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UPDATED TO 2020-22 SYLLABUS

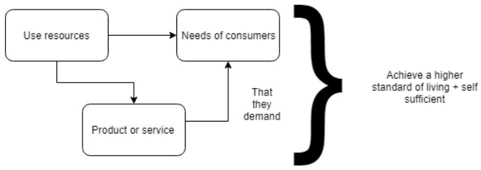
CAIE AS LEVEL BUSINESS (9609)

SUMMARIZED NOTES ON THE THEORY SYLLABUS

1. Enterprise

1.1. Purpose of Business Activity

- Businesses aim to add value to raw materials and semi-finished goods in order to satisfy needs and wants. This helps raise living standards of the economy as businesses will employ people for production.



1.2. Factors of production

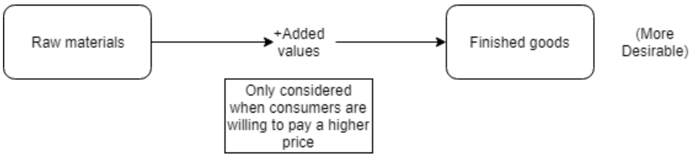
1. Land - all natural resources used in production
   Return for land is “rent”
2. Labour - both manual and skilled work
   Return for labour is “salary” or “wages”
3. Capital - finance that is needed to set up and run the business as well as man made goods used in production (ex. machinery). These are known as capital goods.
   Return for capital is “interest”
4. Enterprise - the driving force that arranges all other factors of productions and takes the risk of the new business venture
   Return for enterprise is “profit”

1.3. Added value

- Added value = selling price - cost price
- Added value is not the same as profit

How to increase added value

1. Increase selling price by providing higher quality goods (higher quality raw materials), increasing advertising, changing packaging, making small improvements in the product.
2. Decrease cost price by reducing wastage through lean production methods, find cheap supplies, reduce quality of the product, increase efficiency by training workers and using advanced technology.


Raw materials
+Added values
Finished goods
(More Desirable)
Only considered when consumers are willing to pay a higher price

1.4. Scarcity

- It occurs as there are limited resources and unlimited wants.
- Due to the existence of scarcity, people are forced to make a choice
- Opportunity cost is the next best alternative forgone

1.5. Entrepreneur

The role of an entrepreneur

- Produce a business idea
- Invest their own capital
- Accept responsibility of running and managing the business
- Accept the risks of failure

Characteristics of an entrepreneur

1. Innovation
2. Commitment
3. Self-motivation
4. Multiskilled
5. Leadership skills
6. Communication skills
7. Self-confidence
8. Ability to bounce back

1.6. Challenges faced by entrepreneurs

- Identifying successful business opportunities:
  - Entrepreneurs need to find markets which have enough demand in order to be profitable
  - People get their ideas from:
    - Own skills
    - Previous employment
    - Small-budget market research
- Sourcing finance:
  - Entrepreneurs face financial issues due to:
    - Lack of own finance
    - Lack of awareness of grants and subsidies
    - Lack of trading records in order to receive loans from bank
    - A poor business plan
- Determining a location:
  - An entrepreneur will have to decide the best location keeping in mind costs, potential target market, status of area, etc.
- Competition
- Building a customer base:
  - For a firm to survive it must build customer loyalty and brand image.
  - Businesses can do this by:
    - Offering pre and after sales services
    - Providing discounts and other sales promotions

- Providing goods that meet specific needs (which a large firm will be reluctant to do)

1.7. Why do new businesses fail?

- Lack of record keeping
- Lack of cash and working capital:
  - Working capital is the capital needed to run the day-to-day business
  - Ways to avoid working capital shortage:
    - Make a cash flow forecast
    - Inject more capital into the business
    - Establish good relations with bank
    - Use effective credit control with customers
- Poor management skills:
  - Essential skills to avoid management problems:
    - Leadership skills
    - Cash handling and cash management skills
    - Planning and coordinating skills
    - Decision-making skills
    - Communication skills
    - Marketing, promotion and selling skills
- Changes in business environment:
  - A few changes include:
    - New competitors
    - Legal changes
    - Economic changes
    - Technological changes

Why may businesses fail in early stages?

- Internal problems –
  - Weak business idea
  - Lack of managerial skills
  - Lack of suitable employees
  - Lack of sufficient finance
  - Lack of entrepreneurial skills
  - Poor initial research
  - Over ambitious ideas
  - Poor decisions
- External problems –
  - Anticipated customers did not materialize
  - Changes in business environment affected customer's spending patterns
  - Unexpected competition

1.8. Types of entrepreneurial businesses

1. Primary sector – extracting materials like fishing and coal mining
2. Secondary sector – manufacturing sector like craft manufacturing
3. Tertiary sector – service sector like hairdressing

1.9. Impact of enterprise on an economy

- Employment creation
- Economic growth
- Firm's survival and growth
- Innovation and technological change
- Exports
- Personal development
- Increased social cohesion

1.10. Social enterprise

Features:

- Directly produce goods and services
- Have social aims and ethical ways of producing them
- Need to make a surplus

Objectives:

- Social
- Economical
- Environmental

Together known as triple bottom line

2. Business Structure

2.1. Classification of business activity

1. Primary sector – extracting natural resources. E.g. fishing, mining
2. Secondary sector – manufacturing sector. E.g. car manufacturing, clothes-making
3. Tertiary sector – service sector. E.g. banking, transportation

2.2. Changes in business activity

The importance of each sector changes as the economy develops. The importance of each sector is measured by employment levels or output levels.

1. Industrialisation is when the importance of secondary sector rises. This occurs in developing countries like India and China

Advantages	Disadvantages
It increases the GDP if the country, helping raise living standards.	Causes a huge movement from rural to urban areas, causing social and housing problems.

Advantages	Disadvantages
It increases the employment opportunities available	Imports of raw materials will increase, increasing import costs.
Increases exports and reduces imports.	Manufacturing industries growth is usually occurred due to growth of MNCs
Firms will be more profitable, increasing tax revenue	
Manufacturing sector goods have more value than primary sector goods.	

2. De-industrialisation occurs when the importance of secondary sector declines. It occurs in developed countries like USA, UK.

- As a country develops, the average income per person increases. Rising incomes lead to increasing living standards as consumers will be able to spend more on services than goods, showing demand for services rises more quickly than physical goods
- As the world industrialises, more and more manufacturing businesses enter the market, increasing the competition and causing prices to fall. This makes it easier for developed countries to buy these goods rather than producing it themselves.

2.3. Public and Private Sector

1. Public sector – firms controlled and managed by the government/local authority.
2. Private sector – firms controlled and managed by individuals.

2.4. Types of Economies

1. Free market economy – only private sector and no government intervention.
2. Mixed economy – both private and public sectors. Governments and individuals make decisions together. Governments usually offer essentials like health care and education.
3. Command economy – economies that have only the public sector.

2.5. Sole trader

- These are businesses owned by one person
- The one person owns and controls the business.
- It has no formal legal structure as business and owner are considered one and the same.

Advantages	Disadvantages
Easy to set up and manage	Limited finance (capital)
Owner has complete control	Unlimited liability
Ability to choose working times	May face intense competition
Easy to establish relations with employees and customers	Unable to specialise
Freedom of making own decisions	Lack of continuity
	Insufficient skills

2.6. Partnership

- It is a business owned by a group of individuals

Advantages	Disadvantages
Each partner may specialise in different areas	Unlimited liability
Shared decision-making	Profits are shared
Additional finance (capital) injected by each owner	Risk of conflicts
Losses are shared	No continuity
Fewer legal formalities	

2.7. Limited companies

Features:

- Limited liability – each shareholder will only lose the amount invested if the business/idea fails
- Legal personality – the company has a separate legal identity from its owners/shareholders
- Continuity – even after the death of a shareholder, there is no need for dissolution.

Private limited companies

- It is a business owned by shareholders who are friends and family

Advantages	Disadvantages
Limited liability	High legal formalities
Separate legal identity	Can't sell shares to public
Continuity	Difficult to sell shares
Original owner will be able to retain control	Have to send accounts to companies' house – less secrecy
Ability to raise capital from sale of shares	
Higher status	

Public limited company

- These are businesses which have legal rights to sell shares to the public.

Advantages	Disadvantages
Limited liability	High legal formalities
Separate legal identity	Cost of hiring specialists
Continuity	High fluctuation in share prices
Easy to buy and sell shares	Less secrecy
Access to substantial capital sources due to the right to issue prospectus (flatation)	High risks of takeover
	Directors influenced by short term objectives of major investors

Legal formalities in setting up a company

1. Memorandum of association – name, address, contact number, maximum share capital, declared aims
2. Articles of association – name of director, procedures to be followed

- These documents must be submitted to the 'registrar of companies

2.8. Other forms of business organisation

Cooperatives

- These are organisations owned by their members
- Features:
  - All members contribute to running and managing
  - All members have a say in important matters
  - Equally shared profits
- Advantages –
  - Buying in bulk
  - Working together to solve problems
  - Good motivation
- Disadvantages –
  - Poor management skills
  - Capital and finance shortage
  - Slow decision making

Holding companies

- A business which owns and controls many different companies, but is not unified as one

Joint ventures

- When 2 or more businesses agree to join for one project
- Reasons:
  - Shared costs and risks
  - Different companies' different strengths
  - Together more powerful
- Risks:
  - Conflicts
  - Errors or mistakes
  - Business failure of one partner, risk the whole project.

2.9. Franchise

- A business which uses the name, logo, trading methods of an existing successful business
- They have a legal agreement to do so

To the franchisor

Advantages	Disadvantages
Guaranteed income from franchisee	Poor management of one business, affecting reputation of all
Easy, risk-free way of expansion	Potential management issues
Easy to manage	Difficult to monitor
Still have some control	

To the franchisee

Advantages	Disadvantages
Lower risks as business is established	Proportion of revenue sent to franchisor
Advice, training, supplies and advertising obtained by franchiser	Rigid business model already made
Economies of scale	Potential loss of large investment
Access to experts	Expensive initial fee
Franchiser won't open another outlet in the same area	

2.10. Public-sector enterprises – public corporations

- Known as public corporation
- In the public sector
- Profit is not their main aim

Advantages	Disadvantages
Managed with social objectives rather than profit	High chances of inefficiencies
Still operate, even if making a loss	Subsidies may encourage inefficiency
Finance raised from government	Government may interfere in business decisions

3. Size of Business

3.1. Different methods of measuring size

1. Number of employees

    1. The size is measured upon the basis on number of workers employed.
    2. Problems- a firm may be capital intensive, making this method insubstantial.
2. Revenue
    1. Used to compare businesses of same industry
    2. Depends on the total value of sales made.
    3. Problem – less effective when comparing high-value and low-value firms.
3. Capital employed
    1. Depends on the total value of long-term finance available in the business
    2. Problem – can't be used to compare firms in different industries
4. Market capitalisation
    1. Market capitalisation = current share price * total number of shares issued
    2. Limited to public limited companies
    3. Problem – share prices change on a daily basis making the comparison unstable
5. Market share
    1. Market share = total sales of business/total sales in industry * 100
    2. Problem – if the total market is small, results will not be accurate

3.2. Measuring business size

Best form of measurement

- No 'best' measure
- To choose which method to use, we need to known if we are interested in absolute size or comparative size.
- Absolute size – test using at least 2 criteria and make comparison

Problems while measuring businesses:

- There are many different methods to measure business size and each method gives us different answers.
- There is no internationally agreed definition on the size of a business.

3.3. Small and micro-businesses

Significance of small and micro-businesses

- Benefits of encouraging development of small and micro-businesses:
- Many jobs created as small businesses won't have funds to buy capital equipment
- Often run by dynamic entrepreneurs. Provides greater variety
- Will create competition for large businesses. Discourage monopoly
- May provide specialist goods or necessities
- Helps them grow and become large
- Will have lower costs as no diseconomies of scale

Government assistance for small businesses

- Governments may provide assistance to small businesses in the form of:
- Reduced rate of tax
- Loan guarantee scheme
- Information, advice, support
- Aid designed to overcome specific problems like:
    - Lack of specialist management expertise
    - Problems raising finance
    - Marketing a limited product range
    - Finding cost-effective premises

3.4. Small and large businesses

Advantages

Small Business	Large Business
Managed and controlled by owners	Ability to employ specialists
Flexible - adapt quickly to changes in demand	Can conduct through market research
Personal contact with employees and customers	Diversified risks
Offer personal service	Ability to sell at lower prices
	Economies of scale

Disadvantages

Small Business	Large Business
Limited access to finance	Diseconomies of scale
Not diversifies, high risks	Divorce between ownership and management
Few economies of scale	Conflicts
Unable to afford specialists	Poor communication, slow decision making
	Difficult to manage and control

3.5. Family business

- These are businesses which are owned and managed by at-least 2 family members.

Strengths	Weaknesses
Commitment - family owners will show more dedication towards their work	Success/continuity problem - there might be failure within the family causing the failure of the entire business.
Knowledge continuity - families ensure they pass on the business knowledge to the next generation allowing experienced and skilled managers.	Informality - there may be many inefficiencies and internal conflicts as personal and professional life is not separate

Strengths	Weaknesses
Reliability and pride - as the family business will have their name and reputation, they try to improve quality at all times.	Nepotism may lead to inefficient management
	Traditional - they are reluctant to change (inflexibility)
	Conflicts - Family problems may affect business management

3.6. Business growth

Reasons for growth –

1. Increased profits
2. Increased market share
3. Economies of scale
4. Lower risks
5. Increased power and status
6. Ability to be more competitive
7. Increase value of business
8. Easy to access new target groups and markets

Internal growth

- It is expansion by expanding the existing operations
- It is cheap
- Avoids takeover problems
- Takes long time for results
- Limited extent of growth
- May not receive the desired outcome
- Ways for internal growth: -
  - Enter new markets
  - Increased marketing activities
  - Increase investment
  - Use newer techniques to produce more efficiently

4. Business Objectives

Aims are the long-term goals of a business. They act as a framework for a business to create further objectives and set a purpose of the business.

4.2. Importance of business objectives

- An objective helps to direct, control and review any business activity.
- For any aim to be achieved successful, there have to be strategies in place which will guide the business to achieve the goal. These strategies must be reviewed constantly to know if it is effective.
- Every business's aims and strategies change over time.

4.3. SMART criteria

- Every business objective must meet the SMART criteria
  - S – SPECIFC: the aim must focus on what the business does and must directly relate to the business's activities.
  - M – MEASUREABLE: every aim must have quantitative values to prove targets are being met effectively.
  - A – Achievable: aims which are impossible to achieve in a time period must not be set. Such aims will demotivate the employees.
  - R – realistic and relevant: aims should be realistic according to the resources available and must be relevant to the people carrying it out.
  - T – time-specific: there must be time limits to the objectives established.

4.4. Benefits of objectives

- They provide a sense of direction
- Helps improve focus of individual employees and departments
- Provides a framework for decision making
- Acts as a motivation tool
- Acts as a means of assess performance, progress and identify training needs
- Helps plan for future in terms of resources required

4.5. Hierarchy of objectives

- This shows the balance and dependencies between the different stages of setting aims and objectives.

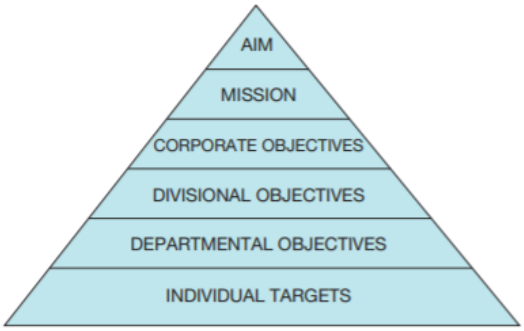


Figure 4.1 Hierarchy of objectives

4.6. Corporate aims

- These are long terms business goals and provides the central purpose of the business.
- These are objectives that translate the aims into achievable targets.

Advantages of corporate aims

- Help develop a sense of purpose and direction for the business
- Help check progress
- They help development of successful tactics and strategies

4.7. Vision statement

- Vision statement is the desired future of the company
- It is a company's road map indicating what the company wants to become in the future.

Mission statement

- Mission statement is a statement of a business's core aims, phrased in a way to motivate employees and to stimulate interests by outside groups.
- It is a summary on how they intend to support/achieve their vision
- Businesses communicate their mission statement through – publishing it in their accounts, websites, banners, advertising posters, company newsletters, etc.

Benefits –

- Helps inform the external stakeholders about the aims and vision quickly
- It helps attract employees, potential investors, shareholders, etc.
- Help motivate employees
- Help guide and direct individual employee behaviour and conduct

Limitations –

- Can be easily adopted by any business of any size
- It is not specific to a business
- They are too vague and general
- Used as a PR activity
- Impossible to analyse

4.8. Corporate objectives

- These are specific to a business and provide a much clearer guide for management.
    1. Profit maximisation –
        1. It means producing at the level of output which leads to the greatest difference between total revenue and total costs.
        2. The limitations of this corporate objective include:
            1. If short term profits are high, competitors may enter jeopardizing the long-term survival
            2. Issues of independence and retaining control maybe of higher importance
            3. Analysts assess business performance through return on capital employed rather than profits
            4. Shareholders may aim for profit maximisation but other stakeholders may want to prioritise other issues
            5. Very difficult to assess when the maximised profit has reached
            6. Negative impact on customers
    2. Profit satisficing –
        1. It means achieving enough profits to keep the owners happy
    3. Growth –
        1. Growth is measured through value of sales/output
        2. Benefits –
            1. Lesser chances of a takeover
            2. Economies of scale
            3. Motivated employees and managers
            4. If not growing, may lose its appeal to new investors.
        3. Limitations –
            1. Too rapid expansion may lead to cash flow problems
            2. Growth may be achieved due to lower profit margins
            3. Diseconomies of scale
            4. Using retained earnings to finance profits will reduce dividends
            5. May lose focus and direction is diversified
    4. Increasing market share –
        1. It is possible for a company to grow but it's market share to reduce, if the market is expanding
        2. If market share is high, it indicates the marketing mix of the business is successful than most of its competitors.
        3. Benefits of being the market leader –
            1. Retailers will be keen to maintain high profile clients, so may provide good quality and low prices
            2. Higher profits, due to lower supply prices
            3. Effective promotional campaigns to attract customers
    5. Survival –
        1. Mostly an objective for start ups
    6. Corporate social responsibility (CSR) –
        1. This concept applies to those businesses that consider the interests of society by taking responsibility for the impact of their decisions and activities on customers, employees, communities and the environment
        2. Benefits –

        1. Helps boost morale of employees as they feel more connected
        2. Helps attract skilled workers
        3. Workers have higher productivity and demand low wages
        4. Helps build reputation as responsible leader, gives competitive advantage
        5. May help reduce costs and improve profits as consumers will be willing to pay higher prices for sustainable products
        6. It increases sales and builds customer loyalty o Helps attract investors
    7. Maximizing short-term sales revenue
    8. Maximising shareholder value -
        1. This involves increasing the share price of the company's stock

4.9. Relationship between mission statements, objectives, strategies and tactics

- Aims and objectives provide basis for business strategies as they are the long-term plans for the company.
- Strategies and tactics are derived from a company's corporate objectives.
- Strategy provides the path a business needs to follow in order to achieve a organisations corporate objective
- Tactics are more concreate and specific smaller steps for shorter time durations to achieve a strategy.

4.10. Objectives and decision making

Stages in decision making framework:

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

4.11. Factors that determine the corporate objectives of a business

1. Corporate culture
    1. It is the code of behaviour and attitudes that influence decision making
2. Size and legal form of the business
    1. Small businesses – profit satisficing
    2. Public limited companies – growth, increase stock value
3. Public sector or private sector
    1. Public sector – CSR
    2. Private sector – profits
4. The number of years the business has been operating
5. Economic conditions
6. Ethics

4.12. Management by objectives (MBO)

- A method of coordinating and motivating all staff in an organisation by dividing its overall aim into specific targets for each department, manager and employee

Communicating objectives

- Benefits of communicating the aims of the business with employees:
    - May achieve more
    - Know how their individual goals fit into the overall plan
    - Creating shared employee responsibility
    - Easier for managers to stay in touch with employees' progress

4.13. Ethical influences on business objectives and decisions

- It is a document detailing a company's rules and guidelines on staff behaviour that must be followed
- It may be expensive in the short term
- But, in the long term:
    - Avoid legal problems
    - Avoid bad publicity
    - Avoid pressure groups
    - May receive grants and subsidies
    - May attract skilled workers and investors

Advantages and disadvantages of targets

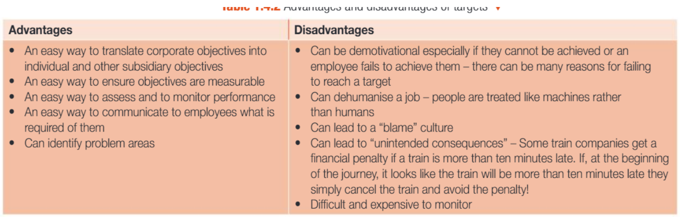


Table 1.4.2 Advantages and disadvantages of targets

Advantages	Disadvantages
• An easy way to translate corporate objectives into individual and other subsidiary objectives • An easy way to ensure objectives are measurable • An easy way to assess and to monitor performance • An easy way to communicate to employees what is required of them • Can identify problem areas	• Can be demotivational especially if they cannot be achieved or an employee fails to achieve them – there can be many reasons for failing to reach a target • Can dehumanise a job – people are treated like machines rather than humans • Can lead to a "blame" culture • Can lead to "unintended consequences" – Some train companies get a financial penalty if a train is more than ten minutes late. If, at the beginning of the journey, it looks like the train will be more than ten minutes late they simply cancel the train and avoid the penalty! • Difficult and expensive to monitor

5. Stakeholders in a business

- Stakeholders: People or groups of people that are affected by, and therefore have an interest in the activities of a business.
- Stakeholder concept: The view that businesses and their managers have responsibilities to a wide range of groups- not just their shareholders
- The roles, rights and responsibilities of stakeholders:

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

5.2. Corporate social responsibility – an evaluation

- It is the concept that accepts that businesses should consider the interests on the society in their activities and decisions, beyond the legal obligations that they have
  - CSR distracts businesses from their key role of using scare resources to their maximum and produce goods and services
  - CSR is a form of WINDOW DRESSING
  - If it is found that CSR is used as a PR activity, it will lead to bad word of mouth
  - CSR maybe expensive in the short run, but will help the business raise profits in the future
  - As it will lead to better reputation, lower regulations, chances of subsidies and grants, customer loyalty, etc.

6. Management and Leadership

6.1. Functions of management – what managers are responsible for

1. Setting objectives and planning
   1. Future planning and creating departmental and individual objectives for each employee
2. Organising resources to meet objectives • They will ensure clear division of work and delegate tasks to keep everyone motivated
3. Directing and motivating staff
   1. Guiding, leading and overseeing people to ensure corporate objectives are met
4. Coordinating activities
   1. Encourage teamwork between departments and division to lower duplications
5. Controlling and measuring performance against targets
   1. Make sure targets are being met and if they are not, find solutions like training workers, buying better equipment

6.2. Management roles

- According to Henry Mintzberg's the nature of managerial work, there are 10 different roles of management.

- These 10 can be classified into 3 main groups:
  - Interpersonal roles – dealing with people
  - Informational roles – receiver, sender of information
  - Decisional roles – make decisions and allocate resources

Interpersonal roles

1. Figurehead – symbolic leader of the company
2. Leader – motivating subordinates, selecting and training workers
3. Liaison – linking managers of one department with others

Informational roles

4. Monitor – collecting data about the operations
5. Disseminator – sending information about internal and external factors to relevant people
6. Spokesperson – communicating information about the business

Decisional roles

7. Entrepreneur – look out for new opportunities
8. Disturbance handler – flexible in responding to changes
9. Resource allocator – deciding on the spending of the business's resources
10. Negotiator – representing the organisation at all negotiations

6.3. Leadership

- It involves setting a clear direction and vision for the company
- The best managers are also leaders
  - Qualities –
    - Desire to succeed
    - Self-confidence
    - Creative and innovative
    - Multitalented
    - Incisive mind

6.4. Important leadership positions in business

- Directors –
  - They are the senior managers elected by shareholders
  - Responsible for delegation, assist in recruitment, meeting objectives within their department
- Managers -
  - Responsible for people, resources and decision making
  - Have authority over people below them
  - Direct, motivate, discipline
- Supervisors –
  - Appointed by management
  - Not a decision-making role
  - Responsible for working towards pre-set goals
- Workers' representatives –
  - Elected by the workforce
  - They discuss areas of common concern with managers

6.5. Leadership styles

Autocratic	Democratic	Paternalistic	Laissez-faire
Decision-making at the centre	Promotes active participation of workers	Believes that manager is in a better position than the workers to know what's best for the business.	It means, let them do it
Leader takes all decisions	Two-way communication	Some consultation, but end decision based on managers	Leaves the decision-making on workforce after the broad objectives are set
Little information given to staff	Full staff involvement	No true participation in decision-making	Very little input from management
Close supervision of workforce	Depends on the level of involvement	Workers maybe dissatisfied and demotivated	High level of delegation
One-way communication	Worker feedback is taken		Workers may not appreciate lack of structure and guidance
Faster decision making \n Good for unskilled workers	Better final decision \n Better motivation		Lack of feedback
May demotivate workers \n No staff input who have hands on experience	Time consuming \n Not helpful during emergencies		

6.6. McGregor's theory X and theory Y

- Douglas McGregor devised a theory on what factors determine the best leadership
- He found that the management attitude is the most important factor
- He identified 2 distinct approaches
- Theory X and theory Y managers
- Theory X –
  - Theory X managers believed that workers are lazy, dislike work, will avoid responsibility, not creative
  - They need to be managed and controlled with close supervision
  - This encourages autocratic leadership
- Theory Y –
  - Theory Y managers believed that workers enjoy work, are creative, ready to accept responsibility
  - This led to democratic leadership style
- He suggested that theory X and Y are MANAGEMENT OPIONIONS not types of workers.
- He believed how managers thought will led to workers becoming like that description

6.7. Factors affecting the leadership style

- Training and experience of workforce
- Amount of time available for discussion
- Attitude of management
- Culture of firm
- Importance of issues
- In general, democratic is considered the best

6.8. Informal leadership

- These are people who have no formal authority but are still respected in the firm
- They have the ability to lead due to their personality, experience, knowledge.
- Informal leaders help achieve the aims of a business
- Informal leaders are a key role of motivation

6.9. Emotional intelligence

- It is the ability of managers to understand their own emotions as well as others
- Daniel Goleman – 4 EI competencies
  - Self-awareness – knowing our own feeling, having self-confidence and realistic views in our abilities
  - Self-management – recover quickly from stress and show self-control
  - Social awareness – sensing others feelings
  - Social skills – handling emotions in relationships well.

7. Motivation

7.1. What is motivation?

- It is the desire of workers to do a job quickly and efficiently.
- They are the external and internal factors that stimulate people to take actions to meet a specific aim.

Importance of motivation

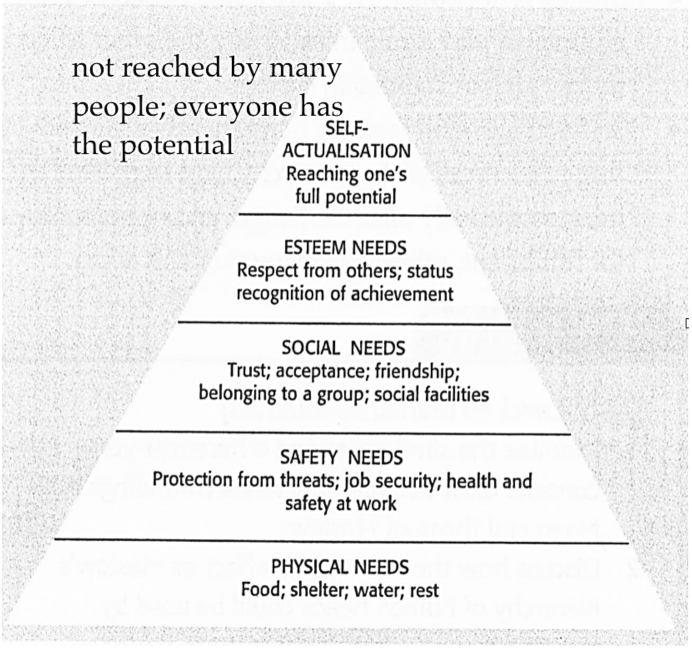
- Help a business achieve its goals
- Help remain as cost-effective as possible (lower accidents and wastage)
- Helps maintain low labour turnover and absenteeism rates
- Impact the productivity and competitiveness of the business
- Well-motivated staff will be ready to accept responsibility and will make suggestions to improve customer service and satisfaction.

7.2. F.W. Taylor – scientific management/theory of an economic man

- His main purpose was to reduce inefficiencies
- His approach included 7 steps:
  - Select group of workers
  - Observe them perform tasks
  - Record time taken
  - Identify the quickest method
  - Train all employees in that method
  - Supervise them
  - Pay them accordingly
- He believed that people are only motivated by money
- He believed piece rate method of payment should be used where worker's output is directly linked to their wage rates
- He believed that autocratic leadership style should be used
- Workers should be closely supervised and no discussion or feedback should be taken
- One-way communication
- Theory X manager ideology is adopted
- Problems of this method –
- Not everyone is motivated by money
- Quantity over quality is encouraged – not acceptable in the long run
- In modern times, due to advanced education and training, worker participation should be encouraged and will help the business in the long run

7.3. Abraham Maslow – Hierarchy of human needs

- He categorised employee needs into 5 levels.
- Every employee starts at the lowest level


not reached by many people; everyone has the potential
SELF-ACTUALISATION
Reaching one's full potential
ESTEEM NEEDS
Respect from others; status recognition of achievement
SOCIAL NEEDS
Trust; acceptance; friendship; belonging to a group; social facilities
SAFETY NEEDS
Protection from threats; job security; health and safety at work
PHYSICAL NEEDS
Food; shelter; water; rest

- Physical needs – food, shelter, water, rest
- Safety needs – job security, health and safety
- Social needs – trust, friendship, teamwork, acceptance
- Esteem needs – respect, status, recognition, achievement
- Self-actualisation – reach one's full potential, challenging and creative work
- Regression is possible – once one need is satisfied, greater quantity of the same need will not motivate people
- Limitations-
  - Everyone has different needs
  - Difficult and impractical to identify for each worker and have separate measures for each
  - Self-actualisation is never permanently achieved

7.4. Frederick Herzberg – Two factor theory

- He conducted interviews and surveys to know and identify factors which give good feelings and the ones that provide negative feelings
- Job enrichment principles should be adopted
- Complete units of work – workers should be allowed to produce a recognisable part of the product/service
- Feedback on performance – workers must be given accurate feedback on their work. Good work must be recognised
- A range of tasks – workers must be given challenging and beyond their current experience tasks
- Team work should be encouraged and adopted
- He divided his results into 2 factors –
- Hygiene factors –
  - Salary, working conditions, supervision, social relations
  - They DO NOT motivate employees, but their absence DEMOTIVATES them
  - They just remove dissatisfaction
- Motivators –
  - Achievement, recognition, work itself, responsibility, advancement
  - These factors MOTIVATE employees

7.5. David McClelland – Motivational needs theory

- He identified 3 types of motivational needs in his book – The achieving society

1. Achievement motivation –
   1. Have realistic goals
   2. Seek opportunities of job enrichment and advancement
   3. Have result driven attitudes
2. Authority motivation –
   1. Desire to control others
   2. Need to be influential, effective, make an impact
   3. Strong leadership instincts
3. Affiliation motivation –
   1. Need for friendly relations
   2. Teamwork and interaction with others
   3. Be liked and popular

- Achievement motivated people are the ones who give the business the best results.

7.6. Vroom – expectancy theory

- Individuals will choose to behave in ways they believe will lead to the best outcome and rewards
- People can be motivated if they believe:
- There is a positive link between performance and effort
- Will result in a favourable reward
- Reward will help satisfy important needs
- Desire to satisfy the need is strong
- 3 beliefs –
  - Valence – depth of the want of an employee for an extrinsic reward
  - Expectancy – degree to which people believe hard-work will lead to their desired reward
  - Instrumentality – confidence of employees that they will receive the reward they desire
- Even if any 1 belief is missing, motivation will not occur

7.7. Motivational theories – evaluation

- They provide the starting point and a framework to defining motivational methods and issues
- They are often criticized due to its lack of rigour and follow up work
- Important to identify the most appropriate theory and identify their relevance in the business

7.8. Motivators - Financial rewards

Time based wage rate	Piece rate	Salary
Payment to a worker made for each hour worked	Payment to worker for each unit produced.	Annual income, paid monthly
Mode of payment for manual, clerical and other blue collared workers	Reflects the difficulty of the job and the standard time.	Professional, supervisory and management staff
Time rate is present, usually paid weekly	Too low- demotivates, too high- reduces incentives (will be able to meet their target wage level easily)	Fixed each year and determines the status of job
Does not directly link to efforts put in	Encourages faster working and efforts	Job evaluation helps decide salary bands
Low security for workers	Requires output to be measurable	Security of income and helps in cost and price calculation
	Little security for workers	Suitable for jobs where output is not measurable
	Helps in price determination on the basis of labor costs.	Can lead to complacency as income is not related to effort
	Quality and safety issues \n Leads to falling quality standards	Regular appraisal is necessary
	Resistance from workers in the event of change of work	

Commission	Bonus	Performance-related pay	Profit-sharing	Fringe Benefits
Proportion of the sales made	In addition to their wages/salary	A bonus scheme to reward staff for "above average work performance"	A bonus for staff based on the profits of the business- can be a proportion of the salary, issue of organizations shares	Non cash forms of reward
Maybe too persuasive, poor brand image	Given for work well done/efficiently	In addition to basic salary	Earns commitment from staff	Com cars insu per sche lo
Low security for workers		Requires regular target setting, annual appraisals against preset targets and paying bonuses	In case of issue of shares solves the problem of "us and them"	add to n pay sch
Teamwork is not encouraged		Often inadequate, short-term effect \n Problem of favouritism	Reduces retained profits and dividends for shareholders	
		Herzberg theory: it only moves, not motivates	Diluted share capital	
		Hawthorne effect: individual focus rather than team.	Workers may sell shares quickly, reducing its effect	

7.9. Non-financial rewards

Job Rotation	Job Enlargement	Job Enrichment
Increasing flexibility of the workforce	Increasing the scope of job	Principle of organizing work
Giving variety of work- multi skills	Broadening the task, deepening	Encouraged to use full ability-not just physical effort
Switch from one job to another- avoids monotony	Includes both rotation and enrichment	Reduction of direct supervision, allowing decision making authority
Series of separate task	Usually happens in case of redundancies or shortage	Based on 3 principles from Herzberg's theory: \n - Complete units of work \n - Direct feedback \n - Challenging tasks

Job Rotation	Job Enlargement	Job Enrichment
Doesn't increase empowerment or responsibility	Horizontal enlargement	
	Adding tasks to avoid it from becoming boring but no power/authority is given	
	Doesn't lead to long-term job satisfaction or enrichment	

Job redesign	Training	Quality circles
Restructuring of a job with the agreement of the employee	Improving and developing the skills of employees	Originated in japan- Kaizen
Attempt to make work more interesting and challenging	Increases status and chances of promotion	Voluntary groups of workers meet regularly and discuss issues
Adding and removing certain tasks can lead to rewarding work	Greater sense of belonging	Employees have first hand experience with the problem
Similar to enrichment		Better and quicker solutions
Allows workers to gain a wider range of skills and increases chances of promotion		Provides a new perspective
		Leads to job enrichment – Herzberg motivation

Worker participation	Team-working	Target setting	Delegation and Empowerment
Actively encouraged to become involved in decision making within the organization	Lower labor turnover	Management by objectives	Passing down of authority

Worker participation	Team-working	Target setting	Delegation and Empowerment
Involvement in decisions on break times, job allocations, productivity	Better ideas, improved quality	Enables feedback and comparison	Delegating control over work
Improves productivity and lowers wastage	Maslow and Herzberg's applications	Provides a sense of direction	
Better decisions, new perspectives	Delayering	Time taking – appraisal every year	
Can be time consuming	Not everyone is a team player		
Autocratic managers find it difficult	Conflict with organizational values		
Paternalistic leadership used – demotivating	Training costs		

7.10. Financial and non-financial motivation – evaluation

- Pay is not the only motivating factor
- Managers must be flexible
- Depends on:
  - Leadership style
  - Culture of management
  - Attitude of managers and workers
- Usually, business use a mix
- Non-financial methods are cheaper than financial

8. Human resource management

- It aims to recruit capable, flexible and committed people, managing and training them and rewarding them accordingly.
- HRM has a major impact on efficiency, flexibility and motivation

8.1. Purpose and roles of HRM

- Recruit and train workers to ensure maximum productivity so that all corporate objectives are met
- In the past, HRM was:

  - Bureaucratic and had inflexible approach
  - Focused solely on recruitment and selection rather than development and training
  - Reluctant to delegate
  - Not part of the strategic management team
- Roles of HRM include:
  - Workforce planning – identifying future needs in terms of number of employees and skills required
  - Recruitment and selection – recruiting the most suitable employees
  - Developing employees – training, appraisal and developing employees
  - Employment contracts – preparing employment contracts and ensure they are abided by
  - Ensuring HRM operates across the business – involving managers in development and training of employees
  - Employee morale and welfare – monitoring and improving employee morale. Giving guidance and advice and ensuring appropriate work-life balance
  - Incentive systems – paying appropriately
  - Monitoring -measuring and monitoring employee performance
  - Dismissing employees with inappropriate behaviour

8.2. Recruitment

- It is necessary when a business is expanding or employees are leaving the organisation

Job analysis

- It involves identifying a vacant position, understanding its roles and responsibilities.

Job description

- It provides a complete picture of what the job will entail, its roles, rights and responsibilities.
- It helps attract the right type of people to the job

Person specification

- It includes analysis of the type of qualities, skills and characteristics needed by any person appointed to a job. It is based on the job description after assessing the complexity of the job. It is a 'person profile' for the job

Job advertisement

- It includes the requirements, personal qualities needed. It can be displayed within the organisation or outside, depending on the recruitment method chosen.
- If external, can advertise in online recruitment services, newspapers, magazines, government agencies, recruitment agencies, etc.

8.3. Types of recruitment

1. External – outside the organisation
   1. Bring new ideas
   2. Wider choice of applicants
   3. Avoids jealousy and resentment
   4. Standard of applicants maybe higher
2. Internal – from within the organisation
   1. Already known to the business, no need for induction training
   2. Known to the selection team
   3. Well aware of the organisational culture, ethical code of conduct, etc
   4. Quicker, less time consuming
   5. Cheaper
   6. Gives workers a chance to progress, motivates them, Herzberg, Maslow
   7. Management style already known

8.4. Selection process

Shortlisting applicants

- After receiving carious applications, the business will shortlist them according to their CV's, references, previous work, etc

Selecting between applicants

- The shortlisted candidates are then selected through interviews, aptitude tests, psychometric tests, trail work, etc
- They often use a 7-point plan – achievement, intelligence, skills, interests, personal manner, physical appearance, personal circumstances

8.5. Employment contracts

- They are legally binding documents to ensure that all policies are fair and in accord with the current employment laws.
- It includes workers responsibilities, working hours, holiday entitlement, wages, appraisal process, etc
- It imposes responsibility on both employers and employees to honour the contract.

8.6. Labour turnover

- It measures the rate at which employees leave the organisation
- Number of employees leaving in 1 year/average number of employees employed * 100
- High and increasing labour turnover indicates low moral and employee discontent
- It increases costs of recruiting, selecting training new workers
- Customer service maybe compromised
- Difficult to establish loyalty and team spirit
- Low skilled workers may be replaced by productive ones
- New ideas

- May reduce costs if business is planning redundancy and rationalisation

8.7. Training and development of employees

- It is work-related education given to employees to improve their efficient and productive
- Types of training –
  - Induction training –
    - It is an introduction training given to all new employees
    - It helps the worker understand the customs, procedure, layout of the organisation
  - On-the-job training –
    - Instructions at the place of the work
    - Done by watching and working closely with an experienced member
    - It is cheaper
  - Off-the-job training –
    - Instructions given away from the work place by experts
    - It is expensive but more productive
    - Training is expensive
    - But it will increase morale amongst employees as they will feel more valued and secured as it will increase chances of promotion
    - It may encourage poaching which acts as a disincentive for companies to set up expensive training programmes
    - Increases productivity and efficiency
    - Makes the workforce more flexible
    - Better customer service and lower accidents

8.8. Development and appraisal of employees

- Development is a continuous process in the form of new challenges and opportunities
- It is to help an employee achieve self-actualisation and fulfilment levels
- Appraisal is a process of assessing employee effectiveness. It is a part of the staff-development programme
- The performance is measured against pre-set goals.
- It encourages them to work harder

8.9. Discipline and dismissal of employees

- If a worker fails to meet obligations in the contract of employment, the HR department has to discipline them
- They can even be dismissed. This is when a worker is asked to leave, due to parts of their job or behaviour being unsatisfactory
- There maybe chances of unfair dismissal allegations if the organisation can not prove that the necessary steps have been take to avoid it.
- These may include verbal warnings, written warnings, training sessions, etc
- An employee may reach out to an employment tribunal to claim unfair dismissal

8.10. Redundancies

- Redundancy is when a worker loses their job because the job is no longer necessary, through no fault to their own
- This is done when there is a fall in demand, advances in technology, business is trying to rationalise and cut costs
- Business must ensure these announcements are made efficiently as they have a major impact on other employee’s morale and job security.

8.11. Employee morale and welfare

- HR departments are expected to offer advice, counselling and guidance to employees who are in need of it.
- Increases morale and sense of loyalty

8.12. Work-life balance

- It is where workers are not able to balance time between their work and their personal life.
- Workers expected to work long and unsociable hours leads to stress and poor health
- HR must work with employees to help them achieve good work-life balance to increase efficiency and productivity
- Some methods to do this may include:
  - Flexible working
  - Teleworking – work from home facility
  - Job sharing – 2 people working as one full time employee
  - Sabbatical periods – extended period leave from work
- This is mainly due to:
  - Consumers expect access to goods and services 24/7
  - Globalisation and increased competition

8.13. Policies for diversity and equality

- Equality is when everyone is treated fairly and has equal chances to succeed
- Diversity is the process of creating a mixed workforce
- Benefits –
  - Higher reputation
  - Higher morale
  - Ability to recruit top talent
  - Capture a greater consumer market
  - Better ideas and greater creativity

9. What is marketing?

9.1. Marketing

- Marketing is the management process responsible for identifying, anticipating and satisfying consumers' requirements profitably.
- Marketing is the process of planning and undertaking the conception, pricing, promotion and distribution of goods and services to create and maintain relationships that will satisfy individual and organisational objectives.

9.2. Related concepts

1. Markets
    1. It is where a group of consumers purchase goods and services. This may or may not be a physical space and area
2. Human needs and wants
    1. Needs are basic requirements that a person needs in order to survive.
    2. Wants are items which are not necessary for survival but satisfy certain requirements
3. Value and satisfaction
    1. Value is not equal to cheapness
    2. A product is considered of good value if it provides satisfaction to consumers and is of a reasonable price
    3. A business must aim to increase satisfaction and value of a product/service to maintain good long-term customer relations

9.3. Marketing objectives and corporate objectives

- Marketing objective may include –
    - Increase market share
        - Increase number of items purchased per customer visit
        - Increase loyalty
        - Increase the number of times a customer shops
        - Increase customer satisfaction
        - Brand identity
        - Increase new customers
    - In order to be success, marketing objectives must be:
        - In line with the corporate and long-term goals of the business
        - Determined by senior managers
        - Must fit into the SMART criteria
- Importance of marketing objectives:
    - Provide a sense of direction
    - Allow progress to be monitored
    - Easily broken down into individual targets (motivation by objectives)
    - Form basis of marketing strategies

9.4. Coordination of marketing with other departments

- Marketing department has a central role in coordinating the work of other departments
- Marketing and finance – know the marketing budget and help make cash flow forecasts
- Marketing and HR – devise a workforce plan and help in recruitment and selection of suitable employees
- Marketing and operations – new product development and plan for the spare capacity and raw materials needed in the future

9.5. Market orientation

- They put customers first. They produce what a consumer wants rather than trying to sell them a product they already developed
- Necessary in these fast-changing, volatile consumer markets
- Benefits –
    - Lower risks
    - Ability to survive longer
    - Constant feedback from consumers

Product orientation

- They invent a product and believe that consumers will want to purchase it. They believe that if a product is innovative and of good quality, then consumers will purchase it

9.6. Market and product-oriented businesses – an evaluation

- If a business tries to change and adapt to every consumer trend it will over stretch it resources
- Trying to offer choice and range is expensive. But, researching and then developing a product reduces risks
- Many companies use ASSET-LED MARKETING
- It is where businesses base the product development on market research but limit it to their own strengths and weaknesses. They try to take advantage of their resources
- Market orientation does not guarantee success. It depends on the whole marketing process

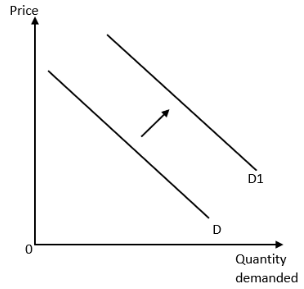
9.7. Societal marketing

- It is an approach where the business considers and focuses on other stakeholders like customers, employees, environment, etc.
- It was founded by Kotler in 1972
- It is not the cheapest but meets the society's long-term interests.

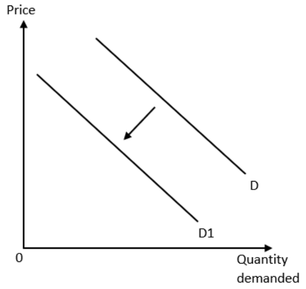
- Implications:
  - Attempt to balance 3 concerns – company profits, consumer wants, society interest
  - Difference between short-term consumer wants (low prices) and long-term social welfare may arise
  - Gives a competitive advantage (USP)
  - Allows the firm to charge higher prices

9.8. Demand

- It is the quantity consumers are willing to and able to buy at different prices

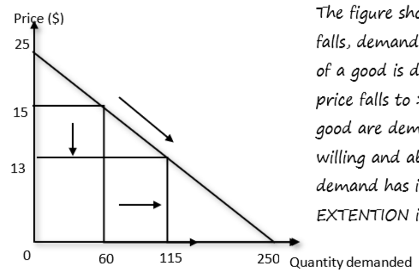


The figure shows a right shift in the demand curve. This shows a rise in demand, due to factors other than a fall in price. This is shown by a shift from D-D1.



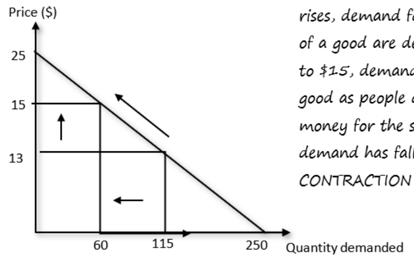
The figure shows a left shift in the demand curve. This shows a fall in demand, due to factors other than a rise in price. This is shown by a shift from D-D1.

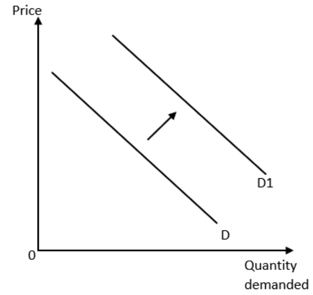
Movements in a demand curve



The figure shows a demand curve. As price falls, demand rises. At price $15, 60 units of a good is demanded. But, when this price falls to $13, 115 units of the same good are demanded as more people are willing and able to buy it. This shows demand has increased. This is known as EXTENTION in demand.

The figure shows a demand curve. As price rises, demand falls. At price $13, 115 units of a good are demanded. But, as price rises to $15, demand falls to 60 units the same good as people are less willing to spend more money for the same good. This shows demand has fallen. this is known as CONTRACTION in demand.





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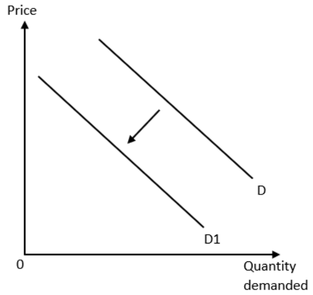


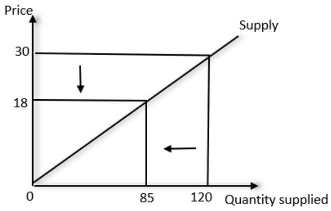
The figure shows a left shift in the demand curve. This shows a fall in demand, due to factors other than a rise in price. This is shown by a shift from D-D1.

Factors affecting demand

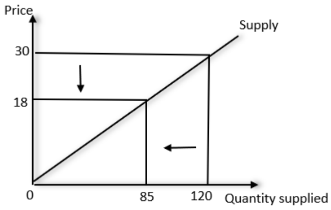
- Changes in consumer income
- Changes in prices of related goods
- Changes in age and population structure
- Fashion, tastes and attitudes
- Advertising and promotion

9.9. Supply

- Supply is the willingness and ability of a firm to sell/produce a product.



The figure shows a supply curve. As price falls, supply also falls. At price $30, 120 units of a good is supplied. But, when this price falls to $18, 85 units of the same good are supplied. This shows supply has decreased. This is known CONTRACTION as in supply.



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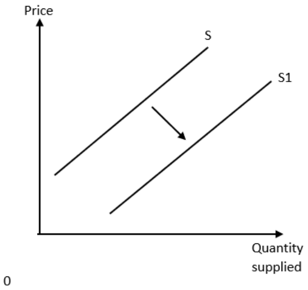

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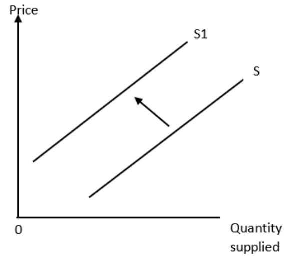


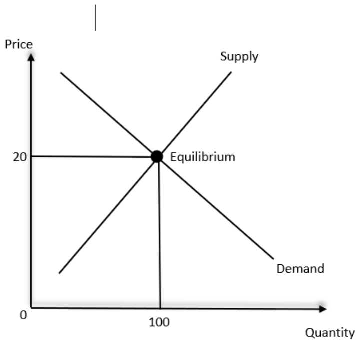
The figure shows a left shift in the supply curve. This shows a fall in supply, due to factors other than a fall in price. This is shown by a shift from S-S1.

Factors affecting supply

1. Costs
2. Taxes
3. Subsidies
4. Weather conditions
5. Advances in technology

9.10. Equilibrium

- It is the price level where demand = supply
- There is no shortage (demand higher than supply) or surplus (supply higher than demand)
- Disequilibrium is when demand is not equal to supply (there's either a surplus or shortage)



The figure shows the equilibrium price and demand. At $20, people are demanding 100 units of a good and producers are also supplying only 100 units. This shows, everything that is produced is sold, no shortage or surplus. Therefore, $20 is known as the equilibrium price level and 100 in known as the equilibrium quantity demand and supply.

9.11. Features of markets

1. Market location –
    1. Businesses may operate locally, regionally, nationally or internationally
    2. Local markets have limited sales. International markets have the greatest sales potential but it is a huge strategic step, differences in tastes, cultures, laws must be considered
2. Market size –
    1. Can be measured by volume of sales or value of goods sold
    2. Reasons to know the size –
        1. Market is worth entering or not
        2. Calculate firm's market share
        3. Growing or declining market
3. Market growth –
    1. If markets are growing rapidly, competition may increase, market share may fall and profits may be negatively affected
    2. The growth pace depends on –
        1. General economic growth
        2. Changes in income
        3. Changes in tastes and preferences
        4. Technological changes
4. Market share – •
    1. Can be measure by volume or value of sales
    2. If market share is increasing, it indicates that the marketing strategies are effective
    3. Benefits of high market share –
        1. Higher sales
        2. Retailers may not charger higher profit margins to stock up goods
        3. Producers may provide higher discounts
        4. Market leader maybe used in ads, USP
5. Competitors –
    1. Direct competition is when 2 companies provide similar products
    2. Indirect competition is the substitute of the good itself \
    3. Businesses must be able to respond efficiently to both direct and indirect competition

9.12. Important marketing concepts

1. Creating/adding value
    1. Added value is the difference between the selling price and the cost of bought in raw materials
    2. Higher the added value, higher the profits
    3. Added value can be increased by –
        1. Create an exclusive and luxurious retail environment
        2. High quality packaging
        3. Promote and brand the product
        4. Create a unique selling point (USP) and differentiate the product
2. Mass and niche marketing
    1. Niche marketing is identifying and exploiting a small segment of a larger market
    2. Mass marketing is selling the same products to the whole market
    3. Niche marketing – advantages –
        1. May survive as are producing customised products
        2. Ability to charge high prices and increase profits
        3. Improves brand image and loyalty
    4. Mass marketing – advantages –

        1. Wider choice for customers
        2. Economies of scale
        3. Fewer risks
3. Market segmentation
    1. Also known as differentiated marketing
    2. Instead of trying to sell one product to the whole market, businesses identify different consumer segments are research each of them separately.

9.13. Market segmentation – identifying different consumer groups

- Businesses create consumer profiles which includes age groups, income levels, gender and social class
- Advantages –
    - Easy to target marketing strategies to specific consumer groups
    - Enables identification of gaps in the market
    - Differentiated marketing strategies can be focused on target market groups
    - Price discrimination may be used to increase revenue and profits
    - Allows specialisation
- Disadvantages –
    - High research and development costs
    - High promotional costs
    - May not be able to enjoy marketing economies
    - High stock-holding and production costs
    - May lead to over-specialisation
    - Extensive market research may be needed

10. Market research

- Process of Collecting, Recording and Analysing data regarding Customers, Competitors and Markets.

10.1. Need for market research

1. To reduce risks associated with new product launches
    1. Market research helps investigate the potential demand for a product.
    2. It allows firms to check the market conditions before launching a product
    3. It identifies consumer needs and tastes, helps test the product idea, packaging design with potential customers, pre test the brand positioning and advertising. It even aids during product launch and after launch periods.
2. To predict future demand changes
    1. Allows businesses to predict future economical/social changes which might affect demand
    2. It gives businesses time to plan and implement effective strategies to tackle the future demand changes
3. To explain patterns in sales of existing products and market trends
    1. Conducting market research for existing products helps firms understand the potential changes in consumer tastes, preferences, incomes, etc in the future and helps identify demand changes.
4. To assess the effectiveness of the marketing strategies used
    1. Conducting market research after implementing few marketing strategies like changed promotion, etc will allow a business to understand the effectiveness of these strategies in achieving the long-term marketing goal
    2. It helps identify whether or not the business requires to change its strategies and tactics to remain successful
5. Know consumer feedback
    1. Investing in market research will allow a firm to know customer feedback regarding the perceived strengths, weaknesses, packaging preferences, sales and distribution methods, etc
6. Identify competitors, their USP and differentiate the product
    1. Market research helps identify competitors, their product differentiation strategies. It allows the business to adapt and modify their USP accordingly

10.2. The market research process

1. Identify problem and define objective
    1. Identify the purpose of the research to ensure unnecessary data is not collected.
    2. After identifying the problem, research objectives are set. These are always in form of questions.
2. Determine research design
    1. Deciding whether to use primary research or secondary research or a mix of both
3. Design and prepare research instrument
    1. Identifying the most suitable method of data collection in terms of cost and time.
4. Sampling and collecting data
    1. Choosing a sample size and method
5. Analyse data
6. Visualise and communicate results
    1. Representing the data in forms of bar graphs, pie charts, line graphs, etc.

10.3. Primary research

- Also known as field research
- It is when businesses collect first-hand data for their own needs

- Benefits –
  - Up-to-date information
  - Relevant information
  - Confidential
- Drawbacks –
  - Expensive
  - Time-consuming
  - Doubts over accuracy and validity (due to sample size)

Types –

Quantitative methods – numerical results that can be statistically analysed

- Observations and recording – marker researchers observe and record how consumers behave. It doesn't give the opportunity to understand the reasons/ask for explanations for the behaviour/trend.
- Test marketing – when businesses produce a limited quantity before launching the product to the entire market. They promote and sell the product in a limited area, record customer reactions and opinions. They then make changes and reduce risks involved before launching it into the market.
- Consumer surveys – involves directly asking consumers for their opinions and feedback. Both qualitative and quantitative.

Qualitative method –

- Focus groups –
  - They are discussion groups where participants are encouraged to actively discuss and give their feedback/opinions on new products/adverts/etc
  - They are more accurate and realistic that questionnaires and interviews
  - There are researches stimulating the discussion so that there is no biased decision made
  - It is cost effective and quick
  - Flexible but it is expensive
  - Subjective and chances of polarizing
  - Skilled moderator needed
  - Less control
  - Not the representative of the entire population

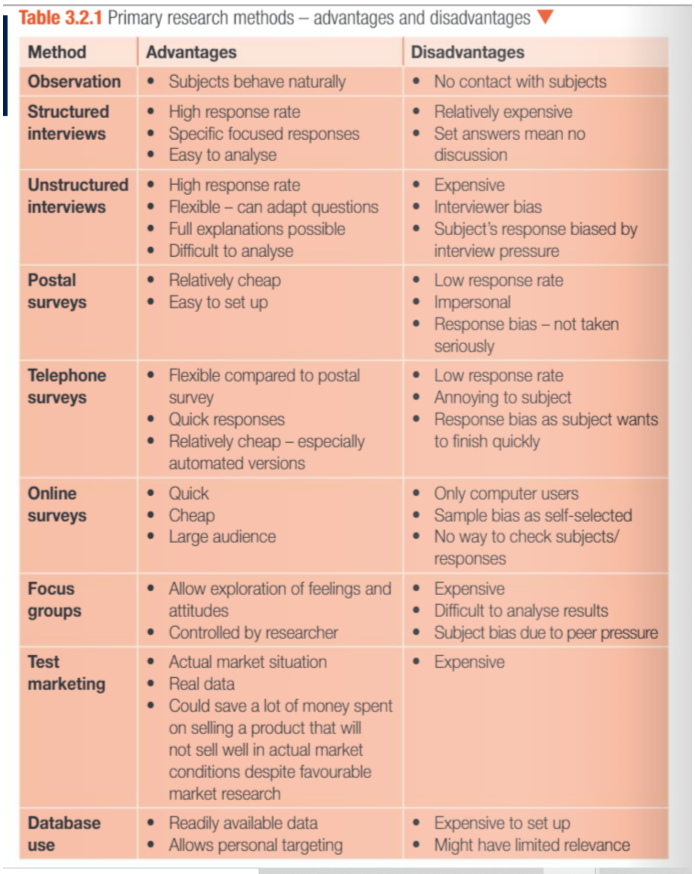


Table 3.2.1 Primary research methods – advantages and disadvantages

Method	Advantages	Disadvantages
Observation	• Subjects behave naturally	• No contact with subjects
Structured interviews	• High response rate • Specific focused responses • Easy to analyse	• Relatively expensive • Set answers mean no discussion
Unstructured interviews	• High response rate • Flexible – can adapt questions • Full explanations possible • Difficult to analyse	• Expensive • Interviewer bias • Subject's response biased by interview pressure
Postal surveys	• Relatively cheap • Easy to set up	• Low response rate • Impersonal • Response bias – not taken seriously
Telephone surveys	• Flexible compared to postal survey • Quick responses • Relatively cheap – especially automated versions	• Low response rate • Annoying to subject • Response bias as subject wants to finish quickly
Online surveys	• Quick • Cheap • Large audience	• Only computer users • Sample bias as self-selected • No way to check subjects/ responses
Focus groups	• Allow exploration of feelings and attitudes • Controlled by researcher	• Expensive • Difficult to analyse results • Subject bias due to peer pressure
Test marketing	• Actual market situation • Real data • Could save a lot of money spent on selling a product that will not sell well in actual market conditions despite favourable market research	• Expensive
Database use	• Readily available data • Allows personal targeting	• Expensive to set up • Might have limited relevance

10.4. Secondary research

- Collection of data from second-hand sources
- It is also known as desk research
- It is gathering data which has already been collected
- Advantages –
  - Cheap
  - Assists planning of primary research
  - Less time consuming
  - Allows comparison between different sources
- Drawbacks –
  - Maybe outdated
  - Not available for new products
  - May not be accurate
  - May not be suitable to the business

Types –

1. Government publications
2. Local libraries and government offices
3. Trade organisations
4. Market intelligence reports
5. Newspapers and specialist magazines and publications
6. Internal company records
7. The internet

Every business, first, carries out secondary research and only if the data which exists is not relevant or no data exists like for newly developed products, primary research should be conducted.

10.5. Sample size

- It is impossible to survey every member of the target population
- This is because the market is too extensive and it is impractical to contact every member in terms of time and money
- Therefore, businesses choose a sample size and choose people accordingly to act as a representative of that sample
- Usually, larger the sample size, more confidence the business has in their results as they are likely to be more accurately
- Major constrains in selecting the sample size – time and money

10.6. Sampling methods

- Probability sampling
  - Selection of a sample based on the principle of random choice
  - It is complex, time-consuming and costly
  - Methods:
    - Simple random sampling –
      - Each member of the target market has an equal chance of being selected
      - Every member of the target market is given a number and then a computer is used to generate a random set of numbers
    - Systematic sampling –
      - Sample selected by taking every nth term from the population
    - Stratified sampling –
      - The target population will include people with different tastes, opinions, preferences, etc.
      - Each of these groups are divided into different levels and the are known as strata
      - Random sampling is used to select different people from each stratum
    - Quota sampling –
      - The interviewer selects different number of people from each stratum of the target population
    - Cluster sampling –
      - Take a sample from one/few groups
      - For example: one town or region
- Non-probability sampling
  - Convenience sampling –
    - People chosen on the basis of ease of access.
    - Ex. sampling friends and family
  - Snowball sampling –
    - First respondent refers a friend and the process continues
    - It is cheap but the sample might be biased as all respondents might have similar lifestyles and preferences
  - Judgemental sampling –
    - Researcher chooses sample based on who they think are appropriate
    - Experienced researcher required
  - Ad hoc quotas –
    - Quota is established and researchers choose from within it

10.7. Accuracy of primary research (evaluation points)

1. Sampling bias
   1. Time and cost constrain make it impossible to question the entire target market which leads to biased answers
   2. Higher the sample size, more accurate the results are likely to be
2. Questionnaire bias
   1. This may occur when there are many leading, misunderstood questions asked. This may lead the respondent to answer in a certain way, leading to inaccurate results
3. Other forms of bias
   1. The respondent may not be truthful

11. The Marketing Mix: Product

11.1. Marketing Mix

- The 4P's include:
  - **Product** – existing product/newly developed product. Includes packaging, quality, features of the product
  - **Price** – amount customers pay
  - **Place** – how the product is distributed
  - **Promotion** – informing customers about the product and persuading them to buy it
- Important for the 4 P's to be integrated in order to achieve the aims

11.2. The 4C's

- **Customer solution** – what a firm needs to produce to meet consumer needs
- **Cost to customer** – total cost of the product to consumers
- **Convenience to customer** – how easily accessible is the product to consumers
- **Communication with customer** – providing 2-way communication channels

11.3. Customer relationship management

- It involves using the 4 C's and the ideology of putting customers first in order to maintain customer relations

and loyalty.
- It has been proven that maintaining existing relations is cheaper than attracting new ones
- CRM's main policy is customer information. It believes in gaining as much information about the target market as possible and then adapting the 4P's to it
- Developing long-term relations with customers can be achieved by:
  - Targeted marketing – providing customers with products they prefer (according to market research/previous purchase)
  - Customer service and support – providing feedback channels and using them to change the 4P's
  - Using social media – businesses can use social media to identify various trends in the market which allows them to make their products more accurate for customers

11.4. Why is product a key part of the marketing mix?

- In order to be able to build relations and establish brand loyalty, the product must be right.
- This includes the quality, durability, performance and appearance
- Customer expectations must be met in terms of these factors

11.5. What is meant by 'product'?

- This includes both consumer and industrial goods and services
- The dynamic market makes the New Product Development (NPD) process a crucial part of the business's success
- NPD is based on market research in attempt to satisfy customer needs
- It is expensive and may not be successful

Unique selling point

- Features that differentiate a product from its competitors
- Benefits of having a USP –
  - Effective promotion
  - Free publicity
  - Chance to charge high prices
  - Higher sales
  - Brand loyalty

11.6. Products and brands

- Product is a general term used to describe what is being sold
- Brand is a distinguishing name given to the product, helping establish a USP
- It can help create a powerful perception in consumer minds – positive or negative

Tangible and intangible attributes

- Meeting the intangible expectations/needs of a customer is achieved through effective branding
- These are subjective to customer opinions and can't be measured or compared

11.7. Product positioning

- Before launching a product, the firm will try to analyse its relationship with other competitor products in the market – product positioning
- One method – market mapping
  - Identify features that consumers deem important
  - Plotting it on a comparison chart

11.8. Product life cycle

- The stages a product goes through from its development to its decline
- Product portfolio analysis involves making decisions about how to allocate resources effectively between the range of products. PLC is one form to do so.

Stages of PLC

- Introduction
  - Low sales
  - Increase slowly
- Growth
  - Significant growth in sales
  - Few competitors start entering the market
- Maturity/saturation
  - Sales remain constant
  - Many competitors are in the market
- Decline
  - Sales fall rapidly
  - May occur due to changes in technology, tastes, etc

Extension strategies

- Strategies used to extend the maturity stage of the PLC
- Examples –
  - Selling in new markets
  - Repackaging and relaunching
  - Finding new uses
  - Sales promotion techniques
  - Adding new features

11.9. Uses of PLC

- Assisting with marketing mix decisions
  - Knowing the stage of PLC helps decide the marketing mix of a product (all 4P's)

    - Every marketing aspect is changed with a change in the stage of PLC
    - But the final decisions even depend on competitor actions, economic state, marketing objectives
- Identifying how cash flow might depend on PLC
    - Every business requires cash flow in order to be successful
    - At the development and decline stage, cash flow is likely to be negative
    - This may even continue into the introduction stage as promotional expenses will be huge
    - But, in the growth and maturity stage, cash flow is likely to improve and become positive
    - Therefore, knowing about the PLC stages of different products, allows a business to plan for its next project and see its effect on cash flow
- Identifying the need for a balanced product portfolio
    - As one product is in the decline stage, the next product is ready to be launched.
    - This allows cash flow to remain balanced throughout as positive cash flows of products in the growth and maturity stage may offset the negative losses by products in decline and development phases.

11.10. PLC – evaluation

- PLC is an important part of the marketing audit and helps in assessing the marketing departments position
- But it is based on past and present data, which may not be necessarily true for future predictions
- Plus, there might be a rapid and quick change in sales, not giving enough time for the marketing department to implement a strategy to offset such a change
- In order to be effective, PLC analysis must be used in relation with sales forecasts and management experiences.

Product portfolio analysis – evaluation

- Having a balanced and managed portfolio allows marketing objectives to be met easily
- But product is only one part of the marketing mix, and the other 3 P's – price, place and promotion are also essential in achieving success of the business
- But without a well-managed product portfolio, the other 3 P's may not be in use and the objectives may not, ever, be met

12. The Marketing Mix: Price

12.1. Why is price a key part of the marketing mix

- Price is the amount paid by customers
- Its impacts:
    - The demand
    - Degree of value added by the business
    - Influence on revenue and profits earned
    - Reflect on marketing objectives and their success
    - Establish psychological image of the business

12.2. Price elasticity of demand

- It is a numerical measure of responsiveness of demand to a change in price
- PED = % change in demand / % change in price
- PED is always negative indicating the inverse relation between demand and price

Types of PED

1. Elastic - % change in demand > % change in price (PED>1)
2. Inelastic - % change in demand < % change in price (PED<1)
3. Unitary - % change in demand = % change in price (PED=1)
4. Perfectly inelastic – demand is the same, irrespective of price (PED=0)
5. Perfectly elastic – demand is infinite at a particular price, and 0 at all others (PED=infinite)

12.3. Factors determining PED

- Necessity or not – necessity = inelastic, luxury = elastic
- Number of substitutes – many substitutes = elastic, no/few substitutes = inelastic
- Level of customer loyalty – high degree of loyalty = inelastic, low level of loyalty = elastic
- Proportion of income – high proportion = elastic, small proportion = inelastic

PED – application

- Helps make accurate sales forecasts
- Assists in pricing decisions

PED – evaluation

- PED assumes nothing else changes (ceteris paribus)
- Maybe outdated very quickly
- Uses past information, may not be accurate considering the dynamic nature of the markets

12.4. Factors affecting pricing decisions

1. Costs of production
    1. A price must cover both variable and fixed costs of a business
2. Competitive conditions
    1. Monopoly – more freedom in deciding prices
    2. Perfect competition – fix similar prices

3. Competitors prices
    1. Difficult to set prices too different from competitors unless true USP is shown
4. Business and marketing objectives
    1. Price must reflect all aspects of the marketing mix and should keep in mind the main goals of the business
5. Price elasticity of demand
    1. Elastic – low prices
    2. Inelastic – increase prices
6. New or existing product
    1. New products – price skimming or penetration pricing

12.5. Pricing methods

Cost based pricing

- **Mark-up pricing**
    - When a percentage of fixed mark-up is added to the cost of the product
    - The mark-up size depends on the strength of demand, number of substitutes, stage of PLC, etc
- **Target pricing**
    - It involves setting a price to achieve a required rate of return
    - This ensures a specific sales revenue is earned
- **Full-cost (or absorption-cost) pricing**
    - It involves setting a price by calculating the unit cost and adding a fixed profit margin
    - This ensures all costs are met
    - Easy to calculate
    - Suitable for firms with high market shares
    - But, doesn't take into account external factors like economic conditions
    - Inflexible method
- **Contribution-cost (or marginal-cost) pricing**
    - Prices are set based on the variable costs and a contribution amount for fixed costs and profits is added
    - Contribution per unit = selling price – variable cost per unit
    - Break even point = fixed costs/ contribution
    - Ensures variable costs are covered
    - Flexible method
    - Fixed costs may not be covered
    - If prices are varied too much, consumers maybe discouraged and business will face menu costs
- **Competition-based pricing**
    - Price is based on that of competitors
    - Scenarios where it is suitable:
        - Following the market leader
        - Avoid a price war
        - Destroyer pricing – force others out of the market
        - Based on study of conditions

12.6. Market-oriented pricing

- **Perceived-value pricing**
    - Also known as customer-value pricing
    - Prices are set based on the value customers place on the product
    - Used for products with inelastic demand
- **Price discrimination**
    - It involves charging different prices to different consumer groups for the same product
- **Dynamic pricing**
    - Changing prices, frequently, to respond to changes in demand
    - It is based on demand level and ability of consumers to pay

12.7. Pricing strategies for new products

1. Penetration pricing
    1. Involves selling at a low price to attract more customers
    2. Used by firms in the mass market with a aim to capture a large market share
2. Price skimming
    1. Setting a high price to differentiate it from competitors
    2. Usually for products with inelastic demand (luxury goods)
    3. It creates an exclusive image for the product

12.8. Pricing decisions – some additional issues

1. Level of competition
    1. It depends on the type of market
        1. Perfect competition
            1. Consumers have complete knowledge
            2. All producers are identical products
            3. Freedom of entry and exit
            4. Equal market share
            5. Here, only competitive pricing will work
        2. Monopoly
            1. Single seller with 100% market share
            2. They are price makers
            3. High barriers to entry and exit
        3. Oligopoly
            1. **Price wars** to gain market share
            2. **Non price competition** – competitive promotional campaigns, product differentiation
            3. **Collusion** – it is illegal and may lead to fines and court cases
2. Loss leaders

    1. It involves setting relatively low prices for some products, expecting consumers to buy it. • They hope, the profits earned from other products will cover the losses for the other product
    2. Usually used for complementary goods
3. Psychological pricing
    1. It involves setting prices just below the whole number
    2. It even involves using market research to avoid setting prices consumers believe is inappropriate

12.9. Pricing decisions – evaluation

- A firm will not use the same strategy for all products as there are differences in external market conditions
- Prices have a huge influence on consumer purchasing behaviours so market research must be carried out to identify consumers ability to pay before setting prices
- Low price may not always be considered the best strategy. It may even discourage consumers if they believe the product is on high value
- Price is only one factor. The complete brand image is more important

13. The Marketing Mix: Promotion

13.1. Why is promotion an important part of the marketing mix?

- Promotion involves communicating with potential customers
- It helps increase awareness and create an image in consumer minds
- The combination of all promotion techniques used (advertising, direct selling, sales promotion) is known as promotion mix
- The promotional budget is a key factor when making promotion mix decisions

13.2. Promotion objectives

- Aims of having promotional objectives:
- Increase sales by new customers
- Raise customer awareness
- Remind customers about the USP/product
- Increase purchases by existing customers
- Demonstrate USP and product differentiation strategies
- Correct misleading reports/image
- Develop a public image
- Encourage retailers to stock and promote their product

13.3. Advertising

- Known as 'above-the-line' promotion
- Communicating information about the product through TV, radio, magazine, etc
- Effectiveness depends on selecting the appropriate target market and suitable media
- Helps increase awareness and long-term brand loyalty and image

Types of advertising

1. Persuasive – involves creating a distinct image for the product and encouraging repeat purchases.
2. Informative – give information about the product's features, USP, qualities, etc. usually used for new products. Used to attract new customers

13.4. Advertising agencies

- They are firms who advertise businesses in the most effective way possible.
- They are expensive but are specialists and will provide the entire promotional plan for a business
- Stages in creation of a promotional plan:
    - Research the market
    - Identify and advise on the most cost-effective forms of media to use
    - Use creative designers to devise ads
    - Print out the adverts
    - Monitor public reactions to improve future ads

13.5. Advertising decisions – which media to use?

- Greater the promotional budget, wider media choices available
- Factors to consider when choosing the media to use:
    - Cost – TV, radio and cinemas are very expensive whereas newspapers emails and leaflets are cheaper forms
    - Size of audience – it will allow the cost per person to be calculated. Larger the size, wider reach media must be used like national or international newspaper
    - Consumer profile of target audience – this will help in designing the advert and identifying which media to use.
    - Message to communicate – written forms are most effective as their hard copy can be stored
    - Other aspects of marketing mix – all marketing mix aspects must be kept in mind to ensure they are integrated as closely as possible
    - Legal and other constraints – there maybe constraints as to what ads can contain in different countries, so

these should be kept in mind in order to avoid legal barriers

13.6. Sales promotion

- Also known as below-the-line promotion
- It aims to achieve a short-term rise in sales

Methods of sales promotion

1. Price reductions –
    1. A temporary reduction in price
    2. Also known as price discounting
    3. Reduce the profit margin on each product
    4. May have a negative impact on reputation
2. Money-off coupons –
    1. They are focused on offering a price discount. These coupons maybe present in newspapers, leaflets
    2. Retailers may not have enough stock, leading to customer disappointment
    3. Effectiveness depends on size of coupon
3. Customer loyalty schemes –
    1. Focused on encouraging repeat purchases. They usually involve loyalty cards reduces profit margin on each product
    2. High administration costs
4. Money refunds –
    1. Offered when receipt is returned to the manufacturer
    2. Involve customers filling in forms which maybe a disincentive
    3. Delay in refund may affect brand image
5. BOGOF –
    1. Buy one get one free
    2. Substantial fall in profit margin
    3. If used to sell of stock, may impact brand image
    4. Current sales may increase, but future sales may fall
6. Point-of-sales-display –
    1. Placing products in attractive and informative places
    2. Only offered to market leaders
    3. New products may struggle

13.7. Personal selling

- It involves having a sales staff communicate and sell to each customer individually
- Expensive
- Requires skilled sales staff
- Used for expensive, luxury items
- High success rates

Direct mail

- Information is directly sent to potential customers, identified by market research
- May provide detailed information
- Well focused on potential customers
- Cost effective
- Maybe missed

Trade fairs and exhibitions

- Used to market to other businesses (retailers and wholesalers)
- Used to make contacts and identify potential customers

Sponsorship

- Involves associating with an event/team
- Leads to free publicity
- Expensive
- Very effective

Public relations (PR)

- It is used to gain free publicity provided by the media
- Tries to arrange positive TV and press coverage
- Maybe used to put forward the company's views on specific incidents
- Used to improve reputation

13.8. Branding

- It is a distinguishing name given to a product
- Aims –
    - Customer recognition
    - Product differentiation
    - Giving the product an identity
- Benefits of branding –
    - Increases chances of consumer recall
    - Product differentiation
    - Reduces PED
    - Increases consumer loyalty

Brand extension

- Using the same brand name for new/modified products will help make a family of costs.
- It will make the brand image even stronger and make advertising easier as the brand can be advertised as one unit which will improve sales of all products associated with it.

13.9. Marketing or promotion expenditure budgets

1. Percentage of sales
    1. Marketing budget varies with sales
    2. Higher sales, higher budget and vice-versa

        3. But, during low sales, promotion budget reduces which is when higher promotion is needed to persuade customers to buy the product
2. Objective-based budgeting
    1. Involves analysing the level of sales required to meet aims and then identifying the amount of expenditure in order to gain that sales level.
3. Competitor-based budget
    1. Two firms with the same size may try to match each other promotional budgets.
    2. May lead to spiralling promotional costs
    3. It doesn't mean both companies promotion is equally effective.
4. What the business can afford
    1. People tend to see marketing and promotion as a luxury
    2. So, in such cases, the budget will only be set after all other expenses have been accounted for
    3. This method fails to take into account market conditions and marketing objectives when deciding marketing budget.
5. Incremental budgeting
    1. This involves adding a percentage to the last year's budget, to account for inflation and price changes
    2. But, it doesn't require managers to justify the total market budget for each year so it maybe used inefficiently

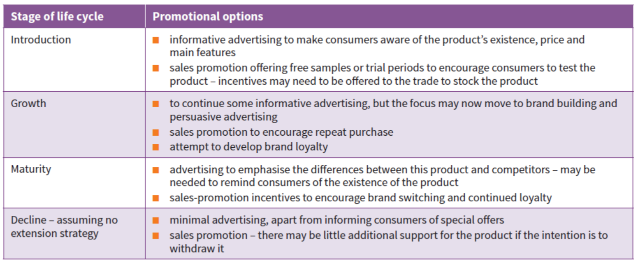
13.10. Is the marketing budget well spent?

1. Viewpoint of society and customer
    1. Many people may observe marketing and promotion as a wasteful expenditure and money could've been used more effectively, elsewhere
    2. Some consumers may even believe that the society has to bear the burden of the unreasonable, excessive advertising each year
2. Viewpoint of business
    1. Advertising and promotion may aim to build brand loyalty in the long-run rather than increasing sales in the short-run
    2. In such cases, the benefits will be spread across the years
    3. Ways to assess the effectiveness of marketing –
        1. Sales performance before and after the promotion campaign – compare sales and calculate the promotional elasticity of demand
        2. Consumer awareness data – identify how well consumers are able to recall the data and advertisements through a series of questions
        3. Consumer panels – focus groups may help gain qualitative data about the effectiveness of promotional strategies
        4. Response rarest to advertisements – number of calls to gain further information, number of website check-ins, views on videos, etc

13.11. Consumer markets and industrial markets

- Industrial products are the ones that are sold to businesses
- Consumer products involves directly selling to the end consumer
- Industrial markets may use trade promotion like trade fairs, specialist magazines
- Consumer markets may use consumer promotion like discounts, TV adverts

13.12. Promotion and the PLC \n



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

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

13.13. Packaging

- The quality, design and colour of packaging play an important role in promotion
- Cheap and nasty packaging may destroy the brand image
- Also, wasteful expenditure on packaging will also lead to negative publicity. This will even reduce the product's competitiveness
- Packaging decisions must be blended in with the overall objectives of the business
- Functions –
    - Protect the product
    - Give important information
    - Support the brand image
    - Aid customer recognition

14. The Marketing Mix: Place

14.1. Why are place decisions an important part of the marketing mix?

- Place is the process through which the product reaches the customer from the manufacturer.
- A correct distribution channel is necessary –
    - Consumers need the product to be convenient and accessible
    - Manufacturers need their outlet to be in line with their brand image
    - Every intermediary will add its profit margin, so it depends on the price the manufacturer wants

14.2. Concept of distribution

- The right product needs to reach the right consumer at the right time in the most convenient way possible
- Supply chain refers to all the intermediaries involved in getting the product to the end consumer

Customer service as objective of distribution

- Distribution channels chosen may not always be the cheapest
- Customer service is the main objective of distribution, therefore convenience to customers may also be a very important factor when deciding the distribution channel
- Businesses even use internet and e-commerce facilities to make it more accessible to customers

14.3. Channels of distribution

1. Manufacturer → Consumer
    1. Direct selling to customers
    2. No intermediaries adding their profit margins to products, lower prices and higher profits
    3. Has complete control of the marketing mix
    4. Quicker
    5. Fresher food available to consumers
    6. Direct contact with customers
    7. Expensive – storage and stock costs
    8. No retail outlets, limits promotion from physical shop/website
    9. Not convenient for customers
    10. No advertising done by intermediaries
2. Manufacturer → Retailer → Consumer
    1. Retailer pays for stock and storage costs
    2. Retailer offers after sales service and has product displays
    3. Available in many locations – convenient for customers
    4. Producers can focus on production
    5. Retailer promotes and advertises the product
    6. Intermediary adds profit margin, more expensive to consumers
    7. Producer loses SOME control over the marketing mix
    8. No exclusive outlet, may sell competing products
    9. Producer bares delivery costs
3. Manufacturer → Wholesaler → Retailer → Consumer
    1. Wholesaler buys in bulk, reducing storage costs for producer
    2. Wholesaler bares transport costs to retailers
    3. Wholesaler break bulk by selling small quantities to different retailers
    4. More convenient for customers
    5. Best way to enter foreign markets
    6. Higher final prices as more intermediaries add profit margins
    7. Producer further loses control over marketing mix
    8. Slow distribution chain
    9. No direct contact with customers

14.4. Factors influencing choice of distribution channel

- Industrial product or consumer product
- Geographical dispersion of target market
- Level of service customers expect
- Technical complexity of the product
- Unit value of product
- Number of potential customers
- Competitors actions

14.5. Internet and 4C's

- Internet is transforming the ways in which businesses market their products and manage relationships with customers
- Selling goods directly to consumers (B2C) or to businesses (B2B) through e-commerce
- Online and mobile advertising (pop ups, social media, websites)
- Sales contacts are established by visitors leaving their details on sites
- Collecting market research data by encouraging visitors on the websites to answer questions
- Ability to use dynamic pricing

Advantages	Disadvantages
Relatively inexpensive	Poorer countries may not have internet access
Reaches a wider target market	Consumers can't touch, smell, feel the product before – limiting their willingness to buy online

Consumers interact with websites and leave their information there, assists in market research	High product returns if customers dissatisfied

Consumers interact with websites and leave their information there, assists in market research	**High product returns if customers dissatisfied**
Easy and convenient for customers	High postal costs
Accurate records and quickly measured	Postal service may be unreliable, affecting company's brand image
Lower fixed costs	Internet security worries
Increasing technological usage	Website must be kept up-to-date, expensive
Easier dynamic pricing	

14.6. Viral marketing

- It involves using social media sites to increase brand awareness or increase sales
- It encourages people to keep passing on marketing messages to others
- They maybe in the form of video clips, interactive flash games, e-books, text messages, social media

14.7. An integrated marketing mix

- If the marketing mix is not integrated, it may confuse customers who will stay away from the product and find alternatives. This will lower long-term sales
- The most effective marketing decisions will –
    - Based on the marketing objectives
    - Affordable within the marketing budget
    - Integrated and consistent with each other
    - Integrated with the 4 C's of marketing

15. The Nature of Operations

15.1. Operations

- The operations department deals with using resources (inputs) to create final products (outputs)
- They are aiming to produce goods and service of the right quality and the required quantity, at the time needed in the most cost-effective method
- They are concerned with –
    - Efficiency of production – produce at the lowest possible cost
    - Quality – maintain quality standards and keep improvising
    - Flexibility and innovation – keep adapting to the dynamic business environment

15.2. Production process – transformation

- Conversion of inputs into outputs is known as the transformation process
- It involves adding value to the product

Factors influencing the degree of value added

1. Design of the product
2. Efficiency with which the input resources are combined and managed
3. Ability to convince consumers to pay more than the price of inputs

15.3. Operations stages

1. Converting a consumer need into a product/service
2. Organising efficient operations
3. Deciding on suitable methods of production
4. Setting quality standards
5. Ensuring they are maintained

15.4. Resources

1. Land – natural resources businesses require
2. Labour – both manual and mental labour. Quality of labour highly influences the operational success and maybe improved through training and motivation
3. Capital – tools, machinery and other man-made resources required for production
4. Intellectual capital – intangible assets of the business. Human capital – trained and knowledgeable employees, structural capital – IT systems, relational capital – relations with suppliers, customers

15.5. Production and productivity

- Production is the absolute measure of the quantity of output that a firm produces in a given time period
- Productivity is a relative measure of how efficiently inputs are converted into outputs.
- Labour productivity = total output/total employees
- Capital productivity = output/capital employed

15.6. Ways to raise productivity

1. Improve training –
    1. Increasing training will make the workforce more flexible and efficient.
    2. But it is expensive and time consuming
2. Improve motivation –
    1. Using Herzberg's and Maslow's theories workers motivation levels can be increased

        2. This will increase productivity but may also be expensive to implement
    3. Purchase more machinery/technology –
        1. Employing more machinery will allow the company to increase output and reduce the amount of labour employed
        2. Plus, it will ensure good quality and maximum efficiency
        3. But it is expensive and labourers may be scared to lose jobs, reducing their motivation to worker harder
    4. More efficient management –
        1. Failure to purchase enough materials, poor schedules will reduce the efficiency of the business

15.7. Is raising productivity always the answer?

- Higher productivity doesn't guarantee success for a business
- Higher productivity may lead to higher wage demands, raising the firm's costs of production
- Quality of management will determine the success of the policies implemented and thus the success of a business
- Effectiveness and efficiency are different. A product maybe efficient but not effective, leading to its failure

15.8. Efficiency and effectiveness

- Efficiency is producing output at the highest input to output ratio
- Effectiveness is producing goods and services that satisfy customer needs and wants
- Being effective involves meeting business's corporate aims by satisfying consumer needs, profitably

15.9. Labour intensive and capital intensive

- Labour intensive is when there are more workers employed than machinery
- Being labour intensive will allow firms to charge higher prices as it is hand-made and maybe customised. It enhances brand image and loyalty.
- But skilled workers are required and low chances for economies of scale
- Capital intensive is when there is more capital equipment employed relative to labourers
- Being capital intensive will allow opportunities for economies of scale, lower unit costs.
- But fixed costs will be high, cost of purchasing and maintaining the machinery is high. Also, skilled employees and engineers will be required to operate the equipment. Also, technology can quickly become outdated and obsolete

15.10. Factors influencing choice of resource (labour VS capital)

1. Nature of product
2. Prices of inputs
3. Size and ability of firm
4. Intended image

16. Operations Planning

16.1. Operations decisions

1. Link with marketing
    1. Operations manager needs to know market demand forecasts to be able to match supply and demand. This is known as operations planning.
    2. If sales forecasts are accurate:
        1. Easily match supply to demand
        2. Keep inventory levels to a minimum efficient level
        3. Reduce wastage
        4. Employee appropriate number of factors of production
        5. Produce the right product mix
2. Availability of resources
    1. Production of goods and services requires – land, labour, capital, raw materials
    2. Lack of these will influence operations decisions:
        1. Location – locate in areas with abundant supply of materials
        2. Nature of production method – if labour productivity is high, business may use labour intensive production method
        3. Automation – if technology is cheaper, business may decide to switch to automated production method.
3. Technology
    1. Technological developments like CAD and CAM have changed the production process
    2. They help the process become more efficient and cost effective

16.2. CAD – computer aided design

- It involves the use of computer programs to create 2D and 3D representations
- Benefits –
    - Lower development costs
    - Higher productivity
    - Improved quality
    - Faster time-to-market
    - Good visualisation

  - Great accuracy
  - Easy to make changes
- Problems –
  - Complex programs
  - Extensive employee training needed
  - Expensive

16.3. CAM – computer aided manufacturer

- Using computers to control and operate machines
- Benefits –
  - Reduced quality problems
  - Faster production
  - Higher productivity
  - More flexible
  - Integration with CAD helps widen product portfolio
- Limitations –
  - Cost of machinery
  - Employee training required
  - Poor motivation – loss of job security
  - Hardware failure, halt production
  - Need for quality assurance or TQM

16.4. Need for flexibility and innovation

- Flexibility is the business's ability to vary production with changes in demand
- Ways to increase flexibility –
  - Increase capacity
  - Hold higher stocks
  - Have a flexible workforce
  - Flexible flow production equipment

Process innovation

- It involves the use of new, advanced technology to improve production
- Done through using CAM, CAD, robots, faster machines, computer tracking inventory system, etc
- Gives a competitive edge
- Better quality
- Higher reputation and brand loyalty
- Expensive

16.5. Production methods

1. Job production
    1. Producing a single, one-off item, specifically designed for the customer
    2. It is labour intensive
    3. Specific consumer needs are met, higher reputation and loyalty
    4. Specialised products are produced, ability to charge higher prices
    5. Cannot enjoy economies of scale
    6. Expensive as requires skilled labour and training
2. Batch production
    1. Producing products in separate groups where the entire groups goes through the production process together
    2. Enables division of labour and specialisation
    3. Economies of scale
    4. Easy to alter batches according to demand and preferences
    5. High storage costs – work in progress inventory
    6. Workers may get bored and demotivated
3. Flow production
    1. Producing products in a continuous process through the use of technology
    2. Higher output
    3. Economies of scale
    4. Consistent and standardised quality
    5. Low labour costs
    6. High initial costs
    7. Lower job security
4. Mass customisation
    1. It involves the use of computer aided production to meet specific customer needs at mass production costs
    2. Allows businesses to focus on differentiated marketing
    3. Increases added value
    4. Low unit costs
    5. Customer needs are met

16.6. Production methods – making the choice

1. Size of market – if the market is small, flow production can not be used, batch or job production is more appropriate
2. Amount of capital available – employing flow production is expensive and requires a high initial capital investment. Small firms may not be able to afford this and therefore use job or batch production
3. Availability of other resources – using flow production requires a high supply of unskilled workers and huge land area. Job production requires highly skilled workers. The chosen production method may even depend on whether the company is able to allocate these resources.
4. Market demand exists for products adapted to specific customer requirements – if the company wants low costs but has a differentiated target market, mass customisation is the best option.

Problems of changing production methods

- Job to batch: high equipment costs, need for extra working capital and fall in employee morale
- Job/batch to flow: high capital cost, costs of employee training, need for accurate demand forecasts

16.7. Location decisions

Benefits of optimum location

- Characteristics of location decisions:
- Strategic (long term) in nature
- Difficult to reverse
- Taken by the highest management level
- The optimal location should help maximise long term profits of a business
- An optimal location:
    - Balances fixed costs, customer convenience and potential sales revenue
    - Balances quantitative & qualitative factors

Factors influencing location decisions

1. Quantitative factors –
    1. Site and other capital costs
    2. Labour costs – depends on whether it is a labour-intensive or capital-intensive business
    3. Transport costs
    4. Sales revenue potential
    5. Government grants
2. Quantitative factors –
    1. Safety
    2. Room for further expansion
    3. Managers preferences
    4. Ethical considerations
    5. Environmental concerns
    6. Infrastructure

16.8. Techniques to assist location decisions

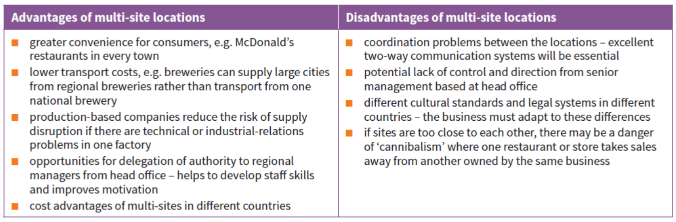
1. Profit estimates – compare estimated revenues and costs to choose the location with the highest profit potential. Only profit forecasts have limited use. They must be compared with capital costs
2. Investment appraisal – it involves looking at locations which will provide the highest potential returns on investment over the years. One method is payback. This helps businesses who face capital shortage. Need estimates of many years, which may not be accurate and bring in uncertainty into the decision making
3. Break-even analysis

Other locational issues

1. Pull of the market
    1. A company producing a product must be located near other companies producing similar products as well
2. Planning restrictions
3. External economies of scale
    1. Cost reductions a business benefits when the industry grows in one area

16.9. Multi-site locations

- A business which operates from more than one location.



Advantages of multi-site locations	Disadvantages of multi-site locations
■ greater convenience for consumers, e.g. McDonald's restaurants in every town ■ lower transport costs, e.g. breweries can supply large cities from regional breweries rather than transport from one national brewery ■ production-based companies reduce the risk of supply disruption if there are technical or industrial-relations problems in one factory ■ opportunities for delegation of authority to regional managers from head office – helps to develop staff skills and improves motivation ■ cost advantages of multi-sites in different countries	■ coordination problems between the locations – excellent two-way communication systems will be essential ■ potential lack of control and direction from senior management based at head office ■ different cultural standards and legal systems in different countries – the business must adapt to these differences ■ if sites are too close to each other, there may be a danger of 'cannibalism' where one restaurant or store takes sales away from another owned by the same business

Table 23.3 Advantages and disadvantages of multi-site locations

16.10. International location decisions

- Offshoring is the relocation of a business process to another country to the same or another business.

Reasons for international location decisions

1. To reduce costs
    1. Companies may switch to law wage countries or to countries with low raw material costs
2. To access global markets
    1. Rapid economic growth in less-developed countries has created huge market potential
3. Avoid protectionist barriers
    1. To avoid trade barriers like tariffs a company may have to relocate to another country
4. Other reasons
    1. Government grants

Problems with international locations

1. Language and communication barriers
2. Cultural differences
3. Level-of-service concerns – quality, reliability of delivery and control with suppliers may be lost with overseas manufacturing
4. Supply-chain concerns
5. Ethical considerations

16.11. Scale of operations

- Scale of operations is the max output a company can achieve using the available inputs
- Only increased by increasing all inputs (factors of production)

- Factors influencing scale of operations:
  - Owner's objectives
  - Capital available
  - Size of market
  - Number of competitors
  - Scope for scale economies

16.12. Economies of scale

- Cost benefits arising with increased scale of operations

Types of economies of scale

1. Purchasing economies
   1. Bulk buying economies
   2. Suppliers may offer discounts on bulk purchases
   3. They will want to keep large customers happy so may provide good quality goods and on time delivery
2. Technical economies
   1. High output will lower unit costs
   2. Fixed costs are spread across the output, lowering its output
3. Financial economies
   1. Banks and other financial institutions will be willing to provide loans to larger businesses
   2. They may be willing to charge lower interest rates to them
4. Marketing economies
   1. Costs of advertising and promotion maybe spread over a larger output, lowering unit costs
5. Managerial economies
   1. Employing specialists and managers will be easier for large firms as their salary will be spread over a larger output

16.13. Diseconomies of scale

- Factors which lead to a rise in average costs of production arising with increased scale of operations beyond a certain size.

Types of diseconomies of scale

1. Communication problems
   1. In a large firm, the feedback provided will be poor
   2. The chain of command may be long leading to distortion of messages
   3. This may cause poor decision making
2. Alienation of the workforce
   1. The bigger the organisation, the more difficult it becomes to involve every worker.
   2. They may feel demotivated due to lower job satisfaction
3. Poor coordination

How to avoid diseconomies of scale

1. Management by objectives: This will help avoid coordination problems
2. Decentralisation: This gives divisions a considerable degree of autonomy and independence.
3. Reduce diversification: Businesses that concentrate on 'core' activities may help to reduce coordination problems and some communication problems.

17. Inventory Management

17.1. Inventory

- Materials needed for the production of goods and services.

Types:

1. Raw materials
   1. Purchased from outside suppliers
2. Work in progress
   1. Work in progress is any product which is not yet converted into finished goods.
   2. Depends on time period of production and production method used.
3. Finished goods
   1. Good ready to be sold to consumers

17.2. Inventory management

- Without effective inventory management, there maybe many problems.
- Insufficient inventories to meet unforeseen changes in demand
- Out-of-date inventories maybe held
- Wastage due to incorrect storage conditions
- High storage and opportunity costs if extra inventory is held
- Poor management may lead to delayed deliveries, ignoring discounts, etc

17.3. Inventory holding costs

1. Opportunity cost – working capital tied up in inventory could be used elsewhere. Higher interest rates, higher the opportunity cost of holding inventory.
2. Storage cost – inventories must be held in appropriate, safe conditions to avoid wastage. Higher inventory, higher the storage costs
3. Risk of wastage and obsolescence – if inventories are kept unused, they may become obsolete, lowering the value of such inventories and increasing the business's expenses

Costs of not holding inventories

1. Lost sales – business may not be able to supply all customers, leading to loss of sales and revenue
2. Idle production resources – if raw material inventories run out, expensive equipment and workers will be left idle, leading to loss of output and wasted resources.
3. Special orders could be expensive – urgent orders given to suppliers may lead to extra delivery, administration costs
4. Small order quantities – higher average costs as the company will not benefit from economies of scale

17.4. Optimum order size

- Operations managers must ensure they have enough stocks to allow for smooth production.
- Operations managers usually order their inventories on the basis of the Economic Order Quantity (EOQ)
- EOQ is the optimum inventory level where the costs incurred are minimum (both re-ordering costs and stock-holding costs)

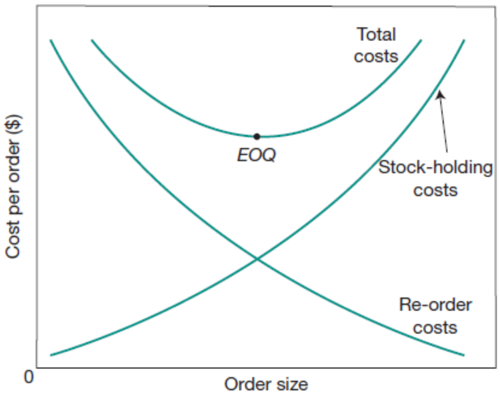


Figure 24.2 Factors influencing the economic order quantity

- The reorder costs decrease as the order size increases, showing a downward sloping graph.
- Whereas, the stock-holding costs increase as the order size rises, showing an upward sloping graph.
- The Economic Order Quantity is shown where the stock-holding costs and re-order costs curves intersect.

17.5. Inventory control graphs

- Inventory-control graphs record the buffer inventories, maximum inventory.
- They help in determining the right order time and quantity.
- Buffer inventory – minimum inventory held to deal with delays in delivery and unforeseen demand changes
- Maximum inventory level – the maximum quantity of inventory the company can hold, space and financial terms
- Reorder quantity – the number of units ordered each time
- Lead time – time taken for the supplier to deliver the raw materials
- Reorder stock level – the level of inventory which will trigger a new order

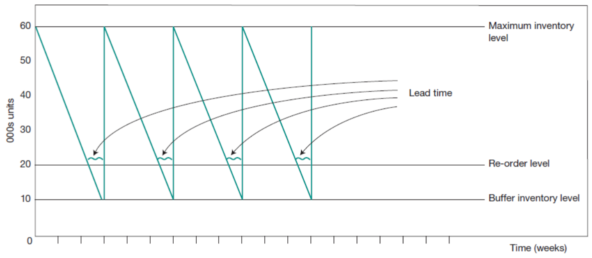


Figure 24.3 A typical inventory-control chart

The maximum inventory is 60000 units. The buffer inventory level is 10000 units and the reorder level is 20000 units. The reorder quantity is 50000 units (60000-10000)

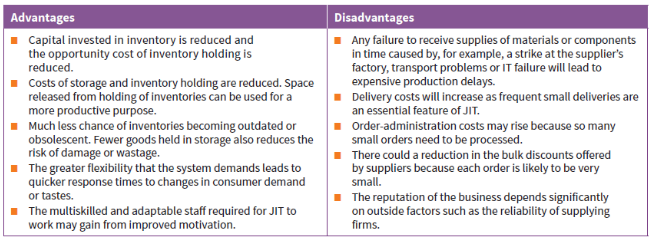
17.6. Just in time (JIT) inventory control

- It is an inventory control system which avoids the need to hold inventories. They arrive just as and when required

Requirements for JIT

- Excellent relations with supplier
- Flexible and multiskilled production staff
- Flexible equipment and machinery
- Accurate demand forecasts
- Latest IT technology
- Excellent employee-employer relations
- Quality must be priority

Advantages and disadvantages



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

JIT evaluation

- JIT requires employees to be accountable for their performance and suppliers to be reliable
- JIT may be unsuitable when:
- Costs of halting production exceed inventory holding costs
- Expensive IT systems cannot justify potential cost savings
- Global inflation makes holding inventories cheaper

18. Business Finance

18.1. Why does a business require finance?

- To buy machinery, capital equipment while set-up of the business. It is called start-up capital
- To fund its day-to-day expenditure. It is called working capital
- While business expansion
- Needed to merge/acquire other businesses
- Unforeseen expenses and difficulties
- Fund research and development

18.2. Capital expenditure

- Long term spending (more than one year) like purchase of assets

Revenue expenditure

- Short term, day-to-day expenditure like wages, salaries, insurance

18.3. Working capital

- It is the finance required to pay for day-to-day expenses
- It is the lifeblood of the business
- Without sufficient working capital, a business will become illiquid (cannot repay its short-term debts)
- Working capital = current assets - current liabilities

How much working capital is required?

- Too high of working capital leads to opportunity cost of too much capital being tied up and can be used elsewhere
- Working capital requirement of a business is determined by its working capital cycle
- Longer the cycle, greater the amount required

18.4. Internal sources

1. Profits retained in the business

- The retained earnings of a business can be used as a source of finance to fund expansion, purchase of assets
- These do not have to be repaid and are a permanent source of finance
- But they may not be enough and new businesses may not have this option

2. Sale of assets

- Assets which are no longer needed/fully employed can be sold in order to get funds
- It will help raise permanent capital for the business
- They can be sold to a leasing company and leased back for business use. But, through this fixed cost will rise
- Also, these assets could have been used as collateral or be used during future expansions

3. Reductions in working capital

- Lowering the amount tied up in working capital may free up some money to be used elsewhere
- It will help reduce the opportunity cost of tying up money in current assets like inventories and trade receivables
- But this may negatively affect the company’s liquidity position, affecting stakeholders like potential investors, bankers, etc

18.5. External sources

Short term sources

1. Bank overdrafts

- Most flexible
- The bank allows the business to overdraw its account
- High interest rates
- Bank can ask the business to repay anytime

2. Trade credit

- The business can lower the credit period provided to trade receivables and ask for greater period from trade payable
- Customers may switch to competitors if they provide greater credit period
- Suppliers may not provide discounts

3. Debt factoring

- This involves selling of a company’s trade receivable claims to a debt factor for immediate money
- Lowers risk for the business
- Full amount is not given

18.6. Medium-term sources

1. Hire purchase

- It is a way of purchasing an asset for credit where money is paid in instalments over the time
- It helps avoid large initial cash payment
- Ownership of asset is obtained

2. Leasing

- It allows a business to obtain the use of an equipment by paying a fixed rental charge, instead of buying the asset
- Leasing company is responsible for maintenance and repairs
- No ownership is gained, can’t be used as collateral during bank loans

3. Medium-term bank loan

18.7. Long term sources

1. Long-term bank loans

- Maybe given for fixed/varying interest rates
- Fixed provide greater certainty but maybe more expensive
- Companies will have to provide collateral/security to obtain the loan
- They require a business plan and cash flow forecast

2. Debentures

- A company can issue bonds to potential investors and pay a fixed rate of interest for the life of the bond
- No collateral security is required

18.8. Sale of shares – equity finance

- Limited companies issue shares when first formed and use it to purchase necessary assets
- They can sell shares anytime required up to a limit of their authorised capital
- It is a method of permanent finance
- Way to sell shares:
  - Public issue by prospectus: company advertises its share sale and invites interested people to apply for them. It is very expensive
  - Arranging a placing of shares with institutional investors without the expense of a full public issue: this is done by the means of a rights issue. The short-term share price falls which reduce shareholders confidence

18.9. Debt or equity capital – evaluation

- Debt finance benefits:
  - Ownership is not diluted
  - No permanent increase in liabilities as the loans will be repaid
  - Lenders have no voting rights
  - Interest is paid before corporation tax
- Equity benefits:
  - Never needs to be repaid
  - Dividends must be paid whenever the business has enough profits

18.10. Other sources of long-term finance

1. Grants

- Grants may be given with certain conditions up on number of jobs, location, etc
- They do not need to be repaid

2. Venture capital

- It is the risk capital invested by wealthy individuals in business start-ups which have good profit potential but can't find other sources of finance
- Venture capitalists provide advice for the business owners
- But they may expect a part of ownership in the business

18.11. Finance for unincorporated businesses

- Unincorporated = sole trade & partnership
- Can not raise finance from the sale of shares
- Unsuccessful in raising finance through sale of debentures
- Sources of finance –
  - Overdrafts
  - Loans
  - Credit from suppliers
  - Borrow from friends and family
  - Own savings
  - Grants
  - Crowdfunding
  - Microfinance

18.12. Microfinance

- Involves selling financial services to poor, low-income customers or small businesses who do not get finance from banks
- High interest rates

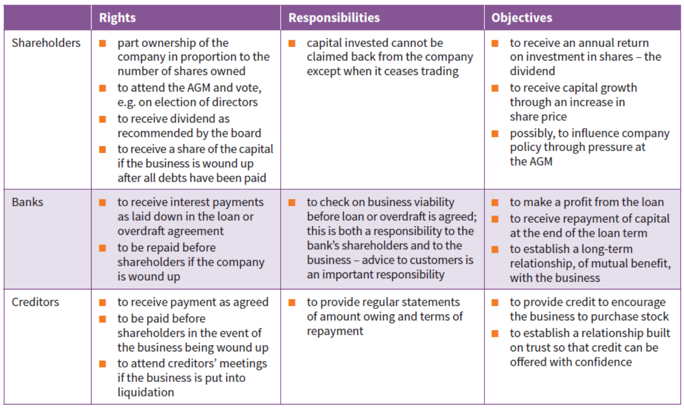
Crowd-funding

- Crowdfunding websites allow entrepreneurs to promote their business and encourage individuals to each invest a small amount
- Effective form of promotion
- Investors may expect a return on investment
- Investors, when the business is successful will receive: initial capital plus interest, equity stake in the business
- Must keep accurate records of thousands of investors
- Increased risks of idea being copied

18.13. Importance of business plan

- Business plan is a detailed document giving information about a business to convince external stakeholders to lend money to the business
- Helps gain loans and credit facilities
- Helps lower risks

18.14. Financial Stakeholders



	Rights	Responsibilities	Objectives
Shareholders	■ part ownership of the company in proportion to the number of shares owned ■ to attend the AGM and vote, e.g. on election of directors ■ to receive dividend as recommended by the board ■ to receive a share of the capital if the business is wound up after all debts have been paid	■ capital invested cannot be claimed back from the company except when it ceases trading	■ to receive an annual return on investment in shares – the dividend ■ to receive capital growth through an increase in share price ■ possibly, to influence company policy through pressure at the AGM
Banks	■ to receive interest payments as laid down in the loan or overdraft agreement ■ to be repaid before shareholders if the company is wound up	■ to check on business viability before loan or overdraft is agreed; this is both a responsibility to the bank's shareholders and to the business – advice to customers is an important responsibility	■ to make a profit from the loan ■ to receive repayment of capital at the end of the loan term ■ to establish a long-term relationship, of mutual benefit, with the business
Creditors	■ to receive payment as agreed ■ to be paid before shareholders in the event of the business being wound up ■ to attend creditors' meetings if the business is put into liquidation	■ to provide regular statements of amount owing and terms of repayment	■ to provide credit to encourage the business to purchase stock ■ to establish a relationship built on trust so that credit can be offered with confidence

18.15. Making the decisions – factors influencing

19. Costs

19.1. Uses of cost information

- Helps calculate accurate profit and losses, calculate profitability, liquidity
- Helps make informed pricing decisions – marketing department
- Allows comparisons to be made, identify cost cutting techniques and implement required strategies
- Help set future budgets
- Managers can make decisions about resource allocation
- Help in decision making

19.2. Classification of costs

1. Direct costs – costs which can directly be identified with one unit of output. Ex. raw materials
2. Indirect costs – costs which can not be directly identified with one unit of output. Ex. rent
3. Fixed costs – costs which do not change with output in the short run. Ex. rent, insurance
4. Variable costs – costs which vary directly with the output. Ex. raw materials, wages
5. Marginal costs – cost of producing one extra unit of output

19.3. Break even analysis

- Break even point is where neither profit nor loss is made. Total revenue = total costs
- Below the break even point, a business makes losses and above the break even point the business makes profits

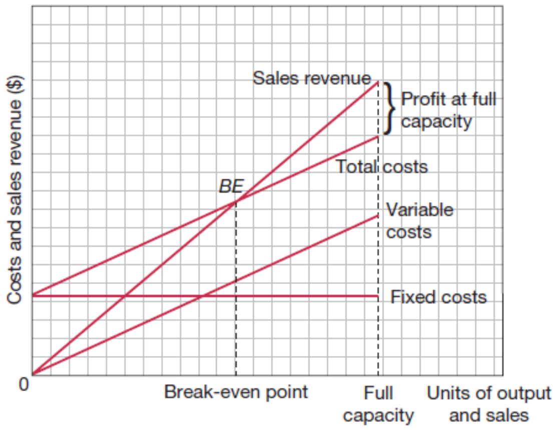


Figure 29.2 A typical break-even chart

Margin of safety

- The amount by which current sales level exceeds the break-even point
- Indicates how much sales could fall without the firm going into losses

Break even equation

- Break-even level of output = fixed cost/contribution per unit
- Contribution per unit = selling price – variable cost per unit

Break even analysis – uses

- Easy to construct and interpret
- Managers can redraw the graph to see effect of changes in costs and prices on profits and break-even points
- Helps in decision making
- Gives information relating the margin of safety

Break even analysis – evaluation

- Assumption that costs and revenue is represented by straight lines is unrealistic
- Not all costs can be classified between fixed & variable
- No allowance for inventory levels
- Unlikely that fixed costs remain unchanged throughout

20. Accounting Fundamentals

20.1. Accounting concepts and conventions

1. Double-entry principle
    1. Every transaction has 2 effects – debit and credit
2. Accruals

    1. All prepayments and overdues must be recorded in the books of accounts
3. Money-measurement principle
    1. Only items with a monetary value should be recorded
4. Conservatism – prudence concept
    1. Accountants should provide for all losses but never anticipate a gain
5. Realisation concept
    1. Revenue and profits should only be recorded when the legal title of the goods is transferred.

20.2. Income statement

- A record of the company's profits, revenue and expenses over a given time period
- Trading account – shows gross profit and cost of sales
- Profit and loss account – shows overall profit and overhead expenses
- Appropriation account – shows dividends and retained earnings

Uses of income statement

- Measure and compare the performance with competitors or over time
- Actual profit can be compared with estimated profit
- Banks & creditors need the information to decide whether or not to lend the business
- Prospective investors assess the level of risk and earnings on investment
- Low quality & high-quality profit is identified

20.3. Statement of financial position

- Records a business's assets, liabilities and capital at a certain point of time
- Sources of shareholder's equity:
- Selling of shares – share capital
- Retained earnings of a company

20.4. Non-current assets

- Assets kept for long term use
- Ex. land, machinery
- Intangible assets – goodwill, copyrights, patents

Current assets

- Short term assets which can easily be turned into cash
- Ex. trade receivables, cash, bank balance, inventory

Current liabilities

- Short term debts
- Ex. overdrafts, trade payables

Working capital

- Current assets – current liabilities

Shareholder's equity

- Share capital + retained earnings

Non-current liabilities

- Long term debts
- Ex. loans, debentures, bonds

20.5. Other published accounts

1. Cash-flow statement –
    1. Focuses on the cash available in the business
    2. Includes a company's cash inflows and outflows over the year
2. Chairman's statement –
    1. General report about the company's major achievements and future plans
3. Chief executive's report –
    1. More detailed analysis of the previous year
4. Auditor's report
5. Notes to accounts

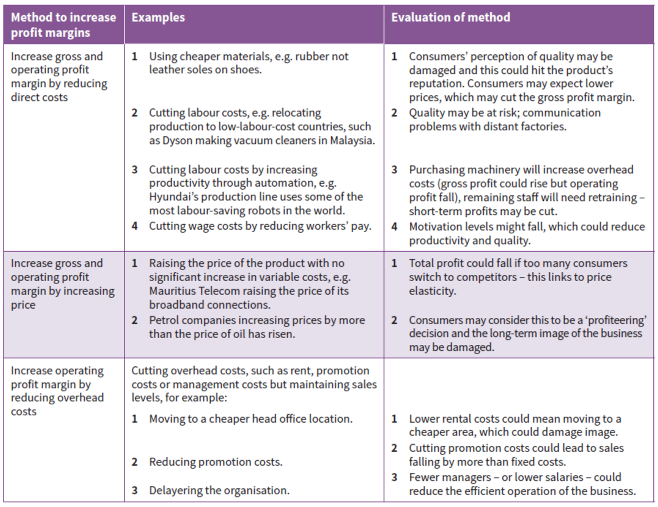
20.6. Profitability ratios

1. Gross profit margin – compares gross profit with revenue. How successful the company is in maintaining its cost of sales

Gross profit margin = gross profit/revenue * 100

1. Operating profit margin – compares operating profit with revenue. How successful is the company in maintaining its overhead costs?

Operating profit margin = operating profit/revenue * 100



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

Table 30.6 Evaluation of ways to increase profit margins

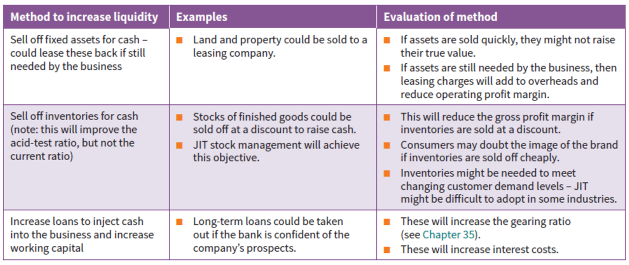
20.7. Liquidity ratios

1. Current ratio

- Current assets/current liabilities
- Safe ratio between 1.5-2
- Depends on the industry

2. Acid test ratio/quick ratio

- Current assets – inventory/current liabilities
- Safe ratio between 1-1.5



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

Table 30.7 Evaluation of ways to increase liquidity

20.8. Limitations of ratio analysis

- Incomplete analysis
- Limited use on its own. Must be compared with other business or over time
- Some may be window dressed
- Ignored qualitative information
- Only provides the problem, doesn't suggest solution

20.9. Users of accounting information

1. Managers

- Measure business performance
- Compare against targets, previous time periods and competitors
- Assist in decision making
- Control and monitor the operation of each department
- To set targets or budgets for the future and review these against actual performance.

2. Banks:

- To decide whether to lend money to the business
- To assess whether to allow an increase in overdraft facilities

3. Creditors, such as suppliers:

- To see if the business is secure and liquid enough to pay off its debts
- To assess whether the business is a good credit risk
- To decide whether to press for early repayment of debts.

4. Customers:

- To assess whether the business is secure
- To determine whether they will be assured of future supplies
- To establish whether there will be security of spare parts
- and service facilities.

5. Government and tax authorities:

- To calculate how much tax is due from the business
- To determine whether the business is likely to expand and create more jobs and be of increasing importance to the country's economy
- To assess whether the business is in danger of closing down,
- creating economic problems
- To confirm that the business is staying within the law in terms of accounting regulations.

6. Investors, such as shareholders in the company:

- To assess the value of the business and their investment in it
- To determine what share of the profit's investors are receiving
- To decide whether the business has potential for growth
- If they are potential investors, to compare these details with those from other businesses before making a decision to buy shares in a company
- If they are actual investors, to decide whether to consider selling all or part of their holding.

7. Workforce:

- To assess whether the business is secure enough to pay wages and salaries
- To determine whether the business is likely to expand or be reduced in size
- To determine whether jobs are secure
- To find out whether, if profits are rising, a wage increase can be afforded

8. Local community:

- To see if the business is profitable and likely to expand, which could be good for the local economy
- To determine whether the business is making losses and whether this could lead to closure.

20.10. Limitations of published accounts

- Future plans
- Performance of each department/division
- Company's effect on the environment
- Research & development plans

Accuracy of published accounts

- Window dressed accounts
- Done to influence stakeholders to lend money/invest

21. Forecasting and Managing Cash Flows

21.1. Cash flow

- It is the difference between a company's cash inflows and cash outflows
- Without sufficient cash flow, a business can become insolvent and force the business into liquidation
- Cash flow forecast is the estimate of a firm's cash inflows and outflows
- Net monthly cash flow is the estimated difference between inflows and outflows
- Opening cash balance is the amount a business has at the beginning of each month

21.2. Need for cash flow planning for entrepreneurs

- New businesses have less credit time
- Banks may not be willing to lend
- Limited finance at the beginning

Cash VS Profit

- A profitable business may fail due to insufficient cash
- Having enough cash – short term goal
- Good profits – long term goal

21.3. Cash inflows

1. Owners capital
2. Bank loans
3. Customer cash purchase
4. Trade receivables payments

Cash outflows

1. Annual rent
2. Lease payment
3. Electricity, water bills
4. Labour costs
5. Variable costs

Cash flow forecasts – limitations

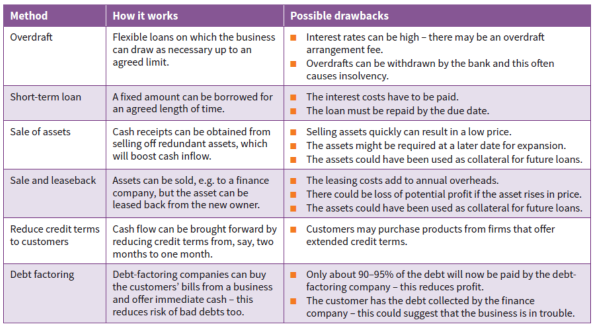
- Inaccurate figures if inexperienced
- Unexpected costs may arise
- Wrong assumptions as a result of poor market research

21.4. Causes of cash flow problems

1. Lack of planning – cash flow forecasts help us plan for the future in terms of the amount of cash needed. Without planning a business may have insufficient cash reserves.
2. Poor credit control – inefficient management of trade receivables. A business must keep reminding its credit customers about the amount they owe, if not they may become bad debts.
3. Allowing customers too long to pay debts – the business may offer too long credit periods when compared to what it receives from suppliers
4. Expanding too rapidly – overtrading will increase cash outflows causing cash flow shortage
5. Unexpected events – only estimates, not 100% accurate. There maybe unforeseen rise in outflows or fall in inflows

21.5. Ways to improve cash flow

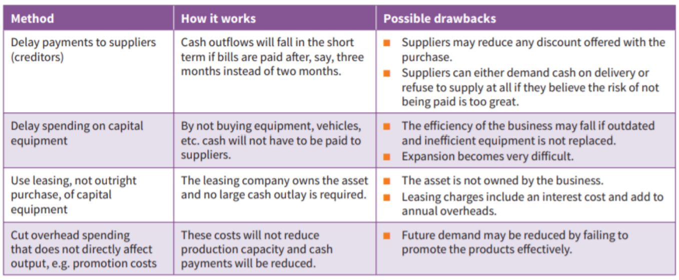
1. Increase cash inflow



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

Table 31.2 Ways to increase cash inflows and their possible drawbacks

2. Lower cash outflow



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

21.6. Management of trade receivables

- Not providing credit to customers. May lead to fall in competitiveness and loss of sales
- Selling claims to a debt factor. May not receive full payment
- Identify credit worthiness of customers
- Offer discounts for prompt payments

Management of trade payables

- Increasing the range of goods bought on credit. Suppliers may not provide discount or may refuse to provide further supplies

- Extend the period of time taken to pay. Suppliers may be reluctant to supply

Management of inventory

- Maintain small inventory levels
- Using computer systems to record inventory
- JIT inventory system

21.7. Cash management

- Use cash flow forecast
- Plan for future and range external finance when needed

Working capital increase – permanent

- Long term loans
- Issue of shares

CAIE AS LEVEL

Business (9609)

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