EDEXCEL GCSE BUSINESS (9-1)

COURSE COMPANION

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Comprehensive Study Notes for Theme 1 and Theme 2 of Edexcel GCSE Business (9-1)

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Theme 1 – Investigating Small Business

1.1 Enterprise and entrepreneurship

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware of the local and national business environment and how this might impact on a small business. Students must be aware of this sections relationship with the other areas in this theme and how these areas may impact on business decision-making.

Section	Key things to learn
The dynamic nature of business	New business ideas and their sources Adapting existing ideas Changes in technology Changes in customer requirements
Risk and reward	Types and impact of business risks Types and impact of business rewards
The role of business enterprise	The role of enterprise in business activity Production of goods and services Meeting customer needs Adding value The role of the entrepreneur

Dynamic nature of business

Where do business ideas come from? In practice, there are many ways in which a business opportunity and idea is first spotted.

Firstly, the world in which we live in is always rapidly changing and therefore businesses are constantly faced with change. These changes include new **legislation,** changes in the **economy,** new **technology**, which may result in some goods and services becoming obsolete, **political** events and even the weather. **Consumer tastes** will change as new fashions arise and as new ideas and developments come along.

Successful businesses will come up with new ideas, adapt existing products and change their location and their staff as different circumstances arise. Change is a massive opportunity! However, it is also a considerable **threat** to those businesses that ignore the changes that are taking place in the market. Businesses should avoid standing still, as those that try to will generally end up failing!

Some of the key changes that give rise to new ideas are summarised below:

Type of change:	Explanation:
New technology	Ideas for new products might come about due to advances in technology. Computers, smartphones, digital cameras and so on, are all examples of products where new technology is constantly allowing new products to be developed and launched for sale.
Change in consumer wants	Fashions and consumer tastes are always changing. As well as the more obvious areas of clothing, designs will also change in areas such as cars, furniture, buildings and many more consumer goods. There are also new trends in terms of healthy eating, fitness and specialist types of holidays.
Products and services becoming obsolete	Over time products become outdated as new products are developed, which is often linked to changes in technology. Other reasons for products becoming obsolete are changes in the economy, for example increased wealth will decrease demand for **inferior products**, such as supermarket value products and bus travel.

Original ideas

One of the key characteristics of many entrepreneurs is their creativity. Entrepreneurs will often produce many original ideas for new goods and services. In many cases, these will not prove practical or profitable to develop on a larger scale and take to market! Some ideas however, will be worth pursuing. At this point, the entrepreneur will undertake research and development of the idea.

Adapting existing products

Many new products are developed from existing goods or services, whereby the entrepreneur thinks of a way of improving them. Consider any technology based product, such as the computer or the mobile phone, and it is clear how much and how quickly the product has been adapted and developed in recent years.

Business experience

Many ideas for successful businesses come from people who have **experience** of working in a particular market or industry. For a start-up business, there are several advantages of applying this experience to a new business idea:

- ☑ Better and more detailed understanding of what customers want
- ☑ Knowledge of competitors, pricing, suppliers etc.
- ☑ Less need for start-up market research
- ☑ Entrepreneur is able to make more realistic assumptions in the business plan about sales, costs etc.
- ☑ The entrepreneur may have contacts in the industry, who might then become the first customers of the start-up!

All of the above help the business planning process and it can be argued that they reduce the risk of starting up a business.

On the other hand, it can be argued that "familiarity breeds contempt". In other words, detailed experience of an industry means that the budding entrepreneur does not have a fresh view. Someone who is new to a market may be able to exploit approaches that have worked in other industries, to make an impact with their idea.

Personal experience

Many ideas come to entrepreneurs from their day-to-day dealings in life or from their hobbies and interests.

For some of us, frustrating or bad experiences are a source of irritation. For the entrepreneur, they might suggest a business opportunity.

It is often said that one of the best ways to spot a business opportunity is to look for examples of poor customer service (complaints, product returns, persistent queues etc). Such examples suggest that there is an opportunity to do something better, quicker or cheaper than the existing offer!

Hobbies and interests are also a rich source of business ideas, although an entrepreneur would have to be careful to avoid assuming that, just because they may have a passion for collecting "rare can openers", there is a ready market from people with similar interests! Many people have tried to turn their hobby into a business and found that it generates only a small contribution to household income and therefore it would not prove to be a sustainable future business for the entrepreneur.

Observation

Simply observing what happens on a day to day basis can be a good way of spotting an idea. Often an idea will be launched in another country that has not yet been tried in other similar economies. For example, successful entrepreneur Stephen Waring, fortunately attended a wedding in the USA and by luck sat next to someone who ran a household service business, treating lawns. After some brief market research, Stephen found out that there was no similar business in the UK, so he launched one in 1986. Green Thumb has since become a hugely successful franchise business providing lawn care and grass maintenance for nearly 500,000 houses in the UK.

It is worth looking at other examples of successful business start-ups, in order to appreciate the wide and diverse range of sources of ideas that these firms are built upon. Here are some good ones:

Business	Entrepreneur	Where the Idea Came From
Propercorn	Casa Stavrou and Ryan Kohn	Casa, recognised that consumers tastes were changing. Consumers were looking for healthier alternatives to their favourite snack foods. Demand for organic, low sugar, low fat snacks, crisps and biscuits was rising. With the help of her best friend, Ryan, they decided to create a snack that they felt was satisfying, delicious and healthy. Propercorn, was born and is now sold in 11 countries and stocked in major supermarkets
King of Shaves	Will King	Will found traditional wet-shaving painful, due to his sensitive skin. His girlfriend suggested using oil to smooth the process. An oil-based solution to shaving was developed and is now a world leader.

Mallzee	Cally Russell	Cally was frustrated with the process of shopping online for clothes. He felt it was time consuming having to visit different sites to source his favourite brands. He create an app – Mallzee. The personalised shopping app allows shoppers to access their favourite stores within one app, making it simpler and easier to buy clothes online.
Superjam	Fraser Doherty	Fraser turned his grandmother's recipe for sugar-free jams into a best-selling grocery brand.

What makes a good business idea?

Having an idea for a business is the easy bit! It is much harder to work out whether the idea has potential and can be turned into a viable business idea.

Good business ideas therefore, tend to have one or more of the following characteristics:

- ☑ They solve a problem
- ☑ Offer a cheaper or better way of doing something than existing goods or services
- ☑ Are simple and practicable
- ☑ Can be developed and delivered to the market quickly
- ☑ Have a clear focus on meeting the needs of the target customer
- ☑ Anticipate market trends and exploit growth opportunities

Risk and reward

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 select private limited companies as their chosen form of business organisation).

Prior to complete failure, the business may also struggle for customers and to generate sufficient revenue to cover costs initially or on an ongoing basis. This may leave the entrepreneur with **a lack of security** – will he/she have enough funds to continue to trade successfully in the future, without being reliant on other sources of finance to keep the firm going? Will the entrepreneur have enough money to pay themselves a decent wage, to maintain his/her desired standard of living?

Another risk is that a failed business may leave the entrepreneur struggling to finance another business or successfully be appointed for a job in someone else's firm. This may be the result of the entrepreneur finding it difficult to face and accept 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 carried out as it is too expensive or, if it is completed, the data is frequently 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 goods 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!

Reducing risk

There are many ways of reducing risk in a new or small business. Some of the key ones are as follows:

- **Plan –** for example prepare a realistic business plan
- **Research** – market research should be valid, up to date and specific to the business's needs
- **Be cautious** – the business should avoid growing too fast

- **Finance with care** – shares and retained profits are safer than loans, as these sources of finance do not need to be paid back
- **Avoid costs** – premises and staff are expensive
- **Protect** – a company with **limited liability** will protect investors
- **Monitor and review** – look back and look forward, ensure the business is on track to where it should be; this can be achieved by monitoring finances and reviewing regularly the aims and the objectives of the business to assess progress

Rewards from enterprise

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

- a personal sense of satisfaction of opening and running a **successful business**
- building something from scratch i.e. their own enterprise
- being in full control and therefore having the **independence** and 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
- having social objectives for society as a whole e.g. 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 of making **profit** 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 Dragons Den, is another example of a successful entrepreneur. Sarah worked in the restaurant industry from the age of 13 and has now 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 into 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!

Role of Business 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".**

Purposes of enterprise

The role of the enterprise will normally revolve around making a profit for the **entrepreneur**. There are a variety of ways that the enterprise can achieve this:

Purpose of enterprise activity	Explanation
Producing goods and services	An entrepreneur will organise the business operation and bring together the resources that are required to ensure that goods or services are produced efficiently and will reach the customer so that a profit can be made
Meeting customer needs	An enterprise should sell goods or services that meet a specific customer need. If an enterprise just produces a product because the entrepreneur knows how to make it, without demand being present in the market, the business will end up with unsold stock
Adding value	In order to make a profit, the enterprise will need to sell at a price that is higher than its costs. This is known as **value added** and can be increased in different ways such as: ☑ **Convenience:** customers may be prepared to pay more for a service at home rather than having to go to the shops ☑ **Branding:** if an enterprise can establish itself as being a good quality or reliable brand, then the business can charge more ☑ **Design:** the use, appearance and cost of a product are all important factors and can add value to its production ☑ **Quality:** customers will have an expectation of the quality of a product and the more a product meets or exceeds this, the more value will be added in its production ☑ **Unique selling point (USP):** if a product is different to that of its competitors in some good way, then the enterprise has the possibility of charging a higher price because of this difference. This might be the name of the product or a particular feature that it possesses

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 and can organise resources to try and 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
- are capable of making accurate business decisions

An entrepreneur will have many different reasons for starting a business and these will vary between different entrepreneurs:

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.

1.2 Spotting a business opportunity

Topic overview

Although this is a separate topic students need to relate these concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware of the local and national business environment and how this might impact on small business opportunities. Students must be aware of this topic's relationship with the other topics in this theme and how these areas may impact on business decision-making.

Section	Key Things to Learn
Customer needs	Being aware of different customer needs such as price, quality, choice and convenience The importance of fulfilling customer requirements
Market research	Objectives of market research Methods and techniques Qualitative versus quantitative research Use of social media in market research Importance of reliable data
Segmentation	Benefits and methods of segmentation Market mapping to identify gaps in the market
The competitive environment	Strengths and weaknesses of competition How competition affects business decisions

Customer needs

In order to successfully sell a product or service, a business will need to know what its customer needs are. These can be summarised as:

providing the right product, of the right quality, at the right price, at the right time, in the right place

These can be explained in a little more detail:

Quality: customers will want the product to be of the quality that they require and expect. This is not necessarily high quality, as they may be happy with a cheaper product of a reasonable quality. There will be some legal requirements related to quality, covered later in this companion.

Price: Customers will expect to pay a reasonable price for the good or service. Price can vary depending on quality, timing, delivery arrangements and the popularity of the particular item. The price of rush hour trains is a good example of how price can change according to different circumstances, in this instance – the time of day!

Competition and choice: Most customers would like to have a range of options for their possible purchase. This could include different brands, different quality and price combinations and even different varieties of the same product.

Convenience: The growth in on line shopping and home delivery highlights how customer needs have changed in recent years. Most successful retailers will now have websites and e-sales options that are more convenient and increasingly expected by customers. Opening hours and location are also factors that are affected by customer needs.

Meeting customer needs

Customers are arguably the most important **stakeholder** in a business. Without customers there is no business.

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.

A new entrepreneur will start with finding out and identifying what a customer wants and needs through market research. He/she will then design a good or service that meets these needs and decide on a price to charge that customers are prepared to pay. This will help the business to generate sales early on and continue to make sales, which will help to **secure the survival** of the business.

Market research

Initially, the entrepreneur comes up with what he/she believes is a good business idea. But, how does the entrepreneur check that this business idea will actually meet customer needs and therefore has the potential to become a viable business? The answer is for the entrepreneur to conduct some **market research**.

Market research for a start-up or small business needs to focus on the fundamental issues, such as:

- ☑ How big the market is (measured by sales or volume)
- ☑ How fast the market is growing and the potential for the market to grow further
- ☑ Who the existing competitors are and their share of the market
- ☑ How the market is divided up into segments, for example low price or high quality
- ☑ What kind of customers there are in the market. It is important for a business to know what their customer preferences are in terms of when and where they buy, and the prices they wish to pay

An entrepreneur needs to be satisfied that there is sufficient **demand** for the product before the business sets up. However, at the start-up stage, funds are often in short-supply, which restricts how much market research an entrepreneur can carry out. Because of this, the entrepreneur should ensure that he/she is conducting effective market research i.e. ensuring he/she has the **right information to make good decisions**, rather than being overwhelmed with too much information taken from detailed reports and statistics.

It is worth remembering that a small business can learn much about the market by simply trading, talking to customers and suppliers on a frequent basis and reading the trade newspapers and magazines. This type of market research is not only cheap or even free, but is very effective and will help the entrepreneur to recognise what the business is doing right and what changes it should make.

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 goods 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 the product or are currently buying it? What price will they pay and what features do they expect? Where would they like to purchase the product? Overall, market research should be used to identify and understand customer needs as exactly as possible
- ☑ **Promotion** – how do my customers find out about products such as mine?
- ☑ **Identifying a gap in the market** – which firms are my rivals? What prices do they charge and what are their products like? Is there room in the market for a new business to open up offering a similar product?
- ☑ **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 also 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 that has been collected for a different purpose

Primary research can be designed to get exactly the data a business needs. The problem with this form of research, however, is that it is usually **time-consuming and expensive**. Getting a market research agency to conduct 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:

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 larger 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 quality 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 truly represents 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.
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.
Customer reviews	The internet provides data from product users who give ratings and feedback about a particular product. In some cases these are independent sites e.g. Trip Advisor, in other cases they are provided by the business itself e.g. Amazon.
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 through 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, are 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

Social media and market research

Most market research is out of date before it can be used. It takes time to collect, analyse and present findings. Social media, as a form of market research, has many **advantages** compared to more conventional methods:

- ☑ It is very quick. If a small business uses Facebook and/or Twitter then reactions to new products or situations will be on Facebook in minutes and can provide instant feedback
- ☑ Provides an insight into the market in which the business is competing through the social media of competitors
- ☑ There are free tools available that allow businesses to collect social media statistics. Although there will be some costs incurred by the business in terms of staff time analysing this data, overall using social media will be very much cheaper than undertaking questionnaires, surveys and consumer panels.
- ☑ Users are engaged in the comments process and will interact with the business and each other. Comments can also be followed up, for example using Facebook private messaging, to gain further data and information.
- ☑ Can allow links to the promotional use of social media which may form part of the firm's overall marketing plan.

However, there are disadvantages:

- ☒ Although it is claimed that 80% of people with internet access engage with social media, it is much harder for a business to engage with its actual and potential customers. This could mean that the feedback provided through social media comments is not representative of actual opinions and may just represent a small number of comments of people who do not like change or new ideas.
- ☒ There is a danger of social media becoming too negative and this message spreading very quickly in a viral fashion.

- ☒ There will be a need for staff training involved in this process, which will increase costs and be time-consuming.
- ☒ For a small business, the monitoring of social media can become very time-consuming, which can detract from other important roles in the firm.

Reliability of Data

Important business decisions will be made on the basis of market research and therefore it is vitally important that it is reliable. Reliability will mean that the results indicate the true situation that the research is trying to find out, for example, the research reflects the views of the whole target market accurately.

However, there are many different reasons why market research results might not be reliable. These can be summarised as follows:

Bias: Most market research involves taking samples. The choice of these samples may well involve some bias either through the time, location or type of people chosen. Smaller samples are more likely to be biased, but large samples are expensive and time-consuming to conduct.

Out of date: Any research will be out of date once it has been collected. But some, especially secondary data, can be very out of date and not a reliable representation of the current situation facing a business. This can result in incorrect decisions being made.

Inaccurate: Either the question or the answers can result in inaccuracies. If the question is not clear, then the answers given will be of little use. Quantitative data will often have numerical scores rating products, but these often mean different things to different people. For example, some people will not give 5*s, whilst others will. Qualitative data will give people’s opinions, but the opinions given may not cover all the areas required and respondents may be reluctant to make negative comments, particularly if interviews are conducted face to face.

There are many examples where specialist market research companies get it wrong, so small and new businesses must be particularly careful not to base too much of their decision making on too little market research.

Market segmentation

Once a business has undertaken market research, it will have a clearer idea of who its customers or potential customers are likely to be. The business may then decide to concentrate on certain groups of customers, in order to gain some advantage over its competitors. This also means that the business can develop some expertise and reputation when targeting this specific group.

This means that 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. This is particularly the case with small business start-ups. Businesses are then in a better position to meet their distinct customer needs more exactly.

The table below summarises some of the benefits to a business 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-price
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

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 other common methods of market 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!
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
Income	Because it is perfectly possible to earn large sums of money in all occupational classes, segmentation by income level is also undertaken. Producers of luxury goods and services will often use this type of segmentation, so that they do miss out on potential customers
Lifestyle	This method of segmentation is where potential consumers are grouped by their activities, interests and opinions; examples include hobbies, types of holiday preferred or whether people are interested in politics or not

Limitations of segmentation

Whilst it is possible for small 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. This is particularly relevant for small businesses, where any research conducted 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 inappropriate targeting 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 goods or services.
- ☒ **All market objectives:** some small businesses will not just want to target one segment; they may have ambitions on a bigger scale, so will be looking to expand their geographical area or the type of customer.

Market mapping

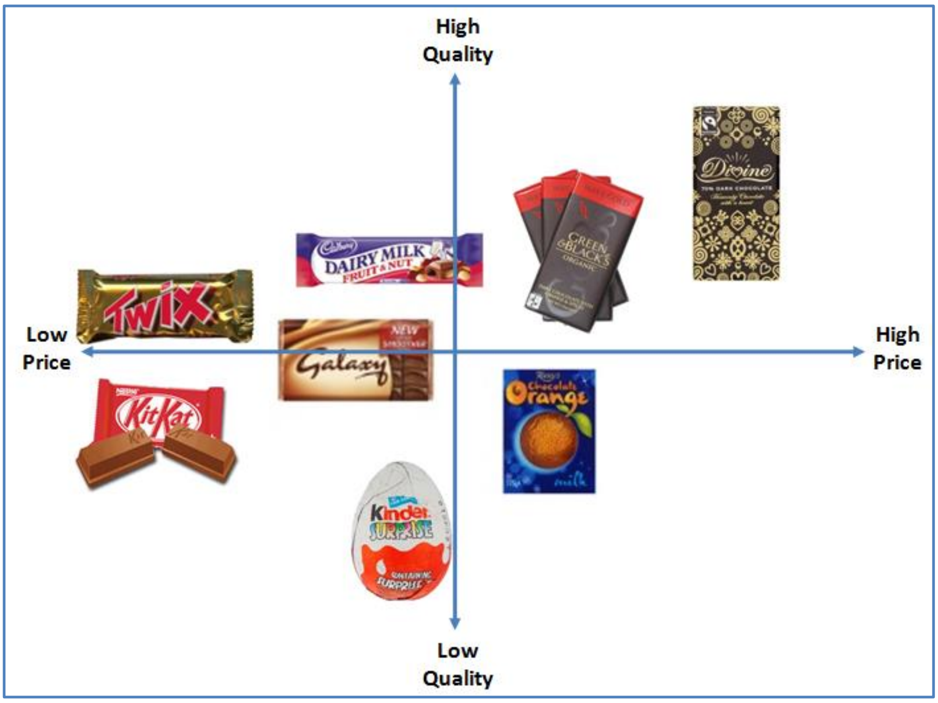
Once an entrepreneur has identified an appropriate segment of the market to target, the challenge is to **position** the product so that it meets the needs and wants of the target customers.

One way to do this is to use a "**market map**". The market map illustrates the range of "positions" that a product can take in a market based on two dimensions that are important to the identified target market.

Examples of those dimensions might be:

- High price v low price
- Basic quality v high quality
- Low volume v high volume
- Necessity v luxury
- Light v heavy
- Simple v complex
- Lo-tech v high-tech
- Young v old

Let's look at an illustrated example of a market map. The map below shows one possible way in which the chocolate bar market could be mapped against two dimensions – quality and price and locates the products of the **competition**:



How might a market map be used?

One way a market map can be used is to identify where there are “gaps in the market,” in other words where there are customer needs that are not being met. For example, in the chocolate bar market, Divine Chocolate is a **social enterprise** which aims to provide better income for cocoa farmers in developing countries. It successfully spotted that some consumers were prepared to pay a premium price for very high quality chocolate made from Fairtrade cocoa and therefore developed a product to meet these specific customer needs. Equally, Green & Black’s exploited the opportunity to sell premium chocolate made from organic ingredients. Both these brands successfully moved into the high quality/high price quadrant of the market map, before too many competitors beat them to it.

The trick with a market map is to ensure that market research confirms whether or not there is actually any demand for a possible “gap in the market”. There may be very good reasons why consumers do not want to buy a product that might potentially fill a gap identified in the market map, for example who would want to pay a high price for a low quality product?

The Competitive Environment

Businesses will try to produce a good or service where they do not face much, if any, competition. However, in reality, all businesses will have some form of competition. This competition might be strong and direct, i.e. there are many businesses producing very similar products, 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 even a small business considerable market power.

Competition

When looking at competition in more detail, the first consideration is to determine what a **market** is.

One definition of a market is that it is a place 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 can be bought and sold. Some of the effects of direct, indirect and no competition on a business can be summarised as follows:

Competition	Description	Impact on business decisions
Direct: product	Businesses have competitors that produce a very similar product.	Businesses will try and make their products different, so they can charge more for them or gain customer loyalty. This may be through reviewing the quality of the product. A local café will aim for good customer service or a children’s play area, so that it is different from nearby national coffee shops. This will attract new and regular customers to their particular business.
Direct: price	Prices will be very similar if not identical. For example, petrol prices are normally very close to each other, despite the petrol station visited.	Small businesses might decide to sell their products cheaper, but risk being in a price war. In this case, the bigger business with the most market power will tend to win, as they are more likely to be able to afford to lower their prices.

Competition	Description	Impact on business decisions
Direct: location	In a local area, a business may compete with other similar businesses. For products, this can be across a wide geographical area or even international depending on the costs of distribution.	Small businesses may try and choose an area where they can target their products without competition, or where competitors target different market segments. A small local hairdresser may be able to work out an area where it can avoid competition from similar businesses.
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 a local independent cinema even though other leisure choices exist.
None	A business has no competition or its product is sufficiently different from any alternative.	Small businesses can charge higher prices and make good profits, particularly if they are targeting a particular segment. Quality however, might suffer due to the lack of competition. This can make the business complacent, which can result in competitors being attracted to the market.

The competitive environment is often out of the control of a business, but the decisions that it makes will be very much influenced by competitors and the threat of future competitors. New and small businesses face particular problems as they can be targeted by other businesses that would prefer to dominate profitable markets themselves.

1.3 - Putting a Business Idea Into Practice

Topic overview

In this topic students need to continue to relate the concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware how business implementation can be affected by the local and national business environment and how this might impact on a small business. Students must be aware of this sections relationship with the other areas in this theme and how again, this may impact on business decision-making.

Section	Key things to learn
Business aims and objectives	Defining business aims and business objectives Financial aims for a start-up business Non-financial aims for a start-up business Differences in business aims and objectives between firms
Business revenues, costs and profits	Understanding and calculating business revenue Understanding and calculating business costs Understanding and calculating business profit and loss Interest Break even concept and the margin of safety Interpreting break even diagrams Changes in break-even variables
Cash and cash-flow	The importance of cash in a business Cash versus profit Interpreting cash-flow forecasts
Sources of business finance	Short term finance options for small and start-up businesses Long-term finance options for small and start-up businesses

Business aims and objectives

What motivates someone to become an entrepreneur?

For many people this will be money. The chance to earn significant profits, buy a yacht, take numerous holidays, buy designer goods and send the kids to the best private schools.

Money and personal wealth may well however, not be the real motivation. Evidence suggests that there are many more reasons why someone wants to start a business.

Every business starts small. However, if the entrepreneur takes some calculated risks, shows a lot of determination and has some luck, a start-up business can become very large, profitable and valuable. However, not every entrepreneur wants to build a big business and earn a fortune.

The objectives when starting a business can be broadly split into two categories: **financial** objectives and **non-financial** objectives.

The purpose of business aims and objectives

Aims and objectives provide a direction for any business. 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 goods 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.
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.

Financial 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 therefore always to survive.
- **Profit** – making 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**, the amount made from sales, or **decreasing costs.**
- Another financial objective is **financial security** or **personal wealth**. Working for someone else might mean the loss of a securely paid job, which means the entrepreneur would have no

financial security. Some entrepreneurs have a longer term objective. They aim to build a valuable business that can substantially increase their future wealth. They could be aiming to build up the business and sell it, or make it so it will provide a substantial future income for them, with no risk to them of being made redundant!

- **Sales maximisation/market share** – some businesses will be more concerned with increasing their sales and therefore their market share. They may accept lower profits in the short term, in order to increase sales.

Non-financial objectives

Although most businesses will be focussed on financial objectives, there are many other priorities that will exist for new and small businesses. Providing a high quality service will be particularly important for a new business. Looking after its customers and its employees would also be an objective for many small businesses.

In many cases, non-financial objectives will link to or be consistent with financial objectives, but not always as sometimes even for a small business quality might conflict with profit. Therefore when businesses set and use objectives, they will prioritise the areas which are most important to their organisation and the owners.

Here are some of the non-financial motives that are often quoted by entrepreneurs:

- **Social objectives** such as benefiting the environment
- **More control over working life** – want to choose what kind of work is done; the need for greater **independence** is a major motivator
- **A more flexible and convenient work schedule**, including being able to work from or close to home; this motive is an important reason behind the many home-based business start-ups
- **Skills are being wasted** and their potential is not being fulfilled
- **Escaping** an uninteresting job or career
- Pursuing an **interest or hobby** that they enjoy
- **Want to be the boss,** as they are fed up with being told what to do
- Want the feeling of **personal satisfaction** from building up a business
- **Fed up** with working in a business hierarchy or a bureaucratic organisation, where there are lots of rules; people with entrepreneurial characteristics often feel stifled working with and for others!
- **Major change in personal circumstances** for example redundancy, divorce, illness, bereavement

Different aims and objectives

Different businesses will have different aims and objectives. This is particularly the case with small businesses, where every entrepreneur is likely to have different motives for starting up their own business. For example:

Entrepreneur 1: has recently been made redundant from a large building firm. He would like to turn his skills and experience into building maintenance in his local area. He wants varied work and enough money to live off, but does not want to build up the business or travel far.

Entrepreneur 2: has a new business idea for a web application for finding places for a good night out. The idea is proving very popular in the local trials. The entrepreneur wants to develop this application and sell it all over the world in order to make a lot of profit.

Business objectives will also be affected by the external environment which firms operate within. A small low cost hairdresser may have direct competition in one area, indirect competition from an expensive hairdressing national brand in another area and no competition at all in a further area. The objectives of such a small business will be different because of the situation it finds itself in.

Business revenues, costs and profits

In order for a business to calculate its profit (or loss) it needs to work out its total costs and total revenue.

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) = total fixed costs (TFC) + total variable costs (TVC)

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 the **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 means that a business may have lower average costs of production as it grows.

Revenue and Profit

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 selling price, which makes the calculation more complicated. However, 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.

Profit is also 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 = TOTAL 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?

Interest

As well as the costs involved in running a business, a business owner may also have to pay interest, if the business needed to borrow money in the form of a loan or mortgage when it was set up. The business may also arrange an overdraft with the bank, which will also involve the payment of interest. Interest will therefore form part of the firm's total costs. The amount needed to be paid may vary if interest rates change. This is however, dependent on the terms of the loan/mortgage/overdraft, which would have been agreed with the bank and the business owner, when the specific source of finance was first taken out.

The following formula can be used to calculate the interest rate on a loan as a percentage:

$$\textbf{Interest on loans (\%)} = \frac{\textbf{total repayment – borrowed amount}}{\textbf{borrowed amount}} \times \textbf{100}$$

Example:

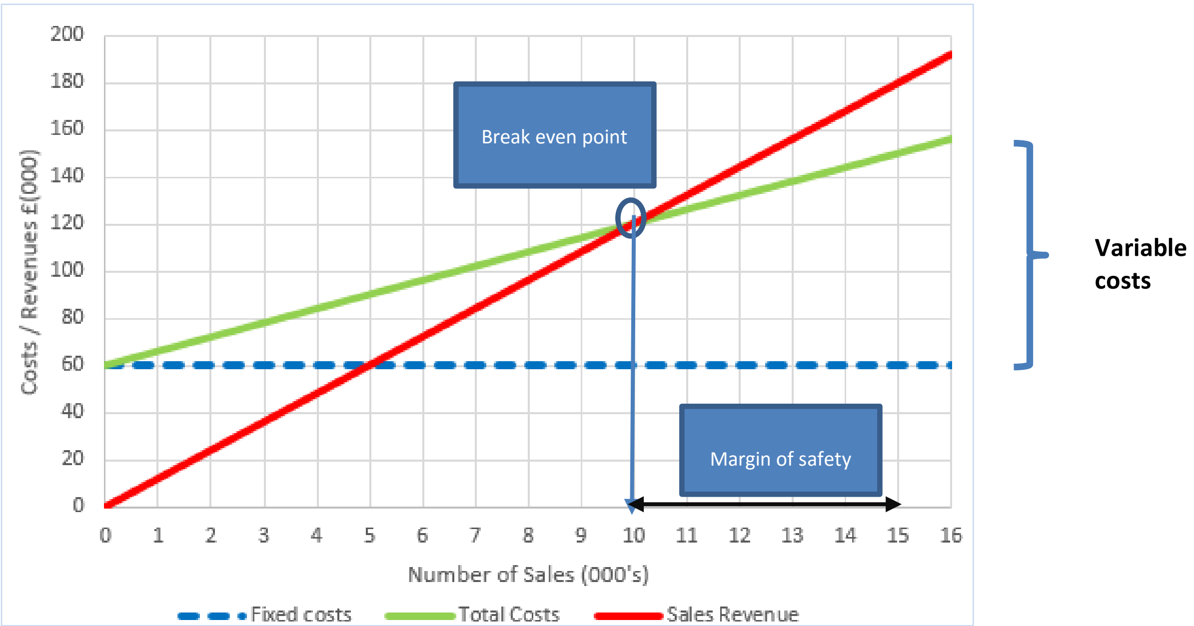
If a new business start-up borrowed £50,000 but repaid £60,000 in total, the interest percentage would be: $\frac{£60,000 - £50,000}{£50,000} \times 100 = \textbf{20\%}$

Break even

A business will calculate its break-even point in order for it to have an idea of how much it will need to produce to survive. Break-even 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 diagram 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 diagram for Business A:



This break even diagram 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.

Margin of safety

Business A can also calculate the margin of safety from the break-even diagram. 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, the business would be making a loss.

A reminder of the formula for margin of safety is shown here:

Margin of safety = actual or budgeted sales – break even sales

Calculating profit and loss from the break-even chart

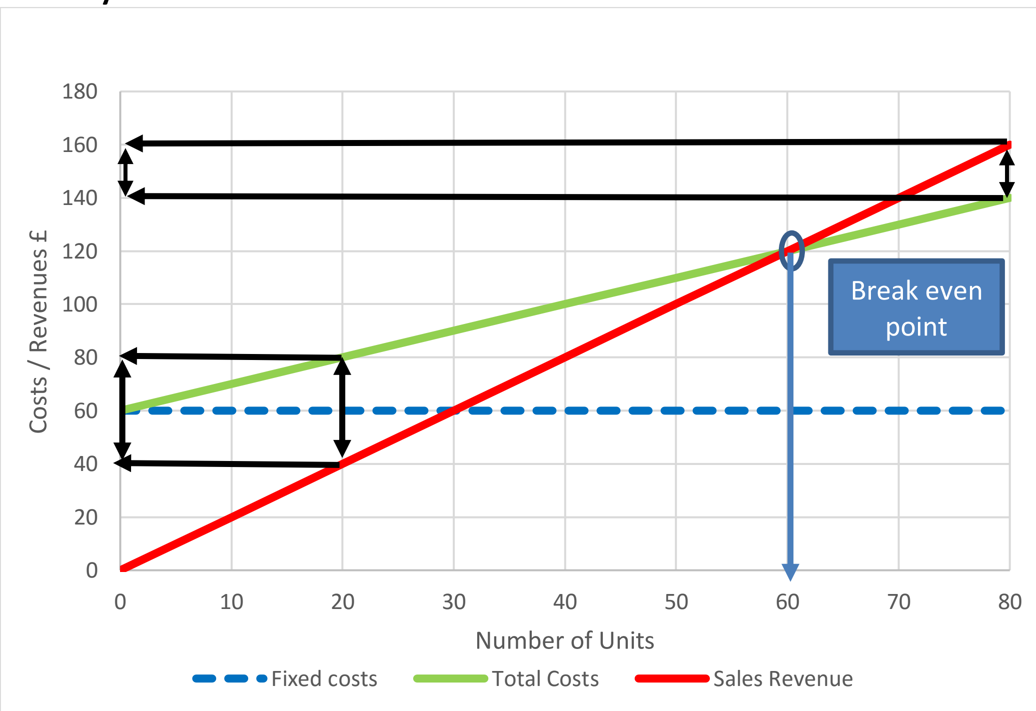
A business can determine the amount of predicted profit or loss level it expects to make at different levels of output from the break-even diagram. As already discussed, profit is calculated by deducting total costs from total revenue. From reviewing the break-even diagram for Business B (on the next page) it can be seen, at an output level of 80 units, the business is making £160 revenue and its total costs equate to £140. If we subtract the total costs from the total revenue the profit at this level of output equals: **£160 - £140 = £20.**

It is clear the business is making a profit at this level of output, as the firm's break-even point is 60 units (the point where total revenue = total costs) and as the business is operating at 80 units, a higher output level than the break-even point, then the business must be making a profit.

However, if the business is operating below the break-even point of 60 units, the business will be making a loss. Looking again at the break even chart for Business B and assuming the business is producing 20 units, the value of total costs at this level of output is £80 and the total revenue figure is £40. Remember that profit = total revenue – total costs, so in this case, the business is making a loss as: £40 - £80 = (£40).

This method of calculating profit/loss for a business can be applied to any level of output for a business that has produced a break even diagram. However, the difficulty is that sometimes values are difficult to read from the diagram and therefore if a business relied on this method only of calculating profit, inaccurate figures may be calculated and therefore used in decision making. For example, looking again at the break even chart for Business B, can the profit or loss be accurately worked out, purely from reading the graph, if the firm was operating at an output level of 55 units?

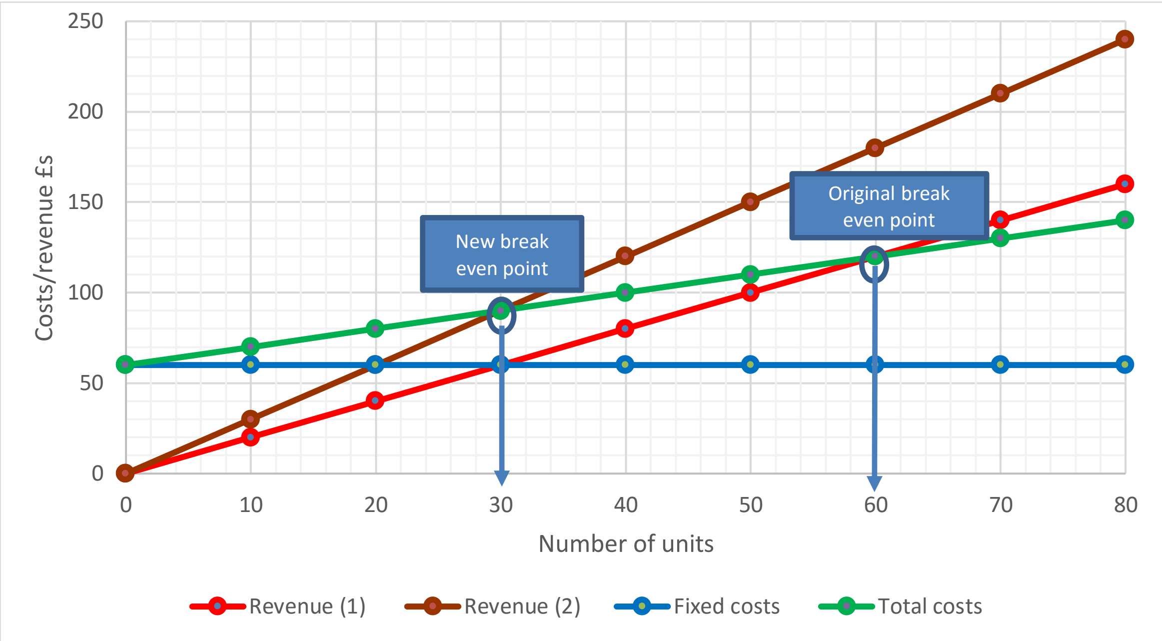
Monthly break even chart for Business B:



The impact of changes in revenue and costs on the break-even point

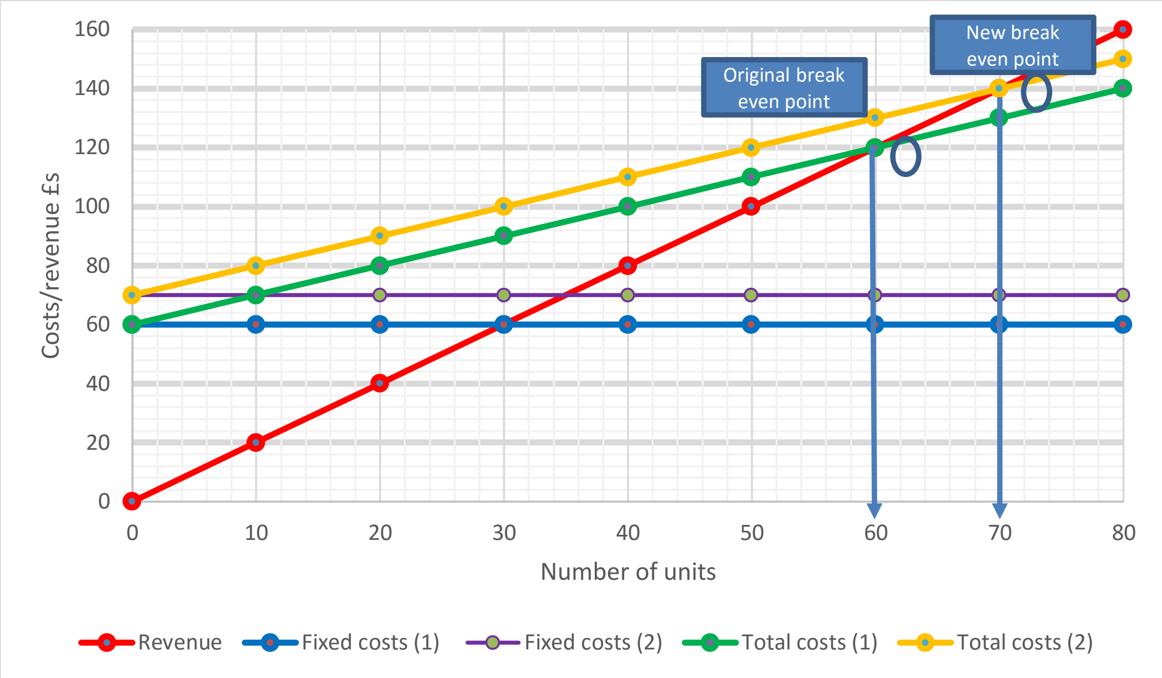
As well as calculating profit and loss and identifying the break-even point, the break-even diagram can also be used to help business owners with decision making and "what if" scenarios. By changing one or more variables in the break-even diagram, business owners, or business decision-makers, can then assess the impact of this change on the break-even point. This will allow worst and best case situations to be prepared for by the business. Some examples are included here to illustrate this further.

Example 1: Break even diagram to show the impact on the break-even point of an increase in selling price



In the above situation, a business's selling price has increased from £2 to £3. This has resulted in the amount needed to be sold to break even (the break-even output) decreasing from 60 units to 30 units. In this case, the business may then conduct some research to see if customers would be willing to pay the increased selling price or whether demand would drop significantly, as even though the break point has lowered, in this case it would take the business a significantly longer time to reach this point due to a drop in demand.

Example 2: Break even diagram to show the impact on the break-even point of an increase in fixed costs



In this case, the fixed costs of the business have increased from £60 to £70. This has increased the total costs which has resulted in the amount needed to be sold to break even (the break-even output) increasing from 60 units to 70 units. In the case, if the business anticipates that its fixed costs are going to rise, which would ultimately make it harder to break even and therefore become profitable, it may look for different ways to become more efficient to lower costs, to overcome this change.

Calculating break even using the formula

Rather than drawing a break even diagram to calculate the break-even point each time, a quicker and more efficient method of calculating break-even is to use the formulae. The break-even formulae are shown in the box:

Break even output = **fixed cost** / **(sales price – variable cost)**

This will give you the number of units the business needs to produce and sell to break even

Break-even point in costs/revenue = break-even point in units x sales price

This formula can be used to calculate the revenue (or costs!) at the breakeven level of output

Break even output using the formula

In order to calculate the break-even output using the formula, three variables are required. These are fixed costs, sales price and variable cost per unit.

In example 2, the original fixed costs of the business were £60.

The current variable cost per unit is £1. Variable costs are not drawn directly onto the break-even chart. However, this value can still be calculated if total costs and fixed costs are known and the formula here is used:

Total variable costs = total costs – total fixed costs

From reviewing the chart, at an easy to read point, i.e. 10 units, the original total costs were £70 and the original total fixed costs were £60. Total variable costs at this level of output therefore = £70 - £60 = £10.

To calculate the variable cost per unit, the number of units just needs to be divided into this amount = £10/10 = £1.

In order to calculate the sales price or the selling price per unit, a similar method can be applied. At an easy to read point i.e. 10 units, the total sales revenue = £20. To calculate the sales price or selling price per unit, the number of units just needs to be divided into this amount = £20/10 = £2.

We now have all the variables required to calculate the break-even output level using the formula as shown:

$$\textbf{Break even output} = \frac{\textbf{fixed cost}}{\textbf{(sales price – variable cost)}} = \frac{\textbf{£60}}{\textbf{£2 - £1}} = \textbf{60 units}$$

This being the same answer as obtained from the break-even chart.

Break-even point in costs/revenue using the formula

We will use example 2 again to illustrate how to calculate the break-even point in costs/revenue. A reminder of the formula is:

Break-even point in costs/revenue = break-even point in units x sales price

The original break-even point in units = **60 units x £2 (sales price) = £120**. This again shows the same value on the "y" axis for costs/revenue in £s as the break-even diagram, at the break-even point.

The benefit 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 diagrams to illustrate the impact on the break-even point if one of the variables on the graph changed. 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 products.
☒ 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!

Cash and cash-flow

Cash-flow describes the movement 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".**

Net cash-flow = cash inflows – cash outflows for a given time period

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 sum**marised as follows:**

Cash inflows	Cash outflows
Cash sales	Payment of overheads, 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
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. The reasons for this can be divided into two types:

- not enough money coming into the business fast enough
- too much money going out of 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 **insolvent**.

If a business has a positive cash-flow it will build up **cash reserves**. This 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).

Looking at this cash-flow forecast a little more carefully, it shows that the business will start the period, i.e. January, with a cash surplus or opening balance of £250,000. During the first three months, the net cash-flow is negative, as it is predicted that there will be more cash outflows than inflows, which will reduce the closing balance surplus to £50,000 in March. In April and June, the cash outflows are estimated to reduce considerably making them less than the cash inflows, resulting in a surplus in the closing balance in those two months. In May again, the outflows are predicted to be higher than the cash inflows. The opening balance, of £100, is not enough to cover this increase and therefore the business is forecasted to go into a deficit of £50,000.

Businesses must carefully monitor when the business is forecast to experience a deficit, as this highlights the business may run out of cash!

To recap the key formulae for cash-flow forecasts are:

Net cash-flow = cash inflows – cash outflows in a given period

Opening balance = closing balance of the previous period

Closing balance = opening balance + net cash-flow

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 and becoming insolvent

- **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, as in this case there would be no-one to either produce the goods or provide customers with the level of service that they demand
- **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. 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 these in an appropriate way

Sources of business finance

A start-up or existing small business will need finance. They will need it for various reasons, short term and long term. There are different sources of finance available and the actual source chosen by a business will depend on the amount and reason the finance is required, as well as the circumstances and the type of legal status the business has.

The challenge of raising money

Often the hardest part of starting a business is raising the money to get going.

An entrepreneur might have a great business idea and clear plan for how to exploit a market opportunity. However, unless sufficient finance can be raised, the entrepreneur will struggle to make the most of the opportunity.

Raising finance for a start-up requires careful planning. The entrepreneur needs to decide:

- **How much finance is required**? Raising finance is hard work and expensive – a start-up business should avoid having to go through the process too often!
- **When and for how long the finance is needed?** A useful distinction can be made between long-term and short-term finance
- **What security (if any) can be provided**? This will affect the ability of the business to raise a bank or other loan where the lender requires some security (or "collateral")
- **Whether the entrepreneur is prepared to give up some control** (ownership) of the start-up in return for investment
- **Whether the cost of the finance**, for example the interest charged, is justified

The finance needs of a start-up should also take account of these key areas:

- **Set-up costs**: the costs that are incurred before the business starts to trade
- **Getting ready to produce**: the fixed or long term assets that the business needs before it can begin to trade, such as machinery, equipment, vehicles etc
- **Working capital**: money required for the day to day operation of the business. Money will be needed by the business to buy the stocks required by the business, such as raw materials, and allowance should be made for amounts that will be owed by customers once sales begin, if the business chooses to offer its customers trade credit
- **Growth and development:** in the future the business may wish to grow and expand and therefore will need to invest in extra capacity, for example in extra space to produce more products

Finance to cover different periods

An important consideration when obtaining finance for a business is when and for how long the finance is needed. A useful distinction can be made between long-term and short-term sources of finance. The table summarises the main examples and uses of each category:

Long-term	Short-term
Finances the whole business over many years	Finances day-to-day trading of the business; repayable usually within a year
Examples:	**Examples:**
☑ Personal savings ☑ Retained profits ☑ Share capital ☑ Venture capital ☑ Bank loans ☑ Crowd funding	☑ Bank overdraft ☑ Trade credit

Short-term sources of business finance:

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!

Bank overdraft

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.

Long-term sources of business finance:

Personal savings

An entrepreneur will often invest personal cash balances into a start-up. This can be personal savings from the bank or building society. This can also be in the form of providing assets for the business, for example using an own car, or it can be as simple as **working for nothing!** By using this source of finance, the entrepreneur is providing a strong signal, to other potential investors and the bank, of his/her commitment to the business venture.

- ☑ This is a cheap form of finance that is readily available.
- ☑ Investing personal savings maximises the **control** the entrepreneur keeps over the business.
- ☑ The amount that is available may be limited, resulting in this being used with other sources of finance to fund the business.

Loans

These might be from friends and family or from financial institutions, such as a bank.

Friends and family:

Friends and family who are supportive of the business idea may be willing to provide money either directly to the entrepreneur or into the business.

- ☑ This can be quick and cheap to arrange (certainly compared with a bank loan).
- ☑ The interest and repayment terms may be more flexible than a bank loan.
- ☒ However, borrowing in this way can add to the stress faced by an entrepreneur, particularly if the business gets into difficulties, as it can cause disagreements.
- ☒ The amount available may be limited, resulting in this being combined with other sources of finance.

Bank loan:

A bank loan is an amount of money borrowed for a set period with an agreed repayment schedule. The repayment amount will depend on the size and duration of the loan and the rate of interest. This is a common source of finance that a small or new business would choose. However, bank loans tend to be more readily 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 start-up or an established small 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 being used 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:

- ☒ **Time consuming -** a new business would need to produce a detailed business plan to show to the bank in order to secure the loan, which would take up time and resource; however it could be argued in the long-run, that this careful planning would help the business to have a greater chance of success in the future.
- ☒ **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 if the business fails.
- ☒ **Lack of flexibility** - a small business might take a loan out for £50,000 but finds it only needed £30,000. That means that interest is being paid on £20,000 of loan that it does not need.
- ☒ **Interest** – interest must be paid on the loan amount, which increases the costs of the business.

Venture capital

Venture capitalists often invest in small businesses. Venture capital can be gained from professional investors or companies who typically invest between £10,000 to £750,000.

Venture capitalists tend to have made their money by setting up and selling their own business – in other words they have proven entrepreneurial expertise. The advantages and disadvantage of this source of finance are:

- ☑ Venture capitalists often make their own skills, experience and contacts available to the firm.
- ☑ They have access to large amounts of funds.
- ☒ The venture capital company or investor will usually want a share of the business and of the profits, which can result in some loss of control over the firm for the entrepreneur, which he/she may not want to give up.

Obtaining venture capital is quite different from raising debt or a loan from a lender, such as a bank. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of the success or failure of the business. By contrast, venture capital is often invested in exchange for a stake in the company where the **return will be dependent on the growth and profitability of the business.**

Not every business is suitable for investment by a venture capitalist. Such investors prefer to invest in small **entrepreneurial** businesses which are aiming (and have the potential) for sales and profit growth. As a rough guide unless a business can offer the prospect of significant turnover growth within five years, it is unlikely to be of interest to a venture capital firm.

Share capital

Small or new businesses that are set up as a private limited company can raise finance by selling shares in the company. 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.

Retained profit

This is a very important source of finance for an existing small business, but is clearly not suitable for a new business, as they are yet to build up reserves of profit!

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 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 – the business owners 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.
- ☒ Growth may be slow if it is dependent on retained profits, as profits may not be high enough to finance the growth quickly.

Crowdfunding

Crowdfunding is a recent way of small businesses or projects raising money from outside investors, often through the internet or a crowd funding platform such as www.kickstarter.com or www.crowdfunder.co.uk

A proposal is publicised and the aim is that a large number of small investors will be attracted from all over the world. The investors will generally be in sympathy with the aims of the project or the cause for which the funds are being raised.

There are some advantages to a business of using crowdfunding to secure finance:

- ☑ It provides cheap investment when other sources of external finance may not be available.
- ☑ If the project is interesting or newsworthy it might attract good publicity, which will help the business in becoming successful.
- ☑ The business may create a web blog or use social media to keep investors informed, which might provide ongoing finance.
- ☑ Investors may have experience or skills that they can offer the business.

There will however be drawbacks:

- ☒ Investors will need to be offered a return; this might be free use of the good or service produced, or a share in the profits. Some schemes will also provide shares, which therefore dilutes the control of the original owners of the business.
- ☒ There is a risk that there will be a limit to the amount of money investors are willing to use in this way.

1.4 - Making the Business Effective

Topic overview

In this topic students need to continue to relate the concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware of the local and national business environment and how this might impact on a small business. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect business decision-making.

Section	Key things to learn
The options for start-up and small businesses	Limited and unlimited liability Business ownership: sole trader, partnership and private limited company Franchise operations
Business location	Factors effecting business location
The marketing mix	Definition of marketing mix Balancing the marketing mix Impact of change on the marketing mix
Business plans	Content of a business plan Purpose of a business plan

Business organisation

Before the different forms of legal structures of a sole trader, partnership and a private limited company are considered, the very important issues of "unlimited liability" and "limited liability" will be discussed.

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 partners are personally responsible for any debts run up by the business, this means their homes or other assets owned by the entrepreneur(s) 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 be set up very quickly. A summary of the benefits to the business of limited liability are:

- ☑ **Investors encouraged** – the owner who normally owns shares, and all other investors who purchase shares, are protected in the way that they can only lose the money they have put into the business, not their personal possessions and property. This should encourage more people to invest in the business, as there is less risk.
- ☑ **Legal separation** – a company has a separate legal identity to the business owners, unlike a sole trader or a partnership where the business is seen as the same as the owners in the eyes of the law. With limited liability any action against the business is taken against the company, not the owners

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.

Forms of Business ownership

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 small businesses grow to become public limited companies.

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**, as already discussed.

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, which covers 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 owner's personal finances. 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.

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
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	☒ 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

	Advantages	Disadvantages
	stressful than operating as a sole trader ☑ Greater potential to raise finance compared to a sole trader, as each partner provides investment ☑ Any losses will be shared	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

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, 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 good 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 significant risk is involved, the business is 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.

Franchising

A business idea for a start-up does not have to be original. Many new businesses are formed with the intention of offering **an existing business idea.** The use of **franchises** is a great example of that.

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 goods 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 this fact:

- 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, food etc are the most popular

Examples of well-known businesses that use franchising to expand their operations include:

- Subway
- McDonalds
- Starbucks
- Pizza Hut
- Thorntons
- KFC
- Europcar

You might have noticed from the list above that nearly all those businesses provide **services** rather than produce **goods.** Franchising is particularly suitable for service businesses.

Advantages of running a franchise

For a start-up entrepreneur, there are several advantages to investing in a franchise:

- ☑ It is still the franchisee's own business – even if they are paying royalties to the franchisor!
- ☑ The investment should be in a tried and tested format and brand
- ☑ The franchisee gets advice, support and training. The franchisor will also supply key equipment, such as IT systems, which are designed to support the operation of the business
- ☑ It is easier to raise finance - the high street banks have significant experience of providing finance to franchises
- ☑ No industry expertise is required in most cases
- ☑ The franchisee benefits from the buying power of the franchisor
- ☑ It is easier to build a customer base – the franchise brand name will already be established and many potential customers should already be aware of it
- ☑ The franchisee is usually given an exclusive geographical area in which to operate the franchise – which limits the competition, since operators of the same franchise are not in direct competition with each other

Overall, investing in a franchise is a **lower risk method** of starting a business and there is a lower chance of **business failure.**

Disadvantages of running a franchise

There are several disadvantages for the franchisee:

- Franchises are not cheap! The franchisee has to pay substantial initial fees and ongoing royalties and commission. He/she may also have to buy goods directly from the franchisor at a mark-up
- There are restrictions on marketing activities, for example not being allowed to undercut nearby franchises, and on selling the business
- There is always a risk that the franchisor will go out of business
- The franchise needs to earn enough profit to satisfy both the franchisee and franchisor - there may not be enough to go round!

There are many good franchise opportunities available for a start-up, but some poor ones too. There is therefore, still a need for the entrepreneur to conduct market research into the franchise before deciding to invest in one.

A franchise is a kind of "halfway house" for a keen entrepreneur. It is a lower risk method of entering a market and it is often easier to raise finance. However, running a franchise does not offer the same kind of long-term financial rewards that owning a business outright can.

Business location

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? How will new technology impact on this decision?

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 coffee shop, for example, a strong location is vital to ensure enough customers visit the store.

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 general 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. The continued popularity of e-commerce makes transport links increasingly important, to ensure products can be delivered to customers in a timely manner. 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 as primary industries will need to be located where their raw materials are and many tertiary businesses will need to be near their customers for the service to be provided. Manufacturing businesses will be influenced by many different factors such as availability of materials and labour, as well as distribution to their customers.

The **short term and long term objectives** of the business can also be significant, for example, will a business have enough room to expand if it needs to increase output in the future?

Marketing mix

Introduction to the marketing mix

The marketing mix consists of four elements and represents the way in which a business uses the following four factors to reach customers:

- ☑ **Product** - the good or service that the customer obtains
- ☑ **Price** - how much the customer pays for the product
- ☑ **Place (distribution)** – how the product is distributed to the customer
- ☑ **Promotion** - how the customer is found and persuaded to buy the product

It is known as a "mix" because each ingredient affects the others and the mix must overall be suitable to the target customer.

For example:

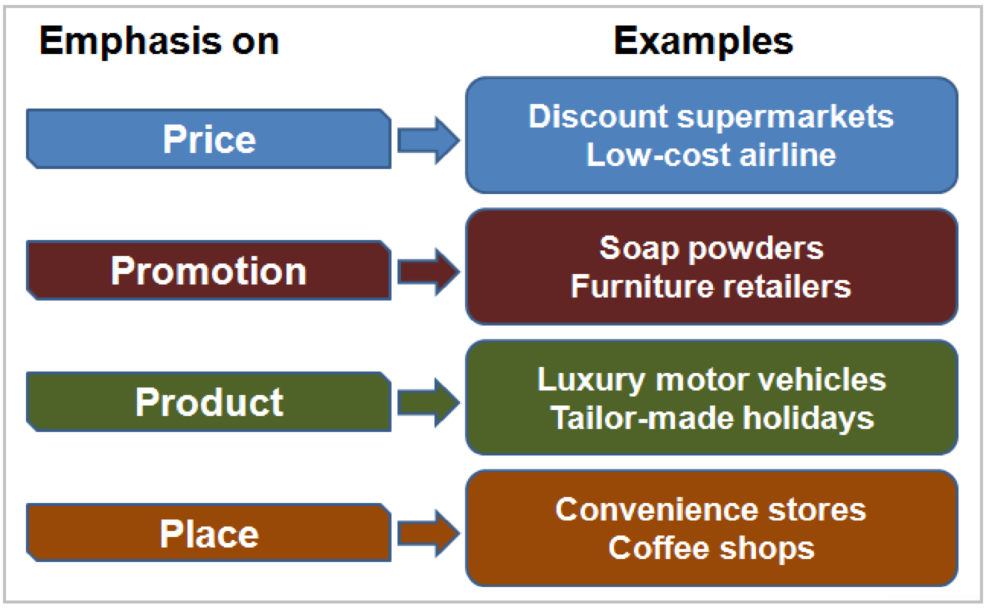
- High quality materials used in a **product** can mean that a higher **price** is obtainable
- An advertising campaign carried out in one area of the country, **promotion**, requires **distribution** of the product to be in place in advance of the campaign to ensure there are no disappointed customers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

An 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:



Changes to the marketing mix

A good example of how changes take place over time is the use of e-commerce. Whereas the retail outlets for electrical goods used to be very important, nowadays price and how quick and conveniently delivery can be arranged is much more critical in getting a sale. Digitial communication has also changed many aspects of promotion, with the extensive use of websites and social media now playing a critical part of even a small business's marketing plans.

The popularity of online and price comparison sites have also made pricing more visible. Consumers are now able to compare very quickly different prices, reviews about the good or service, and then make an informed choice about which product to purchase within a matter of minutes. This means that businesses have to constantly be aware of the information being displayed on their wesbite, as to whether it is up to date and effective.

Customers' needs and wants will always be changing. This can be seen in the "keep fit" market, where new products are constantly being developed, launched and promoted. The Fitbit for example, is priced relatively high and has expensive promotion to support the product and the price. This often makes it difficult for small businesses to compete, which is why they will need to look carefully for a gap in the market or operate in a market niche where there are less competitors.

Business plans

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.

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 with its location
- Where the idea came from and why it is a good one
- Objectives and key aims for the business - sales, profit, growth (gives a sense of direction for the business) ideally for the next 3-4 years
- Finance required and sources of finance - how much from the owners, how much to be loaned over how long and from whom
- Market overview – results of market research, main segments, target market, market size (value, quantity), growth, market share of main competitors (if known)

- How the business will operate (location, premises, staff, distribution methods)
- Marketing mix – description of these four elements
- Cash-flow forecast (important to ensure the business does not run out of cash)
- Forecast revenue, costs and profits

The purpose of business plans

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?
- Produces a document that helps clarify thoughts and identify any gaps in information or research
- 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 by including forecasts of revenue, costs, profits and cash-flow
- A business plan will **minimise the risk** of failure - 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, as it will provide evidence that any loans can be repaid

In addition **existing small 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.
- to 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 revise objectives
- overall it will help the business make informed decisions

1.5 - Understanding External Influences on a Business

Topic overview

In this topic students need to continue to relate the concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware how the local and national business environment might impact on a small business. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect decision-making.

Section	Key things to learn
Business stakeholders	Main business stakeholders and their objectives How stakeholders impact and are impacted by business activity Stakeholder conflict
Technology and business	Different types of technology that businesses use How technology influences business activity
Legislation and business	Purposes and principles of consumer legislation Purposes and principles of employee legislation Impact on businesses of meeting and not meeting legislation requirements
The economy and business	How businesses are affected by the economy and changes to key economic variables
External influences	How businesses are subject to external change and how it influences their business activity

Business stakeholders

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 Groups

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 good 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 customers pay their 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, for example 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

Stakeholder	Mainly interested in…
	• 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

How stakeholders are affected by business activity

Any activity of a business will affect some, if not all of its stakeholders. The impact will differ dependent on the particular stakeholder group. In many cases, the impact will be positive for some stakeholders and negative for others.

Example: If a business decides to relocate to a location that will be more convenient for customers, this will have different effects on different groups of stakeholders. Customers will benefit, the owners will also benefit, as the profits are likely to increase. Employees might lose their jobs or be forced to relocate, so the effect on them will be negative and one local community will lose, whilst the other local community gains in terms of job and therefore wealth creation.

It should be noted that the effect on stakeholders might be different in the short term and long term. A decrease in wages for workers might be negative in the short term, but might ensure that the business remains competitive and survives, which will mean that the workers' jobs will be preserved in the long term.

Impact of stakeholders on business activity

The behaviour of stakeholders will be influenced by their objectives, as previously described, and in turn, this will impact on the activities of the business.

Example: Employees want higher pay. This means they will negotiate with the managers to get a better deal, possibly threatening strike action if they do not get a pay rise. If they are successful, then this will increase the costs of the business. This may result in the business having to increase its prices to maintain its profit level. However, this might not be possible if there are competitors, so the profits earned by the owners or shareholders will decrease, as prices will need to stay the same in order for the business to remain competitive.

All stakeholders can impact business activity. If suppliers insist on immediate payment, this will make the business's cash-flow more difficult to manage. If the owners want short-term profits, they may prefer a high price strategy rather than a low price, high growth option.

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, who may want high profits and high rewards for being a shareholder in the form of dividend payments now and therefore would not be prepared to wait for rewards.

However in the longer-term, 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 some staff redundant 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).

Here are some other potential 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

Technology and business

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.

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.

The table highlights the advantages and disadvantages of e-commerce.

	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 ☑ 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 goods 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 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	☒ 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 available on an international basis ☒ Not all customers have internet access; some customers are afraid of fraud and therefore will not trade electronically ☒ Providing a good customer service, including return of products purchased, can be expensive
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 can be selected from anywhere in the world ☑ Product details and reviews are	☒ 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

	Advantages	Disadvantages
	available, including from other customers ☑ No hard sell from employees; customers are free to choose and buy products that best suit them	☒ Potential customers, with no internet access, may lose out on choice
Communities	☑ Growth of new job opportunities in providing e-sales centres, 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 products from other countries that have cheaper costs, resulting in the loss of direct and indirect jobs from an economy

Social media

Most businesses will now either be using, or at least be aware of, Twitter and Facebook. Social media provides an unrivalled number of direct contacts for communication – said to be 2 to 3 billion potential customers worldwide. It is also not expensive to set up and to operate at a basic level. Most social media sites allow data collection of users.

Marketing and promotion in particular, can be considerably expanded through the use of social media, although small and new businesses may find it hard to establish a following just using a Facebook page. There are an enormous number of similar businesses using similar methods. Social media is often linked to the business website, but provides a more up to date "newsy" type of information or blogs.

Other areas of the business can also benefit, for example the business may well link some recruitment strategies to social media options and sites such as LinkedIn can provide a CV sharing platform.

Digital communication

Digital communication is now in widespread use throughout the world. This includes all devices such as mobile phones, tablets, fax machines 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
- Suppliers – ordering, payments, product information
- Employees – payslips, job information, booking holidays, checking hours to be worked

- Shareholders – annual reports, dividend information and payments

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

Specific advantages and disadvantages of using digital communication to a business are listed in the table:

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 is 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 and videoconferencing 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
	☒ Constant training requirement for staff to understand how to use digital communication efficiently

Payment systems

Technology has been used by businesses for a long time. The paying of staff directly into their individual bank accounts has been used well before the internet was developed. The use of the internet has accelerated the use of e-payments, to such an extent that in many countries it has overtaken the use of cash within the country. This does however, vary considerably between different countries.

One of the first uses of internet payment systems was for businesses to pay suppliers through direct banking payments, either on a one off or regular basis. Similarly businesses can collect payments from customers in a similar way. Methods such as standing orders, direct debits, debit cards and credit cards, now represent the "normal" way for many businesses to collect payments from customers, with contactless pay being the most recent development.

The growth of e-commerce has been linked to the use of electronic payment and firms, such as PayPal, have developed to make this process easier and safer. Mobile payments are also now becoming used on a much wider basis and Apple Pay and Android Pay are examples of a new level of customer friendly applications to set up and make payments.

There are many advantages to a business of having technology based payment systems. These include:

- ☑ Lower costs
- ☑ Quicker receipt of money
- ☑ Happy customers who find it convenient
- ☑ No need for cash to be kept or used

Electronic payment does however have its critics, normally on the basis of security. There have been well publicised examples of fraudulent use of banking details and this concern is still the main reason why some customers will not use digital payment systems. Disadvantages can therefore be summarised as follows:

- ☒ Cost of buying and using payment systems
- ☒ Customers resistance to use of payment systems
- ☒ Not all customers may have access to required technology
- ☒ Risk of fraud

How businesses are affected by the use of 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, as competitors which do use the technology will become more efficient. Those businesses that continue to use old technology will be left behind and may not survive. For a small business lack of knowledge, awareness or finance in this area can be a real problem.

Some examples of how technology influences and is used in business activity are:

Sales – the use of e-commerce, whilst providing many benefits, has also brought a constant need for businesses to keep up to date with payment methods and consumer preferences. This will be expensive and time consuming to entrepreneurs who are generally very busy.

Costs – 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** which are used to provide this data to managers and owners. Software packages are available that are suitable for small businesses, but they are often expensive.

Marketing mix – Digital technology can be used directly in terms of e-commerce and websites. Marketing also makes other widespread use of computers in terms of product design, advertising, social media and its use of customer databases, which is often linked to market research. Setting up, managing and developing technology based promotion are all possible for a small business. However, there is a need for entrepreneurs to understand its benefits and afford its costs.

There will be other uses of digital technology within even a small business and production, human resources and the organisation of administration will all make considerable use of the opportunities that it provides.

Legislation and Business

Governments introduce legislation in many areas of the economy. This is done to control businesses that otherwise might put profits before looking after its customers or treating its employees fairly. It also ensures a fair system, as all businesses in the UK have to meet the same requirements.

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
- 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 completed 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 a customer orders a product, such as a mobile phone, by phone or online, he/she has 14 days to decide whether he/she wants 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.

Employment Law

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 rates as at October 2016 and April 2017 are shown in the table:

Current rates

These rates are for the National Living Wage and the National Minimum Wage. The rates change every April.

Year	25 and over	21 to 24	18 to 20	Under 18	Apprentice
October 2016 (current rate)	£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 increase productivity levels within the business.

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 the products 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.

The economy and business

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.

Level of employment and unemployment

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:

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. Some businesses will benefit more than others, depending on whether their goods or services are targeted at consumers with high or low incomes.

Growth and consumer spending

An increase or decrease in consumer incomes will affect how much money consumers 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.

Inflation

Inflation is a prolonged period of rising prices in an economy. The UK economy has had very low inflation for many years. If inflation were to increase this would mean that the prices of goods and services would increase and there would normally be corresponding increases in wage rates, so that consumers could afford the higher prices.

The effect of inflation on business can therefore be seen in two parts: costs and demand.

Increased costs – wage costs and the cost of materials will rise. This can prove difficult for businesses, as they will always want costs to reduce. It can lead to pay disputes with workers or a decrease in quality of materials purchased in order to save money.

Increased prices – the increased costs will be passed onto the customers. This may reduce **demand** as consumers find cheaper products from goods imported into the country. Some consumers will also not have an increase in their wages. The increased prices might also cause a fall in demand if they sell their products to other countries, which have lower or no inflation.

As well as the additional work involved in managing inflation, there is always the risk of a **wage – price spiral** where wage increases lead to price increases which lead to further wage increases and so on. The inflation rising out of control will damage most businesses in an economy.

Taxation

Taxation will affect businesses directly and indirectly. Firstly businesses will be taxed on their profits. This is known as income tax for a sole trader or partnership. A company pays corporation tax which affects all business with revenue of over £300,000 a year. The rate at which businesses are taxed has been reduced in recent years to encourage businesses to stay in the UK rather than moving to other countries, which may tax profits at lower rates.

Businesses will also be affected by taxes on consumer income and expenditure. Direct taxes on consumers include income tax. If this increases then consumers will have less money to spend, so businesses will suffer (see **consumer spending**). There are also indirect taxes that consumers pay on their spending, VAT being the most important. 20% is currently added to the price of most goods and services. Changes to VAT are used by the government to encourage or discourage consumer spending.

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

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.

These effects are often summarised using the word SPICED:

S	**trong**
P	**ound**
I	**mports**
C	**heaper**
E	**xports**
D	**earer**

The importance of external influences

External influences are very important for all businesses, but this is particularly so for a small or new business, as these influences, and changes to them, are outside the control of a business. Businesses will however, be affected by these factors and have to react to them. A good business will also be looking to the future and anticipating any changes and how they best should prepare for them. These changes can be local, national or international. For example, how will a business be affected if interest rates rise? Or if the large factory nearby closes? Or the minimum wage is increased significantly? Successful businesses are those businesses that are prepared and have a plan in place for these changes.

In order to summarise the way external influences can result in changes of business strategy and planning we can consider a few examples on a small independent hotel business:

External change	Impact on business	Reaction of business
Increase in income tax rates	☒ Business costs increase and consumer income decreases ☒ Reduced demand for goods and services, dependent on the nature of the product, for example there would be less demand for luxury goods In the example set, the business may see a drop in demand from wealthier customers, as they can no longer spend their income on short breaks, but must spend their income on their mortgage	• Short term price reductions to fill hotel • Some staff reductions to save costs • Advertisements in other countries as possible new markets
New anti-pollution law	All businesses need to recycle higher percentage of waste materials. ☒ Costs increased and profits decrease	• Room prices to customers increased, dependent on rivals • Other cost savings made in reducing staffing, less marketing and less training

External change	Impact on business	Reaction of business
Increase in e-shopping using mobile phones	☒ Drop in sales booked through reception and loss of sales to other hotels that were quick to adopt online bookings through mobile phones	• Investment in e-sales and a website which is compatible with smart phones • Daytime hotel reception staff made redundant • Price reductions for online bookings

Theme 2 – Building a business

2.1 Growing the Business

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which a large or growing business will be operating. Students must now be aware of the national and international business environment and how this might impact on a firm. Students must also appreciate this topic's relationship with the other topic areas in this theme and how this might affect business decision-making.

Section	Key Things to Learn
Business growth	Methods of growth: internal and external Public limited companies Sources of finance for growing and large businesses: internal and external
Changes in business aims and objectives	Reasons why business aims/objectives change over time How business objectives change over time
Business and globalisation	Impacts of globalisation Barriers to international trade Competing internationally: e-commerce and the marketing mix
Ethics, the environment and business	Ethics versus profit Environmental considerations and sustainability Pressure group impact on the marketing mix

Business Growth

Most businesses want to **expand** – to grow sales, increase profits, add new locations or extra outlets and take on more staff. However, expansion is not always easy; nor is it the most appropriate option for some businesses, for example those businesses that operate in a very specific niche or specialist market, which does not allow for growth.

What do we mean by expansion? In general, expansion is about **making the business bigger**. However, business size can be measured in different ways and this should be remembered when determining whether a business is growing or not. Listed below are different ways that business growth can be determined:

- Are sales increasing?
- Is the amount of profit generated going up?
- Has the capital invested in a business risen?
- Is the volume or output produced rising?
- Are there an increasing number of employees working for the business?
- Is the number of outlets or locations the business operates in growing?

- Is the value of the business going up (market capitalisation: current share price x number of shares issued)
- Is the market share getting bigger?

A useful way to compare and contrast the options for business expansion is to think in terms of **internal (organic)** and **external (inorganic)** growth. These options will be possible for most businesses and many will do both.

Internal or organic growth

Internal or organic growth can be defined as:

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

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

- By designing and developing new product ranges
- **Changing the marketing mix** to launch existing products directly into new markets, for example exporting. This can also be linked to an introduction or development of **e-commerce**
- Opening new business locations – either in the domestic market or overseas
- Investing in **research and development** to support **new product development** and **innovation**
- Investing in additional **production capacity** or new **technology** to allow increased output and sales volumes
- Training employees to help them acquire new skills and address new technology

Business growth 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 aways, serving everything from pizza to sushi to burgers to burritos! They have grown rapidly with the ability to order online. Their advertising has focussed on smart phone applications with the slogan "just a tap away". This has resulted in consumers being able to order online from their favourite local take-away, even if it is a small sole trader business, creating a clear example of internal or organic growth through e-commerce and advancements in technology.
Aldi	In 2017, Aldi overtook the Co-op as Britain's 5th largest supermarket chain. Its marketing mix aims to provide high quality, own branded products at the lowest possible price. Aldi's innovative "Like Brands" and "Swap & Save" marketing campaigns, which included the use of emails, have improved customer opinion of Aldi. These campaigns have also increased Aldi's sales per store by +100% over 3 years, through the creation of more loyal customers. Its advertising and social media campaigns have also created positive feedback and encouraged new customers to try out Aldi as a supermarket.
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 internal or organic expansion through the opening up of new hotels.
Apple	Apple is one of the biggest companies in the world. It has grown rapidly over the last ten years and its turnover represents 1.25% of the sales revenue of the whole US economy. By investing 30% of its budget in research and development (2016), Apple is able to continually bring out new versions of its existing iPhones, iPads and iMacs. This has not only encouraged existing customers to upgrade their current devices, but also creates new customers, often switching from rival products. Apple has also been able to develop new products, such as iWatches and virtual reality developments, to continue fuelling its growth.
Yorkshire Pianos	Yorkshire Pianos was set up in 2012 to fill a gap in the market for British made pianos. The pianos, which are made in Yorkshire under the Cavendish brand, quickly became successful and with imported piano prices increasing, sales in the firm grew rapidly. In 2014, the company visited the Shanghai Trade Show. It was very popular and in 2016, Yorkshire Pianos started to export its products to China, with the typical customer being a family with at least one child learning to play. British pianos have a distinctive tone, being more "mellow" than the brighter sounding brands, such as Yamaha.

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 internal or organic growth by adding new products, expanding into new geographical areas or increasing its share of the market?

Advantages and disadvantages of internal or organic growth

What are the advantages and disadvantages of internal or 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 business is already a leader
☑ Builds on the strengths of the business, for example the brand	☒ Slow growth – shareholders may prefer more rapid growth
☑ Allows the business to grow at a more steady rate	☒ Retained profits may be used to finance internal growth; this may increase the risk, as there is less left "just in case" the business needs money quickly at another point in time. This also means there would be less to distribute to shareholders or owners

External or inorganic growth

In order to speed up its growth, many businesses choose a strategy of external or inorganic 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 it is not and is therefore 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 in fact unrelated, products.

Advantages and disadvantages of external or inorganic growth

Advantages	Disadvantages
☑ Benefits from **economies of scale**, decreasing 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
☑ Reduced competition and increased market share allowing a business to have more security and to possibly 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 level, which can reduce motivation
☑ The two businesses may allow a transfer of knowledge, skills and/or technology. Goods and services can be shared	☒ The cost savings may not be easy to achieve quickly, as staff will need to be made redundant and premises and equipment sold
☑ Larger businesses may be able to raise money more easily and have more buying power to get cheaper raw materials	☒ 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	☒ If a business grows too large or too quickly it may become inefficient in terms of management and worker motivation

Examples of mergers and takeovers

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

Facebook & WhatApp	In February 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 & LinkedIn	In 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 & Kraft	In 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. This change created 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.

Public limited company (plc)

Most of the largest businesses in a country will be public limited companies. Famous examples of public limited companies based in the UK include Unilever, Tesco ad GSK.

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 for the public to buy. Buyers of plc shares may be financial institutions and investment or pension funds, or they may be just ordinary members of the general public. The key fact to remember is that, in theory, "anyone" can become a shareholder in a public limited company, unlike in a private limited company, where there is more control over who is allowed to become a shareholder in the business.

Trading on the stock exchange makes it easier to value and to buy and sell shares in a plc. 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.

A plc must have at least two shareholders and at least £50,000 of share capital. 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 in a plc.

Advantages and disadvantages of public limited companies

	Advantages	Disadvantages
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 in the business ☑ Stable form of structure – business continues to exist even when shareholders change ☑ Firm is more prestigious and can receive lots of publicity	☒ Shareholders may not agree with how the profits have been distributed or undistributed by the board of directors in the business ☒ Greater administrative costs ☒ Finance can be limited by the stock market valuation of the company ☒ Public can see company information and accounts ☒ Risk of company being taken over ☒ Separation of ownership and control

Sources of finance for growing and established businesses

Growing businesses or large businesses have access to a greater number of sources of capital or finance. One reason for this is they are viewed as less risky, as they are larger and therefore would have more assets to act as security against a loan for example, and therefore there is less danger that a public limited company would not be able to successfully make repayments.

These sources of finance can be divided into internal and external sources:

Internal sources of finance

The main internal sources of finance for an established or growing business are:

- Retained profits
- Selling assets

Retained profits

Retained profit is by some way the **most important and significant source of finance** for an established profitable or growing business.

The idea is simple. When a business makes a net profit, the shareholders have a choice: either extract it from the business, by way of a **dividend**, or reinvest it by leaving profits in the business.

Some of these profits might be in the bank; some might be spent on additional property and machinery; perhaps some are reinvested in more inventory or used to reduce bank overdrafts or loans.

Retained profits have several major advantages:

- ☑ They are **cheap**, though not free, as the **cost** for shareholders of leaving profits in the business is the return they could have obtained elsewhere i.e. through investing.
- ☑ 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 the ownership** of the company.

There are however some disadvantages of using retained profits:

- ☒ Directors of large, profitable businesses are sometimes criticised for having **lower dividends** because they are keeping too much cash in the business. If retained profits do not result in higher profits, then there is an argument that shareholders could make better returns by having the cash for themselves!

Selling 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.

The sale of assets often occurs when management grow the business through mergers and takeovers. The combined businesses may have excess assets which can then be sold to raise finance.

External sources of finance

There are many ways for a larger business to raise finance from external providers. The main methods are:

Loan capital

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 if 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.

Share capital

Both **private and public companies can raise finance by selling new shares** in the company. For the purpose of this section, we concentrate on the main options open to a **publicly-quoted company** – i.e. a company whose shares are quoted and traded on a recognised stock exchange.

The two main options available are:

Flotation – new issue of shares

A **flotation** is a way that a company can raise large sums of money for a new or existing business. It involves selling shares in the company to investors through the stock market. A stock market flotation is an expensive way of raising new capital because of the costs involved in the sale of the shares.

The major change that arises from a flotation is that the shareholder base of the company becomes much wider; potentially many thousands of private shareholders invest in the business alongside the larger "institutional" investors, such as pension and insurance scheme funds.

Rights issue

A **rights issue** is a relatively common way for a company to raise fresh capital. The company issues new shares, offering them first to existing shareholders. Shares in a rights issue will often be offered at a significant **discount** to the current market price, particularly if the shareholders' "appetite" for the shares needs to be encouraged.

What is the best source of finance for a growing or large business?

With such a wide range of potential sources of finance, the truth is that there is no such thing as the ideal or recommended source of finance for a large or growing business. Several factors determine the type and amount of finance that a growing business needs. The most important of these are:

Factor	Explanation
Profitability	A business that has strong profitability is often able to finance expansion through reinvesting profits, rather than looking for external finance.
Management track record	External finance providers, for example banks and venture capitalists, will look closely at the abilities and experience of the business management team. They do this to determine the risks involved in providing finance.
Short or long-term	The nature or reason for the finance is a key consideration. If finance is required for long-term growth, for example to pay for a new warehouse or factory, then that 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 company has the option of raising finance via public stock markets.

Changes in business aims and objectives

As a business grows, its objectives may well change. Established businesses will also expect to change their objectives if the external environment is different. A business specialising in luxury products might aim for strong growth in an economy that is doing well, but may have to change this to survival if the economy weakens or a strong new competitor arrives.

Objectives are often set in financial terms. Those could include:

- How much profit the business wants to earn
- The targeted level of sales for the next year
- How fast the business wants to grow, for example percentage increase in sales
- How much profit is to be paid out to shareholders in dividends

However, business objectives ***do not have*** to be expressed in money terms, or in a way that can be measured. Some objectives are hard to quantify, but are often important. For example, an objective a business might set may be to become recognised as…

- An innovative player in the market
- A leader in the quality of customer service (compared with the competition)

Both of these objectives do not have obvious quantitative measures.

Changes to objectives

There will be various causes of a business choosing or having to change its objectives. This could be due to internal reasons, such as a change in ownership, for example The Body Shop was taken over by profit maximising L'Oreal, which would/may conflict with the ethical objectives of The Body Shop. New directors/managers could also want the business to expand in a particular direction, for example through international expansion. There will also be changes to the business environment which a business cannot control, but will affect the achievement of a business's objectives.

Some examples of how internal and external influences could affect a business are summarised here:

Cause of change	Explanation	Example of effect on the business and the achievement of its objectives	Possible new objective
Market conditions	The current situation in the market that the business operates in e.g. economic conditions, competition, changing tastes and fashions	If there is increased competition or decreased consumer wealth, this could mean increasing sales may be unachievable	Objectives may change from **growth** to **survival** or in reverse if market conditions improve
Change in technology	Advances in technology such as new IT capabilities	New technology could significantly reduce costs, making it easier for a business to increase profits	Objectives such as reducing staffing levels could be introduced to reduce costs to pay for the new technologies

Cause of change	Explanation	Example of effect on the business and the achievement of its objectives	Possible new objective
Change in legislation	New laws introduced such as changing the minimum wage, or shops charging 5p for carrier bags	The new laws could affect sales, employment or production and may increase costs or decrease revenue	Profit targets reduced because of the increased costs caused by the new legislation
Internal reasons	Internal factors such as management capability, availability of employees or the financial position could all change	If there are less employees available then costs might increase to retain staff or to pay for overtime, reducing profits	If the managers cannot cope with the expansion aimed for due to a lack of expertise of staff, then the business might stop trying to grow and reduce its product range

Businesses will always be changing and adapting to change. This will be due to some of the changes identified above and how the business itself evolves over the years. New managers may bring in fresh ideas. Managers may therefore have to adjust objectives to take into account internal and external changes, including particularly the performance of the business.

There will always be a clear sequence:

Existing objective

Change causing factor

Effect on current business objective

New business objective

Globalisation

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 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.

Multinational firms, businesses that produce goods in more than one country, have become increasingly powerful as worldwide brands.

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:

Globalisation – Benefits and Drawbacks

Benefits	Drawbacks
Globalisation has resulted in increased markets for businesses small and large through exporting. 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 through imports.	Domestic firms have had to face competition from businesses throughout the world through imports. Many of these businesses have cheaper costs and larger scale production and as a result other businesses may close.
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. Globalisation has therefore impacted where different businesses or industries locate.	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.
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.	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.
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.	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.

Barriers to international trade

Economic theory would say that all countries can benefit in the long run if there is free trade between them. This means that imports and exports can be exchanged between countries with no barriers to trade in existence, such as **tariffs**, quotas (a restriction on the amount of goods that can come into a country) or regulations. **Barriers to trade** is where a government imposes regulations to restrict the flow of international products into its country.

In reality, countries will prioritise the short term needs of their own economy, which means barriers to trade are often implemented. There are many reasons for this practice, such as allowing domestic new industries to develop, protecting jobs from foreign competition and retaliating against other countries that are also protecting their economy through similar measures.

Tariffs are one of the most common methods used to restrict trade. They are a tax on imports and will allow the businesses which produce similar products within the home or domestic country to grow, or at least to survive, against foreign competition. They can allow businesses to adjust to these new threats, but equally may encourage inefficiency. Tariffs will also reduce consumer choice and increase the price of products.

Trade blocs, such as the European Union, offer the opportunity for free trade within the group of trading nations. They are likely however, to charge high tariffs on imported products from countries outside of the trading bloc, so consumers once again can suffer through restricted choice and higher prices. Because of this, businesses which export to countries outside of the trading bloc may face restrictions, such as tariffs and quotas, on their exports to these countries. At times, if a business exports heavily to a particular country or trading bloc, it may open a site within that trading bloc to avoid these barriers to trade.

There are benefits to consumers of the existence of trading blocs, for example cheaper products from countries within the trading bloc and to businesses which export within the bloc, although they will still face competition from other businesses.

International competition for UK businesses

UK businesses face both the challenges and opportunities of the global market, as described previously. This has been made more complicated by the Brexit vote, which means that traditional trading links within the EU will change when the UK leaves the EU. This will affect both UK firms which export to other EU countries, as well as UK firms which 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 the UK market, which 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. Science and technology has been a traditional strength, but the UK is also acknowledged as a market leader in many areas of industries, including automotive, aerospace and chemical and pharmaceuticals.

Internet and e-commerce

The availability of the internet has allowed businesses to expand their horizons on a worldwide scale. Whilst this would not be suitable for some types of businesses or their products, there will however, be a large number of businesses that now sell or produce their products on a global scale. Even small or growing businesses can promote, sell and distribute their products using digital communication and e-commerce.

Example: Freestyle Xtreme

Freestyle Xtreme is a specialist UK based company that sells sports clothing and accessories, particularly those for extreme sports. The firm decided to expand internationally using Amazon for on-line sales and payments. Freestyle Xtreme's website was first launched in 2004. The business has now developed its own online sale sites and uses online market places in many other countries. Its sales revenue has risen to £10 million in 5 years. Payments are immediate, through internet based systems, and the UK government has encouraged the business by providing financial help towards its distribution costs.

International marketing

Traditionally, the four main methods of selling into international markets have been

- **Exporting direct** – the business stays in the UK and sells directly to the customer in other countries
- **Using overseas distributors and agents** – the business uses other businesses or individuals (agents) who are based in other countries. They help sell the products, as they know the market, in return for a percentage of the price. This practice is very common in the car industry, where the manufacturers use "dealers" to sell their cars.
- **Setting up overseas business units** – the business will set up a factory in another country to make the product, which might be slightly different due to local preferences.
- **Buying a business overseas** – a merger or takeover of an overseas firm allows a business to "buy" the production unit and to carry on selling to their existing customers.

Online advertising and e-commerce are now making direct exporting a much more cost-effective option. International customers find it relatively easy to discover the products offered by firms of all sizes in the UK and complete transactions.

There are however, several changes that businesses will need to consider if international marketing is to be successful.

Marketing Aspect	International considerations
Product	Are tastes and expectations the same in other countries? Fashions might not be the same, climates will vary, cultures will provide different influences and even the electrical system might be different. Product names and brands might mean something different in other countries. There are many well-known examples of this including Coca-Cola's first translation into Chinese as "bite the wax tadpole!"
Price	Income levels in other countries might be very different, even after taking into account the exchange rate. Often basic western consumer goods are luxury products in other countries and will have a relatively high price compared to local alternatives and therefore will only generate low sales.
Promotion	Advertisements and packaging will require translation – websites will need to be understood in the countries targeted. Different legislation will need to be observed, as well as respecting the cultural norms of other countries. Media used will need to be understood, if advertising is to be placed in other countries.
Place	Distribution will clearly need careful checking, both in terms of speed and cost. International payment is not straightforward. There are also issues to do with trade restrictions, such as tariffs, which might mean there is an additional cost to exporting to other countries.

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.

Ethics, the environment and business

In recent years, business stakeholders have taken a much greater interest in the wider aspects of business behaviour. 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.

Making an ethical decision may result in increased costs for a business. It may however, lead to good publicity and a more positive relationship with its stakeholders. In some cases, ethical behaviours or choices will be made because of the moral viewpoint of the business owners, not just because it will increase profitability in the long term!

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	Comment
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. Legal action could be taken against the firm, if they are not meeting the requirements of the law; any fines that result could be expensive and the firm's reputation could be damaged
Suppliers	Cheap suppliers 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 which 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 prevent 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. They pay higher prices, so that the workers in the developing countries can receive higher wages and experience a better standard of living.

Advantages and disadvantages of ethical behaviour

There are arguments for and against ethical behaviour. A business may feel the need to act ethically, particularly if a business faces competition from firms 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, business decisions will be based on the owners' or board of directors' 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 friendly 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 where the business is based • Recycling collections must be arranged and paid for	• Consumers will pay more for goods and services • The society in which people 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 recycling arrangements • Some products, for example cooking oil, have strict disposal arrangements	• Consumers will pay more for goods and services • The society in which consumers 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 prices to consumers may 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** or **trade-offs** 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 sustainability more possible, however increases in population will make it more difficult to achieve.

Growth in economies and their output has 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. In the short term, producers will make less profit 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.

Pressure groups and the marketing mix

A **pressure group** is an organisation with members who have a common interest. They will seek to change business or government policy through actions which can be peaceful, but involve protest. Their actions can also be more forceful and sometimes violent and illegal.

A business's marketing policy is often the target for consumer pressure groups. They can see marketing as a way to exploit the consumer in favour of excessive business profits.

Some of the considerations that businesses might make in the light of actual or threatened pressure group activity are as follows:

Product: - There may be objections to products produced by labour that has been exploited or that has involved product testing on animals. Products could be made more ethically, based on environmentally friendly processes. Supply chains might be changed to ensure there are no issues with suppliers.

Price: - If too high a price is charged for basic or essential goods, there may be pressure group protests. This has happened with petrol and train fares. There have also been successful pressure group campaigns to reduce the price of some medicinal drugs.

The "Treatment Action Campaign" has used mainly peaceful protests such as marches with placards to get publicity and reduce the price charged by companies for anti-Aids drugs. This has resulted in changes to government policies, so that this is achieved.

Promotion: - Pressure groups may object to persuasive promotional campaigns. Bulk offer promotions by businesses are seen by some pressure groups as encouraging waste. There have also been protests against adverts for addictive products or payday loan companies.

Greenpeace uses professional advertising campaigns against governments and businesses that are not in favour or protecting the environment or preventing climate change.

Place: - With the growth of e-sales, there has been widespread closures of retail and financial outlets such as shops, banks and post offices. There have been various local and national pressure group campaigns against these measures, claiming that they will hurt the most vulnerable members of our society.

Local awareness and “use it or lose it” campaigns have been run in many villages to prevent the closure of their rural post office and shop. These have included village school competitions and poster distribution, as well as writing to MPs.

2.2 Making marketing decisions

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which a large or growing business will be operating. Students must now be aware of the national and international business environment and how this might impact on a firm. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect business decision-making.

Section	Key Things to Learn
Product	The design mix The product life cycle Extension strategies Product differentiation
Price	Pricing strategies Influences on pricing strategies
Promotion	Promotional strategies Technology in promotion
Place	Methods of distribution
Using the marketing mix in business decisions	Relationships between marketing mix components Building competitive advantage through the 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 goods and services to meet the changing wants and needs of customers.

The design mix

Good design is not just about having an attractive product. Good design also takes into account a product's usefulness and its cost, as well as its look!

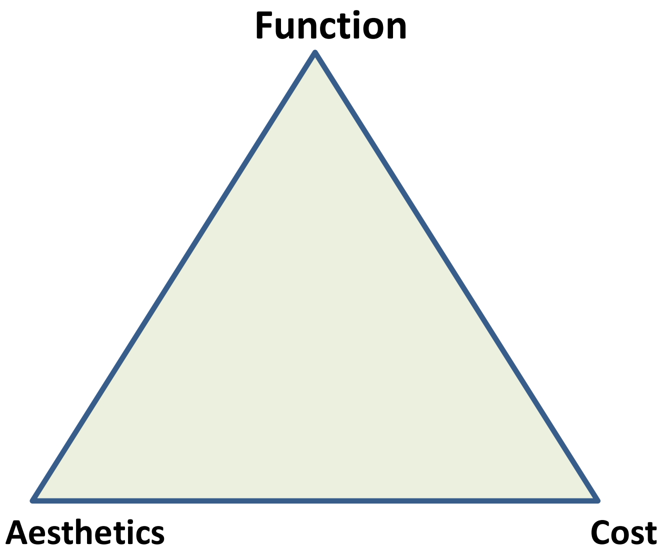
The traditional product design mix emphasises three elements:

- **Function** - The way the product works; does it do what it needs to do? Is the product reliable?

- **Aesthetics** – does the product appeal to the customer in terms of how it looks and feels? This is often based on the subjective judgement of customers and is a popular way to differentiate a product from its competitors.

- **Cost** - does the design allow the product to be made and sold profitably? How much value is added during the production process? The difference between the costs of making something and what a business can sell it for is the value added that allows a profit to be made.

The mix of features required for a successful design of a product is often shown as an interrelated triangle:



Products can be located on the triangle to show the balance between the three features. A long lasting successful product is likely to be located in the centre of the triangle showing a balance in the product's features.

All businesses will focus on costs and operating efficiently. The two other parts of the design mix are now explained in further depth:

Common features of products that successfully emphasise function in the design mix:

- Demand is more stable and predictable
- Longer product life cycles
- Lower promotional costs
- A reputation for quality based on reliability
- Economic to manufacture through low average costs based on high production

Common features of products that successfully emphasise aesthetics in the design mix

- High added value
- Demand fuelled by customer aspirations
- Potentially shorter product life cycle
- Attracts imitation, so there is need for design protection, for example patents, copyright
- Need for greater promotional support

Product life cycle

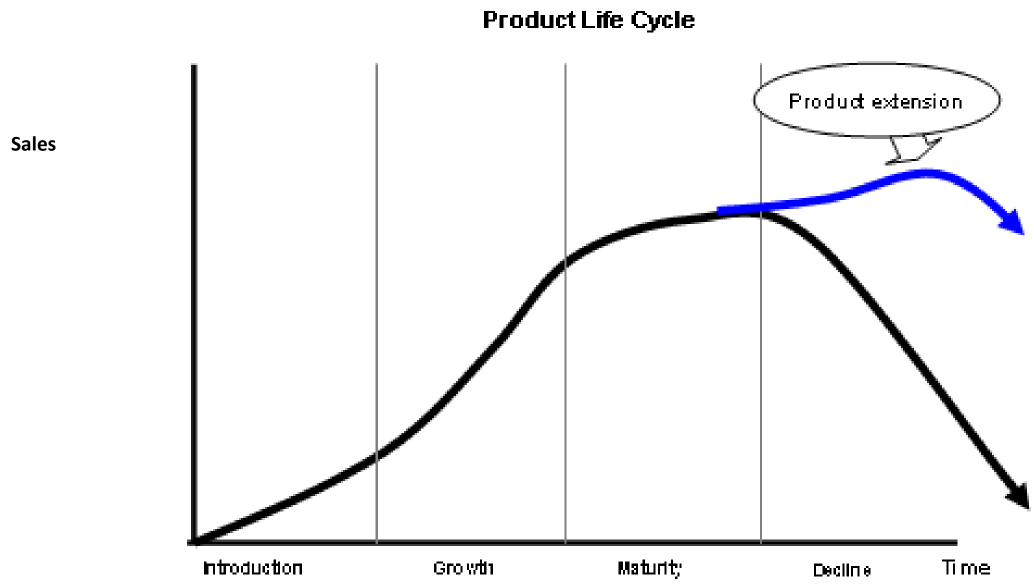
The **product life cycle** is an important concept in marketing. It describes the stages a product goes through from when it was first thought of until it is finally removed from the market. Not all products reach this final stage. Some continue to grow and others rise and fall.

The main stages of the product life cycle are:

- Introduction – researching, developing and then launching the product

- 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 various marketing techniques to improve the sales of an existing product.

Examples of these techniques include:

- 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 making 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 or how cheap they are!

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 its product, where customers will return to the business for repeat purchases. They will also buy other products that are associated with the same brand which they perceive as being good value.

If a business has a unique feature, then it can apply for legal protection for the feature or brand to ensure it cannot be copied. Dyson vacuum cleaners, Head and Shoulders shampoo and Rolls Royce cars can all claim to have unique selling points. If products are successful through their USP, other firms will ultimately try and imitate them, if they legally can – normally at a cheaper price.

Price

The pricing strategies that a business uses for its goods or services is one of the most important business decisions management will make. Setting a price that is too high or too low will, at best, limit business growth. At worst, it could cause serious problems for sales and cash-flow.

This reinforces the fact that setting the selling price of a product is a very important decision. The bad news for entrepreneurs and all businesses is that pricing is really tough to get right. There are so many factors to consider, and much uncertainty about whether a price change will have the desired effect the business was hoping for.

High price or low price?

The law of demand states that, for nearly all products, the higher the price the lower the demand. In other words, sales will fall if prices are increased. However, higher prices can also mean higher profits.

Price is such an important factor for some businesses that it will form part of their overall business objectives and will therefore be a key component of their marketing mix.

The effects on two different businesses of a change in price are given below:

Example 1:

A hotel chain specialising in business travel found that in the recent economic recession demand for its services had decreased and that often its hotels were only half full, a situation that was even worse at the weekends. The chain decided to decrease prices by an average of 25% and by the end of the year its average occupancy rate, or the number of times the rooms were booked, was over 90%. This meant that revenue and profits increased significantly for the chain.

Example 2:

A company supplying fruit and vegetables to a large supermarket chain found its profits getting lower, as costs increased and the price it charged its customers stayed the same. The business decided to increase its prices by 10%. As a result, the supermarket decided to decrease the amount it bought from the company and increase purchases from the many alternative suppliers it could use. As a result, the fruit and vegetable company's sales fell by 50% and revenue dropped similarly, which had a negative knock on effect on its profit.

As can be seen from the two examples, it could be a good idea to reduce prices a little if there is a significant increase in sales. Similarly, it is not a good idea to increase prices if there is going to be significant fall in sales, although the business might benefit if the fall in sales is very small, as revenue may increase, despite the number of units falling.

A new business or an existing business launching a new product would have similar choices. It could enter the market with a high price, because the product is unique and will appeal to those customers who like to be first to have a new product. Many technology products, such as smart phones, use this pricing strategy. Alternatively, businesses could enter the market with a low price, with the aim of getting good sales and market share and building up brand loyalty, which would enable them to increase their selling prices at a later date.

Factors that affect pricing decisions

Some of the more important influences that a business needs to consider when setting the selling price are:

- **Objectives** – what are the objectives of the firm? Is it for a "high price, high quality" business? Or has it 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. **Price comparison sites** often allow competitor price information to be easily accessed and due to this, businesses will be fairly similar in terms of price in some industries. Electrical good prices, such as televisions, are often fairly similar as so many are now brought online and therefore it is easy to gauge prices through price comparison sites.
- **Customers** – the **market segment** which is targeted by the business will influence the selling price set. Factors such as age, income levels, location will impact on the decision.
- **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 expenses or overheads 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. Manufacturers of luxury products may need to drop prices to stimulate demand, 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, an industrial or business customer that buys substantial quantities of a product from another firm 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.

Promotion

The main aim of promotion is to ensure that customers are **aware** of the existence and positioning of products. Without this information customers will not be aware that the product exists. It is no good having a special offer on a product and not telling customers about it!

Promotion is also used to **persuade** customers that one 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 competitors
- To increase **growth** through more sales to existing customers or sell 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 combination of methods used by a business in its promotional strategy is referred to as the **promotional mix.** Three of the most important types of promotion are advertising, public relations/sponsorship and sales promotion or special offers. In recent years, social media has also become widely used and is very important in promoting a good 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 a magazine targeted at women
- **Position in the product life cycle** – the launch stage will require different types of 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, i.e. the cost of reaching each potential customer, 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 and is largely carried out 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

Branding a product

A brand is **a product with unique character, for instance in design or image.** It is consistent and well recognised. Branding is often used as a vital part of the promotional process.

The advantages of having a strong brand are that it:

- ☑ Inspires customer loyalty, leading to repeat sales and word-of mouth recommendation.
- ☑ The brand owner can usually charge higher prices, especially if the brand is the market leader.
- ☑ Retailers or service sellers want to stock top selling brands. With limited shelf space, it is more likely the top brands will be on the shelves in leading stores rather than less well-known brands.

Some retailers use **"own-label"** brands, where they use their name in the product's name, for example "Tesco Finest" or "Sainsbury Taste the Difference", rather than the manufacturers name, such as Heinz. Supermarket own brands tend to be cheaper and will give the retailer more profit, than selling the manufacturers brands.

Some brands are so strong they have become **global brands**. This means that the product is sold in many countries and the contents are very similar. Examples of global brands include Microsoft, Coca Cola, Disney, Mercedes and Hewlett Packard.

The strength of a brand can be exploited by a business to develop new products. This is known as **brand extension** i.e. developing a new product with some of the brand's original characteristics included in it. Examples include Dove soap and Dove shampoo, which both contain a moisturising factor, Mars bar and Mars ice cream, which clearly have many close similarities.

Brand stretching is where the brand is used for a diverse range of products, not necessarily connected, for example Virgin trains and Virgin media, Marks and Spencer clothes and food. Brand stretching will help to drive sales for the business, particularly if the brand is well respected and trusted.

The **logo** on a product is an important part of the product. A logo is a symbol or picture that represents the business. It is important because it is easy to recognise, establishes brand loyalty and can create a favourable image.

Sponsorship

Sponsorship is a specialist type of public relations and is becoming 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 to 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 therefore 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:

- ☑ **Product trials -** a free or reduced price product may be given as a sample with the hope that consumers will then continue to buy the product in the future. Magazine collections are good examples and more recently TV film providers, such as Netflix and Amazon Prime.
- ☑ 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
- ☑ **Special offers/discount** vouchers or temporary price reductions– 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 create 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?

Using technology in promotion

The increased use of the internet has allowed cheaper and far more accurate promotional strategies. Advertising can be linked to the profile of customers using particular websites and allows businesses to capture customer and potential customer details and then communicate with them through special offers, e-newsletters, blogs and many other promotions and reminders.

Social media is both a location for advertising and also a method of advertising. Viral advertising through sharing sites, such as used in Facebook and YouTube, can create real excitement about a product or new product and as a result, can create massive brand awareness very quickly. This often costs very little, but it is clearly very hard for a business to guarantee success.

Smart phones also provide a new opportunity for promotion and the development of “Apps” by businesses allows communication to be easily made with a customer – and for the customer to interact with the business through e-commerce or m-commerce.

Factors influencing the choice of promotion

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 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.

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/e-tailers 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".**

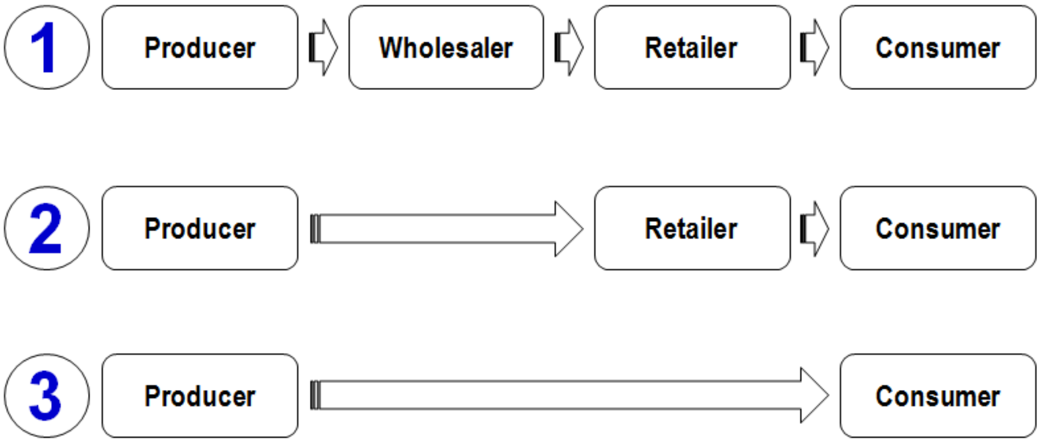
Why does a business give the job of selling its products to intermediaries? After all, using an intermediary means giving up some control over how products are sold and who they are sold to. An intermediary will also want to make a profit by getting involved.

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" or "direct-sale"** channel, since it has no intermediary levels. In this case the manufacturer sells directly to customers. This is increasingly used as e-commerce becomes more popular. Many holiday companies market direct to consumers, bypassing the traditional retail intermediary - the travel agent.

We will now consider these intermediaries in more detail:

Retailers

Retailers are the most popular distribution channel for consumer goods, as they 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.

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 (including e-tailers)

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, direct-mail selling, cold calling, telephone selling **(telesales)**, and door-to-door calling. More recently telemarketing, direct radio selling, magazine and TV advertising, and on-line computer shopping i.e. **e-commerce** have been developed. This has given rise to the development of **e-tailers** who make sales through e-commerce and then distribute their product direct to the consumers.

The main advantages of selling direct are that:

- ☑ there is no need to share profit margins
- ☑ the producer has complete control over the sales process
- ☑ products are not sold alongside those of competitors.

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. A small business that produces boxes of cauliflowers will find it cheaper and more time efficient to use a retailer to sell the cauliflowers rather than driving round every possible customer in a van.

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 produced 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 linked to 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.

Using the marketing mix to make business decisions

The use and importance of the ingredients of the marketing mix will very much depend on the good or service being produced. A high quality perfume will be more focused on promotion and product than price. This would compare with milk, where the product is much more standard and there is limited need for promotion. Therefore, price would be more critical in this instance.

Some of the more important factors affecting the use of the marketing mix are as follow:

- **Competition** – if there is little or no competition then a business may not attach much priority to its marketing at all. Although neglecting the product and the development of new products would not be recommended. The business would be more likely charge a higher price compared to being in a very competitive market, where more is likely to be spent on branding and promotion.
- **Market segment** – Some market segments will be less receptive to some aspects of the marketing mix. E-tailing may not be as successful with retired customers as it might be with teenagers. Retired customers might value a more convenient distribution channel.
- **Nature of the product** – sacks of potatoes will not be ideal products for e-tailing. However, the quality and price of the product will be critical for customer satisfaction and repeat sales in this

instance. Paperless products, such as airline and concert tickets, would however be appropriate, as there is no real need for a physical product to be distributed.

- **Finance** – even for established businesses promotion in general, and advertising in particular, can be very expensive. This might limit the use of the marketing mix to areas which can be demonstrated as cost effective.

Competitive advantage

Based on the above factors the business will balance the marketing mix components to allow it to establish an advantage over its competitors. This might mean a lower price, a better product or a good special offer. Advertising products when rivals are not may result in more potential customers being made aware of a firm's products, who then may be tempted to purchase them too!

Competitive advantage in action:

- Business finds out what their competitive advantage is – this could be unique product or feature – only Ford Cars have heated front windscreens. It could also be a cheaper price because they have access to cheap raw materials, or in the case of Ford they have legal protection on the heated windscreen.
- Decision made – a business may choose to continue to use its current competitive advantage or may look to change it. A successful marketing campaign such the Go Compare singing adverts were used successfully and then dropped as the company wanted a new type of promotion to be used. This was less successful in making its name memorable compared to other price comparison sites, so the singer returned …in a taxi!

There will always be constant change in the environment in which the business operates. If a business is going to continue to be successful and remain competitive over rivals, its marketing mix must be flexible to effectively adapt to these changes and must be fully integrated to ensure that each part of it complements the others.

2.3 Making Operational Decisions

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which a large or growing business will be operating. Students must now be aware of the national and international business environment and how this might impact on a firm. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect business decision-making.

Section	Key Things to Learn
Business operations	Purpose of operations Production processes (job, batch, flow) Productivity Technology and its impact
Working with suppliers	Stock management Procurement Suppliers and logistics
Managing quality	Quality control and quality assurance Controlling costs through quality
The sales process	The selling process Customer service and its importance

Business operations

The purpose of business operations is to turn raw materials into **goods** and **services**. There are a variety of methods that can be used including job, batch and flow production. There are many surrounding issues that are involved in making the business operation as efficient as possible. These include ensuring that supplies are reliable, quality is good and that the customer service involved in the operation is also of a high standard.

Production processes: 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 good 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

Production processes: Batch production

Batch production occurs when many similar items are produced together. Each batch of the product goes through one stage of the production process before moving onto the next stage together as a group. The products will be similar but have some variation, for example different style, different size or different colour. Good examples include:

- Furniture manufacture
- Baking / meal preparation
- Clothing production

The benefits and drawbacks of batch production include:

Advantages	Disadvantages
☑ Making in batches reduces unit costs, as more than one unit is produced at a time, meaning fixed costs are spread across more units	☒ Time lost switching between batches, as machinery may need to be reset resulting in a reduction in efficiency
☑ Can still address specific customer needs including size, weight, style. For example car manufacturers can vary the colour, engine size and extra features even within the production of a batch of one model of car being produced	☒ Need to keep stocks of raw materials, which will impact on cash flow, as money is tied up in stock and in work in progress i.e. products that are moving through the production process but are not yet finished and therefore cannot be sold
☑ Use of specialist machinery and skills can increase output and productivity, making the process more efficient than job production	☒ Potentially de-motivating for staff as tasks are more repetitive compared to job production; this can lower productivity

Production processes: 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, as long as demand for the products in question is there	☒ 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; it takes a lot of planning time to organise the production process

Improving productivity

All businesses want their production operation to be as efficient as possible. In order to do this, they will aim to maximise their productivity.

Productivity can be defined as the amount produced (output) for a given number of employees (input). Clearly businesses want this to be as high as possible!

In order to improve productivity, businesses will invest in their employees through better recruitment, training and motivation. They may also invest in better equipment. Although such investments will have a short term cost, they will have the potential to save the business money in the long run.

It should be noted that improving productivity is **NOT** the same as increasing production. Productivity is about **efficiency** and lowering the **average cost** of producing goods and services. Production is about the total **quantity** produced.

There are many benefits of improving productivity. It allows the business to make **more profits,** as the costs of producing a certain amount of goods will be reduced. This is because a firm's fixed costs are spread across more units. This would therefore enable a business to have more flexibility with its pricing decisions and give it the opportunity to charge **lower prices,** because the average cost of making one unit is lowered. This means the business will be more **competitive**. Alternatively, the business could keep the selling price the same, but with an increase in productivity the business would be able to enjoy an increased profit margin on each item sold.

Production technology

Computer based technology can have many uses in the production process. It can be used in design or in the manufacturing process where it is often linked to the use of robots.

Some of its benefits are:

- ☑ It will increase the speed of production.
- ☑ It can reduce the average unit cost significantly compared to using labour.
- ☑ It allows the business to be flexible, as a computer can now be programmed to add in variations to meet the customer's requirements; this is often used in car production. This is a major development, as traditionally in the past, machines were very difficult to change and adapt to customer requirements.
- ☑ It can also increase the quality of goods, as human variation is removed. As a result, the business should always be able to provide a consistent level of quality to its customers.
- ☑ Machines also do not need regular breaks like workers do!

There are however some drawbacks:

- ☒ The initial costs are very expensive.
- ☒ Machines can breakdown, resulting in a loss of production time.
- ☒ Machines will need some "downtime" or time for servicing to prevent breakdowns in the future; during this time, production will be limited.
- ☒ There may be a waste of capacity if the machines output is not fully needed and therefore it is idle for a period of time.

Overall, a business will need to balance the costs of the technology, with the savings and benefits it will provide, when making any decisions about investing in technology.

Working with suppliers

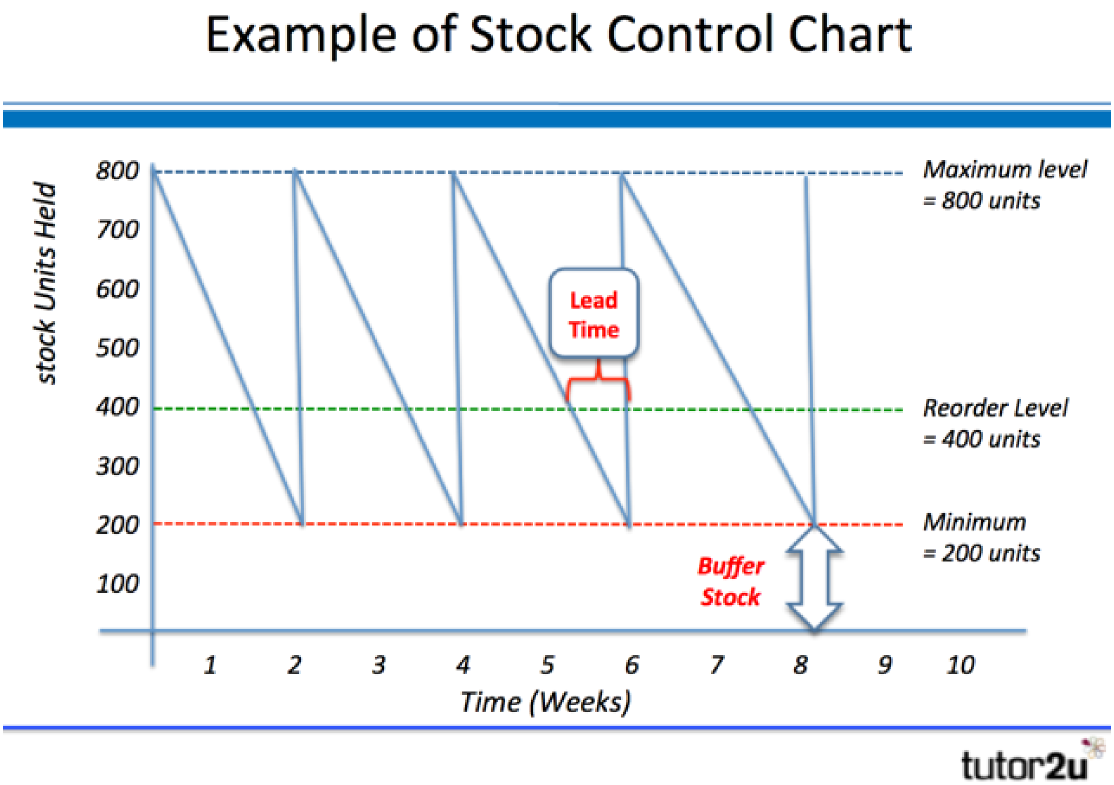
The relationship a business has with its suppliers is absolutely critical in terms of its success. A supplier is another business that supplies goods or services to a business to enable it to function and produce its products.

If a firm's suppliers produces poor quality raw materials and is unreliable with their deliveries, this will affect the performance and reputation of the business. Managing stock in terms of ensuring the right quantity is always available at the right time, at the right quality is therefore a very important role within any business.

Stock control

The overall objective of stock control is to make sure that a business does not run out of stock, but also to order stock in a way that the costs of holding stock is minimised. In order to help the stock control process, businesses will often use bar gate stock control charts, although in today's business world, these are often computerised and linked to suppliers, so the process of stock control is automatic.

An example of a traditional bar gate stock control chart is shown below:



This bar gate stock graph shows how stock levels decrease over time as stock is used up, until a new order arrives when the stock level increases again.

Looking at the example, in week zero the business was holding 800 units of stock. However, by week 2 it had used 600 units, as the volume of stock held in week two reached the minimum level the business overall wishes to hold of 200 units. This therefore shows that the business was using up stock at a steady rate of 300 units per week. In week 2, delivery of 600 units arrives which brought the stock level back up to the maximum stock level that the business wants to hold of 800 units. The maximum level of 800 units may be set at this limit due to a lack of space or alternatively the stock may have a short shelf life and therefore there may be a danger that the stock may become out of date if more was held and not used.

The new order which arrived in week 2, as already discussed, was triggered at the reorder level of 400 units. As a new order and delivery of that order takes just under a week to arrive, a new order must be placed at 400 units, otherwise the business would end up using some of its buffer stock that it is holding "just in case" there is a problem with some stock in the delivery i.e. poor quality or a delivery is late. Alternatively, if the business experienced a rush of orders then the buffer stock is there for the business to use to ensure that all orders are met successfully and customer service is kept high, due to orders being produced and delivered by the business on time!

The key parts of the bar gate stock graph are therefore:

Maximum level

This shows the maximum level of stock a business can or wants to hold.

- Example from graph: 800 units.

Re-order level

This is a trigger point; when stock falls to this level, the next supplier order should be placed.

- Example from graph: 400 units

Lead time

This is the time it takes between placing the order and receiving the stock

- Example from graph: just under a week

Minimum stock level or **Buffer Sock**

This amount of stock is held "just in case" of unexpected orders; this helps to ensure that such orders can be met and other orders can be met in case of any delays in deliveries from suppliers. It is the minimum amount of stock the business would want to hold; the firm would not want its stock levels to fall below this level, as it may run out and therefore may not be able to satisfy customer orders.

- Example from graph: 200 units.

Factors affecting when and how much stock to reorder

There are many factors that a business would need to consider when deciding how much stock to order or reorder, to ensure the business can run as efficiently as possible without running out of stock. These are:

Lead-time from the supplier

- How long it takes for the supplier to deliver the order
- Longer lead times may require a higher re-order level, for example supplies that are being shipped from the Far East may take as long as 8 weeks to arrive into the UK

Implications of running out of stock altogether i.e. the risk of stock-outs

- If stock-outs are very damaging to the firm's reputation and will impact heavily on future orders, then businesses should set a higher re-order level and quantity, plus increase the amount of buffer stock it holds

Demand for the product

- Higher or growing demand normally means higher re-order levels, to ensure that demand and orders can be fully met

Managing stock

All businesses will set itself a target stock level of finished goods that it should achieve. 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 firm's productivity level has fallen since the output per worker has not met the planned requirements.

Modern manufacturing firms use sophisticated production 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, to ensure orders can always 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 supermarket at the checkout.

Just in time (JIT) stock control

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.

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.

The main advantages and disadvantages of JIT can be summarised as follows:

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.

Procurement

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

Procurement is not just the process of choosing a supplier. It is the whole process of managing the ordering and receipt of the goods or services ordered. The details of this process are considered below:

Relationship with 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
Cost	If a supplier's prices are 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. Alternatively, if the costs are high, possibly because of high quality, then profit will be less. In some cases, the business may be able to increase its selling prices and "pass on" the higher costs to its customers.
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. As already discussed, it may mean that costs are likely to be more and profit less.
Delivery	Cost of transporting the supplies may be important in choosing a local supplier. It is no good buying cheaper supplies if the delivery costs are very expensive. Speed of delivery will be important in some industries. If the goods are likely to perish or deteriorate over time, such as fresh fruit and vegetables or flowers, then the speed of delivery is critical. Reliable delivery is essential if a business has a short turn-around time for delivering its product to its customers or if it uses JIT. The business will want a supplier that can deliver, so it does not run out of stock.
Availability	For a supplier to be of use it must be able to supply the business with goods of the quality required at the time that they are needed. In some cases, a supplier may be able to source suppliers from elsewhere if needed at short notice, dependent if they have spare capacity i.e. room in their production schedule to fit another order in. In this case however, quality checks would need to be performed, to ensure quality standards are maintained.
Trust	Some suppliers will have too many orders at certain times than it is able to cope with. For a long term supply relationship to work, then a regular, loyal business will expect to have priority over occasional customers. This will mean that supplies will always be available when required.

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.
- **Customer expectations:** 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.

Logistics

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.

Logistics starts with suppliers and ends with the customer and can be illustrated as a flow of goods and information in one direction with money flowing in reverse. An example of a chain of logistics is illustrated below:

Managing the logistics process is vital for a business to be successful. There are many consequences of failure in this distribution process and the key factors are summarised in the table:

Factor	Explanation
Reputation	If the supply chain breaks or slows, this can mean that products are delayed reaching the retailer, which may then be out of stock of some items. This will affect sales now and also potentially in the long term, particularly if this becomes a persistent problem and the business gains a reputation for being unreliable. In manufacturing, on time delivery can be even more critical, as a missing part might hold up the whole production process. Suppliers who cannot deliver effective logistics will gain a poor reputation and are unlikely to get repeat contracts.
Cost	There are many options in the logistics process. Which method or methods of transport should be used? Should the raw materials be bought directly from the producer – or through an intermediary, such as a retailer? Clearly expected timings must be met, but if the cost of the logistics is too high then competitors will have lower costs and therefore potentially cheaper prices.
Customer satisfaction	If the products arrive with the customer at the time and in the condition expected, given the price paid, then the customer will be happy. If the customer is happy, then he/she may be prepared to tell others and order again. With the use of digital technology today, customers increasingly receive communication updating them on the status of any order, which helps to manage their expectations in terms of delivery status and exact timings.

Managing quality

If a business is to be successful it must have satisfied customers. In order for customers to be satisfied, they must have received a good 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.

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 goods 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.

For the firm, good design is also fundamental, so that the product can be produced efficiently, reliably and at the lowest possible cost.

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 come to light

Consequences of poor quality can be very damaging for a business. There will however, be 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 goods and services are fit for their purpose and meet their specifications. There are two main methods of managing quality in a business:

Quality control

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.

Quality assurance

Quality assurance aims to develop a quality culture throughout the firm using approaches such as **total quality management (TQM)**. Every employee and each part of the production process has a target of "right first time" or **zero defects**. Business can gain an award (ISO9001) to show that they are effective in quality management.

In quality assurance there is more emphasis on **employee responsibility** to get things right, rather than checking by inspectors.

The process starts from receiving raw materials which are checked for quality, before they are used, and continues throughout the production process. This method even includes the administration of the business. It may also involve meetings of management and staff, called quality circles, where improvements to quality are suggested and management then make a decision as to whether to implement the ideas generated.

Advantages of quality assurance are:

- ☑ Costs are reduced because there is less wastage and re-working of faulty products, as the product is checked at every stage
- ☑ It can help improve worker motivation, as workers have more ownership and recognition for their work
- ☑ It can help break down "us and them" barriers between workers and managers, as it eliminates the feeling of being checked up on, as staff are empowered to make decisions about quality
- ☑ With all staff responsible for quality, this can help the firm gain marketing advantages arising from its consistent level of quality

Benefits of managing quality

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

- ☑ Customer loyalty – customers return, make repeat purchases and recommend the good or service to others, increasing sales further
- ☑ Strong brand image and reputation for quality, attracting new customers
- ☑ As the good 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 assurance methods, 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 give the business a **competitive advantage** and support the marketing of a business. Customers are likely to choose to buy from businesses with a good quality reputation, even if they are more expensive. 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.

Drawbacks/costs to a business of 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

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 quality assurance; this may involve a change in working practices in the organisation and therefore will require a significant investment in training for all staff, 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

The sales process and customer service

Sales is the final part of the distribution process and is extremely important, as this is how the business generates revenue. Customer service can be defined as the methods used by a business to look after its current and futures customers. If a business wants customers to return and to gain and maintain a good reputation, it will need to provide good customer service.

Sales 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 sales person, 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:

Product knowledge – sales people must have strong knowledge about the good 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.

Customer 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 purchasing the item 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 of service – 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.

The benefits of getting the sales process right are partly immediate, as more sales are made. Some retail businesses set targets for their managers that every person who visits the store should leave having bought something. Many tourist destinations, including airport duty free shops, will direct all visitors through the shopping area to encourage unplanned sales. Benefits are also long term, satisfied customers will come again and they will tell their friends which will generate sales. Dis-satisfied customers however, will tell far more people, which may damage a firm's reputation in the longer term. Therefore, getting the sales process right is absolutely critical, particularly when a business is operating in a hugely competitive market where lots of substitute products exist.

The importance of 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 good** 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 post-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 as well as reassuring the customer about their purchase.

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 goods/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. Therefore, 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!

2.4 Making financial decisions

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which a large or growing business will be operating. Students must now be aware of the national and international business environment and how this might impact on a firm. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect business decision-making.

Section	Key Things to Learn
Business calculations	Gross profit and net profit Calculation and interpretation of financial data
Understanding business performance	Using and interpreting quantitative data Use and limitations of financial data

Business calculations

Every business and every entrepreneur needs an understanding of the financial performance of the business they are involved in. 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.

The basic financial terms were considered in Theme 1 in terms of costs, revenue and profit. In this section, we will consider profit calculations in more detail.

Profit can be measured and calculated as **gross profit** and **net profit**. Gross profit is the amount the business makes from its actual business operation. From gross profit the business has to then pay for its expenses, which will leave it with its net profit. This is the figure that shows how well the business is really doing.

The formula for gross profit and net profit are as follows:

GROSS PROFIT = SALES REVENUE - COST OF SALES
NET PROFIT = GROSS PROFIT - OTHER OPERATING COSTS AND INTEREST

Here are two examples which illustrate these formulae in action:

	Sales	Cost of Sales	Gross profit	Expenses and interest	Net profit (or loss)
Business A	£100,000	£40,000	**£60,000**	£35,000	**£25,000 (profit)**
Business B	£100,000	£70,000	**£30,000**	£40,000	**£10,000 (loss)**
	Total sales greater than total costs **Total costs greater than total sales** **Total sales = total costs**			**= Net profit** **= Loss** **= 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? If so, 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?

Profitability ratios

The accounts of a business can be used to tell us how much profit a business has made in a period. But, how can a business tell if that level of profit shows good business performance or not? One way to judge how "profitable" a business is to calculate profitability ratios. There are two main profitability ratios:

- Gross profit margin
- Net profit margin

Let's look at how they are calculated and used.

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 this 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 a much higher revenue than Businesses 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 of 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. A high gross profit margin will mean that the business is providing high value added. Price of cups of tea and coffee at roadside cafes are good examples of items with very high gross profit margins.

Net profit margin %

Net profit is what is left after all the costs, expenses and interest 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
Other operating expenses/interest	150
NET PROFIT	**50**
Net profit margin	**12.5%**

In the profit statement above, the business has made a net profit of £50,000. The net profit is calculated by subtracting all the business expenses/overheads and interest, totalling £150,000, from the gross profit of £200,000. In the period, the business has made a net profit margin of 12.5%. That means that it has converted 12.5% or 12.5p of each pound of sales into net profit!

The net profit margin is the most significant out of the two profitability 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?
- Whether a business has been able to “add value” throughout the production process i.e. a business with a high net profit margin must be doing something right!

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	33%	10%	25%

Looking at the financial information given in the example, it can be seen that:

- Company A makes a higher net profit than Company B, even though its sales are lower. It has a higher net profit margin and is clearly controlling its expenses, overheads and cost of sales well compared to the other two businesses.

Investment ratio – average rate of return (ARR)

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. These include growth of the business, replacing worn out machinery or modernisation and mechanisation.

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:

$$\textbf{ARR (\%)} = \frac{\textbf{Average annual profit (total profit from the investment} \div \textbf{number of years)}}{\textbf{Initial cost of the investment}} \times \textbf{100}$$

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.

$$\textbf{ARR (\%)} = \frac{(£22{,}500 \div 5)}{£30{,}000} \times 100 = \frac{£4{,}500}{£30{,}000} \times 100 = \textbf{15\%}$$

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.

ARR is often used to compare different projects to see which one has the highest return. The percentage financial return is not, however, the only factor to be considered. In comparing projects other factors such as risk, i.e. how likely the project is to succeed, must also be taken into account. The initial cost is also relevant as if this is too much, however high the ARR is, the project may not be affordable for the business.

Understanding business performance

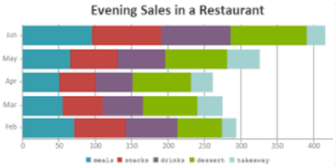
As well as financial data, there are other sources of quantitative information that a business can find and use to help it with effective and accurate decision making. This data can be displayed in tables, graphs or charts.

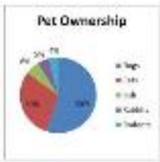
Marketing is one particular area where quantitative business data is commonly found, for example market research and sales data. Operations and human resources will also generate quantitative data in areas such as productivity, costs and staff retention rates. It should also be remembered that the business and its decisions are influenced by the external environment, market data (is the market growing or declining) and information about the economy, such as whether the economy is booming, if interest rates are set to rise etc. All this information will be invaluable to help the business with effective decision making.

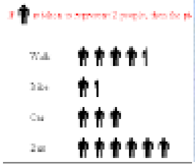
Data presentation and analysis

If a business gathers data first hand, through primary research, it will need to be presented in a way that is easy to understand and interpret for the key decision makers of the business. This will involve combining and presenting the data into a format that will enable easy analysis. This may also be the case with regard to secondary data, dependent on the type of data that has been gathered. 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, for example, 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, for example, from questionnaire responses.

Data analysis and interpretation is also undertaken by firms, from data presentation. 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 and marketing data

One of the objectives of the business is often to increase market share. This is normally measured as the sales of the business compared to the total market sales 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.

- Market information is generally available through secondary data for the industry concerned and includes population information such as age distribution, income levels and employment and unemployment information.
- Marketing data can be used to measure the effectiveness of the marketing strategy or marketing plans of a business. If a business spends money on advertising, it will want to know whether the awareness and the sales of the product increase. If they introduce a sales promotion has the increase in sales made it worthwhile?

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, therefore 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.

Limitations of financial information

As seen with the financial performance data considered earlier, care must be taken when interpreting the data. For example, trying to compare the efficiency of businesses using sales figures will not be valid unless there is reference to productivity i.e. the amount of work produced per employee or how high the sales are of a business as a percentage of its costs.

There are many other limitations in using data, particularly financial data:

Accuracy – does the data represent the actual data that was collected? Are there any results included that have been guessed or made up?

Representative – is this year's financial data useful to compare with previous years? There may be new products or new markets that have been targeted or new stores opened, which would show more sales, but equally higher costs. Data for seasonal products will also need to be interpreted correctly as, for example, ice cream sales always go up in the summer.

Out of date – all data is out of date – the question is by how much and is it still of use? Sales figures will refer to last month, last quarter or even last year. Cost data will be similarly historic. Sometimes the time, effort and cost of collecting and analysing the data too regularly may not be worthwhile, as it will still not necessarily be an accurate guide as to present and future performance.

Qualitative data may be needed – Most data collected and analysed on a regular basis is quantitative. This will be limiting however. Profits and sales figures may indicate that the launch of a new product has been successful. However, it could be that the customers have tried the product once, but do not like certain features of a new model or product and have no intention of buying it again or are only buying the product because there is no alternative. The business can and therefore should support the quantitative data with some in depth qualitative data. This can ask questions about attitudes and values and the combined results will provide a much more reliable basis for management decisions.

It should be remembered that all data, marketing data, financial data, including ratios, operations data and human resources data are only the tools for the decisions. They do not make the decisions – the managers will do that. Managers will take into account the data and all the circumstances faced by the business including internal and external factors and the most important stakeholder objectives when making decisions, to ensure hopefully they are making the right ones!

2.5 Human Resource Decisions

Topic overview

Although this is a separate topic, students need to relate these concepts to the contexts in which a large or growing business will be operating. Students must now be aware of the national and international business environment and how this might impact on a firm. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect business decision-making.

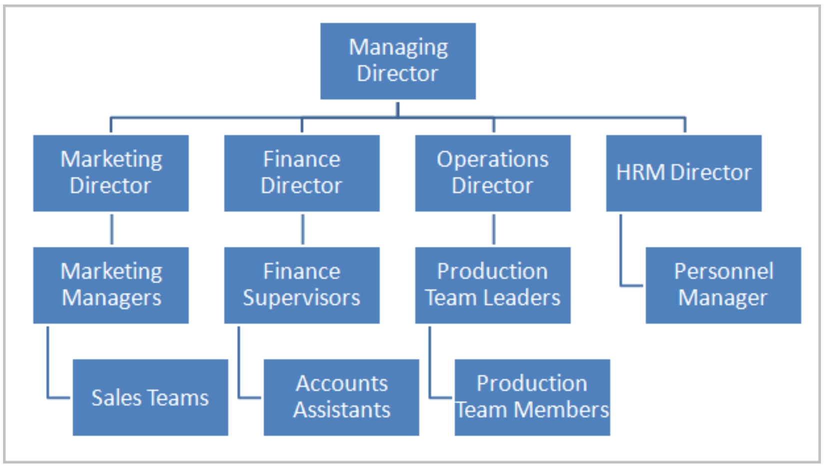
Section	Key Things to Learn
Organisational structures	Different organisation structures and their use Achieving effective communication Different ways of working
Effective recruitment	Different job roles and responsibilities The recruitment process
Effective training and development	Methods of training and development Purposes of training and development
Motivation	The importance of motivating employees Methods of motivation: financial and non-financial

Organisational structures

As businesses grow in size and the number of employees increases, 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.

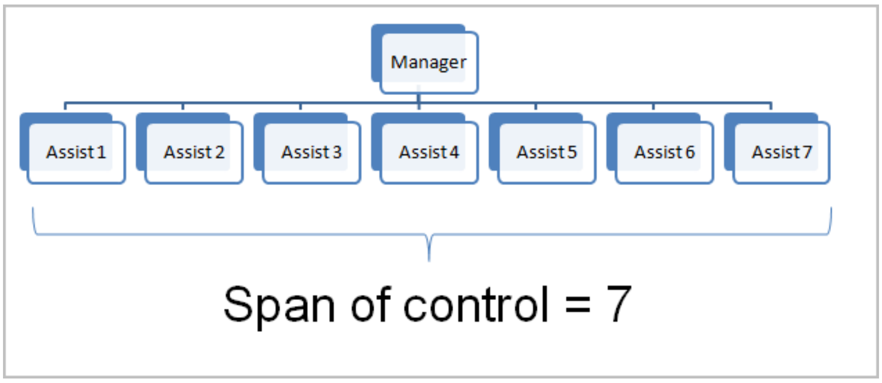
Key job roles and responsibilities

A large business will have employees at many different levels of the organisational hierarchy. With the exception of those employees at the bottom of the structure, these employees will have various management responsibilities including being in charge of the layer below them in the organisational structure. There are many different roles that can be found in a business. The key roles are summarised here:

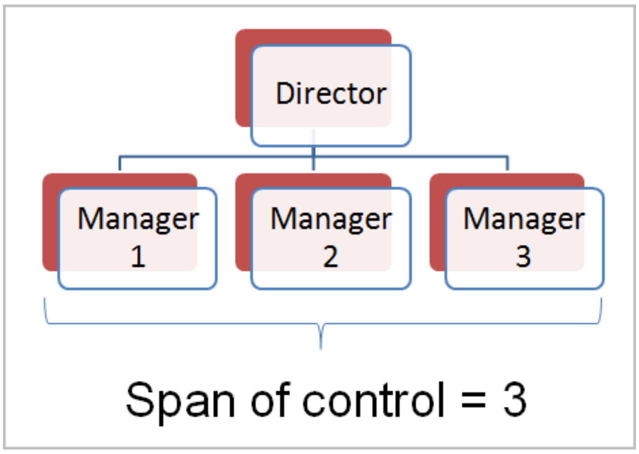
- Directors – in a large company, a director will be in charge of a department of functional area, for example the Finance Director. They will be part of the Board of Directors who manage the company. The most senior director will be the Managing Director.
- Managers or senior managers – managers will 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 directly do the work, such as the manufacturing or providing the service.
- Support staff – alongside the operational hierarchy of the business, there be some employees who are called on to 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.



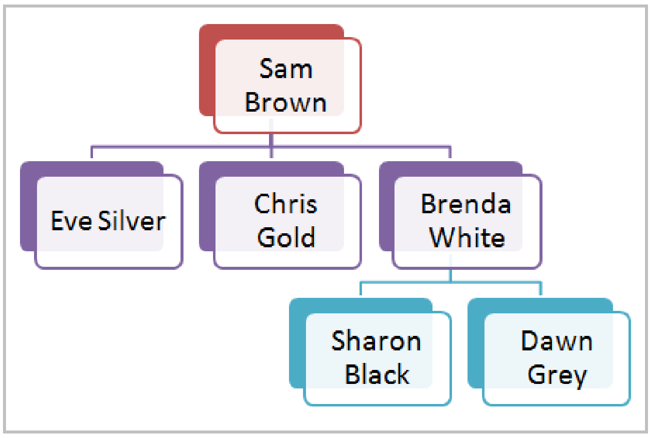
There is no ideal span of control as it will depend upon a number of factors such as:

- The experience and personality of the manager
- The type of business - if being a line manager requires a great deal of close supervision, 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

A flat organisational structure will have a wider span of control, compared to a tall hierarchical structure, which will have a narrow span of control. As there will be less layers of management in the hierarchy, a wider span of control tends to save money for an organisation. There are also benefits, as communication will be easier from the top to the bottom of the organisation, but there could be less control in terms of managing the quality of work.

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.

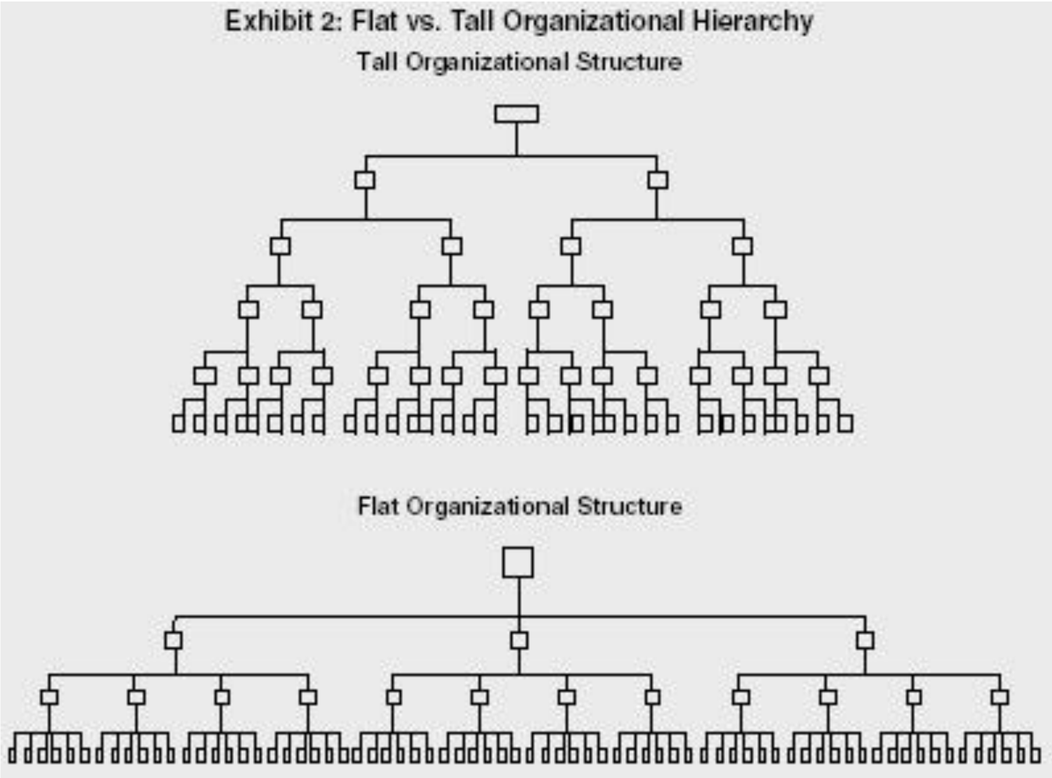


If a business has a wide span of control and very few layers in the hierarchy, there will be a short chain of command and with a narrow span of control, there is a long chain of command.

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 from the top of the organisation to the bottom of it, short chains of command and wide spans of control
- **Hierarchical or tall**: the organisational structure has many layers from the top of the organisation to the bottom of it, long chains of command and narrow spans of control



In the diagram, the hierarchical or 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, co-ordinate 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.

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.

The main 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 and organisational structure	☒ 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	

Centralised structures allow for easy communication, particularly from the top of the hierarchy downwards. If there is a tall hierarchical structure with many layers, it is harder for employees to communicate upwards than it is for managers to communicate downwards, which is explained in further depth in the next section.

Decentralised organisations, particularly those on different sites, find that communication is more difficult. If the locations are in different countries then oral communication can be particularly hard to achieve, particularly if they are not in the same time zones. Electronic communication, such as emails, is often most effective here, although there is a danger of email overload and that some emails will not be read and therefore not actioned.

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.

Effective 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 hierarchical organisational structures, as well as centralised and decentralised organisational structures. Consideration should also be given as to how communication works up and down the organisation. There are two types of communication that are considered here:

Written communication: letters, memos, emails, reports.

These are likely to increase in quantity, as the size of the organisation increases. In a tall hierarchical 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 therefore quicker and easier, due to less layers being in existence.

Mass communication techniques can also be effective, whatever type of organisational structure that is in place, for example a letter sent from the managing director can be sent to all staff. This ensures that the message sent is consistent.

Oral (verbal) communication: face to face, telephone.

Within tall, hierarchical 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.

Barriers to communication

Different organisational structures will have strengths and potential weaknesses related to the use of communication:

- Centralised structures allow for easy communication, particularly from the top of the hierarchy downwards.
- Decentralised organisations, particularly those on different sites, find that communication is more difficult.
- In large multi-location businesses, there may be a need for a communication department to ensure that communication methods used by the business are appropriate and effective.
- If there is tall, hierarchical structure with many layers it is harder for employees to communicate upwards, than it is for managers to communicate downwards, as previously mentioned.

Aiming to achieve effective communication is one thing – actually doing it is another. There are several **barriers to communication**, including:

Barrier	Explanation
Language	The message might use vocabulary that is not understood by the receiver, for example too much use of technical or financial jargon. In some cases, messages may be from different countries and therefore be written in different languages.
Noise	Various things stop a message from getting through or being heard, for example poor connection, background noise, distractions, too many people speaking at once. This can be the case in open plan offices, where large volumes of people work in one room to encourage socialisation and openness. However, this can also create distractions and lots of noise!
Overload	Too much information can cause problems, for example slow down decision-making. Employees will often get too many communications, some of which will be important, some urgent and some not requiring any attention. E-mails have made the overload situation worse for many workers, as sometimes a receiver may receive over 100 a day!

Barrier	**Explanation**
Emotion	The relationship between the sender and receiver of communication might adversely affect the message. Emotions are difficult to read, particularly in emails, and as a result the message could be ignored or misinterpreted.
Gaps	Too many intermediaries, for example too many layers in the hierarchy through which a message has to be passed, might prevent or distort the message.
Inconsistency	If people receive conflicting or inconsistent messages, then they may ignore or block them and therefore important actions may not take place.

The impact of insufficient or excessive communication

Two of the most common complaints about communication is that there is too little or too much! **Insufficient communication** can often lead to poor motivation, as workers believe they are not important parts of the organisation. This can also lead to failure to complete jobs, as employees are not fully aware of the job's requirements. Alternatively, employees complete the job, but not correctly as they do not have all the required details in order to complete it successfully.

Equally too much communication can also lead to workers being ineffective or inefficient. **Excessive communication** can mean unnecessary work acknowledging and responding to the communications. This can slow down the worker's output. It can also cause quality issues, if the communication keeps changing the job requirements or contradicts other communications that have been received. Motivation is best when communication is clear and sufficient.

Different ways of working

Nowadays, there are many different ways of working – in fact more than there has even been! These should be considered from both the **employee** and **employers** point of views. In some cases, these will match, whereas in others the interest of the business may not allow the employee to work in a particular way, for example full-time versus part-time positions. Some of the more common types of working arrangements are summarised below:

Permanent contracts	These provide the most certainty for the employee, but are less flexible for the business. Employees have to be given a contract which gives details of pay, holiday, hours of work, notice requirements and codes of behaviour. All of these must conform to employee law. As workers will be secure in their job, they may be better motivated and productivity levels may rise.
Temporary contracts	Temporary contracts are normally for a fixed period of time. This will be suitable for businesses where they may have a particular contract with no guaranteed or similar work to follow. It can also be used as a trial period for workers. From the employee's point of view, it does not offer job security and can therefore make it difficult to get a mortgage to buy a house for example.
Freelance contracts	These are similar to temporary workers, only normally the freelance employee is hired on a daily basis or just for a specific job. This is very common in some industries, such as the music performance industry where freelance musicians will be employed for a particular concert or tour. This provides flexibility for the

	business, but no guarantee that the chosen worker will be available and therefore the business may not have sufficient workers to carry out a particular task. It also provides no job security for the employee, who may seek to find more secure work elsewhere.
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 workers consistency in the workplace, for example relationships with customers and will provide the employees with a guaranteed 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 holidays are reduced in line with the amount of part-time hours worked. These provide a smaller amount of work for employees compared to full-time, which the member of staff may prefer, particularly if they have other commitments such as childcare. It will also give the business more flexibility to increase the part-time hours of a worker, if the business becomes busier for a period of time.
Flexible or 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.

Technology and working from home - remote working

The widespread adoption of low-cost, easy-to-use information technology means that many entrepreneurs now start and operate their businesses from home. Large businesses have also seen advantages in allowing their employees to work at home, for either some or all of their hours.

Having employees as remote workers will have advantages and disadvantages. In some cases these will be to the worker, in other cases to the business. This works best when it benefits both the business and the employee and in these cases it should increase **business efficiency**.

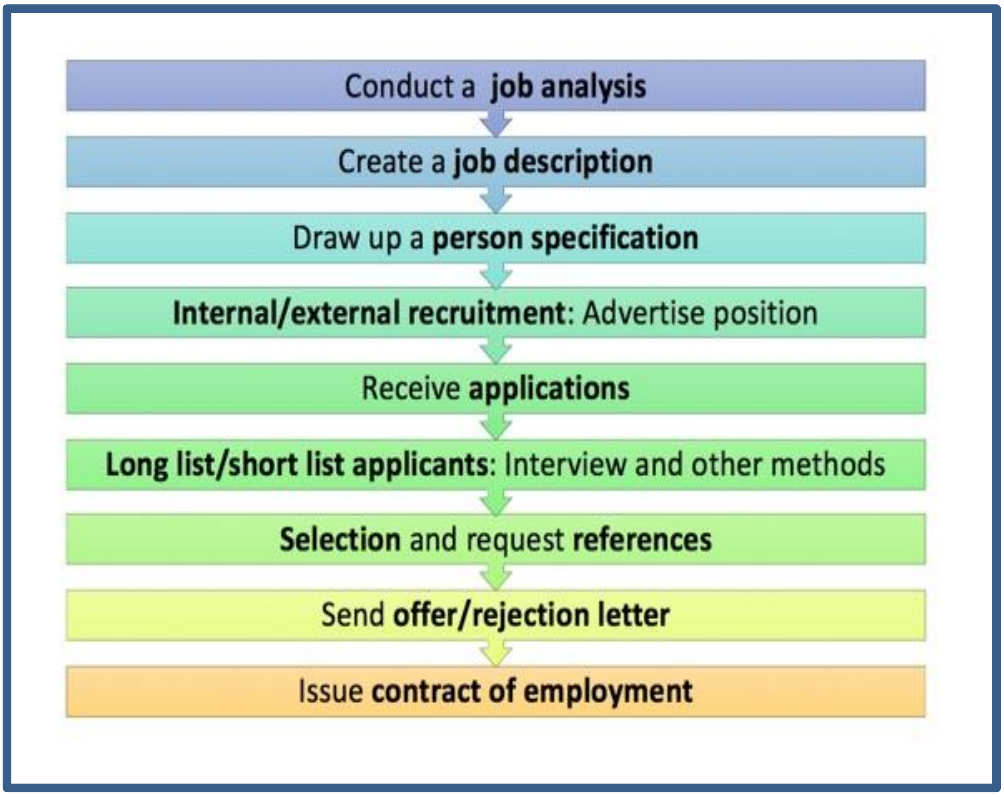
Advantages	Disadvantages
☑ Cheap – the business does not need to provide premises for the workers.	☒ Employees require greater self-discipline – it is easy to get distracted!
☑ Very little travelling, although customers and suppliers might still need to be visited.	☒ Work is often interrupted, for example by callers to the home or by family.
☑ Work can be combined with domestic tasks and responsibilities, for example child care. This can mean significant cost savings for the employee and can also allow businesses to retain valued workers.	☒ Work never goes away – it is difficult to separate work from home life, which can increase stress levels!
☑ Environmental benefits - lower carbon footprint.	☒ Potentially lonely for the employee – this may lead to a lack of motivation, as there is no social interaction from colleagues.
☑ More flexible hours might be possible, as workers may prefer to work early or late to fit in with other commitments.	☒ More difficult for the business to monitor and control work being undertaken.

Effective recruitment

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, the key documents of a **job description** and a **person specification** will be produced.

Key documents

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, nationality, national insurance number
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 is a recent employer or a person who knows the applicant well and are ideally independent and therefore non-biased

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. From this selection process, the most suited candidate for the vacant position will be chosen and an offer letter will be sent to the candidate. If this candidate agrees to take up the post, the new employee must be given an **employment contract** once he/she has started work. 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.

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 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!

Effective training and development

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.

Methods of training

Training can take place in many different ways. These can be formal or informal and be organised through self-learning programmes or external organisations, as well as being provided at the place of work. In large organisations, training and development is part of the performance review process, which will recommend what training is required and how it can be arranged for each individual in the organisation.

Type of training	Description
Formal	This often takes place outside the workplace at colleges, training organisations or other similar provider premises. Training outside of the place of work is otherwise known as "off the job" training. ☑ This allows the employee to concentrate on the training provided and to receive specialist training from expert providers. ☒ It can however, be more expensive than training provided "in house" or at the place of work by other employees, as it means that for existing workers, they will not be carrying out their normal work.
Informal	This normally takes place at the workplace and is often based on observation or being "shown how to do a particular job" by a colleague who already does the same job. This is otherwise known as "on the job" training. ☑ This can be much cheaper than formal training, as it is provided by existing employees and no specialist trainers have to be paid. ☒ It may result in the employee being trained by copying poor practice, rather than learning from scratch the best way of doing a specific job.
Self-learning	The widespread use of the internet means that training can often take place at home, linked to online tests, to ensure that the training has been understood. ☑ Some self-motivated workers and some types of training work well through this method. It can be cheaper, as travelling costs are reduced.

Type of training	Description
	☒ It is not suitable for all employees or all types of jobs. It is also reliant on the employee carrying out the training independently. In this case, not all aspects of the training may be understood and two way dialogue cannot be established to clarify specific points.
Ongoing training	As the pace of change is so rapid, businesses generally have a culture of continuous learning for all their employees. The choice of training to be undertaken may be management or employee driven.
Performance reviews or appraisal	Performance reviews are part of most big business operations and are normally linked to a target setting and an annual review process. This is where an employee usually has a meeting with his/her line manager to discuss the employee's performance over the last year. Based on this review, targets are set for the future and training organised. This may be in the form of remedial or refresher training where poor performance has been identified. Better performance may lead to development training, so that the employee will be able to take on new or more senior roles within the business in the future.

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!

Benefits of training and development

Effective training and development 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; this reduces recruitment and selection costs which can be high and a very time consuming process
- ☑ 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.

Retraining to use new technology

As new technology is introduced into a business then employees will need training on how to use it. It is generally cheaper to retain and retrain existing staff rather than replace them with new employees. As well as management directing employees to training for new technology, their training needs can also be identified as part of the appraisal or performance review process.

Methods of training for new technology can include formal training provided by the supplier of the new technology. This is quite common for new ICT packages and equipment. There can also be cascade type methods, where one employee is sent on a training course and then trains colleagues on their return. All training will cost money, this might be a direct charge for a course or the cost might be included in the purchase of the new technology equipment. There can also be indirect costs such as covering for employee's who are absent from work because they are being trained.

The benefits of the training are normally significant. By introducing new technology, there may be the need for less employees, but it is important that all employees are able to use new technology efficiently. Well trained staff will also ensure that quality is maintained or improved and this can lead to products that are cheaper to produce and more competitively priced, as well as being of good quality.

Motivation

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**. People in business 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, as the firm's fixed costs will be spread across more units, 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

There are many reasons why people work for a living, although 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. This can sometimes be as a percentage of sales.
- **Bonus:** extra pay or reward for reaching a target; can be for an individual, a team or a workforce
- **Profit share**: staff payments or bonuses are linked to the performance of the firm, may include shares for the employees.
- **Promotion:** if an employee does well they will get promoted which will give them a higher salary
- **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.

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 to take place.

Here are some non-financial ways in which business can 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.
- **Job enrichment** – this involves workers being given greater **responsibility** and a wider range of more complex and challenging tasks. This should give a greater sense of achievement.
- **Autonomy** – employees are given more independence so that they are trusted to work on their own and use their own initiative.

Glossary

Term	Definition
Adding value	How a business sells a product for more than it costs through the processes they apply
Advertising	Promotional method where a business pays to place an advert in a form of media, such as a newspaper or television
Aesthetics	The attractiveness of the design of a product
Aims and objectives	The overall goals of a business or organisation identifying 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
Autonomy	The independence a worker has within their job
Average rate of return	The annual percentage profit that an investment makes compared to the cost of the investment
Bar gate stock control graph	A method of displaying data on stock levels, which allows stock control policy to be decided, implemented and reviewed within a business
Batch production	Method of production where groups or types of products are made at several stages
Bonus	An extra amount of financial pay received through achieving a business target
Branding	What distinguishes a good or service from rivals
Break even	Where total revenue is the same as total costs and no profit or loss is made
Buffer stock	A quantity of stock kept in store to safeguard against unforeseen shortages or demands
Business	An organisation set up to meet customer demand and to make a profit for its owners
Business environment	The external factors such as the economy and the law that influence how a business operates
Business plan	A document produced by a new or existing business that shows what its objectives are and how it will meet them
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-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
Centralised	Where business decision making and implementation take place at and from

Term	Definition
	the business headquarters
Chain of command	Part of the structure of a business organisation which shows who is in charge of who
Closing balance	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 advantage	A business has a marketing mix which enables it to be more successful than its competitors
Competitive environment	The number and strength of other businesses in the same market
Competitive pricing	Where the price of a product is decided by comparing it to its rivals
Consumer	The person or business that use the good 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	Where consumers are protected by laws 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
Cost plus	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
Crowd funding	Finance raised through internet appeals from a large number of small investors
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 feedback	Enquiries made after a sale to show how a good, a service or the sales process could be improved
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 needs	What an individual must have in order to survive
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)
Decentralised	A business structure and its decision-making is spread out to include more junior managers as well as individual business units or locations
Delayering	A method of saving costs in an organisation by reducing the number of layers
Demographics	Factors related to population, often used as a basis for segmentation

Term	Definition
Design mix	The use, appearance and cost of a product
Differentiation	When a business makes its product different to those of its competitors
Digital communication	Sending messages using mobile or internet technology
Digital technology	Where businesses use computers in any way to improve their business performance
Directors	People appointed by the shareholders to run the company on a day-to-day basis to make all the important decisions
Discrimination	When an employer choses its workers based on a particular characteristic; many of these are illegal, for example age, gender and race
Distribution	How a product gets from the producer to the consumer
Dividend	The share of the profit received by a shareholder
E-commerce	Using the internet to promote and sell a good or service
Economic climate	How a business is affected by economic variables such as interest rates or inflation in a country or in other countries
Efficiency	Measures of how much output is being produced per unit of input
Employees	People who work within a business
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
E-newsletter	A regular publication sent electronically to customers with items of interest, new products and promotions; used to maintain regular contact with customers
Enterprise	A business that has 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 considerations	The business takes into account consumer and producer concerns about the environment
E-tailer	An electronic retailer i.e. sells goods using the internet
Ethical objectives	Where businesses have as an aim what is morally right rather than necessarily the most profitable option
Excessive communication	When too much communication can lead to workers being ineffective or inefficient because of unnecessary work acknowledging and responding to communications
Exchange rate	The amount of foreign currency that can be purchased with another currency
Exports	Goods or services that are produced in this country and sold to other countries
Extension strategy	Methods of prolonging the product life cycle to extend the life of a product
External finance	Sources of money from outside of a business
External growth	Growth which occurs by a merging with or taking over another business
External influence	Factors that affect a business but they cannot control

Term	Definition
External recruitment	Where a business aims to finds new workers from outside of its current workforce
Finance	The money that is necessary to start and run a business
Financial data	Information on the costs and revenues of businesses showing changes over time and used as the basis for calculations and displaying to managers
Financial objectives	Quantifiable targets for a business including profit, sales and costs
Fixed costs	Business costs that do not vary with output
Fixed premises	Where business premises are located in a building; the use has decreased with the rise of the internet increasing home or teleworking
Flat structure	Where the organisational structure has few layers, short chains of command and wide spans of control
Flexible hours	Either the employee or the employer have some choice about the actual hours worked
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 of actual consumers
Formal training	Specialist training for employees involving courses or off site provision
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
Freelance contracts	Where an employee is available to be hired on a daily basis or just for a specific job
Fringe benefit	Methods of rewarding a worker that are not directly monetary
Full time working	An employee who is employed for a whole weeks work
Function	A feature of product design which shows that the product can perform its intended job
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
Goods	Products that businesses produce that have a physical presence
Gross profit	The difference between revenue and cost of sales; calculated as: gross profit = total revenue – cost of sales
Gross profit margin	The percentage profit made on sales not taking into account the businesses expenses; calculated as: 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

Term	Definition
Hierarchical structure	Where the of organisational structure has many layers, long chains of command and narrow spans of control
Human resources	How a business recruits and manages its workforce
Imports	Goods or services that are produced in other countries and consumed in this country
Inflation	Where costs and prices in an economy are increasing
Informal training	Where employees learn how to do a job at the workplace by observing other employees
Innovation	The introduction of a new product or features on a product
Inorganic growth	Growth which occurs by merging with or taking over another business
Insolvency	Where a business runs out of cash and is not able to obtain new finance
Interest rates	The percentage cost of borrowing money or the reward for saving money
Internal finance	Where a business obtains funds from its own sources such as retained profits
Internal growth	Organic growth which takes place through a business selling more of its own products
Internal recruitment	Where a business aims to finds new workers from within its current workforce
Internet	A means of connecting computer to computer to allow the transfer of information around the world
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 what type if required
Job description	An explanation of the roles and responsibilities of a job
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 roles	What the different types of jobs do in a business
Job rotation	Where a worker moves from one job to another job over a period of time
Just-in-time	Where inputs into the production process arrive on the production line just as they are needed
Labour	The workers who are needed directly or indirectly to provide the good or service that a business produces
Lead time	The time between ordering a good or service and receiving it
Legal structure	What type of organisation a business chooses to be such as a partnership or company
Limited liability	The protection enjoyed by shareholders who can only lose the money they have put into the company
Loan	Source of finance for a business where they receive a fixed amount of money for a specified time, which will need repayment with interest
Loan capital	Sources of finance involving loans normally from banks or other financial

Term	Definition
	institutions
Local community	A business stakeholder who will be affected by a business's location 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
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
Management	How to successfully ensure that employees work effectively
Margin of safety	The additional output that a business produces or expects to produce more than its breakeven output
Market conditions	The current situation in the economy and whether it is improving or worsening
Market data	Quantitative information such as sales figures over time for the market of a product or service
Market map	A diagram representing different businesses in a market that are compared to two variables, such as price and quality; it is used to identify a gap in the market
Market research	Information from existing and potential consumers about their reaction to a good or service
Market share	The percentage of total sales a firm's particular good or service has
Marketing	Providing the goods and services that consumers require whilst making a profit
Marketing mix	The ingredients needed to produce a marketing policy normally known as the 4Ps (product, price, place and promotion)
Market segments	A way of dividing up the market into different groups of potential customers
Materials	The inputs needed for the production of a good or service
Merger	Where two businesses of equal size are joined together
Motivation	The desire of an employee to do a job well
Multinational	A business that produces goods in more than one country
Needs	What an individual must have in order to survive
Net cash-flow	The difference between the cash inflows and cash outflows for a business in a time period
Net profit	The total amount of money made from the trading activities of the business; calculated as: net profit = gross profit - overheads/expenses
Net profit margin	The percentage profit made after all costs and expenses have been deducted; calculated as: net profit/sales revenue x 100
Non-financial objectives	Business targets that involve areas such as improving quality and being more ethical
Observation	A method of market research where direct data is gathered from customer actions
Obsolete	When a type of product is no longer produced because it is not needed or has

Term	Definition
	been replaced
Opening balance	The total cash-flow available at the start of a period
Operational staff	Employees who directly do the work such as the manufacturing or providing the service
Organic growth	Growth which occurs as a business sells more of its own products
Organisational structure	The way employees are arranged into a formal structure for control and communication
Output	The total quantity produced by a business, employee or machine over a given period of time
Overdraft	Source of finance for a business where it is allowed to take more money out of its account than it has deposited
Overheads	Costs or expenses that a business incurs
Partnership	Where a business is started and owned by more than one person, who then share the profits and the responsibilities
Part-time working	Where an employee is employed for less than a whole weeks work
Payment system	The use of digital technology by a business to pay its suppliers and employees
Performance review	A process of staff development looking back at how well an employee is doing their job; often linked to identifying future training needs and bonuses
Permanent contract	A job where an employee will continue working for an indefinite period
Person specification	The qualifications, skills, experience and personal attributes needed for a job
Personal savings	The difference between an individual's income and their spending
Place	How a product or service is distributed to the customer
Post sales service	Following up with a customer after they have made a purchase to check that everything is "ok"
Pressure group	A collection of individuals who have a common cause and campaign to achieve it
Price	The amount of money a customer would need in order to buy a good or service
Pricing strategy	A policy that a business decides to calculate the price at which it chooses to sell its new or existing products
Primary research	First-hand information gathered by a business about existing and potential consumers
Private limited company	The most common kind of limited company in the UK, where shares can only be sold to "family and friends"
Procurement	The process of choosing a supplier
Product life cycle	The stages in the life of a product from when it is first thought of until it is finally removed from the market
Product range	The amount of different types of goods or services that a business chooses to produce
Product trial	A free or reduced price product given as a sample with the hope that consumers will continue to buy the product in the future

Term	Definition
Production	The process which involves taking inputs and transforming them into outputs
Productivity	The amount of output per unit of input (labour, equipment, and capital)
Profit	The difference between costs and revenue
Promotion	Methods of making a consumer aware of a product and persuading them to buy it, includes advertising, sales promotion and public relations
Promotion (human resources)	Where an employee moves job to a more senior position
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
Qualitative data	Results of research that is based on opinions, attitudes and beliefs
Quality	Where a product is of a standard that meets a customer's requirements
Quality assurance	Setting up processes in production to ensure that quality is achieved
Quality control	Checking that the products produced by a business are of the required standard at the end of the production process
Quantitative data	Results of market research that is normally numerical
Questionnaire	A method of gaining market research data through asking the opinions of actual or potential customers
Raw materials	The inputs needed for the production of a good or service
Recruitment	A process a business undertakes to attract new or replacement workers
Reliability	Whether a supplier will always deliver at the agreed time
Remote working	Where employees can be working normally at home away from their business's location being linked through the internet
Remuneration	The package of pay and other rewards provided to an employee
Research and development	Costs that are required in getting a new product ready to launch into a market
Retailer	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; price x quantity sold
Reward	What an entrepreneur receives, financial or non-financial, as the return for the risks that are taken
Risk	The possibility that a business may not be successful
Roles and responsibilities	The details about a job and what it involves
Sales process	A series of activities that are designed to engage customers and to complete a sale

Term	Definition
Sales promotion	Point of sale methods that persuade customers to buy a product
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
Self-learning	A method of training and development where the employee works through a guided programme of information and activities
Selling assets	When a business sells its land, buildings, machinery or equipment that are no longer needed to raise additional finance
Service	Activities that are provided by a business for customers and that are not tangible
Share capital	The money raised by a business from the sale of shares
Share issue	When a company raises finance through selling shares to new or existing shareholders
Shareholder	An owner of a company who receives a dividend as a return for their investment
Shares	When an investor owns part of a private or public limited company
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 keeps all the profits, but holds 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 manager directly controls
Special offers	Temporary deals to encourage customers to try a new product or a relaunched product
Sponsorship	A type of public relations where a business aims to improve brand awareness through making donations to individuals and organisations
Stakeholder	An individual or group that is directly or indirectly affected by the actions of a business
Stock market flotation	When a company raises finance through selling shares to new or existing shareholders
Supervisor	An employee with responsibilities for the work produced by a number of workers
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 good or service to the customer
Support staff	Employees who are called onto assist in any area of the organisation by providing additional labour or specialist skills
Survey	A method of market research where customers and potential customers are asked their opinions

Term	Definition
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
Target market	Where customers are segmented to allow businesses to focus its marketing policy on meeting their specific requirements
Target setting	An employee process linked to performance reviews that sets goals and identifies training needs
Tariff	A tax on imports that increases their price and allows home businesses an advantage
Taxation	How the government collects money to fund its expenditure programme and influence the economy
Team leader	An employee with responsibilities for the work produced by a group of workers
Technology	How businesses uses machines and devices to improve their operation
Temporary contract	A job where a worker will be employed for a fixed period of time
Total costs	All the costs of a business; calculated as: total costs = fixed costs + variable costs
Trade bloc	A group of countries that have free trade within their group and that may restrict imports from countries outside of the trade bloc
Trade credit	When a business orders and receives supplies, but pays for them at a later date
Training	How employees learn to do a job
Unemployment	Where people are able, available and willing to work at the going wage but cannot find a job
Unique selling point	What makes a business's goods or services different from its competitors
Unit costs	The average cost of making one unit or item
Unlimited liability	If a business becomes bankrupt, sole traders and partners are personally liable for their business's debts
Variable costs	Business costs that change with output, such as raw materials
Venture capital	A source of finance normally for small businesses with good growth prospects, where the venture capitalist normally takes a stake in the business
Viral advertising	Where an advert is spread through social media by people spreading the message through forwarding to their friends and contacts
Wants	What an individual would like, but does not need to survive