

## THEME 1 ANSWERS

## CHAPTER 1

## CASE STUDY: MARS AND BANCO SANTANDER

1. Suggest **two** raw materials that might be used by Mars.

Answers may include: cocoa, sugar, milk, dried fruit, nuts and wrapping materials.

2. Suggest **two** examples of different workers that might be employed by Mars.

Answers may include: factory workers, machine operators, production line workers, supervisors, managers or quality inspectors.

3. Suggest **two** services that might be provided by Banco Santander.

Answers may include: the provision of current accounts, insurance policies, loans and overdrafts, credit cards or savings accounts.

4. Discuss in groups the possible reasons why Mars may use more machinery in its operations than Santander.

The provision of services such as banking often requires more people in production. This is because the service industry often involves carrying out tasks for customers that are likely to be done by people. In contrast, Mars is a manufacturer and many of its products are produced on production lines in highly automated factories. Most of the processes used to make chocolate bars, including wrapping and packaging, can be carried out by machines. The use of labour is not significant in relation to the amount of machinery.

However, with more and more people using online banking, the numbers of people employed in the provision of financial services is falling. An increasing number of financial services can be provided online with a small amount of contact between bank employees and customers.

## ACTIVITY 1

## CASE STUDY: JINDAL STEEL AND POWER

1. What is meant by the term **manufacturing**?

One important aspect of production is manufacturing. This involves the use of resources such as raw materials, components, fuel, labour and machinery to make physical goods. In this example, steel products (such as railway lines, steel plate, steel rolls, coils and wire rods) are made from raw materials such as iron ore, coal and complex machinery.

2. Jindal Steel makes a large quantity of **intermediate goods**. What does this mean?

Some manufacturing involves the production of intermediate goods. These goods are made to be used by other manufacturers and enterprises. They are often components and parts for much larger products. In this case, Jindal Steel and Power makes railway track for rail companies.

3. What might be **one** advantage of using a greater quantity of machinery in production than labour?

The use of machinery in production is often more efficient than using labour. It may be possible to reduce production costs if machinery is used. In this case, during the manufacturing process, the rails go through a thorough automated inspection process to maintain quality. Special equipment, which uses ultrasound technology and lasers, helps to inspect the steel's inner quality, the rail surface quality and the track dimensions. The main advantages of this approach is that efficiency is improved in production. Consistency and quality are also guaranteed, which helps to reduce waste and keep costs down.

## ACTIVITY 2

### CASE STUDY: CELIA SANCHEZ

1. Suggest **two** examples of capital that Celia will use.

Capital is often said to be an artificial resource because it is made by labour. Examples of capital used by Celia mentioned in the case study include the property that was purchased where the bakery was built. Celia 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.

2. Celia Sanchez is an entrepreneur. What evidence is there in this case study to support this view?

Entrepreneurs are responsible for setting up and running businesses. Celia has set up a bakery to supply local shops, cafés and hotels with cakes. This was her idea and she owns the business. These are features of being an entrepreneur. Celia has also taken some risk: she has invested MXN700 000 of her own money. If the business is not successful she may lose some, or all, of this money. Celia also organises other production factors. She has purchased some capital and she hired people to help her out once the business was established.

### MULTIPLE CHOICE QUESTIONS

1. B    2. C    3. A    4. A

## CHAPTER REVIEW

### CASE STUDY: TRAVELIBRO

1. What is meant by the term **production**?

Production involves the transformation of resources such as raw materials, tools, equipment and people into goods or services. In this example, TraveLibro is providing a travel service using IT equipment and a range of different workers, for example.

2. Calculate the total income for India (in Rs) from all types of production in 2016/17.

The amount of income generated by the service sector in India is Rs7 378 705. This was 53.66 per cent of the total income for the country. Therefore total income is given by:

$$\text{Total income} = \frac{\text{Rs7 378 705}}{53.66\%} = \text{Rs13 750 847}$$

3. What is meant by **delivering a service**?

A growing amount of production in many countries is associated with the delivery of services. Delivering services involves carrying out tasks for customers or providing facilities which customers can use. In this case, Travelibro is a travel social networking portal designed to connect users with fellow travellers, bloggers, travel agents and other industry partners. Travelibro supplies an app which can provide customised holiday plans for a range of different holiday experiences, such as family vacations and backpacking with friends. It also provides simple and efficient planning tools linked to information sources and an option to make bookings. It also allows users to capture, save, share and relive their travel experiences.

4. Explain **one** factor of production used by Travelibro.

Travelibro is a service-provider. It operates from an office in Mumbai. According to information in the case study, the owners hired some talented people from the technology, travel, research and digital sectors. These people are a factor of production (the labour). These people will use their skills to help Travelibro provide its electronic travel services. For example, some of them would be responsible for providing special technical knowledge in the provision of information online.

5. Discuss the roles played by entrepreneurs such as Monish Shah and Malhar Gala.

Both Monish Shah and Malhar Gala are entrepreneurs. Typical of entrepreneurs, they are both risk takers; they both invested their own money into the venture. Although the venture was launched by Monish, he was joined later by Malhar who contributed a substantial amount of money to the operation. This helped to match the huge amount that Monish had already invested. However, the two were able to reduce the financial risk by continuing to work full-time for their current employers. This means that if Travelibro collapsed, they would still have the income from their jobs.

Another role played by Monish and Malhar was that of organising other factors of production. For example, in 2014 they rented their first office in Mumbai. They also hired some talented people from the technology, travel, research and digital sectors. The two entrepreneurs would have spent time finding the right location for their office and recruiting key skilled-workers. In the first two years the pair worked very hard to develop the business, often only sleeping for 3 hours a night. This reflects the effort and hard work that is expected from entrepreneurs when setting up a new enterprise. As Travelibro grows, Monish and Malhar will need to use a wide range of skills such as decision-making, people management, time management and financial judgement, to organise resources effectively in the future.

## CHAPTER 2

### CASE STUDY: PRODUCTION ACTIVITIES

1. Which of these production activities are concerned with **(a)** agriculture **(b)** manufacturing or **(c)** services?
  - a) The tea plantation in (b) is an example of a business involved in agriculture. It is using the land to grow produce.
  - b) The assembly of televisions in (c) is a manufacturing activity. Physical products are being made.
  - c) Both the airline company in (a) and the architects working in (d) supply services. The airliner is transporting people by plane and the architects are designing buildings for clients.

2. Which of these production activities 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 commercial activity in (b) is most likely to employ the most people in agriculture. The photograph shows tea being harvested by people rather than machines.

### ACTIVITY 1

#### CASE STUDY: COCONUT MILK PRODUCTION

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, the growing of coconuts by small-scale producers 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 coconut growing in this example.

The secondary sector is to do with manufacturing and processing. In this case, coconuts are being processed into coconut milk. Machinery, like that shown in the photograph, is likely to be used to extract all of the milk from the coconuts. This might be followed by a cleaning process to ensure that the coconut milk is pure enough.

2. What has happened to the number of people employed in agriculture in Indonesia since 1976?

In Indonesia, like many countries, the number of people employed in agriculture is falling. The graph shows that the number of people employed in agriculture has fallen from around 66 per cent in 1976 to around 31 per cent in 2018.

3. Describe **one** possible reason for the pattern described in your answer to question 2.

One of the main reasons why employment in agriculture has fallen in Indonesia so sharply is because of advances in technology. Before and around the 1980s, farmers may have relied more heavily on labour. However, due to the growing availability of cheaper technology, they may use more machines. Developments in technology have been enormous in agriculture. Also, in many countries in Asia there has been a shift from employment in agriculture to manufacturing. This may be because wages in many Asian countries are low and therefore manufacturing some goods can be undertaken at a lower cost.

#### MULTIPLE CHOICE QUESTIONS

1. A 2. C 3. C 4. A

### CHAPTER REVIEW

#### CASE STUDY: VINGROUP

1. What is meant by the term **industrialisation**?

Industrialisation is the growth of manufacturing in a particular country where more people are employed in manufacturing and fewer in agriculture. In this case, the number of people employed in agriculture has fallen and the number employed in manufacturing has risen over the time period.

2. What is the difference between secondary and tertiary production? Use examples from the case study about Vingroup.

The secondary sector involves manufacturing and processing, i.e. the conversion of raw materials and components into goods. In this case, Vingroup has commercial interests in manufacturing. For example, one of its divisions, VinFast, manufactures cars and motorcycles. Vingroup hopes to encourage the development of the industrial and manufacturing sector in Vietnam, contributing to the industrialisation and modernisation of the country. In 2018, Vingroup started to make mobile phones. The phones are being manufactured at a large factory in Haiphong.

The tertiary sector is related to the provision of services. In this case, Vingroup also has a range of commercial interests in the services. For example, VinPro is the group's retail operation dealing with the sale of electronics, smartphones, tablets, laptops and home appliances. Vingroup also has commercial interests in shopping malls, offices, apartments, and commercial centres, as well as urban areas. It also operates hotels, resorts, restaurants, golf courses, suites and villas, theme parks, amusement parks, conservation parks and family entertainment centres. Finally, the group controls a number of hospitals and educational institutions.

3. What evidence is there to suggest that Vietnam's economy has become more balanced since 2007?

The pie charts show some important changes in the amount of employment in different industrial sectors between 2007 and 2017. In 2007, Vietnam employed 50.68 per cent of its workforce in agriculture. By 2017, this had fallen to 40.87 per cent. In contrast, the number of people employed in the tertiary sector rose from 28.35 per cent to 34.06 per cent. Employment in the secondary sector also grew from 20.97 per cent to 25.07 per cent. These changes have resulted in a more balanced economy for Vietnam. It was less dependent on agriculture for employment in 2017 than it was in 2007. Although the proportion of the working population in each industrial sector is by no means equal, it is certainly more balanced. The gap between the proportion employed in the primary sector and those employed in the tertiary sector has closed.

4. Describe **one** possible reason for the growth in the secondary sector in Vietnam.

Vietnam is an 'emerging economy'. In 2018, the economy grew at a rate of 7.08 per cent, up from 6.7 per cent in 2017. The growth has been driven largely by success in manufacturing. According to a government official, the manufacturing sector grew by 12.98 per cent as exports of cheap manufactured goods such as Nike shoes, H&M T-shirts and tech products like Samsung phones and Intel computer processors, rose sharply. Vietnam is able to produce manufactured goods cheaper than many of its rivals due to low wages in the economy – lower than China now. This will help the manufacturing sector to grow. Also, companies like Vingroup are making a big contribution to the nation's growing secondary sector. Vingroup hopes to encourage the development of the industrial and manufacturing sector in Vietnam, contributing to the industrialisation and modernisation of the country. In 2018, Vingroup started to make mobile phones. VinSmart, the group's telecom unit, said that it wanted to capture 30 per cent of the Vietnam smartphone market by 2020.

5. Discuss the relationship that exists between businesses in the different industrial sectors.

Businesses in each of the three sectors rely on each other. For example, cereal farmers in the primary sector rely on bakers in the secondary sector to buy their 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.

However, this interdependence can cause problems for some producers. For example, if there is a poor wheat harvest due to bad growing conditions, wheat farmers are likely to lose some income as the amount of available wheat drops. However, this will have a knock-on effect in the chain of production. For example, the manufacturers of bread may face shortages of wheat or higher costs. This will then affect retailers who may also face bread shortages or higher costs. This close relationship that exists between businesses in the different industrial sectors can therefore result in higher costs and/or production difficulties.

In contrast, if retailers experience rising demand for certain products, e.g. electric motor cars, there will be benefits for producers further down the production chain in other industrial sectors. For example, car manufacturers would have to produce more electric cars and suppliers will also have to produce more. The relationship between businesses in different sectors is often very close indeed.

### CHAPTER 3

#### CASE STUDY: CARE WITH EMPATHY

1. In which industrial sector does care in the home fall?

The provision of care by Care With Empathy is an example of a service. Services are included in the tertiary sector of industrial activity.

2. In what way is Nilla concentrating on a narrow range of skills?

Nilla is a qualified care worker and has set up her own business providing respite care in the city of Gothenburg, Sweden. However, inside the business Nilla has a very specific role. She focuses on the recruitment (employing new workers) and training of new carers. It is essential for the future success of the company to recruit and train care workers to a very high standard. Care With Empathy depends on maintaining a high quality of care and empathy. This is the company's unique selling point. The general running of the business is left to a manager so that Nilla can focus entirely on this important role.

3. How might Nilla herself benefit from this narrow focus?

When people concentrate on a narrow range of tasks or skills they become more competent. In this case, as Nilla becomes better at recruitment and training, the quality of care provided by Care With Empathy will improve. This will help the business attract more customers and hopefully increase profits. Nilla might also feel that her skills are being put to a good use and therefore she will be well-motivated and happier in her work.

#### ACTIVITY 1

##### CASE STUDY: IT IN BENGALURU

1. What is meant by **regional specialisation**?

In some countries there is regional specialisation. This means that certain geographical regions specialise in one main production activity. This is common in many countries. For example, the Spanish province of Jaén is a large olive producer. One of the biggest olive groves in the world is located in Jaén. In this case, Bengaluru has become known as the Silicon Valley of India (named after the Silicon Valley in California, USA). Over the years, Bengaluru has attracted large numbers of businesses in the IT sector. It is now a global hub for the IT industry and employs around 2 million IT workers.

2. Describe **two** reasons why Bengaluru developed as a major IT hub.

The main reason for the development of Bengaluru is the local government's focus on technology and engineering. For instance, Karnataka was the first state to have an Information Technology Policy in 1997. This provided the support needed to develop the IT sector. Then, the Infosys headquarters and Texas Instruments in India moved to Bengaluru. This encouraged increasing numbers of IT companies to set up in Bengaluru and many thousands of jobs were created.

Bengaluru is also recognised as an international city and was able to attract large numbers of skilled people to help meet the employment needs of the IT sector. The establishment of Bangalore Institute of Technology and the inclusion of the first computer science engineering program also helped to develop an IT culture in Bengaluru.

3. Describe **one** advantage of regional specialisation such as that in Bengaluru.

Better use will be made of resources if regions and countries specialise. There will be an increase in the scale of production due to economies of scale. Consequently, costs will be reduced and prices for consumers lowered. This will benefit the local economy. For example, a survey stated that Bengaluru will become the single largest IT hub in the world by 2020. It reckoned that Bengaluru would have 2 million IT professionals, 6 million indirect IT jobs, and \$80 billion in IT exports. Bengaluru's population has doubled over the past 15 years, to 11.5 million, as growing opportunities in IT, biotech and other fields, have drawn young, educated professionals from around India. This focus on IT will help to drive up income and employment for the city in the future.

## ACTIVITY 2

### CASE STUDY: ANGOLA AND OIL PRODUCTION

1. Calculate the percentage fall in the price of oil between the high of September 2018 and the low of December 2018.

Between September 2018 and December 2018 the price of oil fell from US\$86 per barrel to US\$50. The percentage fall is given by:

$$\frac{\$86 - \$50}{\$86} \times 100 = \frac{\$36}{\$86} \times 100 = \mathbf{41.9 \text{ per cent}}$$

2. Describe **one** advantage to Angola of specialising in the production of oil.

Economists argue that countries should specialise in the production of those goods in which they are most efficient. By doing this, and then trading with other countries, world output and income will rise. As a result the standard of living for all countries will improve. In this case Angola specialises in oil production. If countries specialise, better use will be made of resources. There will be an increase in the scale of production due to economies of scale. Consequently, costs will be reduced and prices for consumers lowered. Also, countries that have surplus, such as Angola in the production of oil, can export what they do not need to generate income. Around 50 per cent of Angola's income and 70 per cent of government revenue comes from the sale of oil.

3. Using this case study as an example, discuss **one** of the problems of interdependence between countries.

When countries specialise in the production of a narrow range of goods, there are risks. In this case, Angola generates huge amounts of income from the sale of oil – much of which is sold overseas. This income can then be used to buy goods and services that Angola does not produce. However, over time Angola will become dependent on imports of other goods from abroad and when fortunes change it may not have the resources to buy imports. In this case, when the price of oil fell, Angola would have suffered a loss in income. This reduces its purchasing power for other goods and services. It might be argued that Angola is suffering from interdependence.

### MULTIPLE CHOICE QUESTIONS

1. B    2. D    3. A    4. C

### CHAPTER REVIEW

#### CASE STUDY: RONDA CABINS

1. What is meant by the term **division of labour**? Use examples in this case study to illustrate your answer.

In many firms the production process is broken down into small parts or stages and each worker is given a specific task. This is called the division of labour. It allows people to concentrate on the task or skill at which they are best. In this case the construction of a wooden cabin requires specialists such as a project manager, carpenters, plumbers, electricians, labourers and decorators.

2. Describe **two** advantages of the division of labour to Ronda Cabins.

Generally, if workers are more specialised, efficiency improves and firms can make more profit. Efficiency is improved because, through specialisation, workers can perform tasks more quickly and more accurately. There are fewer mistakes and productivity (output per worker) will rise. People who try to perform a wide range of tasks may find it difficult to develop the skills needed to be good at each one. Therefore their productivity will be lower. This is why Ronda Cabins employs specialists such as carpenters and an electrician. Also, when workers specialise, greater use can be made of specialist tools, machinery and equipment. For example, specialist carpentry tools can be used for cutting, planing and other tasks.

Production time is reduced because workers do not have to waste time moving from one task to another. This means that they will not need to move around the workplace to collect tools, change workstations or reset machinery. Specialists are likely to remain at the same workstation repeating their task without the need to move around. In this case, carpenters can just focus their attention on woodwork and not have to make adjustments if they were required to switch tasks.

3. Describe **two** disadvantages of the division of labour to workers.

One of the main problems with worker specialisation is that the work can become boring because it is repetitive. This is most likely to happen if a particular task requires little skill. For example, workers employed on a production line responsible for an assembly task that only takes 30 seconds are likely to get very bored if that single task has to be repeated 120 times an hour, 960 times a day and nearly 4,000 times a week! This boredom may lead to job dissatisfaction and affect motivation. In this case, motivation may not be a serious

problem. This is because carpenters, for example, will do a variety of slightly different woodworking tasks during their day at work. This will make their work life more interesting.

Another serious problem for workers is the risk of unemployment. If demand for a particular skill or trade declines, specialist workers may struggle to find another job unless they can retrain. For example, if there was a big drop in demand for wooden cabins, Ronda Cabin's carpenters might find it difficult to get new carpentry jobs. Some may have to retrain.

4. Why do firms such as Ronda Cabins specialise in a narrow range of products?

The majority of firms specialise in the production of a narrow range of goods or services. In this case, Ronda Cabins specialises in the production of wooden houses. This allows firms to become 'experts' in their field. They can focus more effectively on a narrow range of production. This will improve efficiency because they can employ specialist workers, specialist machinery and use a limited amount of resources. A specialist firm will learn and develop the most appropriate working practices for its needs, it will be more effective at meeting the demands of customers and enjoy lower costs as it produces more output. Since a specialist firm concentrates on the production of one, or a very narrow range of products, it is likely to produce larger quantities and therefore exploit economies of scale.

For most firms, an attempt to provide a range of different and unrelated products would not be sensible. Firms might lose focus. They may become a 'Jack of all trades and master of none'. This means that a firm or individual takes part in a number of different activities but fails to become an expert in any.

5. Discuss the role that commerce might play in the success of Ronda Cabins.

Commerce makes a very important contribution to production in the tertiary sector. Commerce supports the business sector by providing important services that help to facilitate trade between people, businesses and other organisations. Ronda Cabins will benefit from the role played by commerce. For example, one branch of commerce deals with advertising. In this case, the company has paid an advertising agency to promote its business. Ronda Cabins wants to expand and therefore needs to attract more customers. It is likely that Marta and her employees know little about advertising. However, an advertising agency will have expertise in this field and can help Ronda Cabins to invest its advertising budget more effectively.

Another commercial service that Ronda Cabins will benefit from is banking. Ronda Cabins will almost certainly have a bank account through which all of its financial transactions, such as payments and receipts, will flow through. Also, in this case, Ronda Cabins took out a loan at the beginning of the year to pay for some new machinery and the costs of advertising. A bank would have been able to provide Ronda Cabins with a loan and ensure that the whole process of applying for the loan ran smoothly. It may also have given advice on the most suitable form of loan to take out.

## CHAPTER 4

### CASE STUDY: WANGO HOLDINGS AND KIM GOMEZ

1. Why are manufacturers likely to buy more resources than service providers? Use this case study as an example in your answer.

Manufacturers are likely to need more resources than service providers. Manufacturing involves producing a physical good – washing machines in this case. Production like this needs lots of different components such as those shown in the diagram – perhaps hundreds. Other resources such as fuel, tools, machinery and equipment would also have to be acquired.

In contrast, a service provider like Kim Gomez, the guitar teacher, needs smaller quantities of resources. Sourcing materials and equipment would not be an important task for Kim's business. The success of Kim's service will depend on her skill in guitar playing and her ability to communicate effectively with learners.

2. Why might a manufacturer like Wango Holdings buy components from foreign suppliers?

Wango Holdings will want to source its materials and components as cheaply as possible. It may be possible for some manufacturers to buy parts and components from overseas suppliers. These suppliers may be able to produce these goods more cheaply – perhaps because they have lower labour costs or more efficient machinery and equipment. If Wango Holdings can source materials at lower costs its profits will rise.

3. What might be **one** disadvantage of buying from a foreign supplier?

One of the disadvantages of using a foreign supplier is the possibility of hidden costs such as currency exchange fees or tariffs resulting from protectionism. For example, some governments might impose tariffs on certain goods coming into the country from overseas. Tariffs are taxes and will increase the price. Exchange rates can also change, which can affect the prices of goods.

## ACTIVITY 1

### CASE STUDY: KHAN'S MINIMARKET

1. What is the key role of a wholesaler?

Wholesalers act as intermediaries in the chain of distribution. They buy goods from a range of manufacturers and other suppliers and sell them on to buyers. Buyers, such as Abid Khan, can buy a range of produce from wholesalers 'all under one roof'. This makes it easier to source a range of products.

2. Describe **two** advantages to Khan's Minimarket of sourcing goods from wholesalers.

One of the key advantages of using wholesalers is that they can provide a wide range of choice for buyers. In this case, Abid Khan may be able to buy all of his fresh produce from a single fruit and vegetable wholesaler in Sylhet. This makes buying a lot easier by avoiding the need to visit a greater number of suppliers.

Another possible benefit is that some wholesalers meet the cost of transport. For example, they may take on the responsibility for delivery entirely. Some of the wholesalers used by Khan's Minimarket may make regular deliveries direct to his store. This is very convenient and will reduce costs for Khan's Minimarket. Abid Khan will also have more time to focus on other business tasks such as customer service.

3. Describe **one** advantage and **one** disadvantage to Khan's Minimarket of sourcing goods directly.

Some businesses prefer to source goods directly. This means bypassing intermediaries and buying direct from manufacturers or farmers. Abid Khan is considering this approach to sourcing for some of the stock needed by the store. It is cheaper to buy direct from suppliers because the 'middleman' is eliminated from the chain of distribution. This will help to reduce costs and raise profit margins. This is the main advantage.

One disadvantage of this approach is that a temporary break in supply could be a big problem. Relying on one supplier, or a very small number of large suppliers, means that a

break in supply would result in shortages for a retailer such as Khan's Minimarket. Unfortunately, direct buying is not suitable for all businesses. In this case, it is unlikely that Khan's Minimarket could buy large enough volumes for a producer to be interested.

## ACTIVITY 2

### CASE STUDY: VERIZON

1. The weekly pay for a worker with 25 years' experience at the company was US\$1690 per week.

If this worker decided to leave, how much money might the worker receive?

The amount of money the worker in this case might receive as a severance pay is given by:

$$25 \times \$1690 \times 3 = \mathbf{\$126,750}$$

2. What is meant by outsourcing? Use the example in the case study to illustrate your answer.

Outsourcing involves finding another business to carry out work that was previously done 'in-house', i.e. by the company itself. In this case, Verizon has paid \$700 million to an IT company in India (Infosys) to do work previously done by Verizon.

3. Discuss **two** advantages to Verizon of outsourcing.

One of the main reasons for outsourcing is to save money by cutting costs. In this case, the \$700 million deal with Infosys will help to save Verizon around \$10 billion by 2021. This is obviously a significant amount of money.

Another benefit to Verizon of outsourcing activities to Infosys is increase in capacity. Verizon will have more resources to focus on its core activities. The core activities of a business are usually those which generate the most profit. Therefore Verizon will be devoting more resources to profitable production.

## MULTIPLE CHOICE QUESTIONS

1. C
2. B
3. D
4. A

## CHAPTER REVIEW

### CASE STUDY: BEDDO LTD

1. What is meant by the term **lead time**?

The amount of time between a buyer placing an order and the order being delivered is called the lead time. In this case, Beddo Ltd has developed a reputation for short lead times. This means that the company delivers beds very quickly after they have been ordered. Therefore, customers do not have to wait very long.

2. Calculate the cost of buying the four components from the (a) current home suppliers (b) new overseas suppliers.

| Component        | Home suppliers |                  | Chinese supplier |                  |
|------------------|----------------|------------------|------------------|------------------|
|                  |                | Total cost (EGP) |                  | Total cost (EGP) |
| Bed spring WT 41 | 25 000 x 2.6   | 65 000           | 25 000 x 2.4     | 60 000           |
| Bed Spring SZ22  | 32 000 x 2.1   | 67 200           | 32 000 x 1.95    | 62 400           |
| Bracket RTY      | 104 000 1.2    | 124 800          | 104 000 x 1      | 104 000          |
| Bracket VBY      | 89 000 x 1.6   | 142 400          | 89 000 x 1.3     | 115 700          |
|                  |                | <b>399 400</b>   |                  | <b>342 100</b>   |

3. Describe **two** non-financial advantages of buying goods from international sources.

One of the main non-financial advantages of sourcing goods from overseas is that buyers will have a much greater choice when selecting a supplier. The number of potential suppliers across the world will generally exceed, by quite some margin, the number in the home market. In this case, Beddo Ltd has found a Chinese supplier for some key metal components.

Sometimes the quality of products made overseas is superior to those made at home. This might be because they use better quality raw materials, have access to more sophisticated and accurate technology or because the new supplier is a specialist in the field. It is often said that goods sourced from overseas will be cheaper but not as good. However, this is not always the case.

4. Using your answers from question 2, and any other information you think is relevant, consider these two options for Beddo Ltd:

Option 1: Source the components from the Chinese supplier.

Option 2: Continue to source components from the home supplier.

Which option do you think Beddo Ltd should choose and why?

The calculations carried out in question 2 show that Beddo Ltd would save EGP57 300 per annum (EGP399 400 – EGP342 100) if the four metal components were sourced from the Chinese supplier. This is a 14 per cent saving on those four components. This would increase the annual profit made by the business.

There are also some non-financial advantages of sourcing supplies internationally. As stated above, sourcing internationally gives buyers far more choice than being restricted to home suppliers. It is also possible that the Chinese components will be of a better quality. If so, this will help to improve the quality of the beds produced by Beddo Ltd. Also, international producers may be able to supply much larger quantities than home suppliers due to their enormous scale of production. This means that Beddo Ltd would not have to worry about the continuity of supply, i.e. there should not be any shortages.

However, sourcing goods from overseas is not without risk. Different countries are likely to have different technical and industrial standards to those of the home country. This may be very important when producing high quality beds. The quality of springs, for example, could make a big difference to the comfort of the bed and the overall quality of the products sold by Beddo. Cross-border trading may require complex and unfamiliar documentation which

Beddo would have to deal with. It may also be more difficult to settle trading disagreements with Chinese suppliers due to different legal systems, for example.

There may be hidden costs, such as currency exchange fees or tariffs resulting from protectionism. For example, Egypt might impose tariffs on goods coming in from China in the future. In addition, there may be challenging cultural differences such as language, social behaviour and working practices. These might prevent trade between the Egyptian and Chinese companies. Finally, and very importantly, the distance that goods have to travel from abroad often means that lead times will be longer. It may also be very difficult to source goods at short notice if necessary. In this case, the distance between Egypt and China is significant. Beddo has a reputation for short lead times so this might be a problem.

To conclude, the company would save money if the metal components were sourced from China. However, the amount saved may not be that high. It depends on the level of other costs and the amount of profit currently made by the business. If current profit was, say, EGP100 000, the EGP57 300 annual saving would boost profits by more than 50 per cent. However, if current profit was EGP3.4 million, then the saving becomes much less significant. Beddo would have to be sure that the Chinese supplier could meet the tight lead times required by Beddo. The company would not want to lose its reputation in the market as a reliable and prompt supplier. So the decision here depends on the current size of Beddo's profit and whether or not the new supplier can guarantee prompt and speedy delivery. Beddo may decide that the risk of sourcing components from a new supplier overseas may be too high compared with the benefits. Therefore, it might stick with the home supplier for the time being.

## CHAPTER 5

### CASE STUDY: familyworld.net AND PETRONAS CHEMICALS

1. Suggest **three** trading costs that might be incurred by familyworld.net when selling goods online.

Some examples of trading costs that might be incurred by familyworld.net include distribution costs such as postal or courier charges, administration costs for documentation, staffing costs, fees paid to credit card companies and the cost of replacing goods stolen in transit or from the warehouse.

2. Suggest **three** trading costs that Petronas Chemicals might incur when selling huge quantities of chemicals to customers in other countries.

Some of the main costs when selling chemicals to customers include transport, such as shipping, the cost of trade credit if the customer is allowed time before payment is made, administration costs for exporting goods (i.e. documentation), agents' fees if agents are used to sell in other countries, environmental costs resulting from transport and possibly government tariffs if goods are imported.

3. In groups, discuss whether it is the sellers or the buyers that have to meet the trading costs mentioned in your answers.

Some costs will be met by the sellers; for example, the cost of damaged or stolen goods. Others will be met by the buyers, such as tariffs, wages paid to specialist buyers and sales taxes. However, some of the costs may be hidden (i.e. included in the price). This might mean that some of the costs are shared.

## ACTIVITY 1

## CASE STUDY: ALMA CONSTRUCTION SUPPLIES

1. Suggest **two** staffing costs that Alma Construction Supplies incurs when buying inventory.

The cost of staff time will have to be met at all stages in the buying process. In this case, staffing costs would include the salaries paid to the team of buyers employed by Alma. The cost of drivers employed to operate the delivery of goods would also have to be met, as would that of staff employed in the handling of inventory. Finally, the cost of administrative staff needed to process orders, record transactions and communicate with suppliers might be significant for Alma.

2. What is meant by transaction costs when buying goods?

Transaction costs are usually the financial costs associated with the exchange of goods and services. These might include taxes on purchases, such as sales tax or VAT. Also, goods that are bought from overseas might be subject to tariffs. A tariff is like a tax on goods and makes them more expensive. The value of taxes and tariffs will depend on the government. When buying from overseas, payment must be made in the currency used by the seller. This means that a buyer must obtain some foreign currency. In this case, Alma was charged 1.8 per cent by a bank when buying some Mexican currency to pay for an order.

3. An order placed with a Mexican company cost Alma US\$220 000. Calculate the amount of commission paid to the bank if it charged 1.8 per cent when the US\$220 000 was changed into Mexican currency.

The bank commission for changing currency here is given by:

$$\$220\,000 \times 1.8\% = \mathbf{\$3,960}$$

4. Describe the possible research costs incurred by Alma when buying inventory.

The buying process involves searching for new sources of goods and services. This can take time as information from potential suppliers is sourced, sorted, analysed and evaluated. Time will also be used in the discussion of terms and conditions with potential suppliers before a source is selected. The research costs might also include the cost of visits to potential suppliers. This might be significant for Alma since it employs a team of buyers and some of its suppliers are based overseas in Mexico, Canada and the EU.

Research costs for small buyers may be minor – searching on the Internet, for example. However, for large businesses like Alma, and those which frequently develop new products, buying becomes increasingly important. Therefore, research costs will be significant. Most of the costs will be down to the employment of specialist buying staff and the resources they use. Alma employs a team of ten buyers in its head office in Chicago.

## ACTIVITY 2

## CASE STUDY: FUN TOYZ LTD

1. In May 2019, one sales person sold SGD44 000 worth of toys to new customers. This exceeded the monthly target of SGD40 000. Calculate the monthly payment made to this member of the sales team in May.

The salary paid to the sales person is made up of a fraction of the basic salary (one twelfth), commission (10%) and a bonus (SGD2000):

$$1/12 \times \text{SGD } 12\,000 + 10\% \times \text{SGD } 44\,000 + \text{SGD } 2000$$

$$\text{SGD } 1000 + \text{SGD } 4400 + \text{SGD } 2000 = \mathbf{\text{SGD } 7400}$$

2. Describe **two** other costs associated with sales staff.

The salaries paid to the sales team are likely to be the main cost of selling. However, other costs might include expenses such as travel and accommodation as they spend time following up leads and travelling to meet customers. These costs can escalate if sales people have to visit customers some distance away; for example, overseas. Sales reps may get a company car, meals may be paid for when travelling and hotel accommodation will be paid for. There may also be entertaining costs; for example, if sales reps take potential customers out for a meal.

3. Describe the possible environmental costs that might be incurred by Fun Toyz Ltd.

Fun Toyz Ltd will have to buy the materials (mainly plastics) used in its manufacturing process. Buying goods can result in environmental costs. For example, transactions may leave a 'carbon footprint'. Some examples of environmental costs include the pollution resulting from the transport of goods, such as emissions from vehicles, aircraft and ships, the loss of habitat for wildlife and plants caused by the development of transport systems and the construction of warehouses, the waste produced from the purchase of goods such as packaging (particularly plastics) and the depletion of non-renewable resources. In this case, the plastics used by Fun Toyz Ltd are likely to be oil-based.

### MULTIPLE CHOICE QUESTIONS

1. A 2. C 3. D 4. C

### CHAPTER REVIEW

#### CASE STUDY: BUYING AND SELLING COSTS FOR KEELLS SUPERMARKET

1. Suggest **two** possible methods of payment that Keells' customers might use.

When receiving payments from customers, the company is likely to accept cash, debit cards and credit cards and possibly cheques.

2. Describe the costs that might be incurred by the business using these two methods.

The costs associated with cash payments are relatively low. However, cash will need to be counted at the end of each trading period and it will have to be paid into the bank. Some labour costs will be incurred here. It may also be necessary to store cash securely overnight or for longer. This will require a specialised storage facility like a safe.

The use of debit cards and credit cards will attract costs. Sellers, such as Keells in this case, will have to pay a percentage of each transaction funded by a card to banks or other financial institutions. These charges may reach up to 5 per cent.

3. Discuss the possible administration costs that Keells might incur.

The buying of goods is usually supported by an administrative process. A range of documents, such as invoices, delivery notes and receipts, are used to provide records of transactions. Records include the name of the buyer and seller, dates, descriptions and values of goods traded, terms and conditions and signatures to provide authenticity and transparency.

These documents make the rights of buyers and sellers easier to understand. They provide written records to help settle trading disputes and provide evidence of sales and purchases for accountants and the tax authorities. The costs of this administrative process might include the design and printing costs of documents, computer systems (since much

administration is processed by computers), paper and wages paid to admin staff. Keells may incur some of these costs when buying inventory from suppliers.

4. Discuss **two** costs that might be incurred by Keells' online selling operation.

Keells operates an online service for customers. This service will incur some distribution costs. These might include the cost of picking orders from the supermarket. This is where a member of staff walks around the store and collects the goods ordered by the customer. There will also be the cost of transport to customers. Some supermarkets operate a fleet of delivery vehicles themselves. Keells might use this approach, although there is no information in the case study about this. In many cases online sellers make a charge for delivery, but they may offer free delivery for large orders.

5. To what extent might Keells incur shrinkage costs?

Shrinkage costs are incurred when inventory is lost. This may be due to factors like employee theft, shoplifting, fraud, errors and damage to inventories. In this case, a business like Keells might suffer from stolen inventory. Stock might be removed from shelves in the store by shoplifters, for example. Inventory may also be stolen by employees from storerooms or perhaps in transit.

Retailers such as Keells are very likely to incur losses resulting from damaged goods. For example, inventories might get damaged when being handled, or a fork-lift truck operator might accidentally drop or crash into some goods during a manoeuvre. Also, some goods, like fresh produce, have a limited 'shelf life' because their condition gets worse. In some countries, it is forbidden to sell certain types of fresh produce after a certain amount of time. These include fresh meats and some dairy products. Keells sells a range of fresh produce so losses for this reason may be expected.

It is extremely likely that Keells would incur shrinkage costs. There is scope for both stolen and damaged inventory. However, it might be difficult to accurately calculate the size of these losses. It might be possible to keep a record of all goods lost through damage but it would be much harder to determine losses through shoplifting and employee theft.

## CHAPTER 6

### CASE STUDIES: THE GOLDEN DINER AND THE HATTA DENTAL AND IMPLANT CLINIC

1. Who owns the businesses in each of these case studies?

Ye Ko Oo is the sole owner of The Golden Diner. The Hatta Dental and Implant Clinic is owned by Khalid Said and Ismail Mansour. They are business partners.

2. State **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.

3. Business owners have to take risks. What risks are taken in each of these case studies?

In both these cases, the owners had to risk their own money when setting up and running the business. Ye Ko Oo used MMK2 000 000 of his own savings when he started his restaurant in 2012. Similarly, Khalid and Ismail each put AED200 000 into their dental practice when setting up.

### ACTIVITY 1

#### CASE STUDY: BRIT TALK

1. How do sole traders raise capital for their enterprises?

Sole traders raise capital using their own personal resources. They might use their savings or loans from friends or family, for example. In this case, Zhu Tong raised capital by borrowing CNY100 000 from a wealthy uncle.

2. Why is forming a sole trader enterprise easy?

Forming a sole trader enterprise is simple because there are no legal requirements. In many countries it is not necessary to register the business or provide any documentation to the authorities. However, in some areas of business activity, a licence might be required. For example, a licence might be needed to operate a public transport service. In this case, it is unlikely that Zhu would need a licence to design an app for a mobile phone.

3. Zhu has unlimited liability operating as a sole trader. What does this mean?

Like all sole traders, Zhu Tong will have unlimited liability. This means that if the enterprise fails, Zhu 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. Therefore, if Zhu's business fails owing, say, CNY50 000 to creditors, what would happen? He would lose the original CNY100 000 capital used to set up the venture and would also have to somehow find a further CNY50 000 to pay the creditors.

4. Describe **two** other possible disadvantages to Zhu of operating as a sole trader.

One of the disadvantages of operating as a sole trader is the hard work needed. There is no one to share the responsibility with and all business decisions must be made by Zhu. Sometimes sole traders are under a lot of pressure. They may have to work long hours and use a wide variety of different skills. This can be very demanding.

Another problem for sole traders is that if the owner is ill, for example, the business may cease to operate. It may not be possible to find a suitable person to step in and carry on trading. Also, if the owner dies, the business will cease to exist. There is no continuity.

### ACTIVITY 2

#### CASE STUDY: CAIRO CARRIERS

1. What is meant by an unincorporated enterprise?

Unincorporated enterprises are businesses where there is no legal difference between the owner and the business. Everything is carried out in the name of the owner. These businesses tend to be small and owned by one person or a small group of people. In this case Cairo Carriers, which is owned by 12 people, operates as a cooperative. Operating in this way means that all of the owners have unlimited liability.

2. What is meant by a workers' cooperative?

Cairo Carriers operates as a workers cooperative. This means that the enterprise is jointly owned by the employees. These are the 12 people that currently work in business – **nine drivers, one part-time mechanic and two office workers**. In a worker cooperative, employees are likely to contribute to production, be involved in decision-making, share in the profit and provide some capital when buying a share in the business. In this case, each member has contributed EGP40 000 in capital.

3. In 2019, the cooperative made EGP1 800 000 profit. How would this be distributed?

In a workers' cooperative the profit is often shared equally between the workers. In this case, there are 12 workers and the profit made in 2019 was EGP1 800 000. Therefore, if all the year's profit was returned to the owners, each worker would receive EGP150 000 (EGP1 800 000/12).

### MULTIPLE CHOICE QUESTIONS

1. C 2. A 3. C 4. A

### CHAPTER REVIEW

#### CASE STUDY: VINOTH ASSOCIATES

1. How does this case study highlight one of the disadvantages of operating as a sole trader?

One of the problems of operating as a sole trader is that the amount of capital that can be raised is limited. In this case, Nalaka decided that he could make more money and offer his clients a wider range of services if he expanded the enterprise. To raise the money needed for a larger office, and help share the workload, Nalaka recruited two partners. These new partners contributed some capital and helped Nalaka to offer a wider range of services.

2. Why do you think Nalaka, Edison and Kamara drew up a deed of partnership?

When a group of people form a partnership, it is common to draw up a deed of partnership. This is not a legal requirement but it does help to clarify the rights of each partner in the event of a disagreement. The deed of partnership is a legal document; it covers issues such as how much capital each partner has contributed, how profits should be shared and how much control each partner has. In this case, the deed states that profits would be shared with 40 per cent for Nalaka, 40 per cent for Edison and 20 per cent for Kamara. Without a deed of partnership, it might be difficult to resolve a disagreement.

3. In 2018, the partnership made a profit of LKR18 million. Without a deed of partnership, how much profit would Kamara be entitled to?

According to the deed of partnership drawn up by the partners in this case, Kamara is entitled to a 20 per cent share of the LKR18 000 000 made in 2018. Therefore, his share would be LKR3 600 000 (20% x LKR18 000 000). However, without a deed of partnership the profits would be shared equally. This would mean that Kamara would be entitled to a third of the profit, i.e. LKR6 000 000 (1/3 x LKR18 000 000).

4. Describe **two** advantages of a partnership illustrated by this case study.

One of the advantages of forming a partnership is that more capital can be raised. In this case study, the new partners contributed LKR20 million each. Therefore LKR40 million was invested in the business to meet the costs of expansion.

Another advantage is that each partner can specialise in a particular field. In this case, one of the strengths of the business is that each partner is a specialist in a different branch of accountancy: Nalaka is a small business specialist; Edison is a tax and investment analyst; and Kamara is in charge of external audits. This has helped the business to attract a wider range of clients. It will also improve the efficiency of the business.

5. To raise the LKR15 million for expansion, the two options below were identified.

Option 1: Invite a sleeping partner to contribute LKR15 million.

Option 2: Find other alternative sources of funds.

Which option would you recommend?

Vinoth Associates appears to be doing very well as a business. Indeed, the partners now want to expand by creating more office space and upgrading their computer systems. The cost of this expansion will be LKR15 000 000. One way to raise this money would be to invite a sleeping partner to join the business. A sleeping partner will contribute the required capital but take no part in the running of the business. This would leave the existing partners to make all the business decisions.

However, inviting a sleeping partner may have drawbacks. One possible reason for this is that all future profits would have to be shared with the new partner. Although a sleeping partner does not contribute to the running of the business, they are entitled to a share of the profits indefinitely. Some of the existing partners may resent this.

Another possible problem is that the new partner might cause conflict. A sleeping partner may develop an increased interest in the business in the future. This could lead to disagreements about how the business is run and result in wasted resources if the conflict occupies too much of the partners' time.

In this case, Vinoth Associates will have to decide whether they are happy to invite a new business owner into the partnership. If they are uncomfortable with this idea, the LKR15 000 000 will have to be raised in other ways. For example, it may be possible to borrow the money from a bank. If the partnership is on a sound financial footing getting a bank loan, or a mortgage perhaps, might be a better alternative. Inviting a new owner into a business is risky – particularly if the new owner has a strong personality. I would recommend that inviting a sleeping partner should be the last resort when raising finance in this case.

## CHAPTER 7

### CASE STUDY: GRANULES INDIA LTD (GIL)

1. Who set up Granules India Ltd (GIL)?

Granules India Ltd was set up by Mr C Krishna Prasaad in 1984 when it began trading as Triton Laboratories.

2. Who now owns GIL?

Granules India Ltd is now owned by its shareholders. It became a public limited company in 1993.

3. What are the **two** different types of limited company?

Limited companies can be private or public. Shares in private limited companies tend to be in the hands of a few individuals – perhaps family and friends. However, shares in public limited companies can be owned by anyone.

## 4. How did GIL raise its capital?

GIL raised capital from the sale of shares. In 2018, the value of GIL's share capital was Rs 25 crore.

**ACTIVITY 1****CASE STUDY: BÙI HẢI YẾN LTD**1. Describe **two** advantages of becoming a shareholder in Bùì Hải Yến Ltd.

One advantage is that shareholders in Bùì Hải Yến Ltd will be entitled to a share of the profits. They are likely to receive dividends each year if the company is successful.

A second advantage is that shareholders will have a say in how the business is run. Shareholders are owners of the business and therefore are entitled to contribute to company decision making. The extent of their power depends on how many shares they own. Those members with the most shares will have the most power.

## 2. Who runs a private limited company?

A private limited company is run by a board of directors. These directors are elected by the shareholders. The board of directors, headed by a chairperson, is accountable to shareholders. The chairperson should run the company as the shareholders wish.

## 3. Assess the likely impact on Bùì Hải Yến of running her business as a private limited company.

Operating as a sole trader, Bùì had unlimited liability. This means that Bùì's personal wealth and property were at risk if the business failed. However, as a shareholder in a private limited company, she has limited liability; the most she can lose is the original amount used to buy the shares.

A key advantage of becoming a limited company is that Bùì can raise the extra money needed to provide money for the expansion. Banks don't want to lend to Bùì, which has reduced her funding options significantly. The sale of shares to family and two key employees will raise the VND600 million needed.

Another benefit to Bùì is that the company would be trusted more as a private limited company. For example, suppliers and customers often have more confidence when dealing with an 'official' or 'formal' trading operation.

However, there are one or two disadvantages that Bùì may encounter. As a limited company, control and decision-making are shared with the other shareholders. It is possible that Bùì's view about the way the business runs differs from those of other shareholders. This could create conflict and delay the development of the business. The business might also be less flexible. This is because making key decisions is likely to be slower as more people are involved in the decision-making process.

Overall, the impact on Bùì should be positive. With limited liability, she has protection. She will also raise the money needed to expand. If the sale of shares is done carefully, she can ensure that shares are only sold to certain people. This will reduce the risk of conflict in the future.

**ACTIVITY 2****CASE STUDY: DHAKA INSURANCE LIMITED**

1. What evidence is there in the case study to suggest that Dhaka Insurance Limited is a public limited company?

Shares in Dhaka Insurance Limited are included on the Dhaka Stock Exchange. This means that the business must be a public limited company. Only the shares in public limited companies can be traded publicly.

2. State **two** pieces of information that would be included in the memorandum of association for Dhaka Insurance Limited.

The memorandum of association sets out the constitution and gives details about the company. Two pieces of information that must be stated on this document are the name of the company and the address of its registered office. In this case the company's name is Dhaka Insurance Limited and the address of its registered office is 115/7-A, Distillery Road, Gandaria, Dhaka.

3. Who owns and controls Dhaka Insurance Limited?

Dhaka Insurance Limited, like any other public limited company, is owned by the shareholders. In this case the chairperson, Mrs Hamida Rahman, owns 3 per cent of the shares issued by the company. The company will be controlled by the chairperson and the board of directors. However, they are accountable to the shareholders for the performance of the company.

4. How will the profit made by Dhaka Insurance Limited be distributed?

The profits made by a public limited company are returned as dividends to the shareholders, or kept in the business for future use. It is common for businesses to keep some of the profit and also pay a dividend. In 2017, the profit made by Dhaka Insurance Limited before tax was BDT116.18 million. A 12.5 per cent dividend was paid by the company, a slight increase from the previous year (12 per cent in 2016).

**MULTIPLE CHOICE QUESTIONS**

1. B   2. B   3. B   4. D

**CHAPTER REVIEW****CASE STUDY: BINASAT COMMUNICATIONS BHD**

1. What is meant by the term **flotation**?

A flotation is where a company floats on the stock exchange and becomes a public limited company. This means that the shares become available to the public for the very first time. Anyone can purchase the shares once they are listed on the stock exchange. The flotation is used to raise capital for companies like Binasat.

2. (a) Calculate the percentage increase in the share price on the first day of trading.

On the first day of trading the price of Binasat shares rose from RM0.46 each to RM0.59. The percentage increase is given by:

$$\frac{\text{RM0.59} - \text{RM0.46}}{\text{RM0.46}} \times 100 = \mathbf{28.7 \text{ per cent}}$$

- (b) Why did the price of the shares rise?

Binasat's share issue was massively oversubscribed. This means that demand for the shares was greater than the supply. As a result the share price rose very sharply on the first day of trading – by 28.7 per cent.

3. What is the purpose of a prospectus during a flotation?

When 'going public', a company is likely to publish a prospectus. This is a brochure that advertises the company to potential investors and invites them to buy shares before a flotation. The brochure is used to advertise and promote the flotation but the information it contains must be legally accurate.

4. Describe some of the expenses incurred by Binasat Communications Bhd during the flotation.

'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 have accurate information. There are the printing and distribution costs of the prospectus and also an administration fee that must be paid to a bank for processing all the share applications. There are also underwriting, advertising and administrative expenses.

5. Discuss the advantages and disadvantages to Binasat of becoming a public limited company.

One of the main advantages of 'going public' is that large amounts of money can be raised. In this case, Binasat raised RM39.55 million. The company planned to use this money to develop the business. For example, much of it would be used to set up teleports and boost working capital. And remaining money would be used to improve its services and provide money for expansion – particularly into Vietnam, Myanmar and Laos. Some of the money would also be used to cover the expenses associated with the flotation.

Another advantage is that Binasat may be able to exploit economies of scale if it is much larger. For example, it might be able to buy very large quantities of equipment and other resources from suppliers at reduced prices. The company 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 become more well-known, which in turn might boost sales. This would be important when expanding into Vietnam, Myanmar and Laos.

However, there are some disadvantages. Public limited companies are more tightly regulated to protect investors. They also have to publish more detailed financial information that competitors might see. In the future, Binasat could be the victim of an unwanted takeover. This is because Binasat shares can now be bought by anyone. Finally, the costs of going public are significant and some of the RM39.55 million will be used up in the flotation process. Despite these disadvantages, companies like Binasat believe that their future performance will be improved when trading as a public limited company. They believe the advantages are greater than the disadvantages.

## CHAPTER 8

## CASE STUDY: EUROPCAR AND 7-ELEVEN

1. Suggest **two** reasons why an individual would want to trade under the names of the brands shown in the case studies.

One reason why an individual may want to trade under the name of another brand is because they may want to start a business but cannot think of an original business idea for themselves.

Another reason is because using the name of an established brand may give the entrepreneur a 'head start'. When the business is opened it is likely that the brand will be recognised straight away. This will help the business to generate sales quite quickly.

2. What might be **one** advantage and **one** disadvantage of trading under the name of another business?

One advantage of trading under the name of another business is that the risk of going into business is reduced. This is because the business idea is already tried and tested.

One of the main disadvantages of trading under the name of another business is that some of the profit made will have to be shared with the person or company that licensed the trader to use the established brand name.

## MULTIPLE CHOICE QUESTIONS

1. B
2. C
3. A
4. A

## CHAPTER REVIEW

## CASE STUDY: CARREFOUR

1. What is the difference between a franchisor and a franchisee?

A franchisor is a business that allows another business to use its idea for a fee. In this case, Carrefour Group is a franchisor. Around 7,000 of its 12,000 stores are run by franchisees. The franchisee is the business that pays for the right to use the franchisor's idea. They may be individual entrepreneurs or perhaps a small group of people.

2. Discuss the key benefits to franchisees of taking out a Carrefour franchise.

One of the main advantages to entrepreneurs of taking out a franchise is that the business idea is already tried and tested. It is proven to be successful. This helps to reduce the risk to entrepreneurs of starting a business. However, franchisors usually offer franchisees a range of other benefits. In this case, one of the main advantages of taking on a Carrefour franchise is the reputation the group has for providing great value quality products, as well as a network of experienced service and operating staff. Carrefour is a well-developed customer-focused chain and franchisees have the opportunity to exploit Carrefour's powerful purchasing operation and use their own skills to create a successful business.

Another key benefit to Carrefour franchisees is the degree of autonomy they enjoy. Although Carrefour is an international chain, franchisees are encouraged to identify and serve the needs of their local customers. For example, Carrefour reckons that each of their French stores works with about 100 local producers. Finally, Carrefour offers management training programmes, job training and training in merchandising. Carrefour has also created 'Teach', a specialist training centre designed to meet the specific needs of franchisees.

3. Discuss the possible drawbacks to franchisees of taking out a Carrefour franchise.

Although operating as a franchisee has some clear advantages, there are some drawbacks. First, the profit made by the franchisee has to be shared with the franchisor. This will reduce the financial return on the franchisee's skill and effort in running the business. It is also necessary for the franchisee to sign a contract and meet the terms outlined in the contract. This reduces the independence enjoyed by the franchisee. It may limit the creativity of individual entrepreneurs and have a negative effect on motivation. Finally, obtaining a franchise may also be an expensive way of starting a business. This is because of the fees that need to be paid to the franchisor before trading can begin.

4. Assess the benefits and drawbacks to the Carrefour Group of its franchising operation.

One of the main benefits to a franchisor like Carrefour of setting a franchise operation is that business growth will be faster. This is because a large number of stores can be developed all at the same time. The workload and financial risk of developing new stores is transferred to the franchisee. This means that new stores can be opened more quickly. Carrefour now has 12,000 stores in more than 30 different countries. The pace of growth can be much faster using a franchising operation. Franchising is also a much cheaper way of growing. This is because the franchisees provide the start-up capital for each store. In this case, Carrefour franchisees have to provide up to €280 000 in order to obtain a franchise.

Another significant benefit to franchisors like Carrefour is that franchisees are likely to be more enthusiastic than standard employees. This is because they have the chance to make money if the venture is successful and will therefore work much harder to make a success of the business. Carrefour would benefit from this as their financial share from the operation will be higher.

However, there are some drawbacks. For example, the total potential profits from the Carrefour group operation are shared with franchisors; also the cost of supporting franchisees, such as training, might be very high and there is always a chance that a poor franchisee might damage the reputation of the whole group. However, to protect the Carrefour brand the group has a cautious recruitment policy for its franchisees. For example, necessary skills for opening a Carrefour franchise include relevant management experience (ideally gained in food retailing), wanting to be an independent entrepreneur and business owner, customer service skills, management skills, autonomy, sound interpersonal skills and a genuine interest in food distribution. This should help to remove some of the potentially poor franchisees and ensure that the Carrefour retail operation continues to be profitable.

## CHAPTER 9

### CASE STUDY: ASSAM POWER DISTRIBUTION COMPANY LIMITED

1. Who owns and runs the Assam Power Distribution Company Limited (APDCL)?

The Assam Power Distribution Company Limited is a public limited company owned by the state of Assam in India. It is run by a board of directors which is accountable to a government minister.

2. Suggest what the objectives of the APDCL might be.

The key objective of the Assam Power Distribution Company Limited is to make the corporation the pride of Assam. To help achieve this mission the company's employees have identified 15 key tasks that should be carried out. Some examples include: improving the capacity of the infrastructure by investing in electrical sub-divisions and distribution networks; expanding the network to supply power to all the villages in Assam; and trying to collect 100 per cent of all revenue and provide error-free billing.

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, so private sector firms would not be interested in supplying the market. Consequently, the government needs to run and own organisations to provide public services that can be funded from tax revenues.

Some industries, like electricity distribution, are crucial to the well-being or security of the nation. 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: RENFE OPERADORA

1. Using this case study as an example, describe **two** features of a public corporation.

Renfe is responsible for providing most of the railway services in Spain. It is owned by the Spanish government. State ownership is an important feature of public corporations.

Another feature of public corporations is that they exist to provide a public service and to satisfy customers. In this case, the aim of Renfe is to provide a nationwide rail network; for example Renfe provides some loss-making services, such as Cercanías (suburban) and Media Distancia (regional).

2. Who will benefit from the financial performance of Renfe?

In the first half of 2018, Renfe made a profit of €35.5 million. This increase in profit was helped by a 21.9 per cent rise in revenues. Renfe generated €1.79 billion (passenger traffic generating €1.1 billion and freight generating €106.2 million). This profit belongs to the owners, i.e. the government. Therefore, it might be retained in the business for future investment. Part of the profit might also be returned to the government. It could be used to help reduce government debt or fund some public sector spending, such as education and social services. Therefore, indirectly, taxpayers will benefit from the good financial performance of Renfe.

### ACTIVITY 2

#### CASE STUDY: PRIVATISATION IN SAUDI ARABIA

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 study, Saudi Arabia has some ambitious privatisation plans. The plans are part of 'Vision 2030', a set of reforms aimed to transform the Saudi economy. For example, it planned to sell a stake in the state-owned oil corporation, Saudi Aramco, for about US\$100 billion. It also said that a further US\$200 billion would be raised from the sale of assets in education, healthcare, desalination and grain.

2. How will the government of Saudi Arabia benefit financially from privatisation?

One significant benefit to the Saudi government of the privatisation plans is the amount of revenue that will be generated from the sale of state assets. In total the government may raise up to \$300 billion from privatisation (US\$100 billion from selling a stake in Saudi Aramco and a further US\$200 billion from the sale of assets in education, healthcare, desalination and grains and silos). The government will be able to use this money to reduce government debt, lower taxes or invest in public services.

3. Why might privatisation improve efficiency and productivity in some of the Saudi corporations?

One of the main motives for privatisation is to improve the efficiency of public corporations. Many public corporations lacked the incentive to make a profit and often made losses. It was argued that in the private sector they would have to cut costs, improve services and return profits for shareholders. They would also be more accountable. In this case study, two Saudi government ministers have said that privatisation will help to transform the Saudi economy. For example, the minister for the economy said that privatisation aims to strengthen competition, raise the quality of services and economic development, improve the business environment and remove obstacles that prevent the private sector from playing a bigger role in the kingdom's development. Also, John Sfakianakis, a former adviser to the government and director of economic research at the Jeddah-based Gulf Research Centre, said *'Privatisation would improve efficiency and productivity, internally, allowing the kingdom to employ all material and human resources'*.

### MULTIPLE CHOICE QUESTIONS

1. D 2. D 3. A 4. B

### CHAPTER REVIEW

#### CASE STUDY: AIRPORT PRIVATISATION

1. What is meant by the contracting out of airport services?

Many government and local authority services have been 'contracted out' to private sector enterprises. This is where contractors are given a chance to provide a service that was previously supplied by the public sector. These contractors are allowed to provide the services and keep the profit made from their involvement. This case study shows that airports around the world have commonly contracted out services such as car parking, retailing and restaurant services.

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

Governments have usually preferred to keep control of businesses operating airports. Even as recently as 2018, only about 14 per cent of the world's airports were owned or managed by the private sector. This is because airports are considered 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 ideal for the government to maintain control and guarantee the supply and quality.

3. Describe **two** reasons why some oppose the public ownership of enterprises.

Public corporations are often criticised for their low productivity and inefficiency. For example, in some countries (the UK for example) public sector rail providers are often criticised for the poor reliability and regular lateness of trains. The inefficiency is often

blamed on a lack of competition, the absence of profit as an objective and the knowledge that they cannot completely fail because losses will be met by the government.

Public corporations often suffer due to government interference. This may occur because different governments have different views about the way public corporations should operate. As a result, corporations are subject to policy changes every time a new government is elected. For example, a new government may decide that public corporations should raise prices to generate more revenue.

4. Why is the private sector becoming increasingly interested in owning airports?

Most private sector enterprises are motivated by profit. If they identify a market where a profit might be made, they will be interested in becoming involved. This case study says that the private sector is becoming increasingly interested in taking control of airports. One reason is because of the predicted growth in passenger traffic. The International Air Transport Association (IATA) forecasts that 7.8 billion passengers will pass through airports in 2036. This is nearly double the 4 billion passengers that passed through in 2017.

5. Some governments around the world are reviewing the ownership of airports. Two key options are being considered.

Option 1: Maintain public ownership of airports.

Option 2: Privatisise airports.

Which of these options would you recommend?

In some countries, privatisation is becoming increasingly popular. A wide range of state assets have been sold off by governments around the world. In recent years, the sale of airports by governments has increased. For example, the Airports Authorities of India proposed that airports in Lucknow, Jaipur, Ahmedabad, Guwahati, Mangaluru and Thiruvananthapuram be privatised along the lines of Delhi and Mumbai from 2019.

Many believe that airport privatisation is a good thing. For example, one of the main benefits of privatisation is that the government can raise quite large amounts of money. If the government sells a public corporation like an airport, the money can be used by the government. In this case study for example, in 2016 it was reported that Brazil wanted to raise US\$1.3 billion by selling stakes in five of its airports. The money is needed by the Brazilian government to help reduce its budget deficit.

Another advantage of 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, United Arab Emirates: *'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'.

However, there are opponents to airport privatisation. The IATA said in 2018 that there has not yet been one example of an airport privatisation that has delivered the promised benefits. The IATA said that private sector managers with a customer-focused approach would benefit airport efficiency. However, it argued that airports should remain under the control of the state. It said that some research carried out showed that privatised airports ended up costing passengers more. It is not unusual for both consumers and workers to be negatively affected by privatisation. Evidence from the UK suggests that prices go up and workers get laid off as a result of privatisation. It might also be argued that airports are a strategic asset for a country. If they were privatised they may end up in 'foreign hands'. Many would object to this situation.

It may be difficult to determine whether the advantages of privatisation outweigh the disadvantages. As a result it is difficult to say whether airport privatisation is a good thing or not. If prices go up, passengers might argue against privatisation. However, if governments are able to raise large amounts of revenue from the sale of airports, more sales are likely in the future. More evidence about the impact of privatisation on the various stakeholders would be helpful to draw a final conclusion here. However, I would argue that because airports are a strategic asset, they should remain under the control of the government.

## CHAPTER 10

### CASE STUDY: THE SALE OF FRESH PRODUCE

1. Which of the two outlets pictured is likely to be the cheapest?

The street trader shown in the right-hand image is likely to charge lower prices than the supermarket.

2. Give reasons for your answer to question 1.

The street trader will have much lower overheads than the large supermarket. The only costs that the street trader will have to cover is the cost of the produce from suppliers and perhaps a payment for their sales pitch (although even this might be zero). The supermarket will have huge costs such as the cost of building the store (including the land upon which it is built), the overheads associated with running the store such as heating, lighting, insurance and many others) and labour. Therefore the street trader can probably afford to undercut the supermarket.

3. What methods of payment might be accepted by these two outlets?

The street trader will probably only accept cash as payment. However, the supermarket is likely to accept cash and almost certainly debit and credit cards. It may also be possible to pay by cheque at the supermarket and possibly by mobile phone.

4. Why might the display of goods be important to sellers?

If goods are displayed attractively, shoppers are more likely to buy them. Attractive displays might also encourage impulse buying; this is where shoppers did not plan to buy the goods but were persuaded to by the 'enticing display'.

### ACTIVITY 1

#### CASE STUDY: HARRODS

1. What is meant by retailing? Use this case study as an example in your answer.

Retailing involves buying large quantities of goods from suppliers and reselling much smaller quantities of those goods to consumers. In this case study, Harrods buys large quantities of goods like menswear, womenswear, fashion accessories, shoes, homeware, souvenirs, gifts, food and toys from suppliers – probably from all over the world. These goods are then sold in much smaller quantities, usually in units, to shoppers. In this case, the goods are displayed and sold in a huge store in London.

2. Retailers like Harrods provide storage facilities. What does this mean?

One of the functions of retailers is the storage of goods. They hold inventories in their outlets that are bought by customers as and when they are needed. Inventories may be held inside stores and displayed on shelves, in refrigerators or in specialised display units such as those used by jewellers. Inventories may also be held in retailers' storerooms, where back-up stocks might be held to deal with frequent changes in demand or because there is not enough room to display the entire delivery from a supplier. Finally, some large retailers hold stocks in central warehouses ready for distribution to a chain of stores in a particular region. In this case, Harrods holds a lot of stock inside its stores and probably has storage facilities close by.

3. Discuss the role played by window displays in retailing.

Window displays may be important for some retailers. This is because attractive displays might draw shoppers inside. For example, window shoppers may have no plans to visit a particular store. But when they see an attractive window display, they may decide to go inside. The cost of advertising and window displays might be shared between the retailer and the manufacturer since both parties are in a situation where they would benefit from higher sales. Attractive window displays might also encourage impulse buying. In this case, Harrods is famous for its crowd-drawing window displays, which attract thousands of visitors. Harrods is popular with tourists to London and more than 10 per cent of its revenue is generated from overseas shoppers. The attractive window displays are a draw to many customers; this is likely to result in sales.

## ACTIVITY 2

### CASE STUDY: CHOICE OF OUTLET

1. What is meant by the term **independent retailer**?

Independent retailers are usually small shops operated by sole traders. Examples include greengrocers, newsagents, clothes shops and florists. Many independents offer counter service and discourage self-service shopping. In many countries the number of independents has fallen due to the dominance of large chain stores – some of which are powerful multinationals. In this case study, the independents discussed might be regarded as speciality shops. These provide a very narrow range of goods but can often provide expert advice and detailed information about products. Mansoor may sell the dresses made by his business to shops that specialise in such products. They may also offer accessories like handbags and belts, and usually provide a high level of customer service, such as fitting.

2. What is the difference between a department store and a chain store?

A department store is a very large store divided into departments, each one selling a different category of goods. The departments might be menswear, children's clothes, lingerie, home and garden, electricals, sport and leisure, toys and beauty. In contrast, a multiple or chain store sells common goods. The chain might be regional or national. Bata is an example of a national multiple selling shoes in stores all over India.

3. Why is distribution through multiples likely to be more profitable for Mansoor Aslam than selling to independent retailers.

Daniyal is keen to widen the distribution network of his family's business. The aim is to develop distribution channels with department stores and multiples. The main advantage of using these channels is that larger quantities can be sold to the new customers. An order from an independent retailer might be for five dresses. In contrast, an order from a regional or national multiple might be for many hundreds. This should help to generate larger

revenues for the business. Distribution costs might also be lower. For example, it should be cheaper to transport a very large order to a depot or warehouse belonging to a multiple than delivering to many small independent retailers in a wide area.

However, large multiples and department stores would expect to buy dresses from Mansoor's business at much cheaper rates than independents. They would expect discounts for buying in bulk. Daniyal and his family would have to consider whether supplying customers with large orders at lower rates is profitable.

### MULTIPLE CHOICE QUESTIONS

1. B   2. A   3. C   4. D

### CHAPTER REVIEW

#### CASE STUDY: WELLCOME SUPERMARKET

1. Describe **two** features of supermarkets.

Supermarkets are large stores that sell a wide range of goods. When supermarkets first emerged in the 1960s, they concentrated on the provision of groceries, fresh produce and household products. However, today they are likely to offer a much broader range of products including electrical goods, flowers, books, newspapers and many other non-food products.

One common feature of a supermarket is the provision of baskets and shopping trolleys to assist self-service shopping. Shoppers are encouraged to wander around the store at their leisure, browsing and selecting items from the shelves. Another feature is a reliance on a high-volume, low-margin approach to business. This involves selling very large quantities of goods, where each product line generates just a small amount of profit for the supermarket.

2. Most supermarkets, like Wellcome, operate as multiples. Discuss the advantages to the owners of operating in this way.

A multiple is a retail operation that has ten stores or more. Most supermarkets operate as multiples. Some of the larger ones around the world have thousands of branches. In this case study, Wellcome operates a chain of 280 supermarkets in Hong Kong. The operators of multiples, especially very large ones, can benefit from their size by exploiting economies of scale. For example, they can buy huge quantities of produce direct from suppliers at heavily discounted prices. They also tend to be well-resourced and some of them can afford the rents in popular shopping locations. Branches might also cooperate with each other. For example, a branch that runs out of stock may be supplied very quickly from a branch in the next town.

3. To what extent do supermarkets like Wellcome offer after-sales service?

In competitive markets, a business may try to add value to its products. This involves providing 'extra' features for the customer which go beyond their standard expectations. One way of doing this is to offer good quality customer service; for example, clean, friendly, attentive and professional staff create a good image and make customers feel at ease.

After-sales service may be an important feature of added value. Customers may be happier buying from a retailer that operates a helpdesk, shows how to use products or offers a free maintenance service. Other examples of after-sales service include gift-wrapping, delivery, repairs, warranties and courtesy calls (to check that customers are happy with their purchase). In this case, it might be argued that Wellcome does provide good customer service with some after-sales service. For example, the store has won a number of awards

in recent years that recognise the quality of its customer service. The supermarket encourages customers to give feedback and share their ideas for improvements.

One example of after-sales service for Wellcome relates to damaged or spoiled goods. Wellcome will replace or refund products that are damaged, spoiled or out of date. It will also replace or refund products if the wrong product was picked or if a product was not included in the original order. However, many would argue that the after-sales service provided by Wellcome is limited even though its general customer service was good. Therefore, it could be concluded that supermarkets like Wellcome only offer after-sales service to a small extent.

4. Retailers like Wellcome have to hold the right amount of stock. What does this mean and why is it important?

Retailers have to hold the right amount of stock. Stocks must not be too low in case they run out because it would be inconvenient to customers and they might go elsewhere to shop. However, if inventories are too high, storage costs will be high and too much money could be tied up in stock. Money tied up in stock is unproductive.

5. Assess the advantages and disadvantages of Wellcome's online selling operation to shoppers.

There has been an enormous growth in online trading in recent years. The graph in Figure 10.3 shows that the value of global sales is expected to more than double between 2015 and 2020 – from US\$1.548 trillion to US\$4.058 trillion. People appear to like shopping online due to the advantages of the method. Generally, the goods sold online are cheaper than those purchased in stores. This is mainly because online sellers do not have to meet the overheads associated with selling from stores, such as the cost of building stores, rents, heating and lighting, wages paid to shop-workers and insurance. Another advantage is that shoppers can buy goods from anywhere in the world provided they have access to the Internet – at home on their computers, at work or while travelling using mobile phones. They can also shop 24/7 which is very convenient for those with limited time. Finally, online shoppers have more choice. They have access to sellers from all over the world.

However, there are some disadvantages. It can be inconvenient and time-consuming if unwanted goods have to be returned. Goods may be returned if they get damaged in transit or if they do not live up to expectations, for example. There is also the problem of security. It may be possible for criminals to get hold of people's personal data while they are online. It is also possible that buying is made more difficult by technical problems such as loss of Internet connection or the crash of a seller's website. Also, shopping online removes all the physical contact with sellers and their products. For example, it is not easy to discuss the nature and performance of products or try them for size. It is also difficult to identify websites that sell fake goods. Finally, consumers without debit or credit cards and those without access to the Internet cannot do online shopping.

Overall though, it would seem that the advantages of online shopping outweigh the disadvantages. The pattern of growth shown in Figure 10.3 tends to support this view.

## CHAPTER 11

## CASE STUDY: YOU MART

1. Suggest **three** factors that YOU Mart might have considered when locating its new store.

When locating the new store in Ireland, YOU Mart may have considered the following factors before making the final decision:

- the cost of land
- availability of labour
- availability of government support
- planning permission.

2. Why might each of these be important?

The area of land needed to locate a new hypermarket would be quite large. Hypermarkets are huge one-storey buildings that require a large plot of land. A large space will also be needed for a car park. YOU Mart needs to find land at a low enough price so that the return on its investment is maximised.

YOU Mart also needs to consider whether its new site is located close to a suitable supply of labour. YOU Mart will need to employ about 500 people in the construction of the hypermarket and then a further 900 once the store is operational. If the new store is located in a remote (far-away) area, recruiting labour may be very difficult. A shortage of labour would cause operational difficulties.

Firms are keen to locate in areas where they get financial support from the government. This will help to reduce costs. In this case, YOU Mart hopes to get some financial support from the Irish government. However, it will only get support if it locates its new hypermarket on a site preferred by the government.

Firms will need to get planning permission when building a new property. In some countries, obtaining planning permission can be a long and difficult process. Therefore, YOU Mart will prefer to locate on a site where obtaining planning permission is straightforward.

3. Identify **three** retailing techniques that YOU Mart might use to attract more customers.

YOU Mart might use the following techniques to attract more customers:

- Special offers
- Advertising
- Loyalty cards
- Loss leaders
- Sales

**ACTIVITY 1****CASE STUDY: YANG MAN THE BOOKSELLER**

1. Calculate the profit made on a book sold by Yang Man if the price of a new copy was CNY180.

The cost to Yang Man of buying a book for resale is one-third of the original price:

$$\frac{1}{3} \times \text{CNY}180 = \text{CNY}60$$

The revenue from the sale of the second-hand book is half of the original price:

$$\frac{1}{2} \times \text{CNY}180 = \text{CNY}90$$

Therefore the profit made is given by:

$$\text{Revenue} - \text{cost} = \text{CNY}90 - \text{CNY}60 = \text{CNY}30$$

2. Using this case study as an example, discuss the importance to retailers of locating near to **(a)** the market **(b)** suppliers.
  - (i) It is common for retailers to locate their outlets close to their customers. This is because many retailers sell direct to consumers. For example, restaurants, cafés, shops, hair salons, taxi companies and dry cleaners have to be located in towns and cities because this is where the majority of customers live, work and shop. In this case study, Yang Man has located her sales pitch for second-hand textbooks on the university campus. This is very close to her undergraduate market.
  - (ii) It may be important for some retailers to be located close to their suppliers. This would help with the supply of stock and reduce transport costs. In this case study, Yang Man buys her stock from graduates (second-hand books). The location of her sales pitch on the university campus is very convenient for graduates to sell their books to Yang Man.

3. Why do you think Yang Man has located her sales pitch close to her rivals?

Some might expect that retailers would prefer to locate themselves where there is less competition. For example, a trader opening a florist may avoid locations where other florists exist. However, some retailers deliberately choose locations where competitors are closely concentrated. This might be important where shoppers want to make comparisons. Yang Man's sales pitch is located alongside several other second-hand booksellers. She may feel this is an advantage. By locating close to other booksellers, it might be possible to catch the excess demand resulting from those rivals. However, some might regard this approach as risky.

**ACTIVITY 2****CASE STUDY: LIDL**

1. What is the advantage to Lidl of own-brand products?

Like many supermarkets, Lidl stocks own-brand products. Own-brand packaging is distinctive, with clear own-brand labels and design. Own labels are also sold at lower prices than established brands. About 90 per cent of the products sold by Lidl are own own-brand products. This means Lidl has some control over the manufacturing of these products. This seems to be working for the supermarket because Lidl has won awards for the quality of its own-brand products. Awards for Lidl brands went to such items as pulled pork, slow-cooked lamb, piri piri chicken, cheeses, fishcakes, truffles, cookies, apple juice, smoked salmon and popcorn.

2. Why do retailers like Lidl use special offers?

Special offers are the incentives used by retailers to encourage people to buy products. Examples include free gifts; money-off coupons; free entry into a competition with an attractive prize; BOGOF offers (Buy One Get One Free) and customer discounts. Special offers are very popular in supermarkets. They are used to attract customers and increase sales. Lidl uses special offers for these reasons. For example, Lidl has sections marked 'While Stocks Last', usually with an orange label. These might contain clothes, shoes, kitchen gadgets, fitness equipment and lots more – all with limited availability.

3. Lidl has a distinctive, colourful logo. What is the purpose of this?

Brightly coloured logos can be easily recognised and help to promote both products and the business name. They also assist consumers with product recognition.

4. What is **one** advantage of self-service to retailers like Lidl?

Like most supermarkets, Lidl provides baskets and trolleys to assist shoppers as they stroll around a store at their leisure. Self-service cuts labour costs and encourages shoppers to stay in the store for longer – hopefully buying more! Impulse buying is also encouraged when shoppers can help themselves.

#### MULTIPLE CHOICE QUESTIONS

1. C 2. B 3. D 4. B

#### CHAPTER REVIEW

##### CASE STUDY: POH KONG

1. What is meant by a brand?

Branding involves giving a product a distinctive name. It helps shoppers to recognise the product and see how it is different from those of rivals. In this case, Poh Kong stocks numerous in-house brands such as Tranz, Anggun and Happy Love. Poh Kong also sells prestigious international brands like Schoffel and Luca Carati. One of the main advantages of branding is that higher prices can be charged for strong brands and sellers can create customer loyalty.

2. Suggest **two** examples of after-sales service Poh Kong might offer.

Some examples of after-sales-service that Poh Kong might offer are gift-wrapping, a fitting service, cleaning, repairs and modification to pieces of jewellery.

3. What is the importance of packaging to a retailer like Poh Kong?

Appealing and well-designed packaging can distinguish products from those of rivals. It will display information (some legal); protect the product; be easy to handle, open and use; preferably be recyclable; and cost-effective. The design and quality of packaging is vital for products like perfume, cosmetics and confectionery. In this case, packaging will be particularly important. When selling high value goods like jewellery, the quality of packaging can be used to support and enhance the quality of the product. It is very common for watches, earrings, rings, necklaces and other jewellery to be presented in luxury boxes, e.g. lined with velvet.

4. Why is a store like Poh Kong unlikely to sell loss-leaders?

Loss leaders are products sold below the cost of production. The aim of loss leaders is to draw customers into a store where they will buy the loss leader. Once in the store, it is hoped that customers buy other products. Overall this will generate a profit. The use of loss leaders in a jewellery store might be considered 'cheap' and inappropriate when selling high-value luxurious products. The use of loss leaders might also damage the image of Poh Kong. Loss leaders are more suitable for retailers like supermarkets where, once inside, customers might buy lots of other products. Shoppers are not likely to be drawn into a jewellers to buy a loss leader and then purchase more pieces.

5. Assess the importance to Poh Kong of (a) transport links and (b) availability of power when locating its shops.

Retailers such as Poh Kong need good transport links to carry shoppers from their homes into towns and cities where their stores are located. In a relatively developed country like Malaysia, Poh Kong can be confident that trains and buses, for example, will transport large numbers of shoppers into their location. However, many people prefer to drive to the shops. If this is the case in Malaysia then Poh Kong needs to be sure that there is enough parking close to its outlets. In countries where car ownership is low, proximity to effective public transport is very important.

Most retailers need electricity. Poh Kong will need electricity for lighting, heating and communications. Therefore, proximity to reliable power sources such as these is important. In some countries the supply of electricity is unreliable. It may be limited, or cut without notice. In countries with effective power distribution networks this factor is much less important.

In this case study, the quality of transport links and the availability of car parks will be more important than the supply of electricity. This is because in Malaysia, electricity will be available everywhere (within reason). Wherever Poh Kong wanted to open a store, a connection to the power source would not be a problem. However, the quality of transport links is likely to vary. Poh Kong will prefer to locate its stores in malls and other shopping centres where transport links are good.

## CHAPTER 12

### CASE STUDY: NIKE

1. What change in retailing is Nike reacting to with its new store?

There has been an enormous growth in online retailing in recent years. This has had a negative impact on retailers that focus on selling from stores. Its sales have started to fall. Nike is trying to protect sales from stores.

2. What is Nike aiming to achieve in its stores?

Nike is trying to draw customers into its stores by creating a memorable customer experience. It has been suggested that Nike's latest store in New York is like LEGOLAND for people who love sports. The large store houses a mini indoor basketball court, a treadmill, a system that simulates runs in different locations, a small soccer enclosure, a shoe bar where shoppers can personalise a pair of Nike Air Force and coaches who put customers through drills to test out different pairs of shoes. Nike has produced a shopping environment where customers can both play and shop.

3. Suggest **three** other changes that might be taking place in retailing.

Some of the main changes in retailing include:

- omnichannel and multichannel retailing
- click and collect
- self-scan checkouts
- mcommerce
- pay by phone (e.g. Apple Pay)
- rising demand for 'experiences' rather than physical products
- more subscription services like Spotify.

### ACTIVITY 1

#### CASE STUDY: CLICK AND COLLECT IN AUSTRALIA

1. What is meant by click and collect?

Click and collect is a very simple retailing technique. It allows shoppers to order goods online and then collect them from a recognised collection point – perhaps at a store, but not necessarily. For example, in the case study some collection points include lockers at railway stations. In 2016, the Australian transport minister announced an 'Australian first' grocery collection trial for train customers. The aim of the scheme was to save people time after their journey home from work. Sydney Trains is partnering with Woolworths on a 12-month trial of the scheme, launching at Bondi Junction station. Click and collect can be used to sell a wide range of different goods such as groceries, fashion and accessories, sports clothing, automotive parts and many others.

2. What are the benefits of click and collect to shoppers?

Click and collect services provide shoppers with a more flexible and convenient shopping experience – particularly if retailers can offer a number of different collection points – such as stations, car parks and stores, for example. Shoppers do not have to wait at home to receive an online delivery – this can often be very inconvenient when working full-time. Also the waiting times for goods is reduced. Shoppers can collect their orders more quickly than waiting for them to be delivered. Finally, since shoppers collect goods themselves there are no delivery charges.

3. What benefits might Coles and Woolworths enjoy when introducing click and collect?

Click and collect services offer customers more convenience and provide another sales channel. Therefore, retailers that offer this service should enjoy an increase in sales. In addition, if goods are collected from a store then shoppers might make additional purchases, which will also increase sales revenue. Retailers will also benefit from the cost savings made when goods do not have to be delivered.

### ACTIVITY 2

#### CASE STUDY: ROD'S FISHING TACKLE

1. What advantages do large retailers have over their smaller rivals?

Large retailers enjoy some significant trading advantages over their smaller rivals. For example, hypermarkets, supermarkets, department stores and multiples are able to buy huge quantities of inventory direct from producers at heavily discounted prices. This helps to raise their profit margins. They might also employ specialist buyers and can afford heavy advertising and promotional expenditure. Large retailers also have the financial resources to invest in technology to improve efficiency and have a much higher profile in shopping centres.

2. Rod offers his customers a personal service. What does this mean?

A personal service is where a business offers each customer an individual service with a 'personal touch'. An example could be a simple, friendly greeting from the owner of a small retailer upon arrival. This is something that a large retailer can rarely match.

Offering high-quality customer service is a way of adding value to products. It can also give firms a competitive edge in a market and allow smaller retailers like Rod's Fishing Tackle to survive in markets dominated by larger rivals. It is a lot easier for a small retailer to offer customers a personal service. Because customers attach value to dealing directly with the owner of a shop, the owner can charge a premium for this.

It is often said that customer care is about building relationships with customers. It is a lot easier for small retailers to do this because they are closer to their customers. Small retailers may be able to respond to changing customer needs more effectively because they are closer to their customers. In this case, Rod has built up a loyal customer base and has a reputation for his high-quality personal service. Rod is a fine angler himself and is happy to share his fishing experiences, knowledge and other useful information with his customers.

3. Describe **two** additional services that Rod might offer his customers.

Small retailers like Rod's Fishing Tackle may offer additional services to help give them a competitive edge over their larger rivals. One service that Rod might offer is a product trial to customers. If Rod has built up trust with customers he may allow them to try out products – like a new fishing rod or reel – before deciding whether to make a purchase. Rod might also offer a free repair and maintenance service if there are problems with fishing tackle. Finally, it is common for some small retailers like Rod's Fishing Tackle to offer advice and detailed information to customers about products. In this case Rod is an enthusiastic angler himself and is happy to share his fishing experiences, knowledge and other useful information with his customers. For example, he may be able to advise customers where the best local fishing spots are.

### MULTIPLE CHOICE QUESTIONS

1. B 2. A 3. B 4. D

### CHAPTER REVIEW

#### CASE STUDY: DOMINO'S

1. What is the difference between omnichannel and multichannel retailing?

Omnichannel retailing is used to provide consumers with an easier shopping experience. Omnichannel retailing offers an integrated approach to shopping. For example, in this case study, customers can interact with Domino's through mobile and tablet apps, over the web, by phone and in person at its pizza shops. Pizzas are manufactured and delivered within 30 minutes of an order being placed, regardless of the sales channel used.

Multichannel retailing means that a retailer uses different channels to sell products, such as a store and an online operation. There may be no connection between the two; they may operate independently. For example, the two may have slightly different product lines or it may be impossible to return goods bought online to one of the retailer's stores.

2. What are the benefits to a retailer like Domino's of omnichannel retailing?

Retailers like Domino's using an omnichannel approach to selling may see an increase in sales resulting from better customer service. It is also possible that delivery costs will fall, more orders will be completed, consumer information will be centralised, warehousing and storage costs might be lower and there may be savings on marketing expenses.

There is also some research evidence which suggests that omnichannel retailing has its advantages. For example in the USA, 73 per cent of shoppers use omnichannel retailing and 57.5 per cent had used click-and-collect services. This suggests that the service is popular. It has also been found that customers using omnichannel retailers are 23 times more satisfied than those that do not, and that 89 per cent of customers are retained by omnichannel retailers. This is very significant as retailers will not need to spend as much on advertising to attract new customers. Research also found that shoppers made 10 per cent more online purchases with omnichannel retailers and 4 per cent more in-store purchases. According to this research the arguments for offering an omnichannel service, like that of Domino's, are strong.

3. What are the benefits to customers of Domino's omnichannel approach?

Shoppers expect the range of products sold by a particular retailer, their prices, the methods of payment, conditions of sale, consumer rights and all working practices to be exactly the same whichever channel is used. Omnichannel retailing provides shoppers with choice and convenience. In this case, a Domino's key manager said that omnichannel is about delivering the same customer experience via any channel the customer chooses. The pizza ordered needs to taste, look and smell the same whether it was ordered online, through an app or in-store. Also, pizzas need to be consistent whether they are collected in-store or delivered to a customer's home. Omnichannel retailing is about providing high-quality customer service to all shoppers from a fully integrated system of sales channels. Domino's appears to have achieved this and customers appear to be happy. Domino's is one of the biggest franchises in the world. This is a testament to its success.

4. Suggest **two** impacts on individuals that developments in retailing might have.

The changes and developments in retailing are ongoing. Answers may include two of the following:

- Many of the changes taking place in retailing tend to make shopping more convenient. For example, many of the apps produced by retailers help shoppers to access websites more quickly.
- They may also offer coupons that entitle customers to money off purchases.
- Mcommerce allows individuals to shop from any location provided they have an Internet connection.
- Consumers are also likely to benefit from lower prices. Due to the improved efficiency enjoyed by retailers resulting from changes, their costs are often lower. Therefore, retailers can improve their competitiveness by passing on the cost savings to customers in the form of lower prices.

5. Assess the impact on businesses like Domino's of developments in retailing.

The impact of changes on businesses are both positive and negative. Some of the developments in retailing help to lower business costs and improve efficiency. For example, new non-cash payment systems improve security and help to reduce theft and fraud. Self-scan checkouts will help to reduce check-out costs and improve profits. Domino's is using an omnichannel approach to selling. As a result, it has probably seen an increase in sales resulting from better customer service. Also, research seems to support this view since in the USA 73 per cent of shoppers use omnichannel retailing. This suggests that the service is popular. It has also been found that customers using omnichannel retailers are 23 times more satisfied than those that do not, and that 89 per cent of customers are retained by omnichannel retailers.

However, keeping up with the changes can be challenging. Domino's has to focus on customer targets across marketing, technology and operations. Marketing needs to deliver

vouchers that customers want and can use across any channel they choose. The Domino's digital platform needs to be able to handle massive peaks in demand. Operationally, the supply chain needs to be efficient across manufacturing, delivery and service. Meeting such challenges often requires changes to working practices; for example, staff retraining may be required. When new technology is introduced workers have to be taught how to use it. This can add to the cost of retailing as training can be expensive. Also, some of the changes in retailing require firms to update their IT systems. For example, the introduction of an online selling operation depends heavily on the quality of IT used. Finally, most of the changes require retailers to invest money in new systems and working practices. To meet these costs, retailers may have to borrow money or use retained profits.

It might be argued that to remain competitive, retailers have little choice but to adopt and adapt in the face of change. If they fail to do so they may get left behind and fail to survive.

## CHAPTER 13

### CASE STUDY: ADAMJI MULTI SUPPLIES LTD

1. How does Adamji fit in the chain of distribution?

Adamji is a wholesaler. It provides a link in the chain of distribution between manufacturers and retailers. In this case, Adamji provides wholesaling services for the HORECA trade (HOTels, REstaurants and CAFés). Some of its customers include hotels and resorts, airlines, supermarkets and retailers, bakeries, fast food chains and food manufacturers. Adamji buys food produce from local suppliers but also imports food products from countries such as Italy, France, Singapore, Greece, China, Thailand, Turkey and Indonesia.

2. Suggest **three** functions performed by Adamji for customers.

Any three from:

- Storage of goods – helps customers to reduce stock-holding
- Delivery – just-in-time
- Provides a one-stop store
- Advice to customers on products

3. How does Adamji assist producers?

In its role as a wholesaler, Adamji stores goods. It breaks-bulk. This means that Adamji buys large quantities of products from suppliers (producers and manufacturers) and sells small quantities to retailers. This means that producers and manufacturers do not have to store large quantities of their output. This is important because some of the produce handled by Adamji requires expensive storage facilities (refrigerators for chilled and frozen food).

### ACTIVITY 1

#### CASE STUDY: THE CHANGING ROLE OF CASH-AND-CARRIES IN SOUTH AMERICA

1. How does a cash-and-carry operate?

A cash-and-carry is a specific type of wholesaler. It does not provide delivery or offer trade credit. Customers are expected to pay for their purchases before leaving the premises and take their purchases with them. As a result the prices in a cash-and-carry may be lower than rivals. They operate mainly in the grocery trade and serve hotels, small retailers, caterers and other businesses. Atacarejos are a form of cash-and-carry.

2. What has prompted the changes in wholesaling in parts of Latin America?

Economic uncertainty, including rising inflation and recession in parts of Latin America, has resulted in a change in the role of cash-and-carries. They are starting to target price-conscious consumers as well as businesses. Due to recessions in these countries, consumers are looking to buy cheaper goods to help make their incomes go further.

3. Describe the changes in wholesaling that have taken place in this case (i.e. in Latin America).

In parts of Latin America – Brazil, for example – atacarejos have emerged. The format is similar to warehouse clubs in terms of the product range and display of products; however, atacarejos do not require a membership. According to Euromonitor International, two successful atacarejos are Atacadão (owned by Carrefour SA) and Assaí (owned by Casino Guichard-Perrachon SA).

### MULTIPLE CHOICE QUESTIONS

1. B   2. C   3. D   4. A

### CHAPTER REVIEW

#### CASE STUDY: UCP (UNITED COMPANY OF PHARMACISTS)

1. What is the role of a wholesaler in the chain of distribution?

Wholesalers provide an important link in the chain of distribution. They buy large quantities of goods from manufacturers and other producers and sell smaller quantities to retailers. In this case, UCP buys pharmaceutical products from manufacturers and sells them to pharmacies and hospitals.

2. Describe the role played by UCP in the pharmaceuticals industry in **(a)** breaking bulk **(b)** risk bearing **(c)** storage as a wholesaler.

(i) One important function performed by wholesalers is 'breaking bulk'. UCP buys huge quantities of goods from pharmaceutical companies and sells smaller quantities to pharmacies and hospitals. This means that manufacturers do not have to store large quantities of pharmaceuticals. UCP also assists pharmacies and hospitals. This is because most pharmacies and hospitals only want to buy relatively small quantities for their needs. It would not be economical for most large-scale producers to sell such small quantities. Therefore, UCP meets the needs of two important traders in the chain of distribution.

(ii) Wholesalers like UCP take some risk in the chain of distribution. This is because they take ownership of the goods bought from manufacturers. This means that UCP has to find the money needed to buy the goods and also meet the cost of storage until they are sold. This can be a significant expense, so wholesalers need to be accurate and efficient in their purchasing, warehousing and transportation processes. There is also the chance that goods remain unsold if demand patterns change due to changes in consumer tastes. Wholesalers also bear the risk for the products until they are delivered. This means that UCP has to meet the cost of drugs or medicines damaged in transport.

(iii) Wholesalers usually operate from very large warehouses. This is because they are responsible for storing goods bought from producers. UCP handles more than 9,700 different pharmaceutical products. This helps both producers and retailers. Producers are always keen to dispatch their output as soon as it is ready. Retailers do not really have the capacity to store large quantities of goods; therefore

wholesalers bear all the costs of storage. These might include heating, lighting and labour costs (e.g. a security guard to protect stores when the wholesaler is closed). Some products require very special storage conditions; for example, some of the pharmaceuticals may have to be stored at a specific temperature. Also, UCP may have to insure against fire, theft and other damages. The risk of theft might be quite high in this case due to the high value of some pharmaceuticals.

3. Some wholesalers offer trade credit. What does this mean?

Trade credit is when wholesalers allow customers to buy goods and pay for them later. For many retailers this is a valuable service. It helps their cashflow and may avoid the need to borrow money. Wholesalers will probably have to pay manufacturers immediately after goods have been shipped. However, they may allow regular and trusted customers 'buy on account' and let them pay at the end of the month – or perhaps even later.

4. How do wholesalers reduce the cost of transport in distribution?

The role that wholesalers like UCP play in the delivery of goods is significant. This is because it has some positive social benefits as well as saving money in the distribution of goods. For example, in Figure 13.2, in (a), without a wholesaler, the three producers transport goods directly to all six retailers. There are a total of 18 different journeys. In (b), with a wholesaler, the three producers deliver to one wholesaler who then delivers orders (made up of goods from all three producers) to the six retailers. This involves a total of just nine different journeys – three by producers and six by the wholesaler. Clearly, this will reduce transport costs, but it will also reduce traffic congestion and pollution from exhaust emissions. In this case, UCP operates a fleet of 690 vehicles. Consequently, transport costs are probably reduced quite significantly.

5. Discuss the impact of changes in the wholesale trade on retailers and consumers.

The distribution of goods around the world has been subject to a range of changes and developments. For example, there has been a decline in the number of wholesalers as retailers try to 'eliminate the middleman'. For example, an increasing number of retail chains bulk-buy directly from producers to save money. There has also been an increasing amount of business carried out online. Developments in technology, such as automated warehousing, has improved the efficiency of wholesalers. It is likely that UCP uses such technologies in its operations. These changes in distribution, and many others, have had an impact on retailers and consumers.

Competitive pressure has resulted in many of the large retailers buying directly from manufacturers. This has allowed them to save money but also forced them to change their practices. For example, large retail chains are likely to have their own warehousing operations. They may take delivery from manufacturers in a central warehouse and then distribute goods to their own stores. This will obviously increase their costs. Both large and small retailers now sell increasing amounts of their goods online. Consequently, they will have had to invest in IT and change their methods of distribution to accommodate this trend. Many small retailers are making increasing use of the postal system to distribute goods to consumers. This has enabled them to increase sales as a result of selling to more customers – often located all over the world. This has helped to grow market share and increase profits.

Many of the changes taking place in the chain of distribution benefit consumers. They often get cheaper goods and a lot more choice. For example, when supermarkets buy direct from manufacturers, they may pass on some of the savings to customers in the form of lower prices. As a result of the growth in ecommerce, consumers can buy goods from suppliers all over the world. Unfortunately for many wholesalers, the rapid growth in ecommerce suggests that consumers are very much enjoying this relatively new service.

## CHAPTER 14

## CASE STUDY: ETIHAD

1. Suggest **three** reasons why businesses like Etihad have a website.

Three of the following:

- to advertise products
- to provide information about products – such as the times of flights and destinations for Etihad
- to facilitate online purchases of goods and other services
- to allow service providers like airlines to book flights
- to gather information about consumers' shopping habits.

2. Why do you think ecommerce has grown in popularity?

The growth in ecommerce is not surprising. Online shopping sites provide consumers with a great deal of convenience. They can shop 24/7 from anywhere as long as they can access the Internet. Goods are often cheaper online and there is a lot more choice.

3. Why might goods bought online be cheaper than those bought in stores?

Goods bought online are often cheaper than those of rivals sold in stores. This is mainly because online retailers have lower overheads. They do not have to meet the cost of building stores or renting shops. There are lower lighting, display and heating costs and there is no need to employ shop assistants. These cost savings enjoyed by online retailers can be passed on to consumers.

## ACTIVITY 1

## CASE STUDY: BANGLASHOPPERS.COM

1. What is meant by the term **bricks and clicks**? Use this case study to illustrate your answer.

'Bricks and clicks' is a business model which involves a retailer selling goods online and from a store. It is very common in retailing. There may be an argument for shutting down shops and concentrating purely on ecommerce, but some research shows that shoppers still prefer to buy goods from a physical store. Banglashoppers.com operates an online shopping service but also has a small network of stores in Dhaka. These include Banani, Wari Old, Bashundhara and Dhanmondi.

2. What is an advantage to retailers like Banglashoppers.com of running a bricks-and-clicks operation?

Banglashoppers.com will benefit from having stores as well as its online operation. This is because consumers still enjoy shopping in stores. At the moment, the majority of retail sales are conducted at stores. Although ecommerce is growing rapidly, it still only accounts for a fraction of total retail sales.

Bricks and clicks will benefit retailers because customers can research their purchase online, and then buy the product in a store. If the retailer only has an online presence, sales may be lost. This is because customers carry out research at an online shop, and then buy the product from a rival's store. A bricks-and-clicks operation will also help retailers become omnichannel suppliers.

3. What is meant by a returns policy?

A returns policy is the terms and conditions set out by the retailer about how goods should be returned, including timescales. Goods may be returned because they have been damaged in transit, do not fit (in the case of clothes, etc.) or because the wrong goods were dispatched. Goods can be returned to the online retailer by post or courier to where they were sent from. Shoppers are not always required to return goods in exactly the same packaging as they arrived. However, they are responsible for their safe return. Payment for returns is usually met by the retailer.

In this case, Banglashoppers.com has a returns policy. Goods must be returned within seven days to qualify for a full refund. Items purchased must be unused and in the same condition as they were received. However, some goods cannot be returned. These include perishable goods such as food, flowers, newspapers or magazines, gift cards, downloadable software products and some health and personal care items.

## ACTIVITY 2

### CASE STUDY: MOSTPETS.COM

1. How does the information in Figure 14.2 support Aaron's view that 'ecommerce is the future'?

Aaron closed down his specialist shop after he started selling successfully online. He believed that 'ecommerce was the future' because he was making more money from his new online operation than his shop. As a result he moved premises and committed entirely to an ecommerce business. Information in Figure 14.2 seems to support Aaron's view about the future of ecommerce. It shows that the proportion of total global retail sales via ecommerce is expected to grow from 7.4 per cent in 2015 to 17.5 per cent in 2021. This is more than double and the increase will probably continue beyond 2021.

2. Describe **two** factors that Aaron might have considered when finding a location for his ecommerce business.

Transport is important for ecommerce operators, but not necessarily public transport. Ecommerce operators like mostpets.com will favour distribution centres close to major road networks. This helps the transportation of goods into the warehouse from suppliers and the distribution of customer orders. Proximity to a nation's motorway network is often a key location factor for large online traders.

Ecommerce operators usually need a large area of land to locate a distribution centre. Warehouses are usually one-storey buildings, which increases operators' needs for a larger area of land. When locating a fulfilment centre, it is also important to consider future needs. If an ecommerce operation becomes successful, there may be a need to expand. It is therefore a good idea to find a location where the expansion of premises is viable. This will avoid the costly process of moving to a completely new location. In this case, in 2019 Aaron expanded his premises and invested in some automated warehousing equipment. Space for expansion may have been an important consideration when Aaron was looking for a suitable location.

3. Describe the communication process that Aaron might use when fulfilling an order.

Communication between buyers and sellers in ecommerce takes place online. When shopping online, communication will begin when a shopper browses a retailer's website. Once items have been selected the shopper proceeds to the electronic checkout, confirms the order and completes the transaction by paying – usually by credit card. The retailer usually responds very quickly, sending an email with an invoice to confirm the order. Then the order is picked and dispatched. The retailer usually sends an email to inform shoppers of

the date of delivery. It is often possible to track the order by clicking on to a tracking service. Finally, the goods will arrive with a delivery note. Shoppers' details can be stored electronically, which speeds up the whole process if shoppers return to the same website.

### MULTIPLE CHOICE QUESTIONS

1. C    2. A    3. D    4. C

### CHAPTER REVIEW

#### CASE STUDY: DARAZ

1.      What is meant by ecommerce?

Ecommerce refers to financial transactions carried out electronically using the Internet. A huge range of goods and services can be bought online from all over the world.

2.      Suggest **three** examples of ecommerce in addition to the sale of physical goods. It is also possible to buy train tickets, air tickets, cinema tickets, hotel accommodation, insurance and many other services using the Internet.

3.      The Chinese group, Alibaba, is one of the biggest online retailers in the world. To what extent is ecommerce important in China?

Chinese operator Alibaba is one of the biggest ecommerce groups in the world, which would suggest that ecommerce is important in China. Information in Table 14.1 tends to support this view. It shows the projected ecommerce growth in ten different countries. Rapid growth is expected in all of the countries shown. However, China has the highest predicted growth of all ten countries. The value of ecommerce is expected to grow from US\$636.1 million in 2018 to US\$1,086.1 million in 2023. This is a growth rate of over 70 per cent in the time period. Perhaps it should not be surprising since China has by far the biggest population in the world and its economy has been growing rapidly for some years now. Therefore, it could be concluded that ecommerce in China is important to an increasingly large extent.

4.      Describe the importance of websites to online retailers like Daraz.

Websites play a vital role in ecommerce and have a number of functions. They are used to provide information about all the products that are sold by the retailer. Daraz's product range includes consumer electronics, household goods, beauty, fashion and groceries.

Photographs of products, prices, descriptions, instructions and details about warranties are also listed on websites. They also give traders visibility on the Internet. If someone is searching for a particular product, the name of all retailers supplying that product online will be listed by the search engine – or perhaps on a price comparison website.

Websites provide secure and efficient payment systems, gather important data from shoppers (such as name and address for delivery) and generate financial documents like invoices. Once a shopper has arrived at the checkout it is important that the transaction process runs smoothly to avoid a lost sale. It is possible to use a website to collect important information about shoppers – how they use the site and their experiences. For example, something called a heat map can be used to find out where shoppers spend the most and least amount of time on the site. Finally, some websites have a review system so that users and shoppers can provide feedback about products and services. These are available to other shoppers to help make buying decisions. An online retailer like Daraz could not operate without a website.

5. Assess the impact on the environment of ecommerce.

The environmental impacts of ecommerce are difficult to quantify. Some argue that ecommerce reduces the overall damage done to the environment by retailing. This is because traditional retailers operating from a store require display and security lighting, temperature control, fixture installation and equipment such as refrigerators and cash registers – all of which use a great deal of energy. Damage to the environment will also be caused by both employees and shoppers travelling from home to stores. This is due to the energy used by transport when commuting. Retailers also use energy when stores are constructed and renovated.

Some ecommerce operations allow employees to work from home. This reduces the emissions that result from driving to and from work. Also, some distribution centres that ship products to customers may be located by key transport networks. This helps to reduce shipping time, decreasing environmental impacts. Additionally, these distribution centres are often newly built using up-to-date materials and construction methods that are environmentally friendly. For example, they might use recycled materials and renewable energy.

However, there are some negative effects on the environment from ecommerce. Energy is still used to ship packages to and from customers. This has resulted in a huge increase in the number of couriers on the roads. Also, with omnichannel retailing, operators use both stores and ecommerce for business. This means that damage to the environment may actually increase. Finally, if ecommerce results in a significant increase in global consumption, there will be an increase in energy use and a depletion in non-renewable resources. At the moment, it is still too early to draw any meaningful conclusions about the overall environmental impact of ecommerce.

## CHAPTER 15

### CASE STUDY: ICELAND, ARUBA, UAE

1. Why does the UAE sell so much oil abroad?

The UAE is a large oil producer. However, it only uses a fraction of the oil it produces for home consumption. Much of the oil produced by the UAE is exported because it has far more than it needs. Since 2010, oil production has risen by around 50 per cent in the UAE from 2 300 bbl/1k to as high as 3 400 bbl/1k in 2018.

2. Why does Iceland import so much food?

Iceland is one of the most northerly located countries in the world. It has a cold climate and, with the exception of fish, food production is very challenging. Therefore Iceland has to import a large proportion of its food from overseas.

3. Why does Aruba rely so heavily on tourism for its foreign income?

Aruba is a very popular tourist destination and a significant proportion of its income is generated from tourism. Holidaymakers are attracted by the year-round warm climate, attractive beaches and stunning coastal scenery. Aruba relies heavily on tourism for its income because the industry is its main strength.

**ACTIVITY 1****CASE STUDY: MYANMAR**

1. What is the difference between exports and imports? Use examples from the case study.

Exports are goods and services sold abroad by businesses. In this case, some of the main goods sold abroad by businesses in Myanmar are oil and natural gas, vegetables, wood, fish, clothing, rubber and fruits. Imports are goods and services that are purchased from other countries. Myanmar's key imports are fuel, vegetable oil, vehicles, pharmaceutical products, construction equipment, polymers, tyres and machinery. The country's main trading partners are China, Japan, India, Indonesia, Germany, France and Hong Kong.

2. Describe the pattern of trade in Myanmar between 2012 and 2018.

Figure 15.2 shows that Myanmar's monthly exports have risen in value over the time period from around US\$600 million in 2012 to about US\$1600 million at the end of 2018. However, there appears to be quite a lot of volatility in these monthly figures. The monthly values range from a low of around US\$500 million (one month in 2012) to around US\$1800 million (in one month in 2014 and 2018).

Figure 15.3 shows that Myanmar's imports have also risen over the same time period. They rose from about US\$400 million in 2012 to nearly US\$2000 million at times in 2018. There is some volatility in the monthly figures for imports but it is less severe than for exports.

3. Suggest **one** possible reason why most of Myanmar's exports are oil and gas.

Most of Myanmar's important exports are oil and gas. The reason for this is probably because the nation is relatively rich in these two natural resources. Consequently, Myanmar is probably able to produce more than it needs for its own consumption. Therefore, international trade allows the country to sell its surplus.

**ACTIVITY 2****CASE STUDY: NIGERIA'S BALANCE OF TRADE**

1. What is meant by the balance of trade?

The balance of trade, also called the visible balance, is the difference between exports and imports of physical goods.

2. Describe what happened to Nigeria's balance of trade in August 2018.

In most months during 2018, Nigeria enjoyed a surplus on the balance of trade. This means that the country was selling more goods abroad than it was buying. However, in August 2018 the country recorded a deficit of over NGN600 000 million. This means that sales of goods abroad were smaller than purchases.

3. Most of Nigeria's trade is in visible items. What is meant by visible trade?

Trade in physical goods is called visible trade. Examples of visible trade for Nigeria include petroleum, petroleum products, rubber and cocoa. All these goods are physical in nature.

**MULTIPLE CHOICE QUESTIONS**

1. C
2. C
3. D
4. C

## CHAPTER REVIEW

## CASE STUDY: THE CURRENT ACCOUNT OF VIETNAM

1. What do countries trade with each other?

International trade benefits the world. It helps to raise living standards and results in higher levels of output and income. There are some specific reasons though why countries trade with each other. Many countries are unable to produce certain goods. This is because they lack the natural resources that enable such production. Some countries are not able to produce much food because they do not have the right climate.

Some countries can produce goods more efficiently than others. This may be because countries have cheaper resources or because they have become experts through specialisation. For example, China can produce manufactured goods more cheaply than many countries because it has a cheap labour force. It makes economic sense to buy goods from other countries if they are cheaper. Some countries have an abundance of certain commodities. Indeed, in some cases, countries have so much of a resource they could never use it all themselves. For example, the UAE exports lots of oil that it could not consume.

2. What is the difference between visible and invisible exports? Use examples from this case study to illustrate your answer.

Goods and services sold abroad are called exports. These sales can be visible or invisible. Visible exports includes the sale of physical goods. Examples for Vietnam include telephones, mobile phones, textiles, computers, electrical products, footwear, machinery and instruments. Invisible exports are to do with the sale of services. In this case tourism is an example of an invisible export for Vietnam. In recent years Vietnam also benefited from a boost in tourism.

3. What is the difference between the balance of trade and the balance on the current account?

The balance of trade, sometimes called the visible balance, is the difference between exports and imports of physical goods such as commodities, manufactured goods and machinery. The current balance includes invisible trade in addition to visible trade. It is the difference between all exports and all imports for a nation.

4. Calculate the predicted balance on Vietnam's current account for 2019.

The IMF has predicted that exports on the current account will be US\$289.1 billion, while imports will be US\$278.2 billion. Therefore the balance on the current account will be:  
 $\$289.1 \text{ billion} - \$278.2 \text{ billion} = \mathbf{\$10.9 \text{ billion}}$

5. Discuss Vietnam's balance of payments performance between 2016 and 2018.

According to the graph in Figure 15.7, Vietnam has enjoyed a surplus on its current account for the entire time period between 2016 and 2018 **except** for one period in 2017 when there was a deficit of US\$1169 billion. Most countries would probably be pleased with a performance like this. The positive balances on the current account shows that Vietnam can sell goods and services to overseas buyers in competitive markets. In 2019, it has been predicted by the International Monetary Fund (IMF) that exports on the current account will be US\$289.1 billion, while imports will be US\$278.2 billion. This will result in a surplus of US\$10.89 billion for the year.

Vietnam's economy has been doing very well in recent years. People's incomes are rising and there is a growing middle class. The country has benefited from an improving business climate due to government help aimed at reforming the banking sector, cuts in regulations

and privatisations. Vietnam's manufacturing sector has been expanding and retail sales have also performed well. Vietnam is also enjoying a tourist boom. Vietnam has become a popular destination with overseas visitors.

## CHAPTER 16

### CASE STUDY: LUDVIK ANDEL

1. How do you think the Czech Republic joining the EU affected Ludvik's company?

When the Czech Republic joined the EU, Ludvik's company would have benefited. This is because trade becomes easier between member states. For example, trade between his company and German customers would be a lot easier.

2. What do you think the benefits are now for Ludvik when he does business with companies in Germany?

By joining the EU, the Czech Republic is able to participate in the EU's single market. This means that businesses such as Ludvik's can enjoy completely free trade between member countries. There will be no restrictions such as quotas or tariffs. Also, by co-ordinating product regulations, trade between countries is easier. Additionally, because of the EU having a strong presence globally, trade to other countries outside the EU is also easier for Ludvik.

3. State **two** possible difficulties that Ludvik's company might have when exporting.

Selling goods to overseas customers is usually more challenging than selling to the home market. One difficulty is the distance that must be covered when delivering goods to customers. Transporting goods across borders to customers thousands of miles away will be more expensive.

Another difficulty might be communication. In this case, the Czech Republic and Germany speak different languages. This might cause difficulties for Ludvik. He may have to employ a translator to help with communications.

### ACTIVITY 1

#### CASE STUDY: ASSOCIATION OF SOUTH EAST ASIAN NATIONS (ASEAN)

1. What is **one** important feature of a trading bloc such as ASEAN?

One of the main features of a trading bloc is the free movement of people, money and all goods between each member state. For example, in ASEAN a person from Singapore can go and live and work in any other member state such as Laos, Cambodia or Malaysia. There is also no restriction on the amount of money that individuals and businesses can transfer between banks in different member states. Finally, it is also possible to transport goods across the borders of member states without any formal checks.

2. Suggest **two** advantages to members of ASEAN.

Belonging to a trading bloc, such as ASEAN, brings much the same benefits as those which result from free trade. If members of the bloc abolish all trade barriers, goods will be cheaper, there will be more consumer choice and faster economic growth. Firms will be able to exploit economies of scale because they have access to larger markets and extra competition will encourage innovation and improve the quality of goods.

Another benefit is improved cooperation. In this case, ASEAN encourages technical and research cooperation among its members. For example, the ASEAN Outstanding Scientist

and Technologist Award is presented every three years to recognise nationally and internationally acclaimed achievements in the field. The bloc is also keen to protect the region's environment and wildlife. For example, the association's Centre for Biodiversity was established to promote cooperation on conservation and sustainability throughout the region. It oversees 37 protected sites.

3. Describe **one** possible disadvantage to members of ASEAN of belonging to a trading bloc.

Some ASEAN countries may start to rely too heavily on trade within the bloc. This would make them more vulnerable to changes in prices and demand patterns within the bloc. They may also miss out on opportunities in other world markets. Inefficient producers may be protected from competition from businesses outside the trading bloc. As a result, consumers might end up paying more for goods and services in some industries.

Also, members of a trading bloc may start to standardise trading practices, laws and other customs within their bloc. Some people may not like this because they may be happy with the traditional ways of their own country. Changes in laws and customs may also threaten a nation's culture.

## ACTIVITY 2

### CASE STUDY: CROATIA AND THE EU

1. What is the purpose of the EU?

The EU was formed just after the Second World War with the aim of developing economic cooperation. Since then, membership has grown from six countries to 28. The EU now has common policies in a wide range of areas in addition to trade agreements. These include climate, the environment, health, migration, justice and security. Since it was formed in 1958, the EU has delivered more than half a century of peace, stability and prosperity.

2. Assess the possible impact on Croatia of joining the EU.

Croatia joined the EU in 2013. After 12 months of membership Croatia was still in recession and waiting for access to EU money. A government official said that Croatia was 'illiterate in business' and that people had low expectations regarding the benefits of joining the EU. However, after just 12 months exports to the EU had risen by 15 per cent and business owners reported that it was now much easier doing business with EU countries. Figures 16.1 and 16.2 also suggest that things are getting better for Croatia. The current deficit between 2008 and 2018 has been reversed. In 2018 Croatia had a current account surplus of 3.9 per cent GDP. This compared with a deficit of -8.8 per cent in 2008. The economy is also growing now. Between 2012 and 2014 growth was often negative. However, at the end of 2017 it was around 1.5 per cent. Although more recently economic growth has started to decline again. After a slow beginning the Croatian economy looks as though it might be benefiting from its membership of the EU.

3. How might businesses in Croatia benefit from EU membership?

Croatian businesses that export goods to the EU are likely to benefit most from EU membership. One business owner, an olive oil producer in the north of the country, said that the EU was working in their favour. It was now easier to sell to the EU, there was less paperwork and Croatian businesses were being pressurised to be more professional. The owner also said that the outlook for the younger generation is much better; for example, they realise that investment and support for rural products is beginning to emerge. However, some domestic industries may suffer from competition as more imports arrive into Croatia from the EU. They may have to become more competitive to survive.

**MULTIPLE CHOICE QUESTIONS**

1. D    2. A    3. B    4. B

**CHAPTER REVIEW****CASE STUDY: EAST AFRICAN COMMUNITY**

1. Use this case study as an example to explain what is meant by a trading bloc.

The world is generally divided into a number of trading blocs. These are groups of countries situated in the same region that join together and make a free trade area. This means that trade between all the members will be completely free of trade barriers. It is also common for trading blocs to have a common tariff on imports from non-members. In this case, EAC operates as a customs union. This is where trade between all members is free from barriers. However, members of a customs union impose a common set of trade barriers on non-members. This means that products imported by one member can be resold and transported to other members in the union. The aim of the EAC is *'To widen and deepen economic, political, social and cultural integration in order to improve the quality of life of the people of East Africa through increased competitiveness, value added production, trade and investments.'*

2. Comment on the EAC's trade performance with the EU between 2008 and 2018.

The EAC has a trading relationship with the EU. It exports vegetables, other food products, beverages, tobacco, animal products, live animals and some precious metals. Figure 16.5 shows the value of exports from the EAC to the EU between 2008 and 2018. The value of exports has increased over the time period by 22.5 per cent from €1926 million to €2359 million. Although this is a positive change, the EAC may consider it to be disappointing over a 10 year period. They might have wished for a much larger increase.

3. What is a possible benefit to the EAC of sharing a common currency?

The EAC is thinking about setting up a common currency. This means that all six countries in the EAC will use the same currency in their economies. This monetary union will enable members to trade in the same currency and avoid the uncertainties created by fluctuating exchange rates. The cost of changing currencies when trading will also be avoided. This means it will be cheaper for members to trade with each other.

4. Discuss **three** possible difficulties businesses might encounter when exporting.

Trading with overseas customers can be challenging and many firms face difficulties. For example, one difficulty when selling goods and services to foreign countries is communication. This is because customers in another country may speak a different language. This might mean that a business has to employ a translator to help with trade negotiations, for example. Product labelling may also need to be changed so that customers can identify products and read instructions. Businesses might also have to adapt advertising materials and promotions so that foreign customers can understand them. In this case, the languages spoken in EAC countries are likely to be quite different from those spoken by countries in the EU.

Another likely problem when exporting is that longer distances have to be covered when delivering goods. For example, the cost to EAC exporters of shipping goods to the EU will be considerably higher than the cost of shipping goods within the region. Not only will the transport costs be higher in terms of fuel and labour, lead times will also be longer. There is also a greater risk of theft and damage to the goods.

A wide range of documents are used when trading to support the transaction process. They are used to provide records of goods traded and may help to settle disputes. However, the documents used in the EAC may not be exactly the same as those used in the EU. This might cause problems such as misunderstandings. Obtaining the correct documentation can be challenging. It is often necessary to use some special documents when selling goods abroad. For example, a Bill of Lading might be used in the shipping of goods. This shows details of the goods, their destination and the terms under which the shipping company has agreed to carry them. If the correct documentation is not provided at borders, there is a chance that they will not be allowed to enter the country.

5. Assess the benefits to EAC members of belonging to the trading bloc.

If members of the EAC abolish all trade barriers, goods will be cheaper, there will be more consumer choice and faster economic growth. Firms will be able to exploit economies of scale because they have access to larger markets. Also, the extra competition will improve the quality of goods and encourage innovation. It is argued that the formation of trading blocs invites foreign direct investment (FDI). This may be because foreign firms want to locate operations within a trading bloc to get access to a larger and barrier-free market. Many African nations are desperate for increased FDI because it often helps develop much-needed infrastructure.

Membership of the EAC should result in closer cooperation between member countries. For example, countries may share resources, help each other out and introduce common standards, laws and customs. The EAC plans to introduce a common currency. This is an example of closer cooperation between nations.

The EAC economic performance has been good in recent years compared to the rest of Africa. Real GDP in the EAC increased by 5.8 per cent in 2014 compared to a 5.3 per cent growth in 2013. Economic growth in the region was due to better agricultural production, domestic demand and investment in the EAC's infrastructure. The rest of Africa grew by 4.5 per cent in 2014 compared with 4.0 per cent in 2013. This is positive news for EAC members. However, the region's current account deficit (as a percentage of GDP) worsened to 12.4 per cent in 2014 from 11.8 per cent in 2013.

Membership of the EAC may have some drawbacks. Those in favour of worldwide free trade generally oppose trading blocs. This is because trading blocs encourage regional rather than global free trade. However, it is not agreed whether regional trading blocs result in less free trade in the world or encourage further globalisation. One problem with belonging to a trading bloc is the financial cost to the government and therefore the taxpayer. Each member has to pay large sums of money to the organisation to cover administration costs and provide funds for various investment programmes.

Another possible drawback is that some countries may start to rely too heavily on trade within the bloc. This would make them more vulnerable to changes in prices and demand patterns within the bloc. They may also miss out on opportunities in other world markets. Also, inefficient producers may be protected from competition from businesses outside the trading bloc. As a result, consumers might end up paying more for goods and services in some industries. Also, members of a trading bloc may start to standardise trading practices, laws and other customs within their bloc. Some people may not like this because they may be happy with the traditional ways of their own country. According to information in the case study, the EAC is planning closer integration in the future.

Finally, studies have shown that trading blocs can reduce cross-border conflict, promote peace, and achieve substantial social and economic gains. The future of the EAC looks promising due to infrastructure developments right across the region. Further investment is planned in road, railway and ICT. There will also be more integration of systems. The EAC region is expected to grow by 6 per cent in 2018/19. Most would argue that the benefits of EAC membership are greater than possible drawbacks.

## CHAPTER 17

## CASE STUDY: NESTLÉ

1. What are the possible benefits to the local Cuban community of the new factory?

In partnership with the Cuban food producer, Corporación Alimentaria, a new Nestlé factory will produce Nescafé, the local Cuban coffee brand Serrano, Nestlé Fitness cereal snacks, Nesquik and some Maggi products. Nestlé is planning to invest CHF54 million in the project. This investment will help the local economy both during the construction of the factory and when it is open. For example, around 260 new jobs will be created when it is fully open.

Nestlé will also sponsor a permanent education facility in Palacio de los Pioneros Ernesto Guevara in Havana. The project will be focused on healthy food habits and will be targeted at school children. This will help to improve the diets of local children.

2. How might the Cuban national economy benefit from the development?

The Cuban economy might benefit because the output produced by the Nestlé factory will contribute to the national income of Cuba. Nestlé is also likely to pay taxes on any profits resulting from the factory's operations. This tax revenue can be spent to improve government services.

It is also possible that some of the output will be sold overseas. This means that Cuban exports will get a boost. Finally, Nestlé may buy goods and services from Cuban companies – such as raw materials for the manufacturing of Nestlé products. This will help to boost its revenues and profits around the country.

3. What might be the possible drawbacks of the new factory?

The new factory might cause some disruption in the local area once it is operational. For example, there may be some congestion when employees travel to and from work. It is also possible that emissions from the factory might pollute the local environment.

## ACTIVITY 1

## CASE STUDY: TOYOTA

1. Calculate the percentage change in Toyota's total car sales between 2003 and 2018.

The number of cars sold by Toyota rose from 6,247,000 in 2003 to 8,519,000 in 2018. This is an increase of 2,272,000. The percentage increase is given by:

$$2,272,000/6,247,000 \times 100 = \mathbf{36.4 \text{ per cent}}$$

2. Suggest **two** features of a multinational. Use this case study as an example.

Multinationals have huge resources. In this case Toyota employs 340,000 people and generated 29,379,510 million yen in revenue in 2018. It also has factories in plants in 50 different worldwide locations. Multinationals are also controlled from the country in which they originate. In this case, Toyota is controlled from Japan.

3. What are **two** benefits to Toyota of operating as a multinational?

Due to their size, multinational companies generally enjoy higher revenues and lower costs. For example, Toyota will have access to a much wider market than companies that focus entirely on domestic markets. Multinationals can boost their sales revenues by selling to global markets. This will help to increase profits and win market share from competitors. In this case, Toyota sells about 67 per cent of its cars outside of Japan.

Since multinationals are large companies, they can exploit economies of scale and enjoy lower costs. They can buy resources at lower prices and borrow money at cheaper rates. Many will also reduce transport costs. This is because they are likely to set up factories in new countries so that they have shorter distances between the production site and the market. This is particularly important with bulky products like motor cars. Reducing costs will help Toyota gain a competitive edge and put pressure on its rivals such as Ford and Volkswagen.

## ACTIVITY 2

### CASE STUDY: GRANBY

1. Examine **three** possible disadvantages to Granby as a result of operating as an MNC.

It is often suggested that large MNCs become too bureaucratic. Too much time may be spent filling in forms or writing reports. Also, decision making may be too slow and communication channels too long. If resources are wasted in administration, costs will start to rise. In Granby, some managers from Washington have complained that the company has become too bureaucratic. They said that too much time was being spent writing reports, carrying out pointless risk assessments and documenting boring operational procedures. The directors explained that the bureaucracy was necessary to maintain control and ensure that key performance indicators were being monitored.

Another disadvantage is that motivation may suffer as workers become a minor part of the total workforce. For example, in an MNC that employs hundreds of thousands of people all over the world, each individual worker may feel unimportant. This may lead to workers only wanting to 'do the absolute minimum'. There may be higher numbers of staff leaving the business, increased absence and lateness. This will raise labour costs. In this case study, evidence in Table 17.2 suggests that there are motivation problems at the Toulouse factory. For example, more than 50 per cent of workers in the survey are unhappy with the key human resource issues raised in the questionnaire. Workers will feel demotivated if company goals are unclear or if they feel that they cannot approach their line manager.

Finally, MNCs may suffer poor communication because the flow of information between employees, departments and divisions, or between head office and workers, becomes more difficult to manage. Both internal and external communication might be affected. In a large business it is possible to lose touch with customers. As a result, a business may fail to identify changes in customer needs, for example. Table 17.2 provides some evidence of poor communication in the Toulouse factory. For example, 79 per cent of the workforce said that they were not given enough time to discuss work matters with their colleagues. This drawback means that important communication might not be happening. For example, a worker may need to explain to a colleague that product specifications have changed. However, there might not be enough time to communicate the changes effectively.

2. How might the problems discussed above affect the financial performance of Granby?

The problems discussed above could have a very negative impact on the financial performance of Granby. In 2019, the corporation saw a dip in profits. Revenues rose from US\$93.1 billion to US\$99.3 billion. However, profits before tax fell from US\$14.31 billion to US\$11.48 billion. Some of the senior management team are worried that profits will fall further next year if they cannot control costs.

It seems that costs are rising as a result of the extra bureaucracy. This is because important members of staff are leaving the company. As a result, recruitment and retention costs are rising. Poor motivation could also result in higher costs. For example, there may be higher levels of staff turnover, increased absence and poor time-keeping. Finally, poor

communication might result in the production of inferior products which might be returned by customers. This could reduce revenue and affect the image of the company. Generally, the problems experienced here could be the reason why profits have already fallen, and may also continue to fall. Granby has every reason to be concerned.

### MULTIPLE CHOICE QUESTIONS

1. B   2. A   3. C   4. D

### CHAPTER REVIEW

#### CASE STUDY: SHELL

1. What is meant by a multinational company? Use an example from this case study to support your answer.

A multinational is a large business with significant production or service operations in at least two different countries. According to Table 17.1, Shell was the 5th largest company in the world in 2019. Its revenue in 2018 was US\$311 billion. Shell is an energy and petrochemical company that employs around 86,000 people in 70 different countries worldwide.

2. Describe **two** reasons why MNCs like Shell exist.

In some industries, firms that exploit economies of scale can reduce costs. MNCs will be in a better position to exploit economies of scale because they are so large. Firms that sell to global markets will produce more than those who just sell to domestic markets. They can therefore lower costs. These firms are so powerful they can place a lot of pressure on suppliers to lower their prices. One of the main reasons why MNCs have emerged is because as companies get bigger and bigger, their costs get lower and lower.

Some MNCs are happy to invest overseas because they need to buy huge quantities of resources. A significant proportion of MNC activity is in the mining industry. Many African states have attracted MNCs because they have large reserves of valuable resources. In this case, Shell has been active in Nigeria since 1937. Over the time period it must have extracted billions of pounds worth of oil from Nigeria's reserves.

3. Describe **one** possible disadvantage to Shell of operating as an MNC.

One possible disadvantage to Shell of operating as an MNC is that the control and coordination of the organisation is demanding. Thousands of employees, billions of pounds worth of resources and perhaps hundreds of different operational locations all mean added responsibility and more supervision. In many cases, businesses have to employ more managers and supervisors to maintain adequate control. This can result in rising costs. There have been examples recently where senior managers in some big companies have seemingly lost control.

It might be argued that some control was lost when parts of the Niger Delta were damaged due to oil spills. This damage was originally denied by Shell. With more supervisory control the damage may have been avoided.

4. Assess the benefits to Nigeria of Shell's activities in the country.

Evidence suggests that Nigeria has experienced both positive and negative effects from Shell's activities in the country. One of the main benefits when Shell arrived in Nigeria was a boost in jobs and income. In this case, Shell uses Nigerian suppliers for certain goods and services which creates jobs. In 2017, about US\$760 million was spent by Shell companies in the Nigerian economy. In 2017, 95 per cent of Shell's employees in Nigeria were Nigerian and 94 per cent of contracts were awarded to Nigerian companies.

Much of the oil produced by Nigeria is exported. This will help to boost the current account on the balance of payments. Nigeria will be able to support itself when trading internationally and possibly generate reserves of foreign currency. The government will also benefit from Shell's activity. Shell will have to pay taxes on its profits and the wages paid to workers will also be taxed. This will provide money for the government that can be spent on public services in Nigeria.

Another benefit of MNCs is that they may provide training and work experience for workers. In this case, Shell has helped to develop the country's human resources through training and other projects.

Unfortunately, MNC activity can have drawbacks. Many environmentalists are suspicious of multinationals because they may cause environmental damage. In Nigeria, large oil spills in 2008 and 2009 damaged the environment in the Niger Delta. The spills caused very serious damage to thousands of hectares of mangrove in the southern Ogoniland region. This contaminated water supplies, crops and destroyed the livelihoods of thousands of farmers. Following the spills, which were caused by MNC Shell, there was a lengthy legal battle between communities and the company. Shell would not take responsibility for the damage. However, in 2015 the case was settled. Court documents showed that Shell knew that corrosive pipes and equipment were likely to fail. Shell admitted that its figures were wrong and that it had underestimated the amount of oil spilled. The court forced Shell to pay out \$84 million in compensation. The 15,600 farmers and fishermen affected by the spills were to receive about \$2,000 each. However, the money will not reverse the damage done to the environment, which the community depends on for its water, food and livelihood.

To conclude, the benefits of Shell's activity are likely to be greater than the drawbacks. The people of Nigeria will welcome the thousands of jobs created, the training provided and the opportunity to earn more money. The government will welcome the tax revenues and the improvements in economic performance. However, the people affected by the pollution may experience considerable suffering. Unfortunately, the government might consider this is a price worth paying. In the future, the government might try to do more to protect the environment so that the negative effects of Shell are kept down. If it can do this then Shell's activity will be even more welcome.

### EXAM PRACTICE: 1 COMMERCIAL OPERATIONS

- (a) C Labour is a factor of production.
- (b) A Wholesalers operate as intermediaries in the chain of distribution.
- (c) Trade credit is when a customer buys goods and the seller agrees that payment can be made some time later – perhaps 90 days later.
- (d) When the owners of limited companies invest their money to buy shares, the most they can lose is the amount they paid for their shares. This is limited liability.
- (e)
  - (i) China had a balance of trade deficit in March 2018. The value of visible imports exceeded the value of visible exports by \$57.69 billion.
  - (ii) If the USA imposes tariffs on Chinese goods, the value of Chinese exports is likely to fall. This will have a negative impact on China's balance of trade.
  - (iii) China's balance of trade fell from US\$568.35 in December 2018 to US\$40.81 in February 2019. The percentage fall is given by:

$$\frac{\text{US\$568.35 bn} - \text{US\$40.81 bn}}{\text{US\$568.35bn}} \times 100 = \frac{\text{US\$527.54bn}}{\text{US\$568.35bn}} \times 100 = \mathbf{92.8 \text{ per cent}}$$

- (f) One important cost is the wages paid to sales staff. Businesses usually employ a sales team and their main aim is to sell as much as possible. The salaries of sales staff are likely to be linked to their performance. This means the more they sell, the more they earn. For example, a salary may be made up of a basic nominal amount and then topped up with commissions (usually a percentage) based on sales levels. Some firms reward sales staff with a bonus if sales targets are reached. Also, the cost of sales staff is not limited to their salaries. Sales staff might incur other expenses such as travel and accommodation as they spend time following up leads and travelling to meet customers.
- (g) One of the main advantages of franchising to the franchisee is that business risk is reduced. This is because franchisees are paying for the right to trade under the name of a 'tried and tested' trader. When taking out a franchise, the name of the business, such as Subway or McDonald's, is often well-known. Therefore, when trading begins the risk of failure is reduced. This is because customers will already know about the business. They may have tried its products in other outlets.
- (h) One of the effects of ecommerce is that more goods are distributed from warehouses. Many ecommerce operations are run from a single large warehouse located in a strategic geographic position. Large online retailers, such as Amazon or Alibaba, operate globally from a network of warehouses. The use of a warehouse means there is no need to display goods attractively. This saves money. Once an order is received people are employed to 'pick' the order. This means that someone has to locate the product or products ordered in the warehouse and then prepare them for shipping. However, in this case, Abu Ashra Market might employ staff to pick orders from inside its stores.

One of the most important benefits to businesses of ecommerce is the size of the potential market. Any business can sell products all over the world. Consequently the size of the market can rise from perhaps hundreds of customers to many millions. However with some types of ecommerce, markets may be limited. For example, a supermarket is only likely to deliver orders to customers within a certain radius – perhaps just 10 miles in some countries. This is likely to be the case for Abu Ashra Market, which operates in the district of Hurgada in Egypt.

The development and growth of ecommerce has also resulted in an increased supply of goods and services around the world. One reason for this is due to the low cost of setting up as an online trader. For example, an individual manufacturing rugs on a handmade loom at home could set up an online operation with minimal cost. Once their web site is established, rugs could be sent to customers anywhere in the world. However, the biggest contribution to supply has probably resulted from giant online operators like Amazon.

## THEME 2 ANSWERS

## CHAPTER 18

## CASE STUDY: MENDIS MAINTENANCE SERVICES

1. Describe the risk for which Chalana took out insurance cover.

Chalana has taken out some Income Protection Insurance. This is to protect him from the risk that he might be off work due to illness or injury. The policy covers loss of earnings if he is unable to work in his business and entitles him to LKR20 000 per week if he made a claim. This money can be used to support his family when he is unable to earn money from the business.

2. Calculate the total amount of money Chalana would receive for three months (13 weeks) from the insurance company.

According to the terms of the policy, Chalana will be entitled to:

$LKR20\ 000 \times 13 = \mathbf{LKR260\ 000}$  in total.

3. Calculate the total amount Chalana paid the insurance company each year.

Chalana pays LKR4000 per month for his insurance premium. The annual charge will be:

$LKR4000 \times 12 = \mathbf{LKR48,000}$  in total.

4. How can an insurance company afford to make the payments to Chalana?

During 2019, Chalana paid a total of LKR48 000 in insurance premiums. However, he claimed LKR260 000 from the insurance company for loss of earnings. This means that the insurance company paid out more than it collected from Chalana. Insurance companies can afford to do this because only a minority of policy-holders make claims during the year. Most people who take out policies do not make claims but still pay premiums. Consequently, the insurance company can use this money to pay compensation to claimants.

## ACTIVITY 1

## CASE STUDY: BASHIR CONSTRUCTION

1. How does insurance reduce risk for businesses like Bashir Construction?

Businesses like Bashir Construction take risks. For example, when Navid started the business he would have used his own money to help set it up. This money could be lost if the business fails. Businesses face other risks. For example, if a customer fails to pay for goods or if some of the firm's property is stolen, money will be lost. By taking out an insurance policy, it is possible to claim some financial compensation in the event of a loss. By doing this the risk is transferred to the insurer. Consequently, businesses can reduce their exposure to risk.

2. How does the principle of indemnity affect Bashir's claim for a new machine?

The principle of indemnity means that an insurer cannot profit from a claim. The purpose of insurance is to restore the insurer to the financial position that was held before the loss occurred. In this case, Bashir Construction has made a claim for an excavator that was stolen from a construction site. The seven-year-old machine was never recovered. It was a vital piece of equipment and Bashir Construction claimed for a brand new machine costing

PKR16 million. However, according to the principle of indemnity, Bashir cannot claim for the cost of a new excavator. A claim can only be made for the value of the seven-year-old machine. This would be less than the replacement cost of PKR16 million. Bashir Construction cannot profit from a claim by getting a brand new machine to replace the old one.

3. How does the principle of utmost good faith affect Bashir's claim for Habid's compensation?

The principle of utmost good faith means that both the insurer and the insured should be honest when giving each other information. From the insurer's point of view it is important that the terms and conditions relating to an insurance policy are clearly stated. They must not be ambiguous. The insured must provide the insurer with accurate information and must not withhold important details relating to the extent of the risk involved. In this case Habid Ali, a 15 year-old employee, was badly injured on a construction site. However, when Bashir made a claim for compensation, the insurance company would not pay out. This was because the policy clearly stated that workers under the age of 16 would not qualify for compensation. It might be argued that Bashir should not have made a claim for an employee who was under the age of 16. Bashir may not be acting in the utmost good faith.

4. One purpose of insurance is to improve business confidence. What does this mean?

If business owners such as Navid Bashir are confident about the future of their businesses, they are more likely to be successful. Confident business owners will be more positive and more likely to make good business decisions. Taking out insurance cover can help to build business confidence. This is because owners know that any loss resulting from an unexpected event will be covered by the insurer. This also reduces the need to hold large cash deposits in the event of a loss. The money can be invested in the business instead.

## ACTIVITY 2

### CASE STUDY: CAIRO INSURANCE LTD

1. What is the difference between an actuary and an assessor? Use examples from this case study to illustrate your answer.

Actuaries are responsible for statistical work at insurance companies, such as calculating the size of premiums and forecasting losses. They are employed to evaluate a wide range of risks and assess the possible financial consequences of those risks. For example, they analyse statistical data, such as accident rates and claim frequencies, to help calculate the premiums that must be paid for different types of insurance cover. In this case, Cairo Insurance Ltd employs a team of six actuaries.

The job of assessors is different from that of actuaries. They are employed to examine a claimant's situation and help determine the 'true' value of a loss. The role of an assessor is similar to that of a loss adjuster except that they are more likely to represent the claimant. They will examine evidence (both physical and documentary) and arrive at a value for compensation on behalf of the claimant. Assessors are more likely to be used for large insurance claims and in the event of a loss they might organise emergency support, help remove stress and worry and discover hidden losses. In this case, assessors might work with some of Cairo's loss adjusters.

2. Actuaries may forecast losses and calculate the size of premiums. Discuss what this means.

Insurance companies employ actuaries to forecast the losses that might occur resulting from unexpected events. They do this by calculating the probability that a particular event will happen. Historical data is used to help in the calculations. This means that future losses are based on past losses. However, data must span at least five years to be reliable.

Actuaries help to calculate the annual premiums paid for insurance cover by the insured. The size of premiums paid by the insured depends on two important factors. The first is the chances or likelihood of a claim being made by the insured. Premiums will be higher the more likely a claim is to be made. The second is the amount of compensation to be paid to the insured in the event of a successful claim. If large amounts of compensation are made then premiums will be higher. Actuaries will use statistics to help calculate the value of premiums. For example, insurers have to work out the likelihood of an event happening. They will take into account a wide range of factors when doing this.

3. Insurance companies like Cairo Insurance Ltd provide compensation and financial protection. What does this mean?

If a business takes out insurance it will be entitled to financial compensation in the event of a loss. Compensation may be paid to another party if an insurer is responsible for a loss suffered by that party. For example, a customer at a theme park may be injured when one of the rides crashes. That customer may receive compensation from an insurer because the owner of the theme park (the insured) had taken out a policy to provide cover for that event.

Insurance companies also provide financial protection for injured parties. The insurer cannot prevent losses from occurring but it can 'reduce the pain' resulting from a loss. Without the financial protection that insurance provides, individuals' and firms' losses could be great. For example, if a fire destroys a restaurant, the insurer will meet most of the cost of reconstruction. The restaurant owner might lose money from the loss of trade, but without financial protection to cover the cost of reconstruction, the owner could be 'financially ruined' and possibly homeless.

### MULTIPLE CHOICE QUESTIONS

1. C 2. A 3. B 4. B

### CHAPTER REVIEW

#### CASE STUDY: WU LONG PLASTICS

1. What is meant by the pooling of risk in the insurance industry?

Insurance companies collect premiums from the insured and invest them to generate a 'good' return. However, they also have to pay compensation to policy holders if they suffer a loss. Pooling risks relies on the idea that those who do not suffer losses, help to pay compensation to the 'unlucky' ones who do. All the money collected in premiums contributes to the 'pool'. As most of the contributors do not suffer a loss, there is then enough money in the pool to pay quite large sums to the few that do.

2. Why is it not possible for Wu Long Plastics to claim the CNY12.3 million for the damage done to the premises?

Wu Long Plastics cannot claim CNY12.3 million for the damage done to the factory because it does not own the factory. The factory was rented from Li Wing Properties and therefore Wu Long Plastics does not have an insurable interest in the property. The principle of insurable interest stops individuals or businesses from taking out insurance cover against a loss incurred by other parties.

3. Insurance companies are important institutional investors. What does this mean?

The money collected by insurance companies from premiums is generally placed into a range of investments. This helps to generate financial returns for insurance companies. Quite a lot of the money is invested in the shares of public limited companies. Insurance companies are important institutional investors. This is because the money invested is directed towards companies, for example, that need funds to expand and develop new products.

4. Discuss whether Wu Long Plastics could insure against the business losses described in the case study.

Individuals and businesses take out insurance cover to protect themselves against risk. However, some risks are non-insurable; therefore, insurers will not provide any cover. Non-insurable risks are those where it is impossible to calculate the size of a potential loss. This is because there is not enough data available for actuaries to calculate the probability of an event happening, or the amount of money needed for compensation. Wu Long Plastics made a loss of CNY3.7 million in 2018. This was due to some strong competition in one of its key markets. One of the company directors wondered if it was worth Wu Long Plastics insuring against such losses in the future. However, such a loss is non-insurable so it would not be possible to take out insurance cover.

## CHAPTER 19

### CASE STUDY: THÁI THỊ THẢO

1. What do you think about Thái Thị Thảo's decision not to take out insurance?

It might be argued that Thái Thị Thảo is foolish to trade without proper business insurance. Businesses face quite serious risks which could result in financial difficulties if certain events occurred. Her accountant gave a few examples. What would happen if there was a fire in the kitchen or if a customer was poisoned by the food in the restaurant? What would happen if the premises were flooded during the rainy season and what would happen if the cook could not work? If any of these events occurred, Thái Thị Thảo's restaurant would face serious difficulties that would need an injection of cash. Insurance cover would provide this cash.

2. Why is a business loss a non-insurable risk?

It is not possible for a business to insure against the possibility of making a loss. It is said to be a non-insurable risk. This is because it is too difficult to calculate accurately the likelihood of this happening and the size of the potential losses. Therefore insurance companies will not provide cover for this type of risk.

3. In groups, write a list of the different types of insurance cover that might benefit Thái Thị Thảo's restaurant business.

Some examples of insurance cover that Thái Thị Thảo's restaurant might need are fire insurance, premises and contents insurance, product liability, employer's liability, consequential loss, public liability and motor insurance.

N.B. Students may not be able to name these types of insurance but they may be able to describe the cover needed.

### ACTIVITY 1

#### CASE STUDY: VEHICLE AND THEFT INSURANCE

1. In which **two** countries might motor insurance be the most expensive?

Motor insurance cover is likely to be most expensive in Kenya and Uganda.

2. Give reasons for your answer to question 1.

Motor insurance is likely to be more expensive in Kenya and Uganda because there are more fatalities on the roads per 100,000 people. This suggests that there are more road accidents. If there are more road accidents, there will be more claims from insurance companies. If there are more claims then premiums will have to be higher to meet the higher compensation costs. In countries like Norway, Singapore and the UK, where fatalities are much lower, premiums are likely to be lower.

3. What is the difference between third party motor insurance and comprehensive motor insurance?

Third party motor insurance is the cheapest motor insurance. It only provides cover for claims made by others (third parties) involved in an accident. In contrast, comprehensive motor insurance provides the most protection. It covers accidental damage, including fire damage to the insured's vehicle, in addition to claims made by third parties. It also covers injury to the insured driver and theft of both the vehicle and its contents. Comprehensive motor insurance is the most expensive.

4. In which sort of insurance policy is the theft of business inventory likely to be covered?

The theft of business inventory is likely to be covered by contents insurance. Contents insurance covers the cost of replacing inventory, tools, equipment and computers, for example, if these are damaged or stolen. It may be part of premises insurance depending on the type of policy taken out.

### ACTIVITY 2

#### CASE STUDY: ACCIDENTS AT WORK

1. In which industries do you think employees benefit most from employer's liability insurance?

Employees working in the construction industry, manufacturing, transport and agriculture are most likely to benefit from employer's liability insurance.

2. Give reasons for your answer to question 1.

According to the information in Figure 19.2, the highest number of fatal accidents at work are in the construction industry, manufacturing, transport and agriculture. If these are the most dangerous industries to work in, employers must provide employees with compensation in the event of injury or death. Employer's liability insurance would provide the necessary cover for claims of this nature. The industries identified can be very hazardous. For example, in the construction industry employees face many risks – such as falling objects like masonry, electrocution, overexertion, falling from ladders or scaffolding, crushing by machinery or injury when using power tools.

3. Why is employer's liability insurance compulsory in many countries?

Employers' liability insurance provides cover for claims made by employees if they are injured at work. Some of these claims could be substantial – particularly if employees are seriously injured and unable to work again. In many countries, this type of insurance is compulsory. This is to protect employees from unscrupulous employers. Firms that ignore this cover are likely to be fined for every single day that cover is not provided – up to £2,500 per day in the UK.

### MULTIPLE CHOICE QUESTIONS

1. B 2. D 3. C 4. D

### CHAPTER REVIEW

#### CASE STUDY: ZICHANG TOYS LTD

1. What is the difference between public liability and product liability insurance?

Public liability insurance provides cover for the cost of legal action and compensation claims made against a business by a third party. If a member of the public is injured, or their property suffers damage while attending business premises, or when a business is carrying out work on their property, a claim might be made. Also, public liability insurance is likely to be needed if a third party is injured by falling masonry from a building site, for example, while walking past on a pavement.

Product liability insurance provides cover if a customer makes a claim after suffering a loss due to a faulty product purchased from that business. Protection is likely to cover legal costs and any compensation paid to the customer. Zichang Toys Ltd has taken out product liability insurance. This might be because its products are used by children and there may be a degree of risk if a small number of Zichang's products were faulty. However, Zichang Toys Ltd does not have public liability insurance. This is probably because the public would not be at risk. For example, members of the public may be forbidden to enter the firm's factory.

2. Will Zichang Toys Ltd be entitled to claim compensation for consequential loss?

Consequential loss insurance provides cover if a business is unable to trade from its usual premises. It provides financial compensation for the loss of earnings resulting from, for example, damage to premises and/or equipment due to a fire or storm. Some policies might cover the cost of setting up a property to trade from on a temporary basis. Certain policies might also cover the loss of earnings if the business cannot trade due to events such as a power cut, the illness of a key member of staff or the failure of a supplier to deliver crucial components.

Zichang Toys Ltd does have consequential loss insurance and a claim is likely to be successful. This is because the business lost money when it was closed down for two months. Fan Zichang estimated that the business lost CNY12 million in earnings during the closure.

3. Do you think Zichang Toys Ltd would need fidelity guarantee insurance?

Some businesses need protection from the risk of fraud and employee dishonesty. This sort of cover is needed when members of staff have the opportunity to commit crimes if they have access to cash, company bank accounts and other valuable assets. Zichang Toys Ltd does not have fidelity guarantee cover. This is probably because Zichang Toys Ltd is a family business and the only person authorised to make payments is Fan Zichang. She is a member of the family so fidelity guarantee insurance would be a waste of money.

4. How might Zichang Toys Ltd benefit from export credit insurance?

Zichang Toys Ltd has just started to export some of its goods to countries in the EU. Consequently, it might benefit from export credit insurance. It could provide Zichang Toys Ltd with compensation for bad debts overseas, such as if an importer has collapsed, a government has seized the goods or exchange rates have made the goods too expensive. Zichang Toys Ltd does not currently have this cover. However, as the volume of exports increases, such cover might be prudent.

5. Why is premises insurance important to companies like Zichang Toys Ltd?

The premises from which a business operates may be one of the most important and valuable assets it owns. One of the worst losses a business could suffer is the loss of its 'trading centre'. This might mean that the business could not operate. Consequently, protection against such a loss is important.

Premises insurance is likely to cover the risk of damage to the property belonging to the business, the inventory it holds, equipment and machinery used. In this case, Zichang's factory was damaged by fire. The repairs cost the company CNY15 million. This is a lot of money and without premises cover, the survival of the company may have been threatened.

## CHAPTER 20

### CASE STUDY: PATRICK COURTNEY

1. What do you think is meant by policy renewal?

An insurance policy has to be renewed when the current policy expires. Policies usually run for one year, during which the insurer cannot change the premium.

2. Which insurer provides the cheapest cover?

The cheapest cover is provided by Zurich at £1030.78.

3. Why is the monthly payment total higher than the annual payment?

Monthly payments are usually more expensive because payment is delayed. The additional charge is for interest.

4. Describe the cover provided by the policies shown.

The cover provided by all of the policies is for public liability insurance (£1 000 000) and employer's liability insurance (£10 000 000).

### ACTIVITY 1

#### CASE STUDY: INSURANCE PROPOSAL FORM

1. What key details are included in a proposal form?

The details required by the insurance company according to the form for Cromarty Insurance in Figure 20.2 include personal details such as the name of the business, the address of the businessperson and the address of the premises to be insured (if different), contact details and a description of the firm's trade. Details are also needed about the type of cover required and the values of buildings, stock, contents, machinery and fixtures. Finally, details are required of any target stock (stock that is vulnerable to theft).

2. Describe the purpose of a proposal form.

Applications for all types of insurance, both business and individual, must be supported by a proposal form. The form is a request by the proposer to the insurer for protection against a specified risk. The purpose of the form is to provide information about the proposer to the insurer. This is used to assess the risk posed by the proposer and allows the insurer to calculate the premium. Details about the proposer's personal circumstances and information about the nature of the insured risk will be needed. These are outlined in the answer to question 1. The proposal form is the basis of a contract between the insured and the insurer. It is a legal document and at the end of the form the proposer must sign a declaration stating the information recorded on the proposal form is truthful and that nothing has been hidden. Finally, the proposal form provides information about the proposer to get a quote for insurance. This is often the case for online applications.

3. Why might Cromarty Insurance issue a cover note to the insured?

A cover note is a document that provides temporary cover for the insured while Cromarty Insurance prepares the certificate of insurance. It provides proof of insurance and gives brief details of the risk covered and for how much. The length of time a cover note is valid for depends on the insurer and on the policy. However, it is not likely to exceed 60 days.

4. What is the purpose of the certificate of insurance?

A certificate of insurance is issued with an insurance policy. It is a document required by law which shows that insurance for a specified risk exists. A telephone number is usually shown on the certificate so that the insurer can be contacted in an emergency – in the case of medical cover, for example.

### ACTIVITY 2

#### CASE STUDY: MELANIE LANE

1. What is an insurance policy?

An insurance policy is a long document that provides very detailed information about the contract between the insurer and the insured. It is sometimes presented in a booklet and may contain 30 or more pages. It provides details of the terms and conditions contained in the agreement – this includes what is covered and what is not. It also contains written evidence of the contract between the insured and the insurer and clarity about the premiums payable. Finally, the policy gives details on how to make a claim.

2. What is the role of an insurance broker?

Insurance brokers are an intermediary between insurers and proposers. They represent the interests of those who want to buy insurance cover (the proposers). Brokers get a commission, usually a percentage of the value of the policy sold, from the insurer. An insurance broker may perform a number of duties which includes providing quotations for customers from a range of different providers – they may operate a website where customers can compare the policies and prices from different insurers. They work with insurance companies to be able to offer the best terms and premiums to clients and may provide customers with help and advice – such as which type of cover might be the most suitable and how to make a claim. They place insurance with insurance companies and underwriters. They also process transactions, prepare and distribute documentation, collect premiums and keep up with new trends and changes in the industry. They may also handle policy renewals and amend policies, if required.

3. What is the purpose of an exclusion clause?

Insurance policies will contain exclusion clauses. These are statements which make it clear that the insured cannot claim for certain specific events. They appear in the insurance policy and may be in small print. Melanie has some exclusion clauses in her motor insurance policy.

4. Describe the exclusion clause in Melanie's policy.

One of the exclusion clauses in Melanie's policy relates to unlicensed drivers (Clause: 3.41). It states that the insurance company may refuse or reduce a claim if Melanie's vehicle is being driven or used by any person who is not the holder of a current driver's licence that allows the person to drive a vehicle for the purpose for which it is being used, or who does not follow all conditions imposed on their licence.

However, this exclusion will not apply if Melanie can prove that she did not give permission for her vehicle to be driven or used by the person, or she had no reason to suspect that the person driving or using her vehicle with permission was unlicensed.

## CHAPTER REVIEW

### CASE STUDY: ROHIT GANESH

1. Describe the possible process of effecting cover for the travel insurance in the case study.

There are four main stages when effecting insurance cover. The first is to obtain a quote from an insurance company. One way to do this is to go online and use a price comparison website to find the 'best' deal. Insurance companies can also be telephoned directly for quotes. Whichever method is used, a range of details about your circumstances, or those of the business, will need to be provided so that the insurance company can calculate your premium.

These details will be recorded on a document called a proposal form, which is the second stage of the process. The proposal form is a key document when applying for insurance cover. Applications for all types of insurance, both business and individual, must be supported by a proposal form. The form represents a request by the proposer to the insurer for protection against a specified risk. Once this is submitted, the insurer will analyse the information and decide whether it will cover the risk. Assuming everything is OK, the insurer will give a price for the premium.

If the insurer is happy, the contract of insurance has been agreed, and the insured has made a payment to the insurance company, a cover note might be issued. This is the third stage of the process. This document provides temporary cover for the insured while the certificate of

insurance is being prepared. It provides proof of insurance and gives brief details of the risk covered and for how much. The length of time a cover note is valid for depends on the insurer and on the policy.

At the final stage, the customer will be sent an insurance policy. This is a long document which provides very detailed information about the contract between the insurer and the insured. It is sometimes presented in a booklet and may contain 30 or more pages. It provides details of the terms and conditions contained in the agreement – including what is covered and what is excluded. The policy is written evidence of the contract between the insured and the insurer and gives details on how to make a claim. The insurer will also send a certificate of insurance with the policy. This provides documentary proof that insurance cover exists. A telephone number is usually shown on the certificate so that the insurer can be contacted in an emergency – in the case of medical cover, for example.

2. What is an insurance endorsement? Use the example in this case study to illustrate your answer.

A change to an insurance policy is called an insurance endorsement. An insurance endorsement may be used to add to the coverage. For example, with premises insurance a business owner may want to add contents insurance. It may also be used to delete or exclude coverage. For example, a haulage company may want to delete the names of some drivers from its vehicle policy because they have left the company. It may be issued mid-term, at the time of purchase, or at renewal, and it may affect the size of the premium. For example, the premium would probably rise if extra coverage is taken out. An insurance endorsement is a legally binding amendment to the insurance contract.

In this case, Rohit Ganesh wanted to increase cover on some travel insurance. He contacted his insurance broker, arranged an insurance endorsement and paid an extra INR9000 to provide cover for his expensive golf clubs.

3. Explain the difference between underwriters and actuaries.

Underwriters play a crucial role in the insurance industry. They evaluate different risks and decide whether a company can profit from providing specific insurance cover. The underwriter is the 'gambler' in the industry. They are the ones that will lose when claims are made. Underwriters may work for insurance companies or they may work independently.

Actuaries do not take any risks. They provide the statistical information upon which underwriters may base their decisions. The underwriting process is usually automated. This means that proposals can be processed very quickly by computers as long as there are no special circumstances related to the proposal. The programmes are like those used when getting an online insurance quote.

4. Describe **two** important details that will need to be included in this claim form.

When making a claim, a claim form must be completed. Rohit will have to complete the one shown in Figure 20.4. He will have to give his policy number and provide personal details such as his name, date of birth, address and contact details. He will also have to provide a description of the event that resulted in his hospitalisation and the time and date that the accident took place.

He will also have to give details about the nature and cost of the treatment and provide evidence of its value, such as receipts or invoices. The form in Figure 20.4 also requires the claimant's bank details so that compensation can be paid directly into his bank account if the claim is successful.

5. In what way does the principle of utmost good faith (see Chapter 19) influence the claim made by Rohit Ganesh in this case.

When Rohit is making his claim for compensation he must complete the claim form honestly. He must not exaggerate the cost of his hospital treatment, nor must he claim for expenses that did not exist. This is because of the important principle of utmost good faith in insurance. This states that the parties involved in an insurance agreement must be truthful about all the information they provide. For Rohit this applies to the submission of his proposal and then again when making a claim. If Rohit made false claims on his claim form he might face criminal charges.

## CHAPTER 21

### CASE STUDY: MONSANTO v DEWAYNE JOHNSON

1. Why do consumers need protection? Use this case study to illustrate your answer.

Consumers need protection to help prevent exploitation by businesses. Without protection many consumers might be victims of exploitation, such as unfair trading or the sale of faulty goods. This is a very serious case. Dewayne Johnson was made seriously ill as a result of using a Monsanto product, Roundup, which the manufacturer claimed was safe. As it turned out the product wasn't safe. The claims made by Monsanto were not true. Consumers like Dewayne Johnson need protection to prevent further incidents like the one described.

In court the jury said Monsanto's products presented a '*substantial danger*' to consumers and that the company failed to give proper warnings about the risks. This is why consumers need protection.

2. Why was court action necessary in this case?

Court action might be necessary when a seller disagrees with a buyer about one of its products. Monsanto did not accept that Roundup had caused the serious health problems experienced by Dewayne Johnson. It argued that its product was safe. However, Dewayne and his representatives believed he had developed cancer as a result of using Roundup. When there is a serious disagreement like this it is often necessary for the case to go to court. This is what happened here. Dewayne Johnson won his case and was awarded US\$39.2 million in compensation. Monsanto was also fined a further US\$250 million for failing to warn customers about the dangers of roundup.

### ACTIVITY 1

#### CASE STUDY: CONSUMER PROTECTION ACT, 1986

1. What is meant by consumer protection?

Consumers want to buy good quality products at a fair price and receive good customer service. They want information about products that is accurate and clear. They do not want to buy goods that may be dangerous, overpriced or sold to them on the grounds of false claims. Without government regulation, some firms may exploit consumers by using anti-competitive or restrictive practices. These might include increasing prices to higher levels than they would be in a competitive market or price fixing; this is where a number of firms agree to fix the price of a product to avoid price competition. The consumer often needs protection from unscrupulous traders.

2. Describe **two** reasons for having consumer protection.

Consumer legislation is designed to protect consumers from exploitation by businesses. Consumers need protection from businesses for a number of reasons. For example, many businesses are generally larger and more powerful than individual consumers and often have expert knowledge that consumers do not have access to. Also, some businesses are only interested in making as much profit as possible. They may be content to exploit consumers if they can get away with it.

3. What is meant by consumer rights? Use examples from this case study to illustrate your answer.

Consumers are entitled to certain things when they buy goods and services. When they pay money to sellers they expect good quality products at a fair price in return. They might also expect to receive effective customer service. According to the Consumer Protection Act, 1986 (CPA) in India, consumers have the right to be protected from the marketing of hazardous goods and services and to be told about the quality, quantity, potency, purity, standard and price of goods or services. Consumers should also be able to choose between a variety of goods and services at competitive prices and have their interests heard by the appropriate bodies. They should also have the right to compensation if businesses use unfair or restrictive trade practices.

## ACTIVITY 2

### CASE STUDY: BONETTI'S SHOES

1. Discuss whether the manager should have given Roberto a complete refund for the shoes.

Roberto purchased a pair of shoes in a sale for €49 (reduced from €79). He tried them on in the shop and they seemed to fit OK. However, after wearing them for a few hours he noticed that the left shoe fit perfectly but the right shoe was painful to wear. He decided to return them. From his point of view the goods were faulty. He claimed that the shoes were different sizes, which is not normal when buying a pair of shoes. If they were faulty he might be entitled to a complete refund because they may not have been fit-for-purpose.

However, the manager of Bonetti's claimed that they were not faulty because the shoe size was clearly marked and both shoes were size 10½. However, as Roberto says, claims made on labels are not necessarily true. The shoes had also been worn and may not have been fit to be resold (although Roberto did see that they were for sale again two days later).

Since Roberto accepted the credit note that was offered by the manager, the situation seems to have been resolved. Whether the goods were faulty though, entitling Roberto to a full refund, is difficult to decide. It would have been necessary to involve the manufacturer and possibly get an independent judgement – perhaps by a court. In this case, expensive court action was avoided.

2. Describe **three** important measures that might be taken when making a complaint about goods that have been purchased.

A complaint is more likely to be successful if it is made very quickly after the purchase; delaying the complaint may be less effective. It might suggest a lack of commitment. It is also wise to direct complaints at a senior manager (in a large business) or the owner (in a small business). It is important to remain calm and avoid getting angry or abusive. In this case, Roberto returned to the shop almost immediately after the purchase. He did speak to the manager and the conversation in the case study does seem to be calm and certainly without abuse.

3. Why is it important to make complaints when appropriate?

It is important for consumers to make a complaint if they are not happy with their purchases. If complaints are not made, businesses may not know that there is a problem and the problem may not be solved. In today's competitive business environment, businesses often try to exceed customer expectations. If customers draw attention to problems through complaining, businesses will be more able to make improvements. Making a complaint will also benefit consumers because they may get compensation for their disappointment. In this case, at least court action was avoided and Roberto got a credit note.

### MULTIPLE CHOICE QUESTIONS

1. A 2. A 3. D 4. C

### CHAPTER REVIEW

#### CASE STUDY: SAMSUNG

1. What is meant by a product recall?

If a business sells goods that are faulty, it may be forced to ask all customers to return the product. This is called a product recall and happened when Samsung launched its Galaxy Note 7 smartphone in August 2016. Unfortunately, Samsung had to recall all devices and stop production due to a problem with the batteries. This followed a number of serious incidents. For example, on 4th October 2016, a US customer suffered lung damage when a Galaxy Note 7 released fumes in his bedroom. There were many more similar incidents. The Galaxy Note 7 was officially recalled in the USA by the Consumer Product Safety Commission in September 2016. It advised owners of the devices to shut down and stop using them and return them in exchange for a replacement. However, even replacements had problems. Therefore in October 2016 Samsung stopped production of the devices and ordered a product recall.

2. What might be the role of the Consumer Product Safety Commission in the USA?

In this case, Samsung's Galaxy Note 7 was officially recalled in the USA by the Consumer Product Safety Commission. It appears that the Consumer Product Safety Commission is an official body responsible for helping to protect consumers' rights. In most countries around the world there are specialist bodies responsible for enforcing consumer legislation. They investigate possible cases of consumer exploitation where laws may have been broken. They may have the power to take companies to court or make recommendations to the government relating to the action that should be taken against offenders. They may also promote the interests of consumers in the development of government policies relating to competition in business and consumer protection.

3. Discuss whether the action taken by the seller (Samsung) was appropriate in this case.

When goods are faulty the seller is likely to take some form of action. Depending on the circumstances, they might choose between offering a replacement, a complete refund or a credit note. Alternatively, the seller might offer a discount on the faulty goods or refer the customer to the manufacturer. In this case, the fault is clearly very serious and there is a danger to the customer. Samsung responded by organising a product recall. Samsung stopped production of the phones and instructed customers to return the devices 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. Most would argue that the action taken by Samsung in this case was appropriate.

4. Discuss why sellers might have a problem with customers that complain about the 'quality' of a product or service.

Consumers may be unhappy about the quality of goods and services that they buy. This is where the rights of consumers and the obligations of sellers might not be the same. This is because quality is often subjective; this means that the quality of a product depends on what each individual feels or believes. The quality of a product is a matter of opinion.

When product quality is an issue, the action taken by a seller will depend on whether they agree with the nature of the complaint. If the seller is sympathetic to the views of the customer, the seller might offer their apologies and provide a refund, replacement or a credit note. However, if there is disagreement, the seller might give the customer the benefit of the doubt and provide a replacement, refund or credit note. Alternatively, the seller may provide some compensation. For example, in a restaurant if a diner is unhappy with the speed of service, a free dessert or drink might be offered. In this case the product quality is not in doubt: the phone sets are faulty and dangerous.

5. Assess how Samsung may be affected by the sale of faulty goods.

The impact of the product recall at Samsung could be huge. It could have a lasting effect. Immediately after the first announcement, around US\$14 billion was wiped off the value of the company as its share price plummeted. 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 Samsung Galaxy Note 7 is just one of many, many products for the business. If one fails like this, it has many others to fall back on.

## CHAPTER 22

### CASE STUDY: AUSTRALIAN SUGAR PRODUCERS

1. Why is it hard for Australian sugar producers to sell in foreign markets?

Australia produces some of the cheapest sugar in the world. However, Australian sugar producers face difficulties exporting sugar because of trade barriers. For example, sugar farmers are heavily subsidised in the USA and there are also quotas and tariffs (import controls) imposed on imports. Farmers in Europe are also heavily supported and trade with the EU is challenging.

2. Why do you think countries introduce trade barriers like those described above?

Countries impose trade barriers to protect their own industries. In this case, the USA and the EU would claim that very cheap sugar from Australia is threatening the performance or survival of sugar producers in America and Europe. Consequently, they have imposed some import controls on sugar. This should reduce sugar imports and allow producers in the USA and EU to sell more. This will generate more revenue and profits and save jobs.

3. What might be the benefits of lifting all trade barriers?

If all trade barriers are lifted, goods and services around the world might be cheaper. This means that consumers all over the world would have more spending power – they would be better off. Also, low cost producers would benefit, in whichever country they traded in. This would put pressure on less efficient rivals and encourage them to find ways of cutting costs.

### ACTIVITY 1

#### CASE STUDY: DUMPING OF STEEL IN INDIA

1. What impact might the steel imports have had on employment in India?

When cheap imports flood into a country, domestic producers often feel threatened. In this case study, Indian steel producers, including JSW Steel Ltd, Usha Martin, Gerdau Steel India and Jayaswal Neco Industries Ltd asked the DGTR to investigate the prices of steel products coming from China. They felt threatened because the steel imports were very cheap and a threat to their existence. Without some form of control, the cheap imports may have resulted in Indian producers cutting capacity or going out of business. Both of these effects would result in job losses in India.

2. What is meant by dumping?

Dumping is where foreign producers sell goods below cost in a domestic market. This is seen as unfair competition for domestic producers. If very cheap imports are being sold below cost in a country, domestic producers will find it difficult to survive. In this case study, Indian steel producers think that Chinese companies are dumping steel products in India. As a result, India imposed some anti-dumping duties of US\$185.51 per tonne on a variety of steel products arriving from China. The duties were designed to protect domestic steel producers and were recommended by the Directorate General of Trade Remedies (DGTR) in India.

3. A government might respond to dumping by using protectionism. What is **one** other reason why a government might use protectionism?

There are a number of reasons why a government might use protectionism (in addition) to prevent dumping. For example, a country might need to use trade barriers because it has a very large current account deficit on the balance of payments. A country has to pay its way in the world and if a current account deficit gets out of control, action may be needed. A government might try to reduce imports and increase exports at the same time to reduce the deficit. In 2014 the Indian government used trade barriers to restrict the amount of gold coming into the country. One of the main reasons for this move was to help reduce India's growing current account deficit.

### ACTIVITY 2

#### CASE STUDY: MALAYSIAN TARIFFS

1. What is meant by a tariff?

Governments can use a number of trade barriers to restrict trade. One approach is to make imports more expensive. Imports can be made more expensive if the government imposes a special tax on them. Such a tax is called a tariff. In this case study, Malaysia imposed tariffs on a range of steel imports from Taiwan, South Korea, China and Thailand. Tariffs of 111.16 per cent were placed on cold-rolled stainless steel (CRSS) for five years by Malaysia's Ministry of International Trade and Industry (MITI).

2. A Thai exporter sells a MYR50 000 consignment of CRSS to a Malaysian importer. Calculate the amount the Malaysian importer would have to pay for this consignment including a tariff of 111.61 per cent.

The amount paid by the Malaysian importer is given by:

$$= \text{MYR}50\,000 + 111.61\% \times \text{MYR}50\,000$$

$$= \text{MYR}50\,000 + \text{MYR}55\,805$$

$$= \text{MYR}105\,805$$

3. Why has Malaysia imposed tariffs on imports of CRSS?

Tariffs are a form of protectionism. In this case study, Malaysia's decision to impose the tariffs was designed to protect the domestic steel industry from overseas companies charging unfair prices. In 2018, Malaysia imposed anti-dumping tariffs on a range of steel imports from Taiwan, South Korea, China and Thailand. It was claimed that these countries were selling their products at unfair low prices in Malaysia. Tariffs of up to 111.16 per cent were placed on cold-rolled stainless steel (CRSS) for five years by Malaysia's Ministry of International Trade and Industry (MITI). The ministry said that an investigation would be carried out over this time period to clarify the pricing policies used by businesses in these countries. The tariffs would raise the prices of steel products in Malaysia, making it easier for domestic producers to compete.

### MULTIPLE CHOICE QUESTIONS

1. B    2. A    3. C    4. B

### CHAPTER REVIEW

#### CASE STUDY: US TARIFFS

1. What is the difference between a quota and a tariff?

Tariffs and quotas are both used as trade barriers. A tariff is a tax imposed on imports.

A tariff will make imports more expensive so demand for them will fall. This will help to curb the flow of imports into a country. Another way of reducing imports is to place a physical limit on the amount allowed into the country. This is called a quota. By restricting the quantity of imports, domestic producers face less of a threat. They will have more of the market for themselves. In this case, the USA has imposed tariffs on a range of imports. For example, in January 2018, President Trump imposed a 20 per cent tariff on the first 1.2 million imported large residential washing machines and a 50 per cent tariff on machines above that number. A 30 per cent tariff was also to be imposed on imported solar cells and modules.

2. How might the dumping of steel products by foreign countries impact on US steel producers?

Sometimes a business will try to sell its product in a foreign market at below cost price. The motive for this is usually to break into the market. However, it might be used as a strategy to destroy foreign rivals. In this case study, foreign suppliers of steel have been accused of dumping products in the USA. The US Commerce Department imposed tariffs of 16 per cent on imports from South Korea of steel pipe and tubes used for oil drilling. The department claimed that these products were being dumped in US markets. It was hoped that the tariffs would help the US steel industry by raising prices and protecting hundreds of jobs that had been threatened by cheap imports.

Dumping, if proven, is considered to be unethical and in some cases illegal. This is because of the damage it can do to domestic producers. It is considered unfair if domestic businesses have to compete with foreign rivals that are selling the same goods below the costs of production. Over a long period of time, domestic producers are likely to go out of business – particularly if foreign suppliers have the financial resources to support long-term dumping.

3. Describe (a) **one** advantage and (b) **one** disadvantage of using subsidies as a trade barrier.

(a) One of the main advantages of export subsidies is that more domestic firms might be encouraged to enter the market. This will help to boost exports, employment and improve the current account.

(b) The main disadvantage of subsidies is that incentives for firms to look for cost-saving efficiencies might be removed.

4. Assess the possible effects of the USA imposing tariffs on steel imports.

The tariffs proposed by the USA in 2018 were chiefly designed to protect US businesses by making imported goods more expensive. As a result, tariffs would help to redirect spending in favour of US-produced goods. This should help US businesses increase their sales, revenues and profits. For example, in January 2018, the US government announced that it would impose tariffs on solar panels and washing machines. These tariffs should help protect US businesses that produce washing machines and solar panels. Whirlpool, which campaigned for protection against rivals Samsung Electronics and LG Electronics after years of anti-dumping cases, was relieved at the action.

In March 2018 President Trump imposed tariffs of 25 per cent on imports of steel and 10 per cent on imports of aluminium. This was in response to a government report which concluded that foreign shipments of metals were threatening national security interests. Clearly, US businesses in these industries would benefit from the higher prices that foreign rivals would now have to charge. In the short term some would argue that these trade barriers will benefit the US businesses threatened by cheap imports.

However, a number of countries have criticised the tariffs and said that they would retaliate. For example, the EU said that the tariffs violated international trading rules and promised to retaliate if imposed. They proposed restrictions on imports of Harley Davidson motorbikes and Kentucky bourbon. China also said it would retaliate with around US\$3 billion of tariffs. It promised to suspend tariff concessions on 120 US food products. Fresh and dried fruits, almonds, pistachios and wine would be subject to an additional 15 per cent tariff and eight other items, including frozen pork, would be subject to a 25 per cent tariff. If these tariffs were imposed in full a number of US businesses could be hit hard.

Another worrying issue was the rising price of imported components. Jason Andringa, who runs the agricultural and construction equipment maker, Vermeer, in Iowa, says that tariffs could have a negative impact on businesses. Vermeer imports cabs assembled in China, which it uses for its drilling vehicle made in Iowa. This helps the company to keep costs down. However, these components would be hit by the new tariffs, which would raise costs, reduce competitiveness and threaten jobs.

Figure 22.1 shows how US businesses might be affected by Chinese tariffs. According to the chart, California, Washington State and Texas look to be the worst hit. However, businesses in many other US states will feel the impact of the Chinese tariffs. According to the graph California could lose approaching 300,000 jobs and Washington State and Texas 150,000, as a result of retaliatory tariffs. The second graph (Figure 22.2) shows that the worst hit industry will be the plastics industry where businesses will lose almost 300,000 jobs. This evidence, if correct, supports the view that if import controls are used there is the threat of an all-out trade war. This would harm both nations. Many would argue that no one can win a

trade war and the only outcome will be lower income and employment for every country involved. In the long term, businesses are likely to benefit more from free trade. Therefore, protectionist policies will harm businesses.

Many believe that countries, businesses and consumers will all benefit in the long run if trade barriers are eliminated. This suggests then that US businesses are more likely to suffer if the proposed tariffs are not withdrawn.

## CHAPTER 23

### CASE STUDY: DORTMUND CAR PARTS

1. Which currencies are used in **(a)** Germany, **(b)** India and **(c)** Japan?

(a) Germany uses the euro.

(b) India uses the rupee.

(c) Japan uses the yen.

2. Why do we need exchange rates? Use an example to support your answer.

Goods and services purchased from foreign countries may have to be paid for in a different currency to that used at home. For example, when Jasper and Jackie travel to India they need to use rupees to fund their purchases. This means that domestic currency has to be exchanged for foreign currency. Therefore it is necessary to know what the exchange rate is between two currencies.

3. What was the exchange rate in the case of Dortmund Car Parts?

For the transaction involving Ruhr Metal Products the exchange rate was €1 = JNY120.

### ACTIVITY 1

#### CASE STUDY: GALLARDO LTD

1. Calculate the price in US dollars of the televisions sold by Gallardo Ltd to the US firm (assume MXN1 = US\$0.05).

The price in dollars is given by:

$$\text{MXN}3\,600\,000 \times \$0.05 = \mathbf{\$180\,000}$$

2. Calculate the amount paid in MXN by Gallardo Ltd for the EUR2.5 million components bought from Germany (assume MXN1 = EUR0.045).

The amount paid by Gallardo Ltd in MXN is given by:

$$€2\,500\,000 \div €0.045 = \mathbf{\text{MXN}55\,555\,555}$$

3. Calculate the amount in euros received by the Spanish supplier for the MXN20 million of materials sold to Gallardo Ltd (assume MXN1 = EUR0.045).

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

$$20\,000\,000 \times €0.045 = \mathbf{€900\,000}$$

**ACTIVITY 2****CASE STUDY: IMPACT OF CHANGES IN THE EXCHANGE RATE**

1. Calculate the cost in pounds of the aviation fuel in 2018.

The cost in pounds of the aviation fuel in 2018 is given by:

$$\$900\,000 \div \$1.25 = \mathbf{\pounds 720\,000}$$

2. Calculate the price in euros of the return flight in 2018.

The price in euros of the return flight in 2016 is given by:

$$\pounds 220 \times \text{€}1.10 = \mathbf{\text{€}242}$$

3. Calculate the cost in pounds of the aviation fuel at the estimated 2020 exchange rate.

The cost in pounds of the aviation fuel in 2020 is given by:

$$\$900\,000 \div \$1.40 = \mathbf{\pounds 642\,857}$$

4. Calculate the price in euros of the return flight at the estimated 2020 exchange rate.

The price in euros of the return flight in 2020 is given by:

$$\pounds 220 \times \text{€}1.25 = \mathbf{\text{€}275}$$

5. How might the airline be affected by the changes in the exchange rates in this case study?

Following the changes in the exchange rate between the pound and the euro the demand for flights may fall. This is because the price of the flight has increased from €242 to €275. When the exchange rate strengthens, exports become more expensive and therefore demand may fall.

The cost of the aviation fuel has fallen from £720 000 to £642 857. This will reduce the costs to the airline so profits should increase. When the exchange rate appreciates, imports become cheaper. However, the overall impact on the airline is difficult to evaluate. If demand falls then revenues will also fall. What happens to overall profit depends on the extent of the decline in demand.

**MULTIPLE CHOICE QUESTIONS**

1. C   2. B   3. A   4. B

**CHAPTER REVIEW****CASE STUDY: MIRPUR TEXTILES LTD**

1. On 10 April 2019, the exchange rate between the euro and the taka was EUR1 = BDT95. How much in euros would a Spanish customer pay Mirpur Textiles Ltd for BDT90 million of goods?

The amount is given by:

$$\text{BDT } 90\,000\,000 \div \text{BDT } 95 = \mathbf{\text{EUR } 947\,368.42}$$

2. What has happened to the value of the BDT (compared to the euro) between April 2018 and April 2019?

According to the graph in Figure 23.2, the Bangladeshi taka has depreciated against the euro. It has fallen from about EUR1 = BDT103 to EUR1 = BDT95.

3. How might the change in the exchange rate affect Mirpur Textiles Ltd's trade with the EU?

The depreciation in the exchange rate between the taka and the euro should benefit Mirpur Textiles Ltd. This is because when the exchange rate weakens, the price of exports falls. As a result, Mirpur Textiles should sell more to its EU customers because they are cheaper. This should increase sales, revenue and profits.

4. Discuss the possible impact of the bad debt to Mirpur Textiles Ltd.

Bad debts can have a negative impact on a business. To begin with, worrying about whether customers will pay for goods that they have bought can cause stress. This can be a very serious problem for small business owners where one significant bad debt could result in collapse. Even with a relatively large company like Mirpur Textiles, staff can become anxious. Indeed, the managing director of Mirpur Textiles is furious. Bad debts may also cause cashflow problems. For example, it may force a business to go overdrawn at the bank and incur interest charges. Interest payments will reduce the profitability of a business. Businesses may use up valuable resources 'chasing' debts; for example, time and money will be directed towards debt collection when it could be spent more productively elsewhere in the business.

Another problem is that news of a bad debt may circulate in trading communities. This might mean that other businesses think they can also delay payments to that company. For Mirpur Textiles this is the second bad debt of the year. A business may also find it difficult to raise funds if banks or other money lenders discover that bad debts are a problem. Banks may feel that the business is incapable of managing its finances. Finally, if Mirpur Textiles does not get paid for the goods sold to Pedro Fashion, profitability will obviously suffer.

5. Mirpur Textiles Ltd wants to reduce bad debts in the future. The company has identified two possible options that might be adopted to achieve this.

Option 1: Improve internal credit control.

Option 2: Take out export credit guarantee insurance.

Which of these options would you advise?

Businesses like Mirpur Textiles Ltd can take a number of measures to reduce bad debts. One option being considered here is to improve internal credit control. One way to do this is by checking the creditworthiness of customers before allowing them trade credit. This can be done by asking for trade references from the customer's previous suppliers and/or looking at their financial accounts. It might also be possible to carry out an online credit check. Another useful measure is to place limits on the amounts that new customers can buy on trade credit. A business might also allow a customer to 'prove themselves' as creditworthy over a period of time. It will also help to produce very clear terms and conditions when allowing trade credit. Ensure that customers understand the terms and conditions and also agree to them. Customers might be reminded that in some countries sellers are allowed to charge interest on late payments.

Mirpur Textiles should ensure that invoices are sent promptly to the correct person and contact them immediately if a payment becomes overdue. They should also resolve any trading disagreements relating to goods or services quickly. Customers are not likely to pay if there is a disagreement on quality, for example.

A second option being considered by Mirpur Textiles is to take out insurance to cover any losses resulting from bad debts (export credit guarantee insurance). Exporters such as Mirpur Textiles may be able to get help from the Bangladeshi government when selling goods to foreign companies. Many countries offer exporters insurance against bad debts from foreign customers.

In this case, Mirpur Textiles Ltd sells 85 per cent of its goods to the EU. The bad debt incurred here is from Pedro Fashion, a Spanish customer. Possibly the best course of action the company could take is to adopt Option 2 and obtain export credit guarantee insurance. This might be obtained from the Bangladeshi government. It will help to cover any losses resulting from bad debts when selling abroad. However, it might not cost too much money to 'tighten up' internal credit control as well. Both options seem attractive here.

### EXAM PRACTICE: 2 COMMERCIAL RISKS

- (a) C The loss of revenue due to a change in consumer taste is a non-insurable risk.
- (b) A The number of passengers arriving late is 5,368,000 ( $12.2\% \times 4,000,000$ ).
- (c) (i) Between 2014 and 2019 the value of the US dollar appreciated against the Indian rupee. It rose from \$1 = Rs61 to \$1 = Rs69 (approx).
- (ii) The change in the exchange rate shown in Figure 1 also means that the Indian currency is weaker against the US dollar. However, this will benefit Indian exporters because it means Indian goods will be cheaper in the USA. Consequently they should sell more.
- (d) A quota is a form of trade protection. It is a limit placed by the government on the quantity of selected imports.
- (e) One reason why a country would use trade protection, such as quotas or tariffs, is to resist dumping. Dumping is where foreign producers sell goods below cost in a domestic market. This is considered to be unfair competition for domestic producers. If very cheap imports are being sold below cost in a country, domestic producers will find it difficult to survive.
- (f) One way of reducing bad debts is to check the creditworthiness of customers before allowing them trade credit. This can be done by asking for trade references from the customer's previous suppliers and/or looking at their financial accounts. It might also be possible to carry out an online credit check. If a new customer has a reliable trading record with no previous debt history, trade credit may be granted.
- (g) There is clear cause to complain in this case study. A customer has bought a faulty microwave oven and the manager has admitted that there is a fault. Most consumer legislation would probably entitle the customer to a full refund. For example, in the UK, the Sale of Goods Act, 1979, states that products sold by businesses must be of an appropriate quality and 'fit-for-purpose'. In this case the microwave oven is not 'fit-for-purpose' – it does not heat food or beverages – it is clearly faulty.

The manager in the store has told the customer that Head Office might not grant a full refund. This is because the goods were bought in a sale. An alternative might be to compensate the customer by offering a credit note for the value of the goods – LKR14 500 in this case. Many would argue that this is not fair because this means the money must be spent in AP Electrical Supplies. This would force the customer to spend money in a shop that has sold faulty goods.

Many would agree that AP Electrical Supplies should give the customer a full refund. It does not matter that the goods were bought in a sale. This has no relevance. A credit note in this case is not satisfactory compensation.

## THEME 3 ANSWERS

## CHAPTER 24

## CASE STUDY: MAUNG MAUNG MIN

1. Suggest **three** advantages to Maung Maung Min of having a bank account.

If Maung Maung Min had a bank account his money would be safe from theft. He might also get interest and would be able to make payments electronically. He could also withdraw cash from an ATM whenever he needed it.

2. How might Maung Maung Min benefit from a credit card?

The main advantage of a credit card is that it allows holders to buy goods and services and pay for them at a later date. Payments become due a few weeks after receiving a monthly statement, which shows how much is owed. Credit cards are also a convenient method of making payments.

3. How would traders exchange goods if money did not exist?

If money did not exist, trading would be difficult but not impossible. Without money, the exchange of goods takes place using the barter system. This involves people or traders swapping goods with one another. For example, a chicken farmer like Maung Maung Min might swap one chicken for a sack of vegetables.

## ACTIVITY 1

## CASE STUDY: INDIA POST

1. Describe **two** financial services offered by India Post.

A post office can be used to make payments. A number of payment options may be available. For example, money can be sent from one bank account to another using a debit card or credit card. Cash can also be sent from a post office and delivered to a payee's home. In some countries postal orders can be obtained from post offices. Most post offices allow people to open savings accounts. They are likely to get interest on their deposits and usually have access to their money on demand.

In this case, the Indian post office accepts savings deposits, provides life insurance cover, offers retail services like bill collection and performs services for the government, such as the distribution of old age pension payments.

2. Why do post offices play such an important financial role in some countries?

Post offices play a financial role in most countries. In some countries their financial services are particularly valued in rural communities. This is because most banks do not operate branches in areas with a small population. Consequently, post offices 'fill the gap' left by commercial banks. Without post offices many people in rural areas would be excluded from a number of important financial activities.

3. How does India Post provide communication services?

The Indian post office provides an important communication service through the postal system. It is responsible for collecting and delivering mail throughout the whole of India. It operates the largest postal network in the world from over 155,000 post offices around the country.

4. Describe **three** factors that influence the price of postage.

The price of postage will depend on the size or weight of the letter or parcel being delivered, the urgency of the delivery and the distance the item has to be transported. Charges will be higher if letters or parcels are large, if they need to be delivered very quickly or if they have to travel long distances.

## ACTIVITY 2

### CASE STUDY: THE CENTRAL BANK OF SRI LANKA (CBSL)

1. The CBSL is said to be the government's bank. What does this mean?

One of the main functions of any Central Bank is to operate as the government's bank. This means that it will handle all of the government's payments and receipts, just as commercial banks do for individuals and businesses. It manages the government's debt by organising loans and other forms of borrowing and makes interest payments. It also advises the government on economic matters and implements the government's monetary policy. For example, in Sri Lanka the Central Bank is responsible for setting interest rates in the economy. The Central Bank also manages the nation's reserves of foreign currency.

2. Why do you think that the CBSL is the only institution allowed to issue notes and coins in Sri Lanka?

Like most Central Banks around the world the CBSL is responsible for issuing notes and coins in the country. The CBSL is the sole distributor of notes and coins. This is important because if lots of different banks issued their own notes and coins there may be a great deal of confusion. For example, notes issued by a commercial bank in Galle might not be recognised by people living in Colombo. Consequently, they might not be accepted and trading would be very difficult. It is best if everyone uses the same notes and coins throughout the country. There will be more trust and certainty.

3. What changes has the CBSL made to the nation's interest rate in the last five years?

The CBSL is responsible for adjusting interest rates to help the government achieve its economic objectives (such as reducing inflation). In 2014 interest rates in Sri Lanka were 6.5 per cent. However, the CBSL reduced them in 2015 to 6 per cent but increased them again in 2016 back up to 6.5 per cent. Since then they have been increased a few times and now stand at 8 per cent. The CBSL might be increasing interest rates to help control inflation in the Sri Lankan economy.

## MULTIPLE CHOICE QUESTIONS

1. B 2. B 3. A 4. D

## CHAPTER REVIEW

### CASE STUDY: DIGITAL BANKING

1. What does the graph show in Figure 24.3?

Figure 24.3 shows the types of banking activities undertaken by US internet users in April 2018. The most popular activity was checking the bank balance on an account; 81 per cent of respondents said that they did this. People like to know how much money they have to spend. Looking up the balance is also a way of controlling personal spending levels and checking if your account has been 'hacked'. The second most popular mobile banking

activity in the USA was paying bills; 63 per cent of respondents said they did this. The least popular activity according to the survey was buying stocks online. However, this may have been because it is not a popular financial activity anyway.

2. Describe **three** advantages of mobile banking.

One of the main advantages of mobile banking is that bank accounts are accessible 24/7 and from anywhere in the world provided there is an internet connection. This means that banking transactions can be conducted from a hotel, a train, a taxi, a football stadium or a restaurant, for example.

Mobile banking also reduces the need to visit branches in person and therefore saves time for people and businesses.

Business customers can collect payments from customers, transfer funds between different business accounts, manage payments including direct debits and standing orders, organise their payrolls (e.g. pay wages to workers) and conduct many other banking transactions online.

3. What is the difference between a current account and a savings account?

Current accounts are the most popular type of bank account. They are used to deposit cash receipts such as wages for individuals and takings for businesses. Account holders will be issued with a cheque book, a paying-in book and a debit card. Cheques can be used to make payments and paying-in books are used to deposit cash and cheques. Debit cards are used to withdraw money from ATMs (see below) or make payments for goods and services when shopping. However, many payments are made directly from one bank account to another. There may be charges for using current accounts and it is not common to receive interest on any money held in the account. Although recently, as competition in banking increases, some banks are offering fairly low rates of interest (with certain conditions attached).

In contrast, savings accounts are usually designed for people who want to accumulate cash holdings over a period of time. They are often suitable for 'regular savers'; these are individuals who want to deposit money on a regular basis, such as every month. The interest rates on these accounts might be attractive, particularly if account holders want to tie up their money for long periods of time. Instant access savings accounts tend to offer relatively lower rates.

4. How does this case study highlight one of the main problems with mobile and Internet banking?

One of the main fears for people who use mobile and Internet banking is that money will be stolen from their accounts. This might happen if a criminal is able to trick account holders into disclosing their banking details or making a transfer into a criminal's account. In this case, a criminal hacker suspected of stealing about €1 billion from banks all over the world was arrested by Spanish police. The suspect and his 'gang' used Anunak, Carbanak and Cobalt malware (special criminal software) to hack into banks' computers and transfer money into their own accounts.

The gang used phishing emails sent to bank employees to look for computers with access to software that controlled ATMs, bank accounts and transfers. Money was stolen by sending instructions to ATMs to issue money at specific times, where criminals were waiting to collect

the cash. They also withdrew funds from targets' accounts and manipulated banks' databases to increase the balances of accounts belonging to the gang.

Examples of this type of fraud seem to be rising and people are aware that such criminal activity is widespread.

5. Assess whether cashless societies are desirable.

A cashless society is one where every single payment is made with a card, mobile phone or some other electronic device. There would be no cash in circulation because it would not be needed. One of the benefits of a cashless society is that crime might be reduced. Cash is relatively easy to steal and criminal transactions (such as payments for drugs) would be lower without cash because cash payments are more difficult to keep track of. There would also be more transparency. This is because non-cash transactions are supported by records, meaning that it is more difficult to evade tax, for example. It would also be easier for businesses to keep a track of transactions and manage their cash flow. Non-cash payment methods tend to be more convenient for shoppers; so queues may be shorter at checkouts and ATMs would not be needed. It is also argued that payments would be more efficient without cash because the cost of printing, storing, distributing, counting and replacing money will be eliminated. Cash is said to be an inefficient method of payment so the economy will benefit. A cashless society might also benefit the economy because people spend more with non-cash methods of payment. This will boost economic growth. Finally, if there were no cash it would not be necessary to obtain foreign currency when travelling to a foreign country. This would be convenient.

However, there are some disadvantages of withdrawing all cash from circulation. People in many countries prefer to use cash because it is the only available payment method; in many developing countries, non-cash methods of payment are not widespread enough. Businesses that stop using cash risk losing customers. People trust cash – there are no third parties involved in cash payments other than the buyer and seller. The exchange of goods for physical cash can be conducted with absolute clarity. Cash is also reliable because it does not need IT systems for transactions. Consequently, the outages suffered when using non-cash methods cannot occur. The use of cash is said to provide shoppers with confidentiality because all cash transactions are private; there is no electronic record of the transaction. The scope for fraud and identity theft is also eliminated. Finally, for many businesses cash is still a cost-effective payment system. Market traders, for example, will want to avoid the cost of technology to facilitate electronic payments.

Whether a cashless society is desirable depends on people's opinions. Each individual will have a view on whether the advantages outweigh the disadvantages, or not. Many would argue that today cash still has an important role to play in trading; however, there may be pressure from governments to eliminate cash in the future to improve transparency.

## CHAPTER 25

### CASE STUDY: TIANJIN CONSTRUCTION

1. Name **five** sources of finance used by Tianjin Construction.

Five sources of finance in this case are trade credit, mortgage, bank loan, leasing and share capital.

2. Where did the capital come from to set up the business?

The capital to set up the business was provided by four family members. Ten years ago, they each invested CNY200 000.

3. How might the business raise CNY4 million to buy an expensive machine?

The company might lease the new machine or might take out another bank loan. Hire purchase might also be a possible way of funding the new machine.

### ACTIVITY 1

#### CASE STUDY: KR BEVERAGES

1. During 2019 KR Beverages used AED2.7 million of short-term finance. How much of this, in AED, was borrowed using a bank overdraft?

The amount borrowed in 2019 using a bank overdraft is given by:

$$45\% \times \text{AED}2.7 \text{ million} = \text{AED}1.215 \text{ million}$$

2. Why is a bank overdraft a flexible source of finance?

A bank overdraft is where current account holders can spend more money than there is in the account. In other words, they go *overdrawn*. This is a common source of finance for most businesses. An overdraft limit will be set by the bank and interest is only charged when the account is overdrawn. Bank overdrafts are simple and flexible. They are flexible because the money is only borrowed when needed. For example, KR Beverages may go overdrawn just for a few days each month. The company will only pay interest on the amount owed for these few days. Once there is money back in the account, there is no interest to pay.

3. How might trade credit be used by KR Beverages?

Businesses often buy resources and pay for them at a later date, usually within 30–90 days. This is called trade credit (or trade payables) and is a cheap way of raising finance. It means a business holds on to its cash for longer. KR Beverages may use trade credit to buy raw materials for the soft drinks it manufactures. These might include sugar, flavourings and colourings.

4. What is meant by factoring?

KR Beverages used factoring for 22 per cent of its short-term finance in 2019. Factoring involves borrowing money using invoices as security. When firms sell their products they send invoices to their customers stating the amount due. The invoice provides evidence of the transaction and clearly states the amount owed. Factoring involves a specialist financial institution providing finance against these unpaid invoices. A possible arrangement would be for the factor to pay 80 per cent of the value of invoices when they are issued. The balance of 20 per cent is paid by the factor when the customer settles the bill. An administrative and service fee will be charged. Many commercial banks offer factoring services. The fees charged might range from 1.15 – 4.5 per cent per 30 days.

### ACTIVITY 2

#### CASE STUDY: PETAR POPOV

1. What is meant by a bank loan?

A bank loan is an arrangement where the amount borrowed from the bank must be repaid in regular instalments over a clearly stated period of time. Bank loans can be obtained from commercial banks. They are a rigid arrangement and interest will be added to the total. They can be used for long-term or short-term purposes, depending on the needs of the business.

2. Calculate the total interest payable on the five-year loan.

The total interest payable is given by:

$$4.5\% \times \text{BGN}130\,000 \times 5 = \text{BGN}29\,250$$

3. Calculate the monthly repayments on the loan.

Monthly repayments are given by:

$$\frac{\text{BGN}130\,000}{5 \times 12} + \frac{\text{BGN}29\,250}{60} = \text{BGN}159\,250 = \text{BGN}2\,654.17 \text{ per month}$$

4. Discuss whether Petar should invite a business angel to join his haulage company and provide the finance needed for expansion.

At the end of 2019, Petar had the chance to buy another haulage company. The company specialised in the transportation of frozen food. Petar really wanted to diversify his business but the cost of the company for sale was BGN1.5 million. The only way he could raise the money would be to use venture capital and invite a business angel to join his enterprise. Venture capitalists are specialists in the provision of funds for small and medium-sized businesses. They may invest in businesses after the initial start-up and often prefer technology companies with a high growth potential. They prefer to take a stake in the company. This means they have some control and are entitled to a share in the profit.

Some venture capitalists are individuals and may be called business angels. They may invest in a business in exchange for a stake. Most investments are in start-ups or early stage expansions. The problem with this source of finance for businesses is finding a suitable 'angel'. Since angels normally take a stake in the business, the angel and the current business owners must have shared interests and want the same for the future of the business. Business owners also have to be comfortable with sharing profits with the angel for as long as they are involved. Businesses often turn to venture capitalists for funding when they have been refused by other sources. In this case, Petar is unsure about inviting a business angel to provide finance. He may be worried that the investor will want too much control; however, Petar has limited choice in sources of finance. If he can find a suitable business angel the venture might work.

### MULTIPLE CHOICE QUESTIONS

1. D   2. A   3. B   4. C

### CHAPTER REVIEW

#### CASE STUDY: RUAKA MILK LTD

1. What is meant by leasing?

A lease is a contract in which a business acquires the use of resources such as property, machinery or equipment, in return for regular payments. With this type of finance, businesses never own the resource. In some cases, the finance lease arrangement is often for three years or longer and, at the end of the period, the business is given the option to buy the resource. One main advantage of leasing is that no large sums of money are needed to buy or use the equipment. In this case, Victor could lease the land that he wants to acquire to expand his farming business.

2. How does a hire purchase agreement work?

Businesses may use HP to buy tools, equipment, vehicles and machinery. In this case, Ruaka Milk Ltd has used HP to buy a tractor. An HP agreement begins when a business makes a down payment (a small percentage of the cost of the asset). The remainder is paid in monthly instalments. However, the asset bought does not legally belong to the buyer until the very last instalment has been paid. Also, if the buyer falls behind with the repayments, the goods can be repossessed. HP agreements can be short-term or long-term.

3. Why is share capital permanent capital?

Once shares have been issued to raise capital, the money is very rarely repaid to the shareholders. The money is retained permanently for the life of the business. It is used to buy assets and help run the business. It is only repaid if the company ceases trading. However, a shareholder can always sell shares (in public limited companies) on the stock market.

4. What is the main advantage of using retained profit as a source of finance?

Retained profit is profit that has not been returned to the owners. It is retained by the business. It is an important source of finance for a business because it is cheap. This is the main advantage; there are no charges such as interest, dividends or administration. However, if profit is used by the business it cannot be returned to the owners. Some owners might disagree with this. Retained profit is also a flexible source of finance. It can be accumulated by a business and kept in a bank account earning interest. A business can then draw on this source at a later date. In this case, Ruaka Milk Ltd plans to use KES1 000 000 retained profit to help pay for some new land.

5. Victor is considering two sources of finance to buy the land.

Option 1: Take out a mortgage.

Option 2: Issue new shares.

Assess which of these options Victor should choose.

Victor needs to raise KES6 000 000 to buy the land he needs to expand the farm. He plans to use KES1 000 000 of retained profit, which means the company needs KES5 000 000. One option is to take out a mortgage. A mortgage is a secured loan where the borrower has to provide some assets as collateral to support the loan. This means that if the borrower defaults, the lender is entitled to sell the assets and use the proceeds to repay the outstanding amount. In this case, Ruaka Milk Ltd will use the land it is purchasing as security for the loan. Mortgages are long-term loans and are typically for 25 years. Mortgages are usually cheaper than unsecured loans because there is less risk for the lender.

Another way Victor can raise the KES5 000 000 is to sell some shares to a venture capitalist. The sale of shares can raise very large amounts of money. However, once shares have been sold, the buyer is entitled to a share in the profit of the company, i.e. a dividend. Therefore, the venture capitalist in this case will be entitled to a share of the dividends paid by Ruaka Milk Ltd indefinitely. Shareholders are also entitled to influence the way a company is run. In this case, the venture capitalist will have a 20 per cent stake in the business.

In this case, Victor has to consider whether the benefit of not having to borrow KES5 000 000 for 25 years (i.e. interest payments and monthly instalments) is greater than the cost of inviting another owner into the business (the venture capitalist). The new owner will want dividends and a say in how the company is run. It could be argued that a new

owner might cause problems so that the business is unable to continue normally. For example, Victor might want to retain profit in the business rather than pay it out in dividends. If the venture capitalist wants dividends this could be a source of conflict. Therefore, for this reason, a mortgage might be the best option for Victor.

## CHAPTER 26

### CASE STUDY: PINDUODUO

- How much money did Pinduoduo raise when it first issued the shares?

The amount of money raised by Pinduoduo when the shares were first issued is given by:  
 $86.5 \text{ million} \times \$19 = \mathbf{\$1\ 643\ 500\ 000 \text{ million}}$

- What is Nasdaq?

Nasdaq is a US stock exchange. It is the largest stock exchange in the world.

- Suggest **one** reason why share prices like Pinduoduo's fluctuate.

Share prices are likely to fluctuate according to the performance of the company. For example, if investors think that the company is doing well and will grow in the future, they may buy shares. This will drive up the price. Prices will fall if investors sell when the performance does not live up to expectations. However, a number of other factors can influence share prices.

- Calculate the profit or loss made by Hank Browbobble when he sold his shares in Pinduoduo on 7 November 2018.

The profit/loss made by Hank Browbobble is given by:

Cost of shares when bought =  $500 \times \text{US}\$22.50 = \text{US}\$11,250$

Proceeds from sale of shares  $500 \times \text{US}\$20.72 = \text{US}\$10,360$

Loss on sale =  $\text{US}\$11\ 250 - \text{US}\$10\ 360 = \mathbf{\text{US}\$890}$

### ACTIVITY 1

#### CASE STUDY: UK INVESTORS IN THE FTSE 100

- What percentage of shares in the FTSE 100 are owned by UK shareholders?

According to the chart in Figure 26.2, 56 per cent of FTSE 100 shares are owned by foreign investors. Therefore, 44 per cent must belong to UK shareholders.

- Why do financial institutions buy shares?

Many shares are held by financial institutions. They are often referred to as institutional investors. Financial institutions like insurance companies, pension funds and investment trusts trade in shares to generate a financial return. For example, pension funds, which own 3 per cent of FTSE 100 shares, invest pension contributions made by clients. Some of the money made is used to pay clients a pension in their retirement. These institutions employ financial analysts to investigate the financial position of companies from all over the world. They analyse company accounts and other financial information and make recommendations relating to the buying and selling of shares.

3. What important role does the London Stock Exchange play in the provision of capital for companies?

The stock exchange is where shares, debentures and bonds can be traded by investors. This is the main function of any stock exchange. It is a place where shares and other financial assets can be converted into cash immediately (this is what is meant by a liquid market). If this market did not exist, selling shares would be difficult because buyers and sellers would struggle to communicate with each other. As a result, investors would be less interested in buying shares in companies. This means that companies would find it difficult to raise capital by selling shares in the first place.

## ACTIVITY 2

### CASE STUDY: DIVIDEND YIELDS

1. What is meant by a dividend?

A dividend is the money paid by a company to its shareholders. It is paid from profits and is the reward to shareholders for buying shares. Dividends may be paid either once or twice a year. However, dividends are not guaranteed.

2. Calculate the amount of money a Nishi Ltd investor would receive if he or she owned 5000 shares.

The Nishi investor would receive:

$$5000 \times \text{JPY}42 = \text{JPY}210\ 000$$

3. Calculate the dividend yields for Nishi Ltd and Nuton Engineering.

Dividend yield for Nishi Ltd is given by:

$$\text{JPY}42 \div \text{JPY}2200 \times 100 = \mathbf{1.91 \text{ per cent}}$$

Dividend yield for Nuton Engineering is given by:

$$\text{JPY}160 \div \text{JPY}5400 \times 100 = \mathbf{2.96 \text{ per cent}}$$

4. Which company currently provides the most attractive yield?

According to the calculations in question 3, Nuton Engineering offers the most attractive dividend yield. It offers 2.96 per cent compared to Nishi Ltd, which only offers 1.91 per cent.

### MULTIPLE CHOICE QUESTIONS

1. C   2. B   3. D   4. A

## CHAPTER REVIEW

### CASE STUDY: TCNS CLOTHING IPO

1. What is meant by an IPO?

An initial public offering (IPO) is a method of issuing shares. An IPO is used when a company issues shares for the first time. IPOs may involve the use of a public issue, a sale by tender or an offer for sale. In this case, TCNS Clothing raised about NR1125 crore (US\$163.5 million) in an initial public offering (IPO) in 2018.

2. What is meant by an institutional investor?

An institutional investor is a financial institution. It may be an insurance company, pension fund or investment trust. It buys shares to generate returns for its clients. For example, insurance companies buy shares to generate income so that they can pay compensation to claimants from the insured. Financial institutions are an important investor in stock markets. In this case, 20,728,339 shares in TCNS Clothing were owned by institutional investors in April 2019.

3. What is the difference between a speculator and an investor?

Speculators behave in a slightly different way to other stock market investors. Investors analyse companies in detail. They decide what a company is worth, and what its potential might be. They will not invest in a company unless the share price is significantly below what they consider it to be worth. Investors will buy if, for example, Company X is currently priced at US\$1.60 per share, but is actually worth US\$2.80 per share. Their investment decisions are based on factual data.

Speculators buy shares for any other reason. They buy on the chance that share prices will rise from any cause other than that of its projected fundamental value. They aim to make short-term gains and do not normally hold on to the same share for long periods of time. They try to profit from short-term movements in share prices. Some regard speculators as 'gamblers' because of the added risk they take. However, they do perform an important role. They provide liquidity in the market. This is because their trading activities ensure that shares are always available to buy.

In this case, a speculator buying TCNS shares on 23/10/18 and selling less than a month later on 22/11/18 would have made a capital gain of 27.5 per cent. TCNS shares rose from INR449 to INR700.

4. How do stock markets, like the Bombay Stock Exchange, reflect the health of an economy?

The performance of stock exchanges is said to reflect the health of an economy. If share prices are rising this suggests that an economy is doing well. This is because investors are optimistic about the future of company performance and are therefore happy to buy more shares, which drives up prices. Stock exchange movements are said to be a 'forward indicator' of economic performance. This means that if share prices are moving up now, the economy is likely to prosper in the future.

5. Discuss the difference between dividends and interest.

When companies raise long-term finance, they can do this by issuing shares or borrowing money. If a company decides to issue shares, it will eventually have to pay dividends to shareholders. A dividend is the money paid by a company to its shareholders. It is paid from profits and is the reward to shareholders for buying shares. Dividends may be paid either once or twice a year. However, dividends are not guaranteed. The directors decide each year how much profit to retain and how much to pay in dividends. If losses are made, the payment of dividends is unlikely (although money can be taken from reserves to pay dividends).

The directors might prefer to retain most of the profit in order to finance the future growth of the company. If shareholders are unhappy with the size and frequency of dividend payments, they can express their dissatisfaction by selling their shares. If a lot of shareholders do this the share price will fall. This might make the company vulnerable to a

takeover; if this happens the current directors would probably lose their jobs. Consequently, it is important to keep shareholders 'happy'.

If a company decides to borrow money it may take out a mortgage or sell debentures, for example. If it does this it will have to pay interest to the lenders. Interest is the cost of borrowing money. However, it is also the reward given to savers when they deposit their money in deposit or savings accounts. When firms borrow money, the amount they borrow might be determined by the rate of interest at the time. If interest rates are high, this might discourage firms from borrowing.

The advantage of borrowing money is that once the loan is repaid, any future profits can be enjoyed by the current shareholders. However, if new shares are issued a company is obliged to pay dividends indefinitely. In this case, TCNS Clothing has opted to raise US\$163.5 million by selling over 10 million shares. The interest payments on such a large amount of money (if it had been borrowed) would have reduced profits for several years to come.

## CHAPTER 27

### CASE STUDY: METHODS OF PAYMENT IN A SELECTION OF COUNTRIES

1. In Table 27.1, which country makes most use of **(a)** credit cards and **(b)** debit cards?

- a) It could be assumed that Canada makes most use of credit cards. This is because on average, Canadians own 2.16 credit cards each. This is the highest in the sample.
- b) It could be assumed that Japan makes most use of debit cards. This is because on average, the Japanese own 3.3 debit cards each. This is the highest in the sample.

2. Which country in Table 27.1 makes the most use of cash?

According to Table 27.1, the proportion of transactions using non-cash methods of payment is lowest in Russia. Only 4 per cent of the population uses non-cash methods. Therefore 96 per cent must use cash.

3. What does the graph in Figure 27.1 show?

The graph in Figure 27.1 shows that the number of ATM withdrawals in Sweden has fallen between 2012 and 2016 from around 200 million to just over 120 million. The value of ATM withdrawals has also fallen from 193 billion krona in 2012 to 136 billion krona in 2016. This shows that the Swedes are making less use of cash when making payments.

4. Suggest **one** advantage of using cash for making payments.

One of the main advantages of using cash is that it is legal tender. This means that a creditor must accept cash as a means of payment by law.

**ACTIVITY 1****CASE STUDY: CHEQUES**

1. Name the **(a)** drawer, **(b)** drawee and **(c)** payee.

- a) The drawer is Great Barr Timber Ltd.
- b) The drawee is the North West Bank.
- c) The payee is the Birmingham Post.

2. Describe the **two** mistakes in the cheque.

One mistake is that the amount in words is different to that written in numerals. The amount in words appears to have been rounded-up.

The second mistake is that the cheque has not been signed.

3. What is the purpose of the counterfoil?

The counterfoil, or cheque stub, provides a written record of the payment for the payer.

4. Describe **two** advantages of using cheques as a method of payment.

Using cheques for making payments has a number of advantages. They are a flexible means of payment. This means that they can be written for any amount. Paying by cheque is also more secure. It avoids the need to carry large amounts of cash. Cheques can also be crossed, which means that they must be paid into a bank account.

**ACTIVITY 2****CASE STUDY: HANAPI HOSPITALITY**

1. What is the difference between a standing order and a direct debit?

Both a standing order and a direct debit involve the electronic transfer of money directly from one bank account to another. They require prior arrangement between the buyer and seller in a transaction.

A standing order is normally used to make regular payments of the same amount, such as a loan repayment or a monthly insurance premium. A direct debit is used when the timing of payments and the amounts differ. With a direct debit, it is the recipient who administers the payment. Examples of payments made by direct debit might be utility bills, subscriptions and annual payments. In this case, a standing order is used by Hanapi Hospitality to pay the instalments on a loan taken out for three years.

2. What is meant by a bank giro credit?

A bank giro credit is a document that enables money to be paid into a bank account. Businesses sometimes attach a giro credit slip to statements or invoices sent out to customers. Alternatively, it can be presented at a bank or a post office, in which case the teller will stamp the counterfoil as proof of payment. The system reduces the chance of payments being lost because the slip matches payments to particular invoices and also contains pre-printed details of the payee's bank account. In this case, a bank giro credit is used to pay utility bills. This is a common method of payment for such transactions.

3. Describe **two** advantages of using an electronic transfer to pay employees' wages. Hanapi Hospitality uses an electronic transfer to pay its 76 employees their wages. One advantage of this method is that money is paid directly into employees' bank accounts. This removes the need to count cash and make up 'pay packets'. It is much more efficient. It is also more secure. There is no need to hold large amounts of cash ready to pay workers.
4. Suggest a method of payment that might be used by Cheryl to buy foreign currency. Foreign currency can be purchased in a number of ways. One option is to buy it over the counter at a bank or a post office. However, it is also possible to buy it online. Cheryl could use an electronic transfer or a company debit card to make the purchase online and get it delivered to the company office.

### MULTIPLE CHOICE QUESTIONS

1. C 2. B 3. C 4. A

### CHAPTER REVIEW

#### CASE STUDY: PAYMENT METHODS FOR ECOMMERCE

1. Which method of payment is preferred by online shoppers globally?  
When shopping online, the most preferred method of payment is by credit card. According to the chart in Figure 27.5, more than 50 per cent of global online shoppers use credit cards.
2. What is **one** important difference between debit cards and credit cards?  
Only a credit card can be used to buy goods now and pay for them later. Credit cards allow users to buy goods on credit. Users may get up to 28 days to settle their bills after receiving a monthly statement.
3. Discuss the advantages and disadvantages of credit cards to users.  
Credit cards provide a number of benefits to users. They are a very convenient method of payment because they are portable and flexible. They can be used in a very wide variety of outlets, online and for telephone transactions. They are secure because they avoid the need to carry cash. A key advantage is that users can buy goods now and pay for them at a later date. If the bill is settled within the agreed amount of time, the credit granted by the credit card company is free of interest. Another important advantage is that they are internationally recognised, which means they can be used anywhere in the world. Finally, they provide protection against fraud as credit card companies return the money if goods are not supplied.  
However, there are some disadvantages when using credit cards; one of the main disadvantages is that they may encourage people to spend more money than they have. Also, if the amount owed at the end of the month is not paid within the agreed amount of time, the interest charges can be extremely high. Credit cards are also targets for thieves and they may be used to commit online fraud.
4. In which countries is cash on delivery the preferred method of payment by online shoppers?  
According to the chart in Figure 27.5, cash on delivery is a preferred method of payment in Africa, India and the Middle East. For example, in Africa and India more than 80 per cent of online shoppers use this method of payment.

5. What is **one** possible reason why cash on delivery is preferred in these countries?

Cash on delivery may be preferred in these countries because many shoppers may not have a bank account. Online shoppers in many parts of rural Africa and India may not have access to banks or bank accounts. Consequently, they are not likely to have debit cards or credit cards. The use of cash to make payments may be their only real choice.

## CHAPTER 28

### CASE STUDY: SAFARICOM PLC

1. How much profit did Safaricom make in 2018?

The profit made by Safaricom in 2018 is given by:

Profit = total revenue – total costs

$$= \text{KES}233\,717 \text{ million} - \text{KES}178\,428 \text{ million} = \text{KES}55\,289\,000$$

2. How much profit was retained by the business in 2018?

The profit retained by Safaricom is given by:

Retained profit = total profit – dividends

$$= \text{KES}55\,289\,000 - \text{KES}44\,071\,000 = \text{KES}11\,218\,000$$

3. How might Safaricom use the retained profit?

It is common for businesses like Safaricom to retain a significant proportion of their profit each year. If it is retained, it might be invested in expansion or in the development of new products. Alternatively, it might be held in reserve to meet unexpected payments.

### ACTIVITY 1

#### CASE STUDY: ANDART CEMENT

1. Complete Table 28.2 by calculating, for the three years shown, **(a)** the gross profit and **(b)** the profit for the year (net profit).

The gross profit and net profit figures for the three years are shown in the table below.

|                                  | 2017  | 2018  | 2019  |
|----------------------------------|-------|-------|-------|
| Revenue                          | 208.3 | 218.4 | 233.7 |
| Cost of sales                    | 122.4 | 126.5 | 132.9 |
| Gross profit                     | 85.9  | 91.9  | 100.8 |
| Expenses                         | 34.2  | 36.2  | 39.8  |
| Profit for the year (net profit) | 51.7  | 55.7  | 61    |

2. What is meant by cost of sales? Use examples from this case study to illustrate your answer.

For a manufacturer, the cost of sales would include costs such as raw materials and the wages of factory workers. For a retailer the cost of sales are the cost of buying inventory (stock) for resale. For a service provider such as a taxi service, cost of sales are the costs associated with the actual delivery of the service, like fuel and the driver's wages. Andart is a

cement manufacturer and therefore the cost of sales would include the costs of the raw materials used to make cement. This would be the cost of limestone, silica, alumina, magnesia and other chemicals.

3. Comment on the performance of the business over the three-year period.

According to the calculations shown in the above table, the financial performance of Andart has improved each year over the period. Gross profit has risen from PKR85.9 billion in 2017 to PKR100.8 billion in 2019. Profit for the year (net profit) has also risen – from PKR51.7 billion in 2017 to PKR61 billion in 2019. The owners of Andart would probably be content with this performance. Gross profit has risen by 17.3 per cent and profit for the year (net profit) by 18 per cent.

## ACTIVITY 2

### CASE STUDY: DUKES

1. Calculate the mark-up on the tables.

The profit on each table is SGD90 (SGD390 – SGD300). Therefore the mark-up is:

$$\begin{aligned} \text{Mark-up} &= \frac{\text{profit per item} \times 100}{\text{cost per item}} \\ &= \frac{\text{SGD90} \times 100}{\text{SGD300}} = \mathbf{30 \text{ per cent}} \end{aligned}$$

2. Calculate the gross profit made on the order of 12 tables.

The gross profit on the order is:

$$\begin{aligned} \text{Gross profit} &= \text{revenue} - \text{cost of sales} \\ &= 12 \times \text{SGD390} - 12 \times \text{SGD300} \\ &= \text{SGD4680} - \text{SGD3600} \\ &= \mathbf{\text{SGD1080}} \end{aligned}$$

3. How much would Dukes need to charge if it decided that its mark-up on the tables should be 45 per cent?

If Dukes decided to use a 45 per cent mark-up, the price would be given by:

$$\text{SGD300} + (45\% \times \text{SGD300}) = \text{SGD300} + \text{SGD135} = \mathbf{\text{SGD435}}$$

## MULTIPLE CHOICE QUESTIONS

1. D   2. C   3. C   4. A

## CHAPTER REVIEW

## CASE STUDY: ANDALUSIA KITCHENWARE

1. For each of the stores, calculate (a) the average inventory (b) the inventory turnover.

| Financial information            | Seville   | Jerez   | Cadiz   | Malaga    |
|----------------------------------|-----------|---------|---------|-----------|
| Opening inventory                | 145,900   | 122,340 | 135,900 | 150,200   |
| Closing inventory                | 147,100   | 124,200 | 137,800 | 150,100   |
| Average inventory                | 146,500   | 123,270 | 136,850 | 150,150   |
| Inventory turnover               | 4.57      | 3.85    | 2.99    | 4.53      |
| Total revenue                    | 1,290,000 | 980,000 | 780,000 | 1,460,000 |
| Cost of sales                    | 670,000   | 475,000 | 510,400 | 681,000   |
| Gross profit                     | 620,000   | 505,000 | 269,600 | 779,000   |
| Expenses                         | 430,100   | 350,300 | 273,000 | 390,100   |
| Profit for the year (net profit) | 189,900   | 154,700 | -3,400  | 388,900   |

2. Describe the difference between gross profit and profit for the year (net profit).

Gross profit is the profit made by a business after the cost of sales have been subtracted from total revenue. The profit for the year (net profit) is the amount of money left over after all business costs have been subtracted from total revenue. Profit for the year (net profit) is calculated by subtracting expenses from gross profit. It is often referred to as the 'bottom line' (once tax has been subtracted). Profit for the year belongs to the owners of the business.

3. For each of the stores, calculate (a) the gross profit (b) the profit for the year (net profit).

See table in answer to question 1.

4. Discuss the disadvantages to Andalusia Kitchenware of holding too much inventory.

Holding too much inventory can have a negative impact on a business. For example, if too much inventory is held, a business will incur unnecessary costs. Storage costs may be excessive. Stocks of raw materials, components and finished goods occupy space in buildings. A firm may also have to pay heating, lighting and labour costs if, for example, a security guard is employed to safeguard stores when the business is closed. Some products require very special storage conditions. Food items may need expensive refrigerated storage facilities. A firm may have to insure against fire, theft and other damages. There is also an opportunity cost of holding inventory. Money tied up in inventory earns no rewards. The money used to purchase inventory could have been put to other uses, such as new machinery. This might have earned the business money. Also, the quality of some inventory may deteriorate over time; for example, perishable goods. In addition, if some finished goods are held too long they may become outdated and difficult to sell.

Storing inventory may also incur administrative costs. These include the cost of placing and processing orders, handling costs and the costs of failing to anticipate price increases. Also, if inventories are too high and there is an unexpected reduction in demand, the firm may be left with inventory that it cannot sell. Finally, very large inventories might result in an increase

in theft by employees. They may feel the business would not miss a small amount of inventory relative to the total inventory. If a business like Andalusia Kitchenware holds too much stock its financial performance may suffer. There is some evidence to suggest that this might be happening in the Cadiz store.

5. Assess which store should be closed down or sold off by the Boquete family.

According to the calculations above, the best performing store in 2019 was Malaga. It made a gross profit of €779 000 and a net profit of €388 900. The profit for the year (net profit) was more than double that of Seville, the next best performing store with a net profit of €189 900. The worst performing store in 2019 was Cadiz. It made a loss in 2019 of €3400. Its gross profit was positive but it was exceeded by the level of expenses for the year. This suggests that the Cadiz store was struggling to control its costs.

The Cadiz store also has the lowest inventory turnover. It was only 2.99 – lower than Seville (4.57), Malaga (4.53) and Jerez (3.85). This suggests that the financial performance of the Cadiz store may have been hampered by its high inventory levels. Holding too much stock incurs costs and can therefore have a negative impact on profit.

Based on the information provided it might be argued that the Boquete family should close down or sell off the Cadiz store. This is the worst performing store of the four. However, it may be unwise to make such an important decision based on the financial information from just one year. Perhaps the family should take into account the performances of the stores for several previous years. They might also be advised to inspect a wider range of financial information, such as the amount of money invested in each store.

## CHAPTER 29

### CASE STUDY: TESCO AND SUNIL STORES

1. Which of the businesses made the most profit in 2018?

In 2018, Tesco made a profit of £1.14 billion. In the same year Sunil Stores made a profit of £123 556. Clearly, Tesco has made a bigger profit than Sunil. The size of Tesco's profit is about 10,000 times more than that of Sunil Stores.

2. Which business performed the best in 2018? Explain your answer.

Although Tesco made the largest profit in 2018, it could be argued that Sunil Stores has performed better. This is because it generated more profit as a percentage of sales than Tesco. Tesco's profit was only 1.99 per cent of its revenue. In contrast, Sunil's profit was 7.9 per cent of its revenue. As a percentage therefore, Sunil is able to generate more profit from its revenue than Tesco. However, this is only one measure of performance.

3. What impact might the new Tesco brand, Jack's, have on profitability?

The new brand aims to provide customers with more low-priced products. This might have a negative impact on profitability because Tesco will be charging lower prices. However, it depends on whether Tesco can lower its costs by sourcing cheaper goods to sell.

4. What other information might be helpful to measure commercial performance in this case study?

It might be helpful to know how much money each business used to generate the profits shown in Table 29.1. By this we mean how much money was invested in each of the businesses. For example, businesses that invest large amounts of money are expected to make much bigger returns.

## ACTIVITY 1

## CASE STUDY: IKEA®

1. Calculate **(a)** the gross profit and **(b)** the profit for the year (net profit) for IKEA in 2018 and 2017.
2. Calculate **(a)** the gross profit margin and **(b)** the profit for the year (net profit) margin for IKEA in 2018 and 2017.

See the table below.

| Financial information                   | € million<br>2018 | € million<br>2017 |
|---|-------------------|-------------------|
| Gross profit                            | 4,691             | 4,190             |
| Profit for the year (net profit)        | 1,705             | 1,153             |
| Gross profit margin                     | 18.38%            | 18.31%            |
| Profit for the year (net profit) margin | 6.68%             | 5.04%             |

3. Discuss the financial performance of IKEA in 2017 and 2018.

Between 2017 and 2018, IKEA's financial performance seems to have improved. The company experienced increased revenues, from €22 878 million in 2017 to €25 516 million in 2018. Gross profit also rose from €4190 million to €4691 million. Perhaps the best performance was profit for the year (net profit) which rose by 47.9 per cent from €1,153 million to €1705 million.

Over the two years the gross profit margins were fairly stable at around 18 per cent each year. However, the profit margin for the year (net profit) rose from 5.04 per cent to 6.68 per cent over the two years. Overall, the owners of IKEA would probably be very happy with the financial performance over the two years. There have been improvements all round.

## ACTIVITY 2

## CASE STUDY: BMW

1. Calculate the expenses as a percentage of turnover for BMW for all years between 2015 and 2018.

| Financial information                | 2015  | 2016  | 2017  | 2018  |
|--------------------------------------|-------|-------|-------|-------|
| Expenses as a percentage of turnover | 9.66% | 9.61% | 9.44% | 8.97% |

2. To what extent has BMW managed its expenses over the time period?

BMW appears to have kept a tight control on costs over the four-year time period. Expenses as a percentage of turnover have been just over 9 per cent for several years. In 2018, there was a slight improvement when expenses were only 8.97 per cent of turnover. It appears that managers have grasped the importance of cost control in business and have even managed to stop them rising when revenues were rising. This is a good performance.

3. How might BMW improve the expenses turnover ratio in the future?

Even though the management team at BMW have control over the company's expenses, they might still look for further cost savings. This will help to improve profits and generate greater returns for the shareholders. To improve the expenses turnover ratio in the future the managers might look for ways of reducing expenses; for example, they might look for cheaper providers for insurance, advertising and telecommunications.

### MULTIPLE CHOICE QUESTIONS

1. C 2. A 3. A 4. B

### CHAPTER REVIEW

#### CASE STUDY: CHERAS MEDICAL SUPPLIES

- Calculate the profit for the year (net profit) margins for Cheras Medical Supplies for the years 2016–2019.
- Calculate the expenses as a percentage of turnover for the years 2016–2019.
- Calculate the ROCE for the years 2016–2019.

See table below.

| Financial information                   | 2016   | 2017   | 2018   | 2019   |
|---|--------|--------|--------|--------|
| Profit for the year (net profit) margin | 14.06% | 14.70% | 15.08% | 11.58% |
| Expenses as a percentage of turnover    | 29.78% | 29.75% | 29.11% | 39.04% |
| ROCE                                    | 12.72% | 13.96% | 15.78% | 10.22% |

4. Discuss the performance of Cheras Medical Supplies over the time period.

Between 2016 and 2018 the commercial performance of Cheras Medical Supplies was strong. For example, the profit for the year (net profit) margin was between 14 and 15 per cent. This is considered a very healthy margin by businesspeople in general. During the same time period the management team kept expenses under control. Expenses as a percentage of turnover were below 30 per cent for all three years. Most impressive of all is the improvement in ROCE from 12.72 per cent to 15.78 per cent over the three years. This is a good return on capital employed and considerably higher than the current rate of interest in Malaysia. This was 3.25 per cent in 2019 according to the graph in Figure 29.1.

However, in 2019 the performance of the company suffered a blow. Expenses as a percentage of turnover rose, the profit for the year (net profit) margin fell and the ROCE fell. The falls were quite significant. For example, the ROCE fell by around 50 per cent from 15.78 per cent to 10.22 per cent. The owners of Cheras Medical Supplies would probably be worried by such a deterioration in performance.

5. To what extent can the performance of Cheras Medical Supplies be attributed to the management team?

The decline in commercial performance at Cheras Medical Supplies is significant. It is almost certainly due to an external factor. In 2019, the company encountered a setback when a Chinese competitor entered the Malaysian market. The aggressive new competitor started to have an impact on the performance of Cheras. The rival was offering many products at low prices in order to break into the market. It could be argued that the current management

team could not be blamed for the dip in financial performance. They have no control on how competitors behave.

However, it will be important that managers react appropriately to the threat posed by the Chinese rival over the next few months and years. The company cannot afford to do nothing. It will have to come up with a strategy to deal with the threat. For example, Cheras might reduce its prices or emphasise any strengths that it has as a business to retain customers. How good the managers are will be tested over the coming years.

## CHAPTER 30

### CASE STUDY: QUANZHOU FROZEN FOOD

1. Calculate the percentage decline in sales over the six-month period.

Monthly sales turnover has fallen from CNY10.42 million to CNY8.63 million in the last six months. The percentage decline is:

$$\frac{\text{CNY}10.42 \text{ million} - \text{CNY}8.63 \text{ million}}{\text{CNY}10.42 \text{ million}} \times 100 = \frac{\text{CNY}1.79 \text{ million}}{\text{CNY}10.42 \text{ million}} \times 100 = \mathbf{17.18 \text{ per cent}}$$

2. How might Cao Wei spend the CNY1 million to improve sales turnover?

Cao Wei, the sales manager, has been given a budget of CNY1 000 000 to help boost sales turnover. Some of the money might be spent on an advertising campaign. Some of the money might also be spent on special sales promotions. For example, customers might be offered free produce if their orders reach a certain level. This might encourage customers to place larger orders. However, the company needs to do something about the customers that have left Quanzhou Frozen Food. It might be difficult to get them back but the company could contact them individually (the hotels, restaurants and retailers) and offer them some rewards – free produce or special terms, for example.

3. How might Quanzhou Frozen Food diversify?

Quanzhou Frozen Food is a wholesaler. It could diversify by going into retailing. It could perhaps open some stores selling frozen food in the Fujian region. It might also consider selling online direct to individual customers. However, both of these options are likely to require sizable investment. Another option might be to use its existing distribution network to deliver other products; the company could distribute fresh produce such as fruits, vegetables, meats, fish and seafood. This operation might be easier to set up because the company already has distribution capabilities.

4. How might lowering the price increase sales turnover at Quanzhou Frozen Food?

When a company lowers the price of its product it would expect demand to rise. The increase in demand will increase sales turnover. However, the success of this option depends on how sensitive demand is to changes in price. Price cuts are most likely to work if customers can switch easily from one supplier to another. It seems here that Quanzhou Frozen Food is losing customers rapidly because new rivals are cheaper. Customers have already changed suppliers so switching does seem to be easy. However, if Quanzhou is operating on slim margins, price cuts might be risky. It might end up losing money on sales if it cuts prices too much. Perhaps Quanzhou needs to find cheaper suppliers itself.

**ACTIVITY 1****CASE STUDY: ALLBIRDS**

1. How does Allbirds keep its purchasing costs low?

Allbirds has kept purchasing costs low by using recycled materials. It uses sheeps' wool, recycled cardboard, and plastic and castor bean oil to make footwear. Recycled cardboard and plastic will be cheap because it has been discarded by the original user. There may be recycling costs such as collection and processing, but overall the materials will be cheaper because they do not have to be manufactured.

Allbirds also keeps its purchasing costs low by using less energy: it uses 60 per cent less energy than rivals that use synthetic materials to make footwear. This will help to keep prices lower and give Allbirds a competitive edge in the market.

2. How might Allbirds' approach to production help the marketing of the footwear?

Allbirds is an ethical company. It uses sustainable materials such as wool and ensures that the livestock (sheep) are well looked after. It also uses recycled materials and saves energy in its production methods. Allbirds could exploit this approach by targeting its marketing at ethical customers – people who care about the environment and animal welfare. The company may be able to charge higher prices for its products because ethical consumers are often happy to pay more for products produced in this way.

3. How might Allbirds improve its commercial performance by developing its product range?

A business can improve its commercial performance by increasing sales turnover. One way to do this is to extend the product range. Allbirds may have done this already. It may produce different styles of footwear. It may also produce footwear for different consumer groups such as women, men, teenagers and toddlers. In the future it may develop its product range by using its production methods to produce slightly different products such as handbags, belts and other accessories.

**ACTIVITY 2****CASE STUDY: OFFICE RENT**

1. How much would a business save per year if it moved its office (2500 square metres) from London West End to Brussels?

The annual cost of office rent in London West End is  $2,500 \times \text{€}1260 = \text{€}3\,150\,000$ .

The annual cost of office rent in Brussels is  $2,500 \times \text{€}320 = \text{€}800\,000$ .

Therefore, a business would save **€2 350 000** ( $\text{€}3\,150\,000 - \text{€}800\,000$ ) per year by moving its office from London to Brussels.

2. In recent years, in some countries, rents for shops and other retail outlets have fallen. Describe **one** possible reason for this fall in retail rents.

Reducing rent is a way to lower costs and improve commercial performance. Retailers operating from shops and stores have been hit by fierce competition from online sellers recently. Their sales have dwindled and their margins been 'squeezed'. Consequently, many have closed down and others are under serious threat. To help the remaining high street retailers survive, some have been able to negotiate lower rents with their landlords. It could be argued that landlords had little choice but to lower rents as they may otherwise have lost important tenants.

3. How might businesses reduce expenses by using more IT in administration?

A business might reduce expenses by making more use of IT in administration. Although the initial cost of purchasing IT can be high, in the long term IT can lower costs. For example, with many IT systems it is possible to go paperless. Managing paper is time-consuming and expensive. Sorting, filing and finding files requires secretarial/clerical time and space. IT systems allow businesses to digitise papers and keep them in electronic files to save space and administrative costs. Also, the use of IT in communications and administration is generally more efficient.

### MULTIPLE CHOICE QUESTIONS

1. A 2. B 3. D 4. B

### CHAPTER REVIEW

#### CASE STUDY: A/C FOSSE

1. What evidence is there to suggest that expenses have risen in 2018 and 2019?

According to Figure 30.4 the profit for the year (net profit) margin fell quite sharply from 9.1 per cent in 2017 to 4.3 per cent in 2018 and then again to 3.6 per cent in 2019. A fall in the net profit margin is likely to be caused by higher expenses (if the gross margin is stable). It could be the result of falling revenue, but there is no evidence of falling revenue in this case. There is, however, some evidence of rising expenses. The key shareholders in the company think that the senior management team has lost control of overheads. There is particular concern over the amount spent by senior managers on entertainment and business travel.

2. Has there been any significant increase in cost of sales? Explain your answer.

According to the graph in Figure 30.3, the gross profit margin has been fairly stable over the time period. The margin has been steady at about 34 to 35 per cent every year. This suggests that the cost of sales has not increased at a faster rate than turnover. It can therefore be concluded that raw materials and components for A/C Fosse have been purchased at roughly the same rates over the last five years.

3. Describe **two** possible ways in which A/C Fosse might improve its performance by increasing sales turnover.

Any business can improve its commercial performance by increasing sales turnover. There are a number of ways a business can achieve this. One of the easiest ways is to charge higher prices. For example, if a media company raises the price of its newspapers by 5 per cent, it might expect its sales turnover to rise by about 5 per cent. However when prices rise, demand is likely to fall. Businesses will have to be careful when using this approach. If demand is very sensitive to price changes, an increase in price might result in lower revenue. This is because customers react by finding alternatives. Raising price is a method best used when there are limited substitutes for a product. A/C Fosse would have to consider the level of competition in the market before adopting this strategy.

Another option might be to improve both its products and the quality of its customer service. If businesses can improve the quality and appeal of their products, they are likely to increase their sales turnover while their rivals miss out. Businesses often make product improvements after getting feedback from customers. Keeping in touch with the changing needs and wants

of customers is important. If businesses can adapt their products quickly after noticing a new trend in customer feedback, they may be able to increase revenue. For example, A/C Fosse may be able to modify its A/C units to make them more efficient, easier to control, less noticeable or less noisy.

4. Discuss how A/C Fosse might reduce entertainment and travel expenses.

Escalating expenses can have a negative impact on a firm's commercial performance. In this case study, there is a suggestion that A/C Fosse spends too much on entertainment and travel.

A/C Fosse may be able to take a number of measures to cut travel costs. For example, it may eliminate travel by replacing trips with phone calls, emails and video meetings, wherever possible. It may plan ahead to avoid last-minute trips with high transport costs. A/C Fosse could look more carefully at staff expense claims to minimise or eliminate spending. It should insist that staff stay in business hotels rather than luxury hotels. It might also insist that everyone who travels should be a member of the loyalty group sponsored by that hotel to gain discounts and free nights. Finally, the company might use a single car rental provider with whom a cheap rate has been negotiated and encourage staff to use taxis instead of renting a car when they are staying in cities. All of these measures may help to reduce expenses at A/C Fosse.

5. Assess whether A/C Fosse would benefit from the introduction of just-in-time production.

There seems to be some concern about the inventory turnover at A/C Fosse. It fell sharply in 2018 and 2019 and the storerooms appear to be over-full with both inventories of components and finished A/C units ready for sale. To reduce inventory holdings and improve the inventory turnover, A/C Fosse could consider the introduction of just-in-time production. This means that a business does not hold any stocks of raw materials or components. Suppliers have to deliver resources straight to the production line at regular intervals. This might be several times a day. It also means that A/C Fosse does not produce any goods unless they have been ordered. This avoids the need to hold stocks of finished goods; with this approach, inventory turnover would rise. This means that cashflow would improve, there would be more space in the factory, stock-holding costs would fall, there would be fewer suppliers to deal with and there would be less risk of damaged and spoiled stock.

However, A/C Fosse would have to consider the disadvantages. The company would become very dependent upon the reliability of suppliers. It would be at risk of a break in supply and ordering costs would probably rise. It might also be difficult to cope with fluctuations in demand if there are no stocks of finished A/C units. The company might also lose some of the benefits of bulk-buying. The managers would have to consider whether the advantages outweigh the disadvantages for adopting this new approach to production.

**EXAM PRACTICE: 3 FINANCE FOR COMMERCE**

- (a) C A mortgage is a long-term source of finance.
- (b) A A dividend is the reward for holding shares.
- (c) Gross profit is the difference between sales revenue and the cost of sales.  $\text{Gross profit} = \text{sales revenue} - \text{cost of sales}$ .
- (d) A standing order is a method of payment using a bank account. The same amount of money is transferred on a regular basis (every month, perhaps) to a vendor. It may be used to pay the instalments when repaying a loan for example.
- (e) (i) Ceylon Tea Services is likely to use share capital as a long-term source of finance because it is a public limited company.
- (ii) Ceylon Tea Services may use a commercial bank so that it can make payments to suppliers and employees, and receive payments from customers.
- (f) In this case, identify one trend for the first mark and then a mark each for two development points.

One trend in banking is the growth in mobile banking. (1) Mobile banking is very convenient for bank customers because they can conduct financial transactions without having to visit their bank using a mobile device such as a smartphone or tablet. (1) It is also convenient because customers can make transactions at any time of the day, outside of bank opening hours. (1)

- (g) In this case, identify one advantage for the first mark and then a mark each for two development points. Three examples here:
- (i) One advantage of leasing is that a business can pay to use an expensive item of equipment without having to spend a large amount of money to buy it. (1) This means that the business does not have to tie up cash in an expensive machine (1) and can instead spend the cash on other aspects of the business, such as advertising. (1)
- (ii) One advantage of leasing is that maintenance and repair costs are not the responsibility of the user. (1) This means that the business can plan for regular and predictable lease payments (1) and does not have to worry about large unexpected repair bills. (1)
- (iii) One advantage of leasing is that lease hire companies can offer the most up-to-date equipment. (1) This means that a business can make use of modern machinery, which will help make the business more efficient (1) and the business is not left with out-of-date machinery it can no longer use or sell. (1)
- (h) This answer analyses two impacts:
- A falling inventory turnover means that CTS is selling its tea more slowly. One impact will be on its cashflow as it takes longer to turn the stocks of tea into cash. (Impact 1) Cash inflows will be reduced (DP1) and CTS may need to use overdraft facilities with its bank to cover outflows (DP2) such as paying its staff, to pay the tea plantations and to pay for the special storage facilities required to keep the tea at the right temperature.

A second impact of falling inventory turnover might mean that CTS has to lower its prices (Impact 2) in order to shift the tea so that some cash can be generated (DP3) and so that the company is not left with tea which is too old to sell. (DP4) This will mean that margins are squeezed (DP5) and cause the profitability of the business to fall.

## THEME 4 ANSWERS

## CHAPTER 31

## CASE STUDY: HENSON MEDIA PLC

1. Identify (a) the sender, (b) the receiver(s) and (c) the message in the internal email.
  - a) The sender is Deepika Mendis.
  - b) The receiver is Celia.
  - c) The message is a simple request for some information. Deepika needs a copy of a sales report written by Celia for the marketing manager.

2. Describe **one** advantage and **one** disadvantage of holding a business meeting.

One of the advantages of holding a business meeting is that more ideas can be generated. When people start discussing an issue or solving a problem, for example, it is easier to generate a wide range of ideas when there are more contributors. Also, people often 'bounce ideas off each other' when in discussion.

One disadvantage is that some people are happy to sit quietly and make no contribution to the meeting. They may lack confidence or they may not be interested. Consequently, their time is being wasted and their contribution (or lack of it) may be resented by other members of the group. This might result in conflict or the demotivation of some staff.

## ACTIVITY 1

## CASE STUDY: ELMART

1. Who is the sender of the information in this example?

The sender is Roberto Navarro.

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 in the organisational structure.

3. What sort of information is being sent in this example?

Some financial information is being sent in this example. Table 31.1 contains financial information about the performance of the stores in May 2019. The table has been sent to the finance director who is compiling 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 alert them to 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: MEETING AGENDA**

1. What is the purpose of an agenda?

Agendas are a very specific method of written communication. An agenda is a list of topics that will be discussed at a meeting. Agendas also give details of when and where the meetings take place and who attends. For example, the meeting in this case will take place on 20th May at 9.30 am in the Board Room. Listing the topics for discussion will make for a more orderly and efficient meeting. Some agendas, as in this case, allocate a specific amount of time for each item listed. Agendas also help people to prepare for a meeting. They can think about their views on agenda items and perhaps prepare some arguments that they may want to make during the meeting.

2. Who will lead the meeting in this case study?

Caroline Fleet will lead the meeting. She is the Chairperson. However, other people might be asked to lead for some items on the agenda. For example, Tim Wang will lead the discussion on the new moulding machine for the Production Department.

3. Discuss the advantages and disadvantages of meetings as a form of communication.

Few businesses operate without using meetings to communicate. Meetings allow groups of employees (members of the Production Department) to exchange information, share ideas, solve problems and inform others of new developments. Meetings are often used to make important decisions. This may be because a decision can be made together, with the group acting like a democracy.

One of the main advantages of meetings is that more ideas are likely to be generated. It is also likely that people at different hierarchical levels in the business will meet. This provides opportunities for the exchange of views that might not be expressed in other forms of communication. Employees may feel that their views are being considered if meetings are held. It is also possible to get support from colleagues when giving views and exchanging ideas.

However, meetings can be costly because work has to be set aside while the meeting takes place. They can also be time-consuming because people often get distracted from the real issues and conversations can drift from the agenda. They may also be disrupted if, for example, one person is late or one person tries to dominate the meeting; some participants may not prepare for meetings or may sit and let others do all the work.

4. Why might Solomon Plastics benefit from taking minutes at meetings?

Meeting minutes provide a written record of what was discussed and decided in a meeting, what actions must be taken, who must take them and when. Taking the minutes at a meeting is a responsible task and is best undertaken by someone who is capable of recording all of the important details clearly and concisely. Meeting minutes are usually written up soon after the meeting and made available to both the participants and other interested parties. With good meeting minutes, everyone will know what was decided and what needs to be achieved by what date. This will be of benefit to the members of the Production Department at Solomon Plastics.

Failing to take minutes can cost time and money. This is most likely to happen if people who attended the meeting have different memories of what was agreed, which might lead to disagreements and confusion when decisions made at the meeting are put into practice. Taking minutes can help to prevent this from happening.

**MULTIPLE CHOICE QUESTIONS**

1. A    2. C    3. B    4. B

**CHAPTER REVIEW****CASE STUDY: COMMUNICATION AT LANE COVE INSURANCE**

1. Why might Mali use face-to-face communication with Jake Collins but also follow up with a formal letter?

Jake Collins is to be promoted. This sort of news is probably best given using face-to-face communication. This is because it is an opportunity for the company to congratulate a member of staff for their success. Face-to-face communication would be used as a matter of courtesy and to serve as a means of motivation. However, the promotion also needs to be recorded formally because it involves terms and conditions of employment (pay and holiday). The new terms would need to be made 'official' because Jake's contract of employment would be affected. Therefore, the details of the promotion would probably be clarified in a formal letter.

2. What method of communication might be used to deal with the customer whose account is overdue?

Mali might use the telephone to speak to the customer about their overdue account. If it is overdue the customer has probably already received written reminders and still failed to pay. Mali may be able to put a little more pressure on the customer by speaking directly to the person responsible for making the payment. She can also discuss the urgency of the matter and use her tone of voice to place emphasis on the importance of the issue. She may be able to get a verbal commitment to pay the bill by a certain time.

3. Why might a meeting be necessary to discuss the advertising budget?

Mali is due to attend a meeting with the head of marketing, the managing director and the financial controller, to discuss the size of next year's advertising budget. A meeting might be necessary to get the views of each important member of staff. There may be some debate and negotiation needed. For example, the head of marketing is likely to want a larger budget for advertising than might be affordable. This is likely to be an important expenditure decision for the company and the views of all those involved in the decision will have to be expressed and justified. A face-to-face meeting would be the best way to make this decision.

4. Discuss the advantages and disadvantages of using email as a method of communication.

Email is one of the most common methods of electronic communication. It allows businesses and individuals to communicate by sending text or images instantly via a computer. A wide variety of detailed data can be attached to emails, such as images, plans, reports, photographs, video clips and detailed documents like accounts and graphs. It is also very easy to forward messages to other people and copy emails. Finally, many employees have their email open all the time while they are at work so they will be notified the second a new email arrives. This means that all stakeholders can constantly keep in touch.

However, one problem with emails is that they might get ignored. People at work often get so many emails that they do not have the time or the motivation to read and answer every single message. There is also the risk that emails have been infected with a virus introduced by a hacker.

In this case, Mali is going to use email to communicate with the sales team. She wants updates on the sales figures from each member. This is an appropriate method of communication for this type of request. Sales reps will be able to reply wherever they might be using a mobile device.

5. Discuss why effective communication is important in business.

If internal communication is poor, problems can arise. As a result, efficiency and profitability may suffer. Poor communication can lead to mistakes, wasted resources and confusion. It can also lead to workers having poor motivation and not understanding what they have to do. 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 sudden large increase in online orders. These may have to be accepted at a loss. Poor communication with outsiders could also damage the image of the company.

Poor communication may result in higher costs or lost business. For example, if there is a misunderstanding between Lane Cove and a client, the client might be underinsured. This could lead to problems in the future if a claim is made. The client might not receive what they were expecting from the claim.

Poor communication might also slow down decision-making in a business; if information takes too long to reach its destination, there may be a delay in making decisions. This could result in the loss of an opportunity for Lane Cove Insurance. For example, if important information about a takeover target was late arriving, Lane Cove Insurance might miss out on the opportunity to buy the company at an affordable price.

Finally, poor communication can often lead to staff demotivation; if important information is withheld from staff, or if it is inaccurate, employees may not be able to do their jobs properly. This can be very frustrating and lead to staff losing interest. Therefore, effective communication can avoid a wide range of problems in business. Businesses should ensure that their communication systems are well defined, understood by all stakeholders and efficient at all times.

## CHAPTER 32

### CASE STUDY: QUEUES AT AUSTRALIAN PORTS

1. What form of transport was being used in this case study?

Sea transport.

2. What is causing the queues of ships?

The queues were partly the result of maintenance work. One of the ship loaders at DBCT was initially planned to have maintenance from 8th July to early August. However, the deadline was later extended for a week until 14th August. The delays were also made worse by rail disruption caused by maintenance work on a line serving the DBCT.

3. What were **two** effects of the delays?

The delays worried Asian buyers as the price of coal rose from AUD173 per tonne to AUD185 per tonne in just a few weeks. The delays increased costs in a shipping sector already operating on tight margins. Charterers of capesize ships – the largest bulk dry cargo carriers – faced paying an extra US\$1 million per vessel, assuming a 45-day wait. Also, ship owners with ships stuck in the queues missed out twice. They were unable to hire out their vessels at the higher rates that the congestion caused.

4. How might the delays impact on Chinese businesses?

The delays to coal supplies from Australia could have had an impact on Chinese businesses. For example, steel makers in China may have had to halt production if they couldn't get the coal needed to make steel. This may have resulted in idle resources such as labour and machinery. It might also mean that steel producers could not meet demand from customers. As a result, customers might have bought steel from another source. Other Chinese businesses that rely on coal coming from Australia might have had similar problems.

### ACTIVITY 1

#### CASE STUDY: ROAD INVESTMENT IN VIETNAM

1. What are **two** advantages of road transport?

One of the main advantages of road transport is flexibility. Goods can be transported door-to-door between any two destinations at any time. Routes are not fixed and a wide range of goods can be carried. It is also suitable for multi-drop journeys. Another advantage is that a wide range of different modes of transport can use roads, including cars, vans, buses, trams, LGVs, HGVs, cycles and motorcycles. No other form of transport can accommodate such a wide range of transport modes.

2. Describe **one** benefit to commerce of the planned investment in roads by the Vietnamese government.

The Vietnamese government said it would invest US\$921 million in the redevelopment of infrastructure starting in 2018. One of the first projects announced was a new 250 km road network. This will help to improve the competitiveness of Vietnamese commercial enterprises because it will be easier and cheaper to transport goods around the country. According to the 2016–2017 World Economic Forum Global Competitiveness Report, Vietnam was classified as 79th out of 138 different countries for its infrastructure quality and 89th for the level of its roads. The investment in the road network should help to improve Vietnam's ranking.

3. Describe the impact that road transport is said to have on the environment.

One of the major disadvantages of road transport is the damage it causes to the environment. It is argued that the emissions from vehicles, such as HGVs, LGVs and vans involved in the transportation of goods, contribute to global warming and climate change. Emissions can also damage the health of people who live near roads or walk along the pavement next to traffic.

### ACTIVITY 2

#### CASE STUDY: AIR TRANSPORT

1. Calculate the percentage increase in passengers carried between 1980 and 2017.

The percentage increase in passenger traffic between 1980 and 2017 is given by:

$$\frac{3.979 \text{ billion} - 0.642 \text{ billion}}{0.642 \text{ billion}} \times 100 = \frac{3.337 \text{ billion}}{0.642 \text{ billion}} \times 100 = \mathbf{520 \text{ per cent}}$$

2. What might be **two** reasons for the pattern shown in Figure 32.4?

The number of passengers travelling by air increased by 520 per cent between 1980 and 2017. This is a huge increase. One reason for the increase is probably because the cost of flying between countries has fallen. Air fares have fallen due to lower prices for aviation fuel and improvements in aviation technology; this has helped to lower operating costs and improve the efficiency of aircraft. There is also increased competition in the industry – particularly from a number of new entrants operating as ‘budget’ airlines. For example, in India, airlines such as Kingfisher, Indigo and GoAir have emerged since 2005 and all offer cheap air travel.

Another possible reason for the increase is the rise in incomes experienced by many people around the world. For example, increased income in countries such as India, China, Brazil, Mexico and other rapidly developing nations have made air travel more affordable.

3. Describe the advantages of air transport.

The main advantage of air transport is speed. Planes take the shortest routes and there are no physical barriers like mountains and forests. Also, as with sea travel, there is no need for investment in the construction and maintenance of network infrastructure – airways are free (although permission is needed to fly over countries). Air transport is most likely to be used for carrying small, lightweight, valuable, perishable and urgently needed goods. Finally, air transport might be used in large countries where people might not be connected effectively by road or rail networks; for example, in Australia light aircraft are used to deliver light goods to communities living in the outback. Other forms of transport may not be viable in these situations.

### MULTIPLE CHOICE QUESTIONS

1. D 2. A 3. B 4. C

### CHAPTER REVIEW

#### CASE STUDY: LOGISTICS IN INDIA

1. What is **one** advantage of using inland waterways as a form of transport?

Inland waterways include canals, rivers and large lakes. In countries such as Bangladesh, China, Vietnam, Thailand and Indonesia, inland waterways play a vital role in the economic development of remote rural areas and in the welfare of the communities that live there. These are often among the lowest of low-income groups. Without transport along inland waterways, many remote and underprivileged communities would be inaccessible and denied the supply of vital goods.

2. Why did the Indian government invest in Sagarmala?

The Indian government recognised that the nation’s transport structure was holding back economic development. For example, India was ranked 35th in the World Bank’s Logistics Performance Index. This is relatively poor and reflects the low efficiency of trade logistics in India compared to many of its trading partners. The government therefore announced significant investment plans to improve the nation’s transport networks. One of the important programmes announced was Sagarmala.

3. What are the possible benefits to India of Sagarmala?

Sagarmala should generally improve the country's transport infrastructure and make it easier and quicker to ship goods in and out of the country. Transport costs are currently high in India – 18 per cent of GDP, compared to less than 10 per cent in China. Sagarmala should help to reduce these costs. Sagarmala will increase the capacity of ports through modernisation and the addition of new ports. It should improve transport links between ports and the rail network, develop freight-friendly expressways and make more use of inland waterways. It is also creating 14 coastal economic zones (CEZ) and a special economic zone in Mumbai with manufacturing clusters to encourage port-led industrialisation. Finally, Sagarmala will help to develop the skills of fishermen and other coastal and island communities. This has led to expectations that Sagarmala could boost India's physical exports to US\$110 billion by 2025 and create an estimated 10 million new jobs.

4. Discuss the advantages and disadvantages of sea transport.

One of the main advantages of sea travel is that the cost of using oceans and seas is zero. It is not necessary to build a network, as with rail and road transport. Also, over two-thirds of the planet is covered in sea water so the possibility for sea travel is huge. Sea transport is also very cheap per mile – particularly for heavy and bulky goods such as oil, coal and grain – so very large quantities of produce can be carried cost effectively. In addition, the sea does not require maintenance like railways and roads. This helps to keep costs down. A final advantage is that it is an environmentally friendly form of transport – particularly when compared to air travel, which consumes great quantities of fossil fuel.

However, sea transport does have some drawbacks. It is very slow and it can take weeks or months to carry goods from one country to another. Sea travel is therefore unsuitable for urgent deliveries such as medical supplies. Cargos are prone to damage at sea due to the long amount of time needed for transportation and the possibility of storms at sea, which can also cause delays to deliveries. Land-locked countries are also inaccessible by sea.

5. Discuss the importance of transport in the chain of distribution.

Transport plays a very important role in the chain of distribution. It is used to carry raw materials from mines to distribution centres, components from suppliers to assembly plants and finished goods to wholesalers. It is also used to transport goods to retailers and, increasingly, from fulfilment centres direct to consumers in the case of online orders. Many businesses sell goods in markets all over the world. International transport networks are obviously important for exporters. Transportation also encourages specialisation in business. This is because countries can specialise in the production of those goods in which they are most efficient and then transport output all over the world. This specialisation has global benefits because consumers can buy cheap goods.

Transport is also needed in commerce to move people. Huge numbers of people are transported every day all over the world. Businesses benefit from this movement of people. For example, every day people are transported to and from work. Transport networks allow businesses to recruit workers from distant locations. This gives businesses more choice when recruiting workers. Transport systems also carry consumers, allowing them to visit shops and stores which are located in towns and cities away from their homes. People are also transported to restaurants, cinemas, sports stadiums, holiday destinations and to visit friends and relatives. The large-scale movement of people helps to boost the revenues of businesses.

Transport has made a significant contribution to globalisation. International transport networks have improved significantly in recent years. In particular, the cost of flying has fallen and the number of flights and destinations has increased. This means that people can travel to business meetings more easily and goods can be transported more cheaply.

Finally, the transport and logistics industry provides employment for large numbers of people all over the world. The industry makes a significant contribution to national income and helps to generate income and wealth for people. For example, in the USA around 13 million people are employed in transport and transport-related industries. Few could exaggerate the importance of transportation in our modern, globalised world.

## CHAPTER 33

### CASE STUDY: MODES OF TRANSPORT

1. What mode of transport might be used in each of the examples in the case study?

An oil tanker might be used to transport oil from a refinery to an overseas customer.

A passenger aircraft might be used to transport business managers to an overseas meeting.

Delivery vans might be used to transport online orders from a warehouse to individuals.

A passenger train might be used to transport thousands of commuters to a city office.

2. Give reasons for your answer to question 1.

Oil tankers are specialist vessels designed to carry very large quantities of oil overseas.

A passenger aircraft might be used to transport business managers to an overseas meeting because it can transport people very quickly from one country to another.

Delivery vans might be used to transport online orders from a warehouse to individuals because they are a flexible form of transport. They can transport goods (parcels) from door-to-door.

A passenger train might be used to transport thousands of commuters to a city office because they can transport large numbers of people very quickly by rail. They avoid traffic and provide a comfortable ride.

3. Describe **two** factors that would be important in commerce when choosing a suitable mode of transport.

Businesses want supplies to be delivered quickly. They will not want to hold up production while they wait for key materials or components. Breaks in production can be very expensive because resources, such as labour and machinery, will be idle while production is 'down'. Businesses also need to offer their customers a speedy delivery service; customers may switch suppliers if they are kept waiting. Some forms of transport are known for being slow – sea transport and the use of inland waterways, for example. Air transport is very fast over long distances, but expensive.

The situation is also important. Different modes of transport will be selected for different situations, as this case study shows. Oil tankers are specialist vessels designed to carry very large quantities of oil overseas. A passenger aircraft might be used to transport business managers to an overseas meeting because it can transport people very quickly from one country to another. Delivery vans might be used to transport online orders from a warehouse to individuals because they are a flexible form of transport; they can transport goods (parcels) from door-to-door.

**ACTIVITY 1****CASE STUDY: ROAD TRANSPORT**

1. What is **one** possible reason for the pattern shown by the graph in Figure 33.1?

The graph in Figure 33.1 shows that the amount of freight carried by road in the UK has been constant over the time period. However, in both India and China the amount of freight carried by road has risen considerably – particularly in China. This may be because the UK is at a different stage of economic development to India and China. Both India and China have rapidly developing economies. The output produced in these countries is currently rising very fast; therefore, each year the amount transported by road increases. It may also be due to the government investment in road infrastructure, which has made road transport more efficient.

2. What is **one** possible reason for the pattern shown by the graph in Figure 33.2?

The graph in Figure 33.2 shows that the number of vans in the UK has increased from 3.6 million to 4 million. This might be because of the boom in online shopping. Goods bought by online shoppers are often delivered by van. Vans are used to transport orders from fulfilment centres (warehouses) to individual customers.

3. Describe the role played by delivery vans in transport.

Delivery vans are one of the most common modes of transport used to carry goods all over the world. They come in many different sizes. Most are used to carry small quantities of fairly light goods. They are often used by wholesalers and retailers to deliver orders to customers. Vans are also used by tradespeople such as carpenters, mechanics, plumbers, gardeners, builders and electricians, to carry tools, equipment and parts when travelling to jobs. Finally, vans are used by couriers to carry small parcels and other light goods for B2B trade.

**ACTIVITY 2****CASE STUDY: CONTAINERISATION**

1. Which port handled the most freight in 2017?

The port of Shanghai, China, handled the most freight in 2017. It handled 40,343,000 units. This was up 144 per cent from 2008.

2. What is **one** possible reason why so many of the fastest growing ports are located in China?

Five of the fastest growing ports in the list are based in China. China produces a lot of manufactured goods that are exported to other parts of the world. China is currently one of the world's largest manufacturing centres. The ports are needed to handle the transportation of goods by container ship.

3. Describe **two** reasons why shipping costs have fallen since containerisation.

Shipping costs have fallen considerably since the development of containerisation. The use of containers allows carriers to exploit economies of scale. The rapid increase in the capacity of container ships, for example, has significantly reduced the cost per tonne of transportation by sea. Containerisation also reduces the need to employ thousands of dock workers. For example, in 1965 dock labour could load 1.7 tonnes of cargo per hour onto a ship. By 1970, with the use of containers, 30 tonnes per hour could be loaded. This has resulted in huge increases in the efficiency of transportation and cost savings in shipping.

4. Why do around 30 per cent of container ships travel empty?

Many container ships run empty. This is because of the differences in international trade. For example, China exports far more manufactured goods than it imports. Therefore many ships go out full but return to China empty.

### MULTIPLE CHOICE QUESTIONS

1. B 2. C 3. D 4. A

### CHAPTER REVIEW

#### CASE STUDY: HYDERABAD HAULAGE

1. What is the difference between a container ship and a cargo liner?

A container ship is a specialist vessel designed to carry large metal containers that can be loaded and unloaded automatically from trains or container lorries. Since the introduction of containerisation in 1968 the size and capacity of container ships has grown. The capacity has risen from 500–800 containers to 18,000–21,000. The length of container ships has doubled but speeds have peaked to an average of 20 to 25 knots. However, many of the ports around the world are not big enough to accommodate the largest container ships. Therefore, the use of the very largest ships is limited. Hyderabad Haulage transports containers for its customers from Hyderabad to Chennai.

The importance of cargo liners has decreased since the development of containerisation. Cargo liners, also known as passenger cargo-ships, carry both cargo and passengers. The ship's holds are adapted to accommodate different types of cargo. For example, they may have refrigerator space for frozen meats or chilled fruit, tanks for liquid cargos such as plant oils, and lockers for valuables. Cargo liners also run to scheduled timetables.

2. Describe **one** disadvantage of a container ship.

One quite important disadvantage of container ships is their safety. Between 2,000 and 10,000 containers are lost at sea each year. These are a serious hazard to other vessels in shipping lanes. Drifting containers may cause accidents and damage to marine life.

3. Describe **two** advantages of containerisation.

Containerisation has a number of advantages. For example, transportation is much more secure because containers are locked. This has significantly reduced theft of goods and lowered insurance costs. Standard containers can also be adapted to carry specific goods; for example, they can be ventilated, refrigerated or specially sealed to carry liquids and dangerous goods. This gives container transportation some flexibility.

4. To what extent is road transport **(a)** reliable, **(b)** convenient and **(c)** safe?

- a) Some would argue that road transport is becoming less reliable. This is because delays are sometimes caused by appalling congestion in some countries. This might be the result of an accident, roadworks or just the sheer weight of traffic.
- b) Generally, road transport is considered convenient. Many businesses need door-to-door transportation. Road transport is usually the best option if this service is required. Quite often, businesses require flexible transport services – for example, they may want a delivery time changed at the last minute. They may also want to change the destinations of deliveries. Again, road transport is probably the most flexible. Indeed many forms of transport run to timetables, which is very inflexible.

- c) Firms will want their transport providers to maintain the highest possible standards of safety. They will want haulage companies to handle and transport their goods without causing damage to the cargo but, more importantly, they will want them to use transport networks responsibly without causing harm to others – for example, cargo needs to be securely fastened before transit. Drivers should also carry out their duties professionally and responsibly. Air transport has a very good safety record. In contrast, road transport has a poor safety record. In many countries in the world fatalities on road networks are intolerably high.

5. Discuss the advantages to a business of having its own transport fleet.

The transportation of goods is often outsourced by businesses. This means that specialist carriers are paid to deliver goods. This is usually because specialist carriers are more efficient at handling transportation. Many businesses do not have their own transport because it would not be cost effective; however, some businesses do have private fleets. One of the main advantages of this is that firms are likely to consider their own transport fleets more reliable. For example, as businesses expand their logistics, requirements also grow – this might mean that a regular carrier eventually runs out of capacity. This would be a problem for a growing business. Consequently, businesses with their own fleets can ensure they always have enough capacity, helping to avoid delays to customers. Another advantage is that private fleets might be more flexible. Businesses with their own fleets can make last-minute deliveries, change destinations and avoid the restrictions imposed by the timetables used by some modes of transport. This level of flexibility may not be provided by a courier or a haulage company, for example. Flexibility is an important advantage when meeting the changing needs of customers.

Businesses might also argue that they can offer a better customer service when handling their own transport; for example, in-house drivers are likely to know far more about the goods that they are delivering. They can be trained according to corporate standards in customer service, safety and ethical behaviour. This helps to project the company's image more effectively. Another benefit is that firms can use their fleets to reinforce their brands: vans and trucks will carry company logos and other messages that can be read by other drivers and pedestrians during transit. This form of advertising is very cheap for businesses. Finally, if a business can deliver large enough quantities, owning a private fleet will eventually be cheaper. This is because the profit margins enjoyed by the carrier are eliminated. In this case, Hyderabad Haulage is losing valuable custom because its clients are setting up their own transport fleets.

## CHAPTER 34

### CASE STUDY: CENTRAL WAREHOUSING CORPORATION

1. What is the main function of a warehouse?

The main function of a warehouse is to store goods. In this case study, Central Warehousing Corporation® (CWC) is a large Indian warehousing company. It provides storage facilities in the agriculture industry and has the capacity to store nearly 10 million tonnes of produce. CWC provides a range of warehousing services such as food grain warehouses and industrial warehousing.

2. How might CWC help farmers?

Farmers produce agricultural goods, such as grain in this case. At harvest time they have lots of produce that needs to be stored but the demand for the newly harvested goods does not match the supply at this time; therefore, the goods have to be stored. However, many farmers do not have the capacity needed to store their harvests. This is where warehousing companies like CWC provide a useful aid to trade. They take on the responsibility for storage.

3. How might CWC help retailers?

The retailers who buy the grain produced by farmers generally have fairly constant demand throughout the year. For example, bakers who buy wheat for bread and other similar products, would probably buy roughly the same each month. They would not want to buy their year's supply of wheat when it first becomes available at harvest time. They would not have the capacity to store it. Again, warehousing companies like CWC provide the storage facilities.

Finally, CWC might also provide handling and transportation services for both retailers and farmers. For example, it operates container trains transporting export-import containers between key cities such as Delhi and Mumbai. CWC also operates air cargo complexes at international airports.

## ACTIVITY 1

### CASE STUDY: STOCKPILING FOR BREXIT

1. How do warehouses help to protect supply in this case study?

If warehouses did not exist, the supply of some goods may be threatened. For example, if warehouses did not store the output produced by farmers, many farmers would struggle to survive because they may not be able to store their harvests for long periods of time. Perishable goods often require specialised storage facilities, which many farmers could not afford. Consequently, if they could not use the storage facilities provided by warehouses they might stop farming and there would be fewer supplies.

In this case study, the UK government asked pharmaceutical companies to stockpile six month's supply of medicines to protect supply in the event of delays to transportation across borders. Therefore, many pharmaceuticals companies will use warehouse facilities to store medicines. By stockpiling and storing output, supply will be protected.

2. Discuss what might happen to the prices of medicines if stockpiling did not take place.

Another aid to trade provided by warehouses is to help make the prices of goods more stable. The prices of goods tend to fluctuate when there is a mismatch between supply and demand. For example, if there are shortages of goods, prices will rise. Shortages might be caused by insufficient supply or excessive demand. In contrast, if there is a glut of goods caused by overproduction, prices will fall. Warehouses help to avoid this mismatch between supply and demand by storing goods and releasing them according to demand. If demand can be matched by supply at all times, prices are much less likely to fluctuate.

In this case study if there were shortages of medicines caused by delays at customs, their price would rise because demand would be greater than supply. Stockpiling should help pharmaceutical companies meet demand in the event of shortages.

**ACTIVITY 2****CASE STUDY: COLES REGIONAL DISTRIBUTION CENTRE**

1. What is an RDC?

Large retailers, such as supermarkets like Coles, use a specialist type of warehouse called a regional distribution centre (RDC). Manufacturers and other suppliers deliver goods to RDCs, where they are stored for a fairly short period of time. The goods are sorted into orders for individual stores and then redistributed. RDCs are strategically positioned around a country to reduce the distance that goods need to travel. This helps to keep costs down. They are also close to transport networks, like motorways, for quick access. Many chain stores, and supermarkets in particular, take delivery from RDCs.

2. Discuss the benefits to Coles of using a highly automated approach to warehousing.

In this case study, Coles said it would build two new 70,000 square metre automated distribution centres – one in Brisbane and another in Sydney. The two new RDCs are likely to provide a number of benefits for Coles. The highly automated RDCs will provide a safer working environment for employees, lower supply chain costs and improve the competitiveness of Coles. The new technology and automation in the RDCs will replace some existing practices used in Coles stores. For example, products will be packed and delivered for unloading at specific shelf spaces within store. Also, standard pallets will be replaced with pallets designed specifically for aisles. This will reduce the cost of getting goods to the shelves in the store.

3. Why would Coles not use a cash-and carry warehouse?

Cash-and-carry warehouses are very important to independent retailers but not to large supermarket chains like Coles. Goods from a wide range of manufacturers and other suppliers are stored in a cash-and-carry warehouse in large quantities. They are like wholesale supermarkets – retailers can walk around, browse and load up trolleys with goods that they then resell in their own shops. The goods sold are likely to be competitively priced because they are bought direct from manufacturers and they operate with low overheads; for example, they do not have any transport costs to cover. They may also present goods very economically; many will be left on pallets straight from delivery. This also reduces handling costs. Cash-and-carry warehouses are also convenient.

Coles is a large supermarket chain and would not use a cash-and-carry warehouse. It buys direct from manufacturers and other suppliers and uses RDCs to redistribute goods to its stores.

**MULTIPLE CHOICE QUESTIONS**

1. A 2. C 3. D 4. B

**CHAPTER REVIEW****CASE STUDY: ICE CREAM STORAGE**

1. Describe **two** functions of warehousing.

The main function of warehouses is to store large inventories of goods. They take delivery of large quantities of output from manufacturers and farmers and store them until needed. The inventories are eventually sold on to wholesalers, retailers or other buyers. The range of goods stored varies enormously. Examples could be grain, perishable goods, toys, books, household goods, furniture, frozen produce, components and many other finished goods.

Warehouses also take the responsibility for any losses resulting from the storage of goods. They bear the risk associated with storage. This is why warehouses are secure and are built

to withstand extreme weather conditions and any other threats to which inventories might be subjected. Warehouse operators are legally bound to return the goods to their owners in sound condition. In the final case study, very careful storage is needed. Temperature-controlled foods, like ice cream, require very careful handling as they move through the supply chain. Ice cream is very sensitive to changes in temperature and can easily be mishandled during loading, unloading and storage.

2. How does warehousing cope with the seasonal demand for products like ice cream?

One important role of warehouses is to deal with the mismatch that often occurs between the supply and demand for goods. For example, in countries where Christmas is celebrated, there is a huge increase in demand for toys and gifts in the few weeks before 25th December. Many manufacturers are not able to cope with such a sharp increase in demand. They prefer regular production throughout the year. This is where warehouses provide an important aid to trade. They are able to store the toys and gifts produced by manufacturers throughout the year until they are needed in November and December. This is how manufacturers cope with seasonal demand.

Ice cream is stored in special cold storage units for quite long periods of time. Demand for ice cream is seasonal in many countries around the world and usually increases significantly during the summer months. However during the winter, demand is relatively low so some of the ice cream produced by manufacturers is stored until it is needed in the summer months.

3. Describe the role played by cold-storage warehouses.

The role played by cold-storage warehouses is important because they reduce the amount of food that goes to waste. This is because gluts are more likely to be avoided – especially with some agricultural goods at harvest time. They prolong the shelf-life of food and therefore provide goods out of season for customers. Some cold-storage warehouses offer refrigerated transportation. This is a specialist service as refrigerated transportation requires purpose-built vehicles that must be well-insulated and fitted with refrigerators. Ice cream requires very careful handling and transportation to avoid damage to the product. Cold-storage warehouses may offer emergency cold storage if a customer loses power, for example. Finally, they can adjust the temperatures of cold rooms to meet the needs of different goods.

4. Describe why some businesses use bonded warehouses.

Bonded warehouses play an important role in the trade of goods that are subject to customs and excise duties (these are taxes paid on imports). The payment of these taxes can be delayed if imports are unloaded and stored in bonded warehouses close to the port. It will help the cashflow of a business if the payment of taxes can be delayed until the delivery of goods to customers. For some goods, such as tobacco, electrical goods, wines and spirits, taxes can be very high indeed in certain countries. Consequently, delaying their payment is even more beneficial.

Sometimes goods held in bonded warehouses may be transported to another country. If this happens taxes would not have to be paid on the value of goods held and exported. However, once they arrive in another country, customs and excise duties will have to be paid if they are not held in another bonded warehouse.

Businesses are allowed to process goods held in a bonded warehouse. For example, they may be repackaged, branded, matured (like cheese, wine or whisky) or blended. However, firms are not allowed to manufacture goods in bonded warehouses. Bonded warehouses are a very useful aid to trade for exporters and importers and for businesses that need to delay the payment of duties or other taxes like VAT.

## CHAPTER 35

## CASE STUDY: DOMINO'S PIZZA

1. Describe **three** methods used by Domino's to promote its products.

Domino's uses a number of different promotion methods. It uses leaflets to notify customers of special offers. It also uses specially designed boxes, with the Domino's logo and colour scheme, to wrap pizzas for customers. Finally, it uses TV advertising. For example, in some countries it uses TV adverts to encourage viewers watching sports fixtures to order pizzas ready for the half-time break.

2. What changes did Domino's sometimes make to break into foreign markets?

Consumers in different countries are likely to have different tastes and preferences when buying products. Consequently, firms that export goods and services may have to adapt their products to suit the needs of the new market. In this case, in order to get the Domino's brand accepted worldwide, the company had to modify its menu and recipes to meet the needs of different cultures. For example, in India the dough and toppings are similar to the Indian roti (flat bread) and subji (vegetables).

3. How might Domino's promote its products online?

During the 1990s, Domino's launched its website. Since then, the company has enjoyed a boost in sales. Domino's advertises and promotes its products on the website. Once customers 'click on' to the site, they will see colourful images of products and details of current special offers. For example, on 17th May 2019, the Singapore site was promoting a range of offers to celebrate the company's 10th anniversary of trading in Singapore.

## ACTIVITY 1

## CASE STUDY: ADVERTISING MEDIA

1. (i) What might happen to spending by businesses on print advertising in the future?

Spending by businesses on print advertising is likely to fall in the future. The graph in Figure 35.2 shows that the amount spent on print advertising globally is only 15.6 per cent of the total (\$69 bn / \$442bn x 100) spent on advertising in 2019.

- (ii) Account for your answer in (i).

One reason for the decline in newspaper and other print advertising is because advertisers have directed more of their budgets to internet advertising. They must feel that they get better returns on their spending. This may be because the circulation of many newspapers and other printed media around the world is declining as more people go online; for example, to get their news. The graph shows that expenditure on paid search advertising and social media advertising amounts to about 42 per cent of the total. This would have been close to zero 20 years ago.

2. Describe **two** advantages of TV advertising.

Although the amount spent on TV advertising is probably falling, it is still an important medium. This is because it has some significant advantages. For example, it is possible to reach huge audiences using TV. A TV advert placed on a national Indian or Chinese TV

channel might reach several hundred million people. Another advantage is that very attractive and powerful TV adverts can be created. These are capable of having a huge impact when broadcast.

3. What might be **one** benefit to businesses of advertising on social media?

The increase in the amount spent on internet advertising has grown with the increasing use of mobile devices and the growing trend in online shopping. Many companies are placing adverts on social media: in 2019, a total of \$84 billion was spent globally on social media advertising. This type of advertising is proving effective; for example, firms can target customers more accurately using social media advertising and it is more cost-effective for businesses.

## ACTIVITY 2

### CASE STUDY: SPONSORSHIP

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 2018, global sponsorship spending was US\$65,800 million. The majority of this was spent on sport. For example, in the USA about 70 per cent of sponsorship goes on sport. Rolex®, the luxury watchmaker, was one of the official partners of the US Open Golf Championship, which was broadcast around the world – this represents a massive potential audience for the company.

2. What proportion of global spending on sponsorship was spent by the USA in 2018?

In 2018, US businesses spent US\$24.2 billion on sponsorship. In the rest of the world businesses spent US\$41.6 billion. The percentage spent by US businesses is given by:

$$\frac{\$24.2 \text{ billion} \times 100}{\$24.2 \text{ billion} + \$41.6 \text{ billion}} = \frac{\$24.2 \text{ billion} \times 100}{\$65.8 \text{ billion}} = \mathbf{36.8 \text{ per cent}}$$

3. Describe the advantages of sponsorship to a company like Rolex.

One of the key advantages of sponsorship is that the name of the brand can be shared globally on the 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 TV coverage. Major sporting events, such as the US Open Golf Championship, are popular with sponsors because the reach to TV viewers can be global. Rolex is able to locate clocks by each tee on the course, for example. These clocks are shared regularly by TV cameras while a game is in progress. Sponsors of US Open Golf Championship, such as Rolex, will also get logo placement at pre- and post-match interviews and free tickets to each match. The amount of money paid by Rolex for its benefits is likely to be substantial; therefore the match organisers will do whatever they can to meet their commercial needs.

### MULTIPLE CHOICE QUESTIONS

1. C   2. A   3. B   4. D

## CHAPTER REVIEW

## CASE STUDY: TENTMIA

1. What is the purpose of advertising and promotion in commerce?

Advertising and promotion are a very important part of the marketing mix. Generally, the main purpose of advertising and promotion is to sell more. However, there are some specific purposes. For example, one of the main aims is to sell more goods and services and to boost revenues – if revenues are higher it is likely that profits will also be higher. Another purpose is to gain a larger share in the market. This is because having a larger market share is likely to give a business a competitive edge. As its market share grows, a business will have to produce more output; as a result it may exploit economies of scale, which will help to lower costs. Advertising and promotion may also be used to build a brand by giving products brand names and building customer relationships, which means trying to establish a bond with customers through effective communication and developing customer loyalty. 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.

2. How much money was spent on the most popular item of promotion by TentMia in 2019?

The most popular method of promotion used by TentMia was website advertising. This accounted for 35 per cent of the whole budget. The amount spent on website advertising is given by:

$$35\% \times \text{BDT}500\,000 = \text{BDT}175\,000$$

3. Why has this method of promotion become more important to TentMia in recent years?

TentMia recently set up an operation to sell tents online. This has boosted sales and influenced the way it spends its advertising and promotion budget. Ten years ago, 75 per cent of the company's sales were to trade customers – retailers selling camping equipment, for example. However, since selling online, sales to individuals have increased from 25 per cent to 53 per cent. Therefore, it is not surprising that TentMia has spent increasing amounts on internet advertising and promotion.

4. Why does the marketing manager want to phase out free gifts as a promotional method?

Businesses can choose from a wide range of different sales promotion, such as coupons, loyalty cards, competitions and BOGOF offers. Some businesses offer customers free gifts or samples in order to promote products. TentMia offers a free coat every time a customer buys a tent. However, the head of marketing believes that this method is too expensive for the amount of sales it generates. She said that free gifts should be phased out next year. If a particular method of promotion is too expensive, and is not having a sufficient impact on sales, it makes sense to spend the money on another, more effective method of promotion.

5. Why might TentMia spend less on trade fairs and exhibitions in the future?

TentMia attends trade fairs or exhibitions to promote its products. This is where businesses set up a stand and promote their products face-to-face. Trade fairs may be attended by commercial buyers or consumers, or both. One of the main advantages of this method is that products might be considered carefully and tested out on consumers before a full launch. Also, some exhibitions are overseas and can be used to break into foreign markets. However, the head of marketing said that less should be spent on trade fairs and exhibitions because an increasing amount of trade was coming from individuals. This is true because

ten years ago, 75 per cent of the company's sales were to trade customers – retailers selling camping equipment, for example. However, since selling online, sales to individuals have increased from 25 per cent to 53 per cent. Therefore, attending trade fairs and camping exhibitions may not be a cost-effective way of promoting TentMia's products.

6. Assess which method(s) of advertising or promotion might be most appropriate for TentMia in the future.

The information given in the case study suggests that changes need to be made to the way the BDT500 000 advertising budget is spent. If the head of marketing is an influential member of staff, it seems likely that spending on free gifts will be phased out and the amount spent on trade fairs and camping exhibitions will be reduced. This means that more money will be available for other methods.

According to the marketing manager, *'It is better to spend the money on specialist camping magazines. The people who read these buy tents. I suggest we increase our adspend on camping magazines published in Australia, New Zealand and Canada, where camping is popular.'* This seems like good advice. Advertising will be more effective if it is targeted accurately at people who are interested in the firm's products. Clearly, camping magazines will be purchased by camping enthusiasts. These are the people who buy tents. Therefore, placing adverts in specialist camping magazines in Australia, New Zealand and Canada, where camping is very popular, seems to be a good idea.

However, TentMia needs to understand how important it is to keep updating the company's website. It might be too risky to reduce spending on this method of promotion. As more and more sales come from online selling, it is important to keep the website fresh and innovative.

Finally, TentMia might also consider new methods of promotion. For example, if global sales are rising and more resources become available for advertising and promotion, it might be worth considering some of the more expensive methods of promotion. TentMia might consider television and national newspapers – particularly in countries where camping is popular.

## CHAPTER 36

### CASE STUDY: THE IMPORTANCE OF SOCIAL MEDIA FOR BUSINESSES

1. What are **two** possible reasons why businesses or brands should use social media?

Research suggests that businesses that use social media get some real benefits. For example, some research found that 71 per cent of consumers who have had a good social media service experience with a brand are likely to recommend it to others; 63 per cent of customers actually expect companies to offer customer service via their social media channels.

2. Using Figure 36.1, work out how much of the market is dominated by Facebook and YouTube.

Facebook and YouTube dominate about 58 per cent of the social media networking sites ( $2,200 + 1,900 \div 7,000$ ).

3. How might businesses direct traffic to websites using social media?

Businesses might direct an advert at someone using social media and provide users with an opportunity to 'click-on' to their website.

## 4. How might businesses source ideas using social media?

One of the benefits of using social media in marketing is that businesses can get feedback from customers by engaging and communicating with them directly via social media channels. Some of the customer feedback that a business receives might provide ideas for product changes, new products or new services, for example.

**ACTIVITY 1****CASE STUDY: PERSUASIVE ADVERTISING**

## 1. What is meant by persuasive advertising?

Persuasive advertising is designed to make consumers feel like they really need to buy a particular product. The adverts try to convince people that they cannot do without the brand. They are compelling and positive and are often used to persuade consumers to switch brands. A number of techniques might be used by advertisers when designing persuasive adverts. For example, they might promise rewards or suggest an adverse outcome. They might also suggest that there isn't very much of a product and use language that addresses consumers directly (by writing in the second person).

## 2. To what extent is the advert shown persuasive?

Many would argue that the advert shown in the image here is meant to be persuasive. It is an advert inviting shoppers to enter the store. It is very bright, eye-catching and has a very simple message. The advert almost 'implores' people to step inside the store – it almost 'mocks' those that don't.

**ACTIVITY 2****CASE STUDY: CLOUD COMPUTING**

## 1. What is meant by informative advertising?

Informative advertising provides consumers with accurate information about products. It focuses much less on consumers' emotions and aims to educate consumers on the features and benefits of a product. However, informative adverts still aim to encourage consumers to buy the product. Informative advertising may be used when launching a new product, when selling complex products and when modifying or updating products. The advert in the image shown for Cloud Computing is an informative advert. It gives consumers quite a lot of information about a new product.

2. What are **three** pieces of information that are given in this advert?

Three pieces of information given in this advert for Cloud Computing could be:

- Data can be accessed anywhere at any time.
- Cloud Computing offers improved reliability and security when storing data.
- Wider access to free software.
- Up-to-date software that has less malware.
- No set-up costs.

3. Why might a business use informative advertising when updating or modifying products?

Informative advertising may be used to show consumers how existing products have been updated or modified. For example, when a new version of Windows is launched, Microsoft wants to show consumers that the new version is much better. Adverts will emphasise new features such as higher levels of security, new icons, an improved taskbar and options to share content. If consumers can see that an updated version of a product is better than the previous version they are more likely to buy it.

### MULTIPLE CHOICE QUESTIONS

1. C    2. A    3. B    4. D

### CHAPTER REVIEW

#### CASE STUDY: NESTLÉ

1. What percentage of Nestlé's total advertising budget was spent in the USA?

The percentage of Nestlé's total advertising budget spent in the USA is given by:

$$\frac{\$2.13 \text{ billion} \times 100}{\$7.2 \text{ billion}} = 29.6 \text{ per cent}$$

2. What might be a danger to Nestlé of using competitive advertising?

Competitive adverts draw direct comparisons to a rival's product. The advert attempts to show that products are superior to those of a competitor. Therefore the aim of the advert is to increase sales at the expense of competitors. Many competitive adverts don't use the name of rivals; this is to avoid legal challenges from competitors if certain claims are made about relative product performances. One approach used by some companies is to use the results of an independent test that show that a particular product tastes or performs better than those of rivals.

The confectionery industry is very competitive with some very powerful companies selling lots of different brands. Competitive advertising, which draws direct comparisons to those of 'named' rivals, may be considered dangerous. This is because the rival may retaliate with a more effective advert. For this reason it might be risky for Nestlé to use competitive advertising where it suggests that its products are superior to those of competitors such as Mars or Cadbury. There is also the danger that competitive adverts persuade consumers to switch from one Nestlé brand to another Nestlé brand. However, Nestlé may consider that this is a 'price worth paying'.

3. How might using social media help to strengthen a brand like Nestlé?

Many businesses use advertising on social media to strengthen their brands. For example, social media may help to increase trust in a business or brand. Seeing that a particular business is active on social media helps customers to develop trust. A social media presence may suggest that a business cares about its customers. For example, if anything goes wrong, customers will feel more secure if they know that it is easy for them to make contact and raise issues. This will help to strengthen a brand like Nestlé.

4. Assess the benefits to businesses like 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 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 139.8 billion 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. 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. This means that Nescafé can respond to any helpful suggestions resulting from its research very quickly indeed. Finally, the use of social media is not technically difficult and therefore cost-effective to use. Since the beginning of 2016, Nescafé says the Tumblr websites have generated an extra US\$200 000 in sales. Users can make instant purchases by clicking on 'buy now buttons'. Also, total monthly visits have risen by 29 per cent since the beginning of 2016 with users now staying 18 per cent longer per visit. Nescafé clearly values the use of social media in marketing.

## CHAPTER 37

### CASE STUDY: MCDONALD'S

1. Calculate the percentage fall in McDonald's revenue between 2012 and 2018.

The percentage fall in McDonald's revenue between 2012 and 2018 is given by:

$$\frac{\text{US\$27.57 billion} - \text{US\$21.03 billion}}{\text{US\$27.57 billion}} \times 100 = \frac{\text{US\$6.54 billion}}{\text{US\$27.57 billion}} \times 100 = \mathbf{23.7 \text{ per cent}}$$

2. Describe the change in consumer preferences upon which the case study is based.

One important change in consumer tastes is the growing preference to eat healthier food. One reason for this change in preferences is that consumers are responding to the numerous health warnings given around the world about the dangers of eating too much saturated fat. This change has affected McDonald's, the world's largest fast food chain.

3. How has this change possibly impacted on McDonald's sales revenue?

According to the calculation made in question 1, McDonald's revenues have fallen quite sharply between 2012 and 2018. They fell by nearly a quarter (23.7 per cent) from US\$27.57 billion to US\$21.03 billion. It is reasonable to assume that the fall has something to do with a change in consumer preference for healthy food. For many consumers, the food sold by McDonald's contains too much fat. People around the world have been warned about the dangers of consuming too much fat in their diets. Consequently, people are spending less on fast food.

However, there may be other reasons for the fall in revenues at McDonald's. It is possible that the company has lost out to rivals in the industry. For example, customers might purchase from KFC, Wendy's or Burger King. It may also be possible that the advertising and promotion techniques used by McDonald's are less effective. Finally, it could be because consumers have moved to other types of fast food provider such as Domino's, Chipotle, Dunkin' Donuts or Subway.

4. How has McDonald's responded to the change in consumer preferences in its advertising?

McDonald's responded to claims that its foods are unhealthy by adjusting its advertising strategy. For example, it released a series of videos which emphasise the quality of the meat

used in Chicken Nuggets. It also used a marketing campaign that encouraged consumers to ask questions about McDonald's food. However, the quality of some of the consumers' questions suggest that McDonald's still has a lot to do. A small sample of the questions submitted included: 'Is the McRib made from real pork?', 'Are there worms in your beef?', 'Do you make fries with real potatoes?'

### ACTIVITY 1

#### CASE STUDY: THE GLOBAL GAMES MARKET

1. Describe **one** reason why there has been an increase in consumer demand for leisure activities around the world in recent years.

Globally, incomes are rising – particularly in countries like China, India, Malaysia and Vietnam. This often means that people have more money to spend on leisure activities.

2. What does the information in Figure 37.3 show?

Figure 37.3 shows two important trends. First it shows that the amount of money spent on computer games has risen sharply from US\$70.6 billion in 2012 to an estimated US\$180.1 billion in 2021. This is an increase of 155 per cent.

The information also shows the growing importance of mobile devices. The proportion of 'gamers' accessing computer games on their mobile devices has risen from 18 per cent in 2012 to an estimated 59 per cent in 2021. This growth has come at the expense of PCs and consoles.

3. How might the information in Figure 37.3 be helpful to businesses in the video games industry?

The information in Figure 37.3 might be useful in a number of ways. First, the producers of computer games might be able to spend more on advertising as their revenues are rising. They can afford to have bigger advertising budgets. Second, advertisers might need to adjust their advertising techniques to accommodate the trend in mobile gaming. They will need to design adverts that are suitable for small-screen mobile devices. Third, advertisers in general will want to 'cash in' on the gaming boom by targeting 'gamers' with adverts of their own. Businesses will also want to find ways of incorporating their advertising and promotion methods into computer games – product placement, for example.

### ACTIVITY 2

#### CASE STUDY: BOTT SMARTVAN®

1. Why are businesses like Bott Smartvan emphasising their 'green credentials'?

Businesses like Bott Smartvan are emphasising their 'green credentials' because an increasing number of consumers are concerned about the environment. This has resulted in advertisers emphasising how environmentally friendly their products and practices are. This is called 'green marketing'. Businesses using this approach have adapted their advertising to show that they are implementing sustainable business practices, demonstrating social responsibility, making use of recycled materials and reducing expenses (packaging, transportation, energy/water usage, etc.), for example.

2. What evidence is there in Bott Smartvan's advert that the company is using a green marketing approach in its advertising?

The advert used by Bott Smartvan is clearly trying to appeal to customers who have concerns about the environment. For example, the company claims that its shelving

products are made from lightweight materials. As a result, fuel emissions from the vans in which the shelving is fitted will fall; fuel economy will be improved with less weight to carry. Bott Smartvan also claims to use eco-friendly packaging. It packs its products in recyclable and recycled materials where possible. Also, since all of its products are packaged on site, there is no need to waste resources packing and unpacking at different stages in the distribution chain.

### MULTIPLE CHOICE QUESTIONS

1. C    2. A    3. B    4. C

### CHAPTER REVIEW

#### CASE STUDY: GOPRO®

1.      What is meant by viral advertising?

Viral advertising involves any strategy that encourages people to pass on messages electronically to others about a product or a business. 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. People can send texts relating to a marketing message, or they can send images such as photographs and video clips. GoPro has enjoyed considerable success with viral advertising.

2.      How might an advertiser produce a video clip which is likely to go viral? Use the information in Figure 37.6 to support your answer.

Adverts which go viral rely on their creative appeal to the different emotions that people have. According to the information in Figure 37.6, adverts are more likely to go viral if they can make people laugh, fill them with joy, amuse them or, most important of all, appear to be awesome. One of GoPro's most famous adverts went viral several years ago. It was very emotional and featured a firefighter with a GoPro camera inside a house that was on fire. He finds a small kitten overcome by smoke fumes. He saves the kitten's life by giving it water and oxygen. At the end of the advert the firefighter is seen holding the kitten close to comfort it. Within a short space of time, after the advert went viral, it had been viewed around 20 million times. The advert promotes GoPro by linking a real life 'hero' to its popular camera brand. This advert made viewers feel strong emotions. It had a happy ending and made an impact.

3.      How might small businesses use digital marketing?

One of the advantages of digital communication is that it can be used by small businesses; they can use content marketing such as advertorials, blogs or any other kind of content that is published on the web for promotional purposes. It helps to create awareness when it comes to brand storytelling. Content marketing works well with social media as links between consumers and brands have strengthened. This is a relatively cost-effective way to communicate with customers. Small businesses can also use tools such as Google AdWords to create online advertising campaigns. AdWords allows online advertisements with keywords, for example, to target customers. Another important technique is search engine optimisation. This is where keywords are placed in text to get a website ranked higher in search results.

4.      Describe why digital communication is growing in importance in advertising.

Digital communication involves the use of devices such as computers, mobile phones, tablets and laptops to exchange information electronically. Digital marketing is any method of promotion or advertising that uses these devices to transmit messages. It has grown significantly in importance. The information in Figure 37.5 seems to support this view. For example, over 5 billion people in the world have a mobile phone and almost 4.4 billion are internet users. Failure to use digital communication in advertising might be regarded as neglectful.

Some research carried out recently also emphasises the importance of digital marketing. According to a survey carried out by The Manifest in 2018, in 2019 99 per cent of businesses planned to increase their investment in at least one digital marketing channel; over 50 per cent of businesses planned to spend more on social media marketing (64 per cent) and a website (55 per cent); businesses planned to spend less on display/banner advertisements (19 per cent) and paid search advertisements (18 per cent). Finally, the sharp fall in the amount spent on TV advertising and other traditional media suggests that the boom in digital communication will continue.

5. Discuss the different methods that might be used by a business like GoPro to generate more ecommerce business.

GoPro's products, which include the famous brand 'Hero', are sold through distributors and an online shop. A number of methods could be used to help drive traffic towards GoPro's website. One approach is to use a cost-per-mille (CPM) approach to online advertising. This is where an advert is posted on a website but payment is made according to the number of times the advert is displayed. This number is usually a multiple of 1,000 and advertisers pay per thousand, or 'per mille'. This reduces the risk of the advertising because payment is related to the number of times the advert is seen. However, another method – called pay-per-click advertising – is much more cost-effective. Payment is only made if visitors click on the advert and visit your website. This is how advertising on search engines like Google, Bing and Yahoo works. However, this type of advertising is not restricted to search engines; it can be used on many other websites.

Many big ecommerce sites use affiliate marketing. This is where an advert is displayed for nothing. In fact, payment is only made if a visitor buys from the company website or provides contact details. Most large ecommerce sites use affiliate marketing. For example, Amazon tried this approach in the 1990s and many believe this is one of the reasons for its success. Many ecommerce sites like this method because it makes sense to pay commission on actual sales. One advantage is that it helps to quantify the return on advertising. Finally, some businesses might use e-newsletters. These are documents sent electronically to interested parties. They contain a range of content that is not just related to shopping. Companies might include anything from industry news, to interesting statistics, and 'tips' on how to improve one's lifestyle. E-newsletters are only sent to customers that have already purchased some goods or services or have expressed an interest in the company. They may also be personalised, which means that they are less likely to be treated like 'spam'. Provided they are not too long and contain information of interest, they can help to develop relationships with customers and bring their attention to new buying opportunities. GoPro may use this method to send out information to its millions of customers worldwide.

## CHAPTER 38

## CASE STUDY: RECEIPTS

1. What is a receipt?

A receipt is an important business document that provides proof of payment. Customers usually receive a receipt at the checkout when payment has been made for goods or services.

2. Who is the seller in the transaction represented by the receipt?

The seller in the transaction represented by the receipt is BDR SRI Damansara.

3. How much does the buyer have to pay?

The amount due is RM154.97.

4. Why might a customer keep a receipt?

Customers often keep receipts in case they need to return goods. Receipts provide proof of purchase and vendors might not give a refund if the customer cannot present a receipt.

## ACTIVITY 1

## CASE STUDY: SUSAN JAMES LTD

1. Calculate the total amount owed by the customer.

6 @ \$55 each = \$330

6 @ \$8 each = \$48

10 @ \$28 each = \$280

4 @ \$16 each = \$64

2 @ \$28 each = \$56

Therefore the total amount owed will be **US\$778**.

2. Describe the purpose of the invoice.

An invoice is one of the most important source documents. This is because bookkeepers usually transfer the details of transactions from invoices onto their bookkeeping system (if it is not done automatically). An invoice is a demand for payment; i.e. it is a bill that states clearly what is owed. When issued by a supplier it is known as a 'sales invoice'. However, when received by a customer, it is known as a 'purchase invoice'. Invoices usually contain the supplier's address and the customer's address (and the delivery address if different from the customer's address); the invoice number and the customer account number are included to help the supplier cross-reference the documents for the transaction. A customer order number might also be included. This helps the customer to check the invoice against the order. Invoices also show both the order date and the delivery date. This is because the date is the tax point; i.e. the official date of the transaction for tax purposes.

An invoice also gives details about the goods, such as the quantity, a stock or catalogue number, a brief description, the unit price and the total price (quantity X unit price). It will show the total amount of money owed by the customer, which is stated at the bottom of the invoice. The amount shown includes VAT but this is also shown separately to make things clearer. Finally, the payment terms are stated clearly on an invoice. For example, it might say how long the customer has to pay.

3. What document might be sent with the goods when they are transported to the customer?

When goods are sent to a customer they will be sent with a delivery note. Upon delivery, the note can be used to check that the goods delivered are the same as those listed on the delivery note. If they are, the customer will sign for the goods and keep a copy of the delivery note as a record. A copy of the signed delivery note is also kept by the supplier and acts as a goods received note. It provides proof that the customer has taken delivery of the goods should a disagreement occur.

## ACTIVITY 2

### CASE STUDY: CREDIT NOTE

1. What is the purpose of the document shown in Figure 38.11?

The document shown in Figure 38.11 is a credit note. A credit note is sent to a customer if the amount owed on an invoice needs to be reduced. Credit notes may look identical to invoices except that they are often printed in red ink so they are not mistaken for an invoice. They might be used if a mistake has been made when entering details on the invoice, or if goods have been damaged in transit or lost. Credit notes might also be issued if insufficient goods have been delivered or goods are returned by the customer. A credit note is set against the value of future orders. It reduces the amount the customer pays in the future.

2. Why has the credit note been raised?

In this case, the credit note has been raised because the goods received by the customer, Mary Tench, were damaged. A hand was missing from a clock she purchased from J Docherty.

3. How might the GBP489.60 be refunded?

If Mary Tench is a regular customer, the £489.60 would be off-set against future purchases, or subtracted from the total amount currently owing. This is the normal practice. However, if Mary Tench is not a regular customer, the goods would have to be returned and a full refund given.

4. Under what circumstances might J Docherty send a debit note to a customer?

J Docherty might issue a debit note to a customer if a mistake on an invoice results in the customer underpaying the supplier. The debit note will show how much more needs to be paid and why the underpayment occurred.

### MULTIPLE CHOICE QUESTIONS

1. D 2. C 3. A 4. D

## CHAPTER REVIEW

### CASE STUDY: FARZI LTD

1. What is a statement of account used for by Farzi Ltd?

Some businesses have regular suppliers and conduct many transactions during a short trading period, such as one month. One common way of informing customers how much is owed at the end of the period is to send a statement of account. This document lists all the transactions for the time period and also includes details of any payments and refunds that have been made.

2. What do the items in the credit column relate to in the statement of account?

Most statements list transactions in two columns. The debit column lists invoices relating to goods bought by the customer. The credit column shows details of payments made by the customer and any refunds made to them due to goods being returned. For example, in the Farzi Ltd statement, the customer (Omar Hamdy Ltd) made a EGP60 000 payment on 21.05.19. Also, on 26.05.19 Farzi Ltd issued a credit note. This will have the effect of reducing the amount owed by the value of the credit note; i.e. EGP1550 in this case.

3. What is the total amount outstanding according to the entries in the statement of account?

The statement of account is completed below in green. The total amount outstanding is **EGP49 200**.

| STATEMENT OF ACCOUNT      |                     |             |  |               |
|---------------------------|---------------------|-------------|--|---------------|
| FARZI LTD                 |                     | Tel:        | (3) 2345 6998  |               |
| 222 Alman Street          |                     | Fax:        | (3) 2345 6647  |               |
| Alexandria                |                     | Email:      | <a href="mailto:Farzilttd@don.com">Farzilttd@don.com</a> |               |
| Egypt                     |                     |             |  |               |
| Omar Hamdy Ltd            |                     | A/C No.     | 2188   |               |
| Fish Supplies             |                     | Statement   | No. 255  |               |
| 90 Khan St.               |                     | Date:       | 31.05.19   |               |
| Alexandria                |                     |             |  |               |
| Egypt                     |                     |             |  |               |
| Date                      | Reference           | Debit {EGP} | Credit {EGP}   | Balance {EGP} |
| 1.05.19                   | Balance b/f         |             |  | 5,400         |
| 3.05.19                   | Inv. No OHL 2310    | 19,400      |  | 24,800        |
| 10.05.19                  | Inv. No OHL 2388    | 22,350      |  | 47,150        |
| 17.05.19                  | Inv. No. OHL 2491   | 18,700      |  | 65,850        |
| 21.05.19                  | Payment (thank you) |             | 60,000   | 5,850         |
| 24.05.19                  | Inv. No. OHL 2555   | 21,400      |  | 27,250        |
| 26.05.19                  | Credit note 222     |             | 1,550  | 25,700        |
| 30.05.19                  | Inv. No. OHL 2650   | 23,500      |  | 49,200        |
| <b>AMOUNT OUTSTANDING</b> |                     |             |  | <b>49,200</b> |

4. During May, Farzi Ltd received an enquiry for 5000 packs (1kg) of frozen prawns. How might the company respond to this enquiry?

When a business receives a letter of enquiry, it will normally reply quickly if it wants the order. In this case, Farzi Ltd might send a quotation giving details about the prawns that it can supply, e.g. prices, terms of payment, delivery times and any quality guarantees it can offer. The supplier is also likely to give a time limit to the buyer stating how long the offer is open for – often expressed as ‘for acceptance within 30 days’. This is to protect the supplier from any sharp increases in costs that would impact on the profitability of the order. A quotation may be sent in an email or perhaps on a printed form.

5. Describe the purposes of documents in commerce.

Quite a lot of transactions do not use documents. These transactions are usually settled with cash. For example, a street vendor is not likely to use documents when selling newspapers to pedestrians. However, a large wholesaler buying goods from suppliers and selling its products to retailers will use a comprehensive system of documentation. One of the reasons for this is because much of its trade will involve credit transactions – this is where goods are sold but payment is received later. In most countries around the world, the transactions that occur between buyers and sellers are verified by documents. These documents provide evidence that a transaction has taken place and detailed information about the nature of the transaction. They also help to ensure that the right goods are sent to the right place at the right time. They provide a means of checking that the goods delivered are the same as those ordered and can also provide clarity if there are disagreements between traders. Finally, when businesses have their accounts audited, documents are needed to prove that transactions are authentic.

## CHAPTER 39

### CASE STUDY: CONSUMER CREDIT IN CHINA

1. What is meant by the term **consumer credit**?

Consumer credit is where consumers are allowed to buy goods now and pay for them at a later date. There are a number of different types of consumer credit, such as credit cards.

2. How does Tom Wang fund his spending in this case study?

Tom Wang used credit cards to fund his spending.

3. What is **one** reason why consumer credit has grown so fast in China?

There has been a boom in consumer credit in China in the last 10 years. The value of credit purchases has grown from around CNY6000 HML in 2010, to nearly CNY40 000 HML in 2019. This is an increase of about 550 per cent. Much of the increase has been driven by millennials – young people reaching adulthood in the early 21st century. Many millennials are driven by peer pressure to use credit to buy things like English classes, vocational training, weddings, travel or the latest mobile phone. They have rejected the thrifty habits of previous generations and become used to spending with borrowed money.

4. What is the appeal of using credit to fund spending?

One of the main appeals of using credit cards is that it allows users to buy goods now and pay for them later. Consumers can buy goods and perhaps spread out the repayments over several months.

5. Describe **one** danger of consumer credit that this case study highlights.

One of the problems with credit card use is that some consumers spend more than they can afford. As a result they get into debt. For example, in this case, Tom Wang got into debt. He said, *'Using credit cards did not feel like spending money, and the debt grew and grew.'* His low monthly salary did not cover his rent and *'irrational'* spending habits. To cover payments, he obtained four credit cards and kept on borrowing. He also borrowed money online and eventually owed so much money his monthly interest payments were equal to half of his income. Credit card debt on this scale can become a serious burden to consumers.

### ACTIVITY 1

#### CASE STUDY: A HP AGREEMENT

1. How much will Bamba Finance pay to the car dealership when the agreement is signed?

When the HP agreement is signed Prabath will pay a 10 per cent deposit of LKR200 000 (10% x LKR2 000 000). Bamba Finance will pay the car dealership the difference. This is LKR1 800 000 (LKR2 000 000 – LKR200 000).

2. How much in total will Prabath have to pay for the car?

The total amount Prabath will pay for the car is given by:

$$\begin{aligned}
 &= \text{Cost of the car} + \text{interest} \\
 &= \text{LKR2 000 000} + 15\% \times \text{LKR1 800 000} \times 5 \\
 &= \text{LKR2 000 000} + \text{LKR1 350 000} \\
 &= \mathbf{\text{LKR3 350 000}}
 \end{aligned}$$

3. Calculate the monthly instalments paid by Prabath to Bamba Finance.

The monthly instalments paid by Prabath will be:

$$\frac{\text{LKR1 800 000} + \text{LKR1 350 000}}{5 \times 12} = \frac{\text{LKR3 150 000}}{60} = \mathbf{\text{LKR52 500 per month}}$$

4. What are **two** advantages to Prabath of using HP to buy the car?

Using hire purchase to buy the car means that Prabath does not have to wait until he has saved up enough money to buy it outright. This would take him several years. Another advantage is that the monthly payments are fixed and certain. They will not change. This will help Prabath to manage his personal finances more easily.

### ACTIVITY 2

#### CASE STUDY: ANTON NEMENY, NEWSAGENT

1. What is meant by informal credit? Use this case study to illustrate your answer.

Some vendors offer informal credit. This is where customers are allowed to buy goods, usually on a regular basis, and pay for them at the end of the week or the month. This type of consumer credit is likely to be used by small businesses and offered to customers who the vendor knows in person. In this case, informal credit is offered by A Nemeny Newsagent to customers who have their daily papers delivered. Customers get one month's credit. They pay their paper bills at the end of the month.

2. Calculate the total cost of bad debts Anton Nemeny incurs each year.

The value of bad debts incurred by A Nemeny Newsagent is given by:

$$2.4\% \times (260 \times \$80 \times 12) = 2.4\% \times \$249\,600 = \mathbf{\$5990.40 \text{ per annum}}$$

3. What might be **one** advantage to Anton Nemeny of offering customers credit in this way?

The informal credit offered by A Nemeny provides customers with a convenient service. It avoids the effort needed to pay for a newspaper every single day. This level of convenience might attract customers and therefore increase revenue. It also makes life easier for Anton. This is because his shop might get too busy if these 260 customers came in every day to pay for a newspaper.

### MULTIPLE CHOICE QUESTIONS

1. C   2. A   3. B   4. D

### CHAPTER REVIEW

#### CASE STUDY: CREDIT CARD USE IN INDIA

1. What is the difference between a credit card and a store card?

Both store cards and credit cards are a form of consumer credit. The main difference between the two types of card is that store cards can only be used in branches of the chain store that issued the card. In contrast, credit cards can be used to buy a wide range of goods and services wherever credit cards are accepted in the world. Credit cards are flexible; store cards are not.

2. Why is credit card use rising in India?

The number of credit cards in India has risen from 19.55 million in 2013 to 45.17 million in 2019. It is expected that by 2023 the number of credit cards held by Indians will double to around 100 million. This growth has been driven by growing online purchases and generous promotions used by banks, such as cash-backs and reward programmes. There has also been a fall in bad debts resulting from credit card users. This is because Indian banks are finding it easier to check customers' creditworthiness. There has been a growth in the demand for consumer credit in general; one reason in India is that incomes have risen. Higher levels of income can support higher levels of debt.

3. How much interest would an Indian card user pay if the balance owing was INR25 000 per month for a whole year? Assume the interest rate is 2.5 per cent per month.

The amount of interest paid by the Indian card user is given by:

$$2.5\% \times 12 \times \text{INR}25\,000 = \mathbf{\text{INR}7500}$$

4. How does credit card use differ among different age groups in India?

Although there has been a significant growth in the use of credit cards in India, different age groups appear to have slightly different reasons for using credit cards. For example, 24 per cent of 18 to 24-year-olds said they used credit cards to avoid carrying cash, compared to only 14 per cent of the over 45 year-olds; 33 per cent of over 45s like credit cards because they can 'buy-now-pay-later'. However, only 13 per cent of 18 to 24-year-olds used cards for credit.

5. Assess the advantages and disadvantages to Indian retailers of accepting credit cards as a means of payment.

An increasing number of retailers and other vendors around the world accept credit cards for payment. One of the main reasons for this is that sales and revenues will increase due to the appeal of credit cards. Vendors might also gain a competitive edge over rivals that do not accept credit cards. The use of credit cards also avoids the need to handle and store large amounts of cash, reducing the risk of theft. Retailers with online operations would struggle to survive if they did not accept credit cards as credit cards are very popular with online shoppers. A final advantage is that debt problems and the non-payment of debt is the responsibility of the card issuer, not the vendor.

However, there are disadvantages. The main disadvantage is that vendors have to pay a fee to the credit card issuer – usually between 2 and 5 per cent of every transaction. This is an added cost and will reduce profit margins. Some card issuers may also be slow to transfer the money to vendors after a transaction. Vendors will also incur some administration costs when processing payments (such as staff training) and they may have a higher exposure to fraud when payments are challenged by the card issuer or the customer. However, the rapid increase in credit card use suggests that the advantages outweigh the disadvantages.

## CHAPTER 40

### CASE STUDY: SRI LANKA EXPORT DEVELOPMENT BOARD

1. What might be **two** reasons why Sri Lankan exporters need help and support when exporting?

Overseas markets will be unfamiliar. Selling in a different country can be challenging because different countries have different tastes, cultures, languages, working practices and laws. Another problem is that collecting debts from foreign customers is far more difficult than collecting debts from domestic customers. Therefore the likelihood of bad debts increases.

2. Use Figure 40.1 to describe the pattern of Sri Lankan exports between 2010 and 2018.

Over the time period the value of exports in Sri Lanka has increased significantly from less than US\$600 million to over US\$1000 million. However, the chart also shows that the value of exports is quite likely to change over the whole time period. For example, exports fell in both 2013 and 2016.

3. How does a nation benefit from selling goods and services abroad?

There are a number of benefits to a nation if businesses can export their goods and services. For example, more jobs are created, national income rises and the government gets more tax revenue. Generally, the money generated from the sale of goods and services abroad will help to raise the living standards in a country.

4. How might the EDB help Sri Lankan exporters?

Sri Lankan exporters may get help from The Sri Lanka Export Development Board (EDB). The aim of the EDB is to encourage Sri Lankan businesses to expand internationally. This will help to increase export sales and create jobs. The EDB offers consultative services to small and medium-sized businesses in Sri Lanka. It also sponsors and co-sponsors educational courses and training programmes designed for exporters. One of the specific

services the EDB gives is to provide information on, for example, how to get financial support, the nature of overseas markets, how to get access to foreign markets and export statistics from surveys. The EDB also helps with raising awareness and marketing of goods and services in foreign markets, such as attending trade fairs and exhibitions.

### ACTIVITY 1

#### CASE STUDY: WESTPAC® BANK'S EXPORT SERVICES

1. Why do commercial banks offer export services?

Commercial banks are profit-making organisations. They are happy to provide exporters with help and support but they will make a charge for most of their services. The provision of export services is a source of revenue and profit for commercial banks like Westpac.

2. What non-financial support might banks give to exporters?

The non-financial support given to exporters by banks is likely to be the provision of information and advice. For example, some banks help new exporters draw up an action plan before they start to sell in foreign markets. They may also provide information packs about trading conditions in overseas markets. These are sometimes described as 'Country Guides' or 'Country Profiles' and may be presented as booklets. They might contain information about infrastructure, business etiquette, trading standards, taxes, wage rates, working practices, the cost of living, income levels, cultural preferences and economic data. An exporter might like to consult such information before deciding which country to target.

3. Describe the services provided by Westpac to exporters.

Westpac offers a range of support to exporters. For example, it offers special foreign currency bank accounts. These help exporters to make and receive payments in a foreign currency. It also offers a range of foreign exchange services, which helps exporters to protect themselves from frequent changes in exchange rates. For example, for a pre-paid premium, Westpac's *FX Option* provides exporters with the right (but not the obligation) to buy (or sell) a specified amount of a currency against another currency, at an agreed price, on a specified date in the future.

Westpac also offers an export documentary collection service; this is part of Westpac's documentary collection process. It sends export documents to a bank in the customer's country. The documents are only released to the customer when payment terms and conditions are met. It also prepares export documentary letters of credit. These letters are sent to an overseas customer to tell them to instruct its bank to pay an exporter (assuming that the agreed conditions specified in the original documentary credit are met). It is an internationally accepted method of settling trade payments. Westpac also provides exporters with short-term, post-shipment finance by buying the bill of exchange for up to 100 per cent of its face value.

**ACTIVITY 2****CASE STUDY: WTO**

1. What is meant by a trade dispute? Illustrate your answer using the example in this case study.

A trade dispute may occur if a country fails to comply with a trade agreement that has been set up. Trade disputes usually occur when a country imposes a trade barrier that is contrary to the agreement reached. In this case, Pakistani authorities claimed that South Africa had imposed anti-dumping duties of between 15 per cent and 68 per cent on Pakistani cement. The South African government claimed that the cement imports were damaging the domestic cement industry.

2. How might South African consumers be affected by the imposition of anti-dumping duties?

The duties imposed on Pakistani cement imports will raise the prices of cement in South Africa. This means that consumers (in this case, probably customers in the building industry) will have to pay more for cement. This will raise costs and possibly reduce the profits of firms in the South African construction industry.

3. What actions might the WTO have taken in settling this dispute?

Trade disputes between members are not uncommon. The WTO's procedure for resolving trade disputes is vital for enforcing the rules and making sure that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements have been infringed. In this case the WTO has to decide whether South Africa's anti-dumping duties are justified. South Africa has already spent four years investigating Pakistan's claims, but according to Pakistan officials South Africa has failed to address a number of important issues relating to the case; for example, it failed to consider the effects of the breakdown in cartels running the South African cement industry. South Africa also failed to examine the entire product range under investigation and focused only on the market for bagged cement. In addition, it denied Pakistani cement exporters access to trade statistics and therefore did not allow them to defend their case. The WTO will have to consider these issues when making its judgement.

4. How do the activities of the WTO benefit exporters?

The WTO is responsible for promoting free trade around the world. Part of its role is to reduce trade barriers. This benefits exporters because it will be easier to break into overseas markets if all trade barriers have been lifted. The WTO also helps to settle trade disputes. This makes exporters more confident knowing that an official body is available to ensure that trading is fair.

**MULTIPLE CHOICE QUESTIONS**

1. A    2. D    3. A    4. B

**CHAPTER REVIEW****CASE STUDY: KAMEER COSMETICS**

1. What is **one** way a chamber of commerce might help exporters?

A number of organisations represent the interests of businesses. One such organisation is a chamber of commerce; these are found in many countries around the world. They are often described as a network and exist to support and connect companies. They link firms to build new relationships, share best practice, foster new opportunities and provide practical support to help member businesses trade locally, nationally and globally.

2. What is meant by an export credit guarantee?

One of the most challenging problems when selling goods and services to overseas customers is the difficulties that arise if a customer fails to pay on time. It is very hard to collect debts from overseas customers. One way to protect against bad debts from overseas customers is to get an export credit guarantee. This is like an insurance policy against bad debts from foreign customers. If the customer fails to pay, compensation is provided through the export credit guarantee. In many countries the government funds this service. This 'safety-net' encourages businesses to sell abroad. Kameer Cosmetics hopes to obtain an export credit guarantee.

3. What might be the disadvantages to Kameer Cosmetics of using an overseas agent when selling in foreign markets?

Kameer Cosmetics hopes to meet an overseas agent at the MakeUp in Paris trade fair. These agents act on behalf of exporters in foreign markets. They introduce exporters to customers and help to facilitate international trade transactions. Overseas agents are paid a commission for any sales that result from introductions; these fees range from 2.5 per cent to 15 per cent.

Although the use of overseas agents by Kameer Cosmetics has some sound benefits, there are some disadvantages. For example, overseas agents do not meet the costs of shipping and other trade-related logistics and agents may require access to the exporter's sales records to check that their commission payments have been made in full. Also, there may be very little (or no) after-sales service when selling through overseas agents. The responsibility for checking the creditworthiness of foreign customers must be absolutely clear. It may be necessary to state clearly that it is the agent's responsibility in the agent's contract if this is the case. Finally, Kameer Cosmetics would have much more control over the sale of goods in foreign markets if it were to sell without the use of agents. This is because an exporter would use its own employees to set up displays of goods and organise other selling activities – this might be important to a company selling cosmetics, where the point of sale might be crucial.

4. Describe the possible benefits to Kameer Cosmetics of attending the MakeUp in Paris trade fair.

The Pakistani chamber of commerce recommended that Kameer Cosmetics should attend the MakeUp in Paris cosmetics trade fair to help break into the European market. Trade fairs like this are events where manufacturers and distributors put their goods or services on display for current and prospective customers, suppliers and other interested businesses. This approach to marketing is a valuable method of communicating with agents, distributors and consumers in foreign markets. They also provide opportunities for exporters to inspect new products and identify trends and competitors.

Attendance at trade fairs is valuable when marketing new products like Kameer's new range of ethical cosmetics. Kameer is hoping to meet agents or distributors that might be able to market its products. Kameer might also meet influential political representatives who can provide important contacts. Attendance is also an opportunity to 'weigh up' rivals in the industry, carry out research, network and build contacts. Finally, attendees are likely to show a genuine interest in the products on display. About eight out of ten people who attend trade fairs are buyers.

Since attendance at trade fairs and exhibitions is important to exporters, many governments offer help and support to those that might attend. In some countries grants might be available for attendance. Successful businesses can use the grants to fund direct exhibiting costs, including stand costs and conference fees. However, there is no information in this case to suggest that Kameer Cosmetics will get state financial help.

**EXAM PRACTICE: 4 AIDS FOR COMMERCE**

- (a) A Speed is the main advantage of air transport.
- (b) C An overseas agent might help an exporter.
- (c) One benefit to Zhongshan Wanao Mould Products Co. Ltd of using email to communicate with people outside the company is that messages will be sent and received instantly and so an answer can be received more quickly.
- (d) Sea transport is relatively slow, but it is a very cost-effective way to transport large cargos of bulky items. Goods like electric kettles, tea sets, meat grinders and intelligent barrel water pumps are not perishable and so do not require a faster method like air transport.
- (e) A meeting to discuss the design of new kitchen appliances at ZWMP would need feedback from colleagues in different departments on sales of existing products and ideas on how to develop new or improved products. A colleague from Sales might provide feedback on which designs of tea sets have been most popular and which might need modifying. This would allow a colleague from Production to put forward ideas on how much these developments might cost; another colleague might then say whether it could be done profitably.

Fashions in kitchen appliances will change and the meeting will allow people to put forward their views and react to the opinions of others so that weak ideas can be rejected quickly and stronger ideas debated. This should help ZWMP make better decisions, develop appliances that customers will want in their kitchens and so increase the sales and profits of the company.

- (f) ZWMP should use social media to advertise its kitchen products.

One advantage of social media is that specific customer groups could be targeted: adverts for tea sets on Facebook for older customers and adverts for kettles on Instagram for younger customers. Targeting might encourage customers to engage and is less costly for ZWMP. These platforms would allow ZWMP to ask for and encourage feedback on designs and would allow the company to respond to complaints and be seen as responsive. Social media would also allow new products to be brought to the attention of customers very quickly.

One disadvantage of social media is that customers cannot touch and feel the product in the way that they might be able to at a trade show or exhibition – where they could pick up and feel a tea set and perhaps drink from it. Having said that, social media can demonstrate the use of the tea set and show people drinking from it which can be equally powerful. So long as ZWMP has a simple returns policy, a customer could be reassured that if the tea set didn't look and feel how they expected it to, having seen it on Facebook, it could be exchanged or returned easily.

Given a limited advertising budget, ZWMP will reach a much wider audience using social media. While it is true that not all consumers of kitchen appliances use social media, even fewer will be visitors at trade fairs and exhibitions. It is easier for consumers to share social media images and stories which will give ZWMP a bigger reach. Social media will allow the company to have dynamic content, demonstrating its kitchen products and showing them off to good effect.