

## ANSWERS

\*Please note: questions without answers are 'open' and designed for group or class activities.

### CHAPTER 1

#### CASE STUDY: THE KANDY CYCLE SHOP

**1 ▶ Why do you think Tharanga opened a second-hand bicycle shop?**

Tharanga had always wanted to run a business because he wanted to be his own boss. He also had a passion for bicycles and spent a lot of his spare time restoring old bicycles and selling them on to local people as a hobby. He probably felt he could make a living by exploiting this hobby. He may also have been motivated by the prospect of making some money.

**2 ▶ What are three resources used by Tharanga when setting up his business?**

Tharanga when setting up his business used a range of resources. For example, he needed premises, tools and equipment, such as spanners, pliers, screwdrivers and wrenches, spare bicycle parts, lubricants, business stationery, electricity and a mobile telephone. He also employed his younger brother as a shop assistant.

**3 ▶ Why do you think businesses exist?**

Businesses exist to provide goods or services. In this example, Tharanga sold second-hand bicycles and carried out a repair and maintenance service for bicycle owners. In the private sector these goods and services are sold in the hope that a profit is made for the business owners.

#### ACTIVITY 1

##### CASE STUDY: GULF CONFECTIONERY AND BISCUIT CO.

**1 ▶ Does the Gulf Confectionery and Biscuit Co. supply products that satisfy needs or wants?**

The Gulf Confectionery and Biscuit Co. manufactures high-quality toffees, sweets and lollies. These products are designed to meet consumers' wants, not their needs. They are non-essential products. They are not required for human survival. People can live without toffees, sweets and lollies, so they are not designed to meet their needs.

**2 ▶ The Gulf Confectionery and Biscuit Co. is a private enterprise. What does this mean?**

Individuals or groups of individuals own most businesses privately. They are private sector businesses. The Gulf Confectionery and Biscuit Co. is a private enterprise that makes toffees, sweets and lollies. The owners hope that the business is successful and is able to make a profit.

#### ACTIVITY 2

##### CASE STUDY: STAKEHOLDERS

**1 ▶ What is meant by the term business stakeholder?**

A stakeholder is an individual or a group that has an interest in the operation of a business. Some stakeholders, such as owners, have a financial interest in the business.

**2 ▶ Name the two groups of stakeholders in the photograph.**

Customers and employees are the two groups of stakeholders in the photograph.

**3 ▶ The goods sold in the store above are bought from suppliers. What are the possible needs of suppliers?**

Businesses that provide raw materials, parts, commercial services and utilities to other businesses are called suppliers. In this case, suppliers provide the store with the stock that is sold on to consumers. Relations between businesses and their suppliers must be good because they rely on each other. Businesses want good quality resources at reasonable prices. In return suppliers will require prompt payment and regular orders. If suppliers do not receive prompt payment from their customers, this may cause them problems. For example, they may not have enough money to pay their own bills.

#### MULTIPLE-CHOICE QUESTIONS

1C, 2C, 3B, 4A

#### CHAPTER REVIEW

##### CASE STUDY: JCB

**1 ▶ JCB makes producer goods. What is meant by the term producer goods?**

Products sold by one business to another are called producer goods. JCB designs and manufactures a wide range of machinery for the construction industry. These are producer goods because they are sold to other businesses, not consumers.

**2 ▶ What is meant by the term private sector?**

Business organisations owned by individuals or groups of individuals operate in the private sector.

**3 ▶ Name two possible stakeholders in JCB.**

Any two from: shareholders, suppliers, employees, customers, the local community or the government.

**4 ▶ Describe the role played by managers in a business such as JCB.**

Managers help with the running of a business. They are often employed to run the different departments in businesses such as marketing, production, finance and human resources. Managers have to show leadership, solve problems, make decisions, settle disputes and motivate workers. Managers are likely to help plan the direction of the business with its owners. They also have to control resources, such as finance, equipment, time and people. Managers are also accountable to the owners. This means they have to take responsibility if things go wrong.

**5 ▶ JCB operates in a changing business environment. What does this mean?**

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

might be affected by a decline in the construction industry, for example. This might happen if there is a recession or a reduction in government expenditure on building projects. To survive, businesses such as JCB must produce goods and services that satisfy customer needs. They must have clear objectives and recognise that the changing environment can bring both new opportunities and impose limitations.

**6 ▶ Assess whether the owners of JCB would be happy with the financial performance of the business between 2011 and 2014.**

The owners of most businesses hope to make a profit. This is one of the main reasons why people get involved in business ownership – they hope to make some money. In this case, the graph in Figure 1.2 shows that JCB saw profits fall from £355 million in 2011 to £303 million in 2014. This is a 14.6% fall over the time period. Generally, owners would prefer profits to rise over a period of time as their business grows. However, sometimes this may not be possible. Businesses may struggle due to internal factors, such as poor management, or external factors, such as emerging competition or poor trading conditions. In this case, information suggests that the construction industry has struggled between 2011 and 2014 in some parts of the world. Consequently, since this is an external factor, JCB owners might be fairly satisfied with the financial performance of the business. At least it hasn't started to lose money.

## CHAPTER 2

### CASE STUDY: MICROMAX

**1 ▶ What are two reasons why Micromax is starting to struggle?**

Micromax was a successful company in 2015 where it had overtaken Samsung as market leader in the sale of smartphones in India's rapidly growing market. However, a year later the business started to struggle. There were two main reasons for this: stiff competition from Samsung offering a new range of cheaper sets and Chinese low cost producers entering the market. The second reason appears to be an internal problem. Tensions between established managers and new executives are causing conflict and instability. For example, it appears that a funding deal fell through which was crucial to the development of the company.

**2 ▶ What do you think is the main aim of Micromax at this time?**

At the moment, Micromax is struggling to face up to threats from strong rivals in the market. It has also got internal problems that are damaging the progress of the company. Consequently, it could be argued that the main objective of the business at the moment is to survive. If Micromax cannot overcome the threat from strong competition and deal with its internal issues, the business may eventually fail.

**3 ▶ What measures might Micromax take in order to achieve this aim?**

In order to survive in the future, Micromax needs to employ measures designed to make the business stronger. Industry analysts have suggested that Micromax needs to

diversify geographically and develop new products such as tablets and televisions. This means that it must find new markets for its products and also develop new ones. Relying only on smartphones is likely to make the business vulnerable. Micromax has also decided to shift production of its smartphones from China to India. This might help to cut costs and make the business more profitable. Finally, Micromax needs to sort out its internal problems so that established managers and new executives work together more effectively.

**4 ▶ In groups, produce a spider diagram to show the different possible objectives a business might have. Present your ideas to the rest of the class.**

### ACTIVITY 1

#### CASE STUDY: CAIRO FOOD SUPPLIES (CFS)

**1 ▶ What evidence is there to suggest that CFS aims to maximise profits?**

The information shown by the graph in Figure 2.1 suggests that profit is very important to CFS. Between 2008 and 2015 profits have grown from around EGP1110.2 million to EGP3901.7 million. This is a huge growth in profits – over 250 per cent during the time period. The company also has a strong dividends policy which suggests that the shareholders' value high returns on their investments. Therefore, it is reasonable to conclude that CFS is a business that aims to maximise its profits.

**2 ▶ Who is likely to benefit most from such an objective?**

The profit from business activity belongs to its owners. In this case the owners of CFS are the shareholders. Since CFS has a strong dividends policy the shareholders will benefit particularly from profit maximisation and the rapid growth in profits between 2008 and 2015. However, some employees may also benefit. For example, senior executives are likely to get bonuses which are related to profits. Also, profitable businesses can afford to reinvest some of their profits to help develop new products. This may benefit consumers if attractive new products eventually reach the market.

### ACTIVITY 2

#### CASE STUDY: DOHA AIRLINE MEALS

**1 ▶ Why is independence and control an important objective in this case?**

Some people want to be 'their own boss' – they want to be in control. This is an important non-financial objective for many business owners, such as Omar Hassan. These entrepreneurs are driven by the desire to be independent and to take control of their own futures. The freedom to make all the decisions when running a business is very appealing. Some people often resent being told what to do at work. Omar was employed by a large hotel working in the kitchen. However, he did not like following instructions and being told what to do all day. He set up in business mainly because he valued independence very highly. He wanted to take complete control of his life and also thought

he could improve on some of the inflight meals offered by airlines. Omar also had an offer to sell his business – he would also be kept on as the managing director. However, Omar declined; he wanted to keep control because it was very important to him.

**2 ► What is meant by a SMART objective? Use information in this case as an example.**

SMART business objectives should be **Specific**. This means that the objective should state clearly what is trying to be achieved. They should be **Measurable**, which means the outcome must be able to be measured in numbers. They should be **Achievable** meaning that people involved should be able to complete them and **Realistic**, which means that they can be achieved given the resources available. Finally, SMART objectives also need to be **Time specific**. This means that they state a period of time to achieve the objective. In this case, DAM set SMART objectives in 2015. DAM aimed to increase sales from 2.4 million units to 2.8 million units in 12 months.

**3 ► Why is it important for objectives to be achievable and realistic?**

DAM's managing director, Omar Hassan, said that there is no point in setting objectives that are unrealistic and unachievable by staff. In fact, setting unachievable objectives may have a negative effect on business performance. This is because staff might become demotivated knowing that a particular objective is impossible to achieve. Similarly, if there are not enough resources available to a particular objective, it makes the objective unrealistic and could discourage workers. In this case, Omar said that the key objective was agreed with the sales team. This suggests that the sales objective was both achievable and realistic. Consequently, the objective should help to motivate staff to achieve it.

### MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

### CHAPTER REVIEW

#### CASE STUDY: SUPERSKISWISS.COM

**1 ► What is meant by a business objective? Use this case as an example.**

The objectives of a business are the goals or targets which the business wants to achieve. In this case one of SuperSkiSwiss.com's objectives is to grow the business. This is suggested by the fact that the company has grown sales revenue from 0 in 2010 to an estimated €1 543 000 in 2017. SuperSkiSwiss.com also aims to be Europe's number one online shopping site for skiers. SuperSkiSwiss.com hopes to achieve sales of €3 000 000 by 2020.

**2 ► Some businesses have non-financial objectives. Name two examples of non-financial business objectives.**

Examples of non-financial business objectives include social objectives, personal satisfaction, challenge and independence and control.

**3 ► Work out the change in sales revenue between 2010 and 2017.**

For this amended question the answer will be:

$$\frac{€1\,543\,000 - €240\,000}{€240\,000} \times 100 = \frac{€1\,303\,000}{€240\,000} \times 100 = 542.9 \text{ per cent}$$

**4 ► Describe one benefit to SuperSkiSwiss.com of sales growth.**

Many owners aim to grow their businesses. This usually means they want to increase sales revenue. It is a common business objective because growth has a number of benefits. For example, as a business grows it will usually gain a larger market share. As market share grows businesses enjoy a higher profile and eventually may be able to have an influence in the market. For example, it may be able to charge higher prices. Other benefits include lower costs, more profits and more security.

**5 ► SuperSkiSwiss.com may be concerned about social responsibility. What evidence is there in the case study to support this view?**

In recent years a growing number of businesses have been keen to improve their social responsibility. For example, SuperSkiSwiss.com appears to consider the needs of the environment when making business decisions. The biggest environmental impacts from SuperSkiSwiss.com are carbon emissions from the distribution of goods, the running of buildings and waste from packaging. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions, and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used. This suggests that SuperSkiSwiss.com wants to foster a good public image. If a business has a bad image or poor reputation it may lose customers.

**6 ► How might a company like SuperSkiSwiss.com change its objectives as it evolves? Provide two reasons in your analysis.**

Over a period of time, as businesses like SuperSkiSwiss.com evolve, aims and objectives are likely to change. This is usually because businesses have to respond to certain events or changes in circumstances. For example, businesses like SuperSkiSwiss.com operate in dynamic markets. This means they have to deal with regular changes. For example, a new entrant may appear in the market, a rival might introduce a new product or the economy may start to decline. When market conditions change it may be necessary to set new objectives. In this case the fashion industry is highly competitive. For example, if trading becomes difficult as a result of more intense competition, SuperSkiSwiss.com may decide that survival is more important than rapid growth until the market 'settles down'.

New legislation might also have an impact of the objectives of a business. In recent years many business have become more socially responsible. This may be a reaction to new environmental, employment or consumer legislation.

In this case, SuperSkiSwiss.com claims that it wants to grow in a sustainable way. As a result, for example, the businesses is committed to the protection of the environment. This might be the result of a growing body of legislation passed to help protect the environment. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions, and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used. These results suggest that SuperSkiSwiss.com may have modified its objectives as a result of environmental legislation.

Finally, the reasons for a business changing its objectives are often due to external factors. These are factors which are beyond the control of businesses. However, sometimes a business such as SuperSkiSwiss.com might change its objectives for internal reasons. For example, there may be change in the senior management team. In such circumstances the objectives might change. For example, new senior managers might want to pursue profit maximisation so that higher dividends can be paid to shareholders. However, there is no evidence in this case to suggest that SuperSkiSwiss.com has made any such changes.

## CHAPTER 3

### CASE STUDY: MARIANA BELLO

### CASE STUDY: THE HATTA DENTAL AND IMPLANT CLINIC

#### 1 ► Who owns the businesses in the above two case studies?

Mariana Bello is the sole owner of Mariana's. Khalid Said and Ismail Mansour own the Hatta Dental and Implant Clinic – they are business partners.

#### 2 ► Discuss one advantage and one disadvantage of owning a business with a partner.

One advantage of owning a business with someone else is that more money can be raised when setting up. Khalid and Ismail both put in AED200 000 when they set up the Hatta Dental and Implant Clinic. The challenge and responsibility of running the business can also be shared. One major disadvantage is that the profits have to be shared. Owners may also disagree and fall out.

#### Business owners have to take risks.

#### 3 ► What risks are taken in the above case studies?

In both these cases, the owners had to risk their own money when setting up and running the business. Mariana Bello used €20 000 of her own savings when she set up her café in Seville. Similarly, Khalid and Ismail both put AED 200 000 into their dental practice when setting up.

#### 4 ► Discuss in groups whether you would be prepared to take the risk to set up in business. List your reasons for and against and present to the rest of the class.

## ACTIVITY 1

### CASE STUDY: KISULI, OKUMA AND OWINO

#### 1 ► Why do you think Kisuli, Okumu and Owino drew up a deed of partnership?

When a group of people form a partnership, they often agree to draw up a deed of partnership. This is not a legal requirement, but it does help to make the rights of each individual partner clear in the event of a dispute. The deed of partnership is a legal document and covers issues such as how much capital each partner has contributed, how profits (and losses) will be shared, the procedure for ending the partnership, how much control each partner has and the rules for taking on new partners. Without a deed of partnership disputes may be more difficult to resolve.

#### 2 ► How does this case study illustrate one of the main advantages of partnerships?

One of the main advantages of a partnership is that partners are likely to have different skills and by specialising they can offer clients a wider range of services. The partners in this business each specialise in a different specific area of finance or accountancy. Michael Kisuli is a corporate tax specialist, Edwin Okumu is an investment analyst and Joseph Owino specialises in external audits. Specialisation also helps to improve the efficiency of a business because specialists are generally more skilled in their field of expertise.

## ACTIVITY 2

### CASE STUDY: SAVE THE CHILDREN

#### 1 ► What are the features of a social enterprise? Use this case as an example.

Social enterprises aim to improve human and environmental well-being rather than make a profit for owners. Generally, social enterprises have a clear social and/or environmental mission. They generate most of their income through trade or donations and reinvest most of their profits. They are majority controlled in the interests of the social mission and are accountable and transparent. In this case, Save the Children aims to improve the well-being of children across the world. In particular, Save the Children raises money to run world-class programmes to save children's lives and challenge world leaders to keep to their promises to give children a brighter future.

#### 2 ► How might charities such as Save the Children raise money?

Most charities rely on gifts and donations to fund their social activities. In this case Save the Children raises very large amounts of money globally. In 2015, it generated around US\$2100 million. According to the pie chart in Figure 3.2 a large proportion of this money came from institutions and governments – 58 per cent. The next largest source was from individual donations – 25 per cent. Individuals are often generous when giving to causes that protect the interests of children. Corporations and foundations are another important source. This might be companies and special charitable foundations. Save the Children is a large international charity. Smaller charities

might organise fund-raising events such as cake sales, sponsored activities and selling greetings cards. Some also run business ventures, such as charity shops.

### MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: HUSSE

#### Franchisees are entrepreneurs.

##### 1 ► What is meant by the term entrepreneur?

Entrepreneurs are the business owners and without these people businesses would not exist in the private sector. They come up with a business idea, invest their own money and get a business started.

##### 2 ► What is meant by the term franchisor?

In a franchising operation the franchisor is the owner of the franchise. Franchisors receive money when they allow others to take out a franchise and trade under their name.

##### 3 ► What are the four roles of an entrepreneur?

- Innovation
- Decision making
- Organising
- Risk taking

#### Franchisees are likely to have unlimited liability.

##### 4 ► What is meant by unlimited liability?

Many small business owners, such as sole traders and franchisees, have unlimited liability. This is very important because it says something about the risk they take. It means that if the business collapses the franchisee is liable for all business debts. The franchisee can be forced to meet these debts from personal wealth. It means that a person can actually lose more than was originally invested in the business. In this case, a Husse franchisee could lose more than the original £10 000 paid to the franchisor before trading began.

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

Taking out a franchise may suit someone who wants to run a business but does not have his or her own business idea. The Husse franchisor grants the franchisee a licence to trade under the *brand name* of Husse. In return for £10 000 the Husse franchisee gets a range of benefits and support. Husse offers benefits such as £2000 of stock for resale, additional materials worth £2000, which includes items such as a Husse tent, signs for a van, catalogues and a two-day in-house training course. Husse franchisees also get an exclusive territory with around 55 000 households. Regular money for marketing is provided, in the first six months, and so is support such as advisory services and a development manager. All these benefits are key advantages of operating as a franchisee. There is also

less risk when taking out a franchise. Entrepreneurs have to risk their own money to get started. In this case it costs up to £13 900 to take out Husse franchise. This is less risky than starting a business alone because the franchisee has the advantage of trading under an established and successful brand name. In this case, Husse is established in over 50 countries worldwide. Many pet owners will be aware of the 'tried and trusted' brand name. This gives the franchisee a head start and reduces the risk of failure – a huge advantage. However, there are disadvantages when taking out a franchise, such as Husse. In some franchise agreements profit is shared with the franchisor. For example, in addition to the original fee it may be necessary to pay an annual commission. There is also a lack of independence. Franchisors often require strict operating conditions. For example, a Husse franchisee may not be allowed to trade outside the agreed territory. Finally, it can be an expensive way to start a new business. For example, it may be cheaper to set up a pet food delivery service without the use of Husse. To conclude, taking out a franchise may benefit those who are struggling to come up with their own idea, those who want to reduce some of the risk in business and those who are happy to sacrifice some independence.

## CHAPTER 4

### CASE STUDY: QUBIT DIGITAL LTD

#### CASE STUDY: HYUNDAI LTD

##### 1 ► Who owns limited companies?

Shareholders own limited companies. For example, in the Qubit case study, it is likely that the four ex-Google employees who founded the company in 2010 will own shares. In addition, information in the case study says that some of Qubit's shareholders include Goldman Sachs and venture capitalists Sapphire Ventures and Accel Ventures. These investors bought shares when they contributed some of the £50 million capital to the business. These are the current owners of Qubit. Hyundai is also owned by shareholders. Hyundai's shares are listed on the London Stock Exchange. This means that anyone can buy them and become a part owner of the company.

##### 2 ► Who runs limited companies? (Use examples from the case studies.)

Limited companies are run by a board of directors headed by a chairperson. A team of eight senior directors led by Chairman Mong-Koo Chung runs Hyundai, the huge South Korean motor corporation. The team running Qubit is likely to include some, or all, of the original founders – the four ex-Google employees.

##### 3 ► Comment on the size of limited companies, such as those above, compared to sole traders and partnerships.

Evidence in the case studies suggests that limited companies are significantly bigger than sole traders and partnerships. For example, Qubit employs 200 people. Most sole traders and partnerships would employ much smaller numbers of people – perhaps less than 10 in the majority of cases.

For example, Qubit Digital Ltd turned over £11 million in 2016 and employed over 200 people. Not many sole traders would enjoy revenue as high as this and employ so many workers. Hyundai is very large – its turnover in 2015 was KRW 91 959 000 million. It also has factories all over the world including the USA, China, Russia, Turkey, Czech Republic, Brazil and India in addition to those in South Korea.

- 4 ▶ In groups, make a list of 20 companies that you know about. Try to decide whether they are large or small.**

## ACTIVITY 1

### CASE STUDY: KHAN SUGAR MILLS

- 1 ▶ Name the documents needed to set up a limited company.**

Two key sets of documents are needed before a business can trade as a limited company. These include the memorandum of association and the articles of association.

- 2 ▶ Who controls Khan Sugar Mills Ltd?**

Khan Sugar Mills Ltd is a private limited company. It is a family business and is owned by three brothers, a venture capitalist called FarmVent and some of the senior managers. Three quarters of the company is owned by the Khan brothers – Abdul, Mohsin and Nabil; they each own 25 per cent of the shares. FarmVent own 20 per cent of the company while senior managers have a small 5 per cent interest. Since the three brothers own three-quarters of the company, together they have complete control over the company.

- 3 ▶ What are the advantages to Khan Sugar Mills of operating as a limited company. Provide two advantages in your analysis.**

Private limited companies, such as Khan Sugar Mills Ltd, enjoy a number of advantages. One significant advantage is that the company cannot be taken over by outsiders. This is because the shares are not on open sale. Shares in private limited companies cannot be transferred without the permission of the other shareholders. They cannot be bought on the stock market. This is because only shares in PLCs can be traded on the stock market. Therefore, Khan Sugar Mills Ltd is safe from an unwanted takeover.

Another advantage is that all of the shareholders have limited liability. This means that they can only lose the amount of money they originally invested in the company if it were to collapse. Khan Sugar Mills Ltd's shareholders cannot be made to use personal wealth to pay off business debts. Limited liability means they enjoy legal protection from business creditors.

## ACTIVITY 2

### CASE STUDY: SONY

- 1 ▶ What is meant by the term multinational?**

A multinational is a large business with significant production or service operations in at least two different countries.

- 2 ▶ What evidence is there to suggest that Sony is a multinational?**

Sony is a huge multinational corporation. In 2016, Sony employed over 125 000 people across the world and enjoyed sales of about US\$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, the USA and India.

- 3 ▶ Describe two features of multinationals. Use examples from the case study.**

One common feature of multinationals is their powerful advertising and marketing capability. This means, for example, they can invest huge amounts of money in impressive advertising campaigns to outcompete smaller rivals. In this case, Sony is a highly recognised global brand name. The strength of the brand has been built up over many years of successful trading. However, to support the brand Sony continue to invest heavily in global advertising. Figure 4.4 shows that Sony invested JPY 474 370 in worldwide advertising in 2014.

Another common feature of multinationals is the huge assets and turnover. This means that multinationals are extremely well resourced and can often afford to take on large-scale contracts and projects that many other firms could not cope with. In this case, in 2016, Sony enjoyed sales revenue of around US\$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, America and India. Finally, the value of Sony's assets at the end of June 2016 was US\$159 450 million. The scale of these numbers shows how big Sony is as a business.

### MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4C

## CHAPTER REVIEW

### CASE STUDY: HKOFFICESUPPLIES.COM

- 1 ▶ What is meant by the term private limited company?**

A private limited company is an incorporated business that raises capital from the sale of shares to private individuals – often members of the family.

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

- 2 ▶ What information would this document contain?**

A memorandum of association gives important details about the company. Examples include the name of the company, the name and address of the company's registered office, the objectives of the company and the range of its activities and the amount of capital to be raised and the number of shares to be issued.

- 3 ▶ What is the purpose of a prospectus?**

When 'going public', a company is likely to publish a prospectus. This advertises the company to potential investors and invites them to buy shares before a flotation. It is an advertising document but the information it contains must be legally accurate.

### Share issues have to be underwritten.

#### 4 ► What does this mean?

There is a chance that when going public some of the shares put up for sale will remain unsold. To overcome this problem an underwriter is paid a fee to buy up any unsold shares. It is like an insurance policy.

#### 5 ► Why is going public expensive?

'Going public' can be expensive because of the number of different types of costs involved. These include legal costs to ensure that the prospectus is 'legally' correct. Lawyers have to read and analyse all the information in the prospectus to ensure that potential investors will not be misinformed. There are the printing and distribution costs of the prospectus and also an administration fee, which must be paid to a bank for processing all the share applications. There are also underwriting, advertising and administrative expenses.

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

Lee Kwok Hung wants to convert his private limited company into a public limited company. It is unlikely that Lee and his family will be able to raise HK\$200 million in any other way to meet the high cost of developing an online business and expanding into South China. Therefore, he would need to 'go public'. Going public is a way of raising large amounts of money. Another advantage is that Lee's business may be able to exploit economies of scale if it is much larger. They might be able to buy very large quantities of stock from suppliers at reduced prices, for example. The new company, HKofficesupplies.com, might also benefit from the publicity usually associated with a flotation. Public limited companies have a higher profile than any other form of business organisation and as a result they may have more customer recognition, which in turn might boost sales. This would be important when expanding into South China and launching a new service.

However, Lee should consider the disadvantages before making his final decision. Public limited companies are more tightly regulated to protect investors. They also have to publish more detailed financial information, which competitors might see. Lee's business could also be taken over by another company because shares can be bought by anyone. Finally, the costs of going public are significant and some of the HK\$200 million will be used up in the flotation process. Despite these disadvantages, if Lee wants to raise HK\$200 million and become a large supplier in South China, he would probably need to operate as a PLC.

#### 2 ► Suggest what the objectives of the NWSC might be.

The main objective of NWSC is to provide a public service; it has committed to the provision of good quality customer service. NWSC aims to supply everyone with clean safe water within 200 metres of all towns and urban centres (coverage is currently 78 per cent). On the NWSC website, it states that 'The Customer is the reason we exist. We do everything to the delight of our customer.'

#### 3 ► Why do you think the government gets involved in business ownership?

In the private sector, most businesses aim to make a profit. However, organisations in the public sector aim to provide a public service. Sometimes providing a public service may be unprofitable, therefore, private sector firms would not be interested in supplying the market. Consequently the government needs to run and own organisations so that the provision of particular public services can be funded from taxpayers' money.

Also, some industries, like water supply, are crucial to the well-being or security of the nation. Therefore, since they are so important, it is arguably better if the government takes control so that supply and quality can be guaranteed.

## ACTIVITY 1

### CASE STUDY: SNCF GROUP

#### 1 ► Using this case as an example, describe three features of a public corporation.

SNCF is responsible for providing a national train service across the whole of France. It is owned by the French government. Government ownership is an important feature of public corporations. Another feature of public corporations is that they are created by an act of parliament. The powers and duties of each organisation are clearly specified in the act. In this case, under French law, SNCF is an *établissement public industriel et commercial* – a public service company with a commercial and industrial mission, owned by the French state. A third feature of public corporations is that they exist to provide a public service. In this case, the aim of SNCF is to provide a nationwide rail network. It is committed to customer satisfaction and makes social progress a priority. It has recently launched a range of projects to improve punctuality for people travelling to work, make fares easier to understand and make the rail system more accessible for all.

#### 2 ► Who will take financial responsibility for the losses made by SNCF in 2016?

Although SNCF generated revenues of €32 273 million in 2016, which was 2.8 per cent higher than the previous year, it made a net profit of €567 million. A big improvement over 2015 when SNCF made a net loss of €12 228. This loss has to be covered by the French government since they are the owners. However, it is the French taxpayers who take financial responsibility for the loss because all government services are paid for (mainly) from taxes collected by the government.

## CHAPTER 5

### CASE STUDY: THE UGANDAN NATIONAL WATER AND SEWERAGE CORPORATION

#### 1 ► Who owns and runs the Ugandan National and Water Sewerage Corporation?

The Ugandan National and Water Sewerage Corporation is owned by the Ugandan government and run by a board of directors, which is accountable to a government minister.

## ACTIVITY 2

## CASE STUDY: AIRPORT PRIVATISATION

## 1 ► What is meant by the term privatisation?

Privatisation is the process of transferring public sector resources, such as public corporations, to the private sector. In this case, a number of airports and airport facilities have been privatised. For example, in 2013, the Brazilian Government raised US\$ 9100 million by privatising two major airports ahead of the 2014 World Cup.

## 2 ► Why were governments keen to maintain state control of airports until recently?

Governments have historically preferred to keep control of businesses operating airports. Even as recently as 2006, only about 2 per cent of the world's airports were owned or managed by the private sector. The reason for this is because airports are considered as strategically important to the nation. If the provision of a particular service is vital to the well-being or security of the nation it is considered desirable for the government to maintain control so that continuity of supply and quality can be guaranteed.

## 3 ► Describe two possible reasons why governments should want to privatise airports.

One motive for privatisation is to raise money. If the government sells a public corporation, such as an airport, the money can be used by the government. In this case for example, the Brazilian government plans to sell more airports to raise money to help reduce its budget deficit.

Another possible motive for privatisation is that airports are likely to be run more efficiently in the private sector. According to Ahmed Bukalla, director of operations at the Department of Civil Aviation, Sharjah International Airport, UAE. 'When privatisation comes, there will be pressure for further productivity gains, and airport operators will need to be even more innovative and adopt new technologies to stay competitive.' Therefore in the private sector businesses will serve the public better because if they don't they risk 'going bust'.

## MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3D, 4A

## CHAPTER REVIEW

## CASE STUDY: AUSTRALIAN BROADCASTING CORPORATION

## 1 ► What is meant by the term public corporation?

A public corporation is a business organisation that is owned and controlled by the government. The ABC is a public corporation because it is owned and controlled by the Australian government.

## 2 ► Describe two features of public corporations. Use the ABC as an example.

Public corporations, such as the ABC have a number of unique features. One of these is that they are established by law. It is established under the Australian Broadcasting Corporation Act. Another important feature of public corporations is that they aim to deliver a public service.

They are not motivated by profit. The ABC's aim is to serve the Australian people. In particular, it is 'focused on keeping audiences at the centre, providing high-quality programming, independent news and information and content that enriches Australian communities'. If a public corporation does make a profit, the money will be returned to the government or reinvested in the business.

## 3 ► Why might organisations like ABC operate as public corporations? Give two reasons in your analysis.

There are a number of reasons for the public ownership of certain services. First, public corporations, such as the ABC, often provide vitally important public services. It is argued by many that it is better for industries that are vital to the nation's security to be owned by the government. This would prevent 'outsiders' from another country taking them over and exploiting the nation. If the provision of a particular service is vital to the well-being or security of the nation, it is considered desirable for the government to maintain control so that continuity of supply and quality can be guaranteed. In this case, the government can ensure that Australia receives a good quality national broadcasting service.

Second, in some markets the private sector would not deliver important services to unprofitable regions. For example, the cost of providing electricity to a remote farm many miles away from the main power lines would be too high for a private sector operator. However, a public corporation may be prepared to meet this cost because profit is not a key objective. In this case, it is suggested radio and other ABC-like services would not be broadcast to isolated regions if the ABC were transferred to the private sector. Australia covers an enormous geographical area and it is easy to see that providing services to many rural communities, for example, just would not be worthwhile for a private sector operator.

## 4 ► Assess the case for privatising the ABC.

In many countries, the number of public corporations has been reduced. For example, in the UK, industries such as rail transport, water provision, electricity generation and distribution and telecommunications have been transferred to the private sector. In this case, the arrival of digital technology has had a huge impact on the media. The ABC is facing increasing rapidly increasing competition from new media companies and platforms. To add to these difficulties, the Australian government has begun a round of cuts to the corporation's funding. By 2018/19, the ABC will lose a total of A\$254 million. In light of these developments, some have argued that the ABC would perform more effectively in the private sector.

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

a broader range of political views. However, if the ABC operated in the private sector it might be under more pressure to provide a more balanced and independent broadcasting service.

In contrast, many believe that it would be better if the ABC remained under the control of the government. One reason is because according to some surveys the corporation seems to be doing a good job. The ABC does appear to be meeting the needs of its customers. In the annual Newspoll ABC Appreciation Survey, support for the corporation was strong. Around 86 per cent of Australians believed that ABC performs a valuable role, a large majority believed it provides quality content and a majority said it was doing a 'good job' meeting its media obligations. One of its public services is providing online content. According to data in Figure 5.2, this is very well-received. Over a 10-year period, between 91 per cent and 86 per cent of respondents thought the service was 'good'. Between 2007 and 2016, the number of respondents that felt online quality was 'very good' rose from 28 per cent to 40 per cent.

To conclude, it could be argued that the ABC should remain as a public corporation. This is because evidence from surveys generally shows strong support for the corporation in its current form. Transferring it to the private sector might raise some money in the short term, but a valuable public service, available to the whole of Australia, might be lost forever.

## CHAPTER 6

### CASE STUDY: WU YANG

#### CASE STUDY: SHANGRI-LA HOTELS AND RESORTS

##### Wu Yang is happy operating as a sole trader.

##### 1 ► Suggest two reasons why she might be happy.

She likes the independence of operating as a sole trader. She has no real desire to expand and therefore does not need to raise any more capital.

##### 2 ► Why could Shangri-La not realistically operate as a sole trader?

Shangri-La is a large multinational. It is a global hotel company with hotels in North America, Europe, the Middle East, Asia and Australia. Shangri-La could not operate as a sole trader. The company has grown steadily since it was established in 1971 and no doubt has needed some more capital to fund this growth. There is no way a sole trader could provide funding on such a scale. Multinationals need to be PLCs to attract the huge amounts of finance they need and to enjoy a high international profile.

##### 3 ► What evidence is there to suggest that Shangri-La is a growing company?

Since the company was established it has grown significantly. For example, in 2015 the Group opened nine new Shangri-La hotels. It also launched the modernised Shangri-La's Le Touessrok Resort & Spa, Mauritius, rebranded four properties to Hotel Jen. In the last five years it has continued to grow. Figure 6.1 shows that its revenues have increased by 11 per cent from US\$1912 million in 2011 to US\$2123 million in 2015.

##### 4 ► Why might businesses in general be forced to change their legal status as they grow?

The main reason why businesses need to change their legal status as they grow is to attract funding. Businesses will find it very difficult to grow as a sole trader or partnership. They are considered too risky for many investors and often struggle to raise finance. Businesses usually have to raise money by selling shares to become large operators.

### MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3C, 4C

## CHAPTER REVIEW

### CASE STUDY: ESHANIBABYGEAR.COM

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

Many small businesses when they start are sole traders. Unless large amounts of money are needed, this type of organisation is suitable because it is easy to set up and the owner is in complete control. Eshani said 'When I started, I started small, operating from home, and never needed outside funding, so being a sole trader seemed the simplest option.'

##### 2 ► Discuss why Eshani formed a partnership.

After trading successfully from her home as a sole trader for three years, Eshani decided to open a shop. However, she needed money for premises, stock and marketing. Also, after a few months there was a strain on cash flow. Therefore she decided to take on her best friend as a partner. This helped to share the burden of running the business and injected LKR 6 million much needed cash.

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

##### 3 ► Do you think it was appropriate?

After the break-up of the partnership Eshani was right to form a private limited company. This type of organisation helped Eshani to achieve her objectives. Eshani now has control of the business. This is because she has 70 per cent of the shares. Her mother bought 20 per cent and she allowed two of her best staff to buy the remaining 10 per cent. However, with 70 per cent no-one can overrule her. Eshani sold shares to her employees to raise more money for the business. However, another reason was because she wanted to reward them for their loyalty and keep them motivated. Finally, Eshani needed more capital to expand the business. Some of the money raised from selling shares was used to set up an online business.

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

Going public is a big step for a business. It is an expensive move because of the costs involved such as producing a prospectus, administration costs to cover the whole flotation process, legal costs and underwriting fees. Also trading as a PLC means anyone can buy shares in the company. This means that an outsider could take over the company. The business would also have to release more financial information to the public and meet the cost of

stock market regulation. This might allow competitors to plan strategies to overcome the threat of Eshani's business in the market. However, Eshani has a firm objective. She wants to take the business to the next stage of development. Her online business is expanding fast and Eshani also thinks she could develop a small chain of shops. A major retailer has recently offered a number of stores for sale. To buy, convert and stock them would cost LKR 400 million. By going public Eshani could raise this sort of money and achieve her objective.

However, Eshani might need to consider other approaches. She could grow more slowly and fund growth from profits. She may be able to borrow money from banks. Alternatively, she may be able to persuade some other entrepreneurs to invest in her business. All these options would need to be considered before she finally decided to go public. However, if a flotation were successful, it would allow Eshani to achieve her objective.

## CHAPTER 7

### GETTING STARTED – BUSINESS CLASSIFICATION

- 1 ▶ Which of the businesses shown on the previous page are concerned with a agriculture, b manufacturing or c services?**

The farm workers growing crops are an example of a business involved in agriculture. It is using the land to grow produce.

The business processing food is a manufacturer. It is making products.

Both the railway company and the app designer are businesses that supply services. The railway company is transporting people by rail and the app designer is designing new apps for mobile phones.

- 2 ▶ Which of these businesses are most likely to employ large numbers of people in a developing nation? Explain your answer.**

Developing nations tend to employ more people in agriculture. Their economies are still in the early stages of development and generally their focus is on the production of food. Therefore the business involved in agriculture is most likely to employ the most people in agriculture. The photograph shows the crops being harvested by people rather than machines.

- 3 ▶ In pairs, draw up a list of 20 businesses in your area and decide whether they are agricultural, manufacturers or service providers.**

### ACTIVITY 1

#### CASE STUDY: AGRICULTURAL EMPLOYMENT

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

In the primary sector, business activity involves extracting raw materials from the earth. In this case, olive growing by the Casillas family is an example of farming. Farming is probably the most important primary sector activity for

most countries. Most agriculture is concerned with food production like olive growing in this example.

The secondary sector encompasses manufacturing and processing. In this case olives are being processed into olive oil. Machinery is likely to be used to squeeze the oil from the olives. This might be followed by a cleaning process to ensure that the olive oil is sufficiently pure.

**Look at Figure 7.1.**

- 2 ▶ What has happened to the number of people employed in agriculture in Spain since 1980?**

In Spain, like in many countries, the number of people employed in agriculture is falling. The graph in Figure 7.1 shows that the number of people employed in agriculture has fallen from around 19 per cent in 1980 to just under 5 per cent in 2010.

- 3 ▶ Describe one possible reason for the pattern described in question 2.**

One of the main reasons why employment in agriculture has fallen in Spain so sharply is because of advances in technology. Before and around the 1980s, farmers may have relied more heavily on labour. However, because of the growing availability of affordable technology they may employ more machines. Developments in technology have been enormous in agriculture. In this case, Marco Casillas is considering the purchase of some harvesting machinery to reduce labour costs and remain competitive. Once such machines have been purchased, the need for labour drops sharply.

### MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3A, 4B

### CHAPTER REVIEW

#### CASE STUDY: HISENSE

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

The secondary sector involves manufacturing and processing, that is, the conversion of raw materials into goods. In this case, Hisense is a manufacturer of white goods and a range of electronic products. It makes these goods in a wide range of factories both in China and abroad.

The tertiary sector is to do with the provision of services. There are many different types of services, such as professional, household, transport and financial. In this case, Hisense has branched into the provision of services in areas such as information technology and design. These services are aimed mainly at other businesses.

**Look at Figure 7.3.**

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

The pie charts in Figure 7.3 show some important changes in the amount of employment in different sectors of the economy between 1990 and 2015. In 1990, China employed 60 per cent of its workforce in agriculture. By 2015, this had fallen to just 28.3 per cent. In contrast, the

number of people employed in the tertiary sector rose from 18 per cent to 42.4 per cent. Employment in the secondary sector also grew from 22 per cent to 29.3 per cent. These changes have resulted in a more balanced economy for China. It was less dependent on agriculture in 2015 as it was in 1990. However, if the changes follow the same trend, China's economy may become more unbalanced in the future as it becomes more dependent on services.

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

Businesses in each of the three sectors rely on each other. For example, in the primary sector cereal farmers rely on bakers in the secondary sector for their sales of wheat. Bakers may depend on advertising agencies in the tertiary sector to produce television adverts for their products. The transport industry in the tertiary sector relies on the oil industry in the primary sector to provide fuel for its vehicles. Workers in both the secondary and tertiary sectors rely on the primary sector for their food. This reliance between sectors is called interdependence. In this case, Hisense may rely on retailers and other distributors to sell its manufactured goods to consumers.

**4 ▶ What is meant by de-industrialisation?**

De-industrialisation occurs in well-developed countries, such as the USA, Germany, Japan and France. It involves the decline of the manufacturing sector at the expense of the tertiary sector. In the last 20 or 30 years, many western-style economies have seen employment in manufacturing fall sharply. However, at the same time there has been a steady increase in the quantity and value of services.

**5 ▶ Assess the main causes of de-industrialisation.**

A number of suggestions have been suggested to explain the process of de-industrialisation. There may have been a change in consumer demand. People may prefer to spend more of their income on services rather than manufactured goods. For example, people may be spending more on holidays, restaurants, travelling and personal services and less on consumer durables. Competition in manufacturing may be another important reason. Recently there has been some fierce competition in the production of manufactured goods from developing countries such as India, China, Thailand and Brazil. These countries can often produce manufactured goods more cheaply than in western economies. In this case, China has seen an increase in the manufacturing sector. In the last 30 years or so, China has developed a competitive edge in this sector due mainly to its cheap and large supply of labour.

Another reason is that as countries become more developed the public sector tends to grow. Since the public sector mainly provides services such as education and transport and healthcare, this adds to the growth of the tertiary sector. Finally, advances in technology mean that employment in manufacturing falls because machines replace people. The reason for the decline in manufacturing in well-developed countries may be different depending on the circumstances of the individual nation. For example, a country that has an inefficient manufacturing sector may be vulnerable to overseas competition. In this case, China, which is still a developing country (although it is developing

rather rapidly), has seen an increase in the tertiary sector from 18 per cent to around 42 per cent. This trend is likely to continue in the future as the country develops – the tertiary sector will grow as it has done in developed nations.

## CHAPTER 8

### CASE STUDY: NUCLEAR POWER STATIONS

**1 ▶ What are four factors that must be taken into account when locating a nuclear power station?**

Factors that are likely to be taken into account when locating a nuclear power station include the following.

- Government influence: nuclear plants cannot be built without a lengthy consultation process involving the authorities, local communities and the power companies. There are legal controls over their location.
- Nuclear plants need stable ground and plenty of space.
- Most plants need access to a water source, such as a lake or river.
- Access to a large workforce. The construction of nuclear plants may need around 2000 people and around 500 more to help operate them.

Many nuclear plants around the world are built just outside small or mid-size towns and on the coast.

**2 ▶ Describe how the changing business environment has affected the location of many service providers such as retailers.**

The changing business environment may affect the location decisions made by some businesses. In recent years retailing has changed significantly. Many thousands of business providing services now operate online. Some high-profile examples include Amazon, Alibaba, Facebook and Twitter. Online businesses may operate as retailers, consultants, bloggers, tutors, web designers, information providers and teachers, for example. The one thing they all have in common is that they use the Internet to trade. One of the main advantages of these businesses is that they can be located anywhere. Most traders online can locate their base anywhere in the world provided they have access to the Internet.

**3 ▶ In groups, consider where you might locate a a banana plantation, b a large car factory and c a new shopping centre or mall. Give at least two reasons for each answer.**

### ACTIVITY 1

#### CASE STUDY: RENAULT

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

Manufacturers need to consider factors such as the cost of land, transport, labour costs and skills, proximity to the market and whether there is any government help when locating factories. In this case Renault has recently built a factory in Tangier. One attraction of Morocco is that in an area of North Africa where political disturbance is common, Morocco is seen as a politically stable location. Businesses will clearly avoid locations in countries where disruption

from political change is a potential risk. Tangier is also a thriving port and just 10 miles (16km) away from the large European market. This was important to Renault since most of the factory's output in Tangier is intended for export. Economic growth in Morocco is currently high, around 5 per cent in 2016. The people are becoming wealthier. This means that demand for Renault's cars is likely to increase.

Morocco has improved its infrastructure in recent years. For example, Tangier is effectively linked by motorways and railways to industrial parks. Indeed, Renault has its own direct rail link to the port. Morocco also provides a strategic geographical location for manufacturers. It is at the crossroads of the world's most important sea links. Finally, Renault is a French company and French is the commercial language of Morocco. This may have been a factor when choosing Tangier as a location.

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

Most governments are keen for foreign businesses to locate operations in their countries. The benefits can be substantial. For example, in this case Renault will create a lot of jobs for people living in and around Tangier. Initially, while the factory was being built, jobs would have been created for construction workers. Once the factory was operational, a large number of factory workers would have been needed. In addition to this, Moroccan-based suppliers of components and commercial services would have benefitted, which would have created even more jobs. This generates income for these people and hopefully improves their living standards.

The government is also likely to benefit from the new factory. This is because any profits made by Renault from the operation of the plant are likely to be taxed by the Moroccan government. These tax revenues can be used to fund more public services such as education and new infrastructure.

## ACTIVITY 2

### CASE STUDY: RESTAURANT LOCATIONS

**1 ► What factors will Abdullah need to take into account when deciding where to locate his seafood restaurant? Give two factors in your analysis.**

Service providers may have different location requirements to those of manufacturers. In this case, Abdullah is choosing a location for his seafood restaurant in Manama, Bahrain. For many service providers, proximity to their market is crucial. This is because many services are sold direct to consumers. For example, restaurants, cafes, shops, hair salons, taxis and dry cleaners have to be located in towns and cities. This is where customers live and shop. In this case Abdullah wants to target business customers working in the financial quarter of the city so this would presumably influence his search for a location.

For customers, suppliers and employees, easy access and parking is becoming a serious issue. Traffic congestion is a growing problem in many parts of the world. Businesses need to choose locations where there is less chance of traffic congestion. It is particularly important for customers since they will quickly look for alternatives if they cannot

park conveniently. Some service businesses, particularly fast-food providers, are developing 'drive-through' facilities to avoid parking problems. In this case, Abdullah's potential customers, office workers for example, may be within walking distance from his restaurant. This would be an advantage but he might also be keen to find a location where customers can park easily when arriving for a meal or a night out.

**2 ► Why might businesses, such as Abdullah's seafood restaurant, deliberately choose to locate close to competitors?**

Abdullah is currently considering a location close to where a number of other restaurants operate. Premises occupied by a recently failed restaurant have become available but he is concerned about the competition in the area – many entrepreneurs would share this fear. However, in contrast some businesses deliberately choose locations where there is a concentration of similar businesses. This might be important in industries where comparison shopping is popular. It might also be possible to catch the excess demand from existing businesses, particularly if premises are located in a restaurant and entertainment area. Consequently, for these reasons, Abdullah may eventually decide to locate his seafood restaurant close to potential rivals.

### MULTIPLE-CHOICE QUESTIONS

2A, 2B, 3D, 4A

## CHAPTER REVIEW

### CASE STUDY: THE NEW DELHI INSURANCE COMPANY

**1 ► What is meant by the term greenfield site?**

Greenfield sites are areas of land, usually on the outskirts of towns and cities, where businesses develop for the first time. In this case, Site A is a greenfield site. It is a brand new purpose built office block on the outskirts of the city about 3 miles (5km) from a large residential area.

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

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

Monthly rent for site A is given by:

$$2000 \times 200 \times \text{US}\$1.00 = \text{US}\$400\,000 \text{ per month}$$

Monthly rent for site B is given by:

$$2000 \times 200 \times \text{US}\$1.10 = \text{US}\$440\,000 \text{ per month}$$

**Governments may try to influence the location of businesses.**

**3 ► Describe two reasons for this.**

One reason why governments try to influence location decisions is to avoid congestion where there is already enough or too much development. This will reduce the strain on existing infrastructure, such as roads, schools and hospitals. Governments may also aim to minimise the impact businesses might make on local communities. For example, most people would object if a business opened a noisy night club in a highly residential area or if a large petrochemical company established a refinery in a national park.

Some governments use regional policy to help develop 'poorer' areas. Regional policy provides opportunities for businesses. For example, governments use incentives, such as quick planning permission, investment grants, tax breaks, employment subsidies and rent-free factory space, to attract businesses. In this case the government is keen to attract businesses to the greenfield area where Site A is located. The government is offering US\$500 000 of support if the New Delhi Insurance Company locates its call centre there.

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

Service providers like the New Delhi Insurance Company are likely to consider a range of factors when choosing a suitable location for new operations. These might include proximity to market, the cost of land, accessibility and parking, amenities and recreational facilities, network services and competition. In this case, the New Delhi Insurance Company hopes to locate its new call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities, such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre.

As the importance of electronic data continues to grow, businesses will require greater and more capacity. Also, many businesses operate in an increasingly global economy. This means that access to continuous communication systems is vital. These growing requirements have made connectivity a major concern for many office-based businesses, for example. In this case, the New Delhi Insurance Company is opening a large call centre. This will require first class communication networks and that would therefore be a key issue.

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

In this case both Site A and Site B have specific advantages. One of the main benefits of Site A is the quality of the office space available. Site A provides a brand new purpose built office block on the outskirts of the city about 3 miles (5km) from a large residential area. Since the New Delhi Insurance Company needs to attract 2000 new workers, proximity to a large residential area is also attractive.

Information in the table also shows that graduate unemployment around Site A is 8.6 per cent. Since the company needs to attract well-qualified and university educated employees to staff the call centre, the higher level of graduate unemployment means there will be more people available to choose from. Site A can also provide efficient electronic communication connections that are likely to be important for a call centre. Finally, Site A is also attractive financially. Monthly rent will be US\$400 000 compared to the US\$440 000 at Site B. Site A also is a greenfield site and the government is keen to attract businesses to the area. Financial support of US\$500 000 is being offered to the New Delhi Insurance company if it chooses to locate there.

Site B also has attractions. This is a city centre site close to all the amenities. This could be important to the insurance

company because it hopes to locate its new call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre. Access to these facilities might help the company to attract high quality staff. Transport links to the Site B are excellent. The main railway station is just two minutes walk away. Potentially, this means that the company could attract staff from further away. This would provide more choice during the selection and recruitment process.

The office block at Site B is in a fashionable and popular area, however, the building itself is not modern and will require some investment to upgrade the facilities. The cost of modernising is not given but the site does provide room for expansion if the company needs more office space in the future.

Deciding which site to locate the call centre office is not straightforward here since there are advantages to both sites. The New Delhi Insurance Company has to decide on its priorities. If the company wants to minimise costs, Site A might be a preferable location. Monthly rent is 10 per cent lower, the government is offering US\$500 000 financial support and the building is purpose-built and ready for occupation. Modernisation will not be required. However, the more expensive city centre site will provide more amenities for workers and might make the recruitment of high quality staff easier. It is very close to the main railway station so it might be possible to recruit staff from further away. To conclude, if cost is the main issue here, then Site A would be the preferred location. However, if staff recruitment and meeting staff needs is more important, then Site B might be more attractive. It is a close call!

## CHAPTER 9

### CASE STUDY: THE GLOBAL MARKET FOR CARS

**1 ► What do you think is meant by a global market?**

If a business hopes to sell its products to consumers in all countries in the world, it will be selling in a global market, to the largest possible number of customers.

**2 ► Comment on the pattern of global demand for cars.**

The global demand for cars is growing. In 2015, global sales reached 72.37 million. By the end of 2016, it is expected that sales will reach the 75 million mark. One of the main reasons for this growth is the rising demand in emerging economies. Sales in China, for example, were around 25 million in 2015. This is about one third of the total sold. Emerging economies such as China, India and Brazil are becoming wealthier as they develop. This means that people in these countries can afford to buy cars – many perhaps for the first time.

**3 ► Work out the global market share of the major car producers shown in Figure 9.1.**

$$\frac{10.08 + 9.87 + 7.99 + 7.49 + 6.40 + 5.17}{72.37} \times 100$$

$$\frac{47}{72.37} \times 100 = 65.69 \text{ per cent}$$

The six major car producers in the world share 65.69 per cent of the global car market.

**4 ▶ Why do you think Japanese car manufacturers have started to dominate the world market?**

One reason why Japanese car manufacturers might have started to dominate the world economy is because they produce cars more efficiently. Information in the case study says that the emerging Japanese car producers are leaner, that is, more efficient. This means they can produce cars more cheaply and sell them at a lower price. Consequently they have taken market share from the US producers that used to dominate the market.

## ACTIVITY 1

### CASE STUDY: GLOBALISATION AND AIRLINES

**1 ▶ Work out the percentage increase in passengers carried between 1980 and 2015.**

The number of passengers carried rose from 642 million to 3441 million between 1980 and 2015. The percentage increase is given by:

$$\frac{3.441 - 0.642}{0.642} \times 100$$

$$\frac{2.799}{0.642} \times 100 = \mathbf{435.9 \text{ per cent}}$$

**2 ▶ Describe two features of globalisation that have supported the growth of the airline industry.**

One of the features of globalisation is that people are free to live and work in any country they choose. This has resulted in more multicultural societies where people from many different nations live and work in the same city. This increase in the movement of people around the world has increased demand for transport, such as air travel.

Also, rising trade between nations will increase the need for business people to meet up. There has been an increase in the number of business people using airlines as they travel to meet foreign business colleagues. Globalisation has also resulted in the increased transportation of goods around the world. The airline industry will have benefited from this increase in shipping.

**3 ▶ What are the reasons for the development of globalisation? Provide two reasons in your analysis.**

There are a number of reasons for the development of globalisation, for example, developments in technology. Modern computing allows firms to transfer complex data instantly to any part of the world. It also means that more people can work at home, or any other location that they choose as long as there is an Internet connection. Many people do not have to be office-based to do their jobs. This means it is easier for firms to have operations all over the world. The Internet also allows consumers to gather information and buy goods online from firms located in different parts of the world.

A second reason is deregulation around the world. For example, privatisation has allowed more competition in many industries. Also, a lot of the barriers to trade have been removed. An increasing number of economies are more open and more and more countries have stopped

protecting domestic industries. Many countries have also simplified their monetary and legal systems to make international trading easier.

**4 ▶ Produce an illustrated poster that shows what is meant by globalisation.**

## ACTIVITY 2

### CASE STUDY: MOBILE PHONES

**1 ▶ Work out the number of mobile phones sold by Samsung in 2015, assuming it had a market share of 21.4 per cent.**

The number of phones sold by Samsung is given by:

$$\frac{1424 \text{ million}}{100} \times 21.4 = \mathbf{304.736 \text{ million}}$$

**2 ▶ What opportunities might globalisation provide for mobile phone producers such as Samsung, Apple and Huawei? Give two opportunities in your analysis.**

One important opportunity that producers like Samsung, Apple and Huawei might benefit from is lower costs. If businesses are able to grow by increasing output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow. With lower costs businesses will become more competitive. This might help them to win a larger share of the market, increase sales and profit margins. In this case, with sales of over 300 million sets, Samsung should be able to exploit economies of scale.

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

### MULTIPLE CHOICE QUESTIONS

1B, 2A, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: THE GLOBAL ONLINE RETAIL MARKET

**1 ▶ What is meant by the term globalisation?**

Globalisation is the growing integration of the world's economies.

**2 ▶ Work out the percentage increase in estimated online retail sales between 2014 and 2018.**

The percentage increase in global online sales is given by:

$$\frac{2489 - 1316}{1316} \times 100 = \mathbf{89.1 \text{ per cent}}$$

**3 ▶ Suggest two ways in which a government can help to support the process of globalisation.**

Globalisation can only flourish if governments are committed to it. For example, countries cannot trade if the governments keep international borders closed.

International trade will be very limited if governments put up trade barriers. Therefore trade barriers should be removed.

**4 ▶ Describe how interdependence might affect online retailers such as Amazon, eBay and Alibaba in the future.**

One of the features of globalisation is interdependence. This means that events in one economy are likely to affect other economies. For example, a recession in India might have an impact on global online retailers, such as Samsung, eBay and Alibaba. They might experience a loss of sales in the Indian market. This might be significant because the Indian market might be very large indeed. The loss of sales might result in a lower revenues and reduced profits.

**5 ▶ Assess the opportunities that globalisation might bring to online retailers in general.**

Globalisation is likely to provide a range of opportunities that businesses, such as online retailers, may be able to exploit. The most important is probably access to huge markets. Clearly global markets are considerably larger than domestic markets. If a business has access to several billion customers rather than, say, 40 million, this provides huge opportunities to increase sales. Secondly, if online retailers are able to grow by increasing output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow. With lower costs online retailers will become more competitive. This might help them to win a larger share of the market, increase sales and profit margins.

Another opportunity that globalisation is likely to provide results from the free movement of labour. This means that businesses will have access to a larger pool of workers. One benefit of this is that if businesses are growing fast there may be a shortage of domestic labour. Globalisation means that workers from overseas can help to boost the labour supply. It also means that businesses have more people to choose from when recruiting. As a result they may be able to recruit better quality workers who should help to improve productivity. A shortage of labour can restrict the development of a business. Also, a large labour supply might help to prevent wages from rising. It is often said that the arrival of larger numbers of foreign workers holds wages down – particularly in markets where unskilled labour is needed. In online retailing some of the staff employed are likely to be unskilled – order picking and packing goods for example. Lower wages will help businesses to lower their costs.

One benefit of globalisation is that businesses can choose where to locate their base. Consequently they can reduce the amount of tax they pay by locating their head office in a country where business taxes are low. Ireland has proved a popular destination for businesses in recent years since its rate of corporation tax is just 12.5 per cent (on trading income). This is well below other rates in the world which generally greater than 20 per cent.

However, despite the opportunities arising from globalisation there may also be some threats: the main one is competition. As more companies around the world try to sell their goods and services in an increasing number

of countries, many businesses will fear for their survival. Often, the companies that are able to exploit globalisation are strong, well resourced and influential. They can use their resources by investing heavily in marketing, for example, to move into new markets and put pressure on existing firms in the industry. In this case, it is suggested that just three suppliers – Amazon, eBay and Alibaba – could dominate the global online retail market. If they become too strong they might put smaller online retailers out of business. As the pace of globalisation increases, the prospect of increased competition is the most worrying threat for most businesses, both large and small.

Also, with the free movement of capital that globalisation brings, it is possible for a business in one country to take over a business in another. Consequently, companies may feel more vulnerable to a takeover since there are a larger number of predators. If takeovers are hostile it means that a company can be taken over against its will. It is possible that Amazon, eBay and Alibaba might grow by taking over some of their rivals.

To conclude, improvements in online payment systems, shipping, local transport providers, warehousing and the removal of trade barriers have all contributed to the growth in global online sales. Indeed, in just five years global sales have grown by 89 per cent. The opportunities that globalisation brings, such as lower costs, access to wider markets, more labour and reduced tax liabilities, are substantial. However, online retailers will have to protect themselves from intense competition. Indeed, the threat from the 'big three' could be a serious threat to the survival of smaller operators.

## CHAPTER 10

### CASE STUDY: LG ELECTRONICS

**1 ▶ What evidence is there to suggest that LG is a multinational company?**

Multinationals are huge business organisations with production operations in at least two different countries. LG Electronics is a multinational because in 2016 it had 125 global operations and employed 77 000 people worldwide. It also enjoys massive revenues. For example, in 2016 LG generated US\$55 367 million in sales revenue.

**2 ▶ Why are multinationals important for the global economy?**

Multinationals are important for the global economy because of the contribution they make to global output and employment. Huge corporations like LG Electronics employ lots of people worldwide. This gives people income and improves their living standards. Multinationals also pay taxes, which the host government can spend on public services, such as water provision and education. Most multinationals also produce a wide variety of products that provide consumers with lots of choice and helps to improve the quality of life.

**3 ▶ Suggest one possible reason why a company might become a multinational.**

One of the main reasons why businesses become multinationals is because such large businesses can lower

their costs (by exploiting economies of scale). This means they can make more profit. This will benefit shareholders, as they are likely to receive higher dividends.

- 4 ▶ In groups, draw up a list of ten businesses that you think might be multinationals. Then do some online research to see if you are right.**

## ACTIVITY 1

### CASE STUDY: NIKE

- 1 ▶ What are the benefits to NIKE, Inc. of operating so many factories around the world?**

Nike has control of hundreds of factories in over 40 countries around the world. This means they can supply markets close to their factories and avoid the cost of transporting large quantities of stock to buyers from a single factory. This will help to reduce transport costs significantly and improve the profitability of the company.

- 2 ▶ How important is a strong brand name to a multinational like Nike?**

Multinationals tend to have well-known brand names. Nike is a very strong brand name. This is very important because it helps to raise the profile of the business all over the world. A high profile in the market and a strong brand name will help to boost sales. This is because when people see a recognisable brand like Nike, existing customers are encouraged and new customers are attracted.

- 3 ▶ How does Nike remain a high profile company?**

Since Nike's brand name is so important to the profile of the business in the marketplace, it is important to maintain its strong position. Multinationals, such as Nike, are prepared continually to reinforce brand names. One way to do this is to invest heavily in advertising. In this case, Nike spent US\$804 million on advertising in 2016. This was 10 per cent higher than the previous year. This is a huge amount of money to spend on advertising alone. However, it helps to protect the Nike brand and generate global sales. Indeed, Nike made a profit of US\$785 million in 2015.

## ACTIVITY 2

### CASE STUDY: MARS

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

**a** When multinationals set up operations overseas, income in those countries rises. Multinationals create new jobs. In this case, the new US\$160 million Mars factory is expected to create 200 jobs for people in Pune. However, there will also be some indirect employment. Local suppliers are also likely to get work when the Mars factory is complete. The extra output and employment generated by Mars will increase economic growth and raise living standards for people in India, particularly Pune.

**b** The profits made by multinationals are taxed by the host nation. This increases tax revenues for the government in that country, which can be used to improve government services. In this case, the Indian government will tax any

profit made by Mars resulting from production at the new Pune plant.

## MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3D, 4B

## CHAPTER REVIEW

### CASE STUDY: MCDONALD'S

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

McDonald's is a giant multinational. It has operations in over 100 different countries employing around 1.8 million people globally. It has huge assets and turnover. For example, it turned over US\$6620 million in 2015.

### McDonald's has become a multinational through effective marketing.

- 2 ▶ What does this mean?**

Some businesses become multinationals by relying on effective marketing. McDonald's is a classic example. McDonald's is a low-tech firm that developed a highly successful brand in the USA and then exploited it globally. McDonald's does face fierce competition, from KFC, Wendy Burger and other fast-food outlets all over the world, for example. However, McDonald's has probably protected its brand name with patents and uses heavy advertising and innovative marketing to attract customers. Most people will have seen McDonald's adverts on the television, for example.

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

McDonald's, like all multinationals, has access to a much wider market than companies that focus entirely on domestic markets. McDonald's has around 34,000 outlets around the world and in over 100 countries; even in India, where most people do not eat beef or pork, there are about 180 restaurants. It is reckoned that each day over 60 million people worldwide purchase something from McDonald's. It is also estimated that they sell more than 75 hamburgers per second. Multinationals can boost their sales revenues by selling to global markets. This will help to increase profits and win market share from competitors.

Also, since multinationals are large companies, they can exploit economies of scale and enjoy lower costs. McDonald's can buy resources at lower prices and borrow money at cheaper rates, for example. Reducing costs will help them gain a competitive advantage and put pressure on their rivals.

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

When a multinational like McDonald's locates operations in a foreign country, that country and its economy is likely to enjoy a number of benefits. These include an increase in income and employment. Multinationals create new jobs in developing countries. For example, McDonald's employs over 1.8 million people all over the world. Local suppliers are also likely to get some work when a McDonald's outlet is opened. The extra output

and employment generated by multinationals such as McDonald's will increase economic growth and raise living standards for people in these countries.

Another benefit they might provide is income for the government. This is because the profits made by multinationals are taxed by the host nation. This increases tax revenue for the government in that country and this can be used to improve government services such as health care, roads and other infrastructure.

In some cases, multinationals provide training and work experience for workers in less developed countries. Also, governments in less developed countries often spend more on education to help attract multinationals. This happened in India where the government invested heavily in IT education and training. In the case of McDonald's, it is likely that training would be given to all of its employees before they begin work.

The arrival of multinationals like McDonald's has encouraged more people to set up businesses in some countries. Multinationals may provide the skills and motivation needed for enterprise. For example, a new multinational may encourage locals to supply services such as transport, accommodation, maintenance, cleaning and leisure activities.

However, despite the benefits outlined above, multinationals are sometimes criticised for their behaviour. For example, many environmentalists are suspicious of multinationals because they may cause environmental damage. One reason is because multinationals are heavily involved in the extraction industries, such as coal, oil and gold mining. Mining is often destructive. However, McDonald's is not likely to receive such criticism since it is not a mining company.

Multinationals are sometimes accused of exploitation. For example, they may pay locals low wages. There is some evidence in this case of such alleged exploitation. Recently, McDonald's has been attacked for paying its workers low wages. In 2014, it was reported that thousands of fast-food workers around the world stopped work or held protests against McDonalds and other fast-food suppliers. Employee action has been ongoing since 2012 in the USA where workers are demanding US\$15 per hour pay rates and the right to join a trade union. Indeed, around 200 workers went on strike in New York. Also, in Brazil, McDonald's has encountered trade union protests because of wage theft, poverty-level pay and poor treatment of pregnant workers. Protests against McDonald's were also seen in Japan and South Korea in 2014. However, although such exploitation may occur, many multinationals have good records when developing business interests in less developed countries.

Another possible disadvantage of attracting multinationals is that the profits made by multinationals abroad are often repatriated. This means that profits are returned to the country where the multinational is based. As a result the host country loses out.

To conclude, many would argue that in the case of McDonald's, the benefits of multinationals are greater than the disadvantages. Higher incomes, new jobs and rising tax revenues are an attractive proposition for many countries,

particularly developing countries. Provided the activities of multinationals are monitored, it may be possible to minimise the disadvantages such as environmental damage and exploitation.

## CHAPTER 11

### GETTING STARTED – TOYOTA

Look at Figure 11.1.

#### 1 ► What are the key changes in Toyota's regional sales between 2003 and 2017?

- The total number of cars sold in Asia has risen sharply.
- As a proportion of total sales, Asia is now a more important market.
- The total number of sales in the Middle East has risen sharply as a percentage.
- As a proportion, Japan is a slightly smaller market in 2012.
- Sales in Japan have actually fallen.
- As a proportion, America is a slightly smaller market.
- NB Other changes not listed here may be identified.

#### 2 ► Why is international trade important to Toyota?

Figure 11.1 suggests that international trade is very important indeed to Toyota. About 75 per cent of its sales are outside Japan, which suggests that about 80 per cent of Toyota's revenue is the result of international sales.

#### 3 ► How might international trade help a business like Toyota to grow?

By selling overseas businesses can generate more sales and more profit. In this case, without international markets, Toyota would be considerably smaller because around 75 per cent of its revenue is generated outside Japan. The ability to sell in overseas markets has allowed Toyota to grow since it was set up in 1937. It is now one of the biggest corporations in the world.

#### 4 ► In groups discuss how international trade might affect you. For example, think about the products you buy and where they come from.

## ACTIVITY 1

### CASE STUDY: IMPORTS AND EXPORTS IN KENYA

#### 1 ► Using examples from the case, distinguish between exports and imports.

Exports are goods and services sold abroad by businesses. In this case, some of the main goods sold abroad by Kenyan businesses are agricultural products and tea. However, they also sell goods such coffee, tobacco, iron and steel products, textiles, petroleum products and cement. Some of Kenya's customers for its exports are the UK, the Netherlands, Uganda, Tanzania, the United States and Pakistan.

Imports are goods that are bought from overseas. In this case, Kenya buys products like machinery and transportation equipment, motor vehicles, iron and steel and plastics from abroad.

**2 ► Describe the pattern of international trade in Kenya over the period shown.**

Over the time 2001–16 period, both the value of exports and the value of imports have increased for Kenya. For example, the value of exports has grown from around KES 17 000 million in 2001 to around KES 50 000 million in 2016. The value of imports has grown from about KES 20 000 million in 2001 to around KES 120 000 million in 2016 (after reaching KES 160 000 million a short time before). However, it is clear that throughout the time period, the value of imports was always higher than the value of exports. This means that Kenya has been running a trade deficit (it imports more than it exports).

**3 ► Why do you think Kenya relies heavily on primary goods for its exports?**

Many African countries rely on the sale of primary goods for their exports. There may be two reasons for this. One is because many African states, like Kenya, have a large supply of certain natural resources that they can export. Kenya sells agricultural products and tea, for example. Kenya is fortunate to have the right sort of resources needed for the production of these goods. A second reason is because many African states are developing countries. As a result they are yet to develop manufacturing facilities and the required skills to export services. Consequently, they have to rely on the sale of primary goods to earn foreign currency.

## ACTIVITY 2

### CASE STUDY: RONNIE MACKAY

**1 ► Work out the price in US dollars of the machines sold by Ronnie Mackay to the US firm (assume £1 = US\$1.50).**

The price in dollars is given by:

$$£3\,600\,000 \times \text{US}\$1.5 = \text{US}\$5\,400\,000$$

**2 ► Work out the amount paid in pounds by Ronnie Mackay for the €2.5 million of components bought from Germany (assume £1 = €1.10).**

The sterling price of the German components is given by:

$$€2.5 \text{ million} \div €1.10 = £2\,272\,727$$

**3 ► Work out the amount in euros received by the Spanish supplier for the £200 000 of materials sold to Ronnie Mackay (assume £1 = €1.10).**

The amount in euros received by the Spanish supplier is given by:

$$£200\,000 \times €1.10 = €220\,000$$

### MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3C, 4D

## CHAPTER REVIEW

### CASE STUDY: ALUMBURG

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

Countries trade with each other for a number of reasons. One is to obtain goods that others can produce more

cheaply. For example, South Africa buys machinery and scientific instruments from other countries. This may be because other countries have the resources to produce such goods more efficiently. It is obviously beneficial to buy goods from other countries if they are cheaper. South Africa sells commodities such as gold, diamonds and coal. This is because the country has a large supply of these resources. It has more gold, diamonds and coal than it needs for its own purposes. Consequently, it can generate income by selling them abroad.

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

Invisible trade involves the exchange of services. For example, South Africa has a flourishing tourist industry. It has some attractive resorts, such as Cape Town, and an interesting culture. The money South African businesses get from tourists is recorded as an invisible export.

**3 ► Describe two benefits of international trade to Alumburg.**

One important benefit to Alumburg of international trade is that it can sell goods to more customers. By expanding into overseas markets, it can sell more output. These extra sales will generate more revenue and hopefully help to make the business more profitable. In this case, Alumburg has started to enjoy sales in the European market. For example, it has one order worth ZAR 124 million.

Also, by selling abroad Alumburg will reduce its reliance on the domestic market. If sales were to decline in South Africa, it can still generate revenue by selling more in its growing European markets. Trading overseas in a range of different markets helps businesses like Alumburg to reduce the amount of risk involved in business.

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

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

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

**a** Alumburg will be affected by exchange rates because it deals with overseas businesses where the currency is likely to be different from that in South Africa. For example, it sells goods to European countries where the euro is used. This means that a change in the exchange rate could affect the price paid by European customers for Alumburg's goods.

**b** A European customer would pay €12.4 million ( $\text{ZAR } 124 \text{ million} \div \text{ZAR } 10$ ) for the order.

**c** Alumburg will benefit from the change in the exchange rate. The euro has strengthened against the rand: one euro can now buy ZAR 12 instead of 10. This means that goods purchased in South Africa will be cheaper. For example, the ZAR 124 million order for machinery will now cost €6.89 million ( $\text{ZAR } 124 \text{ million} \div \text{ZAR } 18$ ). As a result, there is likely to be an increase in demand for Alumburg's goods because they are relatively cheap for European customers.

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

Sustained changes in the exchange rate can have an impact on the international competitiveness of a country. If the exchange falls sharply for a long period of time, this means that all exporters in the country can sell their goods more cheaply abroad. This can have a positive impact on the economy of that country. Higher export sales mean more employment, income and tax revenues for that country. In this case, the South African exchange rate fell sharply against the euro from €1 = ZAR 10 to €1 = ZAR 18. This meant that price of exports from South Africa fell. A European customer of Alumburg's saw the price of an order fall from €12.4 million to €6.89 million. This is a very significant change in price and should result in more orders for Alumburg. If this fall in the exchange rate is sustained, South Africa will be more internationally competitive during this period.

However, a lower exchange rate means that import prices will rise. This means that consumers will have to pay more for overseas goods and holidays abroad and businesses have to meet the rising cost of imported raw materials and components. In this case South Africans will see steep rises in the price of imports as a result of their falling exchange rate.

## CHAPTER 12

### CASE STUDY: BOOSTING THE JAPANESE ECONOMY

**1 ► What evidence is there to suggest that Japan's economy is still performing weakly?**

The Japanese economy has been performing weakly for 20 years or more. However, the data in the graph shows that even in the last five years the problem still exists. The graph shows that total incomes (GDP) in Japan have fallen. In 2011, GDP was US\$6157.5 billion but by 2015 this had fallen to US\$4383.1 billion. This is a poor performance since most countries would expect incomes to grow over time as the economy expands.

**2 ► How might the construction industry benefit from the measures taken by Shinzo Abe?**

One of the key measures taken by Shinzo Abe was to invest money in infrastructure projects such as building bridges, tunnels and earthquake resistant roads. This would benefit businesses in the construction industry since they would get the work needed to implement this measure.

**3 ► How might lower interest rates benefit businesses?**

When businesses invest money, to expand or develop new products, for example, they often need to borrow the money needed for the extra expenditure. Consequently, if interest rates are lower it will be cheaper for them to borrow. This should encourage more businesses to invest in order to expand since the risk of doing so is reduced with cheaper loans.

**4 ► How might businesses in general benefit from the changes in taxation made by Shinzo Abe?**

The lower levels of business tax will be welcomed by businesses. This means they get to keep more of their profits. Some of this profit is likely to be reinvested to help

businesses to grow. Lower tax on business profits might also encourage more people to set up businesses since the financial rewards will be greater.

## ACTIVITY 1

### CASE STUDY: THE GREEK ECONOMY

**1 ► Why has the Greek government been forced to constrain its spending?**

The Greek government has been forced to reduce its public spending because it has built up too much debt. Years of overspending, together with the impact of the financial crisis, meant that Greece needed 'bail outs' from the EU. For example, in 2015 Greece owed a total of €323 billion and had received around €240 billion in 'bail outs' from the EU. Greece has one of the highest debts (as a percentage of GDP) in the world. Figure 12.3 shows that Greece's debt is 175 per cent of its GDP. Only Japan is higher in the sample of countries shown.

**2 ► How might a government constrain public spending? Give two ways in your analysis.**

In return for the money from the EU, Greece had to raise taxes and cut public spending. One approach to constraints in public spending is to cut wages of public sector workers. In this case, Greece made a 20 per cent cut in public sector wages. Wages were also reduced by 30 per cent in state-run enterprises.

Another way to constrain public spending is to cut departmental budgets. In the case of Greece, there was lower spending on education, defence, healthcare and public investment. Finally, cutting state benefits and other payments to people can reduce spending. Greece was forced to lower pensions and social security payments as a condition of the 'bail out'.

### Kostas Samaras runs a private fitness centre in Athens.

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

The private fitness centre run by Kostas Samaras is likely to have suffered badly as a result of the constraints in public spending. With cuts in wages to public sector workers and lower payments to pensioners and others, many people would not be able afford the fees for the fitness centre. Spending on recreational activities is non-essential and when faced with cuts to disposable income people will react by cutting down on this type of expenditure. As a result, the fitness centre may have struggled to make a profit. At worst, it may have gone out of business due to a lack of revenue.

## MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: GOVERNMENT INFLUENCES ON BUSINESSES

**1 ► What is meant by the term tariff?**

A tariff is a tax on an import. Tariffs make imports more expensive and are therefore designed to reduce demand for imported goods.

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

Consumer legislation is designed to protect consumers and prevent restrictive practices, such as price fixing, restricting consumer choice by market sharing and raising barriers to entry by spending huge amounts of money on advertising, which smaller companies couldn't match.

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

Governments spend large amounts of money on large infrastructure projects such as motorway construction and road maintenance. A 20 per cent cut in such spending is likely to have a negative impact on businesses in the construction industry. Large contracts would be lost and some businesses might struggle with reduced revenue. This could affect profitability and, in some cases, businesses that are too reliant on government contracts, might go out of business. Suppliers in the construction industry are also likely to be hit.

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

Businesses prefer interest rates to be lower rather than higher. This is because high interest rates can damage business activity. When interest rates rise business costs will also rise because interest charges on current loans and overdrafts increase. This will reduce profit.

The purchase of new machines and other capital goods funded by borrowed money is also discouraged because it is more expensive. This will slow the development of businesses and make them less efficient. Consumer demand will fall because people's mortgage payments rise and they have less income. Also, demand for goods bought with borrowed money will fall because consumers will find such purchases more expensive.

Changes in the interest rate will have a bigger impact on those businesses that have lots of debt and those which produce goods bought with borrowed money.

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

It is not uncommon for governments to take measures to help the business sector. This is because businesses provide employment, generate income and provide tax revenues. A flourishing business sector is very good for the economy. In this case, the government has taken a number of measures to help businesses. Two of these relate to taxation. The government planned to increase tax allowances on investment and would reduce corporation tax from 25 per cent to 20 per cent. Both of these measures will help to encourage business investment. Higher tax allowances on investment means that the cost of investment is reduced, which would make investment more attractive. Lower levels of corporation tax means that businesses will be able to keep more of their profits. This would provide more funding for investment. If businesses invest more, in new technology and research and development for example, they are more likely to remain competitive and grow. Lower corporation taxes might also

attract businesses from overseas to set up operations in the country. This would help to generate more employment and income.

The government also plans to hold interest rates at their current low levels for several years. This will benefit businesses since the cost of borrowing will be lower. The purchase of new machines and other capital goods funded by borrowed money will be encouraged. This will help the development of businesses and make them more efficient. Consumer demand will rise because people's mortgage payments fall and they have more disposable income. Also, demand for goods bought with borrowed money will rise because consumers will find such purchases cheaper.

The introduction of tariffs on a range of imported shoes, clothes and fashion accessories will help some businesses. If imports of these goods become more expensive it will be easier for domestic producers in these industries to compete and survive. Therefore clothes and shoe manufacturers, for example, should enjoy a boost in sales as their goods become relatively cheap compared to imports.

If the government relaxes some out of date consumer legislation this could make it easier for businesses to operate. Legislation generally has a constraining effect on businesses and can impose costs. For example, if businesses have to comply with legislation that prevents them from selling products to people under the age of 21, this restricts their market.

The government also plans to open negotiations to join a trade bloc. This could have a positive impact on businesses. For example, trade blocs provide opportunities for businesses to specialise in the production of those goods and services that they can produce more expertly or at a lower cost.

Belonging to a trade bloc also gives them access to wider markets and can help to lower costs if economies of scale can be exploited when sales and output rise. Membership may also provide protection from large predatory multinationals from outside the bloc.

To conclude, all these measures can potentially help businesses, particularly those in the clothes, shoes and fashion accessories industries where competition has been reduced with tariffs on imports. However, the government is also cutting some expenditure and freezing public sector pay. These measures will have a negative impact on some businesses. Therefore the gains mentioned above might be cancelled out to a certain extent.

## CHAPTER 13

### CASE STUDY: SOCIAL MEDIA AND BUSINESS

**1 ► Why is social media so important to businesses?**

Social media is so important to businesses because of the enormous number of people that use it. In 2016, it was reported that every day around 500 million tweets were posted on Twitter, 4500 million 'Likes' were expressed on Facebook and 95 million photos were uploaded onto Instagram. Electronic devices, such as smartphones and tablets, enable people to exchange this wide range of data instantly and globally. Social media has become a powerful

phenomenon and it is no surprise that businesses are making increasing use of it – particularly in the marketing of their products. Social media has a global reach and even small businesses can communicate with large numbers of people all over the world.

### 2 ► How might businesses use social media?

The use of social media generates huge amounts of data about a business's customers such as their profiles, their preferences and what they think of products. This is a valuable resource. Businesses have set up links to some of these social media platforms and these communication channels allow them to tell people about their products and listen to their views. Businesses can use social media to raise and strengthen brand awareness, run targeted adverts with real-time results, increase traffic on their own websites and find out what competitors are doing. Businesses spend huge amounts of money advertising on social media. Figure 13.1 shows that advertising spending on social media is expected to rise to US\$29 910 million in 2016, up from US\$11 360 million in 2013.

### 3 ► In groups, discuss your own experiences of interacting with businesses on social media. Make a list of the possible benefits of such interaction and present the information to the rest of the class.

This is an open question and designed for students to exchange experiences and ideas.

## ACTIVITY 1

### CASE STUDY: 3D PRINTING

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

Technological development usually brings new opportunities for businesses. It could be new products that people have not seen before or new machinery that can be used to improve efficiency. For example, new technology can help to shorten product life cycles. This is because new products are quickly developed to replace ones that use less sophisticated technology. Developments in technology often mean that businesses can replace labour with capital. This is welcomed because human resources are often said to be the most difficult to manage. New technology also lowers unit costs. Recently, the development of social media has helped to improve communications between businesses and customers. This allows businesses to remain aware of changing consumer needs.

In this case study, new 3D printers are expected to make a big impact in business. Although 3D printers were invented in 1986, only in recent years have businesses really started to exploit the new technology on a commercial scale. Between 2016 and 2022, the 3D printing market is expected to grow to US\$30 190 million. 3D printers reduce the need to produce hand built models and prototypes and are very efficient. They are said to be around ten times faster than other methods of model production and five times cheaper. This means that prototypes can be produced in hours rather than days. This will help to speed up product development, for example.

Another attraction of 3D printing is its wide range of applications. The technology can be used to make components for cars, airplanes and spacecraft; produce prosthetics (artificial body parts) for the medical industry and produce an range of personalised products such as jewellery, fashion accessories and toys, for example. Eventually, 3D printing will allow businesses to design, test and manufacture low-volume or one-off parts both quickly and cheaply.

However, 3D printers have some disadvantages. They may cost between US\$25 000 and US\$50 000, although this is less than the cost of more sophisticated rapid prototyping (RP) machines, which can cost between US\$100 000 and US\$500 000. The surface on the models is also a little rough compared to production using RP machines. Also, models can only be made from one or two materials and there are only two colours. Although these disadvantages currently exist, they are not likely to prevent the future success of 3D printing. Like most technology, it will get cheaper and eventually the disadvantages are likely to be resolved.

## ACTIVITY 2

### CASE STUDY: ELECTRIC VEHICLES

#### 1 ► Describe two external factors that have contributed to the development of EVs.

Growing concern about the damage done to the environment has encouraged the development of EVs. The carbon emissions from vehicles contribute to global warming. Also, the rising cost of oil has made driving more expensive and consumers may welcome alternatives, although in 2014 the price of oil fell quite sharply so this reason may have carried less weight at that time.

#### 2 ► What are the advantages of EVs for consumers? Give at least two advantages in your analysis.

EVs will be more environmentally friendly because they will not release carbon into the atmosphere. Many consumers will see this as an advantage. The car is also cheap to run. It is expected to cost about US\$0.04 per mile (US\$0.06 per kilometre). Also, the batteries used to power the car can be recharged in four hours and have a range of 107 miles (about 170 km) on one charge.

#### 3 ► Assess the impact global oil prices might have on the plans of car manufacturers in the future.

Although the price of oil has fallen by over 50 per cent since 2014, according to the graph in Figure 13.2, this may only be a short-term change. In the future, oil prices might rise back to previous levels or beyond; this will make EVs even more attractive. However, even if oil prices remained low, it is possible that car manufacturers will 'push' EVs in the marketplace. One reason for this is that they have probably invested heavily in R&D and will want to recover the outlay. But also, people are still becoming increasingly concerned about the damage done by emissions to the environment and therefore might start to buy EVs on a large scale.

## MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3D, 4C

## CHAPTER REVIEW

### CASE STUDY: ATERRO RECYCLING

#### 1 ► What is meant by external factors?

Sometimes businesses have to deal with events and issues that are completely beyond their control. These external forces can impact on businesses unexpectedly and usually mean that businesses have to make changes to the way they operate. The effects of external factors can be both positive and negative. They may provide new opportunities or they may lead to serious costs. For example, in this case Aterro Recycling is benefitting from an external factor. Owing to rapid technological developments, there has been a huge build-up of e-waste around the world but particularly in India. This has provided a business opportunity for Rohan.

#### 2 ► How will Aterro Recycling help to reduce resource depletion?

Aterro Recycling is making a positive contribution to the environment by recycling waste. This means that it is providing valuable resources from materials that have been discarded and left to deteriorate. The factory uses processes to extract precious metals like platinum, gold and selenium from the e-waste. These precious metals generate revenue for Aterro and ensure that stocks of these resources are not depleted as quickly as they would be without recycling.

#### 3 ► How might developments in technology have impacted on Aterro Recycling?

Aterro Recycling was set up when Rohan Gupta tried to throw away an old laptop without harming the environment. He realised that India did not have a system to deal with the vast quantities of e-waste being generated. Computers, laptops, television sets, mobile phones and electronic office equipment are examples of e-waste. In one Indian city, Bangalore, e-waste amounts to 18 000 tonnes per year and is still growing 20 per cent annually. The growth is driven by rapid developments in technology with the frequent arrival of new, updated and attractive electronic products. E-waste is now the world's fastest growing and most toxic waste. Rapid developments in technology provided Rohan Gupta and his brother with a business opportunity.

**Businesses may be affected by political factors from time to time.**

#### 4 ► Discuss how political factors can affect business decisions.

Some parts of the world are politically volatile and businesses have to be cautious if they develop interests in countries that are politically unstable. For example, few businesses would have considered setting up operations in Syria, Western Turkey, Iraq and Libya in 2016 due to quite severe political instability. However, political factors can also influence businesses in stable, democratic countries. The activities of pressure groups can also play a role influencing business activity. For example, in 2016, the British people voted to leave the EU. Not many people would have predicted this and the effects of Brexit, as it became called, are still to be determined. However,

one immediate outcome was a fall in the exchange rate. The value of sterling fell by more than 10 per cent after the Brexit vote. This means that British exporters may find it easier to sell goods abroad since exports become cheaper. In contrast, imports are more expensive so British businesses using imported raw materials and components, for example, will face higher costs.

#### 5 ► Assess whether Aterro Recycling will thrive in the future.

The future could be bright for Aterro Recycling. The graph in Figure 13.3 shows that the global recycling market is set to grow from €14 000 million to €35 000 million between 2011 and 2020. This is an increase of 218 per cent and suggests that Rohan Gupta and his brother have set up a business in a rapidly growing market. Also, the speed of technological development seems to get faster over time. This suggests that piles of e-waste will grow even faster than at present. This will obviously benefit Aterro Recycling since it means there will always be plenty of e-waste to recycle in their plant. The company's revenue is growing rapidly and in 2013 reached US\$15 million. Aterro Recycling is already expanding and also has processing plants in Mexico and Ireland. If this expansion is continued then revenues and profits should continue to grow.

However, Aterro Recycling will have to be watchful in the market for new entrants. If the recycling of e-waste appears to be a highly profitable business activity, new entrants will enter the market and fight for a share. If very large companies appear, they might be a threat. For example, large multinationals with their huge resources might be able to push Aterro Recycling out of the market if they are not prepared.

Aterro will also need to remember that future external factors might affect their activities. For example, a new government might pass a law that means that Aterro's current industrial processes are not environmentally friendly. This could force them to invest in new plant and equipment. There might also be an evolution in technological development where all new products are perhaps more durable or contain less opportunities for recycling. For example, a lot of new technological products are being 'miniaturised'. This might result in a sharp fall in e-waste.

## CHAPTER 14

### CASE STUDY: DIGI.COM BERHAD (DIGI)

#### 1 ► What evidence is there to suggest that DiGi is a successful business?

Evidence in Figures 14.1 and 14.2 suggests that DiGi has enjoyed some success in the last five years. The company's revenue has increased by around 16 per cent over the time period, from MYR 5954 million in 2011 to MYR 6914 million in 2015. The profit made by the company has also increased over the same period from MYR 1254 million to MYR 1723 million – a significant 37.4 per cent increase. In addition to this, DiGi has won a high profile award. In 2015, it received the prize for being the 'Best Managed Public Company in Asia' (in its category). Most people would judge that this represents success.

- 2 ▶ In pairs, discuss what other information might be helpful to measure the success of DiGi. Draw up a list and present the information to the rest of the class.**

When measuring the success of a business, it is often helpful to make comparisons with other businesses in the industry. For example, if other firms in the telecommunications industry enjoyed much bigger increases in turnover and profits than DiGi, then its performance is not so impressive. It is also important to take into account other factors such as market conditions. If the improvements in revenue and profit were made during a recession, for example, then the figures are perhaps even better than they suggest.

## ACTIVITY 1

### CASE STUDY: ALUMINIUM CANS

- 1 ▶ What is the change in CanKing's revenue between 2010 and 2015?**

CanKing revenue 2010

9 per cent  $\times$  US\$450 million = **US\$40.5 million**

CanKing revenue 2015

8 per cent  $\times$  US\$560 million = **US\$44.8 million**

Change in revenue = **US\$4.3 million (increase)**

- 2 ▶ Do you think CanKing has been successful over the time period?**

CanKing has increased its revenue from US\$40.5 million in 2010 to US\$44.8 million in 2015. This is an increase of 10.6 per cent over the time period. The owners may consider this successful. However, it depends on whether CanKing set any revenue targets for the time period. This would provide a basis for comparison. CanKing's market share is down slightly from 9 per cent to 8 per cent but it still occupies fourth place in the market. Arguably, CanKing has been successful since revenue has increased and its market share is down just a little – its market position is unchanged.

- 3 ▶ Which company has been most successful over the time period? Explain your answer.**

It appears that Singh Holdings has been the most successful business over the time period. It has become the market leader at the expense of Zcan. In 2010, Zcan had 34 per cent of the market with Singh Holdings having 22 per cent. By 2015, Singh Holdings had increased its share to 29 per cent while Zcan saw its share fall to 27 per cent. Singh Holdings also saw its revenue jump from US\$99 million to US\$162.4 million. This is a significant increase of 64 per cent.

(Note: It is calculated from the information in the pie charts and case study material)

- 4 ▶ Why might it be difficult to measure success using market share?**

Measuring market share might be difficult. Information would be needed about the size of the total market and the revenues of the main suppliers in that market. Some of this information might be difficult to obtain. Therefore, using the value of market shares to measure success may not be easy.

## ACTIVITY 2

### CASE STUDY: LOSADA PAELLA

- 1 ▶ What was the size of Losada Paella in 2016 according to EU definitions?**

According to the EU definitions of size, in 2016, Losada Paella was a small company. This is because turnover was less than €10 million and greater than €2 million.

- 2 ▶ In what year did the size of Losada Paella change?**

2008.

- 3 ▶ Do you think Losada Paella has been successful?**

In the first few years of trading, Losada Paella enjoyed healthy improvements in revenue from €98 000 in 2002 to €200 000 in 2008. However, in 2008 Marta set up a website for the business and started to sell her products online. This was an enormous success because by 2016 turnover had risen to €2.4 million. This represents an increase of 1100 per cent!

### MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3C, 4D

## CHAPTER REVIEW

### CASE STUDY: QETIC LATEX PLC

- 1 ▶ Work out the total number of people employed by Qetic Latex.**

$180 = 16\%$  of the total workforce at Qetic. Therefore the total workforce is given by:  $180 \div 0.16 = 1125$  workers

- 2 ▶ Is Qetic a small, medium-sized or large business?**

According to the EU definitions of business size, a firm that employs over 249 is considered large. Qetic employs a total of 1125 workers and is therefore large according to this measure.

- 3 ▶ Discuss how consumer satisfaction might be used to measure the success of a business like Qetic Latex.**

Many businesses will look at how consumers' needs and wants have been satisfied when measuring success. If its customer service is good, a successful business will find that it has loyal customers and a growing customer base. In this case, Qetic Latex sells goods to other businesses. However, it will still be important to meet their needs.

Many businesses are becoming more customer-focused and making efforts to get feedback from their customers. Qetic Latex may have developed a relationship with their business customers over time. If these relationships are strong and customers are loyal then Qetic may consider that it is being successful. Also, in 2016, the company won two high profile industry awards for the quality of its latex products. This suggests that customer satisfaction might be high.

Finally, an increasing number of businesses use customer surveys to gather information about customer satisfaction. The information they gather can be analysed and used to assess customer satisfaction levels. If customer satisfaction levels rise over a period of time then the company will consider it is being successful.

**4 ▶ Describe how shareholders might measure the success of a business.**

Most shareholders in public limited companies will have bought shares with the aim of making money, consequently they will focus on dividend payments and share prices.

Over time, shareholders would want both dividend payments and share prices to rise. In many countries, large financial institutions such as insurance providers, pension funds and investment companies own shares. These groups tend to be very focused on short-term returns. They like to see regular dividend growth and if dividend payments were frozen or cut they might see this as a sign of failure or weakness. In their view, successful companies are those that increase dividends each year. In this case, Qetic is 66 per cent owned by institutional shareholders. Consequently, there is likely to be pressure on Qetic to deliver regular dividend growth.

**5 ▶ Assess the success of Qetic Latex. Make a clear judgement in your evaluation.**

Most Qetic shareholders would argue that the business has been successful. They would point to Figure 14.8 that shows that dividends per share have risen from US\$1.10 in 2011 to US\$1.70 in 2015. This is an increase of 54.5 per cent over the time period. Most investors would consider this a fair return on their investment. Dividends have grown steadily over the whole time period. There have not been any 'dividend holidays' (a year where a company pays no dividends) or dividend reductions. However, shareholders also look at share prices since they can make a profit if they buy shares and sell them later when the price has risen. In this case, the share price fell sharply in 2016. It fell by 12 per cent in one day immediately after the television broadcast showing some disturbances at the Qetic factory. This would be a cause for concern if the fall were not reversed soon afterwards.

Employees in the business may differ in their view about Qetic's success. The needs of employees may be different from those of the shareholders. Employees depend on businesses for their livelihood. Most employees have no other sources of income and rely on their wages. Like the owners, employees want the business to be successful. If a business is growing and profitable, employees are likely to get higher wages, more benefits and perhaps a bonus. They will also feel more secure in their jobs. However, employees have other needs that must be met. They will need to be trained so that they can do their jobs properly. They want good working conditions, opportunities to interact with other employees, fair and honest treatment and opportunities for promotion. Generally, employees will want to maximise their financial rewards and welfare. If the business they work for is able to satisfy all, or most of these needs, then in their opinion the business will be judged as successful. In this case, in order to improve productivity, one of the moulding sections at Qetic was due for automation. This meant that 180 staff would be laid off. The announcement of the job cuts was received very badly by the Qetic employees. Two workers protested by chaining themselves to the main gates preventing the movement of suppliers' vehicles. A week later the situation escalated when a representative of the workers said that

they would 'bring the company to its knees' if the workers weren't deployed in another part of the organisation or paid reasonable compensation for their loss of employment. This would suggest that employees are far from happy and would judge that the company is not being successful.

To conclude, up until the recent internal conflict, the business appeared to be successful. Certainly shareholders were enjoying rising and regular dividends. Qetic also won two high profile industry awards for the quality of its latex products. This was the result of its commitment to product development and investment in a US\$50 million research centre in 2015, an investment that presumably created new jobs. However, at the moment, the future success of the business is in question. Some ugly scenes at the main plant were broadcast on television and it was reported that shareholders were very worried about the ongoing conflict. This concern was reflected in the share price, which fell 12 per cent the day after the broadcast. If the internal conflict is not resolved quickly the performance and success of the business is likely to be at risk.

## CHAPTER 15

### CASE STUDY: THE PEPPERTAP

**1 ▶ Why did the PepperTap fail?**

Businesses may fail for a number of reasons. In this case, there are three specific reasons. First, the PepperTap had problems with some of its partner retailers. They failed to adopt the necessary technology to keep consumer information up-to-date – this meant that customers were not getting the quality of service they needed. Second, the PepperTap was offering high discounts to try and enter the market – this quickly used up the company's cash. Finally, the cost of maintaining high staffing levels to meet delivery commitments was also expensive. The PepperTap promised to deliver groceries within two hours of an order being placed. This was far quicker than any rivals. However, Navneet and his team felt that they had an advantage over their competitors in making their delivery operation more efficient, since some of them had previously worked in this area, and costs would eventually fall. As it turned out, the PepperTap were unable to find fast enough solutions to these problems and they ran out of cash.

**2 ▶ What measures might have been taken to avoid failure?**

Initially, perhaps the PepperTap should have avoided using retailers that were not able to adopt the necessary technology. This may have slowed down the growth of the business but quality would have been maintained. They could also have reduced the discounts they were offering, which cost them a lot of money. Instead of offering 20 per cent, perhaps they could have offered just 10 per cent. Finally, their two-hour delivery promise was too challenging. Although they were probably trying to get a competitive edge, it is still necessary to be realistic and set targets which are achievable.

**3 ▶ In pairs, make a list of things that you think might cause a business to fail. Try to decide which one of these is most likely to be a threat.**

## ACTIVITY 1

## CASE STUDY: VALTrex CONSTRUCTION

## 1 ► What is meant by overtrading?

Overtrading is likely to occur when a business tries to grow too quickly. Cash and other liquid resources get tied up financing the expansion of the business and eventually the cash runs out. Without cash a business cannot trade.

## 2 ► How is it possible for a profitable business, like Valtrex Construction, to fail?

It is possible for a profitable business to collapse if it runs out of cash. One situation in which this might happen is when a business is overtrading. If a business grows too quickly, it uses up liquid resources to fund the growth. This is exactly what happened to Valtrex. Up to 2014, the business had grown to US\$30 million sales and was trading profitably. However, the directors decided to grow the business further and during 2015 recorded sales of US\$45 million. The company appeared to be growing too quickly, resources became strained and it ran out of cash.

Profitable businesses can also fail if they get a large bad debt, if they are faced with a large and unexpected payment or if they offer trade credit that is too generous. Effective cash flow management is important. One of the main reasons for business failures, both profitable and unprofitable, is cash shortage.

## ACTIVITY 2

## CASE STUDY: KINGFISHER AIRLINES

## 1 ► What was the value of Kingfisher's debt in US dollars when it collapsed in 2012 (assume US\$1 = Rs66)?

Kingfisher's debt was Rs7000 crores  
(1 crore = Rs10 million).

Therefore 7000 crores = Rs70,000,000,000.

In US dollars this will be  $70\,000\,000\,000 \div 66 = 1\,060\,606\,100$ , that is, **US\$1600 million**.

## 2 ► How might: a poor management and b high costs have contributed to the failure of Kingfisher Airlines?

**a** Senior managers and business leaders have been known to bring down companies almost single-handedly. A business might lose its competitive edge in the market because the leader makes a mistake. This could be the result of poor decision making or a failure to make urgent changes. In this case, it has been suggested that Kingfisher Airlines lacked a strong leader. There was a frequent change of personal at the top, which meant that the business was unstable. The owner of the airline, Vijay Mallya, never took an active role in running the business and eventually the airline was given to his son, Siddharth Mallya, as an 18th birthday present. It was alleged that Siddharth did not have the experience to run such a large and complex business organisation. One option would have been to make Gopinath (ex-founder of Air Deccan) the CEO. However, this opportunity was missed and, in general, the company lacked the expertise and experience of a specialist manager in the airline industry.

**b** Another possible reason for Kingfisher's collapse was high operating costs. If costs are too high then a business needs to charge more to make a profit. This might result in a loss of trade to low-cost competitors. A firm's costs might be higher than rivals for a number of reasons. For example, businesses may be wasteful. In this case, there is evidence that Kingfisher was wasteful. Kingfisher chose to offer customers some high quality inflight entertainment, which was not usual for domestic flights. For example, a deal with DishTV to provide live inflight entertainment meant that 50 or so customised dishes had to be installed on each aircraft. Passengers were also offered free headphones. In addition, Kingfisher invested in some very expensive advertising campaigns, featuring Deepika Padukone, one of the highest paid actors in the world. It also offered passengers access to exclusive lounges and luxury meals. These costs, and others, made it very difficult for Kingfisher to make a profit.

## 3 ► Describe one external factor that might have contributed to the downfall of Kingfisher.

There may have been some factors beyond the control of Kingfisher that contributed to the failure. Economic conditions were poor for several years after 2008 and the airline was caught out by high fuel prices and some discretionary taxes. However, it might be argued that most of Kingfisher's troubles were internal.

## MULTIPLE-CHOICE QUESTIONS

1A, 2B, 3C, 4A

## CHAPTER REVIEW

## CASE STUDY: DANDENONG SOFT FURNISHINGS

## 1 ► Suggest two possible causes of cash flow problems.

Cash flow problems might be caused by overtrading, investing too much in fixed assets, allowing too much credit, over-borrowing, seasonal factors, unforeseen expenditure, external factors and poor financial management.

## 2 ► How can rising debt affect a business like Dandenong Soft Furnishings?

When a business borrows money, it has to pay interest to the lender. Consequently, when businesses borrow more and more, the size of their interest payments rises along with the size of their debt. This means that costs rise and profits fall. In this case, following the purchase of Marigold Furnishings and investment in an expensive television advertising campaign, Dandenong Soft Furnishings borrowed A\$10 million. This meant that the business had to make regular interest payments until the loan was repaid. This had a negative effect on the financial performance of the business because soon after it started to lose money.

## 3 ► Assess the reasons why Dandenong Soft Furnishings failed. Make a clear judgement in your evaluation.

A number of factors led to the failure of Dandenong Soft Furnishings. Once Charlie had retired from the business and appointed his daughter, Agnes, as CEO, its performance seemed to decline. It could be argued

that despite Agnes's academic qualifications in business management, she was a poor leader and made a number of key errors in the running of the business. One was to buy rival chain, Marigold Furnishings, for A\$ 6.3 million. The price was far too high and Dandenong already had stores competing successfully with Marigold in more than one-half of the locations. This was perhaps a foolish purchase. Another error was to invest heavily in a national television advertising campaign just after the purchase. This stretched the company financially forcing them to borrow A\$ 10 million. However, worse was to come.

The marketing manager wrote a report for Agnes explaining the importance of online selling and that Dandenong should consider very seriously setting up an online facility. However, Agnes was strongly opposed to this. She thought that the main strength of Dandenong business model was the quality of customer service given in the stores. Dandenong had always invested heavily in specialised customer service training. This may have been one of Agnes's biggest mistakes.

In 2010, the company had started to lose money due to falling sales. Agnes thought that the way to improve performance, and prevent cash flow problems, was to open stores in Western Australia, a region in which Dandenong was not represented. This strategy needed investment of A\$ 5 million. Agnes drew up a business plan and approached a number of lenders for finance. However, not a single bank or investor was interested. They felt that online selling was the way forward and Dandenong had 'missed the boat'. Too many businesses were running successful online businesses offering quality furniture at much lower prices than Dandenong. If Agnes had acted on the advice of her marketing manager the business may have survived.

In September 2014, Dandenong closed down owing banks A\$ 9.5 million. Agnes told a reporter that the business had failed due to a lack of finance. This was not really the reason. The business did lack finance but it lacked finance for a reason. It had failed to innovate by selling online and no one was interested in funding a failing business. To conclude, it could be argued that the business failed mainly because of poor leadership. It was Agnes, the leader, who refused to listen and innovate in 2010 and it was Agnes that decided to buy Marigold and invest in television advertising. These were very costly mistakes for the business.

## CHAPTER 16

### CASE STUDY: BUSINESS PRESS CONFERENCE

#### CASE STUDY: INTERNAL EMAIL

- 1 ▶ Name the a sender, b receiver(s) and c message in the two examples of communication shown in the photograph and Figure 16.1.**

Press conference

- The board of directors
- Members of the press – journalists, television, radio and other members of the media
- Information relating to the company's financial performance for the year.

Email

- Deepika Mendis – Head of Finance, Portland Carriers
- Celia
- Request for a sales report to be sent.

- 2 ▶ Produce an illustrated poster that shows the different ways you communicate with your friends.**

## ACTIVITY 1

### CASE STUDY: ELMART

- 1 ▶ Who is the sender of the information in this example?**

The sender is Roberto Navarro in this case.

- 2 ▶ What is meant by vertical communication? (Use an example from the case study.)**

Vertical communication takes place when messages are passed up and down the organisational hierarchy in a business. In this case, the communication is upwards. Roberto Navarro is sending information to the finance director, a superior higher up the organisational structure.

- 3 ▶ What sort of information is being sent in this example?**

Some financial information is being sent in this example. Table 16.1 contains financial information about the performance of the stores in May 2016. The table has been sent to the finance director who is writing a report for a board meeting.

- 4 ▶ Why is upward communication helpful?**

There are a number of reasons why upward communication is helpful. It may help managers to understand the views and needs of subordinates and make them aware of potential problems. It also helps staff to feel that they are valued and provides managers with information that can be used to make decisions. Finally, upward communication can show whether or not downward communication has been effective.

## ACTIVITY 2

### CASE STUDY: STAFF COMMUNICATION

- 1 ▶ Is this case an example of internal or external communication?**

The use of a noticeboard by Yuri, the section manager, to inform all staff in his section to attend a short meeting is an example of internal communication. It is communication that takes place inside the business.

- 2 ▶ What is meant by 'on the grapevine'?**

The grapevine is an informal method of communication. It involves people passing on information unofficially. In this case, Yuri is relying on the grapevine to a certain extent. He is hoping that staff who fail to see his message on the noticeboard will pick up the brief details from those members of staff who have.

- 3 ▶ Do you think using a noticeboard was an appropriate method of communication in this case?**

The use of a noticeboard is not really an appropriate method of communication for the type of message that was being sent in this case. The attendance at the meeting

provided evidence of this: 11 people were absent. Either they had not spotted the message on the board (because it was too messy), had not read any notices on the board, had not heard about the meeting on the grapevine or did not want to come to the meeting. The main problem of using noticeboards for important messages is that the method is unreliable and open to abuse.

### MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: CHOCCOMATE

#### 1 ► What is meant by the term external communication?

External communication involves an exchange of information between the business and those outside it such as customers, investors or the authorities.

#### 2 ► Describe one benefit of using a presentation as a means of communication in this case.

Using a presentation to communicate is a method of face-to-face communication. In this case, Ju Kin Fung is going to give a presentation to the board of directors that aims to show the benefits to ChoccoMate of using social media as a means of communication. A presentation is a formal method of communication and will be taken very seriously. This is an advantage. A presentation will also provide an opportunity for the receivers, the board of directors in this case, to ask questions and express their views on the matter. This is because face-to-face communication allows immediate feedback.

#### 3 ► Why is good communication important in business? Give at least two reasons in your analysis.

Good communication is crucial in business because poor communication can be very expensive. Poor internal communication may cause efficiency and profitability to suffer. It can lead to mistakes, wasted resources and confusion. Poor internal communication can also lead to workers misunderstanding what they have to do. This might affect their motivation and increase staff turnover and absence, for example. Poor internal communication can also result in a duplication of effort – where two people do the same task, for example.

Poor external communication can make the business look foolish and may cost it money. For example, if prices on a company's website are set too low by mistake, this could lead to a flood of online orders. These may have to be accepted at a loss. Poor communication with outsiders could also damage the image of the company.

Finally, if important information is slow to reach its destination, there may be a delay in decision making. This could result in a business missing out on a valuable opportunity or damage relations with an important customer.

#### 4 ► Assess the benefits to ChoccoMate of using social media as a means of communication.

An increasing number of businesses are using social media as a means of communication. Many firms use it to help market products, and more recently, to encourage more

communication between workers. ChoccoMate could enjoy some specific benefits if it uses social media. It is possible to gather personal data from huge numbers of people. ChoccoMate can find out who they are, what they like and what they think of their products. Customer feedback can be obtained instantly from all over the world and all this is free. Businesses are using social media to connect and engage directly with their customers. For example, 65 per cent of small or local businesses said they used social media to communicate with customers, 50 per cent of Facebook users under the age of 35 responded to recommendations about products online and 51 per cent of Facebook users and 64 per cent of Twitter users are more likely to buy products they see advertised on their social media platforms. Also the graph in Figure 16.5 shows the enormous numbers of people that use the different social media platforms. For example, over 1700 million people used Facebook in 2015. This would give ChoccoMate access to a large proportion of both its current customers and also potential new customers.

ChoccoMate could use social media to run targeted adverts. For example, with a Facebook advert, ChoccoMate can target customers based on location, age, interests, behaviours, and connections. It will also be possible to track and measure the performance of adverts on social media.

ChoccoMate could also provide better customer service. Around 67 per cent of customers use social media to get their customer service. People expect to be able to contact a business 24/7. A study by Aberdeen Group, an IT research company, shows that businesses offering customer service using social media enjoyed bigger annual financial gains (7.5 per cent growth) compared with those without (2.9 per cent).

Finally, ChoccoMate could increase website traffic by directing interested customers from a social platform using a link and also monitor the behaviour of competitors. For example, tools are available that allow a business to 'flag-up' key words used on social media such as 'new chocolate bar'.

However, despite these powerful benefits there are some possible disadvantages of using social media. For example, any negative feedback posted by customers would be there for all to see. So while social media can be an extremely powerful tool for building the reputation of the business, it can also damage the reputation of a business. It also takes time to develop a presence on social media. ChoccoMate would have to decide which employees would be involved in monitoring comments and recording, gathering and presenting the huge amount of data that would be generated. There would also be a need to decide what information and other content should be fed onto the social media stream. Finally, although it is free at the very basic level, costs would be incurred such as the time it takes staff to manage media presence and gather and present data in a meaningful way.

To conclude, Ju Kin Fung would probably argue that the benefits of using social media as a means of communication with customers are far greater than the disadvantages. He might say, for example, that negative feedback can be used in a positive way – by solving problems and making improvements.

## CHAPTER 17

## CASE STUDY: PARAPOWERCORP

**1 ▶ Describe the communication problems ParapowerCorp customers are experiencing.**

ParapowerCorp has been criticised in a national newspaper for the poor quality of its customer service. It seems that one of the main problems is its inability to communicate with customers. For example, it could take up to 20 minutes to get a telephone call through to the organisation. This would be very frustrating for callers with urgent problems or queries. Frustration levels would also rise if ParapowerCorp does not answer queries sent in by email; according to the report, emails are sometimes left unanswered. Staff at ParapowerCorp also had poor knowledge of customer details and often blamed computer problems for their lack of information. Finally, it was reported that some staff were rude when talking to customers; staff rudeness is unacceptable and cannot be justified.

**2 ▶ Discuss the impact these communication problems might have on ParapowerCorp.**

Poor communications between a business and its customers can have adverse consequences. In this case, the report claimed that around 39 per cent of the customers they spoke with when gathering information for the report had now switched suppliers. This loss of custom to rivals is a serious matter for ParapowerCorp. If it were to continue, revenue and profit could both fall.

**3 ▶ Suggest how these communication problems might be overcome.**

First, the communication problems at ParapowerCorp suggest that the customer services department is under-resourced. If it takes so long to answer the telephone and emails are being left unanswered this suggests that there are not enough employees to deal with the workload. Therefore ParapowerCorp should take on more workers in the department. Second, if staff cannot access customer details effectively this suggests that either records are not up-to-date or staff are not able to access them. Information in the case suggests that computer problems are the cause here. If this is the case, then the IT systems need to be updated or repaired. Finally, there is no excuse for rudeness to customers. Staff guilty of this may be disciplined or retrained. If staff are frustrated because they cannot do their jobs effectively, then they should find other ways of dealing with their frustration.

## ACTIVITY 1

## CASE STUDY: WORK-RELATED FATALITIES

**1 ▶ Work out the percentage of work-related fatalities in agriculture as a proportion of the total in 2015.**

The percentage of work-related fatalities as a proportion of the total in 2015 is given by:

$$\frac{22}{43} \times 100 = \mathbf{51.2 \text{ per cent}}$$

**2 ▶ Why is clear communication very important on a farm?**

One of the problems that can result from ineffective communication is a rise in work-related accidents. Unfortunately, in agriculture, accidents and fatalities are not uncommon. In 2015, there were 22 fatalities on farms in New Zealand. This was over one-half of the total in all work-related fatalities in the country. If communication about the dangers of working in agriculture could be improved, there might be a fall in accidents and fatalities. It is easy to see why clear communication in agriculture is very important – it could save lives.

**3 ▶ Discuss the possible barriers to communication on farms. Include at least two barriers in your analysis.**

In New Zealand, a few people each year are killed as a result of a work-related quad bike accident. In addition, around 60 people each year are seriously injured. A spokesman for a Health and Safety Agency said ‘The problem is people just don’t understand how dangerous these bikes are. The message just hasn’t got across. Far too many people ride these bikes without helmets. This is so dangerous. These bikes also have limitations – they can’t go everywhere. We need to improve communications here and make sure everyone knows the dangers before they ever take off on one.’

Clearly, there must be some barriers to communication if fatalities are still occurring. One communication barrier might be that messages are unclear. Perhaps the instructions for using quad bikes are not adequately communicated or misunderstood. Another barrier is that instructions may be ignored. People listening to instructions may be poor listeners or uninterested in listening. There may also be a culture of poor communications on farms in New Zealand, however, this is only speculation since there is no information in the case to suggest this. Finally, perhaps the wrong medium is being used to communicate the dangers of quad bikes and other farm dangers. For example, are there clear warning signs on quad bikes that insist riders should wear helmets?

## ACTIVITY 2

## CASE STUDY: POOR COMMUNICATION

**1 ▶ Discuss the appropriateness of the method used by Hutchinson Ports Australia to communicate the information stated in the case.**

Most people would agree that the use of a text to inform workers that they are about to lose their jobs is highly inappropriate, due to the restrictions on how much can be written in this type of communication. Redundancy notices are highly sensitive messages and need to be communicated with care, which requires more than the 140-character limit of text messages. An employer might be better advised to use face-to-face communication, where a sensitive attitude can be used when giving the message. Alternatively, a formal written letter might be written to each individual, with plenty of notice before the end of the employment contract.

**2 ► Describe the possible impact on the business of this method of communication.**

The use of texting to sack employees is unprofessional and insensitive. It is likely to have a negative effect on Hutchinson Ports Australia. The sackings were reported in the media so this would have reflected badly on the company in the view of the general public. Such negative publicity could damage the image of the company and result in lost customers. Regular customers might want to distance themselves from a company engaging in such a practice. It is also possible that the motivation of the other workers would be negatively affected. They might fear for their jobs. Finally, in the case it says that industrial action was taken. There were protests and two physical barriers were put up. This would have affected Hutchinson's port operations and possibly caused some expensive disruption.

**MULTIPLE-CHOICE QUESTIONS**

1B, 2C, 3D, 4B

**CHAPTER REVIEW**

**CASE STUDY: MENDIS HOLDINGS**

**1 ► Describe what is meant by a barrier to communication.**

Communication is only effective if the receiver understands the message sent. Things that get in the way of good communication are called communication barriers.

**2 ► Suggest two examples of barriers to communication at Mendis Holdings.**

A number of communication barriers can be identified in the case of Mendis Holdings, including staff with poor communication skills, a long chain of command, poor office layout (partitions between workers – that is, physical barriers) and possibly a culture of poor communication in the whole organisation.

**3 ► Discuss how Mendis Holdings might improve the communications skills of its staff.**

If it is true, and staff at Mendis Holdings lack communication skills, then it is important to ensure that staff acquire the necessary skills as soon as possible. One way is to train staff in communication. For example, staff can be trained to improve verbal communication skills when dealing with customers on the telephone. This might prevent the apparent anger and rudeness that was detected by at least one client. Staff might be sent on specialised courses to improve their telephone manner.

Some complaints centred on the quality of report writing. Two clients mentioned that some of the reports it was receiving were too long and contained what they considered to be too much jargon. One way of removing the barriers created by poorly written communication is to provide standard company reports, which can be used by all staff. Templates for letters and reports to customers can be stored easily in IT systems. Generally, written communication should be 'short and simple' whenever possible and avoid the use of jargon; staff should be taught this skill. Finally, in the future, Mendis Holdings should also ensure that it recruits staff with good communication skills.

**4 ► Assess the measures Mendis Holdings might take to improve the communications culture at the business. Make a clear judgement in your evaluation.**

In addition to the specific communication problems already mentioned at Mendis Holdings, it is also suggested in the case that the communications culture in the business is poor. A spokesperson for the employees said 'Communications problems here go much deeper than "wordy reports" and "edgy telephone conversations"'. The communication culture at the business is depressing. There is no formal upward communication channel, the chain of command is too long, the senior management team is secretive and fail to make their goals and plans clear and people are developing a silo mentality. The office layout does not help communication either – everyone works in their own little 'cubby hole.' This view does seem critical, and if true, will have a negative impact on the performance of the business. Consequently, measures need to be taken to improve the communications culture.

One immediate issue is the layout of the office. If people are working in 'cubby holes' the layout needs to be changed. The physical barriers between staff need to be removed so that people can see each other and work in a more open environment. This should help to improve internal communications.

Mendis Holdings might also need to introduce some formal communication systems. This is because there is no formal upward communication channel. It might mean, for example, that more meetings have to be held so that staff can express their views, ideas and concerns to senior managers in an open way. It might also be necessary to end the separation of workers according to job status and perhaps introduce an 'open door' policy where staff are encouraged to communicate with their seniors.

It might also be necessary to make the organisation flatter. It states in the case that the chain of command is too long. Therefore Mendis could remove some of the management levels in the organisation. A shorter chain of command means that information can pass through an organisation more quickly. Flatter organisations also lead to empowerment where employees take more responsibility for their own work. This can help to improve motivation. Finally, it is clear that workers are worried about the rumours of a merger and the possible loss of jobs. It is very important for the senior managers or the board to clarify the situation. The representative accuses them of being too secretive. A business must avoid withholding important information. Generally, Mendis Holdings will need to create a climate of openness and trust in order to improve the communications culture.

**CHAPTER 18**

**CASE STUDY: ANKARA HAULAGE COMPANY (AHC)**

**CASE STUDY: KARACHI COATINGS**

**1 ► What is the purpose of the Ankara Haulage Company advert?**

The main purpose of the advert shown here is to attract applications from HGV drivers for driving vacancies at Ankara Haulage Company.

**2 ► What sort of person is the business trying to attract?**

Ankara Haulage Company is trying to attract experienced Class 1 HGV drivers. Drivers must be prepared to travel overseas, work weekends (1 in every 3), stay out 3 nights in 5. The company would also prefer drivers who can speak some English and have some forklift truck driving experience.

**3 ► How much pay is the company offering successful applicants?**

The Ankara Haulage Company is paying TRY 500 per week with an extra TRY 30 a night for staying out overnight.

**4 ► How does Karachi Coatings recruit many of its managers?**

Karachi Coatings recruits a lot of its managers internally. This means they try to promote people who already work at the company.

**5 ► Suggest two advantages of recruiting managers in this way.**

There are some advantages of recruiting people from within the business. For example, promoting from within is safer. The people who are appointed are known to the business. As Umar Iqbal, the human resources manager at Karachi Coatings, says 'We know what these people are like and what their potential is. They are proven workers. It is also cheaper and quicker to recruit in this way.'

**ACTIVITY 1****CASE STUDY: NUJUMBA CEMENT****1 ► Draw up a job description for the production worker jobs at Nujumba Cement.**

**Job Title:** Production Worker

**General role:** Work as a member of the production team.

**Responsibilities and duties:**

- Heavy manual work
- Handling heavy machinery
- Driving a fork lift truck
- Cleaning machinery and equipment
- Heavy lifting in a harsh working environment

**Pay:** Rs400 per hour

**Hours and conditions of work:**

- 40 hours per week
- 4 weeks holiday
- Free protective clothing
- Free lunches

**2 ► Discuss two reasons why a business draws up a job description.**

The main purpose of a job description is to show clearly what is expected of an employee. Extracts from it are likely to be used in a job advert. It might also be used during appraisal to see how well an employee has performed in relation to what was expected of them.

**ACTIVITY 2****CASE STUDY: PALLABI GARMENTS LTD****1 ► What are the advantages to the business of recruiting internally for the job of purchasing manager?**

In this case, the job of purchasing manager is being filled internally. The new purchasing manager will be recruited from the existing purchasing team. It is expected that three suitable people from the department will apply. The advantages of internal recruitment are that it is cheaper because it saves on advertising. Internal recruits are also familiar with company policy and working practices. In addition, staff may be more motivated if they know there is a chance of promotion. Finally, the ability, personality, attitude and potential of the person appointed will be more predictable. This reduces the risk of recruitment.

**During interviews at Pallabi Garments Ltd, open questions are used.**

**2 ► What is meant by an open question?**

An open question is one that requires an answer of more than just one word, such as yes or no. An example, might be 'Why have you applied for this particular job?'

**3 ► What is the main advantage of using open questions in interviews?**

Open questions encourage interviewees to talk more. This helps the interviewers to gather more information about the applicant. When an applicant opens up and talks in more detail, it is easier to assess their personality. It may also be possible to judge their attitudes, opinions and commitment.

**4 ► Discuss how the vacancies for the machinists might be advertised.**

The jobs for machinists could be advertised in a number of ways. They might be advertised by word-of-mouth. Current employees may tell their friends and relatives about the jobs. The jobs may also be advertised in a local newspaper or on the company website. Finally, Pallabi Garments Ltd may use an employment agency or rely on a list of past applications, which have been stored by the business. All of these methods are suitable for jobs like machinists.

**MULTIPLE-CHOICE QUESTIONS**

1C, 2B, 3B, 4B

**CHAPTER REVIEW****CASE STUDY: ONLINE JOB ADVERTISEMENT****1 ► What type of employment will be used to fill the vacancy advertised?**

The advert states that the job is full time. Therefore a full-time employee is sought.

- 2 ▶ Draw up a simple person specification for the job of sales and marketing director. (You do not need to show whether details are essential or desirable).**

Qualifications and Education	Degree in appropriate field
Experience	Minimum five years experience in similar role Has carried out competitor analysis Experienced in new business development Knows how to develop marketing plans
Communication skills	Strong presentation skills Monthly report writing skills Leadership skills
Other skills	Strong analytical skills Motivational skills Ability to chair meetings
Personal attributes	Ability to travel regularly and work in the UK Ability to develop a team

- 3 ▶ How might a business use a person specification?**

The main purpose of the person specification is to help with the shortlisting process. Applications that do not match the person specification can be left out of consideration. This might save a lot of time in the shortlisting process.

- 4 ▶ Suggest two important details that should be included in any job advertisement.**

Some of the important details likely to be included in a job advert are:

job title  
name and address of employer  
brief details of the job description  
skills, qualifications and work experience required for the job

**Applicants for the job shown have to apply with a CV.**

- 5 ▶ What is meant by a CV?**

CV stands for curriculum vitae. It is used by jobseekers to apply for jobs when an application form is not provided. It contains personal details, qualifications, experience, names of referees, hobbies and reasons why they are suitable for the job.

- 6 ▶ Assess whether the business was right to recruit externally for this post.**

External recruitment is when a business recruits new employees from outside the business. There are some advantages of external recruitment. For example, a business will have a much larger pool of potential employees to choose from when attracting a new employee from outside the business. In this case, the job has been advertised on the Internet. People all over the country, or

even overseas, may apply for the job. A new person may be very talented and have some fresh ideas that could help the business become more competitive. However, external recruitment is more expensive than internal recruitment and there is an element of risk because the new employee is unknown to the business. In this case, the job is quite a senior position. It is probably wise to recruit externally to get the best possible person for the job.

## CHAPTER 19

### CASE STUDY: AGE DISCRIMINATION IN A RESTAURANT

- 1 ▶ How does this case illustrate the need for protection at work?**

In this case an employer has mistreated an employee. Without legal protection, a larger number of employees might be subject to exploitation, abuse, discrimination or ill treatment.

- 2 ▶ What do you think is meant by age discrimination?**

Age discrimination occurs when a business makes a specific decision on grounds of age. In this case, an employee, despite having a perfectly good employment record, was told on his 65th birthday that he would no longer be allowed to work full time. He was also told, after returning from long-term leave in 2011, that the company did not employ people over the age of 65. However, he was offered a part-time post. This is an example of age discrimination.

- 3 ▶ How might laws aimed at preventing age discrimination affect a business?**

To start with, if a business does not follow legislation they can be fined. It will cost them money. In this case, two Thai restaurants near Brisbane, Australia, were fined around AS\$30 000 for their treatment of an employee. Laws preventing age discrimination will also mean that businesses must take measures to ensure that they do not break the law. For example, they would have to take care with job adverts to ensure that they do not exclude applicants on grounds of age.

## ACTIVITY 1

### CASE STUDY: WORKPLACE DISCRIMINATION

- 1 ▶ What is meant by racial discrimination?**

Racial discrimination occurs when a business makes a decision on the grounds of a person's colour, race, ethnic origin, religion or nationality. Such discrimination is illegal in most countries around the world. Businesses should not show preference to any particular race, colour, nationality, ethnic origin or religion when offering a promotion, for example.

- 2 ▶ Describe the possible evidence that suggests racial discrimination has taken place in this case.**

In this case, co-owners of Khaira Enterprises Ltd, illegally discriminated against 55 African tree planters at a work camp in Golden, Canada. The 55 workers, who originated from Democratic Republic of Congo, Burundi, Guinea and Rwanda, were treated extremely poorly compared to

their non-African colleagues. For example, the bathroom facilities at the campsite were terrible. One worker as similar to those on ships transporting slaves described the conditions. Toilet paper was not provided and most of the 55 workers were subjected to racial insults. There was also evidence that wages were not given to the African workers while South Asian and Caucasian white workers were paid in full. There is clear evidence of racial discrimination here, as the court found.

**3 ▶ How does this case illustrate the protection given by the law against discrimination?**

Without legal protection, the 55 African workers in this case may not have received any payment. The BC Human Rights Tribunal in Canada found that the co-owners of Khaira Enterprises Ltd illegally discriminated against a group of workers on the grounds of race or colour. As a result, the owners were ordered to pay each of the employees US\$10 000 plus US\$1000 for every month that they had worked at Khaira. The total payment came to around US\$600 000. Therefore as a result of the law the African workers eventually received some money. The ruling and fine might also serve as a warning to any other businesses in Canada that they will be punished if found to be discriminating on the grounds of race, religion, colour, nationality or ethnic origin.

**4 ▶ Design a poster that could be used in the workplace to warn employees that racial discrimination is forbidden.**

## ACTIVITY 2

### CASE STUDY: DISABILITY DISCRIMINATION

**1 ▶ How was the employee in this case a victim of disability discrimination?**

In this case, Starbucks was found guilty of disability discrimination. Starbucks accused one of their employees, Meseret Kumulchew, of falsifying documents. One of Meseret's duties during her shift was to record the temperature of fridges and water at specific times. However, she was accused of falsifying the documents after mistakenly entering wrong information. Meseret, who has dyslexia, said that she had always made it known to her employer that she had difficulties reading, writing and telling the time and had to be shown how to do tasks. Following the accusation made by Starbucks, Meseret was given a less important job at her branch and told to retrain. This was discriminatory action and left the employee feeling that she may kill herself.

**2 ▶ Describe the possible measures businesses like Starbucks might have to take to help avoid disability discrimination.**

Generally, employers are now obliged to make reasonable adjustments to the workplace to help accommodate disabled employees. For example, they may need to improve access to the workplace by widening doors and providing ramps for wheelchairs. They may need to permit disabled workers time to attend medical appointments such as physiotherapy sessions. They may also need to alter equipment such as telephones and computers (software and hardware) to accommodate those with sight or hearing

difficulties and allow more time for training.

In this case, Starbucks had not made reasonable adjustments for Meseret's disability, and had discriminated against her because of the effects of her dyslexia, according to the tribunal. However, after the incident Starbucks said they were having discussions with Meseret about making adjustments to help her cope. Starbucks also made a statement which said the company was committed to having a 'diverse and inclusive workforce' that make people 'feel welcome and comfortable in our stores'.

### MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: GENDER DISCRIMINATION AND THE MINIMUM WAGE

**1 ▶ What is meant by the term equal opportunities?**

Equal opportunities are where everyone has the same chance. In business, it may mean, for example, that everyone has the same chance of selection or promotion. People should also get the same pay rates whether they are male or female providing they are doing the same job.

**2 ▶ Discuss two measures a business might have to take to ensure that gender discrimination is avoided in the workplace.**

Legislation designed to prevent gender discrimination is likely to have an impact on businesses. For example, advertisements for jobs must not specify a particular gender. A business is not allowed to target job adverts at either a man or a woman. Both genders must have an equal opportunity in appointments. Secondly, references to work titles in job adverts must be genderless. For example, a business could not advertise for a 'policeman' or a 'salesman' – the job titles must be 'police officer' or 'salesperson'. Businesses should also avoid promoting people in the workplace on grounds of gender.

**3 ▶ Assess whether discrimination is the reason for so few women sitting on the board of directors at top companies.**

Some statistics relating to women at work suggest some serious imbalances. For example, in the UK, despite the Equal Pay Act 1970, there is an 18 per cent pay difference between men and women. Women are also more likely to be employed in low paid jobs and less than 10 per cent of executive directors at the top FTSE 100 companies are female.

The cause of these gender imbalances may be partly or entirely due to discrimination. However, other reasons may also explain the gender 'gaps'. For example, one of the reasons why there are so few women on the board of directors is because the number of women available to take up such posts is very small. Another reason is that women at the level below the board may not be as well-connected as men at this level, possibly because talented females tend to stay with the same employer for longer. Consequently, they do not get the chance to meet as many different business professionals. Also, once women leave

corporate life to have children, they are sometimes not readily welcomed back. Plus, many of the very talented women become disappointed with companies and prefer to start their own businesses. Finally, it may be that male dominated boards prefer to recruit men like themselves for image reasons.

Unfortunately it may be that gender discrimination is difficult to prove, or perhaps much discrimination goes unreported. The extent of the gender imbalances in many countries does suggest that governments should be concerned.

**A business pays 1340 of its employees US\$9 per hour. Each of these employees works 40 hours per week and is paid for 52 weeks of the year.**

**4 ▶ Work out the financial impact on the business if the government introduces a minimum wage of US\$14 per hour.**

Before the minimum wage the annual wage bill would have been:

$$\text{US\$}9 \times 1340 \times 40 \times 52 = \text{US\$}25\,084\,800$$

After the introduction of the minimum wage the annual wage bill would be:

$$\text{US\$}14 \times 1340 \times 40 \times 52 = \text{US\$}39\,020\,800$$

This represents an increase of **US\$13 936 000**

**5 ▶ Assess the likely impact on businesses, such as the case in 4, of the introduction of a minimum wage.**

One reason why governments introduce minimum wage laws is to help low paid and disadvantaged workers. It is argued that people such as women, ethnic minorities and low-income families benefit from minimum wages. For example, it is estimated that if the UK introduces a mandatory living wage (very similar to a minimum wage) female workers will benefit more. This is shown in Figure 19.2 where the impact of new minimum wage (the living wage) is expected to benefit both full-time and part-time female employees more than men.

In many countries, minimum wages are often part of a broad strategy to end poverty. In the USA, increasing numbers of poor families have to rely on their earnings from low-paying jobs. Therefore, a minimum wage increase will help reduce poverty. The minimum wage raises the wages of low-income workers in general, not just those below the official poverty line. Many families move in and out of poverty, and therefore near-poor families will also benefit.

An increase in the minimum wage, or the introduction of a new minimum wage, is likely to raise the annual wage bill for a business. In this case, the business is paying its workers US\$9 per hour before the introduction of the minimum wage. The wage rate rises to US\$14 per hour when the minimum wage law is introduced. As a result the annual wage bill rises from US\$25 084 800 to US\$39 020 800 – this represents an increase of US\$13 936 000. This is a significant increase – more than 50 per cent. This could have very negative effects on the finances of the business. The business may have to lay off workers if it cannot afford to pay the higher hourly rate. Alternatively, the business may have to take a cut in profit.

However, there may be some benefits to businesses of a minimum wage. People on low pay may be better motivated and more productive when they receive a pay rise resulting from the introduction of a minimum wage. Low wage earners across the nation will have more disposable income so demand for many goods and services will rise. This will help drive up sales and profits for some businesses. Finally, businesses may experience lower levels of staff absence and better reliability. This might be because low paid workers, who often have to have more than one job to survive, will be more committed to a single employer.

To conclude, in this case the new minimum wage is considerably higher than the current wage being paid. As a result the business might be negatively affected – it will depend on the profitability of the business.

## CHAPTER 20

### CASE STUDY: ALBERTA FARMING CORPORATION (AFC)

**1 ▶ Work out the average annual fatality rate in agriculture in Canada between 2005 and 2014.**

$$\text{Average} = \text{total fatalities} \div \text{number of years} = 177 \div 10 = \mathbf{17.7 \text{ fatalities per year}}$$

**2 ▶ Why is training in health and safety is so important to AFC?**

Training in health and safety is important in most occupations. However, in agriculture it is very important. This is because farms are dangerous environments for workers. The graph in Figure 20.1 shows that an average of 17.7 workers are killed on farms every year. Of these 70.9 per cent of these fatalities result from the use of farm machinery. If the lives of workers are at risk, then training in health and safety must be very important.

**3 ▶ Suggest three other reasons for training at AFC.**

Other reasons for training at AFC include:

- learning how to operate the different machines on the farm so that workers can operate them effectively and avoid causing damage to machines
- improving employee flexibility by training workers in a wide range of different jobs
- training people how to do their jobs properly so that workers are confident in themselves – this will improve motivation and productivity
- keeping workers up to date with new developments and new machinery.

**4 ▶ Carry out some research (online if possible) to see what training is offered by some large businesses in your area. Try to decide which business offers the best 'training package'.**

### ACTIVITY 1

#### CASE STUDY: GOOGLE

**1 ▶ What is the purpose of induction training?**

The main purpose of induction training is to help new recruits become more comfortable and familiar with their new surroundings.

**2 ▶ Describe what new recruits might learn during the induction programme at Google.**

During an induction programme, new recruits are likely to get a tour of the whole workplace, an introduction to senior staff, some health and safety training and learn about the company's history, aims and objectives. Recruits are also likely to learn about company policies such as dress code, disciplinary procedures and holidays. They will also get an introduction to the new job and meet their work colleagues. New software engineers at Google are called Nooglers. They attend an induction programme designed to introduce new recruits to the 'Google Way'. The programme starts with a series of lectures and presentations about things like Google's culture, mission and products.

On the second day, Nooglers get involved in technical exercises designed to teach recruits about developing at Google. Google uses training tutorials called Codelabs. These teach recruits about internal technologies that help employees do their jobs. Examples include Bigtable, Megastore, Protocol Buffers and Unit Testing. These tutorials last for about a week and this is how recruits start to learn about their new job.

**3 ▶ Discuss why induction training is so important to businesses like Google.**

If businesses fail to provide adequate induction training, staff may feel anxious. This might lead to poor productivity, and at worst, staff may leave because they have not settled. At Google, induction is important because recruits have to understand the 'Google way'. Most of the information given out is highly confidential and the importance of secrecy and sensitive treatment of information is emphasised. The importance of change is also a priority at Google. All employees are expected to be excited by change since much of their work is involved in future technology and new products. Most of the lectures and presentations for Nooglers are given by senior staff at Google. This suggests that Google attaches a great deal of importance to induction.

## ACTIVITY 2

### CASE STUDY: EMIRATES

**1 ▶ What is meant by the term off-the-job training?**

Off-the-job training is training that takes place away from the work area. In the case of Emirates, all new cabin crew recruits get off-the-training in a special cabin crew training centre.

**2 ▶ Describe the method of training used at Emirates.**

New recruits at Emirates attend a seven-week initial training course. The training is given off-the-job in a specialised training centre. The course provides a mixture of both theoretical and practical elements. To make the practical training realistic, it takes place in machines that simulate the movement of all aircraft types. This helps to give new recruits a taste of the experience required to deliver the best possible customer service to passengers. The training course addresses a range of work related issues such as safety and emergency procedures, first aid, service, uniform, fitness and nutrition and security procedures.

**3 ▶ Discuss two benefits to Emirates of using off-the-job training.**

One of the main advantages of off-the-job training is that mistakes made by new and inexperienced recruits do not have any impact on the quality of the product. In this case, if one of the cabin crew trainees drops a service tray into a passenger's lap, there will be no impact on the airline. This is because there will be no 'real' passengers since the training takes place in simulators. This can help Emirates to maintain a high quality service.

Another benefit is that trainees can learn good practice and not be distracted from their training by the work itself. New recruits can focus on learning and not worry about whether their training work will impact on the airline. Trainees may be more relaxed and learn more quickly.

### MULTIPLE-CHOICE QUESTIONS

1C, 2A, 3C, 4D

## CHAPTER REVIEW

### CASE STUDY: PESHAWAR PRINTWORKS

**1 ▶ Why is training needed at Peshawar Printworks?**

Training is needed at Peshawar Printworks because some new technology has been introduced. There have been some problems and the production manager thinks they can be overcome with proper training. Without training, the new system will take up to six more months before it is up and running.

**2 ▶ Discuss two reasons why businesses like Peshawar Printworks may be reluctant to spend on training.**

Training is often very expensive. As a result, some businesses are unwilling to invest in training. In this case, the CEO of Peshawar Printworks seems unwilling to invest in training – one of the main reasons is the cost. The CEO complains that the amount needed by the production manager, US\$120 000, is double the annual training budget for the entire company. Another reason that explains the unwillingness is that when workers leave, the training has been wasted. The CEO says 'I know that training is necessary but it's so expensive. Plus, what happens when the trained workers leave and go and work for someone else?' However, the production manager points out that Peshawar Printworks often employ workers that have been trained elsewhere. Finally, it appears from what the CEO says that he does not value all types of training. For example, he refers to off-the-job training as 'training holidays'. This may be another reason for not wanting to meet the high cost of training.

**3 ▶ What are the advantages of on-the-job training to Peshawar Printworks? Discuss two advantages in your analysis.**

On-the-job training means that workers are trained in the workplace while the job is being done. One of the main advantages of this is that output is being produced. Although the productivity of a worker may be low while being trained, at least it is positive and the trainee is making a contribution to output. In this case, if training is given on-the-job at least some printed materials will be produced that can be sold to help generate revenue.

The training received on-the-job is also relevant. This is because it is directly connected to the job. There is no simulation. In this case, workers will be trained on the new digital technology that is actually installed at the print works. On-the-job training is also generally cheaper and easier to organise than off-the-job training.

#### 4 ▶ Assess the benefits of training to Peshawar Printworks.

Training has a number of important benefits to businesses like Peshawar Printworks. The main reason for training is to provide workers with the skills and knowledge needed to do their jobs effectively. As a result, their motivation and productivity should increase. However, there are some other specific benefits. Workers will need training if there are changes that might affect their jobs. In this case, some new digital technology has been introduced and employees need more training so that they can operate the new technology. Training might also make a business more flexible. In this case, Kamran informs the CEO that if all 30 staff are trained the workforce is more flexible and the company will not have to spend on training again for quite a while. Peshawar might also benefit from investment in training if workers feel more secure and can do their job effectively. Not being able to do a job properly will be a source of frustration and dissatisfaction for workers. It is also argued that training can be used to motivate staff. Finally, training is usually needed when workers are promoted. At each stage of the promotion process, staff will need to learn new skills and methods; this allows them to handle the different duties and new responsibilities.

However, training does have some limitations. For example, training can be very expensive. Businesses will have to pay training providers if they use external training. Even internal training can be expensive if specialist training staff and equipment is needed. In this case, the CEO is worried about the cost. Some businesses might argue that training is limited because workers do not really start learning how to do the job until they actually arrive at their workstations. In some jobs, the actual work environment, with all its stresses and distractions, cannot be easily simulated. Also, if workers are involved in off-the-job training they will not be producing anything. This will result in lower output levels. The CEO in this case is against off-the-job training, which he regards as a 'training holiday'. Finally, businesses are likely to get very frustrated if employees leave and join a rival company after they have invested in training them. The CEO makes this point but Kamran says '... we often get workers that have been trained elsewhere'.

To conclude, training is felt necessary at Peshawar Printworks because the CEO has offered US\$60 000 to cover the cost of extra training. Clearly, the CEO believes that the benefits of training are greater than the costs and limitations.

- She never really wanted to work in banking – she wanted to go to medical school.
- She is being paid less than one of her close colleagues.
- She may be less driven than other people.

(NB. Other answers may be appropriate.)

#### 2 ▶ Why is motivation important to businesses?

If workers are motivated, they likely to be more productive, they will be committed and work harder. For example, Anju is well motivated. She is always on time, reliable, enjoys solving problems and often gives up her own time to help new recruits. Businesses will benefit from having a well-motivated workforce. It will be easier to attract and retain staff and profits should be higher.

#### 3 ▶ In pairs, discuss whether you are a well-motivated individual. Provide a list of evidence to support your view.

### ACTIVITY 1

#### CASE STUDY: ANDRIS ZJUZINS

##### 1 ▶ What is meant by a well-motivated employee?

Motivation is the desire to achieve a goal. If employees are well motivated, they will be driven and have the desire to reach aims that have been set by employers. They will be productive and committed to the business.

##### 2 ▶ What evidence in Figure 21.1 suggests that workers were poorly motivated?

The information in the bar charts shows that worker motivation at Andris Zjuzins was falling between 2010 and 2015. For example, staff turnover rose from 28 per cent to 33 per cent and the rate of staff absence rose from 6.7 per cent to 7.4 per cent. At the same time productivity at the business fell from 1230 to 1200 units per worker. In 2014 and 2015, after the factory had been re-equipped, worker motivation seemed to improve. For example, labour productivity rose to 1530 units per worker.

##### 3 ▶ Describe the possible effect on the working environment if workers are not motivated.

If workers are poorly motivated the working environment and atmosphere is likely to be unpleasant. Workers are less likely to be cheerful, polite, supportive and positive. This can be quite important because many workers have to deal with customers. A business may lose customers if the attitudes of poorly motivated workers create a negative impression. In this case, it has been difficult for Andris Zjuzins to attract and retain staff. This may be because the working environment is being negatively affected by low morale and poor motivation.

### ACTIVITY 2

#### CASE STUDY: INCHCAPE

##### 1 ▶ What is meant by hygiene factors in Herzberg's two-factor theory?

Frederick Herzberg said that certain factors could leave workers dissatisfied. He called these hygiene factors and explained that if things like pay, working conditions and job security were insufficient then employees would be dissatisfied which would lead to poor motivation.

## CHAPTER 21

#### CASE STUDY: ANJU SHARMA AND JAYA DHAR

##### 1 ▶ Suggest two possible reasons why Jaya is poorly motivated.

Jaya may be poorly motivated for a number of reasons.

- She may find the work boring, unfulfilling or insufficiently challenging.

**2 ► Describe some examples of Herzberg's hygiene factors offered by Inchcape.**

Inchcape appears to provide its employees with a wide range of benefits. Some examples include holiday benefits (where staff get more holidays the longer they work at the company) and a save as you earn scheme (where staff can buy discounted company shares). Other benefits include a customer introduction award, an advantage scheme and childcare vouchers. These are all examples of hygiene factors. According to Herzberg, these alone will not serve to motivate staff.

**3 ► Assess whether Inchcape manages to meet the social needs of staff, as described by Maslow.**

Maslow pointed out that people are social animals and need affection, trust, acceptance and to be cared for. They also want to belong to a recognised group. Employers can help to meet these needs by providing opportunities for staff to communicate with colleagues and work in teams. Businesses could also provide staff with social facilities such as a staff canteen.

In this case Inchcape's employees get involved in charity events where groups can interact socially.

For example, one employee, Rachael Mullard, said 'The charity work is lovely. Last year we did the Three Peaks Challenge. It's a change and nice to know you are doing something good. We were in a minibus for three days with the general manager, bundled up, freezing cold, aching and stinking, but we felt the love.'

**MULTIPLE-CHOICE QUESTIONS**

1C, 2B, 3A, 4D

**CHAPTER REVIEW**

**CASE STUDY: CHESS**

**1 ► Why do people need to work?**

People go to work because it provides the means to satisfy many human needs. For example, the main reason why people go to work is to earn money to pay for food, drink, clothes and shelter. However, work can meet other needs because employers provide opportunities for workers to meet new people, develop skills and reach their full potential. Without work most people would feel aimless, bored, dissatisfied, unfulfilled and lonely.

**2 ► Discuss two reasons why staff motivation is important to businesses such as Chess.**

If a business has a well-motivated workforce, it will perform better. People will be happier in the workplace, the working environment will be more agreeable and labour productivity will be higher. Attracting staff will be easier if workers are better motivated. If a business can recruit highly capable and reliable workers, it might gain a competitive edge on its rivals. If employees are motivated, the working environment and atmosphere is likely to be pleasant. Workers are more likely to be cheerful, polite, supportive and positive. This is important when interviewees are being shown around the work environment. Good candidates will be more likely to accept the job if they are impressed with what they see and feel about the workplace. A business might also develop a

good reputation for employing a happy and well-motivated workforce. Chess has done this by winning an award for the Best Employer in Cheshire. This will encourage people to apply for jobs in the first place. It might also attract good employees from rivals.

Well-motivated employees will work harder. They are likely to take more pride in their work, complete tasks quickly and feel that their jobs are important. As a result, they will produce higher levels of output. Businesses also need workers to cooperate. For example, Chess organises employees into teams. Therefore, if workers do not cooperate with each other, teamwork will be disrupted. At worst, conflict might result if a team member is uncooperative. However, well-motivated employees are likely to be cooperative, so a good team spirit is likely to develop which will help to raise productivity. Certainly this is the case at Chess.

**3 ► Suggest two examples of Herzberg's motivational factors as used at Chess.**

Recognition is one motivational factor evident at Chess. Staff have a 'gimme 5 praise page' on a website which enables them to award each other virtual thanks. Employees are also encouraged to vote for each other to win employee of the month.

Personal development is another motivational factor. Chess invests in training for staff. For example, it launched a customer service academy for new recruits. It also delivered customer passion training that teaches Chess teams how to deal with different customer personality types.

**4 ► Assess whether Chess satisfies any of the employees' needs outlined by Maslow's hierarchy. Make a clear judgement in your evaluation.**

Maslow identified a hierarchy of needs. At the bottom are the physiological needs – these are basic human needs such as food, water and shelter. Businesses can satisfy these needs by providing workers with adequate pay. In this case, it can be assumed that Chess pays their workforce adequately. For example, only 12 per cent of workers left the company last year. This is a very low staff turnover rate.

The second level of needs identified by Maslow was safety and security – this means that people need protection from any form of danger and physical and psychological threats. Businesses can satisfy these needs by providing a safe working environment. In this case, Chess provides a very pleasant working environment. For example, it is well designed with plenty of space, light, plants and fish tanks.

The third level of needs in Maslow's hierarchy is social needs – this means that people are social animals and need love, affection, trust and acceptance. They also want to belong to a recognised group. Chess makes extensive use of teamwork. For example, it delivered customer passion training that teaches Chess teams how to deal with different customer personality types. Teamwork is important at Chess and in a staff survey 92 per cent of employees said that teammates were helpful. Also, Chess encourages its staff to interact socially. For example, the company's summer conference closed with a sociable evening out and last September Chess included employees' families and friends in festivals with a barbecue, bouncy castle and football-focused entertainment.

The next level of needs is esteem needs. This means that people need to be recognised and respected and their achievements praised. They also want self-respect and self-esteem. At Chess, staff have a 'gimme 5 praise page' on a website that enables them to award each other virtual thanks. Employees are also encouraged to vote for each other to win employee of the month. David Pollock also mentioned recognition in his statement at the awards night. He said 'It is with great pride that Chess has been named as Employer of the Year, we continually strive to create a happy working environment where everyone can progress their career, develop knowledge and skill, gain reward and recognition and maximise their potential.'

Finally, at the top of Maslow's hierarchy is self-actualisation – this means that people need to reach their full potential and feel some fulfilment in what they do. At Chess, there is evidence that suggests that workers feel some fulfilment. Employees attend monthly 'ideas lunches' where employees meet, chat, bond and eat together. They are encouraged to be creative and come up with ideas.

Generally, information in the case suggests that Chess makes every effort to meet the needs of employees. Evidence of this commitment is the awards won for Best Employer.

## CHAPTER 22

### CASE STUDY: GVS LIFE ASSURANCE

#### CASE STUDY: THE HERNING CARE HOME

- 1 ▶ Work out how much Nasir would earn if he sold 11 insurance policies during a month.**

Nasir would earn US\$2600 (that is,  $11 \times \text{US}\$200 + \text{US}\$400$ ).

- 2 ▶ Suggest one advantage and one disadvantage of the payment system used by GVS Life Assurance.**

Staff at GVS Life Assurance are likely to sell more policies with this system. This is because there is a significant financial incentive to sell. They get US\$200 for every policy sold. This should mean that sales of policies will be high and the company only incurs labour costs if a sale is made (apart from the low basic salary of US\$400). However, some staff are not happy with the system. They lack the charm and selling skills possessed by Nasir and are often under a great deal of stress trying to earn a living. This might result in a high labour turnover for the company. This means GVS might have to spend a lot of time and money recruiting new staff.

- 3 ▶ Describe the method used to motivate Johanna at the Herning Care Home.**

The Herning Care Home is trying to make Johanna's job more interesting to improve her motivation. Johanna was bored and unfulfilled in her managerial post and was thinking about leaving. However, her employers decided to make her job more interesting and challenging. She was asked to organise monthly meetings with other care home managers in the group and report back to the senior management team. She was also asked to design a formal induction programme for new recruits and represent the group at international care conferences. This is an example of job enrichment.

- 4 ▶ Describe one possible disadvantage of this method.**

One problem with this method of motivation is that Johanna might not have the skills to carry out the extra tasks and responsibilities. As a result, she might get frustrated which could have a negative impact on her performance. Another problem is that after she becomes familiar with these extra duties she may get bored again and want to leave.

- 5 ▶ In pairs, decide what would motivate you to work harder at school. Draw up a list of these things in order of priority.**

## ACTIVITY 1

### CASE STUDY: TOP RANK SERVICE CENTRE

**One of the mechanics worked 50 hours during a busy week in September.**

- 1 ▶ Work out the gross pay earned by this mechanic.**

Gross pay =  $\text{US}\$20 \times 35 + \text{US}\$30 \times 15 = \text{US}\$700 + \text{US}\$450 = \text{US}\$1150$

- 2 ▶ What is meant by the term salary?**

Some employees are paid a salary, which is expressed in annual terms and paid monthly. Salaries are usually paid to *non-manual* workers. Salaried workers are not always paid overtime. In this case, the manager of the Top Rank Service centre is paid an annual salary of US\$62 000.

- 3 ▶ Describe one possible reason why the Top Rank Service Centre chooses not to use piece rates as a method of remuneration.**

Some workers are paid according to how much they produce. This system is called piece rate. This system helps to motivate workers and businesses are likely to 'get more' out of their employees. However, one problem with piece rates is that they are not suitable if work cannot be measured. In this case, it may be difficult to measure the work done in standard units. This is because many of the tasks completed by mechanics may be different. For example, one mechanic may spend time carrying out a routine service while another might be fitting a new engine. These tasks are different and cannot be easily compared or measured. Therefore piece rates would probably not work in this business.

## ACTIVITY 2

### CASE STUDY: TATA STEEL

- 1 ▶ What is meant by the term job rotation?**

Job rotation involves training employees in a range of different tasks and then switching them from one task to another over a period of time – perhaps a day or a week.

- 2 ▶ Discuss one possible advantage of job rotation to a Tata Steel and b its employees.**

Tata Steel will benefit from job rotation because workers will be better motivated. They are less likely to get bored and therefore they will be more productive. This will help produce more output leading to more revenue and higher profit.

Employees will also benefit from job rotation. They will learn a much wider range of skills, for example. This might make them more fulfilled and perhaps help them develop a desirable career path.

### MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4C

## CHAPTER REVIEW

### CASE STUDY: SANTIAGO DISEÑO

#### 1 ► What is meant by the term bonus?

Bonuses are paid in addition to the basic wage or salary. They are usually paid if targets are met. In this case, staff at Santiago Diseño received a bonus if they met a design brief within an agreed time limit.

#### 2 ► How might bonus payments benefit Santiago Diseño?

Bonus payments are only given out if targets are met. In this case, employees in a team were only paid a bonus if they managed to complete a design brief in an agreed amount of time. This means that bonus payments are linked to employee performance. If teams take too long to meet a design brief then they lose out on the bonus and the business does not incur any extra cost. Consequently, bonus payments at Santiago Diseño motivate employees to work quickly.

#### 3 ► Describe how giving workers more autonomy might motivate workers at Santiago Diseño.

Workers with autonomy are set a goal or task by management and then left to decide for themselves the best way to achieve the goal. This gives workers control and suggests that they can be trusted. In this case, workers were split into teams and each team was given a design brief to complete. Teams were responsible for carrying out their work in any way they chose. Their only aim was to meet the design briefs they were given. Each team was free to order resources, choose their own methods of work and communicate with clients directly. Autonomy can give employees more self-confidence and is a way of recognising their achievements. This should help to motivate workers.

#### 4 ► Discuss two benefits to Santiago Diseño of giving staff fringe benefits.

Some employees receive fringe benefits in addition to their normal pay. They are often described as the 'perks' of the job. Examples of fringe benefits used by Santiago Diseño include an attractive company pension scheme, a free canteen, a free bicycle to encourage employees to cycle to work and subsidised childcare. There are some good reasons for rewarding workers with fringe benefits. One benefit is that it may be cheaper to give employees US\$2000 of fringe benefits than US\$2000 in cash. Employees may also pay less tax if they take fringe benefits instead of cash. Another benefit is that productivity may improve because there is less staff absence. Many benefits provide protection and security for workers and their families. This might help to improve worker satisfaction, such as free private health insurance. Workers may be healthier due to private healthcare and using the company

gym or sports facilities. Finally, some benefits help to attract and retain better-qualified employees for a business. This was the aim of Santiago Diseño.

#### 5 ► Assess whether the use of non-financial methods of motivation such as autonomy were effective at Santiago Diseño. Make a clear judgement in your evaluation.

It was recommended to Santiago Diseño by a consultant that they use non-financial rewards to help motivate their staff. Businesses use non-financial rewards for a number of reasons. Some people are not motivated by money; some workers attach more importance to non-financial rewards and an increasing number of people work in teams where individual financial rewards are less appropriate. In this case, Santiago Diseño divided their designers into teams and gave each team complete autonomy.

Each team was responsible for carrying out their work in any way they chose. Their only aim was to meet the design briefs they were given. Teams were free to order resources, choose their individual approaches to providing design solutions and communicate with clients directly. After this reorganisation, and giving teams autonomy, the financial performance of the business improved significantly. Profits rose from US\$11.4 million to US\$23.1 million between 2012 and 2015. This suggests that giving staff autonomy had a huge impact on motivation.

However, it is also important to take into account the impact that fringe benefits had on performance when they were introduced. Since both changes took place at the same time, it is difficult to tell which had the biggest impact. However, one thing is certain, together they worked well to improve motivation if profitability is a guide to motivation levels.

## CHAPTER 23

### CASE STUDY: THE ZETA HOTEL

#### 1 ► Who is in control of the Zeta Hotel?

Anil Karmi is responsible for running the hotel. He is in control and accountable to an area manager.

#### 2 ► Describe briefly how the Zeta Hotel is organised.

Staff at the Zeta Hotel are divided into five different departments. These are front of house, reservations and marketing, housekeeping, the kitchen and the restaurant. Each department has a leader who is accountable to Anil Karmi, the general manager.

#### 3 ► What is Kajal's role in the organisation?

Kajal Verma is head of the reservations and marketing department. He must ensure that all rooms in the hotel are sold out each night at the best possible price. He is responsible for nine other people employed in the department which maintains the hotel's website and promotes the hotel.

#### 4 ► To whom is a Basanta b Pradeep accountable?

- a Basanta is accountable to Aarif Vesawkar, the executive chef.
- b Pradeep is accountable to Anil Karmi, the general manager.

## ACTIVITY 1

## CASE STUDY: YU XIAOTING MOTORS

## 1 ► Name two examples of operatives at Yu Xiaoting Motors.

According to the organisation chart, the machinists and technicians are examples of operatives at Yu Xiaoting Motors.

## 2 ► What is meant by the terms a formal organisation b hierarchy?

a When businesses grow, tasks such as planning, decision making, coordination and communication are easier if people are organised into a structure made up of several different departments. This internal structure is known as the formal organisation of a business. It can be represented by an organisation chart. In this case, an organisation chart is shown for the production department at Yu Xiaoting Motors. It shows how staff in the department are formally organised. For example, it shows that the 40 machinists on Line A are accountable to the four supervisors on that line.

b Many organisational structures are hierarchical. This means that there are different layers of responsibility in an organisation. The lowest is usually at the bottom and the highest at the top. For example, in Yu Xiaoting Motors, the chairperson, who has the most responsibility, is at the top of the hierarchy. Those at the bottom include machinists, packers and cleaners, who have very little responsibility.

## 3 ► Describe the roles of a the production director b line supervisors at Yu Xiaoting Motors.

a Directors are members of the senior management team and appointed by the owners to run the business. The production director of Yu Xiaoting Motors is responsible for the whole of the production department and will work closely with the production manager. The production director will attend board meetings with the chairperson and other directors to plan the direction of Yu Xiaoting Motors.

b Supervisors monitor and regulate the work in their area. They have authority over operatives and general workers. At Yu Xiaoting Motors there are eight supervisors according to the organisation chart. For example, four supervisors are employed on line A. They are responsible for the work of 40 machinists on the line.

## ACTIVITY 2

## CASE STUDY: MPHASIS

## 1 ► What is meant by the term decentralisation?

Decentralisation is a type of organisation system where decision making is pushed down the chain of command and away from the top. At Mphasis, the plan was to allow 17 executives in a management layer lower down in the hierarchy to make decisions without approval from a higher level.

## 2 ► Discuss a one benefit and b one disadvantage of decentralisation to Mphasis.

a One of the main benefits of decentralisation is that it speeds up the decision-making process. This is

because people can make decisions further down the chain of command without seeking approval from those higher up. Seeking approval whenever a decision has to be made can be very time consuming and result in inefficiency. Also, decisions relating to customer service can be made onsite, which means that customers should get a better service.

b One possible drawback of decentralisation to Mphasis is that senior managers lose some of their control. For example, they may lose control of some resources used by the business. In this case, a decision made by a junior executive onsite might involve using up some money to help meet a customer need. Senior managers would no longer be able to prevent this since the decision to spend more has been passed down the hierarchy.

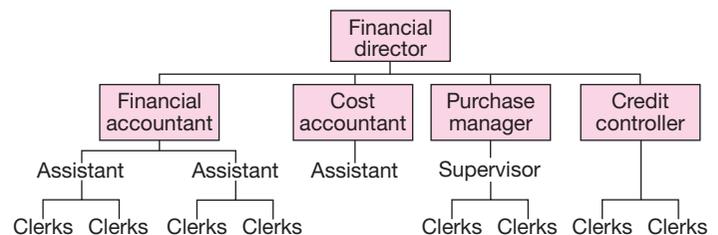
## MULTIPLE-CHOICE QUESTIONS

1C, 2A, 3B, 4D

## CHAPTER REVIEW

## CASE STUDY: TAUKIR MEDICAL SUPPLIES

## 1 ► Draw an organisational chart for the finance department at Taukir Medical Supplies.



## 2 ► What is the span of control for a the credit controller b the cost accountant?

- a The span of control for the credit controller is two.  
b The span of control for the cost accountant is just one.

## 3 ► What is meant by the chain of command? Use this case study as an example.

Organisation charts show the chain of command in a business. This is the path through which orders are passed down in the hierarchy. Orders will pass down through the layers from the top to the bottom. For example, in this case, an order would pass from the chairman, to the finance director, to the purchasing manager, on to the supervisor and finally to the clerk. This is the chain of command.

## The financial accountant often delegates work to the assistant accountants.

## 4 ► What is meant by delegation?

In some situations, it is appropriate for a manager, such as the financial accountant in this case, to hand a task to a subordinate; this is called delegation. Although the assistant accountant will be carrying out the task, the manager will still have responsibility. However, the accountant's time can be saved if a subordinate completes the task. Some workers might enjoy carrying out delegated tasks. They might think that more trust is being placed in them. However, others think that managers are just avoiding work.

The HR manager has suggested to the board that **Taukir Medical Supplies** would benefit from having a flatter organisation structure.

- 5 ▶ Discuss the benefits of a flatter organisation structure. Give at least two benefits in your analysis.

With a flatter organisational structure there will be fewer layers in the hierarchy. One of the benefits of this is that there will be fewer managers and therefore money will be saved. Managers often command higher salaries than non-managerial employees so the savings could be quite significant. The money saved might be spent on something more productive in the business – product development, for example.

Another benefit of a flatter structure is that communication in the organisation might be improved. This is because the chain of command is shorter and there is less distance for messages to travel. This might encourage more communication, particularly from the bottom up. It might also speed up communications since there will be fewer layers of management for messages to pass through. This might allow a business to serve its customers more easily. For example, a request from a customer for a special delivery might be granted more quickly if approval is faster to obtain.

## CHAPTER 24

### CASE STUDY: ZUZZY SOLUTIONS

- 1 ▶ Describe the role of the human resources department at Zuzzy Solutions.

The human resources department is responsible for the welfare of employees in a business. It has a wide range of duties and responsibilities. For example, at Zuzzy Solutions, Patricia Renard is head of the human resources department. Her job is to supervise the recruitment and selection process and ensure that employees' welfare needs are met. She also meets with other heads of department on a regular basis and is responsible for the six staff who work in her department. Another employee, Andre Duval, also works in the human resources department. Examples of the tasks carried out by Andre include organising and delivering induction training, helping Patricia with interviews and selection, dealing with staff grievances and communicating with trade unions.

- 2 ▶ Discuss in groups why it might be an advantage to divide a business like Zuzzy Solutions up into different departments. Produce a poster showing your ideas and present them to the rest of the class.

### ACTIVITY 1

#### CASE STUDY: MARKETING AND PR

- 1 ▶ Describe two other activities that might be carried out in the marketing department.

Other activities that might be carried out in the marketing department include market research, advertising, sales promotion, product planning, public relations, packaging design, distribution and sales.

Marketing departments play an increasingly important role in businesses today.

- 2 ▶ What might have caused this development?

Marketing departments are becoming more important because of changes in the approach made by businesses. Firms are now more market orientated. This means that they focus sharply on the changing needs and wants of customers. Much of marketing is about identifying these needs and satisfying them. Consequently, marketing departments are important.

- 3 ▶ Describe Monica's role in the marketing department.

Monica has quite a specialised job in the marketing department at her company. She is responsible for PR. This involves dealing with the media by answering questions and providing a range of company information. She might also organise company presentations to shareholders, potential investors and customers.

Monica is also employed to negotiate sponsorship deals on behalf of the company. For example, she recently negotiated a contract for her company to sponsor a national football competition in Brazil.

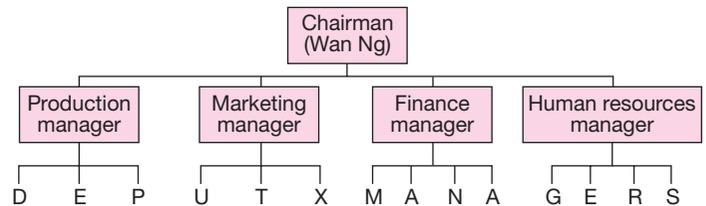
### MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4C

## CHAPTER REVIEW

### CASE STUDY: JAKAC

- 1 ▶ Draw a simple organisation chart for the management team at JakAC.



- 2 ▶ Which departments at JakAC would be responsible for the following activities?

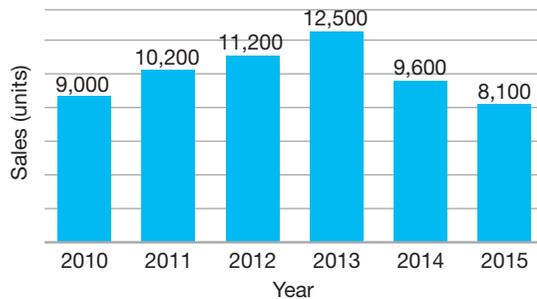
- Chasing customers for late payment.
- Dealing with the dismissal of an employee with a very poor attendance record.
- Using social media to get customer feedback on a new maintenance service.
- Setting output targets for production lines.

- Finance – Chasing customers for late payment.
- Human resources – Dealing with the dismissal of an employee with a very poor attendance record.
- Marketing – Using social media to get customer feedback.
- Production – Setting output targets for production lines.

- 3 ▶ How might the marketing department find out the reasons for the trend in sales of AC Power?

The graph in Figure 24.2 shows that sales of AC Power fell quite sharply in 2014. This fall continued into 2015 and

came after a steady growth in sales for four years. It is important to find out reasons why sales have fallen. One approach that the marketing department might take is to carry out some market research. They might interview customers who have suddenly stopped buying the product. The department could use telephone surveys, for example, to gather information from customers. They might also use social media to get up-to-date information from customers. They may be able to engage them in conversations. Possible reasons why demand has fallen might be because the price is too high, a new competitor has entered the market or the quality of the product has deteriorated.



**4 ▶ Discuss two possible functions of the JakAC production department in addition to making AC units.**

In addition to making air conditioning units, production activities at JakAC might include research and development. This involves the investigation and discovery of new ideas for materials, processes and products. In many industries, research and development is important because new technologies can arrive on the scene very quickly. For example, JakAC might try to develop AC units that use less energy to help reduce global warming.

Another production activity at JakAC is likely to be purchasing. This involves buying in all the resources such as raw materials, components, energy, tools, equipment and packaging that are needed by the business.

**5 ▶ Discuss the importance of interdependence between departments in a business. Use examples from this case study in your analysis.**

There appears to have been a breakdown in communication between the production department and the finance department at JakAC. This is because the production department is overspending on its labour budget. The production department argues that more skilled labour is needed to maintain quality. However, the finance department argues that expenditure budgets should not be exceeded. This breakdown in communication is having a negative effect on the business because the production department has not provided some important data needed for a financial report. Sales of a leading product are also falling – there may be a link between poor communications in the business and the drop in sales of AC Power (although there is nothing in the case information to suggest there is). Conflict between the different departments in a business will generally have a negative impact on the company's overall performance.

## CHAPTER 25

### CASE STUDY: MAURICE OBUYA

#### CASE STUDY: TRIBAL GROUP

**1 ▶ What are the sources of finance used by a Maurice Obuya and b Tribal Group?**

Maurice used two sources of finance to set up his airport taxi service. He used a bank loan to raise KES 2 million and he also used KES 2 million of his own savings.

Tribal Group raised money by selling some shares to existing shareholders and by selling part of their business, Synergy, to another company called Servelec Group.

**2 ▶ Work out the monthly instalment Maurice would have to make in order to repay the five-year bank loan (including interest).**

Calculate the monthly instalments Maurice would have to make in order to repay the five-year bank loan.

$$\begin{aligned} \text{Interest on the loan} &= \text{KES } 2\,000\,000 \times 8 \text{ per cent} \times 5 \\ &= \text{KES } 800\,000 \end{aligned}$$

$$\begin{aligned} \text{Total amount to be repaid} &= \text{KES } 2\,000\,000 + \text{KES } 800\,000 \\ &= \text{KES } 2\,800\,000 \end{aligned}$$

$$\begin{aligned} \text{Monthly instalments} &= \text{KES } 2\,800\,000 \div 60 \\ &= \text{KES } 46\,667 \text{ per month} \end{aligned}$$

**3 ▶ Work out the amount of money raised by Tribal Group by selling shares to existing shareholders.**

$$\text{Share capital raised} = 94.8 \text{ million} \times \text{£}0.22 = \text{£}20\,856\,000$$

**4 ▶ Why did Tribal Group need to raise more money?**

Tribal Group had run into financial difficulties and built up some debt. In 2015, its revenue fell to £106.7 million down from £123.7 million. The group also made losses of £47.3 million and £6.3 million in 2015 and 2014, respectively. In 2016, the company decided to raise more money to reduce its debt and provide some financial stability for the future. The group raised a total of £41 156 000 by selling some new shares and selling off part of the group to another business.

### ACTIVITY 1

#### CASE STUDY: WEDDING PLANNING

**1 ▶ Work out the percentage of the funding provided by the bank.**

Percentage provided by bank:

$$\text{Rs}30\,000 \div \text{Rs}90\,000 \times 100 = 33.3 \text{ per cent}$$

**2 ▶ What is meant by internal sources of finance?**

Internal sources of finance come from within the business. Before a business can start trading the owners have to provide some capital. This is an internal source of finance and in this case Nikki has raised Rs60 000 from personal savings, gifts and family loans. The bank is also providing some external finance.

**3 ▶ Describe one advantage to Nikki of using an internal source of finance.**

One of the main advantages of using internal sources of finance is that they are cheap: there is no interest to pay and no administration charges. This will help to keep business costs down and reduce the financial burden on the business.

## ACTIVITY 2

### CASE STUDY: CROWD FUNDING

#### 1 ► What is meant by the term crowd funding?

Crowd funding is a relatively new source of finance for businesses. It is similar to peer-to-peer funding (where banks are excluded and individuals can lend money via the Internet to others without previous knowledge of them). However, the fund-raisers tend to be businesses or groups who are involved in a particular venture such as putting on a concert, building a school or setting up a community project. The lenders or investors will be large numbers of individuals who together represent 'the crowd'. Transactions are conducted online. In this case, Marine Techno used an online crowd funding platform called CrowdNet to raise KRW 127 million.

#### Crowding funding is an external source of finance.

#### 2 ► What is meant by this?

External sources of finance are those from outside the business. Businesses often have to raise money from outside because the business is not able to generate sufficient funds on its own. In this case crowd funding is an example of an external source. The lenders or investors will be large numbers of individuals outside the business who collectively represent 'the crowd'

#### 3 ► Discuss why Marine Techno used crowd funding to raise finance.

Marine Techno needed some finance to help fund further product development. However, the company was struggling to get the finance it needed. According to the CEO, this was because most of the finance available to businesses ends up in Seoul or the surrounding province of Gyeonggi. When the CEO heard about a new crowd-funding site, CrowdNet, he thought it might be worth a try.

### MULTIPLE-CHOICE QUESTIONS

1A, 2D, 3B, 4C

## CHAPTER REVIEW

### CASE STUDY: BLAKELY MOTOR SCOOTERS

#### 1 ► What is meant by short-term finance?

Businesses often need to borrow money for a short period of time. This is called short-term finance and is money borrowed for one year or less. Short-term finance is often used to boost working capital. For example, Blakely Motor Scooters uses short-term finance to pay for raw materials and wages to meet a large order. Short-term finance is also likely to be used to meet emergency expenditure.

#### 2 ► Why is retained profit an internal source of finance?

Profit is generated by a business. Some of this is returned to the owners and the rest is retained by the business. Retained profit can be used in the future as a source of finance. It is an internal source because it has been generated inside the business through its trading activities.

#### Blakely Motor Scooters often uses retained profit to fund business activity.

#### 3 ► What is the main reason for using this method of financing?

Retained profit is popular because it is cheap. There are no interest or administration charges when using retained profit. It is a free source of finance. However, if profit is retained it cannot be returned to the owners. This may sometimes result in conflict.

#### Blakely Motor Scooters uses trade payables to buy components and parts.

#### 4 ► Discuss one advantage and one disadvantage of trade payables as a source of finance.

Trade payables (or trade credit) involves buying goods and paying for them later – perhaps up to 60 to 90 days after the goods were purchased. It is a popular source of finance because it is cheap and easy. There is often no direct charge for using trade credit. However, many suppliers encourage early payment by offering discounts so a business may miss out on cheaper goods. Also the cost of goods is often higher if firms buy on credit and delaying payment can also upset suppliers since they have to wait longer for their money.

#### 5 ► Assess whether Blakely Motor Scooters should fund the new factory through share capital or a mortgage. Make a clear judgement in your evaluation.

All sources of finance have their advantages and disadvantages. In this case, two particular sources are being considered to raise TNB 700 million for a new production line equipped with new technology – share capital or a mortgage. A mortgage is a long-term source of finance and could be used for the construction of a production line. However, the borrower must use land or property as security for the loan. Presumably here the new production line could be used as security for the loan. Mortgages are popular because the interest rates are much lower than those on unsecured bank loans. Provided the bank is happy for the production line to be used as security, a mortgage may be granted. However, if the business is not able to keep up with the repayments, the lender could repossess the property used as security.

For limited companies, share capital is an important source of external finance. The sale of shares can raise very large amounts of money. In this case, raising TNB 700 million is not an unusual amount. A rights issue may be used to raise more share capital. This is where a company gives the existing shareholders the right to buy the new shares at a discount. The main advantage of selling shares to raise capital is that interest payments are avoided. However, shareholders will expect to be paid dividends if the business is successful. The main disadvantage of issuing shares to raise capital is the cost of administration. There are the costs of promoting the issue, communicating with potential buyers, processing application forms, distributing the shares and possibly underwriting fees. This whole process can use up a significant proportion of the amount raised.

If the business can afford the interest payments, a mortgage may be preferable because once the new production line is up and running the existing shareholders will get to keep all the profit generated by the new investment. However, if interest rates are high, the interest payments over the 25-year period would eat into profits. There is also the chance that interest rates could rise to very high levels.

## CHAPTER 26

### CASE STUDY: AGA BRICK MAKING

- 1 ► Suggest ways in which cash is flowing into and out of the Agas' brickmaking business.**

Cash is flowing into the business from customers. KES 155 000 flowed into the business in June 2016. In the same month, cash also flowed out of the business. Examples include KES 43 000 for raw materials, KES 20 000 for rent and KES 12 000 for fuel.

- 2 ► Work out the net cash flow (cash inflows – cash outflows) for Aga Brick Making.**

$$\text{Net cash flow} = \text{KES } 155\,000 - (\text{KES } 43\,000 + \text{KES } 20\,000 + \text{KES } 12\,000 + \text{KES } 11\,000 + 2 \times \text{KES } 20\,000)$$

$$\text{Net cash flow} = \text{KES } 155\,000 - \text{KES } 126\,000 = \text{KES } 29\,000$$

- 3 ► What does the answer in question 2 show?**

The calculation in (2) shows that the business received more cash than it paid out. There was a positive net cash flow of KES 29 000.

### ACTIVITY 1

#### CASE STUDY: CASH FLOWS

- 1 ► Suggest one example of a a cash inflow and b cash outflow, for Abdul Hassan's laundry.**

A cash inflow would be the US\$1400 cash payments received during the month.

A cash outflow would be the US\$2500 wages paid during the month.

- 2 ► Work out the net cash flow for July 2016 for the laundry business.**

Calculate the net cash flow for July 2016 for the laundry business.

$$\begin{aligned} \text{Net cash flow} &= \text{Total cash inflow} - \text{Total cash outflow} \\ &= (\text{US\$}1400 + \text{US\$}5400) - (\text{US\$}2500 + \text{US\$}400 + \text{US\$}700 + \text{US\$}400 + \text{US\$}100 + \text{US\$}500 + \text{US\$}1000) \\ &= \text{US\$}6800 - \text{US\$}5600 \\ &= \text{US\$}1200 \end{aligned}$$

Therefore the business had a positive net cash flow of **US\$1200** in July 2016.

- 3 ► Why might the net cash flow above not represent the value of profit made in July?**

It is quite normal in a specific trading period for the net cash flow to be different from the profit made. One reason for this is because some goods are sold on credit (trade payables). So, at the end of the period, some customers

will still owe money. Therefore, profit is greater than cash. Similarly, a business may receive cash during that period from credit sales made in the previous period. This would increase the cash balance, but not affect profit. In this case, the laundry does receive US\$5400 from customers who had their laundry cleaned 60 days before. Therefore, the cash received for those sales does not affect the profit for July but for the month 60 days ago. The laundry would have made some credit sales during July but these are not recorded because the cash is yet to be received.

### ACTIVITY 2

#### CASE STUDY: CASH FLOW FORECASTS

- 1 ► Complete the cash flow forecast for Priscila Landa's bookshop to show:**

- the total cash outflows for each month
- the net cash flows for each month
- the closing balance for each month
- the opening balance for February and March.

	Jan	Feb	Mar
<b>Cash inflows</b>			
Book sales	3000	3500	3100
Fresh capital			2000
Interest		150	
<b>Total cash inflows</b>	<b>3000</b>	<b>3650</b>	<b>5100</b>
<b>Cash outflows</b>			
Stock	1700	1790	1900
Casual labour	500	500	500
Rent	1000	1000	1000
Other expenses	230	240	230
<b>Total cash outflows</b>	<b>3430</b>	<b>3530</b>	<b>3630</b>
<b>Net cash flow</b>	<b>-430</b>	<b>120</b>	<b>1470</b>
Opening balance	230	-200	-80
Closing balance	-200	-80	1390

**It is suggested that Priscila Landa's bookshop is struggling.**

- 2 ► What evidence is there in the forecast to support this view?**

Although the cash flow forecast for Priscila Landa's bookshop shows that the closing balance improves from -200 in January to 1400 in March, the reason for this is because 2000 of fresh capital was injected in March. Without the cash injection the closing balance in March would be -600. This shows a worsening situation over the three-month period.

#### MULTIPLE-CHOICE QUESTIONS

1B, 2D, 3A, 4B

## CHAPTER REVIEW

## CASE STUDY: LINARI GARDEN DESIGN

## 1 ► Describe what a 'cash flow forecast' shows.

A cash flow forecast is a financial document, usually produced on a spreadsheet, which shows the likely receipts and payments of a business for a future time period. All expected payments and receipts are listed month by month and the expected cash balance is calculated at the end of each month.

## 2 ► Prepare a nine-month cash flow forecast for Linari Garden Design. (Use a spreadsheet if possible.)

	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
<b>Cash inflows</b>									
Bank loan	3000								
Own capital	2000								
Predicted revenue	2000	2100	2000	2500	2500	2000	1000	500	0
	7000	2100	2000	2500	2500	2000	1000	500	0
<b>Cash outflows</b>									
Van	2000								
Tools and equipment	3400								
Laptop	600								
Business directory		100							
General overheads	400	400	400	400	400	400	400	400	400
Advertising		100		100		100		100	
Drawings			800	800	800	800	800	800	800
Loan repayments	200	200	200	200	200	200	200	200	200
Total payments	6600	800	1400	1500	1400	1500	1400	1500	1400
<b>Net cash flow</b>	<b>400</b>	<b>1300</b>	<b>600</b>	<b>1000</b>	<b>1100</b>	<b>500</b>	<b>-400</b>	<b>-1000</b>	<b>-1400</b>
Opening balance	0	400	1700	2300	3300	4400	4900	4500	3500
<b>Closing balance</b>	<b>400</b>	<b>1700</b>	<b>2300</b>	<b>3300</b>	<b>4400</b>	<b>4900</b>	<b>4500</b>	<b>3500</b>	<b>2100</b>

## 3 ► Comment on the cash position of the business during the nine-month period.

The expected cash position for Linari Garden Design looks quite promising. In the first month of trading, when all the setting up costs are incurred, the business is still expected to have a positive cash balance at the end of the month. After that, the cash position improves every month up until September when it is expected to be €4900. In the next few months, the cash position worsens because revenue starts to decline. But even in December, when there is no revenue, the closing cash position is still positive.

## 4 ► What would you expect to happen to the cash position of the business in early 2016?

The cash position of the business in early 2016 is expected to worsen. This is because revenue is likely to be zero for a few months. Garden design is likely to be affected by seasonal demand and people will not be thinking about their gardens until the growing season begins in the spring. If the cash payments stay at €1400 each month and there is no more revenue, the cash position at the end of February

will be -€700 (€2100 - €2800) if all the outflows remain the same as in December.

## CHAPTER 27

## CASE STUDY: AMPAT CONSTRUCTION

## 1 ► Suggest four costs incurred by Ampat Construction that will rise when more houses are built.

Examples of costs that will rise when more houses are built include bricks, sand, cement, timber, pipes, glass, electrical wire, glass, plastic window frames, insulation materials and labour.

## 2 ► Suggest four costs incurred by Ampat Construction that remain unchanged when more houses are built.

Examples of costs that will remain unchanged when more houses are built include machinery such as cement mixers, lifting gear, vehicles; tools and equipment such as spades, trowels, wire cutters, saws, power tools and protective

clothing and computers smartphones and office furniture at the company office.

**3 ▶ Work out the profit made by Ampat Construction in 2016.**

$$\begin{aligned}\text{Profit} &= \text{Total revenue} - \text{Total cost} \\ &= \text{US\$}64\,340\,700 - \text{US\$}56\,450\,200 \\ &= \text{US\$}7\,890\,500\end{aligned}$$

## ACTIVITY 1

### CASE STUDY: KANDASAN CRICKET BATS

**1 ▶ What is meant by fixed costs? Use examples from the case study in your explanation.**

Fixed costs are costs that do not vary with output. If output is increased, for example, fixed costs will remain exactly the same. In this case, examples of fixed costs include rent, business rates and other fixed costs. These are annual costs and do not vary with output.

**In 2015, Kandasana Cricket Bats produced 4800 bats.**

**2 ▶ Work out the total cost of production.**

$$\begin{aligned}\text{Total cost} &= \text{Fixed cost} + \text{Variable cost} \\ &= (\text{Rs}50\,000 + \text{Rs}5000 + \text{Rs}25\,000) + 4800 \times (\text{Rs}30 + \text{Rs}10 + \text{Rs}50 + \text{Rs}10) \\ &= (\text{Rs}80\,000) + 4800 \times (\text{Rs}100) \\ &= \text{Rs}80\,000 + \text{Rs}480\,000 \\ &= \text{Rs}560\,000\end{aligned}$$

**In 2016, the rent increased to LKR 60 000 and 6000 bats were produced.**

**3 ▶ Work out the effect of this increase on total costs.**

$$\begin{aligned}\text{Total cost} &= \text{Fixed cost} + \text{Variable cost} \\ &= (\text{Rs}60\,000 + \text{Rs}5000 + \text{Rs}25\,000) + 6000 \times (\text{Rs}30 + \text{Rs}10 + \text{Rs}50 + \text{Rs}10) \\ &= (\text{Rs}90\,000) + 6000 \times (\text{Rs}100) \\ &= \text{Rs}90\,000 + \text{Rs}600\,000 \\ &= \text{Rs}690\,000\end{aligned}$$

## ACTIVITY 2

### CASE STUDY: JENKINS LTD

**In 2015, Jenkins produced and sold 4500 control systems.**

**1 ▶ Work out the total cost.**

$$\begin{aligned}\text{Total cost} &= \text{Fixed cost} + \text{Variable cost} \\ &= \text{US\$}160\,000 + (4500 \times \text{US\$}120) \\ &= \text{US\$}160\,000 + \text{US\$}540\,000 \\ &= \text{US\$}700\,000\end{aligned}$$

**2 ▶ Work out the total revenue.**

$$\begin{aligned}\text{Total revenue} &= \text{Price} \times \text{Quantity} \\ &= \text{US\$}250 \times 4500 \\ &= \text{US\$}1\,125\,000\end{aligned}$$

**3 ▶ Work out the profit.**

$$\begin{aligned}\text{Profit} &= \text{Total revenue} - \text{Total cost} \\ &= \text{US\$}1\,125\,000 - \text{US\$}700\,000 \\ &= \text{US\$}425\,000\end{aligned}$$

**In 2016, fixed costs and the price charged remained the same. However, variable costs rose to US\$140 per system.**

**4 ▶ Work out the profit made in 2016 if 5200 systems were sold.**

$$\begin{aligned}\text{Profit} &= \text{Total revenue} - \text{Total cost} \\ &= \text{US\$}250 \times 5200 - (\text{US\$}160\,000 + 5200 \times \text{US\$}140) \\ &= \text{US\$}1\,300\,000 - (\text{US\$}160\,000 + \text{US\$}728\,000) \\ &= \text{US\$}1\,300\,000 - \text{US\$}888\,000 \\ &= \text{US\$}412\,000\end{aligned}$$

## MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

## CHAPTER REVIEW

### CASE STUDY: MODAL METAL PRODUCTS

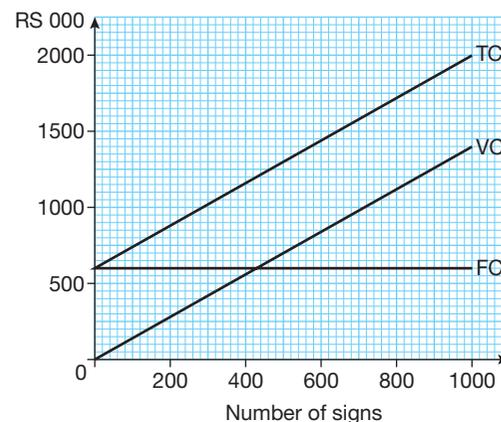
**1 ▶ What is meant by variable costs?**

Variable costs are those costs that change when the level of output changes. They will rise for example when output is increased. An example in this case is the cost of the metal, pipes and paint that Modal Metals uses for the road sign order.

**2 ▶ For the new order, work out a total variable cost and b total cost.**

$$\begin{aligned}\text{Total variable cost} &= \text{Rs}1400 \times 1000 = \text{Rs}1\,400\,000 \\ \text{Total cost} &= \text{Fix cost} + \text{Variable cost} \\ &= \text{Rs}600\,000 + \text{Rs}1\,400\,000 = \text{Rs}2\,000\,000\end{aligned}$$

**3 ▶ Plot fixed cost, variable cost and total cost on a graph. Use a range of output of 0 to 1000 units.**



**4 ▶ Work out the profit made on the order.**

$$\begin{aligned}\text{Profit} &= \text{Total revenue} - \text{Total cost} \\ &= (\text{Rs}2500 \times 1000) - \text{Rs}2\,000\,000 \\ &= \text{Rs}2\,500\,000 - 2\,000\,000 \\ &= \text{Rs}500\,000\end{aligned}$$

**5 ▶ Work out the average cost of each sign.**

$$\begin{aligned}\text{Average cost} &= \text{Total cost} \div \text{Quantity} \\ &= \text{Rs}2\,000\,000 \div 1000 = \text{Rs}2000\end{aligned}$$

Six months later, Modal Metal Products gets another order for 1500 speed limit signs. The variable costs remain the same but fixed costs are only Rs200 000. However, the government will only pay Rs1500 for each sign.

- 6 ▶ Assess whether Modal Metal Products should accept the order. Show all your calculations. Make a clear judgement in your evaluation.

$$\begin{aligned}\text{Profit} &= \text{Total revenue} - \text{Total cost} \\ &= \text{Rs}1500 \times 1500 - (\text{Rs}200,000 + \text{Rs}1400 \times 1500) \\ &= \text{Rs}2\,250\,000 - \text{Rs}2\,300\,000 \\ &= -\text{Rs}50\,000\end{aligned}$$

Since Modal Metals would make a loss of Rs50 000 on the new order, it might be refused. However, if Modal Metals was short of business, it might take on the order to keep its resources occupied and retain the customer. Although this particular order might make a loss, future orders from the government might be more profitable.

## CHAPTER 28

### CASE STUDY: UNIVERSAL MUSIC GROUP

#### CASE STUDY: CONE STREET CYCLES

- 1 ▶ Show whether the firms in the above examples are making a profit, loss or breaking even.

In 2016, Universal Music Group made a profit of €644 million (€5 260 000 million - €4 616 000 million)

Cone Street Cycles broke even in 2015. Its total costs were Rs40 million (Rs20 million + Rs2,000 × 100 000) and its total revenue was also Rs40 million.

### ACTIVITY 1

#### CASE STUDY: GALLE ICE CREAM

- 1 ▶ How many kilos of ice cream must the business sell to break even?

$$\begin{aligned}\text{Break-even point} &= \frac{\text{Fixed cost}}{\text{Selling price} - \text{variable cost per unit}} \\ &= \frac{\text{Rs}100\,000}{\text{Rs}100 - \text{Rs}50} \\ &= \frac{100\,000}{50} \\ &= 2000\end{aligned}$$

So, Galle Ice Cream Ltd would need to sell 2000 kilograms to break even.

- 2 ▶ What is total cost and total revenue at the break-even point?

$$\begin{aligned}\text{Total cost} &= \text{Rs}100\,000 + (\text{Rs}50 \times 2000) \\ &= \text{Rs}100\,000 + \text{Rs}100\,000 = \text{Rs}200\,000\end{aligned}$$

$$\text{Total revenue} = \text{Rs}100 \times 2000 = \text{Rs}200\,000$$

Total revenue and total cost are both Rs200 000 at the break-even point. This shows that the business does not make a profit or a loss.

- 3 ▶ What would happen to the breakeven point if fixed costs were reduced to Rs80 000?

$$\begin{aligned}\text{Break-even point} &= \frac{\text{Fixed cost}}{\text{Selling price} - \text{variable cost per unit}} \\ &= \frac{\text{Rs}80\,000}{\text{Rs}100 - \text{Rs}50} \\ &= \frac{80\,000}{50} \\ &= 1600\end{aligned}$$

When fixed costs fall, the break-even point is lower. Galle Ice Cream Ltd now only needs to produce and sell 1600 kilograms to break-even.

### ACTIVITY 2

#### CASE STUDY: THE GRAND HOTEL

- 1 ▶ What is the value of fixed cost for the Grand Hotel?  
The fixed costs incurred by the hotel are SGD 15 000.
- 2 ▶ How many rooms need to be occupied to break even?  
The hotel will break even when 300 rooms are occupied. This is where total cost and total revenue intersect.
- 3 ▶ What is total revenue at the break-even point?  
Total revenue at the break-even point is SGD 30 000.
- 4 ▶ What is total cost at the break-even point?  
Total cost at the break-even point is SGD 30 000.
- 5 ▶ If 500 rooms are occupied, what is the a amount of profit and b margin of safety?
- a Profit is the difference between total cost and total revenue on the break-even chart. In this case the profit made by the Grand Hotel when 500 rooms are occupied is SGD 10 000. When 500 rooms are occupied, total cost is SGD 40 000 and total revenue is SGD 50 000.
- b The margin of safety when 500 rooms are occupied is 200. It is the difference between the break-even point and current output.

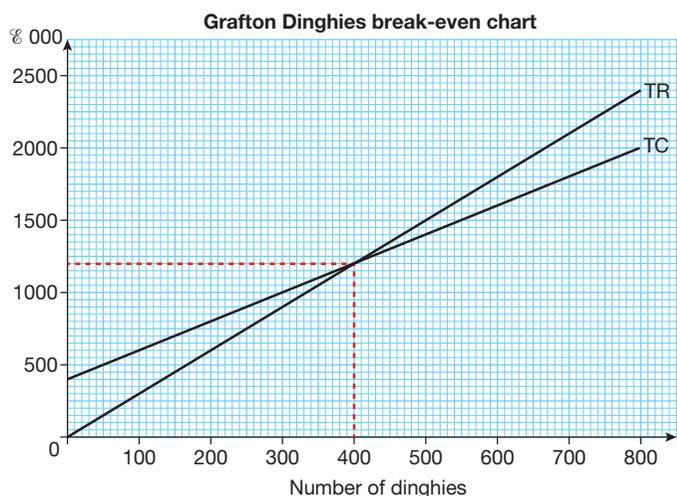
#### MULTIPLE-CHOICE QUESTIONS

1D, 2D, 3A, 4C

### CHAPTER REVIEW

#### CASE STUDY: GRAFTON DINGHIES

- 1 ▶ Construct a break-even chart for Grafton Dinghies.



- 2 ▶ a** What is the break-even point for Grafton Dinghies?  
**b** What is the total cost and total revenue at the break-even point?
- a** Reading from the graph the break-even point is **400** dinghies.  
**b** At the break-even point, reading from the graph:  
 Total cost = **€1 200 000**  
 Total revenue = **€1 200 000**

**Grafton plans to make 600 dinghies during the year.**

- 3 ▶ How much profit will be made?**  
 Reading from the graph, when output is 600 dinghies, profit = **€200 000**
- 4 ▶ Describe what would happen to the break-even point for Grafton Dinghies if variable costs were to increase.**  
 If Grafton's variable costs increase, the total cost function would become steeper. This means that the business would break even at a higher level of output (the break-even point shifts to the right). This is a negative effect for the business because the business has to produce and sell more dinghies to break-even.
- 5 ▶ What are the limitations of break-even analysis to Grafton Dinghies? Discuss at least two limitations in your analysis.**  
 Although break-even charts can provide a business with some useful information, break-even analysis does have some limitations. One of the main limitations is that the total costs and total revenue are shown as straight lines. In practice, they may not be straight lines. For example, a business may have to offer discounts on large orders, so total revenues fall at high outputs. In this case study, the total revenue line would rise and then fall. A business can lower costs by buying in bulk, so unit costs may fall at high outputs and total cost will be curved.  
 Another problem is to do with the information used to construct the chart. The accuracy of the break-even chart depends on the quality and accuracy of the data used to construct total cost and total revenue. If the data is poor and inaccurate, the conclusions made on the basis of the data may be incorrect. Therefore, Grafton must use break-even analysis with some care.

## CHAPTER 29

### CASE STUDY: DOHA FOOD STORE

- 1 ▶ What do you think is meant by the terms a cost of sales and b finance costs?**
- a** Cost of sales in this case is the cost to the Doha Food Store of buying stock or inventory to sell in the shop.  
**b** Finance costs of US\$600 000 is interest paid on any loans or overdrafts that the business has.
- 2 ▶ Suggest three possible expenses that the Doha Food Store might incur.**  
 Examples of expenses might include wages, electricity, advertising, insurance, accountancy fees, telephone, motor expenses or business rates.  
 NB. Other examples are possible.

- 3 ▶ How might Musab Assad use the statement of comprehensive income?**

The statement of comprehensive income will show Musab Assad and his family how well the business has performed during the year. The profit made by a business for the year is a measure of business performance. Musab might also use the statement to make decisions. For example, he may decide to invest some of the profit made by the business in the future.

## ACTIVITY 1

### CASE STUDY: FORMAT 66

- 1 ▶ Work out a gross profit and b operating profit.**
- a** Gross profit = revenue – cost of sales  
 = US\$12.56 million – US\$7.6 million = **US\$4.96 million**
- b** Operating profit = gross profit – expenses  
 = US\$4.96 million – US\$2.56 million = **US\$2.4 million**

**Format 66 distributes US\$0.8 million to shareholders.**

- 2 ▶ How much profit is retained?**  
 Retained profit is the money left after any distribution to the owners. Therefore in this case retained profit is **US\$1.6 million** (US\$2.4 million – US\$0.8 million).
- 3 ▶ What is likely to happen to the profit retained by the business?**  
 Retained profit is kept by the business. This means it may be used to help fund investment projects. It may also be kept as a reserve in case trading conditions become difficult in the future.

## ACTIVITY 2

### CASE STUDY: SANCHEZ SUPERSOFT

**Look at the statement of comprehensive income for Sanchez Supersoft.**

- 1 ▶ Work out the missing values for a cost of sales in 2015, b profit for the year after tax in 2015 and c the operating profit for 2016.**
- a** Cost of sales in 2015 = US\$18.1 million.  
**b** Profit for the year after tax in 2015 = US\$3.1 million  
**c** Operating profit for 2016 = US\$5.1m
- 2 ▶ Comment on the performance of the business over the two years.**  
 It could be argued that the Sanchez Supersoft's performance has worsened since 2015. Revenue has fallen from US\$29.2 million to US\$26.9 million. This is a fall of about 10 per cent. Gross profit has fallen by a similar amount. Profit for the year has fallen by a larger percentage. It has fallen by 29 per cent from US\$3.1 million to US\$2.2 million. A possible reason for this is a slowdown in global growth. When economic growth is low, demand for non-essentials such as computer games is likely to fall. However, at least the business is still trading and making a profit. If the global economy picks up then the performance of Sanchez Supersoft is likely to improve.

**MULTIPLE-CHOICE QUESTIONS**

1D, 2A, 3B, 4C

**CHAPTER REVIEW****CASE STUDY: ROLLS-ROYCE****1 ► What does a statement of comprehensive income show?**

Businesses use the statement of comprehensive income to calculate the profit at the end of the financial year. In this case, the profit made by Rolls-Royce at the end of 2015 was £84 million.

**2 ► Work out a taxation and b gross profit for 2015.**

**a** Taxation in 2015 = £76 million

**b** Gross profit in 2015 = £3266 million

**3 ► What is meant by operating profit?**

Operating profit is the profit made by a business after all business costs and expenses have been subtracted (except for finance costs). It can be calculated by subtracting expenses from gross profit. In this case, the operating profit for Rolls-Royce is £1499 million.

**4 ► Describe two ways in which the statement of comprehensive income might be used by a business like Rolls-Royce.**

The statement of comprehensive income shows business owners and managers the amount of profit made by a business in a financial year. However, the information contained in the statement might be used to help make some important decisions. For example, a business might use the statement of comprehensive income to decide how much money to invest in the business. For example, if the statement shows that profits are rising, this might encourage decision makers to use more funds for investment. In contrast, if the statement shows that the business is struggling, investment plans might be postponed in the hope that the business will pick up in the near future.

The statement of comprehensive income will show a business what has happened to costs during the year. It might show, for example, that the cost of sales has increased sharply. As a result a business can identify reasons for this and take measures to bring costs under control. A business might decide that cheaper suppliers of raw materials must be found or that the wages of production workers must be brought under control. For example, in this case Rolls-Royce has managed to reduce its administrative costs from £1124 million in 2014 to £1059 million in 2015. The business may have analysed costs in 2014 to see if there were certain costs that could be reduced.

**5 ► Assess the performance of Rolls-Royce over the two years. Make a clear judgement in your evaluation.**

The 'bottom' line shows that Rolls-Royce has moved from a loss making position in 2014 to a profit making position in 2015. In 2014, the business made a loss of £84 million. However, in 2015 it made a profit of £84 million. This is a positive development over the time period. However, the size of profit in relation to revenue is quite small. Its profit for the year in 2015 is only 0.6 per cent of the company's revenue.

Over the two years, revenue was fairly stable at around £13700 million – there was just a slight drop in 2015. This shows that Rolls-Royce is getting plenty of orders and has enjoyed a solid year's trading. However, the company may be disappointed in its profitability. With such a high revenue, many would argue that it should make more profit. One of the reasons why profitability is low is because of the high costs of financing. In both 2014 and 2015, financing costs are over £1400 million. This shows that Rolls-Royce has a lot of debt. It is possible that the business is borrowing to invest heavily for the future. There is some evidence of this in the statement of comprehensive income. The statement shows that research and development costs were £818 million in 2015 and £793 million in 2014. This is a large sum and suggests that Rolls-Royce is committed to research and new product development. Sometimes research and development expenditure takes time to bear fruit. Shareholders in Rolls-Royce will hope that much higher profits are generated in the future as a result of this investment. Finally, one of the reasons why Rolls Royce made a loss in 2014 was because of a relatively high tax charge – it was about double the size of the tax paid in 2015.

**CHAPTER 30****CASE STUDY: AZORA DINING FURNITURE****1 ► What is the value of all the assets owned by the business?**

Total assets = US\$395 900

**2 ► How much money does the business owe to a the owners and b all other creditors?**

Owed to owners = US\$200 000 + US\$104 900  
= US\$304 900

Owed to other creditors = US\$91 000

**3 ► What do you notice about the value of assets and the total amount owed by the business?**

The value of the assets is exactly the same as the amount owed. Both values are US\$395 900.

**ACTIVITY 1****CASE STUDY: TESCO****1 ► What is the difference between assets and liabilities? Use examples from this case study.**

Assets are the resources owned by a business. For example, Tesco had £43 904 million of assets in 2016. A significant proportion of this (£17 900 million) was property, plant and equipment. Liabilities are the debts of a business, that is, the amount of money owed to outsiders. The value of Tesco's liabilities was £35 288 million in 2016. £10 711 million of this amount was owed to banks and other financial institutions.

**2 ► Work out the value of capital for Tesco.**

Assets = capital + liabilities

£43 904 million = capital + £35 288 million

£43 904 million – £35 288 million = capital

**£8616 million = capital**

- 3 ▶ Write a letter to a shareholder explaining what a statement of financial position shows.**

## ACTIVITY 2

### CASE STUDY: QETTER TOYS

- 1 ▶ What is the value of a net current assets, b share capital and c plant and equipment for 2016?**

- a** Net current assets = US\$4 390 000  
**b** Share capital = US\$10 000 000  
**c** Plant and equipment = US\$9 120 000

- 2 ▶ What is meant by the term inventories in the statement of financial position?**

Inventories are a current asset for a business. They include stocks of raw materials, components and finished goods ready for sale. In this case, ERCO had US\$4 560 000 of inventories in 2016. As a toymaker, examples might include raw materials such as plastics, paint and packaging. It could also include stocks of toys ready to sell to customers.

- 3 ▶ What is the difference between current assets and non-current assets?**

Current assets are assets that will be changed into cash within one year. They are liquid assets. The liquidity of an asset is how easily and how quickly it can be changed into cash. Examples of current assets for ERCO include inventories (£4 560 000), trade receivables, which is money owed by customers (US\$6 990 000), and cash (US\$2 110 000).

Non-current assets are those that last for more than one year. They are the most productive resources of a business. ERCO has two main non-current assets – factory and plant and equipment. The total value of ERCO's non-current assets at 31 December 2016 is US\$43 770 000.

### MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4D

## CHAPTER REVIEW

### CASE STUDY: HASHAN BATHROOM SUPPLIES

- 1 ▶ What is meant by the term capital employed?**

Capital employed is the amount of money invested in the business by the owners. For Hashan Bathroom Supplies it is US\$236 300 000 for 2016.

- 2 ▶ What is meant by borrowings in the statement of financial position?**

Borrowings are an example of a non-current liability. It is money that the business has borrowed and does not expect to pay back for at least a year – possibly a lot longer. For example, long-term loans could be for 5 years, 10 years, 20 years or longer. Hashan Bathroom Supplies owed US\$300 000 000 at the end of 2016. However, this was US\$50 000 000 lower than the previous year.

- 3 ▶ What is the difference between current assets and current liabilities in the statement of financial position?**

Current assets are assets that will be changed into cash within one year. They are the liquid assets of a business.

The liquidity of an asset is how easily and how quickly it can be changed into cash. Examples of current assets for Hashan Bathroom Supplies include inventories (US\$459 000 000), trade receivables, which is money owed by customers (US\$230 300 000) and cash (US\$67 000 000).

Current liabilities are business debts that must be repaid within 12 months. For Hashan Bathroom Supplies they might include trade payables, which is money owed to suppliers. And taxation, which is money owed by the business to the tax authorities. This might include tax on company profits, VAT or tax that has been deducted from employee wages which must be passed on to the authorities. Hashan Bathroom Supplies owes US\$560 000 000 and US\$230 000 000 to suppliers and the tax authorities respectively.

- 4 ▶ What is the approximate value of Hashan Bathroom Supplies?**

The value of a business is given by the value of net assets. This is shown in the statement of financial position. The value of Hashan Bathroom Supplies in 2016 was US\$236 300 000. However, this is only an approximate value.

- 5 ▶ Describe two uses that a statement of financial position might have to Hashan Bathroom Supplies.**

The statement of financial position shows the capital structure of a business. A business can raise funds from many different sources, such as shareholders' capital, retained profit and long-term and short-term sources. For example, Hashan Bathroom Supplies has raised a total of US\$236 300 000 from the owners of the company, while US\$300 000 000 comes from long-term borrowings and US\$790 000 000 from short-term sources. It might be argued that quite a large proportion of Hashan Bathroom Supplies' finance is from short-term sources.

The statement of financial position also shows the asset structure of a business. This means that we can see where all the money that the business has raised has been distributed between different types of assets. For example, Hashan Bathroom Supplies has US\$570 000 000 invested in non-current assets such as stores, and fixtures and fittings. It also has US\$756 300 000 invested in current assets such as inventories, trade receivables and cash. Note that the value of assets US\$1 326 300 000 (US\$570 000 000 + US\$756 300 000) is the same as the value of money owed US\$1 326 300 000 (US\$236 300 000 + US\$300 000 000 + US\$790 000 000). This will always be the case for a business.

- 6 ▶ Assess the main financial changes that have taken place over the two years at Hashan Bathroom Supplies.**

A number of key changes have occurred in the financial position of Hashan Bathroom Supplies over the two years. First of all, the value of the company has increased from US\$201 600 000 to US\$236 300 000. This is a significant increase and the owners of the company may be pleased with this performance. This is a 17 per cent increase and suggests that the business has performed well between 2015 and 2016. However, it must be remembered that the value of net assets is only a rough guide to the value of a business because assets are difficult to value exactly and other non-physical assets such as goodwill (the amount paid for regular customers to the business) may not be included on the statement.

One worrying change is the fall in the value of net current assets. It was low in 2015 but in 2016 it became negative (at US\$33 700 000). This means that current liabilities are greater than current assets. This could be a problem for Hashan Bathroom Supplies because it might struggle to pay some immediate bills. The main reason for this position is that there has been a big build-up in inventories; more money is owed by customers than in the previous year and the value of cash has fallen. This would be a cause of concern for Hashan Bathroom Supplies. However, during the year it managed to pay off US\$50 000 000 in long-term debt. This might part of the reason for the position. If the business is able to sell its high levels of stocks fairly quickly and put pressure on customers to pay their debts, the position would improve significantly.

## CHAPTER 31

### CASE STUDY: ORIENT PLUS

#### 1 ► What evidence is there to support the view that Orient Plus is starting to struggle?

Both the statement of comprehensive income and the extracts from the statement of financial position show that Oriental Plus was hit by the arrival of a new competitor. The revenue of the business fell from US\$1 231 500 to US\$890 600; this is a fall of about 28 per cent. The profit for the year made by the business also went down. In 2015, Orient Plus made a profit of US\$158 600. However, in 2016 this turned into a loss of US\$2400. This is only a small loss but it is a big drop from the previous year. The extracts from the statement of financial position show that working capital (net current assets) has fallen sharply from US\$239 300 to US\$14 300. This may well mean that the business has difficulties in paying day-to-day bills.

#### 2 ► How might the redundancies improve financial performance at Orient Plus?

Making staff at Orient Plus redundant could improve the financial performance of the business. This is because if people are made redundant the wage bill will be reduced. With lower wages, costs will fall and the company may return to profit again. However, making staff redundant may result in production difficulties.

### ACTIVITY 1

#### CASE STUDY: SANTOS METAL PRODUCTS

Look at the revenue figures for Santos Metal Products between 2010 and 2015.

#### 1 ► How has the company performed?

Revenue has increased significantly between 2010 and 2014. It has increased by nearly 100 per cent from US\$12.4 million to US\$24.1 million. This suggests that Santos Metal Products has performed very well indeed.

#### 2 ► What impact has the flood of orders had on Santos Metal Products?

Table 31.4 shows that both gross profit and operating profit rose sharply in 2013. This occurred at the same time as the flood of orders resulting from the Rio Olympic Games

construction projects in 2013 and 2014. This appears to have had an impact on the profits for 2013 and 2014. Both gross profit and operating profit doubled between 2012 and 2014.

#### 3 ► Work out for both years a gross profit margin and b operating profit margin.

	2010	2011	2012	2013	2014
Gross profit margin	39.5%	40.6%	40.9%	49.5%	51.0%
Net profit margin	8.1%	8.7%	8.7%	10.6%	10.8%

#### 4 ► Discuss possible reasons for the changes in question 3 between 2010 and 2014.

Between 2010 and 2012 both the gross and operating profit margins are fairly stable. They have increased slightly but not by much. However, in 2013 and 2014 they both rise sharply. This occurred at the same time as the flood of orders. The gross profit margin rises from 40.9 per cent to 51 per cent between 2012 and 2014. This may be because the business has been able to buy raw materials more cheaply. They will have increased production for the orders and may have enjoyed cheaper materials through bulk buying. The operating profit margin has increased from 8.7 per cent to 10.8 per cent. This may be because the business has been able to benefit from economies of scale, that is, perhaps by making better use of their machinery when increasing production. The operating profit margin will usually rise if a business keeps control of its expenses. It appears that Santos Metal Products has done this in 2013 and 2014.

### ACTIVITY 2

#### CASE STUDY: COMPARING ASSETS AND LIABILITIES

#### 1 ► Calculate for both companies and for both years the a current ratios and b acid test ratios.

	Patel's		Uzzy Plastics	
	2016	2015	2016	2015
Current ratio	1.16	0.96	1.76	1.58
Acid test ratio	0.37	0.36	0.89	0.85

#### 2 ► Which is the more liquid of the two companies?

According to the calculations in (1), Uzzy Plastics is the more liquid of the two companies. The current ratio in both years for Uzzy Plastics lies in the preferred range of 1.5 to 2. The acid test ratio in both years is just below 1. Patel's figures are significantly worse. The current ratios in both years are well below 1.5 and the acid test ratios are well below the preferred target of 1. Between 2015 and 2016, both companies have improved their liquidity position slightly. For example, the current ratios for both companies have increased.

There may be a reason why Patel's appears to have a poorer liquidity position than Uzzy Plastics. Patel's is a car retailer; it sells cars from car showrooms. Consequently, its main asset will be inventories (the value of cars in the showroom). This would explain the low acid test ratios. It is also possible that Patel's is paid immediately when a sale

is made – it may not have to wait for customers to pay. Therefore, it does not have to wait for cash. This means they can operate with much lower current and acid test ratios. BBG Plastics is a manufacturer and probably allows its customers trade credit. This means they have to wait for cash and therefore need higher liquidity ratios to be safe.

### MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4B

### CHAPTER REVIEW

#### CASE STUDY: AL-DHABIT SHIPPING

**The return on capital employed is a performance ratio.**

**1 ► What is meant by this?**

Performance ratios show how profitable a business is. The ROCE shows how much profit the money invested in the business generates.

**2 ► Work out a operating profit margin b current ratio c ROCE for Al-Dhabit Shipping in each of the three years.**

	2013	2014	2015
Operating profit margin	9.04%	3.54%	9.83%
Current ratio	1.49	1.02	1.64
ROCE	11.30%	2.83%	9.75%

**3 ► Discuss the benefit of using ratios to compare the performance of a business over a period of time.**

Ratios can be used to assess the performance of a business over time. This means that the performance can be tracked. Calculating a ratio in one particular year may not be very helpful because there is no basis for comparison. Also, the particular year used might be an unusual year so the result would be misleading. However, looking at ratios for a period of time, three years in this case, it is possible to make comparisons and identify patterns or trends in performance. This is much more helpful.

**4 ► Assess the performance of the Al-Dhabit Shipping between 2013 and 2015. Make a clear judgement in your evaluation.**

Over the three years, the operating profit margin has risen from 9.04 per cent to 9.83 per cent. This is a small improvement but, during 2014, the operating profit margin fell to 3.54 per cent when both the price of oil and demand fell. This does not suggest that there is a problem with the business, just that trading conditions were difficult. The current ratio has also improved over the time period from 1.49 to 1.64. If the current ratio lies between 1.5 and 2, a business is said to have adequate working capital. Since 1.64 lies in this range, Al-Dhabit Shipping appears to have enough working capital to fund its day-to-day activities. However, the current ratio did fall to nearly 1 in 2014, which provides further evidence that trading was difficult. Finally, the ROCE has fallen over the three years from 11.3 per cent to 9.75 per cent. The company is still recovering from the difficult trading conditions and in 2014 the amount of capital employed was increased when the owners injected another US\$2 million of capital. Clearly, the operating profit has not risen enough yet to recover the lost returns.

### CHAPTER 32

#### CASE STUDY: O'JAR BUILDING SUPPLIES

#### CASE STUDY: PARK FARM FOODS

**1 ► Which stakeholder is interested in the financial information in Tabl 32.1?**

The information in Table 32.1 shows current assets and current liabilities for O'Jar Building Supplies. A supplier will use the information to decide whether to give the company trade credit. If a business is not financially secure it would be risky selling goods on trade credit.

**2 ► What conclusion might the stakeholder in question 1 draw from the information shown in the statement?**

The information in Table 32.1 shows that the working capital position for O'Jar Building Supplies is worsening over the time period. Current assets fall between 2012 and 2015 while current liabilities rise. Indeed, in 2015, working capital is negative because current assets are less than current liabilities. This suggests that the company will struggle to pay its immediate bills. As a result, the supplier is not likely to grant the O'Jar Building Supplies trade credit because they might not get paid.

**3 ► How will Marcus van Zyl use the statement of comprehensive income shown in the statement of comprehensive income to make an important decision?**

Marcus van Zyl is going to use the statement of comprehensive income for 2016 to make an important decision regarding his future. He has decided that if the farm does not make a profit of ZAR 500 000 in 2016, he will retire from farming. Unfortunately, the statement shows that the farm's profit in 2016 is only ZAR 211 000. This is even lower than the profit made in 2015 (ZAR 344 000). Presumably Marcus will retire from the business.

**4 ► Obtain the accounts of two large businesses in your area and compare their performance. (The accounts of PLCs can be obtained very quickly online.)**

### ACTIVITY 1

#### CASE STUDY: BIBBLINGTON PHARMACEUTICALS

**1 ► What is the main reason why the owners of Bibblington Pharmaceuticals use accounts?**

The owners of businesses will obviously be interested in the performance and the financial position of the business. Shareholders in limited companies will also be interested in the performance of the business. They may look at the size of dividends; they may use ratio analysis to see how their investment in the business is performing; and they might also make comparisons with other companies in the same industry. In this case, the shareholders of Bibblington Pharmaceuticals set targets for return on capital employed. The shareholders aim to get a 10 per cent return on capital employed. They use the accounts each year to check whether this target has been achieved.

**2 ► Discuss whether Bibblington Pharmaceuticals has reached the targets set by the shareholders over the time period shown.**

According to the information in Table 32.3, the return on capital employed has exceeded the shareholders' targets every year except for 2016. In 2016, ROCE was only 8.3 per cent. Although this is below their 10 per cent target, it may not be too disappointing. For example, it may be acceptable if trading conditions were difficult during this time. It is possible that the performance in 2016 was caused by unusual circumstances and that in the future trading conditions will return to normal and the performance of the business will improve.

### MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3C, 4A

## CHAPTER REVIEW

### CASE STUDY: VARL TOWN POOLS

- 1 ▶ Describe one reason why employees at Varl Town Pools might be interested in the financial documents shown in the tables above.**

Employees might need financial information during wage negotiations. For example, information about the profitability, liquidity and financial prospects of the business could be used to decide whether a business can afford to raise wages. They may also look at accounting information to see whether their jobs are secure. The information in Tables 32.4 and 32.5 is not very encouraging for employees. Revenue has fallen over the two years and in 2016 the business made a loss. This suggests that their jobs are not entirely safe and that a wage increase is very unlikely at the moment.

- 2 ▶ Discuss two ways in which Varl Town Pools might use financial documents to make decisions.**

Businesses will make better-informed decisions if they have access to financial documents. Since financial documents contain quantitative information, they can be very helpful in the decision making process. For example, Varl Town Pools may need up-to-date financial information to help run the business and make key decisions such as how to reduce costs. The statement of comprehensive income for the company shows that both cost of sales and expenses have increased between 2015 and 2016. For example, cost of sales has increased by around 17 per cent. Varl Town Pools could examine the different costs to help identify problems. For example, if the cost of raw materials is rising, Townsville Pools might decide to find some cheaper suppliers.

In 2016, Varl Town Pools made a loss of A\$3500000. This is shown clearly in the statement of comprehensive income. The business may use the financial documents to try to find ways of improving profitability. For example, if the gross profit margins are small in relation to competitors, it may be because prices are too low or costs of sales are too high. Therefore prices can be raised or new suppliers might be found for raw materials and other key resources. Perhaps wage costs need more control. Profitability might also be improved if revenues are falling behind those of competitors. For example, perhaps a business should try to find new markets to help increase sales – overseas for example. In this case, Varl Town Pools has been lowering prices to fight off new competition. It is possible that the

price reductions have been too severe. Consequently the business may decide to review this strategy.

- 3 ▶ Assess the performance of Varl Town Pools between 2015 and 2016. Make a clear judgement in your evaluation.**

One of the main uses of financial documents is to assess the performance of a business. A number of stakeholders such as the owners/shareholders, potential investors, employees and managers will be interested in the performance of a business. In this case, the information in Tables 32.4 and 32.5 shows that the performance of Varl Town Pools has taken a turn for the worse between 2015 and 2016. For example, in 2015, the business made a profit after tax of A\$6900000. However, in 2016, this became a loss of A\$3500000. This is a significant worsening which none of the company's stakeholders would welcome.

The statement of comprehensive income shows that revenue has fallen by 8.4 per cent and both cost of sales and expenses have risen significantly. Falling revenues and rising costs are a bad sign for a business. In this case, the likely reason for the outcomes is the arrival of new competition in the market. In an effort to improve competitiveness, Varl Town Pools has lowered the prices of its maintenance services and taken on some construction work at a loss in 2016. This strategy does not appear to have worked very well. By lowering prices the business would have expected to raise revenue. But this hasn't happened, in fact, revenue has fallen.

The statement of financial position also shows a downturn in performance. For example, the amount of working capital (net current assets) has fallen by nearly 34 per cent. A particular problem is the fall in the cash balance from A\$5300000 to A\$1200000. This is in spite of borrowing more money (non-current liabilities have increased by A\$900000). Also, the value of the business has fallen sharply. The net assets fell from A\$13300000 in 2015 to A\$9800000 in 2016. This means that the business is worth A\$3500000 less.

To conclude, the performance of Varl Town Pools has worsened significantly as a result of new competition in the market. The outlook is also poor. After lowering prices and, carrying out some construction work at a loss, the business is still struggling. It may not survive much longer!

## CHAPTER 33

### CASE STUDY: TOURISM IN SRI LANKA

- 1 ▶ What was the size of the Sri Lankan tourist market in 2016?**

In 2015, a total of 1 798 410 tourists arrived in Sri Lanka.

- 2 ▶ What is expected to happen to the size of this market in 2017?**

The size of the market appears to be growing. In every month in 2017, the number of tourists arriving in Sri Lanka is higher than the corresponding month in the previous year.

- 3 ▶ How might a tour operator selling adventure holidays in Sri Lanka use the information in Figure 33.2?**

Information in the case states that adventure travel has been growing at over 65 per cent a year since 2009. It is now a US\$263 000 million industry and is still growing. This would be encouraging news for a tour operator selling adventure holidays. The information in Figure 33.2 might suggest to a tour operator that an online presence would be very important when attracting customers. For example, 69 per cent of adventure travellers researched adventure holidays online. This means that the tour operator could advertise its holidays on appropriate websites. The data also shows that adventure tourists are more likely to book their own trips online rather than visit a travel agent. This information also supports the view that an online presence would be important.

**4 ► In groups, discuss what other information might be useful to a European tour operator selling holidays to Sri Lanka. List your results on a poster and present them to the rest of the class.**

There could be many responses to this question. Some examples might include:

- The age profile of tourists to Sri Lanka
- The countries that those interested in Sri Lanka live in (that is, which particular European country, if any)
- The type of accommodation tourists prefer when visiting Sri Lanka
- The amount people are prepared to pay for a holiday in Sri Lanka
- The reasons why people choose Sri Lanka as a destination
- How people book their trips to Sri Lanka

## ACTIVITY 1

### CASE STUDY: MANZINI SAFARI TOURS

**Manzini Safari Tours has used primary research to gather information.**

**1 ► What is meant by primary research?**

Manzini Safari Tours is carrying out primary research because the tour operator is collecting new information – data that has never been collected before. It is phoning potential customers and asking them questions about the tours. This data does not already exist; it is new data and therefore primary research.

**2 ► Describe one advantage and one disadvantage of using telephone surveys.**

Telephone surveys involve interviewing people over the telephone. The main advantage of interviewing people over the telephone is that it is cheaper. People from a wide geographical area can be covered. In this case, the customers may be spread all over the world. However, many people are becoming irritated by telephone interviews because they may be unwelcome and uninvited. They may refuse to take part in the interview.

**3 ► What is the difference between open questions and closed questions in a survey?**

A good questionnaire will usually contain an appropriate balance of closed and open questions. Closed questions

have definite answers. In Figure 33.3, Questions 1 to 5 are all closed questions – there is a definite answer to all of them, either yes or no. Open questions have many different possible answers, so when answering open questions, respondents can give a wide variety of answers. In this case, Figure 33.4 might be answers to the question ‘Why haven’t you been on a Manzini Safari Tour?’ Each one of the responses shown is different. There could also be many other answers to this question. Closed questions can be used to generate quantitative information while open questions tend to generate qualitative information.

**4 ► Look at the data for Manzini Safari Tours and suggest reasons why the number of visitors has fallen in recent years. Give at least two reasons in your analysis.**

There could be more than one reason why the number of people going on safari tours to the Manzini Wildlife Sanctuary has fallen in recent years. Only 7 per cent of people in the survey had been to the sanctuary although 61 per cent had been on safari tours, which would suggest that there is some interest in such trips. It is possible that Manzini Safari Tours are too expensive. Of people 44 per cent said they would go if it was cheaper; this is nearly half of those interviewed. Also, one of the respondents’ comments in Figure 33.4 says, ‘It’s too expensive – it would cost me and my family over £300 to go for the day.’

Another possible reason for the fall in visitor numbers is that the Park’s advertising has not reached many people. Only 7 per cent of respondents had seen adverts for the tours. Also, one response in Figure 33.4 said ‘I have never heard of Swaziland’. Perhaps consumer awareness needs to be raised.

Finally, some of the comments shown in Figure 33.4 might suggest other reasons for the fall in visitors. These include that the tours appear too supervised and that there are no tigers. However, unless a lot of people made similar comments, these may not be very important.

## ACTIVITY 2

### CASE STUDY: NESCAFÉ

**Nescafé uses Tumblr to gather qualitative data.**

**1 ► What is meant by qualitative data?**

Some of the data gathered by market researchers is qualitative. This means that the information is about the attitudes, beliefs and intentions of consumers. It is usually written down in words or recorded – in a video clip, perhaps. Nestlé uses social media to gather qualitative data about what people think of Nescafé. It uses the Tumblr platform to develop consumer-led communications. This information will appear as text as consumers send their messages. Some consumers may also post photos and other images during their interaction.

**2 ► Assess the benefits to Nescafé of using social media to help gather information from consumers.**

In 2015, Nescafé became the first global brand to transfer all of its websites to the social media platform, Tumblr. Social media is playing an increasing role in marketing. It can provide a cheap way of gathering information about a firm’s customers, market, brand appearance and other market issues. For example, most social media platforms

offer numerous ways to analyse trends and conduct market research. One of the main benefits of using social media is the broad reach it has. In this case, Tumblr claims that it hosts around 315.3 million blogs and 150 300 million posts a year. This means that Nescafé can access huge numbers of customers and potential customers using the platform. Another benefit is that social media allows specific groups of people to be targeted. In this case, one of the main reasons why Nescafé switched to social media was to build stronger relationships with younger consumers.

Nescafé can also gather information from consumers instantly. Interaction takes place in real time so information is always up-to-date. This means that Nescafé can respond to any helpful suggestions resulting from their research very quickly. Finally, the use of social media is not technically difficult and therefore is cost effective to use. Over the last six months, Nescafé says the Tumblr websites have generated an extra US\$200,000 in sales. Users can make instant purchases by clicking on to 'buy now buttons'. Also, total monthly visits have risen by 29 per cent with users now staying 18 per cent longer per visit. Nescafé clearly values the use of social media in marketing.

### MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3D, 4A

### CHAPTER REVIEW

#### CASE STUDY: FORD

**1 ▶ Using the data in Figure 33.6, calculate Ford's share of the global car market in 2015.**

Ford's market share

$$= \text{Ford market share} \div \text{total market} \times 100$$

$$= 6.64 \text{ million} \div 72.37 \text{ million} \times 100$$

$$= \mathbf{9.18 \text{ per cent}}$$

**2 ▶ Describe two benefits of using online surveys to gather information from customers.**

Like many businesses, Ford uses online methods to gather information from customers. The main benefit of online surveys is that they can be completed and processed quickly – the person types in the data, which is then fed straight back for immediate analysis. Survey costs are lower because there is no need for printing, postage and typing in. Online surveys are often fun to complete because they may be interactive. They can also be accessed 24/7 and be completed at the convenience of the respondents. Online surveys also make it easy to give feedback. Results can be e-mailed to back to the respondents if this is appropriate.

**3 ▶ Discuss the importance of the reliability of market research data to a company like Ford.**

Although carrying out market research can reduce the risk of products failing in the market, it is important to ensure that the data gathered is reliable. If market research data is inaccurate or out of date, any decisions based on the data are likely to be unsound. A business also needs to appreciate that human behaviour is unpredictable. People might also change their minds or misunderstand the questions. They might also give answers that they think the interviewers wanted to hear.

**4 ▶ Discuss the possible benefit to Ford of the information in Figure 33.7.**

Ford recognises the difficulty in judging the accuracy and authenticity of people's online comments. This is because many users admit that they lie on their social media profiles to make themselves appear better than they are. With this in mind, Ford has established social media guidelines to ensure that its employees are truthful and realistic when discussing the company on social media. The amount of money that Ford invests in the development and launch of a new product is so big that the reliability of data it collects is of crucial importance.

The pie chart in Figure 33.7 shows sales of cars by geographical region. This is an example of quantitative data and may be of use to Ford, for example by showing that nearly one-half of global sales are made in Asia (mainly China). This suggests that the Asian market is important. Therefore, Ford might channel more resources into the development of products suitable for this market. Ford should spend more time and money finding out exactly what people's needs are in this market to ensure that the right sorts of products are developed. It might also suggest that Ford should locate more production units in this market so that transport costs are as low as possible. Also, people in Asian markets may prefer to buy Ford cars if they know that they are produced by factories close to, or actually inside, their own country.

**5 ▶ Assess the possible benefits to Ford of using market research before launching new products.**

Ford will be more successful if it can supply cars that meet customers' needs. This means that a business has to gather information to identify these needs. Once this data has been gathered, Ford can design a car that meets the specific needs of customers. The data gathered by market researchers needs to be as detailed as possible. Ford will try to anticipate customer needs; this means they try to predict what customers want in advance and respond to changes very quickly. Businesses operate in a rapidly changing environment and have to keep up with the latest trends, fashions, technology and designs. The technology used in car design and manufacture is a particularly important issue when meeting customer needs.

Launching a new product is risky. Also, as markets get larger and competition gets fiercer, launching new products gets even riskier. The probability of failure is high but investment in effective market research can help reduce the risk of failure. Ford will want to avoid costly product failures that may result from misreading the market or failing to carry out effective market research.

Gordon Platto, Ford chief designer, says that the company is very influenced by the data gathered from market research. He said 'We go to customer immersion events and spend time with customers in their homes to understand how they use their vehicles. It enables us to better meet the customer needs. You can see the influence in our new vehicles.'

Finally, although Ford is committed to gathering market research data and is prepared to make good use of it, it must understand the importance of data reliability. Evidence in the case does suggest that Ford is aware of this. For example,

Ford appreciates the difficulty in judging the accuracy and authenticity of people's online comments. This is because many users admit that they lie on their social media profiles to make themselves appear better than they are.

## CHAPTER 34

### CASE STUDY: HASAN'S

#### 1 ► Why is Hasan's a successful business?

Hasan's is a successful business for two main reasons. First of all, Aftab serves high-quality reasonably priced food. The restaurant industry is highly competitive so any outlet that offers quality at a reasonable price is likely to enjoy success. However, another important reason is the quality of customer service delivered at Hasan's. About 80 per cent of Hasan's customers are regulars and evidence suggests that a good proportion of them value the quality of customer service offered by Aftab and his family. The quality of customer service is good because Hasan's meets customers' needs.

**Aftab says 'I have worked very hard to build a relationship with my customers.'**

#### 2 ► What is meant by this?

An increasing number of businesses try to build relationships with customers. This involves getting to know them at a personal level. Businesses try to establish a bond with customers through effective communication and do everything possible to meet their needs. Businesses can adopt a number of practices to help build customer relationships. They can personalise communication, say thank you, build trust and connect with them regularly, for example. In this case, Aftab says that he treats customers like his friends and goes out of his way to meet their needs. People are made to feel welcome. For example, the restaurant stays open very late every Thursday night to serve 12 regular customers that come straight from a local factory after a late shift for something to eat. Clearly Aftab has built a sound business relationship with these customers.

#### 3 ► Describe the benefit to Hasan's of having loyal customers.

Every business wants loyal customers. This means that they keep coming back to spend more money. Therefore a business does not have to invest as much money in expensive marketing such as advertising and promotion. The cost of retaining existing customers is much less than the cost of acquiring new ones. Hasan's will enjoy more revenue, lower costs and higher profits if it can continue to hold on to its loyal customers.

## ACTIVITY 1

### CASE STUDY: INTERCONTINENTAL HOTELS GROUP

#### 1 ► What is meant by a customer loyalty scheme?

A customer loyalty scheme rewards customers for repeat purchases. Customers are given benefits when they increase the number or value of their transactions with a business. In this case, the IHG Rewards Club rewards customers according to the number of nights they stay in IHG hotels. Some of the benefits of building up a booking history include the accumulation of points or miles which can be exchanged

for bookings, exclusive rates when staying in a hotel, extended checkout times and free newspapers.

#### 2 ► Describe one important benefit to IHG of using the IHG Rewards Club.

The use of customer loyalty schemes help businesses to retain customers. This can be very important because if customers remain loyal and continue to make purchases in the future, the financial benefits can be high. Many studies in the past have concluded that the cost of retaining a customer is about 10 per cent of the cost of acquiring a new one. Clearly, the costs of customer retention are less substantial than the benefits. If IHG customers join the Rewards Club, and start to enjoy the rewards, they are likely to book IHG hotels whenever they travel.

#### 3 ► In pairs, design a customer loyalty scheme for a small guest house. Present your ideas on a poster to the rest of the class.

## ACTIVITY 2

### CASE STUDY: FERRARI

**In 2015, 72.37 million cars were produced globally.**

#### 1 ► Work Ferrari's share of the global market.

$$\begin{aligned} \text{Ferrari's market share} &= 7664 \div 72\,370\,000 \times 100 \\ &= 0.01059 \text{ per cent.} \end{aligned}$$

#### 2 ► What is meant by a niche market? Use this case study as an example.

A niche market is a small part of a much larger market. In this case, Ferrari targets its cars at a niche market. In relation to the total global car market of 72 370 000 cars, Ferrari had just 0.01059 per cent of the total market. This is a very small proportion and is a classic example of a niche market. Ferrari targets the prestige segment of the car market where performance, quality and exclusivity are highly valued. The prices of its cars are very high and only a small number of consumers can afford to buy one.

#### 3 ► Describe one advantage of operating in a niche market.

A niche market is often left 'untouched' by most of the large producers in a market. Although Ferrari does have competition, it is not from the giant car producers like Ford, Honda, Nissan, VW and Toyota. Consequently, there is more opportunity for raising prices and focusing on production quality. It is also easier to meet the needs of customers in a niche market. This is because the small group of consumers that make up the niche probably have very similar needs.

## MULTIPLE-CHOICE QUESTIONS

1C, 2B, 3A, 4D

## CHAPTER REVIEW

### CASE STUDY: THE GLOBAL MARKET FOR OIL

#### 1 ► What is meant by the term mass market?

Mass markets are huge markets where the same product is sold to huge numbers of people. The global market for oil is an example. Oil producers can produce large quantities at a

lower unit cost by exploiting economies of scale. This might result in higher sales and higher profits. According to the information in Figure 34.5, the market for oil is dominated by just a few countries which includes the US, Saudi Arabia and Russia.

**The global price of oil fell from around US\$115 a barrel in 2014 to US\$45 in 2016.**

**2 ► Work out the percentage change in the price between 2014 and 2016.**

$$\begin{aligned} \text{Percentage change in price} &= \text{US\$80} \div \text{US\$125} \times 100 \\ &= \mathbf{64 \text{ per cent}} \end{aligned}$$

**3 ► Do you think the oil industry is product or market orientated?**

The oil industry is product orientated. This is because oil producers focus their efforts on extracting as much oil as possible and as cheaply as possible. Their major concerns are production costs. Oil producers engage in little marketing since their output is sold into a global market where the price is already determined. Each oil producer makes little or no effort to conduct market research or understand their customers' needs since one company's crude oil is exactly the same as another. The need for oil already exists since it is an essential source of energy so there is little opportunity for advertising and promotion.

**4 ► Discuss one important change that has occurred in the global oil market.**

The price of oil has fallen dramatically since 2014. In less than two years, it has fallen by 64 per cent. One of the main reasons for the fall is the increase in supply of oil and other energies. US production has nearly doubled recently which means that the USA's suppliers, such as Saudi Arabia, Nigeria and Algeria, are trying to sell more of their oil in Asian markets. Canadian and Iraqi oil production is also rising and the Russians are also managing to maintain high production levels.

Businesses in the oil industry have been hit hard. Revenues and profits have fallen which has resulted in many bankruptcies and forced oil companies to cease operation at more than two-thirds of their production facilities. Companies have also cut investment in exploration and production quite sharply. It is estimated that 250 000 oil workers – roughly one-half in the USA – have lost their jobs.

**5 ► Assess the importance to businesses of responding to changes in the market.**

Most markets are dynamic which means they are likely to change. Markets may grow, shrink, fragment and emerge. Some markets can completely disappear. One of the reasons why markets change is because the needs of customers change. These needs change for a number of reasons. For example, consumers are better educated and more sophisticated than ever before. Owing to improvements in communications and the greater availability of knowledge, people are more aware of opportunities and have developed more sophisticated tastes. Consumers have also been influenced by changes in social habits. For example, more people are concerned about the environment and resource depletion and

therefore want to recycle their waste. In this case, it might be argued that the drop in demand for oil might be partly caused by more energy being generated using renewable sources.

Businesses must monitor markets, identify changes in customer needs and be prepared to develop new products in order to meet these new needs. Failure to do so may mean that market share is lost to more responsive rivals. Businesses can also gather information about spending patterns in markets. They can carry out their own research, use statistics generated by the government or purchase market research reports from specialist market research agencies such as Mintel.

Changes in the market might be the result of increased competition. The behaviour of competitors in the market needs to be monitored very carefully. For example, the arrival of a new competitor in the market could have a dramatic effect on sales if their products are more advanced or more effectively marketed. Competition puts businesses under some pressure. It means that they have to encourage customers to buy their products in preference to those of rivals. They will use a range of methods to attract customers. They might do this by lowering prices or making their products appear different to those of rivals, for example.

Finally, if businesses do not respond to market changes, they are likely to lose market share. At worst they could collapse. In the market for oil, demand has fallen, new competition has arrived in the form of US shale gas producers and prices have fallen sharply. Unfortunately, due to the nature of the product, there is not a great deal oil producers can do. It is not possible to develop the product, firms have no control over price and the promotion of oil as a product is not really appropriate. The only way businesses can respond to changes in the market is to cut costs and hope that the price recovers in the future. However, one possibility is for oil companies to diversify. For example, some large oil companies have started to invest in wind farms, electric battery storage systems and carbon capture and storage (CCS) to generate new revenue streams. One of the world's largest oil producers, Saudi Arabia, has said that it will sell off part of its large state-owned oil business and diversify its economy away from oil.

## CHAPTER 35

### CASE STUDY: ACCOR

**1 ► How has Accor divided the market in this case?**

Accor has a number of hotel brands that it targets at different customer groups, each with different needs. For example, some customers, the young and low-income travellers, may only be able to afford 'budget accommodation'. Therefore, the Hotel F1 brand might suit their particular needs. Rooms only cost from €19 per night. Another group of customers targeted by Accor are very wealthy and look for luxury; the Raffles brand will provide for this group. There are just 12 Raffles hotels and each one is unique in style. The brand also offers unique features including the famous Long Bar and Writers Bar (which come from the original Raffles Singapore), Raffles

Patisserie and Raffles Spa. A room in Raffles, Singapore may cost at least €800. Accor also targets well-connected and sophisticated travellers. Its Pullman brand has 100 four- and five-star hotels across Europe, Africa, the Middle East, Asia-Pacific and the Americas. Prices per room will start at around €120, however, they could be a lot higher depending on the location. Finally, Accor has a brand that meets the needs of people with a little more purchasing power than low-income consumers. For about 60 euros per night, the Mercure brand with 738 hotels in 51 different countries, offers warm, personalised contemporary rooms. They are welcoming, clean with high quality furniture. Accor has divided the market according to different needs and income levels.

**2 ► Discuss how Accor might benefit from having many different hotel brands.**

By targeting different customer groups, Accor will be able to serve a wider range of customers. This will enable them to increase their revenue. If Accor only offered, say, the Mercure brand, it would miss out on the opportunity to charge higher prices to those who are willing to pay for a higher quality service such as Raffles. It would also miss out on a large budget hotel market if it did not operate Hotel F1.

## ACTIVITY 1

### CASE STUDY: TOYOTA

**There are many different segments in the market for cars.**

**1 ► What is the main reason for this?**

There is a very large number of different segments in the market for cars because a wide range of different consumers want different types of vehicles. For example, there are small 'low cost' cars, environmentally friendly cars that use electricity, 'sporty' cars, family cars, prestige cars, mid-range cars, 4WDs and commercial vehicles. These different types of cars, and others, are likely to be purchased by different consumer groups that have different needs and wants.

**2 ► Describe the market segment that Toyota is likely to target with the vehicles described here.**

The Toyota Prius is likely to be targeted at people who are concerned about the environment. It produces lower emissions than normal petrol driven cars because it relies more on electricity for its power. The Toyota Prius has become well known among eco-conscious drivers.

The Proace is a commercial vehicle. It is a van and will be targeted at businesses that require this type of transport.

The AYGO is a small, low cost car. It is not a family car and is therefore likely to be targeted at single people on relatively low incomes. However, families might buy it as a second car. It is also said to be the ultimate city car so it might also be targeted at single people who live in cities.

The Land Cruiser is an expensive 4WD and described as a sports utility vehicle. It is likely to be targeted at wealthier people who have an interest in sport. It might also appeal to wealthier families because of its size.

**3 ► Assess if these products are likely to be targeted at particular a geographical areas and b income groups.**

**a** Buyers of the AYGO may be segmented geographically. This is because it is described as the ultimate city car. This suggests that it will be targeted at people living in cities.

It might also be argued that the Land Cruiser is targeted at rural customers because it is an 'off-road' vehicle. It may be that many are sold to people who live in the countryside. However, there is plenty of evidence to suggest that 4WDs are also popular with drivers who live in towns and cities.

**b** The AYGO is likely to be targeted at lower income groups. This is because it is a cheap car at just £8495. It is also economical, which will appeal to lower income groups. In contrast the Land Cruiser may be aimed at wealthier drivers. This is because it is expensive – priced at £36465. It is also said to offer premium levels of comfort, which would appeal to higher income drivers.

**4 ► Choose another well-known multinational car manufacturer and look at the range of models it is marketing (online if possible). Decide which market segment each model is being aimed at. Record your results on a poster and present to the rest of the class.**

### MULTIPLE-CHOICE QUESTIONS

1B, 2A, 3B, 4D

### CASE STUDY: JQBC

**1 ► What is meant by market segmentation?**

Markets can be divided into different sections or segments. Each segment is made up of consumer groups that have similar needs. Businesses recognise this and target particular market segments with their products. For example, JQBC targets at least one of its brands (TV channels), JQBC Kidz, at young children.

**2 ► How does JQBC segment the market for television according to a age, b lifestyle and c gender?**

**a** Evidence in the case suggests that JQBC uses demographic segmentation. This is because some of its brands (TV channels) are targeted at specific age groups. For example, JQBC Kidz is targeted at children. This channel targets the 3–10-year-old age group. It provides a range of cartoons, children's films and learning programmes. The schedule aims to follow the mood and energy levels of young children throughout the day.

**b** Some products are targeted at consumer groups according to their lifestyles. For example, JQBC has JQBC Sport. This channel is aimed at sports enthusiasts. It provides live coverage of a number of key sports events around the world such as golf, association football, auto racing and baseball. It also covers sumo wrestling, martial arts, figure skating and rugby union in depth.

**c** Some businesses may target their products according to gender. In this case, JQBC has a channel which is aimed specifically at the female audience. JQBC Fem It is aimed at female viewers and offers a wide range of programmes including films, lifestyle series, quiz and panel shows, drama series, reality series and talk shows on varying topics including cooking, travel, cars, relationships and sports.

**3 ▶ Discuss how a business might benefit from using the socio-economic table in Figure 35.1**

The table shown in Figure 35.1 is used to divide people into different groups according to their social class. There are six different groups. Those in group A, for example, are described as 'Upper middle class'. The group only accounts for about 4 per cent of the UK population and is likely to include doctors, lawyers, company directors and high level administrators. In contrast, C2, the skilled working-class group, is the largest in the population (33 per cent). It includes skilled manual workers such as carpenters, plumbers, cooks and train drivers.

A business might use this information when targeting products at different market segments. For example, stores like Poundland (UK) and Dollar Stores (US and Australia), where all products are sold for a low currency denomination such as £1 and \$1, may be targeted at Socio-economic groups D and E.

**4 ▶ Assess the possible benefits to JQBC of using market segmentation.**

Generally JQBC will be better placed to meet the needs of different customer groups if the market is segmented. It can design TV channels for groups of customers that have similar characteristics. By producing different channels for different market segments JQBC can increase its revenue. For example, JQBC has TV Channels like JQBC Kidz for children, JQBC for women and JQBC for sports enthusiasts. These are three distinct customer groups with very different needs. By catering for these different needs JQBC can generate more revenue. For example, JQBC Fem is an important channel for the broadcaster since it attracts the most advertising revenue. Advertising revenue is attracted from a large number of businesses and increasingly from businesses that save time for busy families. For example, online grocery retailers are currently targeting working parents who have increasingly less time for family grocery shopping trips.

Another benefit of market segmentation is that customers may be more loyal to a business that provides products which are designed specifically for them. In this case, once consumers become familiar with a particular TV channel, if it meets their needs exactly, they are likely to continue watching it. Also, when a new channel is launched and directed at the same group, they are more likely to try it.

Market segmentation might also help JQBC to maximise advertising revenue. This is because clients buying advertising space on their channels can target their adverts at specific customer groups. For example, a business that wants to advertise its sportswear is likely to place adverts on JQBC Sport. This will make their adverts more cost effective because a larger proportion of the audience is likely to be interested (than the same advert placed on a general TV channel).

However, JQBC probably has to invest very heavily in production and programming to support the wide range of TV Channels it targets at the different market segments. This will be expensive and eat into profits. However, since JQBC has been broadcasting for 19 years and in 2017 made a profit of JPY12 000 million on a revenue of JPY140 000 million, the effective segmentation of the market must make a substantial contribution to its success.

## CHAPTER 36

### CASE STUDY: PRODUCT DEVELOPMENT AT BESTHOME

**1 ▶ What is meant by product development?**

Product development involves identifying opportunities and ideas for new products and converting those ideas into marketable goods or services. BestHome introduces around 1 500 new products each year and is very committed to product development.

**2 ▶ Describe BestHome's approach to product development.**

BestHome claims that its approach to product development is very thorough. For example, the development of new products often starts with a visit to people's homes to find out the real needs of customers. The design process at BestHome is then handled by a number of teams. Each team contains a materials analyst, a product developer and a technician or engineer - in addition to designers. All the teams work transparently so that everyone can see what everyone else is doing. Design work is carried out in a huge aircraft hanger in Frankfurt where all products and prototypes can be seen. This helps to inspire the designers. The design facility has a prototype shop with craftsmen providing a range of different skills and a 3D printing facility. Finally, designers are encouraged to travel and work with foreign designers to learn new techniques and get fresh ideas. They are also required to attend all major international trade fairs to observe developments in the market and explore the activities of competitors.

**3 ▶ Discuss why BestHome brings out so many new products each year.**

BestHome stores typically stock 8000 products and each year around 1500 new products are introduced. This will help to keep the stores 'fresh' and encourage customers to revisit to find out what is new. New products help to generate more revenue and hopefully more profit. Also, a business that continually updates its product lines is likely to have a competitive edge in the market. This will help BestHome to maintain or grow its market share.

### ACTIVITY 1

#### CASE STUDY: PACKAGING

**1 ▶ What is the main role played by packaging in the images?**

The left image shows packaging that can be recycled and a product that is eco friendly. This might attract customers who care more about the environment. They will feel happier buying products knowing that using recycled materials in the packaging has saved resources. Using recycled materials reduces the impact businesses have on the environment. Some consumers might be prepared to pay a higher price for such a product. Also, by using recycled materials, the business might enjoy lower costs.

In the right image, packaging is used to help promote the product. It is designed to be attractive so that customers are drawn to the product. Arguably the bottle design for the perfume is stylish, attractive and 'classy'. It will help

to make the product appear more luxurious. It might also mean that the business can charge a higher price for the product.

### Businesses might need to change their packaging when selling goods abroad.

#### 2 ► Discuss why this might be necessary.

When businesses export their products, it may be necessary to change the packaging. There may be a number of reasons for this. In some cases, the names of products on packaging may have to be changed. This is because they may be misunderstood, inappropriate or offensive in other languages. Different countries also have different regulations relating to the packaging of products. For example, in some countries all the fat and salt content of food products have to be clearly shown on labels.

## ACTIVITY 2

### CASE STUDY: MICROSOFT

#### 1 ► What is meant by an extension strategy? Use examples from this case study in your explanation.

Extension strategies are designed to lengthen the life of an existing product. They may be introduced before the product starts to seriously decline. If a product can be successfully refreshed, sales levels, along with revenues, may start to recover or even grow. In this case, Microsoft has extended the life of Microsoft® Windows by continually updating the product. Since Windows 1 was introduced in 1985, there have been 11 major updates (along with many other versions of the list shown in Table 36.1). Each new version is improved technically and usually contains new features. The product has now been on the market for 31 years.

#### 2 ► Discuss benefits to Microsoft of using extension strategies. Give at least two benefits in your analysis.

One of the main benefits of extension strategies is that products will continue to generate revenues and profits for a longer period of time. A product is likely to be more profitable in the later stages of its life because the research and development costs will have been recovered. Consequently, provided the cost of the extension strategy used is not too high, the longer the life of a product, the more profit will be made. Although Microsoft might invest quite large amounts of money in research and development on the new versions of Windows, the benefits must be greater than the costs because there have been 11 new versions.

Another benefit of lengthening the life cycle of products with effective extension strategies is that competitors will find it more difficult to enter the market. If a business is able to keep updating and modifying a product to make it even better and more appealing, competitors know that they will have to bring out something really special to make an impact on the market. Each new version of Windows that Microsoft launches has better technology and new features. This helps to retain customer loyalty and makes it more difficult for other software producers to take market share away from Microsoft.

### MULTIPLE-CHOICE QUESTIONS

1D, 2C, 3B, 4C

## CHAPTER REVIEW

### CASE STUDY: CHEESY SNAX

#### 1 ► What is meant by the term marketing mix?

The marketing mix is the different elements of a firm's marketing that are designed to meet the needs of customers. Often called the 4Ps, they include product, price, promotion and place. In this case, the product is particularly important for Cheesy Snax. It focuses heavily on the quality of its products.

#### 2 ► What are the features of a cash cow in the Boston Matrix?

In the Boston Matrix, cash cows are mature products with a high market share. There is little potential for growth in the market but the products generate significant amounts of cash for a business. In this case, Cheesy Crackles and Cheesy Pops, are cash cows enjoying annual sales of around 30 million packets each.

#### 3 ► What is the position of Cheesy Puffs in the Boston Matrix?

Cheesy Puffs, was introduced in 2014 and targeted at children. It has a low market share but is showing some potential. This is an example of a question mark in the Boston Matrix. It sold 5 million packets in 2015. The marketing manager thinks that with the right sort of promotion the product will flourish.

#### 4 ► Discuss how Cheesy Snax might use the Boston matrix in the management of its product portfolio.

The Boston matrix may be used to help analyse the products marketed by a business. The matrix enables a business to place their products into different categories according to their market share and position in the life cycle.

When managing its product range, Cheesy Snax must try to make sure it has the 'right balance' of products. This means that it must avoid having too many dogs and try to increase the number of stars and cash cows. Arguably, Cheesy Snax has two cash cows in Cheesy Crackles and Cheesy Pops. Some of the income from these cash cows might be invested in new product development. Another product, Cheesy Puffs, was introduced in 2014 and targeted at children. It has a low market share but is showing some potential. It sold 5 million packets in 2015. This product may be a question mark and may need some adjustment in its marketing. Finally, Cheesy Nuts is in decline (a dog) and may be replaced. The Boston Matrix can be used by Cheesy Snax to help make marketing decisions about its product portfolio.

#### 5 ► Describe the main features of the product life cycle for Cheesy Nuts.

Cheesy Nuts was launched in 2009 after spending about one year in development. The product was slow to take off and only had annual sales of around 500 000 packets half way through 2010. The product did grow for a two-year period but

sales only ever reached just over the 2 million mark. This is significantly lower than the 30 million annual sales of Cheesy Crackles and Cheesy Pops. After reaching their highest point in 2013, sales of Cheesy Nuts started to decline. By 2016, sales were down to about 1 million packets. The cycle suggests that the product has been unsuccessful. If the rate of decline continues, sales could be close to zero by the end of 2017. Cheesy Snax needs to take some action and address the balance in the product portfolio.

**6 ▶ Assess whether Cheesy Nuts should be replaced with Blue Cheesy Crackles in 2017. Make a clear judgement in your evaluation.**

As the product life cycle shows in Figure 36.5, sales of Cheesy Nuts are in decline. The maximum level of sales for the product was just over 2 million in 2013; since then they have dropped consistently to about 1 million in 2016. If no action is taken they will possibly drop to zero. Cheesy Snax has a number of options in dealing with the problem.

One option is to relaunch the product. It has been suggested that the product should be relaunched with a change in packaging and targeted more aggressively at adults. This might reverse the decline and get the product moving again. A promotion clearly targeted at adults might be effective and result in a new interest in the product. However, the cost of this strategy is about US\$1.5 million and some people have said that this is just 'a waste of money'; these people would presumably withdraw the product.

The withdrawal of Cheesy Nuts might be an option if it could be replaced. Cheesy Snax has another product, Blue Cheesy Crackles, under development. The product is close to the test marketing stage. However, there is a worry. Although Blue Cheesy Crackles have a pleasant taste, their bright blue appearance were unpopular with some consumers during development. If the problem could be quickly resolved, and the product launched, Cheesy Nuts could be withdrawn.

Another alternative would be to invest in the promotion of Cheesy Puffs. This product currently has sales of 5 million and is showing some potential even though it has a small market share. Although the investment would cost £2.5 million, this might be the answer if there is going to be a delay in the launch of Blue Cheesy Crackles.

To conclude, it does seem that Cheesy Nuts should be withdrawn from the market. It would be a risk but so would investing a further US\$1.5 million in a relaunch. Assuming that there are not enough funds to both invest in the promotion of Cheesy Puffs and relaunch Cheesy Nuts, this might be the best option. It is not clear cut, but there is always risk in business. Cheesy Snax will also hope that the problem with Blue Cheesy Crackles can be solved quickly – especially if Cheesy Nuts are withdrawn.

starts to fall. For example, a new product called 'Airdust' was launched in India at a price of Rs3600. However, a ten months later, it was available for just Rs2600. This is about 28 per cent lower than the original launch price.

In the second example, the Kowloon Gift Shop bases the prices charged in her store on costs. Yvette Cheng uses a very simple method to calculate the prices of all the gifts sold in the shop: she adds 20 per cent to the cost of buying them in.

**2 ▶ Describe one possible advantage of using the pricing method in each case.**

Selling new products at a high price when they are first launched is a common pricing strategy for some businesses – particularly those in the technology industry. The idea is to generate high levels of revenue by selling to *early adopters*. These are people that attach a great deal of value to buying new technology when it first comes out. They are prepared to pay the higher prices to be the 'first' with the new technology.

The method used by Yvette Cheng will ensure that her business makes a profit. This is because the prices charged are 20 per cent higher than costs.

**3 ▶ In groups, discuss the factors that might influence the price charged for a a carton of milk and b an air ticket to a far-away place. Record your ideas on a poster and present them to the rest of the class.**

## ACTIVITY 1

### CASE STUDY: COFFEE SHOPS

**1 ▶ Describe the pricing strategy being used by the multinational.**

The multinational coffee chain in this case is using predatory or destroyer pricing. The idea is that a very low price is set to deliberately undercut competitors like Eduardo Urondo. Once Eduardo's coffee shop goes out of business, the chain will raise prices.

**2 ▶ How can the new rival afford to trade at a loss?**

Predatory pricing is an expensive approach because it usually means a business has to trade at a loss for a period of time. However, in this case a large multinational is using predatory pricing to drive out a small independent coffee shop. Large multinationals will have huge resources and can afford for one outlet to trade at a loss for a period of time.

## ACTIVITY 2

### CASE STUDY: PHARMACEUTICAL COMPANIES

**1 ▶ Name the pricing strategy used by Pfizer for Atorvastatin.**

Pfizer is using price skimming for its heart disease drug Atorvastatin (40mg). This involves setting a high price for a period while a patent protects sales of the drug. Even when non-branded versions of the drug enter the market, Pfizer's Atorvastatin was selling for US\$191 per month in the USA. In contrast, a non-branded producer of Atorvastatin (40mg) was selling it for US\$160 per month. Another non-branded

## CHAPTER 37

### CASE STUDY: GRANITE TECCO

### CASE STUDY: KOWLOON GIFT SHOP

**1 ▶ How are prices set in the above examples?**

In the first example, Granite Tecco sets a high price for its new products. Then, after a period of time, the price

product, Lovastatin (40 mg), was selling for just US\$51 per month (although this was not exactly the same chemical as Atorvastatin). Skimming is common in the pharmaceutical industry.

**2 ► Discuss the main advantage to Pfizer of this pricing strategy.**

Pharmaceutical companies use skimming for a purpose: in the pharmaceutical industry, businesses spend a lot on research and development and this is a way to recover some of that money. For example, in 2014, Pfizer, the US drugs company, spent US\$7200 million on R&D. In order to encourage research on this scale, pharmaceutical companies can obtain a patent when they launch a new drug. This is a license that protects companies from competition for a period of time. This means they can charge very high prices until the patent runs out. This allows companies like Pfizer to recover the heavy costs of research and development and also make a profit.

**MULTIPLE-CHOICE QUESTIONS**

1D, 2B, 3A, 4D

**CHAPTER REVIEW**

**CASE STUDY: NASSAR'S**

**1 ► What is meant by cost-plus pricing?**

Cost plus pricing is a simple pricing strategy. It involves adding a mark-up (a certain percentage) to the cost of producing or buying the goods for sale. In this case, Nassar's uses a mark-up of 40 per cent for most of its clothing.

**2 ► Work out the price Nassar's would charge for an item costing AED 240.**

Price = cost + (40 per cent × cost)

Price = AED 240 + (40 per cent × AED 240)

Price = AED 240 + AED 96

**Price = AED 336**

**3 ► Discuss one advantage and one disadvantage of cost-plus pricing.**

Businesses have to set prices that generate a profit. One method that ensures that all costs are covered is cost plus pricing. It is simple and involves adding a mark-up to total costs. In this case, 40 per cent is added to the cost to get the price. This method is common with retailers such as Nassar's. It is a simple pricing method, all of the staff understand it and it ensures that profits are made.

However, one of the disadvantages of this method is that it ignores market conditions. For example, the AED 336 price set by Nassar's for the clothing in this case may be far too high in relation to the prices charged by rivals. This might result in low sales and a move in custom away from all of Nassar's stores over a period of time. Setting a price without taking into account the market conditions could be risky.

**4 ► What is meant by psychological pricing?**

One common pricing strategy is to set the price slightly below a round figure – charging AED 399 instead of AED 400.

This is called psychological pricing. Consumers are 'tricked' into thinking that AED 399 is significantly cheaper than AED 400. Of course it is not, but this psychological effect often works for businesses. In this case, Nassar's has used psychological pricing in an effort to increase sales. For example, item 1 was priced at AED 280 using cost-plus pricing but during the trial month it was AED 239.

**5 ► a Complete the tables by calculating the revenue before and after the price change and b then assess whether the sale using psychological pricing was effective for Nassar's.**

To assess whether the new pricing strategy was successful, it is necessary to calculate the revenues from the sales of the four garments in the month before the trial and in the month of the trial. This is easily done by multiplying the sales volume by the prices in each month. These values are shown in the revenue columns of both tables below.

Item	Cost (AED)	Cost + price (AED)	Sales	Revenue (AED)
1	200	280	100	28,000
2	800	1120	50	56,000
3	400	560	80	44,800
4	120	168	200	33,600

Item	Cost (AED)	Psych. price (AED)	Sales	Revenue (AED)
1	200	239	150	35,850
2	800	899	65	58,435
3	400	519	140	72,660
4	120	159	300	47,700

In the month before the trial, where cost plus pricing was used, the total revenue from the sale of the four items was AED 162 400. During the month of the trial, where psychological pricing was used, total revenue was AED 214 645. Therefore, both sales of the four items and revenue have increased significantly. Revenue has increased by AED 52 245, that is, 32 per cent. This suggests that psychological pricing was effective during the month's trial and should be used across all of Nassar's stores. However, some caution is needed. Clearly the alternative pricing strategy has increased revenue, however, Nassar's needs to look at profit as well. It needs to check that business overheads have not increased by more than the increase in revenue as a result of selling more items.

**CHAPTER 38**

**CASE STUDY: UNILEVER**

**1 ► What is meant by distribution in business?**

Distribution is the movement of goods from the supplier to the customer.

**2 ► Describe the method of distribution used by Unilever.**

Unilever uses a number of different distribution methods. Unilever has its own sales force but also uses independent brokers, agents and distributors. It sells to chain stores, wholesalers, cooperatives, independents, food service distributors and institutions. Products are transported

through a network of distribution centres, warehouses, company-operated and public storage facilities and other facilities. Their popular brands can be bought in a very wide range of retail outlets from small independents to giant supermarkets, all over the world.

**3 ▶ Discuss one reason for Unilever's approach to distribution.**

Unilever appears to use a mass distribution approach. It uses many different outlets to sell its products. This approach allows Unilever to sell large volumes all over the world. As a result, it is able to generate large revenues. For example, in 2015, the company enjoyed sales revenue of €53 300 million. If Unilever were more selective about its distribution network, it would be more difficult to generate such high levels of sales.

**4 ▶ In groups, make a list of all the different types of outlet where a Magnum ice cream might be purchased. Compare your results with other groups. Which group has the longest list?**

## ACTIVITY 1

### CASE STUDY: BATA

**1 ▶ What is the difference between retailers and wholesalers?**

Retailers are businesses that buy goods from manufacturers or other suppliers and sell them to consumers. Retailers provide manufacturers and other sellers with some key services. They buy large quantities from manufacturers and wholesalers and sell smaller quantities to customers. This is called bulk breaking and is the main function of retailers. However, they may add value to products by providing other services. These might include help with packing, delivery, repair services, information about products, guarantees and gift-wrapping.

Wholesalers usually buy from manufacturers and sell to retailers. Some wholesalers are called cash and carries. This is because customers can come to the store, buy goods, pay cash and take goods away with them. Wholesalers may break bulk, repack goods, redistribute smaller quantities, store goods and provide delivery services. A wholesaler stocks goods produced by many manufacturers. Therefore retailers get to select from a wide range of products.

**2 ▶ Describe two features of a chain store like Bata.**

One approach to retailing is to develop a chain of stores. This is where one owner or company opens multiple stores selling the same range of goods in many different locations. In this case, Bata has around 5000 stores selling footwear. Each store in the chain will look very much the same and be under the control of a central office. Stores will usually have a standardised product range. This means that each shop will have almost exactly the same products for sale – shoes and other footwear in the case of Bata. Another feature of chain stores is that the facia and layout will be almost exactly the same in every store wherever it is located.

**3 ▶ Discuss the main advantage to Bata of manufacturing shoes and selling them through its own chain stores.**

Bata also manufactures footwear. It has 26 manufacturing units in 18 different countries. The main advantage to Bata

of manufacturing its own shoes is that the intermediary is removed. This means that Bata makes more money because it enjoys the profit margins that the intermediary (perhaps a wholesaler) would normally take. This will increase the profitability of the whole business. It also means that Bata's manufacturers have guaranteed outlets for their output.

## ACTIVITY 2

### CASE STUDY: ROLEX

**1 ▶ Describe the method of distribution used by Rolex.**

Rolex is very selective about where its wristwatches are sold. Rolex watches are only available in a select number of official Rolex retailers. It is important that each outlet has the necessary skills and technical know-how to guarantee the authenticity of each and every part of a Rolex, and to help customers to choose the right model that will last a lifetime. This helps to control the environment in which they are sold and to avoid the sale of fake watches.

**2 ▶ Discuss one possible reason why Rolex watches cannot be purchased online.**

One reason why genuine Rolex watches cannot be purchased online is because Rolex wants to reduce the number of fake watches that are sold under its brand name. It is much easier to sell 'fake' products online since customers cannot touch and look at goods before they are purchased. Rolex claims that none of their watches will be sold online. Therefore, anyone that buys a Rolex from this source is taking a great risk – it is unlikely to be a genuine Rolex.

### MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: NEIMAN MARCUS

**1 ▶ What is meant by the term distribution channel?**

A distribution channel is the route through which goods pass from the manufacturer to the consumer.

**2 ▶ Describe one factor that might affect the choice of distribution channel for a business.**

The distribution channel chosen by a business will depend on a number of factors. One factor is the nature of the product. Different types of products may require different distribution channels. For example, most services are sold directly to consumers. It would not be appropriate for window cleaners, gardeners and hairdressers, for example, to use intermediaries. Businesses producing high-quality 'exclusive' products such as perfume and designer clothes will choose their outlets very carefully. The image of their products is important so they are not likely to use supermarkets, for example. In this case, Neiman Marcus, a luxury department store, stocks some high profile brands such as Chanel, Gucci and Prada. These manufacturers will be happy to see their products stocked in such an exclusive outlet.

**3 ▶ Describe two features of a department store.**

Neiman Marcus is a luxury department store. This is a large store split into distinct selling departments such as

menswear, nightwear, cosmetics, food, gifts and children's clothing. They usually aim to provide good quality products with high levels of customer service. For example, sales staff may receive training in the different products sold in their particular department. Department stores are often found in city centres. Neiman Marcus has around 40 stores selling women's and men's clothing, accessories, jewellery and dinnerware. Five of Neiman Marcus's stores are located in South Florida.

**4 ► Discuss the possible reasons for the growth in online sales for retailers such as Neiman Marcus. Give at least two reasons in your analysis.**

One of the main reasons why online sales have grown so rapidly in recent years is because of the benefits it offers to consumers. Products can usually be purchased more cheaply because e-tailers have lower set-up and operating costs. For example, they do not have to invest in expensive properties to locate shops. Consumers can also shop 24/7 and there is generally a lot more choice. Another benefit is that people can shop from anywhere provided they have access to the Internet.

Another possible reason for the growth is the development of the technology that allows online retailers to operate. People can use PCs, laptops, smartphones or tablets to buy goods online. This provides consumers with a very flexible method of shopping. For example, people could do their weekly grocery shopping using a smartphone while sitting on the train returning from work and so complete an uninteresting household task in what would usually be wasted time. Without reliable and sophisticated technology, online shopping would not have grown.

**5 ► Assess the benefits of e-tailing to Neiman Marcus.**

Neiman Marcus, like many other retailers, has taken up online selling enthusiastically and begun to enjoy the benefits. One of the main benefits is that e-tailers do not have to meet the set-up and operating costs of opening more stores. This will help to reduce both fixed and variable costs and therefore increase profits. There will also be savings because less paper is used for documents, such as invoices and receipts. Transaction costs will be lower because most transactions are automated. Payments from consumers can be received online before goods are sent to. This will help cash flow and avoid bad debts. B2C businesses like Neiman Marcus will also be able to sell to a global market using an online operation and serve their customers 24/7.

Online sales are becoming more important to the business. Neiman Marcus's chief operating officer Don Grimes said that the company sold US\$1300 million online in 2015, an increase of 13 per cent. Web sales made up 25.5 per cent of the company's 2015 sales of US\$.095 million, up from 23.9 per cent a year earlier. The success of its online operation was explained by to investment in technology and the provision of a personalised shopping facility.

However, there are some disadvantages that need to be recognised when selling online. Neiman Marcus will face increasing competition since selling online is a relatively cheap method of distribution and can be organised from any location in the world. Consequently, the business will face more competition from overseas. There is also a lack

of human contact, which might not suit some customers, and there is heavy dependence on delivery services where e-tailers often lack control of the quality of delivery. However, since Neiman Marcus also has its chain of stores, it can serve customers in two ways.

There may also be technical problems online. For example, websites may crash, sites may be affected by malware and Internet connections can go down. There is also a security risk as computer hackers might gain access to sensitive information. Neiman Marcus will need to develop systems to deal with any technical issues encountered. This will cost money but overall it seems that the business is benefitting very favourably from its online venture.

## CHAPTER 39

### CASE STUDY: SKY TELEVISION

#### CASE STUDY: BLAKE STREET BLINDS

**1 ► Describe the methods used by Sky and Blake street Blinds to promote their products.**

Sky is using a giant image of the corporation's name on one of its studio buildings to promote the organisation.

Blake Street Blinds is using a small advert in a local newspaper to advertise its products.

**2 ► Describe one possible advantage of each method.**

For a large company like Sky, the use of posters to advertise the company is a relatively cheap method of promotion. The same poster design can be placed at poster sites all over the country to get national coverage. Since it is so large, the poster is likely to have an impact as people pass by.

For a small family business like Blake Street Blinds, advertising in a local newspaper is a common method of promotion. It will be targeted at residents in the local area that the business is happy to serve. It is an inexpensive form of advertising for a small business.

**3 ► Discuss why Blake Street Blinds is likely to use a different method to Sky when advertising.**

Sky and Blake Street Blinds are very different businesses. Sky is a very large PLC while Blake Street Blinds is a small family business. Blake Street Blinds would not have the resources to meet the cost of a national poster campaign. Neither would it be appropriate since Blake Street Blinds only serves a small market.

**4 ► Design a poster that could be used to advertise a satellite television broadcaster.**

## ACTIVITY 1

### CASE STUDY: TELEVISION ADVERTISING

**1 ► What is meant by above-the-line promotion?**

Above-the-line promotion involves paying the owners of media to place an advert. The amount of money spent on advertising is huge. For example, the global spend on advertising in 2016 was US\$579 000 million, according to media research agency Zenith Optimedia. This was 4.9 per cent higher than in 2015.

- 2 ▶ Work out the percentage increase in television advertising expenditure in China between 2010 and 2016.**

Percentage increase =  $\text{US\$}7.87 - \text{US\$}4.95 \div \text{US\$}4.95 \times 100$   
= **59 per cent**

- 3 ▶ Suggest one possible reason that might account for the growth calculated in (2).**

In China, television advertising is still growing and is expected to continue growing into the near future. It is expected to grow by 59 per cent between 2010 and 2016. This is probably because China has a rapidly growing economy and an increasing number of foreign businesses are trying to penetrate the Chinese market. To get a hold in this potentially highly profitable market, they may be prepared to invest heavily in television advertising.

- 4 ▶ Discuss two benefits to businesses of using television advertising.**

Television advertising is still a hugely important medium for advertising in business. Although it is expensive, it has a number of significant advantages. The main one is that television adverts have a huge reach. A television ad campaign on national television could reach the majority of the population in a particular country. This means that millions of people will see the advert.

Another advantage is that television adverts can now be targeted at specific audiences. This is because there are so many different channels that a particular customer group can be targeted quite effectively. For example, a golf equipment manufacturer could place adverts on a sports channel when golf tournaments are being broadcast. A toy manufacturer could target children with adverts on specialist children's television channels such as Disney Junior India, an Indian television network aimed at Indian pre-schoolers. The ability to target customer groups in this way cuts down the waste in television advertising.

## ACTIVITY 2

### CASE STUDY: COUPONS

- 1 ▶ What is meant by below-the-line promotion?**

Any form of promotion that does not involve using the media is called below-the-line promotion. Examples would include coupons, merchandising and free gifts.

- 2 ▶ Discuss the benefits to businesses of using online coupons.**

Coupons, which entitle the holder to discounts off specified goods and services, can be found in a variety of places. For example, they may be printed in newspapers and magazines or attached to the packaging of products and receipts. Also, in recent years, they have started to appear on specialist coupon websites. They are an important method of promotion for a business and most online retailers make use of coupons. For example, the number of US companies using mobile coupons is expected to grow from 36.5 per cent to 48 per cent by 2017. One of the main advantages of coupons is that they draw in price-conscious customers who would otherwise go elsewhere. This means that coupon-users are persuaded to buy products that they would normally avoid. This helps to increase sales volume

and sales revenue for businesses.

Coupons can also be targeted at those markets where price competition is most intense. Since coupons offer products at reduced prices, their use helps businesses to be more competitive in markets where demand is price sensitive.

### MULTIPLE-CHOICE QUESTIONS

1A, 2D, 3B, 4C

## CHAPTER REVIEW

### CASE STUDY: THE INDIAN PREMIER LEAGUE

- 1 ▶ What is meant by sponsorship?**

Sponsorship is where a business attracts publicity by linking the name of the company, or a product, to a major event. In return for a fee, a business is allowed to advertise in key positions around an event. In this case, the Chinese company Vivo Electronics became the title sponsor of the IPL in 2016. Therefore the league is officially known as the Vivo Indian Premier League.

- 2 ▶ Describe two advantages to sponsors of their involvement in the IPL.**

One of the key advantages of sponsorship is that the name of the brand can be projected globally via television without paying broadcasters. This is because most of the major events targeted by sponsors are televised. Therefore it is a cheap way to get television coverage. Major sporting events, such as the Indian Premier League, are popular with sponsors because the reach to television viewers can be global. Each sponsor is given advertising boards around the edges of the cricket pitch. These images are displayed regularly by television cameras while a match is in progress.

Sponsors of the IPL, such as Vodafone, Yes Bank, CEAT Tyres, Tata Sky, Coca-Cola, Amazon and OPPO, also get their logos displayed during pre- and post-match interviews and free tickets to each match. They also likely to get priority on television adverts during matches to give them maximum exposure.

- 3 ▶ What is meant by viral advertising? Use an example from this case study in your explanation.**

Viral advertising involves any strategy that encourages people to pass on messages to others about a product or a business electronically. It creates the potential for exponential growth in the exposure of a message. Like a virus, these strategies exploit the process of rapid multiplication that results from people sending messages to family, friends and colleagues, who then send them on again. Not only can people send text relating to a marketing message, but they can also send images, such as photographs and video clips. In this case, an advert by smartphone maker Reliance Retail went viral on social media. It featured Bollywood actress Kangana Ranaut and the cricketers M.S. Dhoni, Virat Kohli and Ravichandran Ashwin.

- 4 ▶ Discuss one benefit to businesses of establishing a brand name.**

The aim of many businesses is to build a powerful brand. Branding involves giving a product a name, term, sign,

symbol, design or any feature that allows consumers to instantly recognise the product and differentiate it from those of competitors. Some brand names are very well known and worth a great deal of money. In this case, the IPL brand was said to be worth US\$4500 million in 2015. Branding can be used to differentiate the product, create customer loyalty, help recognition and develop an image. In this case, the IPL brand helps recognition and allows the IPL to charge higher rates for sponsorship and broadcasting rights. All cricket supporters and most people in the sub-continent are likely to be aware of the brand. This means that businesses can project their adverts to larger audiences if they are linked to the IPL in some way. However, they have to pay more to receive these benefits.

**5 ► Assess the benefits to a business of using social media in advertising.**

The use of social media platforms, such as Facebook, Twitter, Instagram and Tumblr, in advertising is growing at a rapid rate. In 2015, the Internet had 3170 million users. There are 2300 million active social media users and 91 per cent of retail brands use two or more social media channels. Internet users have an average of 5.54 social media accounts and social media users have risen by 176 million in the last year.

Social networks gather lots of information about users, which allows businesses to target their adverts more effectively. When people use the Internet, every click, every view and every sign-up is recorded somewhere. This behaviour is collected, processed and eventually ends up with businesses.

In this case, the IPL generates an enormous amount of social media activity. The 2016 Twenty20 saw close to 9 million Tweets, an increase of 122 per cent in Tweets-per-match from 2015. The official IPL website has a 'Social' tab which captures all online conversations including a leader board for Tweets and mentions related to the tournament and each IPL team.

One of the main advantages of using social media in advertising is cost: it is easy and inexpensive relative to other methods of advertising. Another key benefit is that adverts can be targeted. This means that businesses will direct their promotions, offers and other marketing information only to those people who are likely to be interested. As a result, there is much less waste in advertising. Businesses can also respond immediately to developments in the industry and the quality of customer service can be improved because it is possible to communicate instantly with customers. Another big benefit is the ability to reach huge audiences – hundreds of millions or even billions. Finally, links can be used by businesses to draw traffic into company websites. This should help to increase sales.

The importance of social media to advertisers cannot be overemphasised. Figure 39.6 shows that the amount spent by businesses on digital advertising is about to overtake that spent on television advertising. It seems that the use of social media in marketing is here to stay.

## CHAPTER 40

### CASE STUDY: GILLY'S SNACK SHACK

#### CASE STUDY: GRANT FINCH FOODS

**1 ► Which of the two businesses is the largest?**

Grant Finch Foods is the largest business. It employs 110 people while Gilly's Snack Shack is a sole trader. Grant Finch Foods sells about 1 000 000 sandwiches a week to supermarkets while Gilly's Snack Shack sells about 900 to shoppers, tourists and workers in the local area.

**2 ► Which business has the lowest costs?**

Grant Finch Foods buys ingredients direct from farmers and manufacturers. For example, it buys 1000s of loaves of bread from a Chicago baker for US\$1.10 each. It buys tomatoes from a local farm for US\$1.50 per kilo and cheese for US\$7.00 per kilo. Gilly's Snack Shack buys supplies from supermarkets and wholesalers. It buys about 20 loaves of bread at a cost of US\$1.80 each. Tomatoes cost US\$2.50 per kilo and cheese US\$7.00 per kilo. Clearly Grant Finch Foods is buying supplies cheaper. Other costs are lower as well. For example, Gilly's Snack Shack has a US\$5000 loan and pays an interest rate of 8.9 per cent. However, Grant Finch Foods pays 7.5 per cent on a US\$1 000,000 loan.

**3 ► Which firm is likely to be the most efficient?**

Grant Finch Foods is likely to be the most efficient because it has lower costs.

**4 ► How might Grant Finch Foods benefit from its cost advantage?**

Grant Finch Foods sells sandwiches at an average price of US\$1.40 per packet to its customers while Gilly's Snack Shack sells most of their sandwich range for US\$2.00. Gilly's Snack Shack could never compete with Grant Finch Foods on grounds of price. Grant Finch Foods might also make more profit with its lower costs.

## ACTIVITY 1

### CASE STUDY: DIB (DO-IT-BETTER)

**1 ► Discuss how DIB is exploiting a technical economies of scale and b risk-bearing economies of scale.**

**a** One of the reasons for DIB's success has been the ability to keep costs down in manufacturing. DIB is very large and able to exploit economies of scale. For example, it is able to exploit technical economies. Technical economies usually occur because larger plants are more efficient than smaller ones. There can be more specialisation and more investment in machinery.

In this case, DIB benefits from specialisation. It employs specialist workers in different parts of the world to produce different products and components. This division of labour allows average costs to be reduced since specialists are more efficient. DIB also invests heavily in research and development. This allows the business to develop cost effective products and money-saving production techniques.

- b** DIB also exploits risk-bearing economies. Although the business first began trading in painting and decorating materials, DIB is now involved in other markets such as kitchens, garden furniture, timber, tools, light machinery and building supplies. It also operates restaurants and food markets with many stores serving food throughout the day. It also provides childcare with some stores offering safe and supervised play areas. This growth in the business means that DIB can benefit from boom periods in different markets. It can also cope with difficult trading conditions in one market by relying on sales in others.

## ACTIVITY 2

### CASE STUDY: VOLKSWAGEN

#### 1 ► What is meant by diseconomies of scale?

If a business keeps on growing, it is likely to reach a point where average costs start to rise. This is because the firm suffers from diseconomies of scale. In Figure 40.1, average costs start to rise after output has reached 70 000 units of output. Average costs start to rise because aspects of production become inefficient. For example, businesses become too bureaucratic and more difficult to control and co-ordinate. This raises costs.

#### 2 ► Assess whether VW has experienced diseconomies of scale in its organisation.

There is some evidence in this case to suggest that VW might be experiencing diseconomies of scale. In 2015, VW was caught falsifying emissions data on its diesel cars. VW had fitted some special software (a 'defeat device') in about 11 million diesel vehicles so that cars would pass the strict emissions test. As a result, the value of VW fell by around €30 000 million following a flood of bad publicity across the world. Some analysts have suggested that the company is now too big and suffering from diseconomies of scale. This is because big companies like VW, which employs over 500 000 employees, become huge bureaucracies rather than commercial organisations. Controlling and monitoring such vast operations, with factories, offices, warehouses and other operational facilities all over the world becomes a very serious challenge for managers. In this case, it is possible that VW has grown too big to manage. It was claimed that the CEO of VW did not know about this activity. In such a large organisation, this might be true. It is unlikely that any CEO, however capable, committed and well organised, could be in complete control of such a huge quantity of resources that are located all over the world. As businesses grow, at some point, the costs of being big – such as the loss of control, communications problems, the need for more supervision and extra layers of management, the increasing tendency for delegation, the geographical spread of resources, the near impossibility of establishing a common business culture and employing a fully integrated IT system – are greater than the benefits. This is the effect diseconomies of scale can have on a business and may have been the cause of VW's current problems.

### MULTIPLE-CHOICE QUESTIONS

1C, 2D, 3A, 4D

## CHAPTER REVIEW

### CASE STUDY: FLAMBOYANCE

#### 1 ► What is meant by the term scale in business?

The term 'scale' in business means size. If a business increases the scale of operations, it means that the business is getting bigger. For example, in this case, Flamboyance increased its scale when it bought the chain of shops in the Middle East.

#### 2 ► Describe the effect that economies and diseconomies of scale are likely to have on Flamboyance's average cost.

As a business grows and expands the scale of its operations, average costs are likely to fall. Larger firms can operate more efficiently than smaller firms. This is because a business begins to enjoy economies of scale. As Flamboyance grew, it employed a specialist marketing manager, which is a managerial economy. Flamboyance bought more clothes and shoes so they would probably enjoy purchasing economies as well. However, if a business grows too big, average costs will start to rise. This is because inefficiencies slowly develop as a result of diseconomies of scale. For example, in this case Flamboyance bought a chain of shops in the Middle East and it appears that problems started to occur after that point. Communications became difficult due to language and cultural difficulties. Such a problem can result in higher costs as a business tries to find solutions. As a result of economies and diseconomies of scale, a firm's average cost curve is U-shaped.

#### 3 ► Why is employing a specialist marketing manager an economy of scale?

As firms expand, they can afford specialist managers. In this case, Flamboyance has employed a specialist marketing manager. A small business may employ a general manager responsible for finance, human resources, finance, marketing and production. The manager may find this role demanding and lack skills in some fields. A large firm can afford to employ specialists in these fields. As a result, efficiency is likely to improve and average costs fall. Through his or her expertise, the marketing manager was able to raise the profile of the Flamboyance brand right across Singapore. As a result, the company grew quickly and became very profitable.

#### 4 ► Assess whether Flamboyance has benefited from purchasing economies of scale.

Large retail chains like Flamboyance are very likely to benefit from purchasing economies. Those that buy large amounts of stock can get cheaper rates. Shoe and clothes manufacturers will offer discounts to firms that buy stock in bulk. This is similar to consumers buying multi-packs in supermarkets – they are better value for money. Flamboyance has expanded rapidly and now buys large quantities of stock from China. Inevitably, the company will benefit from purchasing economies.

#### 5 ► To what extent has Flamboyance experienced diseconomies of scale?

Diseconomies of scale occur when average costs start to rise because the firm has grown too big. In this case,

there is some evidence that Flamboyance is suffering from diseconomies of scale. Since buying the chain of stores in the Middle East, problems have occurred. For example, communications became difficult due to language and cultural difficulties. There were also some employee problems. There was a lack of employee commitment; many of the staff did not seem to care whether the company succeeded or not. This would result in inefficiencies and rising costs. Also, some of the store managers complained that the company was becoming too bureaucratic; rising bureaucracy is a common source of diseconomies of scale. If a business becomes too bureaucratic it means that too many resources are being used up in administration. Too much time may be spent filling in forms and writing reports. Also, decision making may be too slow, communication channels too long and too many managers may be employed. It could be argued that Flamboyance is experiencing diseconomies of scale to a significant extent since buying the chain of stores in the Middle East.

## CHAPTER 41

### CASE STUDY: M.K. SIDDIQI

#### CASE STUDY: MARS, INCORPORATED

- 1 ▶ Compare the two production methods used in the above examples.**

Mars is a mass producer. It makes millions of units of chocolate bars, foods, cans of pet food and many other brands. Its production methods are capital intensive. This means that plant and machinery are used in large quantities relative to labour. Many of its brands are produced on automated production lines, which run continuously for many hours. The photograph shows bars of chocolate on a production line – this line will run continuously with millions of units being produced. Every unit that comes off the end of the production line will look identical.

In contrast, M.K. Siddiqi operates on a much smaller scale. He produces handmade suits. Production is labour intensive and involves him working alone making products by hand. For example, he will use scissors, a sewing machine, needles and other small items of equipment to make the suits. All his suits are bespoke (that is, made to specific customer orders). He learnt the trade from his father and has been making suits in the same workshop in Chittagong for 43 years. He offers customers a massive choice in terms of different fabrics, designs and styles.

- 2 ▶ Describe two reasons why the two businesses use different production methods.**

Mars produces on a very large scale. Its production processes will be highly automated with little use of labour on production lines. The products produced by Mars are appropriate for mass production. For example, Mars could not use the same production method as M.K. Siddiqi. It is not practical to make millions of chocolate bars and millions of cans of pet food by hand. However, the suits made by M.K. Siddiqi require craft and skill are appropriate for being handmade. The quality of finish could not be guaranteed with mass production techniques.

## ACTIVITY 1

### CASE STUDY: SAUDI ARAMCO

- 1 ▶ What is meant by flow production? Use this case study as an example in your explanation.**

Flow production is a highly efficient method of production. It is organised so that different operations can be carried out, one after the other, in a continuous process. Products move from one operation to the next. In this case study, process production, a form of flow production, is used to refine crude oil. Crude oil is heated and the different products are pulled out at different temperatures. For example, lubricating oil, used for motor oil, grease and other lubricants, boils at a temperature between 572 to 700°C. After this, chemical processes are used to remove impurities. A system of pipes is used to link all the different processes so that refining continues unstopped.

- 2 ▶ Assess the advantages and disadvantages to Saudi Aramco of flow production. Make a clear judgement in your evaluation.**

Flow production is a highly efficient method of production provided large quantities of output can be sold. In this case, Saudi Aramco is the largest oil corporation in the world. It has revenues of around US\$1000 million per day. This suggests that it produces vast quantities of oil. Flow production requires large-scale production but results in economies of scale, therefore unit costs will be low. Saudi Aramco probably enjoys some of the lowest unit costs in the industry. Another advantage of flow production is that the speed of production can usually be varied. In this case, oil refining could be slowed down if there was a drop in demand by pumping less oil into the refinery. Alternatively, to speed production up, more crude oil could be pumped in. Some of the refining facilities operated by Saudi Aramco might be quite flexible. For example, the company may be able to produce many different products from its refineries.

Flow production does have disadvantages. The cost of building a large oil refinery is huge. Oil refining requires a very large financial investment and many companies could not afford the set up costs. However, a corporation like Saudi Aramco is not likely to be restricted in its operations by a lack of financial resources. Another problem might be staff motivation. If the jobs done by people working in refineries are boring, as they often are on production lines, their motivation might suffer. This might lead to mistakes and a loss of output. Finally, businesses using flow production are at risk if breakdowns occur. If there is a breakdown in one small part of the refining process, it may be necessary to stop the flow of production while repairs take place. This could prove very expensive. Overall, in this case, the advantages of using flow production are much greater than any disadvantages.

## ACTIVITY 2

## CASE STUDY: HUBER

- 1 ► Calculate the labour productivity in each of the four factories.

Factory	Output	Number of employees	Labour productivity
India	28,500	150	190
Germany	54,000	270	200
China	79,050	310	255
Brazil	46,000	200	230

- 2 ► Which factory is Huber likely to close down?

Huber is likely to close the factory in India. This factory has the lowest labour productivity at 190 containers per worker.

## MULTIPLE-CHOICE QUESTIONS

1C, 2C, 3A, 4D

## CHAPTER REVIEW

## CASE STUDY: GHF LTD

- 1 ► What is meant by the term capital-intensive production?

Capital-intensive production methods make more use of machinery relative to labour. In this case, GHF Ltd switched to more capital-intensive methods of production by investing heavily in new machinery.

- 2 ► Why was job production inefficient at GHF Ltd?

Job production is where a business produces one product from start to finish before moving on to the next. Each item produced is likely to be different. Job production is used when orders are small, such as 'one-offs'. It is often an inefficient method of production because it is slow. In this case, M. Patel had noticed that job production was inefficient. For example, workers sometimes moved from one job to another (if there was a delay in the supply of a component for example). This would slow down employees as they had to make adjustments to their pattern of work, for example, catch up with what others had been doing, rethink what they were doing and often switch tools and equipment.

- 3 ► Why are unit costs likely to fall when using batch production?

Once batch production was adopted, with the introduction of a small production line, efficiency improved. Batch production usually results in lower unit costs. This would be because some of the fixed costs of production, such as tools, machinery and equipment, would be spread over more units of output.

- 4 ► Discuss one possible impact on workers of making further improvements in productivity at GHF Ltd.

GHF Ltd has already made improvements to productivity by switching production methods from job to batch and introducing more machinery to make production more capital intensive. However, more improvements are planned for the future. It hopes to make further investments in new technology and introduce some non-financial methods of

motivation for the workforce. If non-financial incentives are used, workers' jobs may become more interesting. This will be a positive impact for the workers. However, some measures might have a negative impact. For example, if more new machinery is introduced, some workers might lose their jobs. This could have a negative impact on the business, particularly if workers take industrial action.

- 5 ► Assess the benefits to GHF Ltd of switching from job to batch production.

It is quite common for a business to switch production methods as it grows and larger orders are received. In this case, GHF Ltd switched methods to raise profit margins by moving from costly 'one-off special-project work' to reproducible standard products. The production manager identified problems with the special one-off projects. They often involved research, design and installation costs that did not carry over into another project. For example, one job for a large clothes retailer involved lots of design work. In addition, some of the key parts of the system had to be outsourced to another business. The job was a one-off with no benefits for the next job.

Batch production is generally more efficient. Unit costs are likely to be lower because output is higher, workers can be more specialised and more use is made of machinery. Production is also flexible because orders with different measurements, styles or specifications can still be met. For example, in this case, GHF Ltd started producing batches of ducts using their new production system – a system so flexible that 60 000 variations were possible.

As a result of the switch, GHF Ltd became more competitive. Between 2009 and 2012, GHF Ltd reduced the amount of special project work from 80 per cent to 10 per cent. Producing standard systems in batches filled the gap. It took a while for the factory to adjust to these changes in working practices but even in the first year the company made a small profit. This was largely down to an order for 85 standard silent fans.

However, the switch from job to batch production required a significant amount of investment as the business began to use more capital-intensive methods of production. GHF Ltd had to borrow £900 000. This may have put a financial strain on the business as it needed to pay interest on the debt. However, there is no information in the case study that suggests there were any serious financial problems.

To conclude, it seems that the switch in production from job to batch was a successful strategy for GHF Ltd. Costs are down and profit margins should be up. Further improvements to productivity are planned in the future so the business owners must be pleased with the outcomes.

## CHAPTER 42

## CASE STUDY: GOLDSTONE HOLDINGS

- 1 ► How important was staff involvement at Goldstone when trying to make improvements?

Staff involvement was recognised as being very important when Goldstone began making improvements in its operations. As a result of this, more training was organised. Investment in training improved staff motivation. If a

business is prepared to spend considerable money on training, it shows that staff involvement is highly valued. Workers were also given more authority. They were encouraged to make their own decisions and solve problems. Staff were also given time to 'tidy up' the work environment. They removed all the clutter, such as old tools, spoilt work and items of un-needed stock that had built up over the years.

**2 ► Discuss the possible benefits to Goldstone from introducing Japanese production methods.**

Goldstone enjoyed a wide range of benefits after adopting Japanese production methods. Turnover increased by 50 per cent, production set-up time was reduced by 74 per cent, machine down time was reduced by 73 per cent, delivery targets were increased by 21 per cent and product rejection fell by 50 per cent. The investment in staff training also improved staff motivation.

## ACTIVITY 1

### CASE STUDY: DELL

**1 ► Describe how Dell adopted just-in-time methods.**

Just-in-time (JIT) is an approach to production that involves holding very low levels of stock – in some cases none at all. Suppliers have to deliver inventories straight to the production line at regular intervals. This might be several times a day. JIT also means that goods are not produced unless they have been ordered. This avoids the need to hold stock of finished goods. In this case, Dell used direct selling and all of its products were sold online. A customer would place an order on Dell's website listing the various specifications that were required. Dell would then make that computer and ship it out to the customer very rapidly.

Dell also developed special relationships with its suppliers. It persuaded them to hold inventories of raw materials and components and deliver them very quickly as and when they were needed. This was key to Dell's approach. Dell was passionate about minimising stock levels. It relied heavily on suppliers to bear the burden of inventory holding and meeting very demanding lead times.

**2 ► Describe the benefits to Dell of using a just-in-time approach to production.**

The JIT approach allowed Dell to deliver a tailor-made product at a lower cost. By manufacturing to order, Dell was able to avoid the cost of buying too many components and having to store them. Storage and handling costs were reduced significantly. It also meant that computers were not being stockpiled waiting to be sold. This enabled Dell to put together and deliver products very quickly. It also saved time, improved cash flow, helped to avoid waste and damaged stock and did not waste space. It also allowed Dell to pass on the savings to their customers. This helped the business to become one of the market leaders in sales of computers.

**3 ► Carry out some research to identify another business that uses just-in-time methods. Produce a poster to show how it is used and how the company has benefitted. Present your findings to the rest of the class.**

## MULTIPLE-CHOICE QUESTIONS

1B, 2C, 3A, 4D

## CHAPTER REVIEW

### CASE STUDY: HERMAN MILLER

**1 ► What is meant by kaizen?**

Kaizen is a Japanese word and refers to the practice of continuous improvement. There is a belief in Japan that everything can be improved. Even at work, the Japanese believe it is possible to make small improvements continuously. This means that the workers are always coming up with ideas to improve quality, reduce waste or increase efficiency. The improvements may be very small but over a long period of time they have a huge impact.

Kaizen was introduced at Herman Miller. One example of a small change that was suggested was the position of a bin containing washers. By moving it slightly employees reduced the amount of reaching required by 6 inches. Another was the adjustment in the height of the assembly line. It was changed slightly so that workers did not waste a few moments bending over. Such changes are extremely small. But this is what kaizen is all about and if small changes like this are made continuously over a period of time significant improvements in efficiency can be made.

### **Kaizen is usually driven by 'good housekeeping'.**

**2 ► What does this mean?**

One of the key drivers in kaizen is 'good housekeeping'. A clean and well-organised working environment is needed for continuous improvement to flourish. The Japanese use a method called 5S to ensure that this is achieved. This involves adopting five specific practices (all beginning with 's') The first one is 'Sort'. This is about getting rid of the clutter in the workplace. Only necessary items such as tools should be stored at a workstation. All other items such as excess inventory should be removed. The next, 'Set in order' means the work area should be organised so that it is easy to find what is needed. 'Shine' is to do with making the work area and equipment clean – make it 'shine'. 'Standardise' means that once the most effective working practices have been identified, they should be adopted by everyone in the workplace. Finally, 'Sustain' means that systems should be adopted so that the previous 4Ss are locked into the way people work at all times on a permanent basis.

**3 ► Discuss one advantage to Herman Miller of empowering workers.**

The aim of empowerment is to give employees more control over their own work. In the past, most workers have followed the instructions given to them by managers. They were rarely required to think for themselves. However, if workers are empowered they are given the authority to make decisions, solve problems and work creatively. At Herman Miller, one of the first steps when introducing kaizen was to empower the workforce. Employees in the factory were asked to suggest small changes that could help to improve the speed or ease of working practices around their **workstations**. Empowering people at work

can improve their motivation. This is because workers feel trusted and their work may be more interesting. As a result, they should be more productive and cooperative. This will help to improve efficiency and make it easier to introduce changes. Workers are also more likely to meet their full potential which will help meet their higher level needs in Maslow's hierarchy.

**4 ▶ Assess the benefits to Herman Miller of implementing kaizen and making more effective use of resources.**

The introduction of kaizen at Herman Miller has had a massive impact on the organisation. It has helped Herman Miller to develop a more scientific approach to problem solving and resulted in the introduction of numerous standardised factory procedures. These changes, and many others, have improved the efficiency of operations. For example, a new Aeron chair now comes off the production line every 17 seconds compared with 82 seconds 13 years ago. Production time has been reduced from 600 seconds to 340 seconds. Safety metrics have improved by a factor of six. Quality metrics have improved by a factor of ten and the factory is ten times smaller.

Also, the labour time needed to make a single chair is one-fifth of what it used to be, customer lead times have fallen from two months to ten days, the product range has increased from five standard designs to 17, reliability is 99.4 per cent and product faults have been reduced to less than 0.1 per cent.

The introduction of kaizen has resulted in Herman Miller using its resources far more effectively. This also has clear benefits. For example, if fewer resources are used, business costs will be lower. Herman Miller uses less labour and much less time in its operations. If costs are lowered then businesses will make more profit. This will increase returns for the owners and provide cheap funds for investment in the future.

Lean producers will also have a competitive edge in the market. Businesses that use their resources effectively will be able to lower prices. This should help Herman Miller to win a bigger share of the market. Customers are likely to benefit if a business makes more effective use of resources. For example, Herman Miller has reduced lead times and improved product quality. This means that customers will get their products more quickly and enjoy better performing products. Also, some kaizen practices focus on customer needs, therefore customers are likely to get a better service.

Finally, despite this impressive list of benefits, Herman Miller are still getting improvements of a quarter to a half of a second at a time, month by month as the practice of kaizen continues. The introduction of kaizen has been a great success at Herman Miller.

## CHAPTER 43

### CASE STUDY: DRIVERLESS TRACTORS (ROBOTRACTORS)

**1 ▶ Describe the new technology outlined in the case above.**

The new technology identified in the case study is a driverless tractor – it features the Case IH Autonomous Concept Vehicle. The tractor is pre-programmed and

then remotely controlled by an operator from a desktop computer or other easily transportable device. The tractor uses radar, on board cameras and LIDAR (light imaging, detection and ranging) to find and update its path when moving. If it detects a barrier in its path, it will stop automatically until an operator reprograms the machine. The tractor will also stop if the GPS signal is lost. The machine can take on the traditional land work of tractors such as tillage, planting, spraying and harvesting. According to a spokesman for Case IH, a farm manager can supervise several machines using a mobile device while tending to other tasks or even operating another machine.

**2 ▶ Describe the possible benefits of the new technology to a farmers and b consumers.**

**a** The main benefit of the new technology to farmers is that productivity will improve. This is because the quantity of labour used in production will be reduced. This will reduce costs and raise profitability. Another benefit is that it will help farmers who struggle to find skilled drivers during busy periods such as at harvest time. The driverless tractors are also safe, which is beneficial since farm accidents occur frequently when machinery is used.

**b** Consumers may benefit if food production becomes cheaper as a result of improvements in technology. Food prices might be lower and food may be more plentiful. By 2050, the world's population is expected to grow to around 9 billion. So, in order to feed this rapidly growing number of people, significant improvements in productivity will be required in agriculture. The introduction of driverless tractors might help here.

**3 ▶ In pairs, carry out some research to find out how genetically modified crops are being used in agriculture. Find out the advantages and disadvantages of their use and present your results to the rest of the class using a poster.**

## ACTIVITY 1

### CASE STUDY: ROBOTS IN PRODUCTION

**1 ▶ What is the difference between material handling robots and processing operations robots?**

Robots feature largely in assembly and on production lines. They usually have a mechanical arm that moves according to instructions given by a computer. However, there are different types of robots in manufacturing. Material handling robots are usually employed in the transport of goods, parts or stock from one place to another, most often within the same factory or plant. Automated warehouses are an example of this. In contrast, processing operations robots generally perform a specific task such as spot welding or spray painting. These robots are fitted with a specialised tool to perform the programmed task.

**2 ▶ Describe the new technology invented by Jonathan Zornow in this case.**

In the clothing industry, the role of robots has until now mainly been only in cutting. They were not able to sew because soft fabric is very difficult for robots to handle. It requires a great deal of accuracy to feed a piece of soft material through a sewing machine to create a straight

join. Consequently, the job has always been done manually. However, in 2015, an inventor called Jonathan Zornow developed a technique that allowed a robot to sew effectively. It involved using a water-based plastic to coat the fabric, which made it stiff rather like cardboard. Following the application of this coating robots were able to handle the cloth more easily. Once the 'Sewbo' has completed a sewing task, the coated material is immersed in water and the cloth returns to its normal state.

**3 ► Discuss the possible disadvantages of introducing Sewbo into the textiles industry.**

Like most new technology, robots have their disadvantages when they are introduced into factories. One of the main disadvantages is that workers often have to be laid off. This is usually because robots can do the work of people; consequently, fewer workers are needed. This is likely to result in redundancies and possible hardship for those laid off. In this case, if the technology becomes established, the textiles industry could see some great changes. A large proportion of garment manufacturing takes place in places like China, Bangladesh and Thailand. In much of the industry, workers are treated poorly and receive relatively low wages. Eliminating the exploitation of these of these workers would be a positive move. However, the many thousands of people working in the industry might struggle to find alternative employment once the technology is introduced.

**MULTIPLE-CHOICE QUESTIONS**

1B, 2D, 3A, 4B

**CASE STUDY: ALLIANCE GROUP**

**1 ► Describe one disadvantage to Alliance Group of introducing the new robotic technology into its plants.**

Unfortunately, the introduction of new technology is not without problems. One of the main ones is the high initial cost of buying and installation. In this case, Alliance Group is investing NZ\$ 16 million in new technology. This is a lot of money and may create a financial burden for the group. For example, if Alliance Group have to borrow money it will have to meet interest charges. This will reduce the profits made by the business while the loan is being repaid. It may also cause cash flow problems if the business is short of liquid resources. However, in this case there is no financial information to analyse so the financial impact of the NZ\$16 million is not known.

**2 ► What are the benefits to Alliance Group of introducing new technology in its plants. Give at least two benefits in your analysis.**

The introduction of new technology has a number of benefits. Generally it raises productivity, reduces unit costs and reduces waste in production. In this case, Alliance Group aims to improve operational efficiency as a result of the investment. The two fully automated robots in the first plant will operate safely in the same space as workers in the plant. They take on the difficult and potentially dangerous roles in meat processing and contribute to improvements in quality and hygiene. The new robotic cutting machine for sheep meat will reduce waste in the process and improve hygiene. This is because the machine has circular blades rather than band saws. This machine also improves health

and safety in the plant and reduces some stress from workers. The new packing machine ensures that all meat is not in contact with air after the packaging process. It can also offer a longer shelf-life for the products. This is appealing to some of Alliance's large retail customers. It also has a much larger capacity, which makes the packaging process more cost effective.

Generally, senior managers believe that the company will gain a competitive edge in the market since Alliance is an early adopter of some of this new technology.

**3 ► Assess the importance to businesses of balancing cost, productivity, quality and flexibility when introducing new technology.**

It is often difficult businesses to make decisions regarding when or whether to introduce new technology into production. The financial cost of purchasing, installing and maintaining technology can be very high. In this case, Alliance Group has invested NZ\$16 million in robots and a packing machine. This is expensive and may require the businesses to borrow. There is also the human cost to consider. Introducing new technology often means making people redundant. This too is expensive and can also disrupt the workforce. Decision makers have to be sure that the cost of the technology is greater than the value of the productivity gains. The productivity gains may only be achieved if large quantities of output can be sold. Therefore, Alliance Group must be confident about selling much larger quantities.

Decision makers also have to consider the impact that technology will have on the quality of the product. For example, historically, mass produced products were often seen as lower quality than those that were handmade. Also, some customers are actually happy to pay higher prices for handmade products. This might be the case in the clothing industry, for example. Another issue is the flexibility of new technology. When production processes are automated, it often means that a business can only produce standardised products. This reduces the choice for customers.

However, many would argue that most technology is so sophisticated today that quality and flexibility are not compromised. For example, production lines in the motor industry can deliver flexibility. This is because it is possible to produce cars to many different specifications on the same line.

To conclude, investing in new technology is risky and businesses have to evaluate the costs, productivity gains, the impact on quality and the loss of flexibility (if any) before going ahead. In this case, it appears that Alliance Group is happy to take the risk and be an early adopter in the purchase of this technology.

**CHAPTER 44**

**CASE STUDY: BANANA FARMING IN UGANDA**

**1 ► Describe three possible resources used by Robert Oloya on his banana farm.**

Resources used on Robert Oloya's banana farm are likely to include land, tools and labour. Land would include the soil and water that banana plants need to grow. Tools might

include digging tools for preparing the land for crops and a machete (large knife) to cut the bananas from the plants when they are harvested. Labour would include the people who are employed to help out on the farm.

**2 ► How might the use of machinery (to prepare the land, for example) impact on Robert's banana farm?**

If Robert used machinery on the farm, some of the tasks might become easier. For example, if tractors or other machines were used to prepare the land for crops, this task would become easier and could be done more quickly. However, there may be less need for labour so some of Robert's farm workers might lose their jobs. The purchase of machinery might also put a financial strain on the business, especially if money is borrowed to buy machinery.

## ACTIVITY 1

### CASE STUDY: ANGELA'S BAKERY

**1 ► Suggest two examples of capital that Angela will use.**

Capital is often said to be an artificial resource because it is made by labour. Examples of capital used by Angela that are mentioned in the case include the property that was purchased where the bakery was built. Angela will also have used ovens, cooking implements such as cake tins and baking trays, a food mixer, a mobile phone, some kitchen furniture and a computer.

NB. Any two of these are acceptable – there may be others.

**Angela Collier is an entrepreneur.**

**2 ► What evidence is there in this case study to support this view?**

Entrepreneurs are responsible for setting up and running small businesses. Angela has set up a bakery to supply local shops, cafés and hotels with cakes. This was her idea and she owns the business. This is a feature of entrepreneurship. Angela has also taken some risk: she has invested €40 000 of her own money. If the business is not successful she may lose some, or all, of this money. Angela also organises other production factors. She has purchased some capital and hired people to help her out once the business was established.

## ACTIVITY 2

### CASE STUDY: MOON BROTHERS CONSTRUCTION COMPANY

**1 ► What is meant by the division of labour? Use examples from the case study in your explanation.**

Workers are likely to specialise in certain tasks and skills. This is called the division of labour and allows people to concentrate on a limited range of tasks. The three workers for Moon Brothers Company are all specialists. They all focus on one particular job for the company: Brendan is a bricklayer, Mary is an electrician and Ahab is a plumber. Each of them has specialist skills that are needed to do their jobs; these have taken time to develop.

**2 ► Discuss how specialisation might benefit Moon Brothers Construction Company.**

Moon Brothers Construction Company will benefit from employing specialists. When people specialise, their productivity is higher. This is because the quality of work is likely to be better. They focus on the same limited range of tasks or skills and become very skilled. Specialist workers are usually better trained and more experienced in the specific tasks they take on. This means the company can operate more efficiently and offer customers a higher level of workmanship.

### MULTIPLE-CHOICE QUESTIONS

1D, 2A, 3A, 4B

## CHAPTER REVIEW

### CASE STUDY: TOOTING TOYS

**1 ► What is meant by the term capital-intensive production?**

Capital-intensive production involves using larger amounts of machinery relative to labour in the production process. Yang Chen is considering switching to more capital-intensive methods in this case.

**2 ► Suggest two examples of land used in production at Tooting Toys.**

Tooting Toys has a factory that is located on a plot of land. However, materials such as plastic, which is an oil-based material, is a main input. Other components used when producing pedal tractors might be made of metal.

NB. Any two of these are acceptable – there may also be many others.

**Yang Chen is an entrepreneur.**

**3 ► Discuss his role at Tooting Toys.**

Without entrepreneurs, businesses like Tooting Toys would not exist. In this case study, Yang Chen came up with the business idea to produce small plastic toy tractors using a simple shaping machine. Entrepreneurs are the business owners. Here, Yang Chen is the sole owner of Tooting Toys. He is in complete control of the business and is responsible for its direction. Entrepreneurs are also risk-takers: they risk their own money in a venture. In this case study, Yang Chen risked CNY 70 000 of his own money. When he first set up the business there was a chance that Tooting Toys would not succeed. In this case, Yang Chen could have lost some, or all, of his money. Finally, entrepreneurs are responsible for organising resources. Yang Chen will have to buy and hire resources such as raw materials, tools, equipment and labour. He will also need to use skills such as decision making, people management, time management and financial judgment to organise resources effectively.

**4 ► Assess whether Yang Chen should switch to more capital intensive production methods. Make a clear judgement in your evaluation.**

In 2016, Yang Chen planned to introduce a new product. It is a large plastic pedal sports car. He has had a great deal of interest from large retailers and one has placed an initial order for 100 000. However, to produce such large quantities he would need to consider automating a

significant proportion of production. Investment in new technology would cost CNY 14 million. The business would have to borrow over CNY 7 million to help fund the automation. Before making the switch, Yang Chen would have to consider whether the advantages of more capital-intensive production were greater than the costs.

One of the main advantages to the business would be lower unit cost. Provided Tooting Toys can sell large quantities of its products, investment in technology is usually more cost effective. Also, when machinery is employed in production, the quality of output is usually more precise and consistent. This will reduce defects and cut the waste in production. Another benefit of machinery is that it can be used for long periods of time without breaks and holidays. Machines do not get tired and they can be put to work for 24/7 if necessary. Finally, Yang Chen is likely to find that managing machinery is a lot easier than managing people in production. Machines do not react to instructions, they have no emotions and will not cause conflict in the workplace.

However, Yang Chen needs to be aware that employing more machinery does have disadvantages. For example, there is the huge cost of purchasing and installing new machinery. The cost of the investment to Tooting Toys is said to be CNY 2 million. The business will have to borrow about CNY 7 million, which will place a financial burden on the business. It is also possible that production will be disrupted while the installation takes place. Installing new machinery takes time and workers may need to be retrained. Another disadvantage is that the new machinery may be inflexible. It may be suitable for making the new pedal sports cars but nothing else. Having inflexible machinery can be limiting – particularly if the sports cars do not sell in sufficient quantities. Problems can also occur if machinery breaks down. There may be long delays in production if breakdowns cannot be resolved quickly. This might mean that customers are let down – particularly if joint-in-time methods are being used. Finally, workers may feel threatened by the new machinery. For example, they may feel that their jobs are under threat if machinery is more efficient and cost effective. This could impact on the morale of the whole workforce.

To conclude, there is a lot for Yang Chen to think about before committing to more capital-intensive production. He must be confident that sales will be high enough to justify the investment. He must also manage the introduction of the new technology carefully to minimise the impact on the workforce. He must be confident that the financial burden of the loan will not cause cash flow problems and be sure that the machinery is not too inflexible. Since Dragon Toys already has a large order for the new product, Yang Chen may be full of confidence and go ahead with the switch to more capital-intensive methods.

commitment can be found throughout. For example, the hotel's accommodation is luxurious and has been renovated with respect for the charm and history of the old highland house. Also, much of the food used in the kitchen is high quality locally sourced produce. For example, white fish and shellfish are caught and landed in Ullapool and Lochinver or dived for by friends. Local farmers produce organic vegetables and free-range eggs, a free-range farm in Morayshire supplies beef and lamb, and game, other than barn-reared fowl, is wild and seasonal. Their desire to offer top-quality accommodation and high quality locally sourced food is evidence of how important quality is to their operation.

## 2 ► What evidence is there in the case to suggest that The Albannach provides a quality experience for guests and diners?

The Albannach Hotel was awarded a Michelin star for the quality of its food in 2009 – seven years later it still has that award. A Michelin star is a worldwide recognition of quality restaurant food. This provides 'hard evidence' of the quality they provide. The Albannach is also in the Good Hotel Guide.

## ACTIVITY 1

### CASE STUDY: SAMSUNG

#### 1 ► What is meant by a product recall?

If a business has an unresolved problem with a product, it may be forced to ask all customers to return the product. This is called a product recall. One example is when Samsung launched its Galaxy Note 7 smartphone in August 2016. It hoped to challenge Apple in the market for smartphones. Unfortunately, Samsung had to recall all sets and halt production due to a problem with the batteries. This followed a number of serious incidents. For example, on 4 October 2016, a US customer suffered lung damage when a Galaxy Note 7 released smoke in his bedroom. Also, on 5 October a set caught fire on a Southwest Airlines flight. There were many more similar incidents. The Galaxy Note 7 was officially recalled in the USA by the Consumer Product Safety Commission in September. It advised owners of the sets to shut down and cease all usage, and return them in exchange for a replacement. However, even replacements had problems. Therefore in October, Samsung stopped production of the sets. Samsung instructed customers to return the sets in kits containing special packaging. The kits consisted of an antistatic bag (for the phone) and three layers of wrapping, one of which was made of a fire-proof material.

#### 2 ► Why is quality so important for products like the one in this case study?

Product recalls are, at best, embarrassing for a business. At worst they can do a great deal of damage. With technical products like smartphones, quality is extremely important. If quality is insufficient and customers are put at risk by a defective product, this is a serious issue. Because there is so much to lose from supplying faulty electrical products, quality is of the highest importance for the safety of customers.

## CHAPTER 45

### CASE STUDY: QUALITY AT THE ALBANNACH HOTEL

#### 1 ► Discuss the importance of quality to The Albannach?

Lesley and Colin are passionate about their business. They are totally committed to quality. Evidence of this

**3 ▶ Discuss how Samsung may be affected by this product recall.**

The impact of the product recall at Samsung could be huge. It could have a long-term effect. Immediately after the first announcement, around US\$14 000 million was lost from the value of the company as its share price fell dramatically. Also, hundreds of Koreans have threatened to sue Samsung for compensation. They wanted to recover the costs of visiting shops to exchange their phones, for the time they spent transferring data and for psychological harm from handling a hazardous product. However, Samsung is a powerful and resourceful company. It may have the money and strategies needed to recover and progress in the future. The share price had recovered all losses since October 2016 by the end of the year and gone up further. The Samsung Galaxy Note 7 is just one of many, many products for the business. If one fails like this, they have many others to fall back on.

## ACTIVITY 2

### CASE STUDY: SANTA CRUZ GUITAR COMPANY

**1 ▶ Describe two features of total quality management that are used by the Santa Cruz Guitar company.**

One important feature of TQM is quality chains. Every worker in a business is like a link in a chain and every worker is both a customer and a supplier. This is because a worker on a production line will only receive (as a customer) and pass on (as a supplier) semi-finished work if it has reached specified quality standards. This avoids faulty products ever being made. The Santa Cruz Guitar Company aims to avoid errors in production at all costs. It employs a number of highly skilled craftsmen called luthiers and organises employees around six different workstations. After work on a guitar is completed at one workstation, the job is then passed on to the next. However, each workstation is under the supervision of a senior luthier and no guitar passes on to the next stage without a thorough quality check – usually by two luthiers. Although production is organised like an assembly line, each workstation operates like a link in a chain. They are both customers and suppliers.

Another feature of TQM evident at the Santa Cruz Guitar Company is a focus on the customer. Firms using TQM are committed to their customers. They respond to changes in people's needs and expectations. In this case, each guitar is made to precise customer specifications and the company has a website where guitar owners can communicate directly with the manufacturer. The success of the company is reflected by its long list of customer orders.

**2 ▶ Explain one advantage to the Santa Cruz Guitar company of using TQM principles.**

One key advantage of using a TQM approach to ensure quality is that waste and inefficiencies are removed. At the Santa Cruz Guitar Company, the thorough checks that are made before each guitar is passed to the next workstation help to minimise the possibility of mistakes. This also helps to keep rework and waste to an absolute minimum. No finished product should have a defect by the time production has been completed. This will help to keep costs down and allow the firm to produce high quality products for customers, thus ensuring the company's reputation is maintained.

## MULTIPLE-CHOICE QUESTIONS

1A, 2C, 3B, 4B

## CHAPTER REVIEW

### CASE STUDY: ASHWIN DATA SYSTEMS (ADS)

**1 ▶ How does ADS ensure quality in its business?**

Many businesses follow codes of practice. These show that a production process has been carried out to a certain standard. Once a business has been assessed and has achieved a certain standard, it is regularly checked by the awarding organisation to make sure standards are maintained. In this case, ADS has been granted ISO 9001 certification, the internationally recognised standard for the quality management of businesses.

**2 ▶ Why does quality matter so much to a business like ADS?**

The importance of quality has grown in recent years. Consumers are more aware, they get information through specialist consumer magazines, social media and the Internet and as a result they have higher expectations than ever before. Increased competition has also forced firms to improve the quality of their products. Government legislation designed to protect consumers has forced firms to improve quality. Faulty products are costly for a business. For example, if faulty products find their way onto the market, they may have to be recalled which is expensive and embarrassing for a business. If ADS supplied faulty software to clients, it could disrupt their operations and result in lost customers. Consequently ADS may face compensation claims. Quality matters to a business because, generally, they will enjoy more sales if they can deliver quality products. Poor quality is likely to result in lost customers.

### ADS have been awarded the ISO 9001 certificate.

**3 ▶ Discuss two benefits from winning this award.**

One benefit that ADS should enjoy as a result of ISO 9001 certification is that the award can help a business to examine and improve systems, methods and procedures. This will lower costs, motivate staff and encourage them to get things right first time. It can also highlight product or design problems and develop improvements, record and investigate all quality failure and customer complaints and make sure that they do not recur.

The ISO 9001 award also gives a clear signal to customers that ADS are taking measures to improve quality. This should help to generate more sales and lead to higher profitability. Also, if ADS develops a reputation for quality, they may gain a competitive edge in the market and be able to charge a higher price. Customers are often prepared to pay more if quality can be guaranteed.

### ADS are considering the introduction of TQM.

**4 ▶ Will this benefit the company? Make a clear judgement in your evaluation.**

TQM is an approach to quality control designed to prevent errors, such as poor quality products, from ever happening. The business is organised so that the production process is investigated at every stage. ADS may enjoy a number of benefits if they introduce TQM into their organisation. TQM

helps a business to become more market orientated. This is because it improves customer focus by encouraging staff to focus on customer needs. Since TQM is adopted through the whole organisation, it helps improve quality in all aspects of the business. TQM also removes waste and inefficiencies, which will save ADS money. TQM will also help ADS to develop ways of measuring performance in its operations and improve communication and problem solving.

However, ADS must also appreciate that TQM is very expensive to introduce. There are high training and implementation costs. TQM can also be bureaucratic and will only work if everyone in the business is committed. This means that all personnel must be involved when TQM is introduced, including senior managers and shop floor workers. Without total commitment from everyone, TQM is unlikely to be successful.

Generally, most people would agree that if TQM is introduced effectively with the commitment of all staff and adequate training for everyone, quality will improve and the business will benefit financially in the long term. ADS is a business that values quality and appears to be developing a reputation in the market for quality. If it can achieve this, it may enjoy a competitive edge and begin to dominate the market.

### EXAM PRACTICE: 1 BUSINESS ACTIVITY AND INFLUENCES ON BUSINESS

**a State one non-financial aim of a business. (1)**

One non-financial aim of a business is to gain personal satisfaction.

**b State one way of measuring the success of a business. (1)**

One way of measuring the success of a business is to look at the amount of profit made in a financial year.

**c Explain one way in which a fall in the exchange rate might affect a business. (3)**

Ismail buys jewellery from overseas. Consequently, when he makes a payment he will have to pay in a foreign currency. Unfortunately, when the exchange rate falls the price of imports will rise. This means that Ismail will have to pay more for his stock. This will reduce the profit made by Ismail's business unless he is able to charge his customers a higher price.

**d Explain one disadvantage of operating as a sole trader. (3)**

One of the main disadvantages of operating as a sole trader is that they have unlimited liability. This means that if the business fails a sole trader can lose more money than was originally invested. This is because a sole trader can be forced to use personal wealth to pay off business debts. This could have serious financial implications for sole traders and their families. They stand to lose more of their own money if the business fails.

**Ismail read in a newspaper that interest rates in Bahrain were likely to rise in 2017.**

**e Explain one possible effect on Ismail's business of an increase in interest rates. (3)**

Most businesses would consider an increase in interest rates as negative. This is because higher interest rates might dampen demand for some products. When interest rates rise

people will tend to borrow less because borrowing becomes more expensive; therefore they might cut down the amount of purchases made by credit card for example. This might hit Ismail's business because consumers may use credit cards to buy goods like jewellery. Also, jewellery is a non-essential product, therefore it will be relatively easy for consumers to cut back on the amount of jewellery they buy if it becomes more expensive.

**In 2017, Ismail was informed that his rent in the shopping mall would double. As a result of the news, Ismail was considering two options:**

**Option 1: Move his shop to a Bahraini side street where rent is very cheap.**

**Option 2: Cease trading from a shop and set up an online business selling jewellery.**

**f Justify which one of these two options Ismail should choose. (9)**

It might be argued that the current location of Ismail's jewellery shop is a good one. This is because shopping malls are modern and attract a large number of shoppers in a concentrated area. However, when an important cost like rent doubles, this might be too much of a financial burden for the business to bear. This is presumably why Ismail is considering two options for changing his business.

Moving his shop to a Bahraini side street will reduce costs because rent will be lower. Ismail might also get more retail space for his money. This might mean that profit margins are higher and he may be able to display more stock, which will give shoppers more choice. However, the side street may not attract as many shoppers as the mall and his business may become isolated. To compensate, he may have to spend more money on advertising, which will raise costs.

Setting up an online jewellery business may be a realistic option. The set-up costs would be low and Ismail would avoid all the expenses, such as rent, fixtures and fittings, associated with selling from a shop. He would also be able to locate his operation anywhere he chooses as long as he has a reliable Internet connection. Another benefit is that he may draw customers from all over the world since online selling allows businesses to reach global markets.

To conclude, Ismail needs to choose an option that suits his own personal preference. If operating a store from a mall is too expensive and a new location in a side street is perhaps regarded as a step backwards, the online option may be the right choice. If Ismail can design an attractive website and meet customer needs with an extensive range of jewellery, online selling might be the way forward. The prospect of selling to a global market is very attractive indeed to any entrepreneur.

### EXAM PRACTICE: 2 PEOPLE IN BUSINESS

**a Define the term 'fringe benefit'. (1)**

One example of a motivational theory is Maslow's Hierarchy of Needs.

Some employees receive fringe benefits in addition to their normal pay. They are often described as the 'perks' of the job. Examples might include free or subsidised meals, a company car, discounts on company products and free private health insurance.

**b Outline one reason why motivation in the workplace is important. (2)**

Well-motivated employees will work harder. They are likely to take more pride in their work, complete tasks quickly and feel that their jobs are important. As a result, they will produce higher levels of output. Businesses also need workers to co-operate. For example, more and more businesses organise their staff into teams. Therefore, if workers do not co-operate with each other, teamwork will be disrupted.

**c Outline one legal control over employment that might affect Skyscanner. (2)**

Generally, owners are free to set levels of pay in their businesses. However, in some countries governments have introduced a legal minimum wage. This involves passing legislation that means no employer is allowed to pay their workers an hourly rate below the limit set. Employers face a penalty if they pay wages that are lower than the national minimum wage.

**Skyscanner advertises jobs online.****d Analyse the benefits to Skyscanner of advertising jobs online. (6)**

The use of specialist online sites for advertising jobs is now common. Many jobseekers are familiar with specialist sites that advertise jobs. Some sites are general but others advertise jobs in specific fields such as accountancy or teaching. It is also common for businesses like Skyscanner to advertise jobs online. There may be a link from a general business website which guides jobseekers to a vacancies page, for example. Advertising jobs online is fairly cheap since there is no need to pay a media outlet for advertising space. It is also possible to give a great deal of detail online and modify job adverts easily so that they are always up-to-date.

Another important benefit is that online adverts can be used to attract applicants from all over the world if necessary. This is because online job adverts can be accessed anywhere across the globe. This means that a business like Skyscanner will have a bigger choice when recruiting people and is more likely to be able to recruit high-quality candidates.

**Skyscanner is committed to equipping their staff with new skills. To help with staff training, Skyscanner offers a range of 200 courses to help promote the transfer of knowledge in its organisation. The CEO delivers a five-week programme for high-potential employees, educating them on how to think like an entrepreneur.**

**Many businesses face two key options when training their staff:**

**Option 1: On-the-job training**

**Option 2: Off-the-job training**

**e Justify which of these two options Skyscanner should choose. (9)**

Most businesses have to train their workers. This means they have to be taught how to do their jobs. If workers are well trained, they will be more productive and better motivated. However, there are different ways in which workers can be trained. One of the most common methods is on-the-job training. This means that workers are trained in the workplace

while the job is being done. A number of different approaches might be used by a business. One common approach involves a new recruit watching and copying the actions of an experienced and competent employee. This method can work well if the existing member of staff is a good and committed teacher. If not, the quality of training might be poor. The main advantage of on-the-job training is that it is relevant because workers are learning by actually doing the job. Trainees are also producing output, which can generate revenue. On-the-job training is also relatively cheap and easy to organise. However, on-the-job training may be stressful for the trainee, particularly if working with others. Trainees might also make mistakes and produce output that is unfit to sell. Also, if the trainers are not committed, training quality is likely to be poor. Some employees receive training away from the normal work area. This is called off-the-job training. For example, it might involve workers going to college once a week. Alternatively, it might involve a small group of managers travelling overseas to learn about new management techniques. The main advantages of off-the-job training are that output is not affected if mistakes are made and trainees cannot be distracted by work. Also, training could take place outside of work hours if necessary and customers and others are not put at risk. However, there are disadvantages. Trainees do not produce any output and some off-the-job training is expensive if provided by specialists. Also, some aspects of work cannot be taught off-the-job and it may take time to organise.

Many companies prefer on-the-job training because it is cheap and relevant. However, where there might be a danger to others if workers are being trained on the job, off-the-job training is likely to be used. In this case, Skyscanner organises much of its own training. For example, Skyscanner offers a range of 200 courses to help promote the transfer of knowledge in its organisation. The CEO delivers a five-week programme for high-potential employees, educating them on how to think like an entrepreneur. To conclude, small businesses are likely to use on-the-job training to minimise costs. But as firms grow, like Skyscanner, off-the-job training may be more cost effective.

**EXAM PRACTICE: 3 BUSINESS FINANCE****a Define the term cost of sales. (1)**

The cost of sales is the direct expenses incurred by a business in the course of production. Examples might be raw materials and the wages of factory workers.

**b Calculate the gross profit margin for West Point in 2016. (2)**

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Turnover}} \times 100$$

$$\text{Gross profit margin} = \frac{\text{gross profit}}{\text{revenue}} \times 100$$

$$= \text{US\$}5\,200\,000 \times 100$$

$$\text{US\$}14\,200\,000$$

$$= \mathbf{36.6 \text{ per cent}}$$

**c Outline one reason why West Point might produce a statement of comprehensive income. (2)**

The statement of comprehensive income shows business owners and managers the amount of profit made by a business in a financial year. However, the information

contained in the statement might be used to help make some important decisions. For example, it will show a business what has happened to costs during the year. It might show, for example, that the cost of sales has increased sharply. As a result, a business can identify reasons for this and take measures to bring costs under control.

**d Analyse the importance of cash to a business like West Point Ltd. (6)**

Cash is the most liquid of all business assets. Without cash a business cannot trade. It is reckoned that poor cash flow is the reason why many businesses eventually fail. Even when trading conditions are good, businesses can fail. A business always needs cash to pay important bills. Suppliers have to be paid for the materials and components that have been purchased. If a business fails to pay a supplier on time, it may mean that the supplier will refuse to trade with that business in the future. Businesses also need cash to pay for overheads such as rent, electricity, insurance and telephone charges. Businesses will often get bills for the services that they have used. Again, if these bills are not paid, there is a risk that such services will be terminated. Finally, employees have to be paid every week or every month. If a business cannot pay its employees, it would not be very long before they walked out. If a business runs out of cash, it may become insolvent – this means that the business cannot pay its debts. This would usually result in the business closing down; this is the worst that can happen. Unfortunately, unless a business can raise cash immediately to pay the most pressing debt, the business will collapse. Therefore, it is important that a business continually monitors and controls its cash flow.

**West Point has experienced financial difficulties in recent months and wants to improve its cash flow. Two options have been identified.**

**Option 1: Take out a bank overdraft**

**Option 2: Make more use of trade payables**

**Justify which one of these two options West Point Ltd should choose. (9)**

When a business runs short of cash, it is important to act quickly. Without sufficient cash, a business cannot trade. One way West Point can raise cash quickly is to get an overdraft from a bank. This is a common source of finance for most businesses. A bank overdraft means a business can spend more money than it has in its account. In other words, they go overdrawn. The bank will set an overdraft limit and interest is only charged when the account is overdrawn. Bank overdrafts are simple and flexible. However, the bank has the right to ask for the money owed to be paid back at any time. It may do this if it thinks the business is struggling. A business may use bank overdrafts as a short-term source of finance.

The other funding option being considered by West Point is using trade payables. This is where a business buys resources, such as raw materials and components, and pays for them at a later date – perhaps 30, 60 or even 90 days later. This is a common way of doing business in many countries. It is a cheap source of finance because there is no interest to pay. However, many suppliers encourage early payment by offering discounts and the cost of goods is often higher if firms buy on credit. Also, if West Point Ltd delayed payments for too long, suppliers might get upset and refuse to deliver goods in the future.

In this case, West Point may be better off arranging a bank overdraft. If the business has been struggling financially, it may need an injection of cash very quickly; a bank overdraft will provide such an injection. It is also a flexible source of finance and will only be used when necessary. However, West Point will need to get permission from the bank before an overdraft is granted. If the bank refuses to provide an overdraft, then West Point might be forced to use trade payables. Initially, though, a bank overdraft is probably the better of the two funding options.

**EXAM PRACTICE: 4 MARKETING**

**a Calculate the amount of money Sony spent on advertising as a percentage of its revenue in 2014. (2)**

The amount of money spent on advertising as a percentage of revenue is given by:

$$\text{US\$2350 million} \times 100 = \mathbf{3.4 \text{ per cent}}$$

$$\text{US\$69 050 million}$$

**For some of its products, such as its gaming console, Sony uses a skimming pricing strategy.**

**b Analyse the benefits to Sony of using a skimming pricing strategy. (6)**

Some businesses may launch a product into a market charging a high price for a limited time period. This is called skimming or creaming and is used for some of Sony's products. The main objective is to generate high levels of revenue with a new product before competitors bring out a rival product. In the market for some goods, there is a group of consumers called 'early adopters'. Early adopters are prepared to pay higher prices because they like to be the first to buy the product. It has been suggested that early adopters are younger, have a higher social status with a better education than late adopters. They may also have higher levels of income and be more socially forward. It is reckoned that about 13 per cent of consumers are early adopters in such markets.

Skimming allows businesses like Sony to recover the cost of research and product development. The relatively high levels of revenue that are generated from sales to early adopters contribute to these high R&D costs. The high levels of revenue also act as an incentive to firms like Sony to carry on investing in R&D.

**c Evaluate the importance of market research to a company like Sony. (12)**

Market research involves gathering, presenting and analysing information regarding the marketing and consumption of goods and services. Market research can be expensive but businesses are prepared to meet the cost because of the benefits it brings.

Market research is important because it helps to identify and understand customer needs. A business will be more successful if it can supply products that meet customers' needs. This means that a business has to gather information to identify these needs. For example, when developing a new gaming console, Sony will need to find out which product features are important to potential customers. These might include model design and style, graphics quality, durability, portability and flexibility. Once this data has been gathered, a business can design a product that meets the specific needs of customers.

If possible, businesses need to anticipate customer needs. This means they try to predict what customers want in advance and respond to changes very quickly. Businesses like Sony operate in a rapidly changing environment and have to keep up with the latest trends, fashion, technology and design.

Market research is also important because it helps to identify gaps in the market. If Sony can spot a gap in the market, it is likely to gain a competitive edge. It may be able to generate higher levels of revenue and profit before a competitor, like Microsoft, arrives. Finding untapped markets is not easy but gathering information from people might help.

Businesses can also use market research to reduce the risk in business. Setting up a business or launching a new product is risky. As markets get larger, and as competition gets fiercer, launching new products gets even riskier. The likelihood of failure is high but investment in effective market research can help reduce the risk of failure. There are many examples of costly product failures that may have resulted from misreading the market or failing to carry out effective market research.

Finally, market research information can help a business like Sony to make important decisions. Businesses have to make countless decisions and generally the quality of decision making can be improved if managers have access to meaningful information. Market research can provide a wide range of information that could be used to improve decision making – particularly when making marketing decisions.

Although there are some considerable benefits from carrying out market research, a business needs to ensure that the data gathered is reliable. If market research data is inaccurate or out of date, any decisions based on the data are likely to be unsound. The reliability of market research data often depends on the number of people questioned and whether they represent the views of everyone. Ideally, information could be gathered from every single person in a market. However, this would take too long and cost too much money. To overcome this problem, businesses use a sample of people. A sample is a much smaller group; however, the behaviour and views of the sample must be representative of all the people in the market, otherwise the data will be biased and unreliable.

A business should also appreciate that human behaviour is unpredictable. Although people may indicate their intentions in a questionnaire, what they do in reality might be quite different. People might change their minds or misunderstand the question. They might also give answers that they think the interviewers wanted to hear.

To conclude, these issues must be addressed to ensure the reliability of data. Companies like Sony will understand these issues and take them into account. Market research is vital for companies like Sony where competition is so intense. If they are not able to meet or exceed customer needs and expectations, they will lose out to rivals.

## EXAM PRACTICE: 5 BUSINESS OPERATIONS

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

Labour productivity is the output per worker in a given time period.

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

One example of an internal economy of scale is financial economies.

### c Explain one limit to the growth of a business. (3)

One of the main limits to growth is a lack of finance needed to expand. Growth usually requires investment in new resources such as property extensions, new machinery, equipment and more labour. Unfortunately, some businesses are not able to convince moneylenders that if the company grows it will be more successful and the finance will be repaid. Many small businesses that want to grow are still seen as too risky.

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

Abdul Engineering uses labour-intensive production, which means that they use relatively more labour than capital. One of the main disadvantages of labour intensive production is that labour is more difficult to manage than capital. People have feelings and can react in an unpredictable way. For example, a worker might not follow the instructions given by a manager. This might result in delays, mistakes or conflict. This can be disruptive to production. Sometimes, if there is a serious disagreement between workers and managers, industrial action such as a strike might result. This could not happen with machinery.

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

If resources are used more effectively, efficiency will improve. For example, if fewer raw materials are used in production, costs will fall. If costs are lowered, then businesses will make more profit. This will increase returns for the owners and provide cheap funds for investment in the future. The business will also be more competitive in the market, which will help to generate more sales.

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

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

#### Option 1: Continue using job production.

#### Option 2: Switch to batch production.

### f Justify which one of these two options Abdul Engineering should choose. (9)

Abdul Engineering is currently using job production to manufacture metal frames. This is where a business produces one product from start to finish before moving on to the next. Each item produced is likely to be different such as a different frame design for each greenhouse. Job production is used when orders are small, such as 'one-offs'. The quality of output from job production is usually very good. This is because skilled craft workers often carry out work. Workers are likely to be motivated because the work is varied. Also, each worker is likely to be involved in completing the whole job from start to finish. One key advantage to Abdul Engineering of using job production is that products can be custom made. This means that different farmers can order different sized greenhouses with different designs. However,

although production might be easier to organise when using job production, production may be slower and lead times longer. This is because craft workers take longer than machines to carry out their tasks. Job production is also likely to be more expensive than other methods. This is because the wages of craft workers will be higher and specialist tools might be needed.

When demand grows and orders for multiple units are placed, a business might switch to batch production. This is where a business makes a number (a batch) of products to the same design or specification and then changes production to another product with different specifications. When products are made in batches, production is usually divided into a number of operations or processes. An operation or process is applied to the entire batch before it moves onto the next. Unit costs are likely to be lower when batch production is adopted. This is because output is higher, workers can be more specialised and more use is made of machinery. Production can also be flexible because orders with different measurements, styles or specifications can still be met. However, planning and co-ordination may be more difficult. For example, if a particular operation takes longer than all others in the production process, it is important that resources employed on other operations are not kept waiting. Also, if batches are small then unit costs may still be quite high.

In this case, Abdul Engineering might need to switch to batch production. It has started to receive multiple orders for some of its products and production is likely to be more efficient using batch production. If the business wants to grow, it needs to capitalise on this new opportunity. Abdul may be able to invest in more machinery and rely less on his workforce. This should help to improve efficiency and raise profits. Provided the multiple orders continue into the future, a switch to batch production would be justified.

# PREPARING FOR YOUR PEARSON EDEXCEL INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 1)

## SAMPLE ANSWERS WITH COMMENTS

### Paper 1

1 ► (a) (i) B (ii) C (iii) C

Sample answers to (iv) (v) and (vi) are not given so you try these yourself, for exam practice.

#### Comment, 1 (a) (i), (ii) and (iii)

Multiple-choice questions are designed to test your knowledge. Therefore marks are awarded for satisfying AO1. When answering multiple-choice questions it is important to read all of the answers before making your selection. You must avoid picking the first answer that you think might be right – this is because there might be a more accurate answer further down the list.

The answer to (a) (i) is B. Packaging is a variable cost because as output is increased more materials are needed to package the extra output. The wrong answers, rent, interest payments and insurance premiums are all examples of fixed costs. They do not vary when output changes.

The answer to (a) (ii) is C. A job description is a document that outlines the tasks, duties and responsibilities associated with a job. It is used when recruiting staff. For example, it shows applicants exactly what they will have to do if they get the job.

A job specification is a personal profile of the type of person needed to do a particular job. A job application form is a standard document used to collect information from a job applicant. A curriculum vitae is a document used by a job seeker that lists personal details, qualifications, work experience, referees and other details. These are all wrong answers.

The answer to (a) (iii) is C. Skimming is a pricing strategy that involves charging a high price when a product is first launched. This strategy is often used by businesses selling technological products such as smartphones and computer games.

Penetration pricing involves selling a product at a low price when it is first launched. Cost plus pricing involves adding a mark-up (a certain percentage) to the cost of a product to set the price. Psychological pricing involves setting the price slightly below a round figure – charging US\$99.99 instead of US\$100 perhaps. These are all wrong answers.

#### STUDENT ANSWERS

- (b) Average cost is the unit cost of production. It is the cost of producing a single unit and can be found by dividing total cost by output (in units).
- (c) There is no sample answer for this question so you can try it yourself, for exam practice.

- (d) An example of a stakeholder is an employee.
- (e) There is no sample answer for this question so you can try it yourself, for exam practice.
- (f) One advantage of customer loyalty to a business is that marketing costs will be lower. The cost of attracting new customers is considerably higher than the cost of retaining existing customers. With lower costs, a business should enjoy higher profits and therefore greater returns on the money invested in the business.
- (g) A sole trader is the simplest form of business organisation and has just one owner – in this case Edison Johar. One main advantage to Edison of operating as a sole trader is that he gets to keep all the profit made by the business. He does not have to share the profit with any other stakeholders. This means that he may be more motivated. For example, he might work harder to please his customers. He can also choose whether to keep the profit or reinvest it in the business. To improve efficiency, for example.

Another advantage is that Edison has complete independence as a sole trader. He does not have to consult any other stakeholder before making a business decision. He can run his business in any way that he wants. He can choose his hours of work and take holidays whenever he wants. He is not answerable to anyone. This is often one of the main reasons why people set up a business. They like the idea of being in charge. The possibility of conflict is also reduced since one person (i.e. Edison) has all the power.

#### COMMENT

- (b) Definitions will normally be awarded just one mark for AO1. No more than one or two sentences are required to define a term. In this case, average cost is the cost of producing a single unit. It is calculated by dividing total cost by output.
- (d) Giving a business example is another way of demonstrating knowledge. Therefore 1 mark for AO1 is awarded for a correct example. There are several other examples of business stakeholders in addition to the one given in the student answer – employee. Other possible answers include customers, suppliers, shareholders/owners, managers, the local community or the government.
- (f) This question is again focused on testing knowledge. However there are three marks awarded for AO1 in this question. One mark might be awarded for identifying an advantage and another two for explaining the advantage to a business. One advantage of customer loyalty is that marketing costs will be lower (1). The student answer explains that the cost of attracting new customers is higher than that of retaining existing ones (1). The answer also goes on to explain that with lower costs, profits and returns to the owners will be higher (1).
- (g) This question is about the business in the case and has six marks available. Therefore three might be awarded for AO2 and three for AO3. For AO2 the student answer identifies two advantages to Edison of being a sole trader. Independence, which is explained, and the right to keep all the profit made by the business. To get all three AO2 marks, it is important to answer the question in the context of the business. For AO3 there must be some analysis. Here the student has explained the advantages

of being a sole trader and developed the implications of the advantages for the business. For example, it is explained that Edison has the right to keep all the profit and then decide how to use it. He might keep it for himself or reinvest it in the business, which might help improve efficiency.

## Question 2

### Student answers

- 2 ► (a) A short-term bank loan might be used to raise the Rs50,000 to pay for some new equipment. This would be easy for a small business like Edison's to arrange.
- (b) There is no sample answer for this question so you can try it yourself, for exam practice.
- (c) Retained profit is a cheap source of finance. There is no interest to pay and no administration costs to meet. This source would benefit Edison's business because costs will be lower. This means that profits will be higher. Edison's business would also avoid the additional cost of a loan, which is often important for a small business.
- (d) There is no sample answer for this question so you can try it yourself, for exam practice.
- (e) A business can pursue a number of financial aims. One common financial aim is for the business to make as much profit as possible. Profit is revenue less all business costs. It is the driving force behind most businesses. If the business makes high levels of profit, owners can withdraw it from the business for their own use or retain it in the business for investment in the future. For example, it could be used to help fund the purchase of new equipment.
- (f) Most people would agree that if a business is making a profit then it is successful. Also, if profits are consistently rising then the business is becoming more successful. Rising profits would show that Edison Johar is running his business effectively. It would show that he was able to attract customers, provide them with a quality car washing service and charge a high enough price to more than cover the costs. It shows that the business idea and its implementation are robust. Also, a profitable business is more able to survive going forward. However, profit may not always reflect success. For example, it is possible to make high profits if there is no competition in the market. Therefore, profits made by a monopoly are not as impressive as profits made in a competitive market. In this case, we do not know how much competition Edison has in the market, however, it is very unlikely that Edison has a monopoly in a market which is relatively easy to enter.

It could be argued that a business is successful if the owners are satisfied. If the owners are happy, and are content to carry on running the business, this suggests that the business is successful. If they weren't happy, they would probably close or sell the business and pursue other interests. Success to Edison Johar might mean survival in the market, rising profits/returns or business growth. He might also believe that the business is successful if it continues to provide financial security for him and his family. If Edison said he was satisfied with the performance and future outlook for

his car-washing/valeting business, surely this would suggest that the business is successful and will continue trading. However, personal satisfaction might be difficult to measure accurately. It is not quantifiable. Also, different owners might perceive personal satisfaction in different ways. It is for this reason that Edison might be advised to use profit as a measure of success for his business.

### Comment

- (a) One mark only is awarded here. However, it might be one mark for AO2. This might be because the business in the case is referred to directly in the question. Therefore the answer must be given in the context of Edison's business to demonstrate application. The student answer here states that the source of finance is suitable for a small business like Edison's. This answer therefore recognises that Edison is running a small business and as a result has selected a suitable source of finance.
- (c) Three marks are awarded for this question. Edison's business is referred to in the question so one mark might be awarded for AO1 and two for AO2. In the student answer, the cheapness of the source is given as the advantage (1). The benefits to Edison's business are then explained. A cheap source, such as retained profit, is suitable for a small business. This will keep costs low and future profits higher. (2)
- (e) Three marks are available here. They may be awarded for knowledge since there is no reference to the business in the case study to suggest that application is needed. In the student answer profit has been identified as a financial aim (1). Profit is defined and its role in business explained (1). Possible uses of profit are also explained (1).
- (f) Answers to this question, which offers 9 marks, are likely to require application, analysis and evaluation. So three marks each for AO2, AO3 and AO4 might be awarded. The student answer clearly explains why profit might be a good measure of success. For example, profitability means that the business idea is sound and that the running of the business is effective. This demonstrates analysis. The answer is also set in the context of Edison's business which demonstrates application. Evaluation is demonstrated when the answer also recognises that using profit to measure success may also have drawbacks. For example, if there is no competition in the market, it is easier to make a profit.

The student answer also explains effectively how owner satisfaction can be used to measure the success of a business. For example, if the owners are happy, and are content to carry on running the business, this suggests that the business is successful. If they weren't happy they would probably close or sell the business and pursue other interests. The answer is also set in the context of Edison's business which demonstrates application. Evaluation is used when the student recognises the problems of using the owner's satisfaction as a measure; this is not easy to quantify. There is further evaluation when the student makes a final judgement by saying that profit is probably the best measure in this case. The judgement is also justified. Remember that it is always important to justify any judgement you make in an answer.

- 3 ► (a) Labour intensive means that more labour is used in production relative to capital.
- (b) There is no sample answer for this question so you can try it yourself, for exam practice.
- (c) In a cash flow forecast the closing balance is given by:
- $$= \text{opening balance} + \text{cash inflows} - \text{cash outflows}$$
- $$= \text{Rs}1,000,000 + \text{Rs}3,600,000 - \text{Rs}4,900,000$$
- $$= -\text{Rs}300,000 \text{ (ie a negative closing cash balance)}$$
- (d) Sometimes a business will introduce a new product and charge a low price for a limited period. This is called penetration pricing. The aim of this strategy is to get the product established in the market. Once this objective has been achieved, the price slowly increases to higher levels. In this case, Edison and Nalaka are planning to use penetration pricing when they open *Quickwash*, their new car washing centre in Mount Lavinia. There are two main reasons why penetration pricing might be favoured. First, Edison and Nalaka will hope that drivers get into the habit of using *Quickwash* when the price is low. Then, when they start to increase the price, drivers will carry on using *Quickwash* because they are happy with the car washing service they get. Second, this strategy is also popular if there is a lot of competition in the market. The car washing market is not too difficult to enter so competition might be intense, therefore a low starting price seems a sensible strategy.
- However, the cost of penetration pricing can be high since profit margins will be reduced. There is also the danger of a negative response from drivers when prices start to increase after the introductory offer. Edison and Nalaka will have to be ready for a negative reaction should it happen.
- (e) There is no sample answer for this question so you can try it yourself, for exam practice.

### Comment

- (a) Since this requires a definition, one mark is likely to be awarded for AO1. No more than one or two sentences are required to define a term. Here labour intensive production methods involve making more use of labour in production relative to capital. There is no real point in explaining this further since only one mark is available.
- (c) This question requires a calculation using numerical information from the case. Therefore the two marks are likely to be awarded for AO2. You need to remember how to calculate the closing balance in a cash flow forecast. No formula for this will be given in the exam booklet since it is not a financial ratio. Write down every step in the calculation as the student answer shows here.
- (d) This question requires application and analysis so three marks might be awarded each for AO2 and AO3. The student answer clearly explains how penetration pricing is used by Edison and Nalaka. They want to attract customers to their new carwash venture. One way of doing this is to offer a low price. Two advantages of this are explained clearly and in context. For example, Edison and Nalaka will hope that drivers get into the habit of using *Quickwash* when the price is low. Then, when they start to increase the price, drivers will carry on using

*Quickwash* because they are happy with the car washing service they get. The analysis also considers the main disadvantage of using penetration pricing, i.e. the cost in terms of lost margins. Again this is set in context to ensure that AO2 marks are maximised.

- 4 ► (a) The return on capital employed is given by:

$$\text{ROCE} = \frac{\text{Operating profit}}{\text{capital employed}} \times 100$$

$$\text{ROCE} = \frac{\text{Rs}2,200,000}{\text{Rs}18,000,000} \times 100$$

$$\text{ROCE} = 12.2 \text{ per cent}$$

- (b) There is no sample answer for this question so you can try it yourself, for exam practice.
- (c) Expanding a business by developing a franchise means that the owners (the franchisors) allow other entrepreneurs (the franchisees) to trade under their name. In this case, Edison and Nalaka would allow others to set up *Quickwash* centres in other parts of Colombo, or even in other towns and cities in Sri Lanka. Edison and Nalaka would provide the franchisees with a licence to trade under the brand name of *Quickwash*. They may also offer a start-up package including help, advice, essential equipment and training on how to run a carwash centre and operate the systems used by the franchise. Franchisees might also get materials, equipment and support services that are needed to run a *Quickwash* centre. In return for these services, the franchisees will pay Edison and Nalaka certain fees. These might include a start-up fee – a lump sum – an ongoing fee (usually based on sales) and possibly a contribution to marketing costs. Franchisors sometimes make a profit on some of the materials, equipment and merchandise supplied to franchisees.

The main advantage of setting up a franchise is that *Quickwash* is likely to grow much faster as a business because the brand can be established in many different locations all over Sri Lanka at the same time. This is possible because different franchisees can set up *Quickwash* centres all at the same time with no extra cost to Edison and Nalaka, and because they have already established that there is a demand for this kind of service. A business can usually grow faster using a franchise operation than it could growing on its own.

Another benefit is that Edison and Nalaka will reduce their risk in the business venture. This is because other entrepreneurs, the franchisees, are putting up their own money to set up a *Quickwash* centre in another location. They are funding the growth of the business. If the centres fail, Edison and Nalaka do not have any of their own money at risk.

There is also the attractive benefit that Edison and Nalaka will receive regular payments from franchisees if the operation is successful – plus the original lump sums. Very little extra effort will be needed from Edison and Nalaka to get this money.

However, there are one or two disadvantages with franchising. The total profit potential of a national car washing business is being shared out with other

entrepreneurs. This means that Edison and Nalaka could probably make a lot more money in the long run if the business is grown without the help of franchisees. There is also the danger that one or two 'poor' franchisees could damage the brand; this might happen if a small number of *Quickwash* centres delivered a very poor service. The reputation of the whole operation could be damaged if customers' complaints spread – as they can do with social media. To conclude, Edison and Nalaka would need to be happy to share the profits from their business idea and be prepared to deal with bad publicity if an incompetent franchisee threatened the brand. If they can do this, then a franchising operation might be an appropriate strategy for them.

### Comment

- (a) This question requires a calculation using numerical information from the case. Therefore the two marks are likely to be awarded for AO2. The formula for ROCE will be given on the formula sheet at the beginning of the exam paper. You need to show all your working in case you make a mistake getting to the final answer. Write down every step in the calculation as the student answer shows here.
- (c) For this 12-mark question, three marks each are likely to be awarded for AO1, AO2, O3 and AO4. In this answer, AO1 marks are likely to be awarded for demonstrating a clear understanding of franchising and identifying some advantages and disadvantages of franchising to the franchisor as a method of growth. AO2 marks will be awarded for keeping the answer in context throughout. Throughout the whole of this answer, the advantages and disadvantages of growing a business using franchising is applied to *Quickwash*. Marks for analysis might be awarded for the clear explanations given relating to the advantages and disadvantages of using franchising as way to grow a business. For example, the student answer explains that one advantage is that Edison and Nalaka will reduce their risk in the business venture. This is because other entrepreneurs, the franchisees, are putting up their own money to set up a *Quickwash* centre in another location. They are funding the growth of the business. If the centres fail, Edison and Nalaka do not have any of their own money at risk. There are several examples of clear analysis in the student answer. Finally, AO4 marks are awarded for making arguments with evidence and drawing a clear conclusion. In this case, the student concludes that Edison and Nalaka would need to be happy to share the profits from their business idea and be prepared to deal with bad publicity if an incompetent franchisee threatened the brand. If they can do this then a franchising operation might be an appropriate strategy for them.

## PREPARING FOR YOUR PEARSON EDEXCEL INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 2)

### SAMPLE ANSWERS WITH COMMENTS

#### Paper 2 Investigating large businesses

1 ► (a) (i) D (ii) C (iii) D

Sample answers to (iv) (v) and (vi) are not given so you can try these yourself, for exam practice.

- (b) Branding involves giving the product a feature that allows consumers to recognise the product.
- (c) There is no sample answer for this question so you can try it yourself, for exam practice.
- (d) A trade payable might be an example of a current liability for Coca-Cola. For example, it might owe money to a supplier of sugar.
- (e) There is no sample answer for this question so you can try it yourself, for exam practice.
- (f) Internal recruitment involves filling a job vacancy by appointing someone who already works for the business. One advantage of this is that the cost of recruitment will be lower. The costs of placing a job advert, processing numerous job applications, shortlisting and interviewing a number of different candidates are all avoided. Therefore lower recruitment costs will help to boost profit.
- (g) Sponsorship is an example of below-the-line promotion and involves paying a fee for the right to have the name of the business associated with a particular event. In this case, Coca-Cola has been a sponsor of the Olympic Games since 1928. This is a long association. One main advantage to Coca-Cola of sponsoring the Olympic Games is that the name of the brand gets displayed globally on the television without paying broadcasters. The Coca-Cola logo, and some of its adverts, will be seen all over the world when Olympic events are broadcast. The reach is huge – possibly billions of people. Coca-Cola will be allowed to place its logos around the stadiums at events. For example, its adverts might be seen on the trackside electronic advertising screens. The Coca-Cola logo will also feature on a board (along with other sponsors) – which can be seen during televised interviews with athletes.

The cost of sponsorship is also likely to be considerably less than TV adverts. Therefore Coca-Cola will be saving some money in its advertising budget. Sponsorship is clearly an important element of Coca-Cola's marketing strategy. It must be since the company has sponsored the Olympic Games for nearly 100 years. Sponsorship is a cost effective way to get global television coverage.

### Comment, 1 (a) (i), (ii) and (iii)

As in Paper 1, marks for multiple-choice questions are awarded for satisfying AO1. Once again, remember to read all of the answers before making your selection. Avoid picking the first answer that you see that you think might be right because there might be a more accurate answer further down the list.

The answer to (a) (i) is D. Cash is the most liquid asset of all and is therefore a current asset. Trade payables and a bank overdraft in A and C are both current liabilities. Property in B is a non-current asset.

The answer to (a) (ii) is C. Owners are said to have limited liability when they can only lose the original amount of money invested in a business if it fails. In A, a certificate of incorporation is awarded to a limited company, which permits it to trade as such. In B unlimited liability means that business owners can lose more than the original amount invested in a business if it collapses. In D, a patent is a licence that can be obtained by a business to prevent rivals from copying an idea or invention.

The answer to (a) (iii) is D. Social enterprises are set up to achieve a social or environmental aim, not to make a profit. In A, B and C, multinational companies, private limited companies and public limited companies are all likely to be driven by profit, although some might have other objectives in addition.

- (b) Definitions will normally be awarded one mark for AO1. No more than one or two sentences are required to define a term. In this case, branding also involved differentiation from competitors. The definition is not detailed as it may have been but will likely be awarded 1 mark.
- (d) Giving a business example is another way of demonstrating knowledge. In this case, the example is specific to Coca-Cola so a mark for AO2 might awarded for a correct example. The student answer states that a trade payable might be an example of a current liability for Coca-Cola. For example, it might owe money to a supplier of sugar. This is a relevant example and applied to Coca-Cola. Other examples could have been used such as a bank overdraft or any tax owed by Coca-Cola.
- (f) There are three marks awarded for this question which again is focused on testing knowledge (AO1). One mark might be awarded for identifying one advantage and another two for explaining the advantage to a business. One advantage of internal recruitment is that recruiting costs will be lower (1). The student answer explains that costs like placing a job advert, processing job applications, shortlisting and interviewing a number of different candidates are all avoided (1). The answer also goes on to explain that with lower costs profits will be higher (1).
- (g) This question is about the business in the case and has six marks available. Therefore three might be awarded for AO2 and three for AO3. For AO2, the student answer identifies two advantages to Coca-Cola of sponsorship: lower cost relative to TV advertising and a huge reach. To get all three AO2 marks, it is important to answer the question in the context of the business. This answer makes clear reference to Coca-Cola's long-term sponsorship of the Olympic games. For AO3, there must be some analysis. Here the student has explained the

two advantages of sponsorship to Coca-Cola in detail. For example, it is explained that Coca-Cola will benefit from the huge reach of sponsoring a global event, such as the Olympic Games. Finally, the student also explains why sponsorship is so important to Coca-Cola.

- 2 ► (a) Coca-Cola are likely to recruit full-time workers since they will be needed as operatives in the factory for long periods of time.
- (b) There is no sample answer for this question so you can try it yourself, for exam practice.
- (c) The exchange rate is the rate at which one country's currency is exchanged against the currency of another. Changes in the exchange rate have an impact of the price of exports and imports. For example, if a country's exchange rate strengthens, imports become cheaper and exports become more expensive. Therefore, a business that imports goods will benefit from a rising exchange rate. In contrast, if the exchange rate is falling, it is exporters that benefit. This is because falling exchange rates make exports cheaper. This should result in higher demand and therefore exporters should enjoy higher sales, more revenue and higher profits.
- (d) There is no sample answer for this question so you can try it yourself, for exam practice.
- (e) There is no sample answer for this question so you can try it yourself, for exam practice.
- (f) When Coca-Cola build a new factory, they have to choose a suitable combination of materials, tools, equipment, machinery and labour for production. Some businesses use labour-intensive production. This means that they use relatively more labour than capital. Labour-intensive production is common in Far Eastern countries, such as China and Vietnam, where labour is cheap. In contrast, some businesses use capital-intensive production methods. This means that production relies more on the use of plant and machinery. Generally, Coca-Cola probably uses more capital-intensive methods but it may depend on where the factory is located. Before making the decision Coca-Cola would have to consider whether capital-intensive production or labour-intensive production would be most suitable.

One of the main advantages to Coca-Cola of capital-intensive production would be lower unit costs. Provided Coca-Cola can sell large quantities of its products, investment in technology is usually more cost effective. Also, when machinery is employed in production the quality of output is usually more precise and consistent. This will reduce defects and cut the waste in production. Another benefit of machinery is that it can be used for long periods of time without breaks and holidays. Machines do not get tired and they can be put to work for 24/7 if necessary. Finally, Coca-Cola is likely to find that in production managing machinery is a lot easier than managing people. Machines do not react to instructions, they have no emotions and will not cause conflict in the workplace.

However, Coca-Cola will need to be aware that employing more machinery does have disadvantages. For example, there is the huge cost of purchasing and installing new machinery. The cost to Coca-Cola of the

Gaza Strip factory is around US\$20 million – this is a significant amount of money. Problems can also occur if machinery breaks down. There may be long delays in production if breakdowns cannot be repaired quickly and this might mean that customers are let down.

Labour-intensive methods are often cheaper. They are also more flexible. Labour may be very cheap in the Gaza Strip where unemployment is high. Therefore employing labour-intensive methods in Palestine may be a good production strategy.

To conclude, it is likely that Coca-Cola would prefer to use capital-intensive production. This is because their products are standardised and they produce very large quantities which would allow the company to recover the cost of their investment. However, with workers being so cheap in the Gaza Strip, and possibly willing to work hard once given an opportunity for employment, labour-intensive methods would have to be considered seriously.

## COMMENT

- (a) One mark might be awarded for AO2 since Coca-Cola is mentioned in the question. Therefore the answer must be given in the context to demonstrate application. The student answer here states that full-time employees might be recruited since Coca-Cola will need workers in its factory for a long time, that is, permanently.
- (c) Three marks are awarded for this question. There is no mention of a specific business in the question so three marks for AO1 might be awarded. In the student answer, the meaning of exchange rates is explained clearly (1). It is also explained that changing exchange rates have an impact on import and export prices (1). The impact of a falling exchange rate on a business is then explained (1)
- (f) Answers to this question, which offers 9 marks, are likely to require application, analysis and evaluation. So, three marks each for AO2, AO3 and AO4 might be awarded. The student answer clearly explains the difference between labour- and capital-intensive production. Analysis and application marks might be awarded for explaining the advantages of capital-intensive production with specific reference to Coca-Cola. For example, one of the main advantages to Coca-Cola would be lower unit costs. Provided Coca-Cola can sell large quantities of its products, investment in technology is usually more cost effective. Also, when machinery is employed in production, the quality of output is usually more precise and consistent. This will reduce defects and cut the waste in production. The disadvantages are also explained. For example, there is the huge cost of purchasing and installing new machinery. The cost to Coca-Cola of the Gaza Strip factory is around US\$20 million. This is a significant amount of money. Analysis and application marks might also be awarded for explaining the advantages and disadvantages of labour-intensive production. Finally, evaluation is demonstrated when a judgement is made and justified. For example, the student answer states that it is likely that Coca-Cola would prefer to use capital-intensive production. This is because their products are standardised and they produce very large quantities, which would allow the company to recover the cost of their investment.

- 3 ► (a) The amount spent on raw materials and direct labour is referred to as the cost of sales.
- (b) There is no sample answer for this question so you can try it yourself, for exam practice.

- (c) The operating profit margin is given by:

$$= \frac{\text{Operating profit}}{\text{Revenue}} \times 100$$

$$= \frac{\text{US\$8,728}}{\text{US\$44,294}} \times 100$$

$$= 19.7 \text{ per cent}$$

- (d) Financial ratios can be used to evaluate the performance of a business. For example, profitability ratios, such as the operating profit margin and the return on capital employed (ROCE), can assess the profitability of a business like Coca-Cola. The operating profit for Coca-Cola was 19.7 per cent in 2015 (see c). This can be compared with the operating ratios of other businesses in the soft drinks industry. If it is significantly higher, then it might be concluded that Coca-Cola had performed better. The ROCE looks at the profit made by a business in relation to the amount of money invested in it. This is a common measure of profitability and it can also be used to make comparisons.

Ratio analysis can also be used to assess the liquidity of a business. For example, the current ratio and the acid test ratio are both measures of liquidity. They use current assets and current liabilities to assess whether levels of working capital are sufficient. If the current ratio is significantly less than 1.5 for Coca-Cola then this might suggest that it needs to obtain some short-term finance.

Although financial ratios are very useful it is important to appreciate that their usefulness can be limited. For example, ratio analysis only uses historic data and does not take into account qualitative data such as the quality of the workforce.

- (e) There is no sample answer for this question so you can try it yourself, for exam practice.

## Comment

- (a) One mark for AO1 may be awarded here. The student answer states that the amount spent on raw materials and direct labour is referred to as the cost of sales. Since there is no mention of Coca-Cola in the question, there is no need for application in this answer.
- (c) This calculation question is likely to be awarded two marks for AO2. The formula for the operating profit margin will be given at the front of the answer booklet. Remember to show all your working and set it out neatly like the student answer.
- (d) Since Coca-Cola is mentioned in the question, three marks might be awarded for AO2 and three for AO3. To get all three analysis marks, a student may be expected to explain both the benefits and the disadvantages to Coca-Cola of ratio analysis. For example, profitability ratios, such as the operating profit margin and the return on capital employed (ROCE), can assess the profitability of a business like Coca-Cola. The student answer is in context because it states clearly that the operating

profit for Coca-Cola was 19.7 per cent in 2015 which can be compared with the operating profit ratios of other businesses in the soft drinks industry. If it is significantly higher, then it might be concluded that Coca-Cola had performed better. The ROCE looks at the profit made by a business in relation to the amount of money invested in it. This is a common measure of profitability and it can also be used to make comparisons. At the end of the answer the weaknesses of ratio analysis are explained briefly.

- 4 ► (a) The new cans of coke will be smaller so the cost of filling the cans will be lower. As a percentage the potential costs savings might be:

$$\begin{aligned} &= 355 - \frac{250}{355} \times 100 \\ &= \frac{105}{355} \times 100 \\ &= 29.6 \text{ per cent} \end{aligned}$$

The new cans are 29.6 per cent smaller so the potential cost savings might be 29.6 per cent.

- (b) There is no sample answer for this question so you can try it yourself, for exam practice.
- (c) The use of social media platforms such as Facebook, Twitter, Instagram and Tumblr, in advertising is growing at a rapid rate. In 2015, the internet had 3170 million users. There are 2300 million active social media users and 91 per cent of retail brands use two or more social media channels. Social networks gather lots of information about users which allows businesses to target their adverts more effectively. When people use the Internet every click, every view and every sign-up is recorded somewhere. This behaviour is monitored, processed and eventually ends up with businesses.

One of the main advantages to Coca-Cola of using social media in marketing is cost. Using social media is easy and inexpensive relative to other methods of advertising. For example, television advertising, which Coca-Cola also uses, is a very expensive method of advertising.

Another key benefit is that adverts can be targeted. This means that Coca-Cola can direct their promotions, offers and other marketing information only to those people who are likely to be interested. As a result, there is much less waste in advertising. For example, if Coca-Cola bring out a product that is directed mainly at children, they can adapt their content on social media so that it is suitable for this target. Coca-Cola can also respond immediately to developments in the industry and the quality of customer service can be improved because it is possible to communicate instantly with customers. Another big benefit is the ability to reach huge audiences – hundreds of millions or even billions. One way this can be achieved is through viral advertising. This involves any strategy that encourages people to pass on messages to others about a product or a business electronically. It creates the potential for exponential growth in the exposure of a message. Like a virus, these strategies exploit the process of rapid multiplication that results from people sending messages to family, friends and colleagues, who then send them on again. Not only can people send text

relating to a marketing message, but they also can send images such as photographs and video clips. In a recent marketing event, Coca-Cola positioned what they called Happiness Machines around the world. These are classic Coke vending machines that dish out treats including drinks, pizza, flowers and sandwiches. Some video clips of customers enjoying the free gifts that came from the machines went viral which helped to promote Coca-Cola.

Finally, links can be used by businesses to draw traffic into company websites. This should help to increase sales.

There are some minor disadvantages of using social media. One of the main ones is that Coca-Cola cannot control all the comments and other posts which appear on social media. Therefore, it will have to accept that sometimes there may be some negative information about the company and its products on view. Since Coca-Cola came top in a survey as 'one of the brands doing social media particularly well', this does suggest that social media is very important to the company.

## Comment

- (a) This is a calculation question so there may be two AO2 marks awarded for the correct answer. According to the student answer, savings of around 29 per cent will be made in material costs since the new cans are 29 per cent smaller. This suggests that the contents will be reduced by 29 per cent. However, it might be worth pointing out that some of Coca-Cola's costs will be fixed so the actual savings may not amount to 29 per cent.
- (c) Three marks each may be awarded for AO1, AO2, AO3 and AO4 in this question. In this answer AO1 marks are likely to be awarded for demonstrating an understanding of how social media might be used in marketing and identifying some advantages and disadvantages. AO2 marks will be awarded for keeping the answer in context. Throughout the whole of this answer the advantages and disadvantages of using social media in marketing are applied to Coca-Cola; marks for analysis might be awarded for the clear explanations. For example, a key benefit is that adverts can be targeted. This means that Coca-Cola can direct their promotions, offers and other marketing information only to those people who are likely to be interested. As a result, there is much less waste in advertising. There are several examples of analysis in the student answer. Finally, AO4 marks are awarded for making reasoned judgements and drawing a clear conclusion. In this case, the student concludes that since Coca-Cola came top in a survey as 'one of the brands doing social media particularly well', this does suggest that social media is very important to the company. Also, both the advantages and disadvantages are weighed up.