AQA GCSE BUSINESS (9-1)

COURSE COMPANION

Essential study notes to support your AQA GCSE Business Course

CONTENTS

Section 1 Business in the real world

Topic overview

Although this is a separate topic, students need to relate these concepts to the four functional areas of business, business operations, human resources, marketing and finance.

Section	Key things to learn
The purpose and nature of businesses	What a business is and the reasons why a business is set up Functions of business Type of business Goods and services Needs and wants Factors of production: land, labour, capital and enterprise Opportunity cost Business sectors: primary, secondary and tertiary Enterprise and the role of entrepreneurs in starting businesses Objectives, characteristics and skills of successful entrepreneurs Dynamic nature of business and its changing environment: technology, the economy, legislation and environmental considerations.
Business ownership	The different options for a start-up and established businesses Sole traders, partnerships, private limited companies, public companies, not-for-profit organisations Advantages and disadvantages of each legal structure Importance of limited liability
Setting business aims and objectives	Common aims and objectives How objectives help management run the business Relationships between business objectives and business operation Choice of business objectives and why they change Non-financial objectives
Stakeholders	Who stakeholders are Stakeholder objectives and relationship to business operation Stakeholder conflict
Business location	Factors that influence where a business is located
Business planning	Purpose of business planning Main sections of a start-up business plan Benefits and drawbacks of business planning Difference between variable, fixed and total costs Concepts of revenue, costs, profit and loss
Expanding a business	Why businesses grow Internal and external methods of growth Economies and diseconomies of scale Calculation of average unit costs and importance of this calculation

What is a business?

Businesses - goods and services

We are surrounded by businesses. We come into contact with them every day. But what, exactly, is a **business**?

A ***business*** can be defined as:

> An organisation that exists to produce goods and services on a commercial basis to customers

What are ***goods* and *services***?

Goods are actual objects. They can be touched, felt and held. They are produced and consumed. In a home you will see dozens of examples, from the microwave, to the ready-meals in the freezer, to the flat-screen television and the latest smart phone or games console. Some businesses will be involved in distributing goods so that they can be consumed more easily. These include shops and warehouses.

Services are activities. They are provided for you by other people or businesses. When you book a holiday, visit the hairdresser, eat in a restaurant or visit the cinema, you are consuming one or more services. You cannot touch or hold a service. A service cannot be stored.

In the UK most businesses provide a service rather than make goods. That is particularly true of the small business sector.

Businesses – need, wants and opportunity cost

Needs are those goods and services that we have to consume if we are to live. These include food, shelter and warmth.

Wants are goods and services that we would like, but do not have to consume in order to survive. These include holidays, smartphones, entertainment and other luxuries that we may like, but do not need.

Some goods and services can include both needs and wants. We might *need* a car, so we can work to get the food we need to survive. But we might *want* a car that has a fast engine and a sunroof, so we can enjoy days out, holidays and look good.

We cannot have everything we want, so consumers have to make choices. If we make one choice of what to consume, this may mean giving up the consumption of other goods or services. If you choose to buy some new clothes, this may mean giving up the purchase of a new phone. This is known as the **opportunity cost.**

Opportunity cost is measuring the cost of what you purchase in terms of the alternative that you have given up. The opportunity cost of going to a concert could be the shoes that you now cannot afford to buy, if you purchase the concert tickets.

Businesses – starting up

There are two main reasons why businesses are started that are explained in the table:

Reason	Explanation
Making a profit	A business sees an **opportunity** to make a profit by providing a good or a service. These goods and services will be sold for more than they cost to provide, so a **profit** will be made for the owners. For example: most businesses aim to make a profit. These could be small local firms, such as a window cleaning business, or very large multinational banks and oil companies.
Benefiting others	Some businesses will produce goods or services that will benefit others. Profit is not the reason why the business exists. Any profit the organisation makes will be used for the benefit of consumers, employees or the wider community and not for the owners. For example: running a non-profit making local community shop. It employs local people and provides a delivery service of its products to those who have no transport or find it difficult to leave their own homes.

Often businesses are started because there is a gap in the market. This leads to an opportunity to fulfil a want or need that is not currently being met. This makes it more likely that the business will be successful and ultimately make a profit.

Types of business

Some businesses produce goods and some produce services. There are three different types of businesses, primary, secondary and tertiary. These are sometimes known as the different business sectors. A brief summary is given in the table.

Type of business	Description	Examples
Primary	These businesses produce raw materials which are extracted from nature.	Farming, mining, oil exploration, fishing.
Secondary	These businesses manufacture goods which are made from raw materials and turned into finished goods. This sector also includes firms involved in construction.	Car manufacturing, steel, chemicals, clothing maker, builders.
Tertiary	These businesses provide services. This sector will also include businesses involved in the distribution process.	Shops, transport, hairdressing, banking, entertainment.

Factors of production

In order to produce goods and services, businesses need different inputs that go into making what it is they are producing. There are four factors of production; land, labour, capital and enterprise. Their importance will vary depending on the good or service that the business is making or providing. A brief description of each factor is given in the table.

Factor of production	Description
Land	This is not only the land where the business is based, but also includes the natural resources on, or under, that land. This is very important for businesses in the primary sector.
Labour	These are all the people working in the business including the managers. They are important in all businesses, but are most important in the service sector.
Capital	This refers to the buildings and machinery needed by the business. This is very important for manufacturing businesses, especially as new technology means these businesses now need less people.
Enterprise	These are the **entrepreneurs** who set up the businesses, organise the factors of production and take the risks involved in running the business.

What is enterprise?

The meaning of enterprise

The term “enterprise” has two common meanings.

Firstly, **an enterprise** is simply another name for a business. You will often come across the use of the word when reading about start-ups and other businesses…“Richard Branson’s enterprise” or “Julie set up her successful enterprise after leaving teaching”.

Secondly, and perhaps more importantly, the word **enterprise** describes the actions of someone who takes a **risk** by setting up, investing in and running a business.

Someone who shows enterprise by setting up a business is called an **“entrepreneur”.**

What is an entrepreneur?

There are many definitions of what is meant by an entrepreneur, but they tend to say the same thing, which is that an entrepreneur is…

“someone who takes a calculated risk through starting a business.”

An entrepreneur is someone who is enterprising. In other words they:

- take the initiative in trying to exploit a business opportunity
- take time to understand and calculate the risks involved
- make an investment, often of their own money, to set up the business
- go ahead, despite the risk that the business venture might fail

Reasons for starting a business

An entrepreneur will have many different reasons for starting a business and these will vary between different entrepreneurs. These are described in the table.

Financial objectives	**Making a profit** – this is achieved through creating more revenue than the costs involved in running the business. Alternatively a profit could be made from selling the business or business idea to another business for a lot of money. **Investing money** – some entrepreneurs have a sum of money, which they have gained through redundancy or inheritance, and they want it to provide a return to them i.e. they would like to use the money to make more money in the future.
Non-financial objectives	**Work-life balance** – entrepreneurs can have more choice over what work they do and when they do it. They can often run their business from home, giving them more freedom and flexibility. **Skills and interests** – entrepreneurs often have business ideas that are linked to their own skills or interests. This can be very motivating for the entrepreneur, as they will have a genuine passion for the business idea and therefore will be highly motivated to make the business succeed. **Being their own boss** – many entrepreneurs want to be independent to make their own decisions and not be part of a large organisation. Their current job might also be boring causing them to be unhappy with their existing situation.

In recent years the media has glamourised the challenge of starting and growing a business. A quick search on Amazon.co.uk will display many books by entrepreneurs and other "business experts" describing "how I made my first million" etc. Television shows, such as Dragons Den and The Apprentice, have proved hugely popular by showing the challenges faced in setting up a business or gaining investment for a business idea. Entrepreneurs such as Lord Sugar, Sir Richard Branson and Sir James Dyson have earned enormous fortunes and provide inspiration for the next generation of budding business leaders.

It is important, however, to realise that starting a business is rarely glamourous. In fact it is nearly always very **hard work**. For every success story, there are almost certainly many more business failures or businesses that do not meet the expectations of the people who set them up.

Not surprisingly, much research has been done to examine the personality and other characteristics of successful entrepreneurs, to see if there is a guaranteed method or route to success. You will find many lists of "what is takes to be an entrepreneur", but they tend to cover the same points. The following is a summary of the key findings:

What makes a good entrepreneur?

Successful entrepreneurs tend to have many of the following characteristics and skills:

- **Innovative –** entrepreneurs have lots of ideas and are passionate about their product or service.
- **Risk-takers** – they are prepared to take a calculated risk in order to maximise their rewards.
- **Hard working** – they are prepared to work long hours, especially in the early stages of the business.
- **Organised** – running a business can be very time consuming. They will know how to use their time, so that the business runs efficiently and effectively.
- **Determined** – they are able to handle problems and overcome hurdles. Setting up a business is difficult, as well as time-consuming.
- **Persuasive –** entrepreneurs are good at convincing other people and businesses about their idea, for example, persuading suppliers to supply their new business or convincing a potential employee to leave a current job and join the start-up, which could be seen as a very risky move. They are also good at persuading customers to buy their product or service.
- **Leadership –** an entrepreneur must be able to lead his or her own business. They must be willing and able to effectively perform more than one role.
- **Lucky –** every business needs some good luck e.g. being in the right place at the right time; however the more research, planning and preparation that goes into the business start-up, the more likely the business is to succeed.

The important thing to remember about this list is that an entrepreneur is unlikely to possess all these characteristics! Anyone who starts a business has strengths and weaknesses. However, a successful entrepreneur would recognise where their weaknesses lie and take steps to address them, for example recruit someone with the right skills to support the entrepreneur in the business in this area.

Businesses change

Businesses are constantly faced with change. Some of these changes will be outside the control of the organisation. Successful businesses will be able to meet these changes and demonstrate flexibility in the way their business operates. Examples of external changes that businesses face include new **legislation,** changes in the **economy,** new **technology, political** events and even the **weather**.

Successful businesses will adapt their products, their location and their staff as circumstances change. It is never possible for a business to stand still and those that try to, will generally fail. Section 2 considers this area in more detail.

Business ownership

Introduction

The vast majority of start-ups and small businesses in the UK choose to operate either as a sole trader or set up as a private limited company. A very small proportion of new businesses set up as a partnership and a small proportion of very large companies are public limited companies. We will look briefly at these forms of legal structure before considering the very important issue of **limited liability**.

Sole traders

Most businesses in the UK are small businesses, owned and operated by one person. In most cases, these businesses operate as a **sole trader**.

Look at Yell.com or Yellow Pages (a local free business listing posted through your letterbox). You will see lots of examples of people operating as a sole trader in your area.   Many traders in the service sector e.g. hairdressers, gardeners, plumbers and electricians, use the sole trader option, as do people who run part-time or seasonal businesses.

A **sole trader** is a popular form of business organisation, as it is simple and cheap to set up and operate. Most importantly the sole trader gets to keep all the profits! The sole trader, also takes all the risk and has **unlimited liability**. This concept is explained further later in this section.

Do not forget that a sole trader can and do employ other people to work in their business!

Partnerships

A partnership is formed where a business is **started and owned by more than one person.** Common examples of partnerships are doctors, solicitors or vets.

A legal document called a **Partnership Agreement** is always recommended and sets out how the partnership is run, covering areas such as:

- How profits are to be shared
- How much each partner has to invest into the business
- How decisions are to be taken
- What happens if a partner wants to leave the partnership or dies

The partners own the business and have **unlimited liability**.

Private limited company (ltd)

A company is formed when a business is set up to have a **separate legal identity** from its owners. In the vast majority of cases, the type of company created is a **private limited company (ltd).** These are very common and can include small and very large businesses.

There are many well-known examples of ltd companies, such as Iceland, Virgin, John Lewis and Clarks shoes.

If a business becomes a private limited company, it can raise funds from investors, such as friends and family, but not from the general public, as its shares are not listed on the stock exchange. Every private limited company must have at least one shareholder. Any money raised from new shares is permanently invested in the business.

In this type of business, the company's finances are separate from the personal finances of their owners. The owners are known as **shareholders** who each own shares in the company. They receive a share of the profits, known as a **dividend**, as a reward for being a shareholder. These are paid in proportion to the number of shares that they own. If the company goes bankrupt, shareholders are protected by **limited liability**.

The business will be run by a Board of Directors, appointed by the shareholders. The shareholders may also act as the directors. The Board of Directors runs the company on a day-to-day basis and makes all the important decisions.

Public limited company (plc)

Most of the largest businesses in a country will be public limited companies. Famous examples of public limited companies in the UK include BP, Boots, Barclays and Marks and Spencer.

Plcs are complicated and expensive to set up, but this type of company can raise large sums of money through listing its shares on the stock exchange. This makes it easier to value and to buy and sell shares in the company. The trading of shares in this way can however, make the company vulnerable to a possible takeover. This could mean that the original owners/shareholders of the company can lose control, if they end up holding less than 50% of the shares.

For a plc the Board of Directors is, like a private limited company, appointed by the shareholders. There is however, more of a separation of roles between shareholders, directors and those who manage the company on a day-to-day basis. A plc must have a minimum of £50,000 share capital.

Unlimited liability

There is a big risk when operating as a sole trader or a partnership. It occurs because, in the eyes of the law, **there is no difference between the person running the business and the business itself.** When it comes to money owed by a business, the sole trader or partners have to use their own personal funds to pay these debts, if there is not enough money in the business to do so. The sole trader or the partners are, therefore, **liable** for any **debts** that the business incurs. This is called **unlimited liability.**

As the sole trader or partner is personally responsible for any debts run up by the business, this means their home or other assets owned by the entrepreneur may be at risk if the business runs into trouble. This does happen and each year thousands of people become personally bankrupt, many of them through failed businesses. Some businesses have however, a lower risk of failure, where the owner avoids running up debts through buying and selling in cash, meaning there is no need to borrow large amounts of money.

Limited liability

Shareholders may be individuals or other companies. **They are not responsible for the company's debts**. Shareholders may only lose the money they have invested in the company if a business goes bankrupt, to help pay off any outstanding debts or liabilities. This means that the liability of shareholders is limited to the value of their investment into the company's shares. This concept is called **limited liability.**

It costs very little to set up a business as a private limited company and it can also be set up quite quickly. This is why a private limited company is a popular choice for many new businesses as a form of legal structure. The huge benefit of limited liability is also another major reason why entrepreneurs choose this type of ownership.

Remember: LIMITED LIABILITY is only a benefit to private and public limited companies. Sole traders and partnerships do not benefit from this. They have UNLIMITED LIABILITY. This is a common area of confusion, which needs revising carefully.

Comparing limited companies with sole traders and partnerships

The main differences between the different types of business ownership can be summarised as follows:

	Advantages	**Disadvantages**
Sole trader	☑ Quick and easy to set up – the business can always be transferred to a limited company once launched ☑ Simple to run – owner has complete control over decision-making ☑ Decision-making is quick, important in changing, fast moving markets with lots of competition ☑ Owner gets to keep all the profits ☑ Minimal paperwork	☒ Full personal liability i.e. "unlimited liability" ☒ Harder to raise finance – sole traders often have limited funds of their own and few assets against which to raise loans ☒ The business is the owner – the business suffers if the owner becomes ill, loses interest etc ☒ Limited life as the business is the owner – lack of continuity ☒ Stressful – long hours, no division of labour, no support with decision-making

	Advantages	Disadvantages
Partnership	☑ Quite simple for two or more people to form a business together ☑ Minimal paperwork once Partnership Agreement set up ☑ Partners can provide specialist knowledge and skills ☑ Jobs can be shared, so less stressful than operating as a sole trader ☑ Greater potential to raise finance, as each partner provides investment ☑ Any losses will be shared	☒ Unlimited liability ☒ Partners have to live with decisions of others; a poor decision by one partner damages the interests of the other partners ☒ Decision-making can take longer, as disagreements can occur ☒ Harder to raise finance than a company ☒ Short life, as if one partner leaves or dies the partnership ends ☒ Profits have to be shared
Private Limited company	☑ Limited liability - protects the personal wealth of the shareholders ☑ Easier to raise finance as can sell shares ☑ Stable form of structure – the company continues to exist even when shareholders change ☑ Original owners are likely to retain control	☒ Shareholders have to agree about how profits are distributed ☒ Greater administrative costs than setting up as a sole trader or partnership ☒ Finance limited to “friends and family” ☒ Less privacy - public disclosure of company information, but not as extreme as for a plc ☒ Directors’ legal duties are stricter
Public Limited Company	☑ Limited liability – protects the personal wealth of the shareholders ☑ Can raise large sums of finance via the stock exchange, which is permanently invested ☑ Stable form of structure – business continues to exist even when shareholders change ☑ Firm is more prestigious	☒ Shareholders have to agree about how profits are distributed ☒ Greater administrative costs ☒ Finance can be limited by stock market valuation of company ☒ Public can see company information and accounts ☒ Risk of company being taken over ☒ Separation of ownership and control

Choosing the most suitable legal structure for a business

There will be several factors that will influence the type of structure chosen by a business:

- **Size of business** – start-up businesses often start as sole traders or partnerships, as they are easier and quicker to set up compared to a Ltd. There is less paperwork involved.
- **Type of business** – some business structures relate to the type of product or service provided. If specialist expertise is involved such as doctors, vets or lawyers they are more likely to be partnerships than sole traders. If risks are involved, they are more likely to become a private limited company.
- **Lender requirements** – if a bank loan is needed to start a business, the bank may prefer a small business to be set up a sole trader or partnership, to make sure they can be paid back by the individuals if the business fails.
- **Investment protection** – a private limited company may be chosen, so the investors in a new business or an expanding business can be protected by limited liability.
- **Control** – the owner, as a sole trader, or a shareholder, holding the majority of shares in a company, has total control of the business. This is shared in a partnership and at risk in a company with a minority shareholding.
- **Growth** – a large business (with over £50,000 of capital) might require significant funds that they cannot find themselves. Becoming a public limited company allows them to attract a large amount of finance from a large number of shareholders without the requirement to pay it back.

Not-for-profit organisations

These include community and other voluntary organisations, as well as charities. They are often set up as companies or social enterprises, with any surplus money made through their activities being used to help meet the organisation's aims and objectives.

There are many different types of non-profit making organisations. Local clubs and societies with very low revenue are examples. There are also, however, many large national organisations, such as charities, with considerable income and costs.

Legal obligations for non-profit making organisations

Like any business, not-for-profit organisations must ensure that they meet their legal requirements. These obligations include having correct legal contracts e.g. for premises, having valid insurance, keeping and being able to produce valid financial records and accounts for tax purposes. They must also use correct banking and loan procedures for the organisation.

To be classed as a social enterprise, at least 50% of the organisation's surplus money made must be reinvested back into the enterprise or into activities to help satisfy the social need that the social enterprise is attempting to meet.

Setting business aims and objectives

Introduction

Different businesses may well have different aims and objectives. Before we consider the reasons for setting and changing business aims and objectives, we should firstly consider what these aims and objectives might be.

Businesses aims and objectives

- **Survival** – over half of new businesses fail within five years and many new businesses do not survive much beyond their launch. Often entrepreneurs discover that their business idea was not as good as they originally thought and therefore the business cannot run profitably or it runs out of cash. Changes in the business environment also may make it harder for a business to be successful. The first priority of a business is always to survive.
- **Profit maximisation** – profit is the main objective for most businesses. This is the reward to the entrepreneur for their hard work and the **risks** undertaken, often with their own money. Ideally, the profit earned is sufficient to provide the entrepreneur with enough income to live on. Profits may also be kept in the business to allow it to expand or develop further. Other objectives businesses may have which are linked to profit maximisation are **increasing revenue** or **decreasing costs**.
- Another financial objective is **personal wealth**. Some entrepreneurs set this as a longer term objective. They aim to build a valuable business that can substantially increase their future wealth.
- **Sales maximisation/market share** – some businesses will be more concerned with increasing market share or becoming the market leader. They may accept lower profits in the short term in order to increase their sales. This is more common with large companies.
- **Share value** – shareholders in a company will be interested in how much their **dividend** payment will be; their reward for becoming a shareholder in a company in the first place. Dividends are the proportion of the company's profits that are given out or distributed to shareholders. Shareholders will also be interested in the **share price,** as this will show the value of their shares in the company if they wish to sell them for a profit in the future.
- **Quality** – not all objectives are financial. Some businesses pride themselves on providing a quality service or selling quality products. These businesses might also aim to increase **customer satisfaction,** which may increase their sales and profits in the long term.
- **Growth** – not all businesses want to grow, but most do. This means that they can increase their profits and the value of the business. It is important however, that business growth is not undertaken too quickly or too soon. Survival may be more important for a new business, rather than opening another branch of a business a

few months after launching which could drain cash flow and threaten the existence of the business altogether. Business growth can be achieved through expanding within the home or **domestic country** of where the business first started or it can be achieved through **international** growth, by expanding into different countries, although this can cause problems for many different types of business, such as adapting to differences in cultures between countries successfully.

- **Social responsibilities** – increasingly businesses are aware of their responsibilities to the society in which they operate. These may be related to the **environment** or having correct **ethical behaviour** e.g. not using cheap labour. Not-for-profit organisations will have aims and objectives related to their particular reason for being set up, e.g. raising money for a charitable concern or providing jobs for local unemployed adults.

The role of objectives in setting up and running a business

Objectives provide direction for all businesses. Without clear objectives, a business may provide goods and services that are not appropriate to why the business was set up. This may result in the business not being successful. Having objectives just written down however, is not enough to ensure business success. In order for objectives to be effective, they must be implemented and monitored over time. Some of the benefits to a business of having clear objectives are as follows:

Reason	Explanation
Direction	Clear objectives will allow a business to decide on the direction it should take, for example, whether it should expand or not, whether it should change its target market or perhaps increase or decrease its range of products or services.
Focus for employees	It is important that all employees are aware of the business's objectives and that they are attempting to follow and meet them. If all employees are working together in the same direction, this will increase efficiency.
Allows planning	The overall firm's strategy, what it plans to do in the future, will be in its business plan. Having clear objectives will allow consistent planning for the business as a whole and any departments within the business. The plan will be designed so that the business objectives can be met.

Reason	Explanation
Measurement of success	Having business objectives allows a business to measure its success. In other words, through a business reviewing its objectives, it would be able to see if it had achieved them or not or whether it was on the way to achieving them. This means that the business can then correct or change its business strategy if it is not working. A business might also need to change its business objectives if they are proving impossible to meet or if they are being achieved too easily. The ability to measure success is much easier to carry out for financial objectives, which are easily quantifiable, rather than non-financial objectives, such as "being more ethical" or "increasing customer satisfaction" which are very difficult to measure.

Changing objectives

There can be various reasons for businesses to change their objectives. A good way of dividing these is into **internal** reasons – ones that a business can control – and **external** reasons – changes that are required because of events that are outside of a business's control.

Internal reasons – these could come about because a business has achieved one objective and now needs another one, for example, a firm has survived for a year and now wants to increase profits. Another example is that a company has the biggest market share in the UK and now wants to expand internationally, so that it can gain more customers, sales and profits.

Changes to objectives can also be due to a change in the views or requirements of the owners/shareholders or the Board of Directors. For example, an objective of a business might originally have been to become the market leader or the dominant firm in an industry. This might lead to a policy of low prices and sales maximisation. Once this objective has been achieved, it may change its objective to remaining market leader, which might then lead to strategies such as new product or market development, in other words launching new products into an existing market that the business already operates in or launching existing products into new markets.

External reasons – a new competitor may cause objectives to change from profit maximisation to survival. A change in the economic environment, for example growth in an economy, might lead businesses to seek expansion. Technological change may also result in a firm changing its objectives, particularly if a rival business brings out a new piece of technology before it does!

It is a lot easier for a small business to change its objectives. Large companies may have to consult shareholders, if their changes are very significant. They are also more likely to have much higher initial costs if they are to change objectives e.g. deciding to reduce operating costs through moving production to a different country.

Non-financial objectives

Although most businesses will be focussed on financial objectives, there are many other priorities that will exist for a business. Providing a high quality service will be important for many. The John Lewis Partnership has a clear focus and is well-known for looking after its employees. This will also be an important objective for many other businesses, as this means that employees stay loyal to the firm, which leads to a reduction in recruitment and selection costs.

It is therefore important to remember that success can be measured in many ways not just through a business reviewing its profit objectives. This can be seen clearly through not-for-profit organisations.

Not-for-profit organisations aims and objectives will normally relate to the cause that they have been set up to support, for example certain charities or social enterprise objectives will focus on reducing the number of homeless in the local area or improving local play facilities for young children in the community.

In many cases these objectives will link to or be consistent with financial objectives. In other cases, however, objectives, such as improving quality, might conflict with others such as increasing profit. This is because improving quality will tend to lead to an increase in costs, which restricts profits. However, in this situation, it can be argued that better quality will lead to brand loyalty and the ability of the business to increase its selling prices. This could ultimately lead to an increase in profit, as the increase in revenue could more than cover the increase in costs that the raise in quality would cause.

Overall, businesses, in setting and using objectives, will prioritise what is most important to their individual organisation and its owners/shareholders and measure their success through the review of the objectives that are most relevant to them.

Stakeholders

Main stakeholders in a business

A stakeholder is anyone who has an interest in the activities and decision making of a business.

Stakeholders include:

- Shareholders or business owners
- Managers and employees
- Customers
- Suppliers
- Banks and other finance providers
- Government
- Local community
- Competitors
- Pressure Group

Various factors affect how many stakeholders a business has and the strength of their interest and influence on the business. These factors include:

The size and scale of the business: for example, a small, sole-trader service business will have relatively few stakeholders. Contrast this with a much larger, complex business like a national supermarket chain, which has thousands of employees operating in numerous locations and is an important customer to hundreds of suppliers.

The nature of the product or service: some products are more likely to attract the attention of stakeholders. For example, a manufacturing business that has high levels of carbon emissions or waste packaging will be scrutinised much more closely than a simple service business. The local community will have a greater interest in a business that is a major local employer than in a one-man band.

Objectives of business stakeholders

The main objectives of each main stakeholder group will not always be the same as the objectives the business sets for itself. The objectives of the more important stakeholders to a business can be summarised as follows:

Stakeholder	Mainly interested in…
Shareholders /owners	• Good return on their investment • High level of profits and dividends • Success and growth of the business • Proper running of the business (if shareholders are not directly involved in the day-to-day running of the company)
Managers and employees	• Rewards, including maximising basic pay and other financial incentives • Job security and good working conditions • Promotion opportunities • Job satisfaction and status through high levels of motivation, interesting roles and responsibilities • Success of the business
Customers	• Value for money • Product quality that meets their specific needs • Appropriate levels of customer service
Suppliers	• Fair or high prices and prompt payments • Continued profitable trade with the business • Financial stability – can its customers pay its bills?
Banks and other finance providers	• Profitability and cash flow for the bank • Low risk that the business will not be able to repay finance provided • Growth in profits and value of the business
Government	• Prompt and correct collection and payment of taxes , for example VAT, income tax • Creating jobs e.g. through businesses succeeding and growing • Compliance with business legislation, for example health and safety, minimum wage/national living wage compliance, consumer protection, fair trading, environmental protection
Local community	• Success of the business – particularly creating and retaining jobs • Compliance with local laws and regulations, for example noise, pollution
Competitors	• Profitability and success for their own business • An increase in market share
Pressure Groups	• These could include trade unions and environmental groups. • Best deal for their members, for example trade unions will push for higher wages, environmental groups will want safeguards to prevent business activity damaging the environment

Impact and influence of stakeholders on a business

The objectives of the stakeholders will determine their behaviour towards the business. For example, employees are likely to have regular meetings with the business managers to try and influence improved pay and conditions. The impact they have however, will depend on their power. Are the workers easy to replace? Is the business making enough profit to be able to afford a pay increase? The local community might not like the business increasing production to working 24 hours a day 7 days a week, but they may not be able to influence the business owners, because they have no or very little power to do so.

So, the impact and influence that stakeholders have on a business and its decisions is determined by the power of the stakeholders and the circumstances in which the business operates.

Why might the objectives of stakeholders be in conflict?

Many business objectives are shared by a broad range of stakeholders.

For example, an objective for a business start-up of achieving survival would be supported by nearly all the stakeholders. Other than its competitors, it is unlikely to be in anyone's interest for a business to fail.

However, once a business becomes better established and larger, then potential conflicts begin to arise. Let's look at two examples in a little detail:

Business expansion versus higher short-term profit:

An objective of increasing the size and scale of a business might be supported by managers, employees, suppliers and the local community – largely for the extra jobs and sales that expansion would bring.

However, an expansion is often associated with increased costs in the short-term, for example extra marketing spending, new locations opened, more production capacity added. This might result in lower overall profits in the short-term, which may cause conflict with the business shareholders or owners. In the longer-term, however, most business owners will be in support of expansion, particularly if it increases the overall value of the business.

Job losses versus keeping jobs

This was a big issue for many businesses during the recent economic downturn. In order to reduce costs and not spend cash, business managers made redundancies amongst their workforce or introduced other measures like short-time working to reduce wage costs. This will have been supported by business owners and managers.

However, it created a potential conflict with stakeholders such as employees (who were directly affected), the local community (affected by local job losses) and suppliers (which suffered from a reduction in business).

Causes of conflicts between stakeholders

- "Short-term" thinking by managers who want to maximise profits today, may discourage important long-term investment in the business which would increase owners profits in the long run
- Investing in new machinery to achieve better efficiency to raise profits for the owners, may result in job losses
- Extending products into mass markets to increase sales and profits for shareholders may result in lower quality standards for consumers

Business location

Introduction

Where to locate is an important decision for all organisations. This is especially true however, for a new business. Should it be based at home or located in a nearby office, shop or industrial unit?

Location is also important for existing or growing businesses. Should they stay where they are? Do they need bigger premises? Would it be an advantage to relocate to somewhere else, either in this country or to a different country? Can the business use modern technology to create a "virtual business," so that its employees are all working from home?

Not every kind of start-up business can be based at home. For a new shop, for example, a good location is very important.

One of the most important considerations about location for any business will be **cost**. A start-up business is likely to have limited financial resources and therefore will want to minimise its set-up costs, whereas an existing business is likely to have competitors and will want to keep costs low, in order for it to have the opportunity to compete more effectively on price. Having premises will mean that a business will have to pay rent, rates, insurance and many other **ongoing costs,** as well as the **rental deposit or purchase costs**.

Other factors determining location

Whatever the business, there are several other factors, in addition to cost, that influence the choice of location. These are:

Raw materials	The business may depend on supplies of a particular raw material, so costs will be lower if the business is located near the supplier, for example where the raw material is grown or where a distributor is based. This factor tends to be more important for **primary** and **manufacturing** businesses, rather than businesses in the **tertiary** (service) sector.
Labour	When a start-up business needs to hire employees then access to a reliable supply of skilled staff will be important. Businesses that are labour-intensive often look to locate in areas of traditionally low wages or higher unemployment, although this will depend on the skill level that the business needs and the availability of this type of worker. This factor is important for all businesses, but may be less significant if the business uses a lot of machinery.
Market - customers and population	Businesses may need to be located near particular centres of population. For example, if the product is targeted at a particular type of customer, for example older-aged people, then it is important to be located where they live. This is particularly important for businesses in the tertiary sector, as they provide a service.

Government assistance	This may be available to set up in a particular location. These "assisted areas" are considered to be the poorer parts of the country and may have less wealthy customers. They may however, have cheaper labour available. Assistance may come in the form of grants, loans, reduced tax burdens or use of government owned buildings.
Communications	This includes transport facilities (road, rail, air), as well as information and infrastructure. Transport links are particularly important if the business delivers products, uses a sales force or depends on imports and exports to function. Information technology is less of an issue these days, as even new businesses can normally have fast and reliable broadband internet connections.
Competition	All businesses need to be aware of where their competitors are based when deciding on their own business location. This is particularly important if the business is providing a service. If a new business sees a "gap in the market" where there is no competitor, this might be a good reason to locate there. However, this might mean that this is not a profitable location for any business. In some cases it may be of benefit to be near a competitor, as customers may come to the competitor but see another business that is nearby. This can be seen with the popularity of retailers located in retail parks or clothing stores being clustered together in shopping centres.

There is no magic formula which can be applied in deciding the most important factors in choosing a location. Sometimes the convenience of the location for the entrepreneur will be more important than even cost considerations. The type of business (primary, secondary or tertiary) will also be important, but the short and long term objectives of the business should also be considered, for example, will a manufacturing business have enough room to expand if it needs to increase production in the future?

Business planning

Introduction

In order to be successful, businesses will need to plan. In most cases, this will be through the creation of a **business plan**. A well-used and famous saying is "failing to plan is planning to fail".

What is a business plan?

A business plan is a **written document** that describes a business, its objectives, its strategies, the market it is in and its financial forecasts. The business plan has many functions, from securing external funding to measuring success within the business.

Although a start-up business will need a business plan, the existence of such a document will also be important for an existing business. In this case the plan might be for a longer period and will need to be reviewed on a regular basis.

The purpose of business planning

The main reasons why a **start-up business** should produce a business plan are:

- Provides a focus on the business ideas - is it really a good one, and why?
- Producing a document helps clarify thoughts and identify gaps in information
- The plan provides a logical structure to thinking about the business
- It encourages the business entrepreneur to focus on what the business is really about and how customers and finance-providers can be convinced to buy and lend the business money
- It helps test the financial viability of the idea - can the business achieve the required level of profitability and not run out of cash?
- The plan provides something which can be used to measure actual performance
- A business plan is essential to raising finance from outside providers, such as investors and banks

In addition, **existing businesses** will use this process to:

- review their current performance
- allows business objectives to be modified if required
- allows departments of the business to produce their own plans, for example marketing plan, human resources plan. These plans will guide their policies, resource requirements and departmental operations
- update their current business strategy or plans for the future, based on their current performance, changes to the business environment, over which they have little control, and revised objectives

- overall it will help the business make informed decisions

Information that should be included in a business plan

A simple **business plan** is suitable for a start-up business and is written by the entrepreneur. It summarises the key aims and targets of the business and the actions required to achieve them. The plan will include areas such as:

- The idea - a simple description of the proposed business
- Where the idea came from and why it is a good one
- Objectives and key targets for the business - sales, profit, growth (gives a sense of direction for the business) ideally for the next 3-4 years
- Finance required - how much from the owners, how much to be loaned over how loan and from whom
- Market overview – results of market research, main segments, market size (value, quantity), growth, market shares of main competitors (if known)
- How the business will operate (location, premises, staff, distribution methods)
- Cash flow forecast (important to ensure the business does not run out of cash)
- Forecast revenue, costs and profits

For a large or growing business the same basic structure will apply, but there will be more detail. In this case, a large business plan will often be drawn up for three to five years.

Advantages and disadvantages of business planning

Although it would seem essential that all businesses should plan, in reality there are many cases where firms will not have a business plan at all. In these situations, the planning process will not be detailed and decisions will be often made on the spot when they need to be taken. These businesses will rely on "gut instinct" and "experience" to succeed – although many will fail. A summary of the benefits and drawbacks of having a formal business plan is provided in the table:

Advantages	Disadvantages
☑ Allows entrepreneurs and existing businesses to review their ideas and to see whether they will provide a profitable future ☑ Reduces risk by providing a guide for the business as to what needs doing and when ☑ Allows the business to review its progress compared to the plan and make changes if required ☑ Will help to ensure finance is available, for example getting a bank loan, as lenders will see a business is organised	☒ Having a plan does not guarantee that it is used or that the firm will succeed. The plan may be poor quality, due to a lack of experience by the people who wrote it ☒ Any plan will require constantly updating, as internal and external circumstances change ☒ Producing and reviewing a plan on a regular basis requires time and effort which may be expensive, especially for small businesses ☒ Can cause new opportunities to be missed, if they are not in the plan

Costs, revenue and profit

One of the key parts of the business plan will be the financial section. This will identify and review business costs (fixed costs, variable costs and total costs), revenue and profit. There will be forecast data for a number of years. More details of these crucial business concepts are included in section 6 which relates to business finance.

Expanding a business

Introduction

Most business want to **expand** – to grow sales, increase profits, add new locations and take on more staff. However, expansion is not always easy; it may be risky and it might not be the correct option for some businesses.

Expansion can be measured in different ways, some of which are considered below:

- Sales
- Profits
- Capital invested
- Output
- How many employees work for the business
- Number of outlets or locations
- Value of the business
- Market share

A useful way to compare and contrast the options for business expansion is to think in terms of **organic (internal)** and **external** growth. Some businesses will just use one of these options, some will use both.

Organic growth

Organic growth can be defined as:

> **"expansion from within a business by expanding the number and/or range of products and/or locations"**

Organic growth **builds on the business's own capabilities and resources.** For most businesses, this is the only expansion method used. Organic growth involves approaches such as:

- Designing and developing new product ranges
- Implementing marketing plans to launch existing products directly into new markets, for example exporting. This can be linked to an introduction or development of **e-commerce**
- Opening new business locations – either in the domestic market or overseas. This can be achieved through **franchising**
- Investing in research and development to support **new product development**
- Investing in additional **production capacity** or new technology to allow increased output and sales volumes
- **Outsourcing** by using other businesses to contribute to increased production by making goods on behalf of the business
- Training employees to help them acquire new skills and address new technology

Business case studies

Just Eat	Just Eat was set up in 2001 and has grown rapidly. It is now the world's leading marketplace for online food delivery, operating in 12 countries. They provide a service linking the consumer with local take away delivery food outlets, serving everything from pizza to sushi and burgers to burritos. This has resulted in consumers being able to order on-line from their favourite local take-away, even if it is a small sole trader business! The ability to order on-line provides a clear example of organic growth through e-commerce.
Cadbury's	Cadbury's do not mould and package all of their finished products themselves. They outsource production of certain product lines, particularly seasonal products such as Easter eggs, to carefully chosen outsourcing partners. This is due to Cadbury not having the capacity to produce and store the high volume of Easter eggs that are demanded each year. This highlights how organic growth can be achieved through outsourcing, as it allows a business to expand, in this instance, production, without the business taking on the cost and risk of expanding themselves.
Premier Inn	Hotel chains, such as Premier Inn, continue to report strong growth which is spreading from London to other UK cities, such as Birmingham, Leeds and Edinburgh. Demand has increased from both the business and leisure sectors throughout the UK and investment in new hotels and hotel refurbishments is at record levels. This shows a clear example of organic expansion through the opening up of new hotels.

Keep a look out for these kinds of business stories and other individual business case studies. Add them to your notes. Has the business achieved organic growth by adding new products, expanding into new geographical areas or increasing its share of the market?

Advantages and disadvantages of organic growth

What are the advantages and disadvantages of **organic growth**? Here is a summary:

Advantages	Disadvantages
☑ Less risky than taking over other businesses	☒ Growth achieved may be dependent on the growth of the overall market
☑ Can be financed through internal funds, for example retained profits	☒ Harder to build market share if the business is already a leader
☑ Builds on a strengths of the business, for example brands, customers	☒ Slow growth – shareholders may prefer more rapid growth
☑ **Outsourcing** means growth can be achieved without costly new investment	☒ **Outsourcing** risks quality not being as good as the original firm's produced goods, with possible delays through additional distribution ☒

Advantages	Disadvantages
☑ Allows the business to grow at a more steady rate	☒ Franchises can be hard to manage effectively
☑ Growth through e-commerce allows businesses to access potential customers 24/7, without the need to open up in potentially expensive locations near to where customers are based	☒ Investing in sophisticated e-commerce systems can be expensive; customers may expect free delivery; the business would need to be set up to deal with the processing of returns

Franchising

The use of **franchising** is a popular method of organic growth, particularly for businesses operating in the **service sector,** which want to expand into more locations in order to build sales and profits substantially.

The basic idea for a franchise is this. A **franchisor** grants a licence, the **franchise**, to another business, the **franchisee** to allow it to trade using the brand or business format. There will be restrictions on the franchisee regarding its products or services and its sources of materials, but it is a low risk and relatively low cost of option that does allow a franchisee to have some independence and freedom.

Remember that the **franchisor** is in charge - the franchisor is the original owner of the business idea.

Franchises are a significant and increasing part of business life in the UK. Based on the BFA/NatWest franchise survey (2015) here are some quick statistics that illustrate that:

- Percentage of units profitable (including new businesses): 97%
- Franchises generated annual sales of £15.1 billion in the UK in 2015, selling through 44,200 franchised outlets, employing 621,000 people
- There are over 901 different franchisor brands in the UK, with new franchise ideas becoming available every year
- Average turnover or revenue continues to rise; in 2015 over half had an annual turnover of more than £250,000
- Start-up costs may not be too expensive and can be as little as £10,000 and are typically about £50,000
- In 2015, over 97% of franchises, including new businesses, were profitable
- Franchises are particularly popular in the service (tertiary) sector. Franchises offering property services, for example estate agency, cleaning, gardening etc are the most popular

Growth through franchising

If a business wants to grow rapidly without the trouble of running the new businesses, then selling franchises might be a good option. The franchisor is able to expand nationwide or internationally, without having to invest in staff or premises. This method is particularly popular in the fast food industry, where often over 50% of outlets are operating as franchises. There are arguments for and against this as a growth strategy for a franchisor and these are summarised here:

Advantages to the franchisor	Disadvantages for the franchisor
☑ The franchisor still controls key aspects of the brand and operation	☒ There is some loss of control, as the franchisee runs the business on a day-to-day basis
☑ Less finance is required to expand as the franchisee provides most of the capital needed	☒ It may be difficult to recruit good franchisees who may prefer being employed as a manager, rather than running a franchise business
☑ Little or no involvement in the day-to-day running of the franchise, freeing up time and resource , for example the franchisee would be concerned with finding staff to run the operation, rather than the franchisor	☒ If too many franchisees are sold then they may be located too close to each other, which will make the franchises harder to sell.
☑ The franchisees provide the entrepreneurial effort and energy required to make each location succeed	☒ Reputation of the franchise and the brand is in the hands of the franchisee. Poor decision-making could lead to the franchise gaining a poor reputation in its market
☑ Better able to expand into multiple locations quickly	☒ The franchisee decides how fast the business grows once the franchise has been awarded
☑ Business benefits from several sources of finance from the franchisee, including royalty payments and franchise fees	☒ The franchisee takes a proportion of the revenue earned by the franchise

External growth

In order to speed up its growth, many businesses choose a strategy of external growth and expand through **mergers** or **takeovers**.

Takeovers are where one business buys a controlling interest in another. For a company this would mean buying over half of the shares in that company. These might be agreed by the company being taken over, but in some cases they are not (known as a **hostile takeover**). The firm being taken over will cease to exist and its staff and resources will be owned by the business making the takeover.

Mergers are where two businesses agree to join together to make a new business.

Takeovers and mergers happen for many different reasons and the two firms involved may be competitors to each other, suppliers or customers to a business, or the businesses involved may have related (or unrelated) products and services.

Advantages and disadvantages of external growth

Of course, there are various advantages and disadvantages of growth, and specifically to external growth, that are summarised here:

Overall advantages and disadvantages of growth:

Advantages	Disadvantages
☑ **Economies of scale** which will decrease the cost of producing each unit	☒ **Diseconomies of scale** can occur if a business becomes too large, resulting in an increase in the cost of producing one unit
☑ Larger businesses may be able to raise money more easily and have more buying power to get cheaper raw materials	☒ If a business grows too large or too quickly it may become inefficient in terms of management and worker motivation

Advantages and disadvantages of external growth through mergers and takeovers:

Advantages	Disadvantages
☑ Reduced competition and increased market share will allow a business to have more security and the ability to increase prices	☒ Resentment and clashes of culture may occur between different businesses, which may reduce the effectiveness of the merger or takeover
☑ Risk is spread if products are different to the core product	☒ May need to make some workers redundant, especially at management levels, which can reduce motivation
☑ The two businesses may allow a transfer of knowledge, skills and/or technology. Goods and services can be shared	☒ The firm making the takeover may not have enough knowledge of the other business to make the new business successful
☑ Costs might be saved as the businesses might have duplicated facilities, for example headquarters, outlets in the same places	☒ The cost savings may not be easy to achieve, as staff will need to be made redundant and premises and equipment sold

Examples of mergers and takeovers

As you look through the business media you should come across many examples of mergers and takeovers:

Facebook and WhatsApp	Feb 2014 Facebook bought messaging app "WhatsApp" in a deal worth a total of \$19bn (£11.4bn) in cash and shares. WhatsApp has more than 450 million monthly users and is popular with people looking to avoid text messaging charges. WhatsApp gives Facebook Zuckerberg inroads into international markets and, as importantly, to a younger demographic.
Microsoft and LinkedIn	June 2016 Microsoft bought the business-focused social network LinkedIn for \$26.2bn (£18.5bn) in cash, its biggest ever purchase. The takeover was agreed by both companies. Microsoft said that acquiring the LinkedIn network would give it a competitive advantage and fit well with its business-focused software, such as Office.
Heinz and Kraft Foods	March 2015 H.J. Heinz Co, famous for its ketchup and baked beans, merged with Kraft Foods, famous for macaroni and cheese in a box, as well as brands such as Maxwell House coffee. They create the third-largest US food company. The deal meant each share was exchanged for one share in the new combined company, plus a cash dividend of \$16.50 per share. Heinz shareholders own 51% of the shares, Kraft shareholders the rest.

Economies of scale

One of the main benefits of growth is to increase the efficiency of the firm. These benefits are known as **economies of scale** and mean that the **average cost** (or cost per unit) is reduced. It is worth remembering that the **total costs** or overall costs of the business **do not decrease** when a business grows in size, but the cost of making one unit can.

The ability of a growing business to reduce its unit costs and benefit from economies of scale can be achieved in different ways. For example, an expanding business will have the ability to employ more specialist staff/managers, who will then make more effective decisions. Another is that this type of business would be able to benefit from more favourable interest rates with the bank, due to the business having more assets to secure against a loan. Two of the most important economies of scale that an expanding business will experience however, are **purchasing** and **technical** economies of scale.

- **Purchasing economies of scale** are when big businesses are able to negotiate discounts for buying large quantities or **bulk-buying** supplies of materials. This reduces the unit cost of each item purchased
- **Technical economies of scale** are gained by large-scale businesses, as they can afford to invest in expensive and specialist high output machinery for production, which would not be cost-efficient for a small business to purchase. This would then allow the business to produce far greater quantities from the machinery, resulting in the average unit cost of production decreasing

Diseconomies of scale

If a business grows too fast or becomes too large, then it may become less efficient as a result of **diseconomies of scale**. This means the **average unit cost** of making each item in the business will increase. Examples of different diseconomies of scale are described as follows:

- **Communication** might be more difficult in a big business, because the organisational structure becomes more complex and the chains of command longer. There may also be an increase in the number of locations a business operates in, both nationally and sometimes internationally. This can make decision-making slower and communication inaccurate
- **Motivation** might decrease in a growing business, as workers feel that managers and owners of the business are too remote and therefore do not value them. They may believe that their role is unimportant and this can lead to low morale, resulting in a possible decrease in **productivity**
- **Coordination** may also be more difficult in a large business. There may be different sites for different products or different functions of the business. Controlling and coordinating a large organisation might be difficult, resulting in the possible employment of more managers or a duplication of roles, which will increase costs

Average unit costs

An **average unit cost** is the cost to the business of making one item. In order for a business to calculate this, it will need to divide the total costs of the business by its total output.

Total costs = fixed costs + variable costs

$$\textbf{Average unit cost} = \frac{\textbf{total costs}}{\textbf{output}}$$

This figure will change over time. If the average unit cost is increasing, this means the business is becoming less efficient, which may be caused by diseconomies of scale if the business is growing. Alternatively, if the average unit cost is decreasing, this means the business is becoming more efficient, which may be caused by the business experiencing and benefiting from economies of scale.

Using average unit costs

For any business, calculating average unit costs is one of the key measures that shows how well it is performing. A business will always want this figure to be as low as possible, as this will indicate that is operating efficiently. This will not guarantee however, that the business will make a profit, as goods produced still have to be sold!

Example

Output of bolts	**1000**	**2000**	**3000**	**4000**	**5000**
Total costs	£100	£180	£210	£240	£325
Average unit cost	10p	9p	7p	6p	6.5p

The table shows that as the output of bolts produced increases, the **total costs** of producing these bolts increases too. At the same time, the **average unit cost** of producing each bolt decreases up to a certain point, indicating that the business benefits from **economies of scale**.

However, at an output level of 5,000 bolts, the average unit cost of making one bolt has increased, showing that the business is operating less efficiently and it is experiencing some diseconomies of scale. The best level for the business to operate at is when its average unit cost is at its lowest point, which in this case would be 4,000 units.

Section 2 Influences on business

Topic overview

Students need to be aware of how businesses are affected by external factors and how these influence the four functional areas of business, namely business operations, human resources, marketing and finance. There should also be consideration of how businesses will change in response to changes in these external factors.

Section	Key things to learn
Technology	The impact of changing use of ICT E commerce and how it allows access to wider markets Digital technology and digital communication Digital communication in relation to stakeholders
Ethical and environmental considerations	Ethical behaviour Ethical considerations versus profit Environmental considerations Costs and benefits of environmental responsibility Sustainability
Economic climate	How interest rate changes affect businesses How employment levels affect businesses Income levels and their effect on demand for products and services
Globalisation	How UK businesses compete internationally Exchange rates and their impact
Legislation	The impact of legislation on businesses Employment law Health and safety law Consumer law
Competitive environment	Market competition and its impact Uncertainty and risks

Technology

Introduction

In recent years there has been a revolution in how businesses can benefit from new technology. The invention and widespread use of computers and mobile phones has allowed massive changes to the way businesses operate and how they communicate. It has also redefined markets for many businesses and how they conduct their buying and selling operations. **Digital technology** is an overall term used to include all aspects of computer use and can be applied to most areas of human life from its use in education and health, to its use by government and business.

ICT and e-commerce

Businesses have been using computers for over thirty years. Originally computers were used mainly for the storage of data and the production of documents, but as technology has developed, the amount of uses for **information and communication technology** (ICT) has increased to include stock control and production technologies, such as computer aided design (CAD) and computer aided manufacturing (CAM).

The revolution in the use of computers has taken place since the invention of the worldwide web, which has allowed computers to be linked both nationally and internationally. Combined with the use and availability of mobile phones and smart phones, this has created a new digital world where businesses, customers and employees can all benefit from cheap and affordable technologies.

In the last twenty years the buying and selling of goods through **e-commerce** has grown rapidly. This has included auction sites and internet retailers, as well as high street retailers developing internet sites. There have been many benefits of e-commerce to its users but one of the most important is it allows access to wider markets. This has continued to develop with more recent use of mobile smart phones for buying and selling through **m-commerce.**

Businesses such as Amazon and EBay, are now worldwide internet retailers and have also increased the number and type of customers they sell to within the UK. Many customers will choose to shop on line from the comfort of their own home, as they either do not want the inconvenience or do not have the time to spend visiting shops to make the same purchase they could through using e-commerce.

Other existing businesses, such as Tesco and easyJet, have also benefited from targeting a wider range of customers through adopting e-commerce into their business operations. Firms that have been slow to implement e-commerce, have often suffered from losing sales to competitors who took this leap early. This includes Morrisons, which started selling on-line in 2014 in comparison to Tesco.com, which was launched in 2000, as well as 74% of all small businesses.

Digital technology

- **Digital technology** is a very wide term. Businesses will use computer based tools, systems, devices and resources that generate, store or process data. They will also use digital communication. There are many aspects to digital technology including social media, online multimedia, productivity applications, cloud computing, e-commerce and communication.

- **Digital communication** is now in widespread use throughout the world. This includes all devices such as smart phones, tablets, desktops and video conferencing equipment. It has enormous applications. Digital communication can also happen through social media platforms.

The use of digital communication and digital technology can be applied to all **stakeholders**. Some specific examples are as follows:

Customers – ordering, invoicing or sending bills, customer service, advertising including the use of social media (Facebook, Twitter etc.)

Suppliers – ordering, payments, product information

Employees – payslips, job information, booking holidays, checking hours to be worked, emails and messaging to and from managers

Shareholders – annual reports, dividend information and payments

Managers – using software such as Skype, teleconferencing and web conferencing to communicate with other managers, customers and employees

In addition **e-mail** could be used for communication to all stakeholders, to share relevant information that is appropriate to the individual stakeholder needs

Advantages and disadvantages of using digital communication

Advantages	Disadvantages
☑ Cheap to operate and widely used. Messages and data can be transmitted quickly and is increasingly possible throughout the world	☒ May be unreliable and no guarantee that messages will be received or accessed by the person intended to receive them
☑ Data and messages can be stored electronically, so saves cost of storage. Can be saved digitally and backed up using cloud storage	☒ Can lead to communication overload as more messages are created and more information received and sent. Important messages and emails may be lost or delayed
☑ Possible to produce translated versions using online applications	☒ Equipment may not work and not all places will be connected
☑ Teleconferencing. videoconferencing and web conferencing are possible which can produce considerable time and cost savings	☒ Environmental and health concerns over electronic transmission
☑ High quality advertising and marketing messages are possible through high definition graphic and video images	☒ Lack of leisure time, as employees expected to be available longer hours and when on holiday
☑ Increase in **teleworking**, giving employers a greater pool of applicants to recruit from, as there is less need for employees to live near to where the business is physically located	☒ Constant training requirement for staff to understand how to use digital communication efficiently

How businesses are affected by digital technology

Every business area can make use of digital technology. Ignoring the pace of change is not an option, even if in the short run it may be disruptive and expensive to make changes or adopt new technology in a business. If a firm does ignore the pace of change, the chances are its competitors will not, which will result in them becoming more efficient. Those using old technology will be left behind and may not survive. Recent business closures caused by this have included Blockbuster, HMV and Jessops, all of which failed to anticipate the impact of digital technology on their businesses.

Some examples of how digital technology can be used in a business are detailed here.

Organisation – there have been massive changes to the way business administration operates through the use of ICT. This has included use of computers for communication, data storage and data retrieval. Remote or teleworking has become commonplace and the cost of administration has reduced considerably. Applications such as Skype, email and instant messaging allow easy communication to take place with remote workers.

Finance – financial recording is now predominantly computer based with various software packages available. Digital applications are also used for electronic billing and payments. Many firms will also use programmes for financial modelling and monitoring linked to **management information systems**. Supermarkets can even see how future weather will affect their sales and then adjust their stock accordingly. Online customer payments can be received through electronic transfers as well as contactless payments all of which make it easier for the customer to pay and quicker for the business to be paid.

Human Resources – most aspects of human resource work has benefited from the use of computers. In many businesses, the application process for a job vacancy is partly or fully completed on line and there is also widespread use of digital training (often undertaken at home through digital links). Marks and Spencer's initial stages of the recruitment process for a customer assistant are all completed on-line. This allows the business to screen potential applicants to determine their suitability for a role within one of its stores, before the company invites a potential applicant into store for a role play interview.

Production – as well as computer aided design (CAD) and computer aided manufacturing (CAM), other aspects of production have benefited from digital technology. Stock control can be fully automated and quality control is often linked with computer based monitoring. For example, in breweries technology will weigh each can of beer that is produced. Any can that is under filled will be separated, so that it is not packaged and sent off to supermarkets or wholesalers, the customers of the brewery.

Marketing – this is through the use of e-commerce and websites. The marketing function will also make use of computers in terms of product design, advertising, social media and its use of customer databases (often linked to market research). For example, the growth of loyalty cards allows marketing departments and businesses to track customer shopping habits and send out promotions and information that directly relate to individual customer needs. In late 2015, M&S launched its own version of a loyalty card, the "Sparks" card, 18 years after the launch of the Boots advantage card, which launched in 2007.

Ethical considerations

Introduction

In recent years, business stakeholders have taken a much greater interest in the wider aspects of behaviour of business. These include consideration of ethics, the environment and issues to do with sustainability and global warming.

Business ethics

Business ethics is concerned as to whether businesses have morally correct behaviour. This can be applied to its relationship with suppliers, employees, customers, but will also be relevant to its relationship with the wider community. An ethical decision will be one that is based on what is morally right, rather than the most profitable option. Ethics should not be confused with the law. A decision might be unethical but legal, or ethical and illegal.

Some examples of unethical business behaviour are given in the table, together with the impact that these decisions could have on the business itself:

Stakeholder	Example	Effect/impact on the business
Consumers	Should a business charge very high prices where consumers have no choice of product?	Businesses might get extra profits in the short run, but its reputation might suffer and new competitors could take its trade in the future
Employees	Businesses might pay low wages and provide poor and unsafe working conditions	Workers may choose to leave the business; recruitment may be difficult and the business might face industrial action from trade unions
Suppliers	Cheap suppliers used by a business might be using unethical practices in the production of their goods, such as using child labour, paying cheap prices or using bribes	Use of suppliers who exploit their workers can cause bad publicity which may reduce sales; businesses are increasingly held accountable for the actions and decisions of the suppliers that they use
Community	Ignoring local communities by polluting the local area	Avoiding pollution might save an increase in costs and may improve the reputation of the business, increasing sales and making it easier for the firm to recruit workers. Ignoring pollution issues would have the opposite effect on the business

Fair Trade is a scheme that some businesses agree to. This shows that producers and retailers are being ethical in the way they purchase goods and raw materials from developing countries.

Advantages and disadvantages of ethical behaviour

There are arguments for and against ethical behaviour – this might particularly be the case if a business faces competition from businesses in other countries:

Advantages	Disadvantages
☒ Sales might increase due to good publicity ☒ Improved brand reputation ☒ Employees like working for the business; easier to recruit and retain staff ☒ Meets owners objectives	☒ Costs may increase and profits decrease ☒ Publicity may not persuade consumers to buy ☒ Quality or appearance of products may not be as good

Many of these decisions and examples represent a trade-off between ethical behaviour and increased profit. Overall the decisions will be based on the owners' preferences and the markets in which they operate. An ethical business that goes bankrupt through its actions may result in less ethical businesses succeeding even more.

Environmental issues

Businesses must follow any legislation that is linked to the environment, but some businesses will choose to go beyond this with the environmental policies that they choose to follow. This decision will directly link to the firm's view on ethics.

Over recent years, there has been an increasing concern about the environment and as such, the number of UK laws on business and the environment have increased. Areas such as pollution, waste recycling and energy conservation have all increased business costs, as firms must meet these new standards. In many cases however, this increase in costs has been passed onto the consumer. Consumers will however, generally expect to pay a higher price for goods and services that have been produced in a sustainable more environmentally friendly way, for example, they are happy to pay premium prices for organic products.

Examples of how a business may attempt to reduce the impact on society of different environmental considerations are summarised in the table:

Environmental consideration	Possible effects on producers	Possible effects on consumers
Traffic congestion	• Transport might be retimed to avoid rush hour • Distribution may be moved from road to rail • Businesses may relocate to benefit from better transport links	• Service might be slower • Prices may go up because of the changes • Consumers may buy cheaper goods from less environmentally sources
Recycling requirements	• All businesses must try to reduce waste • Packaging should be minimised and be capable of recycling • Any waste that can be recycled must be separated. This service may vary depending on the area in which the business is based • Recycling collections must be arranged and paid for	• Consumers will pay more for goods and services • The society in which they live should be more pleasant, as there will less rubbish disposal sites in the future • Resources will last longer so future costs will not increase as much
Waste disposal	• Businesses must have all waste collected and disposed of properly or they can fined • This can be combined with the recycling arrangements • Some products, for example cooking oil have strict disposal arrangements	• Consumers will pay more for goods and services • The society in which they live should be more pleasant as there will less rubbish disposal sites in the future
Pollution	• Businesses will need an environmental permit if they produce significant air pollution • All businesses must not be a nuisance to their neighbours, for example smoke, dust, smells or noise • All businesses must have permission to discharge industrial waste into the water supply and are responsible for cleaning up any land contaminated	• Pollution will be reduced • Business costs will increase so costs to consumers will increase • There will be less need in the future for government to increase taxes to clean up business pollution

As can be seen from the table, there are both **costs** and **benefits** to producers and consumers of a business becoming more environmentally friendly. The success of environmental policies will often depend on international comparisons and how well policies are enforced.

Sustainability

For an economy to be **sustainable** it must be able to maintain the current levels of production in the future. As many resources are non-renewable, this causes problems for both businesses and consumers. Consumers have **unlimited wants** yet there are only **limited resources** in a society. New technology and improved communication can make, for example, production, communication and distribution all more efficient and needing less resources. There will, however, be challenges caused by the increases in world population which will make sustainability more difficult to achieve.

Growth in economies and their output have also caused increasing concerns over global warming. Factors such as industrial pollution and destruction of rainforests to increase agricultural production have caused global temperatures to rise. This change has resulted in increasing costs for businesses in order to deal with the many effects of global warming, such as increased flooding and more unpredictable weather.

Businesses and consumers both have a responsibility that any growth achieved is sustainable, but there will be costs. For example renewable energy will be more expensive, recycling will increase costs and choosing more environmentally friendly production methods will mean higher prices passed onto the consumer. In the short term, producers will make less profits and consumers will be able to afford less goods and services, but these choices could mean there is a long term future for the world's population.

The economic climate

Introduction

Governments will all have well established economic policies designed to influence and control how the economy operates in their country. They will have aims such as low inflation, high employment, increased production and a balance in international trade. The policies used to achieve these objectives, which include **interest rates** and **taxation**, will all affect businesses both directly and indirectly through their effects on consumers and employees.

Interest rates

In recent years, interest rates have been very low in the UK. Any change overall or in the direction of interest rates, can influence consumer and business behaviour considerably. An increase in interest rates may cause the following to happen:

Direct effects:

- Business loans will be more expensive. This will discourage investment and may mean businesses become less competitive or are reluctant to expand
- Costs may increase, as the cost of existing loans/overdrafts may be higher, dependent on the terms of the borrowing
- Businesses may choose to save money to earn the higher interest, rather than spend it

Indirect effects:

- Consumers will spend less as it is more expensive for them to borrow money to fund expenditure
- Consumers will also spend less, as they will be more inclined to save more if interest rates are increasing
- Consumers may also spend less, as their costs on existing debts, such as loans and mortgages, may increase, meaning they have less disposable income to spend on other purchases, particularly non-essential goods and services, such as going to the cinema. Certain businesses will therefore see a drop in sales, revenue and therefore profit
- The exchange rate may increase, making the costs of goods sold by businesses to other countries more expensive

Level of employment

Governments will be aiming to have high employment (and low unemployment) in their economy so there will be less people reliant on benefit payments. There are, however, advantages and disadvantages to businesses of high levels of employment. These are summarised in the table below:

Advantages	Disadvantages
☑ Incomes will be higher, so spending on goods and services will increase, particularly on non-essential items ☑ Workers will be more motivated, as they have more job security, increasing productivity levels and efficiency	☒ Fewer workers will be available, resulting in new job vacancies being difficult to fill ☒ Wages and salaries are likely to increase, as fewer workers are available; new and existing workers can demand higher pay ☒ Increased staff turnover, as it easy for workers to move jobs, increasing recruitment and training costs

High unemployment will result in the reverse of the above points and may also cause workers' skills to be lost, particularly in industries using technology.

There will also be considerable regional variation within a country in terms of employment levels. This may encourage businesses to relocate to take advantage of the opportunities that this provides, directly through an increase in the amount of available labour or indirectly through government relocation grants and subsidies. Also some businesses will benefit more than others, depending on whether their goods or services are targeted at consumers with high or low incomes.

Consumer spending

An increase or decrease in consumer incomes will affect how much money they spend and what they spend their money on.

An **increase** in spending will mean that consumers will **purchase more goods and services**. Although this is an opportunity for local, domestic businesses, they will need to produce more or consumers will buy from other countries that may be quicker to expand production and fulfil customer needs more efficiently. If production cannot increase to meet customer demand, there is a possibility that increased consumer spending might lead to prices rising and inflation taking place. When a decrease in consumer spending occurs, the above effects are reversed.

When an increase or decrease in income levels happens, consumers will **purchase different goods and services**. For example, when there is an **increase** in income levels, businesses that produce luxury goods and services will do very well. Businesses that produce more basic products might see a decrease in demand, even though overall customer spending is increasing. This is because customers may switch from buying lower priced products, such as Tesco value beans to buying a branded product, such as Heinz beans. Demand for some products however, will remain near enough constant, despite changes in income levels. Examples of these products include bread, milk and eggs, as they are seen as necessity items.

Globalisation

Introduction

In recent years the world has increasingly become one market. The introduction of new technology, economic development and improved travel have all meant that businesses can consider selling their products and services to anywhere in the world. Trade between countries is now much more important than it ever has been and as a result, there has been an increase in free trade agreements between countries. Globalisation also affects decisions regarding business location. Businesses can either be completely or partly based outside of their own/home country. **Outsourcing** of production is also now commonplace.

There have been huge advantages to businesses of global trading, but there have also been many challenges and adjustments that have had to be made to the way businesses now operate.

Benefits and drawbacks of globalisation

Benefits	Drawbacks
☑ Globalisation has resulted **in increased markets** for businesses small and large. Use of e-commerce and better distribution has made global markets a reality for many businesses. Businesses can also find cheaper raw materials and production opportunities ☑ Where countries have a cost advantage in the production of a good or service, they have been able to specialise in its production and sell throughout the world at cheaper costs. This could be due to easier access to raw materials, climate advantages or skilled labour ☑ **Because there is more competition,** firms have had to become more efficient, which has resulted in consumers having more choice at lower prices of better quality or designed products ☑ With international cooperation and global trade, there has been an increasing transfer of knowledge and skills throughout the world. This has led to increased use of **technology** and more efficient production	☒ Domestic firms have had to face **competition** from businesses throughout the world. Many of these businesses have cheaper costs and larger scale production and as a result businesses may close ☒ **Multinational firms** have become very powerful with their global brands ☒ Some complete industries have closed and this has caused a need for new businesses to be established and training for the **unemployed** workers whose jobs no longer exist. There is no longer coal mined in the UK, so all the miners have had to find other jobs. ☒ In the UK there has been a **decrease in skilled manufacturing** and an increase in the service industry. This has led to changes away from manual skills to managerial and in many cases low level service jobs ☒ An economy is now **vulnerable to world economic conditions**. If there is a change in the economic situation in one country this will affect many other economies. A downturn in the economy of the USA will cause the UK economy to also suffer as export sales to the USA decrease

International competition for UK businesses

As described in the table, UK businesses face both the challenges and opportunities of the global market. This has been made more complicated by the Brexit vote which means traditional trading links with the EU will change when the UK leaves the EU. This will affect both UK firms who export to other EU countries, as well as UK firms who compete against imports from the EU. There will undoubtedly be new markets through new trade deals with non EU countries, but equally there will be new firms seeking to enter UK markets who will pose a threat to existing UK producers.

There are many areas where the UK is a world leader and these tend to be where innovation and design are important. The UK has worldwide reputation for the quality of its products and in recent years it has also increased its ability to be cost efficient and internationally competitive. Science and technology have been traditional strengths but the UK is also acknowledged as a market leader in many areas of industries including:

- Automotive - high quality car designs and innovation, as well as high productivity manufacturing. Leading UK companies in making cars using green technology
- Aerospace – built on world leading university research and development undertaken by hi-tech British firms. High reputations in Air and Defence industries with particular strengths in wing design, engine development and manufacture, as well as material technologies and advanced system design
- Chemicals and pharmaceuticals – a long tradition of world status linked to highly advanced university networks and world-class research and development. UK is also emerging as a world leader in biotechnology
- Agri-food - the UK is strong across food and drink with high-tech farming, productive food manufacturing and strong retail chains. The UK has leading food and drinks brands with constant innovation and new product ranges. It leads the world in niche areas, such as health foods and ready meals
- Green technology and services - the UK has world strengths across a whole range of expertise and capability. There is strong innovation in green manufacturing, alternative fuels and tidal power technologies, as well as high reputations in environmental consultancy and carbon trading initiatives
- Knowledge intensive industries - the UK leads the world on a per-capita basis, mainly driven through the financial services sector (where the UK has the world's largest market share), also extremely strong in insurance, computing and information services

There will continue to be many new challenges for UK businesses in a post Brexit era. Globalisation will not go away and it will be those UK businesses that continue to take the initiative and look to the opportunities it provides that will succeed.

Exchange rates

Where businesses trade with other customers and suppliers in other countries, they will need to take into account the value of that country's currency. This **exchange rate** and changes to this exchange rate will affect the prices that have to be paid and the amount that can be earned from overseas trade.

Imports are goods and services that are purchased from other countries. These might be raw materials or finished products or services purchased by consumers. **Exports** are goods and services sold to businesses and consumers in other countries.

If the exchange rate changes so that the **currency appreciates,** then it will be worth more. This means that it will cost more for businesses located outside of the UK to buy the UK currency or pound sterling. It will also be cheaper for businesses located in the UK to buy another country's currency. This means that imports into the UK will be cheaper and exports will become more expensive.

As a result if a country's currency is appreciating then it is:

- **bad** for a business that exports, as its goods will become more expensive in the countries that it sells its goods in, so sales will decrease
- **good** for consumers, as prices of imports will decrease and they can get different and cheaper goods and services
- **good** if a business imports raw materials, as the business will be able to buy more of these raw materials for the same UK converted price. This will reduce business costs, which would give it more flexibility with pricing. This is very important if the business operates in a competitive market, as a reduction in prices could result in an increase in sales, which if costs are controlled could lead to an increase in profits
- **bad** for a local business that may not be able to compete against the cheap imports

If a **currency depreciates** than it will be worth less (devaluation) and be cheaper for other countries and businesses to buy. This is often seen as a disadvantage to a country, but in reality there are some businesses which will gain from this situation and others that will lose, which can be described as follows:

- **good** for a business that exports, as its goods will be cheaper so sales might increase
- **bad** for consumers, as prices of imports will increase, so they will have to spend more to get the same imported goods and services
- **bad** if a business imports raw materials, as it may increase its costs which might cancel out the benefits of cheaper export prices
- **good** for local businesses as they will be able to compete better against cheaper imports

Fluctuations in exchange rates cause **uncertainty** in business and will impact on business decision-making. Since Brexit, the pound sterling has fallen in value, which has resulted in exports becoming cheaper, but imports becoming more experience. Changes in the exchange rate such as this, might discourage businesses from trading internationally, as it will impact on the profits that a business makes.

Legislation

Introduction

Governments introduce legislation in many areas of the economy. This is done to control business actions that otherwise might put profits before prioritising the needs of its stakeholders.

Equal pay and minimum wage laws

The basic rule for all businesses in the 2010 Equality Act UK is that:

Men and women are entitled to equal pay for work of equal value

... Looking at that rule in a little more detail:

- "Pay" includes everything in the employment contract - bonuses and pension contributions, as well as basic wages or salary
- Workers have the right to ask their employer for information to check equality – using the equal pay questionnaire
- If employees believe their pay is unequal, they can take the employer to an **employment tribunal**

Employees must be paid at least the national minimum wage (NMW) by law. Since April 2016, if staff members are aged 25 or over, they must be paid at least the national living wage (NLW). The NMW and NLW are reviewed and usually changed every year. The current rates as at October 2016 and April 2017 are shown in the table:

Year	25 and over	21 to 24	18 to 20	Under 18	Apprentice
October 2016	£7.20	£6.95	£5.55	£4.00	£3.40
April 2017	£7.50	£7.05	£5.60	£4.05	£3.50
Source: https://www.gov.uk/national-minimum-wage-rates					

Effects on business

The effect of wage legislation on many businesses is often that their wage costs will increase, although some businesses will choose to pay above these levels, to attract a higher calibre of staff. They may also choose to pay higher than the minimum levels to increase staff motivation and reduce labour turnover. This will reduce recruitment costs and productivity levels within the business will increase.

Firms which do not pay minimum wages can face significant fines as well as receiving bad publicity, which will make future recruitment more difficult and may reduce sales.

Discrimination

Discrimination is the **treatment in an unacceptable way of anyone who is termed to be different.** In the UK, it is illegal for an employer to discriminate against an employee on the basis of:

- Sex, including pregnancy and maternity
- Marital / civil partnership status
- A person's disability
- Race
- Age
- Sexual orientation
- Religion/belief
- Trade union membership or non-membership
- Status as a fixed-term or part-time worker

Discrimination laws apply in many areas of employing staff, for example:

- Recruitment
- Employee contract - terms and conditions
- Promotions and transfers
- Providing training
- Deciding which fringe benefits employees receive
- Employee dismissal

Employment rights

An employment right is something to which an employee is entitled, which is protected by law. Laws provide a variety of “rights” for employees, including:

- Reasonable notice before dismissal
- Right to redundancy
- Right to a written employment contract
- Right to request flexible working
- Right to be paid the national minimum or living wage
- Right to take time off for parenting

Health and safety

The **Health and Safety at Work Act (1974)** gives employers the duty to ensure, as far as it is possible, the **health, safety and welfare** at work of all their employees.

The act requires for example:

- safe operation and maintenance of the working environment, plant and systems
- maintenance of safe access to and around the workplace
- safe use, handling and storage of dangerous substances
- adequate training of staff to ensure health and safety
- adequate welfare provisions for staff at work

In terms of health and safety, management must remember that it is not just concerned about protecting staff – health and safety applies to any person who comes into contact with the business. That means that proper health and safety needs to be provided to:

- Employees working at the business premises, from home, or at another site
- Visitors to the premises, such as customers or subcontractors
- Employees working at other premises where their business is working, such as on a construction site
- Members of the public - even if they are outside the business premises
- Anyone affected by products and services the business designs, produces or supplies

For most start-up or small businesses, complying with health and safety does not pose too many problems, although the business will incur additional costs to ensure that it complies with the law properly. For example, there could be staff training costs on relevant health and safety matters, providing appropriate equipment and clothing to staff and lost management time spent checking that the business is obeying all aspects of the law. In some industries however, health and safety is really important, for example:

- Food processing (hygiene)
- Hotels (guest safety, hygiene)
- Chemical production (dangerous processes, waste disposal)
- Air travel (passenger safety)
- Tour operators (holidaymaker safety)

Effects on business of Health and Safety law

Many businesses will often say that meeting health and safety requirements can be expensive and make them uncompetitive, especially if they face competition from firms in other countries where there are less health and safety requirements. However, failure to meet health and safety requirements can result in unlimited fines and imprisonment.

Businesses will also benefit from **a safe working environment,** as staff will stay working for the business and will be happy and more motivated in what they are doing. This will increase productivity levels. Businesses will also find it is easier to recruit new employees, if a vacancy arises.

Consumer Laws

Consumer Rights Act 2015

This law provides consumers with significant protection when it comes to dealing with businesses. All start-up and small businesses, as well as larger businesses, have to ensure that they comply with this legislation. The Consumer Rights Act covers product quality, returning goods, repairs and replacements, digital content and delivery rights.

The main requirements include that:

Goods must fit their description

- E.g. organic wine really must be organic
- Businesses need to take care with descriptions – avoid inaccurate claims

Goods and services must be of satisfactory quality

- The test is whether a "reasonable person" finds them to be satisfactory
- The goods must work and have no significant defects

Goods are fit for the purpose specified

- E.g. a watch should tell the time
- Businesses should take care when explaining what a product can be used for

The Trade Descriptions Act 1968

The Trade Descriptions Act makes it an offence for a trader to make false or misleading statements about goods or services. It carries criminal penalties and is enforced by Trading Standards Officers, making it an offence for a trader to:

- apply a false trade description to any goods
- supply or offer to supply any goods to which a false description has been applied
- make false statements about the provision of any services, facilities or accommodation

The Consumer Rights Act and the Trade Descriptions Act are the two main two acts that exist to protect consumers. However, consumer protection under the law goes much further. For example:

- Businesses may not use **unfair commercial practices**, for example misleading advertising or pressurised selling
- Customers have a right to return and be provided with a full refund if goods/services do not comply with the law
- Services must be done at a reasonable price and by the time stated. The customer can request that unsatisfactory work be repaired or carried out again at no cost
- Since October 2008, consumers buying from home or at work have the right to a "cooling off period". This means if you order a product, such as a mobile phone, by phone or online you have 14 days to decide whether you want to keep it or not.

Effects on business

There will be costs that businesses will need to pay, for example in terms of increased quality control, to make sure that they obey consumer law. There will however, be many benefits to a business of ensuring that they do comply with these laws, such as gaining an improved reputation in the marketplace, which could lead to an increase in sales, and avoiding bad publicity.

Breaking any of these laws can lead to a business incurring costs of repair and replacement, increased administration costs, as well as gaining a bad name in the market. It can also lead to very high fines for the business, which can run into millions of pounds.

Competitive environment

Introduction

Businesses will try to produce a good or service where they do not face much, if any, competition. However, in reality businesses will always have some form of competition. This competition might be strong and direct, i.e. there are many businesses producing very similar products or services, or indirect i.e. competitors are producing goods or services that represent an alternative way for consumers to spend their money. If there is a little competition, this gives a business considerable market power.

Competition

If we now look at these situations in more detail then we must first consider what a **market** is. A definition could be that it is where similar goods and services are bought or sold. Similar would mean that buyers could make choices. This is not always a direct alternative, for example a choice between going to the cinema, going out for a meal or buying a new computer game. Markets are also not always physical places, as much of today's business takes place through online transactions, where competitors' products and services can be bought and sold.

Some of the effects of direct, indirect and no competition on a business can be summarised as follows:

Type of Competition	**Description**	**Effect on Business**
Direct	Businesses have competitors that produce a very similar product. Prices will be very similar if not identical. For example, petrol prices are normally very close to each other, despite the petrol station visited	Businesses will try and make their products different, so they can charge more for them or gain customer loyalty. Petrol stations spend lots of money on shops, cafes or have loyalty cards, in order to try and attract customers to their particular station
Indirect	Consumers may choose a good or service that has similar characteristics (leisure, transport), but is not a direct competitor. Trains, buses and cars may all be ways of getting to work and therefore do compete with each other for customers, but indirectly	Some customers will be affected by changes to an indirect competitor; some customers will not change to, or from, the indirect competitor. For example, people may prefer to use cars even though other choices exist
None	A business has no competition or its product is sufficiently different from any alternative	The business can charge higher prices and make good profits, which can be reinvested back into the business or distributed back to the owners. Quality however, might suffer, as the lack of competition can make the business complacent, as customers have no alternatives to buy, if they wish to purchase this product

Risks to a business

Risk can mean several things:

- the chance of loss or damage
- the probability that something goes wrong, leading to a loss
- when a hoped-for outcome does not happen

If setting up a new business was risk-free i.e. guaranteed to succeed, then we would all do it! The bad news for entrepreneurs is that investing in a start-up business is highly **risky**.

What is the risk? The main risk is that the **business will fail** and that the entrepreneur will **lose his/her investment**. In the case of a sole trader or partnership, the entrepreneur may also end up **personally liable** for the debts of the failed business (an important reason why many start-ups use private limited companies as their form of business organisation).

Another risk is that a failed business will leave the entrepreneur struggling to finance another business or getting a normal job. An additional risk to the entrepreneur is facing the overall failure itself. There is no reason why people should be ashamed of failing in business, but in reality many are.

Taken together, it can be seen why these risks are often the reason why an entrepreneur continues to keep a business going, even when the business is struggling badly. When you are "risking it all" then you put all your effort into making the business a success!

Learning the lessons of failure

A good way of thinking about the risks being taken, is to consider why start-up and small businesses fail. If an entrepreneur can learn from and avoid these mistakes, then any new business that is set up has a greater chance of survival and success.

Here are the main reasons why businesses fail:

Poor management	Plain and simple. Planning is inadequate leading to poor decision-making, costs are not kept under control, business owners or management do not understand their market and customers well enough and/or a poor quality product is provided
Poor market research	In starting a business or keeping an existing business successful, there is a need to undertake market research. This will need to be reliable enough to predict future sales. It is often not done as it is too expensive, or if it is done the data is out of date or not fully relevant
Sales lower than expected	It is very easy to over-estimate the sales that will be achieved by a start-up. The business plan can be over-optimistic about the price that customers will accept and the volumes they will buy
Start-up costs too high	Another common weakness of start-up business planning. Sometimes costs are simply missed out altogether or alternatively the amounts are under-estimated. This is a big concern at the start-up stage, where finance is limited. A delayed product launch or store opening may be the cause of start-up costs being higher than expected
Unexpected shocks	These can come in various forms, for example flash floods that hit different places in the UK from time to time, a new competitor entering the market, a global recession, a change in government and the UK leaving the EU (BREXIT)
Too reliant on a small number of customers	A start-up that is too reliant on one or a few customers is at greater risk of failure than one which has a broader, more diverse customer base. If the customer relationship breaks down and/or the customer stops buying products from the business, then it puts the business at risk
Poor quality	This is linked to poor management. Persistent poor quality products or services will ultimately kill a business, as rival businesses will produce superior products that customers will undoubtedly prefer

By identifying the cause of failure, this allows a business owner to come up with solutions. Better still it allows a business to improve its planning, so that in the future it can minimise its risk and prevent it happening again – if it is not too late!

Rewards from enterprise

As well as risks there are also many rewards for being in business. For entrepreneurs many of these arise from achieving their personal objectives. These include:

- a personal sense of satisfaction
- building something from scratch i.e. their own enterprise
- being in full control and therefore having the ability to make all the decisions
- making that first sale!
- opening in a new location
- employing more people
- getting an industry award or receiving some good publicity
- getting great feedback from customers
- helping others and attempting to meet a social need

These are the kind of **non-financial rewards** that give entrepreneurs a “buzz”.

However, ultimately, it is the financial rewards that justify the effort and make taking the risk worthwhile. Famous entrepreneurs such as Sir Richard Branson (Virgin), Sir Alan Sugar (Amstrad), James Dyson and Charles Dunstone (Carphone Warehouse) have all built very successful businesses that are either worth or have been sold for millions of pounds.

Sarah Willingham, who has appeared as one of the “Dragons” on Dragon Den, is another example of a successful entrepreneur. Sarah worked in the restaurant industry from the age of 13 and has managed some of the world’s most successful restaurants, including launching Pizza Express in Asia and Planet Hollywood in Paris.

In 2004, she saw the opportunity to turn a failing chain of six Indian restaurants into a successful investment. Sarah raised enough finance to buy “The Bombay Bicycle Club” which she sold three years later for well over a million pounds, having made it the largest and most successful Indian Restaurant chain in the UK.

There is a strong tradition of entrepreneurs who have built and sold one business for a substantial amount of money, to go on to build other successful businesses. They never lose the entrepreneurial buzz!

Section 3 Business operations

Topic overview

Students need to know what business operations involve in the production of goods and services and how this relates to the other functional areas of human resources, marketing and finance. There should also be consideration of how operations will relate to the business and its objectives.

Section	Key things to learn
Production processes	Methods of production: job and flow Increasing efficiency Lean production Just-in-time
The role of procurement	Stock management Just in time versus just in case Choice of suppliers Effects of procurement and logistics Efficiency and cost reduction versus quality Supply chain management
The concept of quality	Customer expectations of quality Measuring quality and identifying quality problems Total quality management Cost and benefits of quality
Good customer services	Sales process and methods of good customer service Benefits of good customer service Dangers of poor customer service Use of ICT in achieving good customer service

Production processes

Introduction

Production is the process of turning raw materials into goods and services. There are a variety of methods that can be used by businesses in making goods and providing services. These include job and flow production.

Job production

Job production is typically used by small businesses. It involves making one-off or a small number of items. These are often made to the customer's requirements, ranging from the simple, for example a haircut, to the moderately difficult, for example a wedding cake and finally to something long and complex, for example building a new bridge.

Job production often allows a business to make its product or service different to competitors, including larger businesses, and is particularly common in the service sector. A made to measure clothes shop can be successful, even though there are large multi-national clothes retailers that exist and cater for the **mass market**.

The main advantages and disadvantages of using job production include:

Advantages	Disadvantages
☑ Products are usually of high quality	☑ Costs of producing one unit or job are higher than producing a large number of the same good or service
☑ Producer meets individual customer requirements	☑ Labour intensive, as less suited to the use of machinery
☑ Greater job satisfaction for employees, as they are involved in all stages of production	☑ Requires skilled employees, who will demand higher levels of pay and perhaps require ongoing training

Flow production

As a business grows the scale of its operations, it often needs to change its method of production to allow it to produce more and increase its **production capacity**.

A small business might use job production to provide a personalised or distinctive product. However, if the product is intended for much larger, **mass markets**, then other methods of production may be required in order for the product to be produced **efficiently**. A key production method in these circumstances is **flow production**.

Flow production involves a **continuous movement** of items through the production process. Flow production, also known as **mass production**, uses production lines to manufacture products. For example, in a car manufacturing plant, doors, engines, bonnets and wheels are added to a chassis as it moves along the assembly line. This type of production is appropriate when firms are looking to produce a **high volume of similar items**. Some of the big manufacturing brand names, that have consistently high demand, are most suited to this type of production, for example Heinz baked beans.

Flow production is **capital intensive**. This means it uses a high proportion of machinery in relation to workers.

The benefits and drawbacks of flow production include:

Advantages	**Disadvantages**
☑ Ideal for large-scale production of mass-market products	☒ Expensive to purchase machinery and to set up
☑ Less use of labour; a business can more easily operate 24 hours a day, 7 days a week, reducing the average cost per unit	☒ Production can be inflexible
☑ Workers used can specialise in one job or one part of the production process, which makes them more efficient	☒ Jobs can be repetitive and boring, lowering the motivation of workers
☑ Can still create personalised products using computer-programmed machinery	☒ Can involve considerable risk to a business; therefore it takes a lot of planning time to organise the production process
☑ Products will have consistent quality	☒ Breakdowns experienced on the production line will result in idle resources and inefficiency

Efficiency in production

Introduction

In order to make production more efficient, businesses can use various techniques. These are often known as **lean production** techniques and include the use of **just-in-time** production. A business can measure its efficiency by calculating the cost of producing one unit or the **average unit cost**. An increase in efficiency can be achieved by increasing the output without increasing resources or by cutting costs and maintaining output.

Lean production

Lean production is an approach to management that focuses on **cutting out waste**, whilst **ensuring quality**. Lean production aims to **cut costs** by making the business **more efficient** and responsive to market needs.

The lean approach to managing operations is really about:

- ☑ Doing the simple things well
- ☑ Doing things better
- ☑ Involving employees in the continuous process of improvement
- ☑ …and as a result, avoiding waste

The concept of lean production is an incredibly powerful one for any business that wants to become and/or remain competitive. This is because **waste = cost**! **Less waste therefore means lower costs**, which is an essential part of any business being competitive. If a business can lower its costs, it can then enjoy a bigger profit margin on each unit sold or it will allow the business to have more flexibility on price, which is very important if it operates in a competitive market.

The pioneering work of Toyota, a leader in lean production, identified different kinds of waste which can be applied to any business operation. These are:

Type of waste	Description
Over-production	Making more than is needed – leads to excess stocks
Waiting time	Equipment and people standing idle waiting for a production process to be completed or resources to arrive
Transport	Moving resources (people, materials) around unnecessarily
Inventory/stock	Often held as an acceptable buffer or spare stock, but should not be excessive
Motion	A worker who appears busy, but is not actually adding any value
Defects	Output that does not reach the required quality standard – often a significant cost to an uncompetitive business

If a business can minimise these areas of waste, then it will ultimately become more efficient.

Just in time ("JIT")

In order to help improve and maintain efficiency many businesses use **Just in time** ("JIT"). This aims to ensure that **inputs arrive "when they are needed"** and **outputs are also produced "when they are needed."** If implemented successfully, stock levels of raw materials, components, work in progress and finished goods can be kept to a minimum.

This requires a carefully planned scheduling and flow of resources through the production process. Modern manufacturing firms use sophisticated production scheduling software to plan production for each period of time, which includes ordering the correct stock. (See also the section on "stock management").

Kaizen

Another feature of lean production is Kaizen or "**continuous improvement"**. This is an approach of **constantly introducing small changes** in a business in order to improve quality and/or efficiency. This approach assumes that employees are the best people to identify improvements in the way things are done, since they see the processes in action all the time. A firm that uses this approach therefore has to have a **culture**, or a way of working inside the business, that encourages and rewards their employees for coming up with ideas for improvement.

As the ideas come from the workers themselves, they are less likely to be very different and therefore easier to implement by the business. It will also help encourage employees to take ownership for their work and can therefore also help to reinforce team working. Because of this, worker motivation will improve and as such so will productivity levels and staff retention.

The role of procurement

Introduction

Procurement is the process by which suppliers are chosen. A **supplier** is a business that provides goods or services to another firm. This process will also include deciding what is needed, how it is ordered, as well as the process of receiving and managing the goods arrival into the business. Having the right suppliers is essential if the business is to succeed. A failure in procurement can lead to a failure of the business.

Managing stock

In order to meet demand, a business will have set itself a target stock level of finished goods that it should achieve in a given time period. This is calculated to satisfy the demand expected by the marketing department plans and based on what the production department thinks it can produce. If the stock level falls below this level, then the productive efficiency has reduced, since the output per worker has not met the planned requirements.

Modern manufacturing firms use sophisticated production scheduling software to plan production for each period of time, which includes ordering the correct stock. The planned output levels will in turn, determine how many raw materials are kept in stock, so that orders can be met. **Stock management** also apply to services, for example the level of staffing that is available to meet expected or unexpected demand in a restaurant or in a supermarket on the tills, so that customers do not have to wait too long to be served!

Just in time (JIT) versus Just in case (JIC)

- **Just in time** is a method of stock control that applies to raw materials, work in progress and finished products. If a business applies this technique then it will minimise the amount of all stock held.

- **Just in case** is also a method of stock control, but its principle is to have a large amount of stock of raw materials, finished goods or both. This means that the business will not run out of stock if it gets unexpectedly large orders. It will also have some spare stock if it receives any returns.

The successful operation of **just in time** requires a carefully planned scheduling and flow of resources through the production process. Supplies are delivered right to the production line only when they are needed. For example, a car manufacturing plant might receive exactly the right number and type of tyres for one day's production and the supplier would be expected to deliver them to the correct loading bay on the production line within a very narrow time slot.

Advantages and disadvantages of JIT

Advantages of JIT	Disadvantages of JIT
☑ Lower stock holding means a reduction in storage space, which saves rent and insurance costs	☒ There is little room for mistakes, as minimal stock is kept for **re-working** faulty products
☑ As stock is only obtained when it is needed, less money is tied up in stock and is therefore available for other purposes	☒ Production is very reliant on suppliers and if stock is not delivered on time, the whole production schedule can be delayed
☑ There is less likelihood of stock perishing, becoming obsolete or out of date	☒ There are no spare finished products or spare stock available to meet unexpected orders, because all products are made to meet actual orders. This can lead to lower levels of customer service
☑ Avoids the build-up of unsold finished products that can occur with sudden changes in demand	☒ No economies of scale possible from bulk purchasing and single deliveries

Successful operation of JIT requires a good relationship with suppliers. To ensure deliveries can be made relatively easily and on time, suppliers are normally located relatively close to their customers i.e. the business that operates JIT. Overall, if demand is consistent or easy to predict, then JIT is likely to be successful.

Just in case (JIC) is often used when it is hard to predict demand, suppliers are distant or unreliable and storage is possible and not too costly. The advantages and disadvantages of JIC are mainly the opposite of JIT and are summarised in the table. It is less suitable if products stored are perishable or will go out of date quickly and therefore become obsolete, such as in the technology sector.

Advantages and disadvantages of JIC

Advantages of JIC	Disadvantages of JIC
☑ Stock is available for **re-working** faulty products	☒ Higher stock holding means a need for more storage space, which increases rent and insurance costs
☑ Production is less reliant on suppliers and if stock is not delivered on time, the whole production schedule need not be delayed	☒ Money is tied up in stock and is therefore unavailable for other purposes
☑ Spare finished products are available to meet unexpected orders, which can increase the level of customer service	☒ There is a danger of stock perishing, becoming obsolete or out of date
☑ Economies of scale are possible from bulk purchasing and single deliveries	☒ There is a build-up of unsold finished products

Choosing suppliers

There are many factors that will influence the choice of supplier(s) in a business. When making this important choice, business managers will need to think about many different issues and prioritise the most important to their specific business needs. A brief explanation of the possible factors that a business may consider when making supplier decisions is provided in the table:

Factor	Explanation
Price	If a supplier is cheap, then the business can decrease its selling price and potentially make more sales. It could also just make more profit, as the difference between its unit cost and the selling price will increase. It is possible that by going for the cheaper suppliers however, that quality will suffer and customer satisfaction will also decrease, leading to a loss of long term sales.
Quality	High quality suppliers will mean that customer satisfaction will be high, so it is more likely they will make repeat purchases and remain loyal. It will however, mean that costs are likely to be more and profit less, unless the business can increase its selling prices and "pass on" this increase of costs to its customers.
Location	Easy, quick and low cost transportation of raw materials may be important in choosing a local supplier. This is very important if the business uses JIT.
Reliability	If a business has a short turn-around time for delivering its product to its customers or if it uses JIT, then the business will want a supplier that can deliver what the business needs quickly, without running out of stock.
Government Policy	Pressure may be brought on businesses to use local or **domestic** suppliers to safeguard jobs. This might mean that a business cannot use the cheapest supplier, as it may be based in another country.

A business may also use the following additional criteria to base its supplier choice on:

- **Industry**: in some industries it is essential that prices are set as low as possible, as profits are small and quality is less of a priority. This applies in industries which are very competitive.
- **Cash flow/finance:** some businesses may not have the cash flow to pay suppliers which might have good quality and fairly priced goods, but which require immediate cash payment for them. Some suppliers offer **credit** to the purchasing business which might be a very important factor, as it allows a business to buy the stock, but pay for it at a later date, ideally after the business has had the opportunity to sell it.
- **Customers:** some customers may be less worried about price compared to quality. This will mean that suppliers chosen must maintain quality, even if the price is increased. An expensive restaurant cannot choose low quality low cost ingredients, as otherwise its reputation would suffer and it would lose customers.

- **Speed:** for some businesses it is more important that suppliers can provide a quick reliable service, rather than necessarily being the cheapest option. This is particularly true if the business uses just in time.
- **Tradition:** the use of many suppliers is built up over many years. This creates a loyalty to the customer and it is likely that the suppliers will prioritise the loyal customer in terms of making sure supplies arrive on time and are of the quality promised. This means that the customer or business will experience a consistency in the supplies that it receives.

Procurement and logistics

Procurement is not just the process of choosing a supplier, it is the whole process of managing the ordering and receipt of the products or services in the business.

Logistics is part of the procurement process. Logistics is the part of the supply chain that plans, implements and controls the distribution and storage of goods and services from the supplier until it arrives at the customer. **Logistics** is often seen as the **transportation** of raw materials and finished goods, but as with procurement it is a process not just a single activity.

By focussing on the management of procurement and logistics, the business is able reduce its unit costs and increase its overall efficiency.

The **supply chain** is all activities that are involved in getting a product or service to the customer. This will start with the suppliers and ends with the final retail and distribution process.

Supply chain management seeks to ensure that the right quantity of goods and services are available at the right place at the right time and these are provided at the required quality for the minimum cost. There are various steps a business can take in order to achieve effective management of the supply chain. These include:

- **Planning:** making sure demand forecasts are accurate will help ensure that the right amount of goods and services are being provided
- **Procurement:** getting the best suppliers will result in good value and reliable supplies of the required quality
- **Communication:** coordination and communication with suppliers and logistics (transport) providers will help ensure that there are no delays to the production process
- **Lean production** or removal of waste from any area of the supply chain can result in a streamlined process which is faster, has lower costs, improved quality and better reliability. In manufacturing businesses, methods such as **total quality management**, and **just in time** can all help this process
- **Changing transportation**: logistics need to be constantly reviewed, as new transport options become available and different distribution routes are required

These can often be achieved by examining each of the different stages of the supply chain to see where any improvements can be made. This will help to ensure that the process is streamlined and is as efficient as possible.

The concept of quality

Introduction

If a business is to be successful it must have satisfied customers. In order for customers to be satisfied, they must have received a product or service that matches their expectations of **quality**, taking into account the price they have paid.

A good definition of quality is:

"Quality is about meeting the needs and expectations of customers"

Customers want quality that is appropriate to the price that they are prepared to pay and the level of competition in the market.

Quality

Key aspects of quality for the customer include:

- Good design – looks and style
- Good functionality – it does the job well
- Reliable – acceptable level of breakdowns or failure
- Consistency
- Durable – lasts as long as it should
- Good after sales service
- Value for money

"Value for money" is especially important, because in most markets there is room for products of different overall levels of quality and the customer must be satisfied that the price fairly reflects the quality.

Some products and services are marketed as "basic", having none of the extra features and benefits of more expensive alternatives. Good examples would be budget airlines and low cost supermarkets. Even though they may be "low quality" in terms of style or features, these products can still give good value for money given their expected level of quality.

Measuring quality

Businesses can measure quality through methods such as:

- failure or reject rates, for example on a production line; this may require samples to be taken
- customer satisfaction – usually measured by surveys which are completed anonymously
- mystery shoppers – often used in the service industry to test the quality of service provided
- customer loyalty – sales statistics can be used to work out customer satisfaction by the level of repeat purchases or renewal rates; the existence of loyalty cards helps businesses to measure this
- level of product returns – if there is a high percentage of goods returned by customers then quality is not satisfactory
- customer complaints – these might be letters or online comments

However, it is important to remember that:

- quality is often a matter of personal opinion and what is an acceptable level of quality will vary from one individual to another
- not all aspects of quality can be measured; a firm's name or reputation can be a very important indicator of quality, even though it is hard to measure
- quality standards are always changing as improved technology, better materials, different manufacturing techniques and new competitors arise in markets

Consequences of poor quality can be very damaging for a business and are discussed later. There are however costs to the businesses in providing and ensuring quality that is consistently in line with customer expectations.

Approaches to managing quality

Achieving high quality does not happen by accident. The production process must be properly managed to achieve quality standards. Quality management is concerned with controlling activities with the aim of ensuring that products and services are "fit for their purpose" and meet the specifications.

Historically **quality control** was the main method used to ensure quality standards. This was particularly used in manufacturing and was based on checking a sample or all goods at the end of the production process, to see whether they met the required standard. If they did not, they were rejected and then scrapped or the faults were corrected. This does protect the standard of goods to some extent, but it is an expensive and wasteful method. Employees may be careless, as they know work will be corrected.

The alternative method of **quality assurance** puts the **customer first** and seeks to ensure that they receive the quality of goods or service that is in line with their expectations.

Total quality management

Total quality management ("TQM") is an approach to **quality assurance** that aims to develop a quality culture throughout the firm. Every employee and each part of the production process has a target of "right first time" or **zero defects**. In total quality management, there is emphasis on **employee responsibility**, rather than checking by inspectors, as with quality control.

In TQM the process starts from receiving raw materials, which are checked for quality before they are used. This practice continues through the production process and even includes the administration of the business. It may also involve **quality circle** meetings of management and staff, where everyone is treated as an equal and where possible quality improvements are suggested and discussed.

Advantages of total quality management are:

- ☑ average unit costs are reduced, because there is less wastage and re-working of faulty products, which makes the business more efficient
- ☑ it can help improve worker motivation, as workers have more ownership and recognition for their work
- ☑ it can help break down "them and us" barriers between managers and employees, as it eliminates the feeling of being checked up on
- ☑ with all staff responsible for quality, this can help the firm gain marketing advantages arising from its consistent level of quality

Benefits of maintaining quality to a business

Maintaining quality standards can benefit a business in a number of ways:

- ☑ Customer loyalty – customers return, make repeat purchases and recommend the product or service to others, increasing sales further
- ☑ Strong brand image and reputation for quality, attracting new customers
- ☑ As the product or service is seen as being of good quality, it may command a higher price
- ☑ Fewer returns, product recalls and replacements, leading to reduced costs and increased efficiency
- ☑ The attraction and retention of good staff, who want to work for a business that provides quality goods and services
- ☑ Developing initiatives and changing the way a business operates, through implementing quality methods such as TQM, will help to lower inspection costs, as quality is the responsibility of everyone in the organisation and is embedded throughout the organisation

These points can each help support the marketing of a business. However, firms have to work hard to maintain and improve their reputation for quality, which can easily be damaged by a news story about a quality failure or negative word of mouth from a dissatisfied customer.

Drawbacks/costs to a business of providing poor quality

Poor quality will result in **additional costs** for a business:

- Lost customers – it is very difficult and expensive to attract new customers, if old customers are lost
- Legal action might be taken against the business, if its goods or services are not of the required standard
- Cost of reworking or remaking products that are faulty or not up to the required standard
- Costs of replacements or refunds

Maintaining quality

Whichever method of improving or maintaining quality a business chooses to adopt, it will have a cost. A business would have to balance these costs against the benefits, to ensure the quality method chosen is appropriate to the business needs. These include:

- Costs of inspection and checking for quality control
- Cost of training for implementing TQM; TQM involves a change of working practices in the organisation and therefore will require a significant investment in training for all staff; other methods of quality will require staff to be trained, to ensure that quality standards are consistently met by the business
- Cost of time for quality circle meetings and implementing initiatives that arise from such meetings
- Costs of maintaining quality, for example through arranging and conducting visits and inspections as the business grows. This is particularly important if franchising or outsourcing is used, as there is a different business involved in the production of goods and services, but the branding is that of the original business. Any problems in terms of quality, will reflect badly on the business, even though it may be at the fault of an outsourcing partner or the franchisee

Customer service

Introduction

Customer service can be defined as the methods used by a business to look after its current and future customers. It is not just the responsibility of employees who deal directly with the public, as providing good customer service will involve the whole business. Good customer service leads to **customer satisfaction**. Satisfied customers are more loyal and profitable. Dissatisfied customers take their money elsewhere and also possibly tell their friends about the poor service they have received.

It is worth remembering that it is far more expensive for a business to attract new customers than it is to keep its existing customers. Before we consider customer service in more detail we need to understand the selling process:

Selling process

This can be broken down into stages from attracting a customer's attention through to concluding the sale. Although this is normally seen as being operated by a salesperson, the same process also applies to telephone sales and e-sales where the "selling" is undertaken through a website. In order for the process to be successful there are certain key factors that must be addressed:

Knowledge – the salesperson must know about the product (or service) they are selling. If they do not then the customer will not have confidence in what they are buying, and if they make false statements then consumer protection law might apply.

Engagement – once a potential customer shows an interest in a product then the sales process must engage them in providing information about what it is they are interested in and showing them how its purchase will benefit them. This process might well start with establishing what exactly the customer is looking for, so options can be presented.

Speed and efficiency – consumers are busy people. They do not expect to wait too long to be engaged in a sales conversation (unless the product is in very high demand). In many cases there will be competitors, which could be easier or faster to purchase from. Amazon have set, as a priority, a high speed selling process.

Concluding the sale – there must be appropriate methods for agreeing on the sale. This might be signing a contract or clicking an online button linked to a credit card payment. In a shop, there may be different payment options that are acceptable – and some that are not. These must meet the business and customer requirements.

Post-sales service – a good sales process will follow up a purchase to see if everything is "OK" and determine how things could be improved. As well as the customer feeling their opinion is valued, it means the business can improve its selling process.

Response to customer feedback – having gathered feedback from customers then the business should learn from it and make changes if appropriate. However, changes may not be appropriate in some cases, as all customers would like their purchases to be cheaper! Nevertheless, changes could be made to the product and how it is promoted, as well as to the selling process.

Methods of good customer service

Customer service can now be applied to the selling process. The following are usually considered to be essential in achieving happy customers:

- ☑ **The product** or **service** must meet customer needs and wants i.e. it must be of the expected quality. It should also be reliable and safe. **Delivery** is increasingly important as more shopping takes place on line and facilities such as free delivery, choosing time slots and click and collect are all valued by customers.
- ☑ **Product information** is also important. The legal requirements must be met, for example in terms of product description in food and clothing. Customers expect goods and services to be accurately described. This is especially important for online sales. Product information can also include product reviews.
- ☑ **Sales and promotional activities** need to create a positive experience for the customer. The attitudes of employees who **engage with customers** should be positive and professional.
- ☑ **Pre and after-sales service** provided should be positive and appropriate, for example user training, helplines and servicing. Customers often need reassurance after they have bought something that they have made the right choice or they may need help in using a product properly. Employees will need to be well trained, not just in terms of product knowledge, but also how and when they communicate with customers. Follow up communication can also provide valuable market research information.

Benefits of good customer service

The potential benefits to the firm from providing a consistently high level of customer service include:

- ☑ **Increased sales** – satisfied customers are also more likely to try out other products/services produced or provided by the same business
- ☑ **Customer loyalty** –more likely to be a source of repeat business and to recommend the business to friends and family, creating **new customers**
- ☑ **Enhanced public image** – this helps build a brand and provides protection if there is a slip-up in customer service
- ☑ **More effective workforce** – satisfied customers help create a positive working environment. Employees who deliver good customer service receive their customers' appreciation, rather than complaints, and are further motivated to offer good customer service

- ☑ **Cheaper costs** – good customer service will reduce the number of complaints and refunds, which will save the business costs in providing expensive customer service departments

Dangers in providing poor customer service

Recent research has highlighted the dangers to a business of providing poor customer service i.e. the cost of customer dissatisfaction:

- ☒ **As satisfaction levels drop, loyalty drops faster:** there is a significant drop in loyalty between customers who say they are "very satisfied" and "somewhat satisfied" - sometimes as much as 50%. A dangerous policy in many organisations is to ignore this fact and to just try and improve their combined score, rather than trying to increase the number of "very satisfied" customers.
- ☒ **Problems drive customers away:** there is typically a 25% drop in loyalty amongst customers who experience a problem. In revenue terms, this can be the equivalent of losing some, or all, of the revenue from one in every four customers who have experienced a problem.
- ☒ **More customers have problems than you think:** research shows that as many as 50% of an organisation's customers may actually be experiencing problems at any one time. Only 5% of those experiencing a problem may complain to the firm's complaints or customer services department. As many as 95% of customers who experience a problem may say nothing to the business at all!
- ☒ **Unhappy customers spread the word:** research confirms that on average customers tell twice as many people about a bad experience than they do about a good one. This means, depending on the industry, between 5 and 10 people are told about a bad experience. Today, negative word-of-mouth happens much quicker and to a much greater scale, due to use of the internet and the power of social networks.
- ☒ Effective customer service and response pays: research also confirms the importance of effectively responding to customers when they do complain. Customers can be very demanding but, with an effective response, it is still possible to obtain a more loyal customer afterwards, than you had before they experienced the problem!

Use of ICT

Businesses need to **regularly monitor the quality of service** provided in order to assess and evaluate the degree to which they are meeting and, hopefully, exceeding the needs and expectations of their customers.

A common method is to look at **customer feedback**. It is important for businesses to obtain as much feedback as possible from customers. It is worth remembering that feedback can be **positive** as well as **negative,** and it is just as useful to know what the business is getting right as it is to know what it is doing wrong!

There are several ways that a business can encourage customers to provide feedback:

- Make it easy to complain, for example providing a free phone number, complaint forms
- Customer service feedback forms
- Train staff to listen carefully / look for problems
- Reward customer feedback with incentives, for example discounts, special offers, entry into prize draws

As mentioned previously, don't forget that customer feedback can be:

Positive	Negative
☑ Information from satisfied customers confirms that the business is doing something right / well which will increase staff motivation	☒ Information from unhappy customers is a vital indicator about what may need to be done to gain and keep hold of customers ☒ Often obtained from customer complaints ☒ It is often said that the worst customer is an unhappy customer who doesn't tell you about it!

ICT provides a very cost-effective and quick way of obtaining and communicating customer feedback. Small businesses are just as able to use ICT in these ways as any large business:

- Online feedback forms
- Online customer service questionnaires
- Comment and rating systems on e-commerce sites, including customer testimonials
- After-sales service provided using email
- Providing frequently-asked-questions (FAQs) on the business website

Section 4 Human resources

Topic overview

Students need know what the role of human resources is within a business and how this relates to the other functional areas of business operations, marketing and finance. There should also be consideration of how human resources will relate to the business and its objectives.

Section	Key things to learn
Organisational structures	Different organisational structures and their appropriateness Roles and responsibilities within an organisation Relevance and use of spans of control, chains of command, delayering and delegation Relationships between organisational structures and effective management and communication including centralisation and decentralisation
Recruitment and selection of employees	Methods of recruitment, internal versus external The stages of the recruitment process The benefits of effective recruitment Job contracts including part time, full time, job share and zero hours
Motivating employees	Benefits of motivation Financial and non-financial methods of motivation
Training	Benefits of training Methods of training including induction, on the job and off the job training

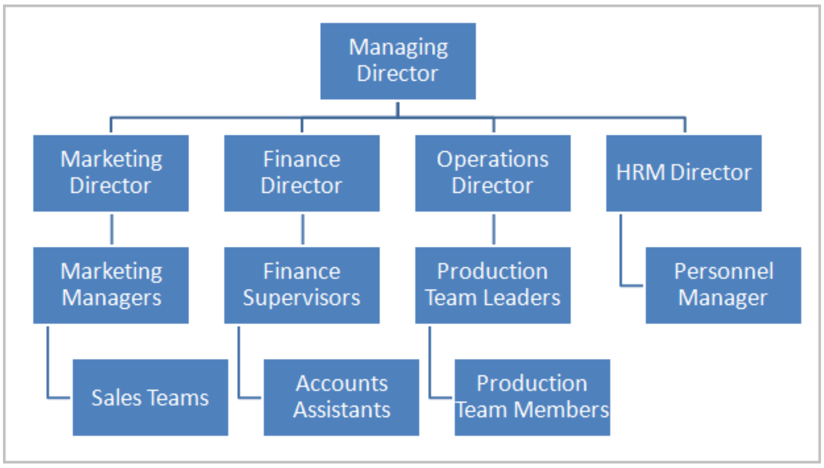
Organisational Structures

Introduction

As businesses grow in size and number of employees, they will need an internal structure to show the relationship between employees, managers, departments and locations. The chosen structure will depend on the type of business and its characteristics. Factors such as cost, control and communication will all influence the most suitable organisational structure for a particular business.

Organisation charts

The simplest way to show how a business is organised is to look at an **organisation chart**. This shows the management **hierarchy** in a business and works from top to bottom. Here is an example of an organisational chart:



As can be seen, the business is arranged into different levels i.e. a hierarchy. Roles are identified and lines of management and responsibility are clearly shown. The Managing Director is at the top of the organisational structure and he/she has four people reporting directly to him i.e. the different directors. The Marketing Director has the different marketing managers reporting into him/her and the sales teams will then report into the marketing managers.

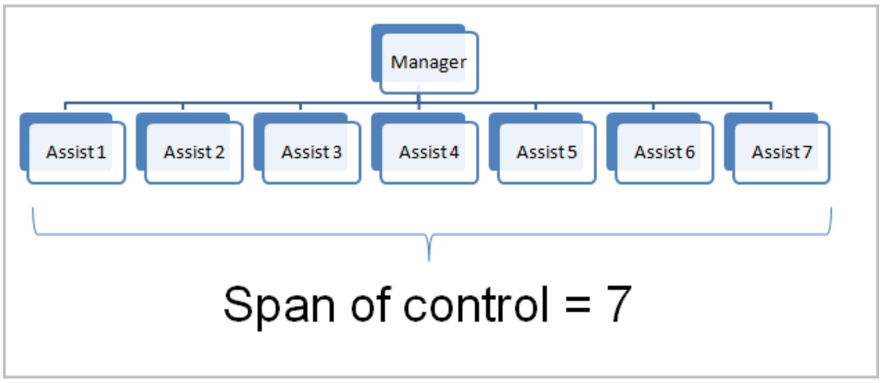
There are many different roles that can be found in a business. The key roles are summarised here:

- Directors – in a large company, a director will be in charge of a department of functional area, for example the Finance Director. They will be part of the Board of Directors who manage the company. The most senior director will be the Managing Director.

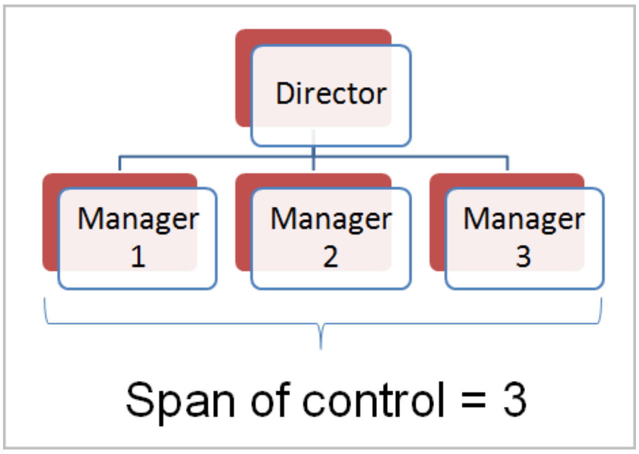
- Managers or senior managers – managers will be responsible for a significant part of the business operation and will be in charge of the performance of a number of employees.
- Team leaders or supervisors – in a large business teams of workers will often have one person who is more senior. As well as working as part of the team, they will have some responsibilities in making sure that the team operates effectively.
- Operational staff –these are the employees who help keep the business running smoothly, working with managers and other personnel to complete tasks as required.
- Support staff – alongside the operational hierarchy of the business, there be some employees who are called onto assist in any area of the organisation. They generally have specialist knowledge or skills. IT support staff are a good example, but this may include less specialist roles, such as cleaning, catering and caretaking staff.

Span of control

One of the features of an organisation chart is it shows the **span of control.** Span of control is the number of employees for whom a manager is directly responsible. The two diagrams below illustrate two different spans of control:



A span of control of 7 would be considered to be quite wide. Contrast this with a span of 3 below, which would be considered narrow.



There is no ideal span of control as it will depend upon a number of factors such as:

- The experience and personality of the manager

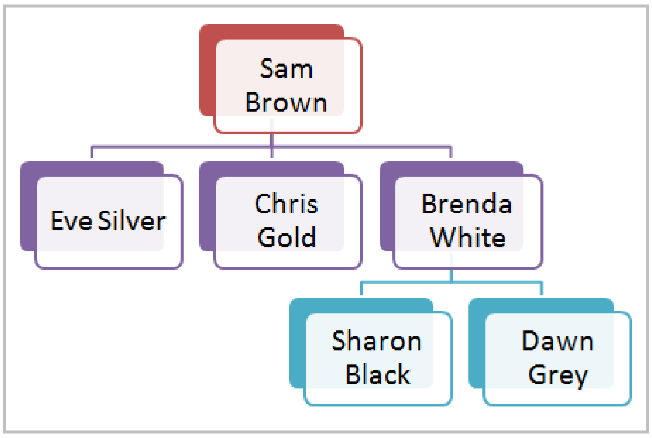
- The type of business - if being a line manager requires a great deal of close supervising, then a narrow span might be appropriate
- The skills and attitudes of the employees – if employees are highly motivated, highly skilled and highly qualified, then adopting wide spans of control could be more suitable

The following table is a summary of the relative advantages and disadvantages of each type of span of control:

Narrow	Wide
☑ Allows for closer supervision of employees, therefore there is less mistakes and the business is more efficient	☑ Gives subordinates the chance for more independence and the opportunity to make their own decisions
☒ Workers lower down the hierarchy may feel demotivated, as responsibility and decision making is kept with senior managers	☑ The number of managers can be reduced, which can lower labour costs for the business ☒ Less managers may demotivate staff, as there is less chance for promotion and potentially an increased workload for no more pay!
☑ More promotion opportunities, which can motivate staff	☑ Helps communication to be more effective within the whole organisation and decision-making to be quicker
☒ Communication may be distorted and delayed, as messages have many layers to pass through	☑ Senior managers are less remote, which can motivate employees as they feel involved and valued

Chains of command

The **chain of command** in an organisation chart, shows the lines of authority within the business. In the example below, Sam is responsible for Eve, Chris and Brenda. Further down the chain, Brenda is responsible for Sharon and Dawn. This means that Sam would directly communicate with his three **subordinates**. Brenda would then pass on any relevant messages to her team, as she would be their **line manager**. Any issues that Sharon and Dawn may have should be directly communicated to Brenda, rather than these two members of staff communicating with Eve, Chris or even missing a layer and going directly to Sam. If Sharon or Dawn, had a particular concern regarding Brenda however, they could directly communicate with Sam, as he is ultimately in charge of everybody.

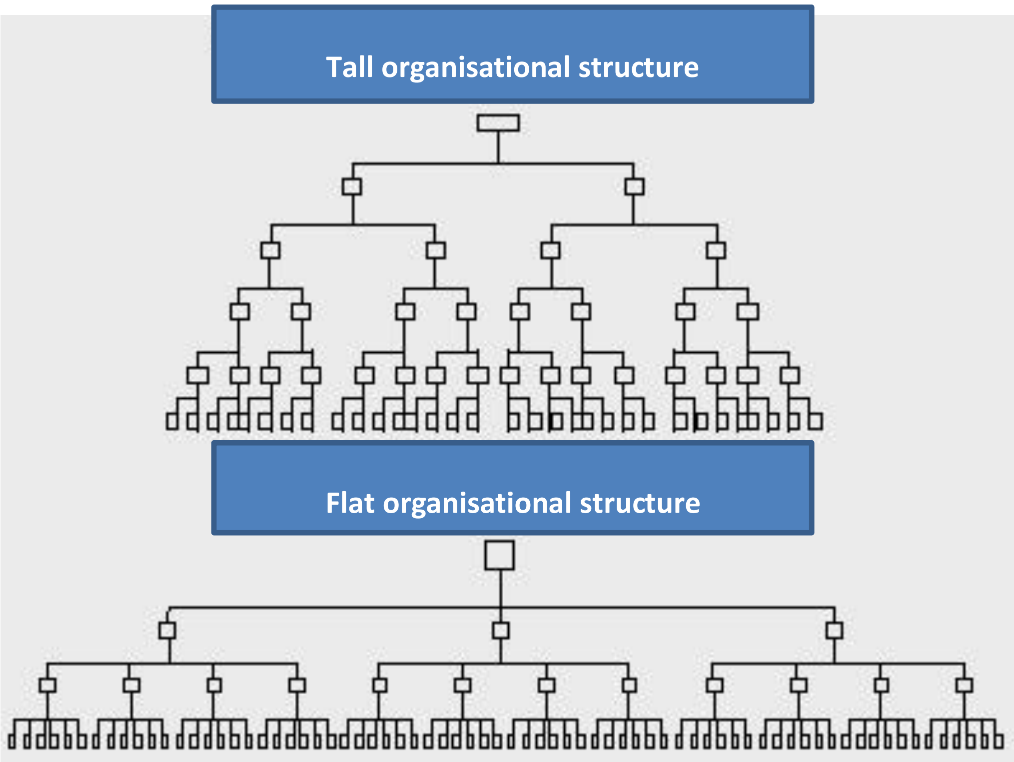


If a business has a wide span of control and very few layers in the hierarchy, there will be a short chain of command and with a narrow span of control there is a long chain of command. The advantages and disadvantages are therefore similar to those for spans of control, but are particularly related to management control and communication.

Choice of organisational structure

There are various ways of arranging the business organisational structure. These are often summarised as:

- **Flat**: the organisational structure has few layers, short chains of command and wide spans of control
- **Tall**: the organisational structure has many layers, long chains of command and narrow spans of control



In the diagram, the tall organisation has **six** layers and narrow spans of control. In contrast, the flat organisation has **four** layers and wider spans of control. The choice of which is most suitable will depend on the nature of the business and the situation in which it operates.

When a business grows, it becomes more difficult to control, coordinate and organise. Therefore in some cases it might be necessary to add in additional managerial positions into the hierarchy, creating another layer in the organisation.

In reverse if a business is decreasing in size or aiming just to reduce costs, it may well decide to take out a layer of management. This process is known as **delayering**. Delayering may help to improve communication within the business, although it will also reduce promotion opportunities, as a layer of management has now been removed. This may impact on motivation levels, as well as the fact that staff will be expected to take on more responsibility, which may increase the costs of the business through increased levels of training.

Delegation

Sometimes a manager or senior employee might choose to give some of their workload to another less senior employee. This is known as **delegation** and normally takes place down the chain of command. The subordinate employee is given permission or **authority** to do the job that has been delegated, but does not take responsibility for the work. **Responsibility remains with the manager** who delegated the job.

There are both benefits and possible drawbacks of delegation and these are summarised in the table:

	Benefits	Drawbacks
For the manager	☑ Quality of work improves, less mistakes, as manager is now not overloaded with work ☑ Chance to prioritise ☑ Can manage other people, rather than just work themselves	☒ Work may not be as well done and time will have to be spent explaining and supporting staff to complete the work ☒ Manager may feel threatened if subordinates work is better
For the subordinate	☑ Work is more interesting and challenging ☑ Motivation increases ☑ Acts as training and possible step to promotion	☒ Can be very stressful ☒ Employees may feel that they do not have the skills or experience to complete the work to a suitable level ☒ May only be given low level work ☒ Staff may feel demotivated, as there may not be an increase in pay to reflect the increase in workload

Centralisation and decentralisation

One of the issues that a business needs to address is where decision-making power is in the organisational structure. The key question is whether it is kept with senior management at the headquarters or the top of the organisation (**centralised**) or whether it is delegated further down the hierarchy, away from the centre and possibly in different locations (**decentralised**).

Most large businesses do use some decentralisation, especially if they operate from several locations or have added new products or markets. The issue is really how much independence business units or groups within a business should have when it comes to key decisions, especially those that might affect the business as a whole.

Centralised structures

Businesses that have a centralised structure keep decision-making firmly at the top of the hierarchy, amongst the most senior management.

Fast-food businesses use a predominantly centralised structure to ensure that control is maintained over their many thousands of outlets. The need to ensure consistency of customer experience and quality at every location are the main reasons why centralisation is chosen.

Advantages and disadvantages of **centralisation** are:

Advantages	Disadvantages
☑ Easier to implement common policies and practices for the business as a whole	☒ There are often more layers in the organisation, which will increase costs
☑ Prevents other parts of the business from becoming too independent	☒ Local or junior managers are likely to be much closer to customer needs, therefore the best decisions for the local area may not be taken by the business
☑ Easier to co-ordinate and control from the centre, for example with **budgets,** which prevents overspending	☒ Lack of authority down the hierarchy may reduce manager motivation
☑ Economies of scale and other savings are easier to achieve; for example, all purchasing may be done centrally, which will mean cheaper unit costs due to bulk purchasing	☒ Customer service does not benefit from flexibility and speed in local decision-making
☑ Greater use of specialist staff, for example in areas such as human resources, finance and marketing	

☑ Quicker decision-making (usually) and easier to show strong leadership	

Decentralised structures

In a decentralised structure, decision-making is spread out to include more junior managers in the hierarchy, as well as individual business units, such as specific stores, or trading locations.

Good examples of businesses which use a decentralised structure include the major supermarket chains. Each supermarket has a store manager who can make specific decisions about their particular store, such as staffing levels. However, bigger decisions regarding store layout are made by head office. In this instance, every store manager is responsible to a regional or area manager. Hotel chains are also particularly keen on using decentralised structures, so that local hotel managers are empowered to make on-the-spot decisions to handle customer problems or complaints.

The main advantages and disadvantages of using **decentralisation** are:

Advantages	**Disadvantages**
☑ Decisions are made closer to the customer and therefore are more likely to reflect their specific needs	☒ Decision-making is not necessarily looking to the long term future direction of the business
☑ Better able to respond to local circumstances	☒ More difficult to ensure consistent practices and policies, customers might prefer consistency from location to location
☑ Improved level of customer service	☒ May be some diseconomies of scale and inefficiencies across the business, for example staff may duplicate roles across different sites
☑ Consistent with aiming for a flatter hierarchy	☒ Nobody to provide quick and strong leadership when needed, for example in a crisis situation
☑ Good way of training and developing junior management	☒ Harder to control costs, which means the business may end up over-spending
☑ Should improve staff motivation	

Organisation and communication

There is a strong link between the organisational structure and the effectiveness of the methods used for internal communication within a business. These can be compared between flat and tall organisational structures, as well as centralised and decentralised structures. Consideration should be given as to how communication works up and down the organisation:

Written communication: letters, memos, emails, reports. These are likely to increase in quantity, as the size of the organisation increases. In a tall structure, written communication from top to bottom of a chain of command is likely to be slow. It is also likely to be used greatly. Even email can produce a large quantity of communication in order to keep layers of the organisation informed. Communication up the organisation is very difficult. The layers act as a "filter" preventing messages getting to the higher levels. In a flat structure, communication is quicker and easier. Mass communication techniques can also be effective, for example a letter sent from the managing director can be sent to all staff to ensure the message is consistent.

Oral (verbal) communication: face to face, telephone. With tall organisations verbal messages can get distorted or lost. Communication may be slow, as there is no one to receive a message. This means that messages have to be left and may not be received. With flat organisations the personal contact can be motivating for subordinates and informing for managers. Upwards communication is much easier in a flat organisation, due to there being less layers in the hierarchy.

Centralised structures: these allow for easy communication, particularly from the top of the hierarchy downwards. If there is tall structure with many layers, it is harder for employees to communicate upwards than it is for managers to communicate downwards.

Decentralised organisations: these type of organisations find that communication is more difficult, particularly if they operate from different sites. If the locations are in different countries, then oral communication can be particularly hard to achieve if they are not in the same time zones. Electronic communication, such as emails, is often most effective here.

In large multi-location businesses, there may even be a communication department which has the responsibility to make sure that communication methods used by the business are appropriate and effective.

Recruitment and selection of employees

The recruitment process

Recruitment and selection is a process that involves:

- Identifying the need for a job
- Defining the requirements of the position and the job holder
- Advertising the position
- Choosing the most appropriate person for the job

Recruitment is a vitally important activity for a business of any size. Indeed, the success of any business depends to a large extent on the quality of its staff. Recruiting employees with the correct skills can **add value** to a business and recruiting workers at a wage or salary that the business can afford, will reduce costs. Employees should therefore be carefully selected, managed and retained, just like any other resource.

Job analysis

When a vacancy arises in an organisation, perhaps due to somebody leaving a position for a job in another firm, the organisation will need to decide whether the job is still really required, before starting the actual recruitment process itself. This stage is called the **job analysis.**

Many small businesses have only one worker and many large businesses do not replace workers if they leave. If the business decides that there is a vacant position, the next stage of the **job analysis** process is to decide what type of worker is needed. In order to help this process, a **job description** and a **person specification** will be produced. These are described as follows:

Job description

- A detailed explanation of the **roles and responsibilities** of the post advertised
- Most applicants will ask for this before applying for the job – they want to know what the job will involve! Making sure this is sufficiently detailed, will make the recruitment process much more efficient for the organisation, as it will help to prevent unsuitable candidates applying for vacant positions
- Refers to the post available, rather than the specific type of person the organisation is looking for

Person specification

- Sets out the kind of qualifications, skills, experience and personal attributes a successful candidate should possess
- A vital tool in comparing and assessing the suitability of job applicants
- Refers to the **person** rather than the post

Internal and external recruitment

When looking for people to fill a vacancy that has arisen, the business may already have employees in the organisation who would be suitable. This is known as **internal recruitment**. If there are no suitable internal candidates, then the business will need applicants from outside of the firm. This is known as **external recruitment**. Of course both internal and external recruitment can be used. This is often the case for senior management appointments.

The most popular ways of recruiting externally are:

- **Job centres** – Government agencies to help the unemployed find jobs or get training
- **Job advertisements** - the most common form of external recruitment. Where a business chooses to advertise will depend on the cost of advertising and the coverage needed i.e. how far away people will consider applying for the job
- **Recruitment agency** - provides employers with details of suitable candidates for a vacancy and can sometimes be referred to as “head-hunters”. They work for a fee

and often specialise in particular employment areas, for example nursing, financial services, teacher recruitment

- **Personal recommendation** - often referred to as "word of mouth" and can be a recommendation from a colleague at work. A full assessment of the candidate is still needed however, but potentially it saves on advertising costs
- **Websites –** these include general sites such as Fish4Jobs and MonsterJobs. Most agencies and major employers will also have their own websites with a specific link to current vacancies. In addition there will be vacancy websites related to particular professions. Examples include farming, nursing and teaching

Internal versus external recruitment

The benefits and drawbacks of internal and external recruitment include the following:

	Benefits	Drawbacks
Internal recruitment	☑ Cheaper and quicker to recruit and fill the vacancy	☒ Limits the number of potential applicants
	☑ People already familiar with the business and how it operates, therefore productivity increases quicker	☒ No new ideas can be introduced from outside
	☑ Provides opportunities for promotion within the business, which could lead to increased employee motivation levels and higher staff retention	☒ May cause resentment amongst candidates not appointed
	☑ Business already knows the strengths and weaknesses of the candidate, which results in less risk in the recruitment process	☒ Creates another vacancy which needs to be filled
External recruitment	☑ Outside people bring in new ideas	☒ Longer process
	☑ Larger pool of workers from which to find the best candidate	☒ More expensive process, due to advertising and interviews required
	☑ People have a wider range of experience	☒ Selection process may not be effective enough to reveal the best candidate

Application process

The most suitable methods of selecting new employees will very much depend on the type of job and the sort of person that is required. Using the wrong method might mean recruiting an unsuitable worker or missing the best candidate for the position. The business must also take into account the legal restrictions on recruitment, such as laws banning most types of **discrimination**.

When recruiting externally, the business will almost certainly have to produce a job advertisement. The objectives of the advertisement are to:

- Inform the audience of potential candidates about the vacancy
- Provide enough information to both inform and interest possible applicants
- Help filter out unsuitable applicants
- Obtain the most number of suitably qualified applicants for the post advertised

The advertisement must not discriminate and should provide details of how to apply for the vacancy.

For many jobs, a business will ask applicants to provide a **curriculum vitae (CV)**. This is a document that the applicant designs providing details such as:

Personal details	Name, address, date of birth, nationality
Educational history	Including examination results, schools/universities attended, professional qualifications
Previous employment history	Names of employers, position held, main achievements, remuneration package, reasons for leaving
Suitability and reasons for applying for the job	A chance for applicants to "sell themselves"
Names of referees	Often recent employer or people who know applicant well and are ideally independent

Sometimes job applicants are asked to fill in a firm's own **application form**. This is different from a CV in that the employer designs it and sends it to applicants, but it will still ask for much of the same information. It has the benefit over a CV in that a business is able to design the form to its exact needs and ask specific questions that it feels are important to help it select the best candidate for the vacant position. Increasingly application forms are completed online.

Once a business has received all the applications, they need to be analysed and the most appropriate candidates identified. This process is known as short listing. The short listed applicants will then normally be invited to the business for further selection tests or interviews.

Selecting the best candidate

An interview is the most common form of selection and it serves a very useful purpose for both the employer and the job candidate. The main benefits of an interview include:

For the employer:

- ☑ Information that cannot be obtained on paper from a CV or application form can be discussed
- ☑ Conversational ability - often known as people skills
- ☑ Natural enthusiasm or manner of applicant
- ☑ See how the applicant reacts under pressure
- ☑ Queries or extra details missing from the CV or application form

For the candidate:

- ☑ Whether the job or business is right for them
- ☑ What the culture of the organisation is like i.e. do they feel as if they would fit into the organisation?
- ☑ Exact details of the job

There are other forms of **selection tests** that can be used, in addition to an interview, to help select the best applicant. These are often put in place as the basic interview can be unreliable and misleading, as applicants can perform well at interview, but not have the qualities, skills or experience needed for the job. This is also the case as a business may miss out on an excellent candidate who is let down at interview by nerves and a poor interview technique.

Other selection tests can be used to increase the chances of choosing the best applicant and so minimise the high costs of recruiting the wrong people. Examples of these tests are **practical exercises**, **roles plays** and various types of **personality tests**. Practical exercises and role plays can be designed to imitate the type of work that applicants would be expected to do in the job applied for.

Recruiting the best staff is one of the most important decisions that businesses make. They produce many benefits for the business as well as providing value for money. Some of the benefits to the business are:

- ☑ **Increase in output and productivity** which makes a business more efficient, leading to lower average unit costs and potentially higher profits. The new member of staff will enjoy his/her new position and be motivated to work hard!
- ☑ **Different ideas** that increase the success in terms of new products or services or just new ways of doing things
- ☑ **Improvements in quality and customer service** that means the business gains new customers or repeat business from existing customers
- ☑ **Increase in staff retention** as the right person is appointed for the position in the first place. Therefore they are unlikely to leave because they have taken on the “wrong” job and therefore do not like either the job itself, the business or both!

Contracts of employment

Once the best candidate has been selected, references have been checked, to confirm the candidate's suitability for the job with another source such as past employers, and an offer letter has been sent to the candidate who has then agreed to take up the post, the new employee must be given an **employment contract**. This is an important legal document that describes the obligations of the employee and employer to each other (terms and conditions), as well as the initial remuneration package and a number of other important details.

There are several types of contract including full time, part time and zero hours:

Full time contracts	Workers will generally have to work 5 days a week and no more than 48 hours (although many will work far less). Having full-time workers will give consistency in the workplace, for example relationships with customers, and will provide the employees with a significant wage that they should be able to live on.
Part time contracts	Part time workers have the same rights as full time workers, although entitlements such as holiday are reduced in line with the amount of part time worked. These provide less work for employees, which they may prefer, and gives the business some flexibility to increase the part time hours if they are busy.
Job share	Where two (or more) employees divide up a full time job between them. This may have benefits to the workers, but can reduce continuity for the business and make communication both within the business, and with customers, more difficult.
Zero hour contracts	This type of contract provides no guarantee of any hours. The worker may have to be available for work, but is not guaranteed any. This gives employers maximum flexibility and is much used in catering, farming and the health service. Some employees like the flexibility, for example students and mothers with young children, but for others it makes planning family income very difficult.

Motivating employees

Introduction

Having recruited the right workforce, a business needs to make sure they continue to work at the highest possible standards for as long as possible. There are many ways of motivating a workforce so that this happens. The success of the methods will depend on the type of the business and the circumstances in which it is operating.

What is motivation?

Motivation is essentially about the **commitment to doing something**. In the context of a business, motivation can be said to relate to:

"the will to work"

However, motivation is about more than simply **working hard** or **completing tasks**. Entrepreneurs and staff can find motivation from a variety of sources.

Motivation can come from the enjoyment of the work itself and/or from the desire to achieve certain goals, for example earn more money or achieve promotion. It can also come from the sense of satisfaction gained from completing a specific problem or achieving a successful outcome after a difficult project.

Motivation is important as people's behaviour is determined by what motivates them. The performance of employees is a product of both their abilities, for example their skills and experience, and their motivation levels. A talented employee who feels de-motivated is unlikely to perform well at work, but a motivated employee can often deliver far more than is expected from them!

Benefits of a well-motivated workforce

A well-motivated workforce can provide several advantages to a business:

- ☑ **High productivity** (amount produced per employee). This can lead to lower average unit costs of production and enables a firm to sell its products at a lower price or benefit from receiving higher profit margins on each item sold
- ☑ **Low levels of absenteeism** as the employees are content with their working lives and will therefore motivate themselves to attend work, even if they feel "under the weather!"
- ☑ **High levels of staff retention** and **low levels of staff turnover** (the number of employees leaving the business). This can lead to lower training and recruitment costs
- ☑ **Improved industrial relations** with trade unions. The relationship between staff and management is strong

- ☑ Contented workers give the firm a **good reputation** as an employer, therefore making it easier to recruit the best workers in the future
- ☑ Motivated employees are likely to **improve product quality** or the customer service associated with a product, as they want to do the best job that they can, as they really care about the quality of their work

Financial methods of motivation

Though there are many reasons why people work for a living, money, or other **financial rewards**, play a key role in motivating people in the workplace.

There are a wide variety of ways in which a business can offer **money,** or financial rewards, as part of the pay package. In many cases an employee may benefit from a mixture of these financial rewards which can include:

- **Salaries**: fixed amounts paid each month for performing a role; these are common for most managerial positions, for example an accountant, teacher
- **Wage**: pay based on time worked; very common in small businesses or in retail stores where employees are paid by the hour
- **Piece-rate pay:** pay per item produced, for example used in fruit picking
- **Commission**: payment based on the value of sales achieved
- **Profit share**: staff payments are linked to the performance of the firm
- **Shares and options**: less common in small businesses, but popular in businesses whose shares are traded on stock markets
- **Pensions:** a payment that is received to employees when they reach retirement age. These are becoming less generous, but all businesses now have to offer pension benefits to their employees
- **Fringe benefits** are **benefits in kind** that are not paid out directly in cash (or cash equivalents such as shares). Examples of these include: company cars, travel and housing subsidies, holidays, childcare provision, staff uniforms and staff discounts. The type of fringe benefits that are given to employees would be appropriate to the size, nature and finances available within the firm.

The main methods of payment are now explored in more detail:

Salaries and wages:

A **salary** is a set, fixed amount for the year, which is based on a certain amount of hours per week that must be worked. This is normally paid monthly.

A **wage** is normally an hourly amount that is paid weekly or monthly, based on the number of hours worked. The number of hours worked may be fixed and will be stated in the contract of employment.

Time worked over this standard is known as **overtime.** Overtime is often paid at a higher rate than the standard wage rate to encourage the worker to give up their leisure time. However, many employees who are paid a monthly salary do not get paid overtime. This is usually the case for managerial positions, where it is generally accepted that the hours worked need to be sufficient to fulfil the role required.

The main **advantages of payment by salary or wages** are:

- ☑ they are simple for a business to calculate and administer
- ☑ they are suitable for businesses that wish to employ staff to provide general roles, for example financial management, administration, maintenance, where employee productivity is not easy to measure
- ☑ they are easy to understand from an employee's point of view
- ☑ the employee can budget personal finance with some certainty
- ☑ it is easier for the employer to plan and budget for employee costs

The main **disadvantage of payment by salary or wages** is:

- ☒ does little to encourage greater productivity. There is no incentive to achieve greater output or efficiency

Commission

Commission is a payment made to employees **based on the value of sales achieved.** It can form all or, more often, part of a pay package. Commission is, therefore, a form of **"incentive pay"**. Commission, like piece-rate, is a reward for value of work achieved. In most cases, the employee is paid a **percentage** of the value of the goods or services that are sold.

The rate of commission depends on the selling price and the amount of effort required in making the sale. For example, commission rates could range from 5% where the product sells easily, for example household goods sold door-to-door, to 30% where the effort is substantial.

- ☑ The main **advantage of commission from an employee's point-of-view** is that it enables high performing sales people to earn huge amounts.
- ☑ The main **advantage to the employer** is that the payroll cost is related to the value of business achieved and how well the member of staff performs. This encourages staff to work hard to earn higher amounts, increasing the overall sales of the business.

However, there are several **drawbacks with using commission payments**:

- ☒ Sales people may cut corners to make sales, for example not explain the product or service in enough detail to potential customers resulting in customers being potentially misled and products being missold
- ☒ High commission earnings enjoyed by some of the sales team may be resented elsewhere in the business, particularly if the sales actually depend on a team effort
- ☒ It is difficult to change over-generous commission structures without upsetting and demoralising the sales team
- ☒ The amount of commission will reflect the price of the good, rather than the effort made to sell it
- ☒ Commission encourages competition between sales staff, which can lead to a negative culture inside the organisation

As a result of the above disadvantages, most businesses use commission as an incentive payment method offering a basic pay plus some commission. In this way, if sales and profits justify the change, the commission rate can always be increased slightly.

Profit sharing

Profit sharing refers to any system whereby employees receive a proportion of business profits. This might be in the form of a dividend, but can also include employee share distribution. This motivates employees to work for the good of the firm.

Profit sharing is generally accepted as having many advantages, providing that all employees are able to participate. Key advantages include:

- ☑ creates a direct link between pay and performance
- ☑ creates a sense of team spirit, as it helps to remove the "them and us" barrier between managers and workers, if all employees are involved in the sharing of profits
- ☑ may improve staff loyalty to the organisation
- ☑ employees are more likely to accept changes in working practices, if they can see that profits will increase overall as a result of these changes

Does money motivate employees?

There is no doubt that most people are motivated, at least in part, by the financial rewards they gain from their work. So, getting employee pay right, often referred to as the "**remuneration package**", is a crucial task for a business.

But, how important is money as a motivator? It is widely accepted that poor or low pay acts as a de-motivator. Someone who feels undervalued or under-paid may soon leave to find better-paid employment. However, it is less clear that paying people more, results in better motivation. For most people, motivation (the will to work) comes from "within". More money can help people feel better about their work, but it is unlikely to encourage them to work harder or to a higher standard.

Why is pay important?

- It is an important cost for a business. In some "labour-intensive" businesses, payroll costs or wage costs are over 50% of total costs
- People feel strongly about the amount of money that they earn
- Pay is the subject of important business legislation, for example the **national minimum wage**, the **national living wage** and equal opportunity laws
- It helps attract reliable employees with the skills the business needs for success
- Pay also helps **retain employees**, rather than them leave and perhaps join a competitor

Because pay is a complex issue, there are several ways in which businesses determine how much to pay their staff members:

- **Minimum wage / Living wage** – The business must pay at least the minimum wage or the national living wage for over 25s
- **Job evaluation / content** - this is usually the most important factor. What is involved in the job being paid? How does it compare with similar jobs?
- **Fairness** – pay needs to be perceived and be seen to match the level of work
- **Negotiated pay rates** – the rate of pay may have been determined elsewhere and the business needs to ensure that it complies with this level. A new supermarket opening is likely to pay its sales assistants the same as a nearby branch of the same supermarket
- **Market rates** – another important influence, particularly where there is a standard pattern of supply and demand in the relevant labour market. If a business tries to pay below the "market rate" then it will probably have difficulty in recruiting and retaining suitable staff
- **Individual performance** – increasingly businesses include an element of "performance-related" reward in their pay structures, which means staff are rewarded according to how well they perform their role within the organisation

Non-financial methods of motivation

An entrepreneur or small business owner is in a good position to be able to motivate his/her staff. The business owner is likely to know personally each member of staff and have a close understanding of their skills, abilities and attitude at work.

Larger businesses will use similar methods providing they know their employees and have an organisational structure that provides opportunities for non-financial motivation methods to take place.

Here are some non-financial ways in which businesses can attempt to keep staff motivated:

- **Job enlargement** – give staff a greater variety of tasks to perform (not necessarily more challenging) which should make the work more interesting. This often happens anyway in small businesses, where staff undertake a variety of tasks. This might take place through **job rotation,** which also means staff can undertake more than one job throughout the day.
- **Job enrichment** – this involves workers being given **greater responsibility** and a wider range of more complex and challenging tasks. This should give an increased sense of achievement to the employees.
- **Management style** will also effect motivation. If management are **autocratic** this means workers will have less freedom and be less motivated, although in some businesses employees may work harder if they are managed under this leadership style. **Democratic or "laissez faire"** management styles will give workers more freedom and more involvement in the decision-making process, which can be motivational.

- **Communication** - regular and truthful communication about what is going on in the business is a key part of keeping employees motivated.
- **Training** – training will motivate staff to do their existing job well, learning new techniques or being trained for future jobs, including promotions. Employees feel more loyal to the business as the business is taking an interest in its workers and therefore staff members feel more valued.

Training

Introduction

All businesses will need to train their staff. New staff will need to know how the business operates and how to do their job well, whereas existing staff will need to be trained in new processes or on new equipment. Some staff may require further training, so they can take on more advanced or difficult jobs in the future.

Training can be defined as:

The process of increasing the knowledge and skills of the workforce to enable them to perform their jobs effectively

Training costs can be significant in any business. Many employers are prepared to pay these costs because they expect their business to benefit from employees' development and progress.

Benefits of training

Effective training has the potential to provide a **range of benefits** for a business:

- ☑ **Higher quality** – workers know how to do the job and will make less mistakes
- ☑ Better levels of **customer service** are provided to customers – knowledge and skills of employees will be increased
- ☑ Increased **productivity** – employees will know the best way of doing their work, increasing their overall efficiency
- ☑ Improved **motivation** - workers feel valued, so will work better and harder
- ☑ Less **supervision** is required, as workers are more motivated and loyal to the business
- ☑ More **flexibility** through better and new skills, which also allows use of new **technology**
- ☑ Easier to recruit and employee **retention** will be higher – staff are happy and want to work for a business that cares
- ☑ Easier to implement **change** in the business

It should be noted that training also benefits the **employee.** In some cases this will be the same benefit as for the business, but not always. A well trained worker may be able to be promoted internally in a business to a higher position in the organisational structure or gain a better job at another business.

Disadvantages of training

Training is expensive, so many businesses do not invest enough time and money into it. Some firms do not invest any resources into training, apart from the training that legally needs to be provided, such as health and safety training. If costs need reducing it is often the first area targeted for cuts.

Some of the most common reasons for businesses not investing in training are:

- ☒ they fear **employees will be poached** by competitors and rivals will therefore benefit from the training and not them
- ☒ they need to **minimise short-term costs** and they cannot justify the expense
- ☒ training **takes time** to have the desired effect – management are impatient!
- ☒ sometimes the benefits of training are not obvious, for example happier workers, or are **longer term**, for example lower staff turnover, or are intangible so they are harder to measure

Methods of training

There are three main categories of training: induction, on the job and off the job. Each of these will be considered in turn.

Induction training

Induction training is training that is received by an employee when he/she first starts a new job.

The length of induction training will vary from job to job and will depend on the complexity of the job, the size of the business and the level or position of the job within the business. Induction training is also needed when employees have a new position within a business where they already work.

The following areas may be included in induction training:

- Learning about the duties of the job
- Meeting new colleagues
- Seeing the layout of the premises
- Learning the values and aims of the business
- Learning about the internal workings and policies of the business

Benefits of Induction training

- ☑ Induction training is important as it enables new employees to become productive as quickly as possible.

- ☑ It can avoid costly mistakes by employees not knowing the procedures or techniques of their new jobs.
- ☑ It also improves motivation and increases employee retention, as employees are more likely to leave if they do not have a good start to their new job.

On the job training

With on the job training, employees receive training whilst remaining in the workplace.

The main methods of on the job training include:

- **Demonstration / instruction** - showing the trainee how to do the job
- **Coaching** - a more intensive method of training that involves a close working relationship between an experienced employee and the trainee
- **Job rotation** - where the trainee is given several jobs in succession, to gain experience of a wide range of activities, for example a graduate management trainee might spend periods in several different departments
- **Projects** - employees join a project team, usually made up of people from different departments, which gives them exposure to other parts of the business and allows them to take part in new activities

The advantages and disadvantages of on the job training can be summarised as follows:

Advantages	**Disadvantages**
☑ Cost effective, as the staff member stays in the business to complete the training ☑ Employees are actually productive ☑ Opportunity to learn whilst doing ☑ Training alongside real colleagues, gaining first-hand experience	☒ Quality depends on ability of trainer and time available ☒ Bad habits might be passed on ☒ Learning environment may not be conducive to the best training ☒ Potential disruption to production and quality standards

Off the job training

This occurs when employees are **taken away from their place of work** to be trained.

Common methods of off the job training include:

- **Day release** - employees take time off work to attend a local college or training centre
- **Distance learning / evening classes**
- **Block release courses** - which may involve several weeks at a local college
- **Sandwich courses** - where the employee spends a longer period of time at college or university, for example six months, before returning to work
- **Sponsored courses** in higher education
- **Self-study**, **computer-based training, simulation**

The main advantages and disadvantages of off the job training can be summarised as follows:

Advantages	**Disadvantages**
☑ A wider range of skills or qualifications can be obtained ☑ Can learn from outside specialists or experts ☑ Employees can be more confident when starting job ☑ No interruptions will occur when training takes place	☒ External training costs can be expensive to attend and there may be additional costs incurred with travel and accommodation ☒ Lost working time and potential output from employee ☒ New employees may still need some induction training ☒ Employees now have new skills/qualifications and may leave for better jobs

Choice of training method

There are many factors that will affect the method or methods of training that a business will use. These include the type of job, for example, airline pilots would not start learning using on the job training, but would need significant off the job training before actually being allowed to fly a plane!

Other factors a business would need to consider in their choice of training would be the firm's budget and time available, whether the business has the capability of delivering its own training, for example trainers, rooms and equipment. Most importantly a firm would need to review carefully the needs of the workers who need to be trained and put in place the most appropriate training package that suits them!

Section 5 Marketing

Topic overview

Students need to what the role of marketing is within a business and how this relates to the other functional areas of human resources, business operations and finance. There should also be consideration of how marketing will relate to the business and its objectives.

Section	Key things to learn
Identifying and understanding customers	Satisfying customer needs
Segmentation	Benefits and methods of segmentation
Purpose and methods of market research	Reasons why market research is conducted Qualitative versus quantitative market research Methods and techniques Data interpretation and presentation Market size versus market share
Elements of the marketing mix: price, product, promotion and place (4Ps)	Pricing methods Factors affecting pricing decisions New product development Product design and product differentiation Product life cycle and extension strategies Product portfolio and the Boston Matrix Promotional methods Benefits and drawbacks of promotional methods Factors affecting promotional decisions Channels of distribution Appropriateness of different channels of distribution E-commerce and m-commerce Benefits and drawbacks of using e-commerce and m-commerce Choosing a marketing mix

Identifying and understanding customers

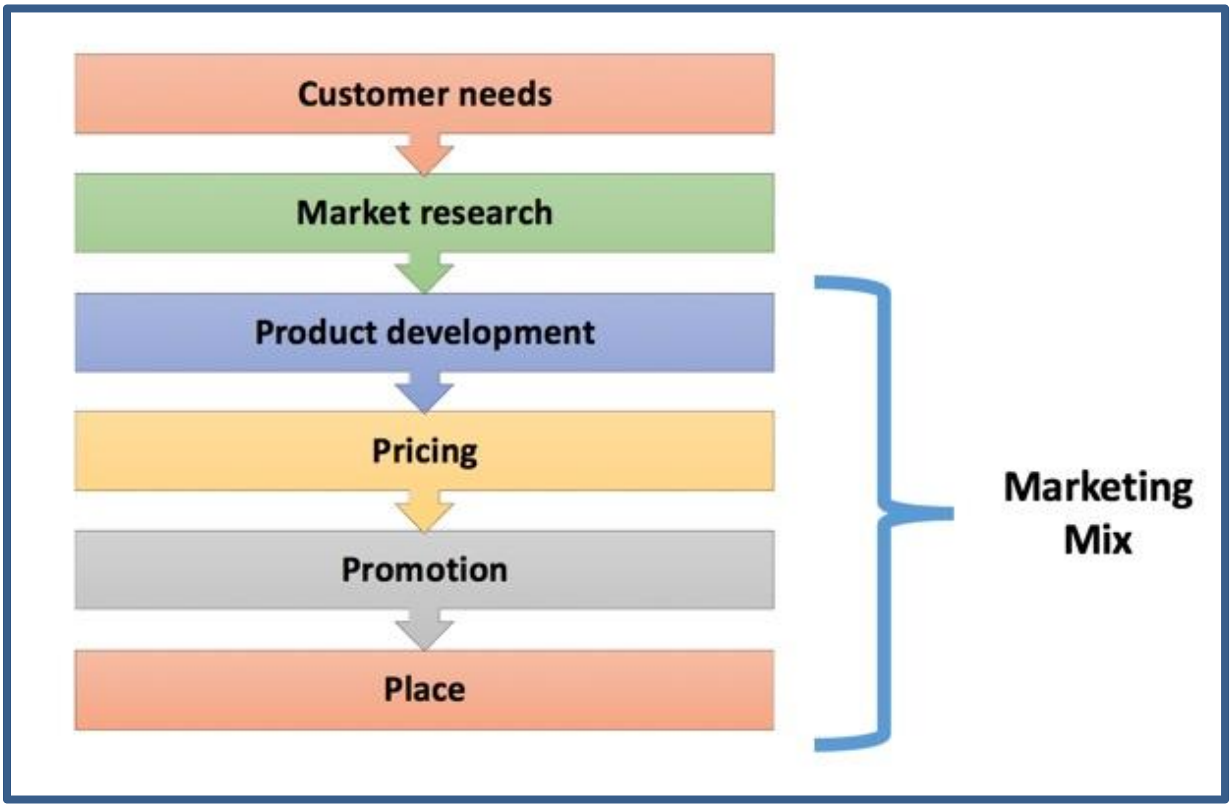
Introduction

Customers are arguably the most important stakeholder. Without customers there is no business. Successful marketing can be defined as:

"Identifying and fulfilling customer needs – at a profit"

Historically many businesses were more production focused. They produced what they were good at producing and customers purchased the goods because there was no choice. In the global economy that we now live in, this is not an option. There is too much competition and businesses spend large amounts of time and money being customer focused.

Marketing will start with finding out and identifying what a customer wants and needs through market research. It will then design a product or service that meets these needs and decide on a price to charge that customers are prepared to pay. It will then need to tell customers about the product and to make it available for them to purchase.



The advantage of being customer focussed is that the business will:

- ☑ be **competitive** – global trade and increased economic development means that producers must provide what the customers want, otherwise there will be a competitor who does
- ☑ **reduce costs** – if a business does not provide what the customers want, it will have unsold stock or unused facilities. This will cost money which the business might not be able to afford
- ☑ **brand loyalty** – if a business gets its product right, at the right quality and price then customers will come back and buy again or buy other products from the business
- ☑ choose the correct **marketing mix** that is in line with customer expectations and will enable **sales to be increased**

Segmentation

Introduction

In order to gain some advantage over competitors and to develop some expertise and reputation most businesses do not try and sell to the whole market population. They choose a smaller part or **segment** of the market to concentrate on. Having identified these potential customers they can be in a better position to meet their needs. The table summarises some of the benefits of segmenting the market:

☑ **Better matching of customer needs**	Customer needs differ; creating separate products for each segment provides customers with a better opportunity to buy products that meet their specific needs; this will increase sales
☑ **Better opportunities for growth**	Market segmentation can build sales, for example customers can be encouraged to "trade-up" after being introduced to a particular product with an introductory, lower-priced product
☑ **More effective promotion**	By segmenting markets the target customers can be reached more often and at lower cost, as there is less waste in the promotion used
☑ **Gain a higher share of the market**	Through careful segmentation and targeting, businesses can often become the market leader, even if the market is small

Ways to segment the market

There are many ways in which a market can be broken down into segments.

A very popular method of **"demographic"** segmentation looks at factors such as age, gender, and income. These are described briefly here, along with social class and geographical segmentation:

Gender	We all know that males and females demand different types of the same product; great examples include the clothing, hairdressing, magazine, toiletries and cosmetics markets
Age	Businesses often target certain age groups; good examples are toothpaste, look at the variety of toothpaste products that are available to buy that target children and adults, and toys, for example pre-school, age 5-9, age 10-12, teenagers and family!
Income	Many companies target rich consumers with luxury goods, for example Lexus, Bose. Other businesses focus on products that appeal directly to consumers on low incomes, for example Aldi and Lidl that are discount grocery stores and fast-fashion retailers such as TK Maxx and Primark
Location	Another approach is known as **geographic** segmentation, which will divide the market up by area. This could be as wide as a country or continent, for example the "European market", but for some small businesses it could just be the local town or village, which usually relates to small service businesses such as shops and cafes
Social class	Many businesses believe that a consumers "perceived" social class influences their preferences for cars, clothes, home furnishings, leisure activities and other products and services

Limitations of segmentation

Whilst it is possible for businesses to gain considerable benefits from segmenting the market there are however some disadvantages:

- ☒ **Lack of information and data:** some markets are poorly researched with little information about different customer needs and wants. Also the firm's own research may be inaccurate, insufficient or out of date.
- ☒ **Difficulty in measuring and predicting consumer behaviour:** humans don't all behave in the same way all of the time. The way that they behave also changes over time. A good example is the "grey generation" i.e. people aged over 50. The attitudes and lifestyles of the grey generation have changed dramatically in recent years. This can lead to missing potential customers through not targeting them appropriately with relevant products.
- ☒ **Customer segments can be hard to reach, once they have been identified:** it is one thing spotting a segment; it is another finding the right way to reach target

customers with the right kind of marketing message in that segment! They may be difficult to reach and inform about products or services.

- **All market** businesses: some large businesses do not want to target just one segment. They have ambitions on a global scale; examples in the drinks and fast-food industries give some idea of the ambition of some businesses. Tesco is another example of a business that attempts to target near enough everyone!

Market research

Introduction

In order to be successful, businesses must know their market. This applies before a firm launches its product, but it must equally continue to monitor the market whilst it is operating. This is because situations change, for example new competitors come along and enter the market, economies develop/change and the business may also decide to try something new or different. This means that the business will need to research its market, both current and potential, using a variety of techniques.

Purpose of market research

The aim of market research is to gather information. This will enable the business to be informed in its decisions and so reduce the risk of failure. Businesses will produce products and services that the customers want at a price they can afford. This will not just be based on guess work, but on accurate and up to date data.

The following list describes some of the areas that market research can be used for:

- **Customers/target market** – what type of person will buy my product or service, or are currently buying it? What price will they pay and what features do they expect?
- **Promotion** – how do my customers find out about products such as mine?
- **Competition** – which firms are my rivals? What prices do they charge and what are their products like?
- **Demand** – how will customer needs change in the future? Are incomes increasing? How will technology change what customers want and how they expect to buy it?

Limitations of market research

No market research will be completely accurate. If it is concerned with the current market, it will normally be based on data from a **sample** of the market. This may or may not be accurate. Costs will restrict the quantity and frequency of market research and researching future markets may not turn out as predicted. Rate of change in a market may make research of limited value. In the IT industry this has meant some businesses being more producer focussed in bringing out new models, rather than seeing what customers want first and then developing products to meet these specific needs.

Primary and secondary research data

An important distinction can be made between two broad kinds of market research data:

- **Primary data:** data collected first-hand for a specific purpose by the business
- **Secondary data**: research data that already exists and which has been collected for a different purpose

Primary research

Primary research can be designed to get exactly the data that a business needs. The problem with it, however, is that it is usually **time-consuming and expensive**. Getting a market research agency to do the primary research is one option often undertaken by big businesses, but the costs are high and the business must wait for the results. Often for new businesses, primary research is done by the entrepreneur, often informally through speaking to potential customers or completing basic surveys or questionnaires.

There are various methods of primary research:

Method	Benefits	Drawbacks
Observation, for example counting customers, watching what they buy and when; can also use video recordings or sales data from till readings for example	☑ Works well in retail markets, for example sit outside a shop and watch how many people walk by, look at the window displays, stock layout etc. ☑ Can see what consumers buy, rather than what they say they will buy!	☒ Expensive and time consuming, though large businesses will use data from tills which can provide detailed sales records.
Surveys and questionnaires Surveys are the process of getting market data, often using a questionnaire and analysing the results	☑ Questionnaires can be undertaken by post, by telephone, face to face or more commonly online. These can be given to existing and potential customers. ☑ They are relatively cheap and can produce good data, if the **sample size** is large enough. ☑ Data collected is usually quantitative and therefore easy to analyse.	☒ Questions need to be well designed, but reply rates are often very low, especially for telephone and postal methods. ☒ They can be expensive and time consuming for a large sample to be obtained, which represent the views of the general population.
Interviews These are often conducted face to face, but can also be conducted by phone	☑ This is a good way to get detailed insights from an individual. ☑ Answers can be checked and followed up. ☑ These are often used in combination with questionnaires.	☒ Interviews are costly in terms of time and may be unrepresentative, as only small numbers will be undertaken. ☒ Results can be influenced by the researcher asking leading questions.

Method	Benefits	Drawbacks
Focus groups Groups of actual or potential customers are brought together to discuss a product or market	☑ Focus groups are a good way of getting detailed information about customer tastes and preferences. ☑ They provide detailed information and opinions.	☒ These can be costly and time consuming to conduct and need careful management to keep individual opinions independent of others opinions. ☒ Only a small amount of data is collected, so may not reflect the viewpoints of others fully.

Secondary research

For new businesses, secondary research will be the main source of market research. This is because it costs less and is quicker and easier to obtain. Examples of secondary research, which can often be obtained free using the **internet** or by visiting local libraries, are:

Government information	Provide detailed insights on the economy and on many industry sectors. There is also **population data** published by the government based on the census.
Competitor websites	Valuable information on marketing activities of competitors including their products, prices and promotional activities and materials. This may include product ratings, which are often independent.
Trade associations, trade press and magazines	Most industries have an industry association - they are a good source of market analysis, which is particularly useful for new businesses which may have little or no experience of the market.
Newspapers (printed press)	Financial and economic information is provided on a daily basis. Newspapers provide local, national and international data which is up to date. They also provide case studies of other local businesses.
Market research reports	Organisations such as Mintel and Keynote produce a wide variety of expensive reports that analyse individual markets.

Benefits and drawbacks of secondary research

By its nature, secondary research will vary in terms of its usefulness. Some **drawbacks** are as follows:

- ☒ The research has been created for a different user and a different purpose, so may not be exactly what the business is looking for
- ☒ Data may be out-of-date, as it will have been completed in the past
- ☒ Information might be biased, because of its previous use or inaccuracy
- ☒ Data is generally available to everyone, so competitors will see the same information

However, secondary research has many **benefits** particularly to a new business:

- ☑ The information is readily available, particularly online, so research can be done quickly
- ☑ It is generally cheaper than primary research and in many cases it is free
- ☑ Good secondary research provides an excellent overview of a target market and can save time compared to primary research, particularly if the market is distant or spread over a wide area

Quantitative and qualitative market research

The distinction between primary and secondary research is really about the different **sources** of market information. A different way of thinking about market research is to consider two main **approaches** – qualitative and quantitative market research.

Qualitative research

Qualitative research is based on **opinions, attitudes, beliefs and intentions**. This kind of research deals with questions such as “why?”, “would?” or “how?”

Qualitative research aims to understand why customers behave in a certain way or how they may respond to a new product. Given that these opinions are often obtained from small numbers of people, the findings are not necessarily statistically valid and may be difficult to draw conclusions from. However, such data can highlight potential issues which can then be explored in quantitative research.

Focus groups and interviews are common methods used to collect qualitative data. This kind of data is often revealing and useful, but it is costly and time-consuming to collect, particularly for a start-up.

Quantitative research

This is research based on larger samples and therefore should be more reliable, but it can be time consuming to analyse and carry out. Quantitative research is concerned with data and addresses questions such as “how many?”, “how often”, “who?”, “when?” and “where?” Questionnaires, that contain closed questions, is the most common method to gain quantitative market research.

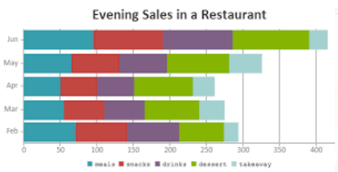
The results of quantitative research will generally be in numerical form, for example:

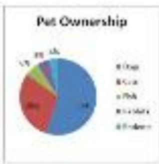
- 35% of customers rate the new product as "attractive"
- 70% of potential customers use the internet to buy their hotel accommodation in Dorset
- 3 out of 5 customers will buy a new food product after being offered a free in-store sample
- Average ratings of a product are 8.5 out of 10

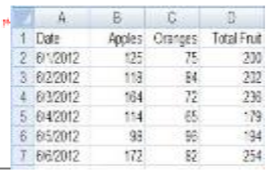
Data presentation and analysis

Once the business or possible business has gathered the data, it then needs to be presented in a way that is easy to understand for the key decision makers of the business. This will involve combining and presenting the data into a format that will enable easy analysis. Quantitative data is much easier to present compared to qualitative responses, which are often difficult to combine and summarise.

There are many examples of **data presentation** which allow market research results to be clearly seen. These include tally charts, bar charts, pie charts, line charts, pictograms and tables of data. In other cases, data can be combined in order to provide average scores to a particular question asked.





Use of computers has made presentation of data very easy and some programmes will allow data to be recorded, totalled and displayed. In some cases this can be done automatically direct from the questionnaire responses.

Market research will not however make decisions. This is the role of the managers. For example, they may choose not to go for the most popular product, because it does not fit in with their business objectives.

Data analysis can also be undertaken. This could mean separating out responses for different groups of people, for example male and female. This can also be displayed using data presentation techniques. For example, the average price people are willing to pay for a haircut may be £20, but the average for women is £30 and the average for men is £10. Therefore, a new hairdressing business would not want to charge £20 to everyone and would have a separate price list for men and women.

Market size and market share

Market size measures whether the overall market is increasing or decreasing. This can be measure by volume, for example the number or amount of sales, or it can also be measured by value. These are not always the same, for instance if the price of petrol goes up it is likely that the amount consumed will go down a little, but the total amount spent on petrol will go up because of the price increase.

One key business objective that many firms have is to increase **market share**. This measures the total sales of one business compared to the total sales in a particular market, expressed as a percentage.

Alongside this objective the market itself might be growing or declining, so it is possible to have higher sales and a lower market share if the market is growing faster than the sales of a business. Secondary research is generally available about the industry concerned, to enable a business to calculate this figure.

An example of sales of a business, Easy Store, compared to the total market is given in the table:

	2013	**2014**	**2015**	**2016**
Easy Store sales	£2m	£3m	£4m	£3.5m
Total market sales	£20m	£24m	£36m	£28m
Easy Store % market share	10%	12.5%	11.1%	12.5%

The data shows that:

- Market size has increased from 2013 to 2015. It then decreases between 2015 and 2016
- In 2014, Easy Store's sales and market share had increased compared to 2013
- In 2015, Easy Store's sales had again increased, but the market size had increased faster so its market share had decreased compared to the year before
- In 2016, Easy Store's sales decreased, but because the market size had decreased faster than Easy Store sales, its market share increased

Based on this information the business will consider what actions it should take. Often the market size is changing through factors outside of the business's control. Therefore a firm's market share percentage will better show how well the business is performing in relation to the external market conditions it faces. If the total market size is falling, a business might decide to cut costs to maintain profit levels. It also might change the nature of the products it sells or the price it charges for its products.

The marketing mix

Introduction

The marketing mix consists of four elements, otherwise known as the **"4Ps"**, which are price, product, promotion and place.

Marketing mix - price

There are many different pricing methods that businesses might choose to use. Which one it chooses will depend on various factors and can change as the market changes.

Cost-plus pricing

This involves setting a price by adding a **fixed amount or percentage to the cost** of making or buying the product.

Cost-plus pricing is widely used in retailing, where the retailer wants to know with some certainty what the gross profit margin of each sale will be. (Gross profit margin is discussed in the finance section).

- It is simple to work out and ensures that any products sold will have made a profit. If the mark-up percentage is applied consistently across product ranges, then the business can predict more reliably what their overall profit margin will be.
- ☒ The main disadvantages are that cost-plus pricing may lead to products that are priced un-competitively or alternatively are under-priced, as the customer may have been prepared to pay a higher price than the one charged.

How high should the mark-up percentage be? That largely depends on the normal competitive practice in a market and also whether the resulting price results in sales to customers. A simple example would be a birthday card that a shop buys for 60p each. The average mark-up for birthday cards is 100% so the business will sell the cards at 60p + 100% of 60p i.e. 60p + 60p = £1.20

New product pricing methods

If a business wishes to introduce a new product or introduce an existing product into a new market, there are two pricing methods that a business usually uses:

Penetration pricing

Penetration pricing involves **setting a relatively low initial entry price**, usually lower than the intended established price, to attract new customers. The strategy aims to encourage customers to switch to the new product because of the lower price. Once customers have tried the product they may become loyal to it and the price can be gradually increased.

Penetration pricing is often associated with an objective of increasing market share or sales volume.

- ☒ In the short term it is likely to result in lower profits than would be the case if prices were set higher.
- However, there are some significant benefits to long-term profitability of having higher sales and a higher market share, so the pricing strategy can often be justified.

Penetration pricing is often used to support the launch of a new product, and works best when a product enters a market with similar products, so a lower price than rival products is a competitive weapon. New series of collector's magazines are often launched at an introductory low price, to encourage people to buy the first edition and once this is bought, the business will hope the customer will continue to buy all future editions, when the price has increased.

Price skimming

Price skimming involves **setting a high price before other competitors come into the market**. This is often used for the launch of a new product which faces little or no competition, usually due to the product possessing some new, advanced technological features. Such products are often bought by customers who are prepared to pay a higher price to have the latest or best product in the market.

Good examples of price skimming include innovative electronic products, such as the latest smart phone or computer game.

- ☑ The advantage of this method is that the business gets high profits straight away, which can help to pay back its research and development costs. The product may get a reputation for quality, encouraging brand loyalty, and the profits made can be invested in the next new product. This has been the pricing strategy used by Apple, when it launches new products onto the market.
- There are some disadvantages with this approach. Price skimming cannot last for long, as competitors soon launch rival products which put pressure on the price. A firm may also slow down the growth in sales of the product, because it is expensive and no more customers can afford or are willing to pay.

Loss leaders

The use of loss leaders is really a method of sales promotion, rather than a pricing strategy. A loss leader is a product priced below cost-price in order to attract consumers into a shop or online store. The purpose of making a product a loss leader is to encourage customers to make further purchases of profitable goods whilst they are in the shop or are shopping. But does this strategy work?

- ☑ Pricing is a key competitive weapon and a very flexible part of the marketing mix. If a business undercuts its competitors on price, new customers may be attracted and existing customers may become more loyal. So, using a loss leader can help produce customer loyalty.

- One risk of using loss leaders is that customers may take the opportunity to “bulk-buy”. If the price discount is sufficiently large then it makes sense for customers to buy as much as they can, assuming the product is not perishable and they have room to store the product at their homes.

Using a loss leader is essentially a short-term pricing tactic. Customers will soon get used to the price, so it makes sense to regularly change the product used as the loss leader.

Competitive pricing

If there is strong competition in a market, customers are faced with a wide choice of who to buy from. They may buy from the cheapest provider or perhaps from the one which offers the best customer service. But customers will certainly be mindful of what is a reasonable or normal price in the market.

Most firms in a competitive market do not have sufficient power to be able to set prices above their competitors. They tend to **set a price in line with the prices charged by direct competitors**. In effect, such businesses are accepting the existing market price as determined by the forces of demand and supply.

- ☑ An advantage of using competitive pricing is that selling prices should be line with rivals, so prices should not be uncompetitive.
- The main problem is that the business needs some other way to attract customers. It may have to use non-price methods to compete, for example providing better quality, good customer service or better availability. It also often leads to special offers or **sales promotions**. The business will also need to research what its competitors are charging, which could increase costs and lower profits.

Factors that affect pricing decisions.

There are several factors a business needs to consider in setting the price:

- **Objectives** – what are the objectives of the firm? Is it for a “high price, high quality” business? Or a “low margin, high sales” strategy.
- **Competitors** – this is really important. Competitor strength influences whether a business can set prices independently or whether it simply has to follow the normal market price.
- **Costs** – a business cannot ignore the cost of production or buying a product when it comes to setting a selling price. In the long-term, a business will fail if it sells for less than cost or if its gross profit margin is too low to cover the fixed costs of the business.
- **Product life cycle** - pricing methods will change dependent on the stage the product is at in its product life cycle. For example, the price of a product in the decline stage of its **product life-cycle** will need to be lower than when it was first launched.
- **The state of the market for the product** – if there is a high demand for the product, but a shortage of supply, then the business can put prices up.

- **The state of the economy** – some products are more sensitive to changes in unemployment and workers' wages than others. Makers of luxury products will need to drop prices, especially when the economy is not doing well.
- **The bargaining power of customers in the target market** – who are the buyers of the product? Do they have any bargaining power over the price set? An individual consumer has little bargaining power over a supermarket, although they can take their custom elsewhere! However, a business customer that buys substantial quantities of a product from another business may be able to **negotiate** lower or special prices.
- **Legislation in the market** – some businesses operate in markets where prices are regulated by government legislation, for example the rail industry.

Price, demand and revenue

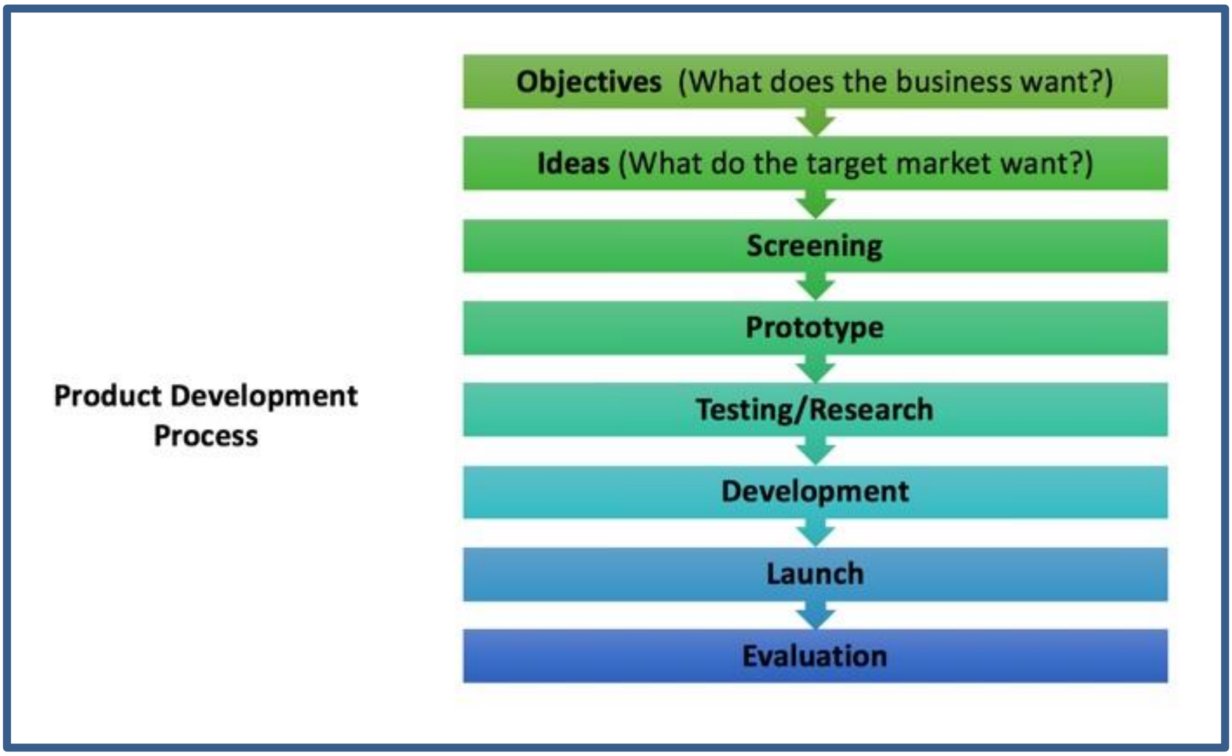
Changing the price of a good or service will take into account costs, what the customers can afford and the prices of competitors. If the business increases the price then it is likely to sell less, as demand from the customers will fall.

This does not mean however that the business will be worse off. If the decrease in demand is only small, as customers are loyal to the product or have no alternative, then revenue (price x quantity sold) will increase. The opposite would also apply if, for example, there are competitors with similar products sold at similar prices. In this situation, an increase in price could lead to a large decrease in demand and so revenue will fall.

The same factors will apply for price decreases, where a small decrease in price can lead to a large increase in demand, which will increase revenue, although it does not guarantee that the price will cover the costs, so profits might not increase!

Marketing mix - product

We live in a time of rapid technological development and constant change. Whilst some products may last for a long time, most do not. There is therefore a constant need to develop new products and services to meet the changing wants and needs of customers.



The above diagram shows one way of how a product can be developed over time. As the process is undertaken, the number of ideas decreases and the cost of the development increases.

- There are considerable **risks** in developing new products. Research and development costs will have to be met, even if the product is not launched or is unsuccessful. There is however risk in not developing new products, as rivals will produce new products and sales will decrease, as customers take their custom elsewhere.
- ☑ There are considerable possible **benefits** of developing new products. If the business is ahead of competitors it may be able to charge high prices. It also may be able to protect its idea through legal means such as patents. All of this can lead to high profits.

Market needs

In deciding what product to develop, a new or existing business may have many different starting points:

- gap in the market identified
- new invention or ideas
- existing product has declining sales
- new fashions and changed customer requirements

Businesses will decide whether they need or want to develop a new product, for example whether it **fits in with their objectives**. They also will have to decide whether they have the capacity, both in terms of money and the management expertise, to develop new products. The pharmaceutical industry gives a good example of where there are a large number of possible products which may or may not be profitable, but will have **high development costs**.

Businesses will also need to decide whether a product is in line with their **image**. A top quality car manufacturer might identify the demand for a budget version of its car, but how will this affect the image of its business, the price it charges and the profit it makes from its existing product range?

Product design features

In order to be successful a **well-designed** product must fulfil certain basic requirements, as well as creating an **image** in line with customer expectations. Some factors a business would need to consider are:

- Functional – does the product do what it is supposed to do?
- Reliable – will it keep doing what is supposed to do over and over again for as long as it is supposed to last?
- Aesthetic - does it appeal to the customer and the **image** they wish to have? Does it look good?
- Quality – does it meet the needs and expectations of customers?
- Economic – can it be efficient in terms of output produced compared to the cost of production? Is it easy to get components and materials, so the product can be produced time and time again?

Product differentiation

In a competitive market, firms will seek to make their product different from their rivals. This could be through different features or designs. If the product has something that no other product has, this is its **unique selling point** (USP). Having a USP will allow the business to charge a higher price and create customer loyalty. This in turn will enable the business to develop a **brand** for their product, where customers will return to the business for repeat purchases. They will also buy other products and services that are the same brand that they associate as being good.

Brand image

A brand can be defined as:

> "a name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers" (American Marketing Association)

If the brand is memorable, it will lead to an impression in the consumers mind of what it associates with that product. This can be positive or negative. Businesses will seek to reinforce this image through its marketing of the product, for example through advertising campaigns.

Successful brands will have products that are less sensitive to price changes. This means they can make more profit through charging a higher price without losing sales. Heinz baked beans and tomato sauce are a lot more expensive then rival or supermarket own brands.

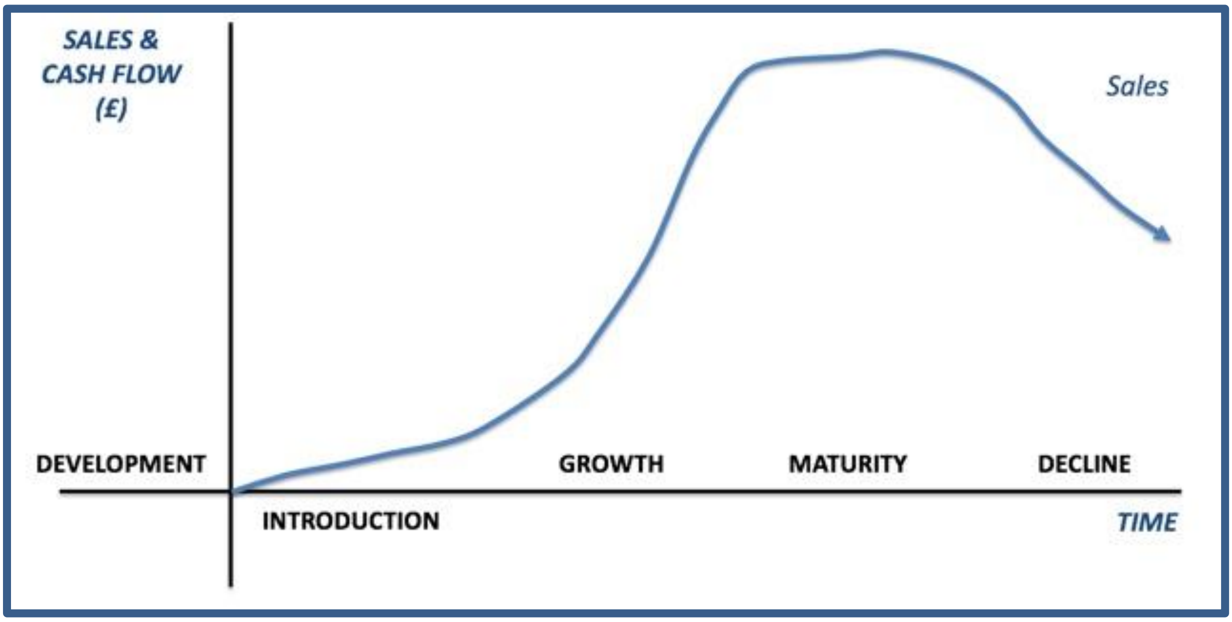
The product life cycle

The **product life cycle** is an important concept in marketing. It describes the stages a product goes through from when it was first thought of until it is finally removed from the market. Not all products reach this final stage. Some continue to grow and others rise and fall.

The main stages of the product life cycle are:

Research and development	Researching and developing the product
Introduction	Launching the product onto the market
Growth	When sales are increasing at their fastest rate
Maturity	Sales are near their highest, but the rate of growth is slowing down because new competitors are entering the market or the market has become saturated with different versions of essentially the same product
Decline	final stage of the cycle, when sales begin to fall and ultimately the product will be removed from the market

The product life cycle can be illustrated in a diagram, by looking at the sales during the time period of a particular product:



Extension strategies extend the life of the product before it goes into decline. Again businesses use marketing techniques to improve sales of an existing product. Examples of these techniques are:

- Advertising – try to gain a new audience or remind the current audience of the product
- Price reduction – makes the product more attractive to customers
- Adding value – add new features to the current product, for example video messaging on smart phones
- Explore new or different markets – for example try selling the product in other countries
- New packaging – brightening up old packaging or small changes, such as putting crisps in foil packets

However successful extension strategies might be, there will still come a time when the sales of a product will make it uneconomic for a business to continue to produce it. This could be because there is a replacement product or because the product is no longer wanted. Black and white TVs, videos, audio tapes and early versions of mobile phones will never gain any sales, however well they are advertised!

Product portfolio - the Boston Matrix

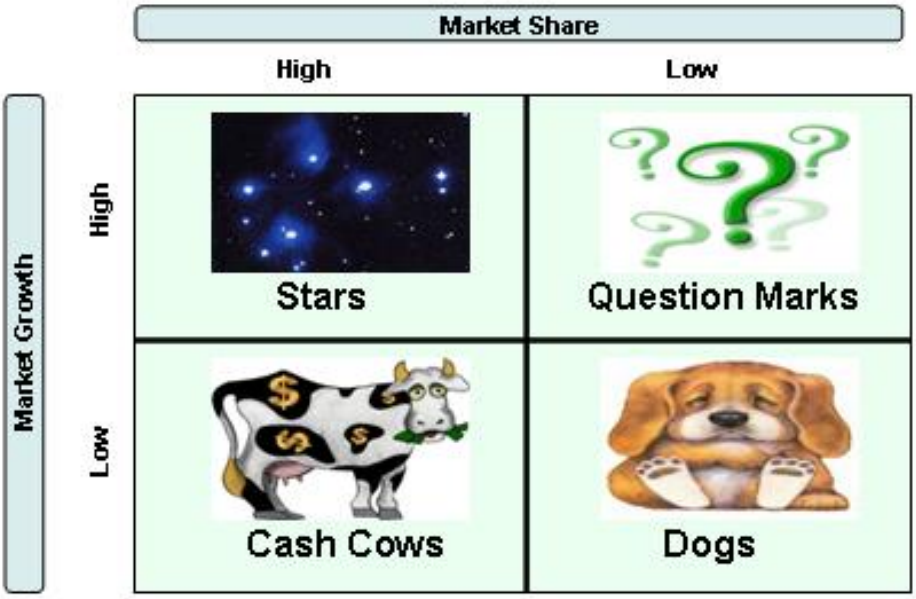
A business with a range of products has a **portfolio** of products. However, owning a product portfolio often poses a problem for a business. It must decide how to best use the money to support the different products in its portfolio, for example on product development or promotion. It must decide which products to prioritise and focus on.

A portfolio of products can be analysed using the **Boston Group Consulting Matrix**. This categorises the products into one of four different areas, based on:

- Market share – does the product being sold have a low or high market share?
- Market growth – are the numbers of potential customers in the market growing or not?

How does the Boston Matrix work?

The four categories of the Boston Matrix can be described as follows:



- **"Stars"** are high growth products competing in markets where they are strong compared with the competition. Often "stars" need heavy investment to sustain growth. Eventually growth will slow and, assuming they keep their market share, "stars" will become "cash cows"
- **"Cash cows**" are low-growth products, with a high market share. These are mature, successful products with relatively little need for investment. They need to be managed for continued profit, so that they continue to generate the strong cash flows that the business needs for its "stars".
- **"Question marks"** or **"problem children"** are products with low market share operating in high growth markets. This suggests that they have potential, but may need substantial investment to grow market share at the expense of larger competitors. Management have to think hard about "question marks" in terms of

which ones they should they invest in and which ones should they allow to fail or shrink.

- Unsurprisingly, the term **“dogs”** refers to products that have a low market share in unattractive, low-growth markets. “Dogs” may generate enough cash to break-even, but they are rarely, if ever, worth investing in. “Dogs” are usually sold or removed from the market.

Ideally a business would prefer products in all categories, apart from “dogs,” to give it a balanced portfolio of products.

Marketing mix – promotion

The main aim of promotion is to ensure that customers are **aware** of the existence and positioning of products. Promotion is also used to **persuade** customers that the product is better than competing products and to remind customers about why they may want to buy it.

Promotional activities can therefore have a variety of aims:

- To **inform** current and potential customers about existing and new products
- To **explain** the potential benefits of using the product
- To **persuade** customers to buy the product
- To **compete** with other businesses and show why a product is different or better than the competitions
- To increase **growth** through more sales to existing customers or selling in new markets
- To present, change or improve an **image** of a business and to develop and sustain a brand
- To **remind** customers about a product and reassure them that they have made the right choice

Methods of promotion

It is a common mistake to believe that promotion is all about advertising. It isn't! There are a variety of approaches that a business can take to get their message across to customers, although advertising is certainly an important one.

It is important to understand that a business will use more than one method of promotion. The variety of promotional methods used is referred to as the **promotional mix.** Three of the most important types of promotion are advertising, public relations/sponsorship and sales promotion. In recent years social media has also become widely used and is very important in promoting a product or service.

Advertising

Advertising is any method of promotion that is **paid for.** Advertising presents or promotes the product to the target audience through different communication **media** such as TV, radio, cinema, billboards/posters, online and newspapers or magazines.

The problem with advertising is that consumers are bombarded with advertising messages every day. How can a business get their message across effectively? And how can a business measure the effectiveness of an advertising campaign? It is often said that businesses waste half their advertising spend – the problem is that they don't know which half!

When deciding which type of advertising to use a business needs to consider factors like:

- **Reach of the media** – national or local; number of potential customers it could reach; how long before the message is seen

- **Nature of the product** – the choice of media needs to reflect the image of the product; a recruitment advert would be placed in a trade magazine or newspaper, but a lipstick advertisement would be shown on television or in women's magazines
- **Position in product life cycle** – the launch stage will need different advertising from products undergoing extension strategies
- **Cost of advert and size of advertising budget** – for example, local newspaper advertising is cheaper than radio, which in turn is cheaper than television. But the business will also want to consider cost per head if aiming to reach a larger audience
- **Online or offline** – there has been substantial growth in businesses that advertise online, as they swap some, or sometimes all, of their advertising budgets to reach internet users

Advertising can also be split into two main types:

- **Persuasive advertising -** this tries to entice the customer to buy the product by informing them of the product benefit
- **Informative advertising -** this gives the customer information. Mostly done by the government, for example health campaigns, new welfare benefits

The main advantages and disadvantages of advertising as a method of promotion are:

Advantages	**Disadvantages**
☑ Wide coverage – can reach mass audiences ☑ Control of message being promoted ☑ Segmentation possible through choice of media used, for example children's television ☑ Repetition means that the message can be communicated effectively ☑ Can be used to build brand loyalty	☒ Often expensive; TV is very expensive ☒ Impersonal and not very accurate in aiming at customers, so high wastage ☒ One way communication and no guarantee the message is being received ☒ Not all potential customers will use the chosen media: TV, internet, radio, newspapers ☒ Easy to get lost in the amount of competing adverts, for example posters, internet ☒ Limited ability to close a sale

Public relations (PR) & sponsorship

Public relations covers a broad series of activities where a business manages its image with different parts of the public, for example customers, the media, local communities, suppliers, employees and investors.

The main objectives of public relations are:

- To achieve **favourable publicity** about the business
- To build a **positive image and reputation** of the business and its products, particularly amongst customers

- To **communicate** effectively with customers and other stakeholders

Methods of public relations can vary from articles sent to newspapers or magazine features, to publicity stunts and free gifts. Many businesses will organise “open day” type events. Websites also allow a lot of image building information about a business and its products and services.

Public relations (PR) has several **advantages** over advertising in terms of promotion:

- ☑ No direct charge is made for the PR, though large businesses will often have to employ their own PR department or pay for an external PR agency or consultant
- ☑ PR is arguably more powerful than advertising, because the message the business communicates through PR is often more believable than paid for advertising

There are however **drawbacks** with PR:

- ☒ agencies can be expensive
- ☒ there is no guarantee that PR will reach its target audience, for example the media may fail to feature the story, whereas advertising must be displayed as it has been paid for
- ☒ the business has less or no control over the messages that are communicated

Sponsorship is a specialised kind of public relations and increasingly popular, particularly with larger businesses. A business will donate money to an event, team or individual, in return for which they will display the business name or logo. This will build brand awareness. A secondary objective might be to emphasise social or ethical policies, but most sponsorship really does have a targeted commercial objective.

Major sporting events, sports celebrities and sporting teams all benefit from substantial business sponsorship. At a local level, it is common for small businesses to sponsor local teams or donate prizes to local events.

Sales promotion

Sales promotion is the process of **persuading** a potential customer to buy the product. It takes place near to where the purchasing decision will take place, for example in a shop, and is often referred to as taking place at **point of sale (pos)**. Sales promotion is designed to be used as a **short-term tactic** to boost sales. It is not really designed to build long-term customer loyalty.

There are many methods of sales promotion, including:

- ☑ Money off **coupons** – customers receive coupons, for example coupons cut out of newspapers or a products packaging, that enables them to buy the product at a reduced price
- ☑ **Additional products** – for example buy one get one free (BOGOF); often seen as encouraging waste, but a business can sell stock quickly
- ☑ **Competitions** – buying the product will allow the customer to take part in a chance to win a prize; can encourage repeat purchases as well as one off sales

- ☑ **Discount** vouchers or temporary price reductions/special offers – these encourage customers to try new products or relaunched products; these offers can then be removed once customers become loyal
- ☑ **Free gifts/samples** – a free product when a customer buys another product; samples are sometimes given to try a product for free, in the hope that customers will then buy the product at a later date
- ☑ **Displays -** near check outs or on shelves in stores can be used to encourage sale of a particular product; this is why chocolate confectionary products are often displayed near the till in many food retailers
- ☑ **Loyalty cards** – these are now offered by many retailers and petrol stations. Customers are able to earn points for buying certain goods or shopping that can later be exchanged for money, goods or other offers. They also provide information to the business about the shopping habits of customers – where they shop, when and what they buy. This is very valuable marketing research and can be used in the planning process for new and existing products

The main advantages and disadvantages of sales promotion are:

Advantages	**Disadvantages**
☑ Effective at achieving a quick boost to sales and can be used to sell stock that is not selling fast enough ☑ Encourages customers to try a product or switch brands	☒ Sales effect may only be short-term ☒ Customers may come to expect or anticipate further promotions ☒ Some customers only buy special offers ☒ May damage brand image

When undertaking a sales promotion, there are several factors that a business must take into account in judging its effectiveness:

- **What does the promotion cost** – will the resulting sales boost justify the investment?
- **Is the sales promotion consistent with the brand image?** A promotion that heavily discounts a product with a premium price might do some long-term damage to a brand
- **Will the sales promotion attract customers who will continue to buy the product** once the promotion ends or will it simply attract those customers who are always on the look-out for a bargain?

Social media

Social media is both a location for advertising and also a method of advertising and promotion. Viral advertising through sharing sites such used in Facebook and YouTube can create real excitement about a product or new product and can create massive brand awareness very quickly, often involving limited expense, but it is hard to guarantee success.

Smart phones also provide a new opportunity for promotion and the development of "Apps" by businesses allowing communication to be easily made with a customer – and for the customer to interact with the business through e-commerce (sometimes known as m-commerce).

Choosing the promotional mix

There are many factors that will influence which mix of promotional methods a business will choose to use:

- **Budget**: all forms of promotion can be very expensive. TV advertising costs run into millions of pounds and even a box advert in a local newspaper can be over £1,000. Some businesses will spend up to 10% of their total costs on advertising. Often it is difficult to directly link promotion costs with sales increases, but without promotion there would be no customers!
- **Type of product**: some products are produced for other businesses to buy rather than the public in general. A tractor company would be better advised to have a PR stall at an agricultural show or an advert in a farmer's magazine, rather than a TV advertising campaign.
- **Type of customer**: choice of promotional strategy will be different depending who the target customers are. For example the Waitrose and Marks and Spencer's food stores will have very different target customers to Lidl and Aldi and will use different promotional strategies.
- **Competition**: the promotional strategy of a competitor will influence a business's own strategy. Advertising and sales promotion will often imitate the strategy of a competitor and competitors may retaliate to any promotional strategy that a business undertakes.
- **Product life cycle**: if the product is new or relates to a new business then the aim of promotion will be to make customers aware that it exists. In this case advertising or PR will be most appropriate. If the customers are aware of the product, but need persuading to buy it then sales promotion is very helpful.
- **Expertise**: although it will not necessarily change their strategy, larger businesses are likely to have their own marketing and promotional departments. They will be able to design and implement their own initiatives. In other cases and for smaller firms, they may have to use marketing or PR agencies who will be able to provide specialist help and advice.

Marketing – place

Place, or its more common name "**distribution**", is **about how a business gets its products to the customers**.

It is one thing having a great product, sold at an attractive price. But what if:

- Customers are not near a retailer that is selling the product?
- A competing product is stocked by a much wider range of outlets?
- A competitor is winning because it has a team of trained distributors or sales agents who are out there meeting customers and closing the sale?

Distribution matters for a business of any size – it is a crucial part of the marketing mix.

The objective of distribution is clear. It is:

"To make products available in the right place at the right time in the right quantities"

Distribution is achieved by using one or more **distribution channels**, including:

- Retailers
- Wholesalers
- Distributors / sales agents
- Direct, for example via e-commerce or telesales

The role of a distribution channel

A **distribution channel** can be defined as:

"all the organisations through which a product must pass between its point of production and consumption"

Looking at that definition, it can be seen that a product might pass through several stages before it finally reaches the consumer. The organisations involved in each stage of distribution are commonly referred to as **"intermediaries".**

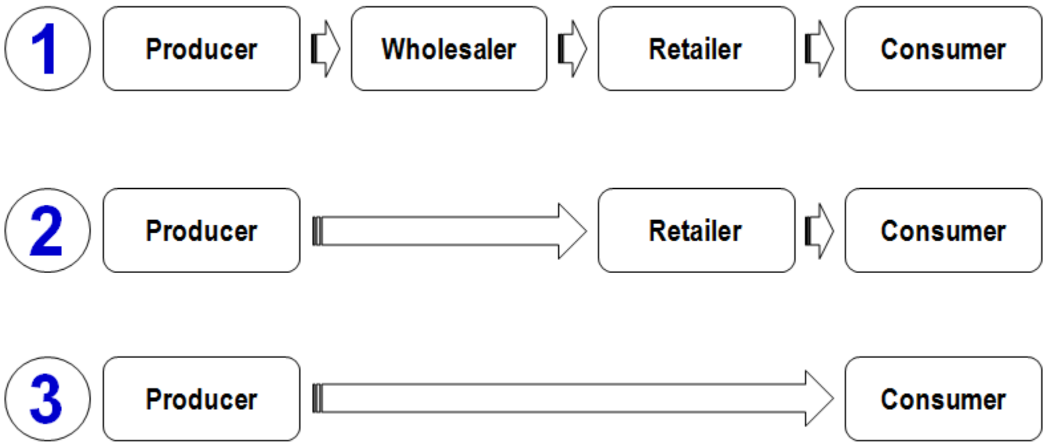
Why does a business give the job of selling its products to intermediaries? After all, using an intermediary means giving up some control over how products are sold and who they are sold to. An intermediary will also want to make a profit by getting involved.

The answer lies in efficiency of distribution costs. Intermediaries are specialists in selling. They have the contacts, experience and scale of operation which means that greater sales can be achieved than if the producing business tried to run a sales operation itself.

The main function of a distribution channel is to provide a link between production and the consumer who will ultimately use the product.

How many stages in the distribution channel?

A distribution channel can have several stages depending on how many organisations are involved in it:



Looking at the diagram:

Channel 1 contains two stages between producer and consumer - a **wholesaler** and a **retailer.** A wholesaler typically buys and stores large quantities of several producers' goods and then **breaks into bulk** deliveries to supply retailers with smaller quantities. For small retailers with limited order quantities, for example the local corner shop, the use of wholesalers makes economic sense.

Channel 2 contains one intermediary a **retailer**. The consumer electrical goods market in the UK is typical of this arrangement whereby producers such as Sony, Panasonic, Canon etc. sell their goods directly to large retailers such as Currys, Tesco and Amazon, which then sell onto the final consumers.

Channel 3 is called a "**direct-marketing" channel**, since it has no intermediary levels. In this case the manufacturer sells directly to customers. An example of a direct marketing channel would be a farm shop. Many holiday companies also now market direct to consumers, bypassing a traditional retail intermediary - the travel agent. Telesales are another example of direct marketing often used by double glazing firms! This is when businesses contact customers by using the phone. However, this is often an unpopular method for customers who more often than not do not like being disturbed at home!

We will now consider these intermediaries in more detail:

Retailers

The most popular distribution channel for consumer goods, retailers operate **outlets that trade directly with household customers**. Retailers can be classified in several ways:

- Type of goods being sold (e.g. clothes, grocery, furniture)
- Type of service (e.g. self-service, counter-service)
- Size (e.g. corner shop; superstore)

- Ownership (e.g. privately-owned independent; public-quoted retail group)
- Location (e.g. rural, city-centre, out-of-town)
- Brand (e.g. nationwide retail brands; local one-shop name)

☑ Retailers enable producers to reach a wider audience, particularly if broad coverage by the major retail chains can be obtained.
☒ The big disadvantage to using a retailer is the loss of profit margin. A high street retailer will typically look to take at least 40-50% of the final consumer price, depending on the nature of the product and the speed of stock turnover.

Wholesalers

Wholesalers stock a range of products from several producers. The role of the wholesaler is to sell onto retailers. Wholesalers usually specialise in particular products, for example food products.

☑ The advantage of wholesalers is they "break the bulk" that is they will receive direct loads from producers and split this into smaller units for retailers. This means that retailers can hold less stock.
☒ However, the costs are increased due to the wholesaler's "middle-man" profits.

Agents

Agents sell the products and services of producers in return for a commission, a percentage of the sales revenues. Agents are often found working in the service sector. Good examples include travel agents, insurance agents and the organisers of party-based selling events, for example Tupperware.

Overall there are several potential advantages of using an intermediary:

☑ More efficient distribution logistics
☑ Costs, even taking into account the intermediaries' profit or commission, may be lower
☑ Consumers may expect choice i.e. the products and brands of many producers at the point of sale
☑ Producers may not have sufficient resources or expertise to sell direct

Selling direct

A key decision a business has to make about distribution is whether to sell “direct”.

Direct marketing means selling products by dealing directly with consumers rather than through intermediaries.

Traditional methods include mail order, telesales, and door-to-door calling. More recently telemarketing, magazine and TV advertising and on-line computer shopping (**e-commerce**) have been developed.

☑ The main advantages of selling direct are that there is no need to share profit margins and the producer has complete control over the sales process. Products are not sold alongside those of competitors either.

There may also be specific market factors that encourage direct selling:

- There may be a need for an expert sales force, to demonstrate products, provide detailed pre-sale information and after-sales service
- Retailers, distributors, dealers and other intermediaries may be unwilling to sell the product
- Existing distribution channels may be owned by, or linked to, competing producers, making it harder to obtain distribution by any other means than direct

☒ However, there are significant costs associated with selling direct which may be higher than the costs associated with using an intermediary to generate the same level of sales.

What is the best distribution channel for a product?

What factors should be taken into account in choosing the best distribution channel? Here is a summary:

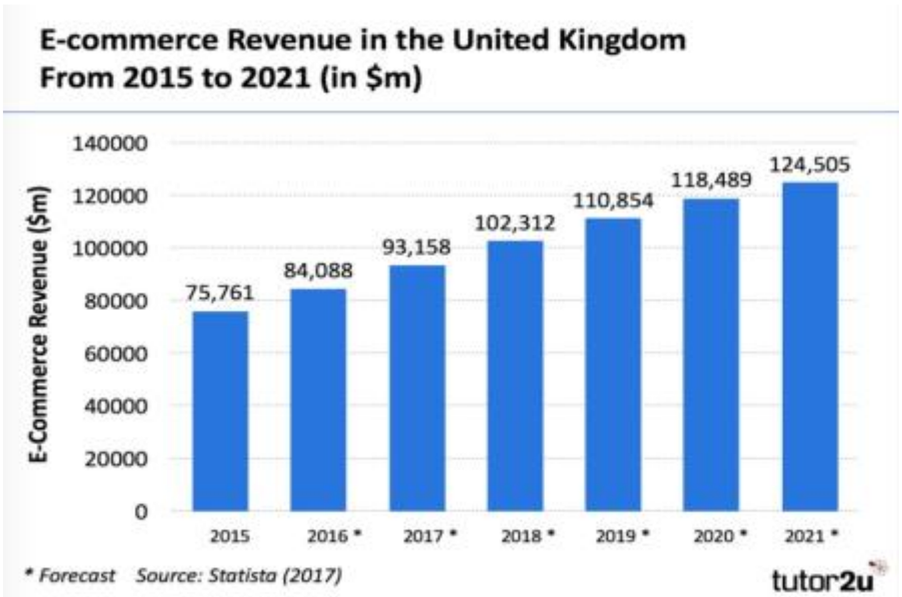
- **Nature of the product**: is it technical/complex? Complex products are often sold by specialist distributors or agents. Cars will often use this type of approach.
- **Customised**: a direct distribution approach often works best for a product that the end consumer wants provided to a distinct specification. A wedding cake, made to measure clothing – or even double glazing are all examples!
- **Image of the product** – if intermediaries are to be used, then it is essential that those chosen are suitable and relevant for the product. Top brands in clothes and cosmetics will want their products sold through John Lewis not through Primark.
- The market, for example is it **geographically spread**? Does it involve selling overseas? If selling products overseas then a car manufacturer business might use an overseas agent to distribute and sell their cars.

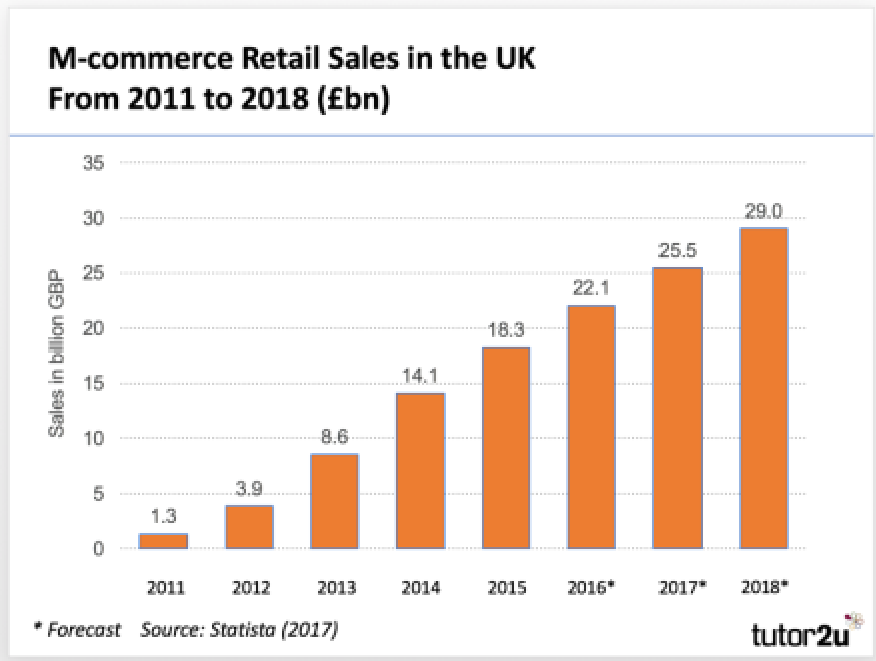
- The extent and nature of the **competition** – which distribution channels and intermediaries do competitors use? Apple might not wish to sell their products through a shop that also sells Samsung products.
- The **business size** – small businesses may have to use wholesalers as they cannot store a large amount of stock. They might also use intermediaries, such as agents, if they are too small to afford an in-house sales and distribution force.
- Its **business objectives** – are they revenue or profit maximisation?
- How much **control** does it want over distribution? The longer the channel, the less control is available. Some manufacturers will want to control how a product is displayed, the price charged and the promotional method used.

E-commerce and M-commerce

We have previously discussed the impact on businesses of digital technology and how this has led to the massive growth of e-commerce. Buying and selling of goods through **e-commerce** and now **m-Commerce is now commonplace**. Whilst **e-commerce** is the buying and selling of goods and services using the internet. The more recent development is **m-commerce,** which is using wireless handheld (mobile) devices, such as smart phones.

Different types of e-commerce have included the development of auction sites such as eBay, specialist internet retailers like Amazon, as well as most high street retailers developing internet sites. The graphs below show the recent and expected growth in e-commerce compared to m-commerce with strong growth expected for both methods.





E-and m-commerce have many advantages and disadvantages, both for the seller and the customer which are summarised in the table:

	Advantages	Disadvantages
Businesses	☑ Can sell products and services 24 hours a day 7 days a week ☑ Costs can be reduced, as no need for retail premises ☑ Market can be expanded on a national and international basis ☑ Quick and easy to set up – the business can always be transferred to a limited company once launched ☑ Quality will be improved, as businesses will be under constant scrutiny, as customers can easily compare one business's products to another through reviewing online feedback; only the best value for money products and services will be chosen resulting in an increase in efficiency ☑ Processing of orders is fast and delivery can be quick and in line with customer	☒ No personal contact with customers, so more difficult to influence sales on an individual basis ☒ ICT systems have to be established, maintained and updated which can add to costs and lead to customer frustration if unreliable ☒ Distribution costs can increase rapidly through increased geographical spread of sales ☒ Increased competition, as businesses can make products and services available on an international basis ☒ Not all customers have internet access and some customers are afraid of fraud, so will not trade electronically ☒ Providing a good customer service including return of products purchased can be expensive

	expectations; delivery can also be tracked ☑ Data recording and analysis is easily achieved; can help with targeted promotional activity ☑ Pure play or e-tailers can locate in less expensive areas of the country, where land is not of a premium price	
Customers	☑ Allows customers to shop from the comfort of their own home at a time when it is convenient ☑ Cheaper prices and better quality due to competition ☑ Availability can be checked which means no wasted journeys to shops ☑ Choice is increased as products and services can be selected from anywhere in the world ☑ Product details and reviews are available, including from other customers ☑ No hard sell from employees; customers are free to choose and buy products that best suit them	☒ Customers cannot see or try goods before purchasing them; returning goods can be inconvenient or expensive ☒ Possibility of personal details being used for fraud or for unwanted advertising ☒ Delays in delivery compared to high street shopping, where goods are available immediately ☒ Potential customers with no internet access may lose out on choice
Communities	☑ Growth of new job opportunities in providing e-sales centres and distribution outlets and transport networks ☑ Increased sales in associated industries, such as technology and communication ☑ Local and national economic benefits from businesses who are successful; individuals with higher disposable incomes, due to now being in employment, will spend this income in other businesses, creating a multiplier effect	☒ Loss of traditional retailers from high street shopping areas and retail parks, due to an increase in competition ☒ Increase in goods and services from other countries that have cheaper costs, resulting in the loss of direct and indirect jobs from an economy

Choosing the marketing mix

The **marketing mix** deals with the way in which a business uses four factors - price, product, distribution and promotion - to reach customers. It is known as a "mix" because each ingredient affects the other and the mix must overall be suitable to the target customer.

For example:

- ☑ High quality materials used in a **product** can mean that a higher **price** is obtainable
- ☑ An advertising campaign carried in one area of the country, **promotion**, requires **distribution** of the product to be in place in advance of the campaign to ensure there are no disappointed customers
- ☑ **Promotion** is needed to emphasise the new features of a **product**

An example of the marketing mix is used can be seen from this example of Premier Inn.

MIX ELEMENT	HOW USED
PRODUCT	Hotel accommodation & related services Proposition: a "good night's sleep – guaranteed"
PRICE	Dynamic pricing; from approx. £69 per night depending on location & availability
PROMOTION	TV advertising; online & social media
PLACE	Predominantly sold direct; emphasis on online booking

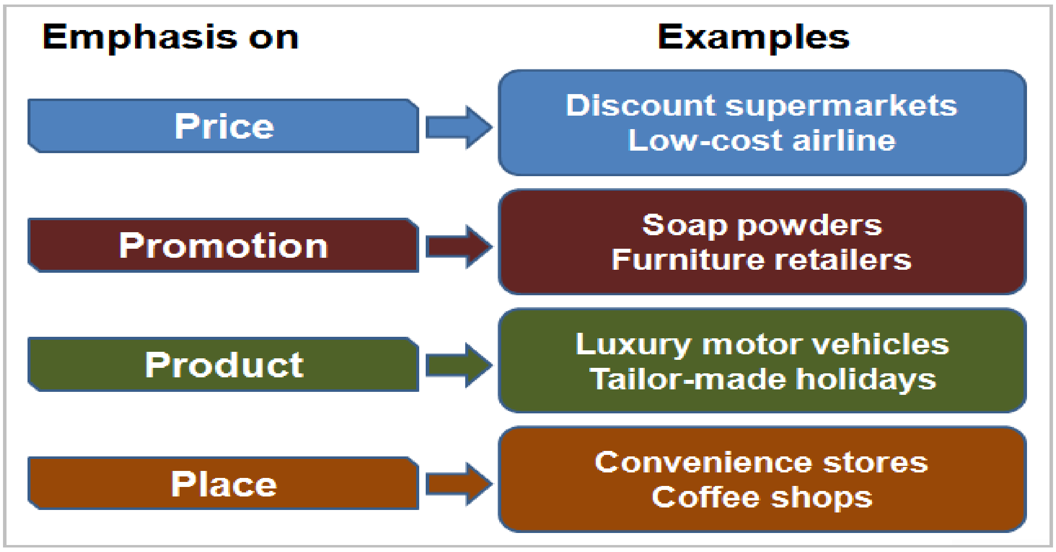
An effective marketing mix

An effective marketing mix is one which:

- Meets customer needs
- Achieves the marketing objectives
- Is balanced and consistent
- Allows the business to gain an advantage over competitors

The marketing mix for each business and industry will vary; it will also vary over time.

For most businesses, one or two elements of the mix will be seen as relatively more important than the others, as illustrated below:



In future years however these might change. If consumers become less wealthy or if competition increases even more, then coffee shops may have to emphasise price rather than location.

Section 6 Finance

Topic overview

Students need know what the role of finance is within a business and how this relates to the other functional areas of business operations, human resources and marketing. There should also be consideration of how finance will relate to the business and its objectives.

Section	Key things to learn
Sources of finance	Sources of internal and external finance for new and existing businesses Advantages and disadvantages of different sources of finance Choosing the most effective finance source
Cash flow	Importance of cash flow to a business Cash versus profit Completion and understanding of cash flow forecasts Causes and solutions to cash flow problems
Financial terms and calculations	Difference between variable, fixed and total costs Calculating revenue, costs and profit Investment measures including average rate of return Understanding and evaluating break-even calculations Interpreting break-even charts, identifying break-even points and the margin of safety
Analysing financial performance	Understanding the components and purpose of financial statements Being able to interpret and compare financial statements and relate to decision making Calculate and interpret gross and net profit margins

Sources of finance

Introduction

Money is essential to any business, whether it is just starting up, as it will need to pay for both its set-up costs and its everyday running costs, as well as for established businesses that might be looking to grow or are facing unexpected difficulties.

In order to consider what options a business has for getting finance, it is necessary to know why the business wants or needs the money, for example:

- **Set-up costs** – to pay for the costs the business has before it can start to trade. These would include legal costs, premises and machinery. These are normally "one-off" costs, although at some point machinery, for example, may need to replaced or upgraded.
- **Getting ready to produce** – these include raw materials, some marketing and administration costs and some management and labour costs, so that the business is ready to start trading.
- **Running costs** – *t*hese will be costs of materials, labour, power and many other costs that the business will have to keep paying on a frequent basis, but which should be covered by the money it receives from sales.
- **Emergency or temporary** – if there is a change in the external environment, for example the emergence of a new competitor or a downturn in the economy, the business may need short term funds to see it through these difficulties.
- **Growth and development** – most businesses want to expand which will require additional finance to invest, for example in larger premises and more machinery. Running costs are also likely to increase.

Methods of finance

Once a business has determined what it needs to use the finance for, it can look at the different sources of finance that are available to it. These are detailed as follows.

Most methods of finance can be categorised easily into internal and external sources.

Internal sources of finance

For an established business the main internal sources of finance are:

- Retained profits
- Selling unwanted assets

In addition, personal finance can be considered as an internal source of finance for a smaller business as can taking on a partner who provides funds.

Retained profit

This is the most important internal source of finance for an established, profitable or large business.

The idea is simple. When a business has worked out its profits the owners or shareholders can decide whether to take the profits for themselves, for example through a dividend, or reinvest the profits back into in the business.

Retained profits have several major advantages:

- ☑ They are cheap, as no interest has to be paid on them.
- ☑ They are very flexible – management have complete control over how they are reinvested and what proportion is kept rather than paid as dividends.
- ☑ They do not dilute or reduce the ownership of the organisation, so for companies there is no increased risk of a takeover.

There are, however, also some disadvantages:

- ☒ If a business needs some temporary finance because it is facing difficulties, then it is unlikely to have any profits that it can use.
- ☒ Businesses might be accused of storing up cash "just in case" when if the owners had been given the profits, they could have invested it elsewhere.
- ☒ Growth may be slow if it is dependent on retained profits, as profits may not be high enough to finance the growth quickly.

Selling unwanted assets

Selling spare or unwanted **non-current assets**, such as spare land, buildings, machinery or equipment that are no longer needed by the business, can result in extra finance being generated on a one off basis.

- ☑ Using this method will mean that no finance needs to be repaid and the business owners keep full control of the organisation.
- ☒ It is however, unlikely to be a long-term solution for most businesses that need to raise finance, as money will be raised on a one-off basis. This method will also reduce the value of the business, as the business will no longer own these assets.

Personal finance

In practice, most start-ups make use of the personal financial sources of the entrepreneur, known as **owner's funds**. This can come from personal savings in the building society or bank, a redundancy payment, inheritance or maybe winning the lottery! This money can be used to provide assets for the business, for example a vehicle.

This is a cheap form of finance that is readily available. Investing personal savings maximises the **control** the entrepreneur keeps over the business. It is also a strong signal of commitment to other potential investors and the bank.

Changing from a sole trader to a partnership or taking on additional partners

A sole trader or partnership might also choose to expand to a partnership with **additional partners**, who can provide finance for the business. This will reduce the control of the original entrepreneur and mean profits are shared more ways, although it will also mean that the business does not have to worry about paying back sources of finance, to the bank for example, which would involve interest payments.

Raising external finance

There are many ways for businesses, small and large, to raise finance from external sources. The main methods are detailed here:

Friends and family

These relate to the friends and family of the entrepreneur. In a start-up business, this may be the main source of external finance that it uses.

- ☑ Advantages of this method include the family/friends may be prepared to invest substantial amounts for a longer period of time at a low or no rate of interest. They also may not want to get too involved in the day-to-day operation of the business. Both of these are positives for the entrepreneur.
- ☒ However, there are disadvantages. The friends and family may want to be involved in the business and as a result, get in the way of business decisions. Also the relationship with the family and friend may become difficult if the business is not doing well.

Mortgage or re-mortgaging

These are also popular ways of raising loan-related capital for a start-up business. A mortgage is a long-term loan taken out to buy land or a property. With a re-mortgage, a second or larger mortgage is taken out on a private property.

- ☑ The use of mortgaging provides the business owner access to relatively low-cost finance, which is repayable in monthly instalments across many years.
- ☒ However, there is a risk that, if the business fails, then the property will be lost too. This is a particular problem in the case of re-mortgaging. In addition, some mortgages are based on a variable rate of interest, which means that if interest rates rise, so do re-payments which a business may find difficult to cover. Finally, to take out a mortgage, some sort of security or collateral may need to be provided before the bank will agree to the terms of the mortgage.

Trade credit

This is used by many businesses as a short-term source of finance. Trade credit essentially means that a firm's suppliers will allow it to have the goods and pay for them at a later date.

- ☑ This can give time for the business to use the goods and sell its products before it pays the suppliers, which will improve its **cash flow** position.
- ☒ If the bills are not paid on time however, this can lead to the business getting a bad reputation and losing future credit arrangements with the supplier. It can also be particularly difficult for new start-up businesses to negotiate trade credit with suppliers, as there is a risk that the business will fail and suppliers may end up not getting paid!

Loan capital from the bank

The two main types of bank finance are overdrafts and loans.

Bank overdrafts

Businesses of all sizes use bank overdrafts as a means of finance. As a business gets bigger, it often finds that its overdraft facility also needs to grow. That is because an overdraft is essentially a short-term source of finance that is available to help fund the day-to-day payments required by a business. It allows the business to withdraw funds from its account that are not there, up to an agreed maximum limit and is only used when the business requires additional, temporary amounts of money.

- ☑ The big advantage of a bank overdraft is its flexibility. If a business experiences a short-term shortage of cash or an unexpected cost, then it can be paid by using some of the overdraft facility. Interest is only paid on the amount used.
- ☒ The main downside of an overdraft is that it is repayable to the bank at any time. A business may have an overdraft facility of £100,000 i.e. it can owe the bank up to that amount, but the bank may lower or even withdraw that facility at any time. This happened to numerous businesses with bank overdrafts during the credit crunch of 2007-8, many of whom were relying on their overdraft to stay in business.
- ☒ The other drawback of an overdraft is that they usually have high levels of interest attached to them, making them an expensive form of finance when they are used.

Bank loans

A bank loan is an amount of money borrowed for a set period within an agreed repayment schedule. The repayment amount will depend on the size and duration of the loan and the rate of interest.

Many businesses use bank loans to finance their business activities. However, bank loans tend to be more available for well-established and growing businesses, rather than start-up businesses. The reason for this is **risk** – banks prefer to loan to successful businesses, which makes them more likely to be able to repay the loan and interest.

If a bank loan can be obtained then there are several advantages for a growing business:

- ☑ The business is **guaranteed** the money for a certain period - generally three to ten years (unless it breaks the loan conditions).
- ☑ Loans can be **matched** to the lifetime of the equipment or other assets the loan is for

- ☑ While interest must be paid on the loan, there is no need to provide the bank with a share in the business, so **no control is lost.**
- ☑ **Interest rates may be fixed** for the term, making it easier to forecast interest payments and cash flow.
- ☑ Repayments are made in **instalments**, resulting in the business having access to substantial amounts of cash that does not need to be paid back all in one-go.

There are also some disadvantages of a bank loan:

- ☒ **Security -** normally has to be given to the bank on some of the assets of the business. The bank will have control over these assets is the business fails.
- ☒ **Lack of flexibility** - a growing business might take a loan out for £500,000 but finds it only needed £300,000. That means that interest is being paid on £200,000 of loan that it does not need.
- ☒ **Interest** – interest must be paid on the loan amount, which increases the costs of the business.

Selling shares

Both private and public limited companies can raise finance by selling new shares in the company. The main options available are:

New issue of shares (flotation)

A flotation provides a way to raise substantial new capital for a business. It can be however, a **costly** way of raising new finance. This is particularly so for a private limited company that is converting to a public limited company. This involves selling a percentage of a company's shares on a stock market for the first time.

The major change that arises from a flotation is that the shareholder base of the company becomes much wider. Many thousands of private shareholders may choose to invest in the business, alongside the larger "institutional" investors such as pension and insurance funds. This might mean the original owners lose some or complete control of a business that they have owned and built up.

There are many **advantages** to a business of raising finance through share issues:

- ☑ Large sums of money can be raised
- ☑ Capital does not have to be repaid
- ☑ There is no interest – dividend payments can be missed if profits are low

There are however some **disadvantages** including:

- ☒ Possible loss of control if the original owners sell more than 50% of the total shares
- ☒ Need to satisfy shareholders expectations of dividends and share price growth

Grants

The government or charitable organisations might be a source of finance for new and existing businesses, through the provision of grants. These are sometimes linked to setting up or expanding a business in an area of economic need, for example if there is high unemployment in a particular location.

- ☑ The advantage of grants is that they will be free and therefore do not need to be re-paid.
- ☒ However, there may be conditions related to having the grant, such as only employing local, unemployed workers or locating in an area of economic need, which might not be the best location for the business to set-up. Government grants are also very difficult for businesses to obtain and can involve a firm completing a great deal of paperwork in order to successfully secure one.

Alternative sources of finance:

There are also other alternatives to getting finance, which include **hire purchase** and **leasing**. Although not a source of finance, these options allow the business to use products or equipment, whilst it is making payments for them. This helps to improve cash flow and allows a business access to a product they may not otherwise be able to afford. In the case of **hire purchase**, a business will only own the product after the final payment. These payments are likely to amount to more than the original product is worth, as usually a charge for interest will be added to the repayments.

Leasing is like a rental agreement will results in a business never owning the product, although upgrades are often possible. This means it is popular for technology type equipment, such as computers and photocopiers.

What is the best source of finance for a business?

With such a wide range of potential sources of finance, the truth is that there is no such thing as an ideal or recommended source of finance for either new or established businesses to use. There are many different factors or considerations that will help to determine which source of finance would be the best for a business, which are listed in the table. It is worth remembering, as already mentioned earlier in this section, that ultimately a business must always think about how much finance is required and what the money is needed for:

Factor	Explanation
Profitability	A business that has strong profitability is often able to finance expansion through reinvesting profits rather than looking for external finance. Lack of profit may lead to more expensive external financial sources being used.
Management	Banks will look closely at the abilities and experience of the business

track record	management team. They do this to determine the risks involved in providing finance.
Short or long-term	If finance is required for long-term growth, for example to pay for a new warehouse or factory, this would support the use of bank loans or share capital (long-term sources) rather than bank overdrafts or trade credit (short-term sources)
Legal structure	A public limited company has the option of raising finance via public stock markets. A private limited company can also raise finance through a share issue to family and friends. Sole traders and partnerships do not have the option of selling shares, although a sole trader can change its legal structure and become a partnership, or an existing partnership can take on more partners.

Cash flow

Introduction

Cash flow describes the movements of cash into and out of a business. It is **not** the same as profit. Many profitable businesses fail because they do not have enough cash to pay their bills. This is because profit is recorded straight after a sale, whereas cash is recorded when it is either spent or received by the business. If a business offers trade credit to a customer for example, of 30 days, then the sale and therefore profit is documented when the goods are taken by the customer, but the cash will not be recorded until payment i.e. the cash is received 30 days later!

In business, cash is always on the move…

- **Cash flows into the bank account** when customers pay for their sales, when a loan is received from the bank, interest is received or when assets are sold
- **Cash flows out of the bank account** when suppliers are paid, employee wages and salaries are paid, interest is paid to the bank and so on…

You need to be able to distinguish between:

- **Cash inflows:** movements of cash **into** a business
- **Cash outflows:** movements of cash **out of** the business

The difference between the **cash inflows** and **cash outflows** during a specific period, for example a week or a month is known as the **"net cash flow".**

The challenge for any business, particularly new businesses, is to manage its net cash flow successfully, so that the business does not run out of money.

Main types of cash inflow and outflow

The main types of cash flow can be summarised as follows:

Cash inflows	Cash outflows
Cash sales	Payment of wages and salaries
Receipts from trade customers	Payment of suppliers, for example raw materials, inventories
Sale of spare assets	Buying equipment
Investment of share capital	Interest on bank loan or overdraft
Personal funds invested	Payment of dividends

Cash inflows	Cash outflows
Receipt of bank loan	Repayment of loans
Government grants	Income tax, VAT and corporation tax

Why businesses suffer cash flow problems

Start-up and small businesses are especially vulnerable to cash flow problems, but all businesses will have cash flow problems if they do not pay attention to this area of business activity.

The reasons can be divided into two types:

- not enough money coming into the business fast enough
- too much money going out from the business too quickly

In addition if a business does have cash flow problems, then new businesses or businesses facing financial difficulties will often not have reserves of **retained profits** to see them through until things improve. If a business runs out of cash and is not able to obtain new finance, it will become bankrupt.

If a business has a positive cash flow it will build up reserves of cash. These can be saved in case of future problems or used for future investment.

The cash flow forecast

The cash flow forecast **predicts** the net cash flows of the business over a future period. It can be used to identify likely **cash flow problems** and help avoid or solve them.

The forecast estimates what the cash inflows into the bank account and outflows out of the bank account will be. The result of the cash flow forecast is also an estimate of the bank balance at the end of each period covered (normally this is for each month). An example of a simple cash flow forecast is shown below:

£'000	**January**	**February**	**March**	**April**	**May**	**June**
Cash inflows	200	250	200	150	100	250
Cash outflows	250	300	300	100	250	150
Net cash flow *(cash inflows – cash outflows)*	-50	-50	-100	50	-150	100
Opening balance *(same figure as the closing balance for the previous month)*	250	200	150	50	100	(50)
Closing balance *(net cash flow + opening balance)*	200	150	50	100	(50)	50

As can be seen from the table, the closing balance becomes the opening balance for the next month. This is then added to the **net cash flow** for that month, which may be a positive (April) or negative (May), in order to calculate the closing balance for that month. The closing balance each month might be a surplus, which means the business has a positive cash balance at the end of the month, or a deficit, which means that the business has a negative cash balance at the end of the month (often indicated by brackets, as in May). Businesses must carefully monitor when the business is forecast to experience a deficit, as this highlights the business may run out of cash!

Why the cash flow forecast is so important

A business uses a cash flow forecast to:

- **Identify potential shortfalls in cash balances in advance** – think of the cash flow forecast as an "early warning system". This is the most important reason for a cash flow forecast and enables the business to take action, so that it does not experience any cash flow issues, which can ultimately prevent the business from trading
- **Makes sure that the business can afford to pay suppliers and employees** - suppliers which do not get paid will soon stop supplying the business; it is even worse if employees are not paid on time

- **Spot problems with customer payments** – preparing the forecast encourages the business to look at how quickly customers are paying their debts. This is only an issue in some businesses and not all. For example, most retailers take most of their sales in cash/credit cards at the point of sale i.e. at the time of purchase
- **Compare actual figures to forecast figures** – this allows management to spot if there are any potential issues and take appropriate action, for example if there are significant differences between the forecasted figures and the actual figures, a business owner would need to arrange appropriate sources of finance to cover any shortfalls in cash
- **External stakeholders such as banks may require a regular forecast** - certainly if the business has a bank loan, the bank will want to look at the business cash flow compared to its forecast at regular intervals, to ensure that the business will continue to make its repayments

Main causes of cash flow problems

A **cash flow problem** arises when a business struggles to pay its debts as they become due. When cash flow is consistently negative and the business uses up its cash balances, then the problem becomes serious.

The main causes of cash flow problems are:

Factor	**Why it causes a cash flow problem…**
Low profits or (worse) losses	There is a direct link between low profits or losses and cash flow problems. Remember, most loss-making businesses eventually run out of cash
Over-investment in capacity	This happens when a business spends too much on machinery, equipment or premises. Factory equipment which is not being used does not generate revenue, so is often a waste of cash
Too much stock	Holding too much inventory or stock ties up cash and there is an increased risk that these inventories become obsolete i.e. it cannot be sold and therefore cannot generate any cash inflows
Allowing customers too much credit	Offering credit to customers, i.e. buy now and pay later, is a good way to build customer loyalty and long-term revenue, but late payment is a common problem and slow-paying customers put a strain on cash flow
Overtrading	This occurs where a business expands too quickly, putting pressure on short-term finance. For example, a retail chain might try to open too many stores too quickly, before each starts to generate profits
Seasonal demand	Predictable changes in seasonal demand create cash flow problems, but because they are expected, a business should be able to handle them

Taking action to improve cash flow

The best way to improve cash flow is to have a reliable and up-to-date cash flow forecast, which is compared to actual figures constantly as they happen. The cash flow forecast will provide the information which highlights the main cash flow issues.

The main actions which management can take to improve cash flow are:

Cut costs – by far the most important method of improving cash flow. Every business can identify savings in non-essential costs if it looks hard enough. The recession in 2008 to 2009 proved that businesses could take drastic actions to cut overheads and other costs, which immediately reduced **cash outflows**.

Cut stocks: reduce the amount of cash tied up by buying and holding less raw materials or goods that will be sold on. This can be done by (a) ordering less stock from suppliers and/or (b) offering discounts on stocks held to encourage customers to buy, ideally for cash!

Delay payments to suppliers – a dangerous option, but widely used in business. By taking longer to pay bills owed, a business can reduce **cash outflow** which gives it time to receive money into the business through sales. However, this plan may risk damaging the relationships with suppliers.

Reduce the credit period offered to customers – this is easier said than done. By asking customers to pay for their purchases quicker, a business can accelerate **cash inflows**. However, there is no guarantee that customers will agree. They may need to be given a financial incentive, such as a prompt-payment discount.

Cut back or delay expansion plans – many of the biggest cash outflows occur when a business is expanding, for example opening new offices or shops, adding a production line or factory. By delaying this expansion less cash would be leaving the business.

In addition, although it is not solving the cause of the cash flow problem a business can arrange:

Additional sources of finance – this would increase the **cash inflow** and could be a temporary solution. An overdraft, for example, might be used to get through a dip in seasonal demand or an unexpected delay in payments. Alternatively a business could receive a more substantial inflow of cash through restructuring or selling assets. Other ways include arranging a loan from the bank or perhaps a share issue could be organised, although this is not normally popular with investors and may take time to arrange.

Financial terms and calculations

Introduction

Every business and every entrepreneur needs an understanding of the financial performance of the business they are involved with. There is a need to understand financial terms and also to be able understand and interpret financial data. Businesses also need to be able to make financial calculations, for example measuring the financial outcome of possible investment opportunities.

Basic financial terms

These can be divided into revenue and costs which then enable a business to work out its profit or loss.

Costs

Costs are the spending that a business has to undertake in order to make goods and provide services. Every business has costs, but they vary in terms of their type and amount. For a new business, estimating what the likely costs are going to be is often very difficult.

Successful businesses place great importance on costs. In most cases they want to ensure they are kept as low as possible. There are many reasons for this including:

- Increases in costs reduce the possible profits that the business can make
- They are the **main cause of cash flow problems** in a small business
- They will change as the output or activity of a business changes

Costs can be divided into two types: **fixed and variable**

Fixed costs

Fixed costs do not change as output varies. In other words, they are fixed even if output moves up or down from period to period.

Examples of fixed costs include:

- Rent and council tax
- Salaries
- Marketing, for example advertising, market research
- Insurance
- Interest repayments
- Leased equipment charges

It is worth remembering that just because a cost is classified as "fixed", it does not mean that the cost will stay the same forever. A fixed cost can change over time. For example, the rent of an office or shop may stay the same for 5 years. However, the rent may change (up or down) when the rental agreement is renegotiated when due. The important point about a cost like rent being "fixed" is that it **has to be paid,** whatever the level of sales achieved.

Fixed costs are particularly important when it comes to calculating the **break-even output** of a business. The higher the level of fixed costs in a business, the higher the output needed to cover these costs and break-even.

Variable costs

Variable costs change when output changes. In other words the higher the output, the higher the variable costs.

Variable costs tend to be those relating directly to the production or sale of a product. Good examples include:

- Raw materials and bought-in stocks and components
- Wages based on hours worked or amount produced
- Marketing costs based on sales
- Agent and other commissions

Total variable costs can be calculated by a simple formula: **Variable cost per unit x output**

Total costs

The total costs of a business can be calculated by simply adding together the variable costs, at different levels of output, to the firm's fixed costs. The formula therefore is:

Total costs (TC) = fixed costs (FC) + variable costs (VC)

Example:

Graham's van repair business is a small business that has the following costs and sales output for March:

Variable costs per job	£75
Garage rent and rates	£500
Salaries	£1,500
Advertising	£100
Other fixed costs	£400
Expected number of jobs for month	100

To calculate the total costs for the business, start with the **variable costs**. These equal £75 per unit x 100 jobs = **£7,500**

Fixed costs = £500 (garage rent and rates) + £1,500 (salaries) + £100 (advertising) + £400 (other fixed costs) = **£2,500**

Therefore **total costs** for Graham's business equal £7,500 (total variable costs) + £2,500 (total fixed costs) = **£10,000**

As output increases the total costs will not increase as fast. This is because the fixed costs will stay the same. This leads to **economies of scale** and is one of the benefits of a business growing, which has been discussed earlier.

Revenue

Revenue is the money the business receives from its sales. This can be represented simply using the formula:

Revenue = selling price per unit x quantity sold

In practice most businesses sell more than one different product and have more than one price, which makes the calculation more complicated, but the method remains the same.

In the above example, if Graham charges £100 for each job that he completes, his **revenue** will equal: £100 (selling price per unit) x 100 (quantity sold) = **£10,000**.

Is Graham's business making a profit?

Profit

Having calculated the total costs and the total revenue for a business, it can now work out its profit. Profit is the financial **return** or **reward** that the owners of a business aim to achieve to reward them for the **risk** that they take. It will measure the success of that investment.

Profit is also an important signal to other providers of finance to a business. Banks, suppliers and other lenders are more likely to provide finance to a business that can demonstrate that it makes a profit, or is likely to do so in the near future, and that it can pay debts as they fall due.

As previously discussed, profit is an important **source of finance** for a business. Profits earned, which are kept in the business and are not distributed to the owners via dividends or other payments, are known as **retained profits**. Retained profits are an important source of finance for any business, but especially start-up or small businesses. The moment a product is sold for more than it cost to produce, then a profit is earned which can be reinvested.

Profit can be measured and calculated by the following formula:

PROFIT = SALES REVENUE - TOTAL COSTS

Here is an example which illustrates the formula in action:

Sales	Costs	Profit or loss?
£100,000	£75,000	£25,000 profit
£100,000	£125,000	(£25,000) loss Note: negative figures are shown in brackets
☑ **Total sales greater than total costs = PROFIT** ☒ **Total sales less than total costs = LOSS** ➢ **Total sales = total costs = BREAK-EVEN**		

Whatever the result, profit, loss or breaking-even a business will always need to review its performance and look at how it might be improved. Can costs be decreased? How? And by when? Can revenue be increased? Should the price stay the same? Can more be sold? Is there a need for further investment to decrease costs or increase revenue?

Investment projects and average rate of return

A business will always be looking to improve its performance and its profitability. Most methods of achieving these improvements will involve **investment**. An investment is where a sum of money, known as **capital,** is spent today in order to get a benefit in the future. There are many different reasons for investment. The main ones are:

- **Expansion:** expenditure on a new location, a new product line or a new factory, so output can be increased
- **Replacement:** some investment will be made into replacing existing machinery or vehicles that may be worn out
- **Modernisation and mechanisation:** as technology develops then businesses can introduce new ways of making products or providing services that will require new and more advanced equipment. This might mean moving from labour intensive to capital intensive production

In order to work out whether the investment is worth taking, there are various calculations a business can make based on the cost of the project and the future returns it will provide. One of these is known as the **average rate of return**.

Average rate of return (ARR)

Average rate of return is a simple method of calculating whether a project is worthwhile. It calculates the annual average return for a project expressed as a percentage. This can be compared with other projects on which the money could be spent or the interest it could earn if saved. It can also be compared with the cost of borrowing money to fund the project, if the business does not have any savings or retained profit that it can use.

The formula for the average rate of return or ARR is:

$$\textbf{ARR (\%)} = \frac{\textbf{Average annual profit (total profit from the investment} \div \textbf{number of years)}}{\textbf{Initial cost of the investment}} \times \mathbf{100}$$

For example a fast food business could expand to operate a delivery service. This would mean buying a van for £30,000. The van would last 5 years and the business has calculated that it would make an extra profit of £22,500 during the 5 years.

$$\textbf{ARR (\%)} = \frac{(£22{,}500 \div 5)}{£30{,}000} \times 100 = \frac{£4{,}500}{£30{,}000} \times \frac{100}{} = \mathbf{15\%}$$

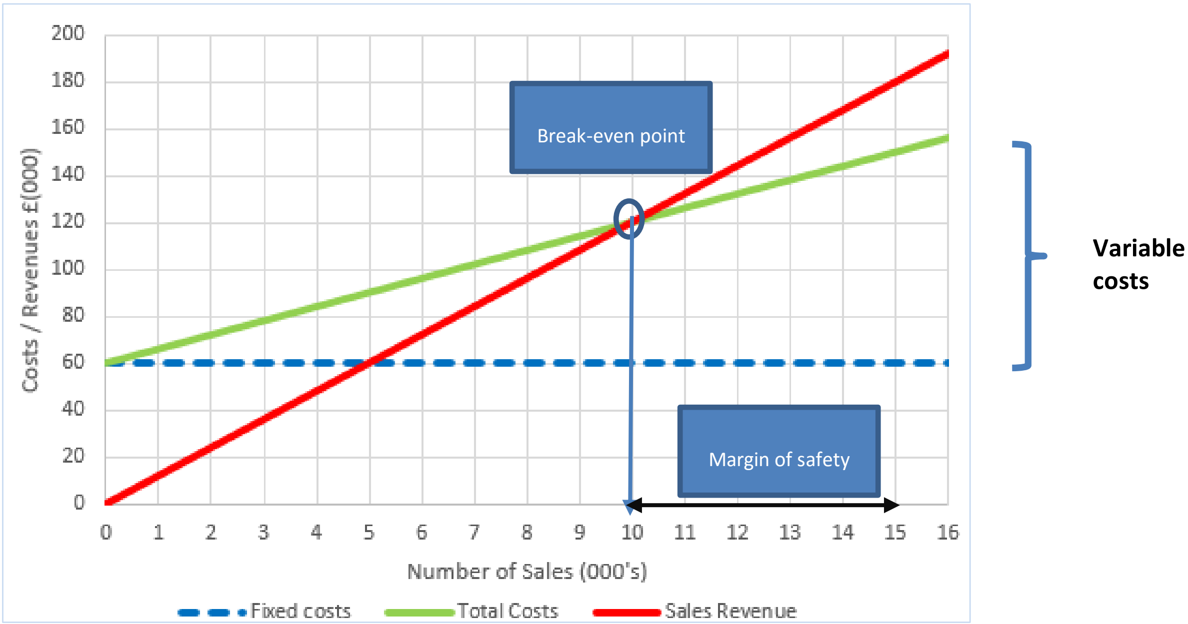
Depending on how reliable the firm's profit estimates are, this would be quite a good return even if the business has to borrow money to fund the investment.

Break-even

In order to have an idea of how much a business needs to produce if it is to survive, it will calculate its break-even output. This is the point where total revenue is equal to total costs, which means the business is not making a profit or a loss. Through calculating break-even, a business knows how many units it will need to produce and sell in order to start making a profit.

This information can be represented on a break-even chart or graph and will show the potential profit or loss that could be made at different levels of output, as revenue and costs change.

Break-even chart for Business A:



This break-even chart shows that fixed costs are drawn as a straight line, which is the case because they do not change with output. The total cost line is also shown, instead of the variable cost line on its own, as the total cost line takes into account both fixed and variable costs. The total cost line starts at the same point as fixed costs, as even if the business is making no output, fixed costs still need to be paid. At zero output however, variable costs are zero resulting in fixed costs and total costs being the same value. The revenue line is lastly drawn, which starts at zero and goes up diagonally. This is because as the business makes and sells more, it will gain more revenue.

In this example, Business A's break-even point is 10,000 units, the point where total costs and total revenue cross. This means that if the business manages to produce and sell this amount of output, it will not be making a profit or a loss.

Business A can also calculate the margin of safety from the chart. This is the difference between its current level of output/sales and the break-even point. If Business A was currently selling or producing 15,000 units, its margin of safety would be 15,000 (current level of output) – 10,000 (break-even point) = 5,000 units. Business A would want the margin of safety to be as high as possible, as this shows how much output or sales could fall before it hits its break-even point and then after this, it would be making a loss.

The value of using break-even analysis to a business

- ☑ Break-even is a very useful business tool, as it can quickly illustrate what happens to a firm's profits at different output levels. This can help a business with decision-making about cost levels and selling prices.
- ☑ A business could create a series of break-even charts to illustrate what would happen if one of the variables on the break-even graph changed and then see the impact on its break-even point. This is called "what if" analysis.

Break-even does however have limitations:

- ☒ It assumes that the average price that goods sell at will stay the same.
- ☒ It gives the impression that just because products are produced that they will be sold at the average price.
- ☒ It can become very complicated to a business which sells many different goods and services.
- ☒ It assumes that variable costs are proportional to output, whereas they may get cheaper as output rises or more expensive if workers have to be paid overtime.
- ☒ It may mean that the business focuses on breaking-even rather than making a profit!

Analysing financial performance

Businesses will be analysing all areas of their business operation, marketing effectiveness, production quality, staff retention and so on. One area where they have no choice but to produce data for is its financial performance.

Overview of financial statements

Every transaction that a business gets involved with ultimately finds its way into the **accounting records** and **financial statements** of the business.

Financial accounts are required to be kept by law by all businesses. Plcs must produce much more detailed accounts for their investors, analysts and other users of accounts, in comparison to sole trader and partnership businesses. Two key financial statements that business's produce are the:

Statement of financial position	This is a snapshot of the business's assets (what it owns) and its liabilities (what it owes) on a particular day, usually the last day of the financial year. The total is the capital value of the business.
Income statement	This measures the business's performance over a given period of time, usually one year. It compares the income of the business against the cost of goods or services and expenses incurred in earning that revenue.

Users of financial accounts

The financial accounts provide a wealth of information that is useful to various external users as summarised here:

User	Interest in / use of accounting information
Investors	Investors are concerned about **risk and return** in relation to their investments. They require information to decide whether they should continue to invest in a business. They also need to be able to assess whether a business will be able to pay dividends and to measure the performance of the business's management overall.
Lenders	Banks and other financial institutions, which lend money to a business, require information that helps them determine whether loans and interest will be paid when due.
Payables	Suppliers require information that helps them understand and assess the ability of a business to pay its debts.
Customers and	Customers require information about the ability of the business to survive

receivables	and do well. As customers of the business's products, they have a long-term interest and may depend on the range of goods and services it produces.
Employees	Employees and organisations that represent them, for example trade unions, require information about the stability and continuing profitability of the business. They are crucially interested in information about employment prospects and the protection of pension funds. They are also likely to be interested in the pay and benefits obtained by senior management!
Government	There are many government agencies and departments that are interested in accounting information. Her Majesty's Revenue and Customs (HMRC) need information on profits, so they can collect business (corporation or income) tax.

Purpose of financial statements

As well as the external users listed previously, the business itself will make much use of the financial statements that are produced.

The **statement of financial position** can:

- show what the business is worth i.e. the total value of all its assets at a point in time. This year's value can be compared to previous years
- provide a comparison between what the business owes and what is owed to the business, which provides an indication as to whether it can pay its bills
- provide a measure of whether the profit it makes is sufficient compared to the money that the business is worth

The **income account** also:

- shows how the business has **performed over a period of time** and whether it has made an acceptable profit or has made insufficient profit or even a loss
- enables the business to compare its **performance with competitors or with last year**, as the accounts can be compared to previous years and with other similar businesses

Statement of financial position

This statement summarises the business's value at a particular point in time. An example of its contents and a simplified layout is provided here:

Anytime Business Limited - Statement of financial position on 31 December	**2016**	**2015**
	£'000	**£'000**
ASSETS		
Non-current assets		
Property	1,800	1,600
Machinery	500	400
Vehicles	300	250
	2,600	**2,250**
Current assets		
Inventories	1,575	1,665
Receivables	4,030	3,800
Cash	1,340	780
	6,945	**6,245**
Current liabilities		
Payables	3,110	2,875
Short-term borrowings	640	805
	3,750	**3,680**
Net current assets	**3,195**	**2,565**
Non-current liabilities		
Long-term borrowings	1,340	1,590
	1,340	**1,590**
NET ASSETS	**4,455**	**3,225**
EQUITY		
Share capital	500	500
Retained earnings	3,955	2,725
TOTAL EQUITY	**4,455**	**3,225**

These statements of financial position show that the value of "Anytime Business Ltd" has increased by 38.14% between 2015 and 2016 or £1,230,000. This is because the business has increased both its non-current assets and net current assets between the two years, as well as successfully reducing the value of its non-current liabilities.

Key parts of the statement of financial position can be summarised as follows:

Non-current assets

This shows the accounting value of what the business owns (assets) i.e. what they are worth. These assets would be expected to last for **more than one year**. The most common examples are buildings, land, vehicles, IT equipment and machinery.

Current assets

This section of the statement of financial position shows the assets a business owns, which are either cash or are expected to be turned into cash during the next twelve months. Current assets are, therefore, **very important to cash flow management** because they are the assets that a business uses to pay its bills, repay borrowings, pay dividends and so on.

The main elements of current assets are:

Inventories	Inventories or stock are the **least liquid kind of current asset**. These include raw materials, finished products that are ready to sell and also the cost of "work-in-progress" i.e. partly finished goods, as they pass through the production process. Inventories will take longer to turn into cash for many businesses and some may need to be sold off cheaply or discarded if they are damaged or customers no longer demand them.
Receivables	**When a customer is allowed to buys goods or services on credit**, they are known as receivables**.** The sale is recognised as revenue in the income statement when the transaction takes place and the amount owed is added to the receivables figure in the statement of financial position. These are assets because at some stage in the future, when the customer pays, the receivables figure becomes cash! Of course some customer debts are never paid, leaving the business with bad debts or money that the business will never receive!
Cash	The most liquid form of current assets is the actual cash balances that the business has in its bank account at a moment in time.

Current liabilities

Current liabilities represent amounts that are **owed by the business** and which are due to be paid within the next twelve months. Current liabilities are normally settled from the amounts available in current assets.

The main elements of current liabilities are:

Payables	Amounts owed by a business to its suppliers for goods and services supplied but not paid for, are called payables. These amounts will be paid some time in the future, dependent on the length and amount of credit the supplier allows.
Short term borrowings	Amounts in this category represent the amounts borrowed that need to be repaid in the next year. This would include any overdrafts.

Net current assets

NET CURRENT ASSETS = CURRENT ASSETS – CURRENT LIABILITIES

This represents the money available to a business for its day to day operations. If it is negative this means it may not have enough money to pay its immediate debts.

Non-current liabilities

This category shows the longer-term liabilities or debts that a business has. “Longer-term” means debts that need to be settled in more than one year’s time. This would include bank loans which are not yet due for repayment.

Net assets

NET ASSETS = NON-CURRENT ASSETS +

NET CURRENT ASSETS – NON-CURRENT LIABILITIES

This represents the total value of a business and is the same figure as its equity.

Equity

The equity section shows the value of capital invested into the business by shareholders or owners and the profits that have been retained. The two main parts are:

- **Share capital** – the cash raised by the business from the sale of new shares
- **Retained earnings** – the total net profits earned by the firm since it was formed, which have been retained and left in the business

Total equity will be the same as net assets and represents the value of the business at a point in time.

Income statement

This statement is a summary of the trading of a business normally over the last year. It shows how much profit or loss the business has made during that year. An example of its contents and a simplified layout is provided here:

Anytime Business Limited		
Income statement	**2016**	**2015**
year ended 31 December	£'000	£'000
Revenue	**21,450**	**19,780**
Cost of sales	13,465	12,680
Gross profit	**7,985**	**7,100**
Distribution costs	3,210	2,985
Administration expenses	2,180	1,905
Net profit	**2,595**	**2,210**
Net interest costs	156	120
Profit before tax	**2,439**	**2,090**
Tax	746	580
Profit after tax	**1,693**	**1,510**

These income statements show that "Anytime Business Ltd" gross profit, net profit and profit after tax have all increased between 2015 and 2016, showing that the business is performing better than the year before. This is because the business has successfully managed to increase its sales revenue figure, but at the same time control both its cost of sales and overhead/expenses i.e. the revenue figure has increased at a greater rate than the increase in cost of sales and expenses during that period.

The different parts of an income statement are briefly described as follows:

Category	**Explanation**
Revenue	The revenue or value of the sales made to customers during the period.
Cost of sales	The direct costs of generating the recorded revenues make up "cost of sales". This would include the cost of raw materials, components, goods bought for resale and the direct labour costs of production.
Gross profit	The difference between revenue and cost of sales. A simple but very useful measure of how much profit is generated from every £1 of revenue before overheads and other expenses are taken into account, is called the **gross profit margin** (%) and is discussed later.
Distribution and	Operating costs and expenses that are not directly related to

administration expenses	producing the goods or services are recorded here.
Net profit	A key measure of profit. Net profit records how much profit has been made in total from the **trading activities of the business**. It is calculated by deducting all overheads/expenses from gross profit.
Finance expenses	Interest paid or received.
Profit before tax	Calculated as net profit plus or minus finance expenses.
Tax	An estimate of the amount of **corporation or income tax** that is likely to be payable on the recorded profit before tax.
Profit after tax	The amount the business has left for either reinvestment or to share out to owners or shareholders in the form of dividends.

Interpreting the financial statements

The statement of financial position and the income statement provide much useful information for a user of accounts to better understand how the business is doing. Some useful analytical tasks would include:

Comparing performance over time	By looking at data over several years, it is possible to see whether a trend is emerging i.e. whether the business's performance is continually getting better or worse!
Comparing performance against competitors or the industry as a whole	Has the business's revenues or profits grown as fast as close competitors? How has the business performed compared with the market as a whole?

From the information provided in both the statement of financial position and the income statement, decisions will be made by the owners or senior managers to improve a firm's performance in order to satisfy as many different stakeholders as possible and so the business can continue to be successful or improve its performance in the future.

Profitability ratios

The income statement shows how much profit a business has made over a period of time. However, it is important for business owners, shareholders, managers and other stakeholders to know whether the level of profit is good or not. One way to judge how "profitable" a business is, is to calculate profitability ratios. There are two main profitability ratios:

- Gross profit margin
- Net profit margin

Gross profit margin

This ratio compares the gross profit earned in a period with the revenues of that period. It is calculated using this formula:

$$\text{Gross Profit Margin} = \frac{\textbf{Gross Profit}}{\textbf{Revenue}} \times 100$$

The table shows some examples of the gross profit margin calculation:

Business	A	B	C
Revenue	200,000	500,000	1,000,000
Cost of Sales	100,000	300,000	750,000
Gross profit	100,000	200,000	250,000
Gross profit margin	**50%**	**40%**	**25%**

In the table, it can be seen that Business C makes the highest gross profit of £250,000. However, this is because it has much higher revenues that Business A or B. In terms of gross profit **relative to revenues**, Business A has the highest gross profit margin of 50%, followed by Business B (40%).

The gross profit margin shows that Business A makes a gross profit of £0.50 for each £1 of revenue. That is twice the level of Business C, which only makes a gross profit of £0.25 for each £1 of revenue.

Why might the gross profit margin of these three businesses vary so much? Well, they might operate in different industries? If they are in the same industry, then Business C might be less efficient than the other two or its selling price might be much lower.

Net profit margin

Net profit is what is left after all the costs of a business have been taken from its sales revenue. The net profit margin compares the net profit earned in a period with the revenues of that period. It is calculated using this formula:

$$\textbf{Net Profit Margin} = \frac{\textbf{Net Profit}}{\textbf{Revenue}} \times 100$$

Look at the following example:

Monthly net profit for January 2016	**£'000**
Sales	400
Cost of sales	200
Gross profit	200
Expenses/overheads	150
NET PROFIT	**50**
Net profit margin	***25%***

The income statement above shows that the business has made a net profit of £50,000. The net profit is calculated by subtracting all the business expenses/overheads totalling £150,000 from the gross profit of £200,000. In the period, the business has made a net profit margin of 25%. That means that it has converted 25% of each pound of sales into net profit – a good achievement!

The net profit margin is the most significant of these two ratios as it shows a business:

- how effectively a business turns its sales into profit
- how efficiently a business is run, in particular, is it keeping its operating costs as low as it can?

On its own, the net profit margin is useful information. However, it is even more useful if comparisons can be made between:

- changes in net profit margin over time, for example month by month or comparing different years
- net profit margins of competitors in the same market

Look at this example:

Example	**Company A £'000**	**Company B £'000**	**Company C £'000**
Sales	150	250	500
Net profit	50	25	125
Net profit margin	20%	10%	25%

Looking at the financial information given, it can be seen that:

- Company A makes a higher net profit than Company B even though its sales are lower, because it has a higher net profit margin and is clearly controlling its expenses, overheads and cost of sales well
- Company C makes the highest net profit margin of the three businesses and also has the highest sales. Therefore this business makes the largest net profit too!

It should be remembered that accounts and their ratios are tools for decisions, they do not make decisions – managers do that! Before making decisions, managers will take into account all the circumstances faced by the business, including internal and external factors and the needs of different stakeholders.

Glossary of key business terms:

Term	Definition
Absenteeism	Where employees are not at work because of choice or ill health
Add value	The process which a business undertakes so a business or service is worth more than the value of its inputs
Advertising	Promotional method where a business pays to place an advert in a form of media, such as a newspaper or television
Aims	The overall goals of a business or organisation; what the business is trying to achieve
Application form	A method of applying for a job where the required details are decided by the business who is recruiting
Asset	A resource owned by a business that is of value
Average rate of return	The annual percentage profit that an investment makes compared to the cost of the investment ARR (%) = $\frac{\text{Average annual profit (total profit from the investment} \div \text{number of years)}}{\text{Initial cost of the investment}} \times 100$
Batch production	Method of production where groups or types of product are made at several stages
Billboard	Very large advertisements displayed on the side of a road or by an important or significant building i.e. large posters
Boston Matrix	A method of classifying a business's product portfolio to help future product planning
Brand image	What distinguishes a product or service from the product or service with which it competes
Break-even	Where total revenue is the same as total cost and zero profit is made
Break-even chart	Graphical representation of costs and revenue for a business's product to show the breakeven output

Budget	(i) A low cost version of a product or service (ii) The amount planned or available to spend as part of a business costs
Buffer stock	A quantity of stock kept in store to safeguard against unforeseen shortages or increases in demand
Business	An organisation set up to meet customer demand and to make a profit for its owners
Business activity	How the business plans and operates its business
Business environment	The external factors, such as the economy and the law, that influence how a business operates
Business operations	The day to day production of the business's product or service
Business plan	A document produced by a new or existing business that shows what its objectives are and how it will meet them
Business start-up	The planning and launch of a new business
Capacity	The maximum production output a business can achieve with its existing resources
Capital	The initial money that is needed to start a business that is normally linked to purchases of machinery and premises
Cash	The money that a business receives from its customers and which it uses to pay its suppliers
Cash cow (Boston Matrix)	A product in a business product portfolio with low growth and high market share
Cash flow	The money that flows into and out of a business
Cash flow forecast	The prediction of how much money will come into and out of a business over a future time period
Cash inflow	The money that comes into a business from sales and other sources
Cash outflow	The money leaving a business that it spends on raw materials, labour and other expenses

Centralisation	Where business decision making and implementation take place at and from the business headquarters
Chain of command	Part of the structure of a business organisation which shows who is in charge of who
Closing balance (cash flow forecast)	The total cash flow left at the end of a period
Commission	The extra amount of pay workers receive as a percentage of their or the business's sales
Communication	How messages are passed within a business or from a business to its customers
Competition	Other businesses that produce the same or similar goods or services
Competitive pricing	Where the price of a product is decided by comparing it to its rivals
Consumer	The person or business that use the product or service produced
Consumer income	How much money consumers have to spend on their needs and wants
Consumer law	Legal constraints that protect the consumer from unfair business practice
Consumer Rights Act	A law protecting the consumer in terms of product quality, returning goods, repairs and replacements, digital content and delivery
Consumer spending	The level of spending that consumers undertake related to their income
Contract of employment	A legal document signed by the employer and the employee providing the details of the job they are employed for
Coordination	Making sure the resources of a business are organised in a way that makes production efficient
Cost of sales	The direct costs of generating production, such as raw materials

Cost-plus pricing	A pricing method where a business decides what price to charge, based only on the cost of its production and some extra to make a profit
Costs	What a business spends its money on
Culture	The business way of doing things
Current asset	Resources owned by a business that can easily be turned into cash
Current liability	Amounts that are owed by the business and which are due to be paid within the next twelve months
Curriculum vitae	A document summarising the personal details, qualifications and experiences of an individual; often used to apply for a job.
Customer engagement	Communicating with customers in a positive way
Customer loyalty	Whether customers return to a business on a regular basis to purchase more of the same goods or other goods that they produce
Customer satisfaction	How happy the consumer is with the product or service they have purchased
Customer service	How a business looks after its customers before, during and after they make a purchase
Customers	The people who purchase a product or service from a business (not always the consumer)
Decentralisation	Where an organisation and its decision-making is spread out to include more junior managers, as well as individual business units or locations
Deficit	Where the closing cash flow balance at the of a period is negative
Delayering	A method of saving costs in an organisation by reducing the number of layers or levels in a hierarchy

Delegation	Where work, but not responsibility for the work, is given to another person
Deliveries	Where a business receives goods from a supplier
Demand	Where a consumer of a business desires a product and has the money to pay for it
Digital communication	Sending messages using mobile or internet technology
Digital technology	Where businesses used computers in any way to improve their business performance
Direct marketing	A business promotes and sells products direct to the customer without using any other businesses as part of the distribution process
Diseconomies of scale	Where the average costs of a business increases as it produces more because of poor motivation, communication or coordination
Discrimination	When an employer choses its workers based on a particular characteristic; many of these are illegal, for example age, gender and race
Distribution channel	How the product or service gets from the producer to the consumer
Dividend	The share of the profit received by a shareholder
Dog (Boston Matrix)	A product in a business's product portfolio with low growth and low market share
E-commerce	Using the internet to promote and sell a good or service
Economic considerations	How a business is affected by economic variables, such as interest rates or inflation, in a country or in other countries
Economies of scale	Where the average costs of a business decrease as it produces more, due to benefits such as bulk buying discounts and use of machinery

Efficiency	Measures of how much output is being produced per unit of input
Employees	The workers who directly or indirectly provide the good or service that the business produces
Employment law	Legal constraints that protect the employees of a business from unfair business practice
Employment level	The % employment rate in a country which will effect consumer spending and the availability of employees
Enterprise	A business that is established or running with the objective of making a profit
Entrepreneur	An individual who takes a calculated risk in starting or running a business in return for making a profit
Environmental expectation	Effect on businesses of consumer and producer concerns about the environment
Equality Act	A law stating that men and women are entitled to equal pay for work of equal value
Ethical objectives	Where businesses have as an aim what is morally right, rather than necessarily the most profitable option
Exchange rate	The amount of one currency that can be purchased with another currency
Expansion	Where a business increases the amount or value of the goods or services that it produces
Expenses	Indirect costs that a business has to pay that do not vary with the amount it produces
Exports	Goods or services that are produced in this country and sold to other countries
Extension strategies	Methods of prolonging the product life cycle to extend the life of a product
External growth	Methods of business growth using acquisitions, mergers and takeovers

External recruitment	Where a business aims to finds new workers from outside of its current workforce
External sources of finance	Sources of money from outside of a business
Equity	An accounting value showing the total value that a business is worth
Factors of production	The necessary ingredients for a business to operate: land, labour, capital and entrepreneurship
Finance (functional area)	The area of a business's operation that considers how money is raised, managed and recorded
Finance	The money that is necessary to start and run a business
Financial methods of motivation	Where an employee is rewarded through money
Financial objectives	Quantifiable targets for a business including profit, sales and costs
Financial statements	Accounts produced by a business to show its financial performance
Fixed costs	Business costs that do not vary with output, for example rent
Flat organisational structure	Where the organisational structure of a business has few layers, short chains of command and wide spans of control
Flow production	Method of production associated with making very large quantities of standard products
Focus group	In depth market research where discussions take place with a group of potential or actual consumers
Franchise	Where a business acquires the right to use the name and products of another business
Franchisee	The business which runs a franchise in a specific territory or area
Franchisor	The seller of a right to operate a franchise

Fringe benefits	Methods of rewarding a worker that are not directly monetary
Full time worker	An employee who is employed for a whole weeks work
Functional areas	Specialist areas within a business, namely operations, finance marketing and human resources
Gap in the market	An opportunity for a business to provide a good or service that is not currently available
Globalisation	The increased integration of trade, finance and communications between countries
Global warming	An environmental factor that influences the policy of a business
Goods	Products that business produce that have a physical presence
Grant	A source of finance for a business that does not have to be repaid
Gross profit	The difference between revenue and cost of sales; gross profit = total revenue – cost of sales
Gross profit margin	The percentage profit made on sales not taking into account the businesses expenses; gross profit/sales revenue x 100
Growth	A business objective of increasing the amount or value of sales
Health and safety law	Legal constraints that protect the employees of a business from unsafe business practice
Hire purchase	A method of buying a product using regular payments
Human resources	How a business recruits and manages its workforce
ICT	Information and communication technology
Import	Goods or services that are produced by other countries and consumed in this country

Income statement	An account measuring the business's performance over a period of time, usually one year comparing the income of the business against the cost of goods or services and expenses
Induction training	Training that a business provides to new employees or an existing employee when starting a new post
Infrastructure	Features of an economy such as buildings, transport and power supplies that are needed for an economy to function
Inspection (quality)	The checking of products to ensure that they meet the required standards before they are sold
Interest rates	The percentage cost of borrowing money or the reward for saving money
Internal recruitment	Where a business aims to finds new workers from within its current workforce
Internal sources of finance	Where a business obtains funds from its own sources, such as retained profits
International expansion	Where a business grows in value through sales in other countries
Internet research	Methods of market research, such as using website data from competitors and government and market reports
Interview	(i) A method of selecting employees (ii) A market research method, where qualitative data is gained directly from a customer or potential customer
Inventory	Stock that is being used or held within a business
Investment	The purchase of new premises or machinery which can be used for growth, replacement or mechanisation
Job analysis	A business deciding whether it needs a worker and if so, what type, for example full time or part time

Job description	An explanation of the roles and responsibilities of a job
Job enlargement	Giving workers a greater variety of tasks to make the work more interesting
Job enrichment	Giving workers more responsibility or more complex and challenging tasks, so they have a sense of achievement
Job production	Method of production where products are made individually
Job role	The type or level of a job undertaken by an employee
Job rotation	Where a worker moves from one job to another job over a period of time
Job share	Where two (or more) employees divide up a full time job between them
Just-in-case	Where more stock than is needed is held to allow for delays and growth in demand
Just-in-time	Where inputs into the production process arrive on the production line just as they are needed
Kaizen	A method of continuously improving quality through introducing small changes
Labour	The workers who are needed directly or indirectly to provide the good or service that a business produces
Labour turnover	The rate at which employees join and leave a business
Lack of continuity	Where a change in business ownership or management makes relations with customers difficult
Land	The area that is needed to locate a business and any natural raw materials that are required for the production process
Lead time	The time between ordering a good or service and receiving it
Lean production	Production techniques that involve reducing waste in the production process

Legal structure	What type of organisation a business chooses to be, such as a partnership or company
Legislation	Laws in a country that affect the economy and businesses in the economy
Liabilities	Amounts that are owed by a business
Limited liability	The protection enjoyed by shareholders who can only lose the money they have put into the company
Line manager	A person with direct responsibility for another employee
Living wage	The minimum hourly wage rate set by the government that must be paid to all employees who are 25 or over
Loan	Source of finance for a business, where they receive a fixed amount of money for a specified time period, which will need repayment with interest
Local community	A business stakeholder who will be affected by a business's location, for example in terms of direct and indirect employment opportunities
Location	The place where a firm decides to conduct its business
Logistics	The management of the flow of goods, information and money along the supply chain
Long list	The possible candidates who have applied for a job who might be suitable
Loss	Where the costs of a business are greater than its income
Loss leader	Where a business prices a good at less than its cost to encourage customers to buy other goods at the same time
Luxury good	Goods of which more are sold as consumer incomes increase
Management	How to successfully ensure that employees work effectively

Management style	The different methods managers use to motivate their workers
Margin of safety	The additional output that a business produces, or expects to produce, more than its breakeven output
Market	Where producers and consumers come together to sell and buy goods and services
Market research	Information from existing and potential consumers about their reaction to a product or service
Market share	The percentage of total sales of a particular product or service that a business has
Market size	The total number or value of sales from all firms in a market for a product or service
Marketing	Providing the goods and services that consumers require whilst making a profit
Marketing mix	A combination of factors such as product, price, place and promotion designed to encourage potential customers to buy a product; often known as the "4Ps"
M-commerce	Using smart phone and mobile phone technology to promote and sell a product or service
Merger	Where two businesses of equal size are joined together
Minimum wage	The different wage rates that a business must pay as a minimum depending on the age of the employee
Mortgage	A long term loan to a business, so that they can purchase land and premises
Motivation	The desire of an employee to do a job well
Mystery shopper	A person employed to secretly assess the quality of goods or services provided by a business
Needs	What an individual must have in order to survive

Net assets	The total value of a business; non-current assets + net current assets – non-current liabilities
Net cash flow	The difference between the cash inflows and cash outflows for a business in a time period
Net current asset	The money available to a business for its day to day operations; current assets – current liabilities
Net profit	The total amount of money made from the trading activities of the business; net profit = gross profit - overheads/expenses
Net profit margin	The percentage profit made after all costs and expenses have been deducted; net profit/sales revenue x 100
New product development	A process undertaken by a business to design and launch new or replacement products
New share issue	When a company raises finance through selling shares to new or existing shareholders
Non-current asset	The value of what the business owns that are expected to last for more than one year
Non-current liabilities	The value of what the business owes that does needs to be repaid after one year
Non-financial methods of motivation	When an employee is rewarded through means other than money
Non-financial objectives	Business targets that involve areas such as improving quality and being more ethical
Not-for-profit organisations	Charity, community or other voluntary organisations
Objectives	The specific targets that a business wants to achieve that are measurable
Off-the job training	Where workers learn how do their job away from the workplace
On-the-job training	Where workers learn how do their job at their actual workplace
Opening balance (cash flow forecast)	The total cash flow available at the start of a period

Opportunity cost	Measuring the cost of what a person purchases against the alternative that he/she has given up
Organic growth	Expansion from within a business by expanding the range of products and/or locations
Organisational structure	The way employees are arranged into a hierarchical structure for control and communication
Output	The total quantity produced by a business, employee or machine over a given period of time
Outsourcing	Where a firm gets other outside businesses to perform work for it
Overdraft	Source of finance for a business where they are allowed to take more money out of their account than they have deposited
Overheads	Costs or expenses of a business that do not vary with output
Part time worker	An employee who is employed for less than a whole weeks work
Partnership	Where a business is started and owned by more than one person, who then share the profits and the responsibilities
Payables	The accounting value of goods that a business has received but not yet paid for
Pension	Money received by an individual after they retire based on contributions they have made whilst working
Person specification	The qualifications, skills, experience and personal attributes needed for a job
Piece rate	Where a wage is based on the quantity produced
Point of sale	Near where a decision is made to purchase a product and is where sales promotions will be targeted
Pollution (noise and air)	An environmental consideration, which businesses may target to reduce as one of their objectives
Post sales service	Following up a customer to make sure they are happy with the product or service purchased

Pressure group	A collection of individuals who have common cause and campaign to achieve it
Price	The amount of money a customer needs to buy a good or service
Price penetration	A strategy of launching a new product with a low price to attract customers and gain market share
Price skimming	A strategy of entering a new market with a high price to recover research and development costs
Primary industries	Business that extract their goods from the land or sea
Primary research	First-hand information gathered by a business about existing and potential consumers
Printed press	Media such as newspapers and magazines
Private limited company	The most common kind of limited company in the UK, where shares can only be sold to "family and friends"
Problem child (Boston Matrix)	A product in a business product portfolio with high growth and low market share
Procurement	The process of choosing a supplier
Product design	A process of coming up with a new product taking into account its function, aesthetics and cost
Product differentiation	When a business makes its product different or unique to those of its competitors
Product life cycle	The stages in the life a product from when it is first thought of until it is finally removed from the market
Product portfolio	The range of products produced by a business
Product recalls	Products that are requested by the business to be brought back to store or sent back to the business due to quality issues

Production	The process which involves taking inputs and transforming them into outputs
Productivity	The amount of output per unit of input i.e. labour, equipment and capital
Profit	The difference between costs and revenue; profit = total revenue – total costs
Profit maximisation	An objective of a business to make as much money as possible
Profit share	A method of incentivising and rewarding workers where they receive a share of the overall business profits
Promotional mix	Methods of making a consumer aware of a product and persuading them to buy it; includes advertising, sales promotion and public relations
Proximity to market	Location factor where a business is influenced by how near it wants to be to its customers
Public limited company	The kind of limited company whose shares can be bought on a recognised stock exchange
Public relations	An approach to promoting a business focussed on producing a positive image using media and other indirect methods
Purchasing economies of scale	When a business receives a discount through buying in bulk, which helps it reduce its average cost of production
Qualitative data	Results of research that is based on opinions, attitudes and beliefs
Quality	Where a product is of a standard that meets customer requirements
Quality assurance	Setting up processes in production to ensure that quality is achieved
Quality circle	Meetings of management and employees on an equal basis to discuss quality improvements
Quality control	Checking that takes place at the end of the production process to ensure that products are of the required standard
Quantitative data	Results of research that are normally numerical, which are used when analysing a market

Questionnaire	A method of gaining market research data, which can be conducted on line, face to face, via the post or over the phone
Raw materials	The inputs needed for the production of a good or service
Receivables	The accounting value of goods that a business has sold, but not yet been paid for
Recruitment	A process a business undertakes to attract new or replacement workers
Recycling	Where waste products from a business are found an alternative use
References	Information provided in support of an application
Reliability	Whether a supplier will always deliver at the agreed time
Remuneration	The package of pay and other rewards provided to an employee
Reputation	The opinion held by other people about a business and the products and services that it provides
Research and development	Costs that are required in getting a new product ready to launch into a market
Retailers	The final part of the distribution process where the product is sold to the customer
Retained profit	A source of finance based on money that a business keeps back after paying shareholders a dividend and giving owners their share of the profits
Retention	How well a business keeps the staff that it employs
Revenue	The income from sales; selling price per unit x quantity sold
Reworking	Mending or remaking a poor quality product

Risk	The possibility that a business may not be successful
Roles and responsibilities	The details about a job and what it involves
Royalty	An extra amount of money earned by a franchisor based on the value of sales that the franchisee makes
Running costs	Day to day costs such as materials, labour, power that a business will have to keep paying on a frequent basis
Salary	Employee pay which is a fixed amount for the year based on a certain amount of hours per week to be worked; usually paid monthly
Sale of unwanted assets	A short term source of finance where a business sells items of stock, equipment and premises that it no longer needs
Sales process	A series of activities that are designed to engage customers and to complete a sale
Sales promotion	Point of sale methods that persuades customers to buy a product
Sample	Where a small number of possible customers are chosen to take part in market research
Scarce resources	The idea that we cannot have everything we want because there is a limited amount of resources in the world
Secondary industries	Business that manufacture or build
Secondary research	Information that has already been collected by other businesses or organisations about existing and potential consumers
Segmentation	A way of dividing up the market into different groups of potential customers
Selection	Methods used by an employer to decide which employees it is going to recruit
Separate legal entity	Where a business has an independent existence from its owners, such as with a private limited company

Service	Activities that are provided by a business for customers which are intangible
Share capital	The money raised by a business from the sale of shares
Shareholder	An owner of a company who receives a dividend as a return for their investment
Shareholder value	The value of a company calculated as the number of shares x the current share price
Shares	When an investor owns part of a private or public limited company
Short list	The most likely candidates who have applied for a job, who are invited to take part in the selection process
Social enterprise	An organisation that runs like a business, but where some or all of its profits are given to meet a specific social need
Social media	Internet sites, such as Facebook and Twitter, that allow individuals to interact through messages and updating
Social objectives	Business objectives such as being ethical or environmentally friendly
Sole trader	Where a business is started and owned by one person who has all the profits and all the responsibilities
Sources of finance	Options that a business has if it needs additional finance to start, run or expand its business
Span of control	The number of employees who a manger directly controls
Specialisation	Where an employee or business concentrates on activities in which they have the most appropriate skills
Sponsorship	A type of public relations where a business aims to improve brand awareness through making donations to individuals and organisations
Staff	The employees of an organisation

Stakeholder	An individual or group that is directly or indirectly affected by the actions of a business
Star (Boston Matrix)	A successful product in a business product portfolio with high growth and high market share
Start-up costs	Money that is required on a one off basis when a business is launched
Statement of financial position	An accounting summary of the value of a business at a point in time
Stock	The amount of raw materials or finished goods that a business holds on its premises
Stock exchange	A market where shares in public limited companies can be bought or sold
Subordinate	An employee in a business, who has a manager who directs their work
Supplier	A business that provides raw materials, components, finished goods or services in exchange for payment
Supply chain	All activities that are involved in getting a product or service to the customer
Surplus	Where the amount of cash flow left at the end of a period is positive
Survey	A method of market research where customers and potential customers are asked their opinions
Survival	A business objective where continuing in existence becomes the short term goal
Sustainability	To ensure that production in an economy can continue at the same level in the future
Takeover	Where a business acquires another business
Tall organisational structure	Where the organisational structure of a business has many layers, long chains of command and narrow spans of control
Target market	Where customers are segmented to allow businesses to focus its marketing policy on meeting their requirements

Technical economies of scale	Where large businesses can afford to invest in high output machinery that reduces their average cost
Technology	How businesses uses machines and devices to improve their operation
Telesales	Direct selling using telephone contact
Tertiary industries	Businesses that provide a service
Total costs	All the costs of a business; total costs = fixed costs + variable costs
Total quality management	A business culture with the aim of zero defects and getting it right first time
Trade credit	When a business orders and receives supplies, but pays for them at a later date
Trade Descriptions Act	A law making it illegal for a business to make false or misleading statement about its goods or services
Traffic congestion	An environmental and cost consideration where a businesses may try and reduce congestion by rescheduling its distribution methods
Training	How employees learn to do a job
Uncertainty	Where a business's risks will be increased in a competitive environment, as it does not know the plans of the rival firms
Unique selling point	What makes a business's product or service different from its competitors
Unit cost	The average cost of production; unit cost = total costs ÷ output
Unlimited liability	If a business goes bankrupt, sole traders and partners are personally liable or responsible for their business's debt
Variable costs	Business costs that vary with output, such as raw materials

Wage	Employee pay which is a based on the number of hours worked; usually paid weekly
Wants	What an individual would like but does not need in order to survive
Website	An online brochure for a business that is available through the internet; it can include links to other services such as sales
Wholesalers	An intermediary between the producer and the consumer
Word of mouth	Where opinions about a business and its product are informally passed from person to person
Zero defects	The aim of the total quality management process
Zero-hour contract	A type of employee contract where there is no guarantee that the worker will receive any work