originally invested in the company if it were to collapse. Khan Sugar Mills Ltd's shareholders cannot be made to use personal wealth to pay off business debts. Limited liability means they enjoy legal protection from business creditors.

ACTIVITY 2

CASE STUDY: SONY

1 ▶ What is meant by the term multinational?

A multinational is a large business with significant production or service operations in at least two different countries.

2 ▶ What evidence is there to suggest that Sony is a multinational?

Sony is a huge multinational corporation. In 2016, Sony employed over 125 000 people across the world and enjoyed sales of about US$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, the USA and India.

3 ▶ Describe two features of multinationals. Use examples from the case study.

One common feature of multinationals is their powerful advertising and marketing capability. This means, for example, they can invest huge amounts of money in impressive advertising campaigns to outcompete smaller rivals. In this case, Sony is a highly recognised global brand name. The strength of the brand has been built up over many years of successful trading. However, to support the brand Sony continue to invest heavily in global advertising. Figure 4.4 shows that Sony invested JPY 474 370 in worldwide advertising in 2014.

Another common feature of multinationals is the huge assets and turnover. This means that multinationals are extremely well resourced and can often afford to take on large-scale contracts and projects that many other firms could not cope with. In this case, in 2016, Sony enjoyed sales revenue of around US$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, America and India. Finally, the value of Sony's assets at the end of June 2016 was US$159 450 million. The scale of these numbers shows how big Sony is as a business.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4C

CHAPTER REVIEW

CASE STUDY: HKOFFICESUPPLIES.COM

1 ▶ What is meant by the term private limited company?

A private limited company is an incorporated business that raises capital from the sale of shares to private individuals – often members of the family.

When Kwok Hung Office Supplies Ltd was formed, Lee had to produce a memorandum of association.

2 ▶ What information would this document contain?

A memorandum of association gives important details about the company. Examples include the name of the company, the name and address of the company's registered office, the objectives of the company and the range of its activities and the amount of capital to be raised and the number of shares to be issued.

3 ▶ What is the purpose of a prospectus?

When 'going public', a company is likely to publish a prospectus. This advertises the company to potential investors and invites them to buy shares before a flotation. It is an advertising document but the information it contains must be legally accurate.

Share issues have to be underwritten.

4 ▶ What does this mean?

There is a chance that when going public some of the shares put up for sale will remain unsold. To overcome this problem an underwriter is paid a fee to buy up any unsold shares. It is like an insurance policy.

5 ▶ Why is going public expensive?

'Going public' can be expensive because of the number of different types of costs involved. These include legal costs to ensure that the prospectus is 'legally' correct. Lawyers have to read and analyse all the information in the prospectus to ensure that potential investors will not be misinformed. There are the printing and distribution costs of the prospectus and also an administration fee, which must be paid to a bank for processing all the share applications. There are also underwriting, advertising and administrative expenses.

6 ▶ Discuss whether Lee should convert his business to a public limited company. Make a clear judgement at the end of your evaluation.

Lee Kwok Hung wants to convert his private limited company into a public limited company. It is unlikely that Lee and his family will be able to raise HK$200 million in any other way to meet the high cost of developing an online business and expanding into South China. Therefore, he would need to 'go public'. Going public is a way of raising large amounts of money. Another advantage is that Lee's business may be able to exploit economies of scale if it is much larger. They might be able to buy very large quantities of stock from suppliers at reduced prices, for example. The new company, HKofficesupplies.com, might also benefit from the publicity usually associated with a flotation. Public limited companies have a higher profile than any other form of business organisation and as a result they may have more customer recognition, which in turn might boost sales. This would be important when expanding into South China and launching a new service.

However, Lee should consider the disadvantages before making his final decision. Public limited companies are more tightly regulated to protect investors. They also have to publish more detailed financial information, which competitors might see. Lee's business could also be taken over by another company because shares can be bought by anyone. Finally, the costs of going public are significant and some of the HK$200 million will be used up in the flotation process. Despite these disadvantages, if Lee wants to raise HK$200 million and become a large supplier in South China, he would probably need to operate as a PLC.

CHAPTER 5

CASE STUDY: THE UGANDAN NATIONAL WATER AND SEWERAGE CORPORATION

1 ▶ Who owns and runs the Ugandan National and Water Sewerage Corporation?

The Ugandan National and Water Sewerage Corporation is owned by the Ugandan government and run by a board of directors, which is accountable to a government minister.

2 ▶ Suggest what the objectives of the NWSC might be.

The main objective of NWSC is to provide a public service; it has committed to the provision of good quality customer service. NWSC aims to supply everyone with clean safe water within 200 metres of all towns and urban centres (coverage is currently 78 per cent). On the NWSC website, it states that 'The Customer is the reason we exist. We do everything to the delight of our customer.'

3 ▶ Why do you think the government gets involved in business ownership?

In the private sector, most businesses aim to make a profit. However, organisations in the public sector aim to provide a public service. Sometimes providing a public service may be unprofitable, therefore, private sector firms would not be interested in supplying the market. Consequently the government needs to run and own organisations so that the provision of particular public services can be funded from taxpayers' money.

Also, some industries, like water supply, are crucial to the well-being or security of the nation. Therefore, since they are so important, it is arguably better if the government takes control so that supply and quality can be guaranteed.

ACTIVITY 1

CASE STUDY: SNCF GROUP

1 ▶ Using this case as an example, describe three features of a public corporation.

SNCF is responsible for providing a national train service across the whole of France. It is owned by the French government. Government ownership is an important feature of public corporations. Another feature of public corporations is that they are created by an act of parliament. The powers and duties of each organisation are clearly specified in the act. In this case, under French law, SNCF is an *établissement public industriel et commercial* – a public service company with a commercial and industrial mission, owned by the French state. A third feature of public corporations is that they exist provide a public service. In this case, the aim of SNCF is to provide a nationwide rail network. It is committed to customer satisfaction and makes social progress a priority. It has recently launched a range of projects to improve punctuality for people travelling to work, make fares easier to understand and make the rail system more accessible for all.

2 ▶ Who will take financial responsibility for the losses made by SNCF in 2016?

Although SNCF generated revenues of €32 273 million in 2016, which was 2.8 per cent higher than the previous year, it made a net profit of €567 million. A big improvement over 2015 when SNCF made a net loss of €12 228. This loss has to be covered by the French government since they are the owners. However, it is the French taxpayers who take financial responsibility for the loss because all government services are paid for (mainly) from taxes collected by the government.

ACTIVITY 2

CASE STUDY: AIRPORT PRIVATISATION

1 ▶ What is meant by the term privatisation?

Privatisation is the process of transferring public sector resources, such as public corporations, to the private sector. In this case, a number of airports and airport facilities have been privatised. For example, in 2013, the Brazilian Government raised US$ 9100 million by privatising two major airports ahead of the 2014 World Cup.

2 ▶ Why were governments keen to maintain state control of airports until recently?

Governments have historically preferred to keep control of businesses operating airports. Even as recently as 2006, only about 2 per cent of the world's airports were owned or managed by the private sector. The reason for this is because airports are considered as strategically important to the nation. If the provision of a particular service is vital to the well-being or security of the nation it is considered desirable for the government to maintain control so that continuity of supply and quality can be guaranteed.

3 ▶ Describe two possible reasons why governments should want to privatise airports.

One motive for privatisation is to raise money. If the government sells a public corporation, such as an airport, the money can be used by the government. In this case for example, the Brazilian government plans to sell more airports to raise money to help reduce its budget deficit.

Another possible motive for privatisation is that airports are likely to be run more efficiently in the private sector. According to Ahmed Bukalla, director of operations at the Department of Civil Aviation, Sharjah International Airport, UAE. 'When privatisation comes, there will be pressure for further productivity gains, and airport operators will need to be even more innovative and adopt new technologies to stay competitive.' Therefore in the private sector businesses will serve the public better because if they don't they risk 'going bust'.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3D, 4A

CHAPTER REVIEW

CASE STUDY: AUSTRALIAN BROADCASTING CORPORATION

1 ▶ What is meant by the term public corporation?

A public corporation is a business organisation that is owned and controlled by the government. The ABC is a public corporation because it is owned and controlled by the Australian government.

2 ▶ Describe two features of public corporations. Use the ABC as an example.

Public corporations, such as the ABC have a number of unique features. One of these is that they are established by law. It is established under the Australian Broadcasting Corporation Act. Another important feature of public corporations is that they aim to deliver a public service. They are not motivated by profit. The ABC's aim is to serve the Australian people. In particular, it is 'focused on keeping audiences at the centre, providing high-quality programming, independent news and information and content that enriches Australian communities'. If a public corporation does make a profit, the money will be returned to the government or reinvested in the business.

3 ▶ Why might organisations like ABC operate as public corporations? Give two reasons in your analysis.

There are a number of reasons for the public ownership of certain services. First, public corporations, such as the ABC, often provide vitally important public services. It is argued by many that it is better for industries that are vital to the nation's security to be owned by the government. This would prevent 'outsiders' from another country taking them over and exploiting the nation. If the provision of a particular service is vital to the well-being or security of the nation, it is considered desirable for the government to maintain control so that continuity of supply and quality can be guaranteed. In this case, the government can ensure that Australia receives a good quality national broadcasting service.

Second, in some markets the private sector would not deliver important services to unprofitable regions. For example, the cost of providing electricity to a remote farm many miles away from the main power lines would be too high for a private sector operator. However, a public corporation may be prepared to meet this cost because profit is not a key objective. In this case, it is suggested radio and other ABC-like services would not be broadcast to isolated regions if the ABC were transferred to the private sector. Australia covers an enormous geographical area and it is easy to see that providing services to many rural communities, for example, just would not be worthwhile for a private sector operator.

4 ▶ Assess the case for privatising the ABC.

In many countries, the number of public corporations has been reduced. For example, in the UK, industries such as rail transport, water provision, electricity generation and distribution and telecommunications have been transferred to the private sector. In this case, the arrival of digital technology has had a huge impact on the media. The ABC is facing increasing rapidly increasing competition from new media companies and platforms. To add to these difficulties, the Australian government has begun a round of cuts to the corporation's funding. By 2018/19, the ABC will lose a total of A$254 million. In light of these developments, some have argued that the ABC would perform more effectively in the private sector.

There are a number of reasons why governments choose to privatise public corporations. In this case, one argument in favour of privatising the ABC is that it does not provide a universal service. According to one survey, over one year, 40.1 per cent of those questioned did not watch the ABC at all. Another reason is that the government would also save money if it were transferred to the private sector. The government currently provides over A$1000 million in funding. Many say that this money could be used to reduce government debt or cut taxes. A third reason is that some people also think that the ABC favours left-wing political parties. In 2016, the ABC's new managing director, Michelle Guthrie, said that the ABC 'can do better' at presenting

a broader range of political views. However, if the ABC operated in the private sector it might be under more pressure to provide a more balanced and independent broadcasting service.

In contrast, many believe that it would be better if the ABC remained under the control of the government. One reason is because according to some surveys the corporation seems to be doing a good job. The ABC does appear to be meeting the needs of its customers. In the annual Newspoll ABC Appreciation Survey, support for the corporation was strong. Around 86 per cent of Australians believed that ABC performs a valuable role, a large majority believed it provides quality content and a majority said it was doing a 'good job' meeting its media obligations. One of its public services is providing online content. According to data in Figure 5.2, this is very well-received. Over a 10-year period, between 91 per cent and 86 per cent of respondents thought the service was 'good'. Between 2007 and 2016, the number of respondents that felt online quality was 'very good' rose from 28 per cent to 40 per cent.

To conclude, it could be argued that the ABC should remain as a public corporation. This is because evidence from surveys generally shows strong support for the corporation in its current form. Transferring it to the private sector might raise some money in the short term, but a valuable public service, available to the whole of Australia, might be lost forever.

CHAPTER 6

CASE STUDY: WU YANG

CASE STUDY: SHANGRI-LA HOTELS AND RESORTS

Wu Yang is happy operating as a sole trader.

1 ▶ Suggest two reasons why she might be happy.

She likes the independence of operating as a sole trader.

She has no real desire to expand and therefore does not need to raise any more capital.

2 ▶ Why could Shangri-La not realistically operate as a sole trader?

Shangri-La is a large multinational. It is a global hotel company with hotels in North America, Europe, the Middle East, Asia and Australia. Shangri-La could not operate as a sole trader. The company has grown steadily since it was established in 1971 and no doubt has needed some more capital to fund this growth. There is no way a sole trader could provide funding on such a scale. Multinationals need to be PLCs to attract the huge amounts of finance they need and to enjoy a high international profile.

3 ▶ What evidence is there to suggest that Shangri-La is a growing company?

Since the company was established it has grown significantly. For example, in 2015 the Group opened nine new Shangri-La hotels. It also launched the modernised Shangri-La's Le Touessrok Resort & Spa, Mauritius, rebranded four properties to Hotel Jen. In the last five years it has continued to grow. Figure 6.1 shows that its revenues have increased by 11 per cent from US$1912 million in 2011 to US$2123 million in 2015.

4 ▶ Why might businesses in general be forced to change their legal status as they grow?

The main reason why businesses need to change their legal status as they grow is to attract funding. Businesses will find it very difficult to grow as a sole trader or partnership. They are considered too risky for many investors and often struggle to raise finance. Businesses usually have to raise money by selling shares to become large operators.

MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3C, 4C

CHAPTER REVIEW

CASE STUDY: ESHANIBABYGEAR.COM

1 ▶ Why was a sole trader organisation most appropriate for Eshani's business when she first started?

Many small businesses when they start are sole traders. Unless large amounts of money are needed, this type of organisation is suitable because it is easy to set up and the owner is in complete control. Eshani said 'When I started, I started small, operating from home, and never needed outside funding, so being a sole trader seemed the simplest option.'

2 ▶ Discuss why Eshani formed a partnership.

After trading successfully from her home as a sole trader for three years, Eshani decided to open a shop. However, she needed money for premises, stock and marketing. Also, after a few months there was a strain on cash flow. Therefore she decided to take on her best friend as a partner. This helped to share the burden of running the business and injected LKR 6 million much needed cash.

Eshani formed a private limited company after the break-up of the partnership.

3 ▶ Do you think it was appropriate?

After the break-up of the partnership Eshani was right to form a private limited company. This type of organisation helped Eshani to achieve her objectives. Eshani now has control of the business. This is because she has 70 per cent of the shares. Her mother bought 20 per cent and she allowed two of her best staff to buy the remaining 10 per cent. However, with 70 per cent no-one can overrule her. Eshani sold shares to her employees to raise more money for the business. However, another reason was because she wanted to reward them for their loyalty and keep them motivated. Finally, Eshani needed more capital to expand the business. Some of the money raised from selling shares was used to set up an online business.

4 ▶ Assess whether Eshani should form a public limited company to buy the shops.

Going public is a big step for a business. It is an expensive move because of the costs involved such as producing a prospectus, administration costs to cover the whole flotation process, legal costs and underwriting fees. Also trading as a PLC means anyone can buy shares in the company. This means that an outsider could take over the company. The business would also have to release more financial information to the public and meet the cost of

stock market regulation. This might allow competitors to plan strategies to overcome the threat of Eshani's business in the market. However, Eshani has a firm objective. She wants to take the business to the next stage of development. Her online business is expanding fast and Eshani also thinks she could develop a small chain of shops. A major retailer has recently offered a number of stores for sale. To buy, convert and stock them would cost LKR 400 million. By going public Eshani could raise this sort of money and achieve her objective.

However, Eshani might need to consider other approaches. She could grow more slowly and fund growth from profits. She may be able to borrow money from banks. Alternatively, she may be able to persuade some other entrepreneurs to invest in her business. All these options would need to be considered before she finally decided to go public. However, if a flotation were successful, it would allow Eshani to achieve her objective.

CHAPTER 7

GETTING STARTED – BUSINESS CLASSIFICATION

1 ▶ Which of the businesses shown on the previous page are concerned with a agriculture, b manufacturing or c services?

The farm workers growing crops are an example of a business involved in agriculture. It is using the land to grow produce.

The business processing food is a manufacturer. It is making products.

Both the railway company and the app designer are businesses that supply services. The railway company is transporting people by rail and the app designer is designing new apps for mobile phones.

2 ▶ Which of these businesses are most likely to employ large numbers of people in a developing nation? Explain your answer.

Developing nations tend to employ more people in agriculture. Their economies are still in the early stages of development and generally their focus is on the production of food. Therefore the business involved in agriculture is most likely to employ the most people in agriculture. The photograph shows the crops being harvested by people rather than machines.

3 ▶ In pairs, draw up a list of 20 businesses in your area and decide whether they are agricultural, manufacturers or service providers.

ACTIVITY 1

CASE STUDY: AGRICULTURAL EMPLOYMENT

1 ▶ What is the difference between the primary and the secondary sectors? (Use examples from this case study.)

In the primary sector, business activity involves extracting raw materials from the earth. In this case, olive growing by the Casillas family is an example of farming. Farming is probably the most important primary sector activity for most countries. Most agriculture is concerned with food production like olive growing in this example.

The secondary sector encompasses manufacturing and processing. In this case olives are being processed into olive oil. Machinery is likely to be used to squeeze the oil from the olives. This might be followed by a cleaning process to ensure that the olive oil is sufficiently pure.

Look at Figure 7.1.

2 ▶ What has happened to the number of people employed in agriculture in Spain since 1980?

In Spain, like in many countries, the number of people employed in agriculture is falling. The graph in Figure 7.1 shows that the number of people employed in agriculture has fallen from around 19 per cent in 1980 to just under 5 per cent in 2010.

3 ▶ Describe one possible reason for the pattern described in question 2.

One of the main reasons why employment in agriculture has fallen in Spain so sharply is because of advances in technology. Before and around the 1980s, farmers may have relied more heavily on labour. However, because of the growing availability of affordable technology they may employ more machines. Developments in technology have been enormous in agriculture. In this case, Marco Casillas is considering the purchase of some harvesting machinery to reduce labour costs and remain competitive. Once such machines have been purchased, the need for labour drops sharply.

MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3A, 4B

CHAPTER REVIEW

CASE STUDY: HISENSE

1 ▶ What is the difference between secondary and tertiary production? Use examples from the case study.

The secondary sector involves manufacturing and processing, that is, the conversion of raw materials into goods. In this case, Hisense is a manufacturer of white goods and a range of electronic products. It makes these goods in a wide range of factories both in China and abroad.

The tertiary sector is to do with the provision of services. There are many different types of services, such as professional, household, transport and financial. In this case, Hisense has branched into the provision of services in areas such as information technology and design. These services are aimed mainly at other businesses.

Look at Figure 7.3.

2 ▶ What evidence is there to suggest that China's economy has become more balanced since 1990?

The pie charts in Figure 7.3 show some important changes in the amount of employment in different sectors of the economy between 1990 and 2015. In 1990, China employed 60 per cent of its workforce in agriculture. By 2015, this had fallen to just 28.3 per cent. In contrast, the

number of people employed in the tertiary sector rose from 18 per cent to 42.4 per cent. Employment in the secondary sector also grew from 22 per cent to 29.3 per cent. These changes have resulted in a more balanced economy for China. It was less dependent on agriculture in 2015 as it was in 1990. However, if the changes follow the same trend, China's economy may become more unbalanced in the future as it becomes more dependent on services.

3 ▶ Discuss the interdependence that exists between the different sectors of business activity.

Businesses in each of the three sectors rely on each other. For example, in the primary sector cereal farmers rely on bakers in the secondary sector for their sales of wheat. Bakers may depend on advertising agencies in the tertiary sector to produce television adverts for their products. The transport industry in the tertiary sector relies on the oil industry in the primary sector to provide fuel for its vehicles. Workers in both the secondary and tertiary sectors rely on the primary sector for their food. This reliance between sectors is called interdependence. In this case, Hisense may rely on retailers and other distributors to sell its manufactured goods to consumers.

4 ▶ What is meant by de-industrialisation?

De-industrialisation occurs in well-developed countries, such as the USA, Germany, Japan and France. It involves the decline of the manufacturing sector at the expense of the tertiary sector. In the last 20 or 30 years, many western-style economies have seen employment in manufacturing fall sharply. However, at the same time there has been a steady increase in the quantity and value of services.

5 ▶ Assess the main causes of de-industrialisation.

A number of suggestions have been suggested to explain the process of de-industrialisation. There may have been a change in consumer demand. People may prefer to spend more of their income on services rather than manufactured goods. For example, people may be spending more on holidays, restaurants, travelling and personal services and less on consumer durables. Competition in manufacturing may be another important reason. Recently there has been some fierce competition in the production of manufactured goods from developing countries such as India, China, Thailand and Brazil. These countries can often produce manufactured goods more cheaply than in western economies. In this case, China has seen an increase in the manufacturing sector. In the last 30 years or so, China has developed a competitive edge in this sector due mainly to its cheap and large supply of labour.

Another reason is that as countries become more developed the public sector tends to grow. Since the public sector mainly provides services such as education and transport and healthcare, this adds to the growth of the tertiary sector. Finally, advances in technology mean that employment in manufacturing falls because machines replace people. The reason for the decline in manufacturing in well-developed countries may be different depending on the circumstances of the individual nation. For example, a country that has an inefficient manufacturing sector may be vulnerable to overseas competition. In this case, China, which is still a developing country (although it is developing rather rapidly), has seen an increase in the tertiary sector from 18 per cent to around 42 per cent. This trend is likely to continue in the future as the country develops – the tertiary sector will grow as it has done in developed nations.

CHAPTER 8

CASE STUDY: NUCLEAR POWER STATIONS

1 ▶ What are four factors that must be taken into account when locating a nuclear power station?

Factors that are likely to be taken into account when locating a nuclear power station include the following.

- Government influence: nuclear plants cannot be built without a lengthy consultation process involving the authorities, local communities and the power companies. There are legal controls over their location.
- Nuclear plants need stable ground and plenty of space.
- Most plants need access to a water source, such as a lake or river.
- Access to a large workforce. The construction of nuclear plants may need around 2000 people and around 500 more to help operate them.

Many nuclear plants around the world are built just outside small or mid-size towns and on the coast.

2 ▶ Describe how the changing business environment has affected the location of many service providers such as retailers.

The changing business environment may affect the location decisions made by some businesses. In recent years retailing has changed significantly. Many thousands of business providing services now operate online. Some high-profile examples include Amazon, Alibaba, Facebook and Twitter. Online businesses may operate as retailers, consultants, bloggers, tutors, web designers, information providers and teachers, for example. The one thing they all have in common is that they use the Internet to trade. One of the main advantages of these businesses is that they can be located anywhere. Most traders online can locate their base anywhere in the world provided they have access to the Internet.

3 ▶ In groups, consider where you might locate a a banana plantation, b a large car factory and c a new shopping centre or mall. Give at least two reasons for each answer.

ACTIVITY 1

CASE STUDY: RENAULT

1 ▶ Discuss the possible reasons for Renault's decision to locate a factory in Tangier.

Manufacturers need to consider factors such as the cost of land, transport, labour costs and skills, proximity to the market and whether there is any government help when locating factories. In this case Renault has recently built a factory in Tangier. One attraction of Morocco is that in an area of North Africa where political disturbance is common, Morocco is seen as a politically stable location. Businesses will clearly avoid locations in countries where disruption

from political change is a potential risk. Tangier is also a thriving port and just 10 miles (16 km) away from the large European market. This was important to Renault since most of the factory's output in Tangier is intended for export. Economic growth in Morocco is currently high, around 5 per cent in 2016. The people are becoming wealthier. This means that demand for Renault's cars is likely to increase.

Morocco has improved its infrastructure in recent years. For example, Tangier is effectively linked by motorways and railways to industrial parks. Indeed, Renault has its own direct rail link to the port. Morocco also provides a strategic geographical location for manufacturers. It is at the crossroads of the world's most important sea links. Finally, Renault is a French company and French is the commercial language of Morocco. This may have been a factor when choosing Tangier as a location.

2 ▶ What are two possible benefits to Morocco of Renault's decision to locate a factory in Tangier?

Most governments are keen for foreign businesses to locate operations in their countries. The benefits can be substantial. For example, in this case Renault will create a lot of jobs for people living in and around Tangier. Initially, while the factory was being built, jobs would have been created for construction workers. Once the factory was operational, a large number of factory workers would have been needed. In addition to this, Moroccan-based suppliers of components and commercial services would have benefitted, which would have created even more jobs. This generates income for these people and hopefully improves their living standards.

The government is also likely to benefit from the new factory. This is because any profits made by Renault from the operation of the plant are likely to be taxed by the Moroccan government. These tax revenues can be used to fund more public services such as education and new infrastructure.

ACTIVITY 2

CASE STUDY: RESTAURANT LOCATIONS

1 ▶ What factors will Abdullah need to take into account when deciding where to locate his seafood restaurant? Give two factors in your analysis.

Service providers may have different location requirements to those of manufacturers. In this case, Abdullah is choosing a location for his seafood restaurant in Manama, Bahrain. For many service providers, proximity to their market is crucial. This is because many services are sold direct to consumers. For example, restaurants, cafes, shops, hair salons, taxis and dry cleaners have to be located in towns and cities. This is where customers live and shop. In this case Abdullah wants to target business customers working in the financial quarter of the city so this would presumably influence his search for a location.

For customers, suppliers and employees, easy access and parking is becoming a serious issue. Traffic congestion is a growing problem in many parts of the world. Businesses need to choose locations where there is less chance of traffic congestion. It is particularly important for customers since they will quickly look for alternatives if they cannot park conveniently. Some service businesses, particularly fast-food providers, are developing 'drive-through' facilities to avoid parking problems. In this case, Abdullah's potential customers, office workers for example, may be within walking distance from his restaurant. This would be an advantage but he might also be keen to find a location where customers can park easily when arriving for a meal or a night out.

2 ▶ Why might businesses, such as Abdullah's seafood restaurant, deliberately choose to locate close to competitors?

Abdullah is currently considering a location close to where a number of other restaurants operate. Premises occupied by a recently failed restaurant have become available but he is concerned about the competition in the area – many entrepreneurs would share this fear. However, in contrast some businesses deliberately choose locations where there is a concentration of similar businesses. This might be important in industries where comparison shopping is popular. It might also be possible to catch the excess demand from existing businesses, particularly if premises are located in a restaurant and entertainment area. Consequently, for these reasons, Abdullah may eventually decide to locate is seafood restaurant close to potential rivals.

MULTIPLE-CHOICE QUESTIONS

2A, 2B, 3D, 4A

CHAPTER REVIEW

CASE STUDY: THE NEW DELHI INSURANCE COMPANY

1 ▶ What is meant by the term greenfield site?

Greenfield sites are areas of land, usually on the outskirts of towns and cities, where businesses develop for the first time. In this case, Site A is a greenfield site. It is a brand new purpose built office block on the outskirts of the city about 3 miles (5 km) from a large residential area.

2 ▶ Determine the monthly rent for each site assuming that the company employs 2000 staff.

Calculate the monthly rent for each site assuming that the company employs 2000 staff.

Monthly rent for site A is given by:

2000 × 200 × US$1.00 = **US$400 000 per month**

Monthly rent for site B is given by:

2000 × 200 × US$1.10 = **US$440 000 per month**

Governments may try to influence the location of businesses.

3 ▶ Describe two reasons for this.

One reason why governments try to influence location decisions is to avoid congestion where there is already enough or too much development. This will reduce the strain on existing infrastructure, such as roads, schools and hospitals. Governments may also aim to minimise the impact businesses might make on local communities. For example, most people would object if a business opened a noisy night club in a highly residential area or if a large petrochemical company established a refinery in a national park.

Some governments use regional policy to help develop 'poorer' areas. Regional policy provides opportunities for businesses. For example, governments use incentives, such as quick planning permission, investment grants, tax breaks, employment subsidies and rent-free factory space, to attract businesses. In this case the government is keen to attract businesses to the greenfield area where Site A is located. The government is offering US$500 000 of support if the New Delhi Insurance Company locates its call centre there.

4 ▶ What factors would service providers, like the New Delhi Insurance Company, have to take into account when deciding on a business location? Give two reasons in your analysis.

Service providers like the New Delhi Insurance Company are likely to consider a range of factors when choosing a suitable location for new operations. These might include proximity to market, the cost of land, accessibility and parking, amenities and recreational facilities, network services and competition. In this case, the New Delhi Insurance Company hopes to locate its new call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities, such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre.

As the importance of electronic data continues to grow, businesses will require greater and more capacity. Also, many businesses operate in an increasingly global economy. This means that access to continuous communication systems is vital. These growing requirements have made connectivity a major concern for many office-based businesses, for example. In this case, the New Delhi Insurance Company is opening a large call centre. This will require first class communication networks and that would therefore be a key issue.

5 ▶ Comparing the two sites, which one might be most appropriate for the new call centre?

In this case both Site A and Site B have specific advantages. One of the main benefits of Site A is the quality of the office space available. Site A provides a brand new purpose built office block on the outskirts of the city about 3 miles (5 km) from a large residential area. Since the New Delhi Insurance Company needs to attract 2000 new workers, proximity to a large residential area is also attractive.

Information in the table also shows that graduate unemployment around Site A is 8.6 per cent. Since the company needs to attract well-qualified and university educated employees to staff the call centre, the higher level of graduate unemployment means there will be more people available to choose from. Site A can also provide efficient electronic communication connections that are likely to be important for a call centre. Finally, Site A is also attractive financially. Monthly rent will be US$400 000 compared to the US$440 000 at Site B. Site A also is a greenfield site and the government is keen to attract businesses to the area. Financial support of US$500 000 is being offered to the New Delhi Insurance company if it chooses to locate there.

Site B also has attractions. This is a city centre site close to all the amenities. This could be important to the insurance company because it hopes to locate its new call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre. Access to these facilities might help the company to attract high quality staff. Transport links to the Site B are excellent. The main railway station is just two minutes walk away. Potentially, this means that the company could attract staff from further away. This would provide more choice during the selection and recruitment process.

The office block at Site B is in a fashionable and popular area, however, the building itself is not modern and will require some investment to upgrade the facilities. The cost of modernising is not given but the site does provide room for expansion if the company needs more office space in the future.

Deciding which site to locate the call centre office is not straightforward here since there are advantages to both sites. The New Delhi Insurance Company has to decide on its priorities. If the company wants to minimise costs, Site A might be a preferable location. Monthly rent is 10 per cent lower, the government is offering US$ 500 000 financial support and the building is purpose-built and ready for occupation. Modernisation will not be required. However, the more expensive city centre site will provide more amenities for workers and might make the recruitment of high quality staff easier. It is very close to the main railway station so it might be possible to recruit staff from further away. To conclude, if cost is the main issue here, then Site A would be the preferred location. However, if staff recruitment and meeting staff needs is more important, then Site B might be more attractive. It is a close call!

CHAPTER 9

CASE STUDY: THE GLOBAL MARKET FOR CARS

1 ▶ What do you think is meant by a global market?

If a business hopes to sell its products to consumers in all countries in the world, it will be selling in a global market, to the largest possible number of customers.

2 ▶ Comment on the pattern of global demand for cars.

The global demand for cars is growing. In 2015, global sales reached 72.37 million. By the end of 2016, it is expected that sales will reach the 75 million mark. One of the main reasons for this growth is the rising demand in emerging economies. Sales in China, for example, were around 25 million in 2015. This is about one third of the total sold. Emerging economies such as China, India and Brazil are becoming wealthier as they develop. This means that people in these countries can afford to buy cars – many perhaps for the first time.

3 ▶ Work out the global market share of the major car producers shown in Figure 9.1.

$$\frac{10.08 + 9.87 + 7.99 + 7.49 + 6.40 + 5.17}{72.37} \times 100$$

$$\frac{47}{72.37} \times 100 = 65.69 \text{ per cent}$$

The six major car producers in the world share 65.69 per cent of the global car market.

4 ▶ Why do you think Japanese car manufacturers have started to dominate the world market?

One reason why Japanese car manufacturers might have started to dominate the world economy is because they produce cars more efficiently. Information in the case study says that the emerging Japanese car producers are leaner, that is, more efficient. This means they can produce cars more cheaply and sell them at a lower price. Consequently they have taken market share from the US producers that used to dominate the market.

ACTIVITY 1

CASE STUDY: GLOBALISATION AND AIRLINES

1 ▶ Work out the percentage increase in passengers carried between 1980 and 2015.

The number of passengers carried rose from 642 million to 3441 million between 1980 and 2015. The percentage increase is given by:

$$\frac{3.441 - 0.642}{0.642} \times 100$$

$$\frac{2.799}{0.642} \times 100 = \textbf{435.9 per cent}$$

2 ▶ Describe two features of globalisation that have supported the growth of the airline industry.

One of the features of globalisation is that people are free to live and work in any country they choose. This has resulted in more multicultural societies where people from many different nations live and work in the same city. This increase in the movement of people around the world has increased demand for transport, such as air travel.

Also, rising trade between nations will increase the need for business people to meet up. There has been an increase in the number of business people using airlines as they travel to meet foreign business colleagues. Globalisation has also resulted in the increased transportation of goods around the world. The airline industry will have benefited from this increase in shipping.

3 ▶ What are the reasons for the development of globalisation? Provide two reasons in your analysis.

There are a number of reasons for the development of globalisation, for example, developments in technology. Modern computing allows firms to transfer complex data instantly to any part of the world. It also means that more people can work at home, or any other location that they choose as long as there is an Internet connection. Many people do not have to be office-based to do their jobs. This means it is easier for firms to have operations all over the world. The Internet also allows consumers to gather information and buy goods online from firms located in different parts of the world.

A second reason is deregulation around the world. For example, privatisation has allowed more competition in many industries. Also, a lot of the barriers to trade have been removed. An increasing number of economies are more open and more and more countries have stopped protecting domestic industries. Many countries have also simplified their monetary and legal systems to make international trading easier.

4 ▶ Produce an illustrated poster that shows what is meant by globalisation.

ACTIVITY 2

CASE STUDY: MOBILE PHONES

1 ▶ Work out the number of mobile phones sold by Samsung in 2015, assuming it had a market share of 21.4 per cent.

The number of phones sold by Samsung is given by:

$$\frac{1424 \text{ million}}{100} \times 21.4 = \textbf{304.736 million}$$

2 ▶ What opportunities might globalisation provide for mobile phone producers such as Samsung, Apple and Huawei? Give two opportunities in your analysis.

One important opportunity that producers like Samsung, Apple and Huawei might benefit from is lower costs. If businesses are able to grow by increasing output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow. With lower costs businesses will become more competitive. This might help them to win a larger share of the market, increase sales and profit margins. In this case, with sales of over 300 million sets, Samsung should be able to exploit economies of scale.

Another important benefit of globalisation to such businesses is access to huge markets. Clearly global markets are considerably larger than domestic markets. If a business has access to several billion customers rather than, say, 40 million, this provides huge opportunities to increase sales. Therefore, access to global markets provides growth opportunities for businesses. This should result in much higher sales revenue and an increase profits.

MULTIPLE CHOICE QUESTIONS

1B, 2A, 3A, 4B

CHAPTER REVIEW

CASE STUDY: THE GLOBAL ONLINE RETAIL MARKET

1 ▶ What is meant by the term globalisation?

Globalisation is the growing integration of the world's economies.

2 ▶ Work out the percentage increase in estimated online retail sales between 2014 and 2018.

The percentage increase in global online sales is given by:

$$\frac{2489 - 1316}{1316} \times 100 = \textbf{89.1 per cent}$$

3 ▶ Suggest two ways in which a government can help to support the process of globalisation.

Globalisation can only flourish if governments are committed to it. For example, countries cannot trade if the governments keep international borders closed.

International trade will be very limited if governments put up trade barriers. Therefore trade barriers should be removed.

4 ▶ Describe how interdependence might affect online retailers such as Amazon, eBay and Alibaba in the future.

One of the features of globalisation is interdependence. This means that events in one economy are likely to affect other economies. For example, a recession in India might have an impact on global online retailers, such as Samsung, eBay and Alibaba. They might experience a loss of sales in the Indian market. This might be significant because the Indian market might be very large indeed. The loss of sales might result in a lower revenues and reduced profits.

5 ▶ Assess the opportunities that globalisation might bring to online retailers in general.

Globalisation is likely to provide a range of opportunities that businesses, such as online retailers, may be able to exploit. The most important is probably access to huge markets. Clearly global markets are considerably larger than domestic markets. If a business has access to several billion customers rather than, say, 40 million, this provides huge opportunities to increase sales. Secondly, if online retailers are able to grow by increasing output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow. With lower costs online retailers will become more competitive. This might help them to win a larger share of the market, increase sales and profit margins.

Another opportunity that globalisation is likely to provide results from the free movement of labour. This means that businesses will have access to a larger pool of workers. One benefit of this is that if businesses are growing fast there may be a shortage of domestic labour. Globalisation means that workers from overseas can help to boost the labour supply. It also means that businesses have more people to choose from when recruiting. As a result they may be able to recruit better quality workers who should help to improve productivity. A shortage of labour can restrict the development of a business. Also, a large labour supply might help to prevent wages from rising. It is often said that the arrival of larger numbers of foreign workers holds wages down – particularly in markets where unskilled labour is needed. In online retailing some of the staff employed are likely to be unskilled – order picking and packing goods for example. Lower wages will help businesses to lower their costs.

One benefit of globalisation is that businesses can choose where to locate their base. Consequently they can reduce the amount of tax they pay by locating their head office in a country where business taxes are low. Ireland has proved a popular destination for businesses in recent years since its rate of corporation tax is just 12.5 per cent (on trading income). This is well below other rates in the world which generally greater than 20 per cent.

However, despite the opportunities arising from globalisation there may also be some threats: the main one is competition. As more companies around the world try to sell their goods and services in an increasing number of countries, many businesses will fear for their survival. Often, the companies that are able to exploit globalisation are strong, well resourced and influential. They can use their resources by investing heavily in marketing, for example, to move into new markets and put pressure on existing firms in the industry. In this case, it is suggested that just three suppliers – Amazon, eBay and Alibaba – could dominate the global online retail market. If they become too strong they might put smaller online retailers out of business. As the pace of globalisation increases, the prospect of increased competition is the most worrying threat for most businesses, both large and small.

Also, with the free movement of capital that globalisation brings, it is possible for a business in one country to take over a business in another. Consequently, companies may feel more vulnerable to a takeover since there are a larger number of predators. If takeovers are hostile it means that a company can be taken over against its will. It is possible that Amazon, eBay and Alibaba might grow by taking over some of their rivals.

To conclude, improvements in online payment systems, shipping, local transport providers, warehousing and the removal of trade barriers have all contributed to the growth in global online sales. Indeed, in just five years global sales have grown by 89 per cent. The opportunities that globalisation brings, such as lower costs, access to wider markets, more labour and reduced tax liabilities, are substantial. However, online retailers will have to protect themselves from intense competition. Indeed, the threat from the 'big three' could be a serious threat to the survival of smaller operators.

CHAPTER 10

CASE STUDY: LG ELECTRONICS

1 ▶ What evidence is there to suggest that LG is a multinational company?

Multinationals are huge business organisations with production operations in at least two different countries. LG Electronics is a multinational because in 2016 it had 125 global operations and employed 77 000 people worldwide. It also enjoys massive revenues. For example, in 2016 LG generated US$55 367 million in sales revenue.

2 ▶ Why are multinationals important for the global economy?

Multinationals are important for the global economy because of the contribution they make to global output and employment. Huge corporations like LG Electronics employ lots of people worldwide. This gives people income and improves their living standards. Multinationals also pay taxes, which the host government can spend on public services, such as water provision and education. Most multinationals also produce a wide variety of products that provide consumers with lots of choice and helps to improve the quality of life.

3 ▶ Suggest one possible reason why a company might become a multinational.

One of the main reasons why businesses become multinationals is because such large businesses can lower

their costs (by exploiting economies of scale). This means they can make more profit. This will benefit shareholders, as they are likely to receive higher dividends.

4 ▶ In groups, draw up a list of ten businesses that you think might be multinationals. Then do some online research to see if you are right.

ACTIVITY 1

CASE STUDY: NIKE

1 ▶ What are the benefits to NIKE, Inc. of operating so many factories around the world?

Nike has control of hundreds of factories in over 40 countries around the world. This means they can supply markets close to their factories and avoid the cost of transporting large quantities of stock to buyers from a single factory. This will help to reduce transport costs significantly and improve the profitability of the company.

2 ▶ How important is a strong brand name to a multinational like Nike?

Multinationals tend to have well-known brand names. Nike is a very strong brand name. This is very important because it helps to raise the profile of the business all over the world. A high profile in the market and a strong brand name will help to boost sales. This is because when people see a recognisable brand like Nike, existing customers are encouraged and new customers are attracted.

3 ▶ How does Nike remain a high profile company?

Since Nike's brand name is so important to the profile of the business in the marketplace, it is important to maintain its strong position. Multinationals, such as Nike, are prepared continually to reinforce brand names. One way to do this is to invest heavily in advertising. In this case, Nike spent US$804 million on advertising in 2016. This was 10 per cent higher than the previous year. This is a huge amount of money to spend on advertising alone. However, it helps to protect the Nike brand and generate global sales. Indeed, Nike made a profit of US$785 million in 2015.

ACTIVITY 2

CASE STUDY: MARS

1 ▶ How might: a the local Pune community and b the Indian government benefit from Mars' investment in Pune?

a When multinationals set up operations overseas, income in those countries rises. Multinationals create new jobs. In this case, the new US$160 million Mars factory is expected to create 200 jobs for people in Pune. However, there will also be some indirect employment. Local suppliers are also likely to get work when the Mars factory is complete. The extra output and employment generated by Mars will increase economic growth and raise living standards for people in India, particularly Pune.

b The profits made by multinationals are taxed by the host nation. This increases tax revenues for the government in that country, which can be used to improve government services. In this case, the Indian government will tax any profit made by Mars resulting from production at the new Pune plant.

MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3D, 4B

CHAPTER REVIEW

CASE STUDY: MCDONALD'S

1 ▶ Suggest two features of a multinational. Use this case study as an example.

McDonald's is a giant multinational. It has operations in over 100 different countries employing around 1.8 million people globally. It has huge assets and turnover. For example, it turned over US$6620 million in 2015.

McDonald's has become a multinational through effective marketing.

2 ▶ What does this mean?

Some businesses become multinationals by relying on effective marketing. McDonald's is a classic example. McDonald's is a low-tech firm that developed a highly successful brand in the USA and then exploited it globally. McDonald's does face fierce competition, from KFC, Wendy Burger and other fast-food outlets all over the world, for example. However, McDonalds has probably protected its brand name with patents and uses heavy advertising and innovative marketing to attract customers. Most people will have seen McDonald's adverts on the television, for example.

3 ▶ What are the benefits to McDonald's of operating as a multinational? Give two benefits in your analysis.

McDonald's, like all multinationals, has access to a much wider market than companies that focus entirely on domestic markets. McDonald's has around 34,000 outlets around the world and in over 100 countries; even in India, where most people do not eat beef or pork, there are about 180 restaurants. It is reckoned that each day over 60 million people worldwide purchase something from McDonald's. It is also estimated that they sell more than 75 hamburgers per second. Multinationals can boost their sales revenues by selling to global markets. This will help to increase profits and win market share from competitors.

Also, since multinationals are large companies, they can exploit economies of scale and enjoy lower costs. McDonald's can buy resources at lower prices and borrow money at cheaper rates, for example. Reducing costs will help them gain a competitive advantage and put pressure on their rivals.

4 ▶ Assess the benefits to a country/economy when McDonald's locates outlets in that country.

When a multinational like McDonald's locates operations in a foreign country, that country and its economy is likely to enjoy a number of benefits. These include an increase in income and employment. Multinationals create new jobs in developing countries. For example, McDonald's employs over 1.8 million people all over the world. Local suppliers are also likely to get some work when a McDonald's outlet is opened. The extra output

and employment generated by multinationals such as McDonald's will increase economic growth and raise living standards for people in these countries.

Another benefit they might provide is income for the government. This is because the profits made by multinationals are taxed by the host nation. This increases tax revenue for the government in that country and this can be used to improve government services such as health care, roads and other infrastructure.

In some cases, multinationals provide training and work experience for workers in less developed countries. Also, governments in less developed countries often spend more on education to help attract multinationals. This happened in India where the government invested heavily in IT education and training. In the case of McDonald's, it is likely that training would be given to all of its employees before they begin work.

The arrival of multinationals like McDonald's has encouraged more people to set up businesses in some countries. Multinationals may provide the skills and motivation needed for enterprise. For example, a new multinational may encourage locals to supply services such as transport, accommodation, maintenance, cleaning and leisure activities.

However, despite the benefits outlined above, multinationals are sometimes criticised for their behaviour. For example, many environmentalists are suspicious of multinationals because they may cause environmental damage. One reason is because multinationals are heavily involved in the extraction industries, such as coal, oil and gold mining. Mining is often destructive. However, McDonald's is not likely to receive such criticism since it is not a mining company.

Multinationals are sometimes accused of exploitation. For example, they may pay locals low wages. There is some evidence in this case of such alleged exploitation. Recently, McDonald's has been attacked for paying its workers low wages. In 2014, it was reported that thousands of fast-food workers around the world stopped work or held protests against McDonalds and other fast-food suppliers. Employee action has been ongoing since 2012 in the USA where workers are demanding US$15 per hour pay rates and the right to join a trade union. Indeed, around 200 workers went on strike in New York. Also, in Brazil, McDonald's has encountered trade union protests because of wage theft, poverty-level pay and poor treatment of pregnant workers. Protests against McDonald's were also seen in Japan and South Korea in 2014. However, although such exploitation may occur, many multinationals have good records when developing business interests in less developed countries.

Another possible disadvantage of attracting multinationals is that the profits made by multinationals abroad are often repatriated. This means that profits are returned to the country where the multinational is based. As a result the host country loses out.

To conclude, many would argue that in the case of McDonald's, the benefits of multinationals are greater than the disadvantages. Higher incomes, new jobs and rising tax revenues are an attractive proposition for many countries, particularly developing countries. Provided the activities of multinationals are monitored, it may be possible to minimise the disadvantages such as environmental damage and exploitation.

CHAPTER 11

GETTING STARTED – TOYOTA

Look at Figure 11.1.

1 ▶ What are the key changes in Toyota's regional sales between 2003 and 2017?

- The total number of cars sold in Asia has risen sharply.
- As a proportion of total sales, Asia is now a more important market.
- The total number of sales in the Middle East has risen sharply as a percentage.
- As a proportion, Japan is a slightly smaller market in 2012.
- Sales in Japan have actually fallen.
- As a proportion, America is a slightly smaller market.
- NB Other changes not listed here may be identified.

2 ▶ Why is international trade important to Toyota?

Figure 11.1 suggests that international trade is very important indeed to Toyota. About 75 per cent of its sales are outside Japan, which suggests that about 80 per cent of Toyota's revenue is the result of international sales.

3 ▶ How might international trade help a business like Toyota to grow?

By selling overseas businesses can generate more sales and more profit. In this case, without international markets, Toyota would be considerably smaller because around 75 per cent of its revenue is generated outside Japan. The ability to sell in overseas markets has allowed Toyota to grow since it was set up in 1937. It is now one of the biggest corporations in the world.

4 ▶ In groups discuss how international trade might affect you. For example, think about the products you buy and where they come from.

ACTIVITY 1

CASE STUDY: IMPORTS AND EXPORTS IN KENYA

1 ▶ Using examples from the case, distinguish between exports and imports.

Exports are goods and services sold abroad by businesses. In this case, some of the main goods sold abroad by Kenyan businesses are agricultural products and tea. However, they also sell goods such coffee, tobacco, iron and steel products, textiles, petroleum products and cement. Some of Kenya's customers for its exports are the UK, the Netherlands, Uganda, Tanzania, the United States and Pakistan.

Imports are goods that are bought from overseas. In this case, Kenya buys products like machinery and transportation equipment, motor vehicles, iron and steel and plastics from abroad.

2 ▶ Describe the pattern of international trade in Kenya over the period shown.

Over the time 2001–16 period, both the value of exports and the value of imports have increased for Kenya. For example, the value of exports has grown from around KES 17 000 million in 2001 to around KES 50 000 million in 2016. The value of imports has grown from about KES 20 000 million in 2001 to around KES 120 000 million in 2016 (after reaching KES 160 000 million a short time before). However, it is clear that throughout the time period, the value of imports was always higher than the value of exports. This means that Kenya has been running a trade deficit (it imports more than it exports).

3 ▶ Why do you think Kenya relies heavily on primary goods for its exports?

Many African countries rely on the sale of primary goods for their exports. There may be two reasons for this. One is because many African states, like Kenya, have a large supply of certain natural resources that they can export. Kenya sells agricultural products and tea, for example. Kenya is fortunate to have the right sort of resources needed for the production of these goods. A second reason is because many African states are developing countries. As a result they are yet to develop manufacturing facilities and the required skills to export services. Consequently, they have to rely on the sale of primary goods to earn foreign currency.

ACTIVITY 2

CASE STUDY: RONNIE MACKAY

1 ▶ Work out the price in US dollars of the machines sold by Ronnie Mackay to the US firm (assume £1 = US$1.50).

The price in dollars is given by:

£3 600 000 × US$1.5 = US$5 400 000

2 ▶ Work out the amount paid in pounds by Ronnie Mackay for the €2.5 million of components bought from Germany (assume £1 = €1.10).

The sterling price of the German components is given by:

€2.5 million ÷ €1.10 = £2 272 727

3 ▶ Work out the amount in euros received by the Spanish supplier for the £200 000 of materials sold to Ronnie Mackay (assume £1 = €1.10).

The amount in euros received by the Spanish supplier is given by:

£200 000 × €1.10 = €220 000

MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3C, 4D

CHAPTER REVIEW

CASE STUDY: ALUMBURG

1 ▶ Suggest two reasons why nations trade. Use examples from this case study.

Countries trade with each other for a number of reasons. One is to obtain goods that others can produce more cheaply. For example, South Africa buys machinery and scientific instruments from other countries. This may be because other countries have the resources to produce such goods more efficiently. It is obviously beneficial to buy goods from other countries if they are cheaper. South Africa sells commodities such as gold, diamonds and coal. This is because the country has a large supply of these resources. It has more gold, diamonds and coal than it needs for its own purposes. Consequently, it can generate income by selling them abroad.

2 ▶ What is meant by an invisible export? Use an example from this case study.

Invisible trade involves the exchange of services. For example, South Africa has a flourishing tourist industry. It has some attractive resorts, such as Cape Town, and an interesting culture. The money South African businesses get from tourists is recorded as an invisible export.

3 ▶ Describe two benefits of international trade to Alumburg.

One important benefit to Alumburg of international trade is that it can sell goods to more customers. By expanding into overseas markets, it can sell more output. These extra sales will generate more revenue and hopefully help to make the business more profitable. In this case, Alumburg has started to enjoy sales in the European market. For example, it has one order worth ZAR 124 million.

Also, by selling abroad Alumburg will reduce its reliance on the domestic market. If sales were to decline in South Africa, it can still generate revenue by selling more in its growing European markets. Trading overseas in a range of different markets helps businesses like Alumburg to reduce the amount of risk involved in business.

4 ▶ a How might Alumburg be affected by exchange rates?

b If €1 = ZAR 10, how much would a European customer have to pay in euros for an order worth ZAR 124 million?

c If the exchange rate rose to €1 = ZAR 18, how might Alumburg be affected?

a Alumburg will be affected by exchange rates because it deals with overseas businesses where the currency is likely to be different from that in South Africa. For example, it sells goods to European countries where the euro is used. This means that a change in the exchange rate could affect the price paid by European customers for Alumburg's goods.

b A European customer would pay €12.4 million (ZAR 124 million ÷ ZAR 10) for the order.

c Alumburg will benefit from the change in the exchange rate. The euro has strengthened against the rand: one euro can now buy ZAR 12 instead of 10. This means that goods purchased in South Africa will be cheaper. For example, the ZAR 124 million order for machinery will now cost €6.89 million (ZAR 124 million ÷ ZAR 18). As a result, there is likely to be an increase in demand for Alumburg's goods because they are relatively cheap for European customers.

5 ▶ Discuss how the international competitiveness of a country could be affected by changes in the exchange rate.

Sustained changes in the exchange rate can have an impact on the international competitiveness of a country. If the exchange falls sharply for a long period of time, this means that all exporters in the country can sell their goods more cheaply abroad. This can have a positive impact on the economy of that country. Higher export sales mean more employment, income and tax revenues for that country. In this case, the South African exchange rate fell sharply against the euro from €1 = ZAR 10 to €1 = ZAR 18. This meant that price of exports from South Africa fell. A European customer of Alumburg's saw the price of an order fall from €12.4 million to €6.89 million. This is a very significant change in price and should result in more orders for Alumburg. If this fall in the exchange rate is sustained, South Africa will be more internationally competitive during this period.

However, a lower exchange rate means that import prices will rise. This means that consumers will have to pay more for overseas goods and holidays abroad and businesses have to meet the rising cost of imported raw materials and components. In this case South Africans will see steep rises in the price of imports as a result of their falling exchange rate.

CHAPTER 12

CASE STUDY: BOOSTING THE JAPANESE ECONOMY

1 ▶ What evidence is there to suggest that Japan's economy is still performing weakly?

The Japanese economy has been performing weakly for 20 years or more. However, the data in the graph shows that even in the last five years the problem still exists. The graph shows that total incomes (GDP) in Japan have fallen. In 2011, GDP was US$6157.5 billion but by 2015 this had fallen to US$4383.1 billion. This is a poor performance since most countries would expect incomes to grow over time as the economy expands.

2 ▶ How might the construction industry benefit from the measures taken by Shinzo Abe?

One of the key measures taken by Shinzo Abe was to invest money in infrastructure projects such as building bridges, tunnels and earthquake resistant roads. This would benefit businesses in the construction industry since they would get the work needed to implement this measure.

3 ▶ How might lower interest rates benefit businesses?

When businesses invest money, to expand or develop new products, for example, they often need to borrow the money needed for the extra expenditure. Consequently, if interest rates are lower it will be cheaper for them to borrow. This should encourage more businesses to invest in order to expand since the risk of doing so is reduced with cheaper loans.

4 ▶ How might businesses in general benefit from the changes in taxation made by Shinzo Abe?

The lower levels of business tax will be welcomed by businesses. This means they get to keep more of their profits. Some of this profit is likely to be reinvested to help businesses to grow. Lower tax on business profits might also encourage more people to set up businesses since the financial rewards will be greater.

ACTIVITY 1

CASE STUDY: THE GREEK ECONOMY

1 ▶ Why has the Greek government been forced to constrain its spending?

The Greek government has been forced to reduce its public spending because it has built up too much debt. Years of overspending, together with the impact of the financial crisis, meant that Greece needed 'bail outs' from the EU. For example, in 2015 Greece owed a total of €323 billion and had received around €240 billion in 'bail outs' from the EU. Greece has one of the highest debts (as a percentage of GDP) in the world. Figure 12.3 shows that Greece's debt is 175 per cent of its GDP. Only Japan is higher in the sample of countries shown.

2 ▶ How might a government constrain public spending? Give two ways in your analysis.

In return for the money from the EU, Greece had to raise taxes and cut public spending. One approach to constraints in public spending is to cut wages of public sector workers. In this case, Greece made a 20 per cent cut in public sector wages. Wages were also reduced by 30 per cent in state-run enterprises.

Another way to constrain public spending is to cut departmental budgets. In the case of Greece, there was lower spending on education, defence, healthcare and public investment. Finally, cutting state benefits and other payments to people can reduce spending. Greece was forced to lower pensions and social security payments as a condition of the 'bail out'.

Kostas Samaras runs a private fitness centre in Athens.

3 ▶ Discuss the possible impact public spending constraints might have on his business.

The private fitness centre run by Kostas Samaras is likely to have suffered badly as a result of the constraints in public spending. With cuts in wages to public sector workers and lower payments to pensioners and others, many people would not be able afford the fees for the fitness centre. Spending on recreational activities is non-essential and when faced with cuts to disposable income people will react by cutting down on this type of expenditure. As a result, the fitness centre may have struggled to make a profit. At worst, it may have gone out of business due to a lack of revenue.

MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3A, 4B

CHAPTER REVIEW

CASE STUDY: GOVERNMENT INFLUENCES ON BUSINESSES

1 ▶ What is meant by the term tariff?

A tariff is a tax on an import. Tariffs make imports more expensive and are therefore designed to reduce demand for imported goods.

2 ▶ Suggest two practices that consumer legislation might attempt to prevent.

Consumer legislation is designed to protect consumers and prevent restrictive practices, such as price fixing, restricting consumer choice by market sharing and raising barriers to entry by spending huge amounts of money on advertising, which smaller companies couldn't match.

3 ▶ Describe one possible impact on businesses of the 20 per cent planned spending cuts on roads and motorways.

Governments spend large amounts of money on large infrastructure projects such as motorway construction and road maintenance. A 20 per cent cut in such spending is likely to have a negative impact on businesses in the construction industry. Large contracts would be lost and some businesses might struggle with reduced revenue. This could affect profitability and, in some cases, businesses that are too reliant on government contracts, might go out of business. Suppliers in the construction industry are also likely to be hit.

4 ▶ Why do businesses prefer lower interest rates? Give at least two reasons in your analysis.

Businesses prefer interest rates to be lower rather than higher. This is because high interest rates can damage business activity. When interest rates rise business costs will also rise because interest charges on current loans and overdrafts increase. This will reduce profit.

The purchase of new machines and other capital goods funded by borrowed money is also discouraged because it is more expensive. This will slow the development of businesses and make them less efficient. Consumer demand will fall because people's mortgage payments rise and they have less income. Also, demand for goods bought with borrowed money will fall because consumers will find such purchases more expensive.

Changes in the interest rate will have a bigger impact on those businesses that have lots of debt and those which produce goods bought with borrowed money.

5 ▶ Assess the possible impact of the budgetary measures designed to help businesses.

It is not uncommon for governments to take measures to help the business sector. This is because businesses provide employment, generate income and provide tax revenues. A flourishing business sector is very good for the economy. In this case, the government has taken a number of measures to help businesses. Two of these relate to taxation. The government planned to increase tax allowances on investment and would reduce corporation tax from 25 per cent to 20 per cent. Both of these measures will help to encourage business investment. Higher tax allowances on investment means that the cost of investment is reduced, which would make investment more attractive. Lower levels of corporation tax means that businesses will be able to keep more of their profits. This would provide more funding for investment. If businesses invest more, in new technology and research and development for example, they are more likely to remain competitive and grow. Lower corporation taxes might also attract businesses from overseas to set up operations in the country. This would help to generate more employment and income.

The government also plans to hold interest rates at their current low levels for several years. This will benefit businesses since the cost of borrowing will be lower. The purchase of new machines and other capital goods funded by borrowed money will be encouraged. This will help the development of businesses and make them more efficient. Consumer demand will rise because people's mortgage payments fall and they have more disposable income. Also, demand for goods bought with borrowed money will rise because consumers will find such purchases cheaper.

The introduction of tariffs on a range of imported shoes, clothes and fashion accessories will help some businesses. If imports of these goods become more expensive it will be easier for domestic producers in these industries to compete and survive. Therefore clothes and shoe manufacturers, for example, should enjoy a boost in sales as their goods become relatively cheap compared to imports.

If the government relaxes some out of date consumer legislation this could make it easier for businesses to operate. Legislation generally has a constraining effect on businesses and can impose costs. For example, if businesses have to comply with legislation that prevents them from selling products to people under the age of 21, this restricts their market.

The government also plans to open negotiations to join a trade bloc. This could have a positive impact on businesses. For example, trade blocs provide opportunities for businesses to specialise in the production of those goods and services that they can produce more expertly or at a lower cost.

Belonging to a trade bloc also gives them access to wider markets and can help to lower costs if economies of scale can be exploited when sales and output rise. Membership may also provide protection from large predatory multinationals from outside the bloc.

To conclude, all these measures can potentially help businesses, particularly those in the clothes, shoes and fashion accessories industries where competition has been reduced with tariffs on imports. However, the government is also cutting some expenditure and freezing public sector pay. These measures will have a negative impact on some businesses. Therefore the gains mentioned above might be cancelled out to a certain extent.

CHAPTER 13

CASE STUDY: SOCIAL MEDIA AND BUSINESS

1 ▶ Why is social media so important to businesses?

Social media is so important to businesses because of the enormous number of people that use it. In 2016, it was reported that every day around 500 million tweets were posted on Twitter, 4500 million 'Likes' were expressed on Facebook and 95 million photos were uploaded onto Instagram. Electronic devices, such as smartphones and tablets, enable people to exchange this wide range of data instantly and globally. Social media has become a powerful

phenomenon and it is no surprise that businesses are making increasing use of it – particularly in the marketing of their products. Social media has a global reach and even small businesses can communicate with large numbers of people all over the world.

2 ▶ How might businesses use social media?

The use of social media generates huge amounts of data about a business's customers such as their profiles, their preferences and what they think of products. This is a valuable resource. Businesses have set up links to some of these social media platforms and these communication channels allow them to tell people about their products and listen to their views. Businesses can use social media to raise and strengthen brand awareness, run targeted adverts with real-time results, increase traffic on their own websites and find out what competitors are doing. Businesses spend huge amounts of money advertising on social media. Figure 13.1 shows that advertising spending on social media is expected to rise to US$29 910 million in 2016, up from US$11 360 million in 2013.

3 ▶ In groups, discuss your own experiences of interacting with businesses on social media. Make a list of the possible benefits of such interaction and present the information to the rest of the class.

This is an open question and designed for students to exchange experiences and ideas.

ACTIVITY 1

CASE STUDY: 3D PRINTING

1 ▶ Assess the possible benefits to businesses of new technology like 3D printers. Make a clear judgement in your evaluation.

Technological development usually brings new opportunities for businesses. It could be new products that people have not seen before or new machinery that can be used to improve efficiency. For example, new technology can help to shorten product life cycles. This is because new products are quickly developed to replace ones that use less sophisticated technology. Developments in technology often mean that businesses can replace labour with capital. This is welcomed because human resources are often said to be the most difficult to manage. New technology also lowers unit costs. Recently, the development of social media has helped to improve communications between businesses and customers. This allows businesses to remain aware of changing consumer needs.

In this case study, new 3D printers are expected to make a big impact in business. Although 3D printers were invented in 1986, only in recent years have businesses really started to exploit the new technology on a commercial scale. Between 2016 and 2022, the 3D printing market is expected to grow to US$30 190 million. 3D printers reduce the need to produce hand built models and prototypes and are very efficient. They are said to be around ten times faster than other methods of model production and five times cheaper. This means that prototypes can be produced in hours rather than days. This will help to speed up product development, for example.

Another attraction of 3D printing is its wide range of applications. The technology can be used to make components for cars, airplanes and spacecraft; produce prosthetics (artificial body parts) for the medical industry and produce an range of personalised products such as jewellery, fashion accessories and toys, for example. Eventually, 3D printing will allow businesses to design, test and manufacture low-volume or one-off parts both quickly and cheaply.

However, 3D printers have some disadvantages. They may cost between US$25 000 and US$50 000, although this is less than the cost of more sophisticated rapid prototyping (RP) machines, which can cost between US$100 000 and US$500 000. The surface on the models is also a little rough compared to production using RP machines. Also, models can only be made from one or two materials and there are only two colours. Although these disadvantages currently exist, they are not likely to prevent the future success of 3D printing. Like most technology, it will get cheaper and eventually the disadvantages are likely to be resolved.

ACTIVITY 2

CASE STUDY: ELECTRIC VEHICLES

1 ▶ Describe two external factors that have contributed to the development of EVs.

Growing concern about the damage done to the environment has encouraged the development of EVs. The carbon emissions from vehicles contribute to global warming. Also, the rising cost of oil has made driving more expensive and consumers may welcome alternatives, although in 2014 the price of oil fell quite sharply so this reason may have carried less weight at that time.

2 ▶ What are the advantages of EVs for consumers? Give at least two advantages in your analysis.

EVs will be more environmentally friendly because they will not release carbon into the atmosphere. Many consumers will see this as an advantage. The car is also cheap to run. It is expected to cost about US$0.04 per mile (US$0.06 per kilometre). Also, the batteries used to power the car can be recharged in four hours and have a range of 107 miles (about 170 km) on one charge.

3 ▶ Assess the impact global oil prices might have on the plans of car manufacturers in the future.

Although the price of oil has fallen by over 50 per cent since 2014, according to the graph in Figure 13.2, this may only be a short-term change. In the future, oil prices might rise back to previous levels or beyond; this will make EVs even more attractive. However, even if oil prices remained low, it is possible that car manufacturers will 'push' EVs in the marketplace. One reason for this is that they have probably invested heavily in R&D and will want to recover the outlay. But also, people are still becoming increasingly concerned about the damage done by emissions to the environment and therefore might start to buy EVs on a large scale.

MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3D, 4C

CHAPTER REVIEW

CASE STUDY: ATERRO RECYCLING

1 ▶ What is meant by external factors?

Sometimes businesses have to deal with events and issues that are completely beyond their control. These external forces can impact on businesses unexpectedly and usually mean that businesses have to make changes to the way they operate. The effects of external factors can be both positive and negative. They may provide new opportunities or they may lead to serious costs. For example, in this case Aterro Recycling is benefitting from an external factor. Owing to rapid technological developments, there has been a huge build-up of e-waste around the world but particularly in India. This has provided a business opportunity for Rohan.

2 ▶ How will Aterro Recycling help to reduce resource depletion?

Aterro Recycling is making a positive contribution to the environment by recycling waste. This means that it is providing valuable resources from materials that have been discarded and left to deteriorate. The factory uses processes to extract precious metals like platinum, gold and selenium from the e-waste. These precious metals generate revenue for Aterro and ensure that stocks of these resources are not depleted as quickly as they would be without recycling.

3 ▶ How might developments in technology have impacted on Aterro Recycling?

Aterro Recycling was set up when Rohan Gupta tried to throw away an old laptop without harming the environment. He realised that India did not have a system to deal with the vast quantities of e-waste being generated. Computers, laptops, television sets, mobile phones and electronic office equipment are examples of e-waste. In one Indian city, Bangalore, e-waste amounts to 18 000 tonnes per year and is still growing 20 per cent annually. The growth is driven by rapid developments in technology with the frequent arrival of new, updated and attractive electronic products. E-waste is now the world's fastest growing and most toxic waste. Rapid developments in technology provided Rohan Gupta and his brother with a business opportunity.

Businesses may be affected by political factors from time to time.

4 ▶ Discuss how political factors can affect business decisions.

Some parts of the world are politically volatile and businesses have to be cautious if they develop interests in countries that are politically unstable. For example, few businesses would have considered setting up operations in Syria, Western Turkey, Iraq and Libya in 2016 due to quite severe political instability. However, political factors can also influence businesses in stable, democratic countries. The activities of pressure groups can also play a role influencing business activity. For example, in 2016, the British people voted to leave the EU. Not many people would have predicted this and the effects of Brexit, as it became called, are still to be determined. However, one immediate outcome was a fall in the exchange rate. The value of sterling fell by more than 10 per cent after the Brexit vote. This means that British exporters may find it easier to sell goods abroad since exports become cheaper. In contrast, imports are more expensive so British businesses using imported raw materials and components, for example, will face higher costs.

5 ▶ Assess whether Aterro Recycling will thrive in the future.

The future could be bright for Aterro Recycling. The graph in Figure 13.3 shows that the global recycling market is set to grow from €14 000 million to €35 000 million between 2011 and 2020. This is an increase of 218 per cent and suggests that Rohan Gupta and his brother have set up a business in a rapidly growing market. Also, the speed of technological development seems to get faster over time. This suggests that piles of e-waste will grow even faster than at present. This will obviously benefit Aterro Recycling since it means there will always be plenty of e-waste to recycle in their plant. The company's revenue is growing rapidly and in 2013 reached US$15 million. Aterro Recycling is already expanding and also has processing plants in Mexico and Ireland. If this expansion is continued then revenues and profits should continue to grow.

However, Aterro Recycling will have to be watchful in the market for new entrants. If the recycling of e-waste appears to be a highly profitable business activity, new entrants will enter the market and fight for a share. If very large companies appear, they might be a threat. For example, large multinationals with their huge resources might be able to push Aterro Recycling out of the market if they are not prepared.

Aterro will also need to remember that future external factors might affect their activities. For example, a new government might pass a law that means that Aterro's current industrial processes are not environmentally friendly. This could force them to invest in new plant and equipment. There might also be an evolution in technological development where all new products are perhaps more durable or contain less opportunities for recycling. For example, a lot of new technological products are being 'miniaturised'. This might result in a sharp fall in e-waste.

CHAPTER 14

CASE STUDY: DIGI.COM BERHAD (DIGI)

1 ▶ What evidence is there to suggest that DiGi is a successful business?

Evidence in Figures 14.1 and 14.2 suggests that DiGi has enjoyed some success in the last five years. The company's revenue has increased by around 16 per cent over the time period, from MYR 5954 million in 2011 to MYR 6914 million in 2015. The profit made by the company has also increased over the same period from MYR 1254 million to MYR 1723 million – a significant 37.4 per cent increase. In addition to this, DiGi has won a high profile award. In 2015, it received the prize for being the 'Best Managed Public Company in Asia' (in its category). Most people would judge that this represents success.

2 ▶ In pairs, discuss what other information might be helpful to measure the success of DiGi. Draw up a list and present the information to the rest of the class.

When measuring the success of a business, it is often helpful to make comparisons with other businesses in the industry. For example, if other firms in the telecommunications industry enjoyed much bigger increases in turnover and profits than DiGi, then its performance is not so impressive. It is also important to take into account other factors such as market conditions. If the improvements in revenue and profit were made during a recession, for example, then the figures are perhaps even better than they suggest.

ACTIVITY 1

CASE STUDY: ALUMINIUM CANS

1 ▶ What is the change in CanKing's revenue between 2010 and 2015?

CanKing revenue 2010

9 per cent × US$450 million = **US$40.5 million**

CanKing revenue 2015

8 per cent × US$560 million = **US$44.8 million**

Change in revenue = **US$4.3 million (increase)**

2 ▶ Do you think CanKing has been successful over the time period?

CanKing has increased its revenue from US$40.5 million in 2010 to US$44.8 million in 2015. This is an increase of 10.6 per cent over the time period. The owners may consider this successful. However, it depends on whether CanKing set any revenue targets for the time period. This would provide a basis for comparison. CanKing's market share is down slightly from 9 per cent to 8 per cent but it still occupies fourth place in the market. Arguably, CanKing has been successful since revenue has increased and its market share is down just a little – its market position is unchanged.

3 ▶ Which company has been most successful over the time period? Explain your answer.

It appears that Singh Holdings has been the most successful business over the time period. It has become the market leader at the expense of Zcan. In 2010, Zcan had 34 per cent of the market with Singh Holdings having 22 per cent. By 2015, Singh Holdings had increased its share to 29 per cent while Zcan saw its share fall to 27 per cent. Singh Holdings also saw its revenue jump from US$99 million to US$162.4 million. This is a significant increase of 64 per cent.

(Note: It is calculated from the information in the pie charts and case study material)

4 ▶ Why might it be difficult to measure success using market share?

Measuring market share might be difficult. Information would be needed about the size of the total market and the revenues of the main suppliers in that market. Some of this information might be difficult to obtain. Therefore, using the value of market shares to measure success may not be easy.

ACTIVITY 2

CASE STUDY: LOSADA PAELLA

1 ▶ What was the size of Losada Paella in 2016 according to EU definitions?

According to the EU definitions of size, in 2016, Losada Paella was a small company. This is because turnover was less than €10 million and greater than €2 million.

2 ▶ In what year did the size of Losada Paella change?

2008.

3 ▶ Do you think Losada Paella has been successful?

In the first few years of trading, Losada Paella enjoyed healthy improvements in revenue from €98 000 in 2002 to €200 000 in 2008. However, in 2008 Marta set up a website for the business and started to sell her products online. This was an enormous success because by 2016 turnover had risen to €2.4 million. This represents an increase of 1100 per cent!

MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3C, 4D

CHAPTER REVIEW

CASE STUDY: QETIC LATEX PLC

1 ▶ Work out the total number of people employed by Qetic Latex.

180 = 16% of the total workforce at Qetic. Therefore the total workforce is given by: 180 ÷ 0.16 = **1125 workers**

2 ▶ Is Qetic a small, medium-sized or large business?

According to the EU definitions of business size, a firm that employs over 249 is considered large. Qetic employs a total of 1125 workers and is therefore large according to this measure.

3 ▶ Discuss how consumer satisfaction might be used to measure the success of a business like Qetic Latex.

Many businesses will look at how consumers' needs and wants have been satisfied when measuring success. If its customer service is good, a successful business will find that it has loyal customers and a growing customer base. In this case, Qetic Latex sells goods to other businesses. However, it will still be important to meet their needs.

Many businesses are becoming more customer-focused and making efforts to get feedback from their customers. Qetic Latex may have developed a relationship with their business customers over time. If these relationships are strong and customers are loyal then Qetic may consider that it is being successful. Also, in 2016, the company won two high profile industry awards for the quality of its latex products. This suggests that customer satisfaction might be high.

Finally, an increasing number of businesses use customer surveys to gather information about customer satisfaction. The information they gather can be analysed and used to assess customer satisfaction levels. If customer satisfaction levels rise over a period of time then the company will consider it is being successful.

4 ▶ Describe how shareholders might measure the success of a business.

Most shareholders in public limited companies will have bought shares with the aim of making money, consequently they will focus on dividend payments and share prices. Over time, shareholders would want both dividend payments and share prices to rise. In many countries, large financial institutions such as insurance providers, pension funds and investment companies own shares. These groups tend to be very focused on short-term returns. They like to see regular dividend growth and if dividend payments were frozen or cut they might see this as a sign of failure or weakness. In their view, successful companies are those that increase dividends each year. In this case, Qetic is 66 per cent owned by institutional shareholders. Consequently, there is likely to be pressure on Qetic to deliver regular dividend growth.

5 ▶ Assess the success of Qetic Latex. Make a clear judgement in your evaluation.

Most Qetic shareholders would argue that the business has been successful. They would point to Figure 14.8 that shows that dividends per share have risen from US$1.10 in 2011 to US$1.70 in 2015. This is an increase of 54.5 per cent over the time period. Most investors would consider this a fair return on their investment. Dividends have grown steadily over the whole time period. There have not been any 'dividend holidays' (a year where a company pays no dividends) or dividend reductions. However, shareholders also look at share prices since they can make a profit if they buy shares and sell them later when the price has risen. In this case, the share price fell sharply in 2016. It fell by 12 per cent in one day immediately after the television broadcast showing some disturbances at the Qetic factory. This would be a cause for concern if the fall were not reversed soon afterwards.

Employees in the business may differ in their view about Qetic's success. The needs of employees may be different from those of the shareholders. Employees depend on businesses for their livelihood. Most employees have no other sources of income and rely on their wages. Like the owners, employees want the business to be successful. If a business is growing and profitable, employees are likely to get higher wages, more benefits and perhaps a bonus. They will also feel more secure in their jobs. However, employees have other needs that must be met. They will need to be trained so that they can do their jobs properly. They want good working conditions, opportunities to interact with other employees, fair and honest treatment and opportunities for promotion. Generally, employees will want to maximise their financial rewards and welfare. If the business they work for is able to satisfy all, or most of these needs, then in their opinion the business will be judged as successful. In this case, in order to improve productivity, one of the moulding sections at Qetic was due for automation. This meant that 180 staff would be laid off. The announcement of the job cuts was received very badly by the Qetic employees. Two workers protested by chaining themselves to the main gates preventing the movement of suppliers' vehicles. A week later the situation escalated when a representative of the workers said that they would 'bring the company to its knees' if the workers weren't deployed in another part of the organisation or paid reasonable compensation for their loss of employment. This would suggest that employees are far from happy and would judge that the company is not being successful.

To conclude, up until the recent internal conflict, the business appeared to be successful. Certainly shareholders were enjoying rising and regular dividends. Qetic also won two high profile industry awards for the quality of its latex products. This was the result of its commitment to product development and investment in a US$50 million research centre in 2015, an investment that presumably created new jobs. However, at the moment, the future success of the business is in question. Some ugly scenes at the main plant were broadcast on television and it was reported that shareholders were very worried about the ongoing conflict. This concern was reflected in the share price, which fell 12 per cent the day after the broadcast. If the internal conflict is not resolved quickly the performance and success of the business is likely to be at risk.

CHAPTER 15

CASE STUDY: THE PEPPERTAP

1 ▶ Why did the PepperTap fail?

Businesses may fail for a number of reasons. In this case, there are three specific reasons. First, the PepperTap had problems with some of its partner retailers. They failed to adopt the necessary technology to keep consumer information up-to-date – this meant that customers were not getting the quality of service they needed. Second, the PepperTap was offering high discounts to try and enter the market – this quickly used up the company's cash. Finally, the cost of maintaining high staffing levels to meet delivery commitments was also expensive. The PepperTap promised to deliver groceries within two hours of an order being placed. This was far quicker than any rivals. However, Navneet and his team felt that they had an advantage over their competitors in making their delivery operation more efficient, since some of them had previously worked in this area, and costs would eventually fall. As it turned out, the PepperTap were unable to find fast enough solutions to these problems and they ran out of cash.

2 ▶ What measures might have been taken to avoid failure?

Initially, perhaps the PepperTap should have avoided using retailers that were not able to adopt the necessary technology. This may have slowed down the growth of the business but quality would have been maintained. They could also have reduced the discounts they were offering, which cost them a lot of money. Instead of offering 20 per cent, perhaps they could have offered just 10 per cent. Finally, their two-hour delivery promise was too challenging. Although they were probably trying to get a competitive edge, it is still necessary to be realistic and set targets which are achievable.

3 ▶ In pairs, make a list of things that you think might cause a business to fail. Try to decide which one of these is most likely to be a threat.

ACTIVITY 1

CASE STUDY: VALTREX CONSTRUCTION

1 ▶ What is meant by overtrading?

Overtrading is likely to occur when a business tries to grow too quickly. Cash and other liquid resources get tied up financing the expansion of the business and eventually the cash runs out. Without cash a business cannot trade.

2 ▶ How is it possible for a profitable business, like Valtrex Construction, to fail?

It is possible for a profitable business to collapse if it runs out of cash. One situation in which this might happen is when a business is overtrading. If a business grows too quickly, it uses up liquid resources to fund the growth. This is exactly what happened to Valtrex. Up to 2014, the business had grown to US$30 million sales and was trading profitably. However, the directors decided to grow the business further and during 2015 recorded sales of US$45 million. The company appeared to be growing too quickly, resources became strained and it ran out of cash.

Profitable businesses can also fail if they get a large bad debt, if they are faced with a large and unexpected payment or if they offer trade credit that is too generous. Effective cash flow management is important. One of the main reasons for business failures, both profitable and unprofitable, is cash shortage.

ACTIVITY 2

CASE STUDY: KINGFISHER AIRLINES

1 ▶ What was the value of Kingfisher's debt in US dollars when it collapsed in 2012 (assume US$1 = Rs66)?

Kingfisher's debt was Rs7000 crores (1 crore = Rs10 million).

Therefore 7000 crores = Rs70,000,000,000.

In US dollars this will be 70 000 000 000 ÷ 66 = 1 060 606 100, that is, **US$1600 million.**

2 ▶ How might: a poor management and b high costs have contributed to the failure of Kingfisher Airlines?

a Senior managers and business leaders have been known to bring down companies almost single-handedly. A business might lose its competitive edge in the market because the leader makes a mistake. This could be the result of poor decision making or a failure to make urgent changes. In this case, it has been suggested that Kingfisher Airlines lacked a strong leader. There was a frequent change of personal at the top, which meant that the business was unstable. The owner of the airline, Vijay Mallya, never took an active role in running the business and eventually the airline was given to his son, Siddharth Mallya, as an 18th birthday present. It was alleged that Siddharth did not have the experience to run such a large and complex business organisation. One option would have been to make Gopinath (ex-founder of Air Deccan) the CEO. However, this opportunity was missed and, in general, the company lacked the expertise and experience of a specialist manager in the airline industry.

b Another possible reason for Kingfisher's collapse was high operating costs. If costs are too high then a business needs to charge more to make a profit. This might result in a loss of trade to low-cost competitors. A firm's costs might be higher than rivals for a number of reasons. For example, businesses may be wasteful. In this case, there is evidence that Kingfisher was wasteful. Kingfisher chose to offer customers some high quality inflight entertainment, which was not usual for domestic flights. For example, a deal with DishTV to provide live inflight entertainment meant that 50 or so customised dishes had to be installed on each aircraft. Passengers were also offered free headphones. In addition, Kingfisher invested in some very expensive advertising campaigns, featuring Deepika Padukone, one of the highest paid actors in the world. It also offered passengers access to exclusive lounges and luxury meals. These costs, and others, made it very difficult for Kingfisher to make a profit.

3 ▶ Describe one external factor that might have contributed to the downfall of Kingfisher.

There may have been some factors beyond the control of Kingfisher that contributed to the failure. Economic conditions were poor for several years after 2008 and the airline was caught out by high fuel prices and some discretionary taxes. However, it might be argued that most of Kingfisher's troubles were internal.

MULTIPLE-CHOICE QUESTIONS

1A, 2B, 3C, 4A

CHAPTER REVIEW

CASE STUDY: DANDENONG SOFT FURNISHINGS

1 ▶ Suggest two possible causes of cash flow problems.

Cash flow problems might be caused by overtrading, investing too much in fixed assets, allowing too much credit, over-borrowing, seasonal factors, unforeseen expenditure, external factors and poor financial management.

2 ▶ How can rising debt affect a business like Dandenong Soft Furnishings?

When a business borrows money, it has to pay interest to the lender. Consequently, when businesses borrow more and more, the size of their interest payments rises along with the size of their debt. This means that costs rise and profits fall. In this case, following the purchase of Marigold Furnishings and investment in an expensive television advertising campaign, Dandenong Soft Furnishings borrowed A$10 million. This meant that the business had to make regular interest payments until the loan was repaid. This had a negative effect on the financial performance of the business because soon after it started to lose money.

3 ▶ Assess the reasons why Dandenong Soft Furnishings failed. Make a clear judgement in your evaluation.

A number of factors led to the failure of Dandenong Soft Furnishings. Once Charlie had retired from the business and appointed his daughter, Agnes, as CEO, its performance seemed to decline. It could be argued

that despite Agnes's academic qualifications in business management, she was a poor leader and made a number of key errors in the running of the business. One was to buy rival chain, Marigold Furnishings, for A$ 6.3 million. The price was far too high and Dandenong already had stores competing successfully with Marigold in more than one-half of the locations. This was perhaps a foolish purchase. Another error was to invest heavily in a national television advertising campaign just after the purchase. This stretched the company financially forcing them to borrow A$ 10 million. However, worse was to come.

The marketing manager wrote a report for Agnes explaining the importance of online selling and that Dandenong should consider very seriously setting up an online facility. However, Agnes was strongly opposed to this. She thought that the main strength of Dandenong business model was the quality of customer service given in the stores. Dandenong had always invested heavily in specialised customer service training. This may have been one of Agnes's biggest mistakes.

In 2010, the company had started to lose money due to falling sales. Agnes thought that the way to improve performance, and prevent cash flow problems, was to open stores in Western Australia, a region in which Dandenong was not represented. This strategy needed investment of A$ 5 million. Agnes drew up a business plan and approached a number of lenders for finance. However, not a single bank or investor was interested. They felt that online selling was the way forward and Dandenong had 'missed the boat'. Too many businesses were running successful online businesses offering quality furniture at much lower prices than Dandenong. If Agnes had acted on the advice of her marketing manager the business may have survived.

In September 2014, Dandenong closed down owing banks A$ 9.5 million. Agnes told a reporter that the business had failed due to a lack of finance. This was not really the reason. The business did lack finance but it lacked finance for a reason. It had failed to innovate by selling online and no one was interested in funding a failing business. To conclude, it could be argued that the business failed mainly because of poor leadership. It was Agnes, the leader, who refused to listen and innovate in 2010 and it was Agnes that decided to buy Marigold and invest in television advertising. These were very costly mistakes for the business.

CHAPTER 16

CASE STUDY: BUSINESS PRESS CONFERENCE

CASE STUDY: INTERNAL EMAIL

1 ▶ Name the a sender, b receiver(s) and c message in the two examples of communication shown in the photograph and Figure 16.1.

Press conference

- The board of directors
- Members of the press – journalists, television, radio and other members of the media
- Information relating to the company's financial performance for the year.

Email

- Deepika Mendis – Head of Finance, Portland Carriers
- Celia
- Request for a sales report to be sent.

2 ▶ Produce an illustrated poster that shows the different ways you communicate with your friends.

ACTIVITY 1

CASE STUDY: ELMART

1 ▶ Who is the sender of the information in this example?

The sender is Roberto Navarro in this case.

2 ▶ What is meant by vertical communication? (Use an example from the case study.)

Vertical communication takes place when messages are passed up and down the organisational hierarchy in a business. In this case, the communication is upwards. Roberto Navarro is sending information to the finance director, a superior higher up the organisational structure.

3 ▶ What sort of information is being sent in this example?

Some financial information is being sent in this example. Table 16.1 contains financial information about the performance of the stores in May 2016. The table has been sent to the finance director who is writing a report for a board meeting.

4 ▶ Why is upward communication helpful?

There are a number of reasons why upward communication is helpful. It may help managers to understand the views and needs of subordinates and make them aware of potential problems. It also helps staff to feel that they are valued and provides managers with information that can be used to make decisions. Finally, upward communication can show whether or not downward communication has been effective.

ACTIVITY 2

CASE STUDY: STAFF COMMUNICATION

1 ▶ Is this case an example of internal or external communication?

The use of a noticeboard by Yuri, the section manager, to inform all staff in his section to attend a short meeting is an example of internal communication. It is communication that takes place inside the business.

2 ▶ What is meant by 'on the grapevine'?

The grapevine is an informal method of communication. It involves people passing on information unofficially. In this case, Yuri is relying on the grapevine to a certain extent. He is hoping that staff who fail to see his message on the noticeboard will pick up the brief details from those members of staff who have.

3 ▶ Do you think using a noticeboard was an appropriate method of communication in this case?

The use of a noticeboard is not really an appropriate method of communication for the type of message that was being sent in this case. The attendance at the meeting

provided evidence of this: 11 people were absent. Either they had not spotted the message on the board (because it was too messy), had not read any notices on the board, had not heard about the meeting on the grapevine or did not want to come to the meeting. The main problem of using noticeboards for important messages is that the method is unreliable and open to abuse.

MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3A, 4B

CHAPTER REVIEW

CASE STUDY: CHOCCOMATE

1 ▶ What is meant by the term external communication?

External communication involves an exchange of information between the business and those outside it such as customers, investors or the authorities.

2 ▶ Describe one benefit of using a presentation as a means of communication in this case.

Using a presentation to communicate is a method of face-to-face communication. In this case, Ju Kin Fung is going to give a presentation to the board of directors that aims to show the benefits to ChoccoMate of using social media as a means of communication. A presentation is a formal method of communication and will be taken very seriously. This is an advantage. A presentation will also provide an opportunity for the receivers, the board of directors in this case, to ask questions and express their views on the matter. This is because face-to-face communication allows immediate feedback.

3 ▶ Why is good communication important in business? Give at least two reasons in your analysis.

Good communication is crucial in business because poor communication can be very expensive. Poor internal communication may cause efficiency and profitability to suffer. It can lead to mistakes, wasted resources and confusion. Poor internal communication can also lead to workers misunderstanding what they have to do. This might affect their motivation and increase staff turnover and absence, for example. Poor internal communication can also result in a duplication of effort – where two people do the same task, for example.

Poor external communication can make the business look foolish and may cost it money. For example, if prices on a company's website are set too low by mistake, this could lead to a flood of online orders. These may have to be accepted at a loss. Poor communication with outsiders could also damage the image of the company.

Finally, if important information is slow to reach its destination, there may be a delay in decision making. This could result in a business missing out on a valuable opportunity or damage relations with an important customer.

4 ▶ Assess the benefits to ChoccoMate of using social media as a means of communication.

An increasing number of businesses are using social media as a means of communication. Many firms use it to help market products, and more recently, to encourage more communication between workers. ChoccoMate could enjoy some specific benefits if it uses social media. It is possible to gather personal data from huge numbers of people. ChoccoMate can find out who they are, what they like and what they think of their products. Customer feedback can be obtained instantly from all over the world and all this is free. Businesses are using social media to connect and engage directly with their customers. For example, 65 per cent of small or local businesses said they used social media to communicate with customers, 50 per cent of Facebook users under the age of 35 responded to recommendations about products online and 51 per cent of Facebook users and 64 per cent of Twitter users are more likely to buy products they see advertised on their social media platforms. Also the graph in Figure 16.5 shows the enormous numbers of people that use the different social media platforms. For example, over 1700 million people used Facebook in 2015. This would give ChoccoMate access to a large proportion of both its current customers and also potential new customers.

ChoccoMate could use social media to run targeted adverts. For example, with a Facebook advert, ChoccoMate can target customers based on location, age, interests, behaviours, and connections. It will also be possible to track and measure the performance of adverts on social media.

ChoccoMate could also provide better customer service. Around 67 per cent of customers use social media to get their customer service. People expect to be able to contact a business 24/7. A study by Aberdeen Group, an IT research company, shows that businesses offering customer service using social media enjoyed bigger annual financial gains (7.5 per cent growth) compared with those without (2.9 per cent).

Finally, ChoccoMate could increase website traffic by directing interested customers from a social platform using a link and also monitor the behaviour of competitors. For example, tools are available that allow a business to 'flag-up' key words used on social media such as 'new chocolate bar'.

However, despite these powerful benefits there are some possible disadvantages of using social media. For example, any negative feedback posted by customers would be there for all to see. So while social media can be an extremely powerful tool for building the reputation of the business, it can also damage the reputation of a business. It also takes time to develop a presence on social media. ChoccoMate would have to decide which employees would be involved in monitoring comments and recording, gathering and presenting the huge amount of data that would be generated. There would also be a need to decide what information and other content should be fed onto the social media stream. Finally, although it is free at the very basic level, costs would be incurred such as the time it takes staff to manage media presence and gather and present data in a meaningful way.

To conclude, Ju Kin Fung would probably argue that the benefits of using social media as a means of communication with customers are far greater than the disadvantages. He might say, for example, that negative feedback can be used in a positive way – by solving problems and making improvements.

CHAPTER 17

CASE STUDY: PARAPOWERCORP

1 ▶ Describe the communication problems ParapowerCorp customers are experiencing.

ParapowerCorp has been criticised in a national newspaper for the poor quality of its customer service. It seems that one of the main problems is its inability to communicate with customers. For example, it could take up to 20 minutes to get a telephone call through to the organisation. This would be very frustrating for callers with urgent problems or queries. Frustration levels would also rise if ParapowerCorp does not answer queries sent in by email; according to the report, emails are sometimes left unanswered. Staff at ParapowerCorp also had poor knowledge of customer details and often blamed computer problems for their lack of information. Finally, it was reported that some staff were rude when talking to customers; staff rudeness is unacceptable and cannot be justified.

2 ▶ Discuss the impact these communication problems might have on ParapowerCorp.

Poor communications between a business and its customers can have adverse consequences. In this case, the report claimed that around 39 per cent of the customers they spoke with when gathering information for the report had now switched suppliers. This loss of custom to rivals is a serious matter for ParapowerCorp. If it were to continue, revenue and profit could both fall.

3 ▶ Suggest how these communication problems might be overcome.

First, the communication problems at ParapowerCorp suggest that the customer services department is under-resourced. If it takes so long to answer the telephone and emails are being left unanswered this suggests that there are not enough employees to deal with the workload. Therefore ParapowerCorp should take on more workers in the department. Second, if staff cannot access customer details effectively this suggests that either records are not up-to-date or staff are not able to access them. Information in the case suggests that computer problems are the cause here. If this is the case, then the IT systems need to be updated or repaired. Finally, there is no excuse for rudeness to customers. Staff guilty of this may be disciplined or retrained. If staff are frustrated because they cannot do their jobs effectively, then they should find other ways of dealing with their frustration.

ACTIVITY 1

CASE STUDY: WORK-RELATED FATALITIES

1 ▶ Work out the percentage of work-related fatalities in agriculture as a proportion of the total in 2015.

The percentage of work-related fatalities as a proportion of the total in 2015 is given by:

$\frac{22}{43} \times 100 =$ **51.2 per cent**

2 ▶ Why is clear communication very important on a farm?

One of the problems that can result from ineffective communication is a rise in work-related accidents. Unfortunately, in agriculture, accidents and fatalities are not uncommon. In 2015, there were 22 fatalities on farms in New Zealand. This was over one-half of the total in all work-related fatalities in the country. If communication about the dangers of working in agriculture could be improved, there might be a fall in accidents and fatalities. It is easy to see why clear communication in agriculture is very important – it could save lives.

3 ▶ Discuss the possible barriers to communication on farms. Include at least two barriers in your analysis.

In New Zealand, a few people each year are killed as a result of a work-related quad bike accident. In addition, around 60 people each year are seriously injured. A spokesman for a Health and Safety Agency said 'The problem is people just don't understand how dangerous these bikes are. The message just hasn't got across. Far too many people ride these bikes without helmets. This is so dangerous. These bikes also have limitations – they can't go everywhere. We need to improve communications here and make sure everyone knows the dangers before they ever take off on one.'

Clearly, there must be some barriers to communication if fatalities are still occurring. One communication barrier might be that messages are unclear. Perhaps the instructions for using quad bikes are not adequately communicated or misunderstood. Another barrier is that instructions may be ignored. People listening to instructions may be poor listeners or uninterested in listening. There may also be a culture of poor communications on farms in New Zealand, however, this is only speculation since there is no information in the case to suggest this. Finally, perhaps the wrong medium is being used to communicate the dangers of quad bikes and other farm dangers. For example, are there clear warning signs on quad bikes that insist riders should wear helmets?

ACTIVITY 2

CASE STUDY: POOR COMMUNICATION

1 ▶ Discuss the appropriateness of the method used by Hutchinson Ports Australia to communicate the information stated in the case.

Most people would agree that the use of a text to inform workers that they are about to lose their jobs is highly inappropriate, due to the restrictions on how much can be written in this type of communication. Redundancy notices are highly sensitive messages and need to be communicated with care, which requires more than the 140-character limit of text messages. An employer might be better advised to use face-to-face communication, where a sensitive attitude can be used when giving the message. Alternatively, a formal written letter might be written to each individual, with plenty of notice before the end of the employment contract.

2 ▶ Describe the possible impact on the business of this method of communication.

The use of texting to sack employees is unprofessional and insensitive. It is likely to have a negative effect on Hutchinson Ports Australia. The sackings were reported in the media so this would have reflected badly on the company in the view of the general public. Such negative publicity could damage the image of the company and result in lost customers. Regular customers might want to distance themselves from a company engaging in such a practice. It is also possible that the motivation of the other workers would be negatively affected. They might fear for their jobs. Finally, in the case it says that industrial action was taken. There were protests and two physical barriers were put up. This would have affected Hutchinson's port operations and possibly caused some expensive disruption.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3D, 4B

CHAPTER REVIEW

CASE STUDY: MENDIS HOLDINGS

1 ▶ Describe what is meant by a barrier to communication.

Communication is only effective if the receiver understands the message sent. Things that get in the way of good communication are called communication barriers.

2 ▶ Suggest two examples of barriers to communication at Mendis Holdings.

A number of communication barriers can be identified in the case of Mendis Holdings, including staff with poor communication skills, a long chain of command, poor office layout (partitions between workers – that is, physical barriers) and possibly a culture of poor communication in the whole organisation.

3 ▶ Discuss how Mendis Holdings might improve the communications skills of its staff.

If it is true, and staff at Mendis Holdings lack communication skills, then it is important to ensure that staff acquire the necessary skills as soon as possible. One way is to train staff in communication. For example, staff can be trained to improve verbal communication skills when dealing with customers on the telephone. This might prevent the apparent anger and rudeness that was detected by at least one client. Staff might be sent on specialised courses to improve their telephone manner.

Some complaints centred on the quality of report writing. Two clients mentioned that some of the reports it was receiving were too long and contained what they considered to be too much jargon. One way of removing the barriers created by poorly written communication is to provide standard company reports, which can be used by all staff. Templates for letters and reports to customers can be stored easily in IT systems. Generally, written communication should be 'short and simple' whenever possible and avoid the use of jargon; staff should be taught this skill. Finally, in the future, Mendis Holdings should also ensure that it recruits staff with good communication skills.

4 ▶ Assess the measures Mendis Holdings might take to improve the communications culture at the business. Make a clear judgement in your evaluation.

In addition to the specific communication problems already mentioned at Mendis Holdings, it is also suggested in the case that the communications culture in the business is poor. A spokesperson for the employees said 'Communications problems here go much deeper than "wordy reports" and "edgy telephone conversations". The communication culture at the business is depressing. There is no formal upward communication channel, the chain of command is too long, the senior management team is secretive and fail to make their goals and plans clear and people are developing a silo mentality. The office layout does not help communication either – everyone works in their own little 'cubby hole.' This view does seem critical, and if true, will have a negative impact on the performance of the business. Consequently, measures need to be taken to improve the communications culture.

One immediate issue is the layout of the office. If people are working in 'cubby holes' the layout needs to be changed. The physical barriers between staff need to be removed so that people can see each other and work in a more open environment. This should help to improve internal communications.

Mendis Holdings might also need to introduce some formal communication systems. This is because there is no formal upward communication channel. It might mean, for example, that more meetings have to be held so that staff can express their views, ideas and concerns to senior managers in an open way. It might also be necessary to end the separation of workers according to job status and perhaps introduce an 'open door' policy where staff are encouraged to communicate with their seniors.

It might also be necessary to make the organisation flatter. It states in the case that the chain of command is too long. Therefore Mendis could remove some of the management levels in the organisation. A shorter chain of command means that information can pass through an organisation more quickly. Flatter organisations also lead to empowerment where employees take more responsibility for their own work. This can help to improve motivation.

Finally, it is clear that workers are worried about the rumours of a merger and the possible loss of jobs. It is very important for the senior managers or the board to clarify the situation. The representative accuses them of being too secretive. A business must avoid withholding important information. Generally, Mendis Holdings will need to create a climate of openness and trust in order to improve the communications culture.

CHAPTER 18

CASE STUDY: ANKARA HAULAGE COMPANY (AHC)

CASE STUDY: KARACHI COATINGS

1 ▶ What is the purpose of the Ankara Haulage Company advert?

The main purpose of the advert shown here is to attract applications from HGV drivers for driving vacancies at Ankara Haulage Company.

2 ▶ What sort of person is the business trying to attract?

Ankara Haulage Company is trying to attract experienced Class 1 HGV drivers. Drivers must be prepared to travel overseas, work weekends (1 in every 3), stay out 3 nights in 5. The company would also prefer drivers who can speak some English and have some forklift truck driving experience.

3 ▶ How much pay is the company offering successful applicants?

The Ankara Haulage Company is paying TRY 500 per week with an extra TRY 30 a night for staying out overnight.

4 ▶ How does Karachi Coatings recruit many of its managers?

Karachi Coatings recruits a lot of its managers internally. This means they try to promote people who already work at the company.

5 ▶ Suggest two advantages of recruiting managers in this way.

There are some advantages of recruiting people from within the business. For example, promoting from within is safer. The people who are appointed are known to the business. As Umar Iqbal, the human resources manager at Karachi Coatings, says 'We know what these people are like and what their potential is. They are proven workers. It is also cheaper and quicker to recruit in this way.'

ACTIVITY 1

CASE STUDY: NUJUMBA CEMENT

1 ▶ Draw up a job description for the production worker jobs at Nujumba Cement.

Job Title: Production Worker

General role: Work as a member of the production team.

Responsibilities and duties:

– Heavy manual work

– Handling heavy machinery

– Driving a fork lift truck

– Cleaning machinery and equipment

– Heavy lifting in a harsh working environment

Pay: Rs400 per hour

Hours and conditions of work:

– 40 hours per week

– 4 weeks holiday

– Free protective clothing

– Free lunches

2 ▶ Discuss two reasons why a business draws up a job description.

The main purpose of a job description is to show clearly what is expected of an employee. Extracts from it are likely to be used in a job advert. It might also be used during appraisal to see how well an employee has performed in relation to what was expected of them.

ACTIVITY 2

CASE STUDY: PALLABI GARMENTS LTD

1 ▶ What are the advantages to the business of recruiting internally for the job of purchasing manager?

In this case, the job of purchasing manager is being filled internally. The new purchasing manager will be recruited from the existing purchasing team. It is expected that three suitable people from the department will apply. The advantages of internal recruitment are that it is cheaper because it saves on advertising. Internal recruits are also familiar with company policy and working practices. In addition, staff may be more motivated if they know there is a chance of promotion. Finally, the ability, personality, attitude and potential of the person appointed will be more predictable. This reduces the risk of recruitment.

During interviews at Pallabi Garments Ltd, open questions are used.

2 ▶ What is meant by an open question?

An open question is one that requires an answer of more than just one word, such as yes or no. An example, might be 'Why have you applied for this particular job?'

3 ▶ What is the main advantage of using open questions in interviews?

Open questions encourage interviewees to talk more. This helps the interviewers to gather more information about the applicant. When an applicant opens up and talks in more detail, it is easier to assess their personality. It may also be possible to judge their attitudes, opinions and commitment.

4 ▶ Discuss how the vacancies for the machinists might be advertised.

The jobs for machinists could be advertised in a number of ways. They might be advertised by word-of-mouth. Current employees may tell their friends and relatives about the jobs. The jobs may also be advertised in a local newspaper or on the company website. Finally, Pallabi Garments Ltd may use an employment agency or rely on a list of past applications, which have been stored by the business. All of these methods are suitable for jobs like machinists.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3B, 4B

CHAPTER REVIEW

CASE STUDY: ONLINE JOB ADVERTISEMENT

1 ▶ What type of employment will be used to fill the vacancy advertised?

The advert states that the job is full time. Therefore a full-time employee is sought.

2 ▶ Draw up a simple person specification for the job of sales and marketing director. (You do not need to show whether details are essential or desirable).

Qualifications and Education	Degree in appropriate field
Experience	Minimum five years experience in similar role
	Has carried out competitor analysis
	Experienced in new business development
	Knows how to develop marketing plans
Communication skills	Strong presentation skills
	Monthly report writing skills
	Leadership skills
Other skills	Strong analytical skills
	Motivational skills
	Ability to chair meetings
Personal attributes	Ability to travel regularly and work in the UK
	Ability to develop a team

3 ▶ How might a business use a person specification?

The main purpose of the person specification is to help with the shortlisting process. Applications that do not match the person specification can be left out of consideration. This might save a lot of time in the shortlisting process.

4 ▶ Suggest two important details that should be included in any job advertisement.

Some of the important details likely to be included in a job advert are:

job title

name and address of employer

brief details of the job description

skills, qualifications and work experience required for the job

Applicants for the job shown have to apply with a CV.

5 ▶ What is meant by a CV?

CV stands for curriculum vitae. It is used by jobseekers to apply for jobs when an application form is not provided. It contains personal details, qualifications, experience, names of referees, hobbies and reasons why they are suitable for the job.

6 ▶ Assess whether the business was right to recruit externally for this post.

External recruitment is when a business recruits new employees from outside the business. There are some advantages of external recruitment. For example, a business will have a much larger pool of potential employees to choose from when attracting a new employee from outside the business. In this case, the job has been advertised on the Internet. People all over the country, or even overseas, may apply for the job. A new person may be very talented and have some fresh ideas that could help the business become more competitive. However, external recruitment is more expensive than internal recruitment and there is an element of risk because the new employee is unknown to the business. In this case, the job is quite a senior position. It is probably wise to recruit externally to get the best possible person for the job.

CHAPTER 19

CASE STUDY: AGE DISCRIMINATION IN A RESTAURANT

1 ▶ How does this case illustrate the need for protection at work?

In this case an employer has mistreated an employee. Without legal protection, a larger number of employees might be subject to exploitation, abuse, discrimination or ill treatment.

2 ▶ What do you think is meant by age discrimination?

Age discrimination occurs when a business makes a specific decision on grounds of age. In this case, an employee, despite having a perfectly good employment record, was told on his 65th birthday that he would no longer be allowed to work full time. He was also told, after returning from long-term leave in 2011, that the company did not employ people over the age of 65. However, he was offered a part-time post. This is an example of age discrimination.

3 ▶ How might laws aimed at preventing age discrimination affect a business?

To start with, if a business does not follow legislation they can be fined. It will cost them money. In this case, two Thai restaurants near Brisbane, Australia, were fined around AS$30 000 for their treatment of an employee. Laws preventing age discrimination will also mean that businesses must take measures to ensure that they do not break the law. For example, they would have to take care with job adverts to ensure that they do not exclude applicants on grounds of age.

ACTIVITY 1

CASE STUDY: WORKPLACE DISCRIMINATION

1 ▶ What is meant by racial discrimination?

Racial discrimination occurs when a business makes a decision on the grounds of a person's colour, race, ethnic origin, religion or nationality. Such discrimination is illegal in most countries around the world. Businesses should not show preference to any particular race, colour, nationality, ethnic origin or religion when offering a promotion, for example.

2 ▶ Describe the possible evidence that suggests racial discrimination has taken place in this case.

In this case, co-owners of Khaira Enterprises Ltd, illegally discriminated against 55 African tree planters at a work camp in Golden, Canada. The 55 workers, who originated from Democratic Republic of Congo, Burundi, Guinea and Rwanda, were treated extremely poorly compared to

their non-African colleagues. For example, the bathroom facilities at the campsite were terrible. One worker as similar to those on ships transporting slaves described the conditions. Toilet paper was not provided and most of the 55 workers were subjected to racial insults There was also evidence that wages were not given to the African workers while South Asian and Caucasian white workers were paid in full. There is clear evidence of racial discrimination here, as the court found.

3 ▶ How does this case illustrate the protection given by the law against discrimination?

Without legal protection, the 55 African workers in this case may not have received any payment. The BC Human Rights Tribunal in Canada found that the co-owners of Khaira Enterprises Ltd illegally discriminated against a group of workers on the grounds of race or colour. As a result, the owners were ordered to pay each of the employees US$10 000 plus US$1000 for every month that they had worked at Khaira. The total payment came to around US$600 000. Therefore as a result of the law the African workers eventually received some money. The ruling and fine might also serve as a warning to any other businesses in Canada that they will be punished if found to be discriminating on the grounds of race, religion, colour, nationality or ethnic origin.

4 ▶ Design a poster that could be used in the workplace to warn employees that racial discrimination is forbidden.

ACTIVITY 2

CASE STUDY: DISABILITY DISCRIMINATION

1 ▶ How was the employee in this case a victim of disability discrimination?

In this case, Starbucks was found guilty of disability discrimination. Starbucks accused one of their employees, Meseret Kumulchew, of falsifying documents. One of Meseret's duties during her shift was to record the temperature of fridges and water at specific times. However, she was accused of falsifying the documents after mistakenly entering wrong information. Meseret, who has dyslexia, said that she had always made it known to her employer that she had difficulties reading, writing and telling the time and had to be shown how to do tasks. Following the accusation made by Starbucks, Meseret was given a less important job at her branch and told to retrain. This was discriminatory action and left the employee feeling that she may kill herself.

2 ▶ Describe the possible measures businesses like Starbucks might have to take to help avoid disability discrimination.

Generally, employers are now obliged to make reasonable adjustments to the workplace to help accommodate disabled employees. For example, they may need to improve access to the workplace by widening doors and providing ramps for wheelchairs. They may need to permit disabled workers time to attend medical appointments such as physiotherapy sessions. They may also need to alter equipment such as telephones and computers (software and hardware) to accommodate those with sight or hearing difficulties and allow more time for training.

In this case, Starbucks had not made reasonable adjustments for Meseret's disability, and had discriminated against her because of the effects of her dyslexia, according to the tribunal. However, after the incident Starbucks said they were having discussions with Meseret about making adjustments to help her cope. Starbucks also made a statement which said the company was committed to having a 'diverse and inclusive workforce' that make people 'feel welcome and comfortable in our stores'.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4B

CHAPTER REVIEW

CASE STUDY: GENDER DISCRIMINATION AND THE MINIMUM WAGE

1 ▶ What is meant by the term equal opportunities?

Equal opportunities are where everyone has the same chance. In business, it may mean, for example, that everyone has the same chance of selection or promotion. People should also get the same pay rates whether they are male or female providing they are doing the same job.

2 ▶ Discuss two measures a business might have to take to ensure that gender discrimination is avoided in the workplace.

Legislation designed to prevent gender discrimination is likely to have an impact on businesses. For example, advertisements for jobs must not specify a particular gender. A business is not allowed to target job adverts at either a man or a woman. Both genders must have an equal opportunity in appointments. Secondly, references to work titles in job adverts must be genderless. For example, a business could not advertise for a 'policeman' or a 'salesman' – the job titles must be 'police officer' or 'salesperson'. Businesses should also avoid promoting people in the workplace on grounds of gender.

3 ▶ Assess whether discrimination is the reason for so few women sitting on the board of directors at top companies.

Some statistics relating to women at work suggest some serious imbalances. For example, in the UK, despite the Equal Pay Act 1970, there is an 18 per cent pay difference between men and women. Women are also more likely to be employed in low paid jobs and less than 10 per cent of executive directors at the top FTSE 100 companies are female.

The cause of these gender imbalances may be partly or entirely due to discrimination. However, other reasons may also explain the gender 'gaps'. For example, one of the reasons why there are so few women on the board of directors is because the number of women available to take up such posts is very small. Another reason is that women at the level below the board may not be as well-connected as men at this level, possibly because talented females tend to stay with the same employer for longer. Consequently, they do not get the chance to meet as many different business professionals. Also, once women leave

corporate life to have children, they are sometimes not readily welcomed back. Plus, many of the very talented women become disappointed with companies and prefer to start their own businesses. Finally, it may be that male dominated boards prefer to recruit men like themselves for image reasons.

Unfortunately it may be that gender discrimination is difficult to prove, or perhaps much discrimination goes unreported. The extent of the gender imbalances in many countries does suggest that governments should be concerned.

A business pays 1340 of its employees US$9 per hour. Each of these employees works 40 hours per week and is paid for 52 weeks of the year.

4 ▶ Work out the financial impact on the business if the government introduces a minimum wage of US$14 per hour.

Before the minimum wage the annual wage bill would have been:

US$9 × 1340 × 40 × 52 = US$25 084 800

After the introduction of the minimum wage the annual wage bill would be:

US$14 × 1340 × 40 × 52 = US$39 020 800

This represents an increase of **US$13 936 000**

5 ▶ Assess the likely impact on businesses, such as the case in 4, of the introduction of a minimum wage.

One reason why governments introduce minimum wage laws is to help low paid and disadvantaged workers. It is argued that people such as women, ethnic minorities and low-income families benefit from minimum wages. For example, it is estimated that if the UK introduces a mandatory living wage (very similar to a minimum wage) female workers will benefit more. This is shown in Figure 19.2 where the impact of new minimum wage (the living wage) is expected to benefit both full-time and part-time female employees more than men.

In many countries, minimum wages are often part of a broad strategy to end poverty. In the USA, increasing numbers of poor families have to rely on their earnings from low-paying jobs. Therefore, a minimum wage increase will help reduce poverty. The minimum wage raises the wages of low-income workers in general, not just those below the official poverty line. Many families move in and out of poverty, and therefore near-poor families will also benefit.

An increase in the minimum wage, or the introduction of a new minimum wage, is likely to raise the annual wage bill for a business. In this case, the business is paying its workers US$9 per hour before the introduction of the minimum wage. The wage rate rises to US$14 per hour when the minimum wage law is introduced. As a result the annual wage bill rises from US$25 084 800 to US$39 020 800 – this represents an increase of US$13 936 000. This is a significant increase – more than 50 per cent. This could have very negative effects on the finances of the business. The business may have to lay off workers if it cannot afford to pay the higher hourly rate. Alternatively, the business may have to take a cut in profit.

However, there may be some benefits to businesses of a minimum wage. People on low pay may be better motivated and more productive when they receive a pay rise resulting from the introduction of a minimum wage. Low wage earners across the nation will have more disposable income so demand for many goods and services will rise. This will help drive up sales and profits for some businesses. Finally, businesses may experience lower levels of staff absence and better reliability. This might be because low paid workers, who often have to have more than one job to survive, will be more committed to a single employer.

To conclude, in this case the new minimum wage is considerably higher than the current wage being paid. As a result the business might be negatively affected – it will depend on the profitability of the business.

CHAPTER 20

CASE STUDY: ALBERTA FARMING CORPORATION (AFC)

1 ▶ Work out the average annual fatality rate in agriculture in Canada between 2005 and 2014.

Average = total fatalities ÷ number of years = 177 ÷ 10 = **17.7 fatalities per year**

2 ▶ Why is training in health and safety is so important to AFC?

Training in health and safety is important in most occupations. However, in agriculture it is very important. This is because farms are dangerous environments for workers. The graph in Figure 20.1 shows that an average of 17.7 workers are killed on farms every year. Of these 70.9 per cent of these fatalities result from the use of farm machinery. If the lives of workers are at risk, then training in health and safety must be very important.

3 ▶ Suggest three other reasons for training at AFC.

Other reasons for training at AFC include:

- learning how to operate the different machines on the farm so that workers can operate them effectively and avoid causing damage to machines
- improving employee flexibility by training workers in a wide range of different jobs
- training people how to do their jobs properly so that workers are confident in themselves – this will improve motivation and productivity
- keeping workers up to date with new developments and new machinery.

4 ▶ Carry out some research (online if possible) to see what training is offered by some large businesses in your area. Try to decide which business offers the best 'training package'.

ACTIVITY 1

CASE STUDY: GOOGLE

1 ▶ What is the purpose of induction training?

The main purpose of induction training is to help new recruits become more comfortable and familiar with their new surroundings.

2 ▶ Describe what new recruits might learn during the induction programme at Google.

During an induction programme, new recruits are likely to get a tour of the whole workplace, an introduction to senior staff, some health and safety training and learn about the company's history, aims and objectives. Recruits are also likely to learn about company policies such as dress code, disciplinary procedures and holidays. They will also get an introduction to the new job and meet their work colleagues. New software engineers at Google are called Nooglers. They attend an induction programme designed to introduce new recruits to the 'Google Way'. The programme starts with a series of lectures and presentations about things like Google's culture, mission and products.

On the second day, Nooglers get involved in technical exercises designed to teach recruits about developing at Google. Google uses training tutorials called Codelabs. These teach recruits about internal technologies that help employees do their jobs. Examples include Bigtable, Megastore, Protocol Buffers and Unit Testing. These tutorials last for about a week and this is how recruits start to learn about their new job.

3 ▶ Discuss why induction training is so important to businesses like Google.

If businesses fail to provide adequate induction training, staff may feel anxious. This might lead to poor productivity, and at worst, staff may leave because they have not settled. At Google, induction is important because recruits have to understand the 'Google way'. Most of the information given out is highly confidential and the importance of secrecy and sensitive treatment of information is emphasised. The importance of change is also a priority at Google. All employees are expected to be excited by change since much of their work is involved in future technology and new products. Most of the lectures and presentations for Nooglers are given by senior staff at Google. This suggests that Google attaches a great deal of importance to induction.

ACTIVITY 2

CASE STUDY: EMIRATES

1 ▶ What is meant by the term off-the-job training?

Off-the-job training is training that takes place away from the work area. In the case of Emirates, all new cabin crew recruits get off-the-training in a special cabin crew training centre.

2 ▶ Describe the method of training used at Emirates.

New recruits at Emirates attend a seven-week initial training course. The training is given off-the-job in a specialised training centre. The course provides a mixture of both theoretical and practical elements. To make the practical training realistic, it takes place in machines that simulate the movement of all aircraft types. This helps to give new recruits a taste of the experience required to deliver the best possible customer service to passengers. The training course addresses a range of work related issues such as safety and emergency procedures, first aid, service, uniform, fitness and nutrition and security procedures.

3 ▶ Discuss two benefits to Emirates of using off-the-job training.

One of the main advantages of off-the-job training is that mistakes made by new and inexperienced recruits do not have any impact on the quality of the product. In this case, if one of the cabin crew trainees drops a service tray into a passenger's lap, there will be no impact on the airline. This is because there will be no 'real' passengers since the training takes place in simulators. This can help Emirates to maintain a high quality service.

Another benefit is that trainees can learn good practice and not be distracted from their training by the work itself. New recruits can focus on learning and not worry about whether their training work will impact on the airline. Trainees may be more relaxed and learn more quickly.

MULTIPLE-CHOICE QUESTIONS

1C, 2A, 3C, 4D

CHAPTER REVIEW

CASE STUDY: PESHAWAR PRINTWORKS

1 ▶ Why is training needed at Peshawar Printworks?

Training is needed at Peshawar Printworks because some new technology has been introduced. There have been some problems and the production manager thinks they can be overcome with proper training. Without training, the new system will take up to six more months before it is up and running.

2 ▶ Discuss two reasons why businesses like Peshawar Printworks may be reluctant to spend on training.

Training is often very expensive. As a result, some businesses are unwilling to invest in training. In this case, the CEO of Peshawar Printworks seems unwilling to invest in training – one of the main reasons is the cost. The CEO complains that the amount needed by the production manager, US$120 000, is double the annual training budget for the entire company. Another reason that explains the unwillingness is that when workers leave, the training has been wasted. The CEO says 'I know that training is necessary but it's so expensive. Plus, what happens when the trained workers leave and go and work for someone else?' However, the production manager points out that Peshawar Printworks often employ workers that have been trained elsewhere. Finally, it appears from what the CEO says that he does not value all types of training. For example, he refers to off-the-job training as 'training holidays'. This may be another reason for not wanting to meet the high cost of training.

3 ▶ What are the advantages of on-the-job training to Peshawar Printworks? Discuss two advantages in your analysis.

On-the-job training means that workers are trained in the workplace while the job is being done. One of the main advantages of this is that output is being produced. Although the productivity of a worker may be low while being trained, at least it is positive and the trainee is making a contribution to output. In this case, if training is given on-the-job at least some printed materials will be produced that can be sold to help generate revenue.

The training received on-the-job is also relevant. This is because it is directly connected to the job. There is no simulation. In this case, workers will be trained on the new digital technology that is actually installed at the print works. On-the-job training is also generally cheaper and easier to organise than off-the-job training.

4 ▶ Assess the benefits of training to Peshawar Printworks.

Training has a number of important benefits to businesses like Peshawar Printworks. The main reason for training is to provide workers with the skills and knowledge needed to do their jobs effectively. As a result, their motivation and productivity should increase. However, there are some other specific benefits. Workers will need training if there are changes that might affect their jobs. In this case, some new digital technology has been introduced and employees need more training so that they can operate the new technology. Training might also make a business more flexible. In this case, Kamran informs the CEO that if all 30 staff are trained the workforce is more flexible and the company will not have to spend on training again for quite a while. Peshawar might also benefit from investment in training if workers feel more secure and can to do their job effectively. Not being able to do a job properly will be a source of frustration and dissatisfaction for workers. It is also argued that training can be used to motivate staff. Finally, training is usually needed when workers are promoted. At each stage of the promotion process, staff will need to learn new skills and methods; this allows them to handle the different duties and new responsibilities.

However, training does have some limitations. For example, training can be very expensive. Businesses will have to pay training providers if they use external training. Even internal training can be expensive if specialist training staff and equipment is needed. In this case, the CEO is worried about the cost. Some businesses might argue that training is limited because workers do not really start learning how to do the job until they actually arrive at their workstations. In some jobs, the actual work environment, with all its stresses and distractions, cannot be easily simulated. Also, if workers are involved in off-the-job training they will not be producing anything. This will result in lower output levels. The CEO in this case is against off-the-job training, which he regards as a 'training holiday'. Finally, businesses are likely to get very frustrated if employees leave and join a rival company after they have invested in training them. The CEO makes this point but Kamran says '… we often get workers that have been trained elsewhere'.

To conclude, training is felt necessary at Peshawar Printworks because the CEO has offered US$60 000 to cover the cost of extra training. Clearly, the CEO believes that the benefits of training are greater than the costs and limitations.

CHAPTER 21

CASE STUDY: ANJU SHARMA AND JAYA DHAR

1 ▶ Suggest two possible reasons why Jaya is poorly motivated.

Jaya may be poorly motivated for a number of reasons.

- She may find the work boring, unfulfilling or insufficiently challenging.
- She never really wanted to work in banking – she wanted to go to medical school.
- She is being paid less than one of her close colleagues.
- She may be less driven than other people.

(NB. Other answers may be appropriate.)

2 ▶ Why is motivation important to businesses?

If workers are motivated, they likely to be more productive, they will be committed and work harder. For example, Anju is well motivated. She is always on time, reliable, enjoys solving problems and often gives up her own time to help new recruits. Businesses will benefit from having a well-motivated workforce. It will be easier to attract and retain staff and profits should be higher.

3 ▶ In pairs, discuss whether you are a well-motivated individual. Provide a list of evidence to support your view.

ACTIVITY 1

CASE STUDY: ANDRIS ZJUZINS

1 ▶ What is meant by a well-motivated employee?

Motivation is the desire to achieve a goal. If employees are well motivated, they will be driven and have the desire to reach aims that have been set by employers. They will be productive and committed to the business.

2 ▶ What evidence in Figure 21.1 suggests that workers were poorly motivated?

The information in the bar charts shows that worker motivation at Andris Zjuzins was falling between 2010 and 2015. For example, staff turnover rose from 28 per cent to 33 per cent and the rate of staff absence rose from 6.7 per cent to 7.4 per cent. At the same time productivity at the business fell from 1230 to 1200 units per worker. In 2014 and 2015, after the factory had been re-equipped, worker motivation seemed to improve. For example, labour productivity rose to 1530 units per worker.

3 ▶ Describe the possible effect on the working environment if workers are not motivated.

If workers are poorly motivated the working environment and atmosphere is likely to be unpleasant. Workers are less likely to be cheerful, polite, supportive and positive. This can be quite important because many workers have to deal with customers. A business may lose customers if the attitudes of poorly motivated workers create a negative impression. In this case, it has been difficult for Andris Zjuzins to attract and retain staff. This may be because the working environment is being negatively affected by low morale and poor motivation.

ACTIVITY 2

CASE STUDY: INCHCAPE

1 ▶ What is meant by hygiene factors in Herzberg's two-factor theory?

Frederick Herzberg said that certain factors could leave workers dissatisfied. He called these hygiene factors and explained that if things like pay, working conditions and job security were insufficient then employees would be dissatisfied which would lead to poor motivation.

2 ▶ Describe some examples of Herzberg's hygiene factors offered by Inchcape.

Inchcape appears to provide its employees with a wide range of benefits. Some examples include holiday benefits (where staff get more holidays the longer they work at the company) and a save as you earn scheme (where staff can buy discounted company shares). Other benefits include a customer introduction award, an advantage scheme and childcare vouchers. These are all examples of hygiene factors. According to Herzberg, these alone will not serve to motivate staff.

3 ▶ Assess whether Inchcape manages to meet the social needs of staff, as described by Maslow.

Maslow pointed out that people are social animals and need affection, trust, acceptance and to be cared for. They also want to belong to a recognised group. Employers can help to meet these needs by providing opportunities for staff to communicate with colleagues and work in teams. Businesses could also provide staff with social facilities such as a staff canteen.

In this case Inchcape's employees get involved in charity events where groups can interact socially.

For example, one employee, Rachael Mullard, said 'The charity work is lovely. Last year we did the Three Peaks Challenge. It's a change and nice to know you are doing something good. We were in a minibus for three days with the general manager, bundled up, freezing cold, aching and stinking, but we felt the love.'

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4D

CHAPTER REVIEW

CASE STUDY: CHESS

1 ▶ Why do people need to work?

People go to work because it provides the means to satisfy many human needs. For example, the main reason why people go to work is to earn money to pay for food, drink, clothes and shelter. However, work can meet other needs because employers provide opportunities for workers to meet new people, develop skills and reach their full potential. Without work most people would feel aimless, bored, dissatisfied, unfulfilled and lonely.

2 ▶ Discuss two reasons why staff motivation is important to businesses such as Chess.

If a business has a well-motivated workforce, it will perform better. People will be happier in the workplace, the working environment will be more agreeable and labour productivity will be higher. Attracting staff will be easier if workers are better motivated. If a business can recruit highly capable and reliable workers, it might gain a competitive edge on its rivals. If employees are motivated, the working environment and atmosphere is likely to be pleasant. Workers are more likely to be cheerful, polite, supportive and positive. This is important when interviewees are being shown around the work environment. Good candidates will be more likely to accept the job if they are impressed with what they see and feel about the workplace. A business might also develop a good reputation for employing a happy and well-motivated workforce. Chess has done this by winning an award for the Best Employer in Cheshire. This will encourage people to apply for jobs in the first place. It might also attract good employees from rivals.

Well-motivated employees will work harder. They are likely to take more pride in their work, complete tasks quickly and feel that their jobs are important. As a result, they will produce higher levels of output. Businesses also need workers to cooperate. For example, Chess organises employees into teams. Therefore, if workers do not cooperate with each other, teamwork will be disrupted. At worse, conflict might result if a team member is uncooperative. However, well-motivated employees are likely to be cooperative, so a good team spirit is likely to develop which will help to raise productivity. Certainly this is the case at Chess.

3 ▶ Suggest two examples of Herzberg's motivational factors as used at Chess.

Recognition is one motivational factor evident at Chess. Staff have a 'gimme 5 praise page' on a website which enables them to award each other virtual thanks. Employees are also encouraged to vote for each other to win employee of the month.

Personal development is another motivational factor. Chess invests in training for staff. For example, it launched a customer service academy for new recruits. It also delivered customer passion training that teaches Chess teams how to deal with different customer personality types.

4 ▶ Assess whether Chess satisfies any of the employees' needs outlined by Maslow's hierarchy. Make a clear judgement in your evaluation.

Maslow identified a hierarchy of needs. At the bottom are the physiological needs – these are basic human needs such as food, water and shelter. Businesses can satisfy these needs by providing workers with adequate pay. In this case, it can be assumed that Chess pays their workforce adequately. For example, only 12 per cent of workers left the company last year. This is a very low staff turnover rate.

The second level of needs identified by Maslow was safety and security – this means that people need protection from any form of danger and physical and psychological threats. Businesses can satisfy these needs by providing a safe working environment. In this case, Chess provides a very pleasant working environment. For example, it is well designed with plenty of space, light, plants and fish tanks.

The third level of needs in Maslow's hierarchy is social needs – this means that people are social animals and need love, affection, trust and acceptance. They also want to belong to a recognised group. Chess makes extensive use of teamwork. For example, it delivered customer passion training that teaches Chess teams how to deal with different customer personality types. Teamwork is important at Chess and in a staff survey 92 per cent of employees said that teammates were helpful. Also, Chess encourages its staff to interact socially. For example, the company's summer conference closed with a sociable evening out and last September Chess included employees' families and friends in festivals with a barbecue, bouncy castle and football-focused entertainment.

The next level of needs is esteem needs. This means that people need to be recognised and respected and their achievements praised. They also want self-respect and self-esteem. At Chess, staff have a 'gimme 5 praise page' on a website that enables them to award each other virtual thanks. Employees are also encouraged to vote for each other to win employee of the month. David Pollock also mentioned recognition in his statement at the awards night. He said 'It is with great pride that Chess has been named as Employer of the Year, we continually strive to create a happy working environment where everyone can progress their career, develop knowledge and skill, gain reward and recognition and maximise their potential.'

Finally, at the top of Maslow's hierarchy is self-actualisation – this means that people need to reach their full potential and feel some fulfilment in what they do. At Chess, there is evidence that suggests that workers feel some fulfilment. Employees attend monthly 'ideas lunches' where employees meet, chat, bond and eat together. They are encouraged to be creative and come up with ideas.

Generally, information in the case suggests that Chess makes every effort to meet the needs of employees. Evidence of this commitment is the awards won for Best Employer.

CHAPTER 22

CASE STUDY: GVS LIFE ASSURANCE

CASE STUDY: THE HERNING CARE HOME

1 ▶ Work out how much Nasir would earn if he sold 11 insurance policies during a month.

Nasir would earn US$2600 (that is, 11 × US$200 + US$400).

2 ▶ Suggest one advantage and one disadvantage of the payment system used by GVS Life Assurance.

Staff at GVS Life Assurance are likely to sell more policies with this system. This is because there is a significant financial incentive to sell. They get US$200 for every policy sold. This should mean that sales of policies will be high and the company only incurs labour costs if a sale is made (apart from the low basic salary of US$400). However, some staff are not happy with the system. They lack the charm and selling skills possessed by Nasir and are often under a great deal of stress trying to earn a living. This might result in a high labour turnover for the company. This means GVS might have to spend a lot of time and money recruiting new staff.

3 ▶ Describe the method used to motivate Johanna at the Herning Care Home.

The Herning Care Home is trying to make Johanna's job more interesting to improve her motivation. Johanna was bored and unfulfilled in her managerial post and was thinking about leaving. However, her employers decided to make her job more interesting and challenging. She was asked to organise monthly meetings with other care home managers in the group and report back to the senior management team. She was also asked to design a formal induction programme for new recruits and represent the group at international care conferences. This is an example of job enrichment.

4 ▶ Describe one possible disadvantage of this method.

One problem with this method of motivation is that Johanna might not have the skills to carry out the extra tasks and responsibilities. As a result, she might get frustrated which could have a negative impact on her performance. Another problem is that after she becomes familiar with these extra duties she may get bored again and want to leave.

5 ▶ In pairs, decide what would motivate you to work harder at school. Draw up a list of these things in order of priority.

ACTIVITY 1

CASE STUDY: TOP RANK SERVICE CENTRE

One of the mechanics worked 50 hours during a busy week in September.

1 ▶ Work out the gross pay earned by this mechanic.

Gross pay = US$20 × 35 + US$30 × 15 = US$700 + US$450 = **US$1150**

2 ▶ What is meant by the term salary?

Some employees are paid a salary, which is expressed in annual terms and paid monthly. Salaries are usually paid to *non-manual* workers. Salaried workers are not always paid overtime. In this case, the manager of the Top Rank Service centre is paid an annual salary of US$62 000.

3 ▶ Describe one possible reason why the Top Rank Service Centre chooses not to use piece rates as a method of remuneration.

Some workers are paid according to how much they produce. This system is called piece rate. This system helps to motivate workers and businesses are likely to 'get more' out of their employees. However, one problem with piece rates is that they are not suitable if work cannot be measured. In this case, it may be difficult to measure the work done in standard units. This is because many of the tasks completed by mechanics may be different. For example, one mechanic may spend time carrying out a routine service while another might be fitting a new engine. These tasks are different and cannot be easily compared or measured. Therefore piece rates would probably not work in this business.

ACTIVITY 2

CASE STUDY: TATA STEEL

1 ▶ What is meant by the term job rotation?

Job rotation involves training employees in a range of different tasks and then switching them from one task to another over a period of time – perhaps a day or a week.

2 ▶ Discuss one possible advantage of job rotation to a Tata Steel and b its employees.

Tata Steel will benefit from job rotation because workers will be better motivated. They are less likely to get bored and therefore they will be more productive. This will help produce more output leading to more revenue and higher profit.

Employees will also benefit from job rotation. They will learn a much wider range of skills, for example. This might make them more fulfilled and perhaps help them develop a desirable career path.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4C

CHAPTER REVIEW

CASE STUDY: SANTIAGO DISEÑO

1 ▶ What is meant by the term bonus?

Bonuses are paid in addition to the basic wage or salary. They are usually paid if targets are met. In this case, staff at Santiago Diseño received a bonus if they met a design brief within an agreed time limit.

2 ▶ How might bonus payments benefit Santiago Diseño?

Bonus payments are only given out if targets are met. In this case, employees in a team were only paid a bonus if they managed to complete a design brief in an agreed amount of time. This means that bonus payments are linked to employee performance. If teams take too long to meet a design brief then they lose out on the bonus and the business does not incur any extra cost. Consequently, bonus payments at Santiago Diseño motivate employees to work quickly.

3 ▶ Describe how giving workers more autonomy might motivate workers at Santiago Diseño.

Workers with autonomy are set a goal or task by management and then left to decide for themselves the best way to achieve the goal. This gives workers control and suggests that they can be trusted. In this case, workers were split into teams and each team was given a design brief to complete. Teams were responsible for carrying out their work in any way they chose. Their only aim was to meet the design briefs they were given. Each team was free to order resources, choose their own methods of work and communicate with clients directly. Autonomy can give employees more self-confidence and is a way of recognising their achievements. This should help to motivate workers.

4 ▶ Discuss two benefits to Santiago Diseño of giving staff fringe benefits.

Some employees receive fringe benefits in addition to their normal pay. They are often described as the 'perks' of the job. Examples of fringe benefits used by Santiago Diseño include an attractive company pension scheme, a free canteen, a free bicycle to encourage employees to cycle to work and subsidised childcare. There are some good reasons for rewarding workers with fringe benefits. One benefit is that it may be cheaper to give employees US$2000 of fringe benefits than US$2000 in cash. Employees may also pay less tax if they take fringe benefits instead of cash. Another benefit is that productivity may improve because there is less staff absence. Many benefits provide protection and security for workers and their families. This might help to improve worker satisfaction, such as free private health insurance. Workers may be healthier due to private healthcare and using the company gym or sports facilities. Finally, some benefits help to attract and retain better-qualified employees for a business. This was the aim of Santiago Diseño.

5 ▶ Assess whether the use of non-financial methods of motivation such as autonomy were effective at Santiago Diseño. Make a clear judgement in your evaluation.

It was recommended to Santiago Diseño by a consultant that they use non-financial rewards to help motivate their staff. Businesses use non-financial rewards for a number of reasons. Some people are not motivated by money; some workers attach more importance to non-financial rewards and an increasing number of people work in teams where individual financial rewards are less appropriate. In this case, Santiago Diseño divided their designers into teams and gave each team complete autonomy.

Each team was responsible for carrying out their work in any way they chose. Their only aim was to meet the design briefs they were given. Teams were free to order resources, choose their individual approaches to providing design solutions and communicate with clients directly. After this reorganisation, and giving teams autonomy, the financial performance of the business improved significantly. Profits rose from US$11.4 million to US$23.1 million between 2012 and 2015. This suggests that giving staff autonomy had a huge impact on motivation.

However, it is also important to take into account the impact that fringe benefits had on performance when they were introduced. Since both changes took place at the same time, it is difficult to tell which had the biggest impact. However, one thing is certain, together they worked well to improve motivation if profitability is a guide to motivation levels.

CHAPTER 23

CASE STUDY: THE ZETA HOTEL

1 ▶ Who is in control of the Zeta Hotel?

Anil Karmi is responsible for running the hotel. He is in control and accountable to an area manager.

2 ▶ Describe briefly how the Zeta Hotel is organised.

Staff at the Zeta Hotel are divided into five different departments. These are front of house, reservations and marketing, housekeeping, the kitchen and the restaurant. Each department has a leader who is accountable to Anil Karmi, the general manager.

3 ▶ What is Kajal's role in the organisation?

Kajal Verma is head of the reservations and marketing department. He must ensure that all rooms in the hotel are sold out each night at the best possible price. He is responsible for nine other people employed in the department which maintains the hotel's website and promotes the hotel.

4 ▶ To whom is a Basanta b Pradeep accountable?

a Basanta is accountable to Aarif Vesawkar, the executive chef.

b Pradeep is accountable to Anil Karmi, the general manager.

ACTIVITY 1

CASE STUDY: YU XIAOTING MOTORS

1 ▶ Name two examples of operatives at Yu Xiaoting Motors.

According to the organisation chart, the machinists and technicians are examples of operatives at Yu Xiaoting Motors.

2 ▶ What is meant by the terms a formal organisation b hierarchy?

a When businesses grow, tasks such as planning, decision making, coordination and communication are easier if people are organised into a structure made up of several different departments. This internal structure is known as the formal organisation of a business. It can be represented by an organisation chart. In this case, an organisation chart is shown for the production department at Yu Xiaoting Motors. It shows how staff in the department are formally organised. For example, it shows that the 40 machinists on Line A are accountable to the four supervisors on that line.

b Many organisational structures are hierarchical. This means that there are different layers of responsibility in an organisation. The lowest is usually at the bottom and the highest at the top. For example, in Yu Xiaoting Motors, the chairperson, who has the most responsibility, is at the top of the hierarchy. Those at the bottom include machinists, packers and cleaners, who have very little responsibility.

3 ▶ Describe the roles of a the production director b line supervisors at Yu Xiaoting Motors.

a Directors are members of the senior management team and appointed by the owners to run the business. The production director of Yu Xiaoting Motors is responsible for the whole of the production department and will work closely with the production manager. The production director will attend board meetings with the chairperson and other directors to plan the direction of Yu Xiaoting Motors.

b Supervisors monitor and regulate the work in their area. They have authority over operatives and general workers. At Yu Xiaoting Motors there are eight supervisors according to the organisation chart. For example, four supervisors are employed on line A. They are responsible for the work of 40 machinists on the line.

ACTIVITY 2

CASE STUDY: MPHASIS

1 ▶ What is meant by the term decentralisation?

Decentralisation is a type of organisation system where decision making is pushed down the chain of command and away from the top. At Mphasis, the plan was to allow 17 executives in a management layer lower down in the hierarchy to make decisions without approval from a higher level.

2 ▶ Discuss a one benefit and b one disadvantage of decentralisation to Mphasis.

a One of the main benefits of decentralisation is that it speeds up the decision-making process. This is because people can make decisions further down the chain of command without seeking approval from those higher up. Seeking approval whenever a decision has to be made can be very time consuming and result in inefficiency. Also, decisions relating to customer service can be made onsite, which means that customers should get a better service.

b One possible drawback of decentralisation to Mphasis is that senior managers lose some of their control. For example, they may lose control of some resources used by the business. In this case, a decision made by a junior executive onsite might involve using up some money to help meet a customer need. Senior managers would no longer be able to prevent this since the decision to spend more has been passed down the hierarchy.

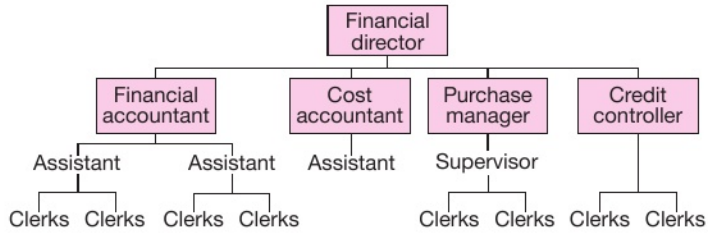
MULTIPLE-CHOICE QUESTIONS

1C, 2A, 3B, 4D

CHAPTER REVIEW

CASE STUDY: TAUKIR MEDICAL SUPPLIES

1 ▶ Draw an organisational chart for the finance department at Taukir Medical Supplies.



2 ▶ What is the span of control for a the credit controller b the cost accountant?

a The span of control for the credit controller is two.

b The span of control for the cost accountant is just one.

3 ▶ What is meant by the chain of command? Use this case study as an example.

Organisation charts show the chain of command in a business. This is the path through which orders are passed down in the hierarchy. Orders will pass down through the layers from the top to the bottom. For example, in this case, an order would pass from the chairman, to the finance director, to the purchasing manager, on to the supervisor and finally to the clerk. This is the chain of command.

The financial accountant often delegates work to the assistant accountants.

4 ▶ What is meant by delegation?

In some situations, it is appropriate for a manager, such as the financial accountant in this case, to hand a task to a subordinate; this is called delegation. Although the assistant accountant will be carrying out the task, the manager will still have responsibility. However, the accountant's time can be saved if a subordinate completes the task. Some workers might enjoy carrying out delegated tasks. They might think that more trust is being placed in them. However, others think that managers are just avoiding work.

The HR manager has suggested to the board that Taukir Medical Supplies would benefit from having a flatter organisation structure.

5 ▶ Discuss the benefits of a flatter organisation structure. Give at least two benefits in your analysis.

With a flatter organisational structure there will be fewer layers in the hierarchy. One of the benefits of this is that there will be fewer managers and therefore money will be saved. Managers often command higher salaries than non-managerial employees so the savings could be quite significant. The money saved might be spent on something more productive in the business – product development, for example.

Another benefit of a flatter structure is that communication in the organisation might be improved. This is because the chain of command is shorter and there is less distance for messages to travel. This might encourage more communication, particularly from the bottom up. It might also speed up communications since there will be fewer layers of management for messages to pass through. This might allow a business to serve its customers more easily. For example, a request from a customer for a special delivery might be granted more quickly if approval is faster to obtain.

CHAPTER 24

CASE STUDY: ZUZZY SOLUTIONS

1 ▶ Describe the role of the human resources department at Zuzzy Solutions.

The human resources department is responsible for the welfare of employees in a business. It has a wide range of duties and responsibilities. For example, at Zuzzy Solutions, Patricia Renard is head of the human resources department. Her job is to supervise the recruitment and selection process and ensure that employees' welfare needs are met. She also meets with other heads of department on a regular basis and is responsible for the six staff who work in her department. Another employee, Andre Duval, also works in the human resources department. Examples of the tasks carried out by Andre include organising and delivering induction training, helping Patricia with interviews and selection, dealing with staff grievances and communicating with trade unions.

2 ▶ Discuss in groups why it might be an advantage to divide a business like Zuzzy Solutions up into different departments. Produce a poster showing your ideas and present them to the rest of the class.

ACTIVITY 1

CASE STUDY: MARKETING AND PR

1 ▶ Describe two other activities that might be carried out in the marketing department.

Other activities that might be carried out in the marketing department include market research, advertising, sales promotion, product planning, public relations, packaging design, distribution and sales.

Marketing departments play an increasingly important role in businesses today.

2 ▶ What might have caused this development?

Marketing departments are becoming more important because of changes in the approach made by businesses. Firms are now more market orientated. This means that they focus sharply on the changing needs and wants of customers. Much of marketing is about identifying these needs and satisfying them. Consequently, marketing departments are important.

3 ▶ Describe Monica's role in the marketing department.

Monica has quite a specialised job in the marketing department at her company. She is responsible for PR. This involves dealing with the media by answering questions and providing a range of company information. She might also organise company presentations to shareholders, potential investors and customers.

Monica is also employed to negotiate sponsorship deals on behalf of the company. For example, she recently negotiated a contract for her company to sponsor a national football competition in Brazil.

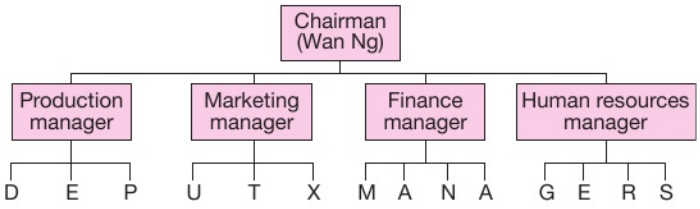
MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4C

CHAPTER REVIEW

CASE STUDY: JAKAC

1 ▶ Draw a simple organisation chart for the management team at JakAC.



2 ▶ Which departments at JakAC would be responsible for the following activities?

a Chasing customers for late payment.

b Dealing with the dismissal of an employee with a very poor attendance record.

c Using social media to get customer feedback on a new maintenance service.

d Setting output targets for production lines.

a Finance – Chasing customers for late payment.

b Human resources – Dealing with the dismissal of an employee with a very poor attendance record.

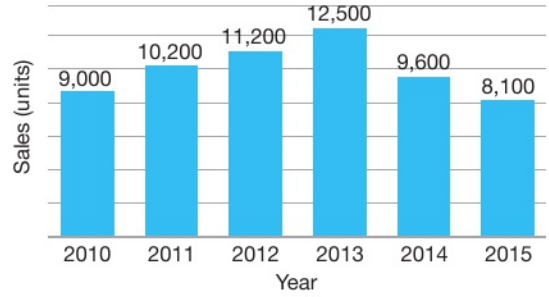
c Marketing – Using social media to get customer feedback.

d Production – Setting output targets for production lines.

3 ▶ How might the marketing department find out the reasons for the trend in sales of AC Power?

The graph in Figure 24.2 shows that sales of AC Power fell quite sharply in 2014. This fall continued into 2015 and

came after a steady growth in sales for four years. It is important to find out reasons why sales have fallen. One approach that the marketing department might take is to carry out some market research. They might interview customers who have suddenly stopped buying the product. The department could use telephone surveys, for example, to gather information from customers. They might also use social media to get up-to-date information from customers. They may be able to engage them in conversations. Possible reasons why demand has fallen might be because the price is too high, a new competitor has entered the market or the quality of the product has deteriorated.



4 ▶ Discuss two possible functions of the JakAC production department in addition to making AC units.

In addition to making air conditioning units, production activities at JakAC might include research and development. This involves the investigation and discovery of new ideas for materials, processes and products. In many industries, research and development is important because new technologies can arrive on the scene very quickly. For example, JakAC might trying to develop AC units that use less energy to help reduce global warming.

Another production activity at JakAC is likely to be purchasing. This involves buying in all the resources such as raw materials, components, energy, tools, equipment and packaging that are needed by the business.

5 ▶ Discuss the importance of interdependence between departments in a business. Use examples from this case study in your analysis.

There appears to have been a breakdown in communication between the production department and the finance department at JakAC. This is because the production department is overspending on its labour budget. The production department argues that more skilled labour is needed to maintain quality. However, the finance department argues that expenditure budgets should not be exceeded. This breakdown in communication is having a negative effect on the business because the production department has not provided some important data needed for a financial report. Sales of a leading product are also falling – there may be a link between poor communications in the business and the drop in sales of AC Power (although there is nothing in the case information to suggest there is). Conflict between the different departments in a business will generally have a negative impact on the company's overall performance.

CHAPTER 25

CASE STUDY: MAURICE OBUYA

CASE STUDY: TRIBAL GROUP

1 ▶ What are the sources of finance used by a Maurice Obuya and b Tribal Group?

Maurice used two sources of finance to set up his airport taxi service. He used a bank loan to raise KES 2 million and he also used KES 2 million of his own savings.

Tribal Group raised money by selling some shares to existing shareholders and by selling of part of their business, Synergy, to another company called Servelec Group.

2 ▶ Work out the monthly instalment Maurice would have to make in order to repay the five-year bank loan (including interest).

Calculate the monthly instalments Maurice would have to make in order to repay the five-year bank loan.

Interest on the loan = KES 2 000 000 × 8 per cent × 5
= KES 800 000

Total amount to be repaid = KES 2 000 000 + KES 800 000
= KES 2 800 000

Monthly instalments = KES 2 800 000 ÷ 60
= **KES 46 667 per month**

3 ▶ Work out the amount of money raised by Tribal Group by selling shares to existing shareholders.

Share capital raised = 94.8 million × £0.22 = **£20 856 000**

4 ▶ Why did Tribal Group need to raise more money?

Tribal Group had run into financial difficulties and built up some debt. In 2015, its revenue fell to £106.7 million down from £123.7 million. The group also made losses of £47.3 million and £6.3 million in 2015 and 2014, respectively. In 2016, the company decided to raise more money to reduce its debt and provide some financial stability for the future. The group raised a total of £41 156 000 by selling some new shares and selling off part of the group to another business.

ACTIVITY 1

CASE STUDY: WEDDING PLANNING

1 ▶ Work out the percentage of the funding provided by the bank.

Percentage provided by bank:

Rs30 000 ÷ Rs90 000 × 100 = **33.3 per cent**

2 ▶ What is meant by internal sources of finance?

Internal sources of finance come from within the business. Before a business can start trading the owners have to provide some capital. This is an internal source of finance and in this case Nikki has raised Rs60 000 from personal savings, gifts and family loans. The bank is also providing some external finance.

3 ▶ Describe one advantage to Nikki of using an internal source of finance.

One of the main advantages of using internal sources of finance is that they are cheap: there is no interest to pay and no administration charges. This will help to keep business costs down and reduce the financial burden on the business.

ACTIVITY 2

CASE STUDY: CROWD FUNDING

1 ▶ What is meant by the term crowd funding?

Crowd funding is a relatively new source of finance for businesses. It is similar to peer-to-peer funding (where banks are excluded and individuals can lend money via the Internet to others without previous knowledge of them). However, the fund-raisers tend to be businesses or groups who are involved in a particular venture such as putting on a concert, building a school or setting up a community project. The lenders or investors will be large numbers of individuals who together represent 'the crowd'. Transactions are conducted online. In this case, Marine Techno used an online crowd funding platform called CrowdNet to raise KRW 127 million.

Crowding funding is an external source of finance.

2 ▶ What is meant by this?

External sources of finance are those from outside the business. Businesses often have to raise money from outside because the business is not able to generate sufficient funds on its own. In this case crowd funding is an example of an external source. The lenders or investors will be large numbers of individuals outside the business who collectively represent 'the crowd'

3 ▶ Discuss why Marine Techno used crowd funding to raise finance.

Marine Techno needed some finance to help fund further product development. However, the company was struggling to get the finance it needed. According to the CEO, this was because most of the finance available to businesses ends up in Seoul or the surrounding province of Gyeonggi. When the CEO heard about a new crowd-funding site, CrowdNet, he thought it might be worth a try.

MULTIPLE-CHOICE QUESTIONS

1A, 2D, 3B, 4C

CHAPTER REVIEW

CASE STUDY: BLAKELY MOTOR SCOOTERS

1 ▶ What is meant by short-term finance?

Businesses often need to borrow money for a short period of time. This is called short-term finance and is money borrowed for one year or less. Short-term finance is often used to boost working capital. For example, Blakely Motor Scooters uses short-term finance to pay for raw materials and wages to meet a large order. Short-term finance is also likely to be used to meet emergency expenditure.

2 ▶ Why is retained profit an internal source of finance?

Profit is generated by a business. Some of this is returned to the owners and the rest is retained by the business. Retained profit can be used in the future as a source of finance. It is an internal source because it has been generated inside the business through its trading activities.

Blakely Motor Scooters often uses retained profit to fund business activity.

3 ▶ What is the main reason for using this method of financing?

Retained profit is popular because it is cheap. There are no interest or administration charges when using retained profit. It is a free source of finance. However, if profit is retained it cannot be returned to the owners. This may sometimes result in conflict.

Blakely Motor Scooters uses trade payables to buy components and parts.

4 ▶ Discuss one advantage and one disadvantage of trade payables as a source of finance.

Trade payables (or trade credit) involves buying goods and paying for them later – perhaps up to 60 to 90 days after the goods were purchased. It is a popular source of finance because it is cheap and easy. There is often no direct charge for using trade credit. However, many suppliers encourage early payment by offering discounts so a business may miss out on cheaper goods. Also the cost of goods is often higher if firms buy on credit and delaying payment can also upset suppliers since they have to wait longer for their money.

5 ▶ Assess whether Blakely Motor Scooters should fund the new factory through share capital or a mortgage. Make a clear judgement in your evaluation.

All sources of finance have their advantages and disadvantages. In this case, two particular sources are being considered to raise TNB 700 million for a new production line equipped with new technology – share capital or a mortgage. A mortgage is a long-term source of finance and could be used for the construction of a production line. However, the borrower must use land or property as security for the loan. Presumably here the new production line could be used as security for the loan. Mortgages are popular because the interest rates are much lower than those on unsecured bank loans. Provided the bank is happy for the production line to be used as security, a mortgage may be granted. However, if the business is not able to keep up with the repayments, the lender could repossess the property used as security.

For limited companies, share capital is an important source of external finance. The sale of shares can raise very large amounts of money. In this case, raising TNB 700 million is not an unusual amount. A rights issue may be used to raise more share capital. This is where a company gives the existing shareholders the right to buy the new shares at a discount. The main advantage of selling shares to raise capital is that interest payments are avoided. However, shareholders will expect to be paid dividends if the business is successful. The main disadvantage of issuing shares to raise capital is the cost of administration. There are the costs of promoting the issue, communicating with potential buyers, processing application forms, distributing the shares and possibly underwriting fees. This whole process can use up a significant proportion of the amount raised.

If the business can afford the interest payments, a mortgage may be preferable because once the new production line is up and running the existing shareholders will get to keep all the profit generated by the new investment. However, if interest rates are high, the interest payments over the 25-year period would eat into profits. There is also the chance that interest rates could rise to very high levels.

CHAPTER 26

CASE STUDY: AGA BRICK MAKING

1 ▶ Suggest ways in which cash is flowing into and out of the Agas' brickmaking business.

Cash is flowing into the business from customers. KES 155 000 flowed into the business in June 2016. In the same month, cash also flowed out of the business. Examples include KES 43 000 for raw materials, KES 20 000 for rent and KES 12 000 for fuel.

2 ▶ Work out the net cash flow (cash inflows – cash outflows) for Aga Brick Making.

Net cash flow = KES 155 000 – (KES 43 000 + KES 20 000 + KES 12 000 + KES 11 000 + 2 × KES 20 000)

Net cash flow = KES 155 000 – KES 126 000 = **KES 29 000**

3 ▶ What does the answer in question 2 show?

The calculation in (2) shows that the business received more cash than it paid out. There was a positive net cash flow of KES 29 000.

ACTIVITY 1

CASE STUDY: CASH FLOWS

1 ▶ Suggest one example of a a cash inflow and b cash outflow, for Abdul Hassan's laundry.

A cash inflow would be the US$1400 cash payments received during the month.

A cash outflow would be the US$2500 wages paid during the month.

2 ▶ Work out the net cash flow for July 2016 for the laundry business.

Calculate the net cash flow for July 2016 for the laundry business.

Net cash flow = Total cash inflow – Total cash outflow

= (US$1400 + US$5400) – (US$2500 + US$400 + US$700 + US$400 + US$100 + US$500 + US$1000)

= US$6800 – US$5600

= US$1200

Therefore the business had a positive net cash flow of **US$1200** in July 2016.

3 ▶ Why might the net cash flow above not represent the value of profit made in July?

It is quite normal in a specific trading period for the net cash flow to be different from the profit made. One reason for this is because some goods are sold on credit (trade payables). So, at the end of the period, some customers will still owe money. Therefore, profit is greater than cash. Similarly, a business may receive cash during that period from credit sales made in the previous period. This would increase the cash balance, but not affect profit. In this case, the laundry does receive US$5400 from customers who had their laundry cleaned 60 days before. Therefore, the cash received for those sales does not affect the profit for July but for the month 60 days ago. The laundry would have made some credit sales during July but these are not recorded because the cash is yet to be received.

ACTIVITY 2

CASE STUDY: CASH FLOW FORECASTS

1 ▶ Complete the cash flow forecast for Priscila Landa's bookshop to show:

- **a the total cash outflows for each month**
- **b the net cash flows for each month**
- **c the closing balance for each month**
- **d the opening balance for February and March.**

	Jan	Feb	Mar
Cash inflows			
Book sales	3000	3500	3100
Fresh capital			2000
Interest		150	
Total cash inflows	3000	3650	5100
Cash outflows			
Stock	1700	1790	1900
Casual labour	500	500	500
Rent	1000	1000	1000
Other expenses	230	240	230
Total cash outflows	3430	3530	3630
Net cash flow	–430	120	1470
Opening balance	230	–200	–80
Closing balance	–200	–80	1390

It is suggested that Priscila Landa's bookshop is struggling.

2 ▶ What evidence is there in the forecast to support this view?

Although the cash flow forecast for Priscila Landa's bookshop shows that the closing balance improves from –200 in January to 1400 in March, the reason for this is because 2000 of fresh capital was injected in March. Without the cash injection the closing balance in March would be –600. This shows a worsening situation over the three-month period.

MULTIPLE-CHOICE QUESTIONS

1B, 2D, 3A, 4B

CHAPTER REVIEW

CASE STUDY: LINARI GARDEN DESIGN

1 ▶ Describe what a 'cash flow forecast' shows.

A cash flow forecast is a financial document, usually produced on a spreadsheet, which shows the likely receipts and payments of a business for a future time period. All expected payments and receipts are listed month by month and the expected cash balance is calculated at the end of each month.

2 ▶ Prepare a nine-month cash flow forecast for Linari Garden Design. (Use a spreadsheet if possible.)

	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Cash inflows									
Bank loan	3000								
Own capital	2000								
Predicted revenue	2000	2100	2000	2500	2500	2000	1000	500	0
	7000	2100	2000	2500	2500	2000	1000	500	0
Cash outflows									
Van	2000								
Tools and equipment	3400								
Laptop	600								
Business directory		100							
General overheads	400	400	400	400	400	400	400	400	400
Advertising		100		100		100		100	
Drawings			800	800	800	800	800	800	800
Loan repayments	200	200	200	200	200	200	200	200	200
Total payments	6600	800	1400	1500	1400	1500	1400	1500	1400
Net cash flow	**400**	**1300**	**600**	**1000**	**1100**	**500**	**–400**	**–1000**	**–1400**
Opening balance	0	400	1700	2300	3300	4400	4900	4500	3500
Closing balance	**400**	**1700**	**2300**	**3300**	**4400**	**4900**	**4500**	**3500**	**2100**

3 ▶ Comment on the cash position of the business during the nine-month period.

The expected cash position for Linari Garden Design looks quite promising. In the first month of trading, when all the setting up costs are incurred, the business is still expected to have a positive cash balance at the end of the month. After that, the cash position improves every month up until September when it is expected to be €4900. In the next few months, the cash position worsens because revenue starts to decline. But even in December, when there is no revenue, the closing cash position is still positive.

4 ▶ What would you expect to happen to the cash position of the business in early 2016?

The cash position of the business in early 2016 is expected to worsen. This is because revenue is likely to be zero for a few months. Garden design is likely to be affected by seasonal demand and people will not be thinking about their gardens until the growing season begins in the spring. If the cash payments stay at €1400 each month and there is no more revenue, the cash position at the end of February will be –€700 (€2100 – €2800) if all the outflows remain the same as in December.

CHAPTER 27

CASE STUDY: AMPAT CONSTRUCTION

1 ▶ Suggest four costs incurred by Ampat Construction that will rise when more houses are built.

Examples of costs that will rise when more houses are built include bricks, sand, cement, timber, pipes, glass, electrical wire, glass, plastic window frames, insulation materials and labour.

2 ▶ Suggest four costs incurred by Ampat Construction that remain unchanged when more houses are built.

Examples of costs that will remain unchanged when more houses are built include machinery such as cement mixers, lifting gear, vehicles; tools and equipment such as spades, trowels, wire cutters, saws, power tools and protective

clothing and computers smartphones and office furniture at the company office.

3 ▶ Work out the profit made by Ampat Construction in 2016.

Profit = Total revenue – Total cost
= US$64 340 700 – US$56 450 200
= US$7 890 500

ACTIVITY 1

CASE STUDY: KANDASAN CRICKET BATS

1 ▶ What is meant by fixed costs? Use examples from the case study in your explanation.

Fixed costs are costs that do not vary with output. If output is increased, for example, fixed costs will remain exactly the same. In this case, examples of fixed costs include rent, business rates and other fixed costs. These are annual costs and do not vary with output.

In 2015, Kandasan Cricket Bats produced 4800 bats.

2 ▶ Work out the total cost of production.

Total cost = Fixed cost + Variable cost
= (Rs50 000 + Rs5000 + Rs25 000) + 4800 × (Rs30 + Rs10 + Rs50 + Rs10)
= (Rs80 000) + 4800 × (Rs100)
= Rs80 000 + Rs480 000
= Rs560 000

In 2016, the rent increased to LKR 60 000 and 6000 bats were produced.

3 ▶ Work out the effect of this increase on total costs.

Total cost = Fixed cost + Variable cost
= (Rs60 000 + Rs5000 + Rs25 000) + 6000 × (Rs30 + Rs10 + Rs50 + Rs10)
= (Rs90 000) + 6000 × (Rs100)
= Rs90 000 + Rs600 000
= Rs690 000

ACTIVITY 2

CASE STUDY: JENKINS LTD

In 2015, Jenkins produced and sold 4500 control systems.

1 ▶ Work out the total cost.

Total cost = Fixed cost + Variable cost
= US$160 000 + (4500 × US$120)
= US$160 000 + US$540 000
= US$700 000

2 ▶ Work out the total revenue.

Total revenue = Price × Quantity
= US$250 × 4500
= US$1 125 000

3 ▶ Work out the profit.

Profit = Total revenue – Total cost
= US$1 125 000 – US$700 000
= US$425 000

In 2016, fixed costs and the price charged remained the same. However, variable costs rose to US$140 per system.

4 ▶ Work out the profit made in 2016 if 5200 systems were sold.

Profit = Total revenue – Total cost
= US$250 × 5200 – (US$160 000 + 5200 × US$140)
= US$1 300 000 – (US$160 000 + US$728 000)
= US$1 300 000 – US$888 000
= US$412 000

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

CHAPTER REVIEW

CASE STUDY: MODAL METAL PRODUCTS

1 ▶ What is meant by variable costs?

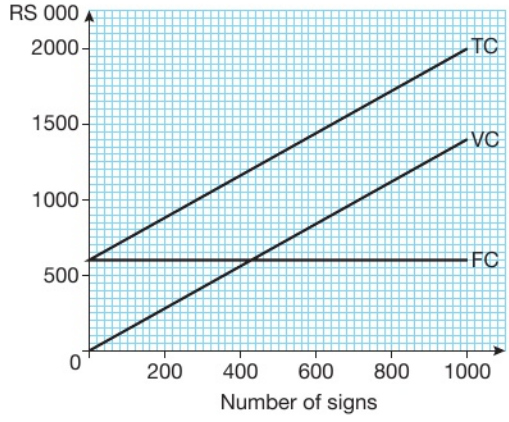
Variable costs are those costs that change when the level of output changes. They will rise for example when output is increased. An example in this case is the cost of the metal, pipes and paint that Modal Metals uses for the road sign order.

2 ▶ For the new order, work out a total variable cost and b total cost.

Total variable cost = Rs1400 × 1000 **= Rs1 400 000**

Total cost = Fix cost + Variable cost
= Rs600 000 + Rs1 400 000 **= Rs2 000 000**

3 ▶ Plot fixed cost, variable cost and total cost on a graph. Use a range of output of 0 to 1000 units.



4 ▶ Work out the profit made on the order.

Profit = Total revenue – Total cost
= (Rs2500 × 1000) – Rs2 000 000
= Rs2 500 000 – 2 000 000
= Rs500 000

5 ▶ Work out the average cost of each sign.

Average cost = Total cost ÷ Quantity
= Rs2 000 000 ÷ 1000 **= Rs2000**

Six months later, Modal Metal Products gets another order for 1500 speed limit signs. The variable costs remain the same but fixed costs are only Rs200 000. However, the government will only pay Rs1500 for each sign.

6 ▶ Assess whether Modal Metal Products should accept the order. Show all your calculations. Make a clear judgement in your evaluation.

Profit = Total revenue – Total cost

= Rs1500 × 1500 – (Rs200,000 + Rs1400 × 1500)

= Rs2 250 000 – Rs2 300 000

= –Rs50 000

Since Modal Metals would make a loss of Rs50 000 on the new order, it might be refused. However, if Modal Metals was short of business, it might take on the order to keep its resources occupied and retain the customer. Although this particular order might make a loss, future orders from the government might be more profitable.

CHAPTER 28

CASE STUDY: UNIVERSAL MUSIC GROUP

CASE STUDY: CONE STREET CYCLES

1 ▶ Show whether the firms in the above examples are making a profit, loss or breaking even.

In 2016, Universal Music Group made a profit of €644 million (€5 260 000 million - €4 616 000 million)

Cone Street Cycles broke even in 2015. Its total costs were Rs40 million (Rs20 million + Rs2,000 × 100 000) and its total revenue was also Rs40 million.

ACTIVITY 1

CASE STUDY: GALLE ICE CREAM

1 ▶ How many kilos of ice cream must the business sell to break even?

$$\text{Break-even point} = \frac{\text{Fixed cost}}{\text{Selling price} - \text{variable cost per unit}} = \frac{\text{Rs100 000}}{\text{Rs100} - \text{Rs50}} = \frac{100\,000}{50} = 2000$$

So, Galle Ice Cream Ltd would need to sell 2000 kilograms to break even.

2 ▶ What is total cost and total revenue at the break-even point?

Total cost = Rs100 000 + (Rs50 × 2000)

= Rs100 000 + Rs100 000 = Rs200 000

Total revenue = Rs100 × 2000 = Rs200 000

Total revenue and total cost are both Rs200 000 at the break-even point. This shows that the business does not make a profit or a loss.

3 ▶ What would happen to the breakeven point if fixed costs were reduced to Rs80 000?

$$\text{Break-even point} = \frac{\text{Fixed cost}}{\text{Selling price} - \text{variable cost per unit}} = \frac{\text{Rs80 000}}{\text{Rs100} - \text{Rs50}} = \frac{80\,000}{50} = 1600$$

When fixed costs fall, the break-even point is lower. Galle Ice Cream Ltd now only needs to produce and sell 1600 kilograms to break-even.

ACTIVITY 2

CASE STUDY: THE GRAND HOTEL

1 ▶ What is the value of fixed cost for the Grand Hotel?

The fixed costs incurred by the hotel are SGD 15 000.

2 ▶ How many rooms need to be occupied to break even?

The hotel will break even when 300 rooms are occupied. This is where total cost and total revenue intersect.

3 ▶ What is total revenue at the break-even point?

Total revenue at the break-even point is SGD 30 000.

4 ▶ What is total cost at the break-even point?

Total cost at the break-even point is SGD 30 000.

5 ▶ If 500 rooms are occupied, what is the a amount of profit and b margin of safety?

a Profit is the difference between total cost and total revenue on the break-even chart. In this case the profit made by the Grand Hotel when 500 rooms are occupied is SGD 10 000. When 500 rooms are occupied, total cost is SGD 40 000 and total revenue is SGD 50 000.

b The margin of safety when 500 rooms are occupied is 200. It is the difference between the break-even point and current output.

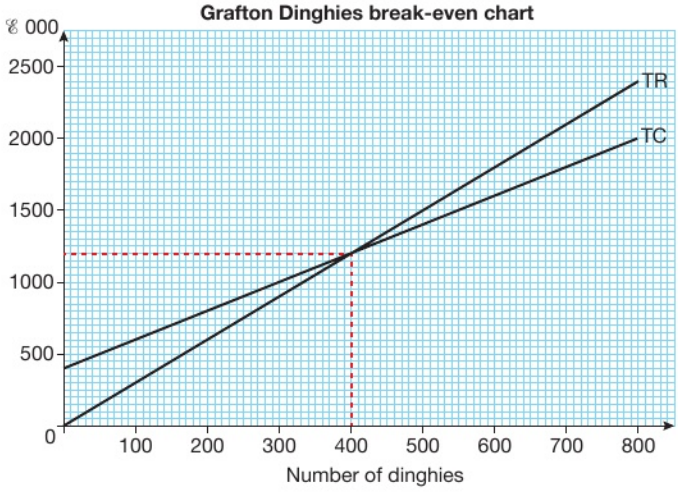
MUTLIPLE-CHOICE QUESTIONS

1D, 2D, 3A, 4C

CHAPTER REVIEW

CASE STUDY: GRAFTON DINGHIES

1 ▶ Construct a break-even chart for Grafton Dinghies.



2 ▶ a What is the break-even point for Grafton Dinghies?

b What is the total cost and total revenue at the break-even point?

a Reading from the graph the break-even point is **400** dinghies.

b At the break-even point, reading from the graph:

Total cost = **€1 200 000**

Total revenue = **€1 200 000**

Grafton plans to make 600 dinghies during the year.

3 ▶ How much profit will be made?

Reading from the graph, when output is 600 dinghies, profit = **€200 000**

4 ▶ Describe what would happen to the break-even point for Grafton Dinghies if variable costs were to increase.

If Grafton's variable costs increase, the total cost function would become steeper. This means that the business would break even at a higher level of output (the break-even point shifts to the right). This is a negative effect for the business because the business has to produce and sell more dinghies to break-even.

5 ▶ What are the limitations of break-even analysis to Grafton Dinghies? Discuss at least two limitations in your analysis.

Although break-even charts can provide a business with some useful information, break-even analysis does have some limitations. One of the main limitations is that the total costs and total revenue are shown as straight lines. In practice, they may not be straight lines. For example, a business may have to offer discounts on large orders, so total revenues fall at high outputs. In this case study, the total revenue line would rise and then fall. A business can lower costs by buying in bulk, so unit costs may fall at high outputs and total cost will be curved.

Another problem is to do with the information used to construct the chart. The accuracy of the break-even chart depends on the quality and accuracy of the data used to construct total cost and total revenue. If the data is poor and inaccurate, the conclusions made on the basis of the data may be incorrect. Therefore, Grafton must use break-even analysis with some care.

CHAPTER 29

CASE STUDY: DOHA FOOD STORE

1 ▶ What do you think is meant by the terms a cost of sales and b finance costs?

a Cost of sales in this case is the cost to the Doha Food Store of buying stock or inventory to sell in the shop.

b Finance costs of US$600 000 is interest paid on any loans or overdrafts that the business has.

2 ▶ Suggest three possible expenses that the Doha Food Store might incur.

Examples of expenses might include wages, electricity, advertising, insurance, accountancy fees, telephone, motor expenses or business rates.

NB. Other examples are possible.

3 ▶ How might Musab Assad use the statement of comprehensive income?

The statement of comprehensive income will show Musab Assad and his family how well the business has performed during the year. The profit made by a business for the year is a measure of business performance. Musab might also use the statement to make decisions. For example, he may decide to invest some of the profit made by the business in the future.

ACTIVITY 1

CASE STUDY: FORMAT 66

1 ▶ Work out a gross profit and b operating profit.

a Gross profit = revenue – cost of sales

= US$12.56 million – US$7.6 million = **US$4.96 million**

b Operating profit = gross profit – expenses

= US$4.96 million – US$2.56 million = **US$2.4 million**

Format 66 distributes US$0.8 million to shareholders.

2 ▶ How much profit is retained?

Retained profit is the money left after any distribution to the owners. Therefore in this case retained profit is **US$1.6 million** (US$2.4 million – US$0.8 million).

3 ▶ What is likely to happen to the profit retained by the business?

Retained profit is kept by the business. This means it may be used to help fund investment projects. It may also be kept as a reserve in case trading conditions become difficult in the future.

ACTIVITY 2

CASE STUDY: SANCHEZ SUPERSOFT

Look at the statement of comprehensive income for Sanchez Supersoft.

1 ▶ Work out the missing values for a cost of sales in 2015, b profit for the year after tax in 2015 and c the operating profit for 2016.

a Cost of sales in 2015 = US$18.1 million.

b Profit for the year after tax in 2015 = US$3.1 million

c Operating profit for 2016 = US$5.1m

2 ▶ Comment on the performance of the business over the two years.

It could be argued that the Sanchez Supersoft's performance has worsened since 2015. Revenue has fallen from US$29.2 million to US$26.9 million. This is a fall of about 10 per cent. Gross profit has fallen by a similar amount. Profit for the year has fallen by a larger percentage. It has fallen by 29 per cent from US$3.1 million to US$2.2 million. A possible reason for this is a slowdown in global growth. When economic growth is low, demand for non-essentials such as computer games is likely to fall. However, at least the business is still trading and making a profit. If the global economy picks up then the performance of Sanchez Supersoft is likely to improve.

MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3B, 4C

CHAPTER REVIEW

CASE STUDY: ROLLS-ROYCE

1 ▶ What does a statement of comprehensive income show?

Businesses use the statement of comprehensive income to calculate the profit at the end of the financial year. In this case, the profit made by Rolls-Royce at the end of 2015 was £84 million.

2 ▶ Work out a taxation and b gross profit for 2015.

a Taxation in 2015 = £76 million

b Gross profit in 2015 = £3266 million

3 ▶ What is meant by operating profit?

Operating profit is the profit made by a business after all business costs and expenses have been subtracted (except for finance costs). It can be calculated by subtracting expenses from gross profit. In this case, the operating profit for Rolls-Royce is £1499 million.

4 ▶ Describe two ways in which the statement of comprehensive income might be used by a business like Rolls-Royce.

The statement of comprehensive income shows business owners and managers the amount of profit made by a business in a financial year. However, the information contained in the statement might be used to help make some important decisions. For example, a business might use the statement of comprehensive income to decide how much money to invest in the business. For example, if the statement shows that profits are rising, this might encourage decision makers to use more funds for investment. In contrast, if the statement shows that the business is struggling, investment plans might be postponed in the hope that the business will pick up in the near future.

The statement of comprehensive income will show a business what has happened to costs during the year. It might show, for example, that the cost of sales has increased sharply. As a result a business can identify reasons for this and take measures to bring costs under control. A business might decide that cheaper suppliers of raw materials must be found or that the wages of production workers must be brought under control. For example, in this case Rolls-Royce has managed to reduce its administrative costs from £1124 million in 2014 to £1059 million in 2015. The business may have analysed costs in 2014 to see if there were certain costs that could be reduced.

5 ▶ Assess the performance of Rolls-Royce over the two years. Make a clear judgement in your evaluation.

The 'bottom' line shows that Rolls-Royce has moved from a loss making position in 2014 to a profit making position in 2015. In 2014, the business made a loss of £84 million. However, in 2015 it made a profit of £84 million. This is a positive development over the time period. However, the size of profit in relation to revenue is quite small. Its profit for the year in 2015 is only 0.6 per cent of the company's revenue.

Over the two years, revenue was fairly stable at around £13 700 million – there was just a slight drop in 2015. This shows that Rolls-Royce is getting plenty of orders and has enjoyed a solid year's trading. However, the company may be disappointed in its profitability. With such a high revenue, many would argue that it should make more profit. One of the reasons why profitability is low is because of the high costs of financing. In both 2014 and 2015, financing costs are over £1400 million. This shows that Rolls-Royce has a lot of debt. It is possible that the business is borrowing to invest heavily for the future. There is some evidence of this in the statement of comprehensive income. The statement shows that research and development costs were £818 million in 2015 and £793 million in 2014. This is a large sum and suggests that Rolls-Royce is committed to research and new product development. Sometimes research and development expenditure takes time to bear fruit. Shareholders in Rolls-Royce will hope that much higher profits are generated in the future as a result of this investment. Finally, one of the reasons why Rolls Royce made a loss in 2014 was because of a relatively high tax charge – it was about double the size of the tax paid in 2015.

CHAPTER 30

CASE STUDY: AZORA DINING FURNITURE

1 ▶ What is the value of all the assets owned by the business?

Total assets = US$395 900

2 ▶ How much money does the business owe to a the owners and b all other creditors?

Owed to owners = US$200 000 + US$104 900

= US$304 900

Owed to other creditors = US$91 000

3 ▶ What do you notice about the value of assets and the total amount owed by the business?

The value of the assets is exactly the same as the amount owed. Both values are US$395 900.

ACTIVITY 1

CASE STUDY: TESCO

1 ▶ What is the difference between assets and liabilities? Use examples from this case study.

Assets are the resources owned by a business. For example, Tesco had £43 904 million of assets in 2016. A significant proportion of this (£17 900 million) was property, plant and equipment. Liabilities are the debts of a business, that is, the amount of money owed to outsiders. The value of Tesco's liabilities was £35 288 million in 2016. £10 711 million of this amount was owed to banks and other financial institutions.

2 ▶ Work out the value of capital for Tesco.

Assets = capital + liabilities

£43 904 million = capital + £35 288 million

£43 904 million – £35 288 million = capital

£8616 million = capital

3 ▶ Write a letter to a shareholder explaining what a statement of financial position shows.

ACTIVITY 2

CASE STUDY: QETTER TOYS

1 ▶ What is the value of a net current assets, b share capital and c plant and equipment for 2016?

a Net current assets = US$4 390 000

b Share capital = US$10 000 000

c Plant and equipment = US$9 120 000

2 ▶ What is meant by the term inventories in the statement of financial position?

Inventories are a current asset for a business. They include stocks of raw materials, components and finished goods ready for sale. In this case, ERCO had US$4 560 000 of inventories in 2016. As a toymaker, examples might include raw materials such as plastics, paint and packaging. It could also include stocks of toys ready to sell to customers.

3 ▶ What is the difference between current assets and non-current assets?

Current assets are assets that will be changed into cash within one year. They are liquid assets. The liquidity of an asset is how easily and how quickly it can be changed into cash. Examples of current assets for ERCO include inventories (£4 560 000), trade receivables, which is money owed by customers (US$6 990 000), and cash (US$2 110 000).

Non-current assets are those that last for more than one year. They are the most productive resources of a business. ERCO has two main non-current assets – factory and plant and equipment. The total value of ERCO's non-current assets at 31 December 2016 is US$43 770 000.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4D

CHAPTER REVIEW

CASE STUDY: HASHAN BATHROOM SUPPLIES

1 ▶ What is meant by the term capital employed?

Capital employed is the amount of money invested in the business by the owners. For Hashan Bathroom Supplies it is US$236 300 000 for 2016.

2 ▶ What is meant by borrowings in the statement of financial position?

Borrowings are an example of a non-current liability. It is money that the business has borrowed and does not expect to pay back for at least a year – possibly a lot longer. For example, long-term loans could be for 5 years, 10 years, 20 years or longer. Hashan Bathroom Supplies owed US$300 000 000 at the end of 2016. However, this was US$50 000 000 lower than the previous year.

3 ▶ What is the difference between current assets and current liabilities in the statement of financial position?

Current assets are assets that will be changed into cash within one year. They are the liquid assets of a business. The liquidity of an asset is how easily and how quickly it can be changed into cash. Examples of current assets for Hashan Bathroom Supplies include inventories (US$459 000 000), trade receivables, which is money owed by customers (US$230 300 000) and cash (US$67 000 000).

Current liabilities are business debts that must be repaid within 12 months. For Hashan Bathroom Supplies they might include trade payables, which is money owed to suppliers. And taxation, which is money owed by the business to the tax authorities. This might include tax on company profits, VAT or tax that has been deducted from employee wages which must be passed on to the authorities. Hashan Bathroom Supplies owes US$560 000 000 and US$230 000 000 to suppliers and the tax authorities respectively.

4 ▶ What is the approximate value of Hashan Bathroom Supplies?

The value of a business is given by the value of net assets. This is shown in the statement of financial position. The value of Hashan Bathroom Supplies in 2016 was US$236 300 000. However, this is only an approximate value.

5 ▶ Describe two uses that a statement of financial position might have to Hashan Bathroom Supplies.

The statement of financial position shows the capital structure of a business. A business can raise funds from many different sources, such as shareholders' capital, retained profit and long-term and short-term sources. For example, Hashan Bathroom Supplies has raised a total of US$236 300 000 from the owners of the company, while US$300 000 000 comes from long-term borrowings and US$790 000 000 from short-term sources. It might be argued that quite a large proportion of Hashan Bathroom Supplies' finance is from short-term sources.

The statement of financial position also shows the asset structure of a business. This means that we can see where all the money that the business has raised has been distributed between different types of assets. For example, Hashan Bathroom Supplies has US$570 000 000 invested in non-current assets such as stores, and fixtures and fittings. It also has US$756 300 000 invested in current assets such as inventories, trade receivables and cash. Note that the value of assets US$1 326 300 000 (US$570 000 000 + US$756 300 000) is the same as the value of money owed US$1 326 300 000 (US$236 300 000 + US$300 000 000 + US$790 000 000). This will always be the case for a business.

6 ▶ Assess the main financial changes that have taken place over the two years at Hashan Bathroom Supplies.

A number of key changes have occurred in the financial position of Hashan Bathroom Supplies over the two years. First of all, the value of the company has increased from US$201 600 000 to US$236 300 000. This is a significant increase and the owners of the company may be pleased with this performance. This is a 17 per cent increase and suggests that the business has performed well between 2015 and 2016. However, it must be remembered that the value of net assets is only a rough guide to the value of a business because assets are difficult to value exactly and other non-physical assets such as goodwill (the amount paid for regular customers to the business) may not be included on the statement.

One worrying change is the fall in the value of net current assets. It was low in 2015 but in 2016 it became negative (at US$33 700 000). This means that current liabilities are greater than current assets. This could be a problem for Hashan Bathroom Supplies because it might struggle to pay some immediate bills. The main reason for this position is that there has been a big build-up in inventories; more money is owed by customers than in the previous year and the value of cash has fallen. This would be a cause of concern for Hashan Bathroom Supplies. However, during the year it managed to pay off US$50 000 000 in long-term debt. This might part of the reason for the position. If the business is able to sell its high levels of stocks fairly quickly and put pressure on customers to pay their debts, the position would improve significantly.

CHAPTER 31

CASE STUDY: ORIENT PLUS

1 ▶ What evidence is there to support the view that Orient Plus is starting to struggle?

Both the statement of comprehensive income and the extracts from the statement of financial position show that Oriental Plus was hit by the arrival of a new competitor. The revenue of the business fell from US$1 231 500 to US$890 600; this is a fall of about 28 per cent. The profit for the year made by the business also went down. In 2015, Orient Plus made a profit of US$158 600. However, in 2016 this turned into a loss of US$2400. This is only a small loss but it is a big drop from the previous year. The extracts from the statement of financial position show that working capital (net current assets) has fallen sharply from US$239 300 to US$14 300. This may well mean that the business has difficulties in paying day-to-day bills.

2 ▶ How might the redundancies improve financial performance at Orient Plus?

Making staff at Orient Plus redundant could improve the financial performance of the business. This is because if people are made redundant the wage bill will be reduced. With lower wages, costs will fall and the company may return to profit again. However, making staff redundant may result in production difficulties.

ACTIVITY 1

CASE STUDY: SANTOS METAL PRODUCTS

Look at the revenue figures for Santos Metal Products between 2010 and 2015.

1 ▶ How has the company performed?

Revenue has increased significantly between 2010 and 2014. It has increased by nearly 100 per cent from US$12.4 million to US$24.1 million. This suggests that Santos Metal Products has performed very well indeed.

2 ▶ What impact has the flood of orders had on Santos Metal Products?

Table 31.4 shows that both gross profit and operating profit rose sharply in 2013. This occurred at the same time as the flood of orders resulting from the Rio Olympic Games construction projects in 2013 and 2014. This appears to have had an impact on the profits for 2013 and 2014. Both gross profit and operating profit doubled between 2012 and 2014.

3 ▶ Work out for both years a gross profit margin and b operating profit margin.

	2010	2011	2012	2013	2014
Gross profit margin	39.5%	40.6%	40.9%	49.5%	51.0%
Net profit margin	8.1%	8.7%	8.7%	10.6%	10.8%

4 ▶ Discuss possible reasons for the changes in question 3 between 2010 and 2014.

Between 2010 and 2012 both the gross and operating profit margins are fairly stable. They have increased slightly but not by much. However, in 2013 and 2014 they both rise sharply. This occurred at the same time as the flood of orders. The gross profit margin rises from 40.9 per cent to 51 per cent between 2012 and 2014. This may be because the business has been able to buy raw materials more cheaply. They will have increased production for the orders and may have enjoyed cheaper materials through bulk buying. The operating profit margin has increased from 8.7 per cent to 10.8 per cent. This may be because the business has been able to benefit from economies of scale, that is, perhaps by making better use of their machinery when increasing production. The operating profit margin will usually rise if a business keeps control of its expenses. It appears that Santos Metal Products has done this in 2013 and 2014.

ACTIVITY 2

CASE STUDY: COMPARING ASSETS AND LIABILITIES

1 ▶ Calculate for both companies and for both years the a current ratios and b acid test ratios.

	Patel's		Uzzy Plastics	
	2016	2015	2016	2015
Current ratio	1.16	0.96	1.76	1.58
Acid test ratio	0.37	0.36	0.89	0.85

2 ▶ Which is the more liquid of the two companies?

According to the calculations in (1), Uzzy Plastics is the more liquid of the two companies. The current ratio in both years for Uzzy Plastics lies in the preferred range of 1.5 to 2. The acid test ratio in both years is just below 1. Patel's figures are significantly worse. The current ratios in both years are well below 1.5 and the acid test ratios are well below the preferred target of 1. Between 2015 and 2016, both companies have improved their liquidity position slightly. For example, the current ratios for both companies have increased.

There may be a reason why Patel's appears to have a poorer liquidity position than Uzzy Plastics. Patel's is a car retailer; it sells cars from car showrooms. Consequently, its main asset will be inventories (the value of cars in the showroom). This would explain the low acid test ratios. It is also possible that Patel's is paid immediately when a sale

is made – it may not have to wait for customers to pay. Therefore, it does not have to wait for cash. This means they can operate with much lower current and acid test ratios. BBG Plastics is a manufacturer and probably allows its customers trade credit. This means they have to wait for cash and therefore need higher liquidity ratios to be safe.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4B

CHAPTER REVIEW

CASE STUDY: AL-DHABIT SHIPPING

The return on capital employed is a performance ratio.

1 ▶ What is meant by this?

Performance ratios show how profitable a business is. The ROCE shows how much profit the money invested in the business generates.

2 ▶ Work out a operating profit margin b current ratio c ROCE for Al-Dhabit Shipping in each of the three years.

	2013	2014	2015
Operating profit margin	9.04%	3.54%	9.83%
Current ratio	1.49	1.02	1.64
ROCE	11.30%	2.83%	9.75%

3 ▶ Discuss the benefit of using ratios to compare the performance of a business over a period of time.

Ratios can be used to assess the performance of a business over time. This means that the performance can be tracked. Calculating a ratio in one particular year may not be very helpful because there is no basis for comparison. Also, the particular year used might be an unusual year so the result would be misleading. However, looking at ratios for a period of time, three years in this case, it is possible to make comparisons and identify patterns or trends in performance. This is much more helpful.

4 ▶ Assess the performance of the Al-Dhabit Shipping between 2013 and 2015. Make a clear judgement in your evaluation.

Over the three years, the operating profit margin has risen from 9.04 per cent to 9.83 per cent. This is a small improvement but, during 2014, the operating profit margin fell to 3.54 per cent when both the price of oil and demand fell. This does not suggest that there is a problem with the business, just that trading conditions were difficult. The current ratio has also improved over the time period from 1.49 to 1.64. If the current ratio lies between 1.5 and 2, a business is said to have adequate working capital. Since 1.64 lies in this range, Al-Dhabit Shipping appears to have enough working capital to fund its day-to-day activities. However, the current ratio did fall to nearly 1 in 2014, which provides further evidence that trading was difficult. Finally, the ROCE has fallen over the three years from 11.3 per cent to 9.75 per cent. The company is still recovering from the difficult trading conditions and in 2014 the amount of capital employed was increased when the owners injected another US$2 million of capital. Clearly, the operating profit has not risen enough yet to recover the lost returns.

CHAPTER 32

CASE STUDY: O'JAR BUILDING SUPPLIES

CASE STUDY: PARK FARM FOODS

1 ▶ Which stakeholder is interested in the financial information in Tabl 32.1?

The information in Table 32.1 shows current assets and current liabilities for O'Jar Building Supplies. A supplier will use the information to decide whether to give the company trade credit. If a business is not financially secure it would be risky selling goods on trade credit.

2 ▶ What conclusion might the stakeholder in question 1 draw from the information shown in the statement?

The information in Table 32.1 shows that the working capital position for O'Jar Building Supplies is worsening over the time period. Current assets fall between 2012 and 2015 while current liabilities rise. Indeed, in 2015, working capital is negative because current assets are less than current liabilities. This suggests that the company will struggle to pay its immediate bills. As a result, the supplier is not likely to grant the O'Jar Building Supplies trade credit because they might not get paid.

3 ▶ How will Marcus van Zyl use the statement of comprehensive income shown in the statement of comprehensive income to make an important decision?

Marcus van Zyl is going to use the statement of comprehensive income for 2016 to make an important decision regarding his future. He has decided that if the farm does not make a profit of ZAR 500 000 in 2016, he will retire from farming. Unfortunately, the statement shows that the farm's profit in 2016 is only ZAR 211 000. This is even lower than the profit made in 2015 (ZAR 344 000). Presumably Marcus will retire from the business.

4 ▶ Obtain the accounts of two large businesses in your area and compare their performance. (The accounts of PLCs can be obtained very quickly online.)

ACTIVITY 1

CASE STUDY: BIBBLINGTON PHARMACEUTICALS

1 ▶ What is the main reason why the owners of Bibblington Pharmaceuticals use accounts?

The owners of businesses will obviously be interested in the performance and the financial position of the business. Shareholders in limited companies will also be interested in the performance of the business. They may look at the size of dividends; they may use ratio analysis to see how their investment in the business is performing; and they might also make comparisons with other companies in the same industry. In this case, the shareholders of Bibblington Pharmaceuticals set targets for return on capital employed. The shareholders aim to get a 10 per cent return on capital employed. They use the accounts each year to check whether this target has been achieved.

2 ▶ Discuss whether Bibblington Pharmaceuticals has reached the targets set by the shareholders over the time period shown.

According to the information in Table 32.3, the return on capital employed has exceeded the shareholders' targets every year except for 2016. In 2016, ROCE was only 8.3 per cent. Although this is below their 10 per cent target, it may not be too disappointing. For example, it may be acceptable if trading conditions were difficult during this time. It is possible that the performance in 2016 was caused by unusual circumstances and that in the future trading conditions will return to normal and the performance of the business will improve.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3C, 4A

CHAPTER REVIEW

CASE STUDY: VARL TOWN POOLS

1 ▶ Describe one reason why employees at Varl Town Pools might be interested in the financial documents shown in the tables above.

Employees might need financial information during wage negotiations. For example, information about the profitability, liquidity and financial prospects of the business could be used to decide whether a business can afford to raise wages. They may also look at accounting information to see whether their jobs are secure. The information in Tables 32.4 and 32.5 is not very encouraging for employees. Revenue has fallen over the two years and in 2016 the business made a loss. This suggests that their jobs are not entirely safe and that a wage increase is very unlikely at the moment.

2 ▶ Discuss two ways in which Varl Town Pools might use financial documents to make decisions.

Businesses will make better-informed decisions if they have access to financial documents. Since financial documents contain quantitative information, they can be very helpful in the decision making process. For example, Varl Town Pools may need up-to-date financial information to help run the business and make key decisions such as how to reduce costs. The statement of comprehensive income for the company shows that both cost of sales and expenses have increased between 2015 and 2016. For example, cost of sales has increased by around 17 per cent. Varl Town Pools could examine the different costs to help identify problems. For example, if the cost of raw materials is rising, Townsville Pools might decide to find some cheaper suppliers.

In 2016, Varl Town Pools made a loss of A$3 500 000. This is shown clearly in the statement of comprehensive income. The business may use the financial documents to try to find ways of improving profitability. For example, if the gross profit margins are small in relation to competitors, it may be because prices are too low or costs of sales are too high. Therefore prices can be raised or new suppliers might be found for raw materials and other key resources. Perhaps wage costs need more control. Profitability might also be improved if revenues are falling behind those of competitors. For example, perhaps a business should try to find new markets to help increase sales – overseas for example. In this case, Varl Town Pools has been lowering prices to fight off new competition. It is possible that the price reductions have been too severe. Consequently the business may decide to review this strategy.

3 ▶ Assess the performance of Varl Town Pools between 2015 and 2016. Make a clear judgement in your evaluation.

One of the main uses of financial documents is to assess the performance of a business. A number of stakeholders such as the owners/shareholders, potential investors, employees and managers will be interested in the performance of a business. In this case, the information in Tables 32.4 and 32.5 shows that the performance of Varl Town Pools has taken a turn for the worse between 2015 and 2016. For example, in 2015, the business made a profit after tax of A$6 900 000. However, in 2016, this became a loss of A$3 500 000. This is a significant worsening which none of the company's stakeholders would welcome.

The statement of comprehensive income shows that revenue has fallen by 8.4 per cent and both cost of sales and expenses have risen significantly. Falling revenues and rising costs are a bad sign for a business. In this case, the likely reason for the outcomes is the arrival of new competition in the market. In an effort to improve competitiveness, Varl Town Pools has lowered the prices of its maintenance services and taken on some construction work at a loss in 2016. This strategy does not appeared to have worked very well. By lowering prices the business would have expected to raise revenue. But this hasn't happened, in fact, revenue has fallen.

The statement of financial position also shows a downturn in performance. For example, the amount of working capital (net current assets) has fallen by nearly 34 per cent. A particular problem is the fall in the cash balance from A$5 300 000 to A$1 200 000. This is in spite of borrowing more money (non-current liabilities have increased by A$900 000). Also, the value of the business has fallen sharply. The net assets fell from A$13 300 000 in 2015 to A$9 800 000 in 2016. This means that the business is worth A$3 500 000 less.

To conclude, the performance of Varl Town Pools has worsened significantly as a result of new competition in the market. The outlook is also poor. After lowering prices and, carrying out some construction work at a loss, the business is still struggling. It may not survive much longer!

CHAPTER 33

CASE STUDY: TOURISM IN SRI LANKA

1 ▶ What was the size of the Sri Lankan tourist market in 2016?

In 2015, a total of 1 798 410 tourists arrived in Sri Lanka.

2 ▶ What is expected to happen to the size of this market in 2017?

The size of the market appears to be growing. In every month in 2017, the number of tourists arriving in Sri Lanka is higher than the corresponding month in the previous year.

3 ▶ How might a tour operator selling adventure holidays in Sri Lanka use the information in Figure 33.2?

Information in the case states that adventure travel has been growing at over 65 per cent a year since 2009. It is now a US$263 000 million industry and is still growing. This would be encouraging news for a tour operator selling adventure holidays. The information in Figure 33.2 might suggest to a tour operator that an online presence would be very important when attracting customers. For example, 69 per cent of adventure travellers researched adventure holidays online. This means that the tour operator could advertise its holidays on appropriate websites. The data also shows that adventure tourists are more likely to book their own trips online rather than visit a travel agent. This information also supports the view that an online presence would be important.

4 ▶ In groups, discuss what other information might be useful to a European tour operator selling holidays to Sri Lanka. List your results on a poster and present them to the rest of the class.

There could be many responses to this question. Some examples might include:

- The age profile of tourists to Sri Lanka
- The countries that those interested in Sri Lanka live in (that is, which particular European country, if any)
- The type of accommodation tourists prefer when visiting Sri Lanka
- The amount people are prepared to pay for a holiday in Sri Lanka
- The reasons why people choose Sri Lanka as a destination
- How people book their trips to Sri Lanka

ACTIVITY 1

CASE STUDY: MANZINI SAFARI TOURS

Manzini Safari Tours has used primary research to gather information.

1 ▶ What is meant by primary research?

Manzini Safari Tours is carrying out primary research because the tour operator is collecting new information – data that has never been collected before. It is phoning potential customers and asking them questions about the tours. This data does not already exist; it is new data and therefore primary research.

2 ▶ Describe one advantage and one disadvantage of using telephone surveys.

Telephone surveys involve interviewing people over the telephone. The main advantage of interviewing people over the telephone is that it is cheaper. People from a wide geographical area can be covered. In this case, the customers may be spread all over the world. However, many people are becoming irritated by telephone interviews because they may be unwelcome and uninvited. They may refuse to take part in the interview.

3 ▶ What is the difference between open questions and closed questions in a survey?

A good questionnaire will usually contain an appropriate balance of closed and open questions. Closed questions have definite answers. In Figure 33.3, Questions 1 to 5 are all closed questions – there is a definite answer to all of them, either yes or no. Open questions have many different possible answers, so when answering open questions, respondents can give a wide variety of answers. In this case, Figure 33.4 might be answers to the question 'Why haven't you been on a Manzini Safari Tour?' Each one of the responses shown is different. There could also be many other answers to this question. Closed questions can be used to generate quantitative information while open questions tend to generate qualitative information.

4 ▶ Look at the data for Manzini Safari Tours and suggest reasons why the number of visitors has fallen in recent years. Give at least two reasons in your analysis.

There could be more than one reason why the number of people going on safari tours to the Manzini Wildlife Sanctuary has fallen in recent years. Only 7 per cent of people in the survey had been to the sanctuary although 61 per cent had been on safari tours, which would suggest that there is some interest in such trips. It is possible that Manzini Safari Tours are too expensive. Of people 44 per cent said they would go if it was cheaper; this is nearly half of those interviewed. Also, one of the respondents' comments in Figure 3346 says, 'It's too expensive – it would cost me and my family over £300 to go for the day.'

Another possible reason for the fall in visitor numbers is that the Park's advertising has not reached many people. Only 7 per cent of respondents had seen adverts for the tours. Also, one response in Figure 33.4 said 'I have never heard of Swaziland'. Perhaps consumer awareness needs to be raised.

Finally, some of the comments shown in Figure 33.4 might suggest other reasons for the fall in visitors. These include that the tours appear too supervised and that there are no tigers. However, unless a lot of people made similar comments, these may not be very important.

ACTIVITY 2

CASE STUDY: NESCAFÉ

Nescafé uses Tumblr to gather qualitative data.

1 ▶ What is meant by qualitative data?

Some of the data gathered by market researchers is qualitative. This means that the information is about the attitudes, beliefs and intentions of consumers. It is usually written down in words or recorded – in a video clip, perhaps. Nestlé uses social media to gather qualitative data about what people think of Nescafé. It uses the Tumblr platform to develop consumer-led communications. This information will appear as text as consumers send their messages. Some consumers may also post photos and other images during their interaction.

2 ▶ Assess the benefits to Nescafé of using social media to help gather information from consumers.

In 2015, Nescafé became the first global brand to transfer all of its websites to the social media platform, Tumblr. Social media is playing an increasing role in marketing. It can provide a cheap way of gathering information about a firm's customers, market, brand appearance and other market issues. For example, most social media platforms

offer numerous ways to analyse trends and conduct market research. One of the main benefits of using social media is the broad reach it has. In this case, Tumblr claims that it hosts around 315.3 million blogs and 150 300 million posts a year. This means that Nescafé can access huge numbers of customers and potential customers using the platform. Another benefit is that social media allows specific groups of people to be targeted. In this case, one of the main reasons why Nescafé switched to social media was to build stronger relationships with younger consumers.

Nescafé can also gather information from consumers instantly. Interaction takes place in real time so information is always up-to-date. This means that Nescafé can respond to any helpful suggestions resulting from their research very quickly. Finally, the use of social media is not technically difficult and therefore is cost effective to use. Over the last six months, Nescafé says the Tumblr websites have generated an extra US$200,000 in sales. Users can make instant purchases by clicking on to 'buy now buttons'. Also, total monthly visits have risen by 29 per cent with users now staying 18 per cent longer per visit. Nescafé clearly values the use of social media in marketing.

MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3D, 4A

CHAPTER REVIEW

CASE STUDY: FORD

1 ▶ Using the data in Figure 33.6, calculate Ford's share of the global car market in 2015.

Ford's market share

= Ford market share ÷ total market × 100

= 6.64 million ÷ 72.37 million × 100

= 9.18 per cent

2 ▶ Describe two benefits of using online surveys to gather information from customers.

Like many businesses, Ford uses online methods to gather information from customers. The main benefit of online surveys is that they can be completed and processed quickly – the person types in the data, which is then fed straight back for immediate analysis. Survey costs are lower because there is no need for printing, postage and typing in. Online surveys are often fun to complete because they may be interactive. They can also be accessed 24/7 and be completed at the convenience of the respondents. Online surveys also make it easy to give feedback. Results can be e-mailed to back to the respondents if this is appropriate.

3 ▶ Discuss the importance of the reliability of market research data to a company like Ford.

Although carrying out market research can reduce the risk of products failing in the market, it is important to ensure that the data gathered is reliable. If market research data is inaccurate or out of date, any decisions based on the data are likely to be unsound. A business also needs to appreciate that human behaviour is unpredictable. People might also change their minds or misunderstand the questions. They might also give answers that they think the interviewers wanted to hear.

4 ▶ Discuss the possible benefit to Ford of the information in Figure 33.7.

Ford recognises the difficulty in judging the accuracy and authenticity of people's online comments. This is because many users admit that they lie on their social media profiles to make themselves appear better than they are. With this in mind, Ford has established social media guidelines to ensure that its employees are truthful and realistic when discussing the company on social media. The amount of money that Ford invests in the development and launch of a new product is so big that the reliability of data it collects is of crucial importance.

The pie chart in Figure 33.7 shows sales of cars by geographical region. This is an example of quantitative data and may be of use to Ford, for example by showing that nearly one-half of global sales are made in Asia (mainly China). This suggests that the Asian market is important. Therefore, Ford might channel more resources into the development of products suitable for this market. Ford should spend more time and money finding out exactly what people's needs are in this market to ensure that the right sorts of products are developed. It might also suggest that Ford should locate more production units in this market so that transport costs are as low as possible. Also, people in Asian markets may prefer to buy Ford cars if they know that they are produced by factories close to, or actually inside, their own country.

5 ▶ Assess the possible benefits to Ford of using market research before launching new products.

Ford will be more successful if it can supply cars that meet customers' needs. This means that a business has to gather information to identify these needs. Once this data has been gathered, Ford can design a car that meets the specific needs of customers. The data gathered by market researchers needs to be as detailed as possible. Ford will try to anticipate customer needs; this means they try to predict what customers want in advance and respond to changes very quickly. Businesses operate in a rapidly changing environment and have to keep up with the latest trends, fashions, technology and designs. The technology used in car design and manufacture is a particularly important issue when meeting customer needs.

Launching a new product is risky. Also, as markets get larger and competition gets fiercer, launching new products gets even riskier. The probability of failure is high but investment in effective market research can help reduce the risk of failure. Ford will want to avoid costly product failures that may result from misreading the market or failing to carry out effective market research.

Gordon Platto, Ford chief designer, says that the company is very influenced by the data gathered from market research. He said 'We go to customer immersion events and spend time with customers in their homes to understand how they use their vehicles. It enables us to better meet the customer needs. You can see the influence in our new vehicles.'

Finally, although Ford is committed to gathering market research data and is prepared to make good use of it, it must understand the importance of data reliability. Evidence in the case does suggest that Ford is aware of this. For example,

Ford appreciates the difficulty in judging the accuracy and authenticity of people's online comments. This is because many users admit that they lie on their social media profiles to make themselves appear better than they are.

CHAPTER 34

CASE STUDY: HASAN'S

1 ▶ Why is Hasan's a successful business?

Hasan's is a successful business for two main reasons. First of all, Aftab serves high-quality reasonably priced food. The restaurant industry is highly competitive so any outlet that offers quality at a reasonable price is likely to enjoy success. However, another important reason is the quality of customer service delivered at Hasan's. About 80 per cent of Hasan's customers are regulars and evidence suggests that a good proportion of them value the quality of customer service offered by Aftab and his family. The quality of customer service is good because Hasan's meets customers' needs.

Aftab says 'I have worked very hard to build a relationship with my customers.'

2 ▶ What is meant by this?

An increasing number of businesses try to build relationships with customers. This involves getting to know them at a personal level. Businesses try to establish a bond with customers through effective communication and do everything possible to meet their needs. Businesses can adopt a number of practices to help build customer relationships. They can personalise communication, say thank you, build trust and connect with them regularly, for example. In this case, Aftab says that he treats customers like his friends and goes out of his way to meet their needs. People are made to feel welcome. For example, the restaurant stays open very late every Thursday night to serve 12 regular customers that come straight from a local factory after a late shift for something to eat. Clearly Aftab has built a sound business relationship with these customers.

3 ▶ Describe the benefit to Hasan's of having loyal customers.

Every business wants loyal customers. This means that they keep coming back to spend more money. Therefore a business does not have to invest as much money in expensive marketing such as advertising and promotion. The cost of retaining existing customers is much less than the cost of acquiring new ones. Hasan's will enjoy more revenue, lower costs and higher profits if it can continue to hold on to its loyal customers.

ACTIVITY 1

CASE STUDY: INTERCONTINENTAL HOTELS GROUP

1 ▶ What is meant by a customer loyalty scheme?

A customer loyalty scheme rewards customers for repeat purchases. Customers are given benefits when they increase the number or value of their transactions with a business. In this case, the IHG Rewards Club rewards customers according to the number of nights they stay in IHG hotels. Some of the benefits of building up a booking history include the accumulation of points or miles which can be exchanged for bookings, exclusive rates when staying in a hotel, extended checkout times and free newspapers.

2 ▶ Describe one important benefit to IHG of using the IGH Rewards Club.

The use of customer loyalty schemes help businesses to retain customers. This can be very important because if customers remain loyal and continue to make purchases in the future, the financial benefits can be high. Many studies in the past have concluded that the cost of retaining a customer is about 10 per cent of the cost of acquiring a new one. Clearly, the costs of customer retention are less substantial than the benefits. If IHG customers join the Rewards Club, and start to enjoy the rewards, they are likely to book IHG hotels whenever they travel.

3 ▶ In pairs, design a customer loyalty scheme for a small guest house. Present your ideas on a poster to the rest of the class.

ACTIVITY 2

CASE STUDY: FERRARI

In 2015, 72.37 million cars were produced globally.

1 ▶ Work Ferrari's share of the global market.

Ferrari's market share = 7664 ÷ 72 370 000 × 100

= 0.01059 per cent.

2 ▶ What is meant by a niche market? Use this case study as an example.

A niche market is a small part of a much larger market. In this case, Ferrari targets its cars at a niche market. In relation to the total global car market of 72 370 000 cars, Ferrari had just 0.01059 per cent of the total market. This is a very small proportion and is a classic example of a niche market. Ferrari targets the prestige segment of the car market where performance, quality and exclusivity are highly valued. The prices of its cars are very high and only a small number of consumers can afford to buy one.

3 ▶ Describe one advantage of operating in a niche market.

A niche market is often left 'untouched' by most of the large producers in a market. Although Ferrari does have competition, it is not from the giant car producers like Ford, Honda, Nissan, VW and Toyota. Consequently, there is more opportunity for raising prices and focusing on production quality. It is also easier to meet the needs of customers in a niche market. This is because the small group of consumers that make up the niche probably have very similar needs.

MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4D

CHAPTER REVIEW

CASE STUDY: THE GLOBAL MARKET FOR OIL

1 ▶ What is meant by the term mass market?

Mass markets are huge markets where the same product is sold to huge numbers of people. The global market for oil is an example. Oil producers can produce large quantities at a

lower unit cost by exploiting economies of scale. This might result in higher sales and higher profits. According to the information in Figure 34.5, the market for oil is dominated by just a few countries which includes the US, Saudi Arabia and Russia.

The global price of oil fell from around US$115 a barrel in 2014 to US$45 in 2016.

2 ▶ Work out the percentage change in the price between 2014 and 2016.

Percentage change in price = US$80 ÷ US$125 × 100

= **64 per cent**

3 ▶ Do you think the oil industry is product or market orientated?

The oil industry is product orientated. This is because oil producers focus their efforts on extracting as much oil as possible and as cheaply as possible. Their major concerns are production costs. Oil producers engage in little marketing since their output is sold into a global market where the price is already determined. Each oil producer makes little or no effort to conduct market research or understand their customers' needs since one company's crude oil is exactly the same as another. The need for oil already exists since it is an essential source of energy so there is little opportunity for advertising and promotion.

4 ▶ Discuss one important change that has occurred in the global oil market.

The price of oil has fallen dramatically since 2014. In less than two years, it has fallen by 64 per cent. One of the main reasons for the fall is the increase in supply of oil and other energies. US production has nearly doubled recently which means that the USA's suppliers, such as Saudi Arabia, Nigeria and Algeria, are trying to sell more of their oil in Asian markets. Canadian and Iraqi oil production is also rising and the Russians are also managing to maintain high production levels.

Businesses in the oil industry have been hit hard. Revenues and profits have fallen which has resulted in many bankruptcies and forced oil companies to cease operation at more than two-thirds of their production faculties. Companies have also cut investment in exploration and production quite sharply. It is estimated that 250 000 oil workers – roughly one-half in the USA – have lost their jobs.

5 ▶ Assess the importance to businesses of responding to changes in the market.

Most markets are dynamic which means they are likely to change. Markets may grow, shrink, fragment and emerge. Some markets can completely disappear. One of the reasons why markets change is because the needs of customers change. These needs change for a number of reasons. For example, consumers are better educated and more sophisticated than ever before. Owing to improvements in communications and the greater availability of knowledge, people are more aware of opportunities and have developed more sophisticated tastes. Consumers have also been influenced by changes in social habits. For example, more people are concerned about the environment and resource depletion and therefore want to recycle their waste. In this case, it might be argued that the drop in demand for oil might be partly caused by more energy being generated using renewable sources.

Businesses must monitor markets, identify changes in customer needs and be prepared to develop new products in order to meet these new needs. Failure to do so may mean that market share is lost to more responsive rivals. Businesses can also gather information about spending patterns in markets. They can carry out their own research, use statistics generated by the government or purchase market research reports from specialist market research agencies such as Mintel.

Changes in the market might be the result of increased competition. The behaviour of competitors in the market needs to be monitored very carefully. For example, the arrival of a new competitor in the market could have a dramatic effect on sales if their products are more advanced or more effectively marketed. Competition puts businesses under some pressure. It means that they have to encourage customers to buy their products in preference to those of rivals. They will use a range of methods to attract customers. They might do this by lowering prices or making their products appear different to those of rivals, for example.

Finally, if businesses do not respond to market changes, they are likely to lose market share. At worst they could collapse. In the market for oil, demand has fallen, new competition has arrived in the form of US shale gas producers and prices have fallen sharply. Unfortunately, due to the nature of the product, there is not a great deal oil producers can do. It is not possible to develop the product, firms have no control over price and the promotion of oil as a product is not really appropriate. The only way businesses can respond to changes in the market is to cut costs and hope that the price recovers in the future. However, one possibility is for oil companies to diversify. For example, some large oil companies have started to invest in wind farms, electric battery storage systems and carbon capture and storage (CCS) to generate new revenue streams. One of the world's largest oil producers, Saudi Arabia, has said that it will sell off part of its large state-owned oil business and diversify its economy away from oil.

CHAPTER 35

CASE STUDY: ACCOR

1 ▶ How has Accor divided the market in this case?

Accor has a number of hotel brands that it targets at different customer groups, each with different needs. For example, some customers, the young and low-income travellers, may only be able to afford 'budget accommodation'. Therefore, the Hotel F1 brand might suit their particular needs. Rooms only cost from €19 per night. Another group of customers targeted by Accor are very wealthy and look for luxury; the Raffles brand will provide for this group. There are just 12 Raffles hotels and each one is unique in style. The brand also offers unique features including the famous Long Bar and Writers Bar (which come from the original Raffles Singapore), Raffles

Patisserie and Raffles Spa. A room in Raffles, Singapore may cost at least €800. Accor also targets well-connected and sophisticated travellers. Its Pullman brand has 100 four- and five-star hotels across Europe, Africa, the Middle East, Asia-Pacific and the Americas. Prices per room will start at around €120, however, they could be a lot higher depending on the location. Finally, Accor has a brand that meets the needs of people with a little more purchasing power than low-income consumers. For about 60 euros per night, the Mercure brand with 738 hotels in 51 different countries, offers warm, personalised contemporary rooms. They are welcoming, clean with high quality furniture. Accor has divided the market according to different needs and income levels.

2 ▶ Discuss how Accor might benefit from having many different hotel brands.

By targeting different customer groups, Accor will be able to serve a wider range of customers. This will enable them to increase their revenue. If Accor only offered, say, the Mercure brand, it would miss out on the opportunity to charge higher prices to those who are willing to pay for a higher quality service such as Raffles. It would also miss out on a large budget hotel market if it did not operate Hotel F1.

ACTIVITY 1

CASE STUDY: TOYOTA

There are many different segments in the market for cars.

1 ▶ What is the main reason for this?

There is a very large number of different segments in the market for cars because a wide range of different consumers want different types of vehicles. For example, there are small 'low cost' cars, environmentally friendly cars that use electricity, 'sporty' cars, family cars, prestige cars, mid-range cars, 4WDs and commercial vehicles. These different types of cars, and others, are likely to be purchased by different consumer groups that have different needs and wants.

2 ▶ Describe the market segment that Toyota is likely to target with the vehicles described here.

The Toyota Prius is likely to be targeted at people who are concerned about the environment. It produces lower emissions than normal petrol driven cars because it relies more on electricity for its power. The Toyota Prius has become well known among eco-conscious drivers.

The Proace is a commercial vehicle. It is a van and will be targeted at businesses that require this type of transport.

The AYGO is a small, low cost car. It is not a family car and is therefore likely to be targeted at single people on relatively low incomes. However, families might buy it as a second car. It is also said to be the ultimate city car so it might also be targeted at single people who live in cities.

The Land Cruiser is an expensive 4WD and described as a sports utility vehicle. It is likely to be targeted at wealthier people who have an interest in sport. It might also appeal to wealthier families because of its size.

3 ▶ Assess if these products are likely to be targeted at particular a geographical areas and b income groups.

a Buyers of the AYGO may be segmented geographically. This is because it is described as the ultimate city car. This suggests that it will be targeted at people living in cities.

It might also be argued that the Land Cruiser is targeted at rural customers because it is an 'off-road' vehicle. It may be that many are sold to people who live in the countryside. However, there is plenty of evidence to suggest that 4WDs are also popular with drivers who live in towns and cities.

b The AYGO is likely to be targeted at lower income groups. This is because it is a cheap car at just £8495. It is also economical, which will appeal to lower income groups. In contrast the Land Cruiser may be aimed at wealthier drivers. This is because it is expensive – priced at £36 465. It is also said to offer premium levels of comfort, which would appeal to higher income drivers.

4 ▶ Choose another well-known multinational car manufacturer and look at the range of models it is marketing (online if possible). Decide which market segment each model is being aimed at. Record your results on a poster and present to the rest of the class.

MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3B, 4D

CASE STUDY: JQBC

1 ▶ What is meant by market segmentation?

Markets can be divided into different sections or segments. Each segment is made up of consumer groups that have similar needs. Businesses recognise this and target particular market segments with their products. For example, JQBC targets at least one of its brands (TV channels), JQBC Kidz, at young children.

2 ▶ How does JQBC segment the market for television according to a age, b lifestyle and c gender?

a Evidence in the case suggests that JQBC uses demographic segmentation. This is because some of its brands (TV channels) are targeted at specific age groups. For example, JQBC Kidz is targeted at children. This channel targets the 3–10-year-old age group. It provides a range of cartoons, children's films and learning programmes. The schedule aims to follow the mood and energy levels of young children throughout the day.

b Some products are targeted at consumer groups according to their lifestyles. For example, JQBC has JQBC Sport. This channel is aimed at sports enthusiasts. It provides live coverage of a number of key sports events around the world such as golf, association football, auto racing and baseball. It also covers sumo wrestling, martial arts, figure skating and rugby union in depth.

c Some businesses may target their products according to gender. In this case, JQBC has a channel which is aimed specifically at the female audience. JQBC Fem It is aimed at female viewers and offers a wide range of programmes including films, lifestyle series, quiz and panel shows, drama series, reality series and talk shows on varying topics including cooking, travel, cars, relationships and sports.

3 ▶ Discuss how a business might benefit from using the socio-economic table in Figure 35.1

The table shown in Figure 35.1 is used to divide people into different groups according to their social class. There are six different groups. Those in group A, for example, are described as 'Upper middle class'. The group only accounts for about 4 per cent of the UK population and is likely to include doctors, lawyers, company directors and high level administrators. In contrast, C2, the skilled working-class group, is the largest in the population (33 per cent). It includes skilled manual workers such as carpenters, plumbers, cooks and train drivers.

A business might use this information when targeting products at different market segments. For example, stores like Poundland (UK) and Dollar Stores (US and Australia), where all products are sold for a low currency denomination such as £1 and $1, may be targeted at Socio-economic groups D and E.

4 ▶ Assess the possible benefits to JQBC of using market segmentation.

Generally JQBC will be better placed to meet the needs of different customer groups if the market is segmented. It can design TV channels for groups of customers that have similar characteristics. By producing different channels for different market segments JQBC can increase its revenue. For example, JQBC has TV Channels like JQBC Kidz for children, JQBC for women and JQBC for sports enthusiasts. These are three distinct customer groups with very different needs. By catering for these different needs JQBC can generate more revenue. For example, JQBC Fem is an important channel for the broadcaster since it attracts the most advertising revenue. Advertising revenue is attracted from a large number of businesses and increasingly from businesses that save time for busy families. For example, online grocery retailers are currently targeting working parents who have increasingly less time for family grocery shopping trips.

Another benefit of market segmentation is that customers may be more loyal to a business that provides products which are designed specifically for them. In this case, once consumers become familiar with a particular TV channel, if it meets their needs exactly, they are likely to continue watching it. Also, when a new channel is launched and directed at the same group, they are more likely to try it.

Market segmentation might also help JQBC to maximise advertising revenue. This is because clients buying advertising space on their channels can target their adverts at specific customer groups. For example, a business that wants to advertise its sportswear is likely to place adverts on JQBC Sport. This will make their adverts more cost effective because a larger proportion of the audience is likely to be interested (than the same advert placed on a general TV channel).

However, JQBC probably has to invest very heavily in production and programming to support the wide range of TV Channels it targets at the different market segments. This will be expensive and eat into profits. However, since JQBC has been broadcasting for 19 years and in 2017 made a profit of JPY12 000 million on a revenue of JPY140 000 million, the effective segmentation of the market must make a substantial contribution to its success.

CHAPTER 36

CASE STUDY: PRODUCT DEVELOPMENT AT BESTHOME

1 ▶ What is meant by product development?

Product development involves identifying opportunities and ideas for new products and converting those ideas into marketable goods or services. BestHome introduces around 1 500 new products each year and is very committed to product development.

2 ▶ Describe BestHome's approach to product development.

BestHome claims that its approach to product development is very thorough. For example, the development of new products often starts with a visit to people's homes to find out the real needs of customers. The design process at BestHome is then handled by a number of teams. Each team contains a materials analyst, a product developer and a technician or engineer - in addition to designers. All the teams work transparently so that everyone can see what everyone else is doing. Design work is carried out in a huge aircraft hanger in Frankfurt where all products and prototypes can be seen. This helps to inspire the designers. The design facility has a prototype shop with craftsmen providing a range of different skills and a 3D printing facility. Finally, designers are encouraged to travel and work with foreign designers to learn new techniques and get fresh ideas. They are also required to attend all major international trade fairs to observe developments in the market and explore the activities of competitors.

3 ▶ Discuss why BestHome brings out so many new products each year.

BestHome stores typically stock 8000 products and each year around 1500 new products are introduced. This will help to keep the stores 'fresh' and encourage customers to revisit to find out what is new. New products help to generate more revenue and hopefully more profit. Also, a business that continually updates its product lines is likely to have a competitive edge in the market. This will help BestHome to maintain or grow its market share.

ACTIVITY 1

CASE STUDY: PACKAGING

1 ▶ What is the main role played by packaging in the images?

The left image shows packaging that can be recycled and a product that is eco friendly. This might attract customers who care more about the environment. They will feel happier buying products knowing that using recycled materials in the packaging has saved resources. Using recycled materials reduces the impact businesses have on the environment. Some consumers might be prepared to pay a higher price for such a product. Also, by using recycled materials, the business might enjoy lower costs.

In the right image, packaging is used to help promote the product. It is designed to be attractive so that customers are drawn to the product. Arguably the bottle design for the perfume is stylish, attractive and 'classy'. It will help

to make the product appear more luxurious. It might also mean that the business can charge a higher price for the product.

Businesses might need to change their packaging when selling goods abroad.

2 ▶ Discuss why this might be necessary.

When businesses export their products, it may be necessary to change the packaging. There may be a number of reasons for this. In some cases, the names of products on packaging may have to be changed. This is because they may be misunderstood, inappropriate or offensive in other languages. Different countries also have different regulations relating to the packaging of products. For example, in some countries all the fat and salt content of food products have to be clearly shown on labels.

ACTIVITY 2

CASE STUDY: MICROSOFT

1 ▶ What is meant by an extension strategy? Use examples from this case study in your explanation.

Extension strategies are designed to lengthen the life of an existing product. They may be introduced before the product starts to seriously decline. If a product can be successfully refreshed, sales levels, along with revenues, may start to recover or even grow. In this case, Microsoft has extended the life of Microsoft® Windows by continually updating the product. Since Windows 1 was introduced in 1985, there have been 11 major updates (along with many other versions of the list shown in Table 36.1). Each new version is improved technically and usually contains new features. The product has now been on the market for 31 years.

2 ▶ Discuss benefits to Microsoft of using extension strategies. Give at least two benefits in your analysis.

One of the main benefits of extension strategies is that products will continue to generate revenues and profits for a longer period of time. A product is likely to be more profitable in the later stages of its life because the research and development costs will have been recovered. Consequently, provided the cost of the extension strategy used is not too high, the longer the life of a product, the more profit will be made. Although Microsoft might invest quite large amounts of money in research and development on the new versions of Windows, the benefits must be greater than the costs because there have been 11 new versions.

Another benefit of lengthening the life cycle of products with effective extension strategies is that competitors will find it more difficult to enter the market. If a business is able to keep updating and modifying a product to make it even better and more appealing, competitors know that they will have to bring out something really special to make an impact on the market. Each new version of Windows that Microsoft launches has better technology and new features. This helps to retain customer loyalty and makes it more difficult for other software producers to take market share away from Microsoft.

MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3B, 4C

CHAPTER REVIEW

CASE STUDY: CHEESY SNAX

1 ▶ What is meant by the term marketing mix?

The marketing mix is the different elements of a firm's marketing that are designed to meet the needs of customers. Often called the 4Ps, they include product, price, promotion and place. In this case, the product is particularly important for Cheesy Snax. It focuses heavily on the quality of its products.

2 ▶ What are the features of a cash cow in the Boston Matrix?

In the Boston Matrix, cash cows are mature products with a high market share. There is little potential for growth in the market but the products generate significant amounts of cash for a business. In this case, Cheesy Crackles and Cheesy Pops, are cash cows enjoying annual sales of around 30 million packets each.

3 ▶ What is the position of Cheesy Puffs in the Boston Matrix?

Cheesy Puffs, was introduced in 2014 and targeted at children. It has a low market share but is showing some potential. This is an example of a question mark in the Boston Matrix. It sold 5 million packets in 2015. The marketing manager thinks that with the right sort of promotion the product will flourish.

4 ▶ Discuss how Cheesy Snax might use the Boston matrix in the management of its product portfolio.

The Boston matrix may be used to help analyse the products marketed by a business. The matrix enables a business to place their products into different categories according to their market share and position in the life cycle.

When managing its product range, Cheesy Snax must try to make sure it has the 'right balance' of products. This means that it must avoid having too many dogs and try to increase the number of stars and cash cows. Arguably, Cheesy Snax has two cash cows in Cheesy Crackles and Cheesy Pops. Some of the income from these cash cows might be invested in new product development. Another product, Cheesy Puffs, was introduced in 2014 and targeted at children. It has a low market share but is showing some potential. It sold 5 million packets in 2015. This product may be a question mark and may need some adjustment in its marketing. Finally, Cheesy Nuts is in decline (a dog) and may be replaced. The Boston Matrix can be used by Cheesy Snax to help make marketing decisions about its product portfolio.

5 ▶ Describe the main features of the product life cycle for Cheesy Nuts.

Cheesy Nuts was launched in 2009 after spending about one year in development. The product was slow to take off and only had annual sales of around 500000 packets half way through 2010. The product did grow for a two-year period but

sales only ever reached just over the 2 million mark. This is significantly lower than the 30 million annual sales of Cheesy Crackles and Cheesy Pops. After reaching their highest point in 2013, sales of Cheesy Nuts started to decline. By 2016, sales were down to about 1 million packets. The cycle suggests that the product has been unsuccessful. If the rate of decline continues, sales could be close to zero by the end of 2017. Cheesy Snax needs to take some action and address the balance in the product portfolio.

6 ▶ Assess whether Cheesy Nuts should be replaced with Blue Cheesy Crackles in 2017. Make a clear judgement in your evaluation.

As the product life cycle shows in Figure 36.5, sales of Cheesy Nuts are in decline. The maximum level of sales for the product was just over 2 million in 2013; since then they have dropped consistently to about 1 million in 2016. If no action is taken they will possibly drop to zero. Cheesy Snax has a number of options in dealing with the problem.

One option is to relaunch the product. It has been suggested that the product should be relaunched with a change in packaging and targeted more aggressively at adults. This might reverse the decline and get the product moving again. A promotion clearly targeted at adults might be effective and result in a new interest in the product. However, the cost of this strategy is about US$1.5 million and some people have said that this is just 'a waste of money'; these people would presumably withdraw the product.

The withdrawal of Cheesy Nuts might be an option if it could be replaced. Cheesy Snax has another product, Blue Cheesy Crackles, under development. The product is close to the test marketing stage. However, there is a worry. Although Blue Cheesy Crackles have a pleasant taste, their bright blue appearance were unpopular with some consumers during development. If the problem could be quickly resolved, and the product launched, Cheesy Nuts could be withdrawn.

Another alternative would be to invest in the promotion of Cheesy Puffs. This product currently has sales of 5 million and is showing some potential even though it has a small market share. Although the investment would cost £2.5 million, this might be the answer if there is going to be a delay in the launch of Blue Cheesy Crackles.

To conclude, it does seem that Cheesy Nuts should be withdrawn from the market. It would be a risk but so would investing a further US$1.5 million in a relaunch. Assuming that there are not enough funds to both invest in the promotion of Cheesy Puffs and relaunch Cheesy Nuts, this might be the best option. It is not clear cut, but there is always risk in business. Cheesy Snax will also hope that the problem with Blue Cheesy Crackles can be solved quickly – especially if Cheesy Nuts are withdrawn.

CHAPTER 37

CASE STUDY: GRANITE TECCO

CASE STUDY: KOWLOON GIFT SHOP

1 ▶ How are prices set in the above examples?

In the first example, Granite Tecco sets a high price for its new products. Then, after a period of time, the price starts to fall. For example, a new product called 'Airdust' was launched in India at a price of Rs3600. However, a ten months later, it was available for just Rs2600. This is about 28 per cent lower than the original launch price.

In the second example, the Kowloon Gift Shop bases the prices charged in her store on costs. Yvette Cheng uses a very simple method to calculate the prices of all the gifts sold in the shop: she adds 20 per cent to the cost of buying them in.

2 ▶ Describe one possible advantage of using the pricing method in each case.

Selling new products at a high price when they are first launched is a common pricing strategy for some businesses – particularly those in the technology industry. The idea is to generate high levels of revenue by selling to *early adopters*. These are people that attach a great deal of value to buying new technology when it first comes out. They are prepared to pay the higher prices to be the 'first' with the new technology.

The method used by Yvette Cheng will ensure that her business makes a profit. This is because the prices charged are 20 per cent higher than costs.

3 ▶ In groups, discuss the factors that might influence the price charged for a a carton of milk and b an air ticket to a far-away place. Record your ideas on a poster and present them to the rest of the class.

ACTIVITY 1

CASE STUDY: COFFEE SHOPS

1 ▶ Describe the pricing strategy being used by the multinational.

The multinational coffee chain in this case is using predatory or destroyer pricing. The idea is that a very low price is set to deliberately undercut competitors like Eduardo Urondo. Once Eduardo's coffee shop goes out of business, the chain will raise prices.

2 ▶ How can the new rival afford to trade at a loss?

Predatory pricing is an expensive approach because it usually means a business has to trade at a loss for a period of time. However, in this case a large multinational is using predatory pricing to drive out a small independent coffee shop. Large multinationals will have huge resources and can afford for one outlet to trade at a loss for a period of time.

ACTIVITY 2

CASE STUDY: PHARMACEUTICAL COMPANIES

1 ▶ Name the pricing strategy used by Pfizer for Atorvastatin.

Pfizer is using price skimming for its heart disease drug Atorvastatin (40mg). This involves setting a high price for a period while a patent protects sales of the drug. Even when non-branded versions of the drug enter the market, Pfizer's Atorvastatin was selling for US$191 per month in the USA. In contrast, a non-branded producer of Atorvastatin (40mg) was selling it for US$160 per month. Another non-branded

product, Lovatstatin (40 mg), was selling for just US$51 per month (although this was not exactly the same chemical as Atorvastatin). Skimming is common in the pharmaceutical industry.

2 ▶ Discuss the main advantage to Pfizer of this pricing strategy.

Pharmaceutical companies use skimming for a purpose: in the pharmaceutical industry, businesses spend a lot on research and development and this is a way to recover some of that money. For example, in 2014, Pfizer, the US drugs company, spent US$7200 million on R&D. In order to encourage research on this scale, pharmaceutical companies can obtain a patent when they launch a new drug. This is a license that protects companies from competition for a period of time. This means they can charge very high prices until the patent runs out. This allows companies like Pfizer to recover the heavy costs of research and development and also make a profit.

MULTIPLE-CHOICE QUESTIONS

1D, 2B, 3A, 4D

CHAPTER REVIEW

CASE STUDY: NASSAR'S

1 ▶ What is meant by cost-plus pricing?

Cost plus pricing is a simple pricing strategy. It involves adding a mark-up (a certain percentage) to the cost of producing or buying the goods for sale. In this case, Nassar's uses a mark-up of 40 per cent for most of its clothing.

2 ▶ Work out the price Nassar's would charge for an item costing AED 240.

Price = cost + (40 per cent × cost)

Price = AED 240 + (40 per cent × AED 240)

Price = AED 240 + AED 96

Price = AED 336

3 ▶ Discuss one advantage and one disadvantage of cost-plus pricing.

Businesses have to set prices that generate a profit. One method that ensures that all costs are covered is cost plus pricing. It is simple and involves adding a mark-up to total costs. In this case, 40 per cent is added to the cost to get the price. This method is common with retailers such as Nassar's. It is a simple pricing method, all of the staff understand it and it ensures that profits are made.

However, one of the disadvantages of this method is that it ignores market conditions. For example, the AED 336 price set by Nassar's for the clothing in this case may be far too high in relation to the prices charged by rivals. This might result in low sales and a move in custom away from all of Nassar's stores over a period of time. Setting a price without taking into account the market conditions could be risky.

4 ▶ What is meant by psychological pricing?

One common pricing strategy is to set the price slightly below a round figure – charging AED 399 instead of AED 400. This is called psychological pricing. Consumers are 'tricked' into thinking that AED 399 is significantly cheaper than AED 400. Of course it is not, but this psychological effect often works for businesses. In this case, Nassar's has used psychological pricing in an effort to increase sales. For example, item 1 was priced at AED 280 using cost-plus pricing but during the trial month it was AED 239.

5 ▶ a Complete the tables by calculating the revenue before and after the price change and b then assess whether the sale using psychological pricing was effective for Nassar's.

To assess whether the new pricing strategy was successful, it is necessary to calculate the revenues from the sales of the four garments in the month before the trial and in the month of the trial. This is easily done by multiplying the sales volume by the prices in each month. These values are shown in the revenue columns of both tables below.

Item	Cost (AED)	Cost + price (AED)	Sales	Revenue (AED)
1	200	280	100	28,000
2	800	1120	50	56,000
3	400	560	80	44,800
4	120	168	200	33,600

Item	Cost (AED)	Psych. price (AED)	Sales	Revenue (AED)
1	200	239	150	35,850
2	800	899	65	58,435
3	400	519	140	72,660
4	120	159	300	47,700

In the month before the trial, where cost plus pricing was used, the total revenue from the sale of the four items was AED 162 400. During the month of the trial, where psychological pricing was used, total revenue was AED 214 645. Therefore, both sales of the four items and revenue have increased significantly. Revenue has increased by AED 52 245, that is, 32 per cent. This suggests that psychological pricing was effective during the month's trial and should be used across all of Nassar's stores. However, some caution is needed. Clearly the alternative pricing strategy has increased revenue, however, Nassar's needs to look at profit as well. It needs to check that business overheads have not increased by more than the increase in revenue as a result of selling more items.

CHAPTER 38

CASE STUDY: UNILEVER

1 ▶ What is meant by distribution in business?

Distribution is the movement of goods from the supplier to the customer.

2 ▶ Describe the method of distribution used by Unilever.

Unilever uses a number of different distribution methods. Unilever has its own sales force but also uses independent brokers, agents and distributors. It sells to chain stores, wholesalers, cooperatives, independents, food service distributors and institutions. Products are transported

through a network of distribution centres, warehouses, company-operated and public storage facilities and other facilities. Their popular brands can be bought in a very wide range of retail outlets from small independents to giant supermarkets, all over the world.

3 ▶ Discuss one reason for Unilever's approach to distribution.

Unilever appears to use a mass distribution approach. It uses many different outlets to sell its products. This approach allows Unilever to sell large volumes all over the world. As a result, it is able to generate large revenues. For example, in 2015, the company enjoyed sales revenue of €53 300 million. If Unilever were more selective about its distribution network, it would be more difficult to generate such high levels of sales.

4 ▶ In groups, make a list of all the different types of outlet where a Magnum ice cream might be purchased. Compare your results with other groups. Which group has the longest list?

ACTIVITY 1

CASE STUDY: BATA

1 ▶ What is the difference between retailers and wholesalers?

Retailers are businesses that buy goods from manufacturers or other suppliers and sell them to consumers. Retailers provide manufacturers and other sellers with some key services. They buy large quantities from manufacturers and wholesalers and sell smaller quantities to customers. This is called bulk breaking and is the main function of retailers. However, they may add value to products by providing other services. These might include help with packing, delivery, repair services, information about products, guarantees and gift-wrapping.

Wholesalers usually buy from manufacturers and sell to retailers. Some wholesalers are called cash and carries. This is because customers can come to the store, buy goods, pay cash and take goods away with them. Wholesalers may break bulk, repack goods, redistribute smaller quantities, store goods and provide delivery services. A wholesaler stocks goods produced by many manufacturers. Therefore retailers get to select from a wide range of products.

2 ▶ Describe two features of a chain store like Bata.

One approach to retailing is to develop a chain of stores. This is where one owner or company opens multiple stores selling the same range of goods in many different locations. In this case, Bata has around 5000 stores selling footwear. Each store in the chain will look very much the same and be under the control of a central office. Stores will usually have a standardised product range. This means that each shop will have almost exactly the same products for sale – shoes and other footwear in the case of Bata. Another feature of chain stores is that the facia and layout will be almost exactly the same in every store wherever it is located.

3 ▶ Discuss the main advantage to Bata of manufacturing shoes and selling them through its own chain stores.

Bata also manufactures footwear. It has 26 manufacturing units in 18 different countries. The main advantage to Bata of manufacturing its own shoes is that the intermediary is removed. This means that Bata makes more money because it enjoys the profit margins that the intermediary (perhaps a wholesaler) would normally take. This will increase the profitability of the whole business. It also means that Bata's manufacturers have guaranteed outlets for their output.

ACTIVITY 2

CASE STUDY: ROLEX

1 ▶ Describe the method of distribution used by Rolex.

Rolex is very selective about where its wristwatches are sold. Rolex watches are only available in a select number of official Rolex retailers. It is important that each outlet has the necessary skills and technical know-how to guarantee the authenticity of each and every part of a Rolex, and to help customers to choose the right model that will last a lifetime. This helps to control the environment in which they are sold and to avoid the sale of fake watches.

2 ▶ Discuss one possible reason why Rolex watches cannot be purchased online.

One reason why genuine Rolex watches cannot be purchased online is because Rolex wants to reduce the number of fake watches that are sold under its brand name. It is much easier to sell 'fake' products online since customers cannot touch and look at goods before they are purchased. Rolex claims that none of their watches will be sold online. Therefore, anyone that buys a Rolex from this source is taking a great risk – it is unlikely to be a genuine Rolex.

MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4B

CHAPTER REVIEW

CASE STUDY: NEIMAN MARCUS

1 ▶ What is meant by the term distribution channel?

A distribution channel is the route through which goods pass from the manufacturer to the consumer.

2 ▶ Describe one factor that might affect the choice of distribution channel for a business.

The distribution channel chosen by a business will depend on a number of factors. One factor is the nature of the product. Different types of products may require different distribution channels. For example, most services are sold directly to consumers. It would not be appropriate for window cleaners, gardeners and hairdressers, for example, to use intermediaries. Businesses producing high-quality 'exclusive' products such as perfume and designer clothes will choose their outlets very carefully. The image of their products is important so they are not likely to use supermarkets, for example. In this case, Neiman Marcus, a luxury department store, stocks some high profile brands such as Chanel, Gucci and Prada. These manufacturers will be happy to see their products stocked in such an exclusive outlet.

3 ▶ Describe two features of a department store.

Neiman Marcus is a luxury department store. This is a large store split into distinct selling departments such as

menswear, nightwear, cosmetics, food, gifts and children's clothing. They usually aim to provide good quality products with high levels of customer service. For example, sales staff may receive training in the different products sold in their particular department. Department stores are often found in city centres. Neiman Marcus has around 40 stores selling women's and men's clothing, accessories, jewellery and dinnerware. Five of Neiman Marcus's stores are located in South Florida.

4 ▶ Discuss the possible reasons for the growth in online sales for retailers such as Neiman Marcus. Give at least two reasons in your analysis.

One of the main reasons why online sales have grown so rapidly in recent years is because of the benefits it offers to consumers. Products can usually be purchased more cheaply because e-tailers have lower set-up and operating costs. For example, they do not have to invest in expensive properties to locate shops. Consumers can also shop 24/7 and there is generally a lot more choice. Another benefit is that people can shop from anywhere provided they have access to the Internet.

Another possible reason for the growth is the development of the technology that allows online retailers to operate. People can use PCs, laptops, smartphones or tablets to buy goods online. This provides consumers with a very flexible method of shopping. For example, people could do their weekly grocery shopping using a smartphone while sitting on the train returning from work and so complete an uninteresting household task in what would usually be wasted time. Without reliable and sophisticated technology, online shopping would not have grown.

5 ▶ Assess the benefits of e-tailing to Neiman Marcus.

Neiman Marcus, like many other retailers, has taken up online selling enthusiastically and begun to enjoy the benefits. One of the main benefits is that e-tailers do not have to meet the set-up and operating costs of opening more stores. This will help to reduce both fixed and variable costs and therefore increase profits. There will also be savings because less paper is used for documents, such as invoices and receipts. Transaction costs will be lower because most transactions are automated. Payments from consumers can be received online before goods are sent to. This will help cash flow and avoid bad debts. B2C businesses like Neiman Marcus will also be able to sell to a global market using an online operation and serve their customers 24/7.

Online sales are becoming more important to the business. Neiman Marcus's chief operating officer Don Grimes said that the company sold US$1300 million online in 2015, an increase of 13 per cent. Web sales made up 25.5 per cent of the company's 2015 sales of US$.095 million, up from 23.9 per cent a year earlier. The success of its online operation was explained by to investment in technology and the provision of a personalised shopping facility.

However, there are some disadvantages that need to be recognised when selling online. Neiman Marcus will face increasing competition since selling online is a relatively cheap method of distribution and can be organised from any location in the world. Consequently, the business will face more competition from overseas. There is also a lack of human contact, which might not suit some customers, and there is heavy dependence on delivery services where e-tailers often lack control of the quality of delivery. However, since Neiman Marcus also has its chain of stores, it can serve customers in two ways.

There may also be technical problems online. For example, websites may crash, sites may be affected by malware and Internet connections can go down. There is also a security risk as computer hackers might gain access to sensitive information. Neiman Marcus will need to develop systems to deal with any technical issues encountered. This will cost money but overall it seems that the business is benefitting very favourably from its online venture.

CHAPTER 39

CASE STUDY: SKY TELEVISION

CASE STUDY: BLAKE STREET BLINDS

1 ▶ Describe the methods used by Sky and Blake street Blinds to promote their products.

Sky is using a giant image of the corporation's name on one of its studio buildings to promote the organisation.

Blake Street Blinds is using a small advert in a local newspaper to advertise its products.

2 ▶ Describe one possible advantage of each method.

For a large company like Sky, the use of posters to advertise the company is a relatively cheap method of promotion. The same poster design can be placed at poster sites all over the country to get national coverage. Since it is so large, the poster is likely to have an impact as people pass by.

For a small family business like Blake Street Blinds, advertising in a local newspaper is a common method of promotion. It will be targeted at residents in the local area that the business is happy to serve. It is an inexpensive form of advertising for a small business.

3 ▶ Discuss why Blake Street Blinds is likely to use a different method to Sky when advertising.

Sky and Blake Street Blinds are very different businesses. Sky is a very large PLC while Blake Street Blinds is a small family business. Blake Street Blinds would not have the resources to meet the cost of a national poster campaign. Neither would it be appropriate since Blake Street Blinds only serves a small market.

4 ▶ Design a poster that could be used to advertise a satellite television broadcaster.

ACTIVITY 1

CASE STUDY: TELEVISION ADVERTISING

1 ▶ What is meant by above-the-line promotion?

Above-the-line promotion involves paying the owners of media to place an advert. The amount of money spent on advertising is huge. For example, the global spend on advertising in 2016 was US$579 000 million, according to media research agency Zenith Optimedia. This was 4.9 per cent higher than in 2015.

2 ▶ Work out the percentage increase in television advertising expenditure in China between 2010 and 2016.

Percentage increase = US$7.87 – US$4.95 ÷ US$4.95 × 100
= **59 per cent**

3 ▶ Suggest one possible reason that might account for the growth calculated in (2).

In China, television advertising is still growing and is expected to continue growing into the near future. It is expected to grow by 59 per cent between 2010 and 2016. This is probably because China has a rapidly growing economy and an increasing number of foreign businesses are trying to penetrate the Chinese market. To get a hold in this potentially highly profitable market, they may be prepared to invest heavily in television advertising.

4 ▶ Discuss two benefits to businesses of using television advertising.

Television advertising is still a hugely important medium for advertising in business. Although it is expensive, it has a number of significant advantages. The main one is that television adverts have a huge reach. A television ad campaign on national television could reach the majority of the population in a particular country. This means that millions of people will see the advert.

Another advantage is that television adverts can now be targeted at specific audiences. This is because there are so many different channels that a particular customer group can be targeted quite effectively. For example, a golf equipment manufacturer could place adverts on a sports channel when golf tournaments are being broadcast. A toy manufacturer could target children with adverts on specialist children's television channels such as Disney Junior India, an Indian television network aimed at Indian pre-schoolers. The ability to target customer groups in this way cuts down the waste in television advertising.

ACTIVITY 2

CASE STUDY: COUPONS

1 ▶ What is meant by below-the-line promotion?

Any form of promotion that does not involve using the media is called below-the-line promotion. Examples would include coupons, merchandising and free gifts.

2 ▶ Discuss the benefits to businesses of using online coupons.

Coupons, which entitle the holder to discounts off specified goods and services, can be found in a variety of places. For example, they may be printed in newspapers and magazines or attached to the packaging of products and receipts. Also, in recent years, they have started to appear on specialist coupon websites. They are an important method of promotion for a business and most online retailers make use of coupons. For example, the number of US companies using mobile coupons is expected to grow from 36.5 per cent to 48 per cent by 2017. One of the main advantages of coupons is that they draw in price-conscious customers who would otherwise go elsewhere. This means that coupon-users are persuaded to buy products that they would normally avoid. This helps to increase sales volume and sales revenue for businesses.

Coupons can also be targeted at those markets where price competition is most intense. Since coupons offer products at reduced prices, their use helps businesses to be more competitive in markets where demand is price sensitive.

MULTIPLE-CHOICE QUESTIONS

1A, 2D, 3B, 4C

CHAPTER REVIEW

CASE STUDY: THE INDIAN PREMIER LEAGUE

1 ▶ What is meant by sponsorship?

Sponsorship is where a business attracts publicity by linking the name of the company, or a product, to a major event. In return for a fee, a business is allowed to advertise in key positions around an event. In this case, the Chinese company Vivo Electronics became the title sponsor of the IPL in 2016. Therefore the league is officially known as the Vivo Indian Premier League.

2 ▶ Describe two advantages to sponsors of their involvement in the IPL.

One of the key advantages of sponsorship is that the name of the brand can be projected globally via television without paying broadcasters. This is because most of the major events targeted by sponsors are televised. Therefore it is a cheap way to get television coverage. Major sporting events, such as the Indian Premier League, are popular with sponsors because the reach to television viewers can be global. Each sponsor is given advertising boards around the edges of the cricket pitch. These images are displayed regularly by television cameras while a match is in progress.

Sponsors of the IPL, such as Vodafone, Yes Bank, CEAT Tyres, Tata Sky, Coca-Cola, Amazon and OPPO, also get their logos displayed during pre- and post-match interviews and free tickets to each match. They also likely to get priority on television adverts during matches to give them maximum exposure.

3 ▶ What is meant by viral advertising? Use an example from this case study in your explanation.

Viral advertising involves any strategy that encourages people to pass on messages to others about a product or a business electronically. It creates the potential for exponential growth in the exposure of a message. Like a virus, these strategies exploit the process of rapid multiplication that results from people sending messages to family, friends and colleagues, who then send them on again. Not only can people send text relating to a marketing message, but they can also send images, such as photographs and video clips. In this case, an advert by smartphone maker Reliance Retail went viral on social media. It featured Bollywood actress Kangana Ranaut and the cricketers M.S. Dhoni, Virat Kohli and Ravichandran Ashwin.

4 ▶ Discuss one benefit to businesses of establishing a brand name.

The aim of many businesses is to build a powerful brand. Branding involves giving a product a name, term, sign,

symbol, design or any feature that allows consumers to instantly recognise the product and differentiate it from those of competitors. Some brand names are very well known and worth a great deal of money. In this case, the IPL brand was said to be worth US$4500 million in 2015. Branding can be used to differentiate the product, create customer loyalty, help recognition and develop an image. In this case, the IPL brand helps recognition and allows the IPL to charge higher rates for sponsorship and broadcasting rights. All cricket supporters and most people in the sub-continent are likely to be aware of the brand. This means that businesses can project their adverts to larger audiences if they are linked to the IPL in some way. However, they have to pay more to receive these benefits.

5 ▶ Assess the benefits to a business of using social media in advertising.

The use of social media platforms, such as Facebook, Twitter, Instagram and Tumblr, in advertising is growing at a rapid rate. In 2015, the Internet had 3170 million users. There are 2300 million active social media users and 91 per cent of retail brands use two or more social media channels. Internet users have an average of 5.54 social media accounts and social media users have risen by 176 million in the last year.

Social networks gather lots of information about users, which allows businesses to target their adverts more effectively. When people use the Internet, every click, every view and every sign-up is recorded somewhere. This behaviour is collected, processed and eventually ends up with businesses.

In this case, the IPL generates an enormous amount of social media activity. The 2016 Twenty20 saw close to 9 million Tweets, an increase of 122 per cent in Tweets-per-match from 2015. The official IPL website has a 'Social' tab which captures all online conversations including a leader board for Tweets and mentions related to the tournament and each IPL team.

One of the main advantages of using social media in advertising is cost: it is easy and inexpensive relative to other methods of advertising. Another key benefit is that adverts can be targeted. This means that businesses will direct their promotions, offers and other marketing information only to those people who are likely to be interested. As a result, there is much less waste in advertising. Businesses can also respond immediately to developments in the industry and the quality of customer service can be improved because it is possible to communicate instantly with customers. Another big benefit is the ability to reach huge audiences – hundreds of millions or even billions. Finally, links can be used by businesses to draw traffic into company websites. This should help to increase sales.

The importance of social media to advertisers cannot be overemphasised. Figure 39.6 shows that the amount spent by businesses on digital advertising is about to overtake that spent on television advertising. It seems that the use of social media in marketing is here to stay.

CHAPTER 40

CASE STUDY: GILLY'S SNACK SHACK
CASE STUDY: GRANT FINCH FOODS

1 ▶ Which of the two businesses is the largest?

Grant Finch Foods is the largest business. It employs 110 people while Gilly's Snack Shack is a sole trader. Grant Finch Foods sells about 1 000 000 sandwiches a week to supermarkets while Gilly's Snack Shack sells about 900 to shoppers, tourists and workers in the local area.

2 ▶ Which business has the lowest costs?

Grant Finch Foods buys ingredients direct from farmers and manufacturers. For example, it buys 1000s of loaves of bread from a Chicago baker for US$1.10 each. It buys tomatoes from a local farm for US$1.50 per kilo and cheese for US$7.00 per kilo. Gilly's Snack Shack buys supplies from supermarkets and wholesalers. It buys about 20 loaves of bread at a cost of US$1.80 each. Tomatoes cost US$2.50 per kilo and cheese US$7.00 per kilo. Clearly Grant Finch Foods is buying supplies cheaper. Other costs are lower as well. For example, Gilly's Snack Shack has a US$5000 loan and pays an interest rate of 8.9 per cent. However, Grant Finch Foods pays 7.5 per cent on a US$1 000,000 loan.

3 ▶ Which firm is likely to be the most efficient?

Grant Finch Foods is likely to be the most efficient because it has lower costs.

4 ▶ How might Grant Finch Foods benefit from its cost advantage?

Grant Finch Foods sells sandwiches at an average price of US$1.40 per packet to its customers while Gilly's Snack Shack sells most of their sandwich range for US$2.00. Gilly's Snack Shack could never compete with Grant Finch Foods on grounds of price. Grant Finch Foods might also make more profit with its lower costs.

ACTIVITY 1

CASE STUDY: DIB (DO-IT-BETTER)

1 ▶ Discuss how DIB is exploiting a technical economies of scale and b risk-bearing economies of scale.

a One of the reasons for DIB's success has been the ability to keep costs down in manufacturing. DIB is very large and able to exploit economies of scale. For example, it is able to exploit technical economies. Technical economies usually occur because larger plants are more efficient than smaller ones. There can be more specialisation and more investment in machinery.

In this case, DIB benefits from specialisation. It employs specialist workers in different parts of the world to produce different products and components. This division of labour allows average costs to be reduced since specialists are more efficient. DIB also invests heavily in research and development. This allows the business to develop cost effective products and money-saving production techniques.

b DIB also exploits risk-bearing economies. Although the business first began trading in painting and decorating materials, DIB is now involved in other markets such as kitchens, garden furniture, timber, tools, light machinery and building supplies. It also operates restaurants and food markets with many stores serving food throughout the day. It also provides childcare with some stores offering safe and supervised play areas. This growth in the business means that DIB can benefit from boom periods in different markets. It can also cope with difficult trading conditions in one market by relying on sales in others.

ACTIVITY 2

CASE STUDY: VOLKSWAGEN

1 ▶ What is meant by diseconomies of scale?

If a business keeps on growing, it is likely to reach a point where average costs start to rise. This is because the firm suffers from diseconomies of scale. In Figure 40.1, average costs start to rise after output has reached 70 000 units of output. Average costs start to rise because aspects of production become inefficient. For example, businesses become too bureaucratic and more difficult to control and co-ordinate. This raises costs.

2 ▶ Assess whether VW has experienced diseconomies of scale in its organisation.

There is some evidence in this case to suggest that VW might be experiencing diseconomies of scale. In 2015, VW was caught falsifying emissions data on its diesel cars. VW had fitted some special software (a 'defeat device') in about 11 million diesel vehicles so that cars would pass the strict emissions test. As a result, the value of VW fell by around €30 000 million following a flood of bad publicity across the world. Some analysts have suggested that the company is now too big and suffering from diseconomies of scale. This is because big companies like VW, which employs over 500 000 employees, become huge bureaucracies rather than commercial organisations. Controlling and monitoring such vast operations, with factories, offices, warehouses and other operational facilities all over the world becomes a very serious challenge for managers. In this case, it is possible that VW has grown too big to manage. It was claimed that the CEO of VW did not know about this activity. In such a large organisation, this might be true. It is unlikely that any CEO, however capable, committed and well organised, could be in complete control of such a huge quantity of resources that are located all over the world. As businesses grow, at some point, the costs of being big – such as the loss of control, communications problems, the need for more supervision and extra layers of management, the increasing tendency for delegation, the geographical spread of resources, the near impossibility of establishing a common business culture and employing a fully integrated IT system – are greater than the benefits. This is the effect diseconomies of scale can have on a business and may have been the cause of VWs current problems.

MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4D

CHAPTER REVIEW

CASE STUDY: FLAMBOYANCE

1 ▶ What is meant by the term scale in business?

The term 'scale' in business means size. If a business increases the scale of operations, it means that the business is getting bigger. For example, in this case, Flamboyance increased its scale when it bought the chain of shops in the Middle East.

2 ▶ Describe the effect that economies and diseconomies of scale are likely to have on Flamboyance's average cost.

As a business grows and expands the scale of its operations, average costs are likely to fall. Larger firms can operate more efficiently than smaller firms. This is because a business begins to enjoy economies of scale. As Flamboyance grew, it employed a specialist marketing manager, which is a managerial economy. Flamboyance bought more clothes and shoes so they would probably enjoy purchasing economies as well. However, if a business grows too big, average costs will start to rise. This is because inefficiencies slowly develop as a result of diseconomies of scale. For example, in this case Flamboyance bought a chain of shops in the Middle East and it appears that problems started to occur after that point. Communications became difficult due to language and cultural difficulties. Such a problem can result in higher costs as a business tries to find solutions. As a result of economies and diseconomies of scale, a firm's average cost curve is U-shaped.

3 ▶ Why is employing a specialist marketing manager an economy of scale?

As firms expand, they can afford specialist managers. In this case, Flamboyance has employed a specialist marketing manager. A small business may employ a general manager responsible for finance, human resources, finance, marketing and production. The manager may find this role demanding and lack skills in some fields. A large firm can afford to employ specialists in these fields. As a result, efficiency is likely to improve and average costs fall. Through his or her expertise, the marketing manager was able to raise the profile of the Flamboyance brand right across Singapore. As a result, the company grew quickly and became very profitable.

4 ▶ Assess whether Flamboyance has benefited from purchasing economies of scale.

Large retail chains like Flamboyance are very likely to benefit from purchasing economies. Those that buy large amounts of stock can get cheaper rates. Shoe and clothes manufacturers will offer discounts to firms that buy stock in bulk. This is similar to consumers buying multi-packs in supermarkets – they are better value for money. Flamboyance has expanded rapidly and now buys large quantities of stock from China. Inevitably, the company will benefit from purchasing economies.

5 ▶ To what extent has Flamboyance experienced diseconomies of scale?

Diseconomies of scale occur when average costs start to rise because the firm has grown too big. In this case,

there is some evidence that Flamboyance is suffering from diseconomies of scale. Since buying the chain of stores in the Middle East, problems have occurred. For example, communications became difficult due to language and cultural difficulties. There were also some employee problems. There was a lack of employee commitment; many of the staff did not seem to care whether the company succeeded or not. This would result in inefficiencies and rising costs. Also, some of the store managers complained that the company was becoming too bureaucratic; rising bureaucracy is a common source of diseconomies of scale. If a business becomes too bureaucratic it means that too many resources are being used up in administration. Too much time may be spent filling in forms and writing reports. Also, decision making may be too slow, communication channels too long and too many managers may be employed. It could be argued that Flamboyance is experiencing diseconomies of scale to a significant extent since buying the chain of stores in the Middle East.

CHAPTER 41

CASE STUDY: M.K. SIDDIQI

CASE STUDY: MARS, INCORPORATED

1 ▶ Compare the two production methods used in the above examples.

Mars is a mass producer. It makes millions of units of chocolate bars, foods, cans of pet food and many other brands. Its production methods are capital intensive. This means that plant and machinery are used in large quantities relative to labour. Many of its brands are produced on automated production lines, which run continuously for many hours. The photograph shows bars of chocolate on a production line – this line will run continuously with millions of units being produced. Every unit that comes off the end of the production line will look identical.

In contrast, M.K. Siddiqi operates on a much smaller scale. He produces handmade suits. Production is labour intensive and involves him working alone making products by hand. For example, he will use scissors, a sewing machine, needles and other small items of equipment to make the suits. All his suits are bespoke (that is, made to specific customer orders). He learnt the trade from his father and has been making suits in the same workshop in Chittagong for 43 years. He offers customers a massive choice in terms of different fabrics, designs and styles.

2 ▶ Describe two reasons why the two businesses use different production methods.

Mars produces on a very large scale. Its production processes will be highly automated with little use of labour on production lines. The products produced by Mars are appropriate for mass production. For example, Mars could not use the same production method as M.K. Siddiqi. It is not practical to make millions of chocolate bars and millions of cans of pet food by hand. However, the suits made by M.K. Siddiqi require craft and skill are appropriate for being handmade. The quality of finish could not be guaranteed with mass production techniques.

ACTIVITY 1

CASE STUDY: SAUDI ARAMCO

1 ▶ What is meant by flow production? Use this case study as an example in your explanation.

Flow production is a highly efficient method of production. It is organised so that different operations can be carried out, one after the other, in a continuous process. Products move from one operation to the next. In this case study, process production, a form of flow production, is used to refine crude oil. Crude oil is heated and the different products are pulled out at different temperatures. For example, lubricating oil, used for motor oil, grease and other lubricants, boils at a temperature between 572 to 700°C. After this, chemical processes are used to remove impurities. A system of pipes is used to link all the different processes so that refining continues unstopped.

2 ▶ Assess the advantages and disadvantages to Saudi Aramco of flow production. Make a clear judgement in your evaluation.

Flow production is a highly efficient method of production provided large quantities of output can be sold. In this case, Saudi Aramco is the largest oil corporation in the world. It has revenues of around US$1000 million per day. This suggests that it produces vast quantities of oil. Flow production requires large-scale production but results in economies of scale, therefore unit costs will be low. Saudi Aramco probably enjoys some of the lowest unit costs in the industry. Another advantage of flow production is that the speed of production can usually be varied. In this case, oil refining could be slowed down if there was a drop in demand by pumping less oil into the refinery. Alternatively, to speed production up, more crude oil could be pumped in. Some of the refining facilities operated by Saudi Aramco might be quite flexible. For example, the company may be able to produce many different products from its refineries.

Flow production does have disadvantages. The cost of building a large oil refinery is huge. Oil refining requires a very large financial investment and many companies could not afford the set up costs. However, a corporation like Saudi Aramco is not likely to be restricted in its operations by a lack of financial resources. Another problem might be staff motivation. If the jobs done by people working in refineries are boring, as they often are on production lines, their motivation might suffer. This might lead to mistakes and a loss of output. Finally, businesses using flow production are at risk if breakdowns occur. If there is a breakdown in one small part of the refining process, it may be necessary to stop the flow of production while repairs take place. This could prove very expensive. Overall, in this case, the advantages of using flow production are much greater than any disadvantages.

ACTIVITY 2

CASE STUDY: HUBER

1 ▶ Calculate the labour productivity in each of the four factories.

Factory	Output	Number of employees	Labour productivity
India	28,500	150	190
Germany	54,000	270	200
China	79,050	310	255
Brazil	46,000	200	230

2 ▶ Which factory is Huber likely to close down?

Huber is likely to close the factory in India. This factory has the lowest labour productivity at 190 containers per worker.

MULTIPLE-CHOICE QUESTIONS

1C, 2C, 3A, 4D

CHAPTER REVIEW

CASE STUDY: GHF LTD

1 ▶ What is meant by the term capital-intensive production?

Capital-intensive production methods make more use of machinery relative to labour. In this case, GHF Ltd switched to more capital-intensive methods of production by investing heavily in new machinery.

2 ▶ Why was job production inefficient at GHF Ltd?

Job production is where a business produces one product from start to finish before moving on to the next. Each item produced is likely to be different. Job production is used when orders are small, such as 'one-offs'. It is often an inefficient method of production because it is slow. In this case, M. Patel had noticed that job production was inefficient. For example, workers sometimes moved from one job to another (if there was a delay in the supply of a component for example). This would slow down employees as they had to make adjustments to their pattern of work, for example, catch up with what others had been doing, rethink what they were doing and often switch tools and equipment.

3 ▶ Why are unit costs likely to fall when using batch production?

Once batch production was adopted, with the introduction of a small production line, efficiency improved. Batch production usually results in lower unit costs. This would be because some of the fixed costs of production, such as tools, machinery and equipment, would be spread over more units of output.

4 ▶ Discuss one possible impact on workers of making further improvements in productivity at GHF Ltd.

GHF Ltd has already made improvements to productivity by switching production methods from job to batch and introducing more machinery to make production more capital intensive. However, more improvements are planned for the future. It hopes to make further investments in new technology and introduce some non-financial methods of motivation for the workforce. If non-financial incentives are used, workers' jobs may become more interesting. This will be a positive impact for the workers. However, some measures might have a negative impact. For example, if more new machinery is introduced, some workers might lose their jobs. This could have a negative impact on the business, particularly if workers take industrial action.

5 ▶ Assess the benefits to GHF Ltd of switching from job to batch production.

It is quite common for a business to switch production methods as it grows and larger orders are received. In this case, GHF Ltd switched methods to raise profit margins by moving from costly 'one-off special-project work' to reproducible standard products. The production manager identified problems with the special one-off projects. They often involved research, design and installation costs that did not carry over into another project. For example, one job for a large clothes retailer involved lots of design work. In addition, some of the key parts of the system had to be outsourced to another business. The job was a one-off with no benefits for the next job.

Batch production is generally more efficient. Unit costs are likely to be lower because output is higher, workers can be more specialised and more use is made of machinery. Production is also flexible because orders with different measurements, styles or specifications can still be met. For example, in this case, GHF Ltd started producing batches of ducts using their new production system – a system so flexible that 60 000 variations were possible.

As a result of the switch, GHF Ltd became more competitive. Between 2009 and 2012, GHF Ltd reduced the amount of special project work from 80 per cent to 10 per cent. Producing standard systems in batches filled the gap. It took a while for the factory to adjust to these changes in working practices but even in the first year the company made a small profit. This was largely down to an order for 85 standard silent fans.

However, the switch from job to batch production required a significant amount of investment as the business began to use more capital-intensive methods of production. GHF Ltd had to borrow £900 000. This may have put a financial strain on the business as it needed to pay interest on the debt. However, there is no information in the case study that suggests there were any serious financial problems.

To conclude, it seems that the switch in production from job to batch was a successful strategy for GHF Ltd. Costs are down and profit margins should be up. Further improvements to productivity are planned in the future so the business owners must be pleased with the outcomes.

CHAPTER 42

CASE STUDY: GOLDSTONE HOLDINGS

1 ▶ How important was staff involvement at Goldstone when trying to make improvements?

Staff involvement was recognised as being very important when Goldstone began making improvements in its operations. As a result of this, more training was organised. Investment in training improved staff motivation. If a

business is prepared to spend considerable money on training, it shows that staff involvement is highly valued. Workers were also given more authority. They were encouraged to make their own decisions and solve problems. Staff were also given time to 'tidy up' the work environment. They removed all the clutter, such as old tools, spoilt work and items of un-needed stock that had built up over the years.

2 ▶ Discuss the possible benefits to Goldstone from introducing Japanese production methods.

Goldstone enjoyed a wide range of benefits after adopting Japanese production methods. Turnover increased by 50 per cent, production set-up time was reduced by 74 per cent, machine down time was reduced by 73 per cent, delivery targets were increased by 21 per cent and product rejection fell by 50 per cent. The investment in staff training also improved staff motivation.

ACTIVITY 1

CASE STUDY: DELL

1 ▶ Describe how Dell adopted just-in-time methods.

Just-in-time (JIT) is an approach to production that involves holding very low levels of stock – in some cases none at all. Suppliers have to deliver inventories straight to the production line at regular intervals. This might be several times a day. JIT also means that goods are not produced unless they have been ordered. This avoids the need to hold stock of finished goods. In this case, Dell used direct selling and all of its products were sold online. A customer would place an order on Dell's website listing the various specifications that were required. Dell would then make that computer and ship it out to the customer very rapidly.

Dell also developed special relationships with its suppliers. It persuaded them to hold inventories of raw materials and components and deliver them very quickly as and when they were needed. This was key to Dell's approach. Dell was passionate about minimising stock levels. It relied heavily on suppliers to bear the burden of inventory holding and meeting very demanding lead times.

2 ▶ Describe the benefits to Dell of using a just-in-time approach to production.

The JIT approach allowed Dell to deliver a tailor-made product at a lower cost. By manufacturing to order, Dell was able to avoid the cost of buying too many components and having to store them. Storage and handling costs were reduced significantly. It also meant that computers were not being stockpiled waiting to be sold. This enabled Dell to put together and deliver products very quickly. It also saved time, improved cash flow, helped to avoid waste and damaged stock and did not waste space. It also allowed Dell to pass on the savings to their customers. This helped the business to become one of the market leaders in sales of computers.

3 ▶ Carry out some research to identify another business that uses just-in-time methods. Produce a poster to show how it is used and how the company has benefitted. Present your findings to the rest of the class.

MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

CHAPTER REVIEW

CASE STUDY: HERMAN MILLER

1 ▶ What is meant by kaizen?

Kaizen is a Japanese word and refers to the practice of continuous improvement. There is a belief in Japan that everything can be improved. Even at work, the Japanese believe it is possible to make small improvements continuously. This means that the workers are always coming up with ideas to improve quality, reduce waste or increase efficiency. The improvements may be very small but over a long period of time they have a huge impact.

Kaizen was introduced at Herman Miller. One example of a small change that was suggested was the position of a bin containing washers. By moving it slightly employees reduced the amount of reaching required by 6 inches. Another was the adjustment in the height of the assembly line. It was changed slightly so that workers did not waste a few moments bending over. Such changes are extremely small. But this is what kaizen is all about and if small changes like this are made continuously over a period of time significant improvements in efficiency can be made.

Kaizen is usually driven by 'good housekeeping'.

2 ▶ What does this mean?

One of the key drivers in kaizen is 'good housekeeping'. A clean and well-organised working environment is needed for continuous improvement to flourish. The Japanese use a method called 5S to ensure that this is achieved. This involves adopting five specific practices (all beginning with 's') The first one is 'Sort'. This is about getting rid of the clutter in the workplace. Only necessary items such as tools should be stored at a workstation. All other items such as excess inventory should be removed. The next, 'Set in order' means the work area should be organised so that it is easy to find what is needed. 'Shine' is to do with making the work area and equipment clean – make it 'shine'. 'Standardise' means that once the most effective working practices have been identified, they should be adopted by everyone in the workplace. Finally, 'Sustain' means that systems should be adopted so that the previous 4Ss are locked into the way people work at all times on a permanent basis.

3 ▶ Discuss one advantage to Herman Miller of empowering workers.

The aim of empowerment is to give employees more control over their own work. In the past, most workers have followed the instructions given to them by managers. They were rarely required to think for themselves. However, if workers are empowered they are given the authority to make decisions, solve problems and work creatively. At Herman Miller, one of the first steps when introducing kaizen was to empower the workforce. Employees in the factory were asked to suggest small changes that could help to improve the speed or ease of working practices around their **workstations.** Empowering people at work

can improve their motivation. This is because workers feel trusted and their work may be more interesting. As a result, they should be more productive and cooperative. This will help to improve efficiency and make it easier to introduce changes. Workers are also more likely to meet their full potential which will help meet their higher level needs in Maslow's hierarchy.

4 ▶ Assess the benefits to Herman Miller of implementing kaizen and making more effective use of resources.

The introduction of kaizen at Herman Miller has had a massive impact on the organisation. It has helped Herman Miller to develop a more scientific approach to problem solving and resulted in the introduction of numerous standardised factory procedures. These changes, and many others, have improved the efficiency of operations. For example, a new Aeron chair now comes off the production line every 17 seconds compared with 82 seconds 13 years ago. Production time has been reduced from 600 seconds to 340 seconds. Safety metrics have improved by a factor of six. Quality metrics have improved by a factor of ten and the factory is ten times smaller.

Also, the labour time needed to make a single chair is one-fifth of what it used to be, customer lead times have fallen from two months to ten days, the product range has increased from five standard designs to 17, reliability is 99.4 per cent and product faults have been reduced to less than 0.1 per cent.

The introduction of kaizen has resulted in Herman Miller using its resources far more effectively. This also has clear benefits. For example, if fewer resources are used, business costs will be lower. Herman Miller uses less labour and much less time in its operations. If costs are lowered then businesses will make more profit. This will increase returns for the owners and provide cheap funds for investment in the future.

Lean producers will also have a competitive edge in the market. Businesses that use their resources effectively will be able to lower prices. This should help Herman Miller to win a bigger share of the market. Customers are likely to benefit if a business makes more effective use of resources. For example, Herman Miller has reduced lead times and improved product quality. This means that customers will get their products more quickly and enjoy better performing products. Also, some kaizen practices focus on customer needs, therefore customers are likely to get a better service.

Finally, despite this impressive list of benefits, Herman Miller are still getting improvements of a quarter to a half of a second at a time, month by month as the practice of kaizen continues. The introduction of kaizen has been a great success at Herman Miller.

CHAPTER 43

CASE STUDY: DRIVERLESS TRACTORS (ROBOTRACTORS)

1 ▶ Describe the new technology outlined in the case above.

The new technology identified in the case study is a driverless tractor – it features the Case IH Autonomous Concept Vehicle. The tractor is pre-programmed and then remotely controlled by an operator from a desktop computer or other easily transportable device. The tractor uses radar, on board cameras and LIDAR (light imaging, detection and ranging) to find and update its path when moving. If it detects a barrier in its path, it will stop automatically until an operator reprograms the machine. The tractor will also stop if the GPS signal is lost. The machine can take on the traditional land work of tractors such as tillage, planting, spraying and harvesting. According to a spokesman for Case IH, a farm manager can supervise several machines using a mobile device while tending to other tasks or even operating another machine.

2 ▶ Describe the possible benefits of the new technology to a farmers and b consumers.

a The main benefit of the new technology to farmers is that productivity will improve. This is because the quantity of labour used in production will be reduced. This will reduce costs and raise profitability. Another benefit is that it will help farmers who struggle to find skilled drivers during busy periods such as at harvest time. The driverless tractors are also safe, which is beneficial since farm accidents occur frequently when machinery is used.

b Consumers may benefit if food production becomes cheaper as a result of improvements in technology. Food prices might be lower and food may be more plentiful. By 2050, the world's population is expected to grow to around 9 billion. So, in order to feed this rapidly growing number of people, significant improvements in productivity will be required in agriculture. The introduction of driverless tractors might help here.

3 ▶ In pairs, carry out some research to find out how genetically modified crops are being used in agriculture. Find out the advantages and disadvantages of their use and present your results to the rest of the class using a poster.

ACTIVITY 1

CASE STUDY: ROBOTS IN PRODUCTION

1 ▶ What is the difference between material handling robots and processing operations robots?

Robots feature largely in assembly and on production lines. They usually have a mechanical arm that moves according to instructions given by a computer. However, there are different types of robots in manufacturing. Material handling robots are usually employed in the transport of goods, parts or stock from one place to another, most often within the same factory or plant. Automated warehouses are an example of this. In contrast, processing operations robots generally perform a specific task such as spot welding or spray painting. These robots are fitted with a specialised tool to perform the programmed task.

2 ▶ Describe the new technology invented by Jonathan Zornow in this case.

In the clothing industry, the role of robots has until now mainly been only in cutting. They were not able to sew because soft fabric is very difficult for robots to handle. It requires a great deal of accuracy to feed a piece of soft material through a sewing machine to create a straight

join. Consequently, the job has always been done manually. However, in 2015, an inventor called Jonathan Zornow developed a technique that allowed a robot to sew effectively. It involved using a water-based plastic to coat the fabric, which made it stiff rather like cardboard. Following the application of this coating robots were able to handle the cloth more easily. Once the 'Sewbo' has completed a sewing task, the coated material is immersed in water and the cloth returns to its normal state.

3 ▶ Discuss the possible disadvantages of introducing Sewbo into the textiles industry.

Like most new technology, robots have their disadvantages when they are introduced into factories. One of the main disadvantages is that workers often have to be laid off. This is usually because robots can do the work of people; consequently, fewer workers are needed. This is likely to result in redundancies and possible hardship for those laid off. In this case, if the technology becomes established, the textiles industry could see some great changes. A large proportion of garment manufacturing takes place in places like China, Bangladesh and Thailand. In much of the industry, workers are treated poorly and receive relatively low wages. Eliminating the exploitation of these of these workers would be a positive move. However, the many thousands of people working in the industry might struggle to find alternative employment once the technology is introduced.

MULTIPLE-CHOICE QUESTIONS

1B, 2D, 3A, 4B

CASE STUDY: ALLIANCE GROUP

1 ▶ Describe one disadvantage to Alliance Group of introducing the new robotic technology into its plants.

Unfortunately, the introduction of new technology is not without problems. One of the main ones is the high initial cost of buying and installation. In this case, Alliance Group is investing NZ$ 16 million in new technology. This is a lot of money and may create a financial burden for the group. For example, if Alliance Group have to borrow money it will have to meet interest charges. This will reduce the profits made by the business while the loan is being repaid. It may also cause cash flow problems if the business is short of liquid resources. However, in this case there is no financial information to analyse so the financial impact of the NZ$16 million is not known.

2 ▶ What are the benefits to Alliance Group of introducing new technology in its plants. Give at least two benefits in your analysis.

The introduction of new technology has a number of benefits. Generally it raises productivity, reduces unit costs and reduces waste in production. In this case, Alliance Group aims to improve operational efficiency as a result of the investment. The two fully automated robots in the first plant will operate safely in the same space as workers in the plant. They take on the difficult and potentially dangerous roles in meat processing and contribute to improvements in quality and hygiene. The new robotic cutting machine for sheep meat will reduce waste in the process and improve hygiene. This is because the machine has circular blades rather than band saws. This machine also improves health and safety in the plant and reduces some stress from workers. The new packing machine ensures that all meat is not in contact with air after the packaging process. It can also offer a longer shelf-life for the products. This is appealing to some of Alliance's large retail customers. It also has a much larger capacity, which makes the packaging process more cost effective.

Generally, senior managers believe that the company will gain a competitive edge in the market since Alliance is an early adopter of some of this new technology.

3 ▶ Assess the importance to businesses of balancing cost, productivity, quality and flexibility when introducing new technology.

It is often difficult businesses to make decisions regarding when or whether to introduce new technology into production. The financial cost of purchasing, installing and maintaining technology can be very high. In this case, Alliance Group has invested NZ$16 million in robots and a packing machine. This is expensive and may require the businesses to borrow. There is also the human cost to consider. Introducing new technology often means making people redundant. This too is expensive and can also disrupt the workforce. Decision makers have to be sure that the cost of the technology is greater than the value of the productivity gains. The productivity gains may only be achieved if large quantities of output can be sold. Therefore, Alliance Group must be confident about selling much larger quantities.

Decision makers also have to consider the impact that technology will have on the quality of the product. For example, historically, mass produced products were often seen as lower quality than those that were handmade. Also, some customers are actually happy to pay higher prices for handmade products. This might be the case in the clothing industry, for example. Another issue is the flexibility of new technology. When production processes are automated, it often means that a business can only produce standardised products. This reduces the choice for customers.

However, many would argue that most technology is so sophisticated today that quality and flexibility are not compromised. For example, production lines in the motor industry can deliver flexibility. This is because it is possible to produce cars to many different specifications on the same line.

To conclude, investing in new technology is risky and businesses have to evaluate the costs, productivity gains, the impact on quality and the loss of flexibility (if any) before going ahead. In this case, it appears that Alliance Group is happy to take the risk and be an early adopter in the purchase of this technology.

CHAPTER 44

CASE STUDY: BANANA FARMING IN UGANDA

1 ▶ Describe three possible resources used by Robert Oloya on his banana farm.

Resources used on Robert Oloya's banana farm are likely to include land, tools and labour. Land would include the soil and water that banana plants need to grow. Tools might

include digging tools for preparing the land for crops and a machete (large knife) to cut the bananas from the plants when they are harvested. Labour would include the people who are employed to help out on the farm.

2 ▶ How might the use of machinery (to prepare the land, for example) impact on Robert's banana farm?

If Robert used machinery on the farm, some of the tasks might become easier. For example, if tractors or other machines were used to prepare the land for crops, this task would become easier and could be done more quickly. However, there may be less need for labour so some of Robert's farm workers might lose their jobs. The purchase of machinery might also put a financial strain on the business, especially if money is borrowed to buy machinery.

ACTIVITY 1

CASE STUDY: ANGELA'S BAKERY

1 ▶ Suggest two examples of capital that Angela will use.

Capital is often said to be an artificial resource because it is made by labour. Examples of capital used by Angela that are mentioned in the case include the property that was purchased where the bakery was built. Angela will also have used ovens, cooking implements such as cake tins and baking trays, a food mixer, a mobile phone, some kitchen furniture and a computer.

NB. Any two of these are acceptable – there may be others.

Angela Collier is an entrepreneur.

2 ▶ What evidence is there in this case study to support this view?

Entrepreneurs are responsible for setting up and running small businesses. Angela has set up a bakery to supply local shops, cafés and hotels with cakes. This was her idea and she owns the business. This is a feature of entrepreneurship. Angela has also taken some risk: she has invested €40 000 of her own money. If the business is not successful she may lose some, or all, of this money. Angela also organises other production factors. She has purchased some capital and hired people to help her out once the business was established.

ACTIVITY 2

CASE STUDY: MOON BROTHERS CONSTRUCTION COMPANY

1 ▶ What is meant by the division of labour? Use examples from the case study in your explanation.

Workers are likely to specialise in certain tasks and skills. This is called the division of labour and allows people to concentrate on a limited range of tasks. The three workers for Moon Brothers Company are all specialists. They all focus on one particular job for the company: Brendan is a bricklayer, Mary is an electrician and Ahab is a plumber. Each of them has specialist skills that are needed to do their jobs; these have taken time to develop.

2 ▶ Discuss how specialisation might benefit Moon Brothers Construction Company.

Moon Brothers Construction Company will benefit from employing specialists. When people specialise, their productivity is higher. This is because the quality of work is likely to be better. They focus on the same limited range of tasks or skills and become very skilled. Specialist workers are usually better trained and more experienced in the specific tasks they take on. This means the company can operate more efficiently and offer customers a higher level of workmanship.

MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3A, 4B

CHAPTER REVIEW

CASE STUDY: TOOTING TOYS

1 ▶ What is meant by the term capital-intensive production?

Capital-intensive production involves using larger amounts of machinery relative to labour in the production process. Yang Chen is considering switching to more capital-intensive methods in this case.

2 ▶ Suggest two examples of land used in production at Tooting Toys.

Tooting Toys has a factory that is located on a plot of land. However, materials such as plastic, which is an oil-based material, is a main input. Other components used when producing pedal tractors might be made of metal.

NB. Any two of these are acceptable – there may also be many others.

Yang Chen is an entrepreneur.

3 ▶ Discuss his role at Tooting Toys.

Without entrepreneurs, businesses like Tooting Toys would not exist. In this case study, Yang Chen came up with the business idea to produce small plastic toy tractors using a simple shaping machine. Entrepreneurs are the business owners. Here, Yang Chen is the sole owner of Tooting Toys. He is in complete control of the business and is responsible for its direction. Entrepreneurs are also risk-takers: they risk their own money in a venture. In this case study, Yang Chen risked CNY 70 000 of his own money. When he first set up the business there was a chance that Tooting Toys would not succeed. In this case, Yang Chen could have lost some, or all, of his money. Finally, entrepreneurs are responsible for organising resources. Yang Chen will have to buy and hire resources such as raw materials, tools, equipment and labour. He will also need to use skills such as decision making, people management, time management and financial judgment to organise resources effectively.

4 ▶ Assess whether Yang Chen should switch to more capital intensive production methods. Make a clear judgement in your evaluation.

In 2016, Yang Chen planned to introduce a new product. It is a large plastic pedal sports car. He has had a great deal of interest from large retailers and one has placed an initial order for 100 000. However, to produce such large quantities he would need to consider automating a

significant proportion of production. Investment in new technology would cost CNY 14 million. The business would have to borrow over CNY 7 million to help fund the automation. Before making the switch, Yang Chen would have to consider whether the advantages of more capital-intensive production were greater than the costs.

One of the main advantages to the business would be lower unit cost. Provided Tooting Toys can sell large quantities of its products, investment in technology is usually more cost effective. Also, when machinery is employed in production, the quality of output is usually more precise and consistent. This will reduce defects and cut the waste in production. Another benefit of machinery is that it can be used for long periods of time without breaks and holidays. Machines do not get tired and they can be put to work for 24/7 if necessary. Finally, Yang Chen is likely to find that managing machinery is a lot easier than managing people in production. Machines do not react to instructions, they have no emotions and will not cause conflict in the workplace.

However, Yang Chen needs to be aware that employing more machinery does have disadvantages. For example, there is the huge cost of purchasing and installing new machinery. The cost of the investment to Tooting Toys is said to be CNY 2 million. The business will have to borrow about CNY 7 million, which will place a financial burden on the business. It is also possible that production will be disrupted while the installation takes place. Installing new machinery takes time and workers may need to be retrained. Another disadvantage is that the new machinery may be inflexible. It may be suitable for making the new pedal sports cars but nothing else. Having inflexible machinery can be limiting – particularly if the sports cars do not sell in sufficient quantities. Problems can also occur if machinery breaks down. There may be long delays in production if breakdowns cannot be resolved quickly. This might mean that customers are let down – particularly if joint-in-time methods are being used. Finally, workers may feel threatened by the new machinery. For example, they may feel that their jobs are under threat if machinery is more efficient and cost effective. This could impact on the morale of the whole workforce.

To conclude, there is a lot for Yang Chen to think about before committing to more capital-intensive production. He must be confident that sales will be high enough to justify the investment. He must also manage the introduction of the new technology carefully to minimise the impact on the workforce. He must be confident that the financial burden of the loan will not cause cash flow problems and be sure that the machinery is not too inflexible. Since Dragon Toys already has a large order for the new product, Yang Chen may be full of confidence and go ahead with the switch to more capital-intensive methods.

CHAPTER 45

CASE STUDY: QUALITY AT THE ALBANNACH HOTEL

1 ▶ Discuss the importance of quality to The Albannach?

Lesley and Colin are passionate about their business. They are totally committed to quality. Evidence of this commitment can be found throughout. For example, the hotel's accommodation is luxurious and has been renovated with respect for the charm and history of the old highland house. Also, much of the food used in the kitchen is high quality locally sourced produce. For example, white fish and shellfish are caught and landed in Ullapool and Lochinver or dived for by friends. Local farmers produce organic vegetables and free-range eggs, a free-range farm in Morayshire supplies beef and lamb, and game, other than barn-reared fowl, is wild and seasonal. Their desire to offer top-quality accommodation and high quality locally sourced food is evidence of how important quality is to their operation.

2 ▶ What evidence is there in the case to suggest that The Albannach provides a quality experience for guests and diners?

The Albannach Hotel was awarded a Michelin star for the quality of its food in 2009 – seven years later it still has that award. A Michelin star is a worldwide recognition of quality restaurant food. This provides 'hard evidence' of the quality they provide. The Albannach is also in the Good Hotel Guide.

ACTIVITY 1

CASE STUDY: SAMSUNG

1 ▶ What is meant by a product recall?

If a business has an unresolved problem with a product, it may be forced to ask all customers to return the product. This is called a product recall. One example is when Samsung launched its Galaxy Note 7 smartphone in August 2016. It hoped to challenge Apple in the market for smartphones. Unfortunately, Samsung had to recall all sets and halt production due to a problem with the batteries. This followed a number of serious incidents. For example, on 4 October 2016, a US customer suffered lung damage when a Galaxy Note 7 released smoke in his bedroom. Also, on 5 October a set caught fire on a Southwest Airlines flight. There were many more similar incidents. The Galaxy Note 7 was officially recalled in the USA by the Consumer Product Safety Commission in September. It advised owners of the sets to shut down and cease all usage, and return them in exchange for a replacement. However, even replacements had problems. Therefore in October, Samsung stopped production of the sets. Samsung instructed customers to return the sets in kits containing special packaging. The kits consisted of an antistatic bag (for the phone) and three layers of wrapping, one of which was made of a fire-proof material.

2 ▶ Why is quality so important for products like the one in this case study?

Product recalls are, at best, embarrassing for a business. At worst they can do a great deal of damage. With technical products like smartphones, quality is extremely important. If quality is insufficient and customers are put at risk by a defective product, this is a serious issue. Because there is so much to lose from supplying faulty electrical products, quality is of the highest importance for the safety of customers.

3 ▶ Discuss how Samsung may be affected by this product recall.

The impact of the product recall at Samsung could be huge. It could have a long-term effect. Immediately after the first announcement, around US$14 000 million was lost from the value of the company as its share price fell dramatically. Also, hundreds of Koreans have threatened to sue Samsung for compensation. They wanted to recover the costs of visiting shops to exchange their phones, for the time they spent transferring data and for psychological harm from handling a hazardous product. However, Samsung is a powerful and resourceful company. It may have the money and strategies needed to recover and progress in the future. The share price had recovered all losses since October 2016 by the end of the year and gone up further. The Samsung Galaxy Note 7 is just one of many, many products for the business. If one fails like this, they have many others to fall back on.

ACTIVITY 2

CASE STUDY: SANTA CRUZ GUITAR COMPANY

1 ▶ Describe two features of total quality management that are used by the Santa Cruz Guitar company.

One important feature of TQM is quality chains. Every worker in a business is like a link in a chain and every worker is both a customer and a supplier. This is because a worker on a production line will only receive (as a customer) and pass on (as a supplier) semi-finished work if it has reached specified quality standards. This avoids faulty products ever being made. The Santa Cruz Guitar Company aims to avoid errors in production at all costs. It employs a number of highly skilled craftsmen called luthiers and organises employees around six different workstations. After work on a guitar is completed at one workstation, the job is then passed on to the next. However, each workstation is under the supervision of a senior luthier and no guitar passes on to the next stage without a thorough quality check – usually by two luthiers. Although production is organised like an assembly line, each workstation operates like a link in a chain. They are both customers and suppliers.

Another feature of TQM evident at the Santa Cruz Guitar Company is a focus on the customer. Firms using TQM are committed to their customers. They respond to changes in people's needs and expectations. In this case, each guitar is made to precise customer specifications and the company has a website where guitar owners can communicate directly with the manufacturer. The success of the company is reflected by its long list of customer orders.

2 ▶ Explain one advantage to the Santa Cruz Guitar company of using TQM principles.

One key advantage of using a TQM approach to ensure quality is that waste and inefficiencies are removed. At the Santa Cruz Guitar Company, the thorough checks that are made before each guitar is passed to the next workstation help to minimise the possibility of mistakes. This also helps to keep rework and waste to an absolute minimum. No finished product should have a defect by the time production has been completed. This will help to keep costs down and allow the firm to produce high quality products for customers, thus ensuring the company's reputation is maintained.

MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3B, 4B

CHAPTER REVIEW

CASE STUDY: ASHWIN DATA SYSTEMS (ADS)

1 ▶ How does ADS ensure quality in its business?

Many businesses follow codes of practice. These show that a production process has been carried out to a certain standard. Once a business has been assessed and has achieved a certain standard, it is regularly checked by the awarding organisation to make sure standards are maintained. In this case, ADS has been granted ISO 9001 certification, the internationally recognised standard for the quality management of businesses.

2 ▶ Why does quality matter so much to a business like ADS?

The importance of quality has grown in recent years. Consumers are more aware, they get information through specialist consumer magazines, social media and the Internet and as a result they have higher expectations than ever before. Increased competition has also forced firms to improve the quality of their products. Government legislation designed to protect consumers has forced firms to improve quality. Faulty products are costly for a business. For example, if faulty products find their way onto the market, they may have to be recalled which is expensive and embarrassing for a business. If ADS supplied faulty software to clients, it could disrupt their operations and result in lost customers. Consequently ADS may face compensation claims. Quality matters to a business because, generally, they will enjoy more sales if they can deliver quality products. Poor quality is likely to result in lost customers.

ADS have been awarded the ISO 9001 certificate.

3 ▶ Discuss two benefits from winning this award.

One benefit that ADS should enjoy as a result of ISO 9001 certification is that the award can help a business to examine and improve systems, methods and procedures. This will lower costs, motivate staff and encourage them to get things right first time. It can also highlight product or design problems and develop improvements, record and investigate all quality failure and customer complaints and make sure that they do not recur.

The ISO 9001 award also gives a clear signal to customers that ADS are taking measures to improve quality. This should help to generate more sales and lead to higher profitability. Also, if ADS develops a reputation for quality, they may gain a competitive edge in the market and be able to charge a higher price. Customers are often prepared to pay more if quality can be guaranteed.

ADS are considering the introduction of TQM.

4 ▶ Will this benefit the company? Make a clear judgement in your evaluation.

TQM is an approach to quality control designed to prevent errors, such as poor quality products, from ever happening. The business is organised so that the production process is investigated at every stage. ADS may enjoy a number of benefits if they introduce TQM into their organisation. TQM

helps a business to become more market orientated. This is because it improves customer focus by encouraging staff to focus on customer needs. Since TQM is adopted through the whole organisation, it helps improve quality in all aspects of the business. TQM also removes waste and inefficiencies, which will save ADS money. TQM will also help ADS to develop ways of measuring performance in its operations and improve communication and problem solving.

However, ADS must also appreciate that TQM is very expensive to introduce. There are high training and implementation costs. TQM can also be bureaucratic and will only work if everyone in the business is committed. This means that all personnel must be involved when TQM is introduced, including senior managers and shop floor workers. Without total commitment from everyone, TQM is unlikely to be successful.

Generally, most people would agree that if TQM is introduced effectively with the commitment of all staff and adequate training for everyone, quality will improve and the business will benefit financially in the long term. ADS is a business that values quality and appears to be developing a reputation in the market for quality. If it can achieve this, it may enjoy a competitive edge and begin to dominate the market.

EXAM PRACTICE: 1 BUSINESS ACTIVITY AND INFLUENCES ON BUSINESS

a State one non-financial aim of a business. (1)

One non-financial aim of a business is to gain personal satisfaction.

b State one way of measuring the success of a business. (1)

One way of measuring the success of a business is to look at the amount of profit made in a financial year.

c Explain one way in which a fall in the exchange rate might affect a business. (3)

Ismail buys jewellery from overseas. Consequently, when he makes a payment he will have to pay in a foreign currency. Unfortunately, when the exchange rate falls the price of imports will rise. This means that Ismail will have to pay more for his stock. This will reduce the profit made by Ismail's business unless he is able to charge his customers a higher price.

d Explain one disadvantage of operating as a sole trader. (3)

One of the main disadvantages of operating as a sole trader is that they have unlimited liability. This means that if the business fails a sole trader can lose more money than was originally invested. This is because a sole trader can be forced to use personal wealth to pay off business debts. This could have serious financial implications for sole traders and their families. They stand to lose more of their own money if the business fails.

Ismail read in a newspaper that interest rates in Bahrain were likely to rise in 2017.

e Explain one possible effect on Ismail's business of an increase in interest rates. (3)

Most businesses would consider an increase in interest rates as negative. This is because higher interest rates might dampen demand for some products. When interest rates rise people will tend to borrow less because borrowing becomes more expensive; therefore they might cut down the amount of purchases made by credit card for example. This might hit Ismail's business because consumers may use credit cards to buy goods like jewellery. Also, jewellery is a non-essential product, therefore it will be relatively easy for consumers to cut back on the amount of jewellery they buy if it becomes more expensive.

In 2017, Ismail was informed that his rent in the shopping mall would double. As a result of the news, Ismail was considering two options:

Option 1: Move his shop to a Bahraini side street where rent is very cheap.

Option 2: Cease trading from a shop and set up an online business selling jewellery.

f Justify which one of these two options Ismail should choose. (9)

It might be argued that the current location of Ismail's jewellery shop is a good one. This is because shopping malls are modern and attract a large number of shoppers in a concentrated area. However, when an important cost like rent doubles, this might be too much of a financial burden for the business to bear. This is presumably why Ismail is considering two options for changing his business.

Moving his shop to a Bahraini side street will reduce costs because rent will be lower. Ismail might also get more retail space for his money. This might mean that profit margins are higher and he may be able to display more stock, which will give shoppers more choice. However, the side street may not attract as many shoppers as the mall and his business may become isolated. To compensate, he may have to spend more money on advertising, which will raise costs.

Setting up an online jewellery business may be a realistic option. The set-up costs would be low and Ismail would avoid all the expenses, such as rent, fixtures and fittings, associated with selling from a shop. He would also be able to locate his operation anywhere he chooses as long as he has a reliable Internet connection. Another benefit is that he may draw customers from all over the world since online selling allows businesses to reach global markets.

To conclude, Ismail needs to choose an option that suits his own personal preference. If operating a store from a mall is too expensive and a new location in a side street is perhaps regarded as a step backwards, the online option may be the right choice. If Ismail can design an attractive website and meet customer needs with an extensive range of jewellery, online selling might be the way forward. The prospect of selling to a global market is very attractive indeed to any entrepreneur.

EXAM PRACTICE: 2 PEOPLE IN BUSINESS

a Define the term 'fringe benefit'. (1)

One example of a motivational theory is Maslow's Hierarchy of Needs.

Some employees receive fringe benefits in addition to their normal pay. They are often described as the 'perks' of the job. Examples might include free or subsidised meals, a company car, discounts on company products and free private health insurance.

b Outline one reason why motivation in the workplace is important. **(2)**

Well-motivated employees will work harder. They are likely to take more pride in their work, complete tasks quickly and feel that their jobs are important. As a result, they will produce higher levels of output. Businesses also need workers to co-operate. For example, more and more businesses organise their staff into teams. Therefore, if workers do not co-operate with each other, teamwork will be disrupted.

c Outline one legal control over employment that might affect Skyscanner. **(2)**

Generally, owners are free to set levels of pay in their businesses. However, in some countries governments have introduced a legal minimum wage. This involves passing legislation that means no employer is allowed to pay their workers an hourly rate below the limit set. Employers face a penalty if they pay wages that are lower than the national minimum wage.

Skyscanner advertises jobs online.

d Analyse the benefits to Skyscanner of advertising jobs online. **(6)**

The use of specialist online sites for advertising jobs is now common. Many jobseekers are familiar with specialist sites that advertise jobs. Some sites are general but others advertise jobs in specific fields such as accountancy or teaching. It is also common for businesses like Skyscanner to advertise jobs online. There may be a link from a general business website which guides jobseekers to a vacancies page, for example. Advertising jobs online is fairly cheap since there is no need to pay a media outlet for advertising space. It is also possible to give a great deal of detail online and modify job adverts easily so that they are always up-to-date.

Another important benefit is that online adverts can be used to attract applicants from all over the world if necessary. This is because online job adverts can be accessed anywhere across the globe. This means that a business like Skyscanner will have a bigger choice when recruiting people and is more likely to be able to recruit high-quality candidates.

Skyscanner is committed to equipping their staff with new skills. To help with staff training, Skyscanner offers a range of 200 courses to help promote the transfer of knowledge in its organisation. The CEO delivers a five-week programme for high-potential employees, educating them on how to think like an entrepreneur.

Many businesses face two key options when training their staff:

Option 1: On-the-job training

Option 2: Off-the-job training

e Justify which of these two options Skyscanner should choose. **(9)**

Most businesses have to train their workers. This means they have to be taught how to do their jobs. If workers are well trained, they will be more productive and better motivated. However, there are different ways in which workers can be trained. One of the most common methods is on-the-job training. This means that workers are trained in the workplace while the job is being done. A number of different approaches might be used by a business. One common approach involves a new recruit watching and copying the actions of an experienced and competent employee. This method can work well if the existing member of staff is a good and committed teacher. If not, the quality of training might be poor. The main advantage of on-the-job training is that it is relevant because workers are learning by actually doing the job. Trainees are also producing output, which can generate revenue. On-the-job training is also relatively cheap and easy to organise. However, on-the-job training may be stressful for the trainee, particularly if working with others. Trainees might also make mistakes and produce output that is unfit to sell. Also, if the trainers are not committed, training quality is likely to be poor.

Some employees receive training away from the normal work area. This is called off-the-job training. For example, it might involve workers going to college once a week. Alternatively, it might involve a small group of managers travelling overseas to learn about new management techniques. The main advantages of off-the-job training are that output is not affected if mistakes are made and trainees cannot be distracted by work. Also, training could take place outside of work hours if necessary and customers and others are not put at risk. However, there are disadvantages. Trainees do not produce any output and some off-the-job training is expensive if provided by specialists. Also, some aspects of work cannot be taught off-the-job and it may take time to organise.

Many companies prefer on-the-job training because it is cheap and relevant. However, where there might be a danger to others if workers are being trained on the job, off-the-job training is likely to be used. In this case, Skyscanner organises much of its own training. For example, Skyscanner offers a range of 200 courses to help promote the transfer of knowledge in its organisation. The CEO delivers a five-week programme for high-potential employees, educating them on how to think like an entrepreneur. To conclude, small businesses are likely to use on-the-job training to minimise costs. But as firms grow, like Skyscanner, off-the-job training may be more cost effective.

EXAM PRACTICE: 3 BUSINESS FINANCE

a Define the term cost of sales. **(1)**

The cost of sales is the direct expenses incurred by a business in the course of production. Examples might be raw materials and the wages of factory workers.

b Calculate the gross profit margin for West Point in 2016. **(2)**

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Turnover}} \times 100$$

$$\text{Gross profit margin} = \frac{\text{gross profit}}{\text{revenue}} \times 100$$

$$= \frac{\text{US\$5 200 000}}{\text{US\$14 200 000}} \times 100$$

= 36.6 per cent

c Outline one reason why West Point might produce a statement of comprehensive income. **(2)**

The statement of comprehensive income shows business owners and managers the amount of profit made by a business in a financial year. However, the information

contained in the statement might be used to help make some important decisions. For example, it will show a business what has happened to costs during the year. It might show, for example, that the cost of sales has increased sharply. As a result, a business can identify reasons for this and take measures to bring costs under control.

d Analyse the importance of cash to a business like West Point Ltd. (6)

Cash is the most liquid of all business assets. Without cash a business cannot trade. It is reckoned that poor cash flow is the reason why many businesses eventually fail. Even when trading conditions are good, businesses can fail. A business always needs cash to pay important bills. Suppliers have to be paid for the materials and components that have been purchased. If a business fails to pay a supplier on time, it may mean that the supplier will refuse to trade with that business in the future. Businesses also need cash to pay for overheads such as rent, electricity, insurance and telephone charges. Businesses will often get bills for the services that they have used. Again, if these bills are not paid, there is a risk that such services will be terminated. Finally, employees have to be paid every week or every month. If a business cannot pay its employees, it would not be very long before they walked out.

If a business runs out of cash, it may become insolvent – this means that the business cannot pay its debts. This would usually result in the business closing down; this is the worst that can happen. Unfortunately, unless a business can raise cash immediately to pay the most pressing debt, the business will collapse. Therefore, it is important that a business continually monitors and controls its cash flow.

West Point has experienced financial difficulties in recent months and wants to improve its cash flow. Two options have been identified.

Option 1: Take out a bank overdraft

Option 2: Make more use of trade payables

Justify which one of these two options West Point Ltd should choose. (9)

When a business runs short of cash, it is important to act quickly. Without sufficient cash, a business cannot trade. One way West Point can raise cash quickly is to get an overdraft from a bank. This is a common source of finance for most businesses. A bank overdraft means a business can spend more money than it has in its account. In other words, they go overdrawn. The bank will set an overdraft limit and interest is only charged when the account is overdrawn. Bank overdrafts are simple and flexible. However, the bank has the right to ask for the money owed to be paid back at any time. It may do this if it thinks the business is struggling. A business may use bank overdrafts as a short-term source of finance.

The other funding option being considered by West Point is using trade payables. This is where a business buys resources, such as raw materials and components, and pays for them at a later date – perhaps 30, 60 or even 90 days later. This is a common way of doing business in many countries. It is a cheap source of finance because there is no interest to pay. However, many suppliers encourage early payment by offering discounts and the cost of goods is often higher if firms buy on credit. Also, if West Point Ltd delayed payments for too long, suppliers might get upset and refuse to deliver goods in the future.

In this case, West Point may be better off arranging a bank overdraft. If the business has been struggling financially, it may need an injection of cash very quickly; a bank overdraft will provide such an injection. It is also a flexible source of finance and will only be used when necessary. However, West Point will need to get permission from the bank before an overdraft is granted. If the bank refuses to provide an overdraft, then West Point might be forced to use trade payables. Initially, though, a bank overdraft is probably the better of the two funding options.

EXAM PRACTICE: 4 MARKETING

a Calculate the amount of money Sony spent on advertising as a percentage of its revenue in 2014. (2)

The amount of money spent on advertising as a percentage of revenue is given by:

US$2350 million × 100 = **3.4 per cent**

US$69 050 million

For some of its products, such as its gaming console, Sony uses a skimming pricing strategy.

b Analyse the benefits to Sony of using a skimming pricing strategy. (6)

Some businesses may launch a product into a market charging a high price for a limited time period. This is called skimming or creaming and is used for some of Sony's products. The main objective is to generate high levels of revenue with a new product before competitors bring out a rival product. In the market for some goods, there is a group of consumers called 'early adopters'. Early adopters are prepared to pay higher prices because they like to be the first to buy the product. It has been suggested that early adopters are younger, have a higher social status with a better education than late adopters. They may also have higher levels of income and be more socially forward. It is reckoned that about 13 per cent of consumers are early adopters in such markets.

Skimming allows businesses like Sony to recover the cost of research and product development. The relatively high levels of revenue that are generated from sales to early adopters contribute to these high R&D costs. The high levels of revenue also act as an incentive to firms like Sony to carry on investing in R&D.

c Evaluate the importance of market research to a company like Sony. (12)

Market research involves gathering, presenting and analysing information regarding the marketing and consumption of goods and services. Market research can be expensive but businesses are prepared to meet the cost because of the benefits it brings.

Market research is important because it helps to identify and understand customer needs. A business will be more successful if it can supply products that meet customers' needs. This means that a business has to gather information to identify these needs. For example, when developing a new gaming console, Sony will need to find out which product features are important to potential customers. These might include model design and style, graphics quality, durability, portability and flexibility. Once this data has been gathered, a business can design a product that meets the specific needs of customers.

If possible, businesses need to anticipate customer needs. This means they try to predict what customers want in advance and respond to changes very quickly. Businesses like Sony operate in a rapidly changing environment and have to keep up with the latest trends, fashion, technology and design.

Market research is also important because it helps to identify gaps in the market. If Sony can spot a gap in the market, it is likely to gain a competitive edge. It may be able to generate higher levels of revenue and profit before a competitor, like Microsoft, arrives. Finding untapped markets is not easy but gathering information from people might help.

Businesses can also use market research to reduce the risk in business. Setting up a business or launching a new product is risky. As markets get larger, and as competition gets fiercer, launching new products gets even riskier. The likelihood of failure is high but investment in effective market research can help reduce the risk of failure. There are many examples of costly product failures that may have resulted from misreading the market or failing to carry out effective market research.

Finally, market research information can help a business like Sony to make important decisions. Businesses have to make countless decisions and generally the quality of decision making can be improved if managers have access to meaningful information. Market research can provide a wide range of information that could be used to improve decision making – particularly when making marketing decisions.

Although there are some considerable benefits from carrying out market research, a business needs to ensure that the data gathered is reliable. If market research data is inaccurate or out of date, any decisions based on the data are likely to be unsound. The reliability of market research data often depends on the number of people questioned and whether they represent the views of everyone. Ideally, information could be gathered from every single person in a market. However, this would take too long and cost too much money. To overcome this problem, businesses use a sample of people. A sample is a much smaller group; however, the behaviour and views of the sample must be representative of all the people in the market, otherwise the data will be biased and unreliable.

A business should also appreciate that human behaviour is unpredictable. Although people may indicate their intentions in a questionnaire, what they do in reality might be quite different. People might change their minds or misunderstand the question. They might also give answers that they think the interviewers wanted to hear.

To conclude, these issues must be addressed to ensure the reliability of data. Companies like Sony will understand these issues and take them into account. Market research is vital for companies like Sony where competition is so intense. If they are not able to meet or exceed customer needs and expectations, they will lose out to rivals.

EXAM PRACTICE: 5 BUSINESS OPERATIONS

a Define the term 'labour productivity'. **(1)**

Labour productivity is the output per worker in a given time period.

b State one example of an internal economy of scale. **(1)**

One example of an internal economy of scale is financial economies.

c Explain one limit to the growth of a business. **(3)**

One of the main limits to growth is a lack of finance needed to expand. Growth usually requires investment in new resources such as property extensions, new machinery, equipment and more labour. Unfortunately, some businesses are not able to convince moneylenders that if the company grows it will be more successful and the finance will be repaid. Many small businesses that want to grow are still seen as too risky.

d Explain one disadvantage to a business of using labour-intensive production. **(3)**

Abdul Engineering uses labour-intensive production, which means that they use relatively more labour than capital. One of the main disadvantages of labour intensive production is that labour is more difficult to manage than capital. People have feelings and can react in an unpredictable way. For example, a worker might not follow the instructions given by a manager. This might result in delays, mistakes or conflict. This can be disruptive to production. Sometimes, if there is a serious disagreement between workers and managers, industrial action such as a strike might result. This could not happen with machinery.

e Explain one reason why it is important to use resources effectively. **(3)**

If resources are used more effectively, efficiency will improve. For example, if fewer raw materials are used in production, costs will fall. If costs are lowered, then businesses will make more profit. This will increase returns for the owners and provide cheap funds for investment in the future. The business will also be more competitive in the market, which will help to generate more sales.

Abdul Engineering has started to receive multiple orders for one of its products.

As a result of the multiple orders, Abdul is reviewing the production method used at the factory. Two options are being considered for the future.

Option 1: Continue using job production.

Option 2: Switch to batch production.

f Justify which one of these two options Abdul Engineering should choose. **(9)**

Abdul Engineering is currently using job production to manufacture metal frames. This is where a business produces one product from start to finish before moving on to the next. Each item produced is likely to be different such as a different frame design for each greenhouse. Job production is used when orders are small, such as 'one-offs'. The quality of output from job production is usually very good. This is because skilled craft workers often carry out work. Workers are likely to be motivated because the work is varied. Also, each worker is likely to be involved in completing the whole job from start to finish. One key advantage to Abdul Engineering of using job production is that products can be custom made. This means that different farmers can order different sized greenhouses with different designs. However,

although production might be easier to organise when using job production, production may be slower and lead times longer. This is because craft workers take longer than machines to carry out their tasks. Job production is also likely to be more expensive than other methods. This is because the wages of craft workers will be higher and specialist tools might be needed.

When demand grows and orders for multiple units are placed, a business might switch to batch production. This is where a business makes a number (a batch) of products to the same design or specification and then changes production to another product with different specifications. When products are made in batches, production is usually divided into a number of operations or processes. An operation or process is applied to the entire batch before it moves onto the next. Unit costs are likely to be lower when batch production is adopted. This is because output is higher, workers can be more specialised and more use is made of machinery. Production can also be flexible because orders with different measurements, styles or specifications can still be met. However, planning and co-ordination may be more difficult. For example, if a particular operation takes longer than all others in the production process, it is important that resources employed on other operations are not kept waiting. Also, if batches are small then unit costs may still be quite high.

In this case, Abdul Engineering might need to switch to batch production. It has started to receive multiple orders for some of its products and production is likely to be more efficient using batch production. If the business wants to grow, it needs to capitalise on this new opportunity. Abdul may be able to invest in more machinery and rely less on his workforce. This should help to improve efficiency and raise profits. Provided the multiple orders continue into the future, a switch to batch production would be justified.