

# AQA BUSINESS

## for GCSE

### APPLIED OPTIONS



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NEIL DENBY  
DAVID HAMMAN



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# AQA BUSINESS *for* GCSE APPLIED OPTIONS



NEIL DENBY  
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# How to use this book

This book provides information, exercises and materials to cover the learning required for the new AQA GCSE Applied Business (Double Award).

The new GCSE qualification has several routes, but all begin with 'Setting Up a Business'. This unit is an introduction to setting up and running a business and looks at the factors that might help the business to succeed or cause it to fail. It also shows that businesses operate within societies and communities and that they must therefore take a number of people and their views into account when operating. This is covered in the book *AQA Business for GCSE: Setting Up A Business* by the same author team and available from Hodder Education (ISBN: 9780340974926).

From this starting point, you may choose to take the full GCSE, the short course GCSE or the GCSE Applied Business (Double Award). For this qualification you would complete the unit 'Setting Up a Business' by taking a one hour written examination. You would then complete **two** out of the three options:

- People in Business
- Marketing and Customer Needs
- Enterprise

These topics are each tested through a Controlled Assessment, a coursework-style assignment which is explained more fully on page 4.

You will also take a one hour written examination in Business Finance.

This book covers each of these areas in detail.

## Section 1: People in Business

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This covers Section 3.4 of the AQA Specification. This section looks at how a business organises its workforce and defines their job roles and

responsibilities within the organisation. It investigates how communication and decision making takes place and how different organisational structures can affect factors such as efficiency and communication. It goes on to explore the rights and responsibilities of both employers and employees and motivation in the workplace. Finally, you will look at your own skills and personality traits, using tools like personality and aptitude tests to measure your own suitability for certain jobs.

Your controlled assessment for this section asks you to research a business to show:

- how the organisation of the business and the roles within it help it to succeed
- what it is that motivates three chosen employees of the business, and
- in the light of your own personality tests, whether the business would be a good place for you to work in the future.

## Section 2: Marketing and Customer Needs

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This covers Section 3.5 of the AQA Specification. This section deals with how businesses compete with each other for customers. It investigates how a business finds out about the needs and wants of its customers and therefore how it can plan to meet them. It explores the marketing mix of product, price, promotion and place, and how this can be altered to better gain a competitive advantage. It also looks at the nature of customer service and how important this is to both the business and its customers.

Your controlled assessment for this section asks you to research a business to show:

- how measuring customer satisfaction helps it to succeed

- how it uses marketing and customer service to compete
- a judgement on the success of the business, relative to its competition.

## Section 3: Enterprise

This covers Section 3.6 of the AQA Specification. This section explores what it is that makes an entrepreneur and lets you test your own skills by running a business enterprise. It investigates the types of skills and attributes that make for a successful entrepreneur and why they are important. It then explores your own enterprise skills by letting you set up an enterprise. You will be expected to work in a team to find or create a 'gap in the market' through market research, write a business plan and then launch and run the enterprise. At the end of the activity, you must judge whether or not your enterprise was a success and use this to plan for the future of both yourself and your enterprise.

Your controlled assessment for this section asks you to set up and run an enterprise and use this to show:

- how enterprise skills help businesses to succeed
- how you planned and carried out the enterprise
- a judgement on the success of your enterprise and the team running it.

## Section 4: Finance

This covers Section 3.7 of the AQA Specification. This section investigates how a business manages its finances. It looks at costs and revenues, breakeven and its use as a tool and the financial statements which businesses use. These include

profit and loss accounts and balance sheets. It also explores the tools used in financial planning and forecasting, such as cashflow forecasts and many key business ratios.

This unit is tested through a one hour examination.

NB This book covers the National Criteria for Business, as they relate to Applied Business, on which all Business Studies courses are based, so is equally useful for Applied GCSE courses other than AQA.

## Getting the most out of this book

This book is divided into four parts, covering all four units of the Applied Business qualification. You only have to choose TWO of the first THREE units. You do not have to study the units in this order: that's up to you and your teacher.

Each chapter is designed to be approached in the same way:

- **Read** the 'Applied in the Business World' section so that you have put the ideas into context and can think about how they apply to the real world
- **Read** the text explaining the ideas
- **Read** 'Core Knowledge' and 'And More' which give the basic information and then further knowledge about the ideas in the chapter
- **'Have a Go'** at the exercises and activities to see how well you have understood the material. You can come back to the activities at any time if you need to revise the topic for tests or examinations, or you need to refresh your memory for the Controlled Assessment.

## Applied in the business world

**E**ach chapter starts with a short news piece, based on recent events or a situation that puts the ideas discussed in the chapter into a real-world context.

This is followed by Live Links to current websites and e-learning materials, so that the story can be followed up or investigated further, or so that additional information can be found. If any of these links do not work, use a search engine to find a similar topic or business on which to base your studies. After the news piece, a set of questions tests you on your understanding of it.

After the news piece, the key information needed for the chapter is explained.

## Hit the spot



- These questions require longer answers, where you can demonstrate your understanding of ideas and information in greater depth.
- The chevrons (➤) show the difficulty levels of the questions. One chevron is used for easier questions, that everyone should be able to do; two chevrons indicate harder questions, where some explanation of the answer is needed. The hardest questions, which may require you to state and justify an opinion, or to weigh up two sides of an argument, have three chevrons.

## Summary

- This set of bullet points summarises the most important information contained in the chapter. You could think of this as the absolute minimum that you should learn from the chapter.

## Core knowledge

The Core Knowledge then gives the basic knowledge that all students will need regarding this topic.

## And more

Following on from the Core Knowledge, And More provides higher level or more in-depth knowledge for students who are aiming at higher grades or just want to improve their knowledge of a particular area.

## Did you know...

These boxes are scattered throughout the book. They contain extra information that is either useful or interesting, and which can often help to put the topic into a real-world context.

## Have a go!



This section contains a set of activities and exercises that can be carried out in class or at home in study time. Some are designed to be carried out on your own, others with friends or by using web resources.

### Group activity



The group activity is designed to be used with the group that you work with in school or college. It is not usually possible for this activity to be carried out by a single person, though sometimes a pair of people might complete the exercise. Often it is a way to gather a wider sample of opinions or skills than you have on your own, or to test your opinions against those of others.

### Discussion



The discussion may follow on directly from the group activity, perhaps so that you can explore why you did or did not agree, had different views, or had different experiences to share. It will make you think more deeply about the area that you are studying!

### Web-based activity



This activity requires access to a computer and an internet connection. It may take you to a specific site or sites, perhaps to see how an idea or knowledge has been put into practice in the real world, or it may ask you to use a search engine to find out more information. There is then a short activity based on what you have found.

### Quickfire questions



These questions appear in every chapter. They will test your knowledge of the ideas and information in the chapter. Your teacher might use them to start or end a lesson, as a quiz with the class, or may ask you to complete them on your own. They are usually simple questions with simple answers, designed to check basic knowledge so, for instance, they might ask for definitions and brief explanations.

### Cracking the code



Some words in the text are highlighted. These terms are explained under the 'Cracking the Code' heading. In business studies many words have a particular meaning, and it may even be different to how you use the word in normal speech. Cracking the Code will help you to use these words and terms in the correct way.

# The AQA GCSE Business Specification

The AQA GCSE Applied Business specification is based on the 'story' of a small business enterprise and the specialised jobs and tasks that take place within it. Unit 1 is called Setting up a Business and looks at the business concepts and ideas that are needed to establish a small business, and at how that business might measure its success. You will then choose to study two out of:

- Unit 4 People in Business
- Unit 5 Marketing and Customer Needs
- Unit 6 Enterprise.

Each of these is tackled through a Controlled Assessment: details of each are provided in the 'Core' feature in the first chapter of each section. Finally, you will be examined on Unit 7 Business Finance.

Unit 1 is intended to provide you with enough information to understand the basics of running a small business. After all, many young people study the subject because they feel they might want to run their own business at some stage in the future.

Unit 1 is covered in a separate book, AQA GCSE Business: Setting up a Business (ISBN 9780340974926). Unit 1:

- Covers how the idea for a business might be created, how a gap in the market could be found (or made) and how an entrepreneur might go about filling that gap.
- Looks at the reasons why people want to go into business – not always just to make money, but for independence or to fulfil an ambition.
- Investigates how a business sets its targets, how it plans and locates and the way in which it must handle its legal paperwork.
- Covers how it lets people know what it is selling, where, when and at what price. You will therefore study the nature of markets and how a business markets its products.
- Shows how a small business raises and records its finance, and the tools that it can use to help it to manage its accounts.

- Looks at how a business recruits its people, makes them want to work hard and keeps the best of them.
- Describes how the operations of the business are carried out.

Many of the topics that you will meet in Units 4, 5, 6 and 7 have similar titles to those in Unit 1. Don't think that you will be covering the same work, however. Each additional Unit will:

- Extend your understanding of the topics by considering how they apply to a business.
- Look in more detail at the topics, so you have a firmer understanding of them and are able to use them in different circumstances.

Unit 4, People in Business, shows how the business organises its staff and defines their job roles. You will investigate the working arrangements of various staff and learn how these meet the needs of the business. You will study how a business motivates its employees and the expectations that employers have of employees. You will also look at your own skills and abilities to gauge what types of occupation or role might best suit you.

Unit 5, Marketing and Customer Needs, shows how the business carries out customer research to identify and meet the needs of its customers. You will study how a business uses marketing to compete with rivals and, in particular, how it adapts and uses various parts of the marketing mix. In addition, you will learn about customer service and its importance to both customers and the business.

Unit 6, Enterprise, shows the importance of enterprise skills in both profit and social enterprises. You will then set up and run a small enterprise of your own, taking it from the planning stage through to operating. You will then judge how well you thought the business was operated and use this to plan for the future.

Units 4, 5 and 6 are tested through a Controlled Assessment in which you investigate a particular

business (even your own business) in order to write about the topic area. For each Unit you are recommended to spend around 17 hours on research and about 7 hours writing up findings.

The specification is designed to encourage you, through your study, to think about the practical aspects of business and how the concepts and ideas that you learn can be applied in the real world. If you take the Double Award Applied GCSE, by the end of your course you should have a complete overview of business studies and have applied this to businesses that you have studied, including perhaps your own enterprise.

The specification also provides a good route to higher qualifications such as AS and A level and the Advanced Diploma in Business, Administration and Finance.

## The examination papers

The GCSE course will be assessed by a combination of controlled assessments (see page 4 for Unit 4, page 66 for Unit 5 and page 122 for Unit 6) and exams.

The Unit 1 exam paper will consist of about three separate questions, based on their own short case study. Each of the questions will have three or four parts or sub-questions. These get more challenging as you work through them, so be prepared for that. The number of marks for each sub-question tends to increase as you work down the list, indicating that more depth needs to be included in your answers to gain these marks.

Early questions are mainly descriptive, assessing your knowledge of business ideas and terms. The later questions assess your ability to apply that knowledge, or in other words to use it in different situations. These questions are also designed to get you to explore your own thoughts on the case study and consider alternative solutions to any problems that have been identified. These skills are called analysis and evaluation.

You will be asked to read the case study and then answer the questions that follow. The case study could contain clues to help you with your answers,

but its main purpose is to set the scene for the questions. The nature of business studies means that there are often different interpretations and solutions to problems. The people who mark your scripts (completed exam papers) are aware of this and will reward you for answers that have been considered and are realistic. So be creative and try to find your own way through the questions. Just make sure you support everything you say with solid business ideas.

Unit 7, Business Finance, is divided into three sections. These are:

- Costs and breakeven – what costs does a business face and how can it both work out and use breakeven.
- Financial Statements – where does the money to establish and run a business come from and how is its use recorded and presented to stakeholders.
- Financial planning and forecasting – how business owners and others can use the financial information to help them make decisions.

The finance paper is likely to include some calculations, so you should make sure that you have a calculator to help you with them.

Each paper has up to 60 marks available. Individual sub-questions can be worth as little as 2 and as many as 10 marks. Use the number of marks available to help guide you on how much detail is needed in your answer. The amount of available space on the question paper is another important clue.

Make sure that you are familiar with the 'command words' in the questions. These are the instructions, such as state, give, describe, explain, advise, and comment. These words are the biggest clues as to what skills (knowledge, understanding, application, analysis and evaluation) the examiner is looking for in your answers.

Finally, remember that, as with other GCSEs, your examiner will look at the standard of your written English and the presentation of your work. Certain questions will be targeted for this and these will be shown on the front of the paper. Make sure you know which ones they are and take particular care when writing them!

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Neil Denby

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# PEOPLE IN BUSINESS

**Chapter 1** Introduction to people in business

**Chapter 2** Organisation structures

**Chapter 3** Communication and decision making

**Chapter 4** Job roles

**Chapter 5** Working arrangements

**Chapter 6** Effective working relationships

**Chapter 7** Motivating staff

**Chapter 8** Appraisal and training

**Chapter 9** Personal skills

**Chapter 10** Personality tests

## **Don't forget**

If any of the weblinks don't work, use a search engine to find a similar topic or business on which to base your studies.

# Chapter 1

# Introduction to people in business

## APPLIED IN THE BUSINESS WORLD

### Dealing with employees

**V**irgin and McDonald's share many similarities. They are both high-profile **multinational companies**. Both are highly successful businesses that are expanding and require an increasing number of employees to service the different parts of their organisations. The two companies are more than happy to state publicly that they value their staff and acknowledge that the success of the businesses is due to the talents and determination of the people who work for them.

Both Virgin and McDonald's go to great lengths to recruit the best people. Their websites are designed to attract those who would like to work for up-and-coming companies. Extensive training is offered to ensure that employees are able to do their jobs well, and each company offers a range of incentives to keep employees motivated and loyal to the business.

### McDonald's

The fast-food chain appeals very much to young people. They enjoy the vibrancy of the restaurants, the informality and value of the food on offer. It is probably no coincidence that a large proportion of McDonald's 'crew members' are young. Many are students who work there on a part-time basis, finding the flexibility of the shifts convenient. They can continue with their studies while funding themselves through their work. Flexible shifts in turn favour



McDonald's which can employ crew members when they are most needed. This way the chain can avoid having to employ a full complement of staff when the restaurants are quiet, bringing more staff in during the busier evenings and weekends.

McDonald's uses a range of incentives to attract crew members and to keep them in the organisation. Pay is comparable with similar work, but there are other benefits. Staff members are able to get discounts on their purchases at McDonald's, as well as other retail outlets, a pension scheme is available and holiday pay is provided. McDonald's emphasises that crew members with the right attitude and motivation are able to become trainee managers, earning up to £21,000 a year, which could rise considerably within a short time of completing their training. McDonald's prefers to recruit its managers from crew members, as they have had the chance to demonstrate that they have the potential to do the job.

McDonald's has a very structured approach to managing staff. Systems are in place to ensure that its high standards of hygiene and cleanliness are maintained. This means crew members are expected to follow a rigorous pattern of cleaning throughout the restaurant. But this principle goes beyond cleaning. In order to ensure its high standards are consistently

applied at all its restaurants, the employees are told how they should undertake all aspects of their tasks. Some see this as being over-prescriptive, in other words, the employees are not given any opportunity to show initiative or creativity.

## Virgin

This company is the subject of a topic later in the book, where you will be able to read more about the organisation. Started by its charismatic leader, Richard Branson, the company has a 'free-spirit' approach to business. Branson is no conventional businessman and has thrown out many of the rules that govern how entrepreneurs should behave and how employees are treated. Branson accepts that unless employees are happy in their work, they will not give their best, and if staff members don't give their best then the customers and the shareholders will suffer.

Branson ensures that Virgin employees are provided with a package of **incentives**, broadly similar to those offered by McDonald's. However, he believes that the best way to motivate Virgin

employees is to trust them. Employees are very much given a free hand to show initiative in their jobs. Virgin actively seeks out people to work for the company who like to be thrown in at the deep end. The company wants employees who will sort out problems rather than pass them on to someone higher in command. This approach is bound to backfire occasionally. Because they are not closely supervised, someone will do something that is costly to Virgin. However, the company accepts that any mistakes, within reason, will be tolerated.

Branson believes in karma: if you treat your employees well, then they in turn will treat you well by working hard and being loyal to the organisation.

### Live links

Both these companies' websites are designed to appeal to young people. You can find out more about the methods used to attract employees. Which of the two companies would you prefer to work for?

[www.McDonalds.co.uk/careers](http://www.McDonalds.co.uk/careers)  
[www.virgin.com](http://www.virgin.com)

Many businesses are quite happy to state publicly that their biggest asset is their staff. In fairness, you would hardly expect an organisation to bother to paste on its website 'we are a successful business despite how poor our staff are'. Whenever the owners of businesses take on employees, they are relying on these workers to make their company flourish. So, they depend on the staff they recruit having the business's best interests at heart and being willing to help the owners achieve their objectives.

The relationship between employers and employees is sometimes said to be symbiotic. This simply means that each side depends upon the other for its livelihood and well-being. In the past, this relationship between

the boss and worker has not been as cooperative. It was not unusual for employers to take the view that they had the upper hand and if the workers weren't happy they could lump it, which usually meant be quiet or quit. For many, the relationship was one of 'us and them', with both sides feeling that they were being taken advantage of by the other side.

### Did you know...

The first McDonald's university opened in 1961 and 15 trainees went on to get their Bachelor in Hamburgerology degrees.

## Hit the spot

- Give two ways that both Virgin and McDonald's use to motivate their staff.
- Explain the difference between the Virgin and McDonald's approaches to giving employees responsibility.
- Consider the employee management approaches used by Virgin and McDonald's. Discuss the strengths of each and decide which approach you would be most motivated by.



During the last few decades, this 'us and them' mentality has effectively disappeared, although it can turn up occasionally. Employers appear to be more willing to recognise the value of the contribution made by their employees. Managers who want to get the best from everyone look to motivational theory rather than threats.

Businesses are sometimes faced with barriers that they have to overcome if they are to attract the best applicants for any vacancies they might have. For McDonald's this has been overcoming the negative impression that some people have of the type of work that the company offers to its employees. The term 'McJob' has become a slang term for low-paid, low-status jobs with few, if any, prospects of promotion or advancement. McDonald's does have a high **turnover of staff**, which means the proportion of the staff leaving the business each year is high. This is

not necessarily an indication that the work is uninteresting and poorly paid. As was stated above, McDonald's employs a large number of young people who are at the start of their careers. Many see their job at McDonald's as a stopgap while they are studying or before they move on with their plan for longer-term employment. So, it is quite reasonable to expect a high turnover of staff.

Virgin has faced another type of challenge. In 2008, a number of Virgin Atlantic cabin crew, demanding more money, threatened to go on strike. They argued that they would be able to earn more money working for another airline. Richard Branson wrote to them personally to acknowledge that Virgin might not pay the highest wages in the industry, but reminded them of the benefits and perks that come from working for a smaller, friendlier company.

### Did you know...

Richard Branson spent a night in police cells when he was a young man. He was found to be bringing music LPs into the country without having paid tax on them.

## Core knowledge

This section of your business course is all about people – no real surprises there then! It covers many aspects of working with the various people who make up the organisation, in particular employees.

You will be assessed on this unit of study through a controlled assessment. This means you have to write up a project under close supervision from your teacher. Your teacher will explain the rules for this assignment and what you are, and what you're not, allowed to do.

Your work will be based on your research into a business. You will need access to this organisation, either through the internet or through personal visits and contacts. Your teacher will probably give you some guidance on what would be a suitable organisation to use for your study.

You will need to look at three distinct aspects of the business. First, you should examine the structure of employees in the business, in something called an **organisation chart**. You can read more about these charts in the next chapter. If the business doesn't have its own organisation chart, it would make sense to produce one yourself. You should also look at the chart from the point of view of how the different job roles help the business become successful. Reading Chapter 4 will help you with this task.

In the second part of the controlled assignment you will need to study how managers, supervisors and employees are motivated to do their best. Help can be found in Chapter 7, but you might find additional support elsewhere in this section of the book.

Finally, the third part asks you to consider whether the business that you are studying might be a suitable place of employment for you, taking into account your skills and personality traits. Clearly, to do justice to this section you will need to be sure what skills and traits you possess. You will read about these in Chapters 9 and 10.

### Did you know...

Controlled assessments have replaced coursework at GCSE.



## Summary

- Virgin and McDonald's have different approaches to giving responsibility to staff
- The relationship between employers and their employees has changed over the years. Employees these days are seen more as being important in the success of a business
- Businesses use different approaches to dealing with staff. Virgin and McDonald's both have similar incentives packages, but their views on giving employees responsibility differ

### And more

How do you research a business? This will depend upon whether you are using the internet or personally visiting the business.

## Visiting the business

Visiting is good because it allows you to ask questions that you want to be answered, rather than having to rely on what the business wants to put on its website. If you are to get the most out of your visit, you will need to plan it very carefully. Spending a few hours in preparation can make all the difference with your final write-up and even save you a great deal of time and stress in the long run.

Make sure that you are completely familiar with what you have to do on the controlled assignment. Have a list of questions that you feel would help you. But think beforehand how you will respond to certain answers that you may be given. For example, if you ask whether the business has an organisation chart and you get the answer 'no', what do you say next?

## Internet research

The best place to start is with the company's website, if it has one. Use a search engine, such as Google, to find it if you are unsure. You could use other general sites if the business doesn't have its own, but it will make your job much more difficult, if not impossible.

A good route is to find a link on the site that refers to 'Working for us' or something similar. Companies often put details about the company in this section. If you can't find what you are looking for, then it may be worth emailing the business. You can do this usually through the 'Contact us' link. If you do email, keep your message as short as you can. You don't need to explain your course and what you are doing, it is better to keep it brief. You need to ask a specific question, and avoid asking the business to send you everything they have about working there. If the email is too general and long winded, it will probably be ignored.

## Have a go!



### Group activity



As a group, list all the possible local businesses that you might be able to study for your controlled assignment. Use *Yellow Pages* and any other sources you can to get a good cross section of businesses.

### Discussion



Discuss whether allowing employees to make decisions without checking with their supervisors is a brilliant idea or rather naïve of Virgin.

### Web-based activity



Go to both the Virgin and McDonald's websites and note the similarities in how each business tries to encourage people to work for them, and any differences too.

### Quickfire questions



- 1 What title does McDonald's give to employees who work in its restaurants dealing with customers?
- 2 Why does McDonald's have a strict cleaning rota?
- 3 How much is a trainee manager able to earn?
- 4 Who is the main owner of Virgin?
- 5 What does Virgin allow its employees to do, which McDonald's doesn't?
- 6 What does Virgin mean when it says it believes in karma?
- 7 What is meant by a symbiotic relationship?
- 8 Which Virgin employees threatened to go on strike for higher wages?
- 9 What is a controlled assessment?
- 10 What problem does McDonald's have about people's perceptions of working for the business?

### Cracking the code



**Multinational companies** Large businesses that operate in several countries.

**Incentives** Things that motivate employees to work hard.

**Turnover of staff** Sometimes called labour turnover, it measures the percentage of employees who leave the business each year.

**Organisation chart** A family tree of the management of a company, usually with the most important people at the top.

## Chapter 2

# Organisation structures

### APPLIED IN THE BUSINESS WORLD

## Orkney Vitreo Glassware

**O**rkney Vitreo Glassware was a school-based enterprise that was set up by students at Kirkwall Grammar School in the remote Scottish Orkney Islands. Vitreo is just another name for glass. The organisation was a short-term project to get the students used to operating in the business world. Most of the team members were sixth formers, but there were also some Year 11 students involved.

The team decided to sell engraved drinking glasses. They use two types of glasses: high ball and tumblers. The business uses standard quality glass, and more expensive crystal glass for those looking for a better quality product. Each glass has an image engraved, or scratched, into its surface. The students decided which designs they felt would be most popular and had these produced in bulk by a local company. Vitreo

Glassware sets a price range of £3.99 to £9.99 for a single glass, depending on its quality. Discounts are available for sets of six glasses. Because of its remoteness, Vitreo relies a great deal on the internet to create a market for its products.

One of the first tasks the students faced before they set up the company was to decide who would take on the different roles within the organisation. The group considered the strengths of each person involved and these were matched with the skills required for each particular role. Some of the students were very good at using ICT and so became responsible for the internet selling side of the business. Others were better at motivating others and driving the business on; these students took on some of the managerial roles. Other students were good at money and maths, so they were well suited to work with the business finances.

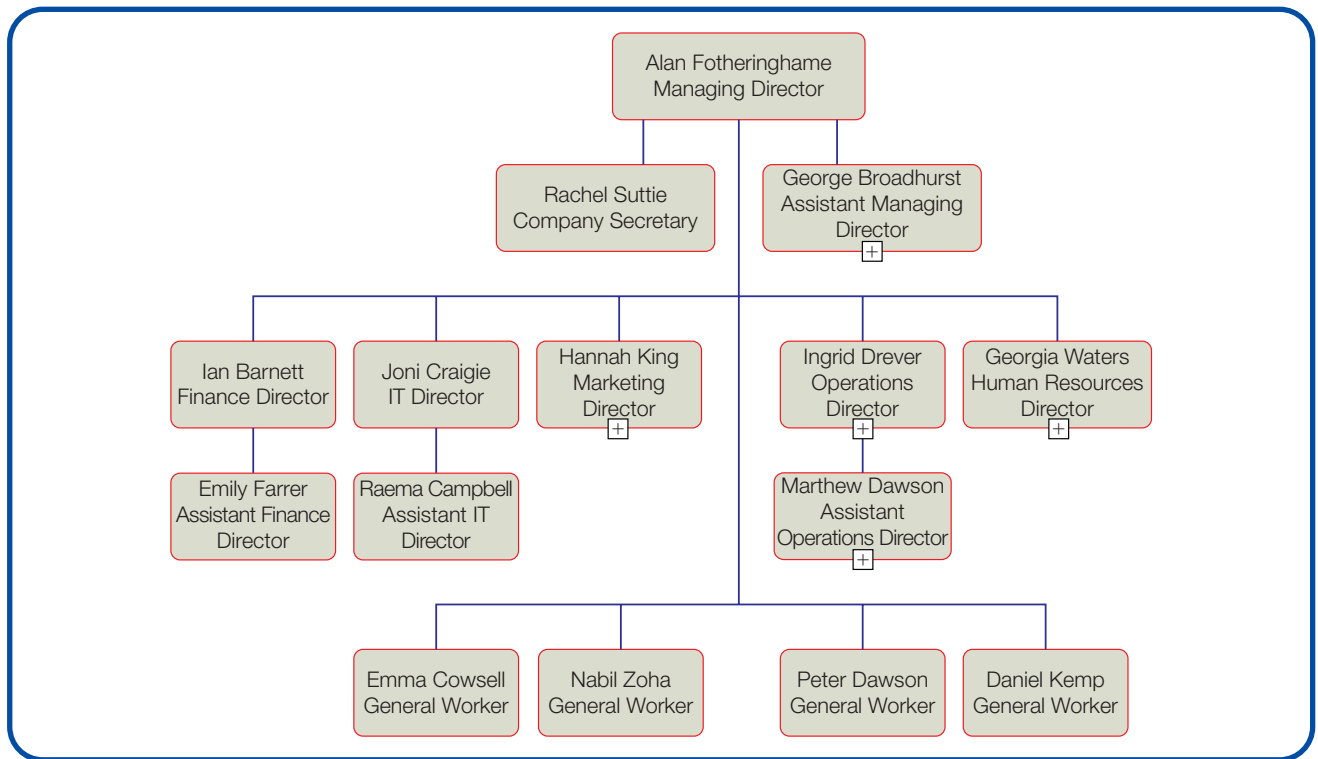
The organisation chart (see following page) helped to show how each role fitted into the business. The students also felt it would be a good idea to have everyone's photograph on the chart. (These can be seen on the company's website.)

### Live links

The group's website can be found at [www.vitreoglassware.co.uk](http://www.vitreoglassware.co.uk).

Even though Vitreo Glassware was a school-based enterprise, it still needed to be carefully structured. A business idea, no matter how good, needs to be properly organised if it is to make a profit for the owners. The students were wise to produce an organisation chart.

Orkney Vitreo Glassware's organisation chart is a **hierarchy**. This means that as you move up the 'family tree' structure, the roles become more important. You can see from the chart that the top position is held by the managing director. The lowest level, or layer, consists of the four general workers.



The organisation chart for Orkney Vitreo Glassware

These roles do not appear to be as important as those higher in the chart. General workers certainly don't have anyone below them, or subordinate to them, while most of those above do.

The route that instructions follow from the decision makers at the top of the organisation chart to the subordinates below is known as the **chain of command**.

Look carefully at the organisation chart. The managing director has responsibility for many of the other members of the enterprise. The chart shows that he is in charge of the company secretary and the assistant managing director on the level below. He also looks after the five middle managers on the third level. Surprisingly, he also has direct responsibility for the four team members on the lowest level. Nobody else in the organisation acts as a manager for more than one other person. This means that Vitreo Glassware has a very short chain of command.

An organisation chart can be useful for outsiders. If a local newspaper wanted to contact Vitreo Glassware to discuss placing an advertisement in the paper, it would see from the chart that the best person to talk to would be the marketing manager. So the chart can

have some practical uses. The chart can also give out underlying messages about how the business is managed. The message given out by the Vitreo Glassware chart is that this organisation is controlled to a large extent by one person. This may not be the case in reality, but the chart appears to be saying this.

The students involved in the enterprise probably all felt proud being part of the organisation and appearing in the chart. Publishing the individual photographs no doubt helped to reinforce that sense of doing something important. So in some way an organisation chart can help motivate staff. Each person can see his or her position in the chart and how the role helps fit into the business as a whole.

## Summary

- Orkney Vitreo Glassware is an example of a successful school enterprise
- Despite the business operating from the remote Scottish Orkney Islands, it was able to function well
- Vitreo Glassware has a clear organisation chart which shows the different roles within the enterprise

## Hit the spot



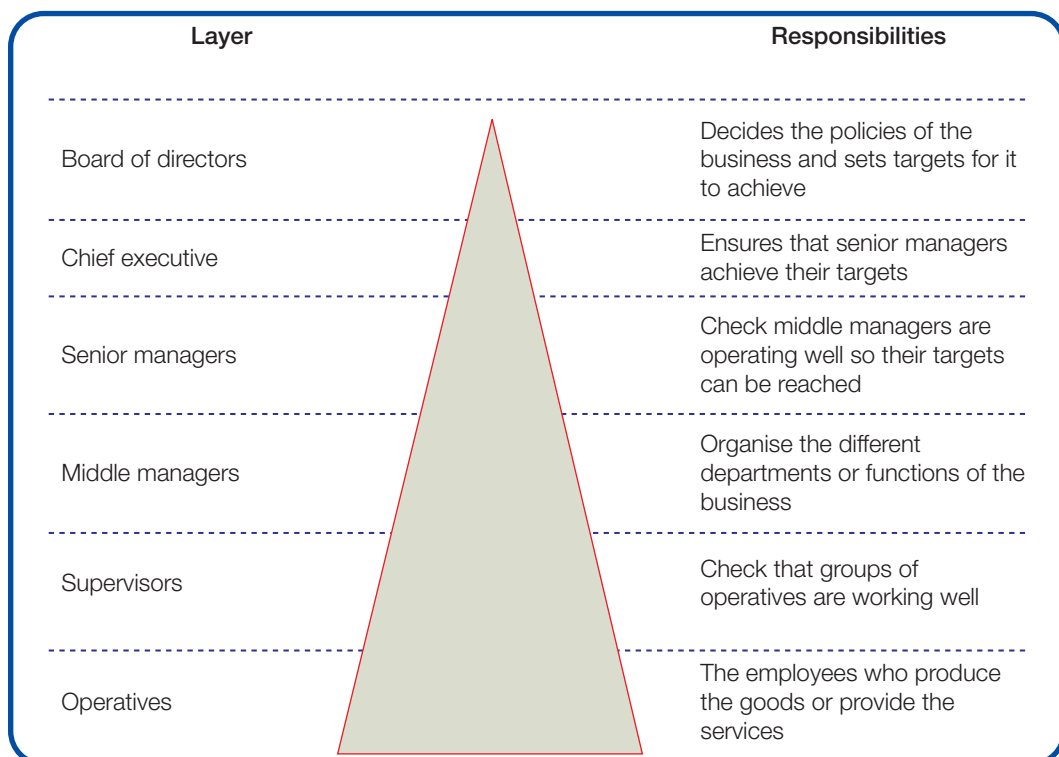
- Give two possible reasons why the Kirkwall Grammar School students decided to set up their business.
- Explain two reasons why having an organisation chart on its website might help Orkney Vitreo Glassware.
- Discuss: if a business can be successfully run as a school enterprise, it would work equally well as a full-time business.

## Pyramid structures

Many businesses' organisation charts are triangular in shape and are called pyramid structures. This is because there are more employees the further down the pyramid you go. This means that there are very few decision-making people at the top layers of the pyramid, compared with the numbers at the lower layers. As you move down the pyramid, the roles are less important as those who are in these layers often

have less opportunity to make important decisions about the business. It is because of this that an organisation chart is sometimes called a hierarchy.

A typical organisation structure is shown in the diagram. In this diagram there are six different layers, or levels. Decisions are usually made by the people at the top layer and these decisions are passed down through the levels until they reach those at the bottom, the people who will put the decisions into practice.



Pyramid structure

This will mean that there will be at least five stages that the messages have to go through to get to everyone in the organisation. Some businesses have attempted to streamline this process by either:

- making communications better (see the next chapter for more information on this);
- removing some of the layers of the structure to create a flatter hierarchy.

### Did you know...

Mathematically speaking, pyramid structures are really triangular in shape as they are usually drawn as 2D, not 3D, diagrams.

## Span of control

The number of people a manager directly supervises is known as the **span of control**. Usually, the taller an organisation chart is (in other words, the more layers it has), the narrower the span of control. As an organisation loses layers (becomes flatter), more employees are at each layer, so managers need to supervise more people. There is no ideal number of employees within a span of control. Different experts have different views on the matter. Some believe that six or seven people is an ideal number. Fewer than this and the manager would not be working efficiently; any more can cause problems with communications and keeping on top of what is going on.

### Did you know...

The army has one of the most recognised organisation charts, with generals at the top, followed by colonels, majors, captains, lieutenants, sergeants, corporals and finally privates. A soldier's position in this hierarchy is called his rank.

## Delegation

The overall responsibility for the business rests with the board of directors. This doesn't mean that they take all the decisions; the board will delegate decision-making powers to the **chief executive** or managing director. This means the person is allowed to make decisions without having to check with the board. Delegation is often passed further down the organisation chart. Middle managers will often have the authority to make important decisions. Some organisations go as far as empowering junior managers, or supervisors, allowing them a free hand to make decisions.

### Did you know...

Most medium and large businesses have a clear organisation chart, but many choose not to publish these on their websites.

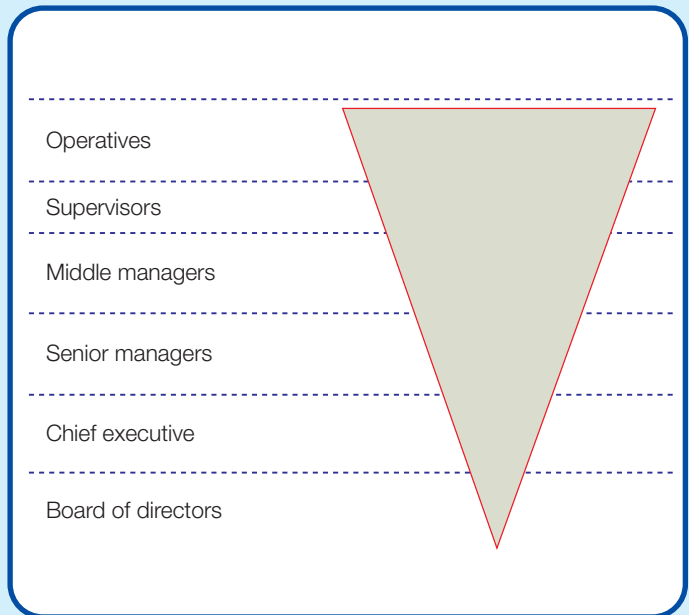
## Chain of command

In a complex organisation structure like the one shown in the pyramid diagram on page 9, there is a long chain of command. Any decisions made by the board of directors need to pass through five layers before they reach the operatives at the bottom. The process of messages travelling through these layers, or links of the chain, can be time-consuming. It is likely that messages will get distorted or altered as they move down the chain. A manager might misunderstand the message and the original meaning may be lost as that person explains it to his or her subordinate.

And more

## Inverted pyramids

Some businesses feel that it is more appropriate to publish their organisation chart as an upside-down (or inverted) pyramid. This means that the people with less authority, the operatives, are at the top of the diagram and the directors and senior managers will appear at the bottom. The reasoning behind this is that it empowers ordinary workers to feel they have the authority to suggest changes which will improve the efficiency of the business. After all, those who make the product or deal with customers are more likely to know what needs to be done to improve the company.



Inverted pyramid

## Matrix hierarchies

Large companies might find the structure of their management system doesn't suit a single organisation chart. Quite often these businesses will be project-based and the work of the teams involved with the projects covers more than one area of the business. For instance, a construction company might have a contract to build a large estate of new houses on the outskirts of a town. This project will need a manager who deals with purchasing materials, another manager who is responsible for the quality of the built houses, an environmental manager who would be concerned that the building has a minimum impact on local wildlife, and the builders who are constructing the houses, who will be accountable not to one but possibly to several managers. This creates the complicated, but realistic, management structure known as a matrix hierarchy.

## Core knowledge

All businesses have a management structure. This structure is not always written down in the form of a chart or diagram, but it still exists. A structure that is put down on paper can make it clearer how the different job roles fit together. It shows who is in charge of each section and who is accountable, or subordinate, to each manager.

You might think that an organisation chart would apply only to a large concern, where there are many people with responsibilities for running the organisation, but this is not true. Even a one-person business would benefit from having a clearly drawn organisation chart.

Imagine the owner of a small shop, for instance. There will be several roles, or functions, that he or she will have to undertake. The shop owner will probably have at least three functions. Items will have to be bought from a supplier, and these will then have to be sold to customers. There will be the additional function of keeping control of the business finances. This may include checking that suppliers' bills have been paid, that cash and cheques are placed in the owner's bank account, and that any shop assistants receive their wages.

The shop owner might find it useful to write three separate lists of his or her tasks.

While this may not look like the organisation chart of a larger business, it still serves some of the same functions. The owner of the shop might be the only person who has management responsibility, but his or her different roles are clearly shown. This will help the owner become more organised in taking responsibility for all the functions of the business.



The owner of a small shop will have to perform several different functions

| Buying function                                                                                     | Selling function                                                                                                             | Finance function                                                                                                                                           |
|-----------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Checking catalogues/brochures<br>Ordering supplies<br>Contacting new suppliers<br>Controlling stock | Advertising<br>Special offers<br>Pricing goods<br>Window and other displays<br>Dealing with customers<br>After-sales service | Checking suppliers' invoices<br>Keeping financial records<br>Negotiating overdrafts with the bank<br>Paying employees<br>Organising cash float in the till |

## Have a go!

### Group activity

Draw an organisation chart/hierarchy for your school. Work out who would be at the top (it's unlikely to be your head teacher). Try to arrange the diagram so members of staff with equal responsibilities are shown at the same level or layer.

## Discussion



Discuss the advantages and disadvantages of having a wide span of control in a business.  
Discuss what you believe would be an ideal number of employees within a span of control.

## Web-based activity



Use a search engine to find a company's organisation chart on the internet. Use this chart to produce a poster on hierarchies that explains the terms mentioned in the chapter.

## Quickfire questions



- 1 How many different levels or layers does Orkney Vitreo Glassware have?
- 2 Which person in the Vitreo Glassware organisation chart has the widest span of control?
- 3 How does having the post holders' photographs on its organisation chart help the organisation?
- 4 Give an advantage a business might gain when it delegates responsibility.
- 5 What is a chain of command?
- 6 Describe a difficulty associated with a long chain of command.
- 7 Which group of people usually decides on the policies of a large business?
- 8 What do we call an organisation chart where the senior managers appear at the bottom of the diagram?
- 9 Why do some large businesses need to have matrix hierarchies?
- 10 Why do some businesses publish their organisation charts on their websites?

## Cracking the code



**Hierarchy** A diagram that shows how important certain people are in an organisation. The higher the person is in the hierarchy, the more authority that person has.

**Chain of command** The route information and instructions have to go through from the senior manager at the top to the operatives at the bottom.

**Span of control** The number of people a manager is responsible for.

**Chief executive** The person in overall control of the day-to-day running of a business.

## Chapter 3

# Communication and decision making

### APPLIED IN THE BUSINESS WORLD

#### Unison

**U**nison is a **trade union** that represents hospital and other public-sector workers. Members often include low-skilled employees in local authority workplaces. Unison's members are some of the lowest paid employees in the country. Unison has 1.3 million trade union members nationally. Its main headquarters is in London, but it has 12 regional offices including Scotland, Wales and Northern Ireland. In addition, many of the hospitals and other workplaces will have their own branches of the union based there. About 1,300 employees work directly for Unison.

It is easy to see that for a large organisation like Unison, communication will be a concern. For one thing, its members are spread throughout the whole country. To make matters worse, in many cases the members work in isolation from each other, or in small groups. Under such circumstances it is potentially very difficult for Unison to keep in touch with everyone and let people know what is happening in their trade union.

As a responsible organisation, Unison feels that it needs to keep all its members and employees up to date with the issues that it sees as being important. To help it achieve this, Unison has set up a Communications Unit within the organisation. This unit has the responsibility to ensure that messages and information get out in an understandable form to those who should know about them. Unison does not rely on a single method to get its messages across, taking



Unison represents workers in hospitals such as nurses

the view that it would be irresponsible to rely on a single method to keep people informed, so it uses a variety of media.

Three different magazines are produced regularly and sent out. Unison members receive *U Magazine*, while its employees are given a publication called *InsideOut*. Union activists are those volunteers who push forward the views of Unison; they have their own magazine called *InFocus*. As well as these, Unison produces a weekly email bulletin called *eFocus*.

#### Live links

[www.unison.org.uk](http://www.unison.org.uk)

Magazines and newsletters are traditional methods of providing information on the union's key priorities and campaigns. These days, people do not always read this type of communication. To account for changing attitudes to receiving information, Unison makes good use of its web pages to update members. The web pages also give access to a range of video clips on union business that might appeal to some members. These clips are also available on YouTube.

Most businesses agree that communications are important if the company is to be successful. Few organisations, however, go to the sorts of lengths that Unison does to get its messages across. Unison believes that communications are needed so everyone connected with the trade union is aware of the key issues that the union, and therefore its members, face.

Unison is involved with many campaigns, such as improving the laws on the **minimum wage**, which affects many of its members. Unison wants its members to be updated on the progress of the campaign. Unison also feels that its members need to be made aware that their union is doing something on their behalf to help them achieve higher wages. Good communications has the effect of encouraging Unison members to become more actively involved with union business.

To achieve these things, communications should be well written so they are easily understood. It would be no good sending out messages that were confusing or were difficult for members to understand. The messages also have to be short enough to keep the reader's attention but with enough detail so that a full picture is given. The quality of the communications can say a great deal about how professional an organisation is. Messages that are full of mistakes and poorly presented do little to make Unison appear that it has the talent to improve members' lives.

## Internal and external communications

The communications that we have discussed so far are all examples of external communications. In simple terms this means that they go to people who are outside the organisation. In Unison's case we are aware that the trade union uses magazines, both paper-based and electronic, video clips and web pages to pass on its key messages. These are all examples of communications that have been produced for external use. Letters and information sheets sent to members would also be external communications.

Unison, like all organisations, will send messages between people within the organisation. These are internal communications. Within a normal working day hundreds if not thousands of internal communications will be sent. These communications will often take the form of emails or memos.

Organisations are probably less concerned about the quality of internal communications than they would be about external communications. Producing a carefully written and presented piece of information takes time for an employee. If there is any confusion when a communication is sent out internally, the person receiving the message (the **recipient**) can get back to the sender to check the details. This would be much harder with external communications. An organisation needs to make a compromise between saving employees' time when producing a communication and having a perfectly clear message.

Emails are a very popular method of sending internal messages using computers or mobile phones. Some organisations go as far as insisting that such communications are kept as brief as possible. To help save time, employees are instructed not to use capital letters or punctuation within the message. Abbreviations are also allowed, as long as the message is clear.

### Hit the spot

- Identify two types of information that Unison might need to pass on to its members.
- Explain why communications are so important to Unison.
- Evaluate whether passing on messages using Unison's web pages is a better method than sending out magazines.



## Summary

- Unison, like most organisations, uses a range of communication methods to get across its key messages
- Communications can be split into internal and external types
- The standard of communications can say a great deal about a business

## Core knowledge

In the previous chapter we looked at organisation structures. You might remember that the chain of command is the route messages and instructions follow from the board and managers in charge at the top of the hierarchy to those employees below.

Businesses will often have a formal system for passing these messages down the hierarchy. This might take the form of briefing meetings, where the subordinates are told by their immediate managers what is happening. The message might be conveyed by email or, as in the case of Unison, through magazine articles and video clips.

**Formal communications** are not the only way in which messages are passed on within organisations. Many organisations rely on **informal communications** for employees to find out what is happening.



Informal communication can be valuable

## Informal communications

When people are at work they will frequently engage in informal communication. They may not realise that they are doing it, but when two employees meet at the photocopier machine and talk about work, they are involved in informal communications. This type of communication is not planned or scheduled; it relies on the sociable nature of fellow humans. If you were to listen in to the conversations in your school's staffroom, you might be surprised that much of what teachers talk about has to do with students and the school. Teachers will talk about any proposed changes within the school, allowing them to find out more about what is happening. Using informal communications as a part of the chain of command happens in many organisations, and not just schools. Some organisations recognise that employees are more likely to pick up on messages when talking informally with colleagues, so will set aside opportunities for employees to meet and chat.

Of course, informal communication can be a little hit and miss in its effectiveness. It works well when employees have the chance to move about and talk to each other. An open-plan office is particularly good. Communication will not be as effective where employees work in isolation and when breaks are staggered. The increased use of email, however, does allow short, informal messages to be sent between employees.

## Other communication methods

### Video conferencing

Technology has allowed exciting and cost-effective ways of communicating. As well as methods already mentioned in this chapter, businesses are making increasing use of video conferencing. The use of webcams and secure conferencing facilities means that several people from different parts of the country, or world, can meet without the need for long and expensive journeys.

### Presentations

Presentations are another way of passing on information to a large number of people. PowerPoints and handouts can be used, containing graphs, charts and summaries. These not only emphasise the message the presenter wants to get across but also serve to sustain the audience's attention.

### Staff councils

If a business is very large, it might decide to set up a staff council, where representatives of the different sections or departments will meet. These councils can be used by senior managers to pass on information. The representatives would, in turn, go back to their colleagues and disseminate (or pass on) the information. This would be an example of a formal meeting that is followed up by informal dissemination to others.

### Did you know...

Text-style language is not a new thing. Abbreviations were commonly used more than 100 years ago in telegrams and in letters. Examples include: 'ea' means 'each', 'ult' is 'next month', 'dr' and 'cr' are 'debtor' and 'creditor', 'iou' is 'I owe you', 'rsvp' is 'please reply'.

### And more

Communications are at the very heart of all business activity. So it is essential that managers in an organisation find out whether the systems of communication that are used are working well. When communications are working properly, everyone in the organisation is fully informed and there is a shared sense of purpose and direction.

### Barriers to communication

Anything that stops messages from travelling successfully from the sender to the recipient is sometimes called **noise**. This is a general term that means something quite different from what we normally understand by the word 'noise'. In a communication sense, noise is any type of barrier that stops, or alters, the message being passed on. For instance, if an organisation relies on using information technology as its main means of communication, if someone doesn't have a computer then the message will not arrive. In this case the lack of a computer is a form of noise. Someone being unhappy about using computers would similarly create a barrier to communication, or noise.

Other barriers might include language problems if the message is sent or received by someone who doesn't speak English well. Problems are also encountered if the message contains technical terms or abbreviations with which the recipient is unfamiliar.

In these cases, the noise has had an effect on the recipient of the message, rather than its sender. There are examples when the sender can face obstructions or barriers to sending a clear communication. Imagine, for example, someone who dislikes public speaking and becomes very nervous when delivering a spoken presentation. This person might know what needs to be said, but his or her nerves get in the way of what is said. Those listening to the talk will probably be distracted from the message by the speaker's discomfort and the message will not be delivered properly.

Organisations should be aware of the barriers, or noise, that could stop effective communication. Care should be taken that the amount of noise is minimised so the message can get through clearly from the sender to the recipient.

### Did you know...

A 'water cooler meeting' is when employees discuss company business or gossip while taking a drink from a dispenser. The term now refers to any form of informal communication and doesn't even have to take place next to the water machine.

### Did you know...

When you speak to someone what you say is not that important. According to psychological research, 55 per cent of the message is conveyed through body language and 38 per cent comes from the tone of your voice. Only 7 per cent of the message is received from the words that we speak.

## Have a go!

### Group activity

Imagine your group has been asked by a local company to produce a template for its half-yearly magazine. Discuss what items its employees would be interested in reading about. Produce an outline of a typical magazine.

### Discussion

Identify ways in which students at your school are kept informed. Discuss how the system of updating students might be improved.

### Web-based activity

Choose and watch one of Unison's video clips on its website or UnisonTV on YouTube.

Comment on (a) the professionalism of the presentation and (b) how clearly the message was put across. Suggest ways in which you believe the presentation might be improved.



## Quickfire questions

- 1 What type of organisation is Unison?
- 2 How many members does Unison have?
- 3 Why is communication particularly important to Unison?
- 4 What is the difference between formal and informal communication?
- 5 What is the name of the magazine that Unison publishes for union activists?
- 6 How might an open-plan office lead to better communications?
- 7 What is meant by dissemination?
- 8 Give an advantage of a business letting its employees know about changes in the company by holding briefing meetings.
- 9 What is meant by noise in the sense of communication?
- 10 Give an advantage and a disadvantage of using internet video clips for Unison to get its message across.



## Cracking the code

**Trade union** An organisation for employees that looks after the interests of its members.

**Minimum wage** The lowest legal wage rate that can be paid to employees.

**Recipient** The person who receives a communication.

**Formal communications** Passing on messages and information through clearly defined official channels

**Informal communications** The transfer of information through unscheduled channels, such as employees chatting to each other.

**Noise** (in a communication sense) Any barrier that stops a message from getting through, or being understood by its recipient.

# Chapter 4

## Job roles

### APPLIED IN THE BUSINESS WORLD

#### Jobs in the music industry

**M**any young people like the idea of working in the music business. This industry is often seen as exciting, with those involved mixing with the rich and famous. Like all jobs though the reality might not be as glamorous as you might expect. The music industry is subject to a great deal of hype. There will be high-profile jobs that will bring celebrity status to some, but much of the work is far more down to earth.

The BBC has put together a list of some of the jobs that relate to music, some of which you might not have thought of before as being part of that industry. These are just some of those jobs.

- A&R (artist and repertoire) men and women are those involved in finding new talent. They will scout music venues watching amateur bands and acts, looking for those which have the potential to hit the big time. A&R staff will work unusual hours and have to be able to assess raw talent as potentially profitable.
- Agents and managers are the representatives of acts. In return for a percentage of the performers' earnings, they will arrange concerts and recording contracts, getting the best deals for their clients. They clearly need to be demanding negotiators and pushy types of people.
- Choreographers are those who arrange the dance routines. Many musicians have dancers when on tour to create a more theatrical experience on the stage. Choreographers need to be talented dance arrangers and able to work together with the musicians and the dancers.
- Designers and stylists are the artists who create the performers' image, from CD designs to backdrops on the concert stages.
- Distributors are the people who get the music to the customers, whether this is in the form of CDs or internet downloads.
- Lawyers are needed to protect the copyright of recording artists' work. They are essential when it comes to writing contracts so their clients' interests are well served. They need a good eye for detail and must be willing to argue their case.
- Press officers are the communications experts. They work closely with the media keeping them up to date with their bands or recording studios. They will need to be well connected and be able to network with journalists.



- Roadies are the musclemen and women who go on ahead of the acts to set up the stage and take it down afterwards ready for the next venue. They no longer rely on brute strength these days as technical knowledge is as important.
- Tour managers make sure that the 100-venue international tour runs without a hiccup. It's not just a case of making sure the band is in the right town on the right day – hotels have to be booked in advance and transport arranged for perhaps 100

people. And these people need to be fed several times a day. Organisational skills are absolutely essential.

### Live links

More details about these and other jobs in the music industry can be found at the BBC Radio 1 website:  
[www.bbc.co.uk/1extra/events/get\\_aheadaz.shtml](http://www.bbc.co.uk/1extra/events/get_aheadaz.shtml)

It might surprise you just how wide a range of jobs there is in the music industry. Each of the jobs listed above requires different skills and talents. But each job is essential if the music is to be of good quality and actually get to the listener.

Before someone is recruited to any one of these jobs, the managers will need to make sure that they get the person with appropriate skills. They will almost certainly produce a **job description** for the post. We will learn later in the book that job descriptions are not just forgotten about once a person is appointed; the document can be used to determine how well a person has performed in the job in relation to the job description.

### Did you know...

The USA has the largest market share of the global music industry at 35 per cent, third is the UK with 9 per cent and second position is held by Japan at 19 per cent.

## Job description

A job description is a document that outlines the duties and responsibilities of a job. Some job descriptions are very basic and do little more than describe in very general terms the role of the person who will be doing the job. Other job descriptions will be far more detailed and have information about different aspects of the job. These aspects might include the job title, the wage or salary that is to be paid, the hours the person will be working, the day-to-day duties of the employee, who the person's manager will be, and whom the person will supervise, if it is a supervisor's job.

A job description is normally produced before the person undertaking the job has been taken on by a business. This helps in the selection process when deciding who would be the most suitable person to do the job. The job description is often sent out to applicants so they can read exactly what the job they are applying for entails. If, for example, the job involves working shifts then this will be made clear to the applicant before he or she applies. This saves the trouble of interviewing someone who would not be prepared to work shifts. The people running the interviews for the job will probably check this when they meet.

A second document that is often produced when a new job arises is the **person specification**, or the job specification as it is sometimes called. This document lists what skills, qualifications and experience are required for a person to undertake the job successfully. Sometimes the person specification will state whether each of the requirements is essential – which means the applicant must have them – or just desirable. For example, the person specification for a sales assistant in an electrical store might say that it is essential that the applicant has GCSE grade C or better in English and maths, while having previous experience of shop working might be seen as just desirable.

### Did you know...

Henry Ford, the founder of Ford cars, was a great believer in shorter working hours. He wasn't so much concerned about the welfare of workers, but wanted them to have enough leisure time so they would be more likely to buy one of his cars.



## Hit the spot

- Outline three items of information that can be found in a job description.
- Explain how a clear job description can help a business select the right candidate for the post.
- Evaluate whether a person's experience and personality are more important when applying for a job than his or her school exam results.

## Summary

- A job description is an outline of what a job entails, its working and pay arrangements and the skills that are needed
- When recruiting, these documents are useful to employers to check they are selecting the right person for the job. Prospective applicants will use the job description to see whether they are suitable for the post
- After someone is appointed, the employee's performance will often be judged against the job description to see how well he or she is doing the work

## Core knowledge

### Job roles in business

It could be argued that each job role in business is never the same as any other. A shift supervisor in one supermarket will probably undertake a slightly different role than someone doing that role in another supermarket. So in a way each job is unique.

### Managers

In medium-sized and large businesses the main decision makers will be the directors. These people will be shareholders, which means that they are part-owners of the business. The key responsibility of directors will be to look after the interests of the other shareholders. They need to make sure that the business is always operating in the way that the shareholders would like it to, which usually means earning a healthy profit. While the directors may be in overall control, it is the managers who run the business on a day-to-day basis. Managers are decision makers and need to be good at problem solving. They will usually be expected to sort out any difficulties that arise rather than pass the problem up the hierarchy. Managers need to be able to communicate effectively and confidently, whether writing a letter or giving a presentation to hundreds of employees.

In a small business there may be a single manager who takes overall responsibility for the business functioning well. This person will need to be a good all-rounder as he or she will have to take on many roles. A general manager will need to ensure supplies are ordered and products or services are sold. He or she will act as a personnel manager, dealing directly with employees, as well as setting targets and overseeing recruiting new staff and training. Managers in larger businesses are more likely to be in charge of a specific part, or function, of the business. Functions include sales and **marketing, human resources, purchasing** and production.

A large business might have three levels of manager: senior, middle and junior. Each manager will need to have certain skills if they are to undertake their jobs effectively. They will need to have good leadership and communication skills in order to do their jobs effectively. Managers also need to be good organisers. They have to ensure that the area of the business that they control functions properly and the work it undertakes is fully coordinated. Managers deal with other members of staff so good **interpersonal skills** are also useful to have.

## Supervisors

Supervisors are sometimes thought of as a halfway house between managers and employees. Quite often supervisors worked as employees and were promoted because they demonstrated management skills. They often work alongside the employees doing similar work, but have an additional responsibility for checking the work of a small group of these workers.

Supervisors will be delegated some responsibility to sort out minor problems as they arise, but they will usually be expected to refer anything more serious to their line manager.

## Employees

These are sometimes called operatives or shop-floor workers. They are often the people who are at the bottom of the organisation chart. Their main job is to operate the company's machinery or equipment, or deal with customers or clients. They sometimes work in teams, each person having a particular job within that team. Teamwork can make the operatives more productive. Many enjoy teamwork because there is a social aspect to working with other people. It is also becoming increasingly common for operatives to be made responsible for checking the quality of their own work. In the past, quality was the responsibility of a separate group of employees, but in many companies everyone is expected to check their own work is up to scratch.

### And more

#### Key responsibilities

We read above that a job description outlines what the responsibilities are for the person doing the job. In some cases, the job description will be very specific. A receptionist at a large company will have to receive visitors, sign them in and out, and answer the telephone. There may be other duties like keeping the reception area neat and tidy, but in a busy company the receptionist might be fully occupied with visitors and phone calls. In a smaller business with fewer visitors and calls, the receptionist might have to perform additional duties such as filing or word processing. Jobs like this tend to be quite repetitive and predictable. A business might rotate administrative jobs like these so employees are moved about to make the work a little more interesting.

Managers' job descriptions are likely to be less precisely written. Such people will have a list of their responsibilities but it is likely they can choose which they do when. They might need to prioritise their work so the most important jobs are tackled first.

## Job security

Most employees want the security of knowing that their jobs aren't likely to become **redundant**. People can never be absolutely sure that jobs will last as long as they want them. Some occupations are more likely to see redundancies than others. The main reasons for redundancies being necessary are:

- new technology being able to do the job cheaper than a human operator,
- the economy going into decline and people not buying the goods that a business sells,
- competitors being able to produce the items cheaper, and
- people's tastes changing in favour of other products.

## Qualifications and personal qualities

Some jobs require specific academic or professional qualifications, while for other jobs employers are more concerned about a person's attitude to work and other skills rather than how well they have done in examinations. Even if a high level of education is required for a job, employers will be looking for other skills as well. Many businesses regard skills like being able to work both in a team and alone without close supervision as being very important. Some jobs require employees to pass on information or to train others, so good communication skills are essential in these circumstances. Most jobs these days require some computer skills. Businesses might be more interested that a person has a positive attitude to using ICT equipment when recruiting than how competent they are. The skills can be taught, but negative attitudes are more difficult to overcome.

## Did you know...

Many people like the idea of having an impressive-sounding job title. Some companies have changed job titles to make them sound more important. A ticket inspector might be a revenue protection officer, a postroom worker could be a despatch services facilitator, and shelf stackers have even been called ambient replenishment controllers.

## Have a go!

### Group activity

Imagine your school is considering recruiting a new teacher. Produce a detailed job description that can be sent out to applicants.

### Discussion

Decision-making and problem-solving skills are very much in demand in industry. Discuss whether schools can actually teach young people these skills and if so, how they might be taught.

## Web-based activity



Choose an industry and research the different types of jobs that can be found in it. You may want to consider fashion, leisure, education or any other industry that you want. Produce a brief outline of each job.

## Quickfire questions



- 1 What is the job of an A&R person?
- 2 What is a choreographer?
- 3 Why does the music industry need lawyers?
- 4 What is a job description?
- 5 Which group of people do directors represent?
- 6 What is a general manager?
- 7 Give one factor that affects job security.
- 8 Give a reason why teamworking is an important skill for employees.
- 9 What is job rotation?
- 10 What responsibilities are increasingly being given to operatives?

## Cracking the code



**Job description** A document that gives an outline of the vacancy, details of working hours, wages and other information to do with the job.

**Person specification** A list of the skills that the successful person will need to be able to do in the job.

**Marketing** The department that is concerned with getting a business's goods or services sold.

**Human resources** The department that deals with the recruitment of employees, their training and development.

**Purchasing** The department responsible for buying materials from suppliers.

**Interpersonal skills** The ability to communicate and deal effectively with different types of people.

**Redundant** A job or resource that is no longer needed.

# Chapter 5

## Working arrangements

### APPLIED IN THE BUSINESS WORLD

#### Manor Bakeries Ltd

**M**anor Bakeries might not be the most famous of household names, but the products it makes are certainly well known. Manor Bakeries makes some of the Mr Kipling, Lyons and Cadbury cake brands. Rather than these companies producing their own cakes, they license their brand name to other businesses. Manor Bakeries also produces confectionery for supermarkets, which is then sold on as those businesses' own labels. Manor Bakeries has several manufacturing units around the country, each employing up to 1,000 people.

Consumer demand for confectionery is seasonal. From April each year, production of cakes increases and continues to rise during the summer months. The peak months, where demand is highest, are between September and December, the run-up to the Christmas period.

In the past, additional temporary employees were recruited locally to help out at times of peak demand. This system, however, was found not to be satisfactory. The temporary staff needed to be trained, which took time, and they were not as efficient as their full-time colleagues. Because they were working at the bakeries for only a short time, they often tended to lack motivation or enthusiasm for the job.

To overcome the difficulties caused by the seasonal demand for cakes, Manor Bakeries decided to look carefully at changing its employees' working arrangements. It was suggested that the company



should employ a larger number of permanent staff and change the shift pattern arrangements. Shifts were adjusted to take account of the time of year. In the summer when demand was high, employees were expected to work more shifts. In return for this extra input, they would be able to enjoy shorter hours during the winter months when demand was low. It was possible for employees to bank enough additional hours during the summer to be able to take two weeks off, with pay, in addition to their normal holiday allowance. Manor Bakeries called the new system 'flexi-shifts'.

#### Live links

You can find some examples of the range of confectionery produced by Manor Bakeries at [www.mrkipling.co.uk](http://www.mrkipling.co.uk).



## Hit the spot

- Describe how the demand for cakes changes over the year.
- Explain two reasons why temporary staff might not be as productive as full-time employees.
- Manor Bakeries discussed flexi-shifts with its employees before any changes were made. Evaluate whether it was this strategy that allowed flexi-shifts to be introduced successfully.

The changes in working practices at Manor Bakeries allowed the manufacturer to improve its efficiency by removing the need to take on temporary staff when it needed additional workers. The success of the changes relied on employees being willing to accept the new working practices and the increased flexibility that they brought. Before the introduction of flexi-shifts, Manor Bakeries discussed the arrangements with the employees' trade unions. While some employees would find the prospect of additional holidays attractive, others would have been cautious about any change to their working arrangements. The changes meant that the workers' **contracts of employment** would have to be rewritten. To help soften the blow of introducing flexi-shifts, the management introduced a new pay structure which made it more attractive financially to employees.

Manor Bakeries was able to take a completely fresh look at the working arrangements of its employees. Workers were able to request time off whenever they wanted it. This allowed them to give greater priority

to their family and leisure interests. Many felt that work was less of a drudge because of the flexi-shifts. The company was willing to accept any of the employees' requests for time off, providing there were sufficient staff members to keep each plant operational.

The experiment at the bakeries proved to be a success. Manor took on an extra 100 employees and this allowed it to avoid using temporary staff. Those taken on were more highly motivated than the temporary staff and this led to an improvement in efficiency by 30 per cent. This was achieved by improved production and an amazing 50 per cent fall in the amount of waste from sloppy work. The project has also created other benefits. Labour costs have been reduced by 11.5 per cent and there has been a marked increase in employee morale and team spirit. Two good indicators of employee satisfaction are the level of **absenteeism** and the rate of staff turnover. After the shift changes were introduced absenteeism fell by a half and staff turnover by 10 per cent.

## Summary

- Manor Bakeries Ltd faces seasonal demand for its Mr Kipling and other types of cakes
- In the past it relied on temporary staff during times of peak demand. Temporary workers were far less efficient than their full-time counterparts
- The company introduced a flexi-shift system where employees had greater choice in the hours that they worked

## Core knowledge

### Contracts of employment

An employment contract is an agreement between the employee and his or her employer, outlining both sides' rights and duties. It is a legal obligation for an employer to provide employees with this document within two months of them starting work. In simple terms, the employee has contracted to work for the business and in return the employee will be paid a wage or salary.

There are some rules that apply to any place of work, regardless of the employment contract. By law, a workplace must be safe, workers should receive suitable training if needed, employees cannot be discriminated against on the grounds of their race and other factors, employees are free to join a trade union, at least the minimum wage must be paid, and personal details held on a computer must be available to employees. These are the laws of the land and an employer is not allowed to have anything in a contract of employment that breaks these rules in any way.

A contract of employment will need to have sufficient detail so both sides are perfectly aware of their rights and duties. A typical contract of employment might contain these details:

- employer's name and employee's name;
- job title;
- date the job started;
- rates of pay, such as a wage of £8.50 per hour or a salary of £21,000 per year;
- frequency of payment, such as weekly or monthly;
- hours of work, for example seven hours per day Monday to Friday, between 08.00 and 16.00 with an hour allowed for meal breaks;
- holidays, for example 25 days per year plus bank holidays with dates subject to agreement with management;
- place of work: the address of the normal place of work including offices, retail outlets, teleworking, mobile and home-based working;
- sickness benefits, stating that the employee is entitled to time off with pay;
- grievance procedure: how to deal with problems at work;
- agreements with trade unions that are legally binding on the employer;
- disciplinary rules;
- period of notice required to leave the employment, both by employer and employee;
- pension rights, if any, with details of contributions.

Sometimes a business will include some of the information that applies to all employees in a 'conditions of service' employees' handbook. The contract may then be a shorter and clearer document. Both employer and employee would still be expected to abide by the terms of the contract and handbook. Employment contracts are required for all workers, whether they are full- or part-time, permanent or temporary.

Manor Bakeries wanted to change its employees' contracts because it needed to make the business more efficient by not having to take on temporary staff during times of peak demand. There are other reasons why changes might be needed. The economy might be in a recession and consumers are not buying

as many of the business's products as they did before. The business may need to be reorganised to take advantage of improvements in technology. New machinery might be available which would mean retraining existing employees or even making some jobs redundant.

### Did you know...

The country with the highest proportion of workers belonging to a trade union is Sweden, with 82 per cent. The UK is tenth with 19 per cent, while the USA has 13 per cent of its workforce unionised.

### And more

Occasions may arise when either the employee or employer might want to alter the employment contract. Circumstances might have changed since the contract was written and these might need to be reflected in the contract. However, no alteration can be made without each of the two sides agreeing to it. In the Manor Bakeries' case study at the start of this chapter Manor negotiated the change in working arrangements with the employees' trade unions so a satisfactory agreement could be reached on both sides.

Things that might change include:

- rates of pay;
- working time (for example, longer or shorter hours, different days);
- the employee's duties and responsibilities;
- the location where the employee works.

In certain circumstances, an employee might be told that he or she is being given a lower-status job (a demotion) or a pay cut as a form of disciplinary measure. An employee might fail to deliver his or her side of the employment contract and the employer may feel that the worker's status and pay should reflect this. The arrangements for this action to take place would be explained in the original contract of employment under the section on grievances.

Employees sometimes might ask to change the terms of their contract. Examples of this include:

- better pay (employees don't have an automatic right to a pay rise, unless it is written in their contracts);
- improved working conditions, such as more or longer breaks;
- more holiday;
- different working hours;
- to work flexible hours or part time.

## Clauses in a contract of employment

Some employment contracts may include what is known as a flexibility **clause**. These give the employer the right to change certain conditions (for example, shift patterns) or there may be a mobility clause, allowing changes to your job location. A clause is just another name for a paragraph or section of a contract.

If an employee agrees to a contract that contains a flexibility or mobility clause, he or she will have no option but to fit in with the new arrangements or resign from the job. Having flexibility built into the contract gives an employer more scope when responding to changes that need to be made within the business. Having a flexibility agreement means the employer does not have to start negotiating with the employees to encourage them to alter their working arrangements.

The law, however, requires the employer to be reasonable when wording a contract of employment. Employees are protected against contracts that have unreasonable or vague clauses. An employer would not be allowed to include sweeping statements, such as 'the employer reserves the right to be able to change the terms of this contract at any time'. This would be unfair on the employee. Employers and employees are expected to operate together in what the law describes as 'mutual trust and confidence'.

### Did you know...

UK contract of employment laws were first introduced in 1823 in what were called the Masters and Servants Acts. These early laws were in favour of the employer, as they required servants to be obedient and loyal to their masters or face prison.

effort and concentration that they put into their work. Good employers will not want rumours of job losses or changes to working practices to upset their employees, because this will affect the workers' effectiveness. This is why many choose to keep the workforce informed about any changes that are in the pipeline.

## The importance of a healthy work-life balance

Very few employers would be prepared to state publicly that their employees' first priority in life should be to their jobs. It has long been recognised that when employees have sufficient time to spend with their families and to pursue leisure interests, they are more productive as workers. Unexpectedly, businesses can become more efficient when their employees work less. Employees who are tired because they spend too long at work are more likely to make mistakes, which can be costly to a business.

## A consideration of flexible working practices

Most people like to have job security. They want to know that they will be able to keep their jobs as long as they want them. If employees are worried that they might lose their jobs, this is bound to have an impact on their morale, which in turn will be reflected in the

### Did you know...

In 2003 the government introduced a law that gave parents of children under the age of six, or the parents of disabled children under 18, the right to ask their employers to be able to work flexible hours.

## Have a go!

### Group activity

Undertake a survey of people's work-life balance. Devise a suitable questionnaire to find out the type of work the respondents do, how many hours they work and their attitudes towards the amount of leisure time they have. You will need to make sure the questionnaire does not contain questions that are too personal.

You should put your results on to a spreadsheet and create graphs of your findings. You should then write a report to summarise any patterns you have found.

## Discussion



Discuss whether businesses have a responsibility to ensure that their employees enjoy a good work–life balance.

## Web-based activity



Look for examples of templates of contracts of employment on the internet. Search for 'contract of employment template'. An example can be found at [www.docstoc.com/docs/288412/Contract-of-Employment-Template](http://www.docstoc.com/docs/288412/Contract-of-Employment-Template). Produce a list of the areas covered in these contracts.

## Quickfire questions



- 1 Which cake brands does Manor Bakeries produce?
- 2 How did Manor Bakeries cope with seasonal demand before it introduced flexi-shifts?
- 3 What are supermarkets' own labels?
- 4 What is absenteeism?
- 5 Why did many employees like flexi-shifts?
- 6 What is a contract of employment?
- 7 Give two reasons why a business might need to change the details in a contract of employment.
- 8 What is a demotion?
- 9 What is a work–life balance?
- 10 Give an example of an unreasonable clause in a contract of employment.

## Cracking the code



**Contract of employment** This is a legal document that outlines the agreement between an employer and an employee. It lists the responsibilities of both parties.

**Absenteeism** When employees should be working, but they fail to turn up to work. It is usually measured as a percentage of full attendance.

**Clause** A section of a contract that explains in more detail an aspect of the agreement.

## Chapter 6

# Effective working relationships

### APPLIED IN THE BUSINESS WORLD

#### A disciplinary matter

**M**ost businesses have rules on employee behaviour, listing what is and what isn't acceptable at work. These rules might be written down and given to employees when they start working at the company, or they might be picked up simply by watching how others behave. For instance, there may be an unwritten rule that says men should always wear ties at work and women shouldn't wear jeans. Some of these rules will be based on the law of the land, such as not making comments of a racist nature and not smoking on the premises. Other rules might be what the employer feels are needed to ensure that the workplace is happy and people are working efficiently.

Modern technology has moved forward very fast in recent years and this has made it difficult for the rules to keep up with the changes. Mobile phones cause a particular problem. One person's idea of a cheery ringtone might be very irritating to other people. This can also apply to loud, pointless conversations on the phone. Mobile conversations can be a nuisance in open-plan offices, which are becoming increasingly common. There is also the issue of mobile users making or receiving personal calls during working hours, when they are being paid to work.

Another modern problem lies with the internet. Many employees use the internet as part of their normal working lives, such as for contacting clients. But what about using the internet for non-work reasons, such as checking your personal emails? Many people might think it does no harm to spend a minute



or two replying to a friend's email, forwarding a joke that has been sent to them or updating Facebook. Legally speaking, by doing this the employee is cheating his or her employer of the time that he or she has been paid for.

Rob Blackthorn, 29, fell foul of these rules in his workplace. Rob is a business development manager for a manufacturing business. When he started working there he was given a copy of the employee handbook, which outlines the company's policy on mobiles and the internet, as well as many other matters. Rob was aware of the rules so always kept his mobile turned off and didn't use his work email address to send personal emails. He was aware that some of his colleagues had been asked to cut back on the amount of time they were spending on the internet because their manager thought they were wasting too long on non-work surfing.

Rob overstepped the mark though by using the company's computer to send copies of photos he took at a weekend party with work colleagues. The pictures were not rude, just a bit embarrassing for the people concerned. Those who received them passed them on in turn, with one person sending the images

to the company boss. The boss said that as Rob was a manager he should have known better and was setting a bad example to other employees.

In accordance with company policy laid out in the handbook, Rob was sent a formal written warning for using company email to send inappropriate material. This will be on his record and is the first stage in the disciplinary proceedings that could result in him eventually being dismissed. Now Rob is particularly

careful not to use the company's computer for personal reasons.

### Live links

You can find out more about this and other issues to do with your rights at work by visiting  
[www.workingrights.co.uk](http://www.workingrights.co.uk).

## Hit the spot



- Outline the reason why Rob was disciplined.
- Explain two ways in which new technology has created additional difficulties for companies.
- Discuss the arguments for and against Rob's boss disciplining him for what he did.

You might be surprised by the way Rob's business responded to his misuse of the company email system. You could say that the business was acting unreasonably by disciplining Rob formally. The manager was, in fact, well within his rights to discipline Rob. As an employee, Rob was not fulfilling his side of the contract of employment. The company had clear regulations on the use of business emails. Rob was aware of these rules, but they still didn't stop him from abusing company policy. The manager might have felt that he needed to make an example of Rob. The photographs had been circulated around the company, so many of his colleagues would have been aware of Rob's actions.

We read in the previous chapter that contracts of employment list the responsibilities of both the employer and the employee. It is a document that is designed to protect the interests and expectations of these two separate groups of people.

Employees are required to work with employers in helping them achieve the objectives of the business in the capacity in which they have been employed. They are expected to conform to the rules and regulations

of the business and can be disciplined if they move from these, as Rob did. But employees do have rights too, some of which are covered below.

## Wages

Employees are usually paid in arrears. This means wages are not received until as much as a month after the work has been done. This requires a certain amount of trust on the part of the employee. The contract will give details of when and how the wage or salary is to be paid. It would be totally unacceptable for a business to delay the payment of wages because the company was having problems with its cash flow. Similarly, the expectation is that if the employee works **overtime**, then this additional payment will be made at the appropriate rate.

## Health and safety

Work places often contain machinery and equipment that are potentially dangerous. Employees have an expectation that they will not be put in a hazardous

position and that they will be able to return home after work as healthy as when they arrived there. The Health and Safety Executive (HSE) is a body that regulates and enforces the rules about safety in the workplace. For instance, the HSE sets rules on the type of training that is needed before someone can operate certain machinery. Employers have to provide, free of charge, any protective clothing, footwear or other equipment needed to carry out the work safely. If there has been a serious accident at work, the HSE will investigate the causes and publish its findings, so others can learn from the mistakes. The HSE can even sue companies if it feels that negligence on their part was a cause of the accident.

It is not just the employer who has to ensure working conditions are safe. Employees have a responsibility to both themselves and their co-workers. It is the responsibility of the employee to look after his or her personal safety while at work. Choosing not to wear protective goggles that have been provided means the employee is at fault if an accident occurs. Employees must go on health and safety training, even if they feel it is unnecessary. Workers are also obliged to watch out for the safety of other employees by, for instance, pointing out any hazard that they have noticed.



A health and safety notice

### Summary

- Contracts of employment list the rights and responsibilities of both employers and employees
- Employers are obliged by law to protect their employees from dangers in the workplace
- Workers are duty bound to look after their own safety as well as that of their coworkers

## Core knowledge

UK employment laws have developed over hundreds of years and are changing all the time. All employers are expected to obey these laws. A company which does not comply with the law and claims that it was unaware of up-to-date legislation would not be able to use this as a defence in a court.

### Discrimination laws

In the UK it is now illegal to discriminate against someone on the grounds of his or her age, gender, sexuality, race, religion and disability. There are also laws to protect part-time workers and pregnant women employees. Discrimination doesn't just mean not giving someone from a certain group of people a job; it can take other forms. An elderly man who has been overlooked for promotion purely

because of his age would be an example of discrimination, as would someone from an ethnic minority group who finds she is regularly given the worst jobs to do at work because of her race. A disabled person who is not offered the opportunity to have training because of transport problems would again be a victim of discrimination.

## Equal pay

One of the first anti-discrimination laws covered equal pay for the same work. It was not uncommon in the past for women to be paid less than men for doing exactly the same job. A common justification for this was that men often have families to support so they need to be paid more. Despite the law, women on average are still paid significantly less than men and experience difficulties rising above a certain level in many businesses. This phenomenon is often called 'the glass ceiling'.

## Disability discrimination

Disability discrimination laws make it an offence not to make reasonable adjustments for a disabled person to be able to work in a business. So a hearing-impaired man might need a special telephone to be able to communicate with clients. This specialist equipment must be provided by the business to allow the disabled person to work. A person cannot be dismissed, or be pressurised into resigning, if he or she becomes disabled while working for a company.

## Working hours

Employees are protected by a series of laws that goes beyond discrimination. There are laws about employees' working hours. The law says that employees should not be required to work regularly more than an average of 48 hours per week, unless they personally choose to do so. Normal working hours will be laid out in the contract of employment, but if hours are worked beyond these times, called overtime, a higher rate of pay is usually paid.

## Minimum wages

The 2009 National Minimum Wage (NMW) was set at £5.80 per hour for adults aged 22 and over, £4.83 for 18 to 21 year olds and £3.57 for young people. It would be illegal for an employer to pay less than these rates to employees. This also applies in those businesses, such as restaurants, where employees expect to receive tips from customers.

### Did you know...

The 48-hours working week rule applies to workers over the age of 18. Young people between school leaving age and 18 have a 40-hour maximum.

### Did you know...

You are not entitled to the minimum wage if you are a prisoner, a member of a family business, an apprentice, a voluntary worker, on work experience or self-employed.

And more

## Freedom to join a trade union

Trade unions are organisations made up of members who pay a subscription to belong. One of a trade union's main aims is to protect and improve the interests of its members in the workplace. Unions are not connected to employers, but most choose to have close working relationships with companies. This relationship is even sometimes called a partnership because both sides share the same interests and objectives.

Many people think that the main job of a union is to negotiate with employers on their members' pay and conditions of work. This is also known as **collective bargaining**. Employers will often ask to meet with unions if there are to be major changes in the workplace such as large-scale redundancies. By involving the unions, companies find that their employees are more willing to accept the job losses. Individual members might need the services of their union. If a person is being disciplined for misconduct, as Rob was in the case study, the union would be willing to support that person at a meeting with the bosses. Unions also provide educational facilities to improve members' chances of promotion.

By law, an employer is unable to dismiss workers or treat them any differently just because they are members of a union. The opposite is also true. Employers cannot discriminate against anyone who chooses not to join a union.

### Did you know...

The tea break is a great British institution, but there is no requirement for the employer to pay workers while they are on a break. The only exception is when employees are 'on call' or if payment for the break has been written into the contract of employment.

### Have a go!



### Group activity



Produce an information sheet for school leavers on keeping inside the law in the workplace. The sheet should outline the responsibilities of both the employer and the employee.

### Discussion



Anti-discrimination laws mean that employers cannot reject certain people as possible workers when they are recruiting for staff. Discuss whether these laws actually help the employer by allowing them to consider a wider range of talented people.

### Web-based activity



Go to the government information website [www.direct.gov.uk](http://www.direct.gov.uk). Produce a PowerPoint presentation on what the law is on discrimination at work.



## Quickfire questions

- 1 Give a reason why a business might decide to discipline an employee.
- 2 How was Rob disciplined in the case study?
- 3 Give two reasons why a business might not allow employees to use their mobile phones at work.
- 4 What is the role of the HSE?
- 5 What is the law on the payment of workers during their breaks?
- 6 What is the glass ceiling?
- 7 What do the initials NMW stand for?
- 8 At what age does the full minimum wage apply?
- 9 Do employees have to buy their own protective work clothing?
- 10 Why do unions often work closely with employers?



## Cracking the code

**Dismissed** Another term for sacking an employee, or letting him or her go.

**Overtime** Those hours worked which are above and beyond the employee's normal contracted hours.

**Glass ceiling** A barrier to promotion that is legally not meant to be there, but still exists.

**Collective bargaining** When a trade union discusses pay rises with employers on its members' behalf.

# Chapter 7

## Motivating staff

### APPLIED IN THE BUSINESS WORLD

#### Virgin

**T**he Virgin Group is a multinational business which was founded in the 1970s by entrepreneur Richard Branson. The company operates a variety of businesses in several industries. Some of these companies are owned directly by Virgin, others are partly owned. Virgin prides itself on the way it gives quality to consumers, value for money and good customer service. Virgin states that it welcomes competition and will enter a market even if there are established giants.

What matters to Virgin is that the customer is served well, because that is what will make the business successful. Richard Branson recognises that giving customers a good service will depend upon having a motivated workforce. As Richard Branson once said:

‘It just seems common sense to me that if you start off with a happy, well-motivated workforce, you’re much more likely to have happy customers. And in due course the resulting profits will make your shareholders happy.’

There are 47,000 Virgin employees throughout the world. They work in offices, call centres, gyms, and even on trains and planes. Each separate Virgin company recruits its own staff but follows the Virgin principles for motivating staff. The businesses might all be different but the approach to employees is the same throughout the group.

Virgin has a policy of being a fun place to work. Without this employees become stale and this shows in their dealings with customers. Virgin wants its



employees to have energy and imagination. There is no room for negative people who constantly need to be told what to do and sap everyone else’s energy. Employees are expected to rise to challenges. They are meant to stand out in a crowd. Virgin says that it wants its employees to be honest, cheeky, questioning, amusing, passionate, intelligent and restless. They are expected to show initiative and to take risks because this makes them more motivated employees. It is accepted that because of this company attitude, employees will occasionally get it wrong. But Virgin is prepared to tolerate the odd mistake that its employees might make as the cost of allowing them to show initiative.

Virgin uses other methods to keep its staff happy. Employees are entitled to a Tribe Card, which gives them substantial discounts on a range of Virgin products and services. If uniforms are needed, then Virgin will provide stylish clothing so employees feel good in them. Some people feel that they need a break every so often in the type of work they do. Virgin staff members are encouraged to move among the

different companies within the group if they believe that they need a change. Virgin sees the value of feeding back how well each employee is doing so appraisals are upbeat and positive. There is more information about appraisals in the next chapter.

### Live links

You can find out about Virgin and its relationship with employees at [www.virgin.com](http://www.virgin.com).

## Hit the spot



- Give two ways that Virgin uses to motivate its staff.
- Explain how contented employees can result in happy shareholders.
- Virgin encourages its employees to show initiative, even if they make the odd mistake. Discuss the advantages and disadvantages to Virgin of treating employees this way.

Virgin sees the value of having well-motivated staff. Richard Branson understands that employees are the most important factor in a successful business. He has an unconventional approach to running his businesses and this style is reflected in the way he deals with the people who work for him.

Virgin uses a range of methods to keep its staff well motivated. In the case study we read that Virgin believes in giving its employees a free hand in how they work, allowing them to show initiative. This motivational technique could backfire for Virgin, if employees get it wrong, but this is something the company is prepared to accept.

Virgin recognises that it does not pay the highest wages in the industries in which it operates. For instance, Virgin Atlantic cabin crew could earn more if they transferred to another airline company. Yet many of them choose to work for Virgin despite the lower wages. This can be interpreted as the job satisfaction being worth at least the additional money they could be earning elsewhere.

## Benefits of a motivated staff

In Virgin's case the effort that has gone into motivating its staff appears to have paid off. It would

seem that its employees appreciate the fun environment at work and being given responsibility. This has made them loyal to Virgin. The company is able to offer lower wages, knowing that employees will remain and not go to work for a competitor. Lower wages allow costs to be reduced, increasing the business's profitability.

## Loyalty

The loyalty that comes from enjoying working for a business brings other company benefits too. If employees remain then labour turnover will be reduced. Labour turnover is a measure of the proportion of staff that leave a business each year. If 10 of the 50 employees in a business resign in a year, the labour turnover is 10/50, which is 20 per cent. Having a small number of people leaving each year brings benefits to the business.

## Training

With lower labour turnover comes an additional benefit. If fewer employees are joining the business to replace those who have resigned, then the company's training **budget** can be lower. When somebody starts in a business he or she needs to have induction training to explain the ethos of the business and health and safety requirements. There will also very

likely need to be on-the-job training to show the person what to do. These types of training all have a cost. If the new recruit is being shown by a colleague how to do the job, for instance, then the trainer is not doing his or her job fully, which is a cost. If off-the-job training is undertaken, then a fee will probably have to be paid to the provider for delivering the training. You can read more about training in the next chapter.

## Teams

For a team to function efficiently there has to be stability with those who make up the team. It takes time to get used to working with other people and if one or more team members leave, there will need to be a readjustment period after the new members join before the team is back up to speed. Teams function well when each member takes on the role to which he or she is most suited. New members' skills and preferences are not known and they need time to fit in.



On-the-job training has a cost

## Summary

- Employees work best when they are well motivated
- Businesses benefit by having a well-motivated staff
- Money can motivate employees but there are many other ways too
- Each person is motivated in a different way

## Core knowledge

Motivating employees is about getting them to want to do their work in an enthusiastic and efficient way, rather than having to monitor them closely to check they are working. Many people think that employees are motivated purely by money and nothing else. Money allows people to enjoy a good lifestyle with holidays, cars and other pleasures.

If money was the only motivator, why would people volunteer to do charity work or to help with worthwhile, but unpaid, jobs coaching sports teams or organisations like Scouts? Similarly, many important jobs are not necessarily well paid. Those people who work for the National Health Service (NHS) as nurses and other support staff do an excellent job, but they could probably earn more by working in one of the private hospitals.

There will be some people who see money as the only factor that will cause them to work harder. But in these cases the effect is often short lived. Giving employees a pay rise might increase their motivation

for a few weeks, but as soon as they are used to the higher wages, the additional money ceases to have any real impact.

So, what motivates employees to put in that extra effort and to support their employer? There is not a clear answer to this as it will vary from person to person. A young worker with a family to support and rent or a mortgage to pay might see money as being very important. But as people get older and financially secure, wage become less important. Older people might be more influenced by an opportunity to work in teams so they can enjoy the social side of work.

Others might like the idea of being given more authority within their jobs. They might respond better if they were given a new job title that made them sound more important. This type of person would probably be motivated by being allowed to control his or her own budget or to take charge of other employees. Making some people feel important can push them to perform well in their jobs.

There are also people who see the little extras they receive as part of their job as being the things that motivate. Most supermarkets, for instance, give their employees big discounts when they shop in the store. Virgin does this with its Tribe Card. Other businesses will provide alternative forms of **fringe benefits** to their employees. Company cars, private health insurance and pension plans are some examples of these. This often creates a caring, family image for the business that some employees respond positively to.

There is another group of people who will work hard if they feel that their bosses value them as good employees. They enjoy the praise they receive for doing their work well and will strive to do their best to impress. Such people will respond to being offered training to widen their skills. This type of employee values training opportunities as a way of developing. They are also motivated by the fact that the employer has chosen them for the training.

### Did you know...

Simon Cowell was offered a £5 million pay rise to encourage him to be a judge on *American Idol* for three additional years.

### Did you know...

In some countries (such as Australia, New Zealand and India) fringe benefits are seen as part of employees' wages and are taxed.

### And more

## Does money motivate?

There have been many studies on motivation in the workplace. There is no conclusive evidence that increasing wages will have a long-term motivational effect. It is thought that as long as workers are paid an acceptable wage, they are able to be motivated by other factors. Without acceptable pay, they will be unhappy in their jobs and other things designed to motivate them will not work. An acceptable wage would be what they could earn elsewhere doing a similar job in a similar business.

## Cost effectiveness of motivation

Most motivational techniques require some funding by an employer. An increase in wages, more fringe benefits and providing a more comfortable working environment all have to be paid for. However, if motivation works, there can be a cost saving for the business. More motivated employees are more likely to be careful with the company's resources, which means less waste will be produced, saving the business money. Employees who are motivated are also more efficient, so they will produce greater revenue for the business.

There are also some hidden cost savings that motivation can bring. Staff members are more likely to work beyond their working hours to get things finished, without asking for overtime pay. They are less likely to leave the business, thus necessitating fewer recruitment and training costs.

## Motivating home workers

Employees who do not come into the business premises, such as home workers or lone workers, are potentially difficult to motivate. Those who work for a business from home cannot engage in the social side of working life and can be out of the loop when it comes to keeping up with what is happening in the business.

One company with experience of this is Freedom Direct Ltd, a holiday sales business based in Newcastle. The company handles over 2,000 customer calls each day. Some are taken at its call centres, others are answered by home workers. Once a call is received, it is passed on automatically to the first available operator regardless of whether that person is in the office or at home. Freedom Direct has invested in some sophisticated equipment, not just to transfer calls but to be able to monitor whether home workers are logged on and working. The equipment allows easy access to home workers so they can communicate easily with others in the business and are aware of what is happening there.

Only employees who appear to have the right attitude to working alone are invited to become home workers. Freedom Direct also has a manager who deals with home workers so they have a point of contact at work.

### Did you know...

In the past it wasn't so unusual for employees to have no choice but to spend their wages in the boss's shop. A series of laws called the Truck Acts put paid to this.

## Have a go!

### Group activity

Conduct a survey of fringe benefits that employees receive. You need to identify the types of benefits and ask people whether they receive them.

## Discussion



Is it possible for an employee to be motivated without a business having to pay out to achieve this?

## Web-based activity



Go on to the Virgin website and produce a PowerPoint presentation of the history of the company from 1970, decade by decade. To make the presentation more exciting, use music and video clips from each decade.

## Quickfire questions



- 1 Who started the Virgin Group?
- 2 What is the Tribe Card?
- 3 What are Virgin's views on staff uniforms?
- 4 How does Virgin benefit from encouraging its employees to have fun?
- 5 Why might wages motivate younger people more than older employees?
- 6 What is a fringe benefit?
- 7 Give two ways teams are affected when someone leaves.
- 8 What is meant by motivation?
- 9 How could offering training to an employee motivate that person?
- 10 Twenty of a business's 80 employees leave during the course of a year. Calculate the rate of labour turnover.

## Cracking the code



**Budget** An amount of money that has been set aside for a particular purpose.

**Fringe benefit** Another term for a perk or a benefit an employee receives.

**Home worker** Someone who works from home rather than comes into the business.

## Chapter 8

# Appraisal and training

### APPLIED IN THE BUSINESS WORLD

#### Anglesey Sea Zoo

For many employees, the prospect of the annual appraisal – that meeting with their line manager during which they are assessed against the targets that were set a year ago – fills them with dread. These employees can feel threatened and believe that they are being put in a position where they are forced to improve or fail to get that pay rise they thought they were due. If employees do feel this way about appraisal – or performance review, as it is sometimes called – then somebody isn't doing their job properly.

It does not have to be this way. An increasing number of companies are recognising that appraisals can be used not just to monitor performance but also as a way of motivating staff. Anglesey Sea Zoo, Wales' largest marine aquarium, is an example of one of these companies. Manager Alison Lea-Wilson has done much to use appraisal as a key **motivator** for the organisation's 25 staff.

At the beginning, appraisals were just an informal chat with each employee to determine how things were going. Alison then decided to introduce twice-yearly formal meetings. What she was concerned about was making sure that each staff member was functioning in step with the business's objectives. These meetings were also a chance to recognise the contribution of each employee and address any issues that they faced that were interfering with the performance of the business.

Alison wanted to be able to determine how well each employee had worked since the last meeting, so



that that person's efforts could be acknowledged and rewarded. One difficulty she experienced was that not all objectives were easy to quantify, which means they cannot easily be measured accurately. For example, it would be hard to determine whose efforts were responsible for there being an increase in the number of visitors to the marine centre. What Alison did was to get the employees to score how well they thought they had achieved on each of their objectives on a scale of 1 to 4. The manager doing the appraising would do the same and a comparison would be made between the two different scores. If there is a big disagreement, then this can be used as the basis for a discussion. It may be that training needs are identified as a way of allowing the employee to achieve his or her objectives.

At the end of their appraisal meetings, employees might need to undertake some action that will allow them to reach their targets on the next occasion.

Employees receive a write-up of their meeting, but it is then left to them to decide when and how they will undertake this action. Sea Zoo believes that empowering the employees this way helps the motivation process.

### Live links

The website  
[www.angleseyseazoo.co.uk](http://www.angleseyseazoo.co.uk)  
will give you a clearer idea of the nature of the aquarium and what it offers to visitors.

## Hit the spot



- Describe what is meant by an appraisal.
- Explain how appraisals can help a business reach its objectives.
- Often a person's pay rise will depend on reaching the targets set in his or her appraisal. Evaluate whether it is fair when wage rises depend upon the outcome of an appraisal.

We read in the previous chapter how companies want to avoid losing their employees. A business with a high labour turnover will have to pay to recruit replacements, which is costly in terms of both money and time. In the case study above, Sea Zoo used an appraisal system to try to make its employees feel important and so less likely to want to leave the business. The manager looked carefully at how Sea Zoo would conduct the appraisals, so that the method was fair and did not worry the employees.

The manner in which businesses conduct their appraisals, or performance reviews, varies from organisation to organisation. For some the procedure will consist of little more than a brief informal chat once a year. The meeting will probably go over what the employee has done over the year, and a couple of targets will be set for the employee to achieve before the next meeting in a year's time. It is unlikely that the written record of the meeting will be looked at again until just before the next meeting.

Alternatively, an appraisal meeting can be a lot more thorough. Very likely an **interim meeting** would have been held half way through the appraisal year. At this meeting, the employee's performance would be assessed to determine whether everything is going well and the person is likely to achieve his or her targets by the full meeting. Support will then be

offered, possibly in the form of additional training, to ensure that there is a good chance of the targets being reached.

## Appraisal as a motivation method

Appraisals are meant to motivate employees to do well and to help the business achieve its objectives. Whether this is the case or not will depend on how the appraisal is conducted. Meetings in which the employee feels threatened because he or she hasn't achieved the targets will do little for confidence and motivation. If the annual appraisal is held in a formal fashion with the employee being expected to account for his or her performance, then understandably it will be difficult for the employee. However, if the employee has been supported throughout the appraisal period with suitable training and encouragement, the meeting will just be part of that process. A good appraisal system will set challenging but achievable targets for the employee. But any training that is needed for the employee to reach these targets will also be identified and provided. If it is well handled and supportive, appraisal can help bring out the best in employees.

## Appraisal and wages

The outcomes of some appraisal schemes link the employee's achievements to his or her wage. Some businesses say that if employees do not achieve their targets then they are not helping the company reach its own objectives, so they do not deserve a pay rise. This can be quite controversial because there are factors beyond employees' control that can stop them achieving their targets. We read at Sea Zoo that it would be difficult to determine which employee was responsible for an increase in the number of people visiting the aquarium. If something unexpected happened, such as a new competitor opening in the area, it might result in the employees not reaching their targets. The employees would have no control over these things, so it would be unfair to judge them against targets which were set before the change happened. Also, some would argue that linking to pay puts additional pressure on the employee which might affect his or her performance in a negative way.

## SMART targets

It is important that when targets are set, they are SMART. This means they should be Specific, Measurable, Agreed, Realistic and Time limited. Some people use different words for SMART, but the principle is usually the same. The targets should not be so vague as to make them meaningless. Having the target 'Get better at dealing with customers' is too loose. It is not clear enough. Which customers are we talking about? All of them? The awkward or difficult ones? And better in what sense? Spending more time with them to make them feel important, or dealing with them quicker so other customers aren't waiting? Only by having precise targets, or SMART targets, can proper judgments be made on whether they have been achieved.

An example of a SMART target for a Sea Zoo employee might be 'Produce five educational worksheets for visiting schoolchildren by December and send these to all the primary schools within a 10-mile radius of the aquarium'.

### Summary

- Appraisal is a way of finding out how well each employee is helping the business achieve its objectives
- Appraisal can be a positive, rewarding experience that motivates staff, or it can put pressure on them and have the opposite effect
- SMART targets are needed to be able to measure how well an employee has performed
- Identifying training needs to reach targets is an important part of appraisal

### Core knowledge

For your parents' or grandparents' generation, training was often seen as something that a person did when he or she entered work after leaving school. The traditional way to train someone was through an apprenticeship scheme. A young person would work alongside an experienced employee, who would show the young person how the job had to be done. At the end of the apprenticeship, the trainee would be qualified enough to work on his or her own. These days it is generally recognised that employees need to be trained throughout their working lives. Training does not just consist of learning how to perform a certain job and becoming competent in it. Training can also be about updating skills or developing new skills and learning new attitudes. Imagine, for instance, a business that wanted its workers to take responsibility for checking the quality of their own work. Training would be needed to show them how to perform these checks, but the employees might also need to be trained to alter their attitude that it was someone else's job to check quality, not theirs.

## Induction training

This is a particular type of training that is given to employees when they join a business. The purpose of induction training is to inform the recruit about the business and to provide basic information about health and safety. They might be given a tour of the business and introduced to the people they will be working with. They will be shown what to do if an alarm sounds and have any rules and regulations explained to them, such as what they need to do if they are too ill to come to work.

When a business trains an employee it must decide which method will be the most suitable. Training could be undertaken in a variety of ways, such as by watching an experienced member of staff, or by following a course at a local college.



A tour of the building will help a new employee find their way around

## On-the-job training

This form of training is work based and involves learning by actually doing the job. Another employee, possibly a supervisor, will demonstrate how to operate a particular piece of equipment or perform a task and then watch while the trainee tries the work himself or herself. Sometimes businesses will employ specialist trainers to do this work for them, particularly if the work is complicated. Sometimes a new employee will be asked to **job shadow** a co-worker for a period of time. This is a similar method to the apprentice system as it involves watching how somebody else does the job. In some types of business a new recruit will be mentored by an experienced senior employee. The **mentor** will monitor the work of the new person and offer advice and support.

## Off-the-job training

Trainees might be sent to a local college to learn how to do the job with this form of training. A company might be big enough to have its own training centre on site. In either case, trainees will receive tuition from specialist instructors, often in a classroom environment. This form of training will often result in the trainees receiving a formal vocational qualification. Learning this way stops the trainee picking up sloppy working practices which non-specialists might pass on and ensures that they are taught the correct way to do things.

### Did you know...

On-the-job training is jokingly called 'sitting next to Nellie'. It means watching someone do the job, then copying what you saw.

And more

Appraisal and training both have the potential to act as motivators. If used in the right way, they can make employees feel that they have the capacity to do a good job and are appreciated for doing it. We have seen that the two things are often interlinked. A good system of appraisal will identify when training is needed to allow an employee to be able to perform his or her work more efficiently and confidently. And training, in turn, allows the employee to reach the targets that were set at the appraisal meeting.

## Investors in People

An increasing number of employers want to gain recognition for the good work they do to ensure that employees are fully trained and involved in standard setting within the business. Many choose to gain Investors in People status. To get this qualification, the company must be able to demonstrate that it has created a plan to develop the skills and expertise of its staff. Employees at all levels must be involved in the process of creating the plan and ensuring that it is achieved. Investors in People status shows that the business is inclusive, which means it values and tries to develop everyone in the business.

## The costs of training and appraisal

Both training and appraisal have costs. A fee will have to be paid for sending a trainee to a college, for instance. If an employee is training a new recruit, that person is not working fully at his or her job, so that is a cost. The time needed to run appraisal meetings has a cost, as the people involved in the process could be doing other work. The list could go on. So, it could be argued, by not doing these things, a business will be better off.

What is often forgotten though is that training and appraisal can help reduce costs and can act to increase revenue. These two effects when operating together can help increase the profits of a business. Training can lead to greater efficiency. Employees get better at doing their jobs, so are able to produce more and cause less wastage. People who have been trained are often more flexible workers. They are able to tackle a wider range of jobs confidently. In addition, they are usually open to change, so are more willing to accept different ways of doing things and work with, rather than against, their employers.

### Did you know...

Much psychological research has been done on how people should sit in an interview. It is thought to be confrontational to have a table between the interviewer and the interviewee. Ideally they should sit on similar height chairs at a slight angle to each other.

### Did you know...

Apprenticeships have been used in the UK since the 12th century. Parents would agree for their sons to be bound or indentured to a master for up to 9 years. The apprentice would not be paid during that time, and would actually have to pay the master for the privilege of working with him.

## Have a go!



### Group activity



As a group, produce the blank forms that would be needed by a business to be able to run its appraisal meetings. The paperwork should have spaces for note taking, training needs, targets and anything else you feel is necessary. You should have at least three forms: one for the target-setting meeting, one for the interim meeting and the final one for the meeting that checks whether the targets have been met.

### Discussion



Discuss whether the only type of training a business needs to do is that which allows an employee to do his or her own job.

### Web-based activity



Research the benefits and disadvantages of both on-the-job and off-the-job training. Produce an information sheet explaining your findings.

### Quickfire questions



- 1 Where is Sea Zoo located?
- 2 How many employees does Sea Zoo have?
- 3 Why does Sea Zoo use a scoring system with its appraisals?
- 4 What is an interim appraisal meeting?
- 5 What are SMART targets?
- 6 What is job shadowing?
- 7 What type of employee receives induction training?
- 8 What is the difference between on-the-job and off-the-job training?
- 9 What is Investors in People status?
- 10 How can training save money for a business?

### Cracking the code



**Motivator** Something that will motivate someone to work harder.

**Interim meeting** A meeting that is held between two more important meetings, often to determine progress.

**Job shadowing** A form of training where the trainee will go around with another employee, observing how he or she does the job.

**Mentor** An experienced employee who offers help and support to someone in training.

# Chapter 9

## Personal skills

### APPLIED IN THE BUSINESS WORLD

#### Rentokil Initial

Originally starting out in the unglamorous world of pest control, Rentokil Initial is now an international business services company that employs over 78,000 people worldwide, half of whom are based in the UK. It still provides pest control as one of its business services, but in addition offers a wide range of other provisions including express parcel delivery, interior landscaping, catering, cleaning and keeping washrooms hygienic. Its customers range from public bodies and major organisations in commercial, retail and leisure sectors to small to medium-sized enterprises.

Rentokil Initial values the skills of its employees. The company recognises the importance of knowing what skills its employees have and offering them opportunities to increase their skills profiles. As a company with many different areas, it recognises that to keep on top of its competitors it needs to develop and make full use of its employees' skills.

The company has worked with the **National Employer Service (NES)**, which is an organisation that advises businesses on how they can provide training programmes. What Rentokil Initial wants is to provide employees with the skills that are needed for it to function effectively in the different markets in which it operates. This difference between what skills employees have and what are needed is sometimes called the **skills gap**.

There are other effects besides simply making sure the employees have the right skills to do their jobs properly. The company has 400 learners on the Skills for Life programme, working towards NVQs in



Cleaning and Customer Service. For many of Rentokil Initial's newly trained employees this will be the first time in their lives that they have gained a formal qualification. The business makes a great deal of the awards ceremonies where employees are presented with their certificates. It is not unusual for employees to bring along their families to share in the occasion.

Many believe there is a close link between the level of skills training a company offers and the degree of motivation within its workforce. This could come from the pride that results from gaining a nationally recognised vocational qualification. It could come from an increase in self-esteem when an employee improves his or her basic numeracy and literacy skills.

#### Live links

You can read more about the history of the company, the range of services it offers and its approach to skills at [www.rentokil-initial.com](http://www.rentokil-initial.com). You can also find out more about the NES at <http://nationalemployer-service.org.uk>.



## Hit the spot

- What is meant by a personal skills profile?
- Explain two reasons why it is important that Rentokil Initial develop the skills of its workforce.
- Rentokil Initial provides training for its employees to help them in their lives outside work. Judge whether the company should just be concerned about developing those skills employees need to do their jobs more efficiently.

## Did you know...

Rentokil's founder, Professor Harold Lefroy, was accidentally killed by poisonous fumes in a laboratory experiment the year after business started in 1925.



Rentokil Initial is very keen to improve the skills profile of its employees. It believes a person's skills are to be developed and that it is important that they are identified at an early stage. Measuring, or at least being aware of, how skilled a person is allows those skills to be developed further.

Skills can be tested during the employee selection process, to ensure that the most suitable person is chosen for the job. Skills tests are also used when businesses decide who would be the best person to promote to a particular job.

## Role play

So, how do we work out how skilful a person is? One method is to use role play. This is something that is used by the police when recruiting new officers. You can read about this process in the next chapter. Observing how someone reacts in a made-up situation will give the business an idea of how well that person would cope in the job.

Skills such as leadership can be identified this way. If someone is happy to sit back in a role-play scenario and let others take over and not become engaged with what is happening, it is very likely that that person would find it difficult to lead a group. Similarly, it would be possible to determine how good someone is at communicating by asking them to give a short presentation. Somebody who is a confident communicator will enjoy the experience and what he or she says will be clear for others to understand.

## Psychometric tests

**Psychometric tests** are a way of measuring a person's character and individual personality traits. Users of these tests claim that they are able to determine the character strengths and weaknesses of a job candidate and provide an accurate profile of their suitability for a position. Psychometric tests measure attributes like intelligence, aptitude and personality. They provide a potential employer with an insight into how well the applicant can work as part of a team, how he or she can handle stress, and whether the person will be able to cope with the intellectual demands of the job. Some employers use the tests before the interview process as a way of screening out unsuitable candidates. Others prefer to use them when they are trying to decide between the final few applicants.

The tests usually involve the applicant answering a series of questions. The questions do not have right or wrong answers; they are designed to examine your attitude to certain situations, so the true personality of the person taking the test can be assessed. Typical psychometric test questions, with multiple choice responses, are:

- 1 How do you feel about clutter in your workspace?
  - I feel the urge to tidy it up
  - I work better when there is a mess around me
  - I tend not to notice it.

2 You are invited to go sky diving for the first time. How do you feel about it?

- Enthusiastic at the prospect of doing something very different
- Excited, but a little worried
- Interested, but you know you will need to be talked into it
- Scared and will look for a reason why you can't do it

The person taking the test would need to choose the response that fitted most closely his or her own feelings. When the applicant has completed all the questions, the responses will be analysed and a profile of that person produced.

There are two main types of psychometric tests: aptitude tests and personality questionnaires. Aptitude tests look at an applicant's intellectual and reasoning abilities. If the job vacancy requires someone who can think on his or her feet, then this skill will be identified using the tests. Personality skills are more to do with measuring a person's attitude towards taking risks or their leadership qualities.

The use of psychometric tests has become increasingly common. In the UK, more than 75 per cent of the top 100 businesses state they use them as part of the selection procedure. Some businesses have even started to use certain tests that claim to be able to measure somebody's honesty and whether the person has an anger management problem.

### Did you know...

Dating agencies are frequent users of psychometric tests. Applicants are asked a series of questions about their attitudes and expectations. This information is then used to match two similar people.

### Summary

- Employees need to have a range of skills and personality traits in order to do a job well
- An increasing number of businesses are using psychometric tests to determine whether job applicants have the necessary personal qualities to work for them
- Psychometric tests can measure both intellectual qualities and personality traits

### Core knowledge

Businesses need people with a wide range of skills. Each employee should be skilled in the work that they do. Operatives, for instance, have to be competent and sufficiently trained to be able to undertake their work effectively. There will also be some jobs that require professional qualifications before the person is allowed to practise. In addition to these skills which are specific to individual jobs, there is a series of personal skills that all employees would benefit from possessing.

### Teamworking

Increasingly these days, much work is performed with employees operating as part of a team. The team might consist of a group of workers each doing the same type of job, such as a team of bricklayers. Or the team might consist of a number of employees from different job backgrounds working on a project. Teamworking requires special skills if the team is to function more efficiently than a series of employees

each operating in isolation to everyone else. There needs to be a willingness on each person's part to work as a single unit. Joint decisions will need to be made, and everyone should accept the team's decision even if they are unhappy with it, which is something called a **consensus**. Individual team members need to be able to cooperate to reach deadlines. Taking the view that 'I've done my bit' doesn't help create a team spirit.

## Entrepreneurial skills

Having entrepreneurial skills is not just about having the ability to start a business. It has much to do with a willingness to get outside your comfort area and to take risks. Someone who rises to the challenge of doing something different is in effect taking a risk. Such people are more willing to accept responsibility and delegation and will work well without being closely supervised.



Teamworking requires everyone to work as a single unit

## Self-confidence

Ideally, businesses will want their employees to have self-confidence. They do not want people who are too reserved and shy. Employees need to work with others and if someone found it difficult to function properly with people he or she didn't know, it would result in the job not being done properly. A self-confident employee will also be more likely to try something out without having to check with a supervisor and be reassured by him or her.

## Motivation

Being a motivated employee is sometimes referred to as being a self-starter. This means that the person has the drive and interest to get the job done as quickly as possible. A motivated person will not wait to be told what to do or need constant supervision to check it is being done.

## Communication skills

All employees need to communicate in one form or another. Communication refers to messages in any form, whether spoken or written. If someone is unable to express themselves so others can understand, this is a huge problem for a business. The lack of communication might come from those whose first language is not English. It can also be the result of a dread of public speaking or a fear of technology.

## Supervisory and leadership skills

Those in managerial roles will obviously require leadership skills, but leadership skills go beyond that. Leadership is about having a clear vision and being able to get others to see the vision and win them over to it. This skill has its uses at all levels of a business.

And more

## The reliability of psychometric tests

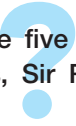
The reliability of psychometric tests has come under question from certain quarters. It is argued that people are not completely honest when they answer psychometric test questions. What they do is give the answer they think the company wants, rather than an honest one. Someone applying for a manager's job might give an answer that he likes to have responsibility, when in fact he doesn't. He might think that if he gave a true answer then the chances of him getting the job would be reduced.

Critics of the tests also say that as the questions are often vague and open-ended, it is important that the results are analysed properly by a suitable professional. Someone unqualified who interpreted the results would be unable to make judgments on whether the candidate was the right person for the job.

Another criticism is that some tests do not take account of different cultures. Some ethnic groups have been brought up to believe it is polite not to hard-sell yourself at an interview or a test and prefer a more modest approach. Unless this cultural factor is built into the interpretation of the results, it would be unfair on groups of people like this.

Most people agree that it would be unfair to use psychometric tests alone to decide who to employ or promote. People tend to be happier if the tests are used to support other activities, such as role play and formal interviews. Alternatively the test can be used to confirm the impressions of the applicant that the selectors have already reached in other tests.

### Did you know...

UK research has shown that entrepreneurs are  five times more likely than average to experience dyslexia. Both highly successful entrepreneurs, Sir Richard Branson and Sir Alan Sugar have the condition.

### Have a go!



### Group activity



In your group, choose one of the skills mentioned in the chapter. Decide how you might test to find out how competent someone would be in the skill area you have chosen. This might be a role-play exercise or a psychometric test. Produce the documentation you need for the test and try it out on a number of people.

### Discussion



Are psychometric tests any real use to businesses?

## Web-based activity



Find a psychometric test on the internet. Print out a number of the questions. Add a commentary to each question saying which skills you believe it is looking for.

## Quickfire questions



- 1 What industry did Rentokil start out in?
- 2 Which organisation does Rentokil Initial work with to improve its employees' skill levels?
- 3 What is the skills gap?
- 4 Why are awards ceremonies important to Rentokil Initial employees?
- 5 What two things do psychometric tests assess?
- 6 Give a reason why an ability to work in a team is important.
- 7 What is meant by a consensus?
- 8 Which skill is about the willingness to take risks?
- 9 Give a criticism of psychometric testing.
- 10 Explain how you might use role play to assess an applicant's leadership skills.

## Cracking the code



**National Employer Service** An organisation that provides advice and funding to help businesses ensure that their employees are fully trained.

**Skills gap** The difference between the skills that the employees in a business have and the skills the business needs to operate efficiently.

**Psychometric tests** A series of assessments used by businesses to determine the true character of people who have applied for jobs.

**Consensus** The conclusion reached by a team. The expectation is that all team members will support this decision, even if they argued against it originally.

# Chapter 10

## Personality tests

### APPLIED IN THE BUSINESS WORLD

#### Police recruitment role play

**T**he police forces around the country need to make sure that when they recruit new officers they get the right sort of people. The police have long since dropped some of the simple tests they used in the past. Policemen and women have to meet certain fitness levels, but they are no longer required to have perfect eyesight or to be taller than average. What matters more these days is that officers have the right personality and temperament to serve the public. When police recruitment panels are considering someone to train as an officer, they want to be assured that the person is going to be calm and reassuring when dealing with the public. What they don't want are officers who behave inappropriately and give the service a bad name. It is for this reason that a series of personality tests was introduced into the recruitment process.

#### Details of the test

The police recruitment panels use a set of four role-play exercises, each one lasting about five minutes. The candidates are given each scenario one at a time and then have a short time to prepare for the activity. During each of the four role-play exercises, the applicants will play the part of a police officer in a fictitious scenario. The potential recruits will not be tested on their knowledge of the law or police procedures, but how they conduct themselves in the



type of situation that they are likely to encounter each day on the beat. A typical exercise may require them to meet an angry woman, played by an actress, who feels that she has received an inadequate response when she complained about abusive comments from a neighbour.

The panel will be looking for an appropriate response from the applicant and will watch how he or she copes with being put under pressure. The panel will record how competently the recruit deals with the situation and will look for evidence of his or her personality coming out during the role play. The testers will want to see someone who is able to take control and is able to reassure the public. They will be looking for the ability to see the situation from other people's viewpoint and other characteristics that they expect each police officer to have.

For some candidates this is the most difficult part of the entire selection process. Many are not

comfortable standing up and acting in a role-play situation. It is not unusual for an applicant to get nervous and often start to panic, which is then reflected in the answers and their actions during the role play.

### Live links

You can discover more about the police recruitment process at [www.policecouldyou.co.uk](http://www.policecouldyou.co.uk).

## Hit the spot



- Describe how the police panel could use a role-play exercise to determine whether a recruit is calm and reassuring.
- Explain why recruits who are not confident would be unsuitable for the police force.
- Judge whether role-play exercises are a reliable way of determining the most suitable people to train to become police officers.

## History of personality tests

**Personality tests** have been used for many years to determine whether a person is suitable for a job vacancy. There are some similarities with psychometric tests, which were described in the previous chapter. Personality tests, however, look for candidates' character traits for jobs, rather than their skills.

The idea behind these tests is that the nature of an applicant can be found out by answering a series of questions about how he or she would respond in certain situations. Many of the tests were developed in the 1940s and 1950s to try to discover the basic

traits of human personality using scientific methods. Different tests have been devised to judge a person's personality. In the past applicants might have been asked to describe what images they saw in ink blots. What a person saw in the blob was meant to provide a deep-rooted insight into the person's true nature.

## Big Brother

The popular television programme *Big Brother* is an extreme example of an extended test. The house mates are watched throughout the experiment to see how they respond to performing certain tasks. Situations are created that allow the housemates' personalities to come through, allowing the public to vote them off if they do not like them.

### Did you know...

The first modern personality test was created by the US army in 1919. It was given to recruits to see who would be most likely to panic under shellfire.



## Summary

- Businesses often use role play or other activities to determine the personality of recruits
- These methods have been criticised because recruits behave unnaturally when they know they are having their personality assessed

## Core knowledge

### What are personality traits?

Personality traits are the things that describe us as a human being. Some psychologists believe that our traits are habitual. This means that we live with them and are not even aware of having them. They also don't change that much over our lifetime. So, if we are a shy type of person who doesn't easily mix with others, this will probably not change throughout our lives. We might pretend we are outgoing and comfortable with new people, but psychologists would argue that it is not our real self. Traits are hard to disguise, so in theory anyway they can be measured.

Often the traits that are being measured lie on a spectrum. This means, for instance, that people are not either completely honest or completely dishonest. There will be a range, or grey area, between these two extremes. It is unlikely that anyone will be dishonest all the time. There will be occasions or situations when a normally dishonest person will behave in a decent way. And this would work the other way too. An honest person might, on occasion, let his or her standards slip and be dishonest. What the tests do is to try to find out where a person is on the spectrum between the two limits. Is the person closer to one extreme or the other?



Different personalities will be suitable for different jobs

### Introvert/extrovert

This is a measure of how outgoing and sociable a person is. An extroverted person will often be talkative, enthusiastic and like dealing with people. Introverts, meanwhile, can be very creative and inventive. Introverts are said to be reflective. They like to think through their thoughts before saying anything, which is the opposite of how extroverts behave. Introverts are not necessarily shy, they just don't seek out human company all the time for reassurance. Shy people, however, avoid contact because of fear.

Knowing whether a person has this trait is important when deciding which role in business is suitable for them. Someone who is to work in marketing, for example, and who will have direct contact with customers will need to be outgoing. Alternatively, an accountant will probably work independently and prefer this approach when he or she is finding ways for the company to improve.

## Risk-taking/risk-averse

Imagine you have some money to save. You have the choice of putting the money in a bank with a guaranteed rate of return or investing it in a business that may give you a much higher rate of return, but in which you could end up losing some of this money. A risk-averse saver will choose the bank account because he or she does not want to take the gamble of losing money. A risk taker will be more willing to accept a loss if it means there is a chance of doing very well out of the investment.

Risk takers can often achieve more in a business than co-workers who are more conservative. If they were buyers negotiating the purchase of materials, they would be more likely to bend the rules in order to get a good deal for the company. The problem with risk takers is that if things go wrong, the company can suffer because of their poor decisions. Risk-averse employees, meanwhile, are more steady and reliable people. Risk takers, or risk-tolerant employees, tend to be more impulsive. They will agree to a deal on the spur of the moment, possibly without thinking the details through. Their worry is that if they take too long they will lose the deal. A risk-averse employee would find it difficult to function this way.

## Egocentric/altruistic

Egocentric people are very much concerned about themselves. They find it difficult to put themselves in other people's shoes and tend to see everything from their own point of view. Egocentrics are not necessarily selfish people. They can be very self-confident and assured of their own abilities. They can find it easy to focus on the work that they do. They do find it hard to delegate responsibility to other people, as they believe that they can do the work better than anyone else. Altruistic people are more concerned about the welfare of others. Unlike the egocentric, they function well in teams. They are willing to share the workload and will support other members of the team. They are willing to share their ideas with the group, but will always accept the team's final decisions or consensus.

### And more

As with psychometric tests, some people question how reliable personality tests are. People answer in the way they think will make them look good – or they will try to out-guess the tester. For instance, imagine being asked the question: If you found £5 in the street, how hard would you try to find the owner? Obviously this question is about a person's honesty. But is saying that you would spend a great deal of time finding the money's owner the most honest response? You might be considered dishonest for saying this, because most people would not go to this degree of trouble to find the owner of £5.

Many businesses have created their own type of test, but no single test has been found to be better than any other. Some use a series (or battery) of tests in which the applicant responds to a number of questions. Increasingly businesses will use activities or role play to find out more about the personality of those being considered for jobs. For instance, if four people are being interviewed for the same job, they may be asked to discuss between them a topic such as: 'What are the strengths and weaknesses of the company?' Members of the interviewing panel will watch the discussion from a distance. This is often called a **fishbowl activity**. The panel will be interested in how people interact. Does someone take on the role of leader? Does anyone fail to get involved? Are there any signs of aggressive or anti-social behaviour? Some argue that this style of assessment is artificial, as each person is attempting to be seen in a good light, even if this is at the expense of the others being interviewed.

### Did you know...

Psychologists cannot agree on whether we are born with our personality traits or whether it is the way we are brought up that influences them. This is sometimes called the 'nature versus nurture' debate.

### Did you know...

The banker in the television show *Deal or No Deal* tries to work out the player's risk aversion when deciding how much to offer for his or her box. Someone who is risk averse will sell the box for a lower amount of money.

## Have a go!

### Group activity

Devise a series of questions or a role-play activity to determine whether someone has introvert or extrovert personality traits. Apply the test to members of the group and write a report on how accurate you believe your findings are.

### Discussion

Discuss the view that trying to find out someone's personality traits before employing him or her is unreliable and so it is a waste of time attempting to do it.

### Web-based activity

The website [http://similarminds.com/personality\\_tests.html](http://similarminds.com/personality_tests.html) lists many free personality tests. Take one of the tests.



## Quickfire questions

- 1 How many role-play tests do police recruits have to take?
- 2 Are police recruits tested on their knowledge of the law?
- 3 Which television programme studies the long-term behaviour and personality of a group of people?
- 4 What is a personality trait?
- 5 How would you describe a gambler: risk averse or risk tolerant?
- 6 What job might be suitable for an extrovert in a business?
- 7 What is the difference between shy people and introverts?
- 8 What is altruism?
- 9 Who functions better as a team member: an egocentric or an altruistic person?
- 10 What is the nature versus nurture debate?



## Cracking the code

**Personality tests** Tests designed to determine the character traits of a job applicant.

**Fishbowl activities** Activities, such as a discussion, that job applicants perform together, watched, but not interrupted, by the interviewers.

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# MARKETING AND CUSTOMER NEEDS

- Chapter 11 Introduction to marketing and customer needs
- Chapter 12 Customers and their needs
- Chapter 13 Measuring customer satisfaction
- Chapter 14 The factors affecting product decisions
- Chapter 15 The factors influencing pricing decisions
- Chapter 16 Using promotional activities
- Chapter 17 Factors affecting distribution
- Chapter 18 Competition
- Chapter 19 Effective customer service
- Chapter 20 Improving customer service

## Don't forget

If any of the weblinks don't work, use a search engine to find a similar topic or business on which to base your studies.

# Chapter 11

# Introduction to marketing and customer needs

## APPLIED IN THE BUSINESS WORLD

### Whiter than white?

**W**hat does a customer need from a washing powder? Clean clothes would appear to be the obvious answer – but there are many other possibilities that could also be true. Perhaps the customer wants to wash clothes cheaply, perhaps by hand, perhaps using a washing machine, perhaps in lower temperatures ... perhaps the customer has specialist materials – silks, wools and satins, that need specialist treatment. Perhaps they need fresh-smelling clothes, or clothes washed in a more environmentally friendly manner or even whites that are ‘whiter than white’. They may even need a detergent that takes up less room in a kitchen cupboard! The two largest manufacturers of detergents in the UK market – Unilever and Procter and Gamble – know all of this (and more) and provide many, many different types of detergent. (All of which, as an end result, wash clothes clean). The two businesses have to find out what it is that their customers want, and then provide it for them. In many cases, they can also try to persuade customers that a new product is exactly what they want, through clever marketing.

Unilever’s leading brand is Persil, which has a market share of around 20–22 per cent. With a market valued at £857 million (Mintel, 2007), a 1 per cent share is important, representing over £8.5 million of sales. Procter and Gamble’s leading brand is Ariel, also with around 18–20 per cent of the market. The rest of the market is taken up with both companies’



‘sub-brands’ and, increasingly, with lower-priced supermarket own brands. To keep customers happy, each business has many ‘sub-brands’, some of which are more major than others. Procter and Gamble has Bold, Fairy and Dreft. Unilever has Comfort and Surf.

Are all these brands necessary to meet customer needs? Or are they really meeting their own marketing needs? Market research will have revealed that customers are willing to pay for each variety. Customer feedback will have been used to direct marketing efforts. The result is that what a customer wants from a washing product seems to be much more than clean clothes (at least according to businesses selling washing products). They want fragrance, whiteness, eco-friendliness, powders, liquids and gels. Are washing powder manufacturers really meeting customer needs – or are they using clever marketing to create these needs – and then meeting them?

## Live links

One recent introduction (2009) is of a 'fragranced' sub-brand to Persil. Visit [www.marketingweek.co.uk/in-depth-analysis/will-persils-fragrance-innovation-refresh-the-brand?/2062269.article](http://www.marketingweek.co.uk/in-depth-analysis/will-persils-fragrance-innovation-refresh-the-brand?/2062269.article)

to read the report in *Marketing Week*. List the marketing reasons for introducing this sub-brand, and the customer needs it meets. Which do you think is the strongest influence? Use the article to support your views.

## Hit the spot



- Give three reasons why a washing powder manufacturer might introduce a new brand.
- Explain how customer research could be used to support brand development.
- Is, in your opinion, the money spent on advertising, promotion and the development of many brands justified? Give reasons for your answer.

## Introduction

To survive in a competitive world, businesses need to recognise the importance of their customers. They need to know what types of customers they have, and what those customers expect. They try to understand what customers need and want so that they can then provide the goods and services to match.

## Customer needs

In this unit, you need to understand the different needs of different customers. This includes the range of customer wants – in the example above, from cheap to expensive washing powders, in different formats and different sizes, and to appeal to different needs. Customers expect to be able to make a choice when they are buying almost any product. To keep customers within a particular business, a business needs to offer a range of products. Product range refers to the different product lines a business sells. Top London department store Harrods, for example, sells a wide range of goods and has always claimed that if it hasn't already got something, it can get it for you. You need to understand how customers choose products – on value and suitability (to them), especially the idea of value for money, which is central to customer choice. You should also understand how businesses choose customers. Markets, and the

customers in them, are divided and targeted by gender, age, socio-economic group, income and lifestyle indicators. Businesses must make sure that information about a product and its functions is available and clear. Customers also need to know that they can rely on further help and support after a sale has been made.

## Measuring customer satisfaction

Different methods of measuring customer satisfaction are used by different businesses and will include both primary and secondary data. Results may also be presented in different ways, some of which are more effective than others. You should be able to analyse results and show that you can draw conclusions from them.

## Marketing mix

To sell a product to a target customer, the business will use various marketing activities. The combination of factors used to develop and sell a product is called the 'marketing mix'. This is the balance of product, price, promotion and place. You should understand that it is the balance of these factors that is important, rather than each individual factor, but that poor decision making in any one area (poor distribution, incorrect

pricing, badly targeted promotion) can cause an imbalance and wreck the whole mix. You should be able to advise on how a business can achieve balance.

## Competition and location

You will need to be able to identify the main competitors of a business, and the ways in which they compete. You will have to judge whether this competition is effective, and whether the business you have chosen to study could compete more effectively. You will also need to understand how the location of a business and of its competitors can be an important factor in its success.

## Customer service

Actual customer service features will vary between businesses, and depend on such things as the size of the business and the product being sold. A business needs to select the most appropriate customer service features for its customers. These include providing a range of quality products, having polite and well-trained staff, offering clean, welcoming and accessible premises and after-sales service such as deliveries, guarantees and service contracts. You should also understand the way that technology is used to both find out about customer needs and to deliver improved customer service.

### Did you know...

Consumers buy products to obtain both tangible and intangible benefits. Buying a branded sweatshirt may give the tangible benefit of keeping you warm and the intangible benefit of being seen to be fashionable. The intangible benefits, on many occasions, will outweigh the tangible ones.

## Summary

- Businesses need customers and customers have needs and wants
- Businesses use market research to find out customer wants
- They then provide for these wants in the form of different products
- Businesses need to measure whether customers are satisfied
- To market products, businesses use the marketing mix, a balance of product, price, promotion and place
- Businesses provide customer service features to both gain and retain customers, and to compete against businesses targeting the same market

## Core knowledge

### The portfolio and how it is marked

Marketing and Customer Needs is assessed on a **portfolio of evidence**, based on your own research of a business. You must choose a suitable business and then investigate:

- how measuring customer satisfaction contributes to the success of the business;
- the key marketing activities and customer service used by the business to meet customer needs;
- whether the business is successfully meeting customer needs, taking into account the activities of competitors.

You must include evidence of materials used to make one presentation on whether the business is successfully meeting customer needs. This could, for example, be notes, a poster or a slide presentation with notes attached. It is suggested that you spend approximately 17 hours researching the business, with a further 7 hours to write up findings.

You will be marked under three headings. **AO1** tests how you collect and organise data and show that you understand the terms and concepts that you are using. At the top level you will show that you can select from a good range of sources and demonstrate very good knowledge and understanding of concepts such as customer satisfaction, value for money and the marketing mix. **AO2** tests how effectively you applied your knowledge and understanding when carrying out the investigation. At the top level, you will show good planning, using your skills and knowledge. You will also show that you have completed all of the investigation and not missed any parts out. **AO3** tests your ability to **evaluate**, to make judgments and to support those judgments with evidence and reasoning. How effective is customer service at your chosen business? On what evidence do you base this? How reliable is this evidence? You need to not only draw conclusions, but be able to support them with well-argued reasons. Finally, you must check your work for correct spelling and grammar.



### And more

## Portfolio advice

In order to **analyse** how the marketing activities of the business meet customer needs, you need to find out about the typical customer of the business. You could produce primary evidence for this such as customer interviews and secondary evidence such as the business's own research. You could use material related to the industry in which the business operates. Your portfolio could consist of description, analysis and conclusions of material under the following possible headings:

- material such as customer interviews, questionnaires and the business's own publications;
- observations at the business to cover packaging, labelling, legal obligations and use of after-sales service, for instance looking at the 'front of house' (e.g. website, ordering process, window display, service characteristics);
- a basic customer research plan to identify customer types, wants and opinions which includes planning and reasons why outcomes, results and materials have been presented in certain ways;
- an analysis of the suitability of each element of the marketing mix in relation to customers;
- an analysis of the effectiveness of the marketing mix of the chosen business and competitors using observations of both, including observations and judgments on the use of technology;
- an analysis of how customer needs are met with an evaluation of these against competitor provision and a consideration, in light of this evidence, as to the alterations that the business could make to improve customer service provision;
- conclusions as to whether the business is successfully meeting customer needs, supporting your judgments with evidence, and comments on the evidence.

You may, of course, decide that it is worth spending more time on particular areas. Perhaps it is distribution that is most in need of improvement. Perhaps promotion is not very effective. Other methods of demonstrating your understanding will be of equal value to those suggested and some of these methods may not be appropriate for the business you have chosen.

### Did you know...

One set of customers that businesses would love to have is 12–16 year olds (you!) online. If you were allowed credit cards, businesses estimate you would spend up to £3 billion on internet purchases.



### Did you know...

Businesses may have both external and internal customers. External customers are 'outside' the business. Those with internal customers may be organised into sections or departments. For example, in a pharmaceutical company, one section may manufacture a basic form of penicillin. Some may be sold to external customers. Some may be 'sold' to an internal section that processes the basic drug into more sophisticated antibiotics. Both sets of customers need customer care.

## Have a go!

### Group activity

If you are going to use a questionnaire with customers, you should always try this out in your group first, using about ten people. This will show up where questions don't work or don't give the information you need.

### Discussion

A huge amount of money is spent on advertising and promotion. Some people say that this is a complete waste, and we could do without it. Others argue that it is a springboard for a lot of creative talent in the film, music and entertainment industries. Which side do you agree with? Why?

### Web-based activity

Visit [www.keynote.co.uk](http://www.keynote.co.uk). For each topic you can access the 'executive summary' for free. This gives a basic run down of information on that market. This can be used as part of your industry research.



## Quickfire questions

- 1 What is Unilever's leading brand?
- 2 What is Procter and Gamble's leading brand.
- 3 List three sub-brands for each business.
- 4 Explain why there are so many brands.
- 5 Outline how the two businesses find out information on customer wants.
- 6 On what areas is the assessment of AO1 based?
- 7 On what areas is the assessment of AO2 based?
- 8 On what areas is the assessment of AO3 based?
- 9 What is meant by 'analysis' in your assessment?
- 10 What is meant by 'evaluation' in your assessment?



## Cracking the code

**Portfolio of evidence** A collection of work, all supporting final conclusions on the business.

**AO1** Assessment on knowledge, understanding and the selection of data to support this.

**AO2** Assessment on the application of skills, knowledge and understanding and on how well an investigation has been carried out.

**AO3** Assessment on the ability to analyse and evaluate evidence, and present conclusions.

**Evaluate** A high-level skill that really means 'form a judgment and back it up'.

**Analyse** A high-level skill of comparing different types of arguments, evidence or outcomes.

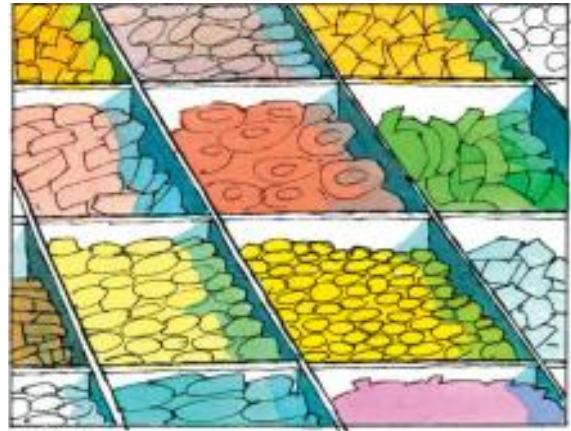
# Chapter 12

## Customers and their needs

### APPLIED IN THE BUSINESS WORLD

#### Customer focus

**B**usinesses need to keep their customer focus at all times – or risk losing their customers. They need to track how customer types and tastes are changing. They then need to change product, price, service or a combination of such factors in order to keep customers happy. Woolworths, the high street store established for over 100 years, had kept good track of the changing tastes of its customers, and of their changing buying habits. In America, Woolworths stores were originally known as ‘five and dime’ stores – i.e. shops where a range of goods was sold, in the price range of 5 cents to 10 cents (a dime). In the UK, this became ‘nothing over sixpence’ (2.5p), a slogan maintained until after the Second World War. Over the years, as customers wants changed, so had Woolworths. It still kept those key things that customers kept coming back for – offerings such as its famous ‘Pick n’ Mix’ sweet variety – but introduced new lines as customer wants changed. Its customers were always in search of a bargain, but, in recent times, did not always want to visit a store. Woolworths locations were, in the main, in central high street positions, where parking and access had become increasingly difficult, while rents and rates had continued to rise. Woolworths saw the change in buying habits and set up an online business, so that customers could order from the comfort of their homes. This proved to be a success, but meant even fewer people visited the high street shops until, in the final week of November 2008, Woolworths plc revealed that it could no longer afford to stay in business. Its debts had become too great, and it could no longer meet payments, so was going into what is called



‘administration’. An accountancy firm was called in to see if it could sell all or part of Woolworths in order to repay creditors. The high street shops had stock, so continued trading into 2009, while the website closed down almost immediately.

The online part of Woolworths – the most customer-focused part of the company – found ready buyers. While the high street shops are boarded up and empty, the online retailer has found a new lease of life with new owners, surviving because it is providing what customers want – low prices, good quality and convenience.

#### Live links

<http://the.marketingeye.blogspot.com/2009/02/woolworths-re-launch.html>

Follow this link to find out what is happening to the Woolworths re-launch. If this site doesn't work, search for 'Woolworths relaunch blog' to find another. Suggest how you think an online blog such as this is a good way to keep customers interested in what Woolworths has to offer.



## Hit the spot

- Identify three key features that customers want in a product.
- Explain why each of these features is important to the customer and to the business.
- Which feature or features do you think is most important to the customer and the business. Explain why you think so.

## Introduction

Customers have high expectations from the products they buy and the businesses from which they buy them. They also expect customer service and care to match the quality of the products being purchased.

## Providing good value and suitable products

Customers usually have a clear idea of the **'value'** of a product. They have a price range in which they

expect the product to fall. A confectionery bar should cost a matter of pence, a box of chocolates a few pounds. Customers often link 'value' with 'price' (so would expect a box of chocolates to cost more than a bar) but also link price with **quality**. Any product that is suitable for its stated purpose is a 'quality' product, providing it falls within the correct 'value' put on it by the customer. Many of Woolworths' products may have been inexpensive but that did not stop them being 'quality' products.

### Did you know...

A snack bar that provides enough nourishment to see you through to lunch is a quality product – provided that is all you want it to do! A snack bar that is too big, or too small, fails this quality test and is not, therefore, a quality product (however expensive it is).

## Product information and labelling

Customers expect clear and honest information about products. This includes information about the features of a product, its price, its delivery, and the aftercare available once the product is bought and taken home. Customers are more likely to buy from a company in the future if they feel that they have been given the full picture. Labels, for example, should be clear and not cause confusion.

## Different payment methods

Customers need to be able to pay for products in different ways, according to what is convenient. Businesses therefore need to provide a range of methods. These range from cash through to personal cheques, debit cards, credit cards and other arrangements that may allow customers to spread or delay payment. Examples include hire purchase

agreements, credit agreements and even informal arrangements whereby a customer pays 'at the end of the week' or when convenient.

## After-sales service

Many businesses provide a high level of help, information, maintenance and even repair once the customer starts to use the product. Reputations are built on good customer service – businesses that are, for example, willing to exchange goods or give refunds even if not obliged to by law.

## The importance of customer characteristics

Different customers have different characteristics – different things that make them unique. Businesses target markets by dividing them up into smaller

segments according to these **customer characteristics**. Each product can then have distribution, advertising, promotion, packaging and price tailored to a particular group of customers. The main ways in which markets are segmented are by age, gender, location, socio-economic factors and lifestyle.

- Targeting by age involves using both age groups and the spending patterns within those groups. New technology could, for example, be targeted at teenagers for social use, or at older people for business use.
- Some features may appeal more to boys than girls and vice versa. Some products are cleverly aimed at both (for example, boys buy boxed chocolates for girls, not for themselves).
- Specific locations can be targeted because they have certain characteristics. Expensive financial

products, for instance, might only be promoted in a wealthy postcode area.

- **Socio-economic group** refers to the level of education and spending power of a customer. It helps marketers to see what a customer might spend money on. The market is divided according to the occupation and income of the head of the household. This is not completely accurate, but helps those wishing to target a particular market segment.
- **Lifestyle indicators** include religion, habits, interests, hobbies, marital status, children, where people take holidays, etc. It is a way of trying to guess on what, given a choice, a person would prefer to spend money. Would they rather splash out on a holiday or save the money in case they need it in the future? There are, of course, products ready to be sold to both groups of customers.

### Did you know...

The smallest market segment is a niche market of one – and some businesses target such a tiny segment by providing a personal service or by customising products to an individual's requirements.

### Summary

- Customers expect quality products and good service
- Quality means suitability for purpose within an accepted price range
- Good service includes both at the point of sale and afterwards
- Point of sale information includes details of the product and its functions
- It also includes providing different ways to pay
- Good after-sales service is crucial to the reputation of a business
- Customer needs change according to changing characteristics
- Characteristics include age, gender, geography, lifestyle and socio-economic factors

### Core knowledge

One of the main ways to measure customer characteristics is through socio-economic groupings.

There are five main socio-economic categories, set out according to the sort of occupations that would be found within those categories. Group A is classified as 'professional' and includes top civil servants, judges, hospital consultants, top engineers and architects. They comprise only 3 per cent of the population but have enormous spending power. Group B is 'professional, managerial and executive'; this group includes bank managers, university lecturers, senior managers in industry, solicitors, engineers and barristers. They are just 12 per cent of the population. Although Groups A and B only represent 15

per cent of the population, they carry almost all of the potential expenditure on luxury goods. Group C is so large that it is generally split into two groups: C1 and C2. C1 is 'supervisory and clerical' staff and includes sales assistants, junior managers and administrative jobs; C2 is 'skilled manual' workers such as carpenters, plasterers, plumbers, mechanics and electricians. This group represents over half of the population, 20 per cent in C1 and 33 per cent in C2. Group D is 'semi-skilled workers' such as fitters, packers and assembly line workers. This represents 20 per cent of the population. Group E is 'unskilled manual' workers such as cleaners and labourers. This group also includes anyone else on a low income such as the unemployed, students and people on state pensions. Group E is under 10 per cent of the population and still worth targeting even though there appears to be little or no spending power in this area – the student market for cheap holidays, for example, is flourishing.

The main groups targeted by mass appeal marketing are B, C and D. A mass market newspaper, such as *The Sun*, knows that in targeting these segments, it is actually targeting three-quarters of the population.

### And more

The more accurately a business understands its customers' needs, the more likely it is to be able to make and sell a product that meets those needs. A great deal of effort is therefore put into learning about customers' characteristics, and coming up with the best possible ways to take advantage of those characteristics. For the customer, of course, this is good, as he or she is more likely to be satisfied with a product that has been specifically designed to fulfil their needs.

Each customer may be targeted by a business according to his or her characteristics. Take television advertising as an example. A producer of a baby food will advertise it in the particular morning slot when it knows that mother and baby will have settled down to watch children's television. It would be pointless to advertise it in a breakfast slot when mother has no time to take in the message; this slot is reserved for the older children and teenagers who are likely to be watching at this time. Older people would habitually not switch on the television until late afternoon, so this is when advertisements for products aimed at them would be placed. The more expensive slots will be at prime time, when audiences are much higher, and when the family watching television together represents the maximum spending power. Here television advertisements will be aimed at different segments within the same advertisement. A car advertisement might have the messages that 'this car is cool and fashionable' (so the children will like it), 'it's fast and technical' (so that father will like it) and 'it's safe and reliable' (so mother will like it). These may be stereotypical images but if they didn't work advertisers would no longer use them.

### Did you know...

Younger age groups have little spending power so advertisers rely on 'pester power' – making products so attractive to children that they will pester parents to buy them. Other important milestones are when couples are at their maximum earning potential, when they are likely to marry, when they have teenage children, when children have left home. Each group is given a tag to identify them to marketing managers (the last group, for example, is called 'empty nesters').

## Have a go!



### Group activity



Newspapers tend to be aimed at different socio-economic groups. List as many national newspapers as you can and then say what group you think each is aimed at.

### Discussion



Some people say that the most important lifestyle indicator is the amount of money a person earns. Others say that it is the level of education they have had. Do you agree that it is either of these? In your group, discuss which factor you think is most important and why.

### Web-based activity



ACORN stands for A Classification of Residential Neighbourhoods, and breaks down areas into many groups and subgroups that can be used by marketers. Visit <http://www.caci.co.uk/acorn/acornmap.asp> to see a full list. Why do you think there are so many? Why are there subdivisions?

### Quickfire questions



- 1 What does a customer mean by 'value'?
- 2 Give a definition of a 'quality' product.
- 3 Outline what is meant by 'price range'.
- 4 Describe customer expectations regarding labels.
- 5 List three types of customer service.
- 6 List three types of after-sales service.
- 7 List three types of payment method.
- 8 What is meant by 'customer characteristics'?
- 9 What is a socio-economic group?
- 10 What is a lifestyle indicator?

### Cracking the code



**Value** For customers, a price that matched their price range for the product.

**Quality** For a product, anything that does what it is supposed to do.

**Customer characteristics** The factors that make each individual customer unique.

**Socio-economic group** Dividing a market according to its education and spending power.

**Lifestyle indicator** Behaviour and habits that indicate on what a person might spend money.

## Chapter 13

# Measuring customer satisfaction

### APPLIED IN THE BUSINESS WORLD

#### Warrens Guest House

**W**arrens Guest House in York has twice reached the finals of the Guest House of the Year Awards and is noted as an excellent place to stay. It has achieved its success by providing what its customers want – in other words, by finding out what they wanted, and then making sure that the business had these features. Different facilities and services have been made available for each type of customer, tailored to their needs. For example, for families there are facilities such as travel cots, high chairs, baby monitors, a special children's selection on the menu and a toy and games box, as well as mention of the location of the North Yorkshire Moors Steam Railway, made famous in the Harry Potter films, and of how close the coast and attractions such as the Flamingo Land theme park are to the guest house. For the business customer there are reduced mid-week rates, computer stations, fax and photocopying facilities and wireless internet access, along with a private, well-lit car park. Warrens Guest House understands why its customers come to York and who its customers are. People come to York for business, for York Races, to look at the City's history, to visit the Minster, even for romantic weekends (there are champagne, chocolates and flowers packages).

Each has a distinct set of desires. As we have seen in Chapter 12, each customer has a different profile – a different set of unique needs and wants – and the



successful business is the one that reaches the majority of these. These 'pictures' of customers are called 'customer profiles'. To build a successful profile the business needs to know about the size of its market, the structure of its market, and, perhaps most importantly, whether its market is happy with the services on offer.

A tourist business such as Warrens Guest House will have a number of ways to measure whether or not customers are satisfied. These will include questionnaires to fill in, verbal feedback and a check on which customers return for further visits or recommend them to other users.

Customer profiles do not stand still but have to be constantly updated and changed as circumstances – and therefore needs and wants – change. Thirty or forty years ago, a guest house would not have felt that having a car park was a particularly attractive feature, as most guests would have arrived by train. Ten or twenty years ago, when there was less crime, it might not have felt the need to advertise that its car park is 'well lit' and 'covered by closed circuit TV cameras'.

It is by using customer research and acting on customer feedback that such changes take place and the business continues to succeed.

### Live links

Warrens Guest House is at [www.warrenshotel.co.uk/](http://www.warrenshotel.co.uk/).  
Suggest ways in which it could collect customer feedback using the website.

## Hit the spot



- Name two different groups and describe how Warrens caters for each.
- Explain how a hotel business could put together a customer profile.
- Of the three ways mentioned to collect customer feedback, which do you think is most effective, and why?

## Introduction

If a business wants to measure the satisfaction levels of its customers, it needs to carry out targeted market research to see what its customers think of it.

**Customer research** can be used to discover the answers to a whole range of questions including what to produce, what price to charge, how to promote the product and how to distribute it. In addition, it will let the business know how it can attract more customers, or get the ones that it already has to spend more money.

## Desk and field research

Customer research information can be gained in two ways – using **desk research** or **field research**. Desk research generally collects secondary data, which means that it makes use of existing information. This can be collected, for example, within the organisation by looking at the business's own records of accounts, sales, returned goods and customer complaints. Information may also be collected from outside the business from trade associations, government statistics, specialist publications and from newspapers and magazines. A major source for such data is now

the internet. Field research generally collects primary data since it usually involves obtaining new information about the business's customers and its market. Methods include questionnaires, surveys, observations, customer panels, focus groups and interviews.



Asking customers for their opinions is an example of primary research

## Research methods

Methods suitable for measuring customer satisfaction include the following:

- Database research: many businesses now create their own databases using ICT to collect, store and analyse data about their customers. This data could include names and addresses of customers, how

often they buy and how much they spend as customer profiles are built up. Increasingly much of this data is created through the use of bar-code scanners and swipe machines for debit and credit cards. Records of communications from customers – whether by post, telephone or perhaps by email – may be kept and analysed to show levels of customer satisfaction. Records are also kept when a customer uses a **loyalty card**.

### Did you know...

Supermarkets do not issue loyalty cards just to reward customer loyalty! They use them to see what customers buy, when and how often. This research lets them try new product lines to keep customers happy.

- Questionnaires can be carried out face to face, over the telephone, by post or by leaving questionnaire sheets for customers to use at the business. A guest house, hotel or restaurant business, such as Warrens, will often leave questionnaires in the room or on the table for customers to fill out. These

are most likely to use quantitative techniques, as customers are asked to rate, for example, levels of service, on a scale, or to tick a box next to a preferred choice. Sometimes they include longer, written, answers. These give more detailed information but are harder to analyse.

### Did you know...

One way to encourage customers to complete questionnaires is to enter every completed questionnaire for a prize draw.

- Interviews are when customers are approached on a one-to-one basis. Skilled interviewers are able to question consumers in more depth and can encourage people to think about their responses more carefully. Interview questions may also be used as part of consumer panels or focus groups. These may be used because some people find it easier to give an opinion in a group situation. Also, for some research, discussion may provide good data.
- Observation of the way consumers act when buying is an important method. Measuring the

time a customer spends in a shop, the direction walked, how products are inspected and whether they appear to be attracted to in-store advertising can all provide useful information.

- **Mystery shoppers** are specially trained employees of the business itself or of a research business, who will go into a shop, restaurant or similar premises anonymously. They will then report back to the business on the levels of service that they receive. Often there are prizes for those staff who showed the 'customer' the best customer service.

## Summary

- Businesses carry out targeted market research to find out if customers are satisfied
- They can change the product they offer to attract or satisfy more customers
- Having the right product is important to attract and retain customers
- Both desk and field research can be used to assess satisfaction
- The more information a business collects on its customers, the better will be its customer service

## Core knowledge

The process of customer research involves six basic steps. These are:

- 1 Defining the problem to be researched – what does the business want to find out?
- 2 Choosing the most suitable research technique – what is the best method to get the most accurate data in the most cost-effective way?
- 3 Selecting the sample – which types or groups of customers should we use in the research?
- 4 Collecting the data – actually carrying out the research.
- 5 Analysing the data – what do the findings of the research really mean.
- 6 Presenting the results – showing what has been found out and the conclusions that have been drawn.

Each of these presents the researcher with a different problem. Firstly, the business may not know precisely what it wants to find out, but only have a general idea. Secondly, both desk and field research have their drawbacks. Desk research may be old and not precisely what is needed. It may also be expensive. Field research relies on asking the right types of questions to the right people. Thirdly, when selecting the sample, cost has to be balanced against accuracy. In general, the bigger the sample, the more accurate it will be, but collecting and processing the data will also be more expensive. Fourthly, data must be collected at the right time and place – particularly field data – as otherwise samples will be biased. It is no use conducting a survey in a town centre aimed at 14-16 year olds on a school day! Fifthly, analysis of the data must be done sensibly and professionally, particularly with regard to its source. For example, information from the internet and from sites such as Wikipedia may be reliable, but often is not. Anyone can put up a website, and anyone can edit a Wikipedia entry, so both should be treated with caution. The problems of presenting the data are explored below.

And more

## Presenting the results of customer research

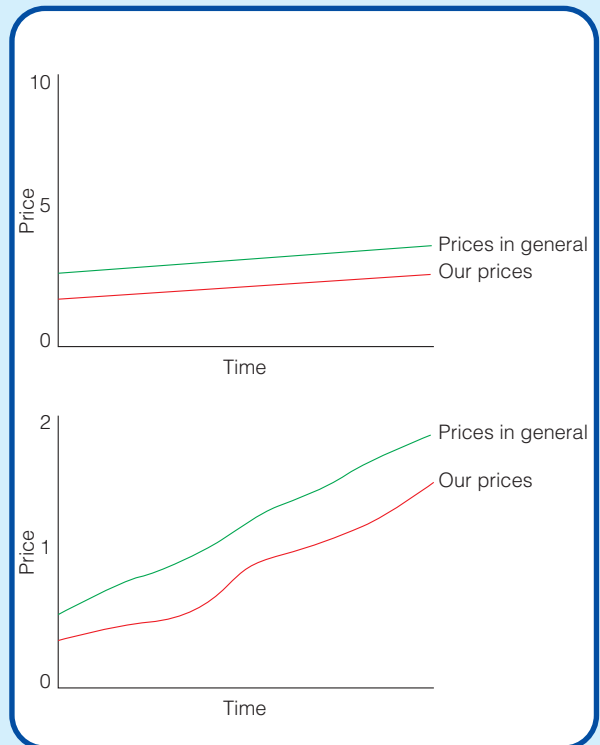
Customer research needs to be presented in a way that is clear to follow, and that will be familiar and acceptable to the intended audience. Businesses that do not present data clearly do not get their message across. While it may be tempting to use all the different ways that a computer program provides in order to present data (cones, pyramids, doughnuts, etc.) the business should choose the method that carries the clearest message. Sometimes, a graph is not appropriate and information is better presented in a table, even though this may be less colourful and therefore appear to have less impact. There are specific visuals that are appropriate to specific data:

- To show a percentage of a sample response, use a pie chart.
- To compare this with another set, use pie charts side by side.
- To show changes over time (such as increased prices over a six-month period) a line graph may be most suitable, especially if the researcher wants to illustrate a trend.
- If data is taken at specific points (i.e. the first of the month) a bar chart may be more appropriate.

The important thing is that the charts show clearly the key features of the survey that the business wants to get across. Even changing axes can have a huge effect on perception. Presentation should highlight the significant features and be used to show where trends or patterns have been found.

Different question types on questionnaires will also have a bearing on the results. A questionnaire could limit customers to yes/no answers, present them with a scale, e.g. Rate the following with 1 being highest, 5 lowest, or give a limited selection of responses, e.g.

Which flavour ice cream do you prefer? a) banana b) vanilla c) chocolate. This means any other flavour has to appear under 'other'. If most people prefer strawberry, the survey is meaningless.



Changing the axes can have a dramatic effect on a presentation

## Did you know...

Customer research can use quantitative techniques (i.e. those that involve numbers, percentages etc.) to discover answers to specific questions that start with 'how much' or 'how many'. In other words, they are trying to collect data that is easily measured and can lead to conclusions backed by valid statistics. Qualitative techniques try to discover consumer attitudes and provide answers to broad questions starting with the question 'why'.

## Have a go!

### Group activity

In small groups create a questionnaire that could be used to measure customer satisfaction with a local supermarket. Remember to include questions about products, packaging, prices, display, availability, advertising, queues, any other general services available such as car parks, and the quality of the customer service provided by the supermarket. Try to use a mixture of questions that use quantitative techniques and qualitative techniques. Test your questionnaire out before trying it on the general public. Once you are happy with your questionnaire, try it out. If you plan to do this at the actual supermarket, you must get permission from the store management first.

## Discussion



As a customer, how do you feel about being asked your opinion of a good or service? Is it a nuisance, or do you feel that it is useful? Share the different opinions in your group and then try to devise a way to collect customer feedback that will upset the fewest people.

## Web-based activity



The North East of England Tourist Board discusses the customer profiles of visitors to the area at [www.tourismnortheast.co.uk/site/business-toolkit/advertising-marketing-and-pr/customer-profiles](http://www.tourismnortheast.co.uk/site/business-toolkit/advertising-marketing-and-pr/customer-profiles). Use this information to profile tourists who might visit your area.

## Quickfire questions



- 1 What is a 'customer profile'?
- 2 Give three characteristics you might find of a typical tourist customer.
- 3 Give three factors that a hotel or guesthouse could provide to attract business customers.
- 4 Give three factors that a hotel or guesthouse could provide to attract families.
- 5 Give three factors that a hotel or guesthouse could provide to attract young people.
- 6 What is meant by customer feedback?
- 7 Give three ways in which a business could collect direct customer feedback.
- 8 What is the difference between desk and field research?
- 9 Give three ways in which a business could use a database to build customer profiles.
- 10 What is a 'mystery shopper'?

## Cracking the code



**Customer research** Market research aimed at seeing whether customers are satisfied, and why.

**Desk research** Secondary market research from published sources.

**Field research** Primary market research not previously collected or published.

**Loyalty card** A card issued by a business that gives 'points' and 'rewards' for repeat trade.

**Mystery shopper** A researcher who tests customer service by posing as a customer.

## Chapter 14

# The factors affecting product decisions

### APPLIED IN THE BUSINESS WORLD

#### Apple's product range

**A**pple is a well-known manufacturer of leading electronics devices best known for innovations such as iPods, iPhones and its range of sleek and stylish Mac computers. It is as well known for its cutting edge and 'cool' design as for the products themselves. In fact, many people buy Apple products because they are attracted by the design. Across the range Apple has built itself an image of modern design and new technology with each new product being sold just as much on its looks as on its performance (of course, Apple cannot rely on looks alone, and would soon be in trouble if its products did not perform to customer expectations!). Apple sells a fairly narrow range of products, concentrated on the electronic goods and computer market, and linked in with the sale of music and video. It continually both updates what it has, removing products that are no longer in demand or that have been replaced by better technology, and introduces new product lines. All of its products are, however, closely tied together – and this is one of the reasons why it is so successful. Its four main product categories may be thought of as:

- operating systems (OS);
- computers, from laptops to network machines;
- music devices and software such as iPods and iTunes;
- iPhones.

New product innovations keep Apple users happy – recent additions include operating system upgrades



(Snow Leopard being the latest version), new lightweight and faster MacBook computers, and an improved iPhone (with better camera and video capability, and full third generation (3GS) compatibility). The success of the iPod was at least in part down to Apple's music site, iTunes. The success of the iPhone is linked to the Apps Store. Apple's Apps Store contains thousands of tiny programmes that do everything the customer wants – some for sale, others free. There are apps for fitness training, for finding places to eat, for travel information, recipes, booking concerts, managing money, revising for tests – even a spirit level app and a joke app for pretending to drink a pint of lager! (If there's anything missing in the App Store, Apple encourages developers to write a new app!)

Each new App extends the product range and makes the iPhone more desirable to a greater part of the market. Apple thus keeps moving with the market – some would say driving the market forward – with new devices and new products that are soon on

everyone's 'must-have' list. At the same time it carefully monitors price and changes it to either shift stock, encourage new buyers or to compete more effectively.

### Live links

Visit Apple's website at <http://www.apple.com/iphone/apps-for-iphone/> to see the latest apps for the iPhone. Try to come up with an idea for an app that is not currently available. Explain why you think anyone would want it.

## Hit the spot



- Outline Apple's four main product categories.
- Explain why Apple keeps extending its product range.
- Do you think Apple's product range is wide or narrow? Give reasons to justify your answer.

## Product decisions

Businesses choose to make and sell particular products. The **product** is just one part of the marketing mix, but perhaps the most important as, without a product, there would be no need for price, promotion or distribution! When deciding what to sell, a business will take a number of factors into consideration. First among these is the type of customer that they wish to attract. They need to know what types of products customers want and what they are willing to pay for them. Some businesses will stick to a narrow range of products, making them specialists in their chosen market. Examples include specialist retailers of goods (fashion stores, electronic goods chains, butchers and bakers) or service providers (taxis, window-cleaners, delivery businesses). Others will provide a wide range of different goods (supermarkets may concentrate on food, but also sell electrical goods and even clothes).

or a range of music players. Apple's iPod range includes four main lines – the iPod Shuffle, iPod Nano, iPod Classic and iPod Touch. For each there are further variations in size, storage, colours and features. This range is designed to cover as much of the market as possible. By extending the range, Apple can bring in new customers.

## Developing a product range

To succeed, a business needs to develop a range that suits both its market and itself. Some businesses try to spread themselves over a wide range of products, only to find that they cannot sell them all. An ice cream manufacturer, for instance, may produce ever more exotic flavours but find that only the 'core' range ever sells well. Even the biggest supermarkets do not carry a full range of products, but limit themselves to just those that they can guarantee selling. For some stores, a rule applies that, unless it can guarantee to sell a certain amount, it will not stock a product.

## Product range

**Product range** refers to the different product lines which a business sells, such as a range of snack foods

## Changing the range

Businesses add products to their range, remove them from the range and change them from time to time.

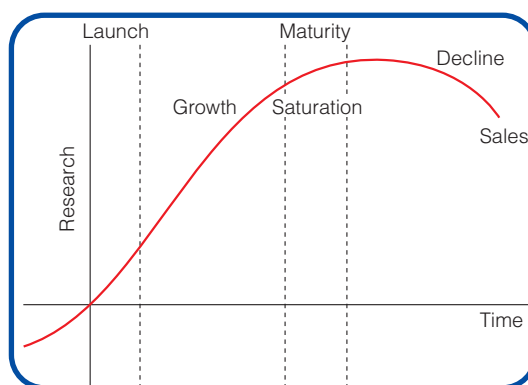
They do this to suit changes in customer tastes, to respond to competition, or to improve products through the latest technology. Sometimes a better product comes out, so something reaches the end of its life cycle. iPods, and other MP3 players, have replaced CD Walkman-type devices, which themselves replaced portable tape recorders. Sometimes competition forces a producer to **differentiate** a product – perhaps by giving it extra features. Sometimes businesses change products because sales are falling – they make real changes (in performance, or ingredients, for example) or cosmetic changes (such as different colours, or redesigned packaging) all in response to movements in their target market.

## Products and technology

New technology affects both products and price. New technology can lead to different products being introduced to extend a range. For instance, the introduction of satellite navigation systems means that this technology is now available on iPhones (and other mobiles). Other technology means that many mobiles now have excellent cameras, music players and even video software. New technology might also lead to falls in price – as technology becomes more widely available, and produced on a larger scale, its price will fall.

## Product life cycles

Most products have a natural product life cycle, from the initial launch of the product, through its development and finally to decline. At each stage, price and marketing activity will be different. In the growth phase, a high price can be charged for the new product – this also helps recover research costs. Later, as competition increases, price will fall.



Product life cycle

### Did you know...

There have been a number of 'famous failures' of a new product. In each case, either the product or the market was not properly researched or tested or a competitor proved to be much better. These include some electrical powered cars, and systems such as Betamax video recorders. Often, with new technology, two competing systems fight it out to find which is best. Blu-Ray, for example, has defeated the HD DVD system.

## Summary

- Businesses choose to make and sell particular products
- When deciding what to sell, a business will consider its target customer
- Some businesses have wide product ranges, others have narrow ranges
- The wider the range, the more types of customer are attracted
- Businesses extend and alter ranges to reach new customers
- Most products have a natural product life cycle, and will eventually die

## Core knowledge

Some businesses may be described as 'market orientated', some as 'product orientated'. Market orientated means that the business puts an emphasis on its target market, and what it thinks it wants. Market orientated businesses try to develop and sell products which are a response to changes in the market. Such businesses would look at market trends and then produce a product to fit with those trends. They rely heavily on accurate market research to tell them exactly what it is that a customer wants and is willing to pay for. For example, if there is a trend towards healthier living, a chocolate manufacturer might start to produce more 'healthy' versions of its products. For example, chocolate manufacturers have recently developed a low-fat alternative to chocolate (called Xocai). Such businesses are said to be looking for gaps in the market.

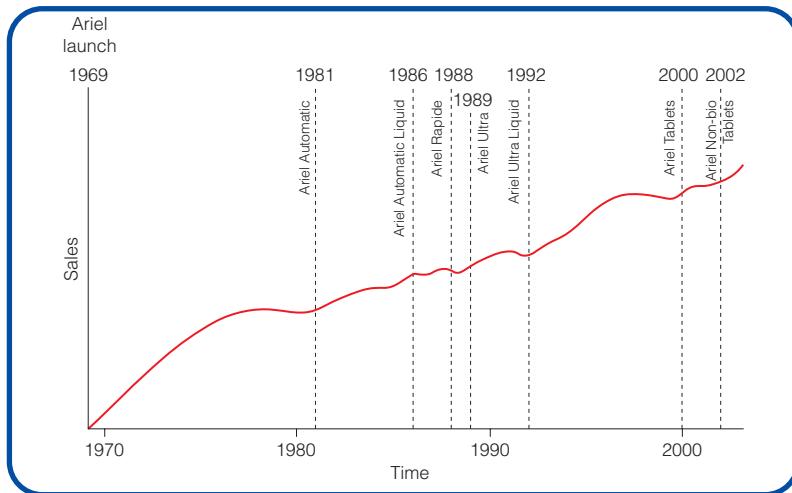
Product-orientated businesses are those which have created something new or different, and then want to try to persuade people to buy it. Product orientated means that the business puts an emphasis on the goods and services that it sells. New technology businesses tend to be in this category – mobile phone developers, for example, are continually developing and upgrading their product – not as a result of consumers asking for changes, but because they think they can persuade the consumers to buy the new models. The new generation of iPhones has more features than the first generation – the next generation will be improved even more. Such businesses are said to be creating gaps in the market. Just look at the features you may have on your mobile – everything from voicemail and texting to satnav and the ability to load video clips straight to YouTube.

And more

## Product extension strategies

Some products cost a great deal to develop and businesses are keen to recoup these costs. At the start of the product life cycle, there is expenditure on research and development but no sales. The most successful products have a long life cycle and pay back their initial costs many times over. A good example of such a product is Rowntree's Kit Kat, which first appeared in 1935 and is still going strong. A **product extension strategy** is when the life cycle of a core product (the original product) is lengthened by various changes which make it 'new', 'improved' or in some way better or more desirable. These may be driven by the market (for example, Ariel Excel Gel is in response to a demand to be able to wash at lower temperatures) or by new technology (Ariel Automatic was a low-suds development needed to cope with automatic washing machines). Look at the way that Ariel has maintained its market position since it was first launched in 1969. Whenever there has been a fall in sales, indicating that the product was going into decline, Procter and Gamble, the manufacturers of Ariel, have changed the product or added new versions to the range already available. In this way they can keep increasing the sales of the brand. Product extension strategies may also be the result of competition. Ariel Gel is as much a response to the launch of Unilever's Persil Small & Mighty concentrate, which dented Ariel's 21 per cent market share, as to wanting to provide a 'greener' product.

You can follow the various developments to extend the appeal of the Kit Kat (now part of Nestlé) at [www.nestleprofessional.com/uk/en/SiteArticles/Pages/History\\_of\\_KitKat.aspx](http://www.nestleprofessional.com/uk/en/SiteArticles/Pages/History_of_KitKat.aspx). Note, however, that despite the many variations, the original product is still popular.



Thirty years of Ariel's product extension strategies – and changes are still being made

### Did you know...

A product can be either a good or a service. A 'good' is basically something that you can touch – anything from an iPod to a car. A service is something that is done for you (or a business) such as transport, communication, banking and personal services such as haircuts and beauty treatments.

### Did you know...

Product differentiation is how a business makes its product stand out in the market. It is how it makes it different to other, competing products. One of the major ways by which a successful business does this is through branding its product range.

## Have a go!

### Group activity

List all the features that you have on your mobile phone. Draw up a table to show which features are likely to appeal to which customers.

### Discussion

When you visit Apple's website, make sure that you are in the UK version as prices on the American site are not only in dollars but, once you have done the conversion, cheaper than the equivalent product in the UK. Discuss why this is the case and how Apple is able to charge different prices for the same product in different markets.

## Web-based activity



Search for Xocai Healthy Chocolate on [www.youtube.com](https://www.youtube.com). Play the clips you find about this new product. Which customer group do you think that this will appeal to? Suggest ways to promote this product to this group.

## Quickfire questions



- 1 What is a product?
- 2 What is a product range?
- 3 What is a narrow product range?
- 4 Outline why a business would develop a wide range?
- 5 Give three reasons why a business would alter a product range.
- 6 Give three ways in which a business could alter its range.
- 7 What is the difference between a real change and a cosmetic change to a product?
- 8 Give three examples of products available as a result of new technology.
- 9 Explain what is meant by the 'product life cycle'.
- 10 Explain why a business would charge a high price in the growth phase of the cycle.

## Cracking the code



**Product** What is actually produced as a result of business activity; it could be either a good or a service.

**Product range** The different product lines which a business sells.

**Differentiate** Making a product different so that it stands out from the competition.

**Product life cycle** The stages from launch through growth to decline and death, through which most products pass.

**Product extension strategy** When the life cycle of a product is lengthened by various changes which make it 'different or better'.

## Chapter 15

# The factors influencing pricing decisions

### APPLIED IN THE BUSINESS WORLD

#### Value for money

**A**s you saw in the previous chapter, Apple is a well-known manufacturer of leading electronics devices, best known for innovations such as iPods, iPhones and its Apple Mac computers. But the products are just one part of the marketing mix. They will only sell if customers think that the price is right for them – in other words, that they are value for money. Apple not only has a good product range, but is also very careful about its pricing policies. It needs to price products so that they are attractive to its target market, but also so that it gets the profit that it wants. This profit allows it to keep its owners happy but, perhaps more importantly, also provides the money for future developments and new products. It introduced the iPhone at a premium, high, price, but then dropped this once the initial impact on the market had passed. The price was taken down to as low as \$99 (around £60) for the cheapest version in the US. Once the upgraded 3GS version was launched (with a number of extra features to make it more attractive to buyers) this was priced at the top of the market, balanced by the price of the older version being reduced. Apple used a tie-in deal with a phone company (AT&T in the US, O2 in the UK) to launch the iPhone, so that the initial high price would be ‘hidden’ by contract costs. When taking out a mobile contract, often the phone is ‘free’ as long as the buyer ties in to a long period – sometimes up to two years – with the service provider.



Apple then dropped these deals when they were no longer to its advantage. Another new product, Snow Leopard, the new operating system, also highlights Apple's pricing strategies. It is being introduced at the amazingly low price of \$29 in the US – a price point aimed at getting as many users as possible to upgrade. This may even be a ‘loss leader’ – a product that is sold in order to tempt customers into buying something else. The price drop (and withdrawal of older models) on the MacBook range was a signal that Apple had a new product up its sleeve that is designed to run on Snow Leopard. This mini laptop (called the iPad) has since been launched at a competitive price in a market that is growing. (See [www.apple.com](http://www.apple.com) for more details.) At the same time, Apple is keeping its prices on top of-the-range models high – but still managing to compete with its PC rivals, because customers still see the range as being value for money.

#### Live links

Visit Apple's website store section at <http://store.apple.com/uk>. Choose three products in different price ranges and list the reasons why you think they are low, medium or high priced.

## Hit the spot



- Give two reasons to explain Apple's pricing policy.
- Explain what a customer means by 'value for money'.
- How successful do you think Apple's deals with phone companies have been? Would you recommend using them in the future, or dropping them for new phones?

## Prices and costs

The most common form of pricing is probably **cost plus pricing**. This is where the business adds up the various costs of producing the good or service and then adds on enough to make a profit. Costs include raw materials, components, power, labour and even research costs. The business then adds on a percentage for profit (called a **mark-up**). Mark-ups are normally expressed in percentage terms. If an iPhone cost £100 to make and there was a 10 per cent mark-up the price would be £110. Although this sounds simple, it is often very difficult to say exactly how much a product costs to produce. Research costs may, for example, be spread over several products. Costs per unit may also fall as more goods are produced. This is one of the benefits of mass production called an '**economy of scale**'.

## Value for money

Businesses may also link mark-up to the price that they feel a consumer will be willing to pay for the product. This is pricing made on the assumption that a consumer has a particular value for a product and so an expected price in mind. Customers will have a range of prices that they think are reasonable for a product. This range will depend on how much they value the product, and how much they can afford to pay. A well-off customer, who wants to be seen as fashionable, may be willing to spend from £200 to £500 on a mobile phone, and will only look for top-branded phones in this range. Another customer may want fewer features and expect to pay £10 to £50 for a phone. They do not believe that the value of a phone to them is greater than £50. Mobile phone businesses may choose to provide for the whole range, or just stay at one end or the other of the market.

## Mark-up and value

If the business can charge a price that reflects the value the customer puts on the product, then it is more likely to gain a sale. If the customer puts a high value on a product, even though costs are not that high, this means that the business can charge a very high mark-up. Think of a designer dress, for example. Compare the real costs of producing it in terms of design, materials and labour against the extremely high prices that are charged for such creations.

## Pricing and competition

As well as the cost of the product and the value that customers put on it, businesses also have to keep an eye on the prices that competitors are charging for similar products. Most methods of pricing can be called **competitive pricing**, as they usually involve pricing in such a way that the good is more attractive so sells more than a competitor. However, to offer the same good or service as a rival at a lower price may be difficult where businesses are in close competition, or have very small mark-ups.

## Pricing and technology

New technology has had a number of effects on price. New materials and methods of manufacture have brought prices down for many products. Flat screen TVs are a good example of this. Earlier models had to pay development costs. As technology has become more widely available, prices have fallen. The same may be said of broadband internet access. The growth of the internet brought a huge growth in online shopping. Here, prices are likely to be cheaper because of lower storage and display costs and no high street rents and rates. The downside to this is that high street shopping is in decline. Some low-price retailers (e.g. Woolworths) have collapsed in the face of competition.

## Summary

- Price is set by a business to cover costs, compete and attract customers
- Cost plus pricing ensures costs are covered by price, plus a mark-up for profit
- Customers only buy if they see a product as value for money
- Businesses set prices to attract customers from competitors
- Development costs may keep prices higher than a business would ideally want
- New technology may bring down cost, and therefore prices

## Core knowledge

Imagine that you are making cakes to sell at a school or college event. You buy the ingredients, so know how much they cost. You can say how long it took you to bake them, so you can account for your time. You can work out what it cost in power to bake the cakes. But what about your skill, what price do you put on this? What about capital costs, such as the oven and kitchen, even the bowls and spoons used in the process? And what about the selling costs, again – your time and expertise. From this you can see that, even at a simple level, it is difficult to say what a product costs to produce and sell.

It is, however, fairly easy to find out the sort of price range that the customer thinks is right for the product. Much of this does not even require market research, but is common sense. Who would pay more than a few pounds for a paperback book, for example, or expect to get a diamond engagement ring for under a fiver? You will soon know if you have overpriced your cakes if you fail to sell any!

When market forces also intervene, pricing becomes even more complicated. A business needs to set a price not only so that it is attractive to its target customer, but so that the customer will choose its product over that of competitors. So how do you persuade people to buy your cakes instead of someone else's? One way to do this is to make the product unique – which in itself carries costs that need to be recouped. Another way is to compete other than on price, by providing, for example, a better service (see Chapter 20).



A business will need to look carefully at the prices it will charge

## Did you know...

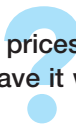
There are pricing 'tricks' such as psychological point pricing. This is where prices are deliberately set below certain 'trigger' prices such as £5 or £100. Prices seem a lot lower when they are £4.99 or £99.99 and promotions can claim the product is 'under a fiver' or 'less than a hundred pounds'.

And more

Businesses use many specialist methods of price setting that are linked to market conditions, rather than to either costs or customer ideas of value. Two typical pricing strategies linked to the market are skimming and penetration pricing. Skimming and penetration prices are each pricing strategies that might be used when a new product is introduced on to the market. Skimming is used for products that can be sold at an initial high price. Often these are examples of new technology. Apple used skimming for both the iPod and the iPhone, charging a high price when these products first hit the market. Those who want to be the first to own such technology are willing to pay a high price for it. Penetration pricing involves pricing at an initial low price in order to enter a market and build up a market share. Once this is established, prices will rise. Low prices may also be used in predatory pricing where a business deliberately undercuts rivals in an attempt to remove them from the market.

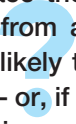
Some pricing strategies are more promotional. A loss leader, for example, is where a product is priced so low that it does not even cover its costs. This may be used to attract buyers who will then realise the benefits of the product and continue to buy it; in retail terms it is usually a staple product (such as bread or milk) priced to attract customers into the shop so that they spend money (and therefore generate profits) on other products.

## Did you know...



Sometimes a business will have to charge lower prices and make a loss in order to survive in a market. It will be hoping that competitors will fail and leave it with market share, or that market conditions will improve and it can then recoup the losses.

## Did you know...



Businesses in close competition are likely to face the same costs. Imagine two competing garages selling petrol. Each buys it at the same price from a supplier. Each has overheads in the form of premises, rents, staff and power which are not likely to be very different. Price competition here can usually only take place for short periods of time – or, if it cuts into profits, may not be possible at all, so that competitors end up selling at very similar prices.

## Have a go!



### Group activity



List some new technology products that have come on to the market in the past 6–12 months. What do you think are the pricing strategies being used with each?

### Discussion



What do you think is more important to a business – making a profit or making a sale? Does everyone in your group have the same opinion? Why do you think this is so?

### Web-based activity



Look at the various laptops being sold by Apple on its website. What type of pricing do you think is being used for each of these? Explain why you think so.

### Quickfire questions



- 1 Explain what is meant by 'cost plus' pricing.
- 2 Explain what is meant by a 'markup'.
- 3 Give three reasons why a business sets price at a certain level.
- 4 Give two ways businesses encourage their customers to believe that they are getting 'value for money'.
- 5 Give three factors that might affect a customer's price range for a product.
- 6 What is an 'economy of scale'?
- 7 What is competitive pricing.
- 8 What is skimming?
- 9 What is penetration pricing?
- 10 Give three examples of promotional pricing.

### Cracking the code



**Cost plus pricing** A price set to cover costs and provide an element of profit.

**Mark-up** The percentage added on to costs to bring about a profit.

**Economy of scale** How costs are spread more evenly as more goods are produced.

**Competitive pricing** Pricing to make products more attractive than competitors'.

# Chapter 16

## Using promotional activities

### APPLIED IN THE BUSINESS WORLD

#### Nivea's online strategy

**N**ivea is a well-known high street brand of skincare products. You would expect it to advertise in the conventional way – on TV, in newspapers and magazines, and on poster sites. But Nivea knows that the market is changing and its core customers are not always newspaper readers, or do not take any notice of TV advertisements. Print advertising, in particular, has been in decline for a number of years as companies have seen it become less and less effective. Television advertising is, nowadays, easily avoided, with many households able to 'pause live TV' and fast-forward to miss advertisement breaks. There are also so many channels now available that TV advertising may well miss a good part of an intended target market. So how does a company such as Nivea make sure that it is promoting its products to the right market segment when it is promoting a product such as the Nivea Visage Young range to 13–19-year-old girls?

Nivea decided to use promotion where it would be most effective, and where it could be sure of reaching this target audience. It has put up pages on social networking sites including Facebook, MySpace and Bebo to take advantage of the fact that girls in its target range will visit these sites. It also launched an online magazine (cheaper and more effective than a print version) called FYI (Fun, Young and Independent) and provided links on the networking sites. It is also keen to let girls try the products for themselves, so that they can form their own



judgments. To this end, it had a policy of giving out sample products. In 2008 alone, it gave away over a million samples of the Nivea Visage Young range via its website, social networking sites, in shops and at roadshows throughout Britain.

This use of new technology to attract customers – especially young customers – is a feature of many forward-looking companies. A number have succeeded in what are called 'viral' campaigns, using the internet, mobile phones, text messaging and email to pass a message on. Usually this is in the form of a short video clip, the success of which is measured by the number of times that it is viewed. Often, these will run into millions – much bigger audiences than any conventional advertising campaign could hope to reach.

#### Live links

Visit [www.tworkshb.com/when-to-invest-in-promotional-merchandise/](http://www.tworkshb.com/when-to-invest-in-promotional-merchandise/) where you will find arguments for and against the use of merchandising by small businesses.



## Hit the spot

- Give three features that define Nivea's target customer for Nivea Visage Young.
- Explain how Nivea used new technology to reach this market.
- Decide which method you think would be most effective for this age group. Give reasons for your decision.

## Introduction

**Promotion** is just one part of the marketing mix, but is essential in letting customers know that a product is available. Even a chalkboard outside a greengrocer's (or the sign above the shop that says 'greengrocer') is a form of promotion – letting the customer know the types of goods that are for sale. Once the chalkboard says 'Special offer, English apples 50p a pound' it is informing, persuading and competing by offering value. Promotion, therefore, does not have to mean TV advertising or expensive poster campaigns, but can take place at a simple level.

## Customers and potential customers

Businesses target both their current customers and those who might become customers (potential customers). To do this, they will aim promotion at particular parts of a market. Markets are divided up into various parts, or segments. Segments may be defined according to where people live, their hobbies and interests, income and education, age or gender, or even race or religion. When a market segment is defined according to the income and educational group that a household is considered to be in, these are called **socio-economic groups**. This use of different market segments means businesses can target particular groups and sub-groups of consumers with communications that are at the right level for that group and which they will see.

## Communicating with customers

To reach customers, therefore, a business needs to recognise its target market. It also needs to pass on the right message – in a format and language to which customers will respond. The way it passes this message on is called the medium. **Media** is the plural of medium and covers the many, many ways that now exist for passing on promotional messages. These include traditional routes such as in print – newspapers, magazines, posters and leaflets – and broadcast media – TV and radio as well as new technology. New technology includes the internet via such routes as viral advertising, social networking sites such as Bebo and Facebook and even messaging services such as text and Twitter.

## Personal selling

Personal selling involves personal contact between the business and the customer. A customer assistant will have the job of persuading a customer in a retail outlet to buy. No amount of promotion can help a business to succeed if it does not have good sales staff. Sales staff are a direct link between the customer and the business, so should always be polite, well-mannered, smart and knowledgeable. This requires training – both in product knowledge and in dealing with customers.

### Did you know...

Personal selling in business has two meanings. As well as selling to a customer in a retail outlet, it is often the way that business-to-business transactions take place. This is when a representative of one company tries to persuade buyers from another business to purchase products. Promotion here will be through verbal persuasion and demonstration of product features, sometimes directly, sometimes at trade fairs and exhibitions.

## Merchandising

**Merchandising** was used, in the past, to cover all methods used to sell a product, but especially point-of-sale, packaging and promotions such as competitions. Now it is used to mean the 'spin-off' items that are often produced to help promote a product or brand. Football clubs are a good example of this. A top club will produce not only replica shirts, kitbags, scarves, T-shirts, tracksuits and leisure wear, but also flags, mugs, pencil cases, key-rings, books, lunch boxes, DVDs and even wallpaper, curtains, baby clothes and bedcovers. Even a small business can promote its name through merchandising items such as key-rings, diaries, pens, mugs and calendars.

## Advertising

Advertising is both letting people know that a product is available (informative advertising) and trying to persuade them to buy it (persuasive advertising). The spending of the business on advertising and promotion is usually called either 'above the line' or 'below the line' expenditure.

- Above the line expenditure is direct expenditure on advertising such as buying media space (space in newspapers and magazines, or slots on television and radio), or the production costs for the making of advertisements.
- Below the line expenditure is indirect spending such as on promotions, competitions, sponsorship and product placement.

### Summary

- Promotion is just one part of the marketing mix
- It informs customers that products exist
- It tries to persuade customers to buy products
- Businesses target particular market segments
- Communications to customers must be in a format and language that appeals to that customer
- Advertising expenditure can be direct (above the line) or indirect (below the line)

## Core knowledge

Businesses must be careful to select the right method of promotion and to ensure that the content – the message of the promotion – will attract their target audience. If the business succeeds in reaching the right target, with the right message, then this is money well spent and effective communication with customers and potential customers. Businesses therefore need to know:

- who their customers are;
- what media will reach them;
- what message they will respond to.

Promotion includes the ways by which the business tries to persuade customers to buy its products. It includes publicity, persuasion and value-added promotions, and encourages loyalty and repeat purchases. **Publicity-related promotions** include:

- point-of-sale material – cards, displays, etc. used where the goods are displayed in a shop or where they will be paid for (e.g. at checkouts);
- shop signs telling the customer what the shop sells.

**Value-added promotions** are where the customer gets more (extra value) for their money than previously. These include:

- free gifts;
- banded promotions – goods may be physically ‘banded’ together, e.g. a brand of toothpaste sold with a brand of toothbrush;
- money-off coupons – published in the press, delivered direct or as part of the packaging of goods (to encourage repeat purchases);
- special offers such as ‘buy one, get one free’ (BOGOF);
- price reductions – when products are offered at a lower price than before;
- joint promotion – where two businesses agree to promote each other’s products because they are aiming at similar markets. A breakfast cereal aimed at children might, for example, promote children’s toys or a children’s magazine.

Some promotions are designed to persuade people to repeat purchases such as customer loyalty cards. With these, every time they make a purchase customers collect ‘points’ electronically that can be redeemed against selected products in the shop. Through mailings customers are also rewarded with money off or coupons.

### And more

One of the main ways in which a business can compete is by making its products unique. One way to do this is through product differentiation. This means making a product different to those of their competitors so that it stands out. One of the main ways to achieve this is through branding. Establishing a brand image may mean having a recognisable name, logo and other marks. These range from the use of a particular style of lettering (such as that used by Coca-Cola – which is trademark protected) through the use of particular colours (such as Ferrari’s red) or the use of signs or signals (such as the ‘three stripes’ of Adidas or the distinctive bitten apple of Apple). If a brand is strong enough, it will allow a business to diversify, that is, move into other products that may have nothing to do with its core product. A company such as Coca-Cola may produce almost as many kitbags and T-shirts as Adidas, along with pencil cases, watches, mugs and other goods. Businesses will hope that the customer will see the value of the brand as being of more importance than the product itself. This is linked to the reasons why customers buy products.

Customers buy products to obtain both tangible (real) benefits and what are called ‘intangible’ benefits – the extras gained from owning a product. A branded T-shirt has a real benefit as an item of clothing, and the extra benefit of being seen to be fashionable. For many of the customers of Nivea, for example, the extra benefits that come with a well-known brand name are worth just as much as any real benefits of the products.

### Did you know...

The bitten apple trademark is used by both Apple computers and the Beatles’ record company Apple, who have fought in recent years over the right to use it. A good place to find out about this branding dispute is at *The Times* newspaper online at [http://business.timesonline.co.uk/tol/business/industry\\_sectors/media/article698735.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/media/article698735.ece)

### Did you know...

There have been a number of brand disputes over the years. Sainsbury's Cola was accused of copying Coca-Cola's logo. More recently, Sainsbury's own brand of Pimms, 'Pitchers', has been criticised by the owner of Pimms.

### Have a go!

### Group activity

As a group, monitor a selection of advertisements over a time period such as one hour. You should each be monitoring a different channel so that you get a range of advertisements. List the advertisements and say, for each, what it is they are promoting. Is the appeal based on price, product features, value or brand, for example?

### Discussion

If a business has spent a lot of money building up a brand, is it unfair for another business to then start to market a similar product? Or is this just an example of fair competition? What do you and the members of your group think? Is this fair practice or not?

### Web-based activity

Visit a supermarket website such as Morrisons, Asda, Waitrose or Sainsbury's. List all the different promotions that are taking place and divide them into categories such as publicity-related, value added, sponsorship and merchandise.

### Quickfire questions

- 1 What are the three main aims of promotion?
- 2 Give three examples of simple promotions.
- 3 What is meant by the term 'potential customer'?
- 4 What is meant by an advertising medium?
- 5 Give three examples of traditional advertising media.
- 6 Give three examples of new advertising media, using new technology.
- 7 Explain the difference between above-the-line and below-the-line advertising spending.
- 8 Explain what is meant by 'merchandising'.
- 9 Give three types of publicity-related promotions.
- 10 Give three types of value-added promotions.



## Cracking the code

**Promotion** Telling a customer about a product and selling it to them.

**Socio-economic groups** Divisions of customers according to education and income.

**Media** The ways by which advertising messages are passed on.

**Merchandising** 'Spin-off' goods that help to promote a business or core product.

**Publicity-related promotions** Used to bring a brand or product to prominence.

**Value-added promotions** Where the customer gets more for their money than previously.

# Chapter 17

## Factors affecting distribution

### APPLIED IN THE BUSINESS WORLD

#### Tesco delivers

**T**esco sales run at over £1 billion a week in the UK and it consistently breaks records with its profit figures, reaching the £3 billion mark for profit in 2009. It has a 30 per cent share of the supermarket market in the UK, with over 2,200 stores, ranging from small Tesco Extras and Tesco Metros to giant superstores with thousands of square metres of selling space. To keep these levels of market share, growth and profitability, Tesco must make sure that it has the goods and services that its customers want available when and where its customers want them. Products need to be delivered on time, in the right quantities, to each and every shop in the chain. Some need to be fresh, some refrigerated; others are distributed in huge quantities, for example almost half a million tonnes of potatoes are sold each year. Delivery of all these products is a massive undertaking that is carried out by one of the biggest distribution networks in the world. As Tesco itself says on its careers website: 'What use is a supermarket shelf if it's not brimming with exactly the products our customers want to buy? The fact is that no matter how hard we try in every other area of our business, if the distribution chain isn't perfect, then our customers won't be happy.' ([www.tesco-careers.com/home/you/distribution](http://www.tesco-careers.com/home/you/distribution)).

Tesco has 24 huge 'hubs' scattered around the country, with each depot capable of servicing hundreds of stores. Some are devoted to fresh food (for example, Peterborough), others to non-food and



clothing lines (for example, Daventry). All have to work efficiently for the network to be effective.

Tesco has its own fleet of delivery vehicles, but also needs the help of a number of major transport partners. In the summer of 2009, the Stobart Group – famous for its Eddie Stobart lorries – won a £25 million-a-year contract to handle Tesco's non-food items. The goods arrive by rail and sea into Tesco's handling depot on Teesside, in the North East, where they are collected by Stobart for transport around the UK. Tesco does not rely solely on road transport, however, and in 2008 awarded the Stobart Group a £15 million-a-year contract to transport goods by rail in Scotland. Stobart also sees the new contract as a way of moving some transport from road to rail, to reduce the **carbon footprint** of the distribution network.

#### Live links

Visit [www.tesco-careers.com/home/you/distribution](http://www.tesco-careers.com/home/you/distribution) to see what the store has to say about the quality of its distribution networks.

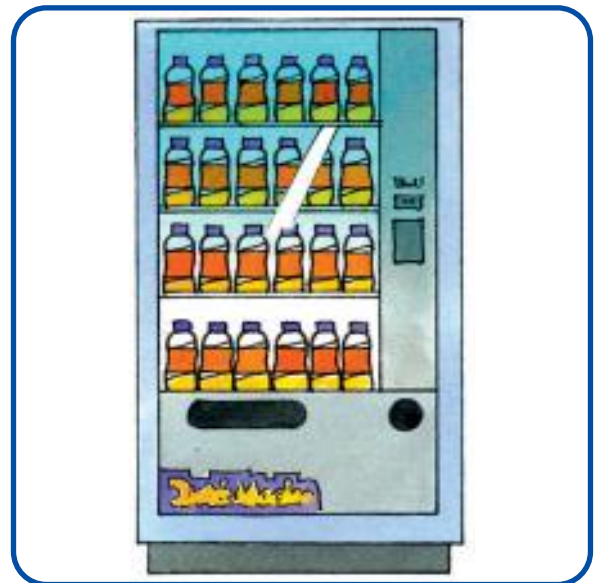


## Hit the spot

- Outline the main purpose of good distribution.
- Explain why Tesco needs different types of distribution for different products.
- Tesco uses road, rail, sea and air for its distribution network. Explain how it could reduce its carbon footprint. Explain how this could improve its relations with its customers.

## Introduction: Place – the 4th ‘P’

Place is the fourth part of the marketing mix. It is used to refer both to where a business decides to sell its products and to how it has them delivered there. The second of these is called ‘**distribution**’ and also refers to how products are delivered to customers directly. In a large business, distribution may be a separate department of the business or an area within it. If separate, it is often called ‘**logistics**’. It may also be a part of the production area in some businesses, as it is to do with distributing the goods once they have been produced. A small business may have to rely on local deliveries, or collect products itself from depots and warehouses.



Vending machines are an appropriate outlet for some types of goods

## Choosing appropriate outlets

The factors that influence the choice of outlet are linked closely to the type of product on offer. They are also affected by the size of the business. Many businesses sell through retail outlets and will obviously want to choose the one that is most likely to give them maximum sales. Some retail outlets sell a variety of products. Others specialise in a particular area – for example, food, fashion, jewellery, mobile phones, televisions, carpets, kitchens and white goods. These

are all called ‘specialist retailers’. Traditional outlets such as butchers, bakers and fishmongers still exist, as do service outlets providing a specific service such as hairdressers or nail bars. Other outlets may have started off as specialists but have since expanded into a number of areas. Marks and Spencer, for example, now sells as much food as clothes, and supermarkets such as Tesco, although still being food shops as their core business, also sell toys, clothes, and gardening, motoring and electrical goods.

## Did you know...

When Stobart and Tesco do use road, they try to make sure that there are as few as possible journeys made where lorries are not filled to capacity as this is both more efficient and more environmentally friendly. Any space in a lorry creates ‘empty miles’ adding to cost and carbon footprint.

Not all outlets must be shops. As well as vending machines, products can be bought via telephone call, or by using catalogues or the internet.

## Outlets and transport

Goods have to be transported, either directly to the customer, or to a warehouse or retail outlet. Many large retail businesses, such as supermarkets, have their own **distribution centres** (called regional distribution centres or RDCs), which act as 'hubs' for the distribution network. Businesses and customers are keen to see the environmental impact of transport reduced. Food miles are the measure used to show how far food has been transported. Customers are urged to eat local produce, or eat foods that are in season, rather than pay for Spanish strawberries or Peruvian green beans. A reduction in transport means a reduction in the carbon footprint of a product and applies to all products, not just food.

## Choosing appropriate distributors

The factors that influence the choice of distributors include the following:

- Cost and efficiency. Retailers need products to be delivered on time, and at competitive prices. They

also need a distributor to be able to deliver to as many outlets as is needed. If outlets are widespread this means the choice of distributor is affected by what is called their 'reach'.

- The nature of the product. Some products are urgent, others very valuable, some are very bulky and others need specialist services such as refrigerated units. Some are even dangerous to transport (chemicals and fuels, for example). Some distributors deal in general goods, others specialise in certain product types.
- Environmental and **ecological factors**. This means reducing the carbon footprint of products and their impact on the environment by reducing transport.

## New technology

The internet and online ordering has created a whole new outlet for products and new distribution channels. Major retailers such as Amazon and Play.com have no retail outlets other than the internet. Others have added web outlets to their high street presence. Sales of certain services may also be made via text on mobile phones. Some sales include distribution. Music, from sites such as the iTunes store, or directly from bands, or ringtones, is delivered direct to a computer or mobile.

### Did you know...

Retailers who have both high street shops and internet operations are often referred to as 'bricks and clicks' retailers.

### Did you know...

Music downloads have only been included in the charts since 2004, when they started to become popular. Now they are just as important, if not more so, than traditional sales.

## Summary

- Place is the fourth part of the marketing mix
- It is used to refer to where a business decides to sell its products
- It also refers to distribution – how it has products delivered
- The choice of outlet is influenced by the product being sold
- Not all outlets are shops – e.g. vending machines and the internet are also outlets
- Choice of distribution channels is influenced by the product, its market, cost and efficiency and ecological factors
- New technology has opened up new distribution channels

## Core knowledge

Products are not usually sold in the same place that they are produced. There is therefore a need to get the goods to the point of sale – the outlet where the customer will buy. The point of sale may be a market or a shop, where the customer comes directly; or it may be a warehouse or similar storage centre, from which customers can order goods. Either way, it is important that customers can easily obtain the product. If not, then they will not buy, but will go to a competitor who provides better service.

Distribution to the customer involves either delivery or collection. Some goods are delivered directly to the customer, for instance, deliveries of milk still take place in most of the UK. This is now provided as an added-value service, rather than for its original reason, which was to ensure that milk was fresh. Bulk goods may also need to be delivered such as sand and cement to a building site. Customers may also order goods from catalogues or advertisements, or online over the internet. These will all be delivered to the customer's home.

In other cases customers collect goods – from outlets such as shops, markets, stores, etc. In the case of services, it is the nature of the service that decides how it is distributed. For a personal service, such as a haircut, it is obvious that the hairdresser and customer have to be in the same place. This place could be a shop, or the service could take place in the customer's home. Some services can take place remotely (for instance, you can ring an information service to find out the times of trains), whereas others must take place where the service is being delivered (you can't paint a wall or cut a lawn without actually being there!).

## And more

The chain of distribution describes the various stages that a product passes through from when and where it is made, to when and where it is bought by a customer. Not all products pass along this chain. In some cases such as personal services, the product is created as it is delivered. Window cleaning, haircutting and taxi services, for example, are created and sold without going down a chain and delivered immediately to the customer. Many goods, however, pass through traditional 'long-chain' distribution. They are produced or manufactured at a plant or factory then transported to a wholesaler. The wholesaler stores products in large amounts, but is able to sell them in smaller amounts to retailers. (This is called 'breaking bulk'.)

Retailers either collect goods from wholesalers or have them delivered to their own outlets. Of course, large concerns such as Tesco have their own chain of distribution and their own distribution centres and warehouses.

Some goods are called bulk-increasing goods, others are called bulk decreasing. What this means is that during the journey from factory to customer some goods become easier to transport as they lose weight or size while others become harder to transport. A typical bulk-increasing good is furniture. It is easier to transport raw timber (and less care needs to be taken) than it is to transport finished furniture. Furniture production should therefore take place near to retailers. A good such as petrol, on the other hand, is refined. During this process it loses bulk so is easier to transport as petrol rather than oil. Oil refineries are therefore placed away from customers and nearer to where oil tankers dock. The choice of outlet and transport will therefore be affected by whether a product is more or less bulky, and what happens to it during production.

## Have a go!



### Group activity



Visit a local supermarket with your group and survey the items in the fresh fruit and vegetable section, to see how far they have travelled to reach the shop. List them in order of the ones with the biggest carbon footprint to the smallest. (You will have to consider the forms of transport they are most likely to have used in your calculation). What advice would you give to shoppers about reducing carbon footprints?

### Discussion



Service providers – e.g. hairdressers, nail bars, plumbers, electricians, window cleaners – have to be near to their customers or be able to travel to customers. How do you think this affects their ability to expand? Are there any large service providers in your area? Why do you think this is so?

### Web-based activity



Calculate your carbon footprint at <http://www.carbonfootprint.com/>. How do you think you could reduce this? How could a supermarket reduce its footprint?

### Quickfire questions



- 1 Place is the '4th P' – what are the other three?
- 2 Give the two parts of 'place'.
- 3 What does the term 'logistics' mean?
- 4 Explain how cost and efficiency factors influence the choice of distributor.
- 5 Explain how the nature of the product influences the choice of distribution channel.
- 6 Explain how ecological factors influence the choice of distribution channel.
- 7 What is meant by 'carbon footprint'?
- 8 Name three outlets for products, other than shops.
- 9 What is an RDC? What does it do?
- 10 Name three methods of distribution using new technology.

### Cracking the code



**Carbon footprint** The amount of carbon generated by a person, journey or activity.

**Distribution** How goods arrive with the customer.

**Logistics** The department responsible for distribution.

**Distribution centre** A hub that accepts bulk deliveries and divides up products for store delivery.

**Ecological factors** Factors that affect the environment.

# Chapter 18

# Competition

## APPLIED IN THE BUSINESS WORLD

### We are better!

**B**usinesses need to both identify who their competitors are and devise ways to gain a competitive advantage over them. Sometimes, in promotions, this is taken to extremes. What in America is called 'combative advertising' has long been a feature of some markets. Most famously, it is a technique that has been used in advertisements for various American beers (most notably Anheuser-Busch and Miller SAB) and for rival wireless and telephone services Verizon and AT&T (formerly Cingular). In combative advertising a business identifies a competitor, and then supports its own case by criticising its rival. It is not just a case of saying 'we are better than the competition' but of saying why the competition is worse. Advertisements called 'spoilers' may be run which say nothing about the advertiser's own product, but merely say how bad the competition is. In the UK, such advertising has, until recently, been fairly rare and low key. It is more a case of comparative advertising than combative advertising, with businesses making gentle comparisons with the performance or features of rivals. In the UK it is not legal to make claims that cannot be supported, but in the US, such advertising is much more aggressive and widespread.

Some businesses use official figures to make comparisons. Car manufacturers say that their vehicle has 'better miles per gallon than ...' 'is more powerful than ...' or 'has better storage space than ...' by using figures that are available for both them and the competition. Supermarkets such as Tesco use price checking as a way to compete, and publish an online



list to compare the price of typical 'baskets of goods' with the two supermarket chains that they see as their main rivals – Asda and Sainsbury's. You can find the information at [www.tesco.com/todayattesco/pricecheck.shtml](http://www.tesco.com/todayattesco/pricecheck.shtml).

Tesco not only publishes this information on the website, but also uses it in other advertising and promotion such as in television advertisements and on point-of-sale material in Tesco stores.

Customers can compare prices online for a number of products. Price check or 'comparison' websites are also now common and make it possible for customers to check the prices being charged by rival businesses. Examples include moneysupermarket.com, pricerunner.co.uk, pricecheck.com and kelkoo.co.uk. Increasingly, therefore, businesses have to provide a level of service and value that puts them ahead of the competition even though they may not be able to match them on price. A loyal customer is worth a great deal to a business.

## Live links

Visit [www.informationweek.com/news/mobility/business/showArticle.jhtml?articleID=218700222](http://www.informationweek.com/news/mobility/business/showArticle.jhtml?articleID=218700222) and read the article in *Information Week* about American telephone companies. Can you think of any similar types of advertising in the UK?

## Hit the spot

- Outline how combative advertising works. What do you think are its drawbacks?
- Explain how Tesco's price-checking service is of benefit to the customer.
- Explain how shops that cannot compete on price still manage to be in competition with Tesco.



## Introduction – competitors: who are they?

A business will always face some form of competition. This will be from businesses that operate in the same market, sell the same products or target the same **market segment**. Take Tesco, for example. It competes against other supermarkets such as Asda and Sainsbury's. It competes against non-supermarket suppliers of many of the products it sells. (Would you go to the corner shop or Tesco's for a bag of crisps? Would you go to Tesco or a specialist retailer to buy a TV?) It competes for the spending of a particular main target group – families and their weekly food shopping budget.



Sometimes direct competition is not as obvious as it is here.

## Direct competition

Sometimes the competition is obvious – two bakers or two banks next door to each other are in direct competition. At other times, the level of competition – or where it is coming from – is less obvious. There may be only one butcher in a village, so it looks like there is no competition. However, the village butcher will actually be competing with any shop that sells fresh or frozen meat, other butchers in nearby areas and supermarkets such as Tesco that have meat counters (and sell frozen meat). There are also online competitors – perhaps people can order online and

have meat delivered to their homes. The butcher is also competing with anyone who sells fish, or any other foods, which someone might wish to buy in preference to meat.

## Establishing competitive advantage

Businesses can choose to change each element of the marketing mix separately, or to change the total

balance. Businesses may compete with each other by charging different prices or by providing different levels of service and other 'extras'. If they compete on price, this is called **price competition**; on anything other than price, it is called **non-price competition**. Much non-price competition is in the form of promotions and offers. Businesses may also offer a better range of products or different version of certain products. For example, Tesco (and other supermarkets) offer their own 'Value' brand alternatives to big brand name products. If the difference becomes too great, then the businesses may no longer be said to be competing with each other, but have instead created their own market. Is a top fashion designer who makes one-off dresses really competing with a high street clothes shop? Although they may be said to be in the same market (clothes) they are so far apart that neither would consider the other to be a competitor. In this case, a different segment of the market is being targeted.

## Location and distribution

It is important to customers that the businesses they use not only provide what they want, but provide it where and when it is wanted. Businesses must be prepared to open the hours that customers prefer, or to come to customers' homes if necessary, or be prepared to lose custom. For example, the rental business which has the latest blockbuster DVD, in sufficient numbers, available late at night, will win out over the business that does not adapt to its customers' wants.

Location, particularly for a retail business, can be a major factor in its success or failure. It needs to be easily accessible to its target market, which could mean parking or public transport provision. It needs to be accessible to suppliers. Often, a retailer gains by being close to other retailers of similar products. For example, TV and electrical stores are often located close to each other. This benefits all of them, as target market customers attracted to one are just as likely to shop at the others.

### Core knowledge

Some businesses are in direct competition with each other. If there are two butchers, greengrocers, hairdressers or pubs in a village or on a high street, then they will be competing directly for the same customers. The degree to which one business competes with another depends on how closely the products that they each sell can be substituted for each other.

Imagine going to a market where only eggs are being sold by a large number of market traders. All the eggs look the same, and are packaged the same. They are all priced at the same price. (In a case like this, because there are so many sellers, the price will have fallen to the lowest possible level that will allow the sellers to stay in business.) What is going to make you buy from one seller rather than from another? In a case like this, the goods are so alike that there may seem to be nothing to make the consumer buy one rather than another.

But even in this case there are differences that can allow businesses to compete. For example, you may prefer brown or white eggs, or speckled ones, or they may come in different sizes, so that you are not actually buying like-for-like. Stallholders will also compete on service – who is fastest, or friendliest – and non-price areas such as making stalls more attractive.

There are bound to be other differences. The stallholder nearest the market entrance will have a competitive advantage – as will the one nearest to the car park or bus stop. The owners of the market are likely to have recognised this, and will charge slightly higher rent for such locations. The sellers will have recognised it, and are likely to charge slightly higher prices for the 'value' of convenience.

And more

## Non-price competition

Non-price competition is when businesses compete with each other in ways other than on price. Examples of non-price methods of competition include:

- providing a better service than a competitor, such as opening for longer hours;
- selling a wider range of products than a competitor;
- providing the customer with convenience and extra facilities, such as car parks, bag packing services, extended opening hours and personal service;
- adding value – for example, special promotions such as ‘buy one, get one free’ or ‘free x with every purchase of y’;
- offering free gifts or other rewards for customer loyalty (often through the use of loyalty cards).

Often, however, there is a cost involved with such ‘extras’ which means that, eventually, prices will actually be higher than competitors’. Businesses are gambling on customers regarding the extras as more important than the price difference.

A separate area under non-price competition is quality. In business, a quality product is defined as one that does exactly the job that the consumer wants it to do. A black bin bag may not be thought of as a ‘quality’ product but, providing that it holds rubbish without tearing, it is exactly the quality that it needs to be.

Consumers often think of quality in different terms. Many think that quality means that a product has to be expensive. This is not the case. A cheap product can be just as much a quality product as an expensive one – providing it fulfils the function that it is supposed to. It is therefore important for any business to make sure that it is dealing in exactly what its customers want. There is little point in providing an item such as a ‘luxury’ bin bag, at a premium price!

### Did you know...

A price war is when two (or more) competitors try to beat each other by lowering prices. Each lowers prices further than the other until one is forced out of business. This is good for the customer in the short term as there are lower prices. However, in the longer term, there will be less choice and higher prices. Less choice because there is now only one business where before there were at least two; higher prices as the business tries to recoup the losses it made during the price war.

### Did you know...

Although high street fashion stores will create lower priced ‘copies’ of designer clothes, their target market is entirely different. For the designer, the market is sports and fashion stars, and other rich individuals. For the high street competitor, the target is much larger (and less well-off).

### Did you know...

That for many businesses, online alternatives have led to changes. For example, as businesses such as LoveFilm, the online DVD rental company, have proved, customers prefer DVDs delivered, for convenience and with no additional cost. Online rental and direct downloading have thus become growth areas, while DVD rental from shops has declined.

## Have a go!



### Group activity



Each person in your group should check the prices of a typical basket of goods in a different local shop either by visiting or online. Compare the results. If prices are different, what are the factors that mean people still shop at the higher priced shop? If they are the same, why?

### Discussion



Competition may bring prices down in the short term but, if it forces one business to fail, there is then less choice for the customer, and higher prices. So do you think competition is a good or bad thing?

### Web-based activity



Choose a particular product you might like to buy. Compare its price on two price check websites. What do the results tell you about such sites?

### Quickfire questions



- 1 What is meant by competition?
- 2 Outline three areas in which a business is likely to face competition.
- 3 What is meant by 'competitive advantage'?
- 4 What is meant by price competition?
- 5 What is meant by non-price competition?
- 6 Give three examples of non-price competition.
- 7 Give an example of direct competition.
- 8 Outline the sort of features that make a good location.
- 9 Explain why similar businesses cluster in a location.
- 10 What is a 'quality' product?

### Cracking the code



**Market segment** That part of the market targeted by a business.

**Price competition** Competing purely on price.

**Non-price competition** Competing on grounds other than price, such as providing a better service.

# Chapter 19

## Effective customer service

### APPLIED IN THE REAL WORLD



### Service is vital

**P**lay.com is a leading online retailer of mainly electronic products, gadgets and music-related products. In 2009, the business came out top when its customer service was measured. Whatever customers expect of an online retailer, it is succeeding in providing it. This will include ease of navigation of its website, ease of ordering, speed of delivery, quality of goods and even the ease with which products can be returned. Customers always have expectations of retailers, and want a good experience.

What do you expect when you walk into a shop? Do you want someone to come and help you straight away? Would you prefer to be able to browse for a while to see if there is anything you like? Is it the same when you visit an online store? Do you want to be able to search for precisely what you want? Or to browse through stock to see if there is anything you would like? If a retailer can provide all the options that you want, then you are more likely to become a customer and, more importantly, to stay as one.

In America, service has long been recognised as an important part of the customer experience, so service in many sectors, including retail, has been measured for a number of years. The American Customer Satisfaction Index (known as the ACSI) measures customer satisfaction in over 200 companies in 43 different industries. It also measures the satisfaction of voters with the federal government. The UK version –

the UK National Customer Satisfaction Index – was first published in the spring of 2009. According to this index, online retailers provide better service than their high street rivals. Top retailer, according to the index, is Play.com, the online store for a range of products. Play.com scored 87 on the index, with close rival Amazon scoring 85. Other successful web operations include eBay, with a rating of 79, and Apple's iTunes, with a rating of 82. Online retailers were seen as providing a better level of service than traditional retailers, scoring an average of 82 over the retail sector's 74.8. Of course, online retailers are able to offer much more stock than their high street rivals, and therefore a greater choice. They are also bound by the UK Distance Selling Regulations – the set of laws that says customers should expect minimum levels of quality and can always return goods as they are, effectively, bought 'unseen'.

### Live links

Visit [www.play.com](http://www.play.com) to see the range of products that it sells. List the customer services it provides. How do you think it could improve this?



## Hit the spot

- Identify three customer service factors most customers would expect when entering a shop.
- Analyse how ACSI and UKNCSI are useful to a) customers b) businesses.
- How important do you think it is for a business to provide good customer service? Give reasons for your answer.

## Introduction

For a business to succeed in a **competitive market**, it needs to recognise the importance of its customers. To compete effectively, it has to understand what customers want and to provide this. It should aim to provide the products and the level of service necessary to keep customers happy. For many businesses this means putting the customers first through the range of goods and services on offer, through the prices charged, and through the customer care and service offered – what is often called the ‘whole’ customer experience. The main areas of importance for a good customer experience are the people that customers deal with, the premises in which they shop and the levels of service, especially after-sales service, offered by the business.

## People

Staff need to be aware of the types of customer with which they are dealing, and the likely needs of that customer. This means training not just in general areas of customer service, but in the specifics of the place they are working. For example, a customer would rightly expect a retail assistant in a DIY store to know something about tools. In some cases, particularly **business-to-business transactions**, knowledge of the product, the competition and the buyer needs to be extensive. Retail staff will also need training in person-to-person skills. They need to know how to respond to any problems, questions or issues that may arise. In any business where there is direct contact with the customer staff need to be well dressed, polite, helpful and be equipped with product knowledge. Even when contact is not direct – such as telephone or online support – assistants still need to be polite and knowledgeable so good communications skills are vital.

## Premises

**Premises** refers to where sales take place. The premises need to be well equipped to deal with customer wants – e.g. changing rooms in a clothes shop, parking for a supermarket, visual and audio displays in TV and electronics outlets. They need to be well laid out, organised and clearly signposted so that customers can find the products they want. Care also has to be taken to make sure that premises are suitable for those with special needs, and disability legislation places this as a duty on many premises.

Websites may also, in their way, be thought of as ‘premises’. They need to be designed so that customers find them easy to use. This means ease of navigation (finding your way round the site), ease of ordering and secure and varied methods of payment. A badly designed website is likely to deter customers whereas a well-designed one will encourage them.



Changing rooms are an important facility for a clothes store

### Did you know...

Male and female shoppers are likely to shop in different ways. Boys are often thought of as 'hunters'. They know exactly what they want in a shop, and, if they can't find it at once, seek help from an assistant. Girls, on the other hand, are often 'grazers'. They like to browse in a number of shops before they make any sort of choice, but may want the help of an assistant in making the choice.

## After-sales service

Once a sale is made, customers need to be offered further services to add value. This keeps them happy and loyal and adds to the reputation of the business. This ranges from services such as bag packing and delivery to how customer complaints are dealt with. For some products there may be advice on how to use them, or installation services. Telephone or web-based help lines may be set up to provide assistance. Customers need to be offered a range of convenient payment methods, such as credit and debit cards and even payments in instalments as well as cash options. They also need guarantees to reassure them that,

should anything go wrong with a product, they can return or replace it. Again, the law lays down minimum levels for these, but many retailers provide much more than the law demands.

## Reputation

It is important that the business has a good reputation. This may be for value, or reliability, or even low prices. Aldi and Netto, for example, are two supermarket chains that have a reputation for low prices. This is not a 'poor' reputation, but one that fits exactly with customer expectations of these stores.

### Did you know...

For some products, the after-sales service is as important as the product itself. This is generally any product that involves parts and specialist servicing.

## Summary

- To be competitive, businesses must look after their customers
- This means that they must know what customers want, and provide it
- Staff need to be polite and knowledgeable – this takes training
- Premises need to be welcoming and well-equipped according to the customer needs of the business
- After-sales service needs to be appropriate to the product and the customer
- The reputation of a business can help to both gain and retain customers

## Core knowledge

### Customer retention

It is vital to the success of most businesses that they retain the customers that they have worked so hard to win. It costs more – in both effort and resources – to gain a new customer than it does to retain an existing one. If customers are happy, they stay with the business. More importantly, they tell others about the business and improve its reputation. Those that stay with the business provide what is called

a '**lifetime spend**'. One customer to a garage, for example, who fills up with £50 worth of fuel, is worth £50 to the business. If the customer can be persuaded to return every time he or she fills up, then this is worth maybe £50 a week, or £2,500 a year or, over a lifetime spend on fuel, 30 or 40 years' worth, maybe as much as £100,000. Retaining the customer, through good service, the convenience of the garage, extra value offered such as a shop or personal service or customer loyalty schemes, therefore provides a huge level of expenditure when taken over a customer's lifetime. How much will you spend in your life on cars and fuel, or food and drink, or entertainment and holidays, for instance? If you multiply a single 'spend' by the number of times you are likely to make it in your lifetime, you will see how important lifetime spend is to a business.

As for word-of-mouth recommendation, it is said that we tell just two other people of a good customer experience, but spread the news of a bad experience to eight or more friends. It is more entertaining to relate the poor service or broken service promises than it is to tell about good service. Good service is expected, poor service is unusual, so worth repeating. Recommendations of good service are thus extremely strong, and important to businesses.

### And more

Jan Carlzon is a Swedish businessman who brought Scandinavian Airlines (SAS Group) from the brink of collapse in the 1980s, turning round its reputation for poor service and unreliability to one of good service and punctuality. Many of the ideas that he used to improve customer service were adopted by other airlines and are still in use, for example, he introduced Business Class to the SAS fleet. In 1987, he published a customer service book called *Moments of Truth*. In it, he talked about a **transaction** (when a customer buys a product) as having many 'moments' or points where it could succeed or fail. He explains that the customer does not just walk into a business and buy a product, but that there are a number of stages to the transaction. At each stage, the way the customer sees the business is closely linked to the level of customer service that is received. At every point, the customer is either happy, and moves on to the next stage, or unhappy, and the transaction does not take place. At each contact point with the business, the customer makes a decision. First contact may be through an advertisement, a promotion, a website or even a friend's recommendation. If happy with what is on offer, including the range, the way it is displayed, price levels and promises of service, the customer moves on to the next stage. The final stage for the business is not the actual transaction, but the after-sales service. Only if customers are completely happy with all aspects of the sale, from first contact to after-sales, are they likely to return for repeat purchases and recommend the business to others.

### Did you know...

Businesses have both internal and external customers. Most of us are external customers, but sometimes products are 'sold' within a business or organisation. If a schoolteacher gave a presentation to school governors, the governors would be internal customers.

## Have a go!



### Group activity



Note the steps you would take to carry out a transaction. This could be to buy a product or order a service. Add notes of every point where you come into contact with the organisation. This could include what, where and when to buy, how to pay and after-sales service. Each take one contact point and decide:

- How could the business improve this?
- How would customers react to the improvement?

### Discussion



Work out your lifetime value to a number of different businesses – supermarkets, for example, fast food franchises and burger bars, car showrooms and service providers such as banks and building societies. What does this tell you about lifetime value?

### Web-based activity



Read the article at

<http://www.iabuk.net/en/1/webretailersofferbestcustomerservice250209.mxs>

What do you think are the factors that make web retailers so good at customer service?

### Quickfire questions



- 1 What does a business need to recognise for good customer service?
- 2 What are the main areas of importance for customers?
- 3 Why is training important for staff?
- 4 Suggest three factors that make for good staff.
- 5 Explain why staff need good communications skills.
- 6 Suggest three things that should be signposted in a retailer.
- 7 Give three features of a good website.
- 8 Give three examples of after-sales service.
- 9 Suggest three different ways to pay.
- 10 Suggest three factors that might give a business a good reputation.

### Cracking the code



**Competitive market** Where more than one business competes for custom.

**Business-to-business transaction** B2B is where both seller and customer are businesses.

**Premises** The place where a transaction happens.

**Lifetime spend** The total amount that a customer will spend on a product in his or her lifetime.

**Transaction** The point at which the product is bought and sold.

# Chapter 20

## Improving customer service

### APPLIED IN THE BUSINESS WORLD

#### Reputation is vital

**E**DF Energy would not have found itself at the top of customer satisfaction surveys in 2009. It has almost 8 million customers in the south of England, many of whom are completely satisfied with its service. But good service should be provided to everyone, and the damage to its reputation that 108 dissatisfied customers caused, means that it will have to work hard to improve customer service. This shows just how important it is to maintain and improve customer service – the customers who received poor service represent around one thousandth of one per cent of EDF's total, yet they were the ones to hit the headlines.

Results published to show consumer satisfaction such as the American Customer Satisfaction Index (ACSI) or the UK National Customer Satisfaction Index (see Chapter 19) allow businesses not only to measure their customer performance against other businesses by comparing index figures but also to compare their own performance year on year. For example, the UK retail industry can compare itself to its counterpart in the US. UK retail scored 74.8 on the satisfaction index, while the American retail average was 75.2, so levels of service come across as being very similar. More importantly, businesses can look at the detail of the index to see how they might improve service. In EDF's case, this was a question of delivering a service on time.

EDF Energy Networks, the French company that sells power in the UK, was fined in 2009 for poor customer service. Ofgem – the regulator for the energy industry – fined the company £2 million for failing to connect customers fast enough. Energy



companies quote to builders for connecting properties and have a timescale in which to carry out these connections. On over 100 occasions, EDF failed to make the connection within this timescale. Not only does it have the fine to pay, and compensation payments of £450,000 to the customers affected, but it also has a dent in its reputation.

In a recession, such as that the UK economy was in during 2008 and 2009, it is important for retailers to keep existing customers happy so that they do not go to rivals. It costs much more to gain a new customer than it does to retain an existing one, so the survival of a business could depend on customer satisfaction. EDF had already contacted all affected customers and agreed compensation with them, but must build systems into its operations to prevent similar problems in the future.

#### Live links

Visit the EDF website at  
**[www.edfenergy.com](http://www.edfenergy.com)**.

How well do you think the website caters for customers?



## Hit the spot

- Outline the role of an industry regulator, such as Ofgem.
- Explain how an index is used to make comparisons.
- Why do you think it is more important to keep existing customers rather than gain new ones? Give reasons for your answer.

## Introduction: recognising and meeting the needs of target markets

Each business targets a certain section or segment of the market, which represents a type or group of customers. Its customer service must therefore be geared to that **market segment**. To be successful it has to recognise the needs of that market and not waste its time providing things that they do not want. For example, a customer of an upmarket jewellery outlet would expect personal service and expensive products – they do not want to be shown anything low priced or accept anything other than one-to-one attention. On the other hand, customers at a **discount store** expect prices to be low and may be happy to help themselves. Each business has its own part of the market to keep happy.



Customers in an upmarket jewellery store will expect personal attention

## Tracking and monitoring customer service

There are a number of ways to check on levels of customer service, many now made more efficient

through the use of new technology. Businesses have customer charters and statements of service levels, and need to ensure that promises they make are kept. EDF's worst mistake was in not keeping to the promises it had made. The most effective way to find out about the quality of customer service is to ask customers what they think. This can be done through surveys, questionnaires, customer panels, **focus groups** and interviews and can also take place online.

## Did you know...

That customer service targets may be measured by using SMART targets. These are S – Specific – as definite as possible; M – Measurable; A – Attainable or Achievable – possible to achieve; R – Relevant – fit in with other targets; and T – Time-related – to be met by a set date. SMART targets can be related to various areas where customer satisfaction is key.

## Improving customer service

To improve service, the business has to have accurate feedback, and act on it. It therefore needs to be able to recognise what customers see as good and bad elements of service. It is vital, therefore, that the information that it collects and acts on is precise. Once good and bad aspects have been discovered, staff training can then be used to improve levels of service. A key way to improve customer service is to make sure that, at each stage of a transaction, the customer is dealing with someone trained for that role. For example, a customer seeking technical advice should be dealt with by an expert. Equally, a customer making a complaint should have it dealt with by someone who shows sympathy and patience. In the case of complaints, customers often want to be dealt with by someone in a senior position – who has, or at least appears to have, the authority to put things right.

Another way to improve service is to use **mystery shoppers** or guests. These are people employed by a business to carry out transactions. They can then report back to the business on the level of customer

care they received and give good indicators on how to improve it.

## Technology and tracking customer service

Technology can be used to monitor the movements and purchases of customers. The use of **loyalty cards**, for example, will let a retailer know exactly when customers have visited an outlet, how often, how much they tend to spend per visit, and what on. Customer databases are used to contact customers from time to time with offers of service or special deals. For example, a car showroom may offer updates on new models along with reminders of service intervals. Databases can be set up to automatically issue such letters and to make them sound personal.

Websites can use technology to monitor the number of visits, track repeat visits and request customers to respond to surveys via email or online. For many, the key measurement is how often and how frequently customers return, and whether or not they make purchases when they do.

### Did you know...

Sometimes new technology gets in the way of good service. For example, people may be happy to have a phone call answered 'within three rings' but less happy if they are only connected to an automated service that takes a lot of time and effort to get them through to the person to whom they need to speak.

## Summary

- Businesses have to know how good their customer service is before they can improve it
- Customer charters can be used to improve service
- Customer opinion can be used to improve service
- Staff training can be used to improve service
- Technology can be used to improve service

## Core knowledge

### Building relationships

All businesses need to build positive relationships with their customers. They need customers to be loyal to them, bring repeat business, and speak well of them to other potential customers such as friends and relatives.

Not only does a business need to know whether or not its customers are satisfied, but exactly why they are. Or if they are not, exactly why they are not. If they can identify the reasons for customer satisfaction, then these can be built into more of their service offering. Equally, if they can identify why customers might not be happy, these areas can be reduced or removed completely by changing practice or by introducing training programmes.

The first question for many businesses, therefore, is 'How do I know that this customer, who has just bought a product, is happy?' Perhaps they have bought the product but still gone away unhappy with the service they received. Maybe on getting home, they do not like the product that they bought, but, if there is nothing wrong with it, may have no legal right to exchange or refund. They will pass this dissatisfaction on to friends and this will damage the reputation of the business. Many businesses therefore provide much better customer care than the law demands. Businesses develop ways to find out if customers are happy. This might be as simple as being polite and respectful to customers. Treating customers well, listening, being courteous and giving them full attention are all the marks of a good customer assistant. The business that remembers a customer's name may provide the difference between whether a customer buys from that business or another, so this is an effective way to compete.

### And more

Businesses that are serious about levels of customer service often lay down exactly what will be provided and what customers should expect in the form of a statement or charter. Customer service charters outline the terms of service a customer should expect from a business or any organisation that has customers. These include many government departments (both at national and local government level). Charters are drawn up to make sure that all of the customers of an organisation are treated as fairly as possible.

Customer charters usually follow a similar format – they will try to be clear, written in straightforward English, and easy to understand. The contents are generally:

- who we are;
- what we do;
- what we promise our customers;
- how we provide information;
- how we will communicate;
- how we will deal with complaints;
- what feedback you will receive;
- how soon you will receive it;
- what you can do if you have any further queries or complaints.

Look at the customer charter at [www.lotteryfunding.org.uk/customer\\_charter.pdf](http://www.lotteryfunding.org.uk/customer_charter.pdf). This is the charter for dealing with customers who make lottery fund applications to the group of public bodies that distribute lottery funds. It tells them about the customer standards they can expect and about the information that should be provided for each grant funding programme. It says what a customer should expect if an application is successful, and what information they should expect if the application is not a success. It is clearly and simply written (it has gained the Crystal Mark from the Plain English Campaign).

In order to make sure that all customers are catered for, charters are often made available in different formats for other members of the community such as large print, Braille, or in different languages.

### Did you know...

That a website can check whether or not you have visited (at least from that computer) before and remember details about what you browsed and what you bought. It sends a tiny programme called a cookie that sits on your computer and activates when you visit the site again. You can block cookies, but many sites will not provide a full service if you do.

### Have a go!



### Group activity



Share an example of good and poor customer service that you have experienced with the rest of your group. How do you think you could improve the poor service (perhaps using the good service as an example)?

### Discussion



What do you think are the problems that customers encounter with automated telephone answering services? What experiences can you share with your group? What recommendations can you make to improve such services.

### Web-based activity



Look at the customer charter at [www.lotteryfunding.org.uk/customer\\_charter.pdf](http://www.lotteryfunding.org.uk/customer_charter.pdf). This is the charter for dealing with customers who make lottery fund applications. Find three good features of the charter. Find three features that you think could be improved.

### Quickfire questions



- 1 What is an industry regulator?
- 2 What is a target market?
- 3 Explain how a business might target particular customers in a market.
- 4 What is a customer charter?
- 5 Suggest three ways to collect customer feedback.
- 6 Explain why a customer with a complaint would want to be dealt with by a senior person.
- 7 Suggest the sort of information that a business could get from loyalty card usage.
- 8 Suggest how a database could be used to improve customer service.
- 9 Suggest how a website could be used to improve customer service.
- 10 What is a 'cookie'? Outline why it is useful to a business.



## Cracking the code

**Market segment** A targeted part of the market.

**Discount store** A shop where prices are low and many products are reduced in price.

**Focus groups** Small groups of people asked to give opinions.

**Mystery shoppers** People employed by a business to carry out transactions and report back to the business on the quality of customer care.

**Loyalty cards** Cards that provide 'points' or other benefits for repeat visits to a retailer.

# ENTERPRISE

Chapter 21 Introduction to enterprise

Chapter 22 Enterprise skills

Chapter 23 The importance of enterprise skills

Chapter 24 Assessing and researching enterprise ideas

Chapter 25 The business plan

Chapter 26 Setting up the team

Chapter 27 Effective communications

Chapter 28 Motivation to succeed

Chapter 29 Monitoring progress and performance

Chapter 30 Evaluating your enterprise

## Don't forget

If any of the weblinks don't work, use a search engine to find a similar topic or business on which to base your studies.

# Chapter 21

# Introduction to enterprise

## APPLIED IN THE BUSINESS WORLD

### Duncan Bannatyne

**E**ntrepreneur Duncan Bannatyne has more money than he could possibly spend. If he had chosen to, he could have retired many years ago, never having to work again for the rest of his life and still enjoying a multimillionaire's lifestyle. But he chooses not to. Like many **entrepreneurs**, he is always on the lookout for the next deal, the next money-making challenge, the next enterprise.

Duncan is, of course, one of the dragons from the BBC television programme *Dragons' Den*. He doesn't try to disguise his humble roots in life, in fact he is proud that he never had a helping hand when he started in business. Everything that he has achieved has been the result of his own efforts, something he finds personally satisfying. Born in 1949 in one of Glasgow's decaying estates, Duncan's family was poor, but loving. As with many of their neighbours, the Bannatyne family were used to going without luxuries and the things that make life pleasant.

At 15 years old, Duncan left school without any qualifications. It was normal for school leavers to look for work in either the local shipbuilding yard or the sewing machine factory, but Duncan wanted more than this. Instead he joined the Royal Navy. He might have travelled the world, but his short temper often got the better of him. He was placed in a military jail for nine months after an argument with his commanding officer, which ended when Duncan tried to throw the man overboard. After being dishonorably discharged from the Navy, he went through the lowest



point in his life. He began drinking heavily and endured another prison stretch for being drunk and disorderly.

Returning from prison, Duncan knew that his choices were limited; no employer would touch him with his record. He really had only one choice: to run his own business. With the little money he could raise, he bought an old ice cream van. He found the name of an ice cream manufacturer in *Yellow Pages* and set off in his van selling ice cream. When he raised enough money he bought another van, then another. Within five years he was the owner of six ice cream vans.

Like all good entrepreneurs, he was always on the lookout for a new direction. He noticed that there were more old folks' homes opening and took this as a sign that there was an opportunity for him. He managed to raise £30,000 to buy his first home by taking three credit cards to their limit and avoiding paying his ice cream supplier until the last moment.

From then on Duncan's businesses thrived. He always keeps a keen eye open for opportunities and has never been scared to take a risk with a venture. He says that anyone can do what he has done, providing they are willing to take risks. It's not about being intelligent, or being good at school, it's all about having drive and not being afraid of hard work.

## Live links

You can read about Duncan Bannatyne and watch a series of videos about his life at the *Dragons' Den* website:

[www.bbc.co.uk/dragonsden/](http://www.bbc.co.uk/dragonsden/).

## Hit the spot



- Give two types of risks that an entrepreneur might face.
- Explain what happened in Duncan Bannatyne's life that encouraged him to be an entrepreneur.
- Discuss whether you believe that all that stops someone from becoming an entrepreneur is an unwillingness to take risks.

This unit of study looks at what it takes to become an entrepreneur. In the chapters that follow you will be able to read about entrepreneurs and what they have managed to achieve. Some entrepreneurs appear to have been born to face the challenges of organising a business. Richard Branson is a good example of this. He had two businesses before he had left school at the age of 17. They both failed, but that is another feature of entrepreneurs: they don't easily give in. While some people might view business failure as a personal catastrophe and look for paid employment, true entrepreneurs examine what went wrong and try to avoid those mistakes next time.

Duncan Bannatyne. You could argue that because of his personal circumstances when he started his first business, the risks were quite low as he didn't really have that much to lose. He was effectively unemployable and he had little money, so if it all failed, he hadn't lost that much.

Another characteristic is a willingness to work to get money. Duncan Bannatyne had a job in a baker's when he was a 13-year-old schoolboy. Entrepreneur Sir Alan Sugar, the boss from *The Apprentice* television programme, used to get up early at a similar age to boil beetroots for a local greengrocer. It is not unusual for budding entrepreneurs not just to earn pocket money but also to gain valuable insights into how businesses operate.

## Taking risks

A common characteristic of all entrepreneurs is the willingness to take risks. This point was made by

## Did you know...

Many entrepreneurs were the oldest child in their family. Having to look after younger brothers and sisters might help develop entrepreneurial skills early in life.

## What drives entrepreneurs on?

You will be able to study this in more detail in later chapters, but one thing that stands out is that it's not just the money. For some, it is the sense of

achievement, others might say it is the excitement of negotiating to get the best deal, or it might be the power and status that success brings. There is even a group of people who set up and run businesses not for their own benefit but to help less fortunate people. Such people are often called **social entrepreneurs**.

### Summary

- Entrepreneurs do not start businesses purely to make a great deal of money. There are some who do so to help other people
- No special training or qualifications are needed to start a business, neither do you need to be very intelligent
- Entrepreneurs must be prepared to take risks

## Core knowledge

### How you will be assessed

This unit will be assessed using a controlled assignment. In order to complete this assessment, you will need to have experience of setting up and running an enterprise. While the assignment must be your own individual response, you will be able to share the work of the enterprise with a group of friends. Your teacher will explain to you the rules that the examination board has on writing up the assignment. It makes good sense to keep notes and other documents right from the start in a folder, which is called a portfolio.

This portfolio will contain the evidence that you have reached the different **assessment objectives** for the exam board. The assessment objectives (AO1, AO2 and AO3) have been looked at earlier in this book. It would be well worth revisiting these to remind yourself what writing skills you are going to be judged upon.

As with other units, there are three main areas to your portfolio. Firstly, you will need to spend some time considering what enterprise skills are and what part each plays in allowing an entrepreneur to become successful. You will find help on this topic in the next two chapters of this book. Secondly, you will need to have plenty of evidence to show how you and your group have carefully planned your enterprise and put it into practice. You will have to show how you came up with the idea of the business, including the market research you have undertaken. This can be found in Chapter 24 and the earlier chapters in the Marketing section. You need written evidence on your plans for the business as explained in Chapter 25. Your team needs to be able to show how you have identified the different jobs or tasks that have to be done and decided who in your group is best suited to each one. Guidance on this can be found in Chapter 26.

Chapter 27 contains information about why communications are important in all businesses, regardless of whether they are large or small. You should also give thought to how the individual members of your team might be motivated to get your enterprise off the ground and running successfully.

The third and final part of your assessment is something that many people find difficult: judging how well you and each other member of your team have worked in achieving your business objectives. Help on this topic can be found in Chapters 29 and 30.

This project should be fun and, if you are like Duncan Bannatyne, exciting. The main purpose of you undertaking this enterprise is to be able to complete your controlled assessment. But, there are more reasons than this. This will probably be the first time you have organised a small business. It will give you and your friends the opportunity to feel for yourselves the frustrations and pleasure that come from setting up your own business. You never know, it might even inspire some of you to go on and repeat the whole process again.

### Did you know...

The dragons in *Dragons' Den* are not the real entrepreneurs in the show, the contestants are. The dragons are there to fund the projects if they like them. Technically the dragons are venture capitalists.

### And more

## Some advice

You should have gone through the chapters of this book in class, covering the ideas contained within them, before you embark on your own enterprise.

Having decided upon your team for the enterprise, probably the most daunting task is to decide what your business will be. Will you provide a service or produce a good? You do not need to have a particular interest in a product to make a success of it. Duncan Bannatyne, for example, decided to sell ice cream. His choice came more from the opportunity of an ice cream van being available for sale than from any long-held desire to sell ice cream. The product doesn't really matter as long as it will sell. However, you should be careful about producing any food or drink items. There are regulations about the manufacture and sale of foodstuff, which you really want to avoid.

Once you have some ideas in mind, you should undertake some market research into how popular your item is likely to be. You should remind yourself of how to conduct market research from the work you did on marketing earlier in your studies.

It is well worth taking time to consider, even at this early stage, how you will record your discussions so they can be included in each of the team's portfolios. Remember, this portfolio will be used to determine the mark that you receive for the unit's work. The work will need to be an individual piece even though you will undertake much of the enterprise as a team.

You will be sharing out the tasks according to each team member's particular interests and strengths. This means you will have to rely on others to undertake part of the enterprise and give you information about these tasks. The place that you can use to personalise your assignment is the final section where you evaluate how well the enterprise was planned and put into practice. You also need to assess how good your and the other team members' contributions were.

### Did you know...

*Dragons' Den* appears in many countries throughout the world, including Afghanistan, where it is called *Fikr wa Talash*, which means Dream and Achieve.

## Have a go!



### Group activity



In your enterprise groups, decide upon a product to make or service to provide. Use market research to confirm that there is a good chance the enterprise will be successful.

### Discussion



Discuss how you can work as a team yet still manage to produce individual responses for the controlled assessment.

### Web-based activity



Have a look at the way in which you will be assessed for this assignment. You can find the grid that your teacher will use to mark your portfolio at

<http://store.aqa.org.uk/qual/newgcse/pdf/AQA-4130-W-SP-10.PDF>.

### Quickfire questions



- 1 What was Duncan Bannatyne's family life like when he was a boy?
- 2 Duncan was in prison on two occasions. Why was he sent there?
- 3 What was Duncan's first business?
- 4 How did he fund his second business?
- 5 How do entrepreneurs view business failure?
- 6 What was Alan Sugar's part-time job as a schoolboy?
- 7 What are the three parts of the controlled assessment?
- 8 What is a portfolio?
- 9 What are the assessment objectives AO1, AO2 and AO3?
- 10 Why is it important that your team conducts some market research?

### Cracking the code



**Entrepreneurs** These are people who have the idea for a business, arrange to set it up and take the risks of it failing.

**Social entrepreneurs** Entrepreneurs who are driven not by profit but by improving the lives of other people.

**Assessment objectives** The skills you will need to be tested on in order to get a good qualification.

# Chapter 22

## Enterprise skills

### APPLIED IN THE BUSINESS WORLD

#### Black Circles

**M**ichael Welch started his car tyre company at the tender age of 18. Even at school, Michael had the makings of an entrepreneur. He was the kid who would record compilation music CDs and bring them in to sell to his friends. His driving force was not so much making a little bit of extra pocket money but the excitement of wheeling and dealing.

Michael decided to leave school at the age of 16, feeling that it had little more to offer him. His first job was as apprentice tyre fitter. He wasn't long into the job when he realised that the owners of the company were putting on a hefty mark-up on what they paid for the tyres at a wholesaler. He was amazed that the customers were prepared to pay these high prices. This was possibly because car tyres are not things that are bought that often and few people bother to track competitors' prices.

Realising that there was money to be made, Michael set up his business. He noticed that specialist wide and performance tyres were the items that had the biggest **profit margins** so initially concentrated on these. In order to keep costs as low as possible, Michael went for the mail order option. As an 18 year old, he found it difficult to convince the banks that the business had potential, so money was tight. He did, however, manage to secure a £500 grant from the Prince's Trust, which helped. Placing adverts in motoring magazines, such as *Max Power* and *Redline*, he was pleased when the orders started to come in.



Michael had the good sense to recognise that he lacked any business knowledge and progress would be limited until he sorted out some training. This he did in two ways: firstly, he enrolled on a business course at his local college in order to learn the basics, such as managing finances. This was followed by a year working under Sir Tom Farmer, who was then the owner and driving force behind Kwik-Fit, the market leader in tyre retailing. It was during his time with Tom Farmer that Michael put together the idea of Black Circles. Building upon the strengths of Kwik-Fit and avoiding its weaknesses, Black Circles started trading and has progressed well. Customers order their tyres online and these are then fitted at a franchised local garage. Many customers like the user-friendly website and are pleased with the service that they receive.

#### Live links

Michael's web address is [www.blackcircles.com](http://www.blackcircles.com), where you can find out more about his tyre business.



## Hit the spot

- Give two reasons why Michael Welch might have found it difficult to obtain a loan from a bank when he started in business.
- Explain how Michael reduced the risks that he faced when he started selling tyres.
- Justify Michael's decision to enter an industry that already had a lot of competition.

## What does it take to become an entrepreneur?

Some people believe that entrepreneurs are born with enterprise skills. They argue that, like some other talents, such as being a gifted athlete or naturally musical, you either have it, or you don't. Others take the view that given the right encouragement and conditions; anyone can acquire the skills necessary to start up a business and make it a success.

### Did you know...

Most businesses fail before they reach their second anniversary.

acquiring wealth so you can enjoy a pop star lifestyle or retire at an early age was not the motivation. Entrepreneurs are quite often motivated by the challenge of building something up from scratch. What mattered to Michael was having the opportunity to demonstrate to others his creativity and to experience the buzz of starting an enterprise that proved to be a huge success. Whatever their reasons for starting a business, entrepreneurs have a common characteristic: they have a vision. They can see in their own minds what they want to achieve and are willing to push themselves to make this vision reality.

### Did you know...

An invention is when a new product is created, but innovation occurs when it is developed into a business idea.

## Self-motivation

It became clear early in his life that Michael Welch had the makings of an entrepreneur. When many young people just have teenage fashions and friends on their minds, Michael was thinking about business. What probably helped him was he was self-motivated. He didn't need someone to tell him what to do, as he had already worked out for himself that unless he organised it then it wouldn't get done. The thing that drove Michael on was not the prospect of making large amounts of money. Like many entrepreneurs,

## Taught skills

Most people would accept that there are some enterprise skills that can be taught. In Michael Welch's case he recognised that he needed to have business knowledge if he was to make it as an entrepreneur. He also realised that he would be more likely to succeed if he had some practical experience of working in a business. When he couldn't learn these skills, he accepted that he needed help and obtained a job in a rival business.

## Summary

- Entrepreneur Michael Welch saw a business opportunity and had the vision to exploit it
- Michael recognised that he needed to acquire some business skills if he was to succeed as an entrepreneur

## Entrepreneurs and learning difficulties

While many entrepreneurs are very intelligent men and women, they did not always achieve well at school. Michael was not that different from many other entrepreneurs when he decided to leave school at the first opportunity, rather than stay on to study for more qualifications. Many of the most successful

entrepreneurs didn't shine academically at school. It has been discovered in a study that 4 per cent of people in the UK experience some form of dyslexia. This figure rises to 20 per cent in entrepreneurs. Whether there is something about dyslexia that gives suffers the skills to become entrepreneurs, or whether dyslexics go on to be successful entrepreneurs to prove that they are good at something, is a matter of debate.

### Core knowledge

## Enterprise skills

It would be very difficult to produce a 'top 10' list of the most important skills needed to become a successful entrepreneur. It will very much depend on the person involved and the circumstances that person faces. For example, if someone has the good fortune to be successful in his or her first business venture, then the ability to keep going, or persevere, in the face of failure is not really going to be an issue. There are some common features of entrepreneurship, however, and without them an entrepreneur is unlikely to be highly successful.

### Self-assurance

This means the person is confident and has faith in his or her own abilities. A self-assured person will not look for support and reassurance from other people before he or she does anything. The entrepreneur will be prepared to face the consequences of his or her actions if anything goes wrong. We sometimes say that such a self-assured person has a '**can do**' mentality; he or she won't let anything stand in the way of getting the business running. This skill is important because entrepreneurs must have confidence in their abilities. It will be unlikely that there will be anybody in the background pushing the entrepreneur on. People who start businesses must have the drive to carry on in the face of disappointment. Many entrepreneurs fail several times before they finally succeed. An entrepreneur will view failure of an early business as a learning experience and will not be put off by it. Anyone who becomes dispirited by failure doesn't really have the makings of an entrepreneur.

### Risk taking

Starting a business is all about taking risks. Time, effort and money must all go into a business long before there are any financial returns. Entrepreneurs are known for the hard work and the long hours they put into their enterprises to try to make them successful. Even if an entrepreneur is fortunate to get back all the money he put into an unsuccessful venture, he has still lost out. When he was working those long hours to get the enterprise off the ground, he could have been employed by someone else and earning a wage. In a way he missed out this opportunity to earn money, so really it is a cost for him. A good entrepreneur takes calculated risks. If the risks of failure appear to be quite low in relation to potential returns, an entrepreneur might consider the gamble acceptable. The greater the possible returns from an enterprise, usually the more willing entrepreneurs are to take risks.

## Finding and exploiting business opportunities

Being able to reduce the risk of failure obviously helps an entrepreneur decide if a venture is worth the effort. Probably the easiest way of reducing risk is to undertake some market research, which is a topic that has been covered in an earlier chapter. Market research allows the entrepreneur to determine realistically if the product or service being provided will actually appeal to consumers. The research will let the entrepreneur know how much competition there is, which is another risk factor.

## Innovation

When starting a business the owner must decide whether he or she will provide a good or a service that already has several competitors or whether they will offer a new type of good or service. The advantage of moving where there are many competitors is that the product must be popular with consumers, so this risk factor is reduced. However, a new entrant will find it difficult to compete with other established businesses in the market. It is for this reason that many new entrepreneurs will use their skills to provide a new or innovative product. Choosing such a product requires creativity and imagination, as well as a good eye for what consumers are likely to buy.

## Building teams

If an enterprise is to succeed then it is important that the people who work there share the same vision as the owner. One way to achieve this is to create a team, the members of which are able to work together effectively. A good entrepreneur will look for ways of motivating his or her staff to get the best out of them. Entrepreneurs need good interpersonal skills and powers of persuasion to get people to work together well.

And more

## Managing risk

A clever entrepreneur will try to keep his or her costs as low as possible. This could be achieved by working from home to avoid having to rent offices or other premises. Another way to lower costs is to lease equipment or vehicles rather than buying them outright. A lease is a type of rent. Instead of buying a van, for instance, a vehicle is leased. The vehicle is not owned by the entrepreneur, so if the business doesn't work out, the owner will not have to worry about trying to recover the money by selling the van.

Another strategy would be to avoid expanding too rapidly. A fast growing business can lead to something called **overstretching**. If an entrepreneur expands the business, he or she will need to spend money buying more equipment and taking on more staff. It will take time, however, for the business to attract new customers, if they can be found at all. This can lead to a **cash flow** problem as the business is paying out more than it is receiving from sales.

## Did you know...

The most common reason for business failure is a lack of market research, resulting in not focusing on a specific market, according to the UK Insolvency Helpline.

## Have a go!



### Group activity



Undertake an audit of the entrepreneurial skills of each member of your enterprise. You should consider the different skills that have been mentioned in this chapter, and any other that you feel are relevant to your project. Produce a profile of each team member, emphasising the contribution that each can bring to the enterprise.

### Discussion



Discuss whether it is possible to teach young people how to become entrepreneurs.

### Web-based activity



Go onto the BBC *Dragons' Den* website and look at the profiles of the dragons and some of the entrepreneurs who have made pitches to the dragons. Produce a table of the characteristics and skills each person has.

### Quickfire questions



- 1 What type of business is Black Circles?
- 2 What was Michael Welch's first job when he left school?
- 3 Who did Michael work for to gain experience of the industry?
- 4 According to research, what do 20 per cent of entrepreneurs suffer from?
- 5 Why does an entrepreneur's time still have a cost to the business?
- 6 Why do entrepreneurs need to be self-assured?
- 7 What does innovation mean?
- 8 What is a lease?
- 9 Give two reasons why entrepreneurs need to have interpersonal skills.
- 10 Give an example of a non-financial benefit of owning a business.

### Cracking the code



**Profit margins** The gap between revenue and costs, measured as a percentage of the revenue.

**'Can do' mentality** Having the confidence and drive to complete tasks when others would give up.

**Overstretching** Expanding a business too rapidly. Costs rise faster than revenue, causing cash flow problems.

**Cash flow** This is the movement of cash both into and out of a business; for there to be a positive cash flow, more should be coming in than leaving.

## Chapter 23

# The importance of enterprise skills

### APPLIED IN THE BUSINESS WORLD

#### *The Big Issue*

**T**he weekly magazine for the homeless, *The Big Issue*, was launched in 1991 by Gordon Roddick and John Bird. The men were concerned about the growing number of people sleeping rough on the streets of London and wanted to do something about it.

Gordon Roddick was an established entrepreneur, having started the famous Body Shop chain with his wife, Anita. On a business trip to America, Gordon bought a copy of *Street News* from a homeless vendor. *Street News* was established in 1989 and was a means by which disadvantaged people could earn some money with dignity by selling the newspaper on the streets of New York. Gordon was aware of a similar problem in London and copied the idea.

Gordon had the help of John Bird, who had experience of working in the printing industry and

himself had been homeless. The magazine is written by professional journalists, but it is sold exclusively by the homeless. The two social entrepreneurs worked on the principle that the best way to solve the problem of homelessness lay in helping people to help themselves. Registered vendors can buy the magazines from the publishers for 70 pence. They are then able to sell them for £1.50. The 80 pence difference between the cost and the selling price is profit for the vendors to keep.

Only homeless people and those who are in insecure accommodation – what *The Big Issue* calls vulnerably housed – are allowed to sell the magazines. By giving these disadvantaged people a role it provides a legitimate alternative to begging on the streets.

There are two parts to *The Big Issue*. There is the magazine, which has been set up as a limited company, and the other side of the organisation which is a registered charity, The Big Issue Foundation. This was created to try to tackle some of the underlying issues which cause homelessness. The Foundation supports the vendors by trying to get them off the street and into safe housing. The organisation is able to provide advice about housing, health issues, education and employment. It also exists to help vendors fulfil their aspirations of doing something worthwhile.

*The Big Issue* has now developed into an international organisation. The enterprise has lent its trademark to social entrepreneurs throughout the world, so other countries can duplicate its valuable service. A version of the magazine is published in Australia, Japan, South Africa and East African states.



#### Live links

Read more about *The Big Issue* and what it is trying to do to help the plight of the homeless at

[www.bigissue.com](http://www.bigissue.com).



## Hit the spot

- Describe *The Big Issue*'s objectives.
- Explain how *The Big Issue* is able to help homeless people.
- Discuss whether you agree that, in most cases, businesses are not too concerned about how profitable they are.

*The Big Issue* is a good example of a social enterprise. This is a type of not-for-profit organisation which is concerned about providing a service for disadvantaged people. The people who organise them are usually called social entrepreneurs. *The Big Issue* operates like any other business but its objective is to improve the lives of the homeless throughout the country. Many social entrepreneurs have used *The Big Issue* business model to help them design their own community projects.

To become a *Big Issue* vendor, the person must be homeless or vulnerably housed. The vendors receive training and sign up to a code of conduct that outlines the rules when selling the magazines. Each vendor is allocated a sales area, or pitch, that no other vendor can use. Vendors buy copies of *The Big Issue*

for 70p and sell them for £1.50. The 80p profit is theirs to keep. There is no limit to how many magazines each vendor can buy to resell, but the money for any unsold magazines is not refunded.

The magazine goes beyond simply giving homeless people the opportunity to sell the magazine to make a little money for themselves, it also provides the vendors with the chance to learn some important skills like managing money and being responsible for their stock. The organisation has helped improve the image of homeless people. The public see the homeless in a better light, because they appear to be doing something to try to improve their lives. *The Big Issue* hopes it will educate its readers by producing informative articles about why people become homeless and what can be done to help them.

## Summary

- *The Big Issue* is an example of a social enterprise
- Social enterprises have the welfare of others rather than profit as an objective
- Social enterprises require the same entrepreneurial skills as commercial organisations

## Did you know...

*The Big Issue* sells about 150,000 copies each week and has a readership of about 600,000. More men than women buy the magazine and three quarters of its readers come from high socio-economic groups.

## Core knowledge

### Enterprise skills for social entrepreneurs

Enterprise skills are not limited to those people who are setting up commercial organisations to make a profit for their owners. There are many people who have the same drive as Michael Welch and share the same entrepreneurial characteristics that he has. These people might not see themselves as being entrepreneurs, but they are doing similar things and using identical skills.

The social enterprise movement can be found in many industries. People who work together in **cooperatives**, housing associations and religious groups can all be described as social enterprises. Many consumers prefer to operate with social enterprises as they believe that the organisations are doing good work and so deserve their custom. This also applies to businesses that use **fairtrade** practices. Such businesses make sure that their suppliers are paid a fair price for their products, even though they could buy them cheaper elsewhere. Although technically not social enterprises, they share some of the characteristic of these organisations. In each case, the morality of how they operate outweighs the **profit motive**.

Starting a social enterprise involves many of the same processes as a business out to make a profit. There were risks involved when Gordon Roddick and John Bird started *The Big Issue*. They worked with professional journalists, who would have wanted to be paid. The magazine needed to be printed, which would cost money and office space was needed. If the magazine had not taken off the way it did, money would have been lost.

A social enterprise is a business whose primary objective is social rather than personal. In other words, the enterprise is set up to benefit those who are not necessarily directly connected to it. Any surpluses that are made (you might note that these are not called profits) are reinvested into the community. The organisation is not driven by the need to maximise profit for shareholders and owners.

Many commercial businesses would consider themselves to have social objectives, but social enterprises are distinctive because their social or environmental purpose is central to what they do.

Some well-known examples of social enterprises include Jamie Oliver's restaurant, Fifteen, and the Eden Project in Cornwall. Social enterprises, like other forms of business, do not have to be long term. A group of students arranging a leavers' prom is being as enterprising as other entrepreneurs. The motive behind their actions is not to make a profit but to provide a service to others.

#### Did you know...

According to the Annual Survey of Small Businesses UK, there are approximately 62,000 social enterprises in the UK with a combined turnover of at least £27 billion.

#### Did you know...

Social enterprises account for 5 per cent of all businesses with employees, and contribute £8.4 billion per year to the UK economy.

And more

## Benefits of operating a business

The benefits of running a business can be split into two types: financial and non-financial. Financial benefits are usually the profits that the business makes. Many people believe that money is the only motivator behind owning a business. This is not the case. Entrepreneurs have many different objectives. Most entrepreneurs put a great deal of their profits back into the business, which is called **investment**, rather than spend the money on a lavish lifestyle.

Non-financial benefits are the advantages that are not money. Entrepreneurs can get satisfaction from creating a successful business from scratch. But an organisation's success needs to be judged on how well it has reached its objectives. We have already seen that many organisations have objectives that do not centre on making high profits for the owner. In the case of *The Big Issue*, the organisation would be seen to be successful if it improved the lives of homeless people.

### Private and social benefits

When a business provides benefits to people outside the business, we say that these are social benefits. So if a business cleared a piece of badly polluted waste ground that was next to its offices, this would benefit the local community and be a social benefit. A private benefit, on the other hand, helps just the business. Sometimes an activity will have both social and private benefits. For instance, the skyscraper at 30 St Mary Axe in the City of London, known better as The Gherkin, is regarded as a building of outstanding beauty. The people who work nearby find it pleasing to look at, and its fame is a form of marketing for its owners.

## Have a go!



### Group activity



In your groups, produce a PowerPoint presentation on the types of enterprises whose main objective is not to make a profit.

### Discussion



Discuss whether a business must make a profit in order for it to survive.

### Web-based activity



Go to Jamie Oliver's Fifteen website at [www.fifteen.net](http://www.fifteen.net). Use information on the site to produce an information sheet designed to explain the concept of a social enterprise to someone who hasn't studied business before.

## Quickfire questions



- 1 What is a social enterprise?
- 2 Give two real examples of social enterprises.
- 3 Who started *The Big Issue*?
- 4 Give two ways *The Big Issue* helps homeless people.
- 5 How do *The Big Issue* vendors make their money?
- 6 What risks did the founders of *The Big Issue* take?
- 7 Why do some businesses have a fair trade policy?
- 8 Give an example of a non-financial benefit of running a business.
- 9 What is the difference between a social and a private benefit?
- 10 Give an example of a social benefit.

## Cracking the code



**Not-for-profit organisation** A social enterprise or charity which has objectives other than making a profit.

**Cooperatives** Organisations run for the benefit of members rather than shareholders.

**Fair trade** Ensuring that suppliers are not exploited and that they receive a reasonable price for their products.

**Profit motive** Organising a business in a way that will create the highest profit for it.

**Investment** Paying for something now in order to benefit from it in the future.

# Chapter 24

## Assessing and researching enterprise ideas

### APPLIED IN THE BUSINESS WORLD

#### Gecko Headgear Ltd

**F**or those who work and engage in sport at sea, safety is essential. Weather conditions are unpredictable and can easily change. It only takes a rogue wave and a piece of debris or sail boom swinging to cause serious head injuries. It is for this reason that many marine professionals and sportspeople choose to wear safety helmets.

Gecko Headgear Ltd both designs and manufactures marine safety helmets. The Cornwall-based business was founded in 1993 by Jeff Sacree. Initially it was set up as a custom surfboard manufacturing business, but Jeff noticed a **niche** watersports market. There were protective helmets available on the market, but none had heat-retaining properties. As a surfer himself, Jeff could see the potential for a helmet that was both lightweight and prevented heat loss.

Jeff recognised that the surfboard market was relatively small and was very much seasonal in nature with most surfers only engaging in their sport during the warmer summer months. Branching out into helmet manufacture would provide work for the whole year. What Jeff did next was to design and make a single helmet for himself. He used this when surfing and other surfers commented on how good the idea was. But Jeff was unsure if the surfers' market was big enough to sustain his business.

A conversation with a lifeboatman at the Royal National Lifeboat Institution (RNLI) gave him hope. At the time RNLI volunteers went out to rescue people in their lifeboats wearing motorbike helmets.



Any crewmember who was unfortunate enough to go overboard had difficulties because of the so-called bucket effect. The bike helmets acted as a heavy weight for someone in the sea, which can lead to neck or spinal injuries.

The RNLI was interested in the helmet, but before its crewmen could use them, the headgear had to be tested and certified to industry standards. It took three years of manufacturing and experimenting with various models before Gecko Headgear came up with the right helmet. The design brief was for a one size lightweight shell that would offer good head protection. It had to function with the other safety equipment worn by crewmen and be at home in salt water without any increase in weight.

After many designs that didn't live up to the brief, Gecko got it right and now manufactures safety helmets for extreme sports enthusiasts and the RNLI.

#### Live links

You can find out more about Jeff Sacree and Gecko Headgear at

**[www.geckoheadgear.com](http://www.geckoheadgear.com)**.

The website shows the range of safety helmets available.



## Hit the spot

- What is meant by a gap in the market?
- Explain how Jeff attempted to reduce his risks of failing when he starting Gecko Headgear.
- Discuss whether a carefully planned business is bound to be successful, and an unplanned business is likely to fail.

Anyone who jumps into starting a business without doing some research and giving the project some serious thought is heading for trouble. We have read in previous chapters that entrepreneurs need to be self-assured and confident, but being too spontaneous and incautious can lead to business failure.

In the case study, we read how Jeff Sacree planned his business carefully. He identified that there was an opportunity to exploit a gap in the surfing market for a practical safety helmet, but didn't start to mass produce these helmets before he was sure that he would be able to sell them. His research told him that the helmets needed to be certified and to gain this the products would have to go through rigorous testing by an outside agency.

What Jeff did was to put together two key ingredients: his practical fibreglass handling skills from his surfboard business and his entrepreneurial skill of innovation. Both these skills were needed together with his 'can do' attitude to develop the right product.

Gecko Headgear was not out to make a fast profit. Jeff recognised that it would be some time before the business would make money from the idea, if it was to make money at all. He had taken on three members of staff to help him develop the helmets. These workers' wages had to be paid, helmets would have

to be made then scrapped if they failed the tests. Jeff's own time would also have to be redirected from his surfboards. It was to be three years of expensive product development before any helmets could be sold. But Jeff had faith in himself and was prepared to commit money to the project.

Like any good innovator, Jeff did not stand back when his helmet design finally was approved. He has since gone on to develop ten more versions of the safety helmet. Each time he changed the product, he would asked his customers what they thought and used this feedback to develop the helmets further. You will see on his website that the business now manufactures full-face helmets for watercraft racing capitalising on the interest in extreme sports. There are also helmet designs for camera attachments and communication systems.

Jeff was prepared to take the risk of spending so long developing the helmet and he is now starting to see the benefits that come from a well-selling carefully designed product. The planning and market research that Jeff undertook will obviously have had an impact on the success of the venture. But a good entrepreneur would not have been disheartened if the product had not worked, but would have instead assessed the situation and moved on to another enterprise.

## Summary

- The owner of Gecko Headgear noticed a gap in the market for a water safety helmet and went on to research the potential market carefully
- A considerable amount of time and expense was put into developing the product so it was acceptable
- Once it was on the market, regular customer feedback was used to develop the helmet further

## Core knowledge

A carefully researched and planned enterprise is far more likely to succeed, bringing benefits to its owners, than one that is rushed through without any real thought or care. We have read that every enterprise faces risks. Planning can help the entrepreneur determine just how great the risks are, and if the potential returns are high enough to justify taking these risks. It would be unlikely that an enterprise that had many risks and a relatively low potential return would get off the ground at all. The entrepreneur would be better off putting his or her money into a savings account at the bank, receiving guaranteed interest without risk.

Of course, there is no certain way of calculating if a business will be successful despite the risks, but there are some techniques that might help. Market research is something that has been considered in an earlier chapter.

## Conducting market research

What you need to remember is that you will have a limited budget, if any money at all, to undertake market research. But it is still important that you find out as much as you can about your target market. Remember, market research is not just about finding out if your product or service will sell to your target market, but what aspects of it appeal most to your potential customers. If you find that there is scope for a dog walking enterprise, in which you are paid to exercise customers' animals, you need to know what time of the day they will require this service. Similarly, you can find out what price people are prepared to pay for such a service. If you are manufacturing candles, what type of candles would be popular? What type of designs and which colours would sell best?

Great care should be taken in putting together your questionnaire, if this is how you plan to undertake your market research. You may choose to use another research method, which you can be reminded about in Chapter 13.

The questionnaire should:

- not be too long, a dozen questions should be enough. People will get bored if they are asked to answer more than this. It will also make the processing of the data more complicated;
- have a purpose for each question. Don't add a question if you do not have a clear reason. For instance, a common question is: What age group are you in? Do you need to know this? If not, then leave it out;
- have questions that are crystal clear. 'Have you ever bought a decorative candle?' is too vague. Since when? What do you mean by a decorative candle? Test the questions beforehand to see that they are easy to answer;

- have response boxes to tick, such as 'often', 'occasionally', 'never'. It makes it quicker to collect the data and the processing of it becomes much easier;
- provide all the information that you will need. It should be unnecessary to have to go back with a second questionnaire at a later date to catch up on information that you forgot to ask about;
- ask enough people so a good sample is achieved. It is no good asking just a handful of people as you can't be sure they are representative of the general public.

Some enterprises like to test their questionnaire out on friends before they run them properly, something called a **pilot survey**. This way any glitches, or mistakes, can be discovered and corrected before the real questionnaire is performed.

Putting the responses into graphs makes it much easier to analyse the findings. But take care with the type of graph and scales that you use. The graph should present the data in a clear and easy to understand way. Using complicated graphs and charts can distract from the data that you have spent time collecting.

### Did you know...

Market research surveys will often split potential customers into what are called socio-economic groups, according to their jobs. These groups are labelled A, B, C1, C2, D and E.

### And more

Once you have conducted the market research and decided that there is a potential market for your business idea, it might be worth looking at an additional analytical methods. Businesses often use what is called a SWOT analysis to get an overview of an intended project or idea.

## SWOT analysis

SWOT is an abbreviation for Strengths, Weaknesses, Opportunities and Threats. It is a method of weighing up the positive and negative points about a business, to help entrepreneurs with their decision making. A SWOT analysis can be used as part of the planning process before a business is started or it is used before a change is made in the organisation, such as when the entrepreneur is thinking of expanding or developing a new product.

The analysis is usually presented in the form of a table. An example can be seen below. Imagine an entrepreneur is planning to open a beauty salon targeted at young women in the 15 to 30 age range. She could list the good and bad points (or positive and negative) about the business. These can then be split into things that she can control and those she can't. We label these as internal and external factors. By writing these points down, she can gain an overview of the organisation, clearly seeing what is good and not so good about her business idea.

SWOT table for a beauty salon aimed at young women

|          | Positive                                                                                                                                                                                                                    | Negative                                                                                                                                                                           |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Internal | <b>Strengths</b> <ul style="list-style-type: none"> <li>● Good premises available at fair rent</li> <li>● Location on high street will get noticed</li> <li>● Experienced friend willing to work at salon</li> </ul>        | <b>Weaknesses</b> <ul style="list-style-type: none"> <li>● Need to raise large sum of money to fund enterprise</li> <li>● New to running a business, so not experienced</li> </ul> |
| External | <b>Opportunities</b> <ul style="list-style-type: none"> <li>● Seems to be gap in the market for young customers</li> <li>● New housing in town with families, some with newlyweds and others with older children</li> </ul> | <b>Threats</b> <ul style="list-style-type: none"> <li>● Other businesses in the area might target this group</li> <li>● Demand might fall due to recession/job losses</li> </ul>   |

It should be remembered though that it's not just a case of counting how many positive and how many negative points there are. Each point raised will not have the same weighting, or importance. There may be just one negative point about opening the business, but it is such a big issue that it outweighs all the positives. Nevertheless, writing out the separate points on both sides helps to give a more balanced view of the project.

If your enterprise is to be successful, you should find it helpful to undertake a SWOT analysis before you start. It will be a good idea to have a full meeting completing this exercise together. Working as a team, you are more likely to be able to identify all the issues that you would face.

To help put your SWOT table into perspective, you might want to say how each of the points that you have identified is likely to affect your enterprise. You could use a five-point scale, with 1 meaning an unimportant factor, or low risk, and 5 indicating a major factor. Then by adding up the positives and negatives, you can use your totals as a basis for a discussion on whether the enterprise is likely to work.

### Did you know...

Many students believe that SWOT tables are split up into only good and bad factors. They forget that the table shows internal and external factors as well.

### Have a go!

### Group activity

Working in your enterprise team, produce a questionnaire for your intended product or service. Test out the questionnaire on friends and make any changes that are necessary. Now run the full questionnaire, producing graphs of your findings. Discuss what the survey has informed you about your potential market and the likelihood of your enterprise succeeding.

## Discussion



Sometimes market research suggests that a business idea will work, when it proves not to be the case. Discuss how errors occur in market research to give unreliable findings.

## Web-based activity



Produce a SWOT analysis for Gecko Headgear. Use the company's web pages for additional information.

## Quickfire questions



- 1 What did Jeff Sacree make before he started Gecko Headgear?
- 2 Why was Jeff looking for work during the winter months?
- 3 What was wrong with the helmets lifeboatmen wore before the new helmets were available?
- 4 How long did Jeff spend developing the helmet?
- 5 Give two risks that Jeff took.
- 6 How can market research help a new business?
- 7 Why are pilot surveys sometimes conducted?
- 8 Why should you use uncomplicated charts and graphs of survey findings?
- 9 What do the initials SWOT stand for?
- 10 How can a SWOT analysis help a new business?

## Cracking the code



**Niche** A smaller, specific market within a larger one.

**Pilot survey** A dry run of a questionnaire to see whether the questions work properly.

# Chapter 25

## The business plan

### APPLIED IN THE BUSINESS WORLD

#### AKC Home Support Services

If an entrepreneur goes to a bank to arrange funding for a new enterprise, the bank will almost certainly want to see a business plan. If this plan seems reasonable, then the bank might be willing to give the loan. If there is anything in the plan that doesn't appear to be right, it will probably refuse funding. Unfortunately many entrepreneurs view the writing of a business plan as a chore, and something that can be forgotten about once financing the enterprise has been successful.

Husband and wife team Darren and Sharron Jones launched their North Wales residential care business, AKC Home Support Services, in the 1990s. The business provides home care and accommodation to the elderly, who would otherwise find it difficult to live on their own at home. When they came up with the idea of AKC, one of the first things that the couple recognised was that they had to write a business plan.

Darren and Sharron regretted the time that they were spending on writing the plan and thought they could be using their time and effort to get things ready to start the business. At the time, they could not quite see the link between this document and operating a successful business. In hindsight, Darren recognises that the plan helped them get going and stopped them making a decision that could have proved disastrous. Darren is now more convinced about the merits of getting the plan right and using it as part of a business's everyday running.



The couple wrote the plan based on blank forms that were provided by their bank. They managed to see a copy of another business's plan which influenced how they presented their own version. One thing that did prove useful was setting short- and long-term objectives. These goals helped them focus and make progress with the business. If they found that there was a major change in the market in which they operated, they would go straight back to the business plan and reassess their objectives. Unlike many businesses which put away the plan once it has been read by their banks, AKC's plan was a working document that formed a type of road map for the business.

The business plan has also stopped AKC from expanding too quickly. Early on in its life, the enterprise was offered work in another county. This seemed exciting initially, but when the effects of this expansion were studied, the cash flow forecasts presented a different interpretation. Overstretching the business in its early days would have had too severe an impact on the cash situation. Had the couple gone with their hearts, rather than referring to their business plan, AKC might not have been around today.

### Live links

The link [www.telegraph.co.uk/finance/2954986/Darren-Jones-AKC-Support-Services.html](http://www.telegraph.co.uk/finance/2954986/Darren-Jones-AKC-Support-Services.html) takes you to a newspaper article on AKC, where you can read about the business in more detail.

### Hit the spot



- What is a business plan?
- Explain how AKC's business plan stopped the business from overstretching.
- Judge whether the better the business plan is, the better the business will be.

## Reasons for a business plan

Darren and Sharron recognised that they had not realised the importance of their business plan until they had started their enterprise. So, why are these plans so valuable to a business?

- First and foremost, a business plan can give a good indication of whether the enterprise is likely to be successful or not. It is a way of checking that a balanced view of its chances of working out is made. Care should be taken to make sure that all the relevant details are included, and nothing, whether good or bad is left out. For it to be a good plan it is important that the true facts are given, not a rosy picture painted to make the prospects look better than they are.
- The plan can also be seen as a guide to the business. Once it is up and running, the managers can refer to the plan to be reminded what the objectives of the business are. This way they can make sure the decisions that they are making on a day to day basis are going to achieve their intended purpose. So, it is a way to check that the organisation is still on track.
- Every now and again the managers will need to stand back and to review just how much progress they have made within the business. To help determine this, the plan might include a set of **interim targets** or objectives. Interim targets are a way of checking that the business is moving in the right direction so it can achieve its main objectives within the stated time. Imagine a business which has the objective of having a turnover of £240,000 within three years of starting. It may set yearly interim targets to check it's getting there. So, an interim target may be set at £100,000 by the end of the first year, £180,000 for the end of year 2, leading to the third-year objective. The interim targets are like a series of stepping stones to make sure the business doesn't suddenly find itself far removed from its main objectives.
- The business's finances can be organised by referring to the plan. Money can be allocated into different areas, such as marketing, purchasing supplies and wage costs. Each amount of money is called a budget, so there might be a transport budget, an advertising budget, and so on. The creation of budgets allows the managers to monitor each part of the business to check it is functioning properly. If one budget is being spent too quickly, attention will be drawn to it allowing the managers to find out what the problem is and do something about it.

### Did you know...

The term budget comes from the French word for a purse.



- A plan is also used as a means of persuading banks and other investors to put money into the business. This is the reason why many entrepreneurs bother to write a plan, but the other reasons (above) are probably more important to the success of the business. Sometimes entrepreneurs are inclined to exaggerate aspects of the plan, such as the forecast cash flow, in order to make the business sound more attractive to investors. Doing this is bad because it means the plan cannot be used properly for its other reasons.



A detailed business plan will persuade banks and investors to fund the business

## Adjustments to the plan

A business plan should never be viewed as something that cannot be changed. The circumstances that influence a business, such as competition and the state of the market, change regularly. So it may be necessary to make adjustments to the plan to take account of these factors. If the economy is in a temporary downturn and there is a lot of unemployment about, this will affect many businesses' performance. Ignoring the downturn will make the business look like it was **underperforming**

and become a cause for concern. The fall in demand would be an issue, but as it was the result of something outside the business's control, it would be wrong not to reflect this in the business plan. Adjusting the cash flow forecast and the objectives would be fairer as it would give the managers something more realistic to aim for and not demoralise them by keeping objectives that would be impossible to achieve.

### Summary

- A business plan is written when an enterprise starts or when there is to be a major change within the business
- The plan sets out the progress the business intends to make during its first few years
- The plan is a working document and needs to be reviewed regularly and changed if necessary

## Core knowledge

### The contents of a business plan

There is no set way to lay out a business plan. It will depend upon several factors, including the size of the business, whether it is a manufacturer or service provider and the personal preferences of the entrepreneur. The plans are normally written in sections to make it easier for readers to find their way around the document.

### Sections of a business plan

- 1 Details of the company. This will contain basic information about the enterprise – the name and contact details of the owners, its objectives, if it is a franchise, and whether it is a sole trader, partnership or limited company.

- 2 The market. In this section will be a description of who your customers will be and where they are located. The main competitors may be identified in this section.
- 3 The product. Here the product is described, in terms of its uniqueness and how it might stand out from the competitors' products. The unique selling point might be something like a more personalised service, or the product might be quite different in some way from the others in the market.
- 4 Pricing and costs. This will give details on the price the product will be sold for and the different costs of production. The entrepreneur might go on to calculate the breakeven point, which is the number of items that need to be made each month in order to cover his or her costs.
- 5 Promotion. This section will look at how the enterprise intends to attract customers. This would include things such as advertising and special offers.
- 6 Staff. Details of the owner and any key staff will be included here. This will contain information about previous experience and a description of the job role of each person.
- 7 Finances. This is probably one of the most important sections and will be studied carefully by anyone intending to invest in the business. It will have a cash flow forecast for at least a year or two, showing the balance at the end of each month. It will have details of how the start-up capital is intended to be obtained, and whether there will be funding from supplier credit. An investor will expect to see reasonably accurate forecast costings and revenue streams and projected profit calculations. The costs should include the repayments on any loan that has been made.

### Did you know...

A business plan is sometimes compared to an ocean liner crossing the Atlantic. Planning is needed to sort out where it should be at different stages on the journey, to ensure that there are enough supplies on board and to decide what it should do if weather conditions change for the worse.

### And more

## Why business plans might be inaccurate

The details in a business plan need to be as accurate as possible if proper use is to be made of the plan. Probably the part that is most likely to cause problems with reliability is the finance section. A business can only speculate on how many items it is going to sell when it starts out. While the turnover figures can be based on actual market research findings, it is still an estimate based on educated guesswork. For this reason, we often call the calculation a **guesstimate**. Costs can be forecast more accurately, but there is still no guarantee that the price of raw materials will stay the same after the business has started.

Many factors can change either before the business starts up or just afterwards that could influence the cash flow. A new competitor might join the market. This would probably result in sales being less than anticipated, or having to accept a lower price than expected. The price of supplies might, for instance, be affected by exchange rate changes, if the items come from abroad.

If the plan is not to overstate the profitability of the business, its sales figures should be on the side of caution. This means that if market research suggests that sales could be between £40,000 and £50,000, the lower figure should be used. The opposite is true for costs where the higher amount should be used.

### Did you know...

When competitors in the *Dragons' Den* give their pitch, they are presenting a short version of their business plan to the dragons. In the US, short summaries of a business plans are known as 'elevator pitches' because you only have so long before the lift arrives at the top floor and your investor gets out.

### Have a go!



### Group activity



Between you create two mock-up business plans. One should be poorly written with obvious shortcomings, while the second needs to be much better. In each case draw attention to the strengths and weaknesses of the plan.

Working with your team, produce a business plan for your own enterprise.

### Discussion



Discuss what advice you would give to a small business to ensure that its business plan is well received by a bank so it is prepared to lend money to the enterprise.

### Web-based activity



Use the website [www.bplans.com/sample\\_business\\_plans.cfm](http://www.bplans.com/sample_business_plans.cfm) to obtain some sample templates of business plan forms. Choose a suitable one and complete it for an enterprise that you are currently running or are thinking about running.

## Quickfire questions



- 1 What type of business is AKC?
- 2 How did the owners of AKC use their bank to help them write their plan?
- 3 How did its business plan stop AKC from overstretching?
- 4 What is a budget?
- 5 What is meant by an interim target?
- 6 What is an investor?
- 7 What is a breakeven point?
- 8 Why is it important that a business plan is frequently looked at as the business develops?
- 9 How might a downturn in the economy affect a business plan?
- 10 Why is a cash flow included in a business plan?

## Cracking the code



**Interim target** A short-term target that can be used to check the enterprise is on track to reach its main targets.

**Underperforming** Operating below expected targets.

**Guesstimate** Something between a guess and an estimate, an educated or informed guess.

# Chapter 26

## Setting up the team

### APPLIED IN THE BUSINESS WORLD

#### State of Undress

**C**anadian born Emma Cheevers and Alex Suhner were art college friends in London. While they grew up close to each other in Vancouver, they only met when they were studying in London. When they graduated from their fashion courses, they both needed to decide what the next stage in their career was to be.

What they chose to do actually shocked their parents. The two young women liked the idea of starting a business together and the product was to come from their art college experiences. They decided to design and sell glamorous women's underwear, or lingerie, and loungewear. Both women enjoyed fashion and had a love of luxurious silk 1940s-style lingerie. To them it seemed an obvious next step to start their business, State of Undress.

Emma had worked as a fashion journalist before becoming an entrepreneur, while Alex had gone straight into design for the classic Burberry company. The women designed and produced a range of underwear to test the market. They were able to use the contacts they had made in their different fashion fields to their advantage. They sent their former colleagues the samples and waited for a reply. The response came back quicker and was better than they could have hoped for, so they decided to go ahead and form their company.

In the past selling luxury ladies' underwear was not seen as a respectable career for two young women.



Over the years, however, attitudes have changed, with mainstream companies like Agent Provocateur selling through high street shops and on the internet. With increased respectability has come an increased demand for sensuous lingerie, which has allowed State of Undress to expand.

Alex and Emma were quite different people and sometimes they experienced a clash of personality. Emma sees herself as far more practical and down to earth than Alex, whom she regards as being more of a temperamental artist.

#### Live links

Alex and Emma's website can be found at [www.state-of-undress.com](http://www.state-of-undress.com).



## Hit the spot

- Give two advantages a partnership has over a sole trader.
- Explain how Alex and Emma's different skills helped the business.
- Judge how important it is for the members of a team to be close friends.

## Working as a team

We read in the case study that Emma and Alex were quite different types of people. They both came from the same Canadian city, but their personalities and preferred ways of working were far from the same. Emma was the sort of person who liked to be organised and to get things done. Alex was the opposite. She was very artistic and creative but temperamental, lacking Emma's practical, realistic nature. Both women had very different skills, but they worked well as a team. Emma was able to deal with the business side of State of Undress, while Alex was more concerned with the designing of the garments.

This is how many successful teams work. There would be little point in having a team of five or six people, each identically skilled. This would mean that there would be competition for the job they were all suited for, resulting in most of the team members taking on a role doing something that wasn't their strength. It makes far more sense to have a variety of people with a range of talents and personalities. This way there is less likely to be any conflict as team members compete for the same job. If in the case study both Emma and Alex wanted to be the main designer then it would probably have led to rivalry. An additional problem would be that there would be nobody prepared to actually run the business.

## Teams

A team is more than just a collection of individuals. Teams function best when each member is working to

a common goal or objective, but each person has a clearly defined role in achieving this goal. This way each of the team members will feel empowered and takes personal responsibility for his or her contribution. No team member wants to let the others down.

## Synergy

It is sometimes said that a team that works well together will create **synergy**. This term is used increasingly in business and is the situation that occurs when the output of a team is greater than all the individual outputs if each person worked on his or her own. It is sometimes jokingly referred to as '2+2=5', or some similar mathematical calculation.

Choosing the most appropriate role for each team member means assessing each individual's strengths and weaknesses. There would be little point in putting someone who found it difficult to speak in public in charge of raising finance. This role would involve having to present the case for the money in a confident and convincing way. It would be better to have someone who was more extrovert to do this job. Similarly, someone who has plenty of drive and is able to motivate others should be used almost as a team captain to keep the others going when times get bad. A distinctive role must be found for each person that suits his or her strengths.

Teamwork also functions best if each member of the team has a clear set of objectives or targets to achieve. SMART targets were mentioned in Chapter 8, and these apply equally to individuals as well as whole businesses.

## Summary

- Operating in teams is an effective way of getting the best from those who work in an organisation
- Teams benefit from having members who have different skills and personalities
- Teams can create synergy if individuals have their own targets which feed into the objectives of the business

## Core knowledge

### Teamwork

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There is a saying that many hands make light work. Most humans find it easier to work when they are with others and teams can be used to harness this energy. There are several reasons why teams work better than a series of individual workers.

#### Greater spread of abilities and talents

Having a range of different skills means that there will probably be someone on the team who can deal with every eventuality that arises in the organisation. This can lead to greater specialisation and improved efficiency. Even if there are no experts available, then at least the person whose skills are most suited can be used. If a problem is encountered, the team can decide as a group who would be most appropriate to solve it. Individuals operating alone tend to put off jobs that they know will stretch their capabilities.

#### Encourages creativity

Working together can fuel creativity. Someone might come up with an idea, which is then refined by others as they discuss the idea. This in turn can start a chain reaction of suggestions and developments. The creativity might be used to overcome a challenge, or simply be 'blue sky thinking' on how the business might develop in the future.

#### Social aspect of work

People are social beings and enjoy interaction with others. Operating within a group allows people to remain alert and makes the workplace more enjoyable. Team membership can make the work seem more enjoyable, if for no other reason than it allows others to see how their own contributions help the business as a whole. Someone working alone might not fully realise how his or her contribution makes a difference to the organisation.

#### Shared values

Having employees operating in teams can encourage the staff to become more focused on the business's objectives rather than their own interests. Working alone can breed selfishness and a narrow point of view. Teamwork tends to improve communications within an organisation with team members being willing to take on the company's objectives and share its values.

#### Moral support

Team members can support each other when the going gets tough. Somebody working on his or her own might give up, but the support of a team can often be enough to drive the project on when things get tough.

#### Skills audit

A **skills audit** is a useful exercise for new teams to perform. It involves producing a profile of the team in terms of the skills each member possesses. Team members will be asked to list what they feel they are good at and this is transferred on to a central list. By doing this, allocating jobs within the team becomes much more reliable, as it is easier to identify the best person to undertake each task.

### Did you know...

The benefits of working in teams were identified by psychologists as far back as the 1920s.

### Did you know...

The French expression *esprit de corps* means the force that drives a team on, particularly when its members are facing difficulty.

### And more

## Teambuilding activities

If people are to function together as a team there needs to be a shared mentality. A team is more than a number of employees lumped together to complete a task. There has to be a common thread that links them if the team is to function as a separate entity. It is not unusual when an organisation is trying to create team spirit within a newly formed group to provide a teambuilding activity.

These activities will have nothing to do with the work the team is to tackle. Instead the team members will be taken away from the business to disassociate themselves from the work. They will often be placed outside their comfort zone. So office based staff might find themselves in a remote country location, miles from facilities.

There are two types of activities that tend to be undertaken: problem solving and trust exercises. The group might be set a task, such as building a bridge across a stream with limited resources. The team members will have to talk with each other and share ideas before trying to solve the problem. These types of activities allow the team to determine the strengths and weaknesses of each person, so roles can be allocated in the future. Trust activities are designed to encourage team member to accept each other as reliable members of the group. Such an activity might involve one person leading others who are blindfolded around obstacles in a daunting situation, such as a forest.

## Teamworking – a criticism

Not everyone agrees that teamworking is a good way of organising employees. Some criticise teamworking as it depersonalises people, with individuals sacrificing their own identities to that of the team. The Japanese use teamwork extensively and this approach is built into their education system and culture. Some would argue that the team mentality is taken too far. For instance, it is considered disloyal to refuse to socialise with your team after work. Employees are expected to fit in with what the team wants even when they are not actually working.

### Did you know...

Several entrepreneurs have spotted a gap in the market providing teambuilding events for businesses. Activities range from extreme sports to chocolate making.

## Have a go!



### Group activity



Make up two activities that are designed to improve the teamworking skills of each member of your enterprise. One should be a problem-solving exercise and the other a trust or bonding activity. When you have agreed on the best two, actually perform these tasks.

Undertake a skills audit of each member of your enterprise group. Discuss the jobs that need to be done and allocate them to the most appropriate people.

### Discussion



Can teams become too big and impersonal? What is the ideal size for a team?

Is teamworking always the best way to operate a business?

### Web-based activity



Research how the Japanese view teamworking. Present a report on your findings.

### Quickfire questions



- 1 Name one of State of Undress's competitors.
- 2 What roles did Emma and Alex undertake in their business?
- 3 What are SMART targets?
- 4 What is synergy?
- 5 What is meant by *esprit de corps*?
- 6 What is a teambuilding exercise?
- 7 What are the two main types of teambuilding exercises?
- 8 How can teams help create shared company values?
- 9 Why is it important to have people with different skills in teams?
- 10 What is needed to make a group of employees into a team?

### Cracking the code



**Synergy** The benefit that teamworking brings: the contribution of the team is greater than that of the individual members put together.

**Skills audit** A survey of the different skills that team members have.

# Chapter 27

# Effective communications

## APPLIED IN THE BUSINESS WORLD

### Hanley Hand Washed Cars

**S**ix school friends from the Midlands were asked by their teacher to run a small enterprise as part of their business course. The hope was that by setting up and operating a business themselves, the students would be able to make more sense of the theory they were to study in the classroom.

In the initial meeting of the group, they considered what form of business they would run. Their choice was limited by the fact that it was to be a short-term project, so nothing could be attempted that would take a long time to set up. There would also be a limit to the amount of money that they could raise; they were all under 18 so there was little chance of obtaining a bank loan. And as they were all full-time students, the business would have to function during times when they weren't at school. The first meeting was confused as there was nobody chairing the meeting, but they did all agree to go off and write a list of five possibilities for the business.

At the second meeting, the group decided to have one of them running the meeting and another keeping a written record of what was discussed. Each person then presented his choices and the arguments for and against each idea were considered. After a long meeting, it was decided they would go for a car washing business.

The intention was to operate the car wash from supermarket car parks. Drivers would park to go shopping and if they wanted their cars washed, it



would be done while they were in the supermarket, so that they didn't waste time waiting. This service was thought to be a compromise between using an automated car wash at a petrol station and going to a specialist wash and valet centre. Petrol station car washes were cheap, starting at £2.50, but the results were not that good. Valet services gave a far superior finish, but they were very expensive and the car had to be driven there and left for at least an hour.

The group decided to call their business Hanley Hand Washed Cars. The team set an objective for the business, which was to make a profit of £200 each within three months of setting up the business.

#### Live links

You can read about other school enterprises on the internet. Just one example is [www.newspostleader.co.uk/latest/Students-run-mini-enterprises.5502224.jp](http://www.newspostleader.co.uk/latest/Students-run-mini-enterprises.5502224.jp).



## Hit the spot

- Describe how the group of students decided what their enterprise should be.
- The group had the objective of making £200 profit each. Explain how they might have arrived at that figure.
- The price of their car wash was set by examining competitors' prices. Discuss whether this pricing strategy was the best one for Hanley Hand Washed Cars.

The students involved in Hanley Hand Washed Cars identified tasks that needed to be undertaken if their business was to take off and become a success. Their meetings had become a lot more organised and productive since they had elected someone to run the meeting.

## Purchasing equipment

The main item of equipment would be a strong gazebo shelter. This shelter would have the name of the enterprise written on it to make it stand out and act as a form of advertising. It would also allow those washing the car a place to go in bad weather. It was felt that the washers should wear a uniform with the name of the business printed on it. This would make the business look more professional and encourage car drivers to pay up front for the wash. This would save the students having to spot the car drivers returning to their cars before they drove off without paying. Specialist cleaning fluids and other equipment would also need to be bought.

## Raising finance

It was estimated that the enterprise would need £300 to buy the equipment and materials that they had identified. Someone would have to raise this money as the students were unable to fund the project from their own pockets.

## Permission from supermarkets

The students needed to be sure that the local supermarkets would allow them to put the car wash

gazebo up in the car park. Someone would need to negotiate with the supermarket managers to gain permission. It was thought using the arguments that it was an additional service to their customers, and they would look good to be helping a local school, might win them over. It was thought inappropriate to ask at the supermarket that had its own automated car wash though.

## Marketing the service

The students realised that they would have to do more than just put up a gazebo and expect customers to flock to them. A pricing system would have to be agreed, based on the cost of alternative car washes and the service would need to be promoted.

## Running the operation

This covered everything from ensuring that the equipment was available at the site, to organising a rota of the team to do the actual washing of the cars.

## Looking after the money

This job involved taking charge of the money received from washing the cars, banking the money at the end of each washing session and keeping financial records of the money coming in and going out of the enterprise.

The team decided to each take responsibility for one of the jobs that are listed above. At the next meeting, objectives were set and agreed upon so the overall objective of their business – to make £200 profit each within three months of starting – could be achieved.

## Summary

- Hanley Hand Washed Cars is an example of one of the school-based enterprises
- The team of six students planned the enterprise well and took care to set clear tasks for each member
- Each person had objectives to achieve in order that the overall enterprise objective could be reached

## Core knowledge

The students involved in Hanley Hand Washed Cars recognised the importance of good communications within a business. They decided regular face to face meetings would be the best way of organising their enterprise, when they could make decisions and resolve any problems that had arisen.

When you are operating your enterprise, you will need to do the same as Hanley Hand Washed Cars. Tasks will have to be allocated to your team members according to who would be the most suitable person to undertake them. Like the students in the case study, you will need to have proper meetings at which the important decisions for your enterprise are made. It is essential that your meetings operate in a professional manner, so the job of chairing these meetings should be carried out by the person in your team who can do it well.

## Running a business meeting

A business meeting needs someone to take charge of its running. This does not have to be as formal as having a chairperson. Much smaller businesses, where owners see themselves as equal partners, would not like the idea of someone having this title as it sounds as if he or she is in total charge of the enterprise. For this reason, some organisations prefer to call the person in charge of meeting a **facilitator**. This is someone whose job it is to make sure that the meetings actually happen. He or she will produce the necessary paperwork and ensure that the meetings run smoothly.

Being a facilitator involves having certain tasks and responsibilities.

## Planning the meeting

The first thing to be done is to discuss with other members of the team what they feel needs to go on the **agenda**, or list of topics to be discussed. Everyone involved is entitled to have any concerns talked about. A compromise needs to be reached between providing an opportunity for team members to talk about problems they are having in their own areas, and not overloading the agenda so meetings become too long.

The facilitator also needs to have clear goals on what you want to achieve in the meeting. This might be some agreement on a key decision that needs to be made, or obtaining different possible solutions to a problem that has arisen. The person must ensure that the meeting is structured and kept on track. He or she must be prepared to draw a discussion to a conclusion, or get agreement to leave it until the next meeting, if the discussion appears to be going nowhere. Meetings should last no longer than is necessary, but people should be able to feel that they have had the opportunity to have a proper discussion on the important issues. They should be conducted in a businesslike manner, but in a way in which everyone feels comfortable and willing to contribute.

One of the facilitator's roles is to make sure that each person is involved in the meeting. Some people are more reserved than others and find it hard to butt in when someone is talking. The meeting facilitator should watch out for those patiently waiting for a chance to say something and give them the opportunity to speak. Similarly, if anyone is not engaging it might be appropriate to ask someone for his or her opinion to get the person involved.

When a decision, or outcome, is made, this needs to be written down so there is a record of it. This also applies if someone has been asked to do something, such as finding out information, before the next meeting. This allows the people at the meeting to read the notes, or **minutes**, of the previous meeting and check things have been done. Most meeting start with a session called '**matters arising**', Here the people who were set tasks at the previous meeting can report back on them.



If the facilitator is disorganised the meeting will not run smoothly

### Did you know...

The term agenda comes from the Latin for things that need to be done.



### Did you know...

An *ad hoc* meeting is one that has been called for a special reason.



### And more

Those involved in managing a business must be effective communicators. We read much about the importance of communication in business in Chapter 3. An effective method of passing messages on is through a formal presentation. Such presentations might be to a handful of people, or possibly to hundreds.

Many people find the prospect of giving a presentation, even to friends or classmates, extremely daunting. There are skills that can be taught that will help the confidence of these people, but it is practice that really matters. It gets easier as you become more experienced.

## Giving a presentation

Before you start a presentation, it is important that you are aware who your audience is and how many people there will be, as these factors will affect the way you tackle your talk. You can afford to be a little more relaxed and informal when talking to people who you know. However, you should take care not to become over familiar as this could be viewed as you not treating the topic that you are talking about seriously enough. Similarly, you can afford to be a little more informal

with smaller groups. No matter if your audience is large or small, though, you should be attempting to make each person believe you are talking to him or her personally.

## The start of the presentation

It is a good idea to hook the audience at the beginning. What this means is to do something that makes them sit up and listen. Some presenters like to start with a bold statement, or a thought provoking question to catch their audiences' attention. There is nothing worse for an audience member than having to listen for quite some time before anything of any importance is said.

During this initial stage you must try to establish a rapport with the audience. This can be done with careful eye contact. Make it look as if you are enjoying the talk, even if you are not. Look around the room and don't concentrate on those directly in front of you. Eye contact is important because it means you are interested in your audience. For this reason never look down or away excessively, such as reading from your notes. Body language gives important messages to your audience. For instance, if you stand with your arms folded it appears as if you are trying to keep the audience at a distance from you. Remember what was said in Chapter 3: 7 per cent of the meaning of a message comes from the spoken word, 38 per cent from the way you speak and the remaining 55 per cent from body language.

## Middle

This is usually when the most important messages are delivered by the speaker. Trying to convey too much information is pointless though. People can only take in so much before they switch off. Going through a long list of fine details is boring for the audience and they are very likely to switch off their attention.

Many people find it easier to deliver a presentation with the aid of a PowerPoint, or similar item of software. PowerPoints are very useful tools for talks and help liven up the presentation, but they can easily be overused and have the opposite effect. PowerPoint slides that contain too much writing can be off-putting. It is far better to have a small amount of information but have an image, say a photograph or a piece of clip art, to break up the page and maintain the audience's interest. But you should use an image that has something to do with the talk, otherwise the audience will be trying to work out why it's there and not be listening to you.

Finally, use bullet points to condense your message into a few headings. This way you will be reminded what you are to talk about and may be able to avoid reading from notes. And, do not use elaborate transitions between slides. These might look clever, but they very soon become tedious for the audience.

## Ending the presentation

Before you finish your presentation you need to summarise the main points you have made, so the message is clear. People tend to remember the last things that you say, so use this opportunity to get the most important parts of your talk across.

### Did you know...

More people say they are afraid of speaking publicly than the combined number of people who admit to being scared of insects, flying and heights.

### Did you know...

The ancient Greeks valued the art of public speaking, or oratory as it was called. Boys were taught in school how to speak with confidence in public.

## Have a go!



### Group activity



Write a list of all the tasks that need to be completed in your own enterprise. Next to each task note the personal skills and expertise that the job requires. Then use this document to help you discuss who would be the most suitable person in your team to be responsible for each task.

### Discussion



Discuss ways of conquering nerves when you give a presentation.

### Web-based activity



Go on to YouTube and look at examples of both good and bad presentations. Use this information to produce a list of the top 10 tips on how to give a good presentation. The list can be in the form of a poster, PowerPoint or leaflet.

### Quickfire questions



- 1 How did the students at Hanley Hand Washed Cars decide what price to charge?
- 2 Which supermarkets did the enterprise not approach?
- 3 What is a facilitator?
- 4 How might the facilitator get reluctant people to contribute in meetings?
- 5 What is the name of the document that summarises what happened in a meeting?
- 6 What are matters arising?
- 7 Which has the biggest impact on an audience: what speakers say, their tone of voice or body language?
- 8 What advice is given when starting a presentation?
- 9 How can the use of PowerPoint help a presentation?
- 10 What does oratory mean?

### Cracking the code



**Facilitator** The person who is in charge of ensuring that the meeting runs smoothly; it is an alternative name for a chairperson.

**Agenda** A list of topics to be discussed at a meeting.

**Minutes** A written record of what happened and was agreed at a previous meeting.

**Matters arising** A regular agenda item where the previous minutes are used to remind people what should have been done by this meeting.

# Chapter 28

# Motivation to succeed

## APPLIED IN THE BUSINESS WORLD

### Motivating your workforce

**I**t's easy to tell when you go into a store or any place of business whether the employees are motivated. If they are, there will be friendly eye contact and you can tell by the way staff talk to each other and to you that they are enjoying what they do. They will go out of their way to help you, and it will never seem like you are inconveniencing them. Their body language will give out positive messages and the whole experience of shopping can be enjoyable.

This x-factor, that makes an employee not just a worker but an ambassador for the business that he or she works for, is an important ingredient in the success of any business. Extensive research has been conducted at universities around the world and within businesses themselves to find out what causes motivation. Unfortunately, there has never been a clear answer. No one has come up with a solution that will turn an unhelpful employee into a model member of staff. This is really no surprise because, as people, we are all different and what we are motivated by changes all the time.

The uncertainty of what motivates doesn't stop employers from using a range of options to try to improve their employees' efficiency. You read about these methods in Chapter 7. Many businesses choose to offer a range of motivators, or **incentives**, to get the best from their employees. So, there may be **performance pay** for reaching targets and high quality training to increase skill levels and make



employees feel important. There may be opportunities to work in teams, which appeals to other types of people. By not depending on one single motivational method you will be more likely to influence a wider group of people.

Julian Richer of the high street electronics stores Richer Sounds takes this approach. He recognises that his employees need an element of fun at work if they are to enjoy their jobs. As most of Richer Sounds' staff are young, this is seen as being particularly important. Employees are encouraged to joke with each other and a 'bring your pet to work' day was introduced to liven up the stores. There is an informal dress code, so people feel comfortable when at work.

But the Richer Sounds motivation package goes beyond this. Employees are made to feel that their contribution to the business is valued. Julian will reward ideas that might help the business and he is always happy to talk personally with anyone who is having a problem. In fact, he will occasionally give each of his staff £10 and tell them to go to the pub and talk together. By doing this he hopes that they will come up with some good ideas to improve the business.

An extensive range of perks is offered as incentives. Julian will invite a number of high performing employees to join him for an all expenses

paid weekend paintballing or quad biking. The business owns holiday villas which are made available for staff free of charge.

Richer Sounds treats the motivation of its employees as seriously as it does the selling of its products. This is probably because Julian Richer has worked out that the two things are very closely connected.

### Live links

You can read more about Richer Sounds' approach to motivation at its website:

**[www.richersounds.com](http://www.richersounds.com)**.

## Hit the spot



- List three ways Julian Richer motivates his staff.
- Explain two ways in which a motivated workforce can improve a business's efficiency.
- Richer Sounds has a very informal approach to dealing with employees. Discuss whether you believe this approach will always work for a business.

You will be part of a team that is to start an enterprise. Like any business you will find there are occasions when either you individually or members of your team need to be motivated. So how do you do it?

## Business can be fun

Richard Branson gives good advice on this. Like Julian Richer, he firmly believes that there has to be a fun element to working as a team. When he was starting out as a young man running his *Student* magazine, if he could sense that the mood in the office wasn't positive, he would insist that everyone leave their desk and go together and let off steam in the park. This is not conventional business theory, but it seemed to work for him. A half hour holiday from work was enough to refresh his staff and to allow them to socialise. But his actions had a hidden message which was: 'I care about how you feel'. This action would be very difficult in a large organisation, but it would be possible in a smaller, closer knit team. Watching out for, and supporting each other is a powerful way of teambuilding.

well to compliments and congratulations as anyone else would. How this is done will depend upon the people who are in your team. Some people like to have a big fuss made when they are doing something worthy, while others just need a quiet word. As long as the comments are sincere they will be well received and help motivate. You may choose to have regular meetings when you celebrate what has been achieved and who was responsible. However, you should be careful of alienating those who are not mentioned, which might have the opposite motivational effect on them. For this reason, many businesses have dropped their employee of the month scheme because it motivated one person and discouraged many of the others.

### Did you know...

Poor motivation is as much of a waste to a business as keeping on the lights and heating over the weekend when there is nobody in the building. You are paying wages and not getting all that you should for your money.

## Recognition

We all like to be told that we are doing a good job and the people who make up your team will respond as

## Job rotation

Earlier chapters have looked at the process of matching people's skills with the jobs that need doing

in an enterprise. This is fine, but if the work is becoming monotonous for someone, or that person is finding it hard to cope and is losing his or her commitment to the project, it might be worth looking at **job rotation**. This simply means swapping jobs around to give people a break from what they were doing. We all know that when we start something new we tend to be enthusiastic initially. You could capitalise on this with a bit of careful rotation of jobs.

## Communication

If you have ever travelled on a train that was running late, you are bound to have heard announcements explaining the cause for the delay. The reason train companies do this is because they have discovered passengers are more tolerant of problems if they are kept up to date with them. The same is true in business. If employees are kept informed about what is happening in the business, whether good or bad, they are more likely to be supportive of the business. Communication can be a very powerful motivator. When you run your enterprise, finding ways of keeping everyone knowledgeable about what is happening will probably keep people on board and motivated.

## Self-motivation

Finding ways to keep yourself on task is another matter. You might find it useful to offer yourself an incentive of some sort. The fact that your GCSE grade will depend upon how well you organise and run your enterprise might be enough to keep you going, if not, you should look for other motivators. Talking things through with your team members might help. As soon as you notice your enthusiasm ebbing, you need to do something about it. The worst thing to do is to let things slide as it is difficult to recover once you have effectively given up.

### Did you know...

Wikipedia describes motivation as 'the activation or energisation of goal-oriented behaviour'. And we thought it was as simple as getting people to work harder!

## Summary

- Motivation is essential to the success of an enterprise
- People are motivated in many ways

## Core knowledge

Incentives are the things that get people interested in doing well. Businesses use a wide range of incentives, not all of which are money based.

## Money incentives

Money can be a great motivator. Most people would like to be able to buy a good car, a nice house, to be able to eat well and enjoy expensive holidays – things that money can give them. A good wage also takes a lot of the uncertainty and risk out of life. You need not worry about your washing machine needing replacing if you have some savings. But there is another reason why money motivates. The amount of money that you earn or have is often seen to be an indication of how successful you are in life. It is because of this that many people exaggerate their incomes and wealth.

The fact that you are in education and not working full time (assuming you are old enough to do this) means that you are making an investment. You are sacrificing your earnings now, so you can benefit more in the future. Your education will allow you to get a better paid job and enjoy a more lavish life style when you get your qualifications. We call this deferred consumption. All the term deferred means is putting something off for a while. This principle works as well with employees. If someone is receiving training with his or her job, that person knows it is improving the chances of earning more in the future. This can act as a powerful incentive with some employees.

But we have already seen that money doesn't always motivate people. In fact it is argued by some business theorists that as long as a reasonable wage is paid, money doesn't motivate as much as other factors. Many say that an increase in wages will have a short-term improvement in motivation, but as soon as employees get used to the higher wage, its effect is limited.

## Non-monetary incentives

These are the factors which are not money that keep an employee interested and encourage him or her to remain in a business, working well. Some researchers argue that non-cash benefits can be far more powerful than money in motivating employees. As we read in the case study above, non-money benefits can often convey hidden messages about the business caring. For instance, if a business invited all employees and their partners to an annual party in a posh hotel, it's not just the party that is the incentive; it's the fact that the business cares enough about its employees to arrange this for them.

### And more

Care must be taken though that what starts out as an incentive does not become an entitlement. If a cake manufacturer, for instance, allows its employees to buy the cakes for much cheaper than they cost in the shops, it will not be long before people see this as part of their wages. It no longer is an incentive but something to which they feel that they are entitled. It makes sense to swap the incentives around on a regular basis to keep them new and fresh. Maybe have a Christmas hamper of food one year and a party the next. This way, the incentives will have more impact on the employees' morale and effort.

## Social and community activities

Businesses have tried new ideas to encourage their employees to become more committed to their organisations. Many appear more aware of the costs of poor motivation, not just in lower output than could be the case, but also in terms of recruitment costs to replace those disaffected employees who have resigned. If the incentives that are being used are not appearing to work, then more subtle strategies are needed. This can be achieved by playing on people's desire to do something worthwhile to help others.

Getting staff involved in activities that help deprived or disadvantaged groups can help. It is not unusual for businesses to have chosen charities to support. Employees are often encouraged to play an active part in helping these charities. Their involvement makes employees feel that their contribution is helping others and promoting a feeling of well-being which overflows into their work, something commonly called 'the feelgood factor'.

**Did you know...**

Some companies don't bother with their own employee incentive schemes; they contract the job out to other specialist businesses. In return for a fee, rewards enterprises will provide gifts and other incentives to help the level of motivation in their client's company.

**Did you know...**

Like many other famous entrepreneurs, Julian Richer started his first business when he was 14 years old.

**Have a go!****Group activity**

Conduct a survey of what types of incentives have the biggest impact. Use people of different ages and types of work to answer your questionnaire. You should list possible incentives and ask the respondents to say how important each factor is to them. Go through your results and produce a presentation of your findings.

**Discussion**

Discuss which strategies you might use in your enterprise groups to ensure that the level of motivation remains high.

**Web-based activity**

Look at how some businesses become involved in helping charities. You could try [www.boots.com](http://www.boots.com) and [www.tesco.com/todayattesco/community/archive/0801\\_tesco\\_charity\\_of\\_the\\_year\\_2008.shtml](http://www.tesco.com/todayattesco/community/archive/0801_tesco_charity_of_the_year_2008.shtml). Produce a list of the benefits that working with charities can bring a business.

**Quickfire questions**

- 1 What type of business is Richer Sounds?
- 2 How does Julian Richer create a fun working environment?
- 3 Why are 'employee of the month' schemes becoming less popular?
- 4 What is job rotation?
- 5 What is a perk?
- 6 Give two reasons why increasing wages can act as a motivator.
- 7 What is a non-monetary incentive?
- 8 Why does offering training to an employee help motivate that person?
- 9 Why is it important that incentives change over time?
- 10 What is the 'feelgood factor'?



## Cracking the code

**Incentives** Benefits given to employees to encourage them to work more efficiently; they are sometimes called motivators.

**Performance pay** That part of a person's wage that depends upon reaching certain targets.

**Job rotation** Moving between jobs to avoid becoming stale and demotivated.

## Chapter 29

# Monitoring progress and performance

### APPLIED IN THE BUSINESS WORLD

#### Personalised Mugs

When a group of five students were asked by their teacher to set up an enterprise, they thought they had the ideal product. They had found an internet site where they could buy plain white pottery drinking mugs in batches of 72. The idea was that they would stencil pattern designs on to the mugs, handwrite names on and sell them around school. They thought that the mugs would make perfect presents for their fellow students to buy for family and friends. They decided a good name for the business would be **Personalised Mugs**.

The team members performed some simple calculations in order to decide what price they should charge for the mugs. The costs of the materials were:

|                     |                         |
|---------------------|-------------------------|
| Mugs                | £125 for 72             |
| Stencils            | £8.50 each              |
| Special marker pens | £6.00                   |
| Paint               | £40 enough for 200 mugs |

They decided to reduce their risks by buying only 144 mugs, 3 stencil designs, 4 pens and £40 worth of paint. This came to a total of £339.50. The money to pay for these items would be raised by selling 100 shares at £3.40 each. The incentive was that each shareholder would hopefully get £4.00 back for each share, when the business closed in two months' time, earning 60p **dividend** on the share.

Charging £4.99 for each mug would bring in £718.56. Once the investors had been paid their £400,



it would leave more than £300 for the five students, or £60 each. The enterprise seemed foolproof, especially if the students bought some of the shares and received an income from those too.

They managed to raise the finance by selling shares in the business and bought the supplies. They then researched the most popular names in school by going through class lists. The team shared out the mugs and decided to decorate and write on the names at home. The team found that if the mugs were to look presentable, they had to spend far longer on them than expected. Unfortunately, several of the mugs had to be scrapped as they were smudged because not enough care had been taken painting them. Some even had basic spelling mistakes.

When the mugs went on sale at break time, they sold very few because nobody seemed to have enough money for them. Some were sold over the next few days, but the team soon realised that writing the names on before selling the mugs meant they didn't have enough of the popular ones and some names

were just not selling. They had forgotten that the mugs were being bought for parents and grandparents whose first names they hadn't even considered.

The enterprise proved to be a failure. The students ended up trying to paint the names off and selling the mugs for £1.00. In the end the enterprise had a turnover of £320, meaning that they could almost pay off the investors, but they would not receive their

dividend. The team received nothing for all their hard work.

### Live links

Advice on dealing with the risks associated with running an enterprise can be found at [www.businesslink.gov.uk](http://www.businesslink.gov.uk).

## Hit the spot



- Give two mistakes that Personalised Mugs made in planning the enterprise.
- Explain how better market research might have helped the business.
- The students decided to decorate the mugs at home. Consider whether this was the best way of organising the production of the mugs.

Personalised Mugs, like any business, took a risk when it started. It would seem, however, that the team of students hadn't really thought through what could go wrong and considered strategies to reduce these risks. The students thought that their only concern was whether the mugs would sell enough. To lower this risk they decided to limit the number they made, which was probably a good idea in hindsight.

Sometimes it helps to think about the risks in an open-ended way. What the team didn't consider was: would they be able to get the mugs cheaper if they bought a larger number? Most companies offer generous discounts when a larger number of items are bought. It might help reduce the risk of not selling enough by actually buying more and being in a position to reduce the price significantly. This way the mugs would be more affordable and the students could make a lower amount of profit on each one, but a higher profit overall.

Another issue was that of monitoring the quality of the decorated mugs. One of the problems the team faced was poor quality workmanship. Decorating the mugs at home on their own might not have been the best way to do this important task. It would have been a better idea to work together after school, so the quality could be more closely monitored. Also they might have been able to specialise with the members

who are good at the decoration doing this, and those who write the names neatly concentrating on that task.

### Did you know...

Large companies often use the services of a professional to determine the likelihood of something happening that would harm the business. Such people are called actuaries.

## Risk assessment

**Risk assessment** is a process by which risks are identified, the probability of them occurring calculated and strategies considered to remove or reduce these risks. This process allows risks to be prioritised. Those risks, which if the problem occurred would have the biggest impact, should be tackled first to see whether they can be eliminated or the chances of them happening reduced.

### Example of a risk assessment

This is an example of just three of the risks that Personalised Mugs faced. All of these risks should have

| Risk                                           | Level of risk | What can be done to reduce this risk                                                                                                                      |
|------------------------------------------------|---------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
| Quality of mug decoration is poor              | Medium        | Operate some form of quality control, check each person's first few mugs. Move them on to another job if necessary.                                       |
| Sales low – some names prove not to be selling | High          | Don't write names before you know the mug will sell. Arrange for orders to be made, so the name is suitable, reducing the amount of waste                 |
| A competitor starts up                         | Low           | Internet competitor risk is low as postage costs and delay puts customers off<br>Another student business start up consider ways of making prices cheaper |

### Example of a risk assessment

been thought of before the enterprise got started. By looking at the risks and what would be needed to bring them to acceptable levels, the team can make an informed decision of how feasible it was to succeed in their decorated mug enterprise.

By identifying the risks, the team would be more able to monitor whether they were becoming a

problem for the business. Monitoring risks should be viewed as part of the normal day to day running of the enterprise and not something that is completed at the end of the project. This would include not just watching that risk factors are not becoming an issue, but also that the team members are engaging well with the task of running the business.

## Summary

- School enterprises are not always successful
- Careful planning and risk assessment are needed in order to reduce the chances of failure

## Core knowledge

By this stage in your course, you should be aware that the main feature of an entrepreneur is that he or she is prepared to take risks. No business is without risks, they cannot be avoided. But what matters is that the risks are assessed before the enterprise starts and then monitored during its life. Circumstances will change over time and these might affect the risks that a business faces. But monitoring the risks and being willing to change how the business operates will go a long way to ensure that the business is successful.

## Types of business risk

The problem with risks is that they are unpredictable. There is no guarantee that the problem will occur, but we have seen that at least proper planning will help to identify them. Having identified the risks, you need to decide if anything can be done to reduce their effects. In some cases, it doesn't take much to do something about them. In the case of Personalised Mugs, taking more care of quality control would have reduced the risk of some mugs being too badly painted to sell. If it is easy to reduce a risk, then this should be done. There are some risks, however, that would be very costly to reduce and with these

you simply have to decide if the risk is worth taking. If the potential returns are high enough, then it may be worth it. If the possible return is low, it's probably not worth the risk.

Business risks can be split into four types. In each case, the risk can be identified; whether it happens is another matter.

- **Supply risk factors.** These include problems such as the arrival of an unexpected competitor or a supplier no longer being available. These factors affect the business's ability to be able to produce goods at the cost it anticipated and to maintain customers.
- **Legal risk factors.** These are laws that are passed which directly affect your business. For instance, laws on health and safety might mean you have to buy expensive safety equipment or may not be able to operate in the way you previously have.
- **Financial risk factors.** This could be customers who do not pay their bills or unexpected increases in interest rates which make your overdrafts and loans more expensive. Sometimes extra money is set aside for unexpected events. This money is sometimes called a 'contingency fund'.
- **Operational risk factors.** These are the factors within the business that, if they occur, make it more difficult to operate. For example, an important piece of machinery could break down halting production, or employees' efficiency might be lowered because they are not as motivated. This would also include losing stock because of theft from your shop or factory.



Equipment should be safe to avoid legal risks

And more

## Monitoring the work of a team member

One concern you might have operating your own enterprise is: how do you monitor the contribution of each team member, so you can determine whether something needs to be done to improve matters?

One system that has worked for some groups like yours is the points system. Each person on the team is given a certain number of points, say 20. These points can be shared out between the other members of the team, according to how well they have each contributed to the project. For instance, you might allocate 7 points to Christine, 6 to Ragine, 4 to Joe and 3 to Matt. When the others have given their scores the totals can be looked at by everyone.

It might be a good idea to get everyone to give a short presentation before the scores are given. The person could remind the others about his or her objectives and how far these have been achieved. This way each team member will be aware of the most up to date contribution. This way it would be fairer on those who have worked behind the scenes, such as undertaking market research, and whose contribution is not always highly visible.

It is hoped that people will work harder in an attempt to gain the highest scores. Similarly, those with low scores might respond with a greater effort so their marks increase the next time the monitoring is done. This is, of course, just one suggestion. You might want to consider other possible ways of monitoring the performance of your team members.

### Did you know...

You can get insurance against most types of business risks. You can even insure against bad weather stopping an outdoor concert and the organisers having to give ticket refunds to customers.

## Have a go!

### Group activity

In your teams, produce a risk assessment for your enterprise. Include as many risks as you can that could have a significant impact on your business.

### Discussion

Is it possible to be able to run a business without any significant risks?

### Web-based activity

Use the internet to identify examples of low, medium and high risks that affect businesses. Use [www.businesslink.gov.uk](http://www.businesslink.gov.uk) as a starting point. Produce an information sheet which should be designed for a new business.

### Quickfire questions

- 1 Which one of Personalised Mug's costs was a fixed cost?
- 2 If the investors in Personalised Mugs had been paid their 60p dividend, what would have been the percentage return on their £3.40 investment?
- 3 Why do businesses sometimes give discounts when you buy in bulk from them?
- 4 Why do you think the team wanted to charge £4.99 and not £5 for the mugs?
- 5 Calculate how much profit the enterprise would have made if it had sold all 144 mugs for £3 each.
- 6 Give an example of a risk that is a financial factor.
- 7 What is a risk assessment?
- 8 What is an operations risk factor?
- 9 How does the points system of assessing the contribution of team members work?
- 10 What are contingency funds?

### Cracking the code

**Dividend** The money paid to a shareholder.

**Risk assessment** A process of identifying risk, examining its likely impact on a business and ways of reducing its effects.

# Chapter 30

## Evaluating your enterprise

### APPLIED IN THE BUSINESS WORLD

#### Trendy Nails

**W**hen three friends decided to work together on their Applied Business enterprise, they knew exactly what they wanted to do. All three girls were very involved in nail art and manicuring, and this interest was something that they thought they could put to good use in an enterprise. All three girls were hoping to start an NVQ Level 3 in beauty therapy at the local college, once they had completed their GCSEs.

The team agreed to call their enterprise Trendy Nails. Market research confirmed that there was a demand for gel and acrylic nail art. Many of the girls at their school liked to have their nails manicured and decorated, and this was where the enterprise saw its primary market. The hope was that before long the girls' mothers might be willing to have their nails styled by Trendy Nails too. The team knew that they would have to get their pricing policy right. There were several beauty salons in the area that styled nails. They tended to be expensive for the girls at school and were generally not used by them. By charging a low price initially, Trendy Nails hoped to establish a good base of regular clients. The team thought that by charging £6 for a simple design, it would be low enough to attract customers. They also decided to have a special offer of ten nail sessions for the price of eight. This they hoped would encourage repeat business.

The students decided to set four objectives for their enterprise:



- To be making a monthly **turnover** of £200 within three months of starting. The girls thought that it would take some time to establish the enterprise and felt they needed this amount of time to build up the business. They believed that it would be unreasonable to judge the enterprise before three months had elapsed.
- To have at least 20 regular clients within three months. They believed that it was important to have a regular client base. They felt that there would be initial interest in the business, but they wanted to ensure that they had customers who kept coming back.
- To have at least 95 per cent of customer questionnaire responses to be good or better. Trendy Nails was to rely on **word-of-mouth advertising** to promote the business. The students felt that if they asked customers to answer one simple question about the service they had had, it would let the girls know whether they were doing well.
- To create an enterprise that was sustainable. They hoped to be able to continue operating Trendy Nails after the project had finished, allowing them to earn money when they were on their college courses.



## Hit the spot

- Give two reasons why it is important that a business has clear objectives.
- Explain why Trendy Nails' pricing policy was so important.
- Judge how successful Trendy Nails was in reaching its objectives.

At the end of the time that they had been given to complete the enterprise, the team thought that they had done well. They were making more than their target turnover of £200 per month. They realised, however, that they would need to complete a full evaluation of Trendy Nails.

They met as a team and went through the objectives of the business and discussed whether each of them had been achieved.

- 1 Trendy Nails exceeded its target turnover of £200 within a month and maintained this over the remaining two months. Given these figures, it was clear this objective had been reached. The girls felt though that they should have used profit rather than turnover in this target. The enterprise had to spend an increasing amount on materials and equipment, if they were to be able to offer a reasonable range of colours and designs. This meant that while turnover was increasing over the three months, profit was not going up at the same rate.
- 2 They failed to achieve 20 regular customers. More than 20 clients had had their nails styled more than once, but the girls were not sure they could be described as regular customers. The girls recognised that they needed to have been clearer what a regular customer was when they came up with the objective.

- 3 Virtually everyone who had their nails manicured or styled said they had a good or an excellent experience. So this objective was achieved. The girls believed that the way they got the feedback might not encourage reliable responses. There was some evidence that the customers gave favourable comments because they didn't want to upset the girls. The team was not convinced that their customer service was as good as the feedback would suggest.

- 4 The enterprise was thriving and there seemed no reason why the three girls couldn't continue with it for longer while they were studying. So, the fourth objective seemed to be reached.

There were some additional observations that the team considered.

- 1 They felt the name Trendy Nails sounded 'cheap and cheerful' which was fine for their current market. If they were to try to expand their customer base to include older women, the name might put some off. A name change might be necessary.
- 2 The promotion strategy of having the special offer, ten sessions for the price of eight didn't appear to work. Even at the reduced price it was too expensive for schoolgirls. In hindsight, having five for the price of four would have worked better.

## Did you know...

The shape of fingernails and toenails is sometimes described as squoval, which is a cross between a square and an oval.



## Summary

- Enterprises need to have clear objectives
- An enterprise can be evaluated by seeing how successful it has been in achieving its objectives

## Core knowledge

# Evaluating your enterprise

## Using your objectives

A key part of your assessment in the Enterprise unit of work will be the evaluation of your enterprise. You might remember it was mentioned in Chapter 21 that you are encouraged to work as part of a team on the enterprise, but the portfolio of evidence that you will be putting together for your grade to be determined must be your own work. One of the three areas that you need to tackle is an evaluation of your enterprise. This is an important activity as it allows the person marking your work to grade your ability to analyse and evaluate. These two skills are critical to you obtaining a good GCSE grade. Together they are known as Assessment Objective 3 (AO3).

Judging whether an enterprise is successful involves comparing what it actually achieved with what the owners intended it to achieve. A business can only be said to be completely successful if it has reached, or exceeded, its targets. It is for this reason that the targets, or objectives, need to be SMART. It would not be helpful if you had the objective: 'To make a good profit' as this is too vague. This target doesn't say what is meant by a good profit and it has no indication of how long it should be before the profit is made. Without SMART targets it is difficult to evaluate.

If you operate your enterprise properly you should have interim targets. These were explained in Chapter 25. Interim targets allow you to find out whether you are on track to reaching your main objectives during the enterprise lifetime. You might need to adjust these final objectives in the light of whether the interims have been achieved. But, your performance in relation to the different objectives can be used to evaluate your success in running your enterprise.

## Measuring success

Enterprises are not either successful or not successful. It's not a case of one or the other. Usually an enterprise will have different levels of success with each of its objectives. For this reason, it would probably be a good idea to use a 4-point system for each of the objectives. This would be done by awarding a score for how well you believe the objective was achieved:

- 1 Exceeded the objective.
- 2 Met the objective.
- 3 Was close to meeting the objective.
- 4 Some progress on reaching objective.

Having decided which point score each objective achieved, you may want to determine how challenging the objectives were. If an objective was challenging, achieving a score of 2 might be worth more than a score of 1 on an easy target. It sounds complicated, but it allows you to make an informed judgment on the success of your enterprise.

## Extending the objectives

Evaluating the success of an enterprise can be extended to other factors besides its objectives. This may be because the factors might not have been considered when the original objectives were set, but they have since been found to be important. For example, in the case study, Trendy Nails recognised that its name might limit its ability to attract more customers in the future.

It is advisable to take into account how the personal skills of the enterprise's participants have developed. When you become involved in your enterprise, you should find that you are developing a range of skills. You may find that your teamworking skills, your ability to be able to deliver a presentation or chair a meeting have all improved. We often call these **transferable skills**. This is because they are skills that can be used in a number of jobs and not just in running a business. When you evaluate your enterprise, the development of your transferable skills and those of your team members should be included in the evaluation.

And more

## Enterprise journal

The evaluation of your enterprise is crucial to you getting a good GCSE grade. When you are busily involved in the running of your enterprise, it can be very easy to forget important observations that could be the basis of your evaluation. One way to avoid this is to keep an enterprise journal. This is just a book or series of loose papers where, whenever anything significant happens, you make a note of it. It is really like a diary, but you jot things down throughout the day and not just in the evening.

You might want to include notes on how you came to a consensus at a meeting looking at your own personal contribution, what factors made it difficult for the enterprise to achieve its objectives and how your transferable skills have developed. The journal can be included in your portfolio, but you might find it more useful simply to remind you when it comes to writing up the enterprise.

## Action planning

When you are writing the evaluation of your enterprise you will probably be at the stage of having completed your enterprise. In the case study, the three students hoped that the enterprise would prove to be sustainable so they could continue with it. In their evaluation the team recognised that aspects of the business could be changed for the better if the enterprise was to continue. To ensure that these changes happen, an **action plan** should be written.

An action plan is normally written in the form of a table. Part of the action plan that Trendy Nails might have is shown as an example.

| Action needed                       | Who is responsible? | Details of actions                                                                                            | Resources required                                                                  | Date for completion/review |
|-------------------------------------|---------------------|---------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|----------------------------|
| Find a bigger customer base         | All team members    | Start to advertise locally                                                                                    | Money to pay for cards in eight shop windows for the next three months £48          | October this year          |
| Increase the number of nail designs | Julie               | Research designs on the internet<br>Survey students to see which they like<br>Practise creating these designs | Time to research<br>Questionnaire printed £10<br>Time and volunteers to practise on | September this year        |

Action plans have a place in developing your own personal skills as well. To do this you need to be completely honest with yourself. By recognising which skills need to be developed, you can put together a plan to work on these so they improve. The column titles can be changed to suit your own circumstances, but the overall principles are the same. You need to recognise what needs to be done, say how you are going to do it, what resources you need to get it done and when it should be completed by.

### Did you know...

The name Enterprise is often used by ships and other craft, including *Star Trek's* Starship Enterprise, and a space shuttle.



### Have a go!

### Group activity



In your enterprise team, consider ways you can plan your enterprise so that it will be possible to evaluate what you have done. In particular, you will need to take into account the objectives that you set for your enterprise.

### Discussion



Discuss which skills can be classed as transferable. Which of the transferable skills are the most commonly used in business these days?

### Web-based activity



Search for examples of action plan templates on the internet. Look at the ones that you find and evaluate how useful they would be for you to use for your personal development action plan.

## Quickfire questions



- 1 Why did the three girls start Trendy Nails?
- 2 What made the three friends choose the service they did?
- 3 Who were Trendy Nails' primary customers?
- 4 What is a SMART target?
- 5 Give two examples of transferable skills.
- 6 Why did Trendy Nails find it difficult to get reliable customer feedback?
- 7 Why is it important that an enterprise has a set of targets or objectives?
- 8 What is an enterprise journal?
- 9 Why did the girls in the case study feel a name change might be necessary for their enterprise?
- 10 How can an action plan help your personal development?

## Cracking the code



**Turnover** The money coming in from selling a good or service, before costs have been taken off.

**Word-of-mouth advertising** A form of advertising that is free and relies on providing a good service so customers give personal recommendations to others.

**Transferable skills** Skills that can be used in a wide range of industries.

**Action plan** A programme for improvement that splits the development into separate points that need to be done.

# SECTION 4

## FINANCE

Chapter 31 Introduction to finance

Chapter 32 Business costs

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### Don't forget

If any of the weblinks don't work, use a search engine to find a similar topic or business on which to base your studies.

# Chapter 31

# Introduction to finance

## APPLIED IN THE BUSINESS WORLD

### Maximising revenue in the games market

All businesses have to make sure that they have a steady flow of revenue, in order to cover their costs. The management of these flows is part of the job of the finance department, or the person in charge of finance in a small business. Businesses will change the prices of a product in order to maximise the amount of revenue from it. Sometimes this means dropping the price, so that a greater number are sold. Sometimes it involves a price increase – with the business hoping that sales will continue at the same level, but at a higher price. Plans to drop the price of both the PlayStation 3 and the Xbox 360 show that both businesses need to ensure a steady flow of revenue. This may be because new products are on the way, and they need to cover development and launch costs. A drop in the price of the PS3 happened in September 2009, in order to clear the shelves of stock of the 80Gb model (to be replaced with the 160Gb version) to be followed by Microsoft dropping its price for the Xbox 360. Sony plans to narrow the price difference between its own and Microsoft's products across the range. Both businesses also plan to tap into the revenue stream from the sale of games by releasing them for download online at the same time that they become available in the shops. This, they say, will give the consumer a better choice. What it will also do, of course, is affect the finances of game-selling shops and cut down the amount of revenue they receive. This probably means that they



will have to cut costs, and several may go out of business.

The new versions of both the Xbox and the PS3 are being sold with larger memory capacity, so that owners have the option of being able to download games. Neither Sony nor Microsoft has much sympathy for retailers, seeing the digital offering as providing more consumer choice, but also giving them increased revenue. In this, they are following in the well-trodden footsteps of Apple, which established a huge digital download market for music with their iTunes software and store. This has not stopped retailers selling iPods, but has made sure that much of the additional revenue from downloads – as with games – goes straight to the hardware manufacturer rather than the retailer.

#### Live links

You can search online to check what has happened to the price of Xbox and PS3 consoles. Try [www.play.com](http://www.play.com).



## Hit the spot

- Give three reasons why accurate financial records are important.
- Explain how lowering the price of a product could increase revenue.
- Sony and Microsoft both want to sell games themselves, by providing downloads. Do you think this is fair on the retailers of games, which also need the revenue? Give reasons for your answer.

### Did you know...

Management accountants – the ones that make the forecasts and use the accounts to manage a business – are often in the very top management of businesses.

## Introduction

Every business needs to manage its finances. If it does not manage its finances successfully then it is likely to fail. This section introduces four key elements of business finance. A business must be able to raise money to start and expand, so sources of business finance are covered. A business needs to keep control of its costs and to manage the revenue streams that flow in. Both Microsoft and Sony might be giant corporations, but they have the same aims as almost any business – for revenues to be greater than costs. It should understand at what point costs have been met by revenues, so should know its breakeven point. In addition, it has a duty to prepare accurate financial statements and to use these to help in its financial planning and forecasting.

## Finance and accounts

The finance area of a business deals with all aspects of money and accounts. Sometimes it is called Accounts. It arranges and manages the flows of money into, out of and inside the business. It is responsible for arranging the funds to start or expand the business and for providing enough money to keep all the other areas operating. This includes setting budgets, paying wages, issuing invoices, paying bills, etc. It is also in charge of keeping all the financial records of the

business. It must make sure they are accurate and available to any official body (such as tax authorities) that needs to see them.

The finance function is central to all businesses. Before a business can begin trading, it will need finance to buy stock or equipment, or to pay for premises and services. The finance function includes raising this initial money. It is also the job of finance to keep records of money in and money out and to advise management if there is likely to be a problem.

## Small business

In a small business, the finance functions still have to be carried out. Often this is by the owner although, in many cases, an outside expert such as an accountant or bookkeeper will be brought in at key times during the year. All businesses need some money with which to start up. The owners need a place to trade from, communications and other equipment and a product to sell. Even if the product is a person's own skills, he or she still needs money to get in touch with customers and offer the product for sale. Once started, the business needs money to continue trading, for example, to advertise, pay bills or buy more stock. As a business becomes more successful, it may need to expand into new products or new markets. As it continues to operate, equipment will wear out and need replacing. All of these mean further finance may be needed.

## What you already know

Of course, you have already covered some of the more general aspects of finance in Unit 1. These were sources of finance, basic financial terms, the calculation of profit and loss and an understanding of

cash flow. In this section, these are added to by studying key costs such as fixed, variable and semi-variable, breakeven, financial statements and some of

the key ratios that let a business know if it is being profitable or efficient in comparison with previous time periods or with other businesses.

## Summary

- Every business needs to manage its finances
- The four key elements in this section are sources, costs, breakeven and planning
- Finance still has to be controlled in a small business
- The owner of a small business may employ an expert, such as an accountant
- Revise Unit 1 for some of the more general aspects of finance

## Core knowledge

### The examination and how it is marked

Business Finance is assessed through an examination paper that is one hour long. It is based on your study of the key areas of finance. You will be presented with some 'background information' on a business and other items of information about it. Usually, all of the questions on the examination paper will relate to the same business, but the items will point out factors that have changed. Perhaps the business is growing and it needs to finance its expansion; perhaps it faces problems with suppliers or cash flows? You will use this information – along with your own knowledge and learning – to answer questions and solve problems.

You will be marked under three headings. **AO1** tests your knowledge and understanding. It looks at how well you understand the terms and concepts that you are using. It also judges how well you communicate this knowledge, and how well you apply it to situations provided in the examination. At the top level you will show that you can select from a good range of knowledge and demonstrate very good application and understanding of concepts such as breakeven, budgeting, financial forecasting and cash flow. **AO2** tests how effectively you applied your knowledge and understanding across the various contexts provided in the examination. At the top level, you will show good use of your skills and knowledge in the contexts given. **AO3** tests your ability to **analyse**, to **evaluate**, to make judgments and to support those judgments with evidence and reasoning. For example, what are the cash flow problems faced by the case study business? What are the various steps that could be taken to prevent a problem? Which of these would be best and why? On what evidence do you base this? How reliable is this evidence? You need to not only draw conclusions, but be able to support them with well-argued reasons. Finally, you must check your work for correct spelling and grammar.

### Did you know...

You are allowed to take a calculator into the examination. You should always estimate an answer first, though, so that you know the answer the calculator gives is right. (It is easy to input the wrong figures.)

And more

## Examination advice

In order to achieve the best possible result for your examination, you should always make sure that you try to answer the questions in context. This means using the business information that you have been given. This is part of an Applied Business qualification, so you have to show that you can apply your business knowledge. You should be able to use the knowledge you learned while studying Unit 1 to also support your answers. What might you be asked?

The business in your case study might need some additional finance. If it does you may be asked to suggest a suitable source and to justify your choice. Whenever you make a decision, higher marks can be earned for justifying it.

On financial statements you may be asked to explain terms and to complete accounts data given to you. This means you will have to do some calculations so make sure you have a calculator and that you use it. When you have completed the calculation take time to review your answer – is it a sensible figure for the type of calculation you have been asked to do?

You might be asked to interpret a cash flow forecast or a breakeven figure so you need to think very carefully what each shows. Use some of the figures shown to show that you are making use of the available data.

Remember, examination practice is very important so that you get used to the style of questions and you learn to work at the right speed. To help you succeed you also need to revise all the content for this unit.

Finally, remember to read the instructions, the data and each question very carefully: no one else can do this for you once you are in the examination room.

## Did you know...

If you have to use a formula for a calculation, this will always be given to you, so you don't have to remember the formulae for, for example, ratios.



## Have a go!



## Group activity



Investigate other businesses in which you are interested and see how they ensure a flow of revenue. You might also see how they keep costs down. Share this information in your group so that you can judge which business is most efficient at controlling its finances.

## Discussion



Which do you think is more important, the records of finance from past time periods, current figures or predictions for the future. Do you all agree?

### Web-based activity



If you go to the exam board website at [web.aqa.org.uk/qual/appliedgcse/bus](http://web.aqa.org.uk/qual/appliedgcse/bus) you will find 10 past papers that you can use for practice.

### Quickfire questions



- 1 What is the finance function?
- 2 Name one body that needs accurate financial records.
- 3 What are the flows with which finance deals?
- 4 Which expert might be employed to help a small business with its finances?
- 5 Outline how ratios are used.
- 6 On what areas is the assessment of AO1 based?
- 7 On what areas is the assessment of AO2 based?
- 8 On what areas is the assessment of AO3 based?
- 9 What is meant by 'analysis' in your assessment?
- 10 What is meant by 'evaluation' in your assessment?

### Cracking the code



**AO1** Assessment on knowledge, understanding and the selection of data to support this.

**AO2** Assessment on the application of skills, knowledge and understanding and on how well an investigation has been carried out.

**AO3** Assessment on the ability to analyse and evaluate evidence, and present conclusions.

**Analyse** A high-level skill of comparing different types of evidence, arguments or outcomes.

**Evaluate** A high-level skill that really means 'form a judgment and back it up'.

# Chapter 32

## Business costs

### APPLIED IN THE BUSINESS WORLD

#### Controlling fixed costs

**J**ames Caan is well known as one of the five dragons of *Dragons' Den*. *Dragons' Den* is the popular BBC television programme that asks budding entrepreneurs to pitch their ideas to a panel of venture capitalists in the hope of gaining funding. Caan, and his fellow dragons such as Peter Jones, Rachel Elnore and Theo Paphitis, may or may not back the business with their own money after questioning the proposer carefully about the idea, the product and the financial planning behind it. Born in 1960, Caan made his wealth through buying and selling businesses. At the age of 25, he founded a recruitment company which grew to operate in 50 countries, with a turnover of £130 million plus, and he later sold it to create the foundation of his £70 million wealth. He has won both Enterprise of the Year and Entrepreneur of the Year. One of the reasons that he has been so successful is that he has kept a close eye on costs, especially the fixed costs of his businesses. Caan's business activities – recruitment, headhunting, venture capital and property investments – all tend to be office based rather than plant or factory based. Many of his organisation's fixed costs are therefore tied up in office space.

During the recession that the UK found itself in through 2008–2009, Caan advised that businesses were more likely to survive if they cut down on their fixed costs. Normally, when the lease on an office property came up for renewal, Caan would automatically renew it. During the recession, however,



he has instead moved some operations to rented, serviced offices. This means that he pays for services as he uses them, rather than just because they are there. This may add to the variable costs of his businesses, but helps to bring the fixed cost base down. In this way, he can keep the business ticking over, on a lower cost base, until such time as the economy improves. If it does not improve, he will have spent a lot less than if he had renewed a long-term lease. As he says, 'Ordinarily, I'd just renew. But because of the credit crunch I decided to move the company into serviced offices and weather the storm from there,' and adds: 'I'll review the situation in 18 months or so. For now, I'm taking down my fixed costs.' (Source: Real Business, April 2008).

#### Live links

Go to [www.flexioffices.co.uk/](http://www.flexioffices.co.uk/) and type in the name of your nearest town, and you will see what office space is available. See if you can find out the sort of prices that would be charged to rent different spaces.



## Hit the spot

- Give an example of James Caan's fixed costs.
- Explain how his actions will reduce his fixed costs.
- Do you think that James Caan has made the right decision? Give reasons for your answer.

## Introduction: typical costs of a business

Whatever the size of the business, and whatever it is producing, it will face costs for what are called the **'factors of production'**. These are recognised as land, labour and capital. The '4th factor' is **enterprise** – the skill to put the factors together in a productive manner. The business will also have to meet the service costs of each factor. The business will have to pay for:

- land – the place from which the business operates and has to pay rent or purchase price;
- labour – the cost of salaries, wages, training, bonuses, fringe benefits, pensions;
- capital – the rent, purchase price and interest on loans on the means of production used by the business such as buildings, factories, vehicles, plant and equipment plus the raw materials, ingredients or components needed for production;
- service costs for the maintenance and repair of equipment, also business rates, water rates, insurance, power, heating, lighting, fuel and communications such as telephone, post and email.

Costs can be divided by a business in a number of different ways. One way is to divide them into fixed costs, variable costs and semi-variable costs.



If the rent stays the same, whatever the output, then the building represents a fixed cost

## Fixed costs

**Fixed costs** are costs that will not change even when the level of output changes. Imagine a factory producing cars. If it is closed on a Sunday, this does not mean that rental payments on the factory or interest on the mortgage are suspended. It doesn't mean that the fixed elements of telephone charges, such as monthly line rental, or of power bills, are not charged. It does not lead to a reduction in business rates or a discount in the annual fire insurance premium. If one of James Caan's offices closes for the day, this does not reduce the rent! All of these costs continue to be charged whether or not the business is producing. All businesses face certain costs that will not change even though production or output changes.

### Did you know...

It is often difficult for a business to work out its costs exactly. This is because many costs may have gone into a product, and many costs are not directly related to it.

## Variable costs

**Variable costs** are the costs that do change when the level of output changes. The car manufacturer will know that some costs change depending on the number of cars made. These include components and parts, labour costs, power, heating and lighting costs. In fact, anything directly linked to production will be a variable cost. Immediately an office opens, lights are on, computers are powered up, air conditioning or heating is fired up and communications begin – all variable costs.

## Different businesses and fixed and variable costs

For some costs, it will be up to the business to define them as fixed or variable. For example, those firms that pay wages which are directly linked to the amount of goods made (such as piece work rates) will view the wages as variable costs. Other businesses may pay workers with no link to the amount of goods produced or services provided, and these will be

classified as fixed costs. The most common form of such payment is called a salary. James Caan's employees, in a service industry, are likely to be salaried.

## Semi-variable costs

In some cases, a particular cost might have an element of both fixed and variable. These are called **semi-variable costs**. For example, communication costs in an office will include the fixed element of telecoms bills – the monthly rental, for example. Once the office opens and the phones are used, costs increase as the variable element – the cost of each call – kicks in. Many costs are really neither fixed nor variable, but semi-variable.

### Did you know...

If trading overseas it is even more difficult to keep costs under control as changes in currency rates will change the price actually paid.

## Summary

- All businesses need resources, so face costs
- Some costs are fixed, they do not change with output
- Some costs are variable, they do change with output
- Some costs are semi-variable, they have elements of both fixed and variable
- Businesses may have other ways to define costs, such as direct and indirect costs
- All businesses try to keep costs down, as this improves profitability

## Core knowledge

It does not matter whether you are running a business providing a service, such as James Caan's recruitment business, or a product such as a car or washing machine – you will still face costs. This is because to produce a good or service requires resources, and these resources need to be paid for.

All businesses need resources. These are likely to include workers, land, buildings such as offices and factories, machinery and equipment, raw materials and parts or components. A business producing a service needs somewhere from which to operate, communications equipment, somewhere to advertise its services and so on. Even a one-person web-based business needs power, an internet connection, a computer and a base from which to operate. Resources are unlikely to be available for free so most businesses will have to pay either to purchase them or to rent or hire them. Payments for the resources needed to produce something are known as costs of production or more simply as costs.

To find out the total costs of producing a certain number of goods or the total costs of providing a particular service, the business adds together the fixed costs and the variable costs for that level of output. If it did this for different levels of output, it could compare its range of total costs with the range of total revenue earned if it sold all that it produced. As a result it could start to estimate the amount of profit (or loss) it could make. It would also help the firm to consider the possible effects of any changes either to its fixed or variable costs.

Any increases in either fixed or variable costs will increase the total cost for a business producing a certain level of output. Some of these costs might be outside the control of the business, e.g. a rise in raw material costs from a supplier putting up its prices, or a rise in taxation. Some costs might be set outside the business but could be influenced from inside. For example, electricity prices might be increased by the supplier, but the business can cut down on its use of power.



And more

## **Differences between start-up and running costs**

There are other ways to define certain groups of costs, all of which help a business to plan, and to make the best use of the resources that it has. One important set of costs is start-up costs. Start-up costs are any costs that a business needs to pay out before it is able to make and sell its goods or provide its services. Obvious examples of such costs include the purchase of premises, equipment to make products, vehicles to deliver products or fetch supplies, even office furniture. Some of these items might be rented or leased, but will still probably involve the payment of a sum of money as a form of deposit in advance. Other start-up costs might include initial market research and payments for the installation of services such as electricity, water, broadband connections and telephones. A manufacturer will need to buy in a stock of raw materials, parts and components before it starts production. A retailer will need to stock the shelves with goods before it opens its doors to customers. Even a service provider may need certain tools or equipment in order to sell the service. Window cleaners need ladders, hairdressers need brushes, scissors and driers, plumbers and electricians need special tools.

Once set-up costs have been paid, and the business is operating, there is then another set of costs to consider: running costs. Running costs are the costs a business needs to pay out for its day-to-day operations as it makes the goods or provides its services. Some of these costs will be quite different to those paid to start up the business. For example, wages will have to be paid once workers start to manufacture goods or serve customers. Electricity and perhaps other forms of energy will be needed once machinery starts to operate. Fuel will be needed for vehicles, along with insurance and maintenance costs. Many running costs will be start-up costs as well. For example, if the building or machinery is leased, then rent will have to be paid out at regular intervals. If a loan has been arranged, interest must be paid. Businesses will try to keep running costs down. However, they will also try to spread start-up costs wherever they can, rather than having to pay them all in one go.

### Did you know...

Although total costs may be rising, costs per item produced can fall as more items are made. This is called an 'economy of scale'.



### Have a go!

#### Group activity

Choose a different business each and work out the balance of factors that it will need according to the product it sells. Compare the results. Why do you think there are so many different combinations?

#### Discussion

'Enterprise' is often called the 'fourth factor of production' whereas really it should be called the 'first' as, without it, there would be no business. Is this true? Do you agree that entrepreneurs are the most important people in business?

#### Web-based activity

Use a search engine to see what you can find out about James Caan. How did he start in business, for example? Do the same for the other dragons. What do you think they have in common?

#### Quickfire questions

- 1 Name the three factors of production.
- 2 Name the costs associated with each (their 'price').
- 3 What is the '4th factor' and what does it do?
- 4 Define fixed costs.
- 5 Define variable costs.
- 6 Define semi-variable costs.
- 7 Why do some businesses find it difficult to allocate costs?
- 8 Wages paid at piece rate would be called what sort of cost?
- 9 Salaries paid regardless of output would be called what sort of cost?
- 10 How would a business calculate total cost?

#### Cracking the code

**Factors of production** The factors needed to make a good or service – land, labour and capital.

**Enterprise** The skill to put the factors together and take risks.

**Fixed costs** Costs that will not change even when the level of output changes.

**Variable costs** Costs that change with the level of output.

**Semi-variable costs** Costs that have an element of both fixed and variable.



## Chapter 33

# Using breakeven to make decisions

### APPLIED IN THE BUSINESS WORLD

#### The magic of breakeven

**M**any businesses have great difficulty in deciding exactly where to find their breakeven point. This is the magic spot where the amount of revenue or income received is exactly equal to the amount of expenditure made by the business. The difficulty arises because most businesses have many, many different costs and many different sources of revenue. The hotel trade has an easy rule-of-thumb regarding breakeven. It links its breakeven point to the number of rooms that it has booked out. This is known as the 'occupancy rate' of the hotel and is expressed as a percentage of the number of rooms available in a hotel. A hotel chain will therefore have a good idea of the levels that will bring it profits.

In the US, breakeven is reckoned to be at around 65 per cent occupancy. In Japan it is higher. Japanese hotels face fixed costs that are above those of many other countries as land is in short supply. This leads to higher fixed costs such as rents. For Tokyo hotels this means that the breakeven occupancy rate has to be at least 70 per cent. In the summer of 2009, the Nikkei (the Tokyo Stock Exchange) revealed that hotels were nowhere near reaching this level. It quoted rates of around 59 per cent (down from nearly 80 per cent the previous year) and as low as 50 per cent in some major chains. The reason for this is that the biggest group of visitors to Japan has stopped coming. South Korean tourists usually make up a large proportion of Japan's 8 million-plus visitors, but the won (the South Korean currency) has lost a third of its value against



the Japanese yen, so they are finding it too expensive to travel. Other groups, such as Europeans and Americans, have also found their currencies weaker, so fewer of them are visiting.

Hotels can fight back by trying to either increase revenue or reduce their costs. Tokyo's Imperial Hotel group is promoting its wedding and conference business, as well as offering up to 40 per cent discounts on family packages. It has created a whole new 'club' – the Imperial Club Grace, whose members are those who have been married at the hotel in the past. This has brought in a lot of new business but the hotel trade still has to cut costs if it is to survive the downturn.

(Source: Nikkei Reports, August 2009)

#### Live links

Go to [www.visitjapan.jp/](http://www.visitjapan.jp/) and you will see why tourists wish to go to Japan and the sort of hotel accommodation that is on offer.

You could cost a trip for yourself!



## Hit the spot

- Outline what is meant by 'occupancy rate' and why it is important to hotels.
- Explain why some businesses have difficulty in finding breakeven.
- How useful do you think breakeven is in business? Give reasons for your answer.

## Breakeven charts and graphs

Breakeven charts and graphs can show a business where to find its **breakeven point**. They are also useful when looking at 'what if?' scenarios. For example, what happens if that cost goes up, or if we increase price, or if sales fall...? The charts, and the graphs drawn from them, are created from data showing how many items were sold, the **fixed costs**, the **variable costs**, the **total costs** and total

revenue. All the figures have to be for a certain time period. This could be for a day, a week, a month, six months or even for a year. A business is able to create a breakeven chart using real figures from its business records or figures estimated from its forecasts.

### Did you know...

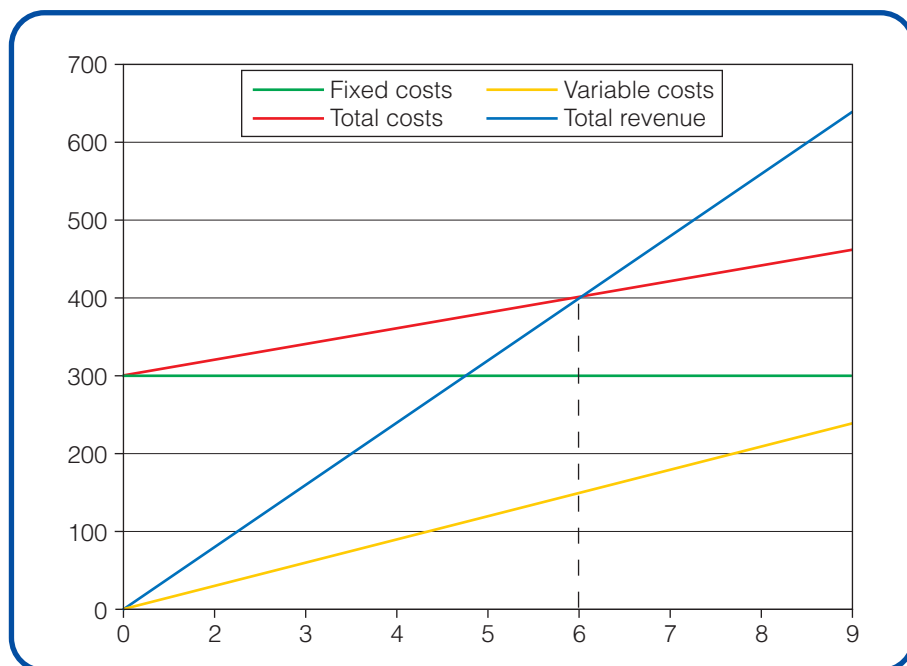
Breakeven should always be calculated on sales, rather than output. This is clearly shown when looking at a service provider such as a hotel.

| Items sold<br>(rooms booked) | Fixed costs | Variable costs | Total costs | Total revenue |
|------------------------------|-------------|----------------|-------------|---------------|
| 0                            | 300         | 0              | 300         | 0             |
| 1                            | 300         | 30             | 330         | 80            |
| 2                            | 300         | 60             | 360         | 160           |
| 3                            | 300         | 90             | 390         | 240           |
| 4                            | 300         | 120            | 420         | 320           |
| 5                            | 300         | 150            | 450         | 400           |
| 6                            | 300         | 180            | 480         | 480           |
| 7                            | 300         | 210            | 510         | 560           |
| 8                            | 300         | 240            | 540         | 640           |

A typical breakeven table for a small hotel is shown above. The costs and revenue are estimated. The hotel reckons the fixed costs – mortgage, rates, fixed element of services, insurance, some salaries – come to £300 per night. The price of a room in the hotel is set at £80 a night. Each time a room is used, there are variable costs in terms of electricity, water usage, cleaning and laundry. These variable costs are estimated at £30 for each room. The hotel has 10 rooms.

You can see from this table that this hotel breaks even once 6 rooms are occupied (a 60 per cent occupancy rate). If it sells more rooms, it makes a profit.

The breakeven graph may then be drawn from this data. Costs and revenue are identified on the vertical axis, and sales on the horizontal one. Normally, four lines are plotted: those for fixed costs, variable costs, total costs and total revenue. You can simplify the graph by using just fixed costs, total costs (fixed plus variable costs) and total revenue. The breakeven point is located where the total cost and total revenue lines cross. Dropping down from this point to the bottom axis, the hotel can see what level of sales is needed to break even each day.



The breakeven graph. Note that even if no rooms are occupied, there are still final costs of £300

### Did you know...

Different industries will have different expected breakeven points, according to how high or low fixed costs are in that sector.

- An increase in fixed costs causes this line to move upwards. This will also move the total cost line upwards and mean breakeven is reached at a later point (and vice versa).
- An increase in revenue will change the slope of the total revenue line, so breakeven is reached earlier (and vice versa).
- An increase in variable costs will change the slope of the variable cost (and total cost) line, meaning breakeven is reached later (and vice versa).

## What if...?

The business can use the breakeven figures to **forecast** what might happen if costs or revenue change. For example, if the hotel were to introduce a new product, say, a wedding service, this would both increase costs and increase revenue. They could draw up a separate set of figures for weddings (to see when this service would break even) or combine the figures with those for accommodation at the hotel. The lines on the graph will move according to changes in costs and revenue. This helps the business to forecast the effect of changes.

By estimating the possible effects of a change in price, change in product range or change in costs, a business can see how its profit and loss position might be affected. To reach breakeven earlier, a business needs lower cost (fixed and/or variable) or higher revenue and it is often these decisions – how to increase revenue or how to cut costs – that are vital to the survival of the business.

### Did you know...

In 1971, hotel occupancy rates fell to an all-time low in the United States, due to the weakness of the pound against the dollar and uncertainty in the US linked to the Vietnam War.

## Summary

- Breakeven point is where total costs equal total revenue
- Before this point, the business is making a loss, after it, it is in profit
- Breakeven is often hard to calculate because there are so many different costs and revenues
- Charts and graphs can show breakeven
- These can be used for 'what if' scenarios and forecasts
- Contribution method gives a more precise breakeven point

## Core knowledge

### Breakeven

Breakeven can be a useful tool to many businesses. It can be calculated on a single product by using charts or graphs. The breakeven point is an important objective for businesses selling a service or those making and selling goods. It is defined as the level of sales where the total cost of making and selling a product is equal to the total revenue from sales of the product. Sales above this point mean that the business is making a profit. Sales below this point mean that the business is making a loss. This makes the breakeven point an important target or objective for a business. Such an objective is particularly important for small businesses because it can be the difference between survival and closure. Medium to large firms may also set a breakeven target when a new production line is started or a new product is introduced to the market.

The purpose of breakeven is to help a business to plan for the future, and to take into account possible changes in its output and its market. It is a useful tool for making forecasts. Its drawback lies in the fact that most businesses sell many different goods and services, so that it is not always easy to see exactly where a breakeven point lies. A supermarket, for example, will have different breakeven points for its food range as against its clothes range, and different points within each range for each product. This is what makes the calculation of breakeven for a product using the contribution method most useful. Different products (and time periods) can be compared and this will help the business to make decisions about future lines to offer.

And more

### Calculating the breakeven point by the contribution method

Graphs and charts may give information that is not completely accurate. What if the breakeven for the hotel example given was a fraction of a room? Obviously the hotel can't let out half a room, or a quarter of a room! What it can do is to use a formula to see exactly where the breakeven point lies by seeing how much the hire of each room is adding, or contributing, to covering fixed costs. This is called the contribution method. It is a much more useful method when a business is dealing with more than one product, as the contribution of each to the business can be calculated. The

hotel in our example would, for instance, be able to clearly see whether or not its additional wedding service was a worthwhile investment.

To overcome the problems of inaccurate calculation using graphs, a simple formula may be used to work out the contribution of each sale towards breakeven.

There are two parts to the formula:

1 Price per unit – (minus) variable cost per unit = contribution to fixed costs

2  $\frac{\text{Fixed costs}}{\text{Contribution}} = \text{breakeven level of sales}$

As with the graph, these figures must be for a certain period of time. This method may be illustrated using the figures for the hotel. The price per room is £80, variable costs per room sold are £30, fixed costs per night £300.

1 (Price per unit) – (variable cost per unit) = (contribution)

$$£80 - £30 = £50$$

2  $\frac{\text{Fixed costs}}{\text{Contribution}} = \text{breakeven sales}$

$$\frac{£300}{£50} = 6 \text{ rooms have to be sold to break even}$$

Most importantly, this shows the business how much each room let is contributing to fixed costs, and at what point they will be covered. It is essential that such calculations are carried out accurately. In the case of breakeven, an inaccurate calculation might mean that a business is aiming for the wrong sales targets, and unexpected losses might result instead of profits. If it does not identify this quickly enough, the business could find itself in serious financial difficulties.

## Have a go!

## Group activity

For each business you have chosen to study, work out all the possible costs and revenues and attempt to draw a breakeven chart. Explain the problems that you face in doing this, and how they could be solved. Compare the problems and solutions in your group.

## Discussion

How useful do you think forecasts are to a business? How do you think you could make them more useful to any business that you are studying?

## Web-based activity



Use a search engine to find hotel occupancy rates over the last few years, either nationally or in your area. (Alternatively you could ask at local hotels.) See if you can work out what economic factors affected the rates.

## Quickfire questions



- 1 What is meant by occupancy rate?
- 2 Outline why this is important to hotels.
- 3 Name three fixed costs of a hotel.
- 4 Name three variable costs of a hotel.
- 5 Give a definition of breakeven.
- 6 How would you define the financial situation of a business before breakeven is reached?
- 7 How would you define the financial situation of a business after breakeven is reached?
- 8 How would you calculate total costs?
- 9 What is meant by a 'what if' scenario?
- 10 Why is contribution a more accurate method of calculating breakeven?

## Cracking the code



**Breakeven point** Where total costs are equal to total revenue.

**Fixed costs** Costs that will not change even when the level of output changes.

**Variable costs** Costs that change with the level of output.

**Total costs** Fixed costs plus variable costs.

**Forecast** A look into the future for planning purposes, based on data already available.

# Chapter 34

## Sources of business finance

### APPLIED IN THE REAL WORLD

#### MixAlbum rocks

Often the most urgent need for finance comes right at the start of a business venture. Perhaps a person has a new idea, but needs time and money to develop it (James Dyson spent over five years developing his Dual Cyclone vacuum cleaner), perhaps stock needs to be bought, or patent protection obtained.

Ian Charmings, a patent lawyer, had the idea that people would like to be able to mix their own dance tracks, rather than have to buy commercial mixes which included tracks that they did not want. He took his idea to the BBC TV programme *Dragons' Den* to raise the finance needed to patent and develop the product. With the backing of Deborah Meaden and Theo Paphitis, who jointly put £150,000 into the business, Ian has developed MixAlbum.com. The user simply chooses the dance tracks that they want to include on a mix, and the software mixes them. Only your favourite dance tracks – the ones that you have chosen – appear, so you do not have to pay for tracks that you do not like. Ian says:

*'I think that some people have been put off buying dance singles for this reason – DJs can mix the tracks themselves, but end-listeners who can't mix (or can't be bothered) need to buy compilations, and most of the time there will be a few tracks you don't want. We've had so many emails along the lines of 'about time', or 'just what I was waiting for'. MixAlbum includes lots of smaller useful features – one of the things I used to dislike when I downloaded a mix was that you couldn't skip to certain tracks like you could with a CD. Our*



*mixes are created using the latest gapless MP3 system, so it produces the mix split into smaller files – so you can skip between tracks, and if you play them on iTunes/iPod there are no gaps. It's all seamless.'*

Since the investment, the website has grown and agreements have been reached with major record companies such as EMI and Sony. In 2009, MixAlbum was licensed to the US service ClickMix.com, which is the market leader in providing music for fitness centres and classes in the US. Without the investment of venture capital, the business would have struggled and possibly even failed.

(Sources: PC Advisor, September 2007. MixAlbum.com, September 2009.)

#### Live links

Visit [www.mixalbum.com](http://www.mixalbum.com) to see what Ian's site has to offer. Would you have been prepared to risk money in a business such as this?



## Hit the spot

- Outline the reasons why finance might be important at the start of a business.
- Explain what happens in the *Dragons' Den* BBC TV programme.
- Venture capital is just one source of finance that Ian could have raised. Suggest other ways in which he could have financed this business. Which do you think is best, and why?

## Introduction

**Venture capital** is finance invested by organisations or individuals who believe in the future of a business. The Dragons are venture capitalists, taking risks in the hope of gaining rewards. Usually, investment is made in return for a share in the ownership of the business. Other types of finance are more common.

## Owners' funds

**Owners' funds** is finance provided by the owner or owners of the business. It is the most common form of finance for small businesses such as sole traders and partnerships. Owners' funds or capital is permanently invested in the business. It is not a loan, so the owners will not earn any interest on this money. Instead, they will expect to share the profits made by the firm. When a limited company is set up, the owners are the shareholders. Their share in the profits is called a dividend.

## Retained profits

Instead of taking out all the profits earned, the owners might decide to retain, or keep, some profit to reinvest in the business. **Retained profit** is one of the most important sources of finance. It has the advantages of being free of interest and not having to be paid back.

## Loans

**Loans** are set sums of money borrowed for a fixed time period. Interest will be charged on the full amount borrowed for the life of the loan. Most of these loans will be repaid monthly. The time period may be short, medium or long term. Short-term loans are generally for up to three years. The loan is usually for a particular purpose such as a new van or a small

machine. Medium- and long-term loans are called 'term loans' and are similar to short-term loans, but with the banks offering a wider range of conditions. Interest rates might be either fixed or variable. Repayment might be made in instalments at the end of each year or might be made at the end of the loan period. The loans are likely to be for larger amounts and the bank is likely to require security for the loan, for example, first call on assets if the business fails.

## Overdrafts

A bank **overdraft** is an agreement with a bank to overspend the business's account, up to an agreed limit. The business will 'go into the red' and interest will be charged according to the amount overdrawn and the time involved. Many businesses arrange permanent overdraft facilities, with the overdraft changing as money flows into and out of the business.

## Mortgages

These are loans for the purchase of land and buildings. The business borrows the money to buy property, with the security for the lender being the value of the property. These may involve very large sums of money and so may be for very long time periods of 25 years plus.

## Leasing

A leasing company will buy an asset and then lease it (effectively, rent it) to a business. The leasing agreement will be for a fixed time period, after which it might be renewed or a new agreement reached for a more up-to-date piece of equipment. The business makes regular payments for the use of the asset. The leasing company may be responsible for repair costs as it remains the owner of the asset.

## Trade credit

**Trade credit** is a very common arrangement between different businesses. For example, a plumber or builder will arrange to take what they need from a builder's yard, but not have to pay for it immediately.

It is an agreement with a supplier to postpone payments for goods and services until an agreed date. In most cases this will be 30 days of credit, but it depends on the reputation of the business. There is no interest charge for this.

### Did you know...

A patent, once granted, provides legal protection against another business stealing your original idea for a new product or process.



## Summary

- All businesses need finance when they are starting
- The most common source is the owner's own money – owners' funds
- If there are several owners, each may have a share in the business
- The business's own profits are a source of finance
- Venture capitalists may provide finance
- Other sources of finance are financial institutions, such as banks
- Different types of finance are raised for different time periods, costs and levels of flexibility
- The government may help new businesses with grants or by loan guarantees

## Core knowledge

Businesses all need finance in order to set up, and for other actions such as expansion, or increasing market share. The sources of finance that are appropriate and available to a business are closely linked to the type and size of the business. A sole trader will not only need less finance, but will have fewer sources from which to obtain it. However, small businesses may have access to government loans and grants that are not available to larger businesses. Sometimes the business owner is able to provide (and risk) his or her own funds in order to support the business. Sometimes outside intervention is needed. Although owners might be able to provide some of the money themselves, most businesses will have to look for additional sources of finance. Many of these sources will involve some form of borrowing.

Some types of finance will have very specific uses, while others may have a variety. Larger businesses find they may have several sources of finance open to them, while smaller businesses usually have a limited choice. Some types of finance might have to be repaid in the short term, while others might be taken out over many years.

There are, therefore, different sources of finance for different time periods. Short-term finance refers to money that is borrowed for between one day and three years. It is mainly needed to help with cash flow, to buy assets such as vehicles and to buy in stocks of materials. Medium-term finance is money borrowed for between three and ten years. It may be used to set up the business, buy assets such as machinery and pay for small-scale expansion. Long-term finance is money that is borrowed for at least ten years. This will be used to start up larger businesses, to buy lifelong assets such as buildings and to pay for large-scale expansion.

And more

Some finance will be needed before the business is ready to open. More will be needed just to keep the business running on a daily basis. Once the business has been operating for a while, it may need further finance to help it progress into the future. There are four broad types of financial need: start-up, cash flow, replacement and expansion.

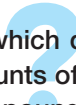
Start-up capital is used when a business is beginning. New businesses are likely to have limited amounts of money available. Large sums of money may have to be borrowed to pay for all the start-up costs. These will include both the purchase of fixed assets such as the premises and equipment and the purchase of current assets such as a first stock of materials.

Funds are needed to ensure there are no cash flow problems. Delays in receiving payment for goods sold may lead to cash shortages when wages have to be paid and materials bought. Most businesses will try to keep a pool of working capital available to cover any temporary cash shortage but may also need to negotiate an overdraft with a bank as a flexible way to access funds only when needed.

Most machinery and equipment will have a certain expected life and at some stage will need to be replaced. Finance will be needed to help renew and maintain these fixed assets. Some businesses will find this a bigger requirement than others. It will depend on how much equipment there is, how expensive it is and how quickly it wears out.

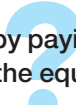
If a business is successful, the owners might want it to grow. In many ways, expansion will be similar to start-up but the business may no longer be small. It may have a good reputation and own valuable assets such as land and property. Large amounts of money might be needed for any expansion.

## Did you know...



Grants can be thought of as a 'gift' of money which does not have to be paid back. A wide range of grants is available to all sorts of firms. The amounts of money involved can vary from £50 per week for new, small firms starting up to many millions of pounds for multinational companies. The grants might be targeted at firms providing certain goods or services, or at those in a particular region. Providers of grants vary from the EU to local councils, and from the UK government to charitable trusts.

## Did you know...



Hire purchase is a method of buying equipment by paying for it in instalments. The full price paid is likely to include a charge for interest. The firm buying the equipment will not own it until the final payment has been made.

## Have a go!



### Group activity



Each choose a business and see if you can find out how it raised the funds with which it started. Suggest reasons why the business raised funds in a particular way. Compare these among your group.

### Discussion



Venture capitalists often want to help run the business. Compare the advantages and disadvantages of having an experienced business person on board. Would you accept their help if it also meant their interference?

### Web-based activity



Visit [www.deborahmeaden.com/investment/mixalbum-com/5/](http://www.deborahmeaden.com/investment/mixalbum-com/5/) to read about Deborah Meaden's support for this business. Explain why you think she thought it was worth backing.

### Quickfire questions



- 1 What is venture capital?
- 2 Why would a venture capitalist invest in a business?
- 3 What are 'owners' funds'?
- 4 Which group provides the 'owners' funds' in a limited company?
- 5 What is their reward for providing these funds?
- 6 Describe the main features of a loan.
- 7 Describe the main features of an overdraft.
- 8 Describe one benefit of using retained profit for finance.
- 9 Short-term loans are generally up to how long?
- 10 Describe the main features of a mortgage.

### Cracking the code



**Venture capital** Finance provided by people who believe in the future of a business and who will take risks in the hope of gaining rewards.

**Owners' funds** Finance provided by the owner or owners of the business.

**Retained profit** Profit that is kept to reinvest in the business.

**Loans** Set sums of money borrowed for a fixed time period.

**Overdraft** An agreement with a bank to overspend the business's account, up to a set limit.

**Trade credit** An agreement to postpone payments for goods and services until a set date.

## Chapter 35

# Profit and loss accounts

### APPLIED IN THE REAL WORLD

#### Excitement, entertainment – it all costs

**E**ver heard of the Merlin Entertainments Group? It is the second biggest (after Disney) visitor attraction operator in the world. Among other things, it owns the Madame Tussauds Group. The name of Madame Tussauds is famous for the waxworks in London, where tourists can have their pictures taken with the likes of Elvis Presley, Michael Jackson, David Beckham and President Obama – alongside a set of famous criminals in the Chamber of Horrors. But Madame Tussauds is not just to be found in London. It has branches in New York, Las Vegas, Amsterdam and Hong Kong. The brand is therefore well known around the world. Tussauds is not just waxworks, either. It owns and operates Chessington World of Adventures, Thorpe Park, Warwick Castle and the Alton Towers Theme Park in the UK along with Heide Park in Germany. It also owns a third of the London Eye, the giant Ferris wheel beside the Thames. In addition, Merlin owns the Legoland parks, over two dozen Sea Life attractions and Gardaland, Italy's biggest theme park.

Merlin therefore takes millions in ticket sales across all of its theme parks, waxworks museums and other attractions. The group also, of course, has many costs, ranging from insurance against accidents to wages and salaries, from advertising to ticket printing, from electricity charges to loan repayments. Merlin has been keen in recent years to increase revenue. A



different, more flexible, ticket pricing structure has been introduced, and its various brands, including Tussauds, marketed heavily.

Merlin Entertainments Group is a private limited company so does not have to publish full accounts. However, it is happy to share its profit and loss figures as they are so healthy. A 37 per cent increase in revenue between 2008 and 2009 led to a 12 per cent growth in profit to £142 million.

All private and public limited companies have to prepare a set of accounts, including a trading and profit and loss account. In the case of public limited companies, these are usually freely available on application to the business. Private limited companies must submit such accounts to Companies House where interested parties can obtain them for the payment of a small fee. Profit and loss accounts let all shareholders, and any other stakeholders, know how well the business is doing. They list how much

is being taken in revenue as against expenditure and, from these figures, it is possible to predict the future direction of the company.

### Live links

Use [www.altontowers.com/tickets/](http://www.altontowers.com/tickets/) to see how tickets are now available at different prices. Explain how Alton Towers has divided its market.

## Hit the spot

- Outline the differences between a private and a public limited company.
- Explain how a profit and loss account is constructed.
- Profit and loss accounts are of use to both the business and its stakeholders. To which group do you think they are most important? Give reasons for your answer.

## Simple profit and loss

The **profit and loss account** is a record of the business's financial position in the past. It can also be used to forecast future profits. It shows the main sources of income and the main items of expenditure for a fixed amount of time, usually for a year. An example of the basic format for a small business is shown below:

|                          | £              |
|--------------------------|----------------|
| Turnover (sales revenue) | 500,000        |
| minus Cost of sales      | <u>200,000</u> |
| Gross profit             | 300,000        |
| minus Expenses           | <u>150,000</u> |
| Net (operating) profit   | 50,000         |

- **Sales revenue** is the income received from sales of the product; it is calculated as price x sales.
- **Cost of sales** is what it costs to buy stock, or to manufacture the product.
- The difference between these two is the gross profit (or loss – usually shown in brackets).
- **Expenses** (or **overheads**) are the other costs the business has to pay such as wages, rent and rates, water rates, power, insurance and equipment costs.
- **Net (operating) profit** is gross profit minus expenses.

New international accounting standards mean there are slight changes in some terms. The new terms are shown in brackets.

A slightly fuller profit and loss account would include more detail and look like this:

|                          | £      | £              |
|--------------------------|--------|----------------|
| Turnover (sales revenue) |        | 500,000        |
| minus Cost of sales      |        | <u>200,000</u> |
| Gross profit             |        | 300,000        |
| minus Expenses:          |        |                |
| Wages                    | 96,000 |                |
| Rent                     | 22,000 |                |
| Rates                    | 10,000 |                |
| Advertising              | 8,000  |                |
| Power                    | 1,000  |                |
| Insurance                | 5,000  |                |
| Maintenance              | 4,000  |                |
| Other                    | 4,000  |                |
|                          |        | <u>150,000</u> |
| Net (operating) profit   |        | 50,000         |

This level of detail allows the business to see which expenses are most important, i.e. which are having the biggest impact on profits. In this case, for instance, the wage bill seems high compared to other costs. Further to this, there may be a section called the appropriation account, which shows where profits have gone – in taxation, in dividends, or retained in the business.

## Profit and performance

One obvious reason for creating a profit and loss account is to use this record of financial transactions to check the performance of the business against, for example, target figures for gross and net profit. The figures for sales revenue, cost of sales and expenses might also be reviewed to see if they are greater or

less than expected. Comparisons with figures from previous years' accounts might be made to spot trends and analyse performance. Comparisons can also be made with other businesses in the same markets, or of a similar size, to see which is the most profitable. Business owners and managers can then try to investigate why a competitor is more profitable, and change their own practices.

### Did you know...

To make the account easier, wage costs are usually all included in 'expenses' even though some of them might really be part of the 'cost of sales'.

## Stakeholders

Profit and loss accounts may be used by stakeholders to assess the performance of the business. Each has his or her own reason for wanting to know how well a business is doing. For example:

- Owners, whether private owners such as sole traders or partners, or the shareholders in a business, will be interested in the size of net profit, to identify their likely share of the profit.
- Suppliers and lenders will be keen to know that the company they are dealing with and lending money to is profitable and a safe risk.
- Managers will compare the accounts with trading forecasts to see how well the company is performing. They will pay particular attention both to trends in sales and to changes in costs, as well as looking carefully at both gross and net profit.
- Employees will want to see that the company is successful and that their jobs are safe. Good profits might help them to gain a pay rise.
- Customers may not want a company to make too much profit out of their need for a product, but a profitable company may suggest that the products are of a good quality.
- Tax authorities need to know profit, so that they can accurately assess tax.

## Summary

- The profit and loss account is a record of the business's financial performance in the past
- It measures sales against their costs and the overheads of the business
- It can also help with forecasts and comparisons with past periods and similar businesses
- It is a management tool, which shows which expenses and costs are most important
- All groups of stakeholders have an interest in this account

## Core knowledge

Most businesses have the objective of making a profit. In simple terms, profit is the surplus of income over expenditure in a certain period of time. The opposite to this is a loss – when expenditure is greater than income. Businesses therefore need to account for how well they have traded, and whether they have made a profit or a loss. This is called the trading and profit and loss account. For most types of

business, it is a legal requirement to produce a profit and loss account in some form or other. All businesses need to keep a record for HM Revenue & Customs for income tax and VAT. A profit and loss account is one of the main documents used to check on the amount of taxes that should be paid.

## Publication

For public limited companies, the profit and loss account has to be published in an annual report that is freely available to everyone. Although published in book format, many of these reports are now available online. Private companies publish a briefer version of the profit and loss account and submit it to Companies House, where it is available on application for a small fee. Sole traders and partnerships can keep their accounts private and only reveal them, as necessary, to the tax authorities. (This is one of the advantages of this form of ownership.)

## Forecasts

One of the main uses for profit and loss accounts is to make forecasts – predictions about the future. If the business has a record of revenue over a time period it will be able to use this to estimate future levels and plan accordingly. Estimates of future revenue will have to consider the possible impact of any proposed price changes, as well as the effects of other factors such as an advertising campaign or an increase in competition. By making an accurate record of the cost of sales, the business can see where costs are rising, and try to do something about this. It can use this as a guide to estimate its future cost of sales, taking into account any possible changes to the prices charged by suppliers. Perhaps it might use less energy, investigate different suppliers, take out a different maintenance contract or make some workers redundant.

### And more

There are a whole range of factors that might affect a business's ability to make profits. The most obvious are changes in costs, changes in revenues and changes that are outside the control of the business. Such changes are called external influences.

## Costs

A change in costs will have an obvious effect on profitability – higher costs reducing profits, lower costs increasing them. Changes could be caused by suppliers changing their prices (in which case, these are outside the control of the business) or because the business itself allows its costs to change. For example, a business could award wage rises to its workers in line with government policy, but these may increase costs and eat into profits. If the business decided to expand, this could involve a whole new set of costs that will have to be paid for, and it may take some time before enough income is generated to fully pay for them. Businesses often take a much longer-term view than an individual might. A business might be prepared, for example, to make losses in a market for a long time in order to secure market share, knowing that eventually they will be in profit (the history of BSKYB is a good example of this).

## Revenue

A change in revenue will be a result of a change in sales, or price, or both. Businesses, especially those with close competitors, have to be very careful about changing price. An increase in price might actually lead to a fall in revenue if it drives customers to the competition. Changes in sales might also be the result of actions such as greater promotion of the products of the business.

## External

External changes can also affect profitability. Competing businesses could take custom (and therefore revenue), governments could decide to increase taxation, new laws could bring extra costs, world events could cause shortages and surpluses and therefore price changes. In general, businesses have to be prepared for uncertainty. The more detail they have on their current situation, the better prepared they will be.

### Did you know...

There are three broad uses of net (operating) profit:

- 1 The Inland Revenue takes a proportion of profit in taxation.
- 2 Profit after tax may be distributed to owners (if shareholders, this is a dividend).
- 3 Profit may be retained either as a cash reserve or for investment in new buildings, processes or equipment.

### Did you know...

That only a public limited company's accounts are fully published and available for the public to look at. Stakeholders in other types of business might find it difficult to obtain an accurate picture of the business's profitability.

## Have a go!

### Group activity

Collect the profit and loss account for the business that you are studying. If it is not available, either use a similar business that does publish accounts, or try to find out the basic figures from the owner. Explain what this tells you about the business and compare your discoveries with the other businesses in your group.

### Discussion

Use the profit and loss account of a chosen business to see which are the most important expenses, and how the business could reduce these. Share your thoughts with the rest of the group. Do all businesses face the same problem areas?

## Web-based activity



Visit the websites of other theme parks and attractions to see how many more ways of flexible pricing you can find. Usually this means charging a different price, but offering a slightly different service.

## Quickfire questions



- 1 Define 'profit' and 'loss'.
- 2 Explain how to calculate gross profit.
- 3 Explain how to calculate net profit.
- 4 What is the difference between 'cost of sales' and 'expenses'?
- 5 What comparisons can be made using profit and loss accounts?
- 6 What is the interest of the owners of a business in profit and loss accounts?
- 7 What is the interest of the suppliers of a business in profit and loss accounts?
- 8 What is the interest of the employees of a business in profit and loss accounts?
- 9 What is the interest of the customers of a business in profit and loss accounts?
- 10 What is the interest of the tax authorities in profit and loss accounts?

## Cracking the code



**Profit and loss account** The account that shows the operational side of a business.

**Sales revenue** The income received from sales of the product; it is calculated as price × sales.

**Cost of sales** What it cost to buy stock, or to manufacture the product.

**Overheads, or expenses** Fixed and variable costs the business has to pay other than cost of sales.

**Net profit (operating profit)** Profit after expenses are taken into account.

# Chapter 36

# The balance sheet

## APPLIED IN THE REAL WORLD

### Sandeep's decisions

**T**he government's Business Link site offers sound advice on all areas of business. It invited businessman Sandeep Sud to comment on how he used his balance sheet to help him improve his business. Sandeep Sud is a qualified solicitor who also runs a school uniform business based in Hounslow, in partnership with his parents. The company, which has four full-time employees, uses its balance sheet to gauge how the business is progressing. It's also been a key factor in securing a bank loan for the improvement and expansion of the company premises.

Sandeep comments: 'As a partnership we produce a balance sheet as part of our annual accounts and as an internal management exercise. A balance sheet gives a snapshot of how the business is doing at a particular time. This is useful, but you have to remember that it could change overnight. For example, if you were in debt on April 30 when you did your year-end accounts, but paid this off on May 1, you would get a completely different picture of the strength of the business.'

The balance sheet is useful when looked at alongside the profit and loss figures because then you get the whole picture. For example, if you borrowed lots in one particular year, but had made a profit, the profit would show on your profit and loss accounts, but what you owed would only be apparent on the balance sheet. It's important to be aware of both sets of numbers.

Having a strong balance sheet helped when it came to borrowing. When we first applied for a



refurbishment loan\* we couldn't provide up-to-date accounts to the bank manager. This could have been a problem, but we quickly got our accounts in order and the loan was approved straight away. Because our balance sheet was strong, the bank thought we were a good risk. Although we decided not to draw down on the loan – because we used cash flow instead – it did open our eyes to the importance of a strong balance sheet. I would have taken the bank loan to drive expansion. In the past we've taken a cautious view of our balance sheet and so never taken the full amount of money available to us, when really the decision to borrow should be based on the risks and rewards of the project. Your balance sheet is essential, but don't let it rule your decision making.'

Source: [www.businesslink.gov.uk](http://www.businesslink.gov.uk)

\* A loan to help bring equipment or premises up to date.

### Live links

Go to [www.businesslink.gov.uk/](http://www.businesslink.gov.uk/) and follow the links to 'your business sector' where you can input the type of business you are studying for details of the rules that affect it.



## Hit the spot

- Outline how Sandeep Sud uses his balance sheet.
- Explain why the information on a balance sheet is important to a business.
- Which do you think is of more use to a business, the balance sheet or the profit and loss account? Give reasons to support your answer.

## Introduction

**Balance sheets** are an important tool for the business. They allow the business to compare its position with previous time periods. They are of more use when looked at alongside the profit and loss account. The detail of the balance sheet lets a business know if, for example, it has too much cash in hand, or is holding too much stock. It lets stakeholders see whether – at that moment in time – the business is strong and likely to be able to pay its debts.

## Snapshot

The balance sheet is often called a 'snapshot' – a position at a certain point in time – of the financial position of a business. It shows a business's wealth on a particular date by showing the state of the **assets** and **liabilities** of the business. Assets are what the business owns, liabilities are what the business owes. The assets have been financed by the liabilities. For example, a business may own a van, which it has bought with a bank loan. The asset is the van and the liability is the bank loan.

## Preparing a balance sheet

There are several ways of presenting a balance sheet, depending on the type of business. A typical balance sheet could be laid out as follows:

### Did you know...

There is often confusion over creditors and debtors. Creditors are owed money by the business; debtors owe money to the business.

|                                                        | £       | £              |
|--------------------------------------------------------|---------|----------------|
|                                                        |         | <b>TOTALS</b>  |
| <b>Fixed assets (non-current assets)</b>               |         |                |
| Land and buildings                                     | 100,000 |                |
| Equipment                                              | 50,000  |                |
| Vehicles and tools                                     | 30,000  |                |
| Computers                                              | 20,000  |                |
| Furniture and fittings                                 | 10,000  |                |
| (Total fixed assets)                                   |         | 210,000        |
| <b>Current assets</b>                                  |         |                |
| Stocks (inventories)                                   | 50,000  |                |
| Debtors (receivables)                                  | 15,000  |                |
| Cash                                                   | 5,000   |                |
| (subtotal of current assets)                           |         | 70,000         |
| <b>Current liabilities</b>                             |         |                |
| Creditors (payables)                                   | 40,000  |                |
| Bank overdraft                                         | 10,000  |                |
| Tax owed                                               | 5,000   |                |
| (subtotal of current liabilities)                      |         | 55,000         |
| <b>Net current assets (working capital)</b>            |         |                |
| Current assets minus current liabilities               |         | 15,000         |
| <b>Net assets employed</b>                             |         |                |
| Fixed assets plus net current assets                   |         | 225,000        |
| <b>Long-term liabilities (non-current liabilities)</b> |         |                |
| Mortgages                                              | 40,000  |                |
| Long-term loans                                        | 20,000  |                |
|                                                        |         | 60,000         |
| <b>Net assets</b>                                      |         | <b>165,000</b> |
| <b>Capital and reserves</b>                            |         |                |
| Share capital (total equity)                           | 125,000 |                |
| Reserves                                               | 30,000  |                |
| Retained profit                                        | 10,000  |                |
|                                                        |         | <b>165,000</b> |

NB: New international financial reporting standards have altered some of the terms. New terms are shown in brackets. For the next few years, both sets of terms are likely to be used together.

**Fixed assets** include buildings, plant and machinery, financial assets such as the ownership of shares in other businesses and intangible assets such as a brand image or a business's 'goodwill'. **Current assets** include both material assets and financial assets. Material assets include stock held by the company either of finished or part-finished goods or inputs such as parts, components and raw materials.

Financial assets are cash in hand and money owed to the business (debtors).

Net current assets are also known as **working capital**. The working capital of a business is its current assets minus its current liabilities. It represents the finance available for the day to day operations of the business. Levels of working capital have to be managed – too little and the business runs the risk of not having enough to meet immediate needs; too much and the business is losing out on possible earnings, such as interest payments.

### Did you know...

For many small businesses, the major asset will be the 'white van' which transports people to jobs and which carries the tools and equipment (also assets) that are essential to the business.

## Liabilities

Liabilities are either current, or long term. **Current liabilities** are amounts that must be paid within 12 months which could include tax liabilities and dividends. Long-term liabilities do not have to be paid for at least 12 months and could include items such as

mortgages and bank loans. Net assets (in our example, £165,000) are calculated as the net assets employed (fixed and current) minus long-term liabilities. The capital account shows how these are financed, so will always be the same figure as the net asset total.

### Did you know...

Cash 'in hand' or on deposit in a bank current account is earning little or no interest and may actually be costing money in bank charges. The balance sheet will show if there is more cash than is needed for day-to-day transactions. This can then be moved to interest-bearing accounts.

## Usefulness

Company law requires a limited company to prepare an annual balance sheet. Sole traders and partnerships are not obliged to prepare such an

account. However, as Sandeep shows, it is a useful account to show how well the business is performing, to present to stakeholders and to make comparisons with previous years.

## Summary

- Balance sheets show assets against liabilities
- They show the wealth of a business at a point in time
- They can be used to compare against other time periods and similar businesses
- Assets may be fixed or current
- Liabilities may be current, or long term
- The account is useful to present to stakeholders, to show how well the business is performing

## Core knowledge

In order to prepare a simple balance sheet, a business needs to be able to list and cost its fixed and current assets, long-term and current liabilities and owners' funds. The balance sheet shows a business the value of what it owns, the value of what it owes and the value of the capital invested in the business by its owners.

The assets that a typical manufacturing business owns are likely to include factory and plant, warehouse and storage facilities, equipment and tools, machinery in the buildings, office accommodation, computers and other hardware, delivery vehicles, furniture and fittings in the buildings, stocks of materials, components, parts and finished, but unsold, goods. Bigger businesses may also have assets that are not material, such as supplier and transport agreements and the reputation of the business for fair dealing or prompt payment (often called 'goodwill'). Assets are anything on which a money value can be placed. For many large businesses, one of the biggest assets will be the brand name. Even a small business will have a number of assets – the stock that it holds, buildings from which it operates and vehicles. Assets also include money owed to the business and deposited in the bank.

Businesses also have a number of liabilities – the things that they owe. These are grouped by those that have to be paid back fairly soon – within a year – and those that have a longer time to go before they must be settled, such as mortgages on property and long-term bank loans. The business's total asset value is reduced by the amount of liabilities to give its net assets.

The third part of the balance sheet, which is called the capital account, shows where the money to pay for these assets has come from. In a small business, this will be 'owners' funds'. In a larger business it may have been provided by shareholders. It may also include reserves that are not yet spent and profits that have been retained in the business.

And more

## The importance of balance sheets to stakeholders

The balance sheet is important to the stakeholders of a business as it shows the current level of debt and indicates whether or not a business will be able to pay its debts if it takes out a loan. This is vital information to anyone considering lending money to the business (Sandeep found it useful to show his bank manager), or investing in it. It is also important to those ordering goods or employed by the business. Remember, though, it is of more use when looked at alongside the profit and loss account. It is also a very fluid account – by the following day the position will have changed as, for example, stock is sold, or components arrive, or debtors pay debts or creditors accounts are settled. The value of assets will also fluctuate. Rising land or property prices might make factories or sites worth more. Ageing equipment will need to have its value reduced as it is worth less the older it gets (depreciation).

- Managers will use the figures to help show trends when compared with forecast figures and with figures for previous years. The figures will show the value of the company, whether there are any problems in meeting debts, and will, with other accounts, allow managers to carry out further calculations to analyse performance.
- Owners – in limited companies these are the shareholders – are able to see the net value or worth of the company. Any growth in value might help push up value, including share prices.
- Suppliers and lenders can check on the company's ability to pay its debts, and will look particularly closely at current assets and liabilities.
- Employees can see the health of the company's cash situation so that they are sure their wages will continue to be paid.

## Have a go!



## Group activity



Find out the details of the balance sheet for the business you are studying. If these are not available, find a similar business that does have figures available, or try to find out the basic figures from the owner. Compare the position of your business with those of the others in your group. Which do you think is the most healthy, and why?

## Discussion



As the figures on the balance sheet are of interest to all stakeholders, they should be made publicly available by all businesses. Explain whether or not you agree with this and why.

## Web-based activity



Business link ([www.businesslink.gov.uk](http://www.businesslink.gov.uk)) has a whole range of useful websites for small businesses (and business studies students). See if you can find a case study to help you with your chosen business.

## Quickfire questions



- 1 Outline what is meant by an asset, and give an example.
- 2 Outline what is meant by a liability, and give an example.
- 3 Explain why assets and liabilities are always equal.
- 4 What is the difference between a fixed and a current asset?
- 5 What is the difference between a current and a long-term liability?
- 6 Explain why the balance sheet is important to owners.
- 7 Explain why the balance sheet is important to financial stakeholders.
- 8 Explain why the balance sheet is important to managers.
- 9 Explain why the balance sheet is important to suppliers.
- 10 Explain why the balance sheet is important to employees.

## Cracking the code



**Balance sheet** A snapshot of the wealth of a business at a point in time.

**Assets** What the business owns, financed by the liabilities.

**Liabilities** What the business owes – used to purchase assets.

**Fixed assets (non-current assets)** Those assets not easily turned into cash.

**Current assets** Material, components, parts and financial assets easily turned into cash.

**Working capital** Represents the finance available for the day to day operations of the business calculated as current assets minus current liabilities.

**Current liabilities** Amounts that must be paid within 12 months.

# Chapter 37

# Cash flow forecasts

## APPLIED IN THE REAL WORLD

### Everything for £1

Poundland is the leading 'single price' retailer in the UK, with 200 stores where everything costs – you guessed – a pound. The shops offer over 3,000 products, ranging from food and drink to beauty products, toys to pet products and gardening to entertainment; it even sells clothes and shoes. The business has hundreds of suppliers, including top brands such as Walker's crisps, Nescafé coffee and Cadbury's chocolate, which deliver to the company's two central warehouses in the West Midlands.

Poundland has over two million customers a week at its 220 shops around the country. That's an annual customer base of over 100 million. Any supplier will obviously be keen to use the chain to shift its stock, but also wants to know that it is going to be paid – and paid on time. This is an important part of any business transaction, with many businesses suffering not from recession, nor from lack of orders or poor quality, but from the inability of their business customers to pay in full and on time. Poundland has built itself a strong reputation for being one of those most reliable of customers – one which pays suppliers in full and on time. As chief executive of Poundland, Jim McCarthy, says: 'We have a reputation for paying on time, in full and on terms.'

This means that suppliers receive their money in total, when they have asked for it, and within the terms of the invoice. (This could, for instance, be 'Net 30' – full payment within 30 days or 'COD' – cash on



delivery.) This also serves to save Poundland money, as terms often include discounts for paying early.

Such prompt payment, within the terms of the contract, is not always the norm for business on the high street. Often businesses delay payment for as long as possible – sometimes because they are waiting for payment themselves. It is certainly not the norm in a recession (when the economy is shrinking, rather than growing), when many traders will try to leave payment until the last minute, in order to keep their own cash flow healthy. The knock-on effect of this, of course, is that they cause problems for their own suppliers – these will also delay payment, and cause further problems down the chain of supply, causing some businesses to fail. Poundland remains confident that it will always get good deals from its suppliers, as it treats them well.

### Live links

On the Poundland website ([www.poundland.co.uk/](http://www.poundland.co.uk/)) look at the information for suppliers. Why do you think a supplier might be tempted to work with Poundland?



## Hit the spot

- Outline what is meant by a 'single price' retailer.
- Explain how, even though each costs £1, Poundland is still selling quality products.
- Explain why businesses sometimes delay payment to suppliers and evaluate how important Poundland's prompt payment policy is for suppliers.

## Introduction

A **cash flow forecast** (sometimes called a cash budget) is a prediction of the future flows of cash into and out of a business. It is a vital aid to businesses when planning for the future. A business needs to be sure that it has enough cash to be able to pay its day to day bills and also enough to be able to pay its debts when they become due. To do this it needs to identify and predict the main cash inflows to the business and the main cash outflows. The importance to the business lies in the problems faced if it does not have access to the funds to pay its bills.

## Inflows

Inflows of cash start when a business is first set up. Owners will put some of their money into a business. There may also be grants from government or business support organisations (such as the Prince's Trust), or even venture capital to help pay for buildings and equipment. Loans might be arranged from banks to help provide the necessary cash to pay for the start-up costs and some of the later running costs of the business. There may be further inflows from owners when the business is expanding. Once the business is running, its main income will be from

the sale of its goods or services, although the actual arrival of cash into the business might be delayed, or might vary from day to day or week to week. The business might have other sources of income such as rent from parts of its premises that it no longer needs to use itself or interest on bank deposits.

## Outflows

When a business is being set up, the main outflow of cash will be for all the start-up costs. If the business is already operating and it expands or introduces a new product, then again the main outflow of cash will be for these additional start-up costs. Once operational, the main outflow of cash will be running costs, loan repayments and interest, returns to owners (such as a sole trader's own 'drawings' or dividends to shareholders) and taxation. Again, these will be irregular in nature. Some will be lump sums, others may be spread over several months.

If there is more cash flowing out of the business than in, there is a **cash deficit**. If there is more cash flowing into the business than out, there is a **cash surplus**. The cash flow forecast is a month-by-month prediction of how much cash will be needed, so that the business can always make sure that it has enough cash to meet demands.



Cash flow measures the flow of money in and out of a business

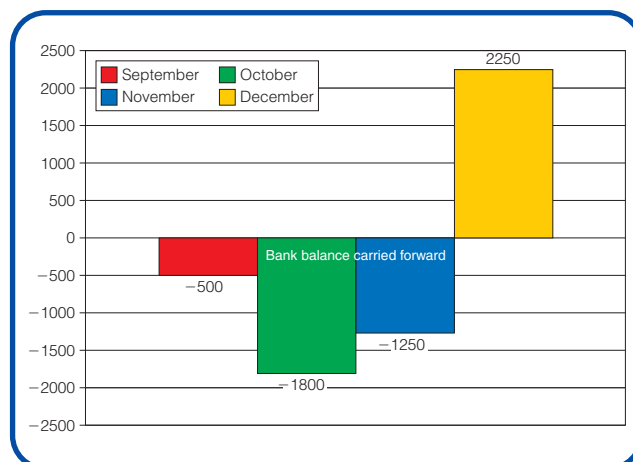
## Creating a cash flow forecast

To create a cash flow chart, the business needs to identify all of the cash coming into and leaving the business. It is reasonably easy to do this historically – i.e. to say what cash has flowed in and out in the past. Using historical figures and its own knowledge, the business can predict flows. For example, in the typical cash flow table shown on the following page, the business knows that business rates fall due twice a year, in September

and March, that extra staff (so extra wages) are needed in December and that when sales increase, more raw materials are needed. The bar chart shows even more clearly the borrowing requirement for this business. It also shows that, by the end of December, the business will have a cash surplus once again.

## Using the forecast

The forecast helps the business to plan its financial activities and borrowing requirements, such as bank overdrafts, and shows when it might suffer from a shortage of cash. The business will compare the cash flow forecast with the actual cash flow so that it knows when a flow of cash into the business is needed, when to slow down outflows (perhaps by delaying a payment or purchase) and what its borrowing requirements will be.



Using the cash flow forecast

| Amount in £                  | Month |        |        |        |
|------------------------------|-------|--------|--------|--------|
|                              | Sept  | Oct    | Nov    | Dec    |
| Bank balance brought forward | 2000  | (500)  | (1800) | (2150) |
| Cash from sales              | 1500  | 2000   | 3000   | 9000   |
| Interest on deposits         | 100   | 100    | 100    | 100    |
| Total cash in                | 1600  | 2100   | 3100   | 9100   |
| Total cash available         | 3600  | 1600   | 1300   | 6950   |
| Cash out                     |       |        |        |        |
| Wages                        | 2000  | 2000   | 2000   | 3000   |
| Transport                    | 300   | 300    | 300    | 800    |
| Materials                    | 300   | 600    | 600    | 1200   |
| Power                        | 100   | 100    | 150    | 200    |
| Business rates               | 1000  | 0      | 0      | 0      |
| Other                        | 400   | 400    | 400    | 400    |
| Total cash out               | 4100  | 3400   | 3450   | 5600   |
| Bank balance carried forward | (500) | (1800) | (2150) | 1350   |

Example of a cash flow forecast

### Did you know...

Direct debit payments or monthly standing orders are easy ways to spread payments of large bills so that they are paid regularly, in small amounts. Many businesses give discounts for customers opting for these payment methods.

### Summary

- A cash flow forecast predicts future flows of cash into and out of a business
- It is sometimes known as a cash budget
- Having a cash deficit, i.e. not having enough cash to pay immediate bills, is one of the main reasons for business failure
- Large cash surpluses also show an inefficient use of resources
- Creating a forecast helps a business to manage its finances and plan its borrowing
- Often cash flow problems can be resolved by delaying, spreading or rescheduling payments

### Core knowledge

Businesses deal in flows of cash – cash received for the sale of their products, cash paid out in various expenses such as wages, materials, bank interest and transport. A manufacturing business will sell its goods, and this will bring its main inflow of cash. Most manufacturers do not sell directly to the public, but to wholesalers or retail outlets. These businesses will often want a period of time within which to pay for the goods received, often a minimum of 30 days, sometimes a lot longer. In the meantime, the manufacturer still has to pay wages, pay for fuel and keep paying for raw materials and other inputs if it is to remain in production. Most cash amounts have to be paid out regularly, either weekly or monthly. The largest item is likely to be the wage bill, followed by overheads such as power, rent and rates. If there is a gap between the amount of cash flowing into the business and the amount flowing out, the business needs to know about this, and arrange appropriate finance to cover it. Even small businesses in the service sector may have gaps between cash in and cash out. A business employed to fit a new kitchen has to buy materials such as worktops, pipes and appliances and needs tools and transport. The customer does not, however, expect to pay for the work until it is complete. How then can the business manage the gap between cash leaving and cash not yet being paid? Not all businesses manage to do this and many business failures are not a result of poor order books, a shoddy product or an unsatisfactory service. They are the result of not managing cash flow, so that problems occur. Often the business is forced to sell assets to meet debts. Just think, once the kitchen business has sold off its tools and transport to pay for fittings, how can it then operate?

### And more

A simple cash flow forecast shows the total inflows and outflows of a business and opening and closing balances of cash. The more detailed the cash flow forecast, the more this allows the business to see exactly where problems might arise and make plans accordingly. The business can interpret the cash flow forecast to identify possible problems,

such as regular outflows outstripping inflows, larger than expected bills and too large a level of surplus cash. It will seek suitable solutions, such as rescheduling payments and receipts of income. The forecast will help the business to predict when it might suffer from cash shortages, and this knowledge will help it to control its business and financial operations. If the business compares this forecast with the actual flow of cash, it will identify when it:

- needs to speed up the flow of cash into the business;
- needs to slow down the flow of cash out of the business;
- can afford to pay off some debts;
- can afford to order new stocks or equipment;
- needs to negotiate an increase in overdraft facilities at its bank.

In the forecast shown, the business could spread business rate repayments by putting money to one side each month and could pay its power bill quarterly (paying it in December saves £350 of borrowing). The forecast lets it know exactly what size overdraft is needed at the bank.

Overdrafts from banks can help the short-term situation, but the interest rates on these are quite high. A bank usually puts an upper limit on the size of the overdraft. If the net cash outflow becomes too large, the bank may refuse to honour cheques made out by the business with the overdraft. In extreme cases, a business might have to stop trading because of a cash shortage, even though it is relatively profitable.

### Did you know...

Forecasts can only be as accurate as the data that is used to make them, so it is essential that such data is accurate.

### Did you know...

Whatever period of time is used (daily, monthly, annual, etc.), the end of one period is always used as the start of the next.

## Have a go!

### Group activity

If you can, find out from the business that you are studying how good it is at paying suppliers. See how many different ways your group can suggest to encourage businesses to pay up either on time or even early.

### Discussion

How useful do you think businesses find cash flow forecasts and cash budgets when they can change so rapidly from day to day? How do you think usefulness and accuracy are linked? Are there any types of business where you think they are more useful than others?

### Web-based activity



Go to [www.bplans.co.uk/calculators/](http://www.bplans.co.uk/calculators/) and click on the cash flow calculator. You can use this to change the flows into and out of a business, to see what the likely effects are on cash.

### Quickfire questions



- 1 What is a cash budget?
- 2 Why might a business delay payment to a supplier?
- 3 What sort of problems do you think such delay would cause the supplier?
- 4 Give an example of a cash inflow.
- 5 Give an example of a cash outflow.
- 6 What is meant by a cash surplus?
- 7 What should a business do with a cash surplus?
- 8 What is meant by a cash deficit?
- 9 What is meant by 'spreading' payments?
- 10 What is meant by 'rescheduling' payments?

### Cracking the code



**Cash flow forecast** Predictions of the amount of cash flowing into and out of a business.

**Cash deficit** When there is less cash than is currently required to meet bills.

**Cash surplus** When the business is holding more cash than it needs.

# Chapter 38

## Business and ICT

### APPLIED IN THE REAL WORLD

#### Not very accurate!

**W**hen asked, under pressure in an examination, what the benefits of using **spreadsheets** are to a business, many candidates fall into the trap of saying that they are ‘quick and easy’ or ‘cheap’. They claim that they are ‘more accurate’ because they ‘do the sums for you’. Actually, in real business, none of these is necessarily true. Spreadsheets are not necessarily ‘quick’. Although they will carry out the calculations that they have been told to carry out, data first has to be entered – and entered accurately. This can be a slow process. Nor are they necessarily ‘accurate’. The biggest problem with spreadsheets in business is the inaccurate entering of original data, or inaccurate formulae being put into a cell. In one famous case, a UK school was faced with a £30,000 shortfall in its budget because figures had been entered as text rather than numbers. They had therefore not been included in the calculation.

In business, the Companies Act requires the directors of limited companies to provide accurate financial information, and to provide it at regular intervals. Often, due to the use of spreadsheets, companies are actually in breach of the Act due to inaccurate information being presented. Such mistakes can also be extremely costly, so, in the long run, the use of the spreadsheet may not be ‘cheap’. The only thing that is ‘easy’ about them appears to be the ease with which incorrect data can not only be entered, but then overlooked.

A ‘White Paper’ report in 2004 by accountants and auditors PricewaterhouseCoopers showed that 90 per



cent of large spreadsheets – those with more than 150 rows – contained errors. More than 40 per cent of small and medium sized enterprises (SMEs), according to Microsoft, actually use the Excel spreadsheet (rather than professional software accounting packages such as Sage) to prepare accounts and budgets. One main problem with Excel is that errors do not always show up immediately. If, for example, text is entered in a cell instead of a figure, the software does not automatically convert it. Also, when spreadsheets are linked, formulae are seldom copied across accurately so that a change in one spreadsheet may not be reflected in another. The bigger the spreadsheet, the more likely the error is to go unnoticed. PwC suggest that spreadsheets should be kept separate from other data, and that only trained operators should be able to change them.

(Source: ‘The Use of Spreadsheets: Considerations for Section 404 of the Sarbanes-Oxley Act’ (PwC), 2004.)

#### Live links

Visit [www.accountingweb.co.uk/item/171091](http://www.accountingweb.co.uk/item/171091) for a run-down of errors in spreadsheets – and how to avoid them. You will need to register, but this is free.



## Hit the spot

- Identify three possible types of error in a spreadsheet.
- Explain why bigger spreadsheets may have more errors.
- Judge which type of error you think is the worst, and why.

## Introduction

Information and communications technology (usually shortened to IT or **ICT**) has become a vital tool in making businesses effective and efficient. All functional areas within a business can benefit from the use of new technology.

## Using ICT in financial decision making

In terms of finance, the main software used is still the spreadsheet. It can be used to build cash flow forecasts, profit and loss accounts and balance sheets, work out ratios and provide graphs and charts to show trends and forecasts. It is, however, of little use if all the data entered is not accurate. Any **formula** entered in cells, or raw figures, must be correctly taken from documentation and correctly copied into the spreadsheet. If spreadsheets are inaccurate, this can cause huge problems for a business. It might order too much stock, or announce profits that it has not made, or give incorrect returns to investors. Such mistakes are, sadly, not uncommon. The correct use of a spreadsheet, (and other specific financial software packages) can help a business to make forecasts (such as cash flow forecasts) and assist managers in key decision making.

## IT and departments

IT can be used to make both storing and manipulation of data more efficient. In many functional areas, there is a use for data storage or handling generally via either a **database** or a spreadsheet. Spreadsheets are more commonly used, as there are a number of database functions (such as searching and sorting) that can be carried out on a spreadsheet.

- Finance can keep all of the financial data regarding the business. Because it can be made available in a format such as a spreadsheet, it makes it easier to extract information from it and to make good use of the figures.
- Production can keep records of inputs, records of stocks of components, parts and raw materials, and records of output, with all costs and revenues recorded on a spreadsheet. It will therefore know what has been spent on inputs and what has been received from sales. This can be linked to software that will re-order stock as necessary.
- Human resources can store employee records on a database, making it easier to deal with promotion, discipline, payroll, pensions, holidays and many other issues.
- Customer services can keep a record of orders and payments from customers. Such spreadsheets should, ideally, be linked to those used to prepare the financial statements of the business.

## IT and reducing costs

IT applications have been particularly successful in reducing costs, especially communication and transaction costs. Email is an efficient and cheap form of communication (once computer hardware and a broadband connection have been paid for) and widely used in business, cutting down on postage, stationery and telephone costs. Transaction costs have also been reduced through the use of electronic funds transfer, online banking and electronic payment systems transferring payments automatically from the customer's bank account to that of the business, making the transaction both fast and efficient, both cheap and secure.

### Did you know...

Many customers now pay for goods with debit and credit cards. This is often known as EFTPOS – electronic funds transfer at point of sale. Any data that is passed electronically within a business is called EDI or electronic data interchange.

## IT and business expansion

Businesses can expand more easily by extending their operations to online business, often called '**e-commerce**'. They can set up a website to show potential customers the products that they have on offer and accept payment electronically and securely.

The only cost implication (apart from web hosting, authoring and maintenance) is the distribution aspect. If a business is offering to sell something, it must be able to deliver it. The most efficient and profitable of such businesses are those that provide a service, such as iTunes and its music downloads or the online marketplace of eBay.

### Did you know...

IT systems can be shut down through 'denial of service' attacks. This is when millions of emails are sent automatically to a business, making its servers crash. Such attacks are often part of a criminal activity.

## Summary

- ICT is a vital tool in making businesses effective and efficient
- All areas within a business can benefit from the use of new technology
- The main software used for financial purposes is the spreadsheet
- Spreadsheets must be accurate if they are to be useful
- IT can make both storing and manipulation of data more efficient
- Use of IT applications can help to reduce costs, especially communication and transaction costs
- Businesses can expand more easily by extending their operations to online business

## Core knowledge

Growth in the area of ICT has been extremely rapid, and new developments are happening all the time. The development of new technology has only taken place over 30-40 years (not a long time in business terms) and rapid computers, robotics and digital cameras are still very recent in real terms. The first calculators were enormous (and very expensive) and could only carry out simple tasks – nowadays they are cheap (or even free, or included in some other piece of technology, such as a mobile phone). The

first computers were room-sized, difficult to use and slow. New developments mean that not only are modern computers fast and efficient, but many products are guided or controlled by computer microchip. Everything from washing machines to cars has benefited from the new technology. Recent advances include the availability of huge amounts of storage space, fast broadband internet access and almost universal access to the internet in the UK.

In the area of business finance, spreadsheets are probably the most useful tool. They are used to store information and carry out calculations, but can also provide graphics and forecasts. Their main function is to calculate. Formulae can be entered in cells so that changes in figures are immediately reflected in totals. For example, a very simple spreadsheet could be set up for sales revenue. What you see is:



Technology has developed rapidly since the first calculators

|   | A     | B            | C             |
|---|-------|--------------|---------------|
| 1 | Price | Product sold | Total revenue |
| 2 | £12   | 10           | £120          |

What is on the spreadsheet is:

|   | A     | B            | C             |
|---|-------|--------------|---------------|
| 1 | Price | Product sold | Total revenue |
| 2 | £12   | 10           | =A2*B2        |

If price or quantity changes, the formula makes sure that the total also changes.

Spreadsheets can be used to manipulate figures, to demonstrate outcomes, for example through the creation of graphs and charts, and to forecast what might happen in the future.

And more

## System management and security

In some businesses there is a separate department to deal with problems and issues of new technology. This not only includes technician support, but also usually an IT expert who is in charge of the business's systems – a systems manager. This person can set passwords and different levels of access, as well as advising on (and often producing) content.

Employees should be able to log on with their own password and to further password-protect files or information that they do not want other employees to have access to. When they have finished for a session, they should log off. System managers will have higher levels of access for themselves and can set levels for various types of employee. These basic levels of security should be common to all businesses using computers. In some cases, it is not just a computer but other computerised systems where people need to log in or out. For example, an employee might have to log on to an electronic till before recording a transaction.

Systems can also be protected by being regularly backed up. The most usual format is called 'grandfather – father – son'. Today is 'son' of yesterday's back-up ('father') which is itself a back-up of the day before ('grandfather'). Data is doubly protected in this way. Security is also important to protect the business's systems from outside interference. This could come in a number of ways:

- hacking – when an outsider tries to break into a system in order to alter or steal information;
- a virus – hundreds of computer viruses and variations on them are released each year; some are fairly harmless but many can cause enormous damage to machines and entire systems.

Businesses protect themselves from such interference through the use of 'firewalls' to prevent outsiders gaining access, through password protection, and through the use of virus protection software.

### Did you know...

It is not just in business that inaccurate spreadsheets cause problems. In 2004, America said it had sent 37,000 National Guard troops to Iraq. It later turned out to be more than 90,000. Staff at Guard HQ, who had misread the entries on a spreadsheet, admitted the error.

### Have a go!



### Group activity



Each person in your group should put a spreadsheet together, with at least three mistakes in it. The other members of the group then have to find the mistakes and put them right.

## Discussion



So many businesses now operate on the internet that it is unfair that 12-16 year olds are not allowed to hold credit cards so cannot take advantage of everything on offer. Do you agree or disagree? Why?

## Web-based activity



If you search for 'spreadsheet errors' or 'computer errors' you will see how many sites are devoted to listing these. Find out about some errors and list your top three in order of which you think were the worst.

## Quickfire questions



- 1 What is the biggest problem with spreadsheets?
- 2 How could this problem be solved?
- 3 What is defined as a 'large' spreadsheet?
- 4 What percentage of large spreadsheets contain errors?
- 5 What is the most popular spreadsheet program?
- 6 Why might an inaccurate spreadsheet be in breach of the Companies Act?
- 7 How do PwC suggest inaccuracies can be avoided?
- 8 Suggest three financial uses for a spreadsheet.
- 9 Suggest two benefits to managers of using a spreadsheet.
- 10 Suggest three ways in which ICT can help businesses expand.

## Cracking the code



**Spreadsheet** A computer application designed to calculate results from figures and formulae entered.

**ICT** Information and communications technology

**Formula** An instruction in a spreadsheet to carry out a numerical action on cells (such as add or multiply).

**Database** A computer application designed to store and manipulate data.

**e-commerce** Trading using online routes such as websites, the internet and email.

## Chapter 39

# Financial ratios – gross and net profit

### APPLIED IN THE REAL WORLD

#### How well is Nokia doing?

**N**okia is the world market leader in sales of mobile phones, selling its billionth handset as long ago as 2005. Originally a paper mill, the company saw the mobile revolution coming and has become a major manufacturer and one of Finland's biggest companies. However, Nokia is not always able to report progress. Sometimes markets slow down, sometimes it does not make the right decision, sometimes the timing of a decision is not quite right. Currently, the mobile phone market is flat, showing little or no growth, due to the global recession. The only area that has seen an increase in sales is smartphones, that offer a great deal more features than the standard mobile phone.

In the summer of 2009, Nokia announced that its revenues had fallen from \$13.02 billion (£11.21 billion) to \$9.81 billion (£8.45 billion), in spite of an increase in market share from 37 per cent in the first quarter of the year to 38 per cent in the second quarter. Nokia's CEO blamed the fall on a plateau in the overall sales market for mobiles even though the company sold 103.2 million handsets in the period, an increase of 11 per cent over the first quarter. Revenues also fell as a result of competition and heavy promotion by both Nokia and its competitors, driving the average price of a handset down from just over \$64 (£55.45) to around \$61 (£53). Net profit for the period was also down, from \$1.09 billion (£0.94 billion) to \$374.6 million (a third of a billion or £322.86 million). Profitability measured by the net



profit to sales ratio was thus down from a healthy 8.33 per cent to a worryingly low 3.81 per cent. Part of the problem lies in high operating costs, or overheads, which the CEO said are being 'tightly managed'. Other problems lie in both the mobile market and Nokia's product range. With the global economy in recession, many customers are not upgrading mobiles as often as previously. Also, a large share of the market is now being taken up with smartphones such as the iPhone and Blackberry curve. Nokia, although the world's largest maker of mobile phones, currently has no smartphone products in its range.

On the back of these results, many investors sold Nokia shares on the stock exchange, bringing the value of the company down by almost 15 per cent.

#### Live links

Visit <http://shop.nokia.co.uk> to see whether Nokia has yet introduced a smartphone (such as the Blackberry or iPhone). What does this tell you about the product range?



## Hit the spot

- Identify two features of the current mobile phone market.
- Explain why the management of overheads is important to a business.
- Nokia faces problems with its product range and with customers not upgrading. Which do you think is the worst problem? Suggest a solution and give reasons to support your suggestion.

## Introduction

**Financial ratios** are part of the 'tool kit' used by management to judge the performance of a business. They can be worked out by looking at the financial accounts of the business, in particular the trading and profit and loss account and the balance sheet. Businesses use them to find out how profitable they are – in other words, how much profit they are making for each pound spent – and how efficient they are – in other words, are they getting the best use out of what they have? The main purpose of working out financial ratios is as an aid to decision making. Ratios may reveal to a business that the owners would be better off doing something else with their money. Owners and other investors will invest in those businesses where they feel returns will be greatest. Those who sold Nokia shares on the back of the results will have bought shares in other companies. Those who bought or held on to the shares believe that Nokia will improve in the future.

## Gross profit to sales revenue

The various measures of profit mean that there are various profitability ratios. The gross profit margin (**gross profit to sales revenue**) is measured as

$$\frac{\text{Gross profit}}{\text{Turnover}} \times 100 = \text{per cent (i.e. expressed as a percentage)}.$$

Gross profit margins need to be interpreted in the light of the type of business the company is engaged in as they are affected by the amount of fixed costs or overheads of the business. The nature of some businesses means that they will have much higher overheads than others. A business providing a service may have very low overheads – a design consultancy,

for example, or an architect's. In the case of a web-based business, overheads may be kept extremely low. A car manufacturer, oil refiner or train operating company, on the other hand, will have very high overheads. Gross profit margin can be calculated from the profit and loss account.

## Net profit to sales revenue

A more accurate measure of profitability is the net profit margin, as this takes overheads into account. Net profit margin (**net profit to sales revenue**) is measured as

$$\frac{\text{Net (operating) profit}}{\text{Turnover}} \times 100$$

The higher the percentage, the better the company is performing. This is usually used as a comparison with previous years, or with similar-sized businesses operating in the same market. Falling ratios over a number of years indicate falling profitability and will ring alarm bells for many stakeholders. The figure shows how much net profit a business earns per pound of revenue. Again using the profit and loss account on page 198.

$$\frac{\text{Net (operating) profit}}{\text{Sales revenue}} \times 100 = \text{per cent gives:}$$

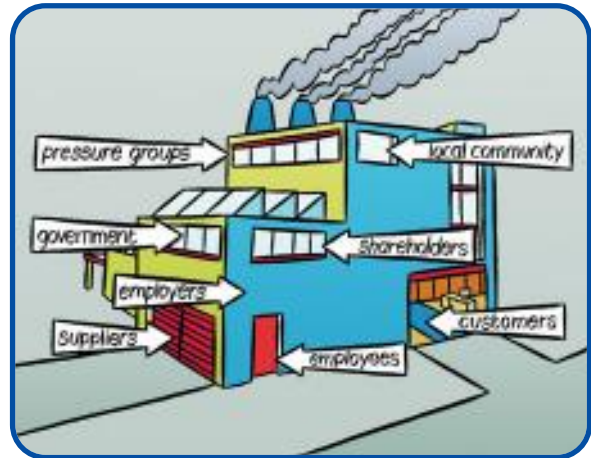
$$\frac{50,000}{500,000} \times 100 = 10 \text{ per cent}$$

This is a much more realistic figure, showing that for every £100 of sales revenue earned, £90 is being spent on cost of sales and expenses. Again, this can be compared with previous years.

## Stakeholders

Ratios are important to various groups of stakeholders in the business:

- Owners, whether sole traders, partners, co-operative members or shareholders, need to see if they are getting a good return on the money that they have risked in the business.
- Employees will want to know that their jobs are secure. They may also be keen to use profitability figures to justify pay rises. Managers, who are also employees, will want to build a good reputation for themselves and the business, and may also feel that a more profitable business should pay them more.
- Customers want to be sure that they will continue to be able to buy from this business. Any business failure reduces customer choice.
- Banks, suppliers and other creditors will want to be confident that bills and debts will be paid.
- Governments and tax authorities will want businesses to be successful so that they provide jobs and keep the economy strong and for the increased tax that is due from increased profits.



All of the stakeholders in a business will be interested in the ratios

## Summary

- Financial ratios are used to judge the financial health of a business
- To judge fairly, you must take the nature of the business into account
- Gross profit margin measures how much profit is being made compared to turnover
- Net profit margin measures how much profit, less expenses, is being made compared to turnover
- All stakeholder groups have an interest in profitability

## Core knowledge

**Ratios** are one factor or group measured in terms of another (such as production to inputs). In a typical class, for example, there could be 8 boys to 12 girls, a ratio of 8:12 – which can be reduced to 2:3. As you can see, this does not tell us much on its own (there are 2 boys to every 3 girls). Where it would be useful is when comparing it with another class to see which has the higher ratio of boys to girls. If the class next door has 10 boys and 14 girls the ratio is 10:14. The comparison is difficult which is why a percentage is used –  $8/12 \times 100 = 66$  per cent;  $10/14 \times 100 = 71$  per cent. The comparison clearly shows that the second class has a better balance of boys to girls. In sport, ratios can show who is more consistent. Take two tennis players, MacEverett and Stanislavski. MacEverett has 13 wins out of 29 matches, Stanislavski 15 wins out of 33 matches. He has played four more matches and has two more wins. Who, however, is the better player? Comparing the ratios of wins to matches played – 13:29 to 15:33 – is not very helpful but as percentages it is clear who is more consistent –  $13/29 \times 100 = 44.83$  per cent;  $15/33 \times 100 = 45.45$  per cent, so Stanislavski is the better player, but only just! This could, however, help you decide who to support.

Business ratios similarly are of limited use if looked at in isolation. Used with each other, however, they can help to give an overall picture of the financial position and strength of the business. Ratios can be compared with each other, with earlier figures, or with other businesses selling similar products. Such comparisons are made much more easily and clearly by using percentages.


**And more**

Using the profit and loss account that we encountered in Chapter 35 (on page 198) we can say that, for this business, application of the formula for gross profitability looks like this:

|                                                                                 |        |                                                                |
|---------------------------------------------------------------------------------|--------|----------------------------------------------------------------|
| $\frac{\text{Gross profit}}{\text{Sales revenue}} \times 100 = \text{per cent}$ |        | so: $\frac{300,000}{500,000} \times 100 = 60 \text{ per cent}$ |
|                                                                                 | £      | £                                                              |
| Sales revenue (turnover)                                                        |        | 500,000                                                        |
| minus Cost of sales                                                             |        | <u>200,000</u>                                                 |
| Gross profit                                                                    |        | 300,000                                                        |
| minus Expenses:                                                                 |        |                                                                |
| Wages                                                                           | 96,000 |                                                                |
| Rent                                                                            | 22,000 |                                                                |
| Rates                                                                           | 10,000 |                                                                |
| Advertising                                                                     | 8,000  |                                                                |
| Power                                                                           | 1,000  |                                                                |
| Insurance                                                                       | 5,000  |                                                                |
| Maintenance                                                                     | 4,000  |                                                                |
| Other                                                                           | 4,000  |                                                                |
|                                                                                 |        | <u>150,000</u>                                                 |
| Net profit (operating profit)                                                   |        | 150,000                                                        |

A gross profit ratio of 60 per cent means that for every £100 of revenue, £40 goes on the cost of sales, leaving a gross profit of £60. The previous year, sales revenue was slightly lower at £460,000 and cost of sales also lower at £170,000, giving a gross profit of £290,000. Obviously profit has increased (from £290,000 to £300,000) but has profitability? One of the reasons for using percentages is to be able to make these sorts of comparisons. To know whether or not this is an improvement on the previous year, the business needs to calculate the ratio.

$$\frac{\text{Gross profit}}{\text{Sales revenue}} \times 100 = \text{per cent} \quad \text{gives: } \frac{290,000}{460,000} \times 100 = 63.04 \text{ per cent}$$

In fact, the previous year each £100 had been yielding £63 of profit. This means that more money is now being spent on the cost of sales, so something is not working as efficiently as it was the year before. Perhaps prices of materials or components have changed? Perhaps a better discount was agreed with suppliers the previous year? Managers can use the detail of the profit and loss account to identify what has changed and make decisions to improve the ratio.

**Did you know...**

In AQA Business examinations, you will always be given the formulae for ratios, so this is something that you don't have to remember. What you will be asked is what the figures mean to the business.

### Did you know...

Sometimes figures show owners that it is not worth investing in a business. If the return on my investment in a business is 4 per cent, and bank interest rates are 5 per cent, then I can make better use of my money by putting it in the bank. Of course, this doesn't account for the fact that many people find owning or running a business exciting and enjoyable.

### Did you know...

Remember, the absolute figures are not always as important as the comparisons that can be made with them.

## Have a go!

### Group activity

Choose a business each, and find its profit and loss account. Work out the gross and net profit margins. Compare this with the results from the rest of your group. Taking into account the type of market each business operates in, which do you think is the most profitable? Draw up a table to illustrate your results.

### Discussion

How useful do you think ratios really are to a business? Can you think of situations where, because of the nature of the business, the profitability ratio is not much use?

### Web-based activity

Visit the websites of several different mobile phone manufacturers. Which do you think has the widest product range? Which do you think has the biggest market share? Draw up a table to compare the different businesses.

## Quickfire questions



- 1 What is a financial ratio?
- 2 Which two accounts are used for financial ratios?
- 3 What is the main reason for working out ratios?
- 4 Give another name for the gross profit to sales ratio.
- 5 What other factor is important when interpreting profit ratios?
- 6 What else is taken into account to produce net profit ratios?
- 7 Outline why employees would be interested in profit ratios.
- 8 Outline why financial stakeholders would be interested in profit ratios.
- 9 Outline why owners would be interested in profit ratios.
- 10 Outline why governments would be interested in profit ratios.

## Cracking the code



**Financial ratios** Show the relationships between key parts of the business's accounts.

**Gross profit to sales revenue** Also gross profit margin; measures the profitability of a business in relation to its turnover.

**Net profit to sales revenue** Also net profit margin; measures the profitability of a business, after expenses, in relation to its turnover.

**Ratios** Measure one variable in terms of another.

# Chapter 40

## Ratios – ROCE and liquidity

### APPLIED IN THE REAL WORLD

#### BA cashes in

**B**ritish Airways (BA) is Britain's major airline, with its main UK hubs at Heathrow, Gatwick and Manchester. It has the largest fleet, more international flights and more destinations than any other UK airline. It has, however, along with many other major airlines, been facing difficulties in recent years. Once Britain and the world entered recession in 2008/9, demand for air travel fell. In particular, demand for business class travel decreased as business people traded down to cheaper seats to save money. This market is especially important to BA, as it provides much of its profitability. While passenger numbers for July 2009 fell just 1.2 per cent compared with July 2008, those for first and business class fell by 11 per cent. The only good news is that the fuel bill is likely to be up to £500 million lower than the previous period, due to changes in currency prices and the price of oil.

BA, in its annual report, posted a loss of £401 million for the full year of 2008–2009. However, it has posted a profit in each of 19 out of the past 20 years, and while investing much of this – for example, in new aircraft or in Terminal Five at Heathrow – it has also retained a large amount as insurance against future upsets in the market. However, with a current ratio, as at August 2009 of just 0.57, the worry in the markets was that it would be unable to pay its debts. This causes uncertainty and makes banks and other lenders more reluctant to extend lines of credit. To



counter this, and strengthen the balance sheet, the business decided to raise almost £700 million in cash. It issued bonds worth £350 million, which can be converted into shares in 2014. In addition, it has persuaded the trustees of its pension fund to supply a further £330 million. This cash injection does not make BA any richer, but it does make both its current and acid test ratios more healthy. The current ratio, at 1.18, shows that the business can just cover its short-term debts. The acid test ratio, at 1.15, is now well within the healthy range. Share prices recovered on the back of the cash announcement.

#### Live links

If you go to  
**[www.britishairways.com](http://www.britishairways.com)**  
you can look at the prices of flights and see the difference between economy, business and first class seats.



## Hit the spot

- Give one reason why business class passengers are 'trading down'.
- Explain how raising £700 million in cash on the balance sheet has improved liquidity ratios.
- Evaluate whether this was the best way to improve ratios and suggest other alternatives that BA could have tried.

## Introduction

Apart from **ratios** measuring profitability, there are other important ratios for a business. For example, investors need to know how well their investment is doing. Managers and owners need to know how efficiently capital is working. Suppliers and bank managers need to know if the business has the ability to meet its debts. These questions may be answered by using ROCE, liquidity and acid test ratios. They help stakeholders to make judgments regarding the efficiency and solvency of the business.

## ROCE

**Return on capital employed**, usually known as **ROCE**, is another measure of the profitability of a business. It compares the amount of profit made with the amount of money invested in the business. The higher the figure, the higher the return that the investor is getting. This is an easy way to compare how well an investment is performing either against other businesses or against previous years. As with gross and net profit ratios, it is expressed as a percentage to make comparisons easier. The formula is:

$$\text{Net profit} \times 100 = \text{per cent}$$

## Total capital employed

Figures for ROCE are obtained from the balance sheet (total capital employed) and the profit and loss account (net profit). A loss-making business may well report a negative figure. (British Airways 2009 ROCE was quoted as -3.49 per cent, but has been positive, and healthy, for most of the last 20 years.) Investors can compare the figure with previous years, similar types of company, the other profitability ratios and

the risk-free return that might be gained by putting money on deposit. If banking the money (a risk-free strategy) could yield 3 per cent interest, then ROCE needs to be above 3 per cent for it to be worth the investor risking money.

## Liquidity ratios

The other common set of ratios calculated are efficiency or activity ratios. These are the ratios that measure how efficiently a business is using both its resources and its finance. **Liquidity ratios** are a subset of activity ratios. They measure the short-term financial health of a business by looking at how capable it is of paying its short-term liabilities. In other words, if called on to do so, could the business pay its debts? Because of the way that these figures are used, they are often expressed as ratios rather than percentages. For example, a ratio of 2:1 shows that the business can pay its debts twice over. The figures for these ratios are taken from the balance sheet.

## Current ratio

**Current ratio** is measured as

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

It is also called the working capital ratio as it uses the two figures that are used to define working capital. A healthy ratio would be in the region of 1.5:1 to 2:1. It measures how many times over the company could pay its current liabilities from its current assets. Too low means the business is over-stretched and in danger of not meeting commitments. Too high means assets are not being used as efficiently as possible.

## Acid test ratio

Current ratios include a figure for stocks or inventories. Should the business get into difficulty, it may be that these stocks are not sold, so the **acid test ratio** takes them out of the equation. The formula for the acid test ratio is thus

$$\frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}}$$

This is a much sterner test of the ability of the business to pay debts and a healthy ratio is considered to be in the region of 0.8:1 to 1:1.

### Did you know...

Liquidity refers to how close an asset is to cash. Cash is the most liquid asset. Buildings and machinery may be least liquid, as they are hardest to turn into cash.

## Core knowledge

Ratios can be used in order to give a picture of the performance, liquidity, profitability, efficiency and vulnerability of a business. The main users of ratio analysis are managers, investors and potential investors, and other stakeholders such as suppliers, competitors and creditors. They can use the accounts, and the ratios calculated from the accounts, to make decisions about the future direction of the business. They can also make decisions on whether or not to invest. For limited companies, accounts have to be public, so it is easy for any person or group to work out the ratios. Private businesses, such as sole traders and partnerships, can keep their accounts to themselves, so that only they know if they are in a strong or weak position. However, they can also make them available as and when needed, such as for bank managers when looking for loans or to suppliers when looking for credit agreements.

Shareholders in limited companies can use published figures. Shareholder ratios are used by shareholders to assess the return they are getting or expect to get on their investment. They are used to measure the value of their investment against other companies and against other possible uses for their money (meaning that current levels of interest rates are important).

The main ratio used is the return on equity, calculated as earnings/shareholders funds and expressed as a percentage. This shows how much profit a shareholder might expect from their investment – the higher the percentage, the better. Earnings per share is calculated as earnings/number of shares issued expressed in money terms. The p/e ratio is the price to earnings ratio, measuring the value of the share against the dividends earned by the share. It is calculated as share price/profit available for distribution. The p/e ratio is often quoted along with share prices.

## Summary

- ROCE is used to measure the profitability of a business in relation to the amount of capital it uses
- It stands for Return on Capital Employed
- Activity or efficiency ratios measure how efficiently a business is using its resources and its finance
- Liquidity ratios measure the short-term financial health of a business
- Current or working capital ratios measure how capable the business is of paying its debts
- Acid test ratio takes the same measurement but disregards unsold stock


**And more**

Using figures from a real business helps to give a much better grasp on why such ratios are considered to be important. BA, before it raised the extra cash to boost its balance sheet, looked like it could be in danger of hitting a crisis in not being able to meet its current liabilities – amounts becoming due in the next 12 months.

| <b>Assets</b>                               | <b>Mar 08</b>   | <b>Mar 07</b>   | <b>Mar 06</b>   |
|---------------------------------------------|-----------------|-----------------|-----------------|
| Current assets                              |                 |                 |                 |
| Cash                                        | 1,863.0         | 712.8           | 906.9           |
| Net receivables (debtors)                   | 585.7           | 653.8           | 684.9           |
| Inventories (stock)                         | 111.9           | 76.0            | 83.0            |
| Other current assets                        | 585.7           | 1,987.5         | 1,990.7         |
| <b>Total current assets</b>                 | <b>3,146.2</b>  | <b>3,430.1</b>  | <b>3,665.5</b>  |
| Net fixed assets                            | 7,259.0         | 7,355.1         | 7,880.9         |
| Other non-current assets                    | 711.6           | 595.8           | 625.9           |
| <b>Total assets</b>                         | <b>11,116.8</b> | <b>11,381.1</b> | <b>12,172.4</b> |
|                                             |                 |                 |                 |
| <b>Liabilities and shareholder's equity</b> | <b>Mar 08</b>   | <b>Mar 07</b>   | <b>Mar 06</b>   |
| Current liabilities                         |                 |                 |                 |
| Accounts payable (creditors)                | 2,588.6         | 2,743.3         | 2,821.6         |
| Short-term debt                             | 422.8           | 416.9           | 478.9           |
| Other current liabilities                   | 230.9           | 463.9           | 131.0           |
| <b>Total current liabilities</b>            | <b>3,242.2</b>  | <b>3,624.1</b>  | <b>3,431.5</b>  |
| Long-term debt                              | 2,749.5         | —               | 3,601.5         |
| Other non-current liabilities               | 2,093.8         | 5,546.6         | 3,278.6         |
| <b>Total liabilities</b>                    | <b>8,085.5</b>  | <b>9,170.6</b>  | <b>10,311.6</b> |
| Shareholder's equity (shareholder funds)    | 3,031.3         | 2,210.4         | 1,860.7         |

NB Figures are in millions and have been rounded to the nearest £100,000.

In order to boost confidence, it raised more cash to change its ratios. This was the most effective way to ensure that the balance sheet was strong. Using the figures from the table you can see that in 2006 its current ratio (current assets/current liabilities) was  $3665.5/3431.5 = 1.06$  but that this had fallen to  $3430.1/3624.1 = 0.94$  in 2007, recovering slightly in 2008 to  $3146.2/3242.2 = 0.97$  (or 0.97:1). In 2009 it was reported as 0.57, meaning that BA could only cover 57 per cent of its short-term debts. The cash injection of £680 million changed this (on 2008 figures) to  $3146.2 + 680/3242.2 = 1.18$ .

The acid test ratio is not a lot different for a business like BA as, compared to other areas, it does not hold a great deal of stock. BA sells a service, rather than a good, so this is not surprising. The acid test ratio (current assets – inventories (stock)/current liabilities), with the extra cash raised changes (on 2008 figures) from  $3146.2 - 111.9/3242.2 = 0.94$  to  $3156.2 + 680 - 111.9/3242.2 = 1.15$ , a healthy position.

### Did you know...

Shareholders will also be interested in the dividends that they can hope to be paid. Dividend yield is calculated as the dividend per share/price of share expressed as a percentage. The higher the figure, the better the return on the share. This return has links with ROCE, as it needs to be above that which could be obtained by no-risk activities such as banking the money.

### Did you know...

Low-cost airlines are expanding at a faster rate than full-cost airlines such as Virgin and British Airways. This is because people are choosing price over other factors, such as comfort and convenience.

## Have a go!

### Group activity

Each collect the balance sheet information for a chosen business (they are published on the internet). Work out the liquidity ratios. Rank the businesses in terms of how solvent they are. Are there any surprises? Why do you think this is so?

### Discussion

To which group of stakeholders do you think ratios are most important? Justify your reasons to your group.

### Web-based activity

If you go to [www.britishairways.com](http://www.britishairways.com) you can go through the process of booking a flight (don't actually book it!). When you get to the price page, you can see the difference between economy, business and first class seats. Use this information to say how important business class is to BA.

## Quickfire questions



- 1 Which ratios help stakeholders to make judgments regarding the efficiency and solvency of the business?
- 2 What does ROCE stand for?
- 3 What does ROCE measure?
- 4 Suggest two ways in which ROCE could be used.
- 5 What is the source of the figures for ROCE?
- 6 What are liquidity ratios a subset of?
- 7 What is meant by 'current ratio'?
- 8 In what range would you find a healthy current ratio?
- 9 What is meant by 'acid test ratio'?
- 10 What does liquidity measure?

## Cracking the code



**Ratios** Measure one variable in terms of another.

**Return on capital employed (ROCE)** Compares the amount of profit made with the amount of money invested in the business.

**Liquidity ratios** Measure the ability of the business to pay its debts.

**Current ratio** Measures how many times the company could pay its current liabilities from its current assets.

**Acid test ratio** Measures the same as current ratio, but disregards unsold stock.

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