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Second Edition

Marianne Hickey Tony Nader Tim Williams



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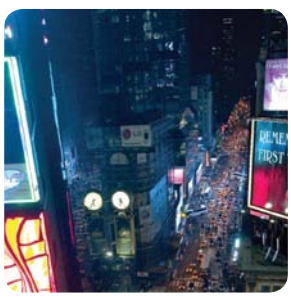
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About the authors



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CASE STUDY

Welcome to Crumpler

It is 1992 and Stuart Crumpler is learning how to sew. Assisted by his grandmother, Crumpler is attempting to convert a truck tarpaulin into a bag strong enough to carry his slab of beer home on his bike. The result is the world's first Crumpler bag.

His simple but functional solution to an immediate and personal problem has since grown into one of Australia's most successful casual bag companies, with stores across Australia, the United States and Asia. The journey has seen Crumpler bags evolve from a dining room table in Ballarat, Victoria to one of the most recognised bag labels across the world. But how did Stuart convert his desire to make great durable bags into such a successful business, and what can we learn from his journey?

While Grandma and her sewing machine assisted with the creation of the prototype Crumpler bag, it was a chance meeting with a fabric seller who also made parachutes that helped Stuart turn his personal interest into a realistic business proposition. The parachute maker saw Crumpler's original idea and product and quickly tore it apart, demonstrating an improved and more reliable process of stitching strong bag style fabric. From there, Stuart developed his craft, improving his design and his technique one bag at a time.

At this time, Crumpler was employed as a bike courier for a messenger company, who ordered some of Stuart's first bags for their riders. The riders loved the lightweight bags, that could be easily opened and closed without having to take the bag off. The owners of the bike messenger company, Dave Roper and Will Miller, were quick to understand the potential in marketing these bags to other bike messenger businesses, and it was not long before their business took off in a completely new direction. In Roper's words, they 'ditched the messenger company' and Crumpler, Roper and Miller formed Crumpler Bags, known simply in today's business environment as Crumpler.



Will Miller, Stuart Crumpler and Dave Roper.

Soon, the bright coloured bags that Crumpler were producing had become a key marketing tool. Their unique and often mismatched colours were attracting the interest of many people, as was the unique logo they plastered on footpaths and around building sites to create a sense of curiosity. Customers followed the trail of logos back to the Crumpler factory in Flinders Lane, Melbourne and the three investors were able to use the money

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Crumpler store – Newtown, Sydney

from these sales to update their equipment and improve the quality of their materials.

This marketing strategy was very successful, a clever use of viral marketing before the strategy had really been developed and understood, and long before the internet had provided the ideal forum for it. The increasing interest it helped build saw respected clothing store Kathmandu acquire the rights to sell Crumpler across Melbourne stores. It wasn't long before Crumpler bags were sought after by customers across the country.

Two years later, Crumpler was exhibited at a trade show in Germany and from there Crumpler sold wholesale to department stores across the United States and Asia. As e-commerce developed, online ordering also became, and remains, an essential element of Crumpler's sales and marketing strategy.

Today, the Crumpler range extends to camera and photography bags, laptop bags, backpacks, everyday bags and luggage. The business is now firmly established as one of Australia's premier bag companies, selling strongly here and across the world.

'Whether for better or worse – and it was often worse – we worked it out ourselves. We found our own way and that's what makes us different.'– Stuart Crumpler



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TOPIC 1

Operations

Introduction

The focus of this topic is the strategies for effective operations management in large businesses.

Outcomes

The student:

- H1 critically analyses the role of business in Australia and globally
- H2 evaluates management strategies in response to changes in internal and external influences
- H3 discusses the social and ethical responsibilities of management
- H4 analyses business functions and processes in large and global businesses
- H5 explains management strategies and their impact on businesses
- H6 evaluates the effectiveness of management in the performance of businesses
- H7 plans and conducts investigations into contemporary business issues
- H8 organises and evaluates information for actual and hypothetical business situations
- H9 communicates business information, issues and concepts in appropriate formats
- H10 applies mathematical concepts appropriately in business situations

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Students learn to:

- examine contemporary business issues
- investigate aspects of business using hypothetical situations and actual business case studies

Students learn about:

- role of operations management
- influences
- operations processes
- operations strategies

Business operations are concerned with the creation of goods and the provision of services by businesses. It is integrated with the other key business functions, in particular marketing because operations produce products that satisfy the wants of the target market. Operations involves planning, purchasing inputs, inventory management, manufacturing techniques and processes used to convert inputs into outputs and the supply of outputs.

Operations managers must consider the influences from the environment. Globalisation has provided opportunities to expand and outsource operations overseas while technological developments have improved the efficiency and quality of operations.

Some businesses invest heavily into research and development to gain a competitive advantage while others will change and improve existing products. Operations managers are increasing their emphasis on quality management and achieving world's best practice.

Corporate social responsibility is a necessary part of operations. Pressure from stakeholders and new legislation has meant that a business's impacts on society and the environment must be considered and possibly included in the costs of the operation's function.

At the end of this topic you should be able to:

- critically analyse the role of businesses in Australia and globally
- evaluate operations strategies in response to changes in the internal and external environment
- discuss social and ethical responsibilities of a business when managing operations
- analyse the operations process in a large and global business
- explain operations strategies and their impact on businesses
- evaluate the effectiveness of operations management
- plan and investigate current issues with respect to operations
- organise and evaluate information about actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats

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CHAPTER 1

Role of operations management

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Operations is the key business function concerned with the **transformation** of **inputs** into **outputs**. The operations manager oversees this process by planning production, organising inputs, motivating employees, and monitoring and controlling the outputs. Outputs can be both physical goods and services. The output may be finished goods sold to final consumers, an intermediate good that will be used as inputs by other businesses or a service provided to consumers or businesses. Many businesses provide both a physical product and a complimentary service. For example, a restaurant will provide a good, the meal itself and the waiting service to the customer's table.

good at a cheaper price. To perform their role the operations manager will need all the skills and qualities discussed in Topic 2, Business management, of the Preliminary course. In particular, communication, decision making, delegating and complex problem solving.

In a large business using a functional organisational structure the operations manager will supervise the specialist line managers. In a small business, operations may be managed by an owner, factory manager or sales manager.

The operations manager will consider business operations as an entire system. A business will be able to produce goods and services that best satisfy the wants and needs of customers at a competitive price. Through their role the operations manager can add value to the product at each stage of operations. Ultimately with an effective and efficient operations system a business will achieve the short-term and long-term objectives of the business.

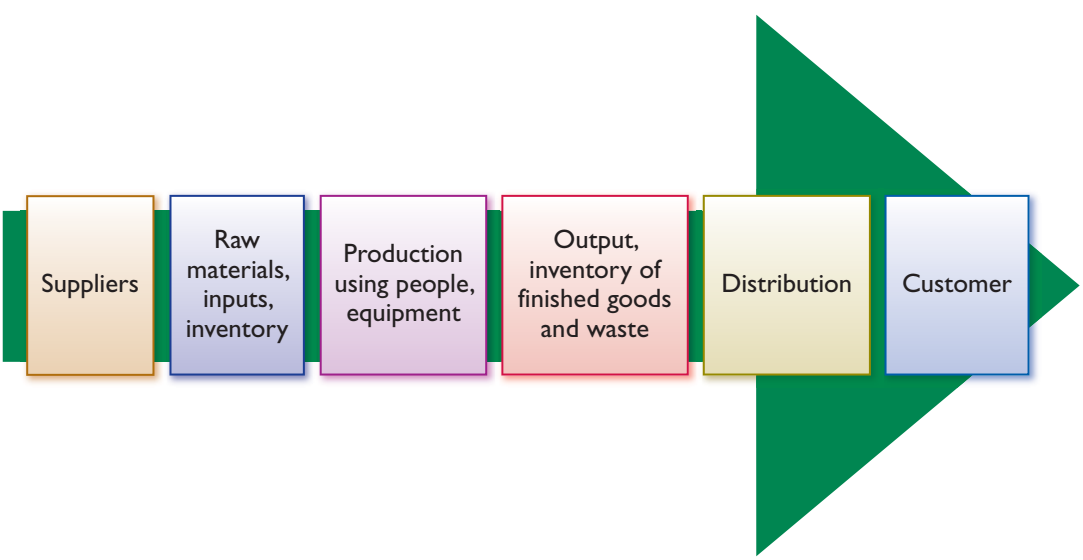


Figure 1.1 Simplified operations process.

Effective operations management adds value to the business by increasing **productivity**, reducing costs and improving quality. This is to achieve a strategic **competitive advantage** through lower costs and/or differentiated goods. The business can offer a better quality

Transformation

Any changes to inputs that adds value and converts them into outputs.

Inputs

The raw materials, components and parts used to produce a good or supply a service.

Outputs

What is made or supplied by the operations process.

Productivity

A measure of how efficiently goods and services are produced. It is usually measured in terms of output per labour hour.

Competitive advantage

Refers to the features implemented by a business that creates an advantage over its competitors.

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Strategic

Long-term planning performed by senior managers.

Efficiency

Achieving maximum output with the minimum level of inputs. It involves achieving an objective without wasting resources and while keeping costs as low as possible.

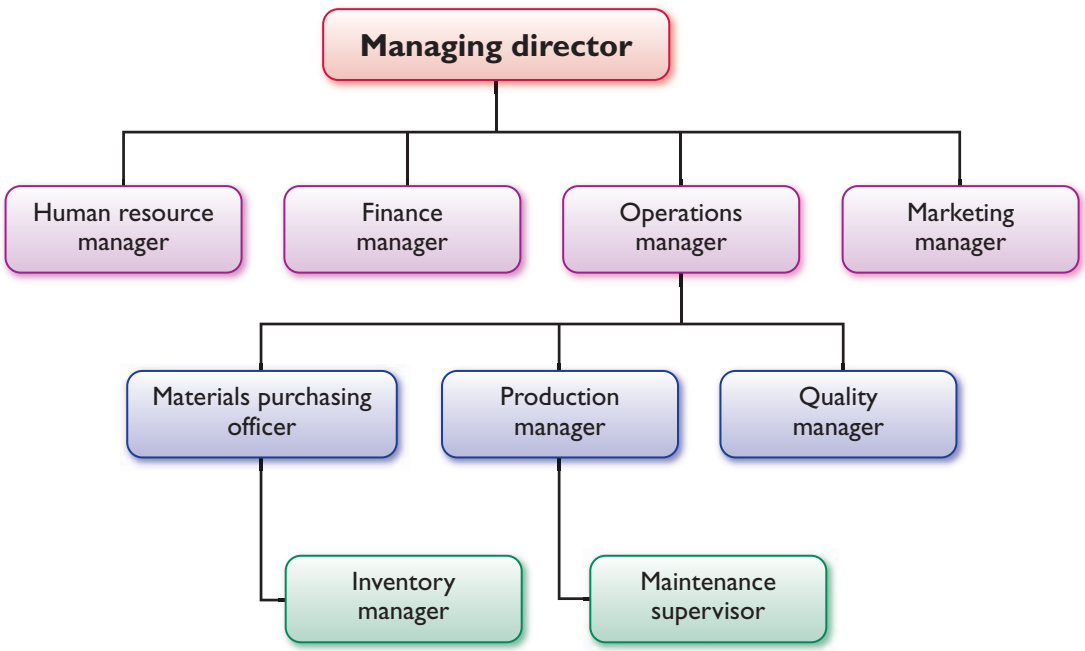


Figure 1.2 Operations in a functional organisational structure.

Strategic role of operations management

The operations manager will make **strategic** decisions about the overall design of the operations system. A strategic decision is one that affects the business in the long term. For example, where the business chooses to make its products will affect the location of operations. Or from where will the business get its inputs. Will the business buy inputs and raw materials from a local supplier or look offshore and buy from another country? The strategic goals are to improve productivity, **efficiency** and quality of outputs. Strategic operational decisions will also need to fit the overall strategic goals and vision in the business plan and fit the changing business environment.

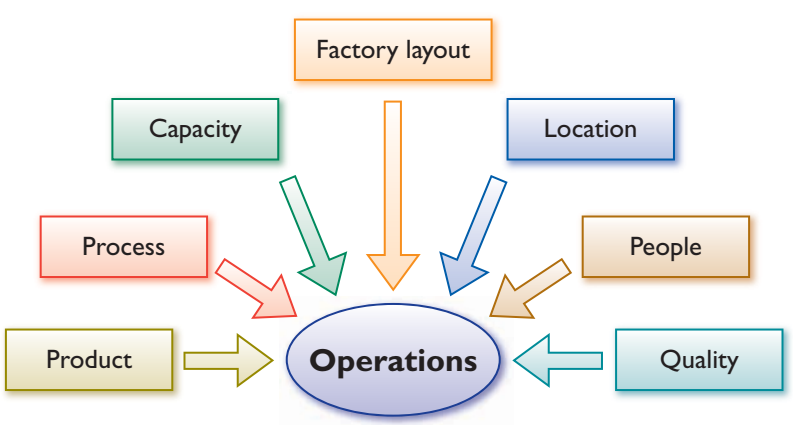


Figure 1.3 Strategic decisions about how operations will be managed.

Long-term decisions will cover three broad areas:

- planning production and delivery
- controls to manage quality
- improving operations.

Therefore, all strategic decisions will focus on lower costs to an industry benchmark through efficiency and producing a good or service that is different to and competitive against rivals in the market.

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Table 1.1 Strategic decisions

Area of strategic decision	Examples of questions to decide
Product	• What new products need to be developed? • What products are reaching the end of their life cycle and need to be deleted from operations? • How will products be made different to competitors, such as better quality? • What services will be provided?
Process	• How much capital and how much labour? • What developments in technology will there be that could be used in operations?
Capacity	• How large does the factory need to be? • How much will the business need to make and supply per hour or day?
Location	• Stay, move to a different location in Australia or relocate overseas? • Can the business provide its services using the internet?
Factory layout	• How will the manufacturing be physically set out: using production lines in a process layout, or use a product layout or fixed position layout?
People	• How many employees will be needed in the future? • What experience and skills will employees need?
Quality	• How will quality be measured? • How will quality be improved?

Activity 1.1 Comprehension

Examine the two advertisements for operations managers below and answer the questions that follow.

Operations manager

Dela Cruz Mining is seeking a talented manager of operations with a background in the management of mineral processing facilities. Applicants will need effective communication, organisation and negotiation skills as well as the ability to take a hands-on, practical approach to work. Technical knowledge of process operations and related equipment is essential. Key areas of responsibility include implementation of health, safety and environmental policies and ensuring production meets targets. Industry leading remuneration and compensation for relocation will be provided. Applications are to be directly submitted to the CEO of Dela Cruz Mining, Kalgoolie, WA.

Head of operations

An ambitions and talented IT executive is required for this rapidly expanding firm. Applicants are required to have an awareness of innovative technological solutions in e-commerce to manage new product development and customer delivery. Applicants must have keen interest in banking and finance and be highly motivated and self-reliant. Strong interpersonal skills, vision, flexibility and the ability to solve complex IT-based problems are required.

Applications online at www.pictor.com. Please quote ref no. 694822.

1 Identify skills that the operations managers will need for these positions. Explain why these skills are needed.

2 Give an example of the strategic decision that each job requires.

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Profit margin

The difference between the sale price of a product and the cost to make the good or supply the service.

Cost leadership

A cost leadership strategy is where a business aims to be the lowest cost manufacturer within its industry. The products are the basic, no-frills type with fewer features, perhaps lower quality and using low-cost packaging. Low costs can be achieved through economies of scale in production and distribution, access to cheaper raw materials or inventing an innovative method of production. The business will expect a small profit margin on each item it sells, balanced by a high volume of sales to generate satisfactory revenue. Other areas in operations where low costs may be achieved include:

- outsourcing product servicing so that the business focuses on its core function rather than after-sales service and warranty administration
- exclusive access to a large source of low-cost inputs
- distributing the product using dealers who work with lower **profit margins**.

If the business is able to achieve cost leadership and sustain it over the long term and is also able to sell its products at prices at or near the industry average, then it would be an above-average performer with healthy sales and profits.



The challenge for a business using this strategy is to achieve long-term benefits. The issues that operations managers need to be aware of when using a cost leadership strategy are:

- Competitors can use the same strategy and may achieve even lower costs. Small businesses are able to implement strategies to reduce costs much faster than larger firms.
- The business's product is not perceived by customers to be equal to its competitors because competitors offer better technology, features and service.
- Developments in technology change consumer preferences. A business may have invested a considerable amount of finance into low-cost manufacturing of a particular product only to find that the wants of its customers have changed to a new technology item.
- Consumer preferences change and the market for a 'low-cost, low-quality' product shrinks. Consumers may even feel that these types of 'throwaway' products are not environmentally sustainable.
- A strong competitor uses aggressive marketing with heavily discounted prices or loss leading prices. The business using a cost leader strategy cannot make a profit even with its cost advantage.
- Being 'leapfrogged' by a business that can afford a large financial investment in research and development.

Therefore, a cost leadership strategy may not be sustainable in the long run unless the benefits can be maintained with effective marketing, finance and human resources strategies.

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Good/service differentiation

A business may decide that a better strategy to achieve a sustainable advantage in a competitive market is to differentiate its products rather than aiming to be the lowest cost supplier. Customers have ever-increasing expectations about quality, service and technology. A product may achieve a greater market share because it is uniquely different to its competitors. Differentiation through operations may be achieved through:

- better quality
- faster delivery
- custom-designed products
- more features and applications
- incorporation of new technology
- clever design.

Good examples of a differentiation strategy are the 'thumbwheel', 'click wheel' and 'touchscreen' technology used in Apple products from iPods, iPhones and iPads.

A differentiated product can command a higher premium price in the market as customers are attracted to the product and build up brand loyalty. The higher price will cover higher costs from investment in a highly creative and skilled product-development sales team to promote the advantages of the product and technological innovation.

The risks associated with this strategy are that competitors can imitate the market leader's innovations and consumer preferences can still change.



Figure 1.4 Touchpad innovation.

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Tangible

A physical good that can be seen and felt.

Customised

Changing the features of a product to suit the precise preferences of a customer.

Goods and/or services in different industries

There are significant differences between manufacturing and service-based businesses.

Manufacturing outputs are **tangible**, that is, they physically exist and can be touched and felt. Therefore, the outputs can be stored before distributed to customers; however, once made, they cannot be changed or **customised**. The productivity of the business making the goods is easy to measure as physical goods can be counted. Services, in contrast, are not tangible. For example, services like financial advice, a doctor's consultation or being represented in court by a barrister are real but do not exist in a physical sense. While manufactured goods use a lot of equipment – that is, they are very capital-intensive – services are much more labour-intensive. Services require a lot of interaction with customers who consume the service where it is provided; for example, at a hair salon. The advantage of services over manufacturing is that it is easy to modify and customise the service to suit the desires of the customer. However, productivity is much harder to measure due to each service being different for different customers.

A business can provide a physical good or a service, and very often provides both. There are also similarities between serviced-based and manufacturing operations. They both:

- use technology
- must make predictions about consumer demand
- deal with customers and suppliers
- make decisions about capacity, location and physical layout of the business.

It is in the services sector where the most development in operational management is occurring.

There is a great variety in the output of the operations of different businesses. It is easier to classify them according to industry sector and new types of industry are developing with technological change. There are a number of ways of classifying different types of businesses in Australia. Grouping different businesses by industry type gives a good indication of the range of goods and services in different industries.

Table 1.2 Australia industry sectors

Sector	Examples	Nature of the goods and services
Agriculture	Cubbie Station Ltd	• Australia's largest cotton producer, located in Queensland
Banking and finance	Macquarie Bank	• Provides banking, finance, advisory and investment services for businesses
Construction and engineering	Brookfield Multiplex	• Construction and development of large buildings and major projects
Education	Bond University	• Australia's first private, not-for-profit university located in Queensland

(continues)

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Table 1.2 Australia industry sectors *(cont.)*

Food and beverage manufacturing	**Coca-Cola Amatil** **Arnotts**	• Bottler of non-alcoholic drinks • 144-year-old biscuit and snack food maker
Healthcare	**Douglass Hanly Moir**	• Medical testing laboratory services and pathology services
Infrastructure and utilities	**AGL Energy**	• Provides natural gas and electricity energy for homes and businesses and energy services
Insurance	**NRMA**	• All types of business and personal insurance as well as motoring services
Information technology	**NetApp**	• Provide innovative data storage, management and security systems
Legal	**Mallesons Stephen Jaques**	• Ranked in the 100 largest law firms globally, providing commercial legal services
Leisure and gaming	**Aristocrat**	• Supplies slot machines, gaming systems, accessories and services worldwide
Media	**PBL Ltd**	• Owns Nine Network, ACP Magazines, Ticketek and Acer Arena
Manufacturing	**Toyota Motor Corporation Australia**	• Cars first assembled in Melbourne in 1963; first Australian built Hybrid is released in 2010
Mining and energy	**BHP Billiton**	• Began in Broken Hill, NSW, in 1885, mining silver, lead and zinc; merged with Billiton in 2001 to be global leader in the resources industry
Property	**Westfield Group**	• World's largest listed retail property group operates a global portfolio of 119 shopping centres in Australia, New Zealand, the USA and the UK
Retail	**Harvey Norman Holdings Ltd**	• Operates in Australia, NZ, Slovenia, Ireland, Singapore and Malaysia, offering franchises within the store to retailers of home and office products
Small business	**7-Eleven**	• Convenience stores first opened in Australia 1977; in 2010 had 650 stores
Telecommunications	**Telstra**	• Formerly a government business enterprise, privatised in 1991, providing landline, mobile and internet services with interests overseas
Tourism	**Hamilton Island Enterprises**	• Leading resort located in the Whitsunday Islands, Great Barrier Reef; 1992 in receivership; relaunched in 2003
Transport and logistics	**Linfox**	• Provides supply chain solutions to leading companies across the Asia-Pacific; began in 1958 delivering soft drinks with one truck

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BUSINESS BITE

Qantas's core physical product is the planes it uses, such as the new A380. This product includes a seat on such a plane, ranging from economy, premium economy, business and first class flyers. The economy class seat is 18.1' wide, ergonomic, with an adjustable headrest, storage space and personal in-flight entertainment screen. In contrast, business class Skybeds are seats that can recline fully flat, have a massage feature, extra ergonomically designed cushioning, storage and a larger widescreen entertainment screen. Qantas offers a full range of services to accompany its product. Flight attendants serve meals, clean up and provide refresher towels. The timetable is also a service as it is intangible. Other services include Qantas holidays, Frequent Flyer and even a limousine service.



Activity 1.2 Comprehension

1. Identify the range of services provided in the tourism industry.
2. Outline the mix of goods and services provided in the media industry.
3. Describe the differences in the nature of service-based businesses and those that produce goods.
4. Explain how a beverage manufacturing business can achieve product differentiation through operations.
5. Analyse the importance of technology when providing services in the healthcare industry.

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Interdependence with other key business functions

There will be a constant flow of information between operations and the other key business functions: marketing, human resources and finance. Each function relies on the other so that the business can achieve its goals. Therefore, with **specialisation** of the business functions there must be **interdependence**.

To illustrate the interdependence between the key business functions consider the following interactions between each. In marketing, research identifies the nature of goods consumers' desire and marketing strategies encourage purchases. Operations must supply a product that has the features and quality consumers demand as well as reliably distributing this product to the market. The finance manager will create budgets and make funds available to purchase inputs, equipment, repairs and maintenance. Production costs will be minimised in order to maximise profit margins. Human resources will ensure that enough employees with the appropriate skills are available for the operations function. The human resources manager will use their leadership style and rewards to ensure quality work is done by employees in the operations function.

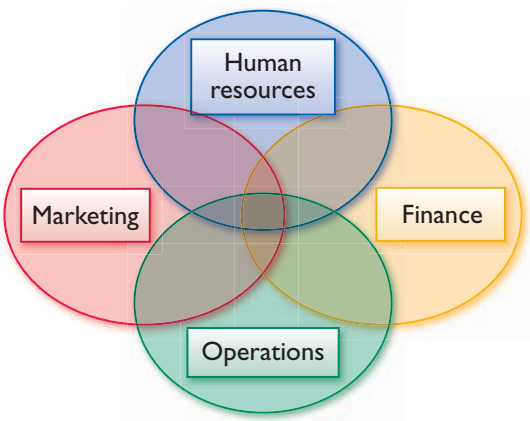


Figure 1.5 The interdependence between the key business functions.

Specialisation

Being highly skilled at a specific task or role.

Interdependence

Different parts of an organisation must rely on each other to perform their task or role.

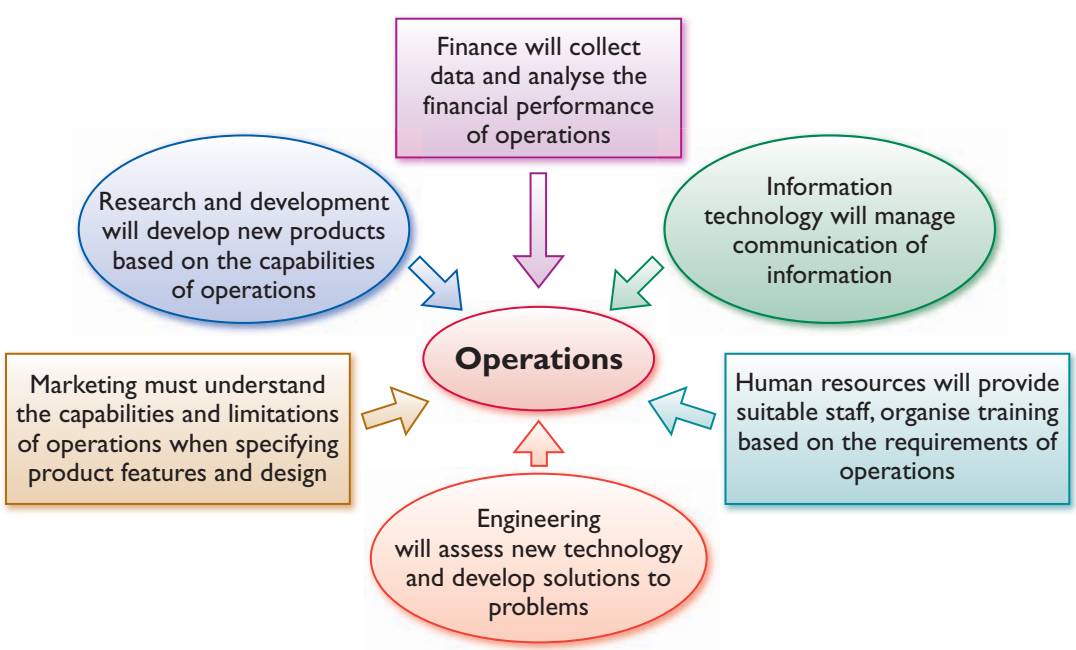


Figure 1.6 The interrelationships between operations and other business functions.

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Chapter summary

- Operations is the key business function concerned with the transformation of inputs into outputs.
- The operations manager oversees this process by planning production, organising inputs, motivating employees, and monitoring and controlling the outputs.
- Effective operations management adds value to the business by increasing productivity, reducing costs and improving quality. This is to achieve a strategic competitive advantage through lower costs and/or differentiated goods.
- A cost leadership strategy is where a business aims to be the lowest cost manufacturer within its industry.
- A differentiated product is one that has unique features based on quality, features and technology and can command a higher price in the market.
- Business operations will be significantly different between a business in a manufacturing-based industry and a business in a service-based industry. Operations will have elements of both.
- Owing to specialisation between the key business functions there will be considerable interdependence as there will be a constant flow of information between operations, marketing, finance and human resources.
- In a customer-focused business operations must produce a product that satisfies the needs and desires of its target market.

Chapter revision task

Copy and complete the following table on the characteristics of manufacturing and serviced-based businesses.

Characteristic of operations system	Service based	Manufacturing based
Nature of output	• Intangible product	
Inventory		• Stored in a warehouse
Size of operations	• Generally small	• Large facilities
Use of equipment	• Labour-intensive	
Measurement of quality	• Difficult to measure (customer feedback)	
Contact with customers		• Low customer contact
Location		• More centrally located
Adaptability	• Short response time to changes in the market	

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Multiple-choice questions

1 What is included in the function of operations?
- **(A)** The actual production of a good
- **(B)** The production of a physical good and provision of a service
- **(C)** The processes involved in turning inputs into outputs
- **(D)** The processes involved in planning and organising raw materials and inputs

2 What is output of a serviced-based business?
- **(A)** Quality products
- **(B)** Final products ready for sale
- **(C)** Fast delivery times for services
- **(D)** Satisfied customers

3 Which of the following are strategic decisions of the operations functions?
- **(A)** Reducing the amount of waste by 10% over 18 months
- **(B)** Forecasting the amount of inputs required for production
- **(C)** Organising repairs to a breakdown in the assembly line
- **(D)** Assessing the potential location for the business in 2015

4 Which of the following are examples of inputs into a service-based business?
- **(A)** People, machines, energy
- **(B)** People, information, raw materials
- **(C)** People, office equipment, managers
- **(D)** Raw materials, buildings, tools

5 A feature of a cost leadership strategy is?
- **(A)** New features developed for existing products
- **(B)** Market research
- **(C)** Assembly-line manufacturing
- **(D)** Outsourcing of non-core operations functions

6 An advantage of a differentiation strategy is?
- **(A)** Increase in revenue and market share
- **(B)** Operational costs can be reduced
- **(C)** Employees are highly specialised and skilled
- **(D)** Quality is improved

7 Which of the following is an example of a strategic operations decision?
- **(A)** Organising the working roster
- **(B)** Having repairs made to equipment
- **(C)** Plans for routine maintenance and updating equipment
- **(D)** Ordering inputs from overseas supplier

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8 Which example illustrates interdependence between operations and the finance key business function?
   (A) Operations supplies a product that satisfies the needs of the target market
   (B) Operations supplies a quality product that generates revenue from its sales
   (C) Human resources employs enough skilled employees within the wages budget
   (D) The product research and development create a prototype for a new product

9 In what industry are tangible products produced by the operation function?
   (A) Tourism, retailing and information technology
   (B) Mining, manufacturing and transport
   (C) Manufacturing, construction and agriculture
   (D) Construction, infrastructure and insurance

10 Which management skill is most important when coordinating the key business functions with the operations function?
   (A) Communication skills
   (B) Interpersonal skills
   (C) High ethical standards
   (D) Flexibility and adaptability to change

Short-answer questions

1 Explain why the operations of service-based industries are more labour-intensive than manufacturing businesses.

2 Explain why communication between operations and the other the key business functions is a critical success factor for a business.

Extended-response question

Outline the strategic role of operations and explain how the role of the operations manager can help a business achieve a competitive advantage.

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CHAPTER 2

Influences

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Globalisation

The integration of different national economies into a single market where goods and services can be traded easily and the development of a world economy owing to the increasing flow of goods, services, people, finance and information around the world.

Every business is influenced by its dynamic external environment and operations is no exception.

Globalisation

Globalisation gives consumers the opportunity to purchase products from the business that provides the most value for money. It is highly likely that students doing their Business Studies homework will be using a pen made by a French company, checking their social status on a Japanese laptop while having some two-minute noodles owned by one of the largest consumer packaged goods companies in the world based in Switzerland.

Businesses operate in a dynamic and highly competitive global environment, which has a significant impact on the operations strategy used by businesses. Globalisation has created many opportunities for Australian businesses to expand into overseas markets. This may be as simple as importing materials or as complicated as using foreign direct investment to establish operations from the ground up in a country where it is cheaper to produce. Therefore, the impacts of globalisation are twofold. First, there is the opportunity to reduce costs through establishing a global supply chain. Second, access to a global market to sell the outputs of operations.

Global businesses

Globalisation is defined as the integration and interdependence of the economies

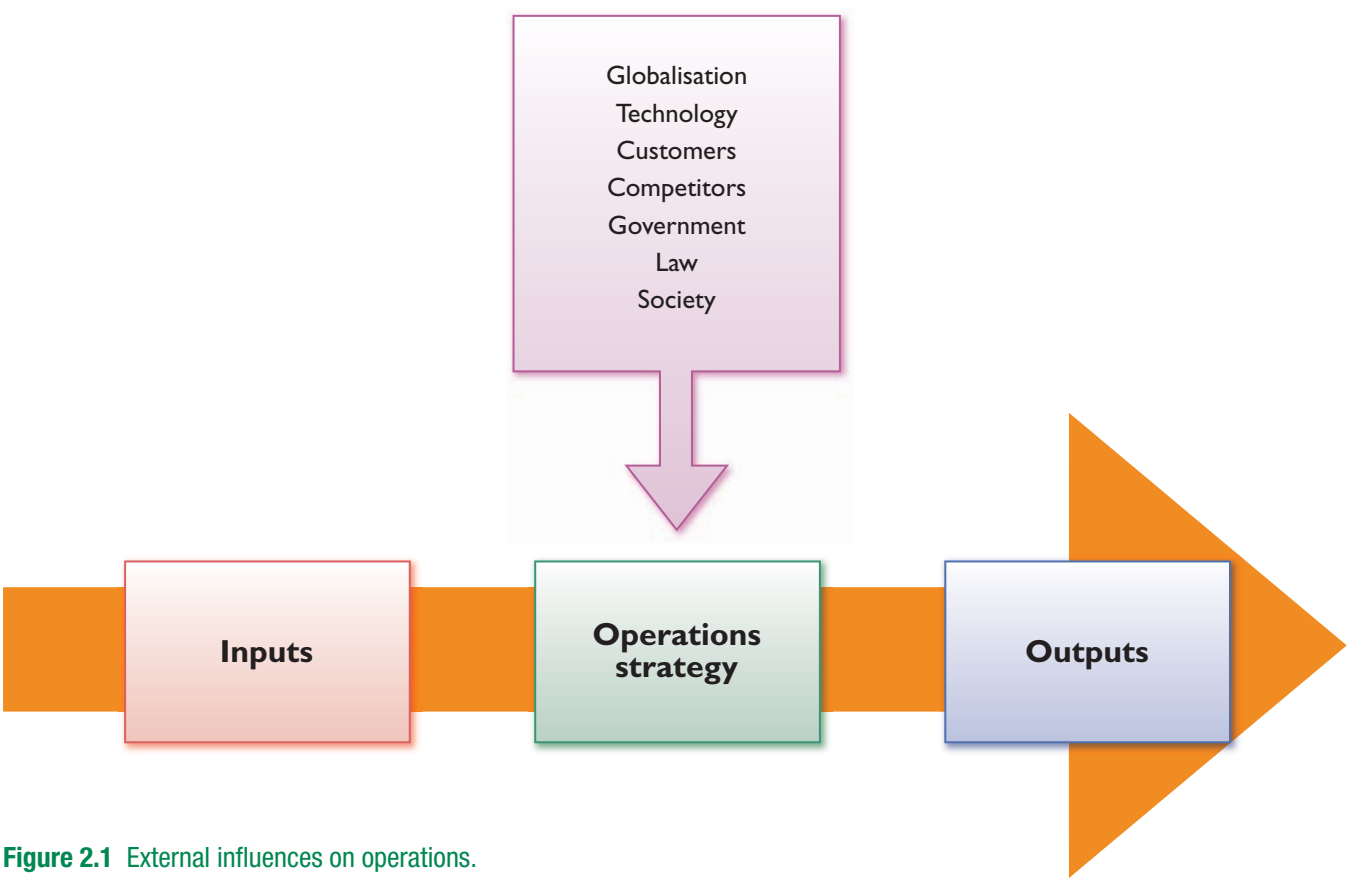


Figure 2.1 External influences on operations.

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of different countries, creating a global economy. Integration refers to the joining together of different economies through trade, technology, deregulation and global businesses. As a result, there is an increasing flow of goods, services, people, finance and information around the world. Geographic location and distance have become less important issues for business. Any business that has a key business function outside its home nation is part of the global economy. Other global businesses are fully integrated into the global economy, usually with each business function operating outside the home nation. A typical global business can be described as one that is integrated with the economies of a number of different countries. Manufacturing may be located where inputs and labour are cheapest, such as in a developing country. Raw materials may be sourced from where they are most abundant. Finance is controlled from headquarters situated in one of the world's financial centres; for example, New York. Products may be distributed and sold to consumers in developed nations, such as Canada, Germany and the United Kingdom. The reasons for the global web of operations is to drive costs down and exploit the competitive advantage each region has to offer. Different nations have become known for having particular strengths that some other businesses wish to use. Examples are shown in Table 2.1.

Table 2.1 Comparative advantages of selected countries

Country	Advantage
Japan	Technological innovation
Italy	Contemporary design
India	A computer-literate workforce
China	Inexpensive labour
Mexico	Skilled labour in manufacturing

With globalisation every function can be outsourced or relocated to reduce costs. For instance, the iPod player produced by Apple Inc. is designed in the United States, using Japanese electronic parts and assembled in China. This is an example of a high-quality and very successful product that represents the movement of businesses toward multinational design, manufacturing and distribution of a product.

With the opportunities to establish a global supply chain, many businesses expand into countries that offer cheaper labour, tax incentives and other benefits. This strategy will expose the business to influences from different currencies, trade agreements, global consumers, technology and differences in cultures.

Difference currencies

When operating in multiple countries a business will have to convert currencies in order to pay suppliers for inputs. This will principally affect the finance function of the business. A **depreciation** of the Australian dollar (AUD) against the currency of the country inputs are being sourced from will lead to rising costs. The original advantage of relocating and outsourcing will be eroded by the changing value of currencies in global finance markets. The business may be forced to seek a supplier elsewhere in the world where the AUD has a higher value.

A business can reduce this risk by using hedging. Hedging is any strategy used by a business to reduce financial risk. In this case the risk is from the exchange rate changing from when a purchase contract is signed and the time payment is made. Global businesses can use hedging to eliminate the risks from the value of currency appreciating and depreciating. Global businesses

Depreciation

(of currency) The fall in the value of a nation's currency against another currency. The nation's currency can fall in value due to a poorly performing economy or inflation. Currencies of other countries may increase in value because their economy is performing better.

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Regionalism

The classification of the world's nations into different regions based on their geography and economic links. The different regions may be classified as North America, Europe, South-East Asia, Asia–Pacific, Africa and South America.

Trading bloc

A group of nations that have formed a trade alliance by signing a multilateral trade agreement.

often enter into contracts to buy and sell foreign exchange to purchase inputs from businesses in other countries. This is called transaction exposure. Hedging can be used to eliminate transaction exposure. Hedging can be done naturally by using subsidiaries. A very common form of hedging is to use a derivative, which is a special contract between global businesses and suppliers. Hedging using subsidiaries involves a global business avoiding changing between currencies by having all transactions between its subsidiaries occur in the same currency. A subsidiary is a business that is owned by the global corporation that supplies inputs. For example, a toy manufacturer in the United States may own an electronics company in Malaysia. The electronics company exports parts to be put into the toys. Transactions are always in US dollars to reduce currency exchange risk.

However, sometimes the economic theory that drives the impacts of changes in the value of a country's currency is counter-balanced by government policy. China manages the exchange of its currency, the Renminbi, to maintain its value against the US dollar. Firms in other countries may significantly reduce the prices of the goods and inputs they export to keep their prices down despite the depreciating value of the importing country's currency.

Trade agreements

A bilateral trade agreement is similar to a treaty between two countries to reduce barriers to trade and promote economic integration. Multilateral trade agreements are between more than two nations. What is important for a global business wishing to enter the market is the amount of protection that exists. Nations may reduce barriers between one another or they may place additional barriers to the entry of an outsider. A business may establish operations within a country that is a member of a trade agreement that has been signed with the business's own country. Therefore, it may be easier for the business to establish overseas in that country than in a country with which no trade agreement exists. Some countries will develop a common trade policy against businesses in nonmember countries. As a result, there is an increase in geographic **regionalism** in the world. As well as global trade and international flows, there are regions of the globe forming an economic alliance. Europe, the North American Free Trade Alliance, or NAFTA, members (Mexico, United States and Canada) and the South-East Asian nations (including China) are the three main regional trading zones that have been established. Reductions in trade restrictions are given to member nations, creating a regional **trading bloc**. There are important implications for Australian businesses if they are excluded from these economic 'clubs'. For example, Australian businesses will have to source inputs and components from other countries and will find it very difficult to export to countries for which Australia is not a member of the trade agreement.

With the growth of the World Trade Organization (WTO) there has been a similar growth in global business, joint ventures, strategic alliances, foreign subsidiaries and multinational corporations, all creating a highly competitive global market. By using a large-scale operations model businesses can share costs and reduce the expense of developing, producing and distributing products to the global market.

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Ethical Issue

What issues does a nation face when it is excluded from a trade agreement or regional trading bloc?

BUSINESS BITE

With the growing emergence of environmental sustainability and social responsibility, a number of nations are using new forms of protection to support their local industry and reduce competition from foreign firms. Protectionism with a 'green cloak' involves the government setting such high environmental standards for imported products so that foreign produced goods cannot enter the local market. These requirements effectively prevent imported goods being able to compete against locally produced goods.

Emergence of global consumers

Globalisation enables higher incomes and many parts of the world have a rapidly growing middle class who wish to buy goods and services that improve their quality of life. For example, by 2025 India's middle class will grow from about 5% of the population to more than 40%, which will create the world's fifth-largest consumer market. The demand for consumer goods such as LCD televisions and other household goods will be enormous. Globalisation opens up new markets and operations may need to change the features, design, quality or information for a good or service. The product may only need small changes or be slightly differentiated to suit different aspects of the target market in different countries such as India. Operations must know the requirements of the product to suit different countries and have the flexibility to modify products as required. A business may not need to alter its core product at all to suit the same target market in different countries. Instead, it is able to supply a standardised product. However, often a product will have to be differentiated in some aspect to suit the different culture of the local market. Owing to differences in language, religion, tastes and ethics it is very important that a business planning to sell in a new market adequately researches the market to reduce the chances of the product failing.

Activity 2.1 Comprehension

1. Define the term *integration* with reference to globalisation.
2. Outline the impact of an increasing value of the Australian dollar on a local business that imports parts for a Sydney factory to assemble into finished goods.
3. Explain why multinational businesses have a global web of operations.
4. Analyse the impact of trading blocs on the operations of an Australian manufacturing business seeking to expand as part of its strategic plan.
5. Explain why an Australian exporting business would use a product differentiation strategy in its operations.

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Jugaad

Making use of what resources are available to complete a project imminently before it is due; a quick fix to a problem using whatever is available.

Technology

Globalisation has spread technological developments worldwide. Technologies such as mobile phones, email, smart phones and the internet are drivers of globalisation, enabling service-based businesses to penetrate global markets with the international distribution of information. With globalisation businesses can access technology not available in their home country. Strategies to acquire technology include a joint venture or strategic alliance with another business or simply purchasing businesses that have the desired technology. For example, the Malaysian car manufacturer Proton was struggling in the highly competitive automotive market as its vehicles were not up to the technological standard of its competitors. In 2003 Proton purchased 100% of the performance car brand Lotus to acquire its superior engine and suspension technology. In 2004 Proton attempted a strategic partnership with Volkswagen AG to access its technology, however, this was never completed.

example, in 2010 the Indian organisers of the Commonwealth Games came under much criticism for their approach to the operation of delivering a well-resourced and organised event. While Japan is famous for its just-in-time approach to efficiency, the Indian way of doing things is termed, **Jugaad** in time. This short-term improvised approach to organising operations was very frustrating for foreign firms and governments as their accepted approach was to use clear scheduling and sequencing, a high level of quality control with plenty of time for product testing and review. In the Jugaad approach, forecasting, planning, operations strategy, project management and checking are considered wasteful and not value adding. Overseas businesses and governments involved in the Commonwealth Games had to trust that given enough manpower everything would be complete in the moments before the event began.

One of the major external influences on business operations is technological change. Technology is the equipment and knowledge that are available to help businesses perform certain functions or make products. Technology can result in the development of new methods of production or new equipment that helps businesses perform functions more quickly and often at a lower cost. There is a heavy reliance on the operations manager to be aware of this technology

BUSINESS BITE

Multinational enterprises (MNEs) are also referred to as transnational corporations, multinational corporations or more simplistically as global businesses.

Different cultures

When relocating or expanding operations a business will encounter differences in the way business operations are organised and managed. It is advisable for global businesses use local experts that can help prevent issues caused by cultural clashes and communication problems. For

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and assess its application to the business. The business will weigh the costs of the upgrade in technology against the expected benefits, such as increased sales or higher profits.

New technology has drastically changed the operations of both manufacturing and service-based businesses. Despite the high initial cost of developing or acquiring new technology, the overall gains to productivity and quality are obvious. New technology can save time and reduce the amount of waste, making the business more efficient and therefore more profitable. A business can obtain a sustainable competitive advantage through the implementation of new technology.

When making a decision about technology use, a business must take into account various factors, including:

- the speed of change taking place in that area of technology
- the technology that competitors are using
- the finances available for a change in technology
- how long it will take to introduce the technology (especially if all work needs to be stopped)
- whether staff will need to be retrained or possibly made redundant.

Managing change with respect to implementing new technology is a challenge for management to maintain effectiveness and efficiency in operations.

Robotics

Technology has progressed so far that in some instances employees have been replaced with machinery, such as robots. **Robotics** refers to the development of robots, which are programmable machines that have sensors that can detect changes in their environment. Initially built to complete repetitive tasks, robots today have a degree of artificial intelligence. They are used where dangerous or hazardous work is required and perform increasingly complicated tasks.

For a manufacturing business, robots can result in increased efficiency by working for set periods of time without a break and performing tasks more precisely than human employees. Employees may become bored with repetitive work, resulting in a drop in the quality of the product. Robots do not suffer from boredom, need lunch breaks, take days off or need to be paid a wage. They only require a power source, maintenance and repairs if there is any mechanical failure. The high cost of robotics often limits its availability to large businesses, such as car manufacturers.

Robotics

The development of robots, which are machines that can be programmed to perform a variety of repetitive tasks.

Table 2.2 Technology in different industries

Automotive technology example	Medical technology example
Computer numerically controlled (CNC) machines, such as robotic arms, manufacture, position and finish car parts. The robotic arm paints every piece of the car more evenly, puts the parts in the correct place every time and manufactures the entire car faster.	3D medical imaging technology using multiple CT, ultrasound and MRI scans combined with software. These 3D images can be reviewed and manipulated by a doctor or specialist to more effectively diagnose disease and other problems without invasive surgery.

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Computer-aided design (CAD)

Computer technology that allows architects, engineers and designers to draw and adjust designs using a computer.

During the 1990s, as workers in manufacturing were becoming increasingly assertive, demanding wage increases and better working conditions, they presented a rapidly increasing cost to businesses and the concept of automated production lines with robots became increasingly desirable.

CAD and CAM

Computer-aided design (CAD) is computer technology that allows architects, engineers and designers to draw and adjust three-dimensional designs using a computer. The designs can be created based on the specifications or special conditions set by each client's requirements. Using email, the client can review the CAD from anywhere in the world, make comments on the designs and request alterations to the design. Additionally, CAD allows designs to be looked at from various angles and provides a more effective visual presentation than a design on a sheet of paper. Three-dimensional images can be manipulated, allowing for greater product innovation.



Figure 2.2 Use of robotics in operations.

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BUSINESS BITE

The Pallet Design System (PDS) is an example of CAD. It is a computer-aided design tool that helps operations design the best pallet for any job at the lowest cost. By inputting all of the customer's pallet design alternatives and the materials needed to build the pallet, the program produces low-cost and accurate performance forecasts, identifies potential problem areas, and redirects the pallet supplier and user to more practical design alternatives without costly trial and error or expensive prototyping and testing.



Utilising computerised order entry and production scheduling to assure accurate delivery, the Global Group produces up to 25 000 units per week, all delivered on time. We feature the Pallet Design System (PDS) software, designed to produce the most efficient and cost-effective pallet for your individual needs. This software generates material specifications and blueprints used to manufacture your pallets so that you know exactly what you are getting before we even start to build them.

Source: Global Group website

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Computer-aided manufacture (CAM)

Computer technology that directly links the design process to the manufacturing process using computers.

CAD can be linked directly to the manufacturing process through **computer-aided manufacture (CAM)**. This process provides electronic links for exchanging data, which results in time being saved and fewer mistakes being made. Subcontractors can receive precise, accurate details about component parts. With CAM software, the computer can be set to control large sections of production with greater efficiency, fewer errors and fewer staff. CAM software allows there to be far greater precision in the calculation of each input required in the production process and calculations of the expected output.



Although it is easy to imagine the use of technology in manufacturing, technology has also had a significant influence on service-based industries. E-commerce, databases, internet and intranet can save both time and money. Staff will need to be more multiskilled and IT-confident. Overall there will be fewer staff required in service-based organisations. For example, one supermarket checkout operator can manage multiple self-service checkout machines as customers use the devices themselves to scan their groceries. The scanner can take a variety of payment methods, dispense change and even determine if an item has not been paid for.

Technology, therefore, has a major impact on the human resources function of a business. Human resources must acquire staff with the appropriate skills and abilities and provide ongoing training to update their skills as technology changes. Other employees may separate from the business and be made redundant by new technology.

BUSINESS BITE

The self-checkout robot offers faster customer service with shorter queues, particularly for dash-in-and-dash-out shoppers. Despite the expense of the technology, savings can be made in human resources as one attendant can monitor 6–10 machines at once. The role of the checkout attendant has changed to providing assistance and trouble-shooting the devices.

The technology first appeared in the USA around 1992 and later in Australia in 2007. It has a level of artificial intelligence in its software, as it is able to learn the features, size and weight of new products without being programmed. The first time the check-out robot scans a new product, it stores the information, then after repeated purchases, the technology is able to learn the variations in weight and other features. This information is passed on to other self-checkout devices. So the machines learn on their own and provide good service to customers, with only a little help from staff. There is a weakness in that the technology means less social interaction or the personal touch from a shop assistant. The technology as yet cannot answer questions or provide advice.

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Quality expectations

A business that is customer focused will wish to produce goods and services that will satisfy the desires of its customers. Customers often have a pre-existing idea about the quality that they will get from a certain product or brand. They will have certain beliefs about:

- durability – how long the product lasts given a reasonable amount of use
- reliability – how long the product functions without needing maintenance or repairs
- fit for purpose – how well the product actually does all the things advertising claims.

damage to its goodwill and reputation in the market. Therefore, operations must be organised to maximise customer satisfaction and customers are a key influence on business operations.

Cost-based competition

A business can gain a price advantage over its competitors by using operational strategies that lower costs. In this way the business can reduce its prices lower than its rivals. Sales and market share should increase as well as profit. This cost leadership strategy was described in

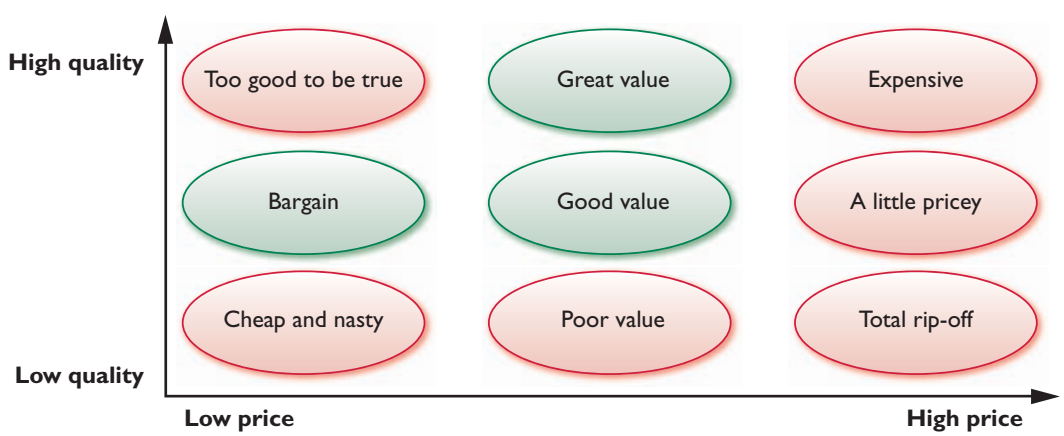


Figure 2.3 Customer perception of quality and price.

This quality expectation can be simply based on the reputation of the brands' products in general and the price paid for the product. Effective marketing fulfils the expectations of customers and, therefore, marketing relies on the operations function to produce a good with the features, design and quality buyers expect. Operations do not necessarily have to make a high-quality product and sometimes the most popular products are not the best quality.

A business that falls short of the customer expectations will suffer long-term

Chapter 1. A cost leadership strategy works best where there is little difference in the products being offered by competitors and businesses attempt to get a competitive advantage by reducing the costs to produce and supply so that they can offer their products at a lower price and yet maintain the profit margin. This influence may force a business to seek its own cost advantages through sourcing cheaper inputs, updating technology or outsourcing. Alternatively, if the business cannot compete on costs then it may switch to a differentiation strategy.

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Tax concession

A reduction in the tax payable by businesses that undertake certain areas of research and development.

Activity 2.2 Research and comprehension

1. Describe the advantages of using technology in the agricultural industry.
2. Describe the impact of technology on the human resources function of a business.
3. Explain the relationship between CAD and CAM.
4. Explain how technology can enable a business to use a cost leadership strategy to obtain a competitive advantage.

Government policies

Government policies are methods used by the government that encourage the operations function of a business to be more innovative and competitive. Economic growth will benefit from Australia being able to 'do more with less', increasing productivity and reducing the cost of producing exports. The federal government has given much support to 'sunrise industries' and new technology where businesses can develop new export products and earn income for the economy. A common way to support these innovative businesses is to provide a monetary benefit such as a financial grant or tax concessions. These financial benefits will give the business more funds to invest in leaner operations and new products. AUSTRADE is a government organisation that provides a range of assistance to Australian businesses that wish to export and expand into the global economy. As well as financial support and assistance for exporters, businesses can get specialist advice about establishing manufacturing overseas and an introduction to potential suppliers. Other government policies involve reducing the amount of protection certain industries receive from overseas businesses. The gradual removal of tariffs, quotas and other types of protection has forced Australian businesses to be more competitive by reducing operations costs. The reduction of protection in clothing manufacturing in the textiles, clothing and footwear industry has forced many businesses to relocate operations to a country where resources are cheaper. Over 2009 and 2010 Pacific Brands closed all of its clothing factories, moving the manufacture of iconic brands such as Bonds and Holeproof to Asia.

BUSINESS BITE

AusIndustry is the federal government agency providing assistance to Australian businesses in their search for innovation, investment and international competitiveness. AusIndustry has given over $2 billion to thousands of Australian businesses each year. It provides grants, loans, capital and **tax concessions**. Other programs are implemented through the Minister for Innovation, Industry, Science and Research. For example, the Australian Government's Innovation Investment Fund provided venture capital to help companies research and develop new products for the Australian economy and export markets. Businesses can apply online for grants totalling several million dollars.

Source: AusIndustry website for Hon. Kim Carr, Minister for Innovation, Industry, Science and Research.

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Legal regulation

The aim of government regulation of business is to promote safety and fair business conduct. These regulations include those covering environmental and consumer protection, trade practices, occupational health and safety and industrial relations. In Australia, over recent years laws have undergone many amendments through parliament and changes in the **common law** judicial system. In many industries regulations have been removed to enable firms to become more efficient and to reduce the number of restrictions hampering competition.

There are numerous laws and regulatory requirements that affect operations. Many of the regulatory requirements exist at a local, state and federal level. It is the legal responsibility of the operations manager to be aware of the all laws relevant to the operations function and ensure that the business complies with them.

Common law

Law that is derived from previous court decisions made by a judge.

Table 2.3 Impact of legislation

Area of regulation	Legislation	Legal obligations and implications
Workplace safety	*Occupational Health and Safety Act 1991* (Cth)	Employers must diligently prepare an occupational health and safety assessment of the business to ensure that employees are provided with a work environment that is both physically and mentally safe. This involves • safe worksite • safe machinery and materials • safe systems of work • information, training and supervision to ensure safety • suitable working environment.
Hazardous materials	*Occupational Health and Safety Act 1991* (Cth) *Dangerous Goods (Road and Rail Transport) Act 2008* (NSW)	Training, warning signs and safety precautions to prevent injury. Businesses are encouraged to eliminate the use of the hazardous products if possible. Safe measures to transport hazardous and dangerous goods.
Environmental protection	Federal *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act)	Operations must ensure hazardous waste, fuels and chemicals do not enter the environment.
Climate change	*National Strategy on Energy Efficiency* Energy Efficiency Opportunities (EEO) Program	This government policy proposes stronger energy efficiency requirements particularly in the building industry. For example, energy efficient types of lighting and power controls. Requires large energy-using businesses to identify, evaluate and report publicly on ways to save energy.
Australian standards for quality, environmental impacts, safety and information	*Competition and Consumer Act 2010* (Cth) (formerly the *Trade Practices Act 1974* (Cth)) *Fair Trading Act 1987* (NSW)	• Quality standards – products must perform the task that they intended to perform. • Goods need to comply with environmental standards before they can be sold. Standards set out an energy rating and labelling system to inform consumers. • Safety standards – goods must comply with particular performance, composition, contents, method of manufacture, design, construction, finish or packaging rules. • Information standards – labels must include all relevant information such as country of manufacture or ingredients.

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There are many federal and state laws principally to ensure three objectives. First, that the business operations are safe. Second, that the negative impact on the environment from business operations is avoided or minimised. Finally, if a business claims the products it makes or supplies meet a particular standard, are safe to use, are of a certain quality and that all relevant information is provided, then it must ensure that this claim is true.

Activity 2.3 Comprehension and discussion

1. Outline an example of workplace safety policy and procedures in an office.
2. Describe the impact of the *Competition and Consumer Act 2010* (Cth) on the operations of a business making children's toys.
3. Account for increasing regulations for environmental protection.
4. Explain why an operations manager must be aware of all relevant laws and regulations.
5. Discuss the impact of rigorous government safety regulations on the operations function of a manufacturing firm.

Environmental sustainability

Ecological sustainability refers to the development and use of methods of production that allow resources to be used by producers today without limiting the ability of future generations to satisfy their needs and wants. The natural environment must be protected from resource depletion and pollution. More than ever, managers have a responsibility to protect the natural environment and ensure that their methods of production incorporate sustainable resource use.

Emphasis needs to be placed on the development of technology that minimises damage to the environment. Thus, the impacts of resource depletion, the site of resource removal, pollution caused by machinery (especially in manufacturing) and the removal and storage of waste need to be taken into account. Consumers need to be aware of the cost and disposal of excessive packaging and be given clear instructions on the proper use of products and, in some instances, how to dispose of products responsibly. For example, Bosch drills are made with fully recyclable parts. As businesses include the cost to the environment in their prices, this will help to increase awareness of environmental impacts. Business managers should realise that the advantages generated by the practices outlined above are broader than the environmental benefits. Society will have a positive attitude towards businesses that are environmentally friendly and good corporate citizens. Society's support for these businesses will be shown through sales and customer loyalty.



Figure 2.4 Bosch drills are made with fully recyclable parts. This is beneficial to the business and the environment.

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Corporate social responsibility

Corporate social responsibility (CSR) has been increasing in its importance as a genuine goal of businesses. It is an extension of the triple bottom line (TBL) concept where a business's performance is evaluated according to its financial, social and environmental criteria. Other CSR issues concern:

- human rights
- corruption and payment of bribes
- corporate transparency and honesty
- labour standards, particularly in less developed countries.

The commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve the quality of their life.

CSR is typically weaker in developing countries as a result of fewer regulations and support for multinational corporations that can stimulate economic growth. Even though momentum for CSR is building, there is still debate about the issue. Many internal stakeholders would argue that the core reason for business is to maximise shareholder value and returns to owners while obeying the laws of the country it is operating in. The other side of the argument is that a business's long-term success and profitability is determined by how well it considers the interests of employees, consumers and the community. Discussion about CSR at a government level as a result of several high-profile examples, such as the building company James Hardie Ltd, may lead to new laws enforcing CSR behaviour.

BUSINESS BITE

Toyota is recognised as a world leader in hybrid technology, creating cars that combine a petrol engine with an electric motor. Initial research began in 1993 and the business's first Prius was launched in 1997. As well as the company's renewable energy focus, Toyota has a comprehensive set of strategies and goals as part of its contribution to sustainable development:

- reducing CO_2 emissions with its Global Warming Prevention Initiative
- 'Sustainable Plant' activities
- environmentally considerate automobile manufacturing
- environmental conservation initiatives such as planting forests at plant sites
- a specialised website targeted at children to educate future generations about environmentally friendly car manufacturing and hybrid vehicles.

More information can be found at http://news.toyota.com.au/environment.

CSR is the duty of care a business has towards its stakeholders other than shareholders. As the concept is still evolving there is not yet a single globally accepted definition, although it is agreed that it is more than supporting charities. The World Business Council on Sustainable Development defines CSR as:

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BUSINESS BITE

James Hardie Ltd failed to provide enough financial compensation for employees affected by asbestos mining and asbestos products the company made. A number of former employees have died from asbestos-related diseases and it was strongly suspected that the company directors were aware of the hazardous nature of the material. The company relocated its headquarters to the Netherlands for tax advantages, separating itself from a subsidiary it established to manage compensation payments called the Medical Research Compensation Fund (MRCF). It was estimated in 2003 that the MRCF would need A$1.573 billion after only receiving $293 million. After its relocation the business refused to accept further responsibility for compensation because the MRCF and James Hardie were separate legal entities.

At present in Australia, company law and common law cannot compel company directors to consider stakeholders other than shareholders when making decisions. There are laws covering working conditions, consumer protection and environmental protection. In the future company directors and owners of businesses may be found criminally responsible for the consequences of poor decisions that affect other stakeholders.

Activity 2.4 Discussion

1. The law should be changed to make company directors criminally responsible for the actions of a business. Discuss.
2. Businesses have a responsibility to their shareholders and owners before other stakeholders. Discuss.
3. Corporate social responsibility practices are marketing strategies. Discuss.

Ethical responsibility and legal compliance

Ethics may be thought of as doing the 'right thing'. It is more than merely complying with the law and pleasing the owners of the business with higher profits. Ethical behaviour involves making decisions that are not only legally correct but also, in a sense, morally correct.

Business practice and ethical behaviour could once have been considered mutually exclusive terms. However, the business community is recognising the need to act in a responsible and transparent manner. Business ethics are the principles a business will follow to be a good corporate citizen. In order to show its commitment to ethical behaviour many industries and businesses will develop, implement and publish a code of conduct. This code will cover issues such as:

- supporting charities and local community organisations
- consulting the community prior to implementing a significant change to the business
- promoting human and civil rights both in Australia and overseas.

For operations, a code of conduct will be concerned with:

- minimising harm to the environment
- reducing waste, recycling and reusing

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- producing value-for-money, quality products
- improved customer service.

Many industries have recently developed a code of conduct to improve that standard of behaviour by all businesses in the industry. A code of conduct is not legally enforceable but is a voluntary set of rules and guidelines to guide the behaviour of businesses or organisations in a way that benefits key stakeholders and customers. For example, fitness centres and gyms have changed their operations to allow customers to avoid being locked into long-term contracts and pay their membership each month they use the centre. The language of contracts too has been changed to plain English so that customers understand what they are signing. In terms of marketing, many centres no longer use high-pressure personal selling techniques to sign up new customers. These changes represent a more ethical and transparent way of doing business.

Ethical Issue

How much responsibility for a community should a business be expected to carry?

BUSINESS BITE

Following the environmentally devastating oil spill in the Gulf of Mexico in 2010, BP has lost significant value in its brand. A survey by the brand consultancy firm, Interbrand, had BP ranked at 83rd in its list of the world's 100 best brands. BP was no longer ranked in the top 100 in 2011, while its main competitor, Shell, moved up 11 places to 81st.

Environmental sustainability and social responsibility

The concept of environmental sustainability has been discussed earlier in the chapter. However, it is related to the idea of social responsibility. By pursuing environmentally sustainable goals a business will be contributing to a better quality of life for society. A business that behaves in a socially responsible manner is one that tries to improve the quality of life of both internal and external stakeholders. This type of behaviour is being measured as a specific outcome of business. AuSSI (www.aussi.net.au) was launched in 2005 and publishes *The Australian SAM Sustainability Index*. This measure determines the performance of Australian companies in terms of their environmental sustainability and social responsibility. These ratings are publically available and put pressure on Australian businesses to improve their performances in this area. Other businesses have developed, offering advisory services to industry so that they can achieve environmental and social goals. Reputex (www.reputex.com.au) is a research and consulting firm that assesses the environmental sustainability of businesses. The business was established in Melbourne in 1999. Reputex measures how a business incorporates clean technology, alternative energy and manages its carbon emissions.

Businesses today are increasingly aware of the impact their decisions have on society and the environment. People in the community are more aware of the activities of businesses by: being owners of shares; greater scrutiny by the

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Social responsibility

Involves taking actions or making decisions that are morally and ethically correct and are in the best interests of the community.

media; organisations such as the not-for-profit Australian Consumers' Association (which publishes *CHOICE* magazine) and government institutions such as Australian Competition and Consumers Commission, and Australian Securities and Investments Commission. There is an expectation by society that businesses must consider and value achievements other than increases in profit, growth and market share. When making decisions, managers need to take into account the consequences of their actions on all stakeholders. It is not sufficient to simply obey the relevant laws, managers are also expected to make decisions that are **socially responsible**. The increased speed of change has resulted in society pressuring businesses to accept additional responsibility that laws have yet to cover. Managers need to consider whether their decision will be good for the community or whether it will provide their business with a cost advantage at the expense of the community. Recent examples of socially responsible decisions include:

- In 2010 the chief executive of BHP Billiton warned that Australia should 'look beyond coal' and towards other energy sources, possibly indicating a change in direction for the company.
- Cue, the fashion brand, continue to manufacture almost all of its products in Australia, keeping jobs in Australia and working closely with the Textiles Clothing and Footwear Union to maintain an ethical workplace.
- Schools and businesses are appointing specialist sustainability experts to implement environmentally sustainable practices and policies.
- More and more businesses are increasingly transparent about the way they make decisions

Some businesses use a public relations department to include their responsible and sustainable activities into their marketing. This is more commonly known as Green Marketing. A good public image will encourage long-term profitability.

In addition to the value added to a brand from CSR strategies, firms may find both short-term cost advantages and long-term financial benefits. For example, a business that has installed renewable energy systems may find that they have a cost advantage over those businesses that have relied on fossil fuels.



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Chapter summary

- Globalisation is integration and interdependence through trade, technology, deregulation and global businesses of the economies of different countries, creating a global economy.
- Globalisation influences business operations as a result of different currencies, trade agreements, global consumers, technology and differences in cultures.
- Customers have a pre-existing expectation about the quality of the products a business produces and do not always expect high quality. Operations must be organised to maximise customer satisfaction by producing products that match the expectations of consumers.
- Government policies encourage businesses in Australia to be more competitive through cost-efficient operations and innovation.
- Legal regulations aim to ensure business operations are safe, that the negative impact on the environment from business operations is avoided or minimised and, finally, that products live up to the quality and safety standards the business claims.
- Business ethics are the rules and principles a business follows to be a good corporate citizen.
- Socially responsible business decisions include promoting human rights, not engaging in corruption or the payment of bribes, being open and consultative, and improving living standards.
- Consumers, the media, organisations and governments are increasingly holding businesses accountable for the social and environmental consequences of their actions.

Chapter revision task

Copy and complete the following passage by selecting the most appropriate word for each space from this list.

operate	cultural	competitive	information	innovations
relocating	risk	costs	increasing	agreements

Businesses _____ in a dynamic and highly _____ global environment. This means that gaining a competitive edge requires reducing operational _____ so that the business can lower prices below its rivals. Often the opportunity to access lower cost inputs and produce more cheaply by _____, which can lower operations costs. Globalisation also offers a global market for a business to distribute its products to which will present more challenges to operations. Operations must have the correct market _____ in order to differentiate products to match the desires of consumers in different countries. There will be other influences on the operations function when operating in the global environment. Payment of inputs will have to be financially managed to reduce the _____ of an appreciating AUD _____ input costs. Trade agreements that Australia is a member of will open up new opportunities to source inputs and distribute final products. However, other trade _____ will exclude Australia from the potential benefits of globalisation. Australian businesses can also access technological _____ in operations through joint ventures or simply taking over other firms. Finally, when operating in different countries, both human resources and the operations function will need to be aware of _____ influences that affect the way people work, make decisions and organise operations.

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Multiple-choice questions

1 Which of the following statements best defines the term globalisation?
- **(A)** Globalisation is the rapidly expanding world population and economic growth
- **(B)** Globalisation is the growth of developing countries increasing their trade with the rest of the world
- **(C)** Globalisation is the integration of the economies of different countries to create a global economy
- **(D)** Globalisation is the growth and expansion of global businesses, consumers and rapid technological change

2 What are the main impacts on the operations function from globalisation?
- **(A)** Input costs and product standardisation
- **(B)** Access to cheap labour and finance
- **(C)** Governments of other countries and legal regulation
- **(D)** Input costs and product differentiation

3 How would resource availability influence business operations?
- **(A)** The location of manufacturing
- **(B)** The distribution of finished products
- **(C)** Access to low-cost labour
- **(D)** Profit on the sale of finished goods

4 What are the main components of CAD and CAM technology?
- **(A)** Computers and software
- **(B)** Information, technological knowledge and skill
- **(C)** Assembly lines and factories
- **(D)** Abacus and set square

5 Which statement best explains the difference between CAD and CAM?
- **(A)** CAM uses a robotics and CAD uses computers
- **(B)** CAD uses robotics and CAM uses computers
- **(C)** CAM occurs before CAD
- **(D)** CAM and CAD are interdependent processes

6 Which of the following exert the greatest pressure on businesses to act in a socially responsible manner?
- **(A)** Government
- **(B)** Society
- **(C)** External stakeholders
- **(D)** Shareholders

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7 Which legislation forces businesses to provide safe working conditions in Australia?
   (A) *Anti-Discrimination Act 1977* (NSW)
   (B) *Workers Compensation Act 1987* (NSW)
   (C) *Dangerous Goods Act (Road and Rail Transport) Act 2008* (NSW)
   (D) *Occupational Health and Safety Act 1991* (Cth)

8 What does legal compliance refer to?
   (A) An operations manager must be fully informed of all relevant laws affecting the business
   (B) An operations manager must report to government on how it is obeying relevant laws
   (C) An operations manager must ensure that policies and procedures are implemented at the business to ensure laws are obeyed
   (D) Paying above minimum wages and offering flexible working conditions for employees

9 Which of the following is a financial reason why a business may implement socially responsible decisions?
   (A) Profitability
   (B) Attract and keep good staff
   (C) Increase sales
   (D) Reduce operations costs

10 What are the expectations consumers have about operations?
   (A) Produce a product that represents good value for money
   (B) Produce products in Australia to keep jobs
   (C) Produce a good that complies with government consumer laws
   (D) Produce goods for the lowest possible price

Short-answer questions

1 Outline the impacts of globalisation on the operations function.
2 Describe how a business would change operations to be more environmentally sustainable.
3 Explain the objectives of business regulation.
4 Explain how quality expectations influence business operations.

Extended-response question

Businesses must act in a socially responsible and ethical manner because current legislation is inadequate. Discuss.

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CHAPTER 3

Operations processes

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Operations processes are the activities involved in the transformation of inputs into outputs. This may also be referred to as the production system or operations system. Each activity adds value so that the output has a greater value than the cost of inputs. The outputs will be sold for a profit. Key questions that must be answered are:

- What production activities are required?
- What will be the sequence of the activities?
- How often will the process need to be changed or adjusted?
- What technology will be used?

to wholesalers, retailers and customers, and provides after-sales customer service. The business may take a 'top-down' approach to operations where the operations business function interprets the overall business strategy and aims to play its role in achieving the business objectives. Alternatively, a systems management approach focuses on integrating operations with the other key business functions of marketing, finance and human resources to create sustainable competitive advantage.

Components

Components are a part or piece that is assembled with other components to create a finished good.

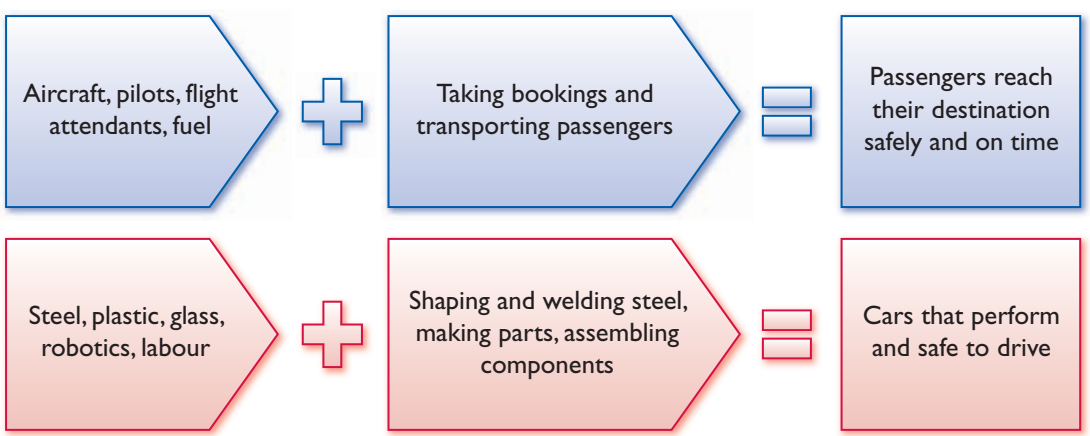


Figure 3.1 Transforming inputs into outputs – operations for different products, an airline and an automotive factory.

The operations manager has a role in every part of the operations process. The value-added objectives are to produce goods and provide services right the first time, save time by eliminating delays and improve delivery times, producing in a dependable and flexible manner and control input costs. When assessing the performance of the operations functions the manager determines how effectively the business makes and assembles raw materials and **components** into finished goods and services, distributes

Inputs

The inputs into an operations system are more than the physical raw materials and components used to make a good or the skills, creativity or knowledge to provide services. Inputs are more complex and have links with the other key business functions: marketing, finance and human resources. Inputs may be classified as materials, people or physical resources and further categorised as transformed or transforming resources.

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Table 3.1 Types of inputs

Materials	People	Physical
Raw materials	Labour (physical and mental)	Factory and office building
Parts and components	Managers	Land
Power and energy	Engineers	Machines and tools
Supplies	Maintenance	Office equipment
		Computers

There are also the intangible inputs of time and money. A business will need enough time to finish operations before a deadline and enough finance to purchase inputs to pay for the operations processes.

When inputs are transformed they are converted into goods and services, known as the outputs. For example, at school the inputs are the classrooms, students themselves, textbooks, computers and the teachers. The transformations that occur involve educating and socialising students and the outputs are knowledgeable students who can learn new skills quickly as good citizens ready for the workforce. Some inputs are transformed resources and others transforming resources. That is, the transforming resources change and convert the transformed resources.



Transformed resources

These are the inputs that are changed and converted into something else such as a component or a finished good or service. Businesses use a combination of materials, information and customers, however, depending on the nature of the industry or type of business one of these will be more important. For service-based businesses such as schools, doctors and financial advisers, information will be processed to produce a 'product' unique to specific needs of the customer. Therefore, customers are the most important resource. Manufacturers will focus on materials as their most important resource. Businesses involved in transporting customers such as airlines will probably have the most equal split between these three. Materials in the form of aviation fuel is a significant expense, information about flights, destinations, bookings and maintenance will be used and, finally, customers determine what type of service they desire, ranging from first-class seats to budget-economy seats, and are transported to their new destination.

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Materials

Materials are the raw ingredients, components, parts and supplies used up in operations. Supplies are different to raw materials because they help in producing the output and are not a component of the final good or service. For example, in a real estate office supplies would include stationery, printer cartridges and the fuel used in the cars of sales representatives. All materials can be considered current assets that are constantly flowing in and out of the business and not kept for longer than 12 months. Some operations do not use up materials but change their location as in a courier business or transport company. Other businesses organise a change in the possession of the materials – retailers do this. Materials may merely be stored or warehoused, however, inventory kept securely for another business is still a materials input.

Information

Businesses must know information relevant to their operations. Information is stored in files, in computer programs and in databases. This information is used to make plans, execute operations and keep controls over materials inputs. Examples of information include the know-how to operate equipment, work schedules such as critical path analysis diagrams, architectural designs, customer orders, engineering plans and quality analysis reports. Information will come from analysis of the performance of the operations system. As a form of feedback, lessons learned from operational mistakes or failing to achieve performance objectives will also be an input into future operations. Information is an input for information-processing businesses such as accountants or banks. The information is analysed and then presented in a new form such as a tax return or investment advice.

Customers

Customers can be changed in different ways. Doctors and hairdressers transform how customers feel and look. Airlines and travel companies change the location of their customers. When customers are entertained by theatres and movies, or stay in a hotel or resort, value has been added to their quality of life. Customers are also an input because it is their needs and desires that 'drive' the operations of a business. Businesses can no longer produce what they think customers want and expect to maintain a competitive advantage. Therefore, this area of operations is closely connected to the marketing function, in particular market research.

Transforming resources

These are the resources that remain in the business and are applied to the inputs to change them to add value.

Human resources

Many businesses recognise that people are their greatest asset. This is because the skill, knowledge, capabilities and labour of people is applied to materials to convert them into goods and services. There is a strong relationship with the human resources function to provide the business with suitably qualified, skilled and experienced employees. Motivated and loyal employees are essential as well.

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Facilities

Facilities are the buildings, land, equipment and technology the business uses in operations. They are the non-current assets of the business because facilities are used to generate profit through their use for a period longer than 12 months. Facilities remain in the business after materials have been used up. Machinery and equipment will be used to physically change the shape and features of materials. Other facilities are concerned with storing and moving materials and partly finished goods to warehouses. Technology is an essential element as it can enable a business to use its transformed resources in a more efficient and effective way.

Table 3.2 Examples of transforming resources in different industries

Transforming resources	School	Airline	Soft drink manufacturer
Human resources	Teachers Cleaning staff Maintenance staff Parent volunteers Administration staff IT support Drivers	Pilots Maintenance engineers Flight attendants Cleaners Baggage handlers Aircraft refuellers Check-in staff	Machinery operators Chemists and food technology scientists Engineers
Facilities	Buildings Playing ovals Library IT equipment and computing lab Classrooms	Aircraft Hangers Terminals Computerised booking system	Mixing vats Warehouses Labelling machines Packing machinery

Activity 3.1 Comprehension

Identify the transformed and the transforming resources used to provide a restaurant meal, a theatre performance and a car.

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Transformation processes

Every business must consider how it will produce goods and supply services. The transformation processes are those activities that determine how value will be added. These processes can add value in four ways:

- physical altering of the physical inputs or the changes that happen to people when they receive a service
- transportation of goods or services, such as having them delivered to a more convenient location for access by consumers
- protection and safety from the environment; for example, a bank keeps savings secure
- inspection by giving customers a better understanding of the good or service.

A local bike store offers bikes for sale and carries a range of brands and types. For a particular customer who wanted a racing bike the shop was able to add value in different ways. First, the owner sourced a quality carbon fibre frame from a distributor and a range of components such as wheels, gears and the seat. The owner then built the bike using the different components to create a value-for-money road racer for under $2000, which was the customer's desire. This was the physical altering of the physical inputs. By sourcing and bringing all the components together at the local bike store the shop was adding value from transport. As the customer could not afford to purchase the bike all at once, the shop kept the bike securely in a locked room until final payment was made. Finally, when the customer paid for and picked up the new bike the owner took time to carefully explain the value, performance and features of each component used to create this unique product, thereby adding further value.

There are many different ways of producing a product. The operations manager must select the optimal process considering the following factors:

- available capacity of the facility
- available knowledge skills of employees
- type of production, whether it be job, batch or flow production
- layout of plant and equipment
- occupational health and safety
- production costs
- maintenance requirements.

The transformation process therefore needs to be designed, planned and controlled to make this flow as smooth and uninterrupted as possible.



Influences – volume, variety, variation and visibility

There are four dimensions of operations, referred to as the 4Vs. Depending on which of the 4Vs is considered the most important to the business, this will affect the type of production method used. One of the most important considerations is

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Job production
Producing a single unique item.

Batch production
Producing a small number of the same item.

Flow production
Producing a large number of items at the same time.

the type of production method that will be used: job, batch and flow. The type will be strongly influenced by the 4Vs, known as volume, variety, variation and visibility to customers.

Job production suits those products and services that require much more than the standard product. Outputs are made on demand to suit what the customer requests. It is a highly flexible system but with a low output. There tends to be less capital and more emphasis on high labour content and skill. At the extreme end are projects such as building a unique architecturally designed home as a one-off job. Costs per unit are quite high.

Batch production is similar to jobbing except products are made in groups or batches. A good example is a bakery that makes a number of slightly different breads, using the same process and produced in batches of 50–200.

Flow production involves a continuous flow of inputs and outputs through the operations and is often associated with assembly lines. Products tend to have little variation. Labour will be used to supervise equipment. Fuel refineries use a continuous flow process where it is extremely difficult to halt production. Costs per unit tend to be low.

A business that must be a high volume producer such as a mining company or car assembly plant will have to use flow production. A business that must produce a variety of models with different features that requires considerable skill will use batch production and even jobbing. Batch production will suit a business that must satisfy variations in demand. As demand for a particular good increases, the business can simply add more batches of the same product and delete batches of products not in demand.

Volume

Volume is the actual number of products or services produced by the operation. A business using mass production will produce a high volume with a high degree of process repetition. A low volume business will use a production process that allows lots of stoppages and adjustments.

The implication for operations when volume has the strongest influence is that there will be a large amount of capital, facilities, technology and materials used and much less labour. Assembly lines using conveyor belts will be common and will be organised in a fixed sequence of activities. Low volume operations will use much less equipment with the emphasis on multiskilled labour and may be a 'craft'-type industry such as custom-designed car restoration. A business that has as its object low costs will use a high-volume operation, while a business that chooses customisation and flexibility will use a low-volume operation.

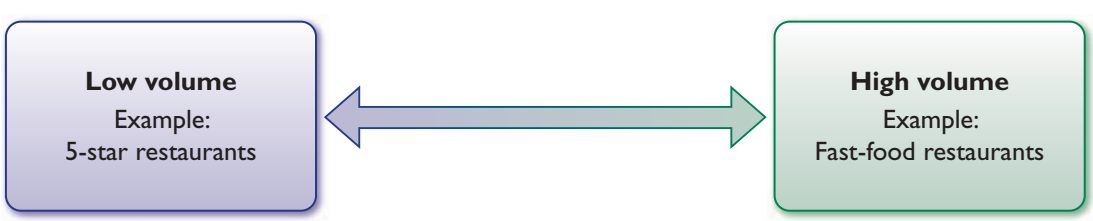


Figure 3.2 Flowchart of the volume of operations comparing restaurants.

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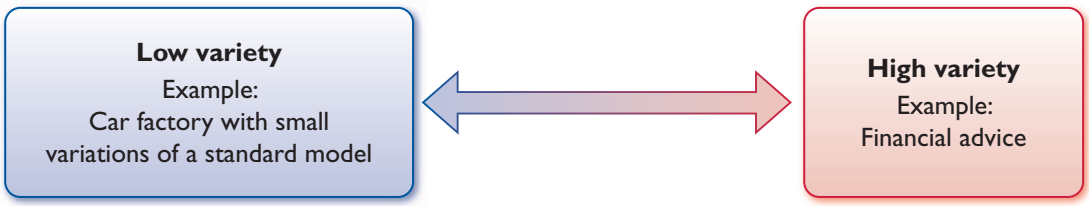


Figure 3.3 Flowchart of the difference of the volume of operations.

Variety

Variety refers to the number of different models and variations offered in the products or services. If the business has customers with different needs, goods and services will have to be modified or a wide variety of models and options will be provided. Low-variety operations are routine in producing a high-volume of standardised product with a low cost.

Therefore, the influence on the operations process will be similar to the influence of volume. A business producing a high volume product with low variety will be capital-intensive, with assembly lines and a focus on producing at lowest costs per unit possible.

Variation

Operations will be strongly influenced by the variation in demand over time. Variation can change according to time of day, season, holidays and time of year. Where there is a steady, predictable level of demand with little variation, operations will be similar to those that produce low variety and high volume. That is, operations are routine, with low unit costs and using more capital than labour. When there is volatility in the pattern of demand, operations will need to be highly flexible. The operations manager will need to anticipate and plan for changes in the demand and have a high level of contact with the market.

Visibility

Operations will also be influenced by the degree to which customers can see the operations in action. Service-based businesses will have a high level of visibility, while customers will rarely see the operations process of a manufacturing-based business.

The implication for operations of a highly visible operations process is that the quality of labour will be significant. Operations will need to have well-trained, highly skilled, adaptable staff to handle the individual needs of customers. A close relationship with the human resources function will be essential. Speed of operations will also be important as customers usually have a much lower tolerance for waiting. So short time lags between customer ordering and delivery will be needed, otherwise the customer will move on to a competitor.

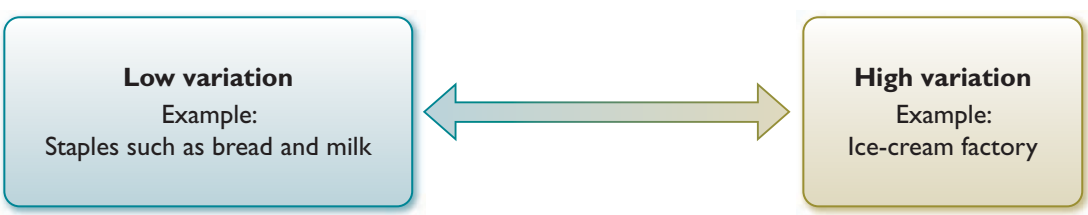


Figure 3.4 Flowchart of the difference of the volume of operations on food staples.

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Figure 3.5 Flowchart of the difference of the volume of operations on customer service.

Many businesses may have a mixture of operations with high visibility for some aspects and low visibility for others. For example, the operations by bank tellers will be highly visible, while back office operations such as processing credit card transactions and managing loan contracts will not be seen. Further, this low visibility has allowed many banks to offshore these processes to countries such as India to reduce operating costs. A business can change from having a high visibility operation to a low one. For example, a retailer may decide to close the physical shop and move to only selling products online. The changing nature of the customer has meant that a high level of personal customer contact is no longer necessary to make the sale.

Of the 4Vs the most significant influences on the operations process will be volume and variety. A business that chooses to produce a high volume will be limited in its flexibility to produce a large variety or respond quickly to a change in demand. A business that is strongly influenced by marketing will tend to produce a higher variety of goods, and unless the business has very sophisticated technology, will produce in lower volumes.

The 4Vs will also be influenced by the product life cycle. During the establishment phase there will be a slow growth in demand and volume and with a higher level of customisation or changes in design. A business can expect demand to increase dramatically once it has passed through the establishment phase

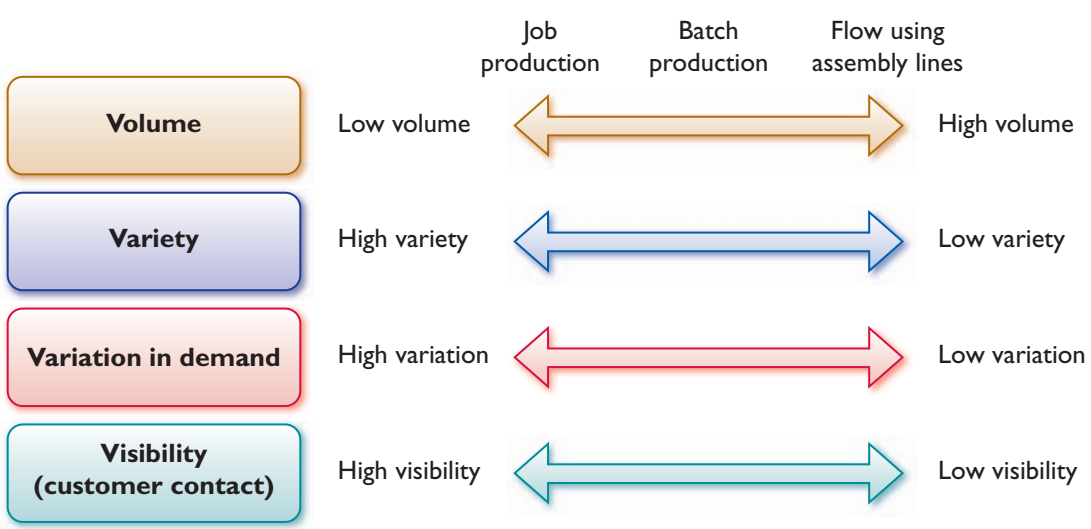


Figure 3.6 Influence of the 4Vs on operations.

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and entered the growth stage affecting the volume the business must produce. Once in the maturity phase the business will have low variations in demand and may offer more variety to attract different target markets. As the business enters the decline phase, demand and volume will fall and some variations on the standard product will be dropped from production. Therefore, businesses need to be flexible in their capacity, and have access to resources and the use of technology to meet these changes in the 4Vs over the life cycle of the business.

Activity 3.2 Comprehension

Construct a business life cycle diagram indicating the changes in 4Vs over the course of the life cycle.

Scheduling and sequencing

Scheduling and sequencing tools are used to identify all steps in the operations process and organise them into the most efficient order to complete. Any sort of production scheduling and sequencing tool will need information about:

- what production activities are used
- when a particular activity will occur
- how long an activity will take to finish
- what activities are independent and can therefore occur at the same time
- what activities are related so that one has to occur before the other
- what resources will be used.

Therefore, a key role of the operations when scheduling and sequencing is to perform a detailed **task analysis** to determine the separate parts of the entire process of making a good or providing a service. Task analysis is the breakdown of exactly how the manufacture of a good or activities to provide a service is to be accomplished.

Gantt charts

One of the most common scheduling techniques is a Gantt chart. A **Gantt chart** records the number of tasks involved in each particular project and the estimated time needed for each task. The business can set specific dates for the completion of each stage of operations. These dates are sometimes referred to as 'milestones'. At each of these points critical decisions may need to be made. A business that organises production based on customer orders may use a Gantt chart for production scheduling. The chart may show the schedule for orders on a day-by-day or week-by-week basis using bars to show the starting and completion dates for each order. In this case, the milestones would allow the firm to quote the dates for the completion of future orders and be the basis for rostering additional staff and determining the schedule for future business operations.

The Gantt chart allows the business to compare actual progress to its originally planned progress. Businesses that do not keep to production targets may find their customers moving to other suppliers. A Gantt chart does have limitations. It will not show the relationship between each of the activities. Also, it will not show which activity relies on other activities for materials or machinery.

Task analysis

The breakdown of exactly how the manufacture of a good or activities to provide a service is to be accomplished.

Gantt chart

Records the number of tasks involved in each particular project and the estimated time needed for each task, but will not show the relationship between each of the tasks.

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Critical path analysis (CPA)

A scheduling tool used in an operation involving repetitive tasks, especially if the exact time each task will take is known.

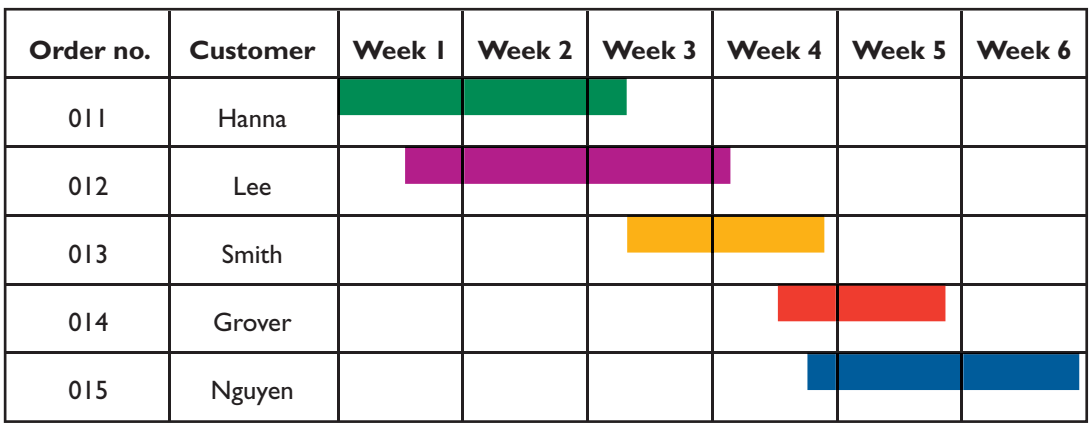


Figure 3.7 A simple Gantt chart where production is based on customer orders.

Activity 3.3 Construct

Construct a Gantt Chart based on the following passage.

Building a house is a project that requires careful planning otherwise expensive mistakes can be made such as having to remove a concrete floor to install plumbing. Task analysis has indicated that there are many different tasks that must be performed, some can occur at the same time as others. First, the architect must finish the design and plans for the builder. This takes a total of four weeks. Once all the approvals have been granted (taking two weeks), the foundations can be laid. While the foundations are being finished the builder will order all the necessary materials for building the house. Before the bricklayers begin, the plumber installs all the taps, pipes and outlets that are needed. The work of bricklayers, carpenters and electricians takes four weeks. Once their work has finished, the plumber will finish installing the bathroom and kitchen fittings, which only takes three days. The house will then be painted and carpeted. Painting occurs before the carpets are laid so that they are not damaged. After a final inspection the project manager may have some minor corrections or work to finish and then the house is ready.

Critical path analysis

A **critical path analysis (CPA)** is an appropriate scheduling tool for use in an operation that involves a series of repeated tasks.

It is a flow diagram that shows the interrelationship of tasks. As all tasks need to be completed for the project to be finished, the critical path time period is the longest path taken to complete the whole project. In the CPA shown in Figure 3.8, the longest path is from A to G to H to I to F = 4 + 4 + 4 + 4 = 16. Therefore, the critical path for this business would be 16 weeks. *Note:* In Figure 3.8, some of the components at G need to be processed through H before they are joined together with the other G components at I. Think of the paths as being like a book, where the front cover has special pictures on it and the back cover is blank. The G to H to I path may be like the front cover, which takes longer than the process from G straight to I, which could be the back cover.

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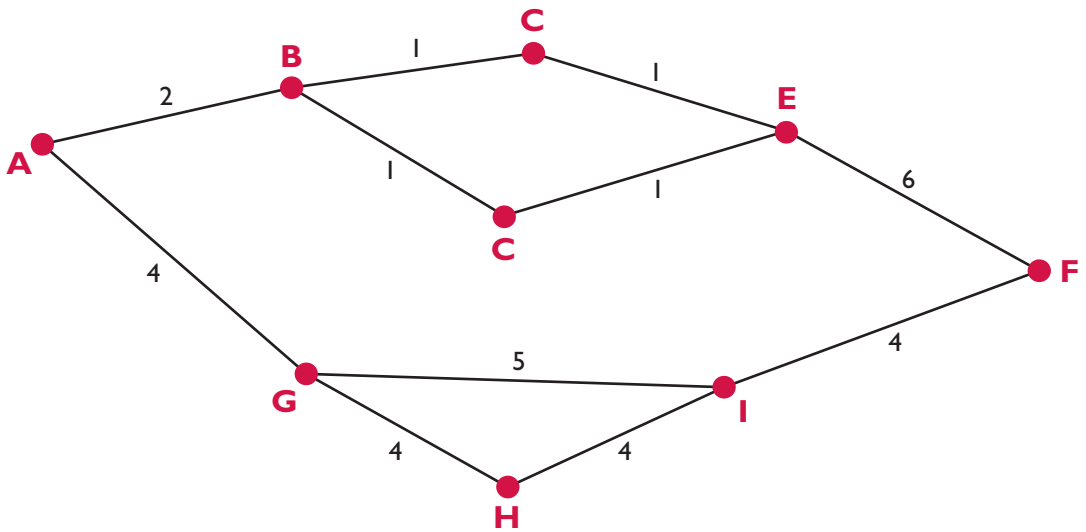


Figure 3.8 A critical path analysis. *Note:* Each number indicates how many weeks it takes to complete each stage or task.

Process technology
The improvements in the machines, equipment and devices used to transform inputs into outputs.

Technology, task design and process layout

Technology

Technology is a key input into the operations process. A business may wish to achieve a sustainable technological advantage over its rivals by using leading-edge technology in its operations. A more conservative strategy would be to use technology that has already been established, tried and proven in operations without the risk of investing in a new technology that may fail. Computer-aided design (CAD), computer-aided manufacturing (CAM) and robotics are technologies used in operations processes and have been described in Chapter 2. The improvements in the machines, equipment and devices used to transform inputs into outputs are called **process technologies**. Even the most labour-intensive industries use process technology. For example, the local organic farmer's market that takes place once a weekend in the grounds of the high school uses wireless EFTPOS machines so that customers do not have to carry large amounts of cash. Product technology is quite different and this is the innovation in the products themselves. A laptop computer is a good example of product technology and – when made on an assembly line using CAM and robotics without the use of labour – is process technology.

Technology can improve the competitiveness of operations by giving it more flexibility as it allows the business to respond to changes in the market more easily. The business can change volumes to meet a sudden increase in demand or produce different variations of products to satisfy changing consumer demands and produce non-standardised versions of its standard product to satisfy individual clients. This is in addition to the commonly understood improvements to productivity, less waste and more efficient use of time. Perhaps the most significant impact on businesses from process technology in recent years is the application of computer software modelling programs, the internet and wireless communication to the operations process.

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Task design

Deciding how a task will be completed.



Figure 3.9 A flexible manufacturing system.

Flexible manufacturing systems (FMS) are an integrated approach to using technology and will have an impact on task design and the layout of the facility. This type of manufacturing can perform multiple tasks at once, reducing the number of individual tasks performed by separate pieces of equipment. Rather than have a process or a product layout, the business may have semi-independent automated workstations to which all the inputs are transported.

Task design

The operations process determines what tasks are to be completed to finish a project. Next management decides how the task will be completed. This is referred to as **task design**. Each individual task is analysed and broken down into separate steps and allocated to machines and employees with the appropriate skills, knowledge and capabilities. Some employees may need training to improve their level of efficiency, and some may require supervision and appraisal programs. Even if the process of operations is already established, task design allows ongoing analysis and adjustments in each activity to ensure continuous improvement in productivity. New ideas, technological change, training and the skills of the workforce available will necessitate continual revision of the operations process in order to maintain competitiveness.

Process layout

Once the task has been analysed and the technology requirements determined, the next strategic decision is to plan the physical layout of the business's factory or office. This is called facilities layout planning and will also be influenced by the size of equipment, work areas and storage space. The aim is to have as an efficient flow of resources through the business as possible.

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A process layout is where all the machinery is arranged by what they do; that is, the functions used to make the good or provide the service. The product moves from department to department, depending on what transformation is needed. This allows for more flexibility and customisation of the product. This is also known as a functional layout and illustrative examples include a factory such as a bakery where some items will need decorating and others will not, or in an office where certain roles are placed together such as marketing or human resources. A process layout requires staff to be specialised and know how to use the equipment and tools in their department.

Process layout is quite different to product layout where a product moves from station to station such as in a car assembly line. Product layouts are used for assembly line manufacturing of large volumes of goods with few variations.

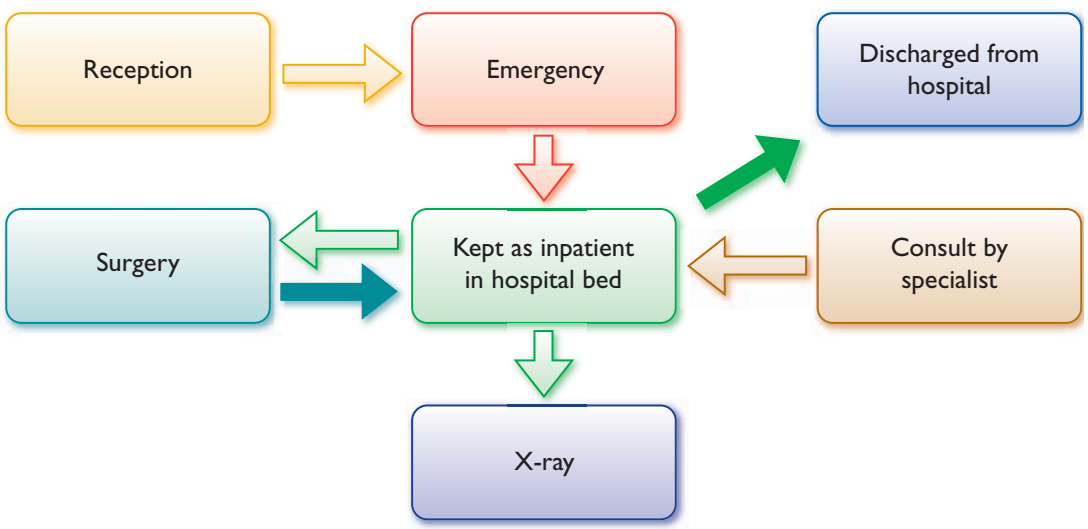


Figure 3.10 Process layout diagram for a patient in a hosptial.

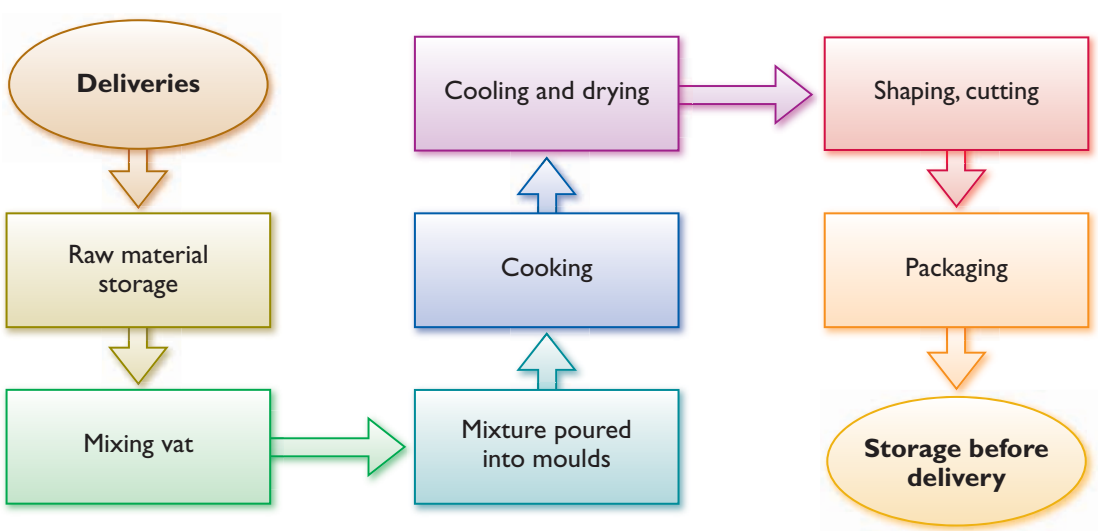


Figure 3.11 Product layout diagram for a food manufacturer.

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Monitoring, control and improvement

No matter how well managed, operations can always be improved. Monitoring, control and improvement relate to performance objectives of quality, speed, dependability, flexibility, customisation and cost in operations. Quality management systems are discussed in detail in Chapter 4. Monitoring, control and improvement are illustrated in Figure 3.12 as they occur at each stage of the operations process.

A business needs to accurately know how well its current operations are working in order to make improvements. A business will find it difficult to assess its performance and make improvements without adequate information. Data will be collected about the following areas:

- operations costs
- waste from operations such as leftover materials
- defects and substandard goods
- quality in terms of the product meeting design specifications
- speed of manufacturing or response to customers
- volume of output.

Key performance objectives of operations will not be achieved without adequate monitoring of operations, controls to ensure that operations are 'on track' and strategies to improve the process.

The purpose of monitoring and control is to ensure the operations process runs efficiently and effectively, producing the goods and services it was designed to do. Control is a management function that aims to keep the business's actual performance as close as possible to what was planned by making adjustments to the operations process. It is coping with changes as they occur; for example, changes in demand. Adjustments and readjustment may need to be made to day-to-day activities in the short term and even the entire operations process in the long term. Effective controls ensure that the business makes and supplies an appropriate quantity of its products, in an appropriate time frame and to the required level of quality according to what it planned.

A key question that must be answered by the manager is whether the current operations are satisfactory, and there will always be areas for improvement.



Figure 3.12 Monitoring, control and improvement occur at each stage of the operations process.

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Improving operations is a key strategic goal of all businesses. Businesses will compare themselves against competitors and industry benchmarks in order to determine areas that need improvement. Generally, a business will seek a competitive advantage through improvements in the following areas of performance:

- quality – by getting it right the first time and having defect-free products and error-free services
- speed – by increasing speed of production and delivery of services
- dependability – by being on time with a reliable operations system, equipment and employees
- flexibility – through having processes that are able to change and offer new products and more choice
- cost improvements – by being efficient and productive to offer more value.



Figure 3.13 Monitoring, controlling and improving process.

In this manner, improvements in operations will be the source of competitive advantage for the businesses. The challenge is to maintain continuous improvement and a system like total quality management will assist in obtaining this.

Outputs

The purpose of the operations function is to produce outputs that have a value to customers that is greater than the cost of its inputs. Outputs are the final products or services that a business offers to customers. Customers may be final consumers who are members of the public or other businesses. An output of one business can therefore be an input for another. For example, cotton fibre produced by a cotton farm will be an input for a clothing manufacturer. Waste, defective products and worn-out machinery may also be considered a secondary output.

Table 3.3 Outputs from different industries

Industry	Output
Banking	Financial services such as home loans and investment advice, security for savings
Education	Socially responsible young adults with knowledge and skills to learn, adapt, work and related abilities
Construction	Buildings, homes, roads that meet the specifications of architects, designers and engineers

Consumers understand the difference between the physical product they buy and the services provided by businesses. However, customer service is also an output of all businesses and perhaps not considered as an essential part of what manufacturing-based business provides. Goods-based businesses can achieve a competitive advantage through improvements in customer service.

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7 steps to a successful sale

1 Introduce yourself and listen to the customer
2 Explain why the offer is important to the individual customer
3 Get confirmation and explain the details
4 Credibility, show the customer why you can be trusted
5 Describe what to do and what it will cost
6 Schedule next steps
7 Ask for the sale

Customer service

Within the vision and mission statements of most businesses is a promise of good customer service. Customer service is an intangible output that requires extensive contact with customers, is labour-intensive and immediately consumed. As an output it is very difficult to measure. When a business cannot achieve a competitive advantage with a better product, it can differentiate itself as better than its competitors because it has better customer service. Customer service is provided to customers before, during and after a purchase.

All businesses provide some degree of services because services are benefits that accompany physical goods. Customer service is a particular output of service-based businesses, however all manufacturing businesses must realise that they also provide services.

Many businesses aim to have a comprehensive service system. That is, policies and procedures on how to manage relationships with customers. It may be as simple as a sales assistant in a clothing store following the owner's '**7 steps to a successful sale**' guideline to more complex and strict rules that cover every situation on how to treat customers. Good customer service will increase consumer satisfaction and contribute a competitive advantage. Customer service includes the following features:

- handling customer returns promptly
- answering questions and providing information
- frequent and meaningful communication
- anticipating customer needs
- following up customer enquiries and complaints
- using technology to offer a 24-hour service: email, Facebook, Twitter.

Technology has changed the way customer service is delivered in many industries. Internet sites and automatic telephone-answering computers with voice recognition software reduce sales staff needs. Although some businesses are restoring the human touch, as service is an emotional experience and frustrated, alienated customers may leave the business.

Good customer service is an aspect of relationship marketing and can enable a business to charge higher prices and lessen the need to reduce costs elsewhere in the

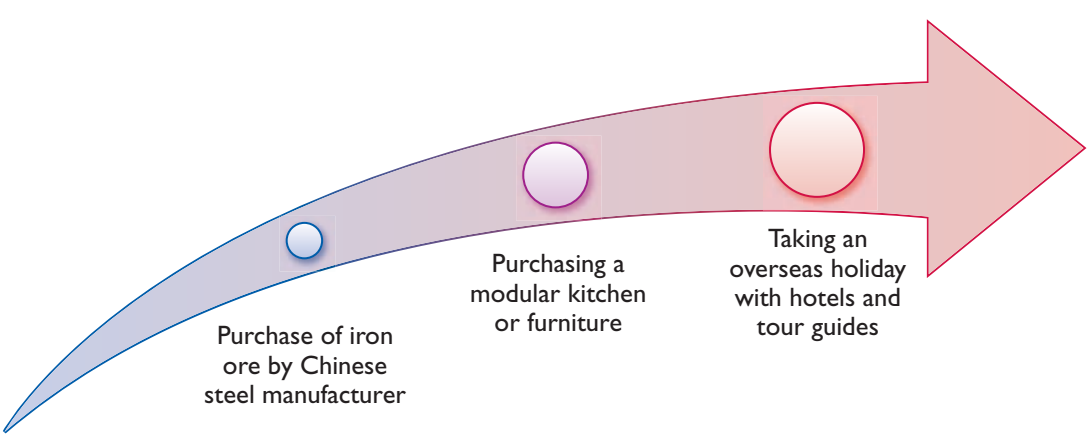


Figure 3.14 Increasing degree of service provided in different industries.

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business. The outcome of good customer service is that customers buy and keep returning. It assists in maintaining the 80/20 relationship. That is, 80% of revenue comes from 20% of the customer base who return to the business. If a business can combine excellent customer service with a high-quality good then it can command a premium price in the market and still achieve a significant market share. Customer service can be measured by using the number of customer complaints or even the average response time of a business to a customer enquiry. In a school the ratio of teachers to students is a measure of the quality of customer service, although the quality of delivery may vary from teacher to teacher.

In a global business the challenge is to replicate its service system in its other locations. There will be challenges from differences in language and culture. Training in customer relations and the customer service policies of the business will be very important to achieving consistency in service delivery.

BUSINESS BITE

IKEA's customer service philosophy is not to 'hassle' the customer but to provide them with as much clear information as possible to help them make their decision. The IKEA showroom has two types of displays: 'room settings' show how the furniture and accessories would look set up in a room, while other displays have all the same types of furniture together for easy comparison. Staff are positioned at specific points in the store to provide assistance if approached by a customer. Customers can even hire an IKEA designer to help them select furniture and accessories. Customer service extends beyond the store with staff that can assist in loading customers' cars in a large loading area and even a home delivery and installation service (they will even bring their own Allen key).



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Activity 3.4 Analysis

1 Outline the services that accompany the following products
   - a A DVD rental.
   - b A new car.
   - c A business that supplies indoor plants for decoration to office buildings.

2 Describe the benefits of faster response times to customer enquiries to a business.

3 Explain why it can be difficult to achieve an increase in productivity in the delivery of service.

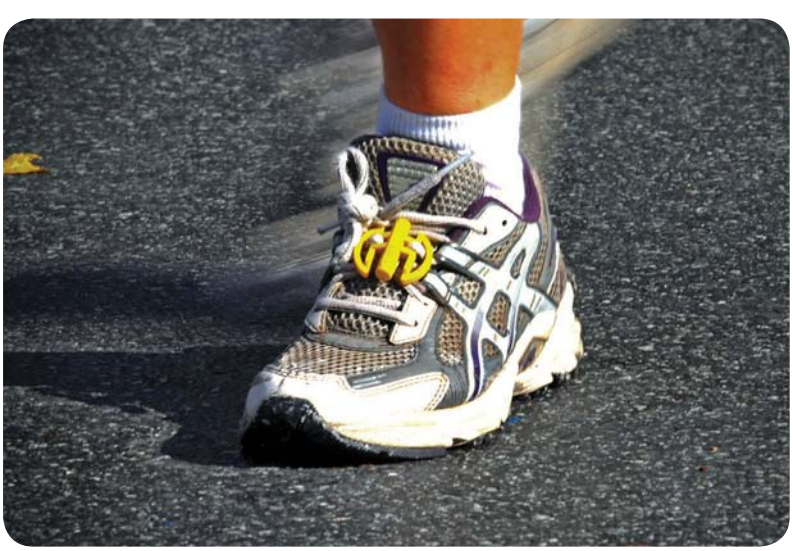
4 Assess the importance of customer service to a business that supplies components to other businesses.

Warranties

A warranty is an assurance that a business stands by the quality claims of the products they make and provide to the market. Under Australian law all businesses must ensure that the goods they sell:

- have a level of quality that is comparable to the price and product description
- are suitable for the purpose or job they will be used for
- match the product description in any advertising or promotion
- are free from defects or faults.

For example, Asics Gel Key-Kayano shoes are a performance running shoe that retails for over $200. Consumers can expect several months of comfortable running for what they are paying, what the advertising promises and based on the design of the product.



These responsibilities make up the statutory (or implied) warranty that give consumers legal protection under the *Fair Trading Act 1987* (NSW) and the *Competition and Consumer Act 2010* (Cth) in Australia. Retailers and manufacturers must comply with the warranty and may need to provide a replacement product if a consumer is not satisfied. Generally, it is the responsibility of the seller to organise this and take the issue up with the manufacturer. Alternatively, a manufacturer may repair faulty goods with skill and care, using spare parts of a suitable quality and then return it to the customer.

A business may offer an extended warranty above the legal minimum, such as a three-year replacement warranty. This comes at an extra cost as it represents an additional service and more peace of mind for the consumer. This is on top of the statutory warranty and may cover the product from manufacturer's defects or faults for an additional time.

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Chapter summary

- Operations processes or the production process are the activities involved in the transformation of inputs into outputs.
- Inputs into an operations system are the materials, people and facilities used to make goods or provide services. Also included as inputs are time and finance.
- Transformed resources or inputs are the materials, information and customers that are changed by the operations process. Transforming resources act on the inputs to change them and are not used up in operations. These are human resources and facilities.
- The transformation processes are those activities that add value to the inputs.
- Businesses that produce in high volumes, low variety and experience little variation in demand will use a high level of capital equipment, technology, materials and facilities. Low-volume operations, producing a wide variety of goods and are subject to a volatile level of demand will need to have a highly flexible operations process using more skilled labour.
- Visibility of operations refers to how 'open' the operations process is to customers. The more visible the operations, the more customer-focused the business is; operations will produce a lower volume, higher variety of made-to-order products unique to the customer's wants.
- Scheduling and sequencing tools are used to identify all steps in the operations process and organise them into the most efficient order to complete. Gantt charts and critical path analysis are the most common.
- Process technology is the improvements in the machines, equipment and devices used to transform inputs into outputs. Product technology is the innovations in the goods and services.
- Monitoring, control and improvement to operations are essential if the business is to achieve its performance objectives and sustain a competitive advantage.
- Outputs are the goods and services provided to customers. Customer service and warranties are an intangible output.

Chapter revision task

1 Match the following outputs with the appropriate business.

Cinema	Kitchen cabinets
Printing company	Mineral ore
Carpenter	Printed signs to order
Accounting firm	Entertained customers
Mining company	Financial reports and statements

2 Categorise each of the following businesses as either a transformer of materials, information or customer inputs:

(a) transport delivery
(b) market research
(c) mining company
(d) dentist
(e) telecommunications
(f) retailer
(g) warehousing
(h) hotel

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3 Complete the following table indicating the impact of the 4Vs on the operations process. The first has been completed as a guide.

	Book publisher	Bridge construction	Hospital emergency	School canteen	Soft drink bottler
Volume	Medium				
Variety	High				
Variation	Medium				
Visibility	Low				

Multiple-choice questions

1 Why are human resources classified as a transforming resource?
- **(A)** Because employees will improve their skills with training
- **(B)** Because employees will use their skills to add value to resources
- **(C)** Because employees are multiskilled
- **(D)** Because employees' productivity and motivation will vary

2 Gantt charts and critical path analysis are both tools that can be used for which activity?
- **(A)** Rostering
- **(B)** Scheduling
- **(C)** Highlighting relationships between task
- **(D)** Task design

3 When is a business considered capital-intensive?
- **(A)** When it has borrowed a lot of capital from the bank
- **(B)** When it is based in a capital city
- **(C)** When is has a very high proportion of fixed costs
- **(D)** When it has a very high proportion of variable costs

4 Which of the following are thought NOT to be a benefit, although it can occur with the introduction of technology?
- **(A)** Reductions in waste and improvements in efficiency
- **(B)** Introduction of new and better products
- **(C)** Industrial relations issues
- **(D)** Improved communication

5 Which influences will cause operations to be more labour-intensive?
- **(A)** Low volume, low variety, low variation, low visibility
- **(B)** High volume, high variety, high variation and high visibility
- **(C)** Low volume, high variety, high variation, high visibility
- **(D)** The actual production process used in the business

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6 Why are scheduling tools used in operations?
   (A) To work out rosters for employees
   (B) To work out when products are sold
   (C) To create the most efficient production process
   (D) To plan production and control operations

7 What are outputs?
   (A) Final goods and services
   (B) What is produced by the operations process
   (C) What is produced from the raw materials
   (D) Components used in operations

8 Which of the following business's operations process will be most influenced by high visibility?
   (A) Restaurant
   (B) Building a house
   (C) Creating the next generation of smart phones
   (D) Producing paper

9 What are the characteristics of a process layout?
   (A) Assembly lines, robotics and CAM
   (B) Activities are organised according to function
   (C) Equipment is set out in the same sequence as the operations process
   (D) Where all the machinery is arranged by its function

10 When do improvements in process technology occur?
   (A) When a business seeks a competitive advantage through lower costs
   (B) When a new invention leads to a new product
   (C) When a business learns from its mistakes
   (D) When a business applies technological innovation to the operations process

Short-answer questions

1 Identify the difference between a transforming resource and a transformed resource?

2 Explain the difference between monitoring and control strategies.

3 Assess why all businesses must consider improvements in customer service.

4 Explain how task design can give a business a competitive advantage.

5 Explain the difference between Gantt charts and critical path analysis.

Extended-response question

Outline the strategic goals of the operations process and explain the influence of volume, variety, variation and visibility on operations.

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CHAPTER 4



Operations strategy

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Operations strategy includes all activities involved in the production of a good or the provision of a service. It also includes all the influences on operations strategies. Specific decisions will have to be made about what and how the business produces. Operations strategies will support the business's strategy to achieve its strategic objectives and will have to be coordinated with marketing strategies, finance strategies and human resources strategy. An effective operations strategy will give a business a competitive advantage in the marketplace.



Figure 4.1 Objectives of a successful business.

Performance objectives

Performance objectives are key areas of focus of operations. When a business chooses one or two areas it is part of its competitive strategy. In this manner, operations offer a strategy for differentiation. In order to gain a competitive edge a business may choose to focus on:

- having the highest quality goods and services
- speed and productivity
- being dependable
- being more flexible than its rivals
- offering customisation
- producing at the lowest cost.

A business that can achieve multiple performance objectives will probably be the industry leader with dominant market share.

Quality

Quality has many different meanings and is much harder to measure than physical output or costs. Quality performance objectives relate to the physical good or service, and also to the process used to produce. For any business the fundamental quality objective is to provide customers with a product or service they like. Good quality prevents costs caused by product recalls and repairs made under warranty and also meets consumer expectations. There are many dimensions to quality that customers have expectations about:

- conforming to specifications – the actual product matches what it was designed to do and lives up to the claims made by marketing
- performance – how well the product does what it claims
- durability – how long the product lasts before it needs servicing or replacement
- features – how many options and variations are provided as well as after-sales service
- reliability – does the product perform the same each time it is used
- aesthetics – how the product looks and feels (is it beautiful or considered ugly)
- serviceability – how easy and convenient is it to perform maintenance and repairs

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- service – how well the customer is treated, the promptness of service and attention to detail.

Activity 4.1 Discussion

1. Evaluate what is the best quality car brand or clothing brand.
2. Discuss which company has the strongest reputation for quality.

Quality is also about the operations process itself. A quality process would be one that gets the operations right the first time. Value is added at each stage of the process with minimal defects or waste. There is very little variation in output and the quality suits what is expected in the market. Statistics are often used to measure quality and gain information about variations from specifications, number of defects and waste.

Speed

Speed is an objective because it relates to productivity. Productivity is simply output divided by input and is sometimes measured in output per unit of time. For example, a car manufacturer is aiming to achieve a record output of 15 000 finished cars in 30 days. The factory has a limited amount of equipment and cannot hire more staff. By keeping all other inputs the same and increasing the speed of the production process, the business calculates that it can reach its target.

Speed of operations can be increased with technology such as CAD, CAM, robotics, etc. The internet has increased the speed of service delivery particularly in banking and finance.

BUSINESS BITE

The production line at Coca-Cola Amatil's bottling plant at Northmead, Sydney, uses a specially designed packing machine that places cans of soft drink on a tray, which is then wrapped for transport. The Vega N80 V machine when running a maximum speed can pack 80 cartons per minute.

There is a limit to speed as an objective as other issues arise. The other parts of the production process must be able to keep up. A production line or operations process can only move at the speed of its slowest machine. Bottlenecks can appear where operations cannot handle any more demand. Similar to traffic that has to merge from three lanes into two, a bottleneck occurs at the point of merging. Increased speed may increase the chance of equipment failure and human labour can only work so fast before mistakes occur and fatigue sets in. A risk of increasing the speed of operations is that quality may suffer.

Dependability

Dependability is the reliability of the product or service. How well the product is designed and made will affect how long the product works to the standard expected by customers. Some brands have a strong reputation for dependability because their products always deliver what marketing promises. There is also dependability in delivery or supply – how well can the business always fill orders and distribute to the market on time.

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Flexibility

Flexibility of operations is how easily and quickly operations can switch to a new model or variation of a good to meet a change in the market or changes in customer wants. There is also flexibility in volume, which is how quickly operations can change from producing few products as a low-volume producer to becoming a high-volume producer increasing output to meet increasing demand for their products in the market. Demand for a product changes according to the product life cycle. As a good enters its growth phase, a business needs the flexibility to match the increase in demand and avoid a **stock-out** where the business runs out of inventory.

Customisation

This is concerned with how quickly a product can be redesigned to produce a unique good or service that matches the customer's desires. Customisation may be challenged as a business may not have the appropriate inputs. There are limits on what the equipment or existing technology is capable of, how much time is available and even on the knowledge and skills of labour.

BUSINESS BITE

An example of a custom-designed service is iTunes Genius, which is a feature of iTunes from Apple Inc. This service not only creates a music playlist based on a user's own music library, it also automatically finds music from the iTunes online store that it thinks the user will probably like based on the existing playlists, previous pattern of purchases and the purchases of similar shoppers.

A business with a focus on customisation will need to have close contact with customers to understand their needs and translate these into design specifications or service requirements so a unique product can be made. Custom designers can usually command a premium price.

Cost

Efficiency is a key objective of operations and cost objectives are concerned with keeping costs as low as possible. Costs must be carefully managed and cost data is collected and analysed. With lower costs there will be improved profit margins on each product sold, which gives the business more revenue. A key measure of costs is using efficiency ratios and average costs. Efficiency ratios such as Operating Expense Ratio compare how much it costs the business in terms of operations to make $1 of sales. This percentage needs to be as low as possible. Average costs is a very basic calculation but is very useful to compare overall figures. A business that can lower average costs per unit sold is obviously achieving a performance objective of efficiency.



Stock-out

Where a business runs out of inventory.

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Lead time

The time it takes for a supplier to provide its customer with the goods ordered; that is, the time between the supplier's receipt of a request for goods until the delivery of those goods to the purchaser.

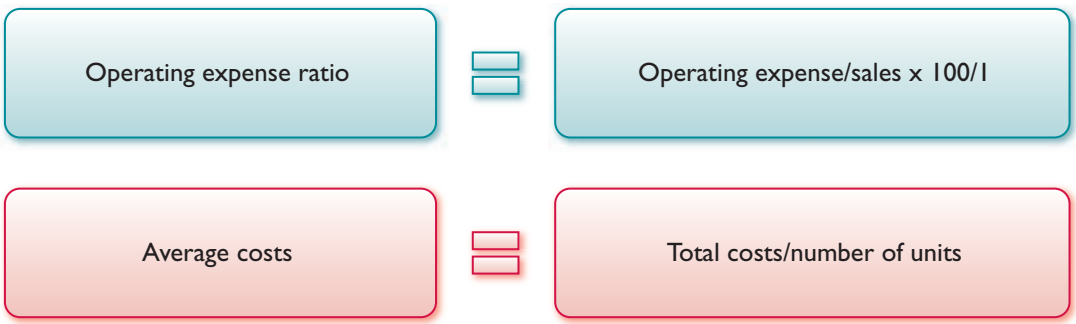


Figure 4.2 Operations costs.

The operations function will be its own cost centre in a business and, within this, costs will be allocated to different parts of the operations process such as raw materials, maintenance costs, power, inventory and waste. Inventory costs may be calculated using a variety of methods such as LIFO and FIFO, however total inventory costs will include transport (cartage) and warehousing. An operations manager will use budgets and compare costs forecasts to actual costs. In this way cost variations can be easily identified. Investigation will reveal the reasons why some costs have exceeded expectations. In order to keep total operational costs within the objectives, cost savings may need to be found elsewhere in the business.

Costs can be categorised into five areas:

- fixed – do not change as output changes and therefore cannot be lowered, such as the cost of the factory building or the lease for office space
- semi-fixed – parts are fixed and parts are variable; for example, power bills may be split into standard charges and excess power charges
- variable – do change as output changes; for example, raw materials
- direct – are directly related to production or supply of service (cost of goods sold)
- indirect – sometimes called overheads and indirectly related to output such as salaries of administration staff.

An important objective for costs involves the break-even point. Break-even analysis is to determine the point at which a business starts to make a profit. A business that can reduce its costs can lower the break-even point so that it can start making a profit sooner in the business life cycle without having to change prices.

Table 4.1 Performance objectives of different businesses

Objective	Business example
Quality	An airline that has all its aircraft arrive and depart on schedule, friendly, helpful staff, entertainment and tasty meals
Speed	A car manufacturer that reduces the **lead time** between when a customer orders a new vehicle and when it is delivered
Dependability	A retailer who always has items in stock and keeps the same opening and closing times
Flexibility	A construction company that can increase the number of houses it can build in response to an increase in demand during an economic upswing
Customisation	A restaurant that can change menus and prepare meals to suit individual customers
Cost	A soft drink bottler that can produce bottles of soft drink at the lowest cost per unit

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Activity 4.2 Comprehension and analysis

1. Identify the main performance objective of a business supplying highly perishable food to restaurants.
2. Analyse the impact of a business pursuing a quality objective on the achievement of speed and cost objectives.
3. Explain the importance of a dependability objective for an airline.
4. Explain how a performance objective of flexibility is important for a business that operates in a dynamic business environment.

New product or service design and development

All businesses experience the decline of products as they reach the end of their life cycle. Often the life cycle can be extended by adding more features or developing a small improvement in design; however, eventually new products must be developed by operations and released to the market.

A business that has the core capability to integrate leading-edge technologies with skills and innovative ideas will be a market leader in new products and services. Apple Inc. is an obvious example of this ability to achieve a long-term competitive advantage in computing, smart phones and data-storage devices such as the iPod. A business that has a well-organised system of research, technical knowledge and innovative skill combined with the ability to translate this into a successful commercial product will be the 'first to market' and initially dominate market share. The Apple iPad is an excellent example, selling 1 million units within 28 days of its release in 2010.

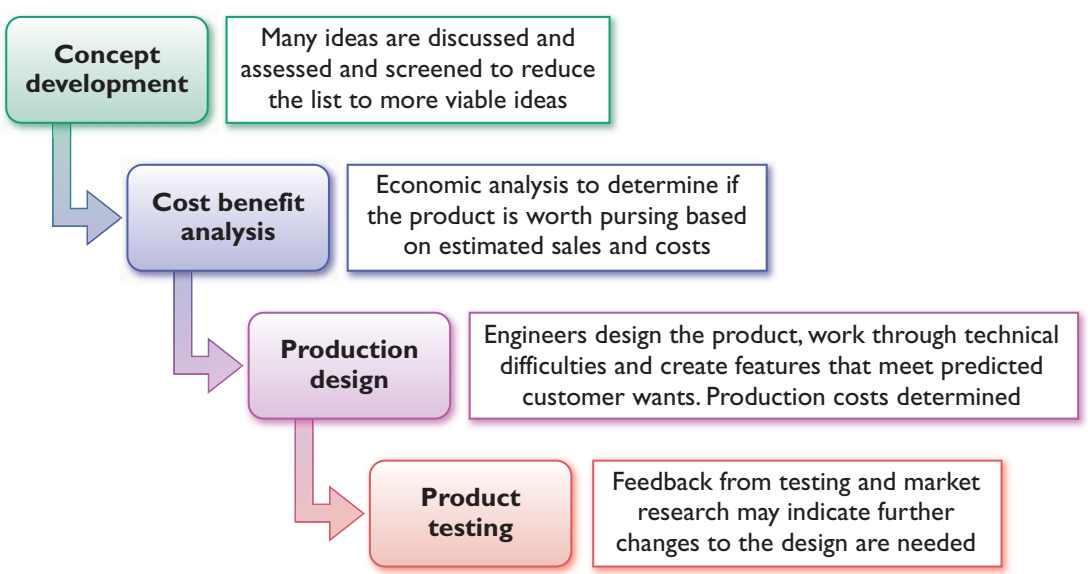


Figure 4.3 New product development process.

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New product design is a lengthy process because initial research may indicate a high number of possible products that could be commercialised into a final product. Cost benefit analysis, design, testing, construction of prototypes and market development will eliminate those ideas that are:

- too expensive to make – a financial filter
- beyond the capabilities of operations to make – a capability filter
- have problems with design – a technical filter
- will not be received well in the market – a commercial filter.

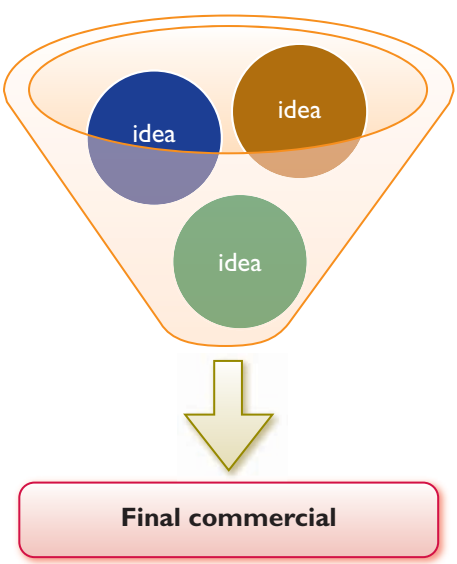


Figure 4.4 Idea elimination funnel.

It may be the situation that out of 50 products initially proposed from research, only one reaches the market and will be a commercial success. The process can be very expensive and time consuming and therefore many businesses choose to imitate a competitor's product. Many businesses simply do not have the financial resources, knowledge or time to commit to new product development. By waiting and imitating, a business can gain the advantage of avoiding the costs and risks of new product development, as even though they are 'second to market', their product may have additional features that give it a competitive edge.

Despite the high attrition rate with many discarded ideas, a business will gain considerable knowledge from this process, which will be an input into future products or services. Given future developments in technology, a discarded idea may have the potential to be a commercial success in the future.

Supply chain management

The supply chain includes all businesses directly linked to the supply of goods or services to the consumer. Businesses need to acquire various resources necessary to produce a good or supply a service. Suppliers need to be found that can provide the most appropriate inputs at the best price and reliably supply the required quantity with the appropriate quality. Suppliers will need to know how far ahead orders have to be made, in what quantities they are required, what transport facilities are available and the expected delivery times. As the Australian economy has become far more globalised and many inputs are imported from overseas, it is important to know the lead time involved for each supplier. The lead time is the time it takes for a supplier to provide its customer with the goods ordered; that is, the time between the supplier's receipt of a request for goods until the delivery of those goods to the purchaser. Both manufacturing and service businesses need to have well-organised supply chains. In each case, the shorter the lead time, the more flexible purchasing

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becomes, which allows greater adaptability in production. The location of the market and the business's major suppliers may be a very important consideration. Factors affecting a business's location may include the availability and cost of transport, perishability of outputs and resources, distance to markets, whether the inputs and outputs have fragile components and the availability of labour. These factors may help to determine the initial location of a factory. Geographic relocation may be necessary if changes in external factors influence costs and therefore profitability.

Many businesses do not own or control their source of raw materials or their distribution channel. This is a consequence of outsourcing and developments in information technology making it possible for businesses to focus on their prime function and communicate with other firms. More recently, businesses have tried to rationalise (reduce) the number of suppliers from which they purchase. Businesses may enter into longer-term contracts in order to tie up their suppliers. This may establish a better relationship between suppliers and business, which benefits both in various ways, such as improved trade credit terms, possible cost reductions due to bulk purchasing, reliability of supply and payments, and quality of service. Businesses do not necessarily choose the cheapest supplier but will try to gain real value for their money. Rationalisation of suppliers makes the job easier. The business deals with fewer suppliers and clearly understands the procedures followed by them. Regardless of the method of ordering used, the prime objective remains the same. The right resources (inputs) need to be available in the right place and at the right time for the operational plan to be put into practice. This will allow the business to achieve its short-term objectives (such as reaching a particular production target or reducing operational expenses) and move towards the goals set out in the strategic plan (such as to achieve a certain level of profit within a specified period of time). Therefore, supply chain management involves the coordination of all these businesses so that goods and services can be delivered to customers in the quickest, most dependable and cost-effective manner.

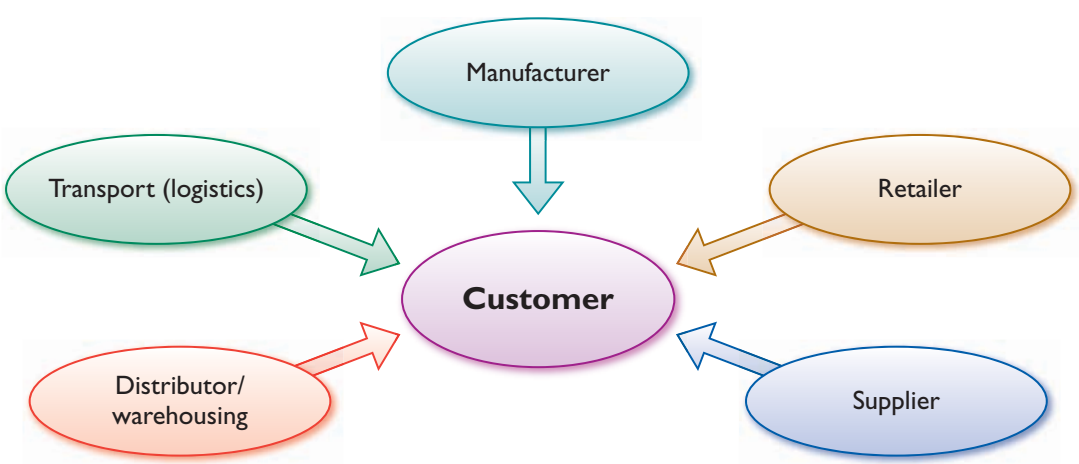


Figure 4.5 Management issues in supply chain management will cover day-to-day operations through to the long-term strategic goals of the business.

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Bottlenecks
Points in the operations process that limit the speed and volume capability of the operations process.

Table 4.2 Supply chain management goals

Strategic – long term	Tactical – medium term	Operational – short term
• Warehouses: number, size and location • Location of manufacturing • Future partnerships with suppliers and distributors • Updating IT and communications systems • Integration of new products with existing products that are at the end of their product life cycle	• Sourcing raw materials • Scheduling and sequencing of production • Inventory decisions: quantity of stock stored, quality of inventory and location • Transport of products • Identifying patterns in the changes in consumer demand • Comparing the business against its competitors and industry benchmarks • Identifying and preventing **bottlenecks** in the supply chain	• Taking orders from customers and setting production targets • Delivery of products from warehouse • Receiving deliveries and storage of inputs • Planning current inventory levels with forecasts in demand from customers • Communicating with suppliers • Managing damaged goods and goods returned by customers and distributors

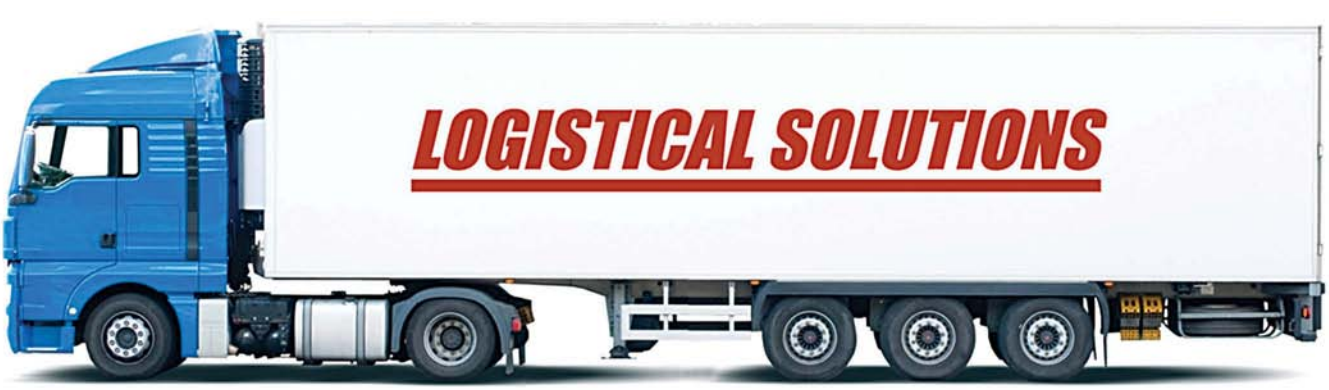
With greater specialisation in manufacturing during the 1990s, industries and individual businesses increasingly outsourced the management of their supply chain. This created an opportunity for businesses to provide supply chain management as a professional service. A new industry developed around organising planning supply, transport and communication systems for supply chain management. This enabled larger businesses who could afford this professional service to focus on their core operations, especially those operating on a global scale.

BUSINESS BITE

Nike has a global supply chain of 700 contract factories located in 52 countries.

Logistics

Logistics involves the transport of physical raw materials, inputs and the distribution of finished goods to markets. It is part of the supply chain that focuses on moving inputs, resources and outputs through the supply chain as quickly as possible, saving



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as much time at each point in the supply chain as possible. The goal is to achieve an efficient steady flow of material through the supply chain.

Correct and timely information is crucial for successful logistics management. For example, the operations manager will need information about how long it takes for inputs to be physically transported from their source of origin to the factory. Sophisticated software programs can be used to identify where efficiencies can be gained. The entire supply chain can be modelled and simulations can be run to optimise the supply chain through better logistical management. As well as computer modelling, technology can create efficiency in managing inventory. Automated warehouse trucks (AWT) can replace the traditional forklift and driver. They operate independently, driven by a software program and guided by laser. AWT's can find and retrieve stock, move stock and store it. The technology also reduces the need for warehouse staff and consequently the number of forklift accidents.

Logistics is necessary due to the increasing complexity of supplying businesses with materials and shipping products in an increasingly globalised supply chain. Business logistics experts are required as a specialised job in operations management. The role of logisticians is to ensure that operations has the right item in the right quantity at the right time at the right place for the right price in the right condition to the right customer. Specific tasks include:

- inventory management
- purchasing inputs
- transporting inventory and products
- storage and warehousing
- packaging
- planning and scheduling.

Therefore, logistics is not concerned with merely the transport of material, but strategies to save time and control the flow of materials to add value to the supply chain and the operations function.



E-commerce

Electronic commerce – or e-commerce – is a part of e-business. It is not to be confused with the term e-tailing, which is used to describe businesses that only use a virtual store and sell their goods and services through a website. E-commerce is a more precise term and identifies the use of the internet to both buy and sell goods and services. The internet, which first became well known in 1994, and the more recent rapid development of wireless broadband have significantly increased the amount of business-to-business (B2B) communications and business-to-consumer (B2C) interaction.

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Electronic data interchange (EDI)

Use of computers, barcodes and scanner systems to monitor individual stock items and keep accurate records of inventory levels.

Changing attitudes towards 'virtual' shopping have seen a significant increase in e-tailing or online retailing. Many consumers enjoy the convenience of browsing products at their leisure without suffering high-pressure selling. Having at least an online catalogue is almost a necessary part of promotions strategy. Owing to the time and expertise required to set up effective web communication many businesses are outsourcing this function to IT experts. However, the cost of an interactive online presence is still beyond the reach of many small businesses.

E-commerce uses **electronic data interchange (EDI)**, email and even Voice over Internet Protocol (VOIP) to have real time conversations with suppliers and customers, exchange data and information. In operations, thousands of businesses that sell products to other companies have discovered that the internet provides a 24-hour advertisement for their products and a quick way to reach the right people in a business such as purchasing officers to give them more information via email. Inventory management can be improved also with e-commerce – it can be set up so that an email to a supplier is automatically generated when inventory levels are getting close to buffer stock levels (the minimum stock a business likes to carry to meet demand). This improves efficiency in the supply chain because the supplier receives the message and can deliver more stock just as the business needs it for just-in-time (JIT) inventory management.

E-business is a broader term that refers to the use of the internet to carry out a variety of business functions such as finance, marketing and even online training programs for human resources.

Global sourcing

Countries throughout the world have different endowments of resources and globalisation has enabled businesses to access resources that were previously beyond their reach. For example, Australia happens to have a huge supply of iron ore and coal, which is supplied to steel mills in China. Resources and the raw material inputs are not available everywhere and their geographic location will influence where a business chooses to:

- locate manufacturing
- locate assembly
- use foreign parts and components.

Global sourcing is where a business seeks to find the most cost-efficient location for manufacturing a product, even if the location is overseas. By locating closer to their raw materials or where there is a source of cheap labour, a business can achieve lower costs. Many global businesses choose this strategy and even have a global web of operations exploiting the cost advantages offered by the location of cheap resources in a number of different countries. There may be an additional incentive of low rates of tax to encourage global businesses to establish in certain countries and stimulate the local economy. Global businesses that use this strategy must keep careful control over their supply chains that cover a global network of suppliers and distributors. An additional issue is that relocating of manufacturing may not create a sustainable advantage as the business may need to relocate again and again because competitors will go further and further to cut costs.

A business may choose to manufacture its products or outsource the manufacture of some or all of the products that it will

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sell. It may be more cost-effective for a global business to purchase the inputs rather than make the inputs itself. Once a global business has made the 'make or buy' decision, it may also choose to vertically integrate to source its inputs. A global business producing a complex product may use both strategies. A specialist supplier is used to produce some parts, while the business itself makes the remainder of the inputs because it has the capabilities, skills and expertise to do it more cheaply than outsourcing to another firm.

When following a 'buy strategy' a business will import its inputs from an overseas supplier that specialises in providing those inputs to businesses. The advantage of this outsourcing strategy is that the business is free to concentrate on its core business activity. The supplier may also offer a good supply of high-quality inputs at a discount price when the business orders in bulk. The inputs may also be well designed and constantly being improved by the supplier to suit its business customers. However, there may be a threat to the business if competitors are also able to buy the same inputs as this will reduce any competitive advantage a business has. Outsourcing stages of production and distribution requires a global supply chain. Outsourcing of non-core business functions and contracting out tasks is becoming a common strategy to reduce costs.

Alternatively, a business may decide to **vertically integrate** and take over a business that can supply its inputs so that it can make its own secure supply of good-quality raw materials and inputs. Other advantages of this strategy are that it allows the business to:

- reduce costs through economies of scale and remove the profit margin a supplier would make from selling the business the inputs
- use a just-in-time (JIT) inventory management method as the business can control when supplies are made and delivered
- use transfer pricing to reduce tax and the negative effects of exchange rates.

This strategy of vertical integration is defined as a business buying out the business that it sources its inputs from. Alternatively, purchasing the business that it supplies to. The business will also need a transport system to send inputs to where they are needed. This is sometimes called **transport logistics**.

Vertically integrate

A style of management control that involves companies in a supply chain being integrated by one current owner.

Transport logistics

The organisation of the physical movement of goods from their point of origin to their destination. The route, method and speed of transportation are all factors to consider when delivering materials, inputs or final goods to their user when they are required.

Table 4.3 Comparison of sourcing decisions

Advantages of making inputs	Advantages of buying inputs
• Lower costs when economies of scale achieved	• Lower costs by selecting cheapest supplier
• More control over design, quality and timing of delivery inputs	• Specialist forms able to produce better designed, better quality inputs in quantities required
• Able to protect technological innovation advantages	• Business only requires particular inputs in small quantities
	• Business can cancel order as the supplier changes its processes and quality changes, giving flexibility
	• No need to invest in a factory

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Activity 4.3 Comprehension

1. Define the term *logistics*.
2. Describe the supply chain of an online retailer of mobile phones.
3. Explain why cost minimisation is not always the best strategy when managing a business's supply chain.
4. Explain the impact of global sourcing on a business's supply chain.
5. Evaluate the importance of supply chain management for a business supplying fresh fruit and vegetables to supermarkets.

Outsourcing

Outsourcing is the contracting out of a non-core business activity. A business may wish to focus on its main activity and organises another business to provide a support service such as transport, security, supply chain management, logistics, maintenance and servicing of equipment, producing components or supplying materials. By outsourcing, a business can free up resources to invest in the core business activities such as management time.

An impact of globalisation is that market conditions can change, which may cause a rise in the cost of components. If the business's supply chain is not flexible enough to move to a different supplier then any advantage from outsourcing may be lost.

Another impact of globalisation is the opportunity to outsource to an overseas supplier known as offshoring. For example, many IT, software and banking administration tasks have been sent offshore to India to take advantage of less

Table 4.4 Advantages and disadvantages of outsourcing

Advantages	Disadvantages
The business to which the service is outsourced to has: • Access to a specialist knowledge and expertise because the function is their core business • More efficient methods • Specialist knowledge of relevant laws and regulations • Better access to IT, technology and the most suitable equipment • Experience at solving complex problems • Lower costs as the contracted business can achieve better economies of scale, which can be passed on • Increased speed and quality of outputs	• Breakdowns in the business outsourced to will affect the entire operations • Loss of control over quality, reliability and even costs • Loss of control may be exaggerated with the business being located in another country (cultural incompatibility) • Possibility that a competitor outsources to the same business, which may eliminate a competitive advantage and even expose the business to rivals discovering commercial secrets • Slower lead times and response to changes in the market • Poorer relationship with stakeholders such as the community and redundant employees

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expensive skilled and educated labour with faster turnaround times for work. There is a large pool of talented and motivated young workers, many who are graduates from India's 380 universities. There is a risk, however, that when offshoring, a business can lose its knowledge and capabilities. In essence, the business may be hollowed out as internal departments are closed and moved to an outside supplier.

Technology

Businesses operate in a dynamic environment. One of the major external influences on business is technological change. **Technology** is the equipment and knowledge that are available to help businesses perform certain functions or make products. Technology can result in the development of new methods of production or new equipment that helps businesses perform functions more quickly and often at a lower cost. There is a heavy reliance on the operations manager to be aware of this technology and assess its application to the business. The manager weighs the costs of the upgrade in technology against the long-term expected benefits, such as increased sales or higher profits.

When making a decision about technology use, a business must take into account various factors, including:

- the speed of change taking place in that area of technology
- the technology that competitors are using
- the finances available for a change in technology
- how long it will take to introduce the technology (especially if all work needs to be at a standstill)
- whether staff will need to be retrained or possibly made redundant.

Some technological changes cannot be ignored. The evolution of computer technology has resulted in major changes for most businesses. The use of computers as word processors, storage systems and communication systems has changed the way businesses record and process information about transactions, employees and general data. It has even enabled people to work from home.

Leading edge

In a highly competitive market many businesses seek a competitive advantage by being the first to develop and implement new technology. Leading-edge technology may be referred to as being at the cutting edge. One step further is bleeding-edge technology – this is technology so new that there is a high level of risk and uncertainty in using it. A business that can incorporate leading-edge technology will force its competitors to follow it if they also wish to remain competitive. Unfortunately, once leading edge is discussed in the everyday media and school textbooks it may no longer be leading edge.

The goal of the federal government's Department of Innovation, Industry, Science and Research is to encourage the sustainable growth of Australian industries by encouraging innovation, knowledge creation, cutting-edge science and research, international competitiveness and greater productivity. Australia will benefit from long-term economic growth and international competitiveness of exports.

Technology

The equipment and knowledge that are available to help businesses perform certain functions or make products.

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Table 4.5 Examples of leading-edge technology

Industry	Example of leading-edge technology
Agriculture	Using Global Positioning System (GPS) units to precision map areas for planting and ploughing, direct equipment and fertilise with little human intervention.
Education	Delivery of all course materials online, tutorials using blogs, forum posts and video conferencing, submission of assignments using email.
Medicine	A tissue regenerating powder made from pig bladders called extracellular matrix. It is a mix of protein and connective tissue that can be used to repair tendons and other human tissue. It may be used to regrow lost limbs and damaged organs.
Transport	The new Airbus A380 contains approximately 25% carbon fiber-reinforced plastic (CFRP), a lightweight, but expensive material.

Established

This type of technology has been tried and proven and is therefore very reliable and dependable. In operations the implementation of technology has three broad aims:

- to remove geographic barriers
- to find cost savings and time savings
- to give a business better control over operations.

Types of established manufacturing technology include CAD, CAM and robotics described in Chapter 2. The internet has been a business tool since the mid-1990s. Computer modelling software is used to integrate all parts of operations management to find costs savings and time savings. Office technology, such as business intranet, smart phones and EFTPOS, have been used to offer better services and faster service delivery to anywhere in the world.

Two more examples of established technology are electronic data interchange and project management software. EDI involves the use of computers, barcodes and scanner systems to monitor individual stock items and keep accurate records of inventory levels. Today, with the use of computers, EDI, inventory methods and rationalisation of suppliers, many businesses maintain relatively low inventory levels. In order for this system to operate efficiently there must be close communication between the functional departments and the business's major suppliers.

Computer modelling or project management software for operations can be used to create Gantt charts and perform critical path analysis. Software such as Microsoft Project allows an operations manager to precisely plan and schedule operations because lead times, delivery times, inventory requirements task analysis, labour needs, equipment and even breaks for maintenance can be entered into the model so that the most efficient sequence and schedule can be calculated. Regular reports can be produced so that operations managers can monitor the progress of operations and take any corrective action if needed.

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Inventory management

The term **inventory** and stock are often used interchangeably but both refer to a business's transformed resources. Nearly all businesses have an inventory of raw materials, work-in-progress and finished goods, as well as information resources and customers. In the case of service-based businesses, queues of customers represent customer inventory. For businesses the warehousing and care of inventory can be very expensive. The inventory may account for 30–50% of the total assets of the business. Thus, inventory management and control becomes a very important procedure. Controlling the level of inventory in a business is very important because the business must hold enough to meet demand but not too much. Too much inventory will increase storage costs while not having enough stock on hand will result in lost sales and potentially damage the business's reputation as a reliable supplier. Ultimately, a business will need to balance its inventory expenses with the need to meet changing demand. Technology has made inventory management much more efficient and accurate. Many businesses use barcodes and electronic barcode readers to keep track of what they have, what has been sold and the exact location of stock.

Businesses monitor and control inventory levels so that they:

- do not accumulate dead stock (stock that is old, out of date or unable to be sold)
- identify and sell slow-moving stock
- maximise the sale of fast-moving items
- maintain some holding stock
- are aware of stock losses through theft or damage.

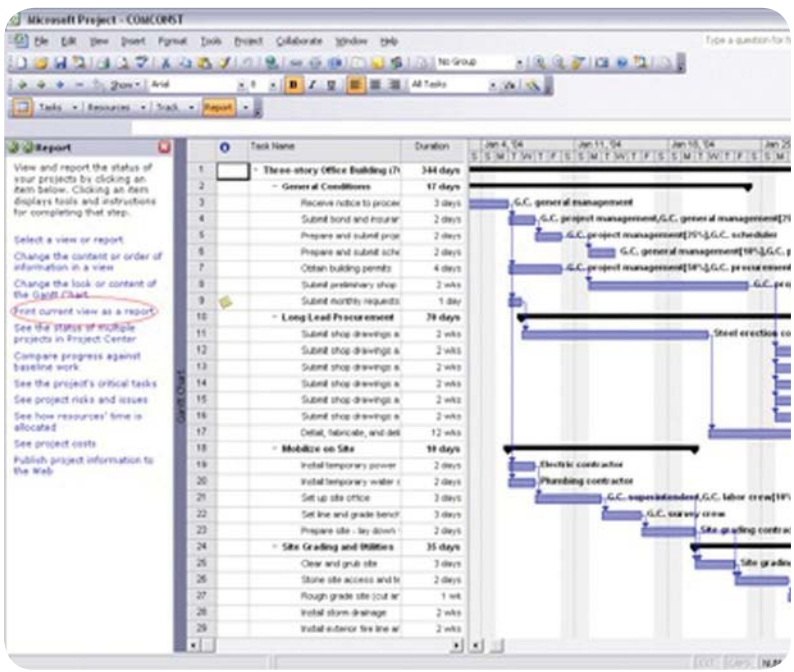


Figure 4.6 Screen print from Microsoft Project.

Source: http://download.microsoft.com/download/2/9/d/29d9b1f1-f875-430e-8138-8d0a23dbd1c4/ProjectStdGuide.doc

Inventory management involves making decisions regarding how much stock to have on hand at any one time and the most appropriate systems of storage and methods of handling. Management takes into account such factors as:

- the time needed for various supplies to arrive
- cartage and freight costs
- perishability or life span of the product and its components
- seasonal patterns in demand
- insurance premiums
- costs of handling and packaging.

In order to have the ideal level of inventory an operations manager will consider the following questions:

- At what stage of the life cycle is the business at?
- At what stage is the product life cycle at?
- What is the trend in the size of the market – growing or shrinking?

Inventory

Includes the raw materials and input supplies used in the production process, the goods that are partially processed and the firm's finished products are also known as stock.

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- What is the inventory turnover? Is the product a low-profit-margin, fast-selling item or a high-profit-margin, slow-selling item?
- How perishable is the product? What is its use-by date?



Figure 4.7 Storage of inventory inside a warehouse.

- How much storage space is available and what is required?
- What type of funds are used to finance the purchase of the stock? Can the business reduce financial costs by using commercial bills or other forms of debt finance with a longer term than an overdraft of business credit card?
- Will there be enough staff to manage the delivery and storage?
- Can deliveries of stock be kept secure?

Inventory management can be as much an art as a science. Managers will use their past experience, knowledge of the business and the market to hold an efficient level of stock as possible. However, sophisticated software programs and computerised inventory management systems that can update records, generate orders and forecast demand have made inventory management much more precise.

Holding stock

Holding stock is also known as just-in-case (JIC) or buffer stock. This is where a business holds a certain level of stock as a reserve to cover interruptions to supply or an unexpected increase in demand. The advantage for cash flow is that stock is ordered at regular intervals, which reduces the pressure on the business to have a higher amount of cash readily available. Purchases can be planned so that working capital is managed more efficiently. There is usually a certain pattern to sales over the year with predictable changes. For example, more stock will be ordered prior to Christmas for a toy store and less during January and February. Holding stock also suits suppliers who need a longer lead time. This is the time it takes between when a supplier is notified and stock is actually delivered.

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Other advantages of holding stock include:

- stock is ready to use
- no need to rely on suppliers for prompt deliveries
- opportunity for discounts when ordering large amounts of stock
- able to take advantage of growing market domestically and overseas
- inputs and components can be used as spare parts if required.

Overall, holding stock is conservative inventory management and it does keep valuable liquidity tied up in stock. There are warehouse expenses for storage and security. There is also the risk that inventory may become **obsolescent**. For example, if an electronics business held a large stock of plasma televisions ready for Christmas in 2010 it would have found that this stock was made obsolescent by the development of LCD televisions. This would have caused the value of stock as a current asset to fall significantly. Perishable items such as food, if held for too long, can spoil. A business may have to sell stock at a large discount to recover cash if it experiences a cash-flow crisis. When there is not enough stock on hand a business may experience a stock-out, where inventory levels fall and there is no supply of stock available for customers. Customers may switch to a competitor as a result.

Overall, the challenge for inventory management is to have enough stock on hand to satisfy changes in customer demand and not be overstocked so that costs can be kept low. This will give a business a competitive advantage because it contributes to efficient operations, which provides for lower prices and customers will always be satisfied as products will be available on demand.

LIFO

LIFO literally means 'last in, first out' – the stock purchased most recently is sold first. This method can be used for goods that have no use-by date such as machinery parts or canned food. The LIFO system is actually an accounting method of recording inventory costs and the reality may be quite different to how costs are calculated for the financial statements.

The LIFO method can be used to determine a more accurate cost of inventory per unit over the financial year. New inventory can cost more than stock purchased at the start of the year. On the balance sheet, stock will be valued at the older value and therefore will be lower than what it really is. On the revenue statement, the newer, more expensive stock is sold, making a higher cost of goods sold and lower profit. This can reduce the tax a business has to pay.

Obsolescent

Loss of value or need of an object, service or practice by becoming less suitable for use.

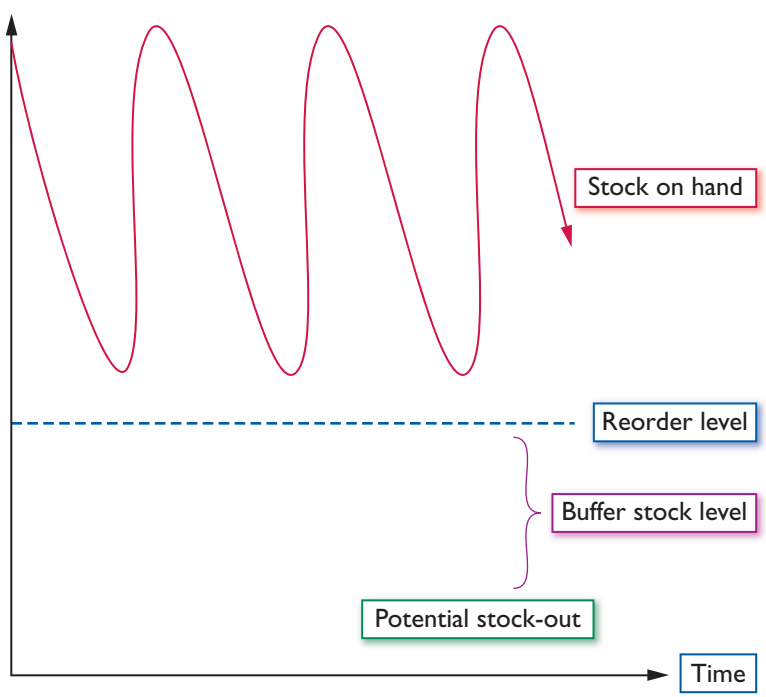


Figure 4.8 Inventory management stock management to ensure sufficient stock on hand.

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FIFO

'First in, first out' (FIFO) assumes that the first stock that has been purchased is the oldest and will be sold first. FIFO is more appropriate for perishable items such as food and drink. Imagine a supermarket where the oldest stock that has to be sold before it reaches its use-by date will be placed at the front of the shelf and new stock will be placed behind, ready to replace it as it sells. Using FIFO, the business assumes that the first goods sold are the oldest and the most recently acquired items remain in inventory on the balance sheet. The impact of this cost accounting method is that closing stock on the balance sheet has a higher value, increasing the value of current assets. Cost of goods sold will be lower and income higher than if the LIFO method was used.

JIT

The aim of just-in-time (JIT) inventory management is to hold as minimal stock as possible and only bring in stock from suppliers as required. Only the exact number is delivered at a specific time. This not only reduces the impact on working capital with liquidity locked up as inventory, but should improve the efficiency of the whole operations process. This system requires suppliers to have excellent inventory management and delivery systems to send out stock as soon as it is ordered. Sophisticated scheduling software to plan production is used to order the correct stock. Information is exchanged with suppliers and customers through **EDI (electronic data interchange)** to help ensure all information is correct.

The advantages of JIT are:

- reduces costs of storage and securing stock
- increases the liquidity of working capital as less cash is tied up as stock
- reduces the chance of stock becoming obsolete and unsellable
- reduces the chance of perishable stock spoiling (e.g. fresh fruit)
- less warehouse space allows more room for other activities
- less time is spent on checking products as without extra work in progress stock, the production process must get it right the first time.

However, as supply is outsourced there is a further disadvantage that if a supplier experiences a problem and stock is not delivered on time, the entire production schedule is disrupted.

Overall, JIT gives a business more flexibility to respond to changing market and other external influences that can affect sales. However, a business must have reliable and dependable suppliers who can respond to the business's inventory needs quickly.

Quality management

Quality has a number of different ideas. For a consumer it can mean that the product provided by a business:

- lasts a long time; it is durable
- is free from any defects
- does everything that advertising claims.

For a customer-focused business, quality also means that each and every good made or provided by the business is consistent in its quality. For service-based businesses quality will be measured in terms of satisfactory customer service.

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Quality management, therefore, involves all activities to ensure that the outputs of the business are consistent, durable, reliable and meet what was the quality standard stated in the operations plan. In order to remain competitive in today's business environment, a business will aim to produce a quality product or service that provides value for money.

To achieve a competitive advantage over other businesses in the same market, a business may choose as its performance objective to have products of a superior quality. If not superior quality, a business will strive for a certain standard of quality because poor quality will be an operations cost. Customer returns, poor service, product recalls and repairs as well as being a significant expense will also damage the value of the business.

As well as customers that expect a certain level of quality, there are other external influences on quality. The government tries to ensure the quality of all goods by establishing laws that protect consumers from unscrupulous business practices and also protect businesses from one another. In Australia products must be fit for the purpose for which it was intended. This means that the product must be able to do

BUSINESS BITE

Australian standards are specifications for manufacturers that outline acceptable standards of quality, safety and reliability for manufactured goods.

The following information about baby cots is an example of the standards established by this organisation:

Around one in five accidents involving baby furniture occurs in the cot. Injuries include falls and getting parts of the body stuck between bars. All cots sold in Australia need to comply with the Australian Standard AS2172 … [and must meet] the following requirements:

- *The bars should be spaced between 50 and 85 mm apart.*
- *The cot should have a minimum depth of 600 mm from the top of the mattress to the top of the cot.*
- *The gap between the mattress and the cot on all sides should be under 2.5 cm.*
- *Make sure that only two legs have castors, or at least two out of the four castor legs have brakes.*

Source: Better Health Channel (www.betterhealth.vic.gov.au).



Figure 4.9 Baby cots are just one of the many manufactured products that must comply with Standards Australia's specifications.

Further information on standards for manufactured goods can be found at the Standards Australia website (www.standards.org.au).

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Quality control

Checking resources and products in all stages of the production process. Includes feed-forward, concurrent and feedback controls.

what the business claims it can do, as well as do it safely. This legislation includes the *Competition and Consumer Act 2010* (Cth) and the *Fair Trading Act 1987* (NSW). The government also requires certain businesses that provide services (such as nursing homes and builders) to be licensed or certified. Licence renewal will require inspections and special forms to be completed in order to ensure that certain standards of facilities and care are being maintained.



There are a number of strategies that businesses can use in order to achieve improved quality in both manufacturing goods and the provision of services. The three main approaches to quality management are quality control, quality assurance and quality improvement.

Quality control

It is generally agreed that good management anticipates and prevents problems before they occur. For a business that discovers too late that it has been selling poor-quality or defective goods the consequence is lost customers, damaged goodwill and expensive warranty costs and even complete recall of products. Between 2009 and 2010 Toyota had to recall over 8 million cars globally after a series of quality issues.

Quality control involves checking transformed and transforming resources in all stages of the production process. These controls can take place at three different stages: feed-forward, concurrent and feedback controls.

Feed-forward controls involve the use of careful planning, before production begins, in order to prevent a problem occurring. Proactive management will anticipate a problem before it arises and amend the situation so that the problem does not occur. An example of a feed-forward control is a hamburger outlet checking the size of buns on arrival from the bakery before they go to the production line. Concurrent controls are used during work in progress; that is, during the manufacturing process. This could include a soft drink manufacturer using laser beam technology to determine whether soft drink bottles have been filled to the correct level. Feedback controls involve checking the final product – after production or delivery of the service is complete. In some cases, customer surveys are included with the product to try to gauge the degree of customer satisfaction with the product. Large motor mechanic businesses often send out a letter to the client a few days after the client's car has been serviced to thank the client for allowing the business to service the car and to gauge customer satisfaction with the service. In each case of quality control there is heavy reliance on the employees to complete jobs properly.

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Figure 4.10
An example of a feedback control. This note was found in the pocket of a pair of jeans purchased from a jeans store. A worker, given the number 3, has checked the garment to ensure it has been properly made for sale.

With the use of batch numbers and codes on products, firms can check where problems exist, determine the production time period involved and identify where improvements need to be made. The problem may arise at the retail end of the distribution chain. For example, inadequate refrigeration in a supermarket may result in dairy products going sour.

Ethical Issue

Some businesses may ignore problems with their products. Their research may have told them that the cost of the recall may be a lot more than the cost of consumer legal action requiring compensation payouts. Do businesses have an ethical responsibility to recall their products if they are found to be faulty?

BUSINESS BITE

Global recall

In 2010 Toyota recalled over 400 000 units of its 2010 model Prius and Lexus hybrids globally. The recall was prompted by customer complaints about slipping brakes while being driven on bumpy roads. Even though there were only 111 cases reported globally, Toyota was very prompt to alert customers. Toyota calculated that repairs to fix the problem would take around 40 minutes per car, which required a software upgrade to the car's on-board computer brake management system. Only 2378 Prius cars in Australia were potentially affected and repairs were at no cost to the owners. Through this approach Toyota has proven that it is a company committed to quality, which is considered a lifeline of the business. Unfortunately, a much more serious problem occurred in late 2009 and 2010 in the USA where a number of motor vehicle accidents and deaths could have been caused by a faulty accelerator pedal sticking causing sudden unintended acceleration. Nearly 4 million Toyotas of various models had to be recalled. This problem, thankfully, did not occur in Australia. News clips and stories related to this issue can be found on YouTube.

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Benchmarking
The process of measuring performance against established standards, such as a comparison of a firm's performance against standards set by competitors in the same industry in the domestic market.

Quality assurance
Establishing and using a set of procedures and/or processes that will prevent products from having problems (such as faults or errors).

Quality circles
Regular meetings of a group of employees from different sections of the business to discuss issues arising in the workplace.

Today, far more products are recalled to ensure that safety issues are addressed.



Product Safety Recall

Fisher-Price® Kawasaki Dora the Explorer Tough Trike toddler tricycles. Approximately 1,229 units of the affected product were sold at Toys 'R' Us in Australia in 2007–2008.

Fisher-Price

Description: Mattel® is recalling the Fisher-Price® Kawasaki Dora the Explorer Tough Trike toddler tricycles. This trike is intended for children 2 to 5 years of age. The Fisher-Price® Kawasaki Dora the Explorer Tough Trike includes a pretend key that is located about 3 inches (7½ centimeters) in front of the seat and protrudes at least ⅝ inches (1½ centimeters) above the trike's body. The model number is K6672 and is located under the seat in the storage compartment.

Please go to **www.service.mattel.com** for product images and further information regarding whether your product is affected.

Any Fisher-Price® Trike with a key located on the handle bars is not affected by this recall.

Hazard: A child can strike, sit or fall on the protruding plastic ignition key, resulting in serious groin injury.

What to do: Please discontinue use of the affected Trike immediately and Contact Mattel® for a repair kit, a refund or a replacement product. Consumers should not return the product to retail stores.

Contact Details: Contact Mattel® at **1800 674 753** EST Mon–Fri 8am–5pm or at **infoaust@mattel.com** or go to **www.service.mattel.com**

See www.recalls.gov.au for Australian product recall information

Figure 4.11 Recall notice.

Activity 4.4 Discussion

1. Identify why a firm would want to recall its product.
2. Evaluate what advantages and disadvantages could a recall present for the firm.
3. Describe an appropriate strategy that could have been used to prevent this quality issue.

Control involves establishing evaluation procedures and setting standards to measure performance. One of the main reasons for planning an activity is to achieve a particular objective or goal. Once the plan has been put into action, the whole procedure needs to be controlled and monitored. The actual performance of machinery and staff should be measured and compared with what was originally planned. A measure or standard is identified so that results can be compared. A firm may compare its performance to other businesses in the same industry by using the industry average as a **benchmark**. This provides a guide to the business's progress. The business will then make necessary corrections or adjustments to its processes in order to achieve the desired results. Businesses will try to establish why the variations have occurred and would look at both the internal and external influences. Many professional occupation associations have established standards as a control mechanism for services they provide. These standards are often referred to as codes of practice. They set out the minimum level of service that registered members of a profession are expected to provide. These standards go beyond the rules set by the relevant legislation. Codes of practice have been set up by various professional groups in Australia, including the Institute of Chartered Accountants, the Law Society and the NSW Medical Board.

Quality assurance

While quality control tends to involve measuring quality and taking correcting action, quality assurance is much more proactive. **Quality assurance** involves establishing and using a set of procedures and/or processes that will prevent product defects from occurring or errors in delivering services. There is more emphasis on the contribution to quality from the whole operations system and the entire business. Employee involvement through **quality circle** and work teams has been an effective strategy to identify and discuss quality issues and solutions.

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Many businesses seek to achieve quality certificates from Standards Australia, AS/NZS for Australian and New Zealand standards and even obtain ISO certification for meeting international standards:

- AS/NZS ISO 9001 or 9002 and 9003 – the business has satisfied these requirements and is recognised as a 'Quality Endorsed Company'
- 9001 – indicates that the business has quality assurance in product design, development, manufacture, installation and servicing
- 9002 – indicates quality assurance in manufacturing
- 9003 – covers service-based industries.

As a 'Quality Endorsed Company' the certificate provides assurance that a quality management system is used. The other advantages of obtaining a quality assurance certificate is many businesses and government organisations will prefer to deal with suppliers with quality systems, the law requires business to accept responsibility for the goods and services they sell and many industries are trying to be more internationally competitive.

Table 4.6 Comparison of quality control to quality assurance

Quality control	Quality assurance
After the event, one person reviews the products made and checks for mistakes	No one individual is responsible for quality; everyone has a contributing role no matter how small
A certain percentage of defects is allowed and set as a standard	Quality is assured as all products are expected to pass inspection; zero defects
Assembly lines flow continuously unless repairs are required	Production process can be interrupted to improve systems
Quality stops once the product leaves the business	Quality is provided through after-sales service
Autocratic leadership style	Employees included in decision making through quality circles, consultation and two-way communication

Quality improvement

The **total quality management (TQM)** approach to quality relies on continuous improvement in all functional areas, not just operations. It is often referred to as *kaizen* and is widely used in Japanese industry. Controls are put in place to ensure poor-quality goods are not passed on to the consumer. The greatest success would come from getting the process right the first time; that is, zero defects as a performance objective. The concept of quality circles is relevant to TQM. Quality circles are regular meetings of a group of employees from different sections of the business to discuss issues arising in the workplace, even if there are no current problems with quality. There is a focus on continuous small improvements in products and processes and it is a much more effective strategy than waiting for major improvements from technological breakthroughs. The group tries to clearly identify any problem areas and come up with possible solutions to those problems. The team presents its results to management for consideration, who then make the final decision about the actions to take. TQM necessitates careful review of the actions of competitors and possible innovative measures to be taken in relation to all aspects of the business. Through benchmarking many businesses are able to compare themselves with the rest of their industry operating in the domestic market. This allows a firm to identify critical processes that may need improvement. The firm will then study the best operational processes used by its immediate competitors

Total quality management (TQM)

An approach to quality control that relies on continuous improvement in all aspects of the business. It is often referred to as *kaizen* and is very evident in Japanese manufacturers, such as Toyota.

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World's best practice

Comparison of a firm's performance with the highest standards achieved worldwide.

Driving force

A force that pushes towards the need for change.

Restraining force

A force that holds back a business and resists change.

in order to select ways that the firm can improve its own methods. Through **world's best practice** the firm can compare its productivity or performance with the highest standards achieved by businesses worldwide and select businesses to use as models.

Improvements in quality can be measured using key performance indicators (KPIs). These will vary from industry to industry and are often based on industry benchmarks of what is commonly accepted in Australia (or internationally) as the standard a business should aim for. A business may even compare itself to its largest competitor. Examples of KPIs include:

- percentage of defects per 100 units manufactured
- number of warranty claims made by customers
- percentage of repeat customers
- number of accidents and operational incidents
- repair costs
- number of working hours lost due to breakdowns or interruptions to operations
- amount of positive customer feedback from surveys.

With improved quality a business will experience reduced operations costs, higher sales and repeat customers and hence more profit.

Overcoming resistance to change

Resistance to change was discussed in the Preliminary course, however, it is worth revisiting again as businesses are changing in the response to the external environment, globalisation and the need to maintain a competitive advantage through operations. Kurt Lewin was an American social psychologist and is regarded as one of the founders of modern psychology. He is perhaps best known for developing Force Field Analysis. Lewin's Force Field Analysis identified that a business has driving forces and restraining forces. **Driving forces** are those that push towards the need for change. **Restraining forces** are those that hold the business back and resist any change that is attempted. The challenge for management is to identify and develop strategies to overcome the resistance to change. In operations the resisting forces will be related to costs and inertia. Costs may be associated with purchasing new equipment, redundancy payments for employees replaced by capital or technology, retraining costs to operate and manage new equipment and technology, and reorganisation costs associated with changing the layout of the plant, factory or office. There is also resistance owing to inertia as people in the business can react emotionally to change and rather than embrace the challenges and opportunities it offers, merely wish for things to remain as they are.

Purchasing new equipment

Management needs to be aware of technological change and assess its application to the business. Not all technological developments or equipment need to be introduced to the business. Managers must assess the cost of the installation of the equipment, its impact on production and the expected profitability generated by the change. There will be long-term impacts on the financial position of the business, often because new equipment and technology may need to be funded from debt finance. Purchasing new equipment is an internal influence because the managers decide whether and how to use it in the

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business. Several technological changes may not be simple to implement but result in a long-term reduction in operating costs, decreased time delays in communication and faster decision-making processes. Old equipment may still have a value and may be sold to create space for new equipment. Ultimately, the operations manager must consider all the costs associated with purchasing new equipment and weigh up the long-term cost savings against the short-term impact on the business.

Redundancy payments

An employee redundancy occurs when an employee is no longer required because their job no longer exists or they have been replaced by new technology or equipment. Their role may have become automated and they are unable to find a position in another area of the business. In Australia redundancy payments are legally required in the following circumstances:

- there is an Award of Enterprise Agreement covering redundancy pay
- the business is not a small business, having more than 15 employees
- the employee has worked full-time and has worked continuously for 12 months or more.

From 1 January 2010 the National Employment Standards stated the redundancy entitlement of employees based on their base rate of pay.

Table 4.7 Employee redundancy entitlements

No. of years of service	Redundancy pay of
1–2 years	4 weeks
2–3 years	6 weeks
3–4 years	8 weeks
Maximum payment	
9–10 years	16 weeks

If a large number of long-time serving employees are made redundant by changes to the business operations then redundancy payments represent a significant cost of implementing change.

Retraining

Labour is often considered to be a business's most valuable asset. When changes are made to the business another cost consideration is the cost of retraining staff so that they are productive, work efficiently and effectively. Even when retraining is successful there will still be a period of adjustment as employees improve their familiarity with new equipment, new technology or changes in systems and procedures. It may take an extended period before employees are back to the productivity levels they had prior to any changes. These are the more hidden costs of change.

Without adequate training the benefits of new equipment, technology or new processes will not be fully realised. The implementation of comprehensive training programs can go a long way to overcoming employee resistance to changes.

Reorganising plant layout

With acquisition of new equipment and technology at the factory or plant there may need to be a reorganisation where equipment is placed so that manufacturing occurs in the most efficient manner and bottlenecks are avoided. A business may change from a process layout using assembly lines to a product layout where the product remains in a fixed spot and all the inputs and components converge to a centre location for final assembly. The plant layout may

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have to change to manage more product variety or volume. Significant changes will occur to the layout if the business moves from a highly repetitive operation to one that uses batches or jobbing to make products for customer orders. Other examples could be reorganisation of displays in a shop to achieve a better flow of customers through the store and changing the layout of the dining room and kitchen to fit in more tables and prevent congestion as staff move around serving customers.

The costs of reorganising can be a disincentive to change as it can require closure of the business while equipment is physically moved. Obviously the larger the equipment and more complicated the plant layout, the longer it will take to reopen and generate sales again.

Inertia

There is also resistance owing to inertia. Internal stakeholders such as owners, managers and employees can become comfortable in a stable environment as there is a feeling of security and predictability. Change can create uncertainty and risk and therefore employees may resist change, owing to fear of deskilling, job loss, higher workloads and loss of their familiar work environment. Owners and managers may also have fears about the financial future of the business and if change will enable the business to be more competitive. If the business has had a history of 'change for change's sake' or has failed to capitalise on previous changes, then inertia will be a greater resisting force.

Operations management has to identify as many forces for change as possible and use its skills of effective management to create a positive culture for change. There needs to be an understanding of the driving forces. Globalisation, technology, demographics, attitudes, the law, economic growth and competitors are all external drivers of change. Internally sources may occur with new products because when they are developed there may be changes in the way the business's production is organised with possibly increased automation a driving change in the business. Managers need to motivate and communicate with staff, encourage participative decision making, provide training and counselling, negotiate, possibly manipulate or even coerce. Strategies that management may use to overcome resistance to change could include retraining programs, work teams and a flatter management structure.

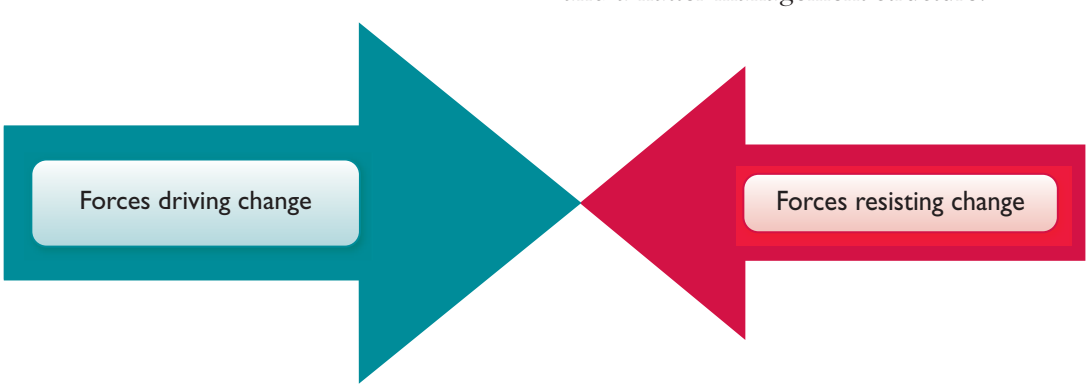


Figure 4.12 The driving forces for change must outweigh the resisting forces.

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Global factors

Globalisation can present many cost-saving opportunities for managers if they choose to expand operations. Global factors are another external influence on business and must be managed to reduce the additional risks of operating in a global business environment. Operations strategies need to be able to respond as the international business environment changes. Global factors that can influence business operations are the opportunity to source inputs from cheaper sources overseas, to expand and achieve economies of scale, and develop new products for an international market.

Global sourcing

Global sourcing was discussed earlier in this chapter under 'Supply chain management'. A benefit of globalisation is the opportunity for businesses to acquire inputs from other countries or a low-cost region (LCR) in order to reduce overall costs. However, just purchasing from a low-cost source does not guarantee low total costs. There are additional influences from the global environment in setting up a system of sourcing inputs from overseas sources, including:

- considerable time must be invested searching for and researching suppliers as well as time to build up relationships with suppliers
- lack of experience in international transactions in addition to language and cultural barriers
- increased lead times
- less control over the quality and reliability of inputs
- competitors may use the same supplier.

Therefore, it is recommended that businesses manage these risks by outsourcing to experts in the field of global sourcing solutions.

A **global web strategy** involves a business sourcing inputs from the cheapest regions, manufacturing where it is cheapest to do so, obtaining finance from the country with the lowest interest rates and distributing products to any nation that demands them. There is an intricate web of subsidiaries around the world all linked by transactions and the movement of goods. The global business using the global web strategy will not be able to function if a subsidiary cannot fulfil its role. A key type of global web strategy is where a global business has each input made in the country that can make inputs at the best quality and at the lowest price. Some inputs need low labour costs, while others need a certain level of technology. These resources are only available in certain parts of the world. An input may be quite rare and only available at an affordable price from a certain part of the world. A global business using a global web strategy will most likely locate its financial headquarters in a developed country (such as the United States), source its inputs from around the world, produce in the country with the cheapest labour costs and export to its global market. With this strategy, coordinating the delivery of each input is very difficult and has to be scheduled efficiently to reduce costs. Inputs may be delivered too early (increasing storage costs) or too late (delaying production) or not delivered at all.

Global web strategy

Involves a business sourcing inputs from the cheapest regions, manufacturing where it is cheapest to do so, obtaining finance from the country with the lowest interest rates and distributing products to any nation that demands them.

Activity 4.5 Comprehension

1. Define 'global web strategy'.
2. Explain the types of businesses that it offers the most advantages to.

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Economies of scale

Developing economies of scale is a strategy to reduce production costs by increasing in size. The larger the size of the business, the actual cost of making each individual product decreases, until the business becomes too big. Through global expansion a business can achieve production economies of scale by having larger manufacturing facilities, moving closer to raw materials and labour or delivering services to a larger market. By increasing in size, the business spreads its costs over more units. The average cost of making or supplying each unit will fall. Other costs can be reduced as a large business can obtain discounts for large orders of inputs and the actual process of operations may flow more efficiently.

communication over the internet, decision making can slow down as more people are involved, considering more variables that influence operations.

An option to achieve some of the advantages of economies of scale is to have a joint venture or strategic alliance with a business in the same industry. An Australian manufacturer may join with a foreign-based supplier and manufacturer to give both businesses advantages of economies of scale.

Scanning and learning

The globalisation of the business environment means that operations managers must scan the global environment to identify and learn the critical global trends that may impact on

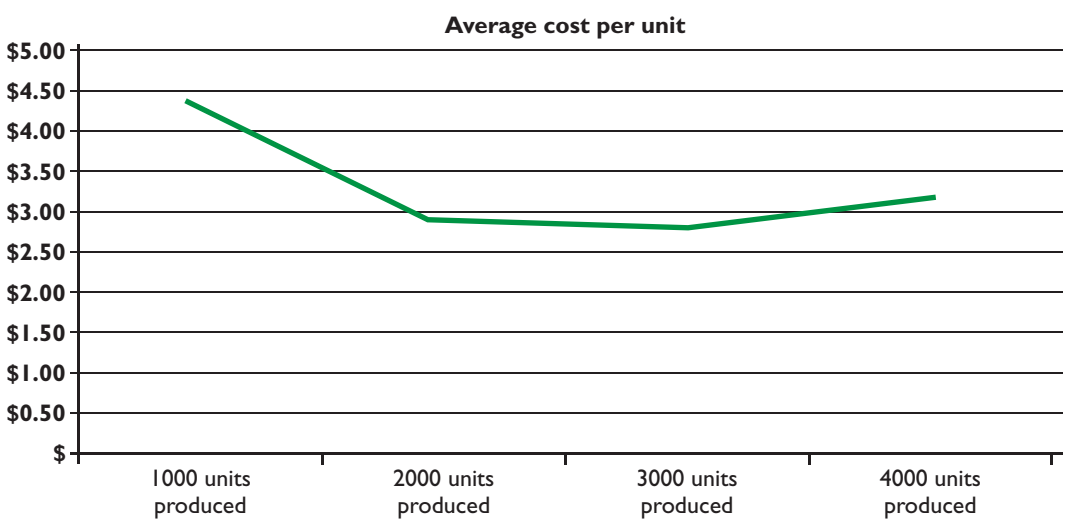


Figure 4.13 Economies of scale.

Bigger can mean cheaper but only up to a certain point. Diseconomies of scale will occur, causing costs to rise. Inefficiencies are caused by overly complex operations, loss of direction and control by operations managers. In very large, geographically dispersed organisations even with instant

the business. These trends refer to both the macroeconomic environment and those specific to the industry the business operates in. By continuously monitoring the global environment the business has an informed basis for making strategic business planning decisions with respect

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to operations. Businesses must be aware of developments and changes in:

- global demand for their goods and services, what parts of the world are growing and what parts have a shrinking market
- supplies of transformed and transforming resources, whether new lower cost sources are available
- new manufacturing processes available
- emergence of new competitors as a potential threat
- new products and services that the business could invest in
- changes to labour and environmental protection laws
- nations with policies to attract global businesses such as offering low-cost energy and infrastructure.

For example, China has been viewed as a cheap manufacturing location, however, recent studies show that Shanghai has become a more expensive place to do business and better opportunities now exist in two neighbouring provinces, Zhejiang and Jiansu, which border China's commercial centre.

Of particular relevance to operations managers, changes to the suppliers of materials will need to be monitored and assessed. Changes such as quality, quantity, price and potential delivery delays will be significant.

A business may also learn about a technological innovation or research into new product development that may be applicable to its industry. Even if the business does not have the resources to develop its own innovations it can imitate by detecting and learning about developments of its competitors or overseas. The business can closely follow with its own version of the new product of process innovation and maintain its competitive advantage.

Research and development

Research and development is commonly called R&D and is an innovation strategy associated with the creation of new products and the improvement of existing ones. This type of innovation is crucial to the long-term survival of any business. A business cannot stand still once it has launched a product and leave it in the market. It will eventually reach the end of its life cycle as it becomes obsolete and competitors release new products. The first stage of this strategy is to discuss as many potential new products as possible. Market research may indicate that there is enough demand for a vehicle fuelled by renewable energy. Research will examine all possible vehicle types and options that might meet this potential demand. The development stage is the process of determining which product from all of the suggestions should be pursued until eventually a final commercial product is released to the market. (This process is discussed in further detail in Chapter 5 in the section 'New product design and development' on page 99.)

Despite the financial risk of investment, R&D can have significant advantages for a business. It can:

- extend the product cycle
- open up new markets internationally
- give the business a reputation as a leading innovator
- lead to improvements in quality
- reduce costs
- provide higher profit margins
- give the business 'breathing room' to develop other new products.

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Patent

A patent gives the owner the exclusive rights to sell, market, license or make a profit from an invention, innovation or production technique.

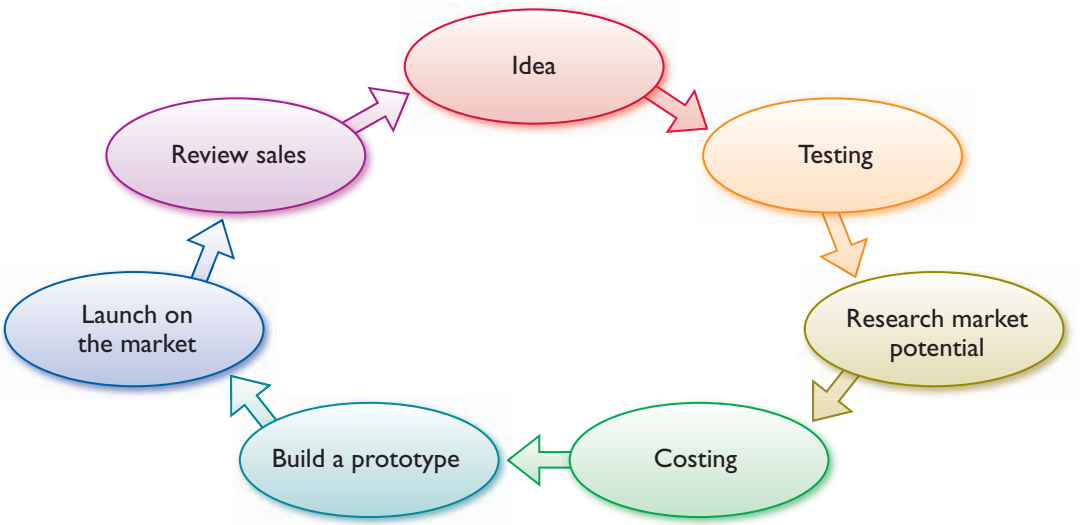


Figure 4.14 Summary of R&D process.

However, there may be several issues and problems created by this innovation strategy:

- it may send the business in a direction away from its prime function
- it can consume valuable financial resources that do not yield a return for years
- there is an opportunity cost of what other projects the money could be spent on, such as more marketing
- it can be wasteful as many suggested projects never make it to market
- there may be commercial conflict between rival companies where all energy is focused on eliminating the competitor rather than supplying the market
- there may be ethical issues involved
- the business must have the technical ability and equipment to build the product or deliver the service.

Innovation is not limited to products. Process innovation involves the development of the operations function itself to bring benefits to the business. New technology or JIT inventory management may be introduced or an innovation in the production method itself may be developed.

New ideas are sometimes referred to as intellectual property. Any business that invents a new product or innovation needs to protect their intellectual property. An international **patent** gives an individual or business 20 years' protection from any organisation copying their new idea. The business has a 'first mover' advantage in the market. This head start can give a business a dominant market share and the name of the product can become the generic name used for the product such as Band-Aid or iPod.

There are limits on R&D mainly because it is such a long-term, higher financial risk strategy. Other constraints on innovation include the cost and availability of new technology, shareholder pressure for good financial returns in the short term and even lack of competition in the market and resistance to change. Given these issues, businesses should still invest in some research and development to order to make small changes to improve productivity, reduce costs and improve quality.

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Chapter summary

- The decisions of the operations manager about the strategies used will have a major impact on the cost of producing goods and delivering services, how well they are produced and delivered, and their quality. Effective and efficient operations management reduces costs, increases revenue and improves profit.
- Operations strategies are its objectives, plans and policies used to give the business a competitive advantage and how this advantage will be sustained.
- Performance objectives for operations strategies are quality, high speed, dependability, flexibility in production and service delivery, opportunity for customisation and low costs.
- Innovation is not limited to products. Process innovation involves the development of the operations function itself to bring benefits to the business.
- Supply chain management aims to reduce inventory costs, reduce waste, enable faster delivery to markets and more satisfied customers.
- Holding stock as buffer stock has the advantage of meeting unexpected increases in demand; however, there are higher costs, lower liquidity and greater risk of spoilage or obsolete stock.
- Quality management is a three-stage process. First, quality controls are established. Second, the business aims to establish a set of procedures and/or processes that will prevent problems from occurring or errors in delivering services. Finally, to improving quality through a total quality management approach.
- Overcoming resistance to change in operations requires strategies and management skills to emphasise the long-term contribution to lower costs and better quality. Resisting forces are related to costs of changing operations and to the personal inertia of owners, managers and in particular employees.
- Global factors that can influence business operations are the opportunity to source inputs from cheaper sources overseas, opportunity to expand and achieve economies of scale, and development of new products for an international market.

Chapter revision task

Place the correct term against each statement.

Scheduling	CAD	World's best practice
Robotics	Codes of practice	Gantt chart
Quality assurance	Wholesaler	Intermediate good
Stocktake	Quality circles	Rostering
Benchmarking	CAM	Supply chain

1 Used by other businesses in the next stage of manufacturing as an input for further processing.

2 The development of programmable devices built to complete repetitive tasks.

3 Obtains goods in bulk from lots of suppliers and then make these goods available in smaller quantities, most often to retailers.

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4 Process of arranging staff in order to complete tasks within the organisation.

5 Levels of conduct that registered professionals adhere to that go beyond the rules set by legislation.

6 Physical counting of inventory or stock.

7 Establishing the time each task will take and identifying the order of steps to be taken.

8 Purchasing system used by a firm.

9 Establishing a set of procedures to follow to prevent products from having problems.

10 Measuring a business's performance against that of the rest of the industry operating in the domestic market.

11 Comparing a business's performance with the highest standards achieved worldwide.

12 Regular meetings of employees from different sections of the business to discuss issues arising in the workplace.

13 Technology that allows designs to be drawn and adjusted using computers.

14 CAD linked directly to the manufacturing process.

15 Records the number of tasks involved in each particular project and the estimated time needed for each task.

Multiple-choice questions

1 Which inventory control system would minimise warehousing costs?
- **(A)** Just-in-time
- **(B)** Just-for-now
- **(C)** Bulk purchasing
- **(D)** Longest lead time

2 Which of the following best defines operations strategy?
- **(A)** How the business will employ its production capabilities to reach its strategic operations objectives
- **(B)** How a business makes goods and supplies services
- **(C)** How a business uses market research to produce goods that customers desire
- **(D)** The amount of capital or labour used to produce

3 Which of the following is a disadvantage of upgrading technology?
- **(A)** Better quality and employees with new skills
- **(B)** Lower operations costs in the short term
- **(C)** Disruption to the operations process
- **(D)** More effective communication

4 What is an operational advantage of a business vertically integrating?
- **(A)** The business has better quality control over its inputs
- **(B)** The business can earn revenue from the business it has purchased
- **(C)** The business can distribute its products to more countries
- **(D)** The business will have a global supply chain

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5 Which business would use the FIFO system of inventory management?
   (A) A car dealership
   (B) Qantas
   (C) An electronics retailer
   (D) BHP Billiton

6 What is a stock-out?
   (A) When a business runs the risk of running out of stock to make or supply products
   (B) When stock levels reach the minimum buffer level
   (C) The difference between when stock is ordered and when it arrives
   (D) When a business is oversupplied with stock

7 What is an advantage of large-scale operations?
   (A) Greater efficiency in production
   (B) Low costs for the supply of inputs
   (C) Higher average costs
   (D) Access to a larger global market

8 What is e-commerce?
   (A) When a business uses email to communicate to customers and suppliers
   (B) When a business has an online store
   (C) When a business uses the internet to both buy and sell goods and services
   (D) When a business uses technology to get access to overseas markets

9 Which of the following are financial costs to a business of implementing change?
   (A) Retraining staff and redundancies
   (B) Personal inertia of employees
   (C) Lost markets from changing the products
   (D) The cost of purchasing a supplier

10 Which of the following identifies disadvantages of outsourcing?
   (A) Access to a specialist knowledge and expertise, which can be expensive
   (B) Shorter lead times, increased speed and quality of outputs
   (C) Loss of control over quality, reliability and even costs
   (D) A possibility that two businesses share the same supplier

Short-answer questions

1 Describe the nature of the performance objectives of operations strategy.

2 Explain how a business can gain a competitive advantage with operations strategy.

3 Explain the difference between quality control, quality assurance and quality improvement.

4 Analyse the impacts of the global environment on operations strategies.

5 Assess the use of technology to improve the operations of service-based businesses.

Extended-response question

Outline the methods of quality management and explain its role in operations management.

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CHAPTER 5



Operations at Crumpler

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Crumpler began in 1992 with a single sewing machine, some heavy-duty cloth and a desire to create a tough messenger bag. There was an opportunity in the market as existing bags did not satisfy the quality expectations of customers, particularly bike couriers. By the mid-1990s additional second-hand sewing machines were purchased, the operations processes improved and the business had moved into a small factory in Melbourne.

Role of operations management

The aim of Crumpler is to clearly differentiate the business's products from its competitors rather than using a cost leadership strategy. Differentiation through operations has been achieved through:

- a better quality product
- a vast variety of products in its range to suit individual customers
- more features and versatile applications
- incorporation of new technology
- clever design.

Crumpler may be classified as a manufacturer and retailer. However, the majority of operations have been outsourced overseas with the business now concentrating on design.

In Marketing, research identifies the nature of goods consumers' desire and marketing strategies encourage purchases. Operations must supply a product that has the features and quality consumers demand as well as reliably distributing this product to the market.

Influences on Crumpler operations

Globalisation

For Crumpler, globalisation has created opportunities to access to a global market to sell the outputs of its operations. Crumpler Australia's export sales are currently estimated at around $6 million, approximately 50% of sales overall. Between 2007 and 2010 it has launched retail stores in New York, Toronto, Manila and Singapore, with stores also planned for San Francisco, Vancouver and Beijing.

The emergence of global consumers and their homogeneity of wants as a driver of globalisation have created marketing opportunities for Crumpler in a number of developed countries. Crumpler bags are universally popular among young city males and females regardless of which country they live in. Crumpler bags are available in Belgium, Germany, Greece, Japan, Hong Kong, China, the Netherlands, New Zealand, Spain, Singapore, Taiwan and the UK. Crumpler has also managed to work with Apple in the USA. The company has just negotiated an agreement to stock the 150 Apple stores throughout America. To support this expansion Crumpler has recently opened an American office and warehouse.

Globalisation has also meant that Crumpler can outsource its manufacturing and now has a global supply chain. Costs of operations have significantly fallen as overseas manufacturers have access to cheaper material and labour inputs.

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Economic

There are several economic influences on the business. These include the rising cost of oil, general economic conditions across North America and Asia and the rising cost of labour across Asia:

- Crumpler's use of nylon across all its products is considerable. The business purchases hundreds of thousands of metres of nylon per year. As oil is a key factor in the production of nylon, rising oil costs contribute significantly to the rising cost of nylon.
- The global economic slowdown had adversely affected sales across all regions of Crumpler's North American market (although the Apple deal will help).
- The increasing cost of labour across Asia is placing considerable pressure on the costs of Crumpler's imported materials.

Technology

Technological developments in the production of clothing and communication have had the most significant effect on Crumpler. Originally all production was done by hand. As the business incorporated CAD and CAM into its operations, technology became a crucial element of the business. B2B communication using email allows Crumpler headquarters to keep in touch with its manufacturing contacts in Korea and Taiwan, as well as its retailers. B2C communication is through its website portal www.crumpler.com. Three-dimensional design software programs are used to virtually create new products.

Design and manufacturing process

All products are designed in-house in Melbourne, from concept through to prototype. Once Crumpler is happy with the product, patterns are made in the pattern room, and then the final prototype, pattern and detailed technical pack are sent to the most suitable manufacturer. The manufacturer prepares a counter sample and returns it with their detailed quote.

Crumpler feels that finding manufacturing partners who understand the brand is an important part of the business – a mutual respect must be developed to create a good long-term relationship.

Crumpler purchases materials from a range of different sources – leather from Melbourne, nylon from Taiwan and South Korea, canvas from China, buckles and clips from Japan, webbing from China and luggage handles from Taiwan.

Crumpler believes that the first and foremost criterion for their design team is strength and practicality. They use the strongest materials possible; for example, the webbing used for the shoulder straps is designed for use in crane cargo slings, capable of lifting the weight of a car. The buckles used are as big and strong as possible. Zips are the largest size to be found, as in their opinion there is nothing more annoying than the zip on a backpack not working. As their previous employment was in the courier business they were acutely aware that their product needed to be tough. Opening and closing bags at least 100 times a day requires a bag to be tough. Crumpler learnt from trial

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and error, gradually improving the gear, thanks to feedback from couriers. These days they very rarely see a bag come back for repairs.

Quality expectations

From personal experience of the owners and through researching competitors' products, Crumpler realised that existing messenger bags did not satisfy the expectations of customers. Quality, versatility and durability were key features desired by consumers to protect fragile electronic devices such as laptops and cameras. Consequently, Crumpler bags are water-resistant as they are made from a tough, rip-resistant nylon shell. In addition, the bags have an inner protective lining and padding. Although more expensive than other similar bags, customers equate price with quality and are obviously satisfied with the product as sales have increased each year the business has been in operation. The Crumpler brand is now associated with tough, versatile bags that last for years, making them a good investment.

Competition

Many of Crumpler's competitors cannot match the quality of its bags and focus on threatening Crumpler's market share with lower cost options. These 'generic' products are typically made using lesser quality nylon and only have basic features. Most commonly these are made in China, Vietnam and Cambodia.

Crumpler's closest competition in the camera bag segment comes from Lowepro and Tamrac, both brands focus on quality and durability. The North Face is one of many companies also competing directly with Crumpler in the messenger bag category. Crumpler does not attempt to compete with premium brands such as Prada and Louis Vuitton.

Social and environmental sustainability

Crumpler acts in a socially responsible manner by ensuring the durability of its products. Many competitors' products have a built-in obsolescence without any repair value. This makes it necessary to purchase additional bags, which consumes more resources. It is possible to recycle nylon.

Crumpler is an ethical business, however a possible problem with factories in Vietnam is that Crumpler does not run them directly. They sub-contract their production to factories that may potentially have substandard labour practices. Crumpler acknowledges a responsibility to be aware of the conditions and enforce a code of conduct to improve them. One option could be to set up an independent monitor to ensure the code of conduct is followed.

Eco bags are a new entrant into the market and a potential competitor for Crumpler. These are often made using recycled plastics coloured with natural vegetable dyes.

Operations process

The operations process at Crumpler involves physical altering of the inputs into the finished bags. It is also concerned with the transportation of the finished bags, such as having them delivered to a more convenient location for access by consumers.

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Figure 5.1 Flowchart showing how value is added at Crumpler.

Inputs

Materials

Originally the company used canvas, however, the key material inputs are heavy-duty ripstop nylon and thread to construct the bags. The thread came from the wetsuit industry. Crumplers' bags have a water-resistant 900 denier shell. The lining of Crumpler bags is most often in either a 300D (density) or 600D ripstop nylon, which is super strong, lightweight, durable and resistant to fraying, tearing and ripping. All the straps are nylon webbing, while other inputs are plastic zips, buckles and Velcro.



Figure 5.2 'Spring Peeper. No monogrammed pretension ad infinitum. No near extinct Amazon amphibian crotch skin trim. No risk of being overcharged for ordinary-ness or underwhelmed by useless-ness. No sir. No way. Not with this here medium Spring Peeper duffle' – Crumpler.

Information

Initially the owners had to learn how to make a durable product. Information from a parachute manufacturer enabled the business to incorporate a new stitching method into the operations process that added considerable strength to the final product. Extensive data for the design specifications for every model of bag ever produced by Crumpler is kept in readily accessible files. When designing a new camera bag, for example, the specifications from similar models can be recalled and used as a basis for the new design. This saves considerable time and significantly reduces mistakes during the development of new prototypes.

Customers

Crumpler encourages feedback from its customers. Ultimately, the business aims to meet the specific requirements of its customers. By monitoring blogs and message boards Crumpler can also see a demand for potential new products and how to improve existing ones.

Human resources

The creative talents of the design team are the key human resource input. Principally this comprises Dave Roper, Will Miller and Stuart Crumpler. In the near future the business aims to bring in some highly skilled international designers for further international expansion.

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Facilities

Crumpler began in a suburban shed before moving out into a small warehouse in Flinders Lane, Melbourne. Its first sewing machine was purchased for $20 from a market. Now the design studio of the business is located in Ballarat and the major warehouse is located in Melbourne.

Transformation processes

Crumpler is no different to other businesses in that its operations is strongly influenced by the 4Vs. Customers only see the finished product so customer contact with operations does not occur, making visibility negligible. Although, in retail outlets a 'sample' bag that has been bisected is usually on display so that customers can appreciate the quality, durability and effort put into production of each bag.

Being a small company Crumpler aims to produce nearly a million bags per year. There is a low variation in demand so the business over the year and life cycle of the business, although the volume of output is steadily growing all the time. In the early years of the business the owners quickly realised that its Australian-based operations would not keep up with demand, nor could it achieve the economies of scale needed to reduce operations costs and hence maximise profits. Even though output is still not large using its competitors as a benchmark, operations must have the ability to switch between different styles of bags.

Therefore, of the 4Vs, variety is the most significant influence. Crumpler needs to be able to produce a variety of styles and models for its product. Each model of bag will need to be produced in different sizes and a range of colour options. Crumpler uses a batch-type production method. Only a few hundred of each specific bag is produced but batch production enables the business to produce a variety of styles and sizes. The operations process can be interrupted and adjustments made to add a different variety of bag to the production line.

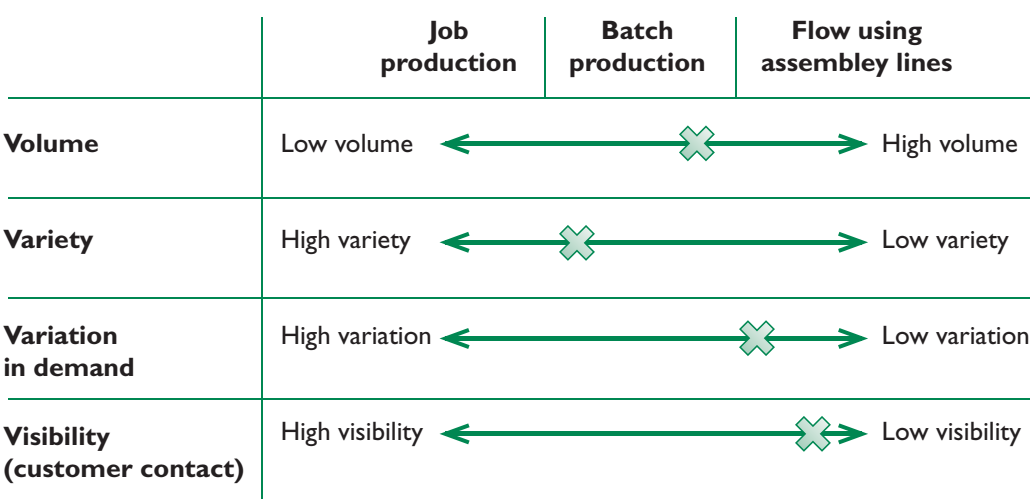


Figure 5.3 The 4Vs.

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In addition, if a particular bag exceeds demand forecasts then it's a relatively easy process for management to email the supplier who will simply enter the specifications of the desired bag into the production system to produce a new batch of 1000 new bags.

Operations are now mainly concerned with producing prototypes of new products.

Sequencing and scheduling

Crumpler aims to have its new design put into production as quickly as possible. Clear sequencing and clever scheduling ensures that Crumpler can have its new products available for customers to purchase. Task analysis is particularly important for each individual product to determine the most efficient way to make each.



Figure 5.4 Stencil of the Crumpler logo.

Outputs

Crumpler began with a simple messenger bag and now offers an extensive range of bags. Each model has a variety of styles and sizes. There is over a dozen variations of the bags to accommodate laptops and cameras, as well as backpacks for regular gear such as folders. Its most recent product is a specific iPad bag. There is a service component as well to Crumpler's output such that there is a 70:30 mix of goods and services, whereas customers who purchase competitors' products must do so without any assistance or service advice.

Customer service

Crumpler also differentiates itself from its competitors by providing a high level of customer service at the point of sale and with any customer questions or issue after the sale. While other bags are sold in department and sports stores, Crumpler bags are distributed through its branded retailers. Store managers are well informed of all Crumpler's range and can translate customer wants into finding the most suitable Crumpler product. In addition, Crumpler offers extensive after-sales service through its outlets and website. It has a no-questions-asked policy when dealing with repairs or replacements, although a customer may be asked to pay for repairs caused by abnormal use.

Warranties

Crumpler stands by its quality claims. In addition to any statutory warranty, which protects consumers from defective materials or workmanship, Crumpler provides a lifetime warranty on zippers, buckles,

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fabrics, bindings and workmanship on their bags. The business calls this its 'Til Death Do Us Part' Warranty.

Operations strategy

Performance objectives

Of all the performance objectives – quality, speed, dependability, flexibility, customisation and cost – it is quality that is the most important to Crumpler. This feature was the original point of differentiation for the business and gives it a sustainable competitive advantage. Owing to the nature of manufacturing, speed is an objective of Crumpler's manufacturers and will impact on the wholesale costs of the bags for Crumpler. Speed of operations can be increased with technology such as CAD, CAM, robotics and JIT inventory management. Speed of delivery is important for Crumpler to get bags from the warehouse to retailers.

Dependability is the reliability of the product or service. Crumpler's products are designed and made to the quality standard expected by customers. Crumpler has a strong reputation for dependability because their products always deliver what its marketing promises. There is also dependability in delivery or supply. Through effective communication with its website Crumpler always manages to fill orders and distribute to its retailers on time and as soon as web orders are made.

Crumpler does not need to customise its products because they are so versatile. A customer has the option to change the internal configuration of their bag by moving, adding or removing dividers where they are merely attached with Velcro. This is a clever design feature that was one of the unique attractions of the product that competitors were not able to offer.

Crumpler's manufacturers require more flexibility of operations than traditional process assembly lines. They will need to switch to a new model or variation of a good to meet a change in the market or changes in customer wants. There is also flexibility in volume, which is how quickly operations can change from producing few products as a low-volume producer to becoming a high-volume producer increasing output to meet increasing demand. Crumpler needs manufacturers who have excess capacity or the ability to increase the volume of output as it continues to experience rapid global growth in the demand for its bags. There is a risk that demand will outstrip supply and Crumpler will experience a stock-out in its stores for some models and variations.

New product design and development

Crumpler is constantly improving its existing products and developing new bags for electronic appliances. The release of the Apple iPad lead to the creation of The Herbus and The Fug bags. The business seeks to improve its comfort design and include clever compartments.

Crumpler is keen to make improvements to its existing products. A little part making a big difference to the business was the Vislon® zipper. Further improvements involved using zippers coated with water repellant. Customer feedback indicated that Velcro made an annoying sound when bags were opened

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Figure 5.5 'Not big on nostalgia? Neither is the Seedy One, a not-too-large-not-too-small reduced scale redux of the oh-riginal Crumpler CD3 from the early nineties' – Crumpler.

so a silent closure option was developed. A new unique feature was developed so that a bag can be securely closed using two clasp closures and the cover can be untucked and placed over the Velcro. This meant that the bag could be opened and closed without the rip and tear commotion caused by the large Velcro fasteners.

Crumpler is also branching out into other sectors of the bag market. The business is now focusing on designing a range of handbags and luggage. This will involve a new material input of leather, which will require changes to the equipment and technology used in the business. As Crumpler has no seasonally influenced products, its manufacturing will not have to change, unlike other fashion businesses that release new products each season. Crumpler does not want to get into fashion, but make very basic, well-made, hard-wearing things like jackets and jeans.

Supply chain management

Supply chain management and logistics has not been one of the business's strengths, however a recent affiliation with two German partners has brought a lot of expertise in this area to the business. Much of this function has been outsourced while the owners concentrated on design. Unfortunately, costs tend to rise when there is a lack of control over the supply chain. Crumpler has to ensure that

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products are available in its shops to avoid disappointing customers. The company is developing strategies to improve its supply chain management in the areas of:

- setting accurate production targets for its suppliers
- speeding up the delivery of products from warehouse to retailers
- storage of inputs at the Melbourne site
- planning current inventory levels with forecasts in demand from customers
- managing damaged goods and goods returned by customers and distributors.

With more global operations and less direct control over manufacturing and delivery to overseas-based warehouses and retailers Crumpler is considering outsourcing this function to a specialist supply chain solutions firm.

Outsourcing

Crumpler bags were originally made in Melbourne using their fabric suppliers in Korea and Taiwan. Owing to a need to increase capacity and grow, the company sourced manufacturers in Korea and Vietnam, where the majority of the bags are now made, although a small number are still manufactured in Melbourne. Although Vietnam has at times a reputation for breaching international labour standards, Crumpler stresses that it will not use suppliers that exploit labour, particularly children. Vietnam was chosen for quality and reliable supply rather than cost-cutting.

Technology

The technology that Crumpler uses is not new. The core material inputs such as the heavy-duty nylon and zippers were patented in the 1930s, Velcro a few years later and the plastic buckles not until 1977. Therefore, Crumpler's technology is tried and proven rather than cutting edge. However, the design team heavily rely on CAD to develop new products. Computer programs that are used to produce cutting patterns similar to the clothing industry such as CUTPLAN is used to identify all the material inputs, their size, shape, configuration and even colour. Precise specifications can be emailed to the production factory. These specifications are entered to software programs that drive precision cutting robots that will cut each piece of fabric and padding exactly as required and with minimal waste. Crumpler bags are made using one-piece construction and, therefore, CAM is very important in the factories that produce Crumpler products.

Inventory management system

Owing to the extensive product range and continuous new product releases by the business, inventory management is a real challenge. To keep track of what stock is kept at the warehouse, what is available in retail outlets, and what stock is due for delivery requires accuracy through using IT. Each product is given a unique identifying barcode, which is scanned each time the product reaches a specific location. This information is stored in a computer database so that any retailer can find out the exact availability and location of a particular model of bag. This is exceptionally useful and adds to the service that Crumpler offers because a specific bag can be located if a customer is unable to find it at the store.

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First in, first out (FIFO) is the inventory management system used at Crumpler. There is the assumption that the first stock that has been purchased and is the oldest will be sold first. This prevents old stock building up and potentially becoming obsolete. However, owing to longevity of Crumpler's products (not seasonal or perishable) it is more important that stock is available as it is promoted.

Quality management

Crumpler has a performance objective of the highest quality and, therefore, quality control and improvement are essential. Bags are randomly inspected to ensure that they are free from manufacturing defects as a form of quality control. However, Crumpler relies heavily on the quality control and quality assurance systems used by the factories it outsources to. These factories must be certificated with ISO 9002, which indicates quality assurance in manufacturing. Crumpler aims for zero defects in the products it offers for sale.

Change at Crumpler

Change at Crumpler was concerned with the decision to outsource manufacturing. The business is principally a design and marketing company today. There were significant financial costs in paying contracts to overseas suppliers and redundancy payments for local workers in its factory. There have been significant costs in updating design technology, however a driving force for Crumpler is to be debt-free.

Global factors

Global sourcing

Crumper obtains its inputs from the following areas:

- Zippers and Quick-Flick buckles from YKK manufactured in Vietnam, also Taiwan, Korea and Shenzhen (China).
- Ripstop Nylon and thread from various manufacturers located in Jiangsu province, China. Originally sourced from Australia importers in the early years of the business.
- Neoprene sheets imported by Australian companies from Taiwan and China.

Economies of scale

Crumpler makes close to a million units a year and by increasing its capacity through global expansion, significant economies of scale have been achieved. The Vietnamese manufacturers often produce bags for similar businesses under the same roof, making operations much larger than just for a single customer like Crumpler. Manufacturers will drive down costs as much as they can to offer low production costs to clients. Crumpler has come a long way since producing by hand a few hundred bags a year.

Scanning and learning

Crumpler scans and monitors the activities of its competitors and developments in the industry by attending travel goods trade shows in Europe and the USA. Unfortunately, Crumpler's competitors can do the same and the business has witnessed a number of copies of its products.

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TOPIC 2

Marketing

Introduction

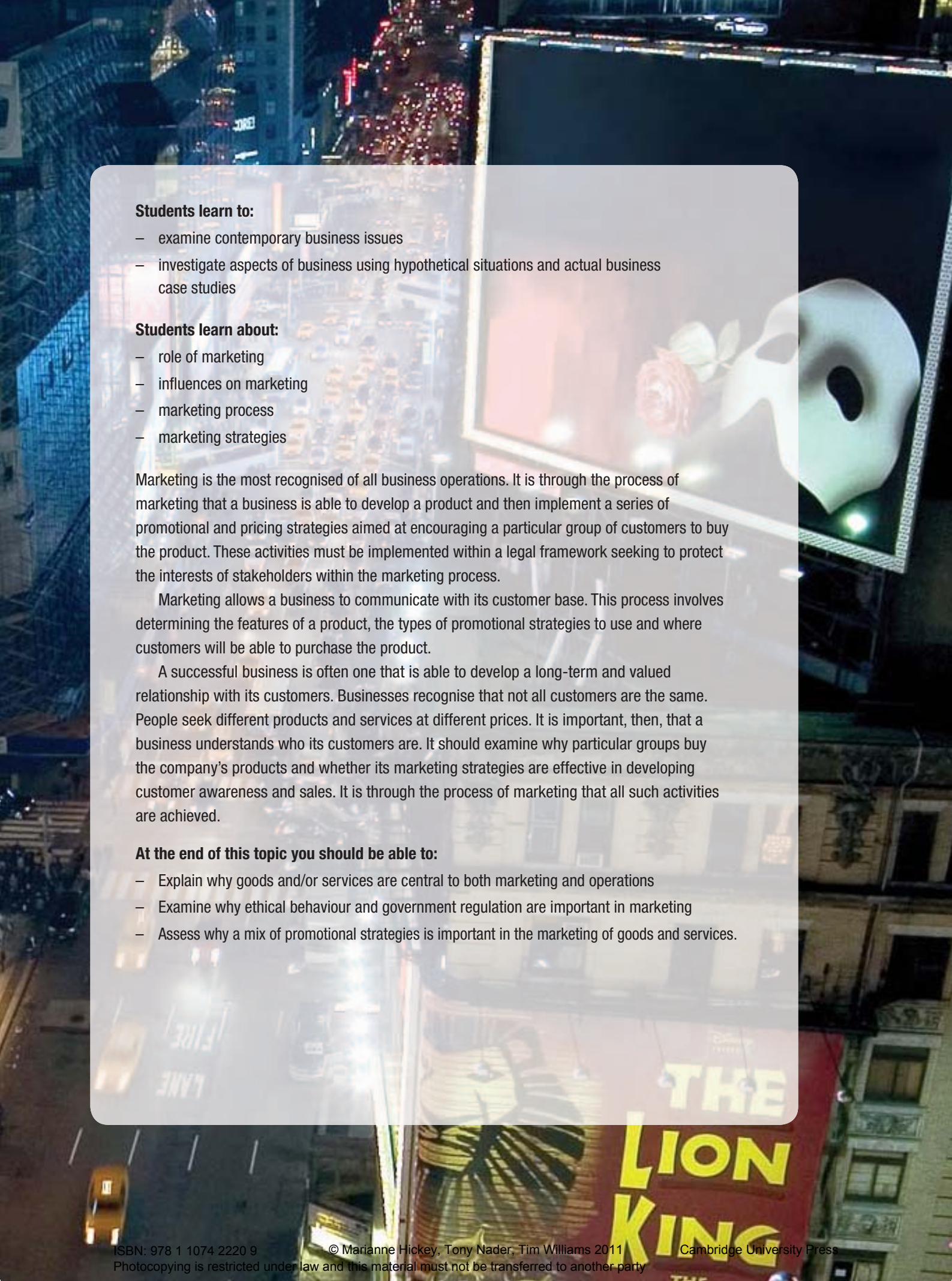
The focus of this topic is the main elements involved in the development and implementation of successful marketing strategies.

Outcomes

The student:

- H1 critically analyses the role of business in Australia and globally
- H2 evaluates management strategies in response to changes in internal and external influences
- H3 discusses the social and ethical responsibilities of management
- H4 analyses business functions and processes in large and global businesses
- H5 explains management strategies and their impact on businesses
- H6 evaluates the effectiveness of management in the performance of businesses
- H7 plans and conducts investigations into contemporary business issues
- H8 organises and evaluates information for actual and hypothetical business situations
- H9 communicates business information, issues and concepts in appropriate formats

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Students learn to:

- examine contemporary business issues
- investigate aspects of business using hypothetical situations and actual business case studies

Students learn about:

- role of marketing
- influences on marketing
- marketing process
- marketing strategies

Marketing is the most recognised of all business operations. It is through the process of marketing that a business is able to develop a product and then implement a series of promotional and pricing strategies aimed at encouraging a particular group of customers to buy the product. These activities must be implemented within a legal framework seeking to protect the interests of stakeholders within the marketing process.

Marketing allows a business to communicate with its customer base. This process involves determining the features of a product, the types of promotional strategies to use and where customers will be able to purchase the product.

A successful business is often one that is able to develop a long-term and valued relationship with its customers. Businesses recognise that not all customers are the same. People seek different products and services at different prices. It is important, then, that a business understands who its customers are. It should examine why particular groups buy the company's products and whether its marketing strategies are effective in developing customer awareness and sales. It is through the process of marketing that all such activities are achieved.

At the end of this topic you should be able to:

- Explain why goods and/or services are central to both marketing and operations
- Examine why ethical behaviour and government regulation are important in marketing
- Assess why a mix of promotional strategies is important in the marketing of goods and services.

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CHAPTER 6

Role of marketing

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Marketing is the process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers. More than any other business function, it is the role of marketing to develop and implement strategies that generate revenue and sales for the business. While other functions may make the product, it is the responsibility of marketing to sell it. Marketing involves researching the changing nature of consumers' tastes and preferences: what they like and what they don't. The purpose of this is to determine what the business should be producing. It also involves the development of products to provide consumers with an improved **standard of living** and greater choice within the marketplace. Marketing is also concerned with determining a price that is consistent with consumers' expectations and reflects the desired image of the product or business. Marketing should consider the impact that price will have on the perceived quality of the product and the ability of that price to sustain market share against its competitors.

The strategic role of marketing goods and services

Marketing is used primarily by a business as a method of enhancing its revenue streams and increasing the market's awareness of its products. The **strategic role of marketing** also extends beyond the business itself, and its influence is shown clearly through its impact on society.

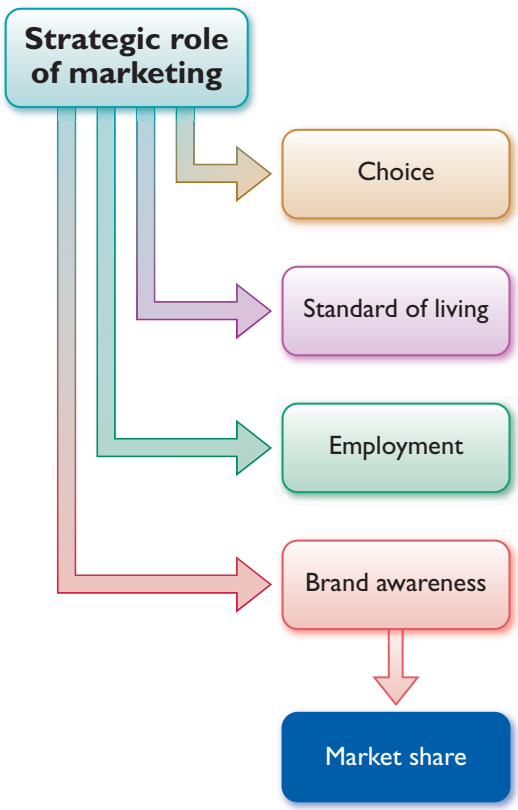


Figure 6.1 The strategic role of marketing.

Choice

An important feature of any business environment is competition. Businesses compete to attract customers to purchase their products. To do this they must differentiate their products from similar products in the marketplace, otherwise consumers would perceive the products to be the same. In doing this, the business must consider how to make its product or service different. This could relate to product features, pricing strategies or promotional activities. This concept is known as a competitive advantage. Competitive advantage refers to those features of a product or business that provide it with an advantage over its competitors. It could include price, product quality and reputation or

Marketing
The process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers.

Standard of living
An individual's quality of life. It is partly based on what goods and services the individual can afford to buy.

Strategic role of marketing
Refers to the long-term role that the key business function of marketing has within a business.

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consumer loyalty. It is what enables a business to attract consumers to the business or its products in preference to a competitor. Marketing provides consumers with choice. What may act as a competitive advantage for one business and its customers may be different for another. For example, Samsung televisions are highly regarded within the home entertainment marketplace due to their leading 3D viewing technologies. The reputation of these products is outstanding and, as a result, those customers who place emphasis on innovative consumer technologies when deciding what to purchase will consider the Samsung range of products. Other businesses gain a competitive advantage in the area of price. Brands such as AWA and Sanyo are priced at the lower end of the market and would have greater appeal to more price-conscious customers.



Figure 6.2 Marketing provides consumers with goods that improve our standard of living. This is reflected by the wide selection of breads available to cater to a diverse range of health interests.

BUSINESS BITE

In 2010 Samsung released the 3D television to the Australian market. Its release was to coincide with the first 3D telecast of a sporting event on Australian television using 3D technologies. The 3D viewing glasses cost approximately $200 each and can only be used on the Samsung 3D television. Consumers now have the choice of standard televisions or being able to watch various specific programs on a 3D television, providing the viewer with a more entertaining and visual experience.

Standard of living

To ensure that businesses are providing consumers with goods that appeal to the 'want' element of human behaviour, organisations will develop and market products that are aimed at enhancing our lifestyles. To provide consumers with better products and, more importantly, allow businesses to develop their income streams, businesses are constantly improving the features of their products. In the early 1980s consumers would not have imagined that telephones would be pocket-sized, mobile and have communication access, computers would be hand-held and people would talk to one another using a computer rather than a fixed-line telephone.

Through the variety of products and services provided by business, the quality of life for all Australians has improved. Research and development have also played an important role in improving quality of life. Businesses spend millions of dollars each year developing products that will help consumers to adopt and maintain a healthy lifestyle. Bakeries have now developed

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a range of bread types catering to the diverse dietary and nutritional requirements of a varied and changing society. Basic necessities such as milk and bread are now available to cater for the broad range of health concerns that consumers may have.

BUSINESS BITE

The federal and state governments have sought assistance from investors to develop products that will improve consumers' quality of life. Many of the express motorways in New South Wales are privately owned; some hospitals are owned and operated by private companies. While there are generally higher fees attached to such services, they have significantly improved the quality of life of consumers. Examples of such services include the Mater Private Hospital, Crows Nest and Sydney's Cross City Tunnel.

Employment

Often when the term marketing is discussed, people associate it with publicity, pricing and advertising gimmicks. It is important to remember that marketing would not exist without a product or service to sell. To provide a product to consumers, a business must employ labour to assist in the transformation process of changing input resources into finished goods. It must use the skills of this labour to research innovative methods of improving and enhancing the product. Some people are required to sell the product. Marketing, therefore, provides a source of income and employment for millions of Australians each year. It is with this income that they are able to purchase the goods and services that satisfy their needs and wants.

Ethical Issue

If businesses are attempting to improve the standard of living of communities, why are consumers forced to pay high prices for goods that are often considered to be needs?

Brand awareness

A fundamental goal of any marketing campaign is to increase a brand's visibility within the commercial environment. Strong brand awareness allows a product to remain in the mind of consumers. This, in turn, is likely to influence the consumer's purchasing decision. Successful businesses are often those who have high brand awareness from consumers.

Brand awareness is often achieved through strong and effective marketing campaigns. Businesses make use of electronic and print media to publicise their products.





Figure 6.3 Australia's two leading department stores have sought to increase the awareness of their brands through the use of well-known and highly-publicised models.

Brand awareness

Refers to the extent to which consumers are aware of the existence of a particular product, its features, price and possible places of purchase.

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Market share
The percentage of total sales a business has compared with its competitors within a particular market.

Operations function
The physical production of a good or the provision of a service, such as a dental visit.

Increasing market share

Market share refers to the percentage of total sales a business has compared with its competitors in a particular market. The purpose of attempting to increase the market share of a business is to increase the business's sales and profitability. Achieving this objective allows the business to become stronger and more consumer aware in the marketplace. In 2009, Coles Supermarkets signed as one of the major sponsors of the Network Ten program, *MasterChef Australia*, with the slogan: 'If you want to cook like a masterchef cooks, then shop where a masterchef shops'. The objective of this promotion would have been for Coles Supermarkets to attract more customers in the grocery market. Coles association with *MasterChef* has since proved to be most successful, limiting the ability of competitor Woolworths to capitalise on the extraordinary success of the television program.

Activity 6.1 Comprehension

1. Marketing provides consumers with choice. Identify two methods used by business to do this.
2. Describe the importance of market share to a business operating in a highly competitive environment.

coles

Interdependence with other key business functions

A successful business incorporates many features. This would include strong profitability, good brand awareness and high employee satisfaction. Given this, a successful business is also one where the internal components of the organisation work together to achieve the goals of the business. Each key business function must work effectively with other functions to ensure the goals of the business are achieved. The business becomes a team where the four key players must work together to win the game. Each function works independently and with the other to ensure the success of the business.

The **operations function** refers to the physical production of a good or the provision of a service. In the case of manufacturing, inputs are combined to process or transform them into a finished product. These inputs may be raw materials or partly processed products. For example, a café will require bread, an assortment of meats and vegetables and beverages to present to the customer a finished product.

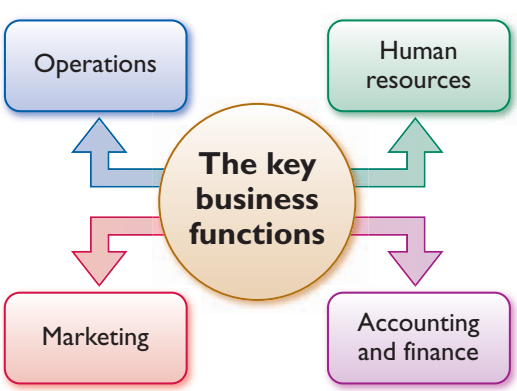


Figure 6.4 The key business functions.

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How is the operations function related to marketing?

The operations function is concerned with the process of manufacturing a particular good. They work closely with the marketing department to incorporate product features that consumers will respond positively to. It is the responsibility of the marketing function to develop strategies that would sell the product.

The **human resource function** deals with the relationship between the owners of a business and the people who work for the business. It is a support function that aims to find, attract, develop and motivate the people who can provide the services that the business requires. These human resources should have skills and abilities that are specific to the nature of their job. The business tries to acquire the right person for each job and to keep them on board, as well as improve the quality of their skills. Therefore, this business function involves acquiring, developing and maintaining staff and, if necessary, separating them from the business.

How is the human resource management function related to marketing?

The **employment relations function** is focused on the role of employees within an organisation. Staff must be motivated and skilled to develop products within the business that cater to the needs and wants of potential customers. It is through the marketing process that a business is able to determine the skills required for employees to produce the desired product. The features of the product would come through market research. In many instances, staff are the public face of the business. Their actions towards consumers will influence the decision of a consumer to purchase a product, return to the business and recommend it to others.

The **marketing function** involves finding out what consumers need and want, and linking these research findings to the business product. This research may result in changes to the features of a product or the development of a new promotional campaign. The financial resources that are available to a business influence its ability to grow and develop.

The **accounting and finance function** is responsible for providing the financial information needed for sound and viable decision making. A business must determine the total cost of producing a product in order to set an appropriate price or to assess the business's ability to acquire additional finance when and if it is needed. All these functions are interdependent. There is heavy reliance on the functions working together as a team, resulting in the business as a whole operating efficiently and profitably.

How is the accounting and finance function related to marketing?

One of the key goals of marketing is to sell the goods and services that a business produces. This in turn benefits the profitability of the business. The organisation must also consider whether the needs of its potential customers are financially viable for the business to pursue. Budgets and forecasts must also be established for promotional campaigns and sales.

Human resource function

Deals with the relationship between the owners of a business and the people who work for the business.

Employment relations function

Deals with the relationship between the owners of a business and the people who work for the business.

Marketing function

Involves finding out what consumers want and need and attempting to link the results of this research to the business's product.

Accounting and finance function

Responsible for providing the financial information needed for sound and viable decision making.

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Marketing mix

The process of developing a product that meets the needs of consumers and implementing a series of promotional, pricing and distribution strategies that will encourage consumers to purchase the product.

Selling approach

Involves a business placing emphasis on strategies aimed at convincing consumers of the need to buy a product.

Activity 6.2 Diagram

1. Create a diagram that outlines the role of each key business function
2. In each section, identify how the key business function is interdependent with marketing.

Production, selling, marketing approaches

Businesses will often use a combination of strategies, all aimed at increasing product awareness and generating sales of their products to satisfy the needs of consumers. Marketing has not always been carried out in this way. Over the years, businesses have focused their efforts on single elements of the **marketing mix**, rather than a combination of strategies. This section will examine these different approaches to marketing.

Production approach

During the 1920s–30s, many businesses assumed that the high quality of a product would ensure its success within the marketplace. There was a view that consumers would seek goods based on the level of quality. The high price was merely a representation of the high quality. As a result, businesses placed considerable emphasis on ensuring production methods were consistent with the high standards of quality expected. The business would focus on how the good was produced, as it believed that customers would be drawn to the quality of the product.

Selling approach

While product quality was seen as an important feature of the marketing process, businesses began to believe that some consumers needed to be convinced of the need to buy a particular product. This saw the development of the **selling approach**, which involves a business placing emphasis on strategies aimed at convincing consumers of the need to buy a product. A good cannot be sold based solely on its quality. People need to believe that the good will be of benefit to them. While promotion played some role here, the aim was to take the product and its benefits to the consumer – through the all-important salesperson. These people were hired to communicate the virtues of their employer's products. Promotion assisted businesses in differentiating themselves from their competitors.

Ethical Issue

Examine the extent of honesty in the selling orientation. Should the desire to achieve sales override the need for the business to be honest with its customers?

Marketing approach

Businesses have now recognised the importance of developing an integrated approach to selling. A product that is marketed successfully must incorporate a strategy to make the consumer desire the product and think it is catered to their needs. It should be promoted appropriately and priced strategically to ensure consumers are willing to buy the good without concerns about its quality. It makes little sense for a business to spend thousands of dollars researching

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and developing a product without providing avenues for the product to be appropriately promoted to increase its awareness among a core group of customers. The pricing strategy used by the business must be able to generate a return on the funds invested by the owners of the business to develop the product. It must also be competitive and affordable for those to whom the product is targeted.

Activity 6.3 Comprehension

1. Explain why businesses may benefit from using the production approach.
2. Outline the importance of promotion to the selling approach.

Types of markets

The production and sale of goods and services is not restricted or targeted solely to consumers. Businesses purchase their supplies from other businesses to produce goods and services that are then sold to consumers. These goods and services are known as inputs. Some organisations simply buy a finished good from a manufacturer to sell to consumers. Certain businesses will choose to concentrate on one section of the market, meaning they specialise their products to a select group of consumers. As can be seen, there is a diverse range of markets that demand goods and services.

Resource markets

Resource markets are those markets where the production and sale of raw materials occurs. Some businesses require materials (such as gold, aluminium, sugar, wheat) to produce the goods and services that they then sell to other businesses. These raw materials are traded in the resource market. Examples of businesses that operate in the resource market are BHP Billiton and Rio Tinto. Given that labour is a key factor of production, it can be argued that labour is traded in the resource market. While much of the Australian labour force is regulated through government legislation and tribunals, some employees are able to negotiate higher wages based on their ability, skill and reputation.

Industrial markets

Industrial markets are where goods that are used as supplies in the production process are traded. It is unusual for a business to develop all the resources it requires to produce finished goods. Toyota Australia each year spends hundreds of millions of dollars for Australian companies to supply Australian-made components for Toyota vehicles manufactured in Australia:

> *Toyota Australia's investment in local suppliers forms an integral component as part of the supplier development overall strategy. This initiative saw Toyota specialists coordinate with selected suppliers to assess their processes and facilitate improvement activities. The consequent enhancements to supplier function allowed Toyota Australia to continue their local partnerships without the need to source from the overseas market.*
>
> *Source: Toyota Motor Corporation Australia website.*

Resource markets
Where the production and sale of raw materials occurs.

Industrial markets
Where goods that are used as supplies in the production process are traded.

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Intermediate markets
Where retail businesses purchase products that have been produced by other organisations. Also known as wholesalers.

BUSINESS BITE

Futuris Automotive supplies seats and interior trims to Holden and Ford cars produced in Australia. Based in Adelaide, South Australia, the business is responsible for the manufacturing of seats and interior features used in Holden and Ford motor vehicles. The company employs a large number of employees, which contributes greatly to the South Australian economy.

Intermediate markets

Intermediate markets are commonly referred to as wholesalers. They sell products to retail businesses that have been produced by other organisations. Wholesalers generally do not sell products to consumers. Armstrong Electrical Wholesalers is a Perth-based business that supplies mining, industrial, and oil and gas equipment to businesses around the world. While this wholesaler does not manufacture the goods itself, it supplies its customers with finished goods, such as Pirelli cables, Clipsal switches and Siemens communications systems.

Consumer markets

Consumer markets are the most recognised market in the business environment. They are where businesses sell their products directly to consumers. Often the business would have purchased the products from other businesses that produce the item rather than deal directly with consumers. For example, Panasonic manufactures many consumer electrical goods (including digital cameras, televisions, video cameras and DVD recorders) but does not sell its products directly to consumers. Instead, the products are sold to stores such as Harvey Norman, Myer and David Jones and these stores act as the market where consumers can access Panasonic branded products.

Consumer markets can be broken down into three categories.

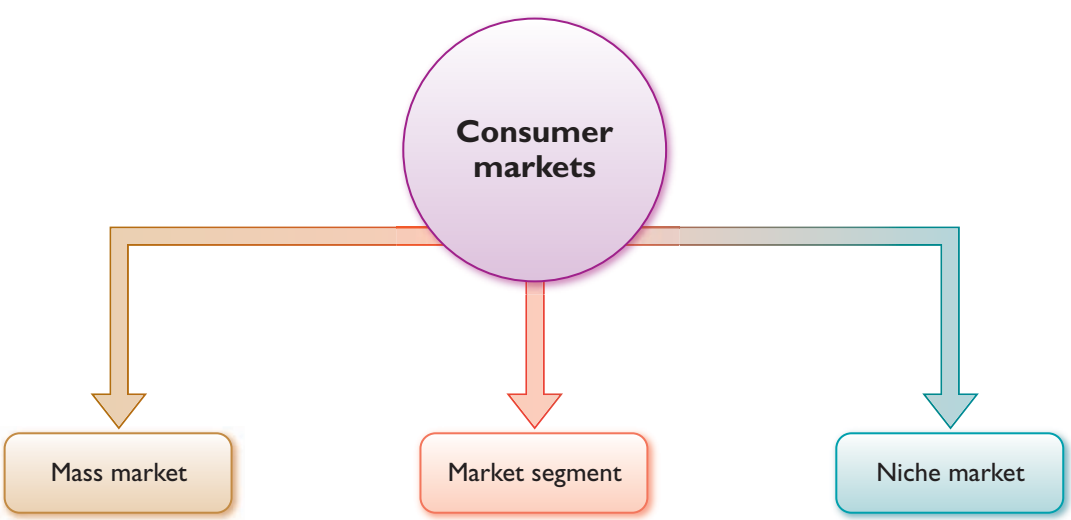


Figure 6.5 Types of consumer markets.

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Mass market

The **mass market** is the market where the products are aimed at all consumers irrespective of their age, gender, residential location or income. The business does not target its products to a particular buyer group. Products sold in the mass market have appeal to all consumers. Petrol, electricity, water and postal services are examples.

Market segments

A market segment is one area of a particular market. Businesses may choose to focus on a single market segment. Radio stations often target one market segment of the overall radio-listening market. The owners and management team of radio station Mix 106.5FM, for example, have decided to aim their product at women aged 20–50 year. To appeal to this market segment, they play a broad selection of female-friendly music, place an emphasis on comedy and encourage their listeners to call in and share with the audiences aspects of the life experiences.

Niche markets

A niche market is a smaller section of a larger market segment. While a business targeting a niche market would still focus on a select group of customers, a niche market differs from a market segment in that its customer base is narrower. Owing to the small client base, sales are not as frequent, although the goods sold in this type of market are usually higher-priced than those in broader markets.

BUSINESS BITE

Honeymoon Boutique is a travel agent located in Sydney's inner west. It specialises in providing honeymoon packages for new married couples.

The increasing cultural diversity of Australia's population has been accompanied by the growth of speciality food stores that cater to these groups. These businesses specialise in only one small sector of the market. If you were to travel to the main shopping centre of Campsie, a suburb located in Sydney's south-west, you would find many speciality food stores catering to the needs of the dominant Asian and Indian cultures within that region.

Activity 6.4 Classification

Identify the types of markets in which the following business transactions occur:

a A mining company has discovered iron ore deposits in Queensland.

b A motor vehicle production company uses tyres produced by Kuma Runer Automotive.

c A bread manufacturer has released a type of bread that appeals to a variety of consumers.

d An electronic store sells a range of television brands, including Panasonic, Samsung and LG.

e A jeweller specialising in bridal jewellery.

f A TV station believes its niche market to be males aged 40 years and over interested in sport.

Mass market

The market where the products are aimed at all consumers.

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Chapter summary

- Marketing is the process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers.
- The strategic role of marketing refers to the long-term role that the key business function of marketing has within a business.
- The strategic role of marketing involves five key areas:
  - Choice: businesses differentiate themselves from their competitors through price, product quality and features and service. All these provide consumers with greater choice when purchasing a product.
  - Standard of living: businesses will often develop and market products that improve and enhance standard of living.
  - Employment: to provide a product to consumers, businesses must employ labour to assist in transforming input resources into finished products. Labour is also required to sell these goods and services.
  - Brand awareness: brand awareness refers to the extent that customers are aware of a product/brand and its features.
  - Market share: businesses will attempt to develop, promote and price products to a standard that will give the organisation more customers than its competitors.
- Marketing is one of four key business functions. The other business functions are operations, human resource management and finance. Each of these functions works closely with the other to achieve the goals of the business.
- There are three core approaches to marketing:
  - Production approach: relies on the view that consumers base their purchasing decisions on the quality of the product.
  - Selling approach: based on the belief that a business will be successful in selling a product if it is able to promote the benefits of the product to its target market.
  - Marketing approach: the basis of which is that the customer is at the core of all business activities. It involves adopting a customer orientation with the belief that all actions in the business should be aimed at satisfying the needs of the customer.
- The four markets in the marketing process are resource markets, industrial markets, intermediate markets and consumer markets.
- Consumer markets consist of the following markets:
  - Mass markets: apply to goods and services that appeal to all types of consumers.
  - Market segments: where a business chooses to focus on only one area of particular market.
  - Niche markets: a smaller section of a market segment.

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Chapter revision task

Rewrite the following passage, using the words listed in the box below to fill in the blanks.

employment	percentage	product	living
finished	aware	income	differentiate
community	improving	competitors	convenient
consumers	competitors	increase	input
health	price	mind	particular
marketing	labour	research	

There are five key strategic roles of _____ in the firm and society:

1 Choice: Marketing provides _____ with choice. Businesses will often attempt to _____ themselves from their _____. They can do this through _____ quality, _____, service, packaging and loyalty programs.

2 Standard of living: Many of the products that businesses develop and market are aimed at _____ our quality of life and standard of _____. They do this by providing goods that improve our _____ and wellbeing, developing goods and services aimed at making our lifestyles more _____ and working with governments to distribute essential _____ services.

3 Employment: To provide consumers with a product to sell, a business must employ _____ to assist in transforming _____ resources into a _____ product. It also uses the skills of this labour to _____ and develop methods of improving this product. In this way, marketing provides a valuable source of _____ and _____ to millions of Australians.

4 Market share refers to the _____ of total sales a business has compared with its _____ in a particular market. The purpose of attempting to _____ the market share of a business is to increase the business's sales and profitability.

5 Brand awareness refers to the extent to which consumers are _____ of the existence of a _____ product, its features, price and possible stores of purchase. Strong brand awareness allows a product to remain in the _____ of consumers.

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Multiple-choice questions

1 How may marketing best be defined?
- **(A)** The process of developing promotional and pricing strategies to sell a product
- **(B)** The process by which a business attempts to raise awareness of the goods and/or services it sells in the marketplace
- **(C)** All forms of promotion, such as advertising, publicity and public relations
- **(D)** The process of developing a product and implementing a series of strategies aimed at promoting, pricing and distributing the product to a core group of customers

2 Mobile Buzz has developed a new marketing plan that seeks to attract the interest of young adult mobile phone users. Which strategic role of marketing is this concerned?
- **(A)** Choice
- **(B)** Market share
- **(C)** Standard of living
- **(D)** Brand awareness

3 Which of the following strategies could a business use to increase its market share?
- **(A)** Market research
- **(B)** Discount pricing
- **(C)** Product testing
- **(D)** Quality control procedures

4 Which of the following is a product that is sold in the mass market?
- **(A)** A product that has appeal to a limited number of individuals
- **(B)** A product that is characterised by a high price and low sales
- **(C)** A product that has appeal to a number of different groups
- **(D)** A product with features and attributes that are very similar to those of competitors' products

5 Rheanna and Hayley have developed a new range of female swimwear aimed at women aged between 18–35. What is this new product's market commonly referred to as?
- **(A)** Resource market
- **(B)** Mass market
- **(C)** Market segment
- **(D)** Select market

6 With information obtained from market research, Therese hopes to establish a product that is more suited to consumers' needs, using relevant pricing and promotional strategies. Which form of approach would Therese be using?
- **(A)** Production
- **(B)** Selling
- **(C)** Marketing
- **(D)** Societal

7 'Turn on tomorrow' and 'i'm lovin' it' are the slogans that Samsung and McDonald's use to promote the quality of their products. Which form of orientation do these slogans emphasise?
- **(A)** Selling
- **(B)** Marketing
- **(C)** Societal
- **(D)** Production

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8 Which of the following statements best describes the relationship between the marketing and operations functions of a business?

(A) The operations department work closely with the marketing department to incorporate product features that consumers will respond positively to

(B) The operations department produces goods and services within a budget developed by the marketing department

(C) The operations department is responsible for the recruitment of staff, who then produce goods and services favourable to the needs and wants of consumers

(D) The operations department develops goods and services from which the marketing function becomes responsible for promoting

9 Hilltop Mining are one of Australia's largest iron ore exporters. Which type of market does this business operate within?

(A) Resource

(B) Industrial

(C) Intermediate

(D) Consumer

10 Quicksmart Supermarkets have developed a marketing strategy that incorporates an emphasis on production quality, discount pricing and a wide distribution of its stores. Which of the following approaches is the business using?

(A) Production

(B) Selling

(C) Marketing

(D) Relationship

Short-answer questions

1 **(a)** Explain how a consumer market differs from the other types of markets in the business environment.

(b) Describe and give examples of the three types of consumer markets.

2 Andreanna has decided to establish a homeware store. She believes that the quality of her products, for which she has been recognised, will ensure the success of the business. Vanessa is also opening a similar store but has conducted market research to develop a more thorough understanding of her local area and their needs. Outline how the approach that Andreanna is using differs from that used by Vanessa.

Extended-response question

Marketing is essentially aimed at selling the goods and/or services of a business. Describe what is meant by the term *marketing* and explain, with reference to the different types of markets the different types approaches to marketing businesses may use to market their products.

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CHAPTER 7



Influences on marketing

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Factors influencing customer choice

Factors outside the business environment will often play an important role in the success of an organisation's marketing plan. While the business has no direct control over these factors, it is essential that the business has a strong understanding of how such factors can influence the buying behaviour of its customers. The four key factors influencing consumer choice are psychological, sociocultural, economic and government.



Figure 7.1 Factors influencing consumer choice.

Psychological factors

Psychological factors are the personal characteristics of an individual that influence their behaviour. These factors relate to the way people think and develop attitudes to certain products. The psychological factors that influence the different types of goods and services customers buy include:

- motivation
- perception
- learning
- beliefs and attitudes
- lifestyle
- personality and self-concept.

Motivation

When consumers have decided to buy a product, there is a belief within them that they need the product. Various factors will have influenced this decision for the good to be thought of as a need. To understand the motivational forces that cause consumers to act on their perceived needs we can look to Abraham Maslow's hierarchy of needs (Figure 7.2 on page 122).

Maslow, who was one of the world's leading psychologists, studied the forces that motivate humans. He attempted to explain why people have different needs at different stages of their life. Maslow believed that there is a hierarchy of needs, the foundation of which are the basic needs (such as food and shelter). People will ensure their basic needs are met before they seek to meet other needs, such as education and love. If consumers are not able to satisfy their basic needs, they will not be motivated to satisfy other desires within the hierarchy of needs.

Perception

Perception is the opinion that a customer has about a particular product. As consumers vary, different people may perceive the same product in different ways. It could depend on the amount of information gathered, the age of the consumer or cultural issues, such as the consumer's ethnicity or religion. It is important that businesses develop a

Psychological factors

The personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and develop attitudes to certain products.

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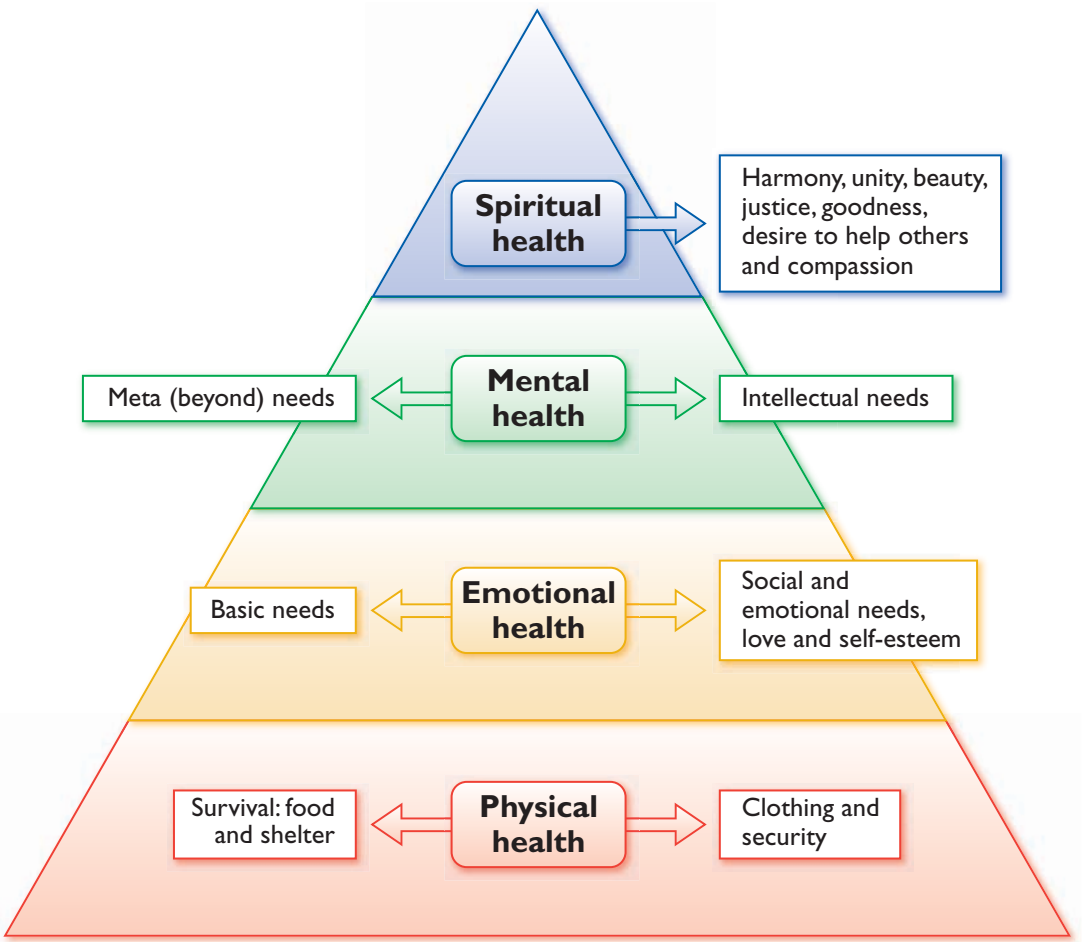


Figure 7.2 Maslow's hierarchy of needs.

marketing campaign that promotes to the targeted customer group a positive image of the product – an image that the consumer relates to and identifies with. This may include a focus on the product's quality or a promotion of the product's health benefits. Price is becoming an increasingly important influence on consumers' perception of a product. Some consumers perceive the quality, reliability and reputation of a product to be reflected in its price. Leading European car manufacturers (such as Ferrari and Porsche) are priced at the higher end of the luxury motor vehicles market. As such, consumers associate these products with images of prestige, quality and reliability.

BUSINESS BITE

Since 2001, Aldi has been one of the fastest growing players within the Australian supermarket industry. Much of Aldi's success has been attributed to its effective marketing campaign that heavily promotes the low price of its products. Given this, some consumers believe that the pricing of Aldi products is reflective of lower quality products.

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Learning

Learning describes the changes in an individual's behaviour as a result of an experience. This experience could be the consumer's use of a product, increased awareness of its features or learning about a friend's perception of the product. Consumers learn from each purchase they make. They determine the level of satisfaction they gain from using a product. Consumers also decide whether they will purchase that product again or make a further purchase from the business where the product was bought.

Beliefs and attitudes

Our beliefs and attitudes are shaped by our environment and life experiences. They include our ethnic or religious beliefs and our political persuasions or attitudes towards social issues, such as the environment, animal cruelty or child labour. A consumer's attitude towards a particular product is clearly influenced by his or her broader beliefs and attitudes. Businesses cannot always influence a consumer's beliefs and attitudes. Factors such as culture or religion may prevent certain consumers from buying particular products.

Lifestyle

Lifestyle is a significant influence on buyer behaviour. People of similar age and income will not always buy the same goods and services. Leisure preferences, interests, attitudes and gender all influence a person's



Figure 7.3 High prices will discourage some consumers but will not be a concern for others.

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lifestyle. From a marketing perspective, it is important that a business consider the influence of lifestyle on the demand for its product. The business should look beyond specific target groups (such as consumers of a certain age and income level) and instead determine what sort of lifestyle their target consumers will most likely have.

Personality and self-concept

The way we view ourselves and the way we respond to other people's perception of us will influence the types of goods and services we purchase. The basis for this idea is that we buy products that often reflect our personalities. For example, people who enjoy cafes, the theatre and the opera, rather than nightclubs and popular sporting events, will show little or no interest in buying such clothing brands as G Star Raw, Billabong and Roxy. They are more likely to buy brands such as Polo Ralph Lauren and Country Road.

Sociocultural factors

Sociocultural influences on a customer's choices are those that come from the customer's society and culture. An example of a sociocultural factor is a consumer's place of residence. Culture can be defined as an individual's values, beliefs and customs. It influences almost every aspect of human behaviour, including our attitudes towards the various products offered within the marketplace. Businesses have recognised the increasing importance of catering to the cultural beliefs and attitudes of particular groups within the community. This presents a business favourably in the community and allows it to expand its available market, both of which will benefit the business.

BUSINESS BITE

Australia, as a multicultural society, consists of consumers from a diverse range of ethnic backgrounds. A consumer's ethnicity will influence many of his or her consumption decisions. A successful business will be aware of and responsive to these influences. As an example, fast food restaurants in Sydney's south-west, including KFC and McDonald's, have recently introduced a halal menu to cater for its predominantly Islamic market. This has proven to be a very successful initiative from these businesses.

Economic factors

A person's socioeconomic status is largely determined by the person's level of income, occupation and level of educational attainment. Socioeconomic status is a significant influence on the types of goods and services a consumer will buy. In marketing terms, people from a high socioeconomic background come from the 'A demographic'. They are people who have a high income, are often university educated, are either professionals or self-employed and are willing to spend their income on goods that are perceived to be prestigious. In the majority of instances, the more income an individual earns, the greater is the individual's ability to purchase goods and services from a wider price range. This allows them to seek products with superior quality, advanced features and a more prestigious reputation. However, all adults must devote part of their income to

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essential forms of expenditure. Essential expenses could include costs related to rearing children, paying a mortgage loan and saving for future needs, such as retirement. As such, high-income earners will not always be able to purchase products aimed at their particular income group. However, in comparison with a low-income earner, a person with a high income is more likely to be able to borrow from financial institutions. Banks, credit unions and finance companies hold the view that the ability of a person to repay debt is significantly influenced by the person's income.

Government factors

While it may not appear to directly do so, the government is an important influence on the goods and services that consumers purchase. One of the key government factors influencing customer choice is the federal government's regulation of the economy. This regulation takes place through the implementation of the government's fiscal and monetary polices and through microeconomic reform. Fiscal policy refers to the actions taken by the federal government to influence economic activity through the use of its Budget. This can impact, for example, on the level of taxation consumers pay in the form of income tax and the goods and services tax (GST) on the purchase of goods and services.

Monetary policy is used by the Reserve Bank of Australia to influence the level of economic activity through the use of interest rates. Interest rates are significant in determining the level of expenditure in the economy and the level of credit that consumers and business will access. Microeconomic reform has proven to be successful in encouraging greater competition in the telecommunications, finance and airline industries. It has offered consumers greater product choice and lower prices.

Governments also play an important social role in influencing customers' purchasing behaviour. Age restrictions on the purchase of alcohol and tobacco and censorship warnings on television programs and films reflect the government's role in promoting social responsibility in the community.

BUSINESS BITE

In 2009, the federal government initiated an Economic Stimulus Program to encourage consumer spending during a strong phase of economic downturn. Many Australian taxpayers were sent one-off cheques of up to $900 to spend as they pleased. Retailers such as Woolworths, Coles and Harvey Norman all benefited from the stimulus as consumers were responding to the payment by increasing their spending.

Activity 7.1 Comprehension

1. Describe how an improvement in economic conditions could influence customers' buying behaviour.
2. Examine the importance of sociocultural factors in influencing customer choice.

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Figure 7.4 Microeconomic reform has been successful in encouraging greater competition in the airline industry.

Consumer laws

It is widely recognised that a successful business is one that looks beyond profit maximisation and is able to develop a motivated, positive workforce while adopting ethical and legally correct practices through all operations of the organisation. Marketing is an important role in any business. It is the function that takes a product to the consumer. Given the significance of the marketing function, some businesses may attempt to develop practices that take advantage of consumers' trust and good faith in the organisation and its products. Businesses now operate within a legislative framework outlining the responsibilities of businesses in relation to the field of marketing.

Role of consumer laws

Consumer protection in Australia is the domain of state governments. Under the Constitution, the state governments have responsibility for developing laws that protect the interests of consumers within the business environment. The Commonwealth Government controls business behaviour through the *Competition and Consumer Act 2010* (Cth). This legislation attempts to promote fair and competitive behaviour in the marketplace. While all levels of government acknowledge that businesses need to seek to be profitable for their owners and shareholders, the government also accepts that businesses should conduct themselves in a way that does not take advantage of consumers through misleading and deceptive behaviour.

Deceptive and misleading advertising

Advertising is one of the most powerful and effective methods of promotion. It takes the business and its products directly to the consumer. Because of its benefits, some businesses will attempt to use advertising in a way that is unfair, deceptive and misleading to the consumer. Examples of deceptive and misleading advertising under the *Competition and Consumer Act* include:

- giving misleading information about a product's features, content or place of manufacturer
- overstating the benefits that a product will provide to the consumer
- offering discounts and special offers that do not, in fact, exist
- using bait and switch advertising, which promotes a product that is heavily discounted even though the business has very limited supplies or no stock at all. When the consumer comes into the store and expresses an interest in buying the product, the salesperson will attempt to switch the consumer's interest to a more profitable item.

While the *Competition and Consumer Act* seeks to discourage businesses from

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unfair, deceptive and misleading behaviour, consumers are responsible for reporting such cases.

Activity 7.2 Comprehension

1. Explain why deceptive and misleading advertising is considered to be unethical.
2. Deduce whether it should be the role of the consumer to be more careful when making commercial decisions.

Price discrimination

Price discrimination refers to the process of a business giving preference to some retail stores by providing them with stock at lower prices than is offered to the competitors of those retailers. The competitors are being discriminated against by being forced to pay a higher price for a product that is identical to one the other retailers are receiving at a discounted rate. The *Competition and Consumer Act* aims to discourage price discrimination in the business environment. It is uncompetitive and can often disadvantage smaller businesses that have less influence in the marketplace. The Act does, however, allow businesses to provide different prices to different stores for identical goods should one business order a bulk quantity. This is a method by which business can engage in price discrimination and are legally able to do so.

Implied conditions and warranties

A good way for a business to show its faith in the products it sells is to offer a warranty to consumers. Most businesses offer a warranty of at least 12 months for electrical products and home appliances. Warranties can be a very powerful marketing tool for a business to attract customers. When purchasing a product, the consumer expects that the business will fulfil its legal obligation to provide a good or service that is consistent with the description given and is in full working order. Regardless of whether the product is carrying a warranty, a business must, by law, either refund a client's money or offer an exchange of the good should the good be recognised to have been faulty at the time of leaving the store. This is why all products are said to have an **implied warranty**. By administering this legislation, the state government seeks to ensure consumers' rights are protected.

Resale price maintenance

Businesses will often seek to balance the competing goals of profit maximisation with a competitive pricing strategy. Under the *Competition and Consumer Act*, a manufacturer cannot refuse to sell goods to a retailer who decides not to sell the good at the price that is suggested by the manufacturer. Businesses may be offered suggested prices at which to sell a good. As consumers we see this in stores as the recommended retail price. Some businesses choose to go below this recommended price. A manufacturer cannot discriminate against stores for selling at a price that is lower than it has recommended.

Activity 7.3 Comprehension

1. Define what is meant by resale price maintenance.
2. Identify two examples of how a business may engage in deceptive and misleading advertising.

Price discrimination

A business giving preference to some retailers by providing them with stock at lower prices than is offered to the retailers' competitors.

Implied warranty

Regardless of whether a product is carrying a warranty, a business must, by law, either refund a client's money or offer an exchange of the good should the good be recognised to have been faulty at the time of leaving the store.

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What are misleading advertising and selling practices?

Any kind of conduct or behaviour that could give consumers the wrong impression may potentially breach the Act. It doesn't matter whether the representation is deliberate or accidental. What does matter is the impression that is left in the mind of the customer. Various sections of Part V of the Act target specific types of trader behaviour:

- A business must have **reasonable grounds** when predicting future events. Businesses should consider, or adequately address, the range of uncertainties and variables involved (section 4).
  Example: An oven retailer falsely stating that their ovens were 'risk free' as they could be returned within 12 months if the buyer was not satisfied.
- Commercial conduct must not **mislead or deceive, or be likely to mislead or deceive**. This is a very broad provision (section 18).
  Example: A fruit juice producer representing a product as being 100% cranberry juice, when the product is 50% orange juice.
  Example: A company representing that an international calling card has no fees, other than timed call charges, when in fact other fees are charged.
- Businesses must not make **false or misleading representations** about the characteristics of goods or services, including sponsorship, price, place of origin, guarantees, availability of spare parts and the buyer's need for goods (section 29).
  Example: A car company misrepresenting that a car has five doors when it actually has three.
  Example: A seller claiming that a product with significant imported components is 'Australian made'.
- Businesses must not engage in **false or misleading** conduct, or in certain other practices, when buying or acquiring an interest in land (section 30).
  Example: An agent misrepresents fixtures to be included with rural land, the position of a 'beachfront' lot or suitability for strata conversion.
- Businesses must not engage in conduct that **misleads or is likely to mislead** people about the details of possible employment (section 31).
  Example: An educational institution offering 'scholarships via paid training courses' when, in fact, applicants are required to pay a substantial fee, there is no employment provided and the scholarships don't exist.
- If a seller makes a **representation** about part of the cost of goods or services it **must also specify the cash price** of those goods or services (section 48).
  Example: A used car dealer advertising the price of a car as periodic repayments without stating the actual cash price of the vehicle.
- Businesses must not engage in conduct that **misleads or is likely to mislead** the public about the characteristics, suitability or quantity of services (section 34).
  Example: An allergy treatment company stating that it can cure or eliminate virtually all allergies or allergic reactions when the company actually can't do this.
- The ACL prohibits **false or misleading conduct** in connection with work at home schemes, or other business schemes requiring investment and/or labour by participants (section 37).
  Example: A person being misled about the profitability of a worm farm investment scheme.
  Example: A company misrepresenting the level of business available to drivers.

Source: Australian Competition & Consumer Commission, Advertising and selling

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Ethical aspects of marketing

Ethics are a fundamental aspect of a successful business. They represent actions taken by businesses to act as responsible corporate citizens within the community. Ethics are the cornerstone on which all responsible businesses are established. Ethics in marketing refers to a combination of broad principles that establish standards of behaviour and guidelines for people working across the marketing industry. They are not enforceable through law and rely on the goodwill of all stakeholders in the business process to work successfully.

Truth, accuracy and good taste in advertising

A marketing campaign is established to promote consumer awareness and interest in a particular product. It is also designed to increase a product's sale and increase the market share of a business. Given this, businesses spend considerable amounts of money each year on promotional campaigns.

Marketers are expected in engage in fair and honest behaviour when developing a marketing campaign. It is expected that when promotional material is distributed, this material represents information that is truthful, accurate and in good taste. Failure to do this may result in a breach of the *Competition and Consumer Act*. The *Competition and Consumer Act* prohibits a corporation from supplying consumer goods that do not comply with prescribed product safety standards.

Working alongside the legislative framework is also the Advertising Federation of Australia (AFA). This is the peak body representing companies in advertising and marketing communications. AFA seeks to promote best practice in advertising by members of the industry. This also includes compliance with the codes and laws that affect advertising. The Advertising Federation of Australia is also referred to as The Communications Council.

BUSINESS BITE

In 2009, companies such as Wesfarmers (Coles, Target, Bunnings Warehouse, Kmart), Woolworths (Woolworths, Big W, Dick Smith), Harvey Norman, Telstra, Commonwealth Bank, Optus and Westpac spent a combined total of more than $1 billion on advertising alone across all forms of media. This is a considerable cost to each business and given the amount of funds allocated to only part of the selling process, management of the business do seek strong returns.



Figure 7.5 Major advertisers in the Australian market.

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The Communications Council code of ethics

1 **Stand up for what you believe is right.** Be open-minded and receptive. If something's wrong, try to resolve it. Let a well-informed conscience be your guide.

2 **Honour all agreements.** Agreements are expressions of trust. Honour all promises – written or spoken – to clients, colleagues and suppliers. Respect confidentiality.

3 **Don't break the law.** Don't bend the law. Think beyond legal argument to moral argument – the spirit of the law. Don't stretch the truth. Don't look for loopholes.

4 **Respect all people.** No stereotypes please. Individuals should be understood, not portrayed in a way that could bring disrespect. Use humour, but avoid cheap shots.

5 **Strive for excellence in everything you do.** Create an open, trusting environment with colleagues, clients and suppliers. Raise the standards of creativity and professionalism.

6 **Give clients your best advice, without fear or favour.** Act in your clients' best interests. Tell them what they need to know, not what you think they want to hear.

7 **Look after you colleagues.** Responsibility is a two-way street. Look for the best in one another, acknowledge it, and reward it. Leave room for fun, family and friends.

8 **Compete fairly.** Be honest in commenting on competitors and our industry. No dirty tricks in new business. No misrepresentation of the capabilities of you business.

9 **Think before you act.** The best decisions are informed decisions. Think before you act. Will this action connect with your personal sense of what is right or wrong?

10 **Be honest.** This can be tough. Be honest without being brutal. Be true to yourself. Recognise the trust placed in you, your company and the marketing communications industry, then act accordingly.

Source: www.communicationscouncil.org.au/public/content/viewCategory.aspx?id=593

Ethical Issue

Should fast food restaurants be allowed to make use of logos endorsing their business as healthy? What impressions does this give of the business's menu across the board?

Brand awareness is a key component of a business's marketing strategy. It allows the business and its product to become known. Some organisations, however, will seek to implement strategies that create some degree of controversy. Not only does this promote the business and/or its product, but it also encourages the media to facilitate debate regarding the nature of the advertisement. This debate serves only to generate further publicity for the business. Publicity that would normally costs thousands and thousands of dollars.

The concept of taste in advertising is subject to considerable debate. An individual's image of one advertisement may differ from that of another individual. United Colors of Bennetton is a leading fashion house across the world. It, however, uses somewhat controversial advertisements

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BUSINESS BITE

The question of truth and accuracy in advertising does create considerable debate. In 2007, McDonald's Australia paid $330 000 per year for the right to use the Heart Foundation logo across a range of its Healthy Choices. These menus were tested according to strict guidelines established by the Heart Foundation. The Heart Foundation is one of Australia's most trusted health and lifestyle logos. Given this, the decision is place the 'tick' on various McDonalds' products raised considerable debate. Commentators suggested that this would give the impression that McDonald's is healthy, rather than suggesting specific menu items only fit that criterion. McDonalds' use of this logo remains as it attempts to develop a healthier menu, seeking to attract children, mothers and other weight-conscious individuals. The business now labels the nutritional content of each of its items.

to promote social issues, while at that the same time selling its brand name.

Do you consider the following advertisement as 'good taste'?



Ethics in advertising is outlined in the Australian Association of National Advertisers. Their Code of Ethics outlines key principles to be followed in the process of developing advertisements (as outlined in the table on page 133).

Products that may damage health

The nature of Australian businesses is guided by government policies that seek to encourage competition in the marketplace. Competition benefits businesses through increased product innovation, improved manufacturing techniques and greater workplace efficiency. A key benefit is also in providing consumers with choice.

The federal and state governments have sought to restrict the provision of various goods and services that may act as a health detriment to the consumer, without applying a ban on their sale.

These goods and services are often referred to as 'sin' goods, because, in essence, they are bad for us. Examples include: the sale of cigarettes and alcohol, restrictions on tobacco sponsorship and entries into casinos (refer to Table 7.1 on page 134).

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Figure 7.6 Domestic violence is a serious issue that requires education and awareness in all countries. Should victims of this horrible crime be used to endorse a clothing company and their fashion?

Source: www.adpunch.org/entry/united-colors-of-benetton-colors-of-domestic-violence

Engaging in fair competition

Businesses across Australia operate in highly competitive environments, with considerable amounts of money spent each year in order to increase sales and market share. Given this, some businesses do attempt to engage in behaviour that is either legally or ethically unfair to their competitors.

From a legal perspective, it is the role of the Australian Competition and Consumer Commission to regulate business behaviour. Common practices of unfair competitive behaviour include:

- price-fixing between two or more major competitors in the market with the aim of reducing competition
- long-term loss leader – pricing strategy by undercutting smaller competitors in the short term, forcing the smaller business to engage in a price war.
- misleading advertising regarding the products of a competitor.

Australian Competition and Consumer Commission

The Australian Competition and Consumer Commission (ACCC) was formed in 1995 and has as its primary role the administration and enforcement of the *Competition and Consumer Act 2010* (Cth) and the *Prices Surveillance Act 1983* (Cth). The ACCC attempts to regulate the level of competition within a range of industries. It aims to promote fair and ethical behaviour by businesses towards their competitors and allows businesses to lodge complaints against competitors regarding behaviour that they deem to be unfair and against the Acts. The ACCC is also able to penalise businesses that engage in deceptive and misleading conduct and those that engage in price-fixing with their competitors. Price-fixing occurs when two or more business competitors combine to set a high price within the market. It reduces the level of competition within the market.

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Section 2 of the Australian Association of National Advertisers code of ethics

2.1 Advertising or Marketing Communications shall not portray people or depict material in a way which discriminates against or vilifies a person or section of the community on account of race, ethnicity, nationality, sex, age, sexual preference, religion, disability or political belief.

2.2 Advertising or Marketing Communications shall not present or portray violence unless it is justifiable in the context of the product or service advertised.

2.3 Advertising or Marketing Communications shall treat sex, sexuality and nudity with sensitivity to the relevant audience and, where appropriate, the relevant programme time zone.

2.4 Advertising or Marketing Communications to Children shall comply with the AANA's Code of Advertising & Marketing Communications to Children and section 2.6 of this Code shall not apply to advertisements to which AANA's Code of Advertising & Marketing Communications to Children applies.

2.5 Advertising or Marketing Communications shall only use language which is appropriate in the circumstances and strong or obscene language shall be avoided.

2.6 Advertising or Marketing Communications shall not depict material contrary to Prevailing Community Standards on health and safety.

2.7 Advertising or Marketing Communications for motor vehicles shall comply with the Federal Chamber of Automotive Industries Code of Practice relating to Advertising for Motor Vehicles and section 2.6 of this Code shall not apply to advertising or marketing communications to which the Federal Chamber of Automotive Industries Code of Practice applies.

2.8 Advertising or Marketing Communications for food or beverage products shall comply with the AANA Food & Beverages Advertising & Marketing Communications Code as well as to the provisions of this Code.

Source: The AANA Code of Ethics is correct as at 10 March. The Code is currently being reviewed by an independent reviewer and will be released later in 2011. For updates refer to www.aana.com.au.

Sugging

The business environment is competitive. This leads some businesses to engage in unethical marketing practices, such as **sugging**. This process involves selling under the guise of research. Consumers are asked general questions on a range of topics, such as 'Where would you like to go for a holiday?' and 'Would you like to be a millionaire in two years?' From the responses the interviewer is able to determine the needs of the consumer and suggest products offered by the business that cater to these needs. The ethical issue here is whether the consumer is aware that the business is, in fact, attempting to promote and sell its products from the outset of the interview; that is, when the questions were first being asked. Sugging is regarded as unethical because the consumers are not aware that they are being encouraged to buy the product.

Sugging
A disguised marketing process that uses general questions in a survey or questionnaire to determine the interests and needs of a consumer and then offers the consumer a product that the business believes caters to the consumer's needs.

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Table 7.1 Measures used to control the selling of restricted goods

Tobacco – sold widely across Australia	• Purchases restricted to people aged 18 and over • Must not be displayed openly • Packets contain health warnings • Unable to sponsor sporting/community events
Alcohol – sold across Australia	• Purchases restricted to people aged 18 and over • All staff serving alcohol must complete Responsible Service of Alcohol course • Sponsorship of sporting/community events permitted
Casino/Gaming – restricted to people aged 18 and over	• Visible and clear information informing people of support services for gambling addiction • Restricted opening hours for leagues and RSL clubs

BUSINESS BITE

In August 2010, the Federal Court of Australia ruled that phone card sellers Prepaid Services Pty Ltd and Boost Tel Pty Ltd had engaged in misleading conduct and made false representations in regard to the value, price and benefits of their phone cards. This conduct breached the *Trade Practices Act 1974* (Cth) [superseded by the *Competition and Consumer Act 2010* (Cth) on 1 January 2011].

In recent years the ACCC has been active in promoting truth in advertising in the telecommunications industry. Prepaid Services Pty Limited is a member of the Optus Group of companies. Boost does not have its own telecommunications services but buys telecommunication services through PPS. The ACCC argued that PPS and Boost contravened the Act by representing that certain phone cards would provide consumers with a specified amount of call time, when that was not the case; and that no fees, other than timed call charges, would apply when in fact other fees were charged.

Both phone card businesses also suggested to consumers that a specified rate per minute would apply to calls regardless of the number and length of calls made, when in fact the specified call rate was highly unlikely to be ever achieved. For example, Boost represented that its card offered 1896 minutes of talk time to various countries including the UK and Japan at a flat rate of half a cent per minute, however, the 1896 minutes could only be used in exceptional circumstances, such as through one continuous call in excess of 30 hours or through a series of calls of exactly one or five minutes duration. A seven-minute call to Japan would cost 44 cents and not the 7.5 cents as expected.

The courts declared Boost's conduct was false and misleading and ordered the business publish notices correcting their actions.

Source: ACCC Website

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Chapter summary

- There are four key factors that influence consumer choice: psychological, sociocultural, economic and government.
- Psychological factors are the personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and develop attitudes to certain products. Psychological factors include a consumer's understanding of a product and what motivates the consumer to purchase particular products.
- Economic factors relate to an individual's level of income and ability to access credit.
- Sociocultural influences on a customer's choices are those that come from the customer's society and culture, such as where they live and their religious beliefs.
- The government has an important role in influencing the goods and services that consumers purchases. It does this through its use of fiscal and monetary policies, microeconomic reform and age restrictions placed on the purchase of specific products.
- Under the *Competition and Consumer Act 2010* (Cth), businesses are prohibited from engaging in deceptive or misleading conduct. This extends to conduct in the area of marketing, such as advertising, sales promotions and discounts.
- Price discrimination refers to the process of a business giving preference to some retail stores by providing them with stock at lower prices than is paid by the retailers' competitors.
- Implied conditions and warranties ensure that a product is sold in full working condition and is consistent with the description given.
- Resale price maintenance ensures a manufacturer cannot refuse to sell goods to a retailer who decides not to sell the good at the price that is suggested by the manufacturer.
- Marketers are expected in engage in fair and honest behaviour when developing a marketing campaign. It is expected that when promotional material is distributed, this material represents information that is truthful, accurate and in good taste. Failure to do this may result in a breach of the *Competition and Consumer Act*.
- The federal and state governments have sought to restrict the provision of various goods and services that may act as a health detriment to the consumer, without applying a ban on their sale.
- Some businesses do attempt to engage in behaviour that is either legally or ethically unfair to their competitors.
- From a legal perspective, it is the role of the Australian Competition and Consumer Commission to regulate business behaviour.
- Sugging is the process that involves selling under the guise of research.

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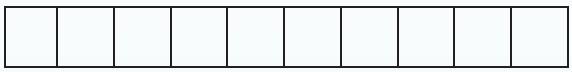
Chapter revision task

Copy the word puzzle below. Then complete it using your answers to the clues listed below.

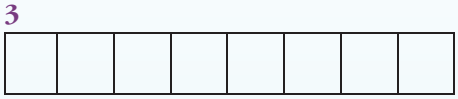
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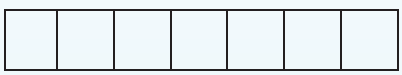
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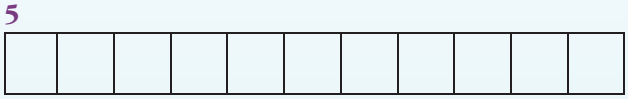
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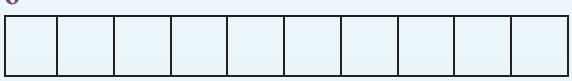
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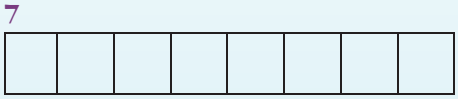
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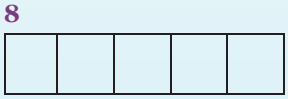
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7



8



Clues

1 These factors relate to our thoughts and attitudes towards particular products.

2 This is the image a particular product or brand has in the mind of a consumer.

3 A consumer's _____ may act to discourage the consumer from purchasing a certain good or service.

4 Our perceptions of and attitudes towards particular products are influenced by this.

5 An individual with a high income may purchase goods and services of this kind.

6 An organisation that influences the types of goods and services consumers purchase.

7 Factors related to an individual's level of income and financial commitments.

8 An important factor influencing the perception of a product.

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Multiple-choice questions

1 Which of the following scenarios best describes the practice of price discrimination?
   (A) Smarta Electrics sells air conditioners to consumers located in different geographic areas at different prices
   (B) Sing Lee and Davie Jones each sell the same digital video camera but at different prices
   (C) Vision Central offers discounts to pensioners and to consumers willing to pay cash
   (D) The manufacturer of Toko cars sells the cars to different car dealerships at different prices

2 Helen visits a furniture store hoping to purchase an outdoor setting that was advertised as being priced 'below cost'. When Helen asks the salesperson to show her the setting, she is told that there was only a very limited number and they were sold that morning. Helen is then shown a more expensive style of outdoor setting. This practice is typically known as:
   (A) Bait and switch advertising
   (B) Sugging
   (C) Retail price maintenance
   (D) Higher costs

3 Ben's pies are advertising their food products as '97% fat free'. Independent tests reveal the fat content is actually greater than this. Which of the following processes is the business engaging in?
   (A) Deceptive advertising
   (B) Price discrimination
   (C) Taste in advertising
   (D) Sugging

4 Psychological factors are reflected through which part of consumer behaviour?
   (A) Their personality
   (B) Their culture
   (C) Their income
   (D) Government policies

5 People of similar age, income and ethnicity will not always buy the same types of goods. What factor influencing consumer choice is reflective of this?
   (A) Culture
   (B) Lifestyle
   (C) Socioeconomic status
   (D) Government

6 What are two economic factors influencing consumer behaviour?
   (A) Culture and lifestyle
   (B) Income and financial commitments
   (C) Culture and socioeconomic status
   (D) Perception and culture

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7 Isam has applied to a religious council to receive approval for the ingredients of the products he uses in his food business. He believes this will allow his business to better cater to the religious needs of his customers. What factor has influenced Isam's decision?
   (A) Socioeconomic status
   (B) Culture
   (C) Income
   (D) Learning

8 A consumer's decision to buy up-market clothing brands would be influenced by which factor?
   (A) Culture
   (B) Personality and self-concept
   (C) Government policy
   (D) Motivation

9 The Reserve Bank of Australia has lowered interest rates as a way of encouraging consumers to increase their level of spending. Which government policy is this an example of?
   (A) Monetary policy
   (B) Fiscal policy
   (C) Microeconomic reform
   (D) Industry reform

10 Which of the following represents a criticism of the concept of sugging?
   (A) Its ability to promote products in a misleading manner
   (B) Consumers are made to believe that the purpose of the questionnaire is legitimate market research
   (C) Consumers pay higher prices
   (D) The business is able to identify the needs of consumers in a deceptive way

Short-answer questions

1 Explain how economic and government factors influence a business's marketing plan during a downturn in economic activity.

2 Describe the role of ethics for a business developing a marketing campaign.

Extended-response question

Identify the factors influencing consumer choice and examine the impact of ethical and legal regulations on the process of marketing of a product.

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CHAPTER 8

Marketing process



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Product analysis
Examines the current position of the goods and/or services that a business produces in the marketplace.

Planning is a central activity of any organisation. It allows a business to examine its current position within the market, consider opportunities to strengthen that position and determine the most effective method of implementing the required changes. This chapter examines the common elements involved in developing a marketing plan. These elements exist in all marketing plans regardless of the business's size, activity or legal structure. They are summarised in Figure 8.1. How businesses develop the elements will vary. Some businesses have specialised marketing departments to devote considerable financial and human resources to its plan. Smaller businesses may engage the services of marketing firms, which would be an example of outsourcing.

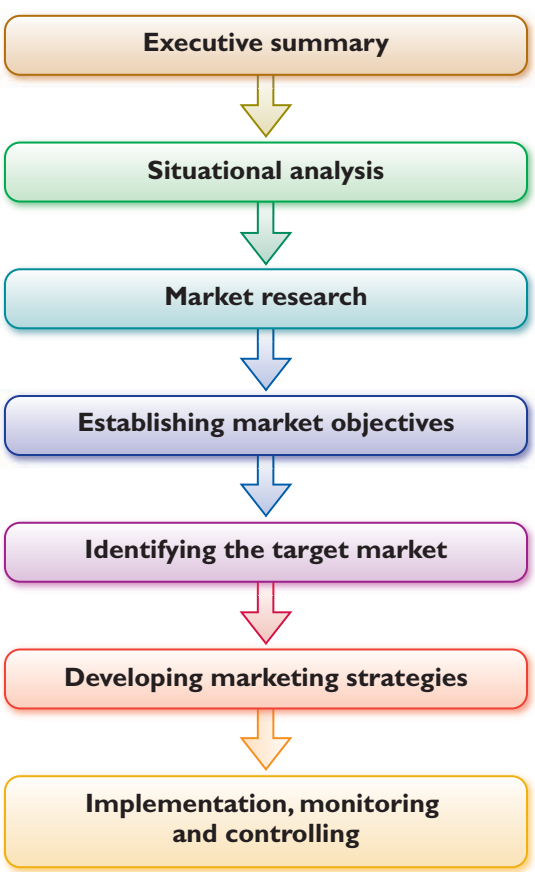


Figure 8.1 The elements of a marketing plan.

The executive summary

The executive summary provides a brief description of current issues facing the business. It provides an overview of the goals and strategies that are to be featured in the marketing plan. A short summary of the main recommendations to be presented in the plan is also provided.

The situational analysis

The situational analysis provides the firm with an opportunity to examine its current position within the market. The business will examine such areas as:

- the market share of its product
- future trends within the market
- strategies used by competitors
- changing consumer tastes and preferences.

There are two key elements to a situational analysis when presenting a marketing plan.

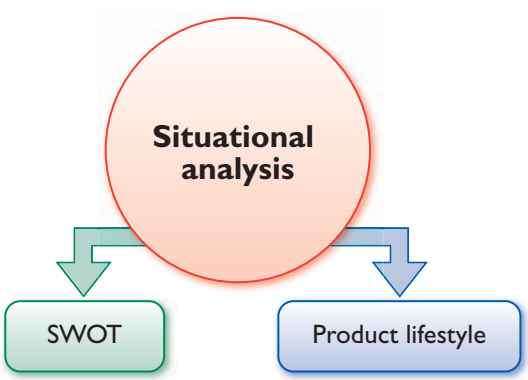


Figure 8.2 The two components of a situational analysis.

Business life cycle

Product analysis examines the current position of the goods and/or services that a business produces in the marketplace. Changing trends, innovation, product prices, sales and profit margins will

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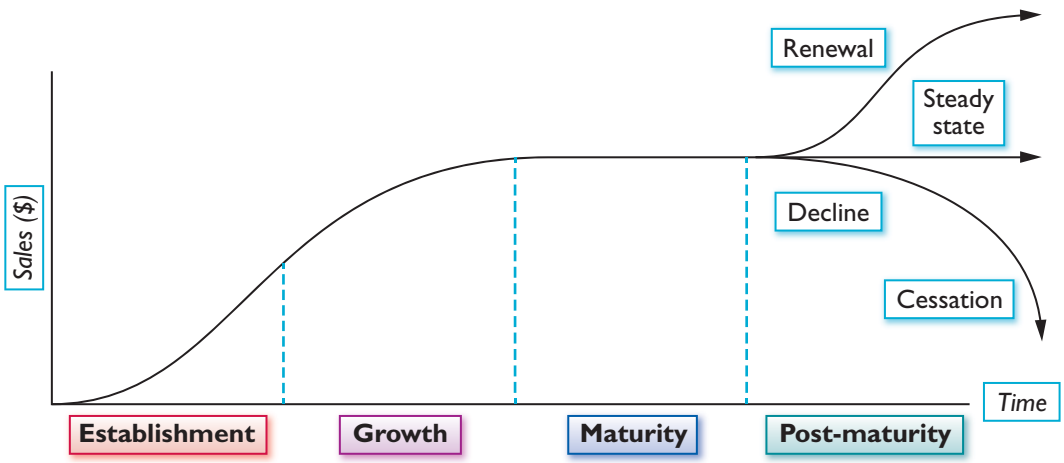


Figure 8.3 The business life cycle.

Business life cycle

The different phases a business and/or its product will often go through over the course of its existence.

impact on the success of a product within the marketplace and it is something all businesses will experience. A business or its product will often go through different phases over the course of its existence. This is known as the **business life cycle**. There are four phases, or stages, to the business life cycle: establishment, growth, maturity and post-maturity (as outlined in Figure 8.3).

When looking at the business life cycle it is important to remember two key points:

- The business life cycle can apply to a particular product that the business provides and not the business itself, as some businesses sell more than one product or brand.
- Not all business will experience all four stages in the cycle. If a business is able to successfully adapt to changes within the environment in which it is operating it will be able to avoid the final stage of decline.

Establishment stage

The establishment stage of the product life cycle is when the new product is first launched. Establishment takes time. Sales growth may be slow because the business is only beginning to establish awareness of the product in the market and needs some time to develop a loyal customer base. Profits are limited because of the lack of revenue, while costs, which include fixed expenses (such as rent and insurance), are high. Management may decide to launch the product with a high price accompanied by limited promotional spending. The high price may assist in recovering some of the establishment costs and develop an image of product quality among consumers. The limited promotional spending will keep costs down. Consumers may be willing to try the product and are often prepared to pay the higher price for this privilege. However, limited expenditure on promotion could hinder the business as it attempts to gain market share. On the other hand, a business may launch a product with a low price to establish quick entry into the market and make considerable expenditure on promotion. This pricing strategy is known as penetration pricing (discussed in detail in Chapter 9). Aldi Supermarkets have been successful through the use of this pricing strategy. Since its establishment in 2001, the grocery store has heavily promoted itself on its low-cost items.

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Growth stage

If a new product can begin to attract a core group of customers who display their loyalty to and satisfaction with the product by making repeated purchases then the business will enter the growth stage of the product life cycle. The business's profitability will grow as sales expand. Attracted by opportunities for profit, competitors will enter the market. The marketing strategies of the business will also change. Businesses may choose to lower their price to deal with the increased threat of competitors in the market or consider the possibility of expanding their distribution channels to allow greater access by customers in areas where other competitors are showing signs of success. It is also expected that promotional costs will increase during this stage in a product's life cycle.



Figure 8.4 Aldi has been very successful in using penetration pricing strategies to increase its market share in the Australian grocery market.

Maturity stage

The maturity stage is the period of the product life cycle where sales will begin to slow. The business is faced with a steady income stream with limited prospects for growth. Both the business's product and competing products are readily available. Consumers now have considerable choice as to where to purchase the product from. At this stage the business must modify its marketing strategies to ensure continued success. During this stage it is important that the business establishes a competitive advantage by differentiating itself from its competitors. This could include strategies of price differentiation, after-sales service, unique forms of promotion or making it easier for consumers to access the product.

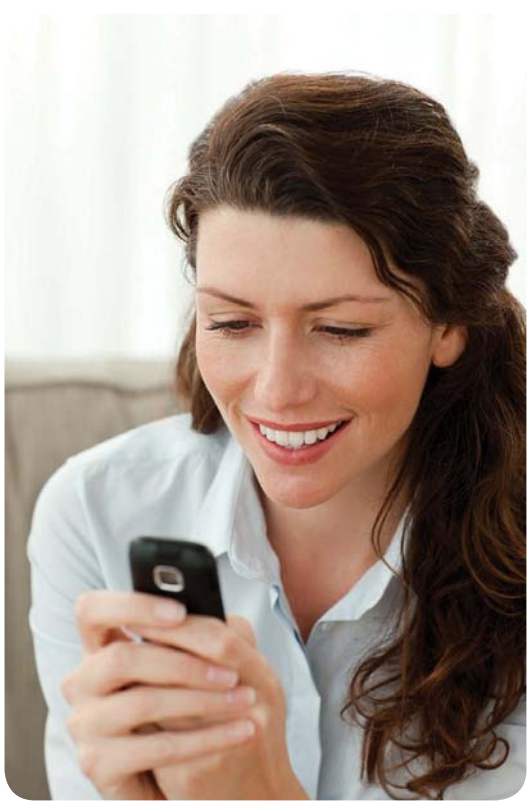


Figure 8.5 Mobile phones combined with internet technologies are a source of considerable growth for Australian telecommunication companies.

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BUSINESS BITE

The considerable growth of the mobile phone market in Australia has forced Australian telecommunications companies to devote more of their resources to marketing strategies geared towards 'bundled' products. Telstra and Optus, for example, have devoted fewer financial resources to the use of fixed-line phones, seeking to promote mobile, internet and pay television packages. Both telecommunication businesses also promote the use of internet technologies on mobile phones. This is seen as a considerable area of sales growth for the businesses.

Post-maturity stage

The post-maturity stage is the final phase of the business life cycle. During this stage, key decisions will be made that will ultimately affect the long-term survival of the business. By now the business is an established organisation within the market. Increased competition and changing consumer preferences may create the need for change. During the post-maturity phase the long-term future of the business will be dictated by one of four paths:

- decline
- renewal
- steady state
- cessation.

Decline stage

During the decline stage, the business faces a marketplace where there is increased competition and changes in the business environment. Its product no longer meets the needs of consumers and/or is considered to be outdated and irrelevant to their needs. Marketing strategies implemented by the business would aim at revitalising the product. Should these strategies prove to be unsuccessful in the marketplace, the closure of the business may be inevitable.

Renewal stage

To restrict the impact of increased competition and to re-establish itself with a competitive edge, the business may look to revitalise its product. The business may alter the product's features or packaging and relaunch the product as it seeks to invigorate the image and perception of the product in the marketplace. Many businesses develop new promotional campaigns aimed at sustaining interest in a particular brand. Alternatively, new strategies may be developed to take the product to a new audience.

BUSINESS BITE

Bonds have been highly successful in using Australian celebrities Pat Rafter and Sarah O'Hare to promote the Bonds range of underwear to a younger market. People in the 18–39 age group now regard Bonds as fashionable.



Figure 8.6 The strategy adopted by Bonds to use prominent, well-respected celebrities has proven to be very successful in capturing a more youthful market.

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Ethical Issue

Should a business be able to use strategies similar to its competitors' if it found that they are more successful than those the business is using?

SWOT analysis

A SWOT analysis is used to examine the strengths and weaknesses of a business and the opportunities and threats that lie within its external environment. By working through this process, a business is able to determine what strategies would be suitable to rectify the organisation's weaknesses and how to best handle the possible opportunities and threats. Some issues to consider in a SWOT analysis are discussed below.

Strengths and weaknesses

The strengths and weaknesses of any business are factors that are developed and controlled from inside the business. Questions to consider when examining a business's strengths and weaknesses could include:

- Does the business have a good reputation amongst its stakeholders (customers, creditors, employees and suppliers)?
- Does the business have highly skilled, well-trained, motivated staff who can achieve the organisational objectives of the business?
- Is the business financially stable and does have it have the necessary funds to finance opportunities to enhance its strengths, improve its weaknesses, take advantage of possible opportunities and deal with threats?
- Is the business recognised for the high quality of its products and its ability to meet changing trends within the marketplace?

Activity 8.1 Comprehension

1 Examine how a SWOT analysis assists a business to consider its current position within the marketplace.

2 Discuss how the different stages of the product life cycle influence a business's choice of marketing strategies.

Opportunities and threats

The opportunities and threats of any business are factors that are developed from the external business environment. The business has very limited control as to how or when these issues arise. Questions to consider when examining a business's opportunities and threats could include:

- What is the degree of competition in the marketplace and does this impact on the business?
- To what extent is the business subject to changes in its external business environment (such as interest rates, the economy, wage growth and industry assistance) and do they provide avenues for the business to grow?
- Are competitors reacting to the business's products by producing less expensive substitutes?
- Is the competitors' performance sufficient to place pressure on the business to reduce its cost base?
- To what extent is the business responding to changing tastes and preferences within the marketplace?

For a business to be effective and successful, it should constantly work

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to consider the needs of its consumers. Business goals must be developed in a way that, if achieved, will not only benefit the business but also ensure consumers are satisfied with their purchase of the business's product. It should consider the impact that changes in its external environment will have on the future operations of the business and how these changes will influence the marketing function of the business. Market research is an essential component of any business activity. It allows a business to gather information that is relevant to its needs and those of its clients. It provides businesses with data so that informed and intelligent decisions can be made regarding various issues.

Market research

When conducting market research, it is important that the business first determines its information needs; that is, the business should have some idea about the type of information it is looking for. It could vary from customer profiles or brand awareness through to attitudes towards certain new products. Once its information needs are established, the business can determine the most appropriate research method.

Data collection (primary and secondary)

There are two types of data that an organisation may seek to gather: primary and secondary.

Primary data refers to information that is collected for the specific purpose for which it will be used. For example, if Myer conducted research to determine the age bracket of its customers visiting a specific store, the data it gathered would be primary data. It would be primary data because it was gathered only to fulfil the specific purpose of the research; that is, to find out the age profile of Myer customers.

Secondary data refers to information that already exists, having already been collected for another purpose. Myer, for example, may use the information that it collected from earlier market research to make comparisons with current data. It may want to study the data collected from past research into the age profile of its customers and compare it with the current data. It may also want to examine previously collected (that is, secondary) data about the type of purchases and amounts of money spent by these customers. Given that this information already exists and was collected for another purpose, it is an example of secondary data.

Primary data

There are three common types of market research that can be used to collect primary data.

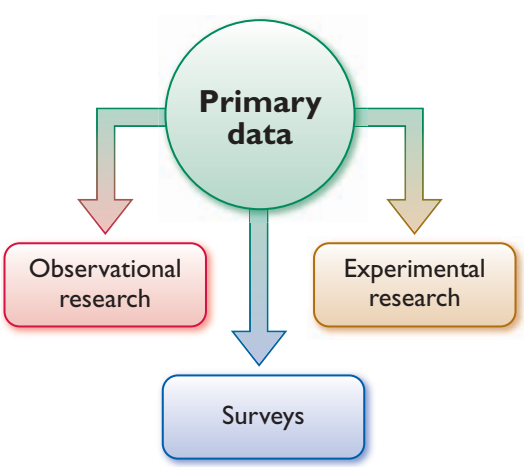


Figure 8.7 Types of market research used to gather primary data.

Primary data
Information that is collected for the specific purpose for which it will be used.

Secondary data
Information that already exists, having already been collected for another purpose.

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Observational research

Observational research is the process of gathering primary data by observing a relevant group of people, their actions and how they respond to certain situations. For example, researchers for a department store may observe the number of people who stop to look at a display located in a particular area of the store and their responses to the display.

Surveys

Surveys involve gathering primary information by asking a number of people the same questions. These questions could be about the respondent's knowledge, attitudes, preferences and buying behaviour.

Experimental research

Experimental research is used to examine how people react to different products and features. For example, two versions of the one movie may be shown to two different audience groups. Each version is the same except for the last few scenes. This will allow the film company to determine which ending receives a better response from the audience.

Secondary data

Businesses may access secondary data from internal or external sources.

Internal sources

Internal sources of secondary data are those within the business itself. Data from these sources have been collected by the business. These data can include annual and financial reports, prior research, past surveys and previous sales figures. Businesses may use internally sourced data to make comparisons between past and present results. For example, if a business sought to compare its current sales performance against that of previous years it could obtain data collected from previous years. Changes in profitability from one year to the next could be examined by looking at previous reports describing conditions under which the business was operating in previous years.

Ethical Issue

To adequately understand the needs of its consumers, a business must encourage regular feedback from them. Do you agree that a business has a responsibility to ensure that its customers know how to contact the business and that staff members are willing to listen to customers' feedback?

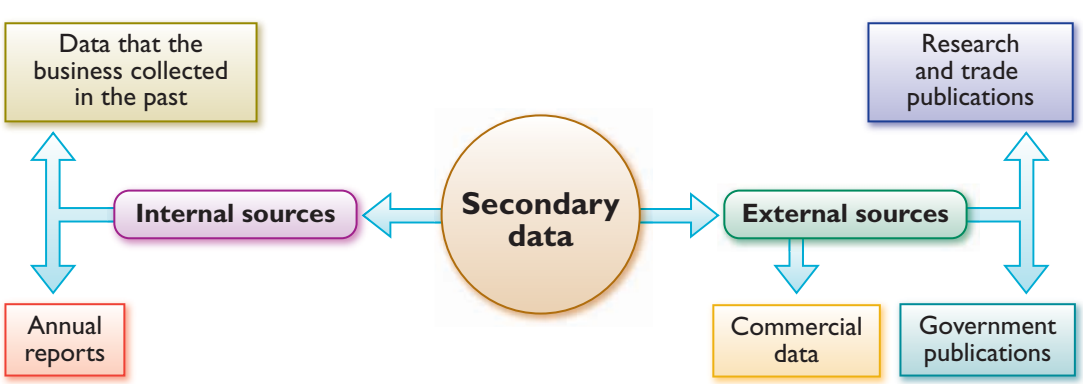


Figure 8.8 Sources of secondary data, with examples.

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External sources

External sources of secondary data are sources that exist outside the business. These data have been collected by other organisations or individuals. If the business wants to use these data it may need to pay the organisation that owns the data. However, much secondary data from external sources are readily available to interested parties at no cost. These include government publications, generally from the Australian Bureau of Statistics, and books, magazines and the internet.

Data analysis and interpretation

After a business has gathered the information it requires, it must then make some meaning of it. The business will attempt to analyse and interpret the data so that management can gain a better understanding of the impact of the data on the operations of the business. Once this has been achieved, management is able to determine the most appropriate course of action to take.

Activity 8.2 Comprehension and research

1. Outline the difference between primary and secondary data.
2. Develop a survey based on the shopping habits of your Business Studies class. The survey questions should consider:
   - the types of shops visited
   - the reasons for visiting specific stores
   - how often the student would visit the store.

   Once you have completed the survey, you could:
   - a Display your survey results in a bar graph.
   - b Examine current promotional material from the businesses identified by your class, and consider their effectiveness in reaching the businesses' desired target market.

Establishing market objectives

The objectives of a business provide the framework for the business to develop a series of activities and operations that aim to achieve these objectives. In essence, the objectives, or goals, guide the activities of the business. It is important that the goals be flexible so they can be adapted to the changing nature of the business environment.

BUSINESS BITE

The success of Network Ten's *MasterChef Australia* has seen consumers taking a more active and informed interest in the types of food-based television programs. In response to this, all major television stations across Australia, including Seven, Nine, ABC and SBS, now offer programs that feature cooking. These family friendly and feel-good programs have achieved some extraordinary viewer numbers. Changing circumstances in the businesses external environment meant that new objectives were set and strategies established for each network.



Figure 8.9 *MasterChef Australia's* success has seen many other cooking shows developed and now featured across Australian television.

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Businesses generally adopt a SMART approach to setting objectives; that is, an objective needs to be:

- **S** = specific – the objective needs to be clear and precise and relate to specific elements of the business.
- **M** = measurable – the business needs to develop controls that are effective in measuring the extent to which the goal has been achieved.
- **A** = achievable – the business needs to have the financial and human resources required to achieve the goal.
- **R** = realistic – the objective should not be based on unreasonable expectations; that is, it must be possible for the business to achieve the objective.
- **T** = time – the time frame within which the business hopes to achieve the goal must be determined.

General market objectives

There are three general market objectives that most businesses may adopt: increase market share, expand into new geographic markets and expand the product range. An effective business is one that develops goals that relate to the specific needs of its organisation.

Increase market share

Market share refers to the percentage of total sales a business has compared with its competitors in a particular market. The purpose of attempting to increase the market share of a business is to increase the business's sales and profitability. Achieving this objective allows the business to become stronger and more dominant in the marketplace. Sydney radio station 104.1 2Day FM has been highly successful in maintaining its market shares amongst radio listeners aged between 18–39. A key component of this success has been the use of highly-publicised radio personalities, competitions offering unique prizes and its rotation of new music.

Expand into new geographic markets

Some businesses may decide to expand the areas where their goods and services are distributed. This allows a business to increase its sales but, more importantly, allows the brand or product to achieve a higher level of awareness amongst an increased number of customers. In recent years, Australia has seen a considerable growth in the number of international fashion boutiques. For example, Spanish fashion brand Zara has recently opened up in Sydney, Australia. Zara is perceived by many young adults as having contemporary clothing at affordable prices. Zara's Sydney store is the first of its kind in the Pacific. This is a new geographic market for this firm.

Expand the product range

The extension of a business's product range presents the business with a number of opportunities. Providing a wider range of products may allow the business to target new markets in order to attract consumers who have not previously purchased its brands. The new products may not be substantially different from the existing brands but will be promoted and distributed in a way that reaches new markets. Unilever, for example, has two similar beauty product brands: Dove and Lux. Each brand is aimed at a different target market. The business develops, promotes and distributes both brands in order to establish a broad customer base.

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Figure 8.10 Unilever has two brands of beauty products, ensuring the company maintains a broad customer base.

Activity 8.3 Matching

The objectives and explanations below are in the wrong order. Match each objective with the correct explanation.

Table 8.1 Objectives and explanations

Objective	Explanation
Expand into new geographic markets	Provide a wider range of produce to target new markets in order to attract consumers who have not previously purchased its brands
Expand the product range	Increase the percentage of total sales a business has compared with its competitors in a particular market
Increase market share	Expand the areas where the products are distributed

Identify target markets

A target market is a group of consumers for whom a particular product has been developed. The business hopes that these people will buy the product when it is made available in the marketplace. Some products appeal to all consumers, while others have very limited appeal. To identify the appropriate target market for its product, a business needs to understand the nature of consumer markets. Consumer markets are the most recognised market within the business environment. It is where businesses sell their products directly to consumers. Often the business would have purchased the products from other businesses not dealing in the consumer market. For example, Sony and Panasonic are manufacturers of many popular home

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entertainment appliances. While they manufacture the items, stores such as The Good Guys, Bing Lee, Myer and David Jones act as the market where consumers can access these brands.

Types of consumer markets

Consumer markets can be broken down into a number of different categories.



Figure 8.11 The three types of consumer markets.

Mass market

The mass market consists of all consumers; that is, people of both genders and of all ages, geographic locations and income levels. Products targeted to the mass market are not aimed at a specific buyer group. Instead, mass market products appeal to all consumers. We all consume these products and there are limited strategies a business can use to make these products different from competing products. Some of the ways the business can differentiate their products is through packaging, brand loyalty, price or the offer of customer loyalty products. It is in these areas that a business operating in the mass market would attempt to gain a competitive advantage.

Market segments

A business may choose to target its products to a specific market segment; that is, one area of a particular market. A business decides to segment its market to ensure that appropriate promotional and pricing strategies are developed.

BUSINESS BITE

Channel Ten has developed products and promotional strategies aimed at attracting the 16–39 years demographic. People in this age group have a high willingness to spend, making them an attractive target for advertisers. Many of the television programs featured on Network Ten cater to a teenage-to-young-adult audience. News and current affairs play less of a role in the channel's program schedule. This is an example of targeting a market segment of, in this instance, the broader television-viewing market.

Activity 8.4 Develop a map

Construct a mind map of the three different types of consumer markets. For each market, provide a simple definition and two examples of businesses and their products operating within these markets.

Niche markets

Each market segment consists of a number of smaller markets, called niche markets. A business targeting a niche market has a specific, narrow customer base. For example, Fernwood gyms were established to cater for the growing number of women who sought female-only gymnasium facilities.

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Wedderburn is an international business with Australian operations. The business specialises in the production of and sale of scales. These scales are used by other businesses to weigh such items as foods and medicines. Other examples of targeting niche markets include travel agents specialising in services to specific regions and magazines for specific hobby enthusiasts.

Developing marketing strategies

Once the strategic goals of a business have been set and the organisation has established specific market objectives, the business must develop appropriate marketing strategies. The success of these strategies is crucial if the business is to achieve its objectives.

The marketing mix

Developing marketing strategies involves using the marketing mix. It is referred to as a mix because the strategies often consist of a combination of four elements: product, price, promotion and place. These elements are known as the 4Ps and are discussed as follows. (The 4Ps are covered in further detail in Chapter 9.)

Product

Product refers to the good or service the business intends to provide in the marketplace. The business must consider the product's quality, image, logo and packaging and where the product will be positioned against competitors' products; for example, whether the product will be up-market or a discount product. Consideration of this will also include decisions about the benefits attached to purchasing the product, such as warranties, after-sales service and maintenance.

Price

Price is the cost to the consumer of buying a good or service. When determining an appropriate price for a product, the business must consider its cost to the business (production and distribution), the desired profit margin and the pricing strategies used by competitors. The way consumers react to this price will also be an influence. A low price may encourage sales but some consumers will perceive the product to be of poor quality.

Promotion

Promotion is the process of creating and maintaining consumer awareness and interest towards a particular product. It is hoped that the various forms of promotion used by the business will convince consumers that they 'need' the product, ultimately translating into purchases. Traditional forms of promotion include radio, TV and newspaper advertising. Innovative methods include the use of mobile phone text messages, the internet and publicity stunts.

Place

The place element of the marketing mix refers to the methods of distribution and the availability of the good. When a business is considering this element it needs to decide where the consumer will be able to purchase the product. Issues such as storage, transportation and costs of distribution must also be considered. While some goods are readily accessible to the public, businesses may restrict the availability of others to create an image of prestige.

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Figure 8.12 Pepsi is well-known for using music stars and other popular public figures to promote its range of products.

Activity 8.5 Role-play

Role-play a scenario where you assist a customer with his or her inquiries about a particular product. The discussion between you and the customer should include:

a. A description of the product's features.
b. Where the product is positioned against its competitors.
c. The price of the product.
d. Factors influencing the price of the product.
e. Where the product is available.

Implementation, monitoring and controlling

Implementing

Once the marketing plan has been devised, a business must implement the strategies contained in the plan. Implementation is the process of organising the activities of the business to achieve goals. Successful implementation relies on the ability of management to effectively organise and lead the business. Management must ensure that the methods of production will ensure the finished goods are of the expected quality. Management also needs to make sufficient funds available to cover costs. Employees need to have the skills and training necessary to assist in the transformation process.

Monitoring and controlling

It is important that a business develops methods that management can use to determine the extent to which the implemented strategies are achieving the desired outcomes. Businesses monitor the progress of their operations through controlling. Controlling is the process of comparing actual results with the results that the business had planned to achieve. It allows management to determine whether the organisation is achieving its objectives and the reasons why the objectives are, or are not, being met. The three common forms of analysis and control used by a business when monitoring the performance of its marketing plan are:

- sales analysis
- market share analysis
- marketing profitability analysis.

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Sales analysis

Sales analysis examines the sales of a particular product among different customer groups (age, income and location), sales representatives and times of the year. When a business has product depth (that is, when it has a range of products that appeal to a number of markets), it can use sales analysis to determine which product is performing strongly and whether one product is being sold to the detriment of another. By comparing actual sales against those forecasted, a business is able to examine how effective its marketing strategies have been. It would also take into account external factors that would have caused the differences, such as changes to interest rates, employment conditions, consumer confidence and political concerns.

Market share analysis

Market share analysis examines the sales performance of a business and compares it against that of its direct competitors. It allows management to determine whether the marketing strategies implemented by the business have increased the number of customers the business has and the extent to which these customers have come from competitors. Market share analysis is a very useful tool in examining the strengths and weaknesses of a business's marketing plan in comparison with the plans of its main competitors.

Marketing profitability analysis

Marketing profitability analysis is the process of evaluating the financial (such as profit and sales) and non-financial (such as brand awareness and customer satisfaction) benefits that have been achieved by a specific marketing plan against the costs of implementing the plan. This form of control is based on the concept of cost benefit analysis. It involves asking whether the financial and non-financial benefits achieved by a marketing plan can be justified based on the cost of implementing the plan.

Revising the marketing strategy

While monitoring and controlling the marketing plan is essential, the business must also adopt revised strategies, when necessary, to ensure its continued success. The extent to which the marketing strategies are altered will depend on whether the business has achieved its objectives, as well as by relevant changes in the business environment.

Sales analysis
An examination of the sales of a particular product among different customer groups, by sales representatives and during various times of the year.

Market share analysis
An examination of the sales performance of a business and its comparison with that of its direct competitors.

Marketing profitability analysis
The process of evaluating the financial (such as profit and sales) and nonfinancial (such as brand awareness and customer satisfaction) benefits that have been achieved by a specific marketing plan against the costs of implementing the plan.

BUSINESS BITE

The global financial crisis saw considerable uncertainty regarding people's employment across many world economies, including Australia's. During this time, many businesses engaged in heavy discounting as a way of maintaining customer interest in their products.

Activity 8.6 Discussion

1. Discuss the purpose of a business developing a financial forecast before implementing its marketing strategies.
2. Suggest two reasons why a business may consider revising its marketing plan.

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Chapter summary

- Planning is a central activity of any business. It allows a business to examine its current position in the market, consider opportunities to strengthen that position and determine the most effective method of implementing the required changes.
- The elements of a marketing plan are:
  - the executive summary
  - the situational analysis.
- The purpose of market research is to:
  - establish market objectives
  - identify the target market
  - develop marketing strategies
  - implement, monitor and control.
- The executive summary provides a brief description of current issues that are facing the business and an overview of the main goals and recommendations that will be presented in the plan.
- The situational analysis provides the firm with an opportunity to examine issues the business is currently facing within the market. The two key elements to a situational analysis are:
  - product life cycle
  - SWOT analysis.
- Market research is an essential component of any business activity. It allows a business to gather information relevant to its needs and those of its clients. It provides businesses with data, ensuring they can make informed decisions.
- When conducting market research it is important that a business determine what type of information it needs and how this information will be used to assist the business.
- Primary data refers to information that is collected for a specific purpose. Types of market research that can be used to obtain primary data include observational research, surveys and experimental research.
- Secondary data refers to information that already exists somewhere, having already been collected for another purpose. It can either be internal or external.
- Once a business has gathered the information it needs, it must analyse and interpret the information so it can understand the impact of the data on the operations of the business.
- Market objectives need to be SMART; that is, specific, measurable, achievable, realistic and have a time frame.
- The general market objectives of a business are to increase its market share, expand into new geographic markets and develop its product range.
- A target market is a group of customers for whom a business has developed a product. The three categories of target markets are:
  - mass markets
  - market segments
  - niche markets.

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- Developing marketing strategies is the process of developing a product that meets the needs of consumers and then implementing a series of promotional, pricing and distribution strategies to encourage the consumer to purchase the product.
- The marketing mix is made up of four key elements: product, price, promotion and place.
- Implementation is the process of organising the activities of the business to achieve goals.
- Controlling allows management to look at whether the organisation is achieving its objectives and determine the reason for this.
- The three common controls used by businesses to monitor their marketing plan are:
  - sales analysis
  - market share analysis
  - marketing profitability analysis.

Chapter revision task

Tonad Consulting has provided you with a summary of its report to the owners of Arabia, a well-known Middle Eastern restaurant located in Sydney's inner west. The summary is given below. Read the summary and then answer the questions below.

> Arabia is one of the northern beaches' most respected eateries. It is held in high regard for the quality of its food and the outstanding service it provides. Its client base, 30–45-year-old females, tends to be very loyal.
>
> Rising rental costs have forced the owners of the restaurant to consider increasing the price of all main meals. They are showing some hesitation in doing this as a newly established competitor in the area has been successful in attracting a more diverse group of customers to its restaurant.
>
> It is recommended by our consulting firm that Arabia use local-based advertising to generate increased awareness of its outstanding products and service. It is very likely that the rising rents will force an increase in prices. However, we believe that when more consumers become aware of the business, Arabia will benefit through increased revenue.

1. Identify which stage of the product life cycle Arabia is in.
2. Discuss two strengths of Arabia.
3. Identify the name given to the type of market Arabia has targeted.
4. Identify two threats facing Arabia.
5. Recall the name given to the customer group of Arabia's competitor.
6. Outline two marketing strategies the consulting firm recommends Arabia use.
7. Outline the market objective the consulting firm best believes the restaurant should pursue.

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Multiple-choice questions

1 Painaway is a recognised and trusted form of minor pain-relief medication. In a SWOT analysis, what would Painaway's reputation be considered to be?
- **(A)** A strength
- **(B)** A weakness
- **(C)** An opportunity
- **(D)** A threat

2 Due to heavy discounting and changes in peoples travel patterns, a budget motel has ceased trading. During which stage of the product life cycle is the business presently in?
- **(A)** Establishment
- **(B)** Growth
- **(C)** Post-maturity – decline
- **(D)** Post-maturity – renewal

3 What do market segments allow a business to do?
- **(A)** Develop and sell its product to a number of different markets
- **(B)** Identify the characteristics of people who will most likely purchase its product and then develop appropriate promotional and pricing strategies
- **(C)** Choose a price that appeals to a select group of customers
- **(D)** Examine the purchasing trends of its target market

4 What is the name given to the core group of customers to whom a business primarily promotes and prices its products?
- **(A)** Target market
- **(B)** Market segment
- **(C)** Niche market
- **(D)** Mass market

5 Which statement best describes a product targeted at a niche market?
- **(A)** A product with high turnover and a large consumer base
- **(B)** A product with appeal to large groups of customers
- **(C)** A specialised product with appeal to one segment of a market
- **(D)** A product with little or no differentiation between it and competing products but with wide appeal

6 Better Bread has released a new form of bread aimed at children. Which word best describes the market to which this product is targeted?
- **(A)** Consumer
- **(B)** Mass
- **(C)** Differentiated
- **(D)** Niche

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7 *Antoinetta* is a new magazine aimed at young adults who display an interest in cooking. To which type of market is this product being targeted?
   (A) Micro
   (B) Niche
   (C) Concentrated
   (D) Segment

8 Market objectives can, at best, guide the operations of a business but cannot dictate its actual progress. What would be the best reason for this?
   (A) A business may lack the human and financial resources necessary to achieve the objectives
   (B) Any business is subject to the forces of its external environment, which can easily impact on the operations of the business
   (C) Management may decide to review the marketing plan and alter any strategies that it regards as ineffective
   (D) Market objectives tend to have a short-term time frame and therefore are in constant need of change

9 What is market research?
   (A) The process of examining market trends and their impact on the operations of a business
   (B) The study of consumers' buying behaviour
   (C) A process of gathering information relevant to the needs of the business and those of its clients
   (D) The study of the operations and practices of a business's competitors

10 What do external sources of secondary research refer to?
   (A) Data that have been collected by the business for a specific purpose
   (B) Data that have been previously collected by the business and are used for a different purpose
   (C) Data that are not collected by the business and are to be used for a specific purpose
   (D) Data that have not been collected by the business and are used for a variety of purposes

Short-answer questions

1 **(a)** Explain what is meant by a situational analysis.
   (b) Describe the four key elements of a situational analysis.

2 **(a)** Outline the different types of target markets that exist in the consumer market.
   (b) Provide examples of businesses appropriate to each market.

Extended-response question

> Helen's is an upmarket fashion boutique store in Sydney's east. Falling sales have been reflected by surveys that reveal consumers' view the business as outdated and no longer relevant to consumers' needs. Strong competition in the area has placed considerable pressure on pricing. The business's target market, 50–65-year-old females, no longer dominates the now younger demographic character of the area.

Develop a marketing plan for the business that suggests how Helen's may improve its performance.

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CHAPTER 9

Marketing strategies

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When devising a marketing strategy, it is important that a business has a clear understanding of the consumers to whom it believes the product will appeal; that is, who its target market will be. Once this has been established, the organisation will develop appropriate promotional and pricing strategies that cater to the needs of this target group. The business will also need to consider appropriate locations to sell the product.

Market segmentation

The wide variety of goods and services that businesses produce is a reflection of the diverse range of tastes, preferences and attitudes of consumers. In fact, only a limited number of products appeal to all consumers, irrespective of age, income, gender or cultural background. As we have seen, these products form part of the mass market – they cater for the needs of the whole market. Examples include electricity, gas, rail services and postal services. **Market segmentation** is the process of breaking down a total market into small markets based on the similar characteristics of a customer group. It allows businesses to focus their efforts and resources on a section of the market. By focusing on a particular target group, a business is able to identify the specific needs of this group and tailor its marketing plan accordingly. It would consider the features that consumers of this target group would be looking for in a product, the appropriate promotional strategies to generate awareness of and sustain interest in the product, and the most suitable pricing policies and distribution channels.

Methods of market segmentation

Geographic segmentation

Geographic segmentation is the process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations, states or local government areas. A business may choose to operate in specific geographic areas so it can focus on exclusively meeting the needs and wants of people in those areas.

This presents the business with an opportunity to adjust its marketing plan to suit the buying behaviours of consumers in specific geographic locations. McDonald's India, for example, does not use beef or any beef-related product. This is because of the spiritual and religious beliefs of India's predominantly Hindu population.

Market segmentation

The process of breaking down a total market into small markets based on the similar characteristics of a customer group.

Geographic segmentation

The process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations, states or local government areas.



Figure 9.1 The different types of the same product available reflect the growing segmentation of the consumer markets for this basic product.

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Demographic segmentation

The process of dividing a market into smaller markets based on the customers' age, gender, income, family size and level of education.

Demographic segmentation

The demographics of a customer group refer to the characteristics of the group's members, such as their age, gender, income, family size and level of education. **Demographic segmentation** is one of the more common forms of market segmentation. It most often includes consideration of age, gender and income.



Figure 9.3 Magazines often use age segmentation to attract a different reader group.

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Age

Consumers will demand different products at different stages of their life. Therefore, the marketing strategies used by a business will need to incorporate features that appeal to specific age groups. *Total Girl* is an Australian-based magazine that caters to the interest of the female tween market. This market represents girls aged 9–13. Older teenagers may read *DOLLY* magazine, with young adult woman having an interest in such magazines as *Cleo* and *Cosmopolitan*.

Gender

Market segmentation based on gender has been widely used by businesses for a range of products, including clothing, magazines, soft drinks and motor vehicles. It aims to break down the market of a product based on gender influences. Some products and services are marketed in a way that will have more appeal to either females or males.

BUSINESS BITE

Triple MMM is a Sydney-based radio station that caters to the listening habits of adult males. They have a strong emphasis on rock-style music and seek to incorporate sporting-based news and features into their breakfast program.

Income

Income influences the types of goods and services people buy. Some businesses develop products aimed at high-income earners who have the capacity to purchase luxurious goods. Certain car manufacturers, clothing designers and service providers use this form of market segmentation to sell their products. It allows them to decide on the most appropriate promotional and pricing campaigns and the suitable location for their business.

While having appeal to all income groups, discount department stores (such as Big W and Kmart) have been successful in promoting their stores as providing value for money. This would have considerable appeal to low to middle income earners.

BUSINESS BITE

Hugo Boss is one of the world's leading male fashion houses. Its clothes are aimed at individuals with a high income. Hugo Boss stores are located in Sydney's central business district and eastern suburbs. These areas are distinguished by the high average income and socioeconomic status of consumers who shop there.

Psychographic segmentation

Psychographic segmentation allows a business to segment the market into different groups based on consumers' lifestyle, personality, values and interests. For example, sporting equipment retailers (such as Rebel) divide their stores into sections based on the different sports. Part of a store will specialise in cricket clothing, while another section is for gym enthusiasts and another caters for people with outdoor leisure pursuits. The store layout reflects the community's wide range of sporting interests.

Psychographic segmentation

The process of dividing a market into smaller markets based on consumers' lifestyle, personality, values and interests.

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Behavioural segmentation

The process of dividing a market based on people's knowledge of, attitudes towards and use of a product.

Behavioural segmentation

Behavioural segmentation is the process of dividing a market based on people's knowledge of, attitudes towards and use of a product. When using this form of market segmentation, a business may consider four factors. These factors are discussed below.

Purchase occasion

The business will consider when a customer is most likely to purchase its product. Florists, for example, will vary their promotional and pricing strategies throughout the year to suit the significant occasions when people commonly buy flowers and to target the group who usually buy the flowers for the particular occasion. For instance, marketing strategies leading up to Valentine's Day will target men, whereas strategies for Mother's Day may aim to appeal to children and fathers, as they commonly buy flowers for this occasion.



Benefits sought

An understanding of the benefits consumers seek from a purchase is an important facet of behavioural segmentation. Businesses can divide the market according to what customers want from a product.

Usage rate

Usage rate is a factor influencing this form of market segmentation. It allows a business to differentiate its customer base by establishing how often customers use the business's good or service. Broadband internet companies have adopted this strategy by offering different groups of consumer's different internet packages, depending on their internet usage requirements.

User loyalty

Relationship marketing is an important part of any business. It provides an opportunity for businesses to develop a loyal customer base. Businesses attempt to develop strategies that will establish and maintain customers' loyalty towards the business and its products. Credit card rewards schemes and the Woolworth's Everyday Rewards card are examples of such strategies.

Activity 9.1 Summarise

Construct a diagram that summarises the methods that a business may use for segmenting consumer markets. Include examples of products that businesses have used to segment their markets.

Product/service differentiation and positioning

Product differentiation

Product differentiation is the process whereby a business distinguishes the attributes and features of a product from those of its competitors' products. It is what the business believes will attract customers

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to its products over similar products offered by its competitors. Businesses may use a variety of strategies to emphasise product differentiation. These often focus on price and product quality.

Price

If a business intends to use **price** as the basis for product differentiation it will promote itself as being the cheapest provider of a specific range of goods. Big W and Kmart have been highly successful in using this strategy to differentiate themselves from their competitors. This is reflected by their slogans. Big W promotes itself as the store that provides consumers with 'Australia's lowest prices everyday'. Kmart uses the slogan 'Great value and everyday low prices'. Some businesses will use a business name that emphasises price differentiation. Budget Rent a Car and Supercheap Auto are two such examples.

Product quality

Some businesses attempt to differentiate themselves based on product quality. They believe that the quality of their products is what will successfully distinguish them from their competitors. Businesses often use a slogan that promotes product quality. For instance, Woolworths uses the slogan 'The fresh food people', while BMW emphasises its cars as 'The Ultimate Driving Machine'.

Service differentiation

Service is crucial to the success of any business. It is an important feature of all businesses as it involves a direct and immediate form of contact between the business and the consumer.

While small businesses may be limited in their product range and ability to provide discount prices, it is widely acknowledged that the service offered by small businesses is more personalised and effective than that offered by their larger competitors. Businesses may use a variety of strategies to emphasise service differentiation. These could include after-sales service. Some businesses recognise the importance of maintaining a relationship with their customers after the purchase. They believe that this will develop into strong brand loyalty.

BUSINESS BITE

Hyundai offers its customers a 130 000 km/five-year warranty on all its new cars. This is one of the few car companies in Australia to do so and is 40 000 km above Australian industry norms.

The marketing mix

When devising marketing strategies, businesses need to consider the four elements of the marketing mix: product, price, promotion and place (or distribution).

Products

Goods and/or services

The term *product* can refer to either a good or service. While some businesses provide consumers with products that are tangible (that is, they can be seen and touched) other businesses will offer services to consumers, which are products

Price

The cost to the consumer of buying a good or service.

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Positioning

The image that a product has in the mind of the consumer. How consumers compare one product against alternative products.

Branding

The reputation that a business or product has developed over a period of time.

that involve one person performing a task on behalf of another person. Crust Pizza, for example, provides consumers with a food product while Mobile Mechanics offers a car repair and maintenance service. A product offers a consumer tangible and intangible benefits. Tangible benefits refer to the physical attributes of the product. These can include the design, style, colour and features of a product. They can be seen, touched or used. Intangible benefits refer to the benefits a consumer associates with purchasing a product. This could include the prestige and image associated with owning a particular brand and the after-sales service a business offers its customers, such as customer care help desks, warranties and maintenance checks. When developing its marketing strategies a business must look beyond the physical attributes and features of its product. It must also consider other product-related marketing concerns, such as positioning, branding and packaging.

Positioning

Positioning refers to the image that a product has in the mind of a consumer. It is based on how consumers compare one product against alternative products. Positioning is determined by how consumers perceive the product in terms of the relationship between product quality and price. The position of some products is that of prestige and reliability.

Branding

Branding refers to the reputation that a business or product has developed over a period of time. The brand name or logo attached to a product essentially provides a message to consumers about the quality, value or prestige associated with that product. Over time, consumers come to develop expectations of certain products and brands. These expectations arise from the reputation that the products and brands have established over some time. When a consumer recognises a brand name, he or she is immediately able to form judgements on its product quality, price and value. A strong brand name is important in enhancing the relationship between a business and its customers. An organisation that is well-respected for its product quality is likely to retain its customers over a business that has encountered negative publicity due to faults in its products.

Packaging

Packaging refers to the physical appearance of the good; that is, how a good appears when it is presented for sale. While packaging has little or no impact on how the product will be used by the consumer, it is often the first image of the product that the consumer will see and therefore the image needs to be effective and positive. The packaging of a product also aims to protect and maintain the quality of the product. In recent years businesses have developed packaging to maintain and enhance the quality of the product once it has left the manufacturers. Foil wraps for food and seals for medical products are examples of improved packaging that benefit consumers. Packaging is also important because it is the last point of contact between the producer and the consumer before the

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final purchase decision is made. The packaging must offer the consumer some reason to buy the product. It could reveal the benefits of using the product or the product's features, nutritional information or colour, design and style. The packaging of services differs considerably from the packaging of goods. The packaging of a service includes, for example, the attitudes and product knowledge of the salesperson and that person's willingness to assist with customers' concerns and inquiries. When considering the packaging of a service, consumers will look at the level of service provided by the business when selling the service.

Activity 9.2 Discussion

Conduct a group or class discussion on the topic: 'Consumers are swayed more by the packaging of a product; hence, some people's reluctance to purchase generic brands. Consumers can, at times, be more interested in how it looks than how it works'.

Price

Price refers to the amount of money a business charges for the purchase of its products. It is often one of the most influential considerations for a consumer before purchasing a good. The price charged by the business must reflect the position and branding of the business or product within the marketplace. A brand that is well-established and highly regarded in terms of reliability and value may sell for a higher price with the expectation that consumers will pay for the perceived benefits of using the brand.

Pricing strategies to generate fast sales

Penetration pricing

A **penetration pricing** strategy refers to setting prices at the lowest possible price to gain an immediate group of customers. It is used to penetrate a market and gain market share rapidly by setting a price much lower than competitors. Penetration pricing aims to undercut the main competitors of the business and act as an encouragement for consumers to switch over to the new product. Once a loyal group of customers has been developed, it is expected that the business will raise its prices. By this time, it is hoped that consumers are attracted to the product for its features and reliability more so than its price.

Loss leaders

The **loss leader** pricing tactic involves providing a limited number of goods at a price that generates minimal profit or even a loss to encourage consumers to purchase goods from the business. A business using this strategy will lose money on the loss leader goods it sells if the price is set below the cost of making and supplying the goods. The aim of this pricing structure is to entice consumers into a store with the availability of some stock that is relatively inexpensive. It is hoped that, once in the store, consumers will purchase other goods, which will be slightly more expensive than those of competing businesses.

Product-deletion pricing

The **product-deletion pricing** strategy is used to clear stock that the business believes is no longer selling or attracting interest from consumers. The purpose is to quickly

Penetration pricing

A pricing strategy where prices are set at the lowest possible price to gain an immediate group of customers.

Loss leader

A pricing strategy that involves providing a limited number of goods at a price that generates minimal profit or even a loss to encourage consumers to purchase goods from the business.

Product-deletion pricing

A pricing strategy that is used to clear stock that a business believes is no longer selling or attracting interest from consumers.

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Market skimming

A pricing strategy that is used when a business wants to recover the high costs involved in establishing a product and releasing it onto the marketplace by setting a high price.

Cost-plus pricing

A pricing strategy where the business considers the total cost to the business of manufacturing or providing a good or service to the consumer and then adds an amount to allow for a profit margin.

clear the stock from the store and allow the business to replace it with goods that are currently popular and more likely to sell.

Pricing strategies to achieve the greatest financial return

Market skimming

Some businesses are known in the marketplace for their innovative products and ability to constantly improve the features of their products. A business cannot achieve such innovation and improvements without devoting considerable funds to research and development. The **market skimming** pricing tactic is used by a business when it wants to recover the high costs involved in establishing a product and releasing it onto the marketplace by setting a high price.

Demand-based pricing

It is generally assumed that within the business environment the higher the demand for a product, the stronger the ability of the organisation to charge a higher price for that product. An organisation that prices its products based on this assumption is using the demand-based pricing tactic.

Prestige pricing

Consumers' perceptions of a product will influence the price they are willing to pay for it. This perception is influenced by product quality, reliability and the image associated with owning such a product. Prestige pricing is used for products that consumers regard as prestigious and, therefore, for which they are willing to pay a higher price to obtain.

Price including pricing methods

Cost-plus pricing

The **cost-plus pricing** tactic considers the total cost to the business of manufacturing or providing a good or service to the consumer and then adds an additional amount to allow for a profit margin.

Competition-based pricing

Competition-based pricing is a commonly used pricing strategy. It involves a business publicly stating that it will match the advertised price of the product sold by a competitor if that price is lower than the price the business is charging for the same product.



Figure 9.4 Bunnings is renowned for using the competition-based pricing strategy.

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Price points

The use of price points is a pricing strategy where a business sets different prices for similar products. The products are differentiated by their features. Examples would include mobile phone prices, where business users tend to attract lower weekday costs while consumers are offered promotional features, such as free message services and reduced weekend call rates.

Psychological pricing

Research has shown that consumers are influenced by even the most minor price difference. Psychological pricing is the pricing tactic used to take advantage of this consumer response. For example, although there is only a $1 difference, consumers will react in a more positive way to a product priced at $99 than if it was set at $100.

Price and quality interaction

Consumers often associate price with quality. Goods and services that are expensive are perceived by consumers to be of higher quality than cheaper equivalents. Lower prices are regarded as being reflective of the poor quality of the product. This perception is not necessarily accurate. Many consumers are willing to pay more for a good or service because of the perceived quality benefits. High-quality goods tend to last longer and break down less frequently than goods of lower quality. In regard to quality of services, consumers will seek the highest quality expertise and skill they can afford.

Promotion

Promotion is the most public aspect of marketing. It is that arm of the marketing mix that gives the business its public image and profile. Marketing is often the first form of information that a consumer will receive about a product. Promotion can take form in many ways. From the traditional methods of advertising through the media to more innovative methods (such as publicity stunts), promotion is a core element of any marketing plan.

Activity 9.3 Analysis

For each of the situations described below, identify the pricing strategy used by the business.

1. Longstar Air has entered the Australian domestic market with prices much lower than those of its competitors.
2. Big T is selling its televisions at cost price to encourage consumers to visit its stores and become more aware of its range of DVD recorders.
3. Samir has received a discount for making a bulk purchase of timber from Harry's Hardware.
4. Josephine Watches have an exclusive image and, therefore, are sold at a considerably higher price than watches sold by a competitor with a less up-market image.
5. Eastside Bank has lowered its fees because of a fall in the number of new customer accounts being opened.
6. Textafone has established different pricing rates for its various mobile phone packages.

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Relationship marketing
The process of building and maintaining long-term relationships with customers.

Elements of the promotion mix

The promotion mix is that part of the marketing mix that seeks to generate interest in and awareness of a particular product or brand. The various elements of the promotion mix are discussed as follows.

Personal selling

Personal selling aims to establish a direct link between the business and the consumer. It involves the process of taking the business and the product directly to the consumer. Forms of direct selling include door-to-door sales and party plans. While door-to-door sales have experienced a considerable slow-down in their popularity, party plans are now a popular method of selling due to the range of products that can be sold. No longer are these parties restricted to middle-aged women being shown displays of plastic kitchen appliances. Party plans selling jewellery, clothing, toys and make-up are increasing in popularity. A recent development is businesses using the service industry to promote a business's products and services. Hairdressers and beauticians may be given complimentary cinema tickets in return for telling their customers how much they enjoyed a particular show. The client is not aware that the service provider has been engaged by another business to sell the product in return for complimentary goods. This word-of-mouth style of personal selling is referred to as whisper marketing.

Relationship marketing

Many companies have recognised that clients represent more than a point of sale. They are, in fact, the lifeblood of the business and strongly influence the profitability and growth prospects of any business. **Relationship marketing** is the process of building and maintaining long-term relationships with customers. It involves creating a high level of customer satisfaction, value and service, thus ensuring that customers will return to the business. It is based on the concept of promoting brand loyalty among consumers. Loyal customers provide a constant client base and are likely to refer the business to family and friends. Relationship marketing is now used by many businesses. Through the establishment of a regular client base, businesses are able to offer special packages, discounts and promotional events.

Advertising

For the majority of businesses, advertising is the most public face of the promotion mix. It is the most common form of promotion used by Australian businesses. It seeks to convey a message to a broad group of customers. Advertising traditionally appears in the media (such as television and magazines); although the increasing use of e-commerce has meant that the internet has become a powerful advertising medium.

Sales promotions

Sales promotions are intended to create interest in and generate awareness of a particular product. These promotions include competitions, samples, discounts and offers to buy one and get one free.

Businesses are increasingly using the internet as a form of sales promotion. Many businesses will ask customers for their email addresses. This provides the business with a cost-effective method of attracting the interest of consumers through a variety of forms. A common promotion would

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be emailing the consumer information regarding clearance sales, customer preview evenings and discounted dining offers.

Publicity and public relations

Public relations, or publicity, is the process of creating an event for a business to generate awareness of its products and, in so doing, attracting interest in the business's activities and its products.

The purpose of these forms of promotion is to increase brand awareness. Often Australian businesses will pay overseas music and film stars considerable amounts of money to visit Australia and launch a new product. Media interest in the celebrity will always carry with it the reason why the celebrity is visiting Australia; hence, the business and its brand profile increases considerably.



Figure 9.5 Celebrities play an important role in enhancing a business sales promotion.

Businesses are increasingly using celebrities as a form of sales promotion. It is suggested that US pop singer Kelly Rowland was paid more than $120 000 to visit Australia to assist Optus in launching the iPhone 4. Rowland's visit attracted much media interest and, in turn, increased awareness of her association with Optus and the iPhone.

The communication process

Promotion is the element of the marketing mix that a business uses to convey a message. Therefore, communication is the most important aim of any promotional campaign. The promotional strategies of a business should be effective in communicating to the product's target group of customers. When developing a promotional campaign, a business should use market research. This will allow the business to develop strategies that will attract the interest of the product's intended market. Often customers are willing to purchase a product if the business's message is communicated via opinion leaders and through word of mouth.

Ethical Issue

Suggestive promotions are used to attract the attention of consumers. They generate awareness and interest. Should businesses be able to use suggestive methods of advertising to promote their products?

Opinion leaders

Businesses recognise that certain individuals in the community are highly respected and often seek to use these people to promote their products. Whether it is their profile within the community,

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Place

The methods of distribution and availability of a good from different outlets and locations.

Distribution channels

The channels by which a product is moved from the place of manufacture (the product's place of origin) to the consumer (the product's final user).

their knowledge and expertise or even their personality, these opinion leaders are used to sell a product based on their influence. The benefit of using an opinion leader is that consumers will create a link between the leader's image and reputation and the product.

Word of mouth

Word of mouth is a form of publicity over which many businesses have little or no direct influence. It involves consumers relating to others, their reaction to the use of a product, including the degree to which they were satisfied with the product. Positive word of mouth is a valuable form of promotion. Given that it is not coming from the business but from those with whom consumers associate on a daily basis (such as family and friends), consumers are likely to place more weight on word of mouth than on the biased images presented by the company. It may influence a consumer to either try the product or avoid it, depending on the information the consumer received via word of mouth.

Activity 9.4 Research

Choose an advertisement in a magazine or newspaper and answer the following questions.

1. Identify the name of the business/product being advertised.
2. Assess who you think is the target market for this business/product.
3. Classify what form of market segmentation the business used to establish this target market.
4. Distinguish if this advertisement is an unconventional or new form of advertising.
5. Evaluate how effective you think this advertisement is in appealing to its target market.

Place/distribution

Place is the fourth element of the marketing mix. It is primarily concerned with the process of distributing the product from where it is made to the consumer.

Distribution channels and reasons for intermediaries

Distribution channels are the channels by which a product is moved from the place of manufacture (the product's place of origin) to the consumer (the product's final user). The distribution process may involve a number of steps. There are three common channels of distribution that various businesses may use.

Producer to consumer

The producer to consumer distribution channel is where the good or service is produced by an individual/organisation and is then passed directly onto the consumer. There is no other business involved in the selling; that is, no intermediary is used. An intermediary is a business that purchases the final product and then takes on the responsibility of selling this product to the consumer. Examples of products with a producer to consumer channel of distribution are those provided by the services and hospitality industries, such as taxation accountants, hotels and dentists.

Producer to retailer to consumer

A producer may need to include a retailer in the distribution channel. The retailer is used as an intermediary who accesses the good from the producer and then sells it to the consumer. This is a popular method of

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Table 9.1 Advantages of the commonly used distribution channels

Producer to consumer	Producer to retailer to consumer	Producer to wholesaler to retailer to consumer
• Allows the producer to maintain control over all areas of the product, including quality control and marketing • Provides the producer with a direct point of contact with consumers, allowing a better understanding of consumers' needs	• Allows the producer to concentrate on the manufacturing component of the business's operations • The use of a retailer encourages greater distribution and access to the good	• The use of a wholesaler allows the produce to hold lesser amounts of idle stock • Marketing and sales tend to be the responsibility of the retailer, not the producer, thereby saving on costs

distribution and the retailer and producer will often share marketing responsibilities. It does, however, restrict the ability of the producer to directly examine the buying patterns and behaviour of consumers.

Producer to wholesaler to retailer to consumer

The producer to wholesaler to retailer to consumer distribution channel includes an additional intermediary: the wholesaler. In this system the wholesaler takes responsibility for distributing the product from the producer to the retailers.

Channel choice

The choice of distribution channel will influence the type of customers the product attracts, the perception of the product in the market and, above all, the ease with which the consumer is able to access the product. The distribution channels can be categorised as intensive, selective and exclusive.

Intensive distribution

Intensive distribution occurs when the product is readily available to a wide selection of stores or locations. The product is easily accessible by consumers and can be found at a number of different types of stores. Convenience items (such as milk, soft drink, confectionery and newspapers) are examples of products where intensive distribution is used.

Selective distribution

Selective distribution involves the use of a limited number of stores/locations to sell or distribute a product. This method allows a business to control where its product is sold and ensure the places chosen are consistent with the image that the business is attempting to project and that the product will reach its target market. Cue is a ladies fashion brand available at a limited



Figure 9.6 Convenience items are distributed using an intensive distribution channel.

Intensive distribution
Occurs when a product is readily available to a wide selection of businesses or locations.

Selective distribution
Involves the use of only a limited number of stores/locations to sell or distribute a product.

Exclusive distribution
A form of distribution where there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of outlets.

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Exclusive distribution

A form of distribution where there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of outlets.

number of Cue stores and also available across all Myer stores. The stores where this fashion brand is sold all appeal to the same demographic.

Exclusive distribution

Exclusive distribution is a form of distribution where there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of venues. This allows the business to maintain control of all elements of the production, distribution, sales and marketing of the product. Tiffany & Co. is one of the world's most exclusive lines of jewellery. The jewellery it designs and manufactures is only available in Australia from two stores.

Physical distribution issues

When a business is establishing how to physically distribute its product it needs to consider several issues, including transport, warehousing and inventory.

Transport

Transport refers to the process of moving goods from one location to another. Businesses must consider the length of time needed to transport goods from the place of production to the retail store, for example. The type of good being distributed will be an important consideration for the business in deciding on the best method of transportation. Many fresh foods must be refrigerated while transported and there is a limit on how long they may be stored. Transportation can be expensive and it is important that the business factors this cost into the final price of the good.

Warehousing

Warehousing refers to the process of storing products before they are distributed to the consumer. Many businesses use warehouses as a facility to store the finished products. Warehousing allows a business to build up its holding stock of a particular good. The warehouse will distribute the stock to the retailer at a later time and with minimal delay. As with transportation, warehousing is influenced by the type of good being stored and distributed. Some goods can only be warehoused for a very limited time before losing their use to the consumer. Examples of these goods, which are known as perishables, are fresh fruit, vegetables and flowers.

Inventory

For any business, it is the sale of stock that provides the business with the means to achieve its financial objectives. Stock is also referred to as inventory. A business must ensure that it has sufficient stock to satisfy consumer demand. It is also important for the business not to overstock throughout other times of the year. Overstocking may force the business to hold clearance sales where profits are reduced and may restrict the ability of the business to store new, possibly more attractive, forms of stock.

Activity 9.5 Comprehension

1. The distribution channels can be categorised as intensive, selective and exclusive. Describe these three ways that a business may sell its products to consumers.
2. Explain why a business should consider transport and warehousing issues in determining the most appropriate form of physical distribution for its products.

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People, processes and physical evidence

In recent times, business analysts have recognised that the traditional concept of the 4Ps has become outdated. It is now suggested that the marketing mix involves seven key aspects, and not just the four, as discussed earlier. The three additional Ps are referred to as the people, process and physical evidence (packaging) of the marketing mix. By adding these three aspects to the marketing mix, you get what is known as the 7Ps of marketing.

Businesses should now consider the role each of the Ps has in the marketing mix. Each of the Ps must be examined within a manner that would effectively target the business's customer base.

People

An important aspect of any organisation is having the right people to support the company's products and/or service. This can be reflected through high standards of customer service across all aspects of the business. Excellent customer service is an important element of a business seeking to maintain high levels of customer satisfaction. This may include detailed product knowledge and attending to customer concerns in an understanding manner.

Process

The relationship that the business has with its customer does not end once the consumer has purchased a product from that business. Process is the consumer's total experience of buying the product from a simple stage of searching for information to the final stage of experiencing the benefits of the purchase. All aspects of the sale process are focused on delivering to the expectations of the consumer.

Physical evidence/ packaging

This refers to the physical appearance of the product across every aspect of its presentation to the consumer. The business should consider the size, shape, colour, material and label of the packaging of the product. The packaging needs to be able to talk to the consumer as it is the final point of promotion where a business is able to communicate with an interested consumer.

Visual packaging of a product is significant in influencing customer buying behaviour. Small improvements in the packaging or external appearance of a product or service can lead to different reactions from a business's customers.

It is also important in selling and marketing services and intangible products that you can't see, but that can provide the support needed to the customer who can see and feel the physical evidence.

Physical evidence may also refer to the people within a business and the visual presentation that they display to clients. It may relate to how employees dress and act. It can refer to how your office is set up, the professionalism of staff and advertising material. In essence, physical evidence relates to every single visual element of a business.

Each aspect of physical evidence is then crucial in promoting a positive image of the business to its client's base. In recent years, a number of football clubs across New South Wales have lost significant amounts of sponsorship, as businesses no longer sought to have their image associated with the negative publicity that the football clubs were attracting.

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E-marketing

The growth of technology over the past 20 years has considerably impacted upon business operations. A key aspect of this is the manner in which businesses are able to interact with their customers. Technological mediums such as the internet have provided businesses with an opportunity to interact with customers in a manner not seen before. It serves as an area of personalised marketing, sales growth and brand awareness.

Internet marketing is also known as e-marketing. This is a broad form of marketing as it also involves the use of emails to directly liaise with and communicate with customers. E-marketing allows a business with online operations to reach a global audience. Internet marketing involves the use of a multifaceted approach to marketing. The website must be creative to attract the interest of consumers while fulfilling technical aspects of the site, ensuring the site is user friendly and suitable for the intended audience to navigate.

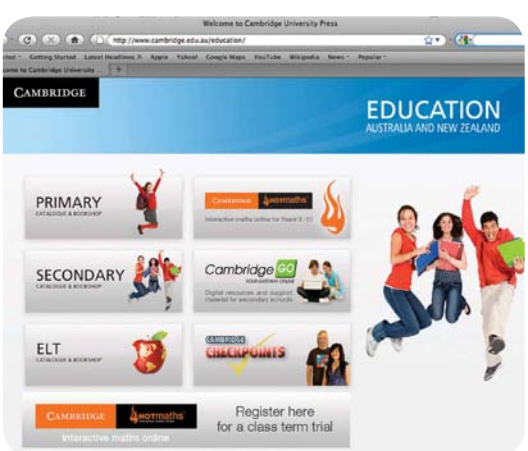


Figure 9.7 A website must be user friendly and suitable for the intended audience to navigate.

E-marketing is now the fastest growing sales medium in Australia. It caters to a diverse group of customers, who range from time-poor consumers (usually owing to work hours) who are unable to access the traditional trading hours of retail stores or who wish to avoid queues and parking problems.

Stores have also sought to establish secure payment methods as a means of reassuring customers that their financial details are safe and secure.

Global marketing

Many businesses operate in countries beyond their domestic operations. This provides the business with an opportunity to increase sales, further their brand awareness and establish markets in new countries. Like people, not all countries are the same. Our needs and wants are influenced by such things as culture, income and standard of living. As such, some businesses will modify their product or promotional strategy to cater for the needs of their new foreign market.

Global branding

When a product can be marketed to consumers in many different countries then branding becomes very important. Because a brand has the same meaning in any language, a recognisable name and logo are essential. It is more effective and efficient to promote a brand rather than individual products. Nike has been very successful in using this promotional strategy. Brands become universally recognisable. The same marketing message is delivered to customers in different nations when they identify the brand.

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Standardisation and differentiation

A business may not need to alter its core product to suit the same target market in different countries. Instead, it is able to supply a standardised product. However, often a product will have to be differentiated in some aspect to suit different cultures and the local market. Owing to differences in language, religion, tastes and ethics it is very important that a business planning to sell in a new market adequately researches the market to reduce the chances of the product failing. The 4Ps of the marketing mix (product, price, promotion and place) must be appropriate to the new market.

Activity 9.6 Comprehension

1. Explain the importance of primary market research for a global business.
2. Summarise global branding and what difficulties in marketing a global business may experience with branding.

Activity 9.7 Research

Research some of the great international marketing errors that have occurred. What other examples can you find of unfortunate translations of product names and slogans?



Figure 9.8 Popular brands often use the same logo worldwide.

They may be quite different from the strategies used in the domestic market. It is even possible that the name of the product once translated is meaningless or even offensive in the foreign market.

Marketing strategies

The 4Ps or marketing strategies selected by a global business will reflect its long-term marketing goals. Often the marketing plan will aim to position the overseas product as having more benefits and being better quality than locally made products. A global business may chose a 'hit and run' strategy by marketing a product aggressively, and maximising sales and profits quickly, before a competitor can copy the product or service.

Product

A product's features will vary from market to market to suit customers in different countries. Labels need to be printed in the correct language and may require additional information, according to legal

BUSINESS BITE

When 'Coca-Cola' was first sold in China in 1927, Chinese employees tried to create an equivalent name for the 'Coca-Cola' trademark, in Chinese characters. Whilst conducting their research, they came across transliterations adopted by shopkeepers that translated to 'female horse fastened with wax' and 'bite the wax tadpole'. Although the Company wanted a phonetic equivalent of 'Coca-Cola', employees could not ignore the meaning of the characters, although shopkeepers had. The closest Mandarin equivalent was found to be 'K'o K'ou K'o Lê', a combination of characters that translates as 'to permit mouth to be able to rejoice', which was fortunately a fitting definition.

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Competitive positioning

Involves the formal process of a business determining how to differentiate itself from its competitors and, in doing so, develop strategies for the business to create value from these differences.

and cultural concerns and issues. Where customers in developing countries have difficulty reading, the packaging will use pictures and diagrams; although these too can create misunderstanding. A brand of tinned baby food in Africa is sold with a picture of a smiling baby on the label. However, as many product labels in Africa use a picture of what the product is made from, confusion was created as some customers believed the product was made out of smiling babies.

Price

The pricing strategy used by a global business should add to the reputation of the brand. Because of the additional costs of exporting – packing, transport, insurance, documentation and currency variation – a competitive price is more difficult to establish. If customers perceive the product as value for money or exclusive then the business will not have to compete with lower prices. A value-based pricing strategy can be used. Alternatively, a penetration pricing strategy can be used to gain and establish market share. The global business may lose money on each sale, the product being a loss leader. However, these losses can be subsidised from profits made in other markets in other countries.

Promotion

Promotion involves much more than advertising on television. Global businesses have a variety of media they can use to promote their product, but they must understand the marketing variations needed in language, religion and culture. Language is a common problem as product names do not always translate well and give the same meaning. Names and slogans can be meaningless, embarrassing or, at worst, offensive. A global business may need to outsource promotion to a local advertising agency as it will best know its own market.

Place

Place in the marketing mix refers to the process of delivering the product to consumers so that it is available to them to buy. The internet has had an obvious impact here by creating 24-hour shopping with the convenience of never leaving the home or office.

Activity 9.8 Comprehension

1. Outline the financial benefits to a global business of standardisation of its product.
2. Under what market circumstances will a global business need to differentiate its product?

Having a good relationship with the local distributor is important. It will ensure products are given the attention they need to succeed. The distributor's staff need to be given training to correctly promote the good and provide after-sales service. Personal visits to the distributor by a senior manager are most important to establish and maintain this relationship.

Competitive positioning is a cornerstone of any successful business. It involves the formal process of a business determining how to differentiate itself from its competitors and, in doing so, develop strategies for the business to create value from these differences.

When customers are able to clearly see the manner in which a business differentiates itself and how it is different

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from its competitors, it becomes much easier for the business to highlight key points of difference. Without differentiation a business would require more time and money to develop customer and brand awareness.

One of the key elements of competitive positioning refers to the concept known as value proposition. There are three essential types of value: operational excellence, product leadership and customer intimacy.

Operational excellence refers to the ability of the business to be run efficiently as a means of producing a low-cost operation. The benefit of this structure allows the business to pass on cost savings to consumers. A business with lower costs is able to offer consumers with lower prices. This form of excellence and efficiency is achieved across all aspects of the business. The business promotes these efficiency and customers are reminded that operational excellence does, in fact, result in lower prices.

Customer intimacy involves a business developing a personalised profile of their customers shopping habits so the business is able to deliver the correct marketing strategies over time. The business develops

Table 9.2 Value propositions

Operational excellence	Product leadership	Customer intimacy



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BUSINESS BITE

Aldi opened the first of its Australian stores in 2001. Since then, the business has opened more than 200 stores across New South Wales, Queensland and Victoria. Aldi believes that a key component of offering low-cost grocery items is based on achieving operational excellence. The store has the following features that clearly differentiate itself from its competitors in the Australian grocery market:

- Most brands are developed through suppliers who then package the product as an Aldi brand. As a result, consumers do not have to pay for high advertising costs that are often included in the price of well-known and more trusted brands.
- Each store has limited staff on each shift, with normally two check-out lanes operating at a time. This reduces the need for staff, lowering the costs to the business.
- Trolleys must be returned to the trolley bay for the consumer to be refunded their coin.
- The business limits advertising to local community-based newspapers, emails and brochures. Aldi does not advertise on television.

Product leadership refers a business that continually enhances its brands through innovation and quality. The business is constantly working on product improvements and new ideas that they can bring to market. This allows the business to capture a greater share of the market. It is seen as a leader within the marketplace and the business is often associated with high brand awareness and strong consumer loyalty.

a relationship with the customer in order to develop a long-term association. This is achieved through a detailed understanding of the buying behaviour of customers.

Technology is a key component of developing customer intimacy.

BUSINESS BITE

Woolworths is a key proponent of customer intimacy. Its Everyday Rewards card is issued by consumers to access the 4 cents per litre fuel discount. The card, however, allows Woolworths to access information on the individual shopping habits of its customers. Woolworths is then able to send emails to its customers promoting products and specials that would appeal specifically to the consumer.

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Chapter summary

- Market segmentation is the process of breaking down a total market into smaller markets based on the similar characteristics of a customer group.
- Geographic segmentation is the process of developing marketing strategies based on the different geographic locations of customers.
- Demographic segmentation refers to the selection of target groups based on characteristics, such as age, gender, income, family size and level of education.
- Psychographic segmentation allows a business to segment markets based on people's lifestyle, personality, values and interests.
- Behavioural segmentation examines how often and when a consumer will make use of a product, the benefits sought when purchasing the product and user loyalty.
- Product refers to the good or service that a business is selling. Positioning is the image that the product has in the mind of a consumer. Branding refers to the reputation that a business or product has developed over a period of time. Packaging is the physical appearance of the product.
- Price refers to the amount of money a business charges for the purchase of its products.
- The pricing strategy used by a business will depend on its marketing goals. There are various strategies, including penetration pricing, loss leaders, product-deletion pricing, multiple-unit pricing, market skimming, demand-based pricing, prestige pricing and psychological pricing.
- Promotion is that element of the marketing mix that raises awareness and interest towards a particular product. Common elements of promotion include advertising, direct marketing, personal selling and public relations and publicity campaigns.
- Place is primarily concerned with the process of distributing the product. It must consider how the good is transported from the place of manufacture to the consumer and from where the good or service will be accessible.
- The product distribution channels can be categorised as intensive, selective and exclusive distribution.
- When physically distributing a product, a business must consider issues relating to transport and warehousing and the appropriate level of inventory.
- The 7Ps of marketing include the standard 4Ps with business analysts now incorporating people, processes and physical evidence into the marketing mix:
  - people refers to the conduct and performance of employees
  - processes involves the complete buying experience a customer has
  - physical evidence refers to all the visual elements of a business.
- E-marketing is the use of the internet to promote and sell goods and services.
- Global branding occurs when a business adopts a universal slogan and logo.
- Product differentiation is where a product is modified to suit the needs of a local market.
- Competitive positioning involves the formal process of a business determining how to differentiate itself from its competitors.

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Chapter revision task

Create a table using the points in the three lists below. Your table should have three columns with the following headings: Keyword, Definition and Examples. Match each keyword with the correct definition and examples.

Keyword

- Market segmentation
- Demographic
- Marketing mix
- Branding
- Penetration pricing
- Market skimming
- Above the line
- Word of mouth
- Place
- Intensive distribution

Definition

- Traditional forms of promotion used by business
- Prices are set at a high level to recover costs involved in research and development
- The area where a product is sold
- The process of choosing a target market
- The reputation a business or product has established over time
- The product is widely available
- Prices are set at a level below competitors' prices in order to generate fast sales and establish market share
- The process of developing a product and then implementing a series of appropriate pricing, promotional and distribution strategies
- A form of publicity based on an individual's own experiences with the product
- Customer groups based on age, gender, income, family size and level of education

Examples

- A company advertises in newspapers, television and colour brochures
- Antonio spoke highly of his visit to a health resort
- Cherie's Chewies are available in convenience stores, supermarkets and variety stores
- Country Style is considering which department store is the appropriate retail outlet to sell its products through
- Air Blue has entered the Australian airline market offering prices much lower than those of its competitors

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- Samdak has released a new computer technology onto the market
- Rohan Clothing is widely respected in the men's fashion industry for its contemporary designs and quality garments
- Given its location, Burger World is seeking to meet with local religious leaders to discuss the dietary requirements of its local customer base
- Telchoice has released a new mobile phone package that offers consumers unlimited calls for $50 per month; it has advertised this on radio and the package is available from all Telchoice stores
- Radio 2TN plays 80s and 90s music aimed at older female listeners

Multiple-choice questions

1 SuperFizz has released a new soft drink targeted towards women aged 18–39 years. Which form of market segmentation is SuperFizz using?
- **(A)** Demographic
- **(B)** Geographic
- **(C)** Psychological
- **(D)** Behavioural

2 Which statement best describes behavioural segmentation?
- **(A)** Market segmentation based on the use of particular products by a certain group of customers
- **(B)** Market segmentation based on the earning capacity of individuals
- **(C)** Market segmentation based on a target group's age, gender and economic status
- **(D)** Market segmentation based on an individual's lifestyle and personality

3 Mobile phone companies are well-known for their ability to offer consumers a basic product at several different price levels. At each level, the features that the consumer will receive differ. What form of pricing strategy would such a business be using?
- **(A)** Penetration pricing
- **(B)** Price lining
- **(C)** Market skimming
- **(D)** Competitive pricing

4 Which of the following examples presents the pricing strategy of market skimming?
- **(A)** Tonasonic releases a new DVD recorder that is unlike any of its competitors' products and it is priced very low to quickly establish a market share
- **(B)** Jetfly Airlines has reduced its prices as a result of its competitors lowering their prices
- **(C)** Hannah introduces a buy-one-get-one-free promotion for her cafe's new lunch menu
- **(D)** Red Star Medical has released a new form of medicine to relieve chronic arthritis and, in order to recover the research and development costs, the business is charging a high price for the product

5 What is meant by the position of a product?
- **(A)** The image of the product in the mind of the consumer
- **(B)** The location of the product in retail stores
- **(C)** The image of the product against its competitors
- **(D)** The location of the product in wholesale stores

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6 A business's reputation, logo and slogan and consumers' expectations of its product are features of which element of the marketing mix?
   (A) Positioning
   (B) Branding
   (C) Packaging
   (D) Price and quality

7 Nadton Motors has decided to use a popular racing car driver to promote the quality and value of its range of motor vehicles. Which element of the marketing mix is being used?
   (A) Product
   (B) Price
   (C) Promotion
   (D) Place

8 Why does the marketing mix need to be differentiated when selling goods in different countries?
   (A) It ensures promotion does not offend customers in the domestic market
   (B) People in different countries like different things
   (C) It can make marketing appropriate for the foreign market in which it is sold
   (D) It advertises the product

9 Aco-Pop is a healthy soft drink style beverage. Its manufacturer has decided to first sell the product only at health food stores around the country. Which form of distribution is being used?
   (A) Intensive
   (B) Selective
   (C) Exclusive
   (D) Mass

10 What are global brands?
   (A) They are logos that are easily recognised in different languages
   (B) They are the products that are sold worldwide
   (C) They are the name used to identify a range of products worldwide
   (D) They are a method of promotion used in different countries by the same business

Short-answer questions

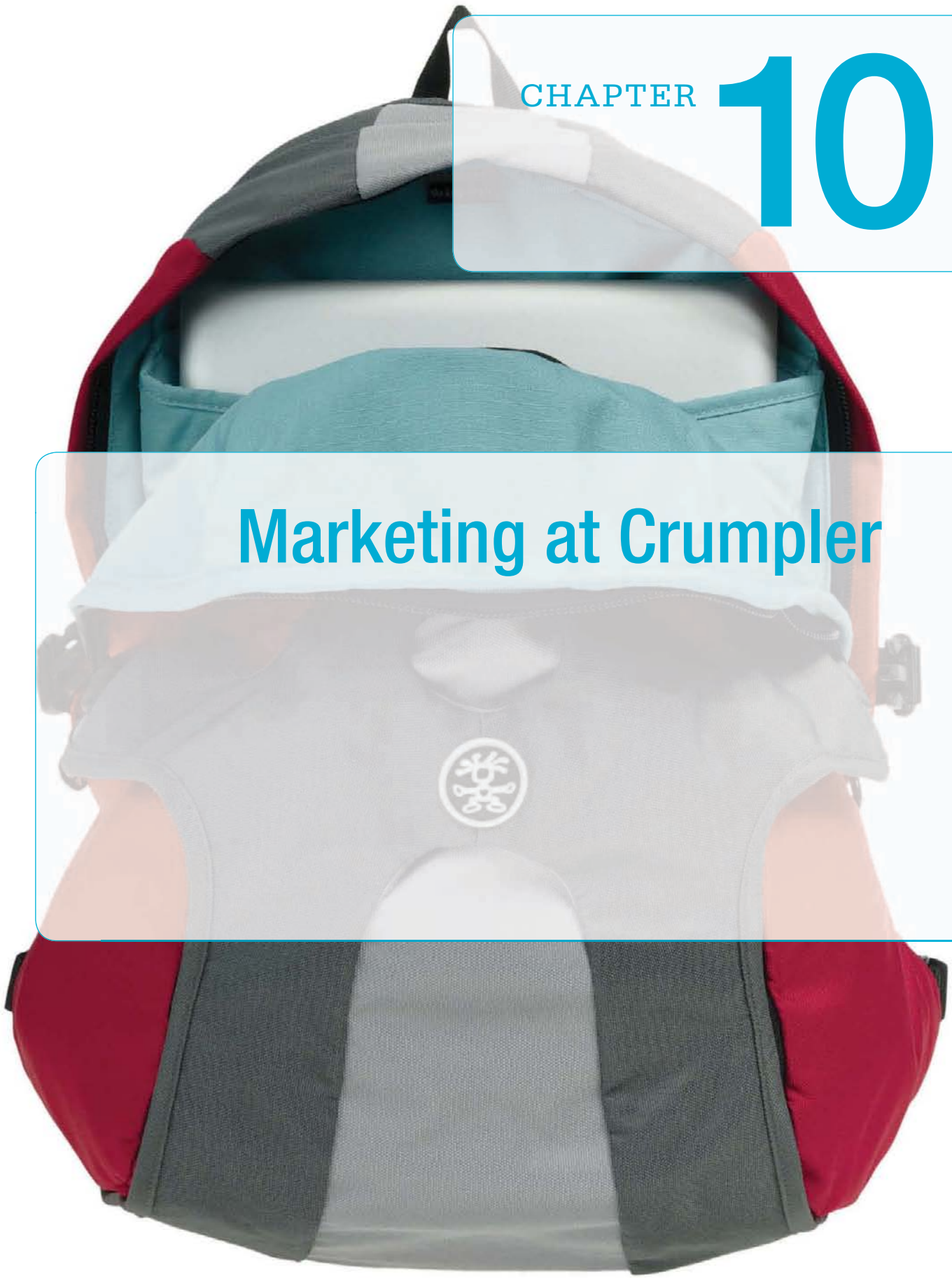
1 **(a)** Define the term market segmentation.
   (b) Outline the four keys methods used by business to segment consumer markets.

2 **(a)** Explain the role of product in the marketing mix.
   (b) How do businesses use different elements of the product strategy in their marketing mix?

Extended-response question

Market segmentation serves a considerable purpose for the operations of a business. Outline the benefits that market segmentation offers a business and describe, using examples, how businesses use market segmentation to target particular consumer groups.

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CHAPTER 10

Marketing at Crumpler

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Interdependence of marketing and other key business functions

Each year, the focus of marketing represents a different avenue for the Crumpler brand. The marketing strategies used by the business are based on the operational developments of Crumpler. New releases across specific types of bags may be used as a primary focus for the marketing strategies of the business.

Types of markets

Crumpler began by offering messenger bags, but over the years has expanded to camera and laptop bags, duffel bags and luggage.



Figure 10.1 'The Squid. Now you see it, now you don't. The incredible shrinking Squid is a stow-away drawstring backpack that appears on demand to accommodate your cargo carrying needs, then returns to the fold just as quickly' – Crumpler.

The diverse range of Crumpler bags are all aimed towards 18–35-year-olds. This is reflected through their unique designs, emphasis on colour and quirky humour in naming their bag designs (The Seedy One, The Squid, The Old Banger, The Cashmere Blazer, etc.).

Crumpler, therefore, uses a market segment based on demographic segmentation.

Given the target market of Crumpler, the business is able to effectively develop unique designs for products that are considered to be mainstream. The use of colour is effective in creating a perception of uniqueness and fun within the brand, both within the business itself and its customers.

Competition

Because Crumpler offers a diverse range of bags, they have different competitors in different categories.

They have a well-established reputation for their messenger and camera bags, but the newer areas of travel goods and luggage are very competitive and price sensitive. They are responding to this by employing smarter and experienced luggage designers who can teach them how to develop products more cost effectively.

Crumpler's success has meant that copycat and counterfeit goods are beginning to appear. Crumpler is setting up special arrangements with customs offices around the world that monitor ports for counterfeit goods.

Sales outlets and pricing

In Australia, Crumpler sells fairly exclusively through their own stores, so they are able to set and maintain their pricing.

In the USA, most of the product is sold through a dealer network. In

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order to maintain price, Crumpler set a manufacturer's suggested retail price (MSRP) and the retailers agree to stick to this pricing as part of their reseller agreement.

In other countries, the sole distributors and importers monitor and manage pricing by also setting a MSRP.

Most reputable retailers are happier working with brands that monitor and work to maintain consistent pricing, as this protects their margin and makes it a worthwhile business.

Marketing strategies

The marketing strategies of Crumpler are deliberately informal and because their approach to business is to have fun, and as this approach has been successful, they intend to keep it that way.

Crumpler has always been known for its innovative, idiosyncratic approach to marketing, leading to consumer perception of unique and well-made bags made by a company that doesn't take itself too seriously.

Early days – guerrilla marketing

One of the earliest Crumpler marketing 'campaigns' involved the three founders driving around and stencilling their logo (without any supporting text, or even the company name) on any available surface. Local authorities did not always look kindly upon graffiti advertising, which resulted in the trio being fined a few times in Melbourne – and in Dusseldorf, Germany, they even had to spend a night in jail. However, this approach generated a great deal of word-of-mouth publicity. As stated by Dave Roper, one of the founders of Crumpler, 'It was a real adventure and a real challenge to actually get our products seen and bought and known. We just didn't have much money – or any money – for marketing, so we thought that was a really easy, and cheap, way to promote the brand'.

In an interview with the ABC, interviewer Jayne Edwards said that Crumpler 'is credited with pioneering what's known today as viral marketing'. Although Dave Roper rejects this label: 'that phase was coined in the mid-90s and it became quite a popular thing to do, so we don't do it any more'.

Demographic targeting

Many of Crumpler's marketing strategies specifically target their customer demographic: 18–35-year-olds who enjoy Crumpler's casual and irreverent approach. These have included advertising in street magazines and free music magazines, where its advertising style fits comfortably. It also targets the student market by sponsoring university and college events, parties and competitions, and advertising in relevant magazines. The logo was included in the Melbourne Fringe Festival guide in the form of a flick book. In more traditional media, the Crumpler team made a 60-second cinema advertisement that ran in the art house cinemas Nova and Kino in Melbourne.

Other campaigns have included:

- short videos on YouTube and the Crumpler website
- paying apple growers to put the Crumpler logo on the stickers they place on their apples
- sponsorship of the SBS program Rockwiz
- sponsorship of a nude footrace at the Meredith Music Festival (in which runners have the Crumpler logo stencilled on their bodies).

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'Beer for bags'

Probably Crumpler's most notorious strategy is its 'beer for bags' promotion. Each year, across all of its markets (excluding Adelaide and Brisbane), Crumpler encourages its customers to pay for their products through beer. In essence, beer becomes the currency accepted by Crumpler, for one week only. This unique promotional strategy has created a significant degree of controversy – which brought further publicity – across all its markets, both in Australia and overseas.

Trade shows

Because of its association with technology (camera and laptop bags), in 2005 Crumpler decided to exhibit at the 2005 International Consumer Electronics Show – the largest electronic and technology show in the USA. As a low-budget beginner to the show, the best exhibit space Crumpler could afford was a $30 000, 10 x 30 foot spot in a tented exhibit hall in the parking lot of the Las Vegas Convention Center. It had to find a way to stand out among the more than 2500 other exhibitors at the show. As with Crumpler's consumer marketing campaigns, the solution was unconventional: they hired a University of Melbourne architecture student to design a low-tech environment consisting of 55-gallon oil drums and plywood walls and floors painted with green chalkboard paint. Crumpler bags were included with the design, but there was lots of space for people to write on the walls, which, as designer Michael Macleod said, 'added to the interactive element of the booth. Plus, most people like drawing on walls'. As with other Crumpler marketing, this approach caused word-of-mouth advertising and by the end of the show, approximately 500 people had written messages on the walls of the booth, Crumpler brought in 50 qualified leads, and then signed three major companies for projects.

This booth was used at subsequent trade shows that year, and has been followed up by further, quirky designs, such as a boxy, fully recyclable cardboard booth in 2007, and an Escher-inspired look in 2008. Crumpler booths are frequently regarded as the most distinctive of the whole show – and this draws people to visit them.

Ethical influences on marketing

It has been suggested by some commentators that the 'beer for bags' campaign is encouraging the illegal trade of alcohol and promotes drinking amongst the 18–35 demographic.

However, Crumpler argues that they are not, in fact, promoting drinking among their customers: 'we're taking beer off the streets and giving you the bags'. In Brisbane and Adelaide, police closed down the sale, arguing that Crumpler were in



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breach of liquor licensing laws. In fact, the publicity surrounding this issue (it was featured on local news TV and in newspapers, and even internationally) possibly helped to enhance the brand.

Market research

The original Crumpler bags had a very direct line of customer feedback. Stuart Crumpler, bag designer and co-founder of the company, was working as a bicycle courier for Minuteman Messengers (owned by Will Miller and Dave Roper, the other Crumpler founders) and designed the bag for his own use. Other couriers started using the bags, and told him what did and didn't work with them, which Crumpler incorporated into his designs. In a letter to the Powerhouse Museum Stuart Crumpler wrote:

> *Since they grew out of necessity, invention's dear old Mummy, the early bags had everything the courier needed, but nothing they didn't. Looks were not much of a concern, and they would not want to be since the canvas used got covered in road crud. Features? Not many, the early bags were a very simple pattern, a very simple bag. No zips to bugger up, just a few pockets and one main compartment.*

Today, the development of Crumpler bags is often determined in-house through its team of designers, who are encouraged by management to bring ideas on board. Crumpler needed specific expertise to go forward, but also needed fresh ideas and new ways of doing things. Everyone has a say. Consumer input into the process is encouraged through consumer request forms available online and in-store.

Consumer laws

Crumpler's warranty service is testament to the quality of their products. The business believes that their warranty should reflect the quality of the product and customer confidence in the product. Not just 'a' warranty, but the Legendary Crumpler 'Til Death Do Us Part' Warranty!

> *If your Crumpler bag fails as a result of defective materials or workmanship under normal use while you: a) draw breath and b) remain the bag's owner, we'll repair or replace the part(s) in question – no questions asked. Just drop your bag off at a Crumpler Store or mail your bag to a Crumpler HQ, postage paid, together with your proof of purchase and a short note to explain the problem. We'll make it right and send it back to you ASAP.*

Source: www.crumpler.com/AU/FAQs.html#warranty

Words from the founders

Dave Roper: *We very much enjoy having fun. We put that first, really, before anything else. If you don't enjoy what you're doing, and your staff aren't happy, then why bother, really. Go and do something else.*

Will Miller: *Our method has always been, if we think it could work, do it, if not we learnt from it anyway.*

Dave Roper: *It has been an amazing ride, but we do work very hard. You have to, if you're going to make it work. That's the secret. I think you have to be stubborn too, and stick to your guns if you really believe in what you are doing.*

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TOPIC 3

Finance

Introduction

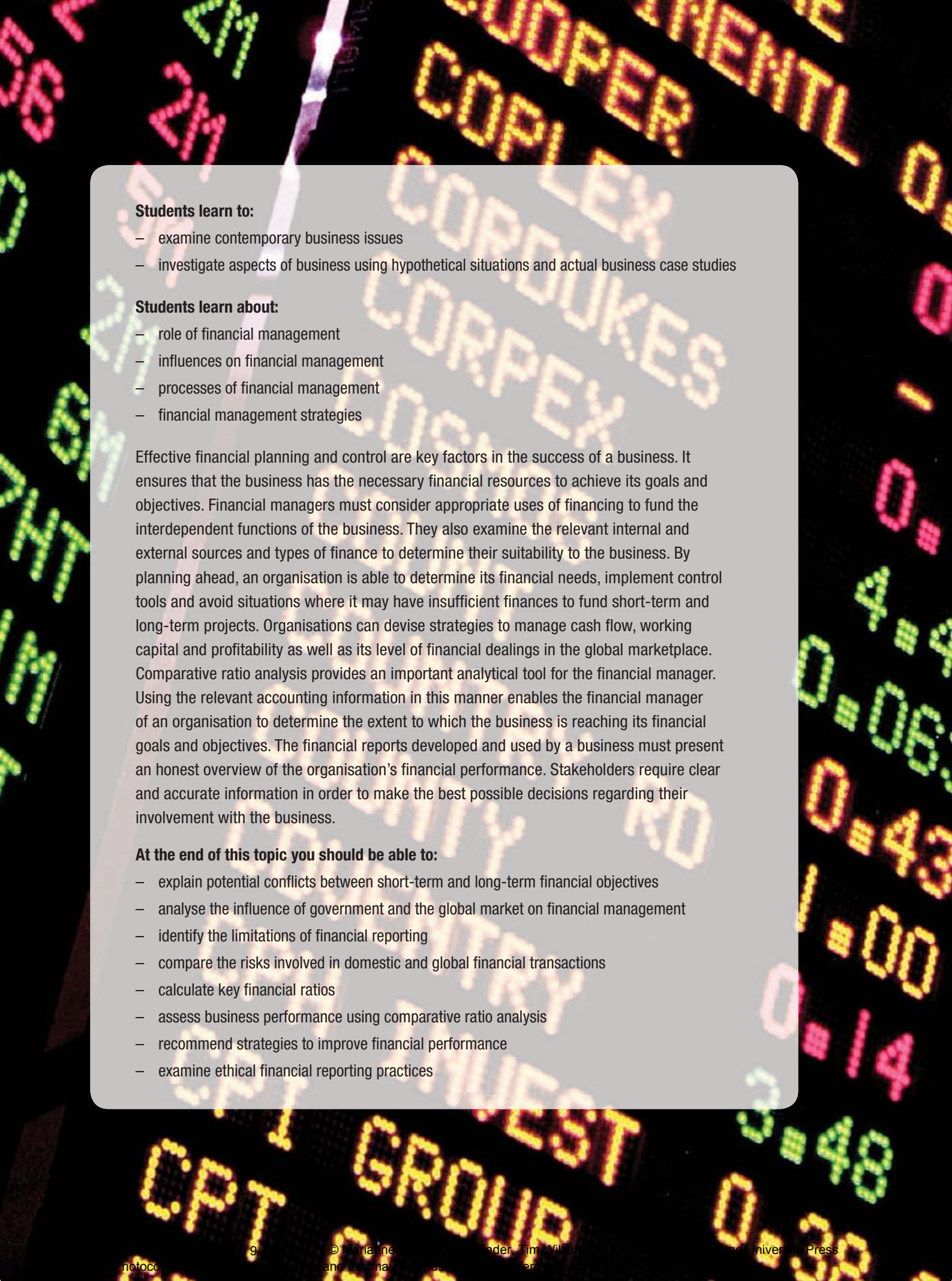
The focus of this topic is the role of interpreting financial information in the planning and management of a business.

Outcomes

The student:

- H2 evaluates management strategies in response to changes in internal and external influences
- H3 discusses the social and ethical responsibilities of management
- H4 analyses business functions and processes in large and global businesses
- H5 explains management strategies and their impact on businesses
- H6 evaluates the effectiveness of management in the performance of businesses
- H7 plans and conducts investigations into contemporary business issues
- H8 organises and evaluates information for actual and hypothetical business situations
- H9 communicates business information, issues and concepts in appropriate formats
- H10 applies mathematical concepts appropriately in business situations

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Students learn to:

- examine contemporary business issues
- investigate aspects of business using hypothetical situations and actual business case studies

Students learn about:

- role of financial management
- influences on financial management
- processes of financial management
- financial management strategies

Effective financial planning and control are key factors in the success of a business. It ensures that the business has the necessary financial resources to achieve its goals and objectives. Financial managers must consider appropriate uses of financing to fund the interdependent functions of the business. They also examine the relevant internal and external sources and types of finance to determine their suitability to the business. By planning ahead, an organisation is able to determine its financial needs, implement control tools and avoid situations where it may have insufficient finances to fund short-term and long-term projects. Organisations can devise strategies to manage cash flow, working capital and profitability as well as its level of financial dealings in the global marketplace. Comparative ratio analysis provides an important analytical tool for the financial manager. Using the relevant accounting information in this manner enables the financial manager of an organisation to determine the extent to which the business is reaching its financial goals and objectives. The financial reports developed and used by a business must present an honest overview of the organisation's financial performance. Stakeholders require clear and accurate information in order to make the best possible decisions regarding their involvement with the business.

At the end of this topic you should be able to:

- explain potential conflicts between short-term and long-term financial objectives
- analyse the influence of government and the global market on financial management
- identify the limitations of financial reporting
- compare the risks involved in domestic and global financial transactions
- calculate key financial ratios
- assess business performance using comparative ratio analysis
- recommend strategies to improve financial performance
- examine ethical financial reporting practices

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CHAPTER 11

Role of financial management

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Financial management deals with the analysis, interpretation and evaluation of all financial records of the business. It is a financial manager's responsibility to source finance that will enable the business to achieve its strategic goals.

Strategic role of financial management

One of the toughest periods for a business to survive is its first year of operations: the establishment phase. During this phase of the business life cycle the short-term financial objective for most businesses is to ensure that it is able to cover its costs by paying bills as they fall due and ultimately to make a profit. In Australia during the 2009 to 2010 financial year there were 4589 business–related **bankruptcies**. Other data indicate that very few businesses survive until the retirement of the owner. In the long term, businesses have broader financial goals. The term *strategic* refers to any plan that will span a number of years. The long-term or strategic role of financial management is to ensure that a new business continues to operate, grows and is able to achieve its goals and objectives. Financial managers will plan the financial aspects of a business for years into the future. By managing the business's finances efficiently and effectively, managers and owners can achieve the goals and objectives of the business. Figure 11.1 illustrates the decision-making process used by owners and managers for all objectives, including those concerning financial management.

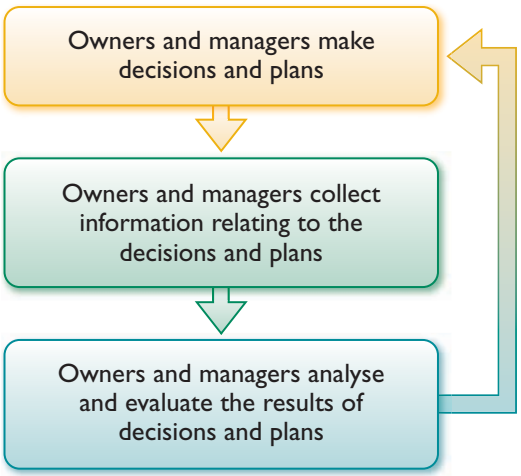


Figure 11.1 The decision-making process used by owners and managers.

Financial managers need strong accounting knowledge and skills to interpret and analyse a business's financial data. Accounting is the language of the financial aspects of the business. It measures, processes and communicates financial information.

Objectives of financial management

Businesses must decide what they want to achieve – what their objectives are. A prime objective of many business owners is to become wealthy. This is how they measure their success. There are different ways to measure the financial success of a business. The first measure owners want to establish is how much **profit** their business is making; that is, how much revenue remains after all expenses have been paid, and represents their return on the capital they have invested in their business. Any profit belongs to the owners. They can use this money for whatever purpose they wish. The owners can choose to reinvest it back into the

Bankruptcy

A legal declaration that a person or business has more liabilities than assets. A consumer or business that is unable to pay its bills may be formally declared bankrupt by a court. A business may declare itself bankrupt voluntarily as part of the process of closing the business.

Profit

What remains from revenue after all expenses have been paid.

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Sole trader

An unincorporated business with one owner.

business to help it grow or withdraw money (called drawings in the balance sheet) for their own use. Owners can reward themselves by using their profit to buy a luxury car or overseas travel or save for their children's education. The financial manager's objectives will include the business's profitability, growth, efficiency, liquidity and solvency. Their job will be to ensure adequate short-term and long-term funding decisions on debt and equity sources of funds, financial policies for things such as cash control or borrowing as well as gaining maximum utilisation of the organisation's scarce financial resources.

Financial reports give a detailed financial picture of the business's profitability and financial stability. When examining the data from financial reports the financial manager will be able to measure the extent to which the objectives of the business have been achieved. Analysis of the data in the financial reports will show change in the results from one year to the next, providing a trend for the business. The financial manager can use these changes and trends to determine whether the business is making more money and is more financially stable than in the previous year.

Ethical Issue

Some objectives may conflict. For example, imagine you are the financial manager of a large logging company. How do you decide between the pursuit of a growth strategy for your business and the cost of that growth to the environment?

A useful guide to determine whether a **sole trader** is making a worthwhile profit is to compare the profit to the average yearly income in Australia. Sole traders must ask themselves whether they are making sufficient profit to justify the hard work, stress and risk of owning a business.

Table 11.1 Summary of financial objectives

Objective	Definition	Data from financial reports	Analysis
Profitability	The earnings of the business after expenses have been paid	Gross profit Net profit Earnings before interest and tax (EBIT)	Formulas are calculated as a percentage of sales
Efficiency	How much of total revenue is spent on expenses	Expenses	Formula is calculated as a percentage of sales
Growth	The size of the business compared to its competitors in the same market	Market share Number of outlets	Compare business sales to total sales in the market
Liquidity	The ability of the business to pay short-term liabilities using its current assets	Current assets and current liabilities	Compare current assets and current liabilities
Solvency	The ability of the business to pay both short-term and long-term liabilities as they fall due	Current assets, current liabilities, non-current assets and non-current liabilities	Compare total assets and total liabilities

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If a sole trader is working seven days a week and earning less than $64 600 a year (the average annual income in Australia in early 2010) it may be more financially rewarding and secure to become an employee.

Profitability

Profitability is the most recognisable financial objective as nearly all businesses will seek to increase profit through increased sales and decreased costs.

Owners contribute financial resources to a business when it is established and throughout the businesses lifetime. This is called capital. The return on this capital is the amount of profit returned to owners or shareholders, which is expressed as a percentage of their original capital investment. Owners can reinvest the profit into the business or withdraw part or all of their share of the profits from the business. The withdrawal of profits is recorded as **drawings** under equity in the balance sheet. For shareholders it will be the **dividend** they are paid. For example, one of the owners in a partnership invested $100 000 of her money when the business was established. At the end of one year the owner receives $25 000. The owner's return is 25%. The business would be judged a success if the return was greater than safer alternatives, such as investing in a savings account or property.

Profitability is measured using net profit from the income statement (a summary of all the revenue and expenses of the business over a period of time, such as the financial year). Figure 11.2 shows how net profit is determined from revenue received by a business after paying its expenses.

Activity 11.1 Comprehension

Explain why having more current assets than current liabilities is essential to a business's short-term survival.

Gross profit is the profit made on the sale of goods after paying the expenses of purchasing them wholesale and transporting them to the business ready for sale; that is, sales revenue minus wholesale cost and freight inwards (or cost of goods sold). Alternatively, it is the cost of buying the inputs that are made into the goods for sale. The gross profit figure does not take into account any other expense. **Net profit** is the final amount of revenue remaining after all expenses have been paid. A financial manager is able to work out whether the business is making enough profit from its investment

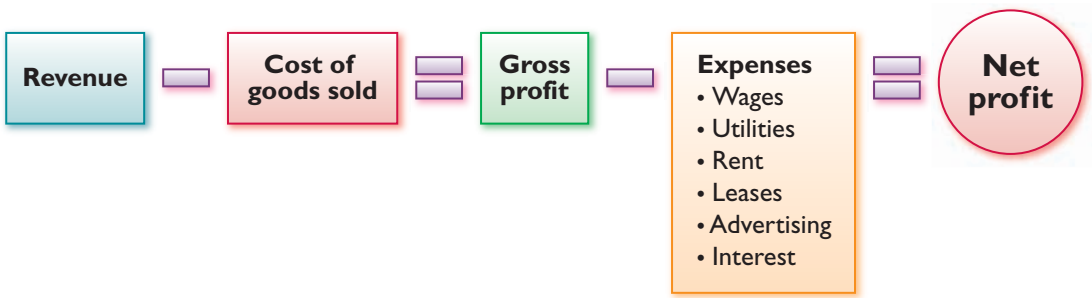


Figure 11.2 Calculating net profit.

Drawings

When the owners of a business take money out of the business for their own use. This reduces the owners' equity because the owners are reducing their original investment in the business by withdrawing capital. However, if the owners pay themselves a salary this is recorded as a business expense and does not reduce the owners' equity.

Dividend

The income earned from owning shares in a company. It is usually paid every six months and is based on the profits the company makes.

Gross profit

The revenue remaining after paying the cost of goods sold; that is, the expenses of purchasing the goods wholesale (wholesale cost) and transporting them to the business ready for sale (freight inwards).

Net profit

The final amount of revenue remaining after all expenses have been paid.

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BUSINESS BITE

Janine Allis cornered a niche market with Boost Juice, a healthy and fast alternative to traditional fast food. Janine opened her first store in Adelaide in 2000. Having thoroughly researched the market, she decided that setting up her first store in a smaller market offered her less financial risk. By developing a franchise model after her initial success, Janine has established 189 new Boost Juice stores to open throughout Australia and the rest of the world between 2000 and 2006. Boost Juice sells over 1 million juices and smoothies every month.



in assets by calculating and analysing the gross profit ratio and the net profit ratio. Earnings before interest and tax (EBIT) is a more precise measure of profitability than is net profit. This is because it measures the profit made directly from the operations of the business.

Growth

A business that grows will increase its profitability in the long term. More output will result in more sales, which will increase revenue and therefore profit. This also depends on expenses being well managed. Growth can be achieved by:

- increasing the physical size of the business by expanding or moving to a larger office or factory
- increasing the value of the assets in a business
- increasing sales and profits
- increasing market share
- opening more branches or offices in Australia or overseas
- the takeover or purchase of a competitor
- merging with another business in the same industry
- diversifying by buying other businesses
- expanding its range of products.

Efficiency

Efficiency is related to profitability because a business will be able to increase its profit when it can decrease its costs. In many service-based businesses the largest expense is usually the wages and salaries of staff. In modern manufacturing businesses the largest expense will be raw materials and inputs. Efficiency may be calculated using an expense ratio, such as total expenses divided by total sales. The result is written as a percentage. The lower the result, the more efficient is the business. Efficiency is also gained if a business can achieve the same level of profit from a smaller amount of inputs. For example, a small manufacturing business may have the latest equipment, allowing it to make the same level of profit as a larger manufacturer that has older, less technologically advanced equipment. In this example, the small business would be considered more efficient than the large business. Another measure of efficiency is the business's ability to collect accounts receivable. Many businesses are happy to sell on credit to those clients with whom they have a good relationship. The

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customer has an account, which it will pay later. The customer receives a bill, or **invoice**, from the business, which requires it to pay by a specified date, such as seven days' time, 30 days' time or at the end of the month. How long a business is given to pay will depend on the credit terms the seller allows. The accounts receivable turnover ratio calculates how many days, on average, it takes customers to pay their invoices. The shorter the average time, the more efficient the business is in collecting its accounts receivable.

Activity 11.2 Comprehension

1. Explain the impact that increasing efficiency will have on a business's profitability.
2. Explain how sales can be used as a measure of a business's growth.
3. Explain why a new business may choose to have growth objectives rather than objectives for profitability.

Liquidity

Liquidity is a measure of how quickly an asset may be converted into cash and therefore available to pay short-term debts as they fall due. Cash is the most liquid asset. **Debtors** are expected to pay their accounts within a short time, so accounts receivable is a relatively liquid asset. Inventory may take some time to sell and convert to cash, making it less liquid. Non-current assets are the least liquid because it takes time to advertise and negotiate the sale of non-current assets to convert them to cash. Financial managers are interested in liquidity because businesses need to know how quickly they can convert an asset into cash in order to pay a **liability**. Liquidity provides a measure of how successfully a business manages its working capital by maintaining current assets that are greater than current liabilities, and therefore having enough short-term assets to pay short-term debts as they fall due. An objective of financial management is to keep the business in a financially stable position in the short term by keeping it liquid. **Current assets** are cash and other assets that are expected to be used, sold or converted into cash within 12 months. Cash in the bank, accounts receivable, inventory and prepaid expenses are current assets. **Current liabilities** are debts that are due to be paid within 12 months. **Accounts payable**, bank overdrafts, short-term loans, interest payable on loans and salaries payable are all current liabilities. For a business to be liquid there needs to be sufficient cash and other current assets to pay creditors and the bank overdraft. Businesses A and B in Tables 11.2 and 11.3 illustrate the breakdown of different current assets, which is an important factor when determining liquidity.

Table 11.2 Balance sheet for business A

Current assests	$	Current liabilities	$
Cash	1000	Bank overdraft	2000
Inventory	6000	Accounts payable	3000
Accounts receivable	3000		
Total current assets	*10 000*	*Total current liabilities*	*5000*

Invoice
A bill sent to a customer requiring payment by a specified date. Invoices are primary documents in accounting because they are records of credit sales.

Liquidity
Indicates how much ready cash is available in a business. Current assets are listed in order of liquidity, which is how easily they can be turned into cash. Savings in the business's bank account are the most liquid as they are already cash.

Debtors
The businesses or individuals that owe money to a business. Also known as accounts receivable.

Liabilities
Amounts of money owed to individuals (for example, suppliers or institutions, such as a bank) that are part of the external environment.

Current assets
Assets (such as cash in the bank and accounts receivable) that earn revenue for a business in the short term; usually fewer than 12 months.

Current liabilities
Money that is owed to an external business or person that will be repaid in the short term; usually fewer than 12 months.

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Accounts payable
The money a business owes to its suppliers and service providers. Accounts payable is also known as creditors or trade creditors.

Creditors
The businesses, financial institutions and individuals to which a business owes money. Also known as accounts payable.

Accounts receivable
A current asset that represents money owed to the business in the short term. This money is owed to the business by customers who are yet to pay for goods or services they have already received. Accounts receivable is also known as debtors.

Solvency
The ability of the business to pay both short-term and long-term liabilities as they fall due. It is a measure of whether a business is financially stable.

Business A has twice as much finance available as it needs to pay all its current liabilities: $10 000 in current assets compared with only $5000 in current liabilities. However, if all suppliers have to be paid immediately the business does not have enough cash on hand to pay them.

Table 11.3 Balance sheet for business B

Current assests	$	Current liabilities	$
Cash	4000	Bank overdraft	2000
Inventory	3000	Accounts payable	3000
Accounts receivable	3000		
Total current assets	*10 000*	*Total current liabilities*	*5000*

A business that cannot pay its liabilities on time may find:

- its electricity, telephone or water services are cut off
- its suppliers won't wish to trade with it
- its credit rating falls, which affects its ability to obtain loans in the future
- it may have to increase long-term debt to raise cash, putting the business in a less financially stable position.

The liquidity position of business A could be improved. Examine business B and note the difference in its liquidity. Business B has better liquidity than business A because it has more cash on hand. It has invested less money in inventory, holding a lower level of stock. Having less inventory can reduce storage costs. More money is held as available cash in the business's bank account. Business B can afford to pay either the bank overdraft or **creditors** and will still have cash left over. However, a business with very high liquidity is not more successful than one with lower liquidity. If the financial manager decides to keep a lot of cash in the business bank account he or she will be criticised by the owners for being too cautious and not using finance effectively. Having too much cash saved is a waste of financial resources. This cash could be put to better use in the business rather than earning a very small amount in interest from a bank.

Finally, liquidity is affected by the ability of the business to collect its **accounts receivable**. This is the money owed to it by customers who made their purchases on credit and have been given time to pay their account. The business may have a large amount of money owed to it by customers, which it records as a current asset: accounts receivable. However, if the business is unable to collect these debts in a short time it cannot convert accounts receivable to cash very quickly. Despite having a good measure of liquidity the business may find that it does not have enough physical cash to pay liabilities. Liquidity is calculated by using the current ratio. The formula is:

$$\text{Liquidity} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Solvency

Solvency is the ability of the business to pay both short-term and long-term liabilities as they fall due. It is a measure of whether a business is financially stable. Most businesses have a mixture

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of debt and equity financing. **Gearing** (or leverage) tells you how much debt finance the business has acquired to fund its operations compared to its use of equity finance. Borrowed (debt) finance may be used to purchase expensive assets such as machinery or a factory that is needed by the business. These will be used to earn revenue through sales of output and hopefully more than enough profit to repay the loans. As long as the business can continue to make repayments on the due date it will remain solvent and be financially secure. When interest rates on loans are low, the cost of the debt is low. As loans are repaid, the ratio of debt to equity falls, reducing the level of gearing in the business.

Gearing
How much debt finance the business has acquired to fund its operations compared to its use of equity finance.

A business may wish to source the cheapest funds possible (these funds are necessary for the business to be able to pursue its goals), however this may not provide them with a long enough repayment period for financial management. A business may need its costs spread over a longer period for the venture to be viable.

Successful financial management involves monitoring costs on a continuous basis through budgets and the control of the liquidity of the organisation to minimise the cost of having too much cash available to pay liabilities or the risk of not having enough cash to pay creditors on time.

Overall the long-term objective of financial management is to increase the wealth of the owners of the business. The strategic financial decisions may relate to expansion, takeover of another business, restricting of loans, etc. and wealth in the long term is dependent on profitability in the short term resulting from increased operating

Activity 11.3 Comprehension and application

Explain how return on capital can be used as a measure of profitability.

1 Imagine you are the senior financial manager of Jump and Jive Clothing Company, a large retailer of street fashion clothing for 14–24-year-olds. Write financial objectives for this business as they should appear in the business plan. Use the SMART system:

S = specific – objectives need to have detail about what is planned to be achieved.

M = measurable – the financial manager needs to be able to calculate performance and determine whether the objectives have been reached.

A = achievable – it must be possible to reach the objectives given the business's resources.

R = realistic – it must be possible to reach the objectives given the business's environment.

T = time – a time limit needs to be set for when the objectives are to be met.

Here is an example to assist you: 'Jump and Jive Clothing Company's profitability objective is to reach a gross profit ratio greater than 50% for the next financial year'.

2 Write objectives for the following:

a Profitability. b Growth. c Efficiency. d Liquidity. e Solvency.

Short term and long term

Even though the business identifies its objectives, it must often prioritise them as they cannot always all be achieved at the same time.

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efficiency. However, if another one of the business's objectives is to be environmentally responsible, then the managers of the business may not be able to choose the least expensive method of waste disposal (for example, where the cheapest method is also bad for the environment). This conflicts with maximising profits in the short term. Consumers can reward businesses who use socially responsible methods of production by purchasing the products of that business. Consumers can also turn to a business's competitors if a business is not seen to be environmentally responsible. If sales drop, so do profits. In this case, stakeholders may come into conflict and the managers will need to negotiate to achieve an acceptable result overall.

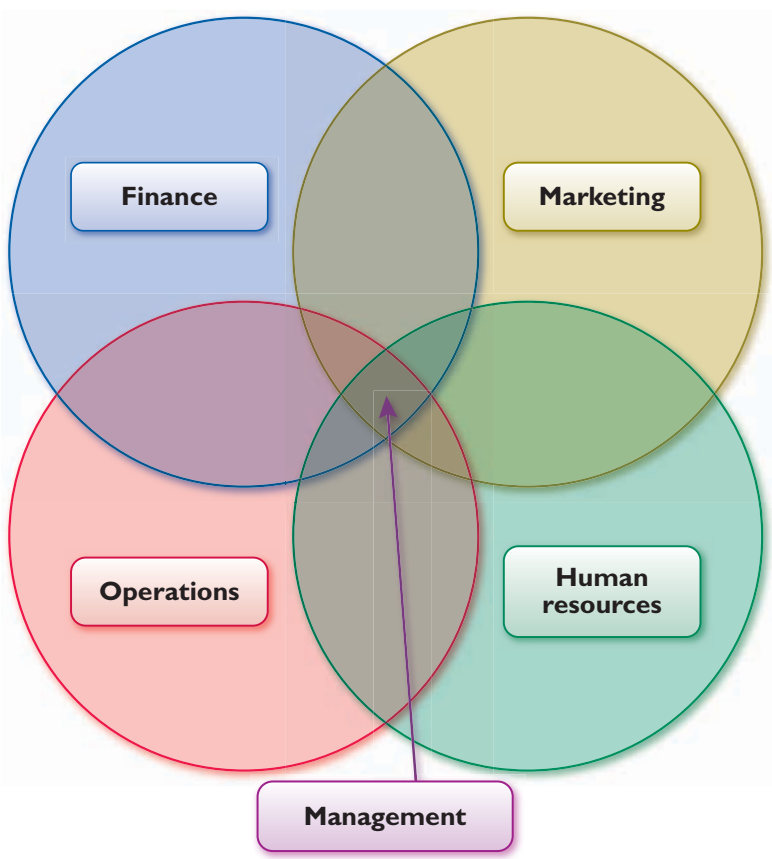


Figure 11.3 The interdependence of business functions, each part supporting the other parts of the business.

Interdependence with other key business functions

The main functions that a business needs to perform are operations, human resources, marketing and finance. Middle management develops short-term plans known as tactical plans, which are based on information provided by each of the businesses functions. These plans enable the business to achieve the goals set out in its strategic plan. All the functions of the business must work together and rely on each other for the business to be successful.

As the business grows, the coordination of the separate functions becomes more complicated and difficult to manage. It is essential that all internal stakeholders understand how the business works and know what the business hopes to achieve. As the firm grows and undergoes changes, the skills of management become increasingly important. Communication between departments must be effective, clear and complete. All departments need to see themselves as one part of a larger unit and to understand their importance and dependence on the other parts. In order to be successful, management needs to be able to see the business as a whole unit with many individual parts operating together. The financial manager must allocate adequate funds to each department to be able to operate successfully. The financial manager will also need to develop budgets and cost controls for each department. If marketing was provided with large funding, however, operations that provide the core product does not have enough money to keep up supply, then the money spent on marketing would be wasted.

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Chapter summary

- The long-term or strategic role of financial management is to ensure that a business operates with a return on investment and continues to grow and meet its objectives.
- Financial objectives are more detailed than strategic objectives and identify what the owners of a business want to achieve. Objectives will be developed for profitability, growth, efficiency, liquidity and solvency. A financial manager will use a number of measures to determine whether the objectives have been achieved for each of these categories.
- Profit is what is left over from revenue after all expenses have been paid. Retained profit is reinvested back into the business as capital, adding to the owners' original investment. Profit will also be distributed to owners and shareholders as their return on their investment. Profitability is represented by the gross profit and net profit earned in a financial year.
- A business that grows will increase its profitability. Growth can be achieved, for example, by increasing market share and increasing total sales.
- Efficiency is achieved when a business can generate a greater output with the same level of inputs (or the same output using less inputs). Efficiency is related to profitability because a business will be able to increase profit when it reduces costs.
- A business needs to hold liquid assets. The most liquid asset is cash. Current assets are more liquid than non-current assets. Financial managers are interested in liquidity because it shows how well working capital is being managed and whether the business can meet its short-term obligations.
- Solvency is the ability of the business to pay all its debts as they fall due. The higher the gearing or debt compared to equity finance, the greater the financial burden the firm has to deal with, the greater the risk involved.
- In order to achieve long-term business objectives, the organisation must achieve its short-term objectives. Overall the objective of financial management is to increase the wealth of the owners.
- The main functions of a business include operations, human resources, marketing and finance. These functions are interdependent and must rely on each other for the business to achieve its goals and objectives.

Chapter revision task

Rewrite the following passage on the planning cycle, using the words listed in the box below to fill in the blanks.

long	interdependent	rely	functions	source	takeover	goals	profitability
owners	investment	tax	wealthy	market	increased	short-term	decreasing

It is a financial managers responsibility to _____ finance to enable a business to achieve its strategic _____. A prime objective of many business owners is to become _____. Any profit the business makes belongs to the _____. A business pays _____ on its profits for each financial year. Financial reports are prepared to give a detailed financial picture of the business's _____ and financial stability. Objectives of a business may include:

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- Growth: growth can be achieved through the _____ of another business or by increasing its _____ share.
- Profitability: providing a return on the owners initial _____.
- Efficiency: by achieving _____ output from the same level of inputs.
- Liquidity: by being able to pay all of their _____ - _____ debts as they fall due.
- Solvency: by _____ their gearing levels

It must be remembered that short-term objectives need to be achieved to achieve _____-term objectives.

The business _____, operations, human resources, marketing and financing are _____ and _____ on each other for success.

Multiple-choice questions

1 Which objective of financial management is concerned with the ability of a business to efficiently manage its revenue and expenses?
- **(A)** Profitability
- **(B)** Liquidity
- **(C)** Efficiency
- **(D)** Growth

2 What is liquidity used to determine?
- **(A)** The profitability of a business
- **(B)** The ability of a business to repay its short-term debts
- **(C)** The return to shareholders on their investment
- **(D)** The ability of a business to maximise revenue

3 The financial manager of Caitlin's Cafe has decided to monitor and control all areas of spending in the business. What is the purpose of this?
- **(A)** To increase spending
- **(B)** To decrease spending
- **(C)** To increase solvency
- **(D)** To increase liquidity

4 During the establishment stage what is the most likely short-term financial objective of a business?
- **(A)** Profitability
- **(B)** Efficiency
- **(C)** Liquidity
- **(D)** Return on investment

5 Which of the following can be used to measure business growth?
- **(A)** Sales, market share and net profit
- **(B)** Revenue, expenses and cost of goods sold

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(C) Expenses, profitability and liquidity
(D) Expenses, equity and solvency

6 Of the following measures of profitability, which will provide the most precise measure of the profitability from the operations of the business?
(A) Earnings before interest and tax
(B) Earnings after interest and tax
(C) Net profit
(D) Dividends paid to shareholders

7 What does efficiency refer to in the financial management of a business?
(A) Increasing the sales of a business
(B) Ensuring there are enough liquid assets in the business
(C) Reducing expenses to increase profit
(D) Keeping spending low and profits high

8 Why is the effective management of a business's financial resources important in the long term?
(A) It encourages a business to develop expensive marketing strategies
(B) It is through the effective use of financial resources that a business is able to achieve its financial objectives
(C) It is through the use of financial resources that a business is able to obtain the best inputs
(D) It allows a business to acquire highly skilled and motivated employees

9 The level of gross profit is determined by:
(A) Total revenue minus all expenses
(B) Total revenue minus cost of goods sold and freight inwards
(C) Gross profit less expenses
(D) Net profit plus total revenue

10 A business is solvent if it can:
(A) Pay all of its short-term liabilities as they fall due
(B) Pay all of its short-term and long-term liabilities as they fall due
(C) Pay for all of its current liabilities
(D) Pay its mortgage repayment on time

Short-answer questions

1 Outline the five objectives of financial management.

2 Using examples, explain the importance of setting objectives in the financial management of a business.

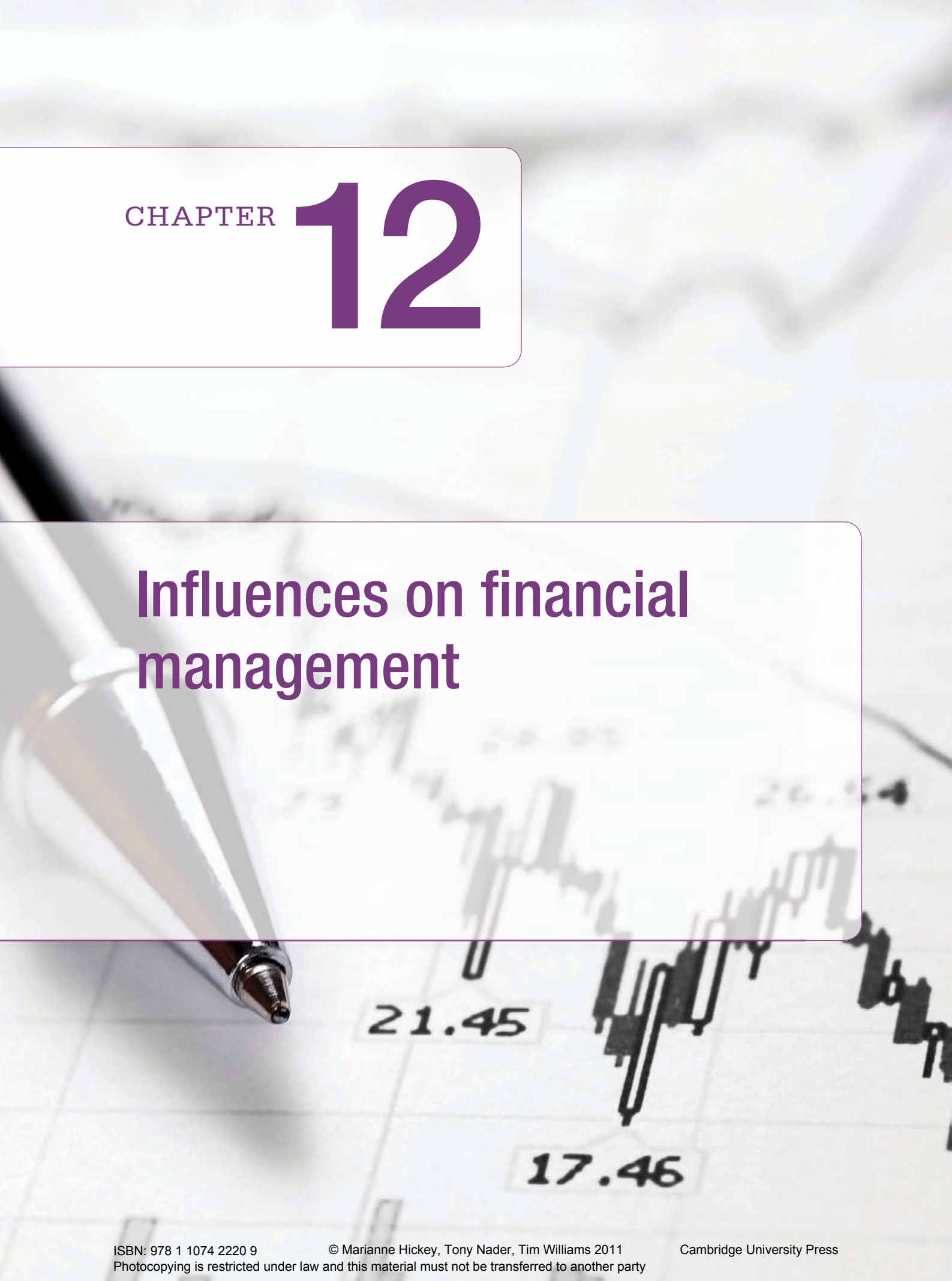
Extended-response question

Analyse potential conflicts between the main objectives of financial management.

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CHAPTER 12

Influences on financial management



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A business can source money from inside the business itself as well as from outside the business. There are two sources of finance: internal and external.

Internal sources of finance

Internal sources of finance are recorded under equity in the balance sheet. These sources are reinvested profits and the capital contributed by owners when the business began.

Where can an **entrepreneur** obtain the finance needed to start a business? This person may purchase an existing business or start a business from scratch. Alternatively, an entrepreneur could purchase a franchise; however, this can be even more expensive than purchasing an existing business. Although costs vary from industry to industry, opening a business can be very expensive. Let's assume that it costs $100 000 to create and open a good restaurant. Where can someone obtain $100 000? An owner can invest his or her own money. This money may be:

- personal savings
- an inheritance
- a gift from parents
- a payout from being retrenched from a job
- a personal loan or mortgage loan using the family home as security.

The owner of a sole trader or partnership deposits cash into the business bank account when it is started. As the owner has contributed this money when the business began, this source of finance is called capital. This can also be called shareholders' funds, proprietorship or proprietors' funds. Recorded under equity it represents the owner's financial claim on the assets of the business.

Retained profit

Retained profit is another common type of internal equity finance. Sometimes retained profit is called undistributed profits. If the business makes a profit the owner may decide to only take part of this as his or her reward for entrepreneurship and reinvest the remainder back into the business. In this situation the business has received finance from two internal equity types: the owner's capital contribution and retained profit.

Entrepreneur

A person who possesses natural business ability and takes a calculated risk to start a new business.

Retained profit

Net profit that is reinvested into the business. Retained profit is added to equity because it increases the owners' claim on the assets of a business.



Figure 12.1 Incorporated businesses can raise more finance from selling shares.

External sources of finance

Debt

There are a number of external sources of finance. These usually involve some type of loan and, therefore, are called debt finance. Debt finance is any money that has been borrowed. There are many types of short-term and long-term debt finance available

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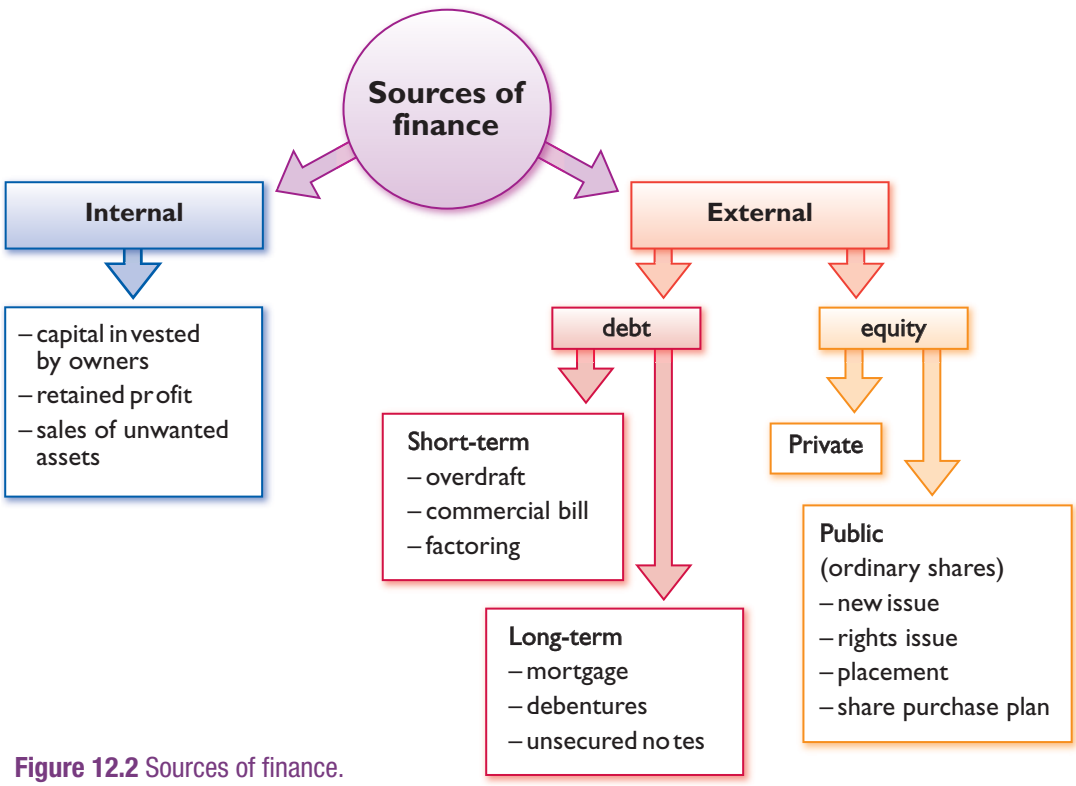


Figure 12.2 Sources of finance.

from different suppliers. Debt finance is generally categorised according to the term of the loan; that is, its repayment period. Generally, a short-term debt would be repayable within 12 months. There are also sources of finance that are external to the business but are not a loan. These include venture capital and grants.

Activity 12.1 Comprehension

1. Outline the sources of equity for a new business owner.
2. Explain one advantage of using retained profits to finance the purchase of assets.

Short-term borrowing

The most common forms of short-term borrowing include an overdraft, commercial bills and factoring.

Overdraft

A bank overdraft gives a business flexibility to borrow money from a bank at short notice through its cheque or current account. A bank may allow a business to overdraw their current account up to a specified maximum limit as agreed between the bank and the business. This overdraft facility allows a business to have a negative value in its account. Later, when the business receives cash from sales, money is deposited into the bank account, thereby reducing the overdraft. Overdraft facilities are very convenient, but can have very high costs (such as a high daily interest rate). Interest is charged on the overdrawn amount for the period of time that the account remains overdrawn. They carry a financial risk because the business must repay the interest regardless of the level of

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profits that the loan could generate. This form of debt finance can provide short-term finance for business requirements such as working capital, especially where a business is affected by seasonal fluctuations, such as a winter ski resort in the summer season. An advantage of bank overdrafts is that current taxation law allows interest paid to be claimed as a tax deduction.

As an alternative to an overdraft, a business can have its own credit card on which to make purchases and pay expenses. This is becoming more common due to banks providing business with specialist credit cards that offer a lower rate of interest and loyalty programs.

Ethical Issue

Frank and John often attend business meetings interstate and they have both accumulated a lot of frequent flyer points in their own names. Is it ethical that Frank and John can use those points at no cost to travel on personal holidays with their families, even though the business (and therefore shareholders) paid for the flights that earned those points?

Commercial bill

A commercial bill (or bank bill) is a written order for a loan amount that is guaranteed by the business's bank. The money is borrowed from other companies that have surplus funds. Businesses and governments that need funds in the short term sell these bills. The funds and the interest will be repaid to a particular person or business on a certain day in the future. Usual terms are 30–180 days. Commercial bills are usually for amounts in the hundreds of thousands of dollars and are used to finance expenses, such as payment to suppliers of materials and wholesale goods. These bills can be rolled over for extended time periods, even indefinitely. They are often considered to be the cheapest form of finance. The bill needs to be reassessed each time it matures, thus retaining its short-term classification.

Activity 12.2 Comprehension

1. Describe two advantages for a business that has an overdraft facility with its bank.
2. Identify qualities that a supplier will require of a business before providing it with trade credit.

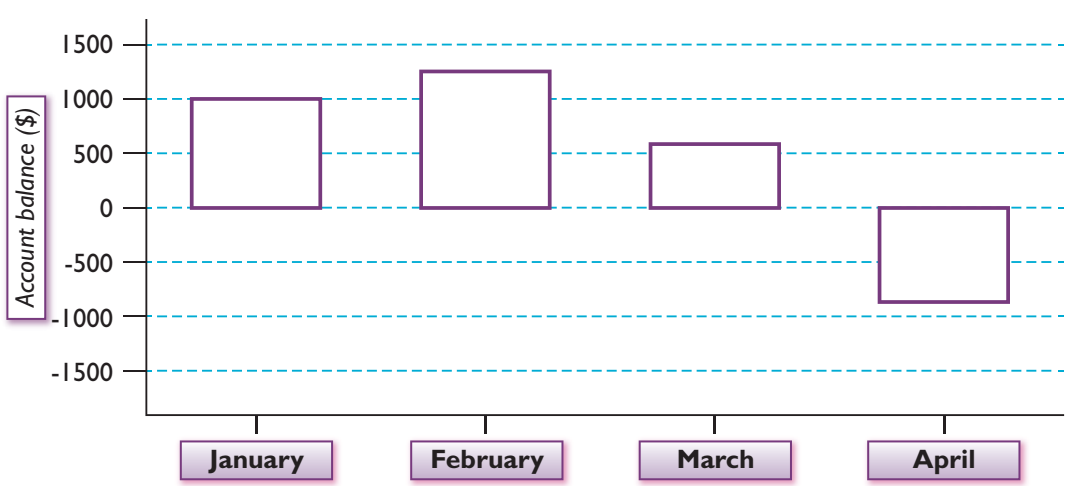


Figure 12.3 An overdraft facility allows a business to have a negative value in its account.

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Factoring
Occurs when a business sells its accounts receivable asset to a specialist factoring firm to create cash inflow for the business.

Trade credit
Money owed to a creditor for the purchase of supplies and services that have already been provided.

Factoring

Factoring is a source of short-term finance because it can be used to obtain cash reasonably quickly. It can be used to improve cash flow, using the unpaid invoices of a business as security. Factoring is the cash sale of a business's accounts receivable (or trade debtors) at a discount to a factoring company. This can be done on an ongoing basis.

The factoring company takes over management and collection of the unpaid accounts under terms agreed with the business. The factoring company will pay the seller the value of the accounts receivable, less a commission or fee. The fee charged will vary with the size of the credit sales and the credit rating of accounts. Thus, the greater the risk, the higher the fee. Debtors pay directly to the factoring company. Factoring is a method of improving a business's liquidity at the expense of some of its working capital in the short term.

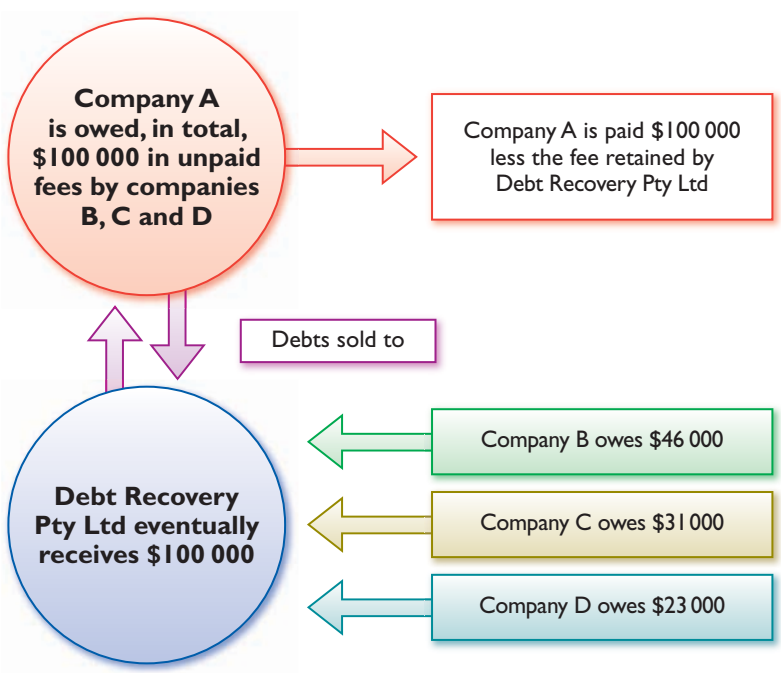


Figure 12.4 Factoring.

Reliable businesses can also use **trade credit** provided by their suppliers, which effectively allows them to use goods and services that they pay for at a later date (trade credit is a type of loan from a supplier, because payment to the supplier from the customer is delayed). Good relationships with suppliers can result in trade credit that allows from 30 to 90 days of actually free finance. The supplier will need to have in place effective controls to monitor its accounts receivable (or trade debtors) in order to maintain its profitability.

Long-term borrowing

A loan that has a term of repayment longer than 12 months would be considered a form of long-term debt finance. Businesses may take out term loans for three, five or 10 years or longer. The more common forms of long-term borrowing for businesses include mortgages, debentures, unsecured notes and leasing.

Mortgage

The most well-known type of debt finance is a business mortgage loan, which is repaid over a set number of years. Mortgage loans have a long repayment period (or term) and therefore are classified as long-term finance. To start a business an entrepreneur may purchase non-current assets using a mortgage loan from a bank or business lender.

Mortgages are loans used to fund the purchase of property, such as land, a factory site, offices, a building (such as a shopping centre, warehouse or other commercial property). The property asset becomes the security for the repayment of the loan. Monthly repayments are made to

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repay the loan and interest. Mortgage loans are typically very long term; some being repaid over 15 to 30 years. In some cases, firms purchase property on interest-only loans and hope to gain capital gains when it is resold and they move their production facility to offices elsewhere.

Debenture

Large, established companies can obtain finance by issuing debentures. Finance companies and other large firms are invited to invest in these businesses by lending large amounts of money to the businesses. These loans are used to buy buildings and equipment and are for a fixed amount, for a fixed time and at a fixed interest rate. A business that has lent money becomes a debenture holder. Repayment is ensured by the appointment of a trustee who monitors the debenture-issuing business to ensure it operates profitably and can therefore repay its loans and interest. The debenture holder's funds are invested with the business as secured loans with the security in the form of a fixed or floating charge over the assets of the business. Debentures may be private or public issue. For a public issue a company must issue a prospectus, which is also lodged with ASIC. Public issue debentures may be traded on the securities exchange.

Unsecured notes

Unsecured notes are notes usually issued by finance companies to gain funds. They are not secured and do not provide any claim on the assets of the business. Therefore, they offer higher interest rates reflecting the greater risk to the investor. The unsecured note issuer is only backed by its creditworthiness and good reputation. Unsecured notes are called bonds. The borrower must pay a specified amount of interest, often quarterly or half-yearly, and repay the entire amount borrowed on maturity. Interest is often higher than for debentures.

Leasing

Leases are similar to rental agreements. Businesses lease non-current assets, such as a company car, delivery vehicles, equipment and office or factory space in return for payments to the owner. This reduces the cost of acquiring these assets as the business does not have to outlay the full value of the asset in one transaction. Instead, it rents the asset over an agreed period of time. When a business leases an asset it is agreeing to an ongoing, regular payment that allows it to use an asset that is owned by another business. The firm will have an obligation to pay another business and therefore a lease is a type of debt finance. This agreement can provide

BUSINESS BITE

Angus Securities Limited issued a prospectus on 1 April 2010 in order to raise debenture finance. It proposed to raise $300 million in new capital at an issue price of $1 each. This is Angus Securities 11th successful prospectus. Prospectuses are lodged with ASIC and need to satisfy strict criteria. ASIC can and has issued stop orders on several debenture issuers, forcing companies to revise information in their prospectus in order to ensure investors are properly informed.

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Equity

The owner's financial claim on the assets of the business. It is the original investment the owners made into the business by contributing capital or buying shares, plus any profit the business makes. Also called proprietorship or proprietors' funds.

Ordinary shares

Can be issued with or without the right to vote at the annual general meeting. Ordinary shareholders receive dividends after preference shareholders.

Liquidation

Occurs when all the assets of a business are sold to generate cash to pay liabilities and creditors. A business that has to liquidate its assets has most likely declared itself bankrupt.

tax advantages as the lease payments are usually tax deductible. They are not shown in the balance sheet and do not affect the company's gearing. At the end of the leasing period, the business may re-lease the item, upgrade the lease for a different or newer item, or offer to buy the leased item, usually at the agreed 'residual value' that was negotiated at the start of the lease.

Equity

Funds may be invested into a business by its owners. The term **equity** is usually attached to the ownership of shares in an incorporated business.

Private equity

If a business does not wish to increase its level of debt it can invite other people to become part-owners by selling them shares in the business. In this case, the business will have become incorporated and now has a company structure. Unincorporated businesses (such as sole traders and partnerships) cannot sell shares. The business has gone outside of the business to seek funds and therefore is classified as external equity finance. The advantage for the business is that the cost of the finance can be postponed as shareholders will not need to be paid dividends immediately. However, with more owners the disadvantage is that ownership becomes diluted, or spread, among more people. This means the original owners have less control as they now own a smaller share of the business. In addition, selling shares is not necessarily cheaper than debt finance and is more complex to organise. Using the original restaurant example, let's assume that your business sells nine shares at $10 000 each to nine friends. These shareholders will give you $90 000. To this you add $10 000, which is your share of the business, giving you the total finance ($100 000) needed to open the restaurant. Private equity relates to a private company because the shares were not sold through the securities exchange and does not involve invitations to the general public to invest.

Ordinary shares

Another form of incorporated business structure is a public company. Public companies issue securities or shares to the general public through the securities exchange. There are a number of different types of shares that companies issue to suit a variety of investors. **Ordinary shares** are the basic form of equity capital. Ordinary shares can be issued with or without the right to vote at the annual general meeting. Preference shares usually do not give shareholders voting rights, but preference shareholders receive dividends before ordinary shareholders. This means if the business is **liquidated** the preference shareholders will receive payment from the sale of assets followed by debentures holders and then ordinary shareholders and unsecured creditors.

New issues

This first issue of shares is known as the primary market. A prospectus is issued through a stockbroker and shares are made available on the securities exchange. For example, say 100 000 shares are offered at $1 par value each (par value is the value of the share set by the company issuing them – it can be quite different from the value set by the free market or secondary market). This would be the authorised capital. If all shares are sold, the business collects

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$100 000. Each shareholder or owner contributes to the business the money he or she paid for the shares. Shareholders receive a dividend, as their proportion of the company's profits, the value of which is determined by the board of directors. It is only when shares are sold for the first time that the business actually receives the money. In the secondary market when shares are sold ownership of the shares changes and the previous owners receive the money.

Rights issue

In order to raise additional funds, a company may organise a rights issue. In this case, the existing shareholders of a company may be offered additional shares in proportion to their current holdings of that company's shares. These additional shares may be purchased from the company. The shareholder is not obliged to take up the rights issue and may reject, sell or transfer his or her rights to another shareholder. A rights issue may be part of the company's original prospectus and therefore will not need to incur the expense of a new prospectus, only a written proposal to shareholders.

Placements

Another method to raise additional funds and more frequently used these days is to offer additional shares to specific institutions and specific investors. The company does this without a formal prospectus and does not need to obtain general shareholder approval. Through share placements a company can raise up to 15% of its current capital base. These funds can be raised quietly, often within 24 hours and in large amounts, such as $500 000.

BUSINESS BITE

Boral – $490m rights issue, 7 July 2010

Boral, a major supplier of building products, plans to restructure its business operations in the global environment. As part of these plans Boral wishes to raise $440 million through a $4.10 a share rights issue. This is a 16% discount on its previous closing share price of $4.89. Boral aims to streamline its structure by consolidating seven divisions into five. Its aim is to focus on its core construction: cement and building product assets.

Source: Sydney Morning Herald, *7/7/10, Philip Wen.*

The company may wish to use these funds to significantly expand its activities; for example, by taking over a new business. In this case, speedy acquisition of funds would be essential.

These companies may need to pay underwriters fees in order to make up for any shortfall in the money to be raised. The institution that underwrites the issue of shares agrees to buy any share not bought by investors.

Share purchase plans

Share purchase plans allow existing companies to issue a maximum of $5000 in new shares to each existing shareholder without issuing a prospectus. Each share is offered at a below-current-share price. Permission is required from ASIC and the process is relatively inexpensive and benefits both the company and the investor, and is completed quickly. In order to proceed with a takeover, funding would need to acquired very quickly.

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Venture capital

Capital acquired from a specialist venture financial institution that seeks to become a part-owner in the business.

Grants

Financial gifts provided by government to assist businesses to establish or expand.

An entrepreneur, finance company or superannuation fund can provide finance to a business in exchange for part-ownership, through **venture capital**, although the venture capitalist will have very little say in the day-to-day management of the business. For instance, the owners of a new business may have an innovative idea but lack the capital they require to act on it. Owing to their high risk, the owners are unable to acquire a loan. They could present their business innovation to a well-established businessperson, or entrepreneur, who will review the business plan. If the entrepreneur determines that the risk is worthwhile, the entrepreneur will provide the capital for the business to grow.

Grants are financial gifts provided by government to assist businesses to establish or expand. Some businesses may also be eligible for government grants or low interest rate loans. Businesses can use the internet to apply for the variety of grants that are available. To qualify, businesses need to meet strict criteria. Governments have decided that certain industries will benefit the economy and therefore should be encouraged by receiving grants.

BUSINESS BITE

AMP, July 2003

AMP used a share purchase plan in July 2003. At that time, shareholders could buy AMP shares at $4.82, which was at a 5% discount to the market price. In another more recent example, Macquarie Airports offered its small shareholders the opportunity to buy up to $5000 at $2.78 per share, representing a discount of 9% on the security price. Macquarie Airports wish to use the money for expansion, whereas AMP needed to fund its current operations.

Activity 12.3 Analysis

Imagine you own a successful business and one of your social goals is to provide opportunities for young entrepreneurs who wish to start their own business. You will assist by providing venture capital. Identify five characteristics that a venture capitalist would like to see young entrepreneurs display before providing them with finance. One characteristic is provided below as an example.

- An innovative business idea that meets the needs of consumers in a niche market.

Activity 12.4 Comprehension

1. Explain why an owner of a new small company may be reluctant to acquire additional equity finance from shareholders.
2. Outline the advantages of a partnership incorporating to become a company.
3. Outline three features of a company that a potential shareholder will wish to consider before investing.
4. Discuss the factors that influence an owner's decision concerning how to raise the finance to establish a new business.

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Financial institutions

The most obvious place where a business can acquire finance is a bank. However, deregulation of the financial sector in Australia since December 1983 has allowed many more participants to enter the market for business financial services. This change has made it possible for a business to acquire finance from any of the following participants: banks, investment banks, finance companies, superannuation funds, life insurance companies, unit trusts and the Australian Securities Exchange. As a result of globalisation, businesses can also acquire finance from international financial markets and overseas stock exchanges. For example, Australian companies can sell shares on the US Stock Exchange; that is, Wall Street.

The financial market has become more competitive. Not only are participants competing in terms of the interest rates offered, they are also developing new financial 'products' to sell to businesses. Businesses are able to shop around and find the most suitable **debt security** for their needs at the cheapest interest rate.

Banks

Banks accept deposits from the general public and provide funds for loans. Most large banks have specialist business services that are separated from individual savers or families with home mortgage loans. Banks provide many financial products for their corporate clients, including:

- online banking, detailed statements, business credit cards and bank overdraft management
- services such as **EFTPOS** and **BPAY**
- business insurance and superannuation
- legal and taxation advice
- international trade finance
- risk management
- economic outlook reports.

Debt security

Any type of loan that a business obtains that is issued by a promise of repayment on a certain date at a specific rate of interest.

EFTPOS

Electronic funds transfer at point of sale. EFTPOS allows customers to pay for their purchases electronically using their bank keycard or credit card.

BPAY

Payment of bills using online (internet) banking.



Figure 12.5 Australian companies can sell shares on the US Stock Exchange

Activity 12.5
Research and comprehension

1. Research the services that large Authorised Deposit-taking Institutions (ADIs) offer businesses. Using the internet as a starting point, access the website of a large ADI (or bank) and a non-bank financial institution and describe the services they specifically offer to businesses.
2. Outline the differences between personal banks and commercial banks.
3. Discuss the purpose of superannuation funds.
4. Explain why superannuation funds are a participant in financial markets.
5. Explain why some businesses participate on financial markets as a provider of finance.

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Unsecured loan

A loan that does not have an asset as security. If the loan is not repaid then the creditor who lent the money receives nothing. Unsecured loans have a much higher rate of interest than secured loans.

Leasing finance

Involves a business 'hiring' the assets it needs for a period, such as a year. The business has the right to use the asset (such as a car, machinery or building) without having to buy it. A fee must be paid every week, fortnight or month, which is an expense for the business.

Debentures

A type of long-term debt finance that a business can acquire by offering a prospectus to the general public on the securities exchange. The business is offering an investment opportunity to people who want a good return from a more risky investment.

Superannuation fund

All superannuation payments are invested in a superannuation fund. The fund invests the superannuation in, for example, shares or property to earn a return for the employees whose superannuation has been invested with the fund.

Investment banks

Businesses can now gain funds from consumer or personal banks. These are often referred to as Authorised Deposit Taking Institutions including the Commonwealth Bank, National Australia Bank and the St George Bank. Businesses also acquire funds from investment banks. They are also known as merchant banks in the UK. Investment banks deal with businesses and governments in raising large amounts of capital by underwriting share issues. Investment banks generally want some equity in the business borrowing funds so that they can influence the direction of the business's activities. They also assist businesses involved in mergers and takeovers. They provide advice and can arrange nearly any type of finance a business may need. Business loans will be customised to the specific needs of the business. They have developed new financial products and become more competitive.

Finance and life insurance companies

Finance and life insurance companies provide different types of secured and unsecured loans to business. Secured loans require an asset (such as property) that is security for the loan. If a business fails to repay a secured loan, the asset will be forfeited to the lending institution. **Unsecured loans** do not require an asset to act as security. These loans are advertised to businesses and are generally repayable in instalments. Finance and insurance companies can arrange commercial bills, **leasing finance** and **debentures**. They do not accept deposits from the general public. Life insurance companies' main business is providing insurance against death and disability through householders investing funds with the company. The participants buy policies, pay regular premiums and are guaranteed a minimum payment at the time of the policy holders' death or in the event of an accident causing disability. Ongoing premium payments provide the life insurance company with funds available for lending to businesses. Generally, interest rates would be higher from these institutions than from banks.

Superannuation funds

Due to changes in federal government policy and law, all employees must have a small part of their wage or salary invested in a **superannuation fund**. This is currently set at 9% and is paid into the fund by the employer. The purpose of **superannuation** is to provide an investment that people can use as a source of income once they stop working and thereby reduce the need for the aged pension provided by the federal government. Over his or her working life, an individual can build up an enormous amount of savings that, when invested wisely, can grow to be a substantial investment. Superannuation funds therefore have very large amounts of money that need to be invested to make a return to pay for the retirement income of the investors in the funds. Superannuation funds earn returns by selling debt securities to businesses, which repay these loans with interest. From July 2005 individuals have been free to choose their own fund.

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Unit trusts

A unit trust is formed under a trust deed. A trustee controls and manages the trust. Units are offered to the public for investment. All the money from the sale of units is pooled and invested by the trustee. The type of investment is specified in the trust deed. The four main types of unit trusts are property trust, equity trusts, mortgage trusts and fixed-interest trusts. Unit trusts are increasing in popularity and can be listed on the securities exchange.

Australian Securities Exchange

The Australian Securities Exchange (ASX) is a market that brings together buyers and sellers to exchange shares. The ASX is a market where:

- once approved by the ASX, businesses can issue shares to the general public on the *primary market*.
- buyers and sellers can exchange shares on the *secondary market*.

The Australian Stock Exchange was formed in 1987, after an amalgamation of six separate stock exchanges located in each state's capital city. In 2006 this organisation merged with the Sydney Futures Exchange to become the Australian Securities Exchange (ASX).

Listing on the ASX, a procedure known as an *Initial Public Offering* (IPO), is a common way for businesses to raise capital. An Initial Public Offering follows several distinct steps. First, the business must be of a reasonable size, and have been in continuous successful operation for a reasonable time. If the business meets these requirements, they can then issue a Product Disclosure document or **prospectus**. This document gives potential investors a detailed depiction of the business and, importantly, its finances. It must provide an outline of the business's past, and predicted future financial performance as well as the risks the business may face. This document must be lodged with the Australian Securities and Investment Commission (ASIC).

Once the prospectus has been issued, investors can apply for a share allocation. If the level of interest in the IPO is greater than the number of shares available, investors may not receive all of the shares they applied for as the IPO has been oversubscribed. A company that has an attractive financial record and excellent management should find it quite easy to raise finance and hence could well be oversubscribed The price that the shares are sold at can either be prescribed in the prospectus, or determined by tender. The money collected through this process is known as equity finance.

The company can then use this money to fund expansion, to launch a new project, to continue growth or for any other business expense.

Once the IPO process has occurred, and the business is floated, investors are able to trade those shares with other investors on the secondary market. Rather than being determined by the prospectus or a tender process, the price of these shares will be determined through the principle of supply and demand.

Activity 12.6 Comprehension

Identify the major participants in the financial market and – for each – identify one advantage that it can offer a small business.

Superannuation

Compulsory savings (additional to the employee's wage or salary) paid by the employer and invested in a superannuation fund on behalf of the employee.

Prospectus

A company's invitation to investors to buy shares in the company. The prospectus is a brochure that describes the business and indicates what shareholders will receive if they invest by purchasing shares.

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Monetary policy

Steps taken by the Reserve Bank of Australia to affect the finance market and assist the federal government to achieve its goal of low inflation and economic growth.

Influence of government

In Australia, the federal government also participates in the financial market to influence the Australian economy. This is called **monetary policy**. Through the Reserve Bank of Australia, the federal government will buy and sell government securities and loans and put pressure on interest rates to alter the economic cycle by stimulating an upswing or downswing as needed. The federal government also offers low-interest loans and grants to businesses that will make a significant contribution to the economy, such as earning export income. The government's GrantsLINK website (www.grantslink.gov.au) provides information for businesses on what grants they may be eligible for. The Export Market Development Grant administered through Austrade provides 50% of the marketing costs for exporters where the business has spent more than $10 000 on international advertising. A New Enterprise Incentive Scheme has been set up to provide a person starting a new small business with accredited small business training, advice and mentoring as well as ongoing income support for up to one year.

Australian Securities and Investment Commission

The government set up the Australian Securities and Investment Commission (ASIC) in 1998 to regulate corporations, markets and the provision of financial services covered under the *Corporations Act 2001* (Cth). The Act contains provisions for consumer protection, the supervision of financial market operations, insurance, superannuation, life insurance, retirement savings and medical indemnity. With 1800 staff and a budget of approximately $300 million, ASIC collected more than $550 million in fees and charges in 2008–9.

ASIC performs market assessments of businesses, such as the ASX Limited, IMB Ltd, Asia Pacific Exchange Ltd and Yieldbroker Pty Ltd, and identifies areas of improvement to meet corporate requirements.

ASIC's responsibilities include ensuring that company directors carry out their duties honestly, diligently and in the best interests of their company. Financial service providers must be honest, efficient and fair.

Company taxation

Company tax is presently 30% of net profit. Many overseas countries such as Japan (40.7%), USA (40%) and France (33.3%) currently impose higher rates of company taxation. In Australia, we pay the same as companies in New Zealand, Indonesia and Thailand. Other countries are lower, such as China where company taxes are levied at 25% and Singapore at 18%. However, in Australia in the case of financial institutions, various rates apply. Superannuation funds and retirement savings accounts pay 15% tax. This is an incentive program by the government to encourage people to save for retirement. The federal Labor Government has also planned for the company tax rate to drop to 29% in 2013–14 and to 28% from the 2014–15 income year. The government sees this as an incentive for businesses to retain profits and use the funds to grow their businesses. This would provide additional benefits for new people thinking of going into business themselves and taking the risk involved. It would also make Australia more attractive for foreign investment, and create new jobs and ultimately higher economic growth.

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Global market influences

To reduce risks and minimise losses, financial managers must be aware of the influences on the Australian financial market, both from within Australia and from overseas. As part of managing proactively, financial managers will be most concerned about what may happen to the cost of finance in the future. The cost of finance is the rate of interest charged. Because interest rates vary from day-to-day, the interest cost of a loan can change significantly. Deregulation of the Australian financial sector by the federal government occurred during the 1980s. There was a removal of restrictions on the interest rates that banks could charge and new overseas banks were allowed to operate in Australia. Businesses could now choose from a greater number of participants and financial products and services and at more competitive prices; that is, lower interest rates. The freeing up of the financial sector has made it necessary to introduce independent monitoring and regulation to ensure all participants behave competitively. Since 1998 the Australian Prudential Regulation Authority has become the main regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, insurance companies, friendly societies and most members of the superannuation industry who hold assets for Australian depositors, policy holders and superannuation fund members.

The Reserve Bank is the Australian Government monetary authority. It formulates and administers monetary policy. The main objectives of monetary policy are to control inflation rates to a level between 2–3%; maintain full employment between 5–7%; and to maintain economic growth between 3–4%. The main tool that the Reserve Bank uses is purchasing of securities to increase the supply of funds in the market. This will place pressure in the market to decrease interest rates. This occurred in 2008–9 in order to stimulate economic growth as Australia became affected by the international recession. Alternatively, businesses will anticipate interest expenses to rise as the economic cycle reaches the boom phase and inflationary pressures increase.

Since 2000 the RBA has decided to increase interest rates only by very small amounts and generally let the market set what the rate should be. Overseas influences have increasingly affected the Australian financial market due to globalisation. A downturn in the global economy or a downturn in the enormous economies of the United States and Japan, which are some of our major trading partners, may cause the Australian economy to decline. There will also be influences on the financial market caused by the value of the Australian dollar against currencies of other countries. International shocks such as the Asian Currency Crisis (1997–98), terrorism, the 2004 oil shortage, the swine flu epidemic in 2009, the global financial crisis of 2009 and the major earthquake and tsunami in Japan in 2011 have affected Australia to some degree by creating nervousness in the market. There will also be different interest rates between countries. If Australia is seen as providing a higher return than Japan or the United States, for example, money will flow into Australia. This will reduce local interest rates, making it cheaper for businesses to borrow.

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Chapter summary

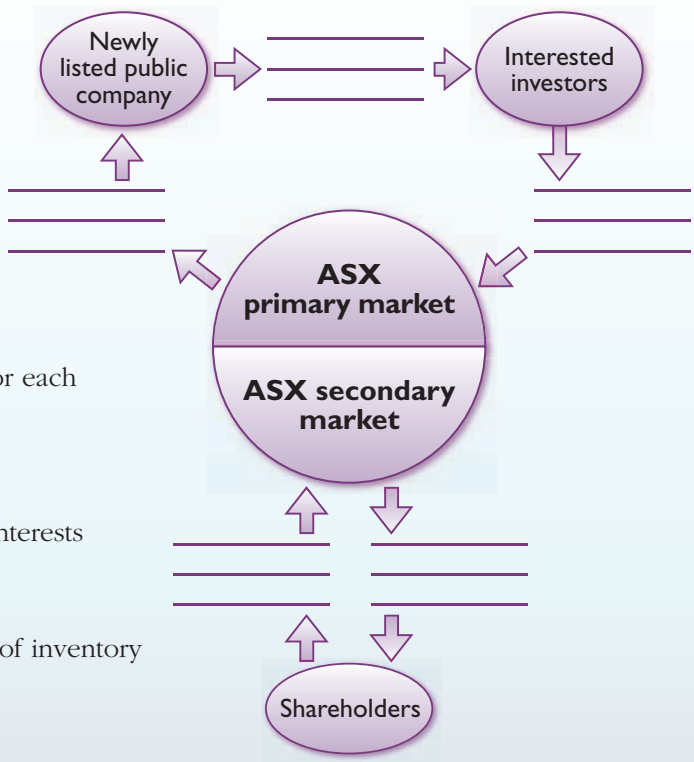
- A business can source money from inside the business (internal finance) or outside the business (external finance).
- Internal sources of funds are called equity. These sources of funds are reinvested profits and capital contributed by owners when they bought shares or invested by owners when the business began.
- External sources of finance include debt finance, which is borrowed money, and equity in public and private companies.
- Types of debt finance are short-term and long-term. Short-term types include bank overdrafts, commercial bills and factoring. Long-term types include mortgage loans, debentures, unsecured notes and leasing.
- Leasing allows a business to finance an asset by effectively hiring it for a fixed period of time.
- Factoring enables a business to increase its cash to finance the payment of short-term liabilities and expenses. Accounts receivable is sold to a factoring firm for cash at a discounted price.
- External equity involves the issue of new shares for public companies; rights issues to existing shareholders; placements to specific institutions and specific investors; and share purchase plans to existing shareholders.
- Private equity refers to selling shares by inviting specific people to become owners of the business in a private company.
- Many different types of businesses operate in and influence Australia's financial markets, including:
  - traditional banks, which have moved into the market for business financial services as well as services for personal depositors
  - investment banks, which deal solely with businesses, have developed new financial products and become more competitive, finance, life insurance companies and superannuation funds and unit trusts that lend finance.
- The Australian Securities Exchange is a market that allows companies to issue shares on the primary market to raise equity finance. It also facilitates the buying and selling of shares on the secondary market.
- The federal government:
  - influences interest rates by buying and selling securities and offers financial grants
  - established ASIC to oversee the operations of financial institutions
  - gains funds through taxation on company profits
  - uses monetary policy to adjust interest rates to drive the economy and make the cost of borrowing cheaper or more expensive.
- Deregulation of the Australian financial sector means Australian businesses can now choose from a greater number of participants and financial products and services and at more competitive prices; that is, lower interest rates (the interest rate is the cost of debt finance).
- Globalisation has resulted in finance flowing into Australia when interest rates are higher than countries overseas or flowing out when they are lower. Businesses can acquire finance from overseas stock exchanges and overseas financial institutions.

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Chapter revision task

1 Copy the figure and use the labels provided in the box below to fill in the blanks.

Issues prospectus using a stockbroker
Purchases shares from primary market
Receives equity finance
Buys shares for investment
Receives dividends as return on investment
Sells shares for potential capital gain (profit)



2 Identify the most appropriate source of finance for each of the following:

- an office block for a company's headquarters
- a fleet of company cars for sales staff
- purchase of a company overseas to diversify interests
- food and drink supplies for a restaurant
- purchase of inputs imported from overseas
- a warehouse to store a temporary oversupply of inventory
- electricity, telephone and internet bills
- an internet software development company
- a factory building
- office stationery.

Multiple-choice questions

1 What are the internal sources of finance available to a business?

(A) Shares, retained profit and loans
(B) Leasing, factoring and venture capital
(C) Retained profit, start-up capital and the sale of business assets no longer required
(D) Commercial bills, shares and leasing

2 An entrepreneur who provides capital to a high-risk business venture in exchange for part ownership is:

(A) Providing leasing finance
(B) Expecting an immediate return on investment
(C) Providing bridging finance
(D) A venture capitalist

3 When interest rates are expected to rise, what is a financial manager's most likely response?

(A) Reduce the level of equity in the business
(B) Reduce the level of debt in the business
(C) Increase output to increase cash inflow from sales
(D) Reduce output to reduce costs

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4 Unincorporated businesses are:
   (A) Limited to using only debt as a source of finance
   (B) Limited to using only equity as a source of finance
   (C) Able to participate on foreign financial markets
   (D) Unable to sell shares

5 What is the advantage of a bank overdraft for a small business?
   (A) Interest rates are usually lower and more variable than mortgage loans
   (B) Interest rates are usually higher and finance is available at very short notice
   (C) Finance is available at short notice and is preapproved
   (D) Interest rates are fixed and repayment can be delayed

6 What is an advantage of raising capital through a rights issue?
   (A) Anyone can buy the shares
   (B) The cost of the finance is postponed
   (C) Can be sold on the securities exchange
   (D) The ownership of the business becomes diluted

7 Which organisation provides grants to assist businesses?
   (A) Government departments
   (B) Venture capitalists
   (C) Merchant banks
   (D) Other companies

8 When taking part in factoring a business:
   (A) Sells its accounts receivable
   (B) Sells its accounts payable
   (C) Sells its non-current assets
   (D) Sells its inventory

9 Fred & Jane's gelato bar use an overdraft to supplement their cash flow in the winter season. An overdraft is:
   (A) Available through their cheque account facility
   (B) Part of their equity financing
   (C) Provided through their superannuation fund
   (D) A long-term solution to their problem

10 What source of funds is most appropriate for purchasing stock in a small shop or restaurant?
   (A) Factoring and leasing
   (B) Commercial bills and bank overdraft
   (C) Bank overdraft and trade credit
   (D) Trade credit and debentures

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Short-answer questions

1 Describe the process a company must follow in order to raise equity finance through the Australian Securities Exchange.

2 Outline the impact of federal government monetary policy on the financial markets in Australia.

Extended-response question

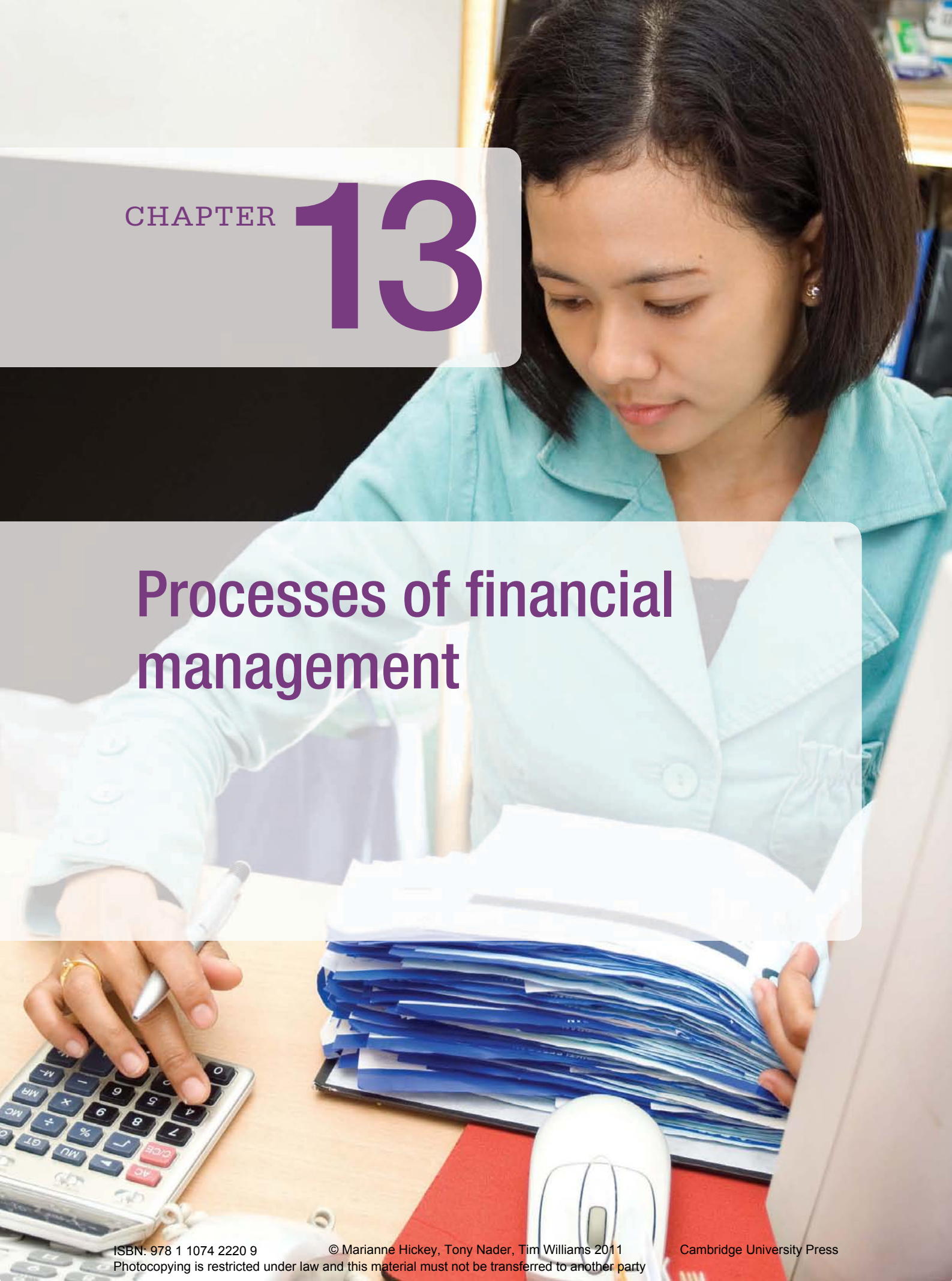
Business Report

> The Great Aussie Meat Pie Company has developed a Wasabi-flavoured pie for export to the Japanese market. The company wishes to find out more information about funding new equipment for producing the new pie and what it needs to do financially to begin exporting.

Access the website of a leading savings bank (such as St George, Commonwealth Bank, National Australia Bank, HSBC or Macquarie Bank) and research the financial services and products that it advertises for businesses. Write a report describing these financial services and products and recommend the financial services and products The Great Aussie Meat Pie Company should use.



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CHAPTER 13

Processes of financial management

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Planning and implementing

Financial management is responsible for the financial planning of the business. This will help determine the viability of the venture, make decisions about its future and make projections for liquidity and expected future performance.

Financial management must plan, obtain and control the business's finances for each department to be able to achieve their objectives. The financial statements that back up the business plan will show whether the plan for a product will generate sufficient cash flow to be successful, cover expenses, fulfil debt obligations and provide a return for investors in the business.

In order to do this, financial managers implement reports to determine financial needs of each department, set budgets, instigate record systems, determine financial risks and use various financial controls.

Financial needs

A new business will have to determine its start-up costs; this will include such things as the purchase of new equipment, obtaining an appropriate premises, inventory, staff, marketing, utilities and paying legal fees and other service providers.

Once a business has begun operations, funds need to be available when needed or else liquidity problems will develop. Cash-flow shortages present major problems for a business.

The business will need to make financial forecasts based on information gained from market and product research.

Budgets

A budget is a plan for achieving set outcomes and is based on forecast figures or expectations of future operations. This plan could be for six, nine or 12 months or longer. In most businesses, planning includes individual departments being presented a budget to work with. Department managers need to determine the resources needed and identify future **opportunities** and **threats** in order to reach their set objectives.



Figure 13.1 Budgets monitor the movements of the business.

Budgets provide details, in money terms or units, about what the business wants to achieve and creates a framework for internal decision making. Budgets are also used to monitor the movements of the business. A budget establishes standards and can be used as a control method, allowing comparisons of actual results with the initial plan and an evaluation of progress. This may lead to adjustments being made to parts of the business plan or to the procedures followed in individual departments to bring in line with the rest of the business.

An existing business has the benefit of its historical records and an understanding of how the business already operates.

Opportunities

Changes in a firm's external environment that may present a benefit for the firm or present the firm with an opportunity for improvement or expansion.

Threats

Changes in a firm's external environment that may present problems for the firm.

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It must also, however, adapt to a dynamic business environment, especially changes in economic conditions and consumer trends.

Budgets may be divided into several categories, the main ones being operating budgets and financial budgets.

Operating budgets provide estimates of the revenue generated and the expenses made to generate this revenue. This information may be used to produce a budgeted income statement. It may also be used to plan necessary inventory levels, labour requirements or raw materials needed for production.

Financial budgets use the information from operating budgets and estimate revenue and expenses resulting from operations. Financial budgets present a forecast of funds required to pay for inputs and anticipated inflow of funds from future sales. This budget should highlight periods of cash shortage where management may need to organise short-term finance (such as an overdraft) and also periods of cash surplus. Thus, a budgeted cash-flow statement will be required. Firms may also use financial budgets to plan for future capital expenditure (such as the introduction of new technology) or business expansion and to ensure that funds will be available when necessary.

Record systems

Businesses need to set up a record system that allows them to record data needed by the business. This would include such items as collection of revenue, payment of employees, accounts payable (e.g. suppliers) and taxes.

Today, many businesses use an electronic record-keeping system. Electronic accounting payments such as MYOB can easily generate orders, invoices, financial statements, employee pay records and inventory details. Businesses may also do this manually. Hard copies or paper copies of transactions such as invoices and receipts still need to be filed efficiently and be able to be accessed easily when required. In each case, businesses must ensure that they meet accounting standards and provide accurate and useable financial reports.

Accounting records of expenses and revenues are kept by law and an annual financial report is presented to shareholders and the Australian Taxation Office. Businesses that use imported goods and export products must provide the Australian Customs Service with access to information. Internally, the business needs to have records available for future planning and control procedures to ensure that goals are achieved.

Records management receives, stores and retrieves relevant information whenever necessary. Some of this information may be confidential and therefore a security system should be in place to control who has access to particular information. This would take into account privacy laws and the need for industry secrets.

Records management is refined to meet managers' specific needs for information from both internal and external sources. Management information systems (MIS) are often developed by larger businesses to allow managers to access organised units of information appropriate to their needs. The human resources department would need to have access to employees' work history, skills, qualifications and often data of a personal and private nature. MIS involves collecting information as data and processing and interpreting the information from within the firm as well as from outside sources.

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BUSINESS BITE

The federal government wants to build a national, secure eHealth system. Under its National Health and Hospitals Network, funding will be provided to establish a personally controlled electronic health record system, which will be available to all Australians who wish to participate. Beginning in 2012–13 consumers will be able to access their health information on the internet. This will connect existing information systems across the health sector. Additional security and privacy controls are being developed.

Source: Australian Government – National Health Reform Plan, www.yourhealth.gov.au.

Financial risks

Financial managers need to assess the financial risks that a business faces each day. These may include theft of goods from a retail store, non-payment of accounts receivable or possible interest rate increases, etc.

Businesses should be proactive and ensure that they are fully aware of possible future threats to their business by undertaking continuous research of the internal and external business environment in which they operate; for example, the introduction of the much-debated super profits tax for large mining firms in 2010. Businesses need to have alternative strategies in place to cope with these problems. They can also take out insurance against possible risks; for example, against mining collapses in the mining industry, such as the collapse which occurred in Chile trapping 33 miners in August 2010.

Financial controls

Financial managers will need to put in place several financial controls that can be used to establish if the business is achieving its objectives. The managers use tools such as budgets to indicate the difference between what was planned and actually achieved. This enables the manager to determine if the objectives set were not achievable or need to be reassessed, or the strategy to achieve the objective may not be successful or possibly based on unrealistic or incorrect assumptions. Financial managers will need to make changes to the original plans to ensure that the business can maintain its strengths and be on the path to achieving its SMART goals.

Debt and equity financing

Debt finance is made up of borrowed funds. It involves a contractual agreement based on specific conditions over a period of time. The borrower will need to repay the principal (the initial amount borrowed) as well as pay interest. Most debt finance usually incurs administration fees and government charges such as stamp duty.

Equity financing is money lent to the business in exchange for ownership in the business. This includes start-up capital and additional capital raised through share issues.

Newly established small businesses will not have the past history to obtain a sizeable loan. They will need a good business plan, good business idea and some start-up capital to attract additional investors. They often cannot afford to

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repay debt finance; however, personal investment may be a possibility for large future projects. A struggling business or one in the post-maturity phase of its life cycle may find equity finance easier to achieve than debt. Once a business is capable of maintaining debt repayments they should probably use debt finance.

Table 13.1 Advantages and disadvantages of debt finance

Advantages of debt finance	• Interest payments are tax deductible business expenses • If bankruptcy or insolvency occurs debt providers have priority before equity providers • Can be relatively simple to acquire • Loan terms can be negotiated to meet the business's specific needs • Debt repayment can be easy to plan as these are normally scheduled, regular payments of interest and often principal • Will not decrease your ownership in the business and the owner can maintain their own control of the business
Disadvantages of debt finance	• Debt can be expensive • Repayments begin immediately and must be met regardless of the business cash flow • Collateral is often needed to secure a loan • In some cases, personal guarantees may be needed • You may require a good credit history for borrowing • It is up to the owner of the business to clearly establish the value of the business and their ability to repay the loan

Table 13.2 Advantages and disadvantages of equity finance

Advantages of equity finance	• Does not have to be paid back • No repayments, therefore the firm has more cash flow • Cash flow generated (especially from additional share issues) can be used for further investment and expansion • Does not incur interest charges • Investors are prepared to wait for some time to get a return on their investment
Disadvantages of equity finance	• You are exchanging ownership of your business • A proportion of the profits go to the additional new owners • Does not provide a tax deduction for the business • New investors often expect improved growth and performance of the business and therefore a better return on their investment

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Matching the terms and source of finance to business purpose

When managing finance, the accountant will distinguish between short-term and long-term debt finance. This is important because short-term finance will need to be paid back sooner and usually costs more than long-term finance. However, there is usually greater convenience with short-term finance. For instance, a credit card gives instant access to funds, while a mortgage loan can take weeks to organise.

purchased with long-term finance, such as a 25-year mortgage loan.

Therefore, the choice of which finance to use should be directly linked to the intended use of the finance. This is referred to as the **matching principle**.

The matching principle also refers to the accounting rule that revenue earned must be matched to the expenses incurred while earning that revenue. For example, the wholesale cost of stock is an expense that is matched against the revenue earned from selling the stock. The legal structure of the business also has an impact on

Matching principle

Involves using the appropriate finance for purchasing an asset. Current assets should be purchased with short-term finance while non-current assets should be purchased with long-term finance, such as a 15-year mortgage loan. The matching principle also relates to matching the recording of a transaction to the date that it occurred.

Table 13.3 Comparison of short-term and long-term debt finance

Type of debt	Length of loan
Short-term debt	
Bank overdraft	Indefinite but the business must make minimum monthly payments; rolled over each month
Credit card	Indefinite but the business must make minimum monthly payments; rolled over each month
Trade credit	Minimum of 7 days; maximum of 90 days
Commercial bills	90 days but can be rolled over for additional months
Long-term debt	
Term loan	Fixed number of years
Debentures	Number of years set by the issuing company
Mortgage loan	Up to 30 years

The main reason for identifying the options for short-term and long-term debt finance is to match the length, or term, of the loan with the economic lifetime of the asset it is used to purchase. It would be inefficient to buy a short-term asset with a long-term loan. A short-term asset needs to be matched with a short-term loan; for example, inventory could be financed with trade credit or an overdraft. Current assets should be purchased with short-term finance while non-current assets should be

the source of finance it uses. Companies can carry a higher level of debt to equity, while the owners of unincorporated enterprises will carry lower levels of debt to equity. This is because of the potential for personal bankruptcy for the owners owing to unlimited liability if a sole trader or partnership fails. Therefore, determining how much equity there is in the business compared to debt is an important issue for the financial manager.

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Insolvency

Occurs where expenditure has exceeded income for an unacceptable length of time and the firm is unable to pay its debts.

Cash-flow statement

A financial report illustrating the movement of cash into and out of a business over time.

Activity 13.1 Comprehension

1. Explain the differences between debt finance and equity finance.
2. Describe the advantages of equity finance over debt finance.
3. Explain why an owner of a new small company may be reluctant to acquire additional equity finance from shareholders.
4. Outline three features of a company that a potential shareholder will wish to consider before investing.
5. What factors will influence an owner's decision concerning how to raise the finance to establish a new business?

Monitoring and controlling

Accounting information is used by managers to monitor and control the business's functions. The general purpose of financial reports is to communicate relevant, reliable and understandable information about the business that can be used by managers to make decisions.

Internal stakeholders, such as owners and senior managers, want financial information that is reliable and relevant. They need to be able to trust that the figures and calculations are correct. Data can be used to make forecasts (such as projected sales) and to evaluate the business's performance by comparing current year's sales to the previous year's sales.

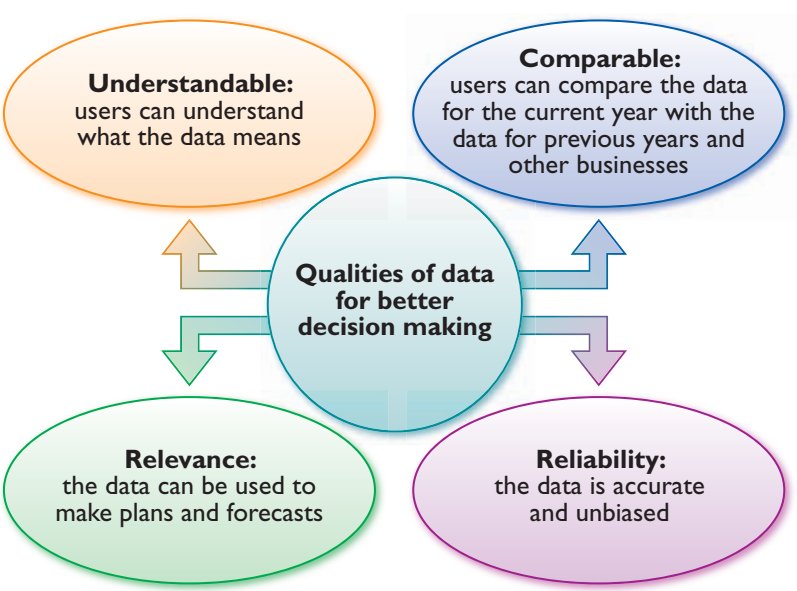


Figure 13.2 Data needs to have certain qualities to facilitate better decision making.

Cash-flow statement

One of the biggest problems that businesses face today is their ability to control their cash flow; that is, to maintain their liquidity. Firms need to be able to pay their debts as they fall due or they run into financial trouble. Failure to control the cash flow can result in liquidity problems in the short term and insolvency in the long term. This would lead to the closure of the business. **Insolvency** occurs where expenditure has exceeded income for an unacceptable length of time and the firm is unable to pay its debts.

A **cash-flow statement** summarises cash transactions that have occurred over a period of time. This statement is also known as the funds statement or the statement of cash flow. Its purpose is to provide information about the flow of cash receipts and cash payments within the accounting period and provide

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management with necessary details for budgeting. This enables the business to monitor and control its business functions.

There are two financial statements that a financial manager will use to determine if the business is reaching its financial objectives: the **income statement** and the balance sheet. Technology has had a significant impact on planning and management. These accounting statements can be produced on computers using inexpensive, easy-to-use software. By entering all primary transactions (such as each sale and expense) the software can summarise the data entered and produce accurate statements on request.

Income statement

The **income statement** is a summary of the income and expenses of a business over a set period of time, such as a financial year.

It shows the relationship between revenue and expenses to calculate net profit. It therefore indicates the business's profitability and efficiency. This financial report is also known as the **profit and loss statement**, or revenue statement, as it shows total revenue received, gross profit, the cost of goods, expenses and net profit. The income statement is usually produced at the end of the financial year (on 30 June) and will show the net profit earned over a specified period of time. A financial manager is free to produce this report at will to monitor the progress of the financial and business plans over the course of each week and month.

Balance sheet

The **balance sheet** gives a snapshot or summary of what the business owns and owes on a certain day; that is, its financial position on a specific date. The balance sheet illustrates the relationship between

BUSINESS BITE

The Australian Securities and Investments Commission (ASIC) monitors companies to ensure they fully disclose in their financial reports how they have interpreted accounting procedures. ASIC makes sure that companies comply with Australian Accounting Standards (AAS). Financial records must be kept for seven years. With the development of information technology, financial records may be kept electronically and there are numerous accounting software packages available. ASIC is able to audit the reports of companies to ensure compliance and full disclosure. Typical errors discovered in the reports of public companies include:

- reporting certain expenses as 'other expenses' although they exceed 10% of total expenses
- recording revenue in the current financial year before it has all been earned
- failing to give an appropriate value to an asset or investment the business has purchased.

In situations where ASIC believes a company's interpretation of an AAS is incorrect or difficult to justify, ASIC will request the company correct its reports, change its accounting procedures, reissue its reports to the market or face legal action.

Income statement

A summary of a business's revenue and expenses over a set financial period. It is completed in order to determine the business's profitability and efficiency. Also known as a 'revenue statement' or 'profit and loss' statement.

Profit and loss statement

A summary of a business's revenue and expenses over the financial year. It is completed in order to work out the business's profitability and efficiency. Also known as a revenue or income statement.

Balance sheet

A snapshot on a particular day (usually the last day of the financial year) that shows the assets a business owns, the liabilities the business owes and the equity the owner have invested in the business. The balance sheet gives an indication of the financial stability of a business. It represents the accounting equation $A = L + E$.

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the assets, liabilities and equity (A = L + E). The balance sheet can be analysed to determine the financial stability of a business in the short term and long term. The balance sheet is sometimes referred to as the statement of net worth.

Table 13.4 Balance sheet for Charmac Pty Ltd as at 30 June 2010

	$		$
Current assets		**Current liabilities**	
Cash	7 000	Bank overdraft	5 000
Accounts receivable	20 000	Accounts payable	17 000
Inventory	17 000		
Non-current assets		**Non-current liabilities**	
Company car	35 500	Mortgage loan	70 000
Equipment	70 500	Debentures	30 000
Land and buildings	100 000		
		Equity	
		Capital	100 000
		Retained profit	28 000
Total assets	250 000	Total liabilities + equity	250 000

Table 13.5 Income statement for Charmac Pty Ltd for the period ending 30 June 2010

		$
Sales revenue		160 000
less Cost of goods sold		48 000
Gross profit		*112 000*
less Operating expenses		
Administrative expenses		
Wages	50 000	
Insurance	6 600	
Leases	8 200	
Accountant's fees	2 400	
Telephone	2 800	70 000
Financial expenses		
Interest	1 000	1 000
Selling expenses		
Advertising	1 000	1 000
Total expenses		*72 000*
Net profit before tax		*40 000*
Tax on profits		12 000
Net profit after tax		*28 000*

Activity 13.2 Comprehension

1 Define the following terms as they apply to financial statements:
   a Reliable.
   b Understandable.
   c Relevant.
   d Comparable.
2 Describe the implications for a business if its financial statements are not reliable, understandable, relevant or comparable.
3 Identify the stakeholders that would use the financial statements of a business.
4 What is the historical cost assumption for valuing assets on the balance sheet?

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BUSINESS BITE

Revision of some Preliminary course material on the accounting equation may provide a clearer understanding of the sources of finance for a business. The following three common transactions affect the accounting equation (A + L = E).

James and Julie were good friends at school, both studying Visual Arts for the HSC. They were always interested in designing jewellery for their friends and realised that there was an opportunity to make and sell jewellery for a young, wealthy female target market. They decided that after they finished school they would work together designing and selling their jewellery. They each had $2000 to put into their new business, a partnership they would call J&J Designs. As they were giving the business their own money as capital the source of finance is internal equity. The money was deposited in a business bank account set up by James and Julie. The bank account represents an asset.

Assets =	Liabilities +	Equity
$4000		$4000

James and Julie knew they would need more money than $4000 to start their business and therefore needed to source their finance from a source other than equity. The business would need to buy jewellery-making equipment as well as precious metal (gold, silver and platinum) and small gemstones. The two owners were able to obtain a bank loan for $6000 repayable over three years based on their business plan. This represents a liability for the business and is therefore recorded as a form of external debt finance.

Assets =	Liabilities +	Equity
$4000 + $6000	$6000	$4000

The business now has $10 000 in finance available to buy assets to generate an income. This finance came from two sources: equity and debt. James and Julie contacted a supplier who was prepared to provide the business with $1500 of materials to make jewellery without immediate payment. The supplier delivered the materials and enclosed an invoice requesting payment within 14 days. This transaction represents $1500 in trade credit, which is a short-term liability and therefore a source of short-term external debt finance.

Assets =	Liabilities +	Equity
$4000 + $6000 = $1500	$6000 = $1500	$4000

Overall J&J Designs has $11 500 in cash and inventory, which was paid for from $4000 in equity, $1500 in short-term debt and $6000 in long-term debt. For each of these transactions there are two sides that are both recorded using the accounting equation. In each case the finance that is available has been obtained from a particular source. Therefore, the sources of finance will always equal the uses of funds.

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Current ratio

This ratio, which is also known as the working capital ratio, is used to measure a business's ability to pay its current liabilities from its current assets. It is calculated by dividing the value of current assets by the value of current liabilities. The result is usually expressed as a percentage.

Activity 13.3 Classification

I This activity is revision for the classification of accounts learnt in the Preliminary course. Classify each of the following accounts as an asset, liability, equity, revenue or expense.

a Sales.
b Cost of goods sold.
c Accounts receivable.
d Lease.
e Mortgage loan.
f Inventory or stock.
g Advertising.
h Interest paid on loans.
i Bank overdraft.
j Company car.
k Equipment.
l Land and buildings.
m Owners' capital.
n Accounts payable.
o Tax on net profit.
p Telephone.
q Accountant's fees.
r Wages.
s Cash.
t Insurance.
u Retained profits.
v Debentures.

Financial ratios

Accounting is a tool managers use to help them manage a business's finances and make informed decisions. Accounting is the language of a business's finances. The income statement and balance sheet provide an accurate summary of a business's financial position. Ratio analysis of these financial statements allows managers to identify trends in their businesses and to compare its performance with the average performance of similar businesses in the same industry. The formulas are summarised in Table 13.6. Financial ratios are tools used by financial managers to analyse and interpret the financial statements of a business. Ratios using the balance sheet are used to assess the business's liquidity and gearing. Ratios using the income statement are used to assess the business's profitability and efficiency. They provide an effective way to understand the financial performance of a business.

Ratios should be simple and quick to use. Frequent review of ratios enables managers to stay informed and have better control of their business.

Liquidity

The **current ratio**, which is also known as the working capital ratio, measures liquidity. It tells the manager if the business is financially stable in the short term (12 months) by working out if it can afford to pay all its short-term liabilities using its current assets. Cash to pay liabilities can be obtained from the business's bank account, sales of stock and cash received from customers. A business will want more current assets than current liabilities; that is, a ratio greater than 1:1. However, a very high ratio (for example, 4:1), where assets are much greater than liabilities, will be criticised as an inefficient use of working capital. The business will have too much cash spent on stock or waiting on cash payment from accounts receivable when this money could be put to better use paying off short-term loans and reducing interest expenses. If the result shows the value of total current assets is less than the value of total current liabilities

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Table 13.6 Financial ratios

Ratio type and name	Formula	Results from Simtel Mobile example
Liquidity		
Current ratio (working capital ratio)	Current assets/ current liabilities	*2:1* $2 of current assets for every $1 of current liabilities
Gearing		
Debt to equity ratio	Total liabilities/equity	*0.95:1 or 47.5%* financed from gearing debt; that is, $0.95 gearing debt for every $1 equity
Profitability		
Gross profit ratio	Gross profit/sales x 100	*70%* For every $1 of sales $0.70 is made in gross profit
Net profit ratio	Net profit/sales x 100	*25%* For every $1 of sales $0.25 is made in gross profit
Return on equity	Net profit/total equity x 100	*28%* For every $1 of sales $0.28 is made in gross profit
Efficiency		
Expense ratio	Total expenses/sales x 100	*45%* For every $1 of sales $0.45 is made in gross profit
Accounts receivable turnover ratio	Number of days in a year, 365 (366 in a leap year) divided by the result from the following formula: Sales/accounts receivable	*46* days on average to pay

the business is in a very risky financial situation. If a creditor demands payment, the business is not liquid enough to pay its short-term liabilities.

Gearing (solvency)

The **gearing debt to equity ratio** tells the manager if the business can pay all its liabilities. It is a measure of the business's long-term financial stability. It gives an indication of how risky it is to buy shares or invest in the business, so owners and shareholders will be most interested in this ratio. The higher the ratio of debt to equity, the more financially unstable the business is. A business in a risky position will have a high level of leverage, be highly geared and, hence, have a low level of solvency. When businesses have a higher level of debt they are vulnerable to increased interest expenses, particularly when interest rates rise with an upswing in the economic cycle. As a general rule, a business should have more equity than debt. An acceptable level of gearing is 1.5:1 (3:2) or 66% equity, 40% debt; that is 40% of sources of funds in the business come from some form of debt. As the percentage increases, the more the business is financed from debt. A business that has over 80% of its funds sourced from debt would generally be considered to have

Gearing debt to equity ratio

This ratio is used to determine whether a business can pay all its liabilities. It is a measure of the business's long-term financial stability.

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Secured creditor

A bank, financial institution, supplier or individual that is owed money by a business and holds security over an asset the business owns in case the loan is not repaid.

Administrator

Appointed to manage a business on behalf of the business's creditors. The administrator may be able to trade the business out of trouble so that creditors are repaid or close the business and sell its assets to repay creditors.

Receivership

Where a receiver has been appointed to administer a business that has become insolvent. A receiver can either trade the business out of financial trouble or sell its assets and close the business. The final step is called liquidation.

Gross profit ratio (GPR)

This ratio is a measure of a business's profitability before expenses. It is calculated by dividing the value of gross profit by the value of sales. The result is usually expressed as a percentage.

Net profit ratio (NPR)

This ratio is a measure of a business's profitability after all expenses have been paid. It is calculated by dividing the value of net profit by the value of sales. The result is usually expressed as a percentage.

poor solvency and would find it harder to obtain more credit.

When interest rates are low, a higher level of gearing and a lower level of solvency are acceptable. A business can exploit the advantage of borrowing to invest in assets that will earn a much higher level of profit than the interest expense on the loans; for example, borrowing to open a second shop or factory from which profits can be earned by making and selling more goods. If interest rates rise owing to government policy and the economic cycle moves into a downswing, the business will need to reduce its level of gearing by paying off as much debt as possible. Otherwise the business must make repayments with a higher interest expense from falling profit. Profit falls as sales fall during periods of slower economic growth. The business will risk insolvency and bankruptcy if it does not reduce its gearing.

The current ratio and gearing debt to equity ratio give a very good idea of a business's financial stability. A business that has results for these ratios that show it is insolvent risks its trading future. It will be in serious financial difficulty. In this circumstance a **secured creditor**, the company directors or the shareholders may appoint an **administrator**. An administrator will take control of the business, investigate its financial position and report to the creditors. These are the businesses and individuals who are owed money. A secured creditor is able to appoint an administrator because it will have a legal claim on the business's assets if the business cannot repay its loans. The administrator may attempt to trade the business out of trouble to repay all creditors or appoint a receiver to close the business; that is, place it into **receivership**. The assets of the business are liquidated, or sold, to pay creditors. Secured creditors will be paid first. Any money left over will be distributed to unsecured creditors and finally the owners.

Profitability

The income statement is used to determine how profitable the business is. Ultimately, the financial manager will wish to know that the returns offered by the business are better than any safer alternative investment, such as a savings account. Gross profit is important for a retailer because it represents the money made from the core business activity, which is to sell inventory. Gross profit is calculated by subtracting the cost of goods sold from total sales revenue. The **gross profit ratio (GPR)** calculates for every $1 of sales how much gross profit the business makes after paying for the cost of goods sold. The ratio represents the profit margin between the wholesale cost of the firm's inventory and the price the business sells it for. A result of 70% tells us that for every $1 in sales the business makes $0.70 in gross profit. A small increase in the GPR indicates an increase in overall profitability. The **net profit ratio (NPR)** works out for every $1 of sales how much net profit the business makes after paying all expenses. A result of 25% tells us that for every $1 in sales the business makes $0.25 in net profit. Comparisons with other businesses should be made before tax because tax liabilities vary from one business to another and make comparisons more difficult. The return on equity works out how much income the owners receive for their investment in the business. In order to perform this analysis figures from both the income statement and the balance sheet are needed.

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Efficiency

Efficiency ratios show how well the business is keeping expenses under control and how long it takes for the business to receive money from accounts receivable. An expense ratio can be calculated using any expense. A financial manager may want to analyse a particular area of the business, such as:

- financial expenses (interest)
- selling expenses (marketing costs)
- operations (manufacturing costs).

For a retailer, the business aims to sell inventory as quickly as possible. Any unsold goods are a cost to the business in storage and cash tied up in a less liquid form. A business would prefer to have this cash free to pay liabilities. The faster the sales occur, the higher the profit. Therefore, any business will desire a high turnover; that is, will want inventory to be in store for as short a time as possible. Using the **accounts receivable turnover ratio**, the business can work out how many days it takes, on average, for account customers to pay their invoices. This result will be compared to the **credit policy** of the business to see if customers are taking far too long to pay. If a business has an inventory turnover of 52 times a year, it will have to restock at the end of each week as all inventory is sold in seven days; that is, 365/52 = 7.

The following is a calculation of the accounts receivable turnover ratio for Charmac Pty Ltd in Table 13.4 (page 228). Using the figures for sales and accounts receivable in Table 13.5, it can be seen that the inventory turnover is eight times a year; that is, 160 000/20 000. By dividing the number of days in the year by the turnover (365 days/8), it can be established that, on average, it takes approximately 46 days for account customers to pay their invoices. This will be an unsatisfactory result if the credit policy of the business is only 30 days.

Accounts receivable turnover ratio

This ratio is a measure of how long, on average, account customers take to pay the invoices sent to them by the business. It indicates how promptly customers who have been given credit take to pay for the products they have bought.

Credit policy

The conditions under which a business is willing to allow other businesses to postpone their payment for goods and services they have bought from it; for example, how many days are permitted to pass before payment is due.

Activity 13.4 Comprehension

1 Identify which financial statement is required to calculate each of the following.
   a Profitability. b Solvency. c Efficiency. d Liquidity.

2 Explain how a financial manager may use financial ratios to analyse the financial performance of a business.

3 Select the most appropriate ratio for each of the following situations:
   a Marc and Robbie need to work out how much their wholesale cost of inventory is contributing to the total costs of running their pizza shop.
   b Kate and Amy want to determine whether their business has been a good investment compared to investing in property.
   c James and Joseph operate a sailing school. They want to calculate how much their spending on marketing has contributed to total expenses.
   d Lillian and Mariko operate a wholesaler business that imports and distributes toys from Japan. They think they may need to change the credit terms they offer their account customers.
   e Eric and Taka wish to open a second computer retail store. They want to determine whether they are financially secure enough to borrow the finance necessary to establish a new outlet.

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Comparative ratio analysis

The ratios that are calculated using the financial statements are used to make comparisons over different time periods, against standards and with similar business. By comparing the current year's results to those of previous years, the financial manager will be able to identify trends in profit, costs and financial stability. The financial manager will want to determine if the business is reaching its financial goals of increasing profitability, growth, efficiency, liquidity and solvency. The financial manager will also compare the results to those of other businesses in the same industry. This is called benchmarking. The manager will want to establish whether the business's performance is above average. If the results are below the industry standard then the business plan will need to be reviewed and new strategies worked out. The financial manager will also compare the results of the business to what is considered to be the best possible result. A standard, or benchmark, is the result that the business is aiming for in its objectives. This benchmark may be a global standard (in this case it is called World's Best Practice). The manager

Activity 13.5 Calculation

Use the income statement in Table 13.7 to complete the questions that follow.

Table 13.7 Income statement for Average Joe Ltd.
Industry profitability average is 10%.

For the period ending 30 June 2010

	2008 $	2009 $	2010 $
Sales revenue	208 000	305 000	362 000
less Cost of goods sold	96 000	155 500	222 500
Gross profit	*112 000*	*149 500*	*139 500*
Less Operating expenses			
Financial expenses			
Interest	900	1 050	1 150
Selling expenses			
Advertising	11 600	18 450	19 550
Wages	30 900	36 000	45 200
Administrative expenses			
Wages	32 000	34 500	37 000
Electricity	1 000	1 100	1 200
Insurance	4 500	4 800	5 300
Lease	2 000	2 000	3 000
Stationery	600	600	600
Total expenses	*83 500*	*98 500*	*113 000*
Net profit before tax	*28 500*	*51 000*	*26 500*

1 Calculate the gross profit and net profit ratios for 2008, 2009 and 2010.

2 Calculate an efficiency ratio using total expenses for 2008, 2009 and 2010.

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will want to know how the Australian business compares against the best in the world. For example, the manager may want to determine the best profit result possible given the resources the business has and how efficient the business can be. Some generalised standards have been worked out for ratios that are considered by financial analysts to be ideal results. These are:

- liquidity – current assets should be 1.2 to 2.5 times greater than current liabilities
- return on equity – this result should be greater than the current interest rate
- gearing debt to equity ratio – this result should be no higher than 60%.

Limitations of financial reports

Financial statements do not tell the whole financial story of a business. The rules followed to produce them can create a misleading impression of a business's profitability and value. In accounting, statements must be reliable; that is, the values and data must be accurate and be verifiable by an independent expert. This is known as the reliability principle. In reality, the business may be quite different from what is recorded on paper in the income statement and balance sheet. The income statement may not give a clear picture of a business's profitability. One of the limitations of financial statements is the way they are written and presented. Complicated and detailed accounts will confuse individuals who do not have a background in accounting. The actual profit may also be artificially reduced through complicated intracompany transactions to reduce the business's tax liability.

Nominalised earnings

Nominalised earnings are earnings adjusted to take into account cyclical upswing of downsizing in the economy, or even adjusted to remove one-time influences.

Capitalising expenses

Capitalised expenses are the costs incurred when financing a non-current asset (e.g. the purchase of a factory site would involve payment for legal fees and stamp duty). When placed into the accounting framework these expenses are capitalised (i.e. added to the cost of the asset). They are not deducted from revenue in the period they were incurred. Instead they are deducted through depreciation or amortisation over time as the asset will be generating revenue over several years, thus matching the expense with the revenue earning period.

Valuing assets

When an asset is listed on the balance sheet, its value is written at its historical cost; that is, the original cost of the asset when it was bought. The reason why assets are valued this way is to make sure every business values their assets in the same manner. It means there is consistency between businesses and comparisons between businesses can be made. However, the original cost of an asset on the balance sheet is different from its market value. If the business sells an asset, the cash it receives will be different from the historical cost of the asset. This is because some assets increase in value. For instance, the land a factory is located on can over time be worth more than what the business originally paid for it.

Nominalised earnings

The earnings adjusted to take into account cyclical upswings or downswings in the economy, or to remove one-time influences.

Capitalised expenses

The costs incurred when financing a non-current asset and added to the cost of the asset.

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Activity 13.6 Assessment

Use the balance sheet in Table 13.8 to assess the trend in financial stability by comparing the results of the calculations for the current ratio and the gearing debt to equity ratio to the industry averages.

Table 13.8 Balance sheet for Paradise Hotel Pty Ltd
Industry averages: liquidity is 2:1; solvency/gearing is 90%

As at 30 June 2009 and 2010

	2009 $	2010 $
Current assets		
Cash	1 000	5 000
Accounts receivable	2 000	4 000
Inventory	15 000	15 000
Total current assets	*18 000*	*24 000*
Non-current assets		
Equipment	12 000	12 000
Motor vehicles	36 000	52 000
Total non-current assets	*48 000*	*64 000*
Current liabilities		
Bank overdraft	2 000	3 000
Accounts payable	4 000	9 000
Total current liabilities	*6 000*	*12 000*
Non-current liabilities		
Mortgage loan	40 000	40 000
Total non-current liabilities	*40 000*	*40 000*
Equity		
Capital	20 000	20 000
plus Retained profit	36 000	41 000
less Drawings	6 000	11 000
Total owners' equity	*50 000*	*50 000*

Inflation also affects the cost of assets. Due to the general increase in the prices of all goods and services over time, an asset purchased a number of years ago is worth less than the same asset bought today. The historical cost assumption will mean that the value of the asset on paper is different from what it is worth in reality. Therefore, when the business is sold, the balance sheet does not truly represent the worth of the business's assets. If a business wishes to revalue its non-current assets, it must have them valued by an independent, objective individual expert or business. For example, a building a business owns has obviously increased in value since it was bought 10 years previously for $250 000. The owners wish to revalue the asset to present a more reliable balance sheet. The owners feel the building is worth $1 million based on the sale of other buildings in the area. An independent real estate valuer is hired and appraises, or values, the building at $850 000. This is the value that can be recorded on the balance sheet because it has been calculated by an independent, objective expert. Asset value can also be decreased or written down. This could be because the business paid too much for them in the first place or even included old, unsellable inventory. Other assets that need revaluing are those that lose value over time owing to **depreciation**. Assets such as equipment and vehicles wear out

Depreciation
(of assets) Occurs where assets (such as motor vehicles and equipment) lose their value over time owing to wear and tear and the development of new technology.

Ethical Issue

Quantum Corporation Ltd is a business that sells innovative financial services online. The business has long-term financial stability with valuable intangible assets and goodwill. However, the business has experienced some short-term liquidity problems, making it vulnerable to takeover. The owners have chosen to make the business appear more financially stable in the annual financial statements without breaking the law to maintain the value of its shares, investor confidence and avoid being taken over. What are the issues involved with 'dressing up' the financial statements under these circumstances?

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and are replaced by better quality and more efficient products that are developed with new technology and more features. This is called obsolescence. If the business wants to replace its older assets it will have to pay the difference between the cost of the new assets and the income received from the sale of the old asset. This is a cost for the business and therefore depreciation is an expense.

Accountants are allowed to depreciate assets using accounting standards and applying the matching principle (matching the value of depreciation to the fall in value of the asset each year) so that the assets on the balance sheet present a more reliable picture of the business. Following the matching principle, assets lose more of their value in the early years of their economic life and lose less value each subsequent year. For example, a company car can lose 30% of its value after one year. A higher depreciation expense is therefore recorded in the early years of the asset's life. Another limitation of financial statements is that the financial manager cannot record all types of **intangible assets** on the balance sheet. Intangible assets are items that are of value to a business but do not physically exist. You cannot see or touch them. Patents, **trademarks** and brand names are examples of intangible assets. They can be used to earn income for the business but are not listed on the balance sheet. **Patents** are the legal protection a business can obtain to prevent other businesses copying its ideas and therefore protect profits. Although **goodwill** is an intangible asset, it can be included as a balance sheet item when a business is bought and sold. A business creates goodwill by providing good service and 'value for money' products. The business will have regular customers who are loyal and this guarantees the business sales in the future. Goodwill cannot be sold separately from the business. The reason some intangible assets are not included on the balance sheet is that there is no consistent rule to work out their value. A financial manager could be tempted to include and/or overvalue intangible assets to make the business appear more financially stable than it really is. However, intangible assets can be included in the price of a business if the business is for sale.

BUSINESS BITE

ABC Learning Centres revalued their goodwill based on their estimates of what their future cash flow would be. When the business collapsed, much of ABC's assets actually did not exist.

Intangible assets can also lose value over time for the same reasons as tangible assets depreciate. This is called **amortisation**. For example, a patented invention may be replaced by a technologically advanced product. Finally, some liabilities and future expenses have to be estimated because it is hard to determine the future debt that may be incurred. For instance, it is difficult to estimate the future costs that will be incurred repairing and replacing faulty goods that are under **warranty**.

Timing issues

Accountants may adjust the timing of revenue inflows and debt repayments to make the business appear more profitable. They could delay banking revenue until the start of a new financial year in order to decrease the business's current taxation commitment. This would delay an expense

Intangible asset
An asset that does not physically exist and therefore is not written on a business's balance sheet unless the business is to be sold. However, it is of value to the business because it can earn revenue from the asset. Intangible assets include a business's good reputation, trademark, design or brand name.

Trademark
A symbol or name that a business uses and has registered to represent its product. It is part of a business's intellectual property.

Patent
A patent gives the owner the exclusive rights to sell, market, license or make a profit from an invention, innovation or production technique.

Goodwill
An intangible asset valued according to the advantage or reputation a business has acquired over time.

Amortisation
The depreciation of intangible assets over time. It can also refer to the repayment of debt by a series of instalments.

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Warranty

An agreement or undertaking by the seller of a product that the seller will be responsible for the repair or replacement of the product if it is found to have a defect in its quality, condition or quantity.

and incur a tax liability for the following year. Additional methods of prepaying expenses may provide businesses with an additional tax deduction for the current financial period. They would argue that the finance was available, they have gained future services, etc. at a reduced cost to the business and also possibly secured a valuable input for future operations. Financial managers may also use a shorter accounting period (less than a year) to avoid including transactions that would affect the business's profitability or financial stability.

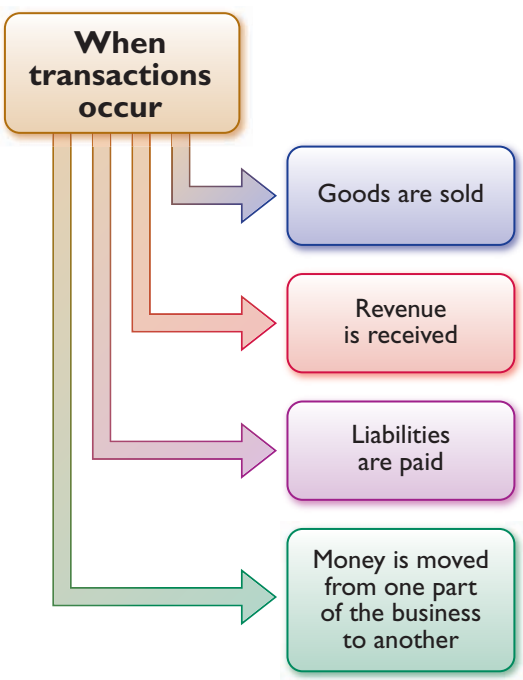


Figure 13.3 When transactions occur.

Each transaction is supposed to be recorded at the time that it actually occurs. This is the matching principle. When the matching principle is followed for recording expenses, it means the accountant has matched the revenue earned to the costs that were incurred to earn this revenue. For example, a business sells $12 000 worth of goods in June 2010. During June 2010 it also paid a salesperson $1200 in wages. Therefore, the business must record $12 000 in sales revenue less $1200 in wages expenses in June 2010. The business cannot record expenses for July against revenue earned in June. No business can record expenses from a different financial year to revenue earned in the current financial year. For example, if a business purchases an asset in the 2008–09 financial year, it cannot record the purchase in the 2009–10 financial year. It is possible to hide unfavourable transactions by recording them in a period other than the one in which they occurred. By recording these transactions outside the current financial year, for instance, they will not appear on the current financial reports. They will be hidden in the accounts for a different financial year.

BUSINESS BITE

Driver Wholesalers Pty Ltd owes Williams Bros Transport Pty Ltd $100 000. This is recorded by Williams Bros as a current asset on its balance sheet. On 28 June, Driver Wholesalers declares bankruptcy and will never pay the money it owes. Williams Bros must record this as a bad debt, which will reduce the business's profitability by $100 000. However, by recording the transaction on 1 July, the first day of the financial year, this negative transaction is held over into the following year's financial reports. Effectively, the business has committed fraud by not following the rules of recording transactions. Fraud is the intentional deception or misrepresentation that could result in some benefit to the business or person. Fraud is illegal and carries a penalty when proven.

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Figure 13.4 Some airlines have frequent flyer programs or similar loyalty programs whereby customers are provided with free goods and services when they have accumulated enough points.

Sometimes a business may use the excuse that mistakes are made due to the huge volume of transactions that occur in a business each day. They may claim that this makes it impossible to get accurate reports for the last day of the financial year as reports are prepared a few days in advance.

Debt repayments

In addition, staff members are free to choose when they take their holidays or may choose to take a payment for holidays they are owed when their employment is terminated. It will be difficult to determine exactly when a payment for entitled leave is required or when wage costs will rise for replacement staff who are hired to cover for vacationing employees. Businesses in the airline industry (such as Qantas) and other companies that have frequent flyer programs or similar loyalty programs have a liability to provide customers with free goods and services when they have accumulated enough points. Funds need to be set aside to provide for these liabilities. Business may also roll over debt finance and thus put off repayments until a later date.

Notes to the financial statements

Stakeholders should read the 'Notes to the Financial Statements', which is additional information normally at the end of the financial reports. These notes provide additional information and details about items included in the balance sheet and income statement. They could include methods of recording transactions, pension plan details, intercompany or director loan debts. The notes would provide a deeper understanding of the transaction and why it was recorded in a particular way.

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Triple bottom line (TBL)

A measure of a business's financial, social and cultural and environmental performance.

Audit

An independent check of the financial records of a business by a certified accountant. Alternatively, it can be performed internally by managers.

Ethical issues related to financial reports

Changes in social attitudes have forced business owners and managers to consider the ethics of the decisions they make. They must ensure that the financial decisions they make are judged to be morally correct, socially and environmentally responsible and 'the right thing to do'. In recent years, society has become increasingly aware of actions of senior company executives and questioned their behaviour and accountability. Accountants are expected by society, and the professional associations to which accountants belong, to display integrity, objectivity, confidentiality and a high level of professional and technical ability. The Institute of Chartered Accountants in Australia oversees and sets accounting standards that must be followed in the preparation of financial reports. However, some financial managers will try to stretch the boundaries set by these rules. Financial managers and accountants cannot 'be creative' when recording transactions and preparing financial reports in order to make the business appear more profitable and financially secure. It may have a higher share value to attract investment, find it easier to acquire debt finance, have better relationships with suppliers and experience higher sales owing to its good reputation. The collapses of Ansett, HIH Insurance, One.Tel and ABC Learning Centres since 2001 were all unexpected. Many thousands of employees lost their jobs overnight. Investors lost their assets while senior executives received enormous payouts despite mismanaging their businesses. From 1 July 2004, amendments to the *Corporations Act 2001* (Cth) forced companies to reveal the details of the salary packages of their directors and executives. This forces companies to be more honest in their behaviour. In addition, there is now greater pressure from shareholders and society for directors and executives to perform according to what they earn. Owners and shareholders are able to bring pressure on managers to increase the financial benefits to them at the expense of other stakeholders. However, businesses have a responsibility to look after the people they employ, the natural environment in which they operate and the local community in which the business owners and employees live. Managers may misuse the business funds. They may use the business's credit cards for personal expenses. This is an unethical use of company funds. Internal control could eliminate this problem.

Business owners need to accept the concept of the **triple bottom line (TBL)**; that is, as well as financial returns, there is a cost or return to society and the environment. Businesses should act in a more socially responsible and ecologically sustainable manner by formally recognising the wider costs or impacts of the business. As well as reporting on the profitability of a business, TBL-based reporting provides a more balanced and enhanced non-financial disclosure. In recent years, TBL-based reporting has become more accepted as a method of reporting the success of a business and allows an organisation to better prepare for future challenges and opportunities, including those traditionally considered intangible, such as reputation.

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Ethical Issue

Why is it important for a business to accept a triple bottom line when reporting on the success of the business?

Business accounts can be monitored through auditing. An **audit** is an independent check of the financial records of a business by a certified accountant to ensure that the financial reports represent a true and fair financial picture of the business. Audited accounts are a legal requirement of all public companies, clubs and associations each year. Alternatively, it can be performed internally by managers. Audits are necessary because:

- shareholders need to be able to trust the annual report if they wish to invest in the business, sell their shares or determine whether the dividend paid is fair
- owners want to know the accuracy of profit results
- the government wants to determine how much tax the business should pay
- managers want to establish whether resources or money can be saved, there has been fraud or any misuse of funds by employees, and correct rules and accounting standards have been followed when creating reports.

In some cases, financial reports have many assets valued at historical cost (original purchase price), have an undervalued share price or low profitability. These undervalued businesses are targets for unethical corporate raiders. These raiders take over the undervalued businesses; and strip them of their assets for profit.

Activity 13.7 Comprehension

1. Explain why a financial manager would internally audit a business.
2. Outline the advantages of internally auditing a business.
3. Identify the disadvantages of relying on computer-based accounting systems.
4. Explain the term *creative accounting*.
5. Outline why a financial manager may choose to make a business's financial position, as recorded in the financial reports, appear better than it really is.

Ethical Issue

Consider the following ethical dilemma. Imagine you are a line manager or team leader for a large company. You have discovered that the entire board of directors has been paying themselves secret commissions and bonuses. If this practice continues, the amount of money being withdrawn from the business may cause the company to become bankrupt in a number of years. You inform the managing director, who offers you a promotion and a $100 000 bonus if you keep silent about what you have discovered. What would you do? Would you:

- take the bribe and keep quiet
- take the bribe and inform the police and shareholders
- take the bribe and resign
- refuse the bribe and resign
- refuse the bribe and continue working
- refuse the bribe and inform the police and shareholders?

Interestingly, surveys of university students studying accounting suggest that more than half would accept the bribe.

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Chapter summary

- Financial management is responsible for the financial planning of the business. They must determine the financial needs of each division of the business, set budgets, develop record systems, instigate controls and analyse the financial risks of the business.
- A budget is a plan in money terms or units about what the business wants to achieve and monitors revenue and expenses of the business's various departments,
- A business may acquire funds from both equity and debt sources. Equity is lent to the business in exchange for ownership. Debt is made up of borrowed funds that have to be repaid with interest.
- Financial managers must match the type of debt finance and the term of the loans to the economic life of the asset it is used to purchase.
- Equity finance is directly linked to ownership.
- Financial statements need to communicate relevant, reliable and clear information about the business for the stakeholders. They must be prepared according to certain rules and accounting standards.
- The three main financial statements are the cash-flow statement, income statement and the balance sheet.
- The income statement is a summary of the income and expenses of a business over a set period of time. It enables a financial manager to calculate total revenue, cost of goods sold, gross profit and net profit. It summarises the profitability and efficiency of the business over a period of time.
- The balance sheet gives a summary of the assets, liabilities and equity of the business as at a particular date. It provides a look at the financial stability or net worth of the business. Information from the balance sheet can also be used to determine the business's liquidity and gearing.
- Financial ratios are management tools used to analyse the financial statements of a business. The aspects of a business that can be determined, and the ratios used to make the determinations, are:
  - liquidity: current ratio
  - gearing: debt to equity ratio
  - profitability: gross profit ratio, net profit ratio and return on equity ratio
  - efficiency: expense ratio and accounts receivable turnover ratio.
- By comparing the results of the most recent ratio calculations with those for the corresponding period for previous years, a financial manager can determine the changes and trends in the financial performance of a business and whether it is reaching its objectives.
- Ratio results may also be compared with industry averages through benchmarking, World's Best Practice and the results of direct competitors.

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- Financial statements have limitations, including the following:
  - Assets such as land and buildings can appreciate in value over time while other assets, such as company cars and equipment, can depreciate. However, they are recorded at their original historical cost on the balance sheet. Cost of non-current assets may also be capitalised.
  - Intangible assets are usually not recorded on the balance sheet because their value is not independently verifiable. Goodwill will be added to the cost of business when it is sold.
  - There will often be differences in the asset values recorded in the financial statements and their values in the real world.
  - Earnings may be nominalised or hidden by timing issues.
  - Debt payments may be rolled over.
- Audited accounts are a legal requirement of all public companies. These are an independent check that financial reports represent a true and fair financial picture of the business.
- Australian Accounting Standards regulate how financial reports are to be prepared.
- Businesses cannot alter the accounting period to manipulate the financial records to make the business appear more profitable or financially secure than it actually is.
- The Australian Securities and Investments Commission (ASIC) ensures all companies comply with company and financial services laws to protect consumers, investors and creditors.
- Many stakeholders suffer as a result of corporate raiding and asset stripping. When a business is taken over, the assets sold and the business closed down, the new owner is able to increase his or her personal wealth at the cost of employees who lose their jobs and consumers who lose goods and services.

Chapter revision task

1 Identify which financial statement summarises the accounting equation for a business.

2 Explain the impact of the following transactions on the accounting equation for a business:
   (a) The owner invests $10 000 of his or her own savings.
   (b) The business takes out a mortgage loan of $50 000.
   (c) The business sells stock for $1000 net profit.

3 Explain the difference between the cash-flow statement, the balance sheet and the income statement.

4 Explain the difference between liquidity and solvency.

5 What information may a financial manager gain by comparing the business's results for financial ratios to industry averages and over time?

6 Explain why assets must be depreciated and their revised value recorded on the balance sheet.

7 Explain why goodwill is not recorded on the balance sheet despite its being commonly accepted as an asset.

8 Explain why the financial statements do not fully show the situation the business is in.

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Multiple-choice questions

1 Which financial statement best gives an indication of a business's financial stability?
- **(A)** Cash-flow statement
- **(B)** Gearing report
- **(C)** Income statement
- **(D)** Balance sheet

2 What is the current ratio used to measure?
- **(A)** The value of current liabilities in a business
- **(B)** The value of current assets in a business
- **(C)** The ability of a business to pay its current liabilities
- **(D)** How much cash there is in a business

3 What is the purpose of financial ratios?
- **(A)** To analyse the financial performance of a business
- **(B)** To evaluate the financial stability of a business
- **(C)** To further summarise the financial statements
- **(D)** To estimate the financial performance of a business

4 Seoul Computing Company sells computing equipment wholesale to computer retailers. The business gives its customers credit terms of seven days net. However, its accounts receivable turnover ratio is 19 days. What does this mean for the management of account customers?
- **(A)** The business's customers are paying every 19 days
- **(B)** The business's customers are taking too long to pay, affecting cash inflow
- **(C)** The business has offered more relaxed credit terms
- **(D)** The business offers its customers 19 days to pay

5 If a business has a solvency ratio of 4:1, how can this be interpreted for the business?
- **(A)** It is highly geared and has poor solvency
- **(B)** It has low gearing and high solvency
- **(C)** It has more equity than debt
- **(D)** It has a low level of leverage

6 What do efficiency ratios give a measure of?
- **(A)** How expensive it is to run a business
- **(B)** The control over costs in a business
- **(C)** The value of expenses compared to cost of goods sold
- **(D)** The effectiveness of management in achieving a business's goals

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7 What are business ethics?
   (A) Acting in a socially responsible and morally appropriate behaviour
   (B) Acting to protect the interests of internal stakeholders
   (C) Acting in the financial interests of the owners
   (D) Producing environmentally safe products

8 What is the usual period of the financial year?
   (A) From 1 July to 30 June the next year
   (B) From 31 July to 1 June the next year
   (C) From 1 January to 31 December
   (D) Divided into quarters of three months

9 What is the name given to taking over an undervalued company and selling off its assets?
   (A) Corporate raiding and asset stripping
   (B) Misuse of funds
   (C) Fraud
   (D) Corporate embezzlement

10 What is the principal role of the Australian Securities and Investments Commission?
   (A) To ensure companies pay company tax
   (B) To ensure companies comply with all relevant company and financial services laws
   (C) To monitor the behaviour of businesses in the market
   (D) To protect consumers

Short-answer questions

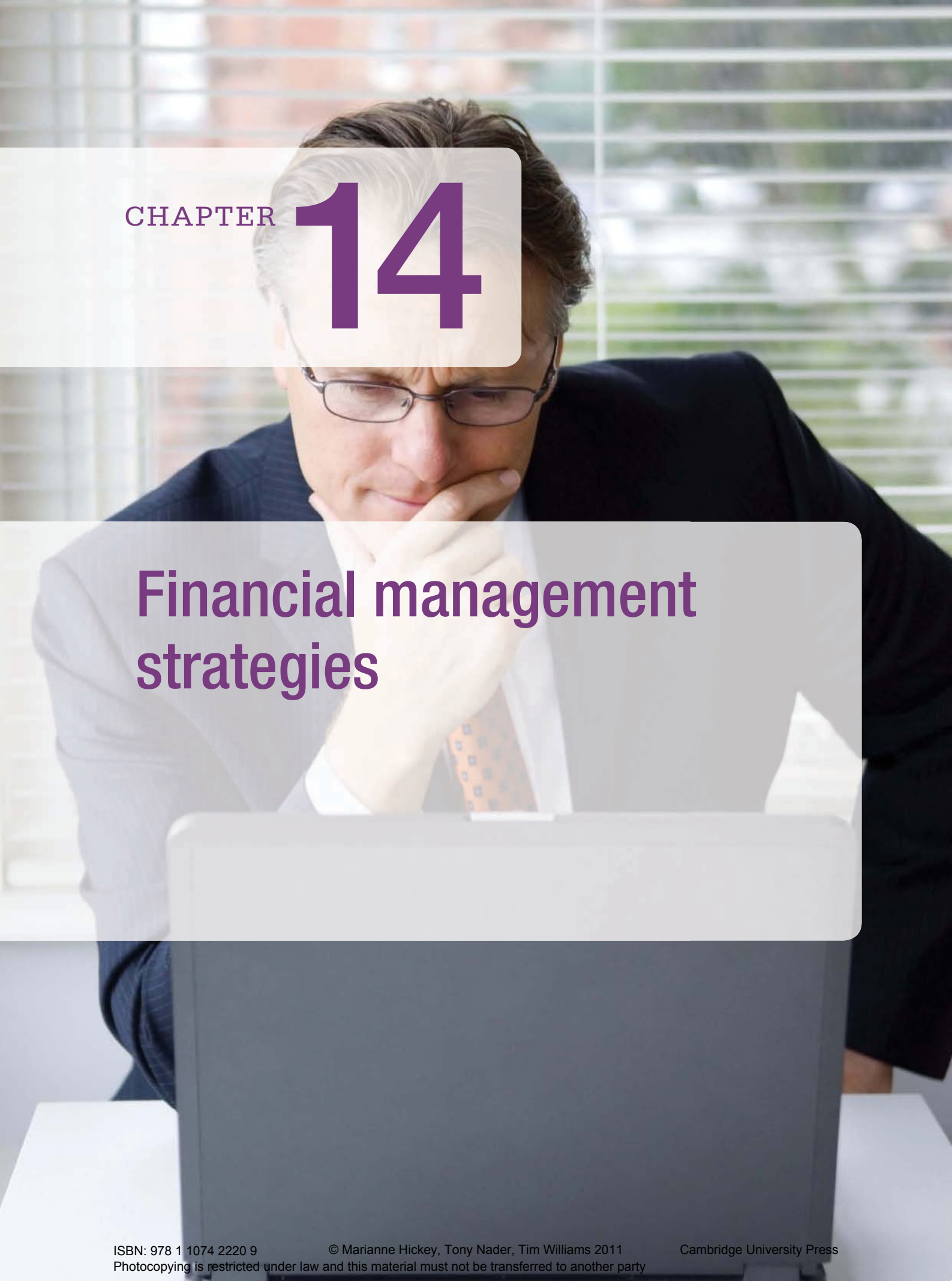
1 Explain the strategies that a business can use to control its cash flow.

2 Discuss the reasons why a business may act unethically and protect the financial interests of internal stakeholders.

Extended-response question

Analyse the sources of funds available to a private company that has been operating for 10 years and wishes to expand globally.

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CHAPTER 14

Financial management strategies

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Cash-flow management

A business must always have enough cash available to pay bills. Businesses will have a bank account from which they will make withdrawals to pay expenses, such as:

- rent due each month
- leasing costs for the company car
- monthly phone bill and internet service
- wages of staff paid fortnightly.

A financial manager can draw up a budget to anticipate how much cash the business needs to pay expenses. A **budget** is a tool to evaluate the performance of a business by comparing actual results with planned results. Budgets are usually drawn up as a spreadsheet illustrating the changes in data over time, such as weeks or months. Some months will be more expensive than others and therefore the financial manager needs to be prepared. The business must always be liquid enough. A business may have plenty of non-current assets and a lot of cash tied up in accounts receivable. However, it can still go bankrupt if it does not have adequate liquidity. A creditor, such as a bank, can put a business into receivership for not being able to pay its loan instalments.

Cash-flow statements

Cash-flow statements are sometimes referred to as continuous, or rolling, cash budgets. This financial report is used to show the pattern of short-term management of cash inflow and outflow. Cash-flow statements usually cover a period of 12 months.

Sources of cash inflow and outflow are listed in Table 14.1. Cash flows can be classified as those occurring due to the operation of the business and the financing of the business and flows from investment decisions. The cash-flow statement summarises how the business will pay for short-term liabilities from sales of inventory. By creating a cash-flow statement of predicted cash flows, managers can avoid a cash shortage by planning ahead. It is possible to predict when cash will be needed and retain cash from earlier periods when cash inflow is much higher, thereby avoiding the need for more debt. If the business does expect to need more debt owing to a cash shortage, it is able to shop around earlier for the cheapest interest rate for short-term loans and overdrafts. The predicted cash flows in Table 14.1 are based on the owner's knowledge of the market, figures from the previous year and external influences (such as competitors). The change in seasons and weather will be a unique external influence on the level of sales in a ski and snowboard shop. Although actual results may vary, the cash-flow statement is a useful tool as it shows when the business may anticipate a shortage of cash, and plan for it. A number of strategies can be used to avoid cash-flow problems as well as to retain cash from more profitable months.

Budget

A tool to evaluate the performance of a business by comparing actual results with planned results. Budgets are usually drawn up as a spreadsheet illustrating the changes in data over time, such as weeks or months.

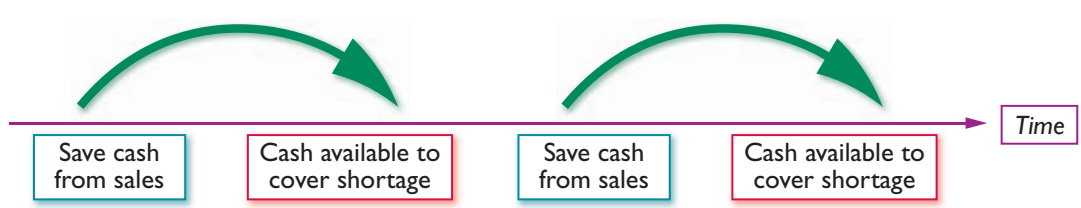


Figure 14.1 Managing cash flow.

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Figure 14.2 shows the yearly cash flow for a ski and snowboard retailer. By examining Figure 14.2, the financial challenges faced by Snowsports can be managed by planning for expected variations in sales and expenses over a typical year. Sales rise and fall with the seasons. Demand is very low during summer when the weather is unsuitable for skiing. The business makes a loss during the summer period because expenses are greater than sales. This business must continue to pay its expenses (such as rent and wages) in order to remain open. When autumn approaches there is a high expense in buying stock for the new season (however, sales demand also begins to increase during autumn). The manager of this business will plan for the slow summer period by keeping enough cash in the business from winter sales to pay for expenses that occur during summer. This strategy will reduce the financial risks to the business when sales are low.

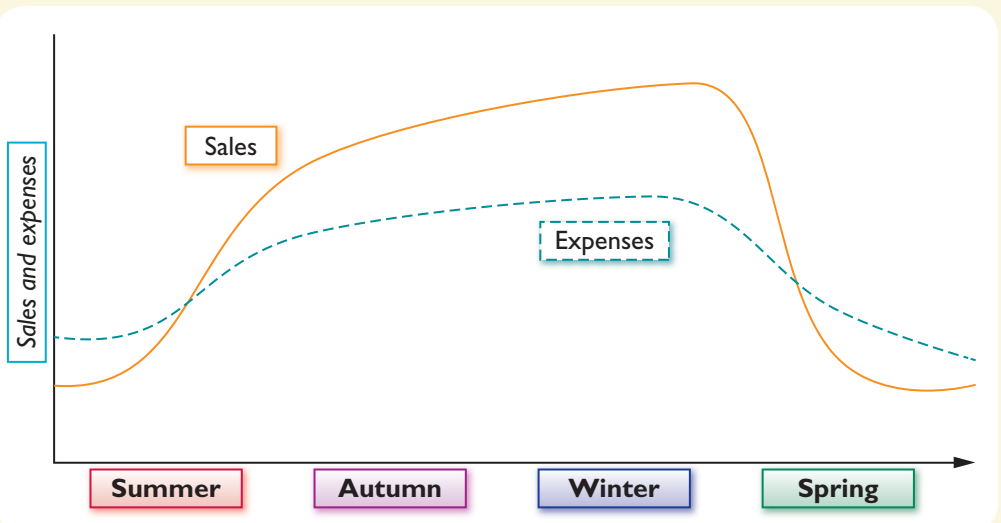


Figure 14.2 Sales and expenses for Snowsports Pty Ltd.

Table 14.1 Sources of typical cash flows

Cash in	Cash out
Operational activities	
Sale	Payments to suppliers
Collections of credit sales	Payments to employers
	Payment of expenses
Financial activities	
Issue of shares	Interest paid on loans
	Payment of dividends
Investment activities	
Collection of loans	Loans to other companies
Interest earned from investments	Cash payments to buy non-current assets

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Activity 14.1 Comprehension

1. Define the term *cash flow*.
2. Assess the impact on cash flow of leasing equipment compared with purchasing the equipment outright.
3. Evaluate the benefits to cash flow of holding lower inventory levels and only ordering the amount of stock that is required.
4. What period does the cash-flow statement usually cover?
5. Identify factors a financial manager should consider when preparing a spreadsheet of estimated future cash flows.
6. Explain how the cash-flow statement may be used as a planning tool.

Table 14.2 Cash-flow statement for Snowsports Pty Ltd

	May $	June $	July $	Aug $
Cash in bank on first day of the month	10 000	(10 000)	12 000	42 000
Cash inflows from sales	*22 000*	*28 000*	*34 000*	*15 000(a)*
Cash outflows from payments				
Staff wages	3 000	3 000	3 000	2 000 (b)
Purchases of stock	37 000 (c)	1 500	0	0
Telephone bill	2 000	1 500	1 000	1 000
Total cash outflows	*42 000*	*6 000*	*4 000*	*3 000*
Net cash inflow for the month	22 000 – 42 000 = (20 000)(d)	28 000 – 6 000 = 22 000	34 000 – 4 000 = 30 000	15 000 – 3 000 = 12 000
Cash in bank on the last day of the month	10 000 + (20 000) = (10 000)	(10 000) + 22 000 = 12 000	12 000 + 30 000 = 42 000	2 000 + 12 000 = 54 000

Explanations:
(a) Declining sales due to end of ski season. (b) Casual staff member no longer needed. (c) Winter season stock purchased.
(d) Negative amounts are shown in ( ).

Management strategies

Distribution of payments

A business can ensure that all large, predictable expenses do not occur at the same time. By spreading expenses over the whole year there is a more equal cash outflow each month rather than one huge outflow during one month. In Table 14.2, the manager should spread stock purchases over July, August and September to avoid cash-flow problems. Other costs may be paid monthly instead of once a year. Many insurance companies offer the choice of paying

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Working capital
The current assets used in the day-to-day running of a business.

insurance premiums monthly instead of annually because of their high cost. A business can also stretch its accounts payable by paying liabilities and expenses on the last possible due date, to keep the money in the business bank account for as long as it can. Another strategy is for the business to prepay expenses, such as rent or interest, when it has the cash to avoid problems arising from non-payment at a later time. Leasing new equipment and expensive technology will distribute this cost evenly over the term of the lease (for example, two years) or the life of the asset. Instead of using cash to purchase such assets outright, a lease will incur a much smaller and predictable monthly expense for the business.

Activity 14.2 Comprehension

The Simple Life Pty Ltd runs survival holidays in the Australian bush. Although it runs 18 trips a year for groups of, on average, 12 people, the business is only just breaking even. An accountant has explained to the owners that their business is experiencing poor liquidity with a slow accounts receivable turnover. He fears the business may become insolvent.

1. Explain the most likely reason why this business has slow accounts receivable turnover.
2. Propose an appropriate strategy this business could use to solve its liquidity problems.

Discounts for early payments

A business may offer discounts to account customers for early payment of their accounts to speed up cash inflow. This discount may be as little as 2–5%. Other incentives for early payment could include small gifts and discounts on future orders.

The business may choose to shorten the credit terms it allows for account customers. Reducing the number of days that a customer can take to pay its invoice will speed up cash inflow into the business as it receives cash from its sales sooner. Alternatively, it may notify the account holder of changes to the contract and in future charge a late payment fee for account holders who exceed the account payment period, thus encouraging payment before the due date.

Factoring

Accounts receivable represents the amounts of money owed to the business from credit sales. These accounts can be sold to a factoring business (often a finance company) at a discount. The factoring firm pays the business the value of accounts receivable, less its fee or commission. Hence, its original total current asset is now actually worth less; however, this creates an immediate cash inflow and the factoring firm collects the money from the accounts as they fall due.

Working capital management

Working capital is the current assets used in the day-to-day running of a business. Current assets need to be well managed so that the business always has enough cash in the bank to pay bills when they are due.

The business needs to manage accounts receivable to ensure it receives payment for goods it has sold on credit to customers.

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Finally, the business needs to have stock available to sell. Net working capital can be calculated using this formula:

Net working capital =
current assets − current liabilities

Effective working capital management will mean the business's current assets will always be greater than its current liabilities.

The working capital ratio, which is also referred to as the liquidity ratio, is used to determine whether working capital is being managed effectively. The formula for the working capital ratio is the same as that for the current ratio. The formula is:

Working capital ratio (current ratio) =
current assets ÷ current liabilities

If the results for the working capital ratio are greater than 1:1 then the business is in a financially stable position. A business can manage working capital by using strategies to control current assets and current liabilities. Management strategies involve increasing the value of current assets and decreasing the value of current liabilities. The business can use various strategies to ensure current assets are always greater than current liabilities. These strategies are outlined in Table 14.3.

Control of current assets

Control of current assets involves ensuring there are enough liquid assets to pay current liabilities when due. These more liquid or current assets are assets that can be readily converted into cash within a 12-month period. The three most common assets are cash, accounts receivable and inventory. The role of the financial manager is to develop strategies to increase the amount of cash in the business's bank account or increase the reliability and frequency of cash inflow.

Cash

Cash is the most liquid current asset and is the balance in the business's bank account. A business can increase the amount of cash it has by using sale and leaseback. This strategy involves the business selling non-current assets (such as company cars, buildings or equipment) to a firm that specialises in leasing assets. The advantage of leasing is that the cash from the sale can be put into the business's bank account, which increases the cash current asset. Depending on the details of the lease agreement, the business can lease the same equipment it once owned. It is also easier to budget for fixed payments for a lease. The business needs to lease the equipment only for the time it is needed. It will not have assets idle for part of the year. Finally, the business can choose to update to the latest technology for machinery or new cars each year. The disadvantage of this strategy is that expenses are increased as there is now a monthly lease to pay.



Figure 14.3 Ensuring there is stock available to sell is part of working capital management.

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Bad debts

Accounts receivable, or debtors, who are unlikely to pay their debts to a business. These individuals or firms may have entered bankruptcy and are unable to pay their invoices. The business will have to reduce the value of accounts receivable in the balance sheet by writing off these debts. The business will receive less cash from account customers because of bad debts.

Write off

To eliminate an asset from the balance sheet as it has no value. The asset may be an item of equipment that has reached the end of its useable life or perishable stock past its use by date. Income may also be written off from a customer that is unable to pay its invoice and is therefore a bad debt.

BUSINESS BITE

In the example given in Table 14.3, current assets are $4000 and current liabilities are $2000. The calculation is 4000/2000 = 4:2 or 2:1. The business has $2 in current assets to pay for every $1 of current liabilities, so the business has a good level of working capital.

Table 14.3 Worked example of working capital ratio

	$		$
Current assets		**Current liabilities**	
Cash	1 000	Bank overdraft	1 500
Accounts receivable	2 000	Accounts payable	500
Stock	1 000		
Non-current assets		**Non-current liabilities**	
Equipment	10 000	Mortgage loan	50 000
Building	86 000		
		Equity	
		Capital	48 000
Total assets	*100 000*	*Total liabilities + equity*	*100 000*

Ethical Issue

What are the ethical issues involved with delaying payment of invoices until the last day they are due? This is also known as stretching accounts payable. How long should a business delay paying its short-term liabilities using a variety of excuses in order to maintain liquidity and a cash surplus?

Receivables

Receivables or accounts receivable is also known as debtors. The effectiveness of control over accounts receivable is measured using the accounts receivable turnover ratio. If the accounts receivable turnover ratio (total sales ÷ accounts receivable) is low, this reveals that account customers are taking far too long to pay. This slows down the collection of revenue for the business and cash coming into the business. There may also be a high number of **bad debts**, which is where a firm that owes the business money can no longer afford to pay. The business has to **write off** this potential income. To increase cash inflow into the business, the business may sell its accounts receivable to a specialist factoring firm. The factoring firm will give the business cash for its accounts receivable, which it can use to cover short-term liabilities. Note that factoring will reduce the value of total current assets and make the working capital ratio worse. Alternatively, a business may offer its account customers discounts for early payment to speed up cash inflow. Unless specifically written into a contract, it is illegal for a business to arbitrarily impose a late payment fee. Another strategy is a

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review of the firm's credit policy by the financial manager. The manager may decide to impose a credit limit on customers, make a more careful check of the credit history of those who are given credit, send regular reminder notices for overdue accounts, reduce the time account customers are allowed to pay and even refuse credit to those firms who consistently do not make payments before the due date.

Inventories

Another working capital problem a business may experience is to have too much cash invested in inventory, which includes raw materials, work-in-progress and finished goods. The business has used cash to buy inventory (or stock) and now does not have enough cash to pay short-term debts. In addition, this stock may take a long time to sell to convert back into cash. The business can find itself with a very high inventory of stock, which is a cost in storage space as well. Finally, the business may discover that it loses stock as a result of poor monitoring, inadequate security or administration errors. Lost or damaged stock will be another cost for the business. Successful businesses closely monitor and protect their inventory. Inventory is essential for retailers and wholesalers because it earns revenue as it is sold. Methods for internal control over inventory include:

- physical inspections and counts or stocktakes

Activity 14.3 Comprehension

The following questions are based on the stimulus below. The credit terms offered by this business are net seven days.

Table 14.4

Account customer	Total owed	0–7 days	8–30 days	31–60 days	61 days+
A	$2 100			$2 100	
B	$120				$120
C	$14 500	$14 500			
D	$3 520	$2 950	$439	$131	
E	$3 216		$3 216		

1 Identify which account the business will most likely write off as a bad debt.
2 Analyse which business should have its credit terms reviewed.
3 Outline two appropriate strategies that may be used to encourage account customer C to pay the amount owing.
4 Explain why customer A is still able to have $2100 owing after 31 days.
5 This report is called an aged debtors listing. Explain why it is a very effective tool to control accounts receivable.

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Stock movement

The physical movement of stock into a business when it is bought as inventory and out of a business when it is sold.

Credit rating

An assessment of a business's ability to repay loans based on its past financial performance and repayment of past loans. Credit ratings are usually expressed as letter grades, such as A–, B or C+.

- security, such as cameras and security tags to prevent theft
- suitable transportation and storage to prevent accidental damage or spoilage; for example, ensuring food is stored at the correct temperature
- limiting staff access
- only purchasing enough inventory to satisfy anticipated sales and providing a sufficient buffer to cover unexpected increases in demand and to avoid running out
- keeping accurate records of purchases, inventory received and inventory sold.

Even in the best accounting systems mistakes can occur. Therefore, a physical count is the best way to determine how much inventory is physically present in the business. A physical stocktake may be performed each week or annually, depending on the type of goods the business sells. Accounting records will need to be corrected if an error is detected.

A just-in-time (JIT) inventory management system can be used to reduce the costs of storing stock and inputs. A business with such a system has arranged for its suppliers to deliver stock just in time for when it is needed. The business needs a much smaller amount of storage and warehouse space, which reduces expenses and frees up cash to pay liabilities. A computerised inventory management system using barcodes to identify **stock movement** will give the business instant information about what stock it needs to order. This strategy will also reduce stock loss due to its being mislaid or stolen. The internet can be used to automatically email suppliers to deliver additional stock when the computer calculates that current stock is getting too low. A computerised system may also identify stock that is not selling very well. The financial manager and the marketing manager can decide to eliminate this item from the product mix.

Activity 14.4 Comprehension

1. Outline the three most common current assets that many businesses own.
2. Explain why accounts receivable is classified as a liquid asset.
3. Analyse why a business needs to have more current assets than current liabilities.
4. Discuss why is it considered inefficient to have cash reserves that are too large.
5. A business can offer discounts for early payment but cannot freely impose a late penalty fee on account customers. Evaluate why this is.
6. Describe a situation when a business should use leasing rather than purchasing assets outright.

Control of current liabilities

Payables

Payables or accounts payable is the money the business owes to its suppliers. Accounts payable is also known as creditors. A supplier will deliver goods to the business with an invoice that the supplier expects will be paid within the time it allows; that is, the credit period. (An invoice is also called an account or bill.) A supplier may give 7, 14 or 30 days or longer to pay. The number of days given will depend on the **credit rating** the business has and the reputation it has with the supplier. The business may have a short-term problem with too many bills needing to be paid at once. More cash is going out than coming in from sales, creating a cash-flow problem. Paying bills too early is an inefficient use of cash as the business should hang on to the money

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and use it to pay more urgent expenses or invest the cash to earn interest. If the business pays its invoices too late then it risks its reputation with its suppliers. The supplier may no longer offer a discount or may shorten the credit period. The business could even be taken to court by the supplier for not paying. A strategy to control payables while keeping a good reputation and credit rating with its suppliers and avoiding penalties is to stretch accounts payable. This is where the business pays its invoices on the last day they are due. Therefore, the business can keep as much cash in the business as possible to pay more urgent liabilities.

Loans

The business must compare the costs and term of the loan with other sources of finance such as leasing in order to use the most appropriate form of finance for short-term needs.

Rather than borrowing finance to purchase assets and increasing the amount of debt the business has, the business could lease non-current assets. An extra advantage is that lease payments are a tax deduction.

Overdrafts

Overdrafts are intended as a short-term source of finance and should be used to fund short-term needs.

A business can control its overdraft by ensuring that all cash received is promptly deposited in the business's overdraft account to reduce the amount owing. Online banking systems give financial managers access to the business's bank accounts 24 hours a day, seven days a week.

BUSINESS BITE

Newcastle Sound and Vision Pty Ltd, a retailer of electrical entertainment goods, needs to stock Sony 3D televisions. Newcastle Sound and Vision sends a purchase order to Sony Australia for the stock it needs. When Sony Australia receives the purchase order it electronically scans it and organises the goods for dispatch from its warehouse.



Figure 14.4 Management of cash is required when purchasing inventory.

The goods are sent out the same day along with an invoice requesting payment from Newcastle Sound and Vision. Often the invoice arrives in the mail before the stock is delivered. However, Newcastle Sound and Vision will not pay it immediately. Instead, the manager will wait until the stock arrives to check that the goods are correct in type and quantity as well as quality; for example, that they are not damaged. Newcastle Sound and Vision is not required to pay the invoice for 30 days. By delaying payment until the last few days, Newcastle Sound and Vision reduces cash outflow in the short term. However, if it is offered a discount of 2%, for example, by Sony Australia for early payment, Newcastle Sound and Vision may wish to reduce its costs by taking advantage of the discount.

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Fixed costs

Costs that do not change when a business varies the amount of goods and services it produces. Rent is an example of a fixed cost.

Insurance premium

The cost of obtaining insurance. The premium is based on the risk of the insured event actually occurring.

Variable costs

Costs that change when a business varies the amount of goods and services it produces. The cost of raw materials is an example of a variable cost.

Management strategies

Leasing

Leasing assets will not use up the cash available as there is no deposit required. The business has to make a payment each month based on the terms and amount included in the lease agreement. Thus, the assets expense will be spread over a period of time.

Sale and lease back

Selling a non-current asset owned by the business will provide a cash injection to the business, thus making funds available to pay expenses as they fall due. The business can enter into a sales agreement that allows them to lease back the equipment or premises and make monthly payments to the new owner.

Profitability management

A good accounting and financial system has effective controls to ensure the business:

- does not overspend
- does not lose assets
- records financial records and transactions correctly.

Cost controls

Fixed and variable

A business can increase profits by cutting costs. Businesses can reduce costs in two areas: labour and inputs. Outsourcing of non-core functions has been the most popular method of reducing costs by larger organisations. Examples of outsourcing are contracting a call centre to handle customer inquiries or hiring a specialist firm to handle payroll, cleaning, security or marketing. These organisations are aiming to achieve greater efficiency, allowing them to focus on their core business.

Costs may be classified as either fixed or variable. **Fixed costs** do not change when a business produces more goods or if it sells more goods and services. Examples of fixed costs are management salaries, rent, lease payments, fixed-interest payments on loans, **insurance premiums**, rates and government fees. Fixed costs are often contract based and negotiated before production and sales have begun and hence harder to reduce. **Variable costs** do vary as output and sales change. Examples are employee wages and overtime payments, advertising, cost of purchasing inputs, raw materials, electricity, phone, warehouse storage costs and the cost of transporting materials. Management's control of costs will focus on variable costs as there is more flexibility to change these. In each case, managers will want to eliminate waste (i.e. where an expense does not add value to the product or service the business provides).

Strategies to cut variable costs include:

- negotiating discounts with all suppliers; for example, bulk ordering stationery supplies
- reducing the number of suppliers and negotiating contracts for discounts – called supplier rationalisation
- switching to a cheaper supplier, reducing the number of sales staff and multiskilling remaining staff
- increasing self-servicing by customers (for example, use of automatic teller machines) and reducing the number of staff employed

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BUSINESS BITE

Alex owns an indoor climbing gym business. As well as the gym, Alex operates a small shop selling climbing equipment. She also owns the building as well as all the shop fittings and equipment used in the gym. The business has been experiencing a steady decline in revenue because the popularity of indoor climbing has been falling in recent years. Creditors have been contacting Alex as she has failed to meet several deadlines for payment. This is affecting her relationship with her suppliers. Her supplier of drinks and snack food will no longer deliver unless Alex pays up-front in cash. The bank overdraft has also reached its limit of $5000. Alex feels that if she renovates the gym and uses a new promotional strategy she will be able to attract new customers and move the business into the renewal phase of its life cycle. What should Alex do?

Answer

Alex needs to control the business's current liabilities by finding enough cash to pay her suppliers and reduce her bank overdraft. Her accountant should advise her that the building in which the gym is located is a valuable asset that is not being used effectively. Alex should seek a business that will purchase the building as a property investment and allow her to lease it back from the purchaser so she can keep operating her business. Alex will receive enough cash from the sale of the building to pay her liabilities and rejuvenate the business. Alex will have an additional financial obligation in the lease of the building. However, this should not be a concern once customers and revenue increase.



Figure 14.5 A business may be advised to sell its premises and lease back the building from the purchaser, allowing it to continue to operate as normal.

- sharing resources with other businesses, such as sharing delivery costs
- replacing full-time permanent staff with casual staff because no **on-costs** (such as holidays and sick leave) need to be paid to casual staff
- using just-in-time inventory management.

Ethical Issue

What are the ethical issues of downsizing a business's workforce to reduce costs and increase profits in the short term? What may be the impact on the business in the long term?

On-costs

The additional costs to a business of employing staff. As well as paying a wage or salary, a business must pay staff leave for sickness, holidays and maternity leave. A business must also contribute to the retirement savings of employees by paying superannuation. These are legal requirements.

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Cost centres

The expenses associated with each key business function (that is, marketing, finance, human resources and operations) providing a product to consumers.

Cost centres

Cost centres are set up for divisions or departments of a business to account for their expenses/costs involved in the function they perform (for example, marketing). Management may provide them with a budget and monitor their expenses to minimise waste and achieve maximum use of resources. For every good sold there are operations expenses involved in making and supplying, financial expenses (such as interest on loans taken out to buy machinery and supplies), marketing expenses, administration expenses and human resources expenses. A financial manager can take the total cost of making and supplying a good and calculate the percentage contribution of each cost centre.

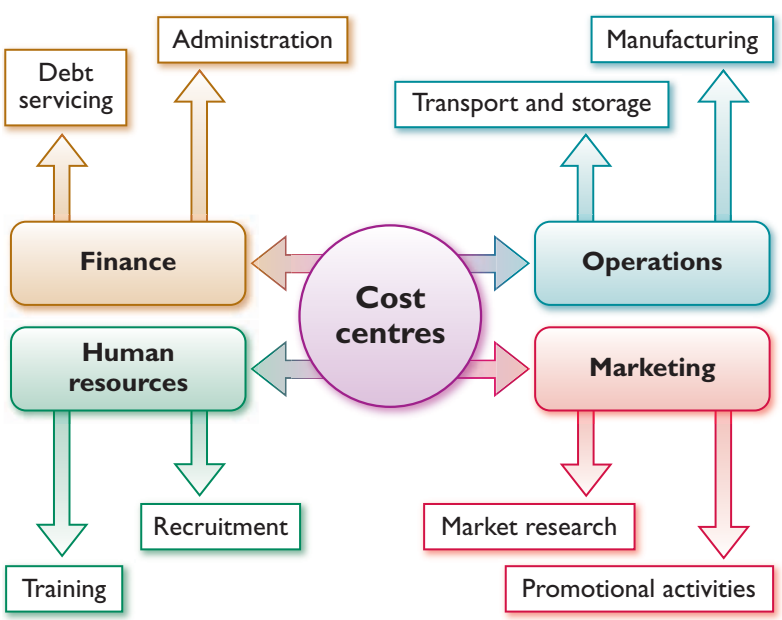


Figure 14.6 Cost centres.

Expense minimisation

Cost centres can be used to identify which type of expense contributes most to the product. This would be the area where any expense minimisation would have the greatest effect.

Cost centres use budgets as tools to evaluate the performance of a business by comparing actual amounts spent to the planned figures. If the business did not achieve a specific financial objective, changes can be made to the business plan.

Budgets are used to predict changes in fixed and variable costs. Since most fixed costs cannot be changed, variable costs will usually be targeted for expense minimisation where the business can eliminate unnecessary costs while producing the same quality and output with fewer resources. For example, many businesses have managed to decrease the costs of packaging their products. A just-in-time system of purchasing inventory will reduce inventory costs such as warehousing, the efficiency of the workforce can be increased through multiskilling, machinery can even be substituted for labour and the firm can downsize middle management. Budgets can also be used to identify which expense contributes the most to cash-flow problems so that specific strategies can be developed to deal with the expense. In expense budgets, management puts a limit on what may be spent on certain expenses in individual **cost centres**.

This will reduce cash outflow, especially where there are specific policies to deal with managers and employees who overspend.

Revenue controls

Marketing objectives

On the whole, marketing strategies and objectives should result in increased sales and therefore increased revenue for the business. Revenue controls can be used to achieve marketing objectives. Revenue

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controls include sales forecasts, analysing the sales mix and the pricing policy of a business. Budgets can be applied to **sales forecasts**. A sales budget is used to predict future sales of the business based on:

- patterns of sales in previous years
- performance of marketing strategies
- economic conditions
- level of competition
- stage in the product's life cycle.

Businesses will have short-term sales objectives. The actual level of sales can be compared to what was budgeted each month, week or even day to determine whether the business is on track to reach its sales objectives. Sales reports can provide a lot of information for the financial manager.

Sales mix is the marketing strategy used to sell the range of products a business supplies. It is a report that can be used to identify which method of promotion works best; that is, which is most efficient and effective. From the sales mix the financial manager can also identify which product contributes most to total revenue and which product contributes least to total revenue and therefore identify which product to concentrate on and which to eliminate from the product range. For Snowsports (see the 'Business Bite' box below) the owner may decide to delete snowboards from the product range of the business and use the extra space for displaying more clothing accessories, as sales of these are consistently higher than expected.

From studying Table 14.5 it is obvious that Trent was consistently below what was predicted for him. The manager may need to develop a strategy to motivate Trent to sell more or fire him.

Sales forecast
The predicted future sales a business expects to make during the year considering the business's internal and external environments.

BUSINESS BITE

By analysing sales reports the sales manager at Snowsports can determine which salesperson, Trent or Harry, is not meeting his sales objective. He may need to be given more training or be fired.

Table 14.5 Sales report for Snowsports Pty Ltd

	July		August		September	
	Budget	Actual	Budget	Actual	Budget	Actual
Sales by Trent						
Skies	6 000	5 800	5 000	4 700	4 000	2 800
Accessories	3 000	2 700	3 000	1 200	2 000	1 700
Snowboards	2 000	1 300	2 000	1 400	1 500	1 300
Sales by Harry						
Skies	6 000	6 200	5 000	6 300	4 000	5 100
Accessories	3 000	2 900	3 000	3 100	2 000	3 000
Snowboards	2 000	1 100	2 000	1 300	1 500	1 100

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Exchange rate
The value of a country's money calculated using another country's money.

Euro
The currency of the European Union. It was introduced in 2002.

A pricing strategy to control cash is to use a cost-based pricing method where the price is based on what the good costs to supply. Using this method there will be a set percentage mark-up on each item sold to ensure the business receives a certain amount of profit on each sale. Also, a price for each product will need to be determined that will ensure market share is maintained or even improved as well as ensure the business meets its profitability objectives. A business may choose to reduce the price of products that are not selling well and offer them at a discounted price. This may increase total sales. However, because the profit margin on each good is smaller, the business may not experience an increase in total revenue. The business would have to sell a much higher volume of goods at the discounted price to increase the value of total revenue.

Activity 14.5 Comprehension

1. Explain the difference between cash flow and working capital.
2. Outline the differences between fixed costs and variable costs.
3. Explain how cost centres can be used to reduce costs.
4. Describe how a budget can be used as a cost control.
5. Explain the advantages (to both the business and the customer) of discounts offered for early payment of accounts payable.
6. Explain why discounting to sell stock quickly may not improve cash inflow.

Global financial management

When a business becomes part of the global economy, it is open to additional influences from the external environment. Global financial variables are an additional risk that must be managed.

Exchange rates

Anyone who watches the news or follows the financial reports will understand that the value of the Australian dollar (AUD) is very important. Each day its value changes according to the performance of the Australian economy as well as other economies. Currency fluctuations are changes in the value of a country's money. An **exchange rate** is the value of a country's money calculated using another country's money. It involves calculating how much is received when the AUD is exchanged, or swapped, for money from another country. For example, we use the exchange rate when calculating the value of the AUD in US Dollars (USD). Businesses that sell goods and services overseas will also closely monitor the value of the AUD.

Currency fluctuations are a significant influence on the profitability and financial stability of global businesses. When costs and revenues are transferred between nations the exchange rate can further increase or decrease the value of net profit for a global business. Table 14.6 illustrates the changing value of the AUD in relation to three other currencies, including the **euro**, which is the currency of the European Union. The value of the AUD depreciated significantly against the currencies of Australia's major trading partners from 1980 until 2001.

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Table 14.6 Comparison of value* of AUD with USD, euro and Japanese yen, 1980–2004

Year	1 AUD buys USD (monthly average)	1 AUD buys euro (monthly average)	1 AUD buys yen (monthly average)
1980	1.0831	Not yet introduced	270.13
1985	0.7051	Not yet introduced	176.94
1990	0.7542	Not yet introduced	118.79
1995	0.7280	Not yet introduced	64.92
2000	0.6055	0.6317	63.77
2001	0.4890	0.5559	60.96
2002	0.5316	0.6086	70.53
2003	0.6036	0.5576	71.97
2004	0.7589	0.6203	79.08
2005	0.7719	0.5973	82.69
2006	0.7382	0.5889	84.05
2007	0.8070	0.6049	94.94
2008	0.9180	0.5813	91.58
2009	0.6873	0.5190	67.48
2010	0.9120	0.6716	82.58

**The values are the averages for the month of March* *Source: Reserve Bank of Australia website.*

This had made imported goods coming to Australia relatively more expensive and the prices of Australian exports in foreign markets relatively cheaper. Businesses must plan for the value of the AUD being quite volatile. For instance, after appreciating since 2002 and peaking at US 96 cents during June 2008, the value of the AUD depreciated steadily from July 2008 until January 2009 and since then generally appreciated again. If an Australian company is exporting its product around the world it will want to be paid in AUD. How much it will be paid is uncertain because the value of the currency changes all the time. Similarly, an Australian business that imports parts or components will need to pay its suppliers in the currency they request, such as USD or Japanese yen. Currency fluctuations will affect the business's ability to meet its revenue and cost goals and therefore its profit targets. Financial managers spend a lot of time developing detailed budgets to allow accurate planning. Uncertainty created by changing exchange rates make these budgets useless and unacceptable for business.

Uncertainty created by changing exchange rate is not acceptable in business. A business will need to use strategies to ensure that the amount it receives or pays is not affected by currency fluctuations. When the AUD increases, or appreciates, it is worth more when converted to other currencies. The result of any appreciation is that imported goods become cheaper. It costs the Australian business less to pay a US business in USD. If the cost of inputs fall, wholesale cost is lowered, making it possible for the Australian business to produce and

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supply the same amount of goods at a cheaper price. However, Australian goods exporting overseas become more expensive compared with what they were previously. Higher prices will mean that sales will fall as US consumers substitute the Australian product with one that is cheaper from another country or one that is made in the United States. If the AUD is depreciating, or losing value, Australian businesses that export goods and services will find sales will increase as their goods and services are now cheaper and they will receive more revenue. Australian businesses that import goods and services will have to pay more. The importer may pass on these costs to consumers as higher prices. However, the importer may reduce its orders because it costs more AUD to buy the same amount of foreign currency to pay the supplier. It has become more expensive. Increased financial risk is likely from unfavourable currency changes that increase expenses and erode profits.

Interest rates

A global business can borrow money from financial markets in other countries and will aim to borrow at the cheapest price. A business will borrow from the country with the lowest interest rate. However, there is an exchange rate risk to the business. If the value of the home country's money depreciates then interest repayments increase because it costs more AUD to obtain the same amount of foreign currency to pay the interest and repay the loan. When a business borrows money from overseas it is described as buying a security. An Australian business can also lend money on overseas financial markets, such as Wall Street in the United States or the London, Hong Kong or Japanese stock exchanges. Overseas borrowing has a number of advantages over borrowing locally:

- the rate of interest can be cheaper
- appreciation of currency makes interest repayments cheaper
- there are fewer restrictions, such as on the amount that can be borrowed, the repayment period or the conditions of the loan
- finance may be acquired more quickly and easily
- banking industry technology, information technology
- international monetary transfers and deregulation of the banking system have made foreign currency loans available to Australian businesses.

Interest rates overseas can have a significant impact on an Australian business's profitability. If the Australian firm has borrowed money from finance markets overseas its repayments will be affected by the government's economic management policies and the economic cycle of the country from which it has borrowed money. Lower interest rates overseas are very attractive, but rates can rise. The Australian business will need to thoroughly research overseas economies to assess the financial risk to the business of interest rate rises. Overseas interest rates in the economies of Australia's trading partners (such as the United States and Japan) will influence local interest rates. Australia tends to follow the economic trends of its trading partners. However, this relationship is not as strong as it once was. Today, the Australian economy is less influenced by the economies of its trading partners.

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Activity 14.6 Comprehension

1. Analyse why the currencies of different countries are most often compared with the US dollar.
2. Describe the advantages for an Australian business of acquiring finance from foreign financial markets rather than from the Australian market.
3. Explain how a business can at first benefit from acquiring cheaper debt finance from overseas and then lose the benefit of cheaper finance owing to exchange rate changes.
4. Slim makes genuine kangaroo leather belts and whips. He has successfully penetrated the US market by selling his Australian products on eBay in the USA. If there is a depreciation of the Australian dollar relative to the US dollar, describe how this will affect Slim's revenue.

Methods of international payment

An importer will want to minimise costs, make payment as late as possible and have the goods before paying for them. On the other hand, exporters will want the highest price for their goods, to be paid quickly and try to keep control of the goods until they are paid for. There are many methods of payment used by global financial managers for the export and import of goods and services. The main ones include:

- payment in advance
- letters of credit
- bills of exchange.
- clean payment

Payment in advance

Obviously the most secure method of payment, where the exporter bears the least risk, is to receive payment for goods before they are sent. However, this will be the least desired by the importer as it has all the risk of the goods never being sent.

Letter of credit

The preferred method to ensure payment from an importer is to require it to have a letter of credit, confirmed by a secure bank. A letter of credit is a document issued by a bank to the seller of goods that has specific instructions from the buyer of the goods giving the seller the authorisation to draw a specified sum of money from the buyer's bank account under certain conditions. The exporter may also require partial payment for the goods in advance. This strategy carries a lower amount of risk for the exporter.

Bills of exchange

An exporter and importer may agree to use a bill of exchange and an international bank as an intermediary in the transaction. A bill of exchange is a written order from a seller requesting that an importer or buyer pay the seller a specified amount of money at a specified time. The bank, acting as a negotiating intermediary, ensures that the importer receives its goods and that the exporter is paid. When the exporter arranges for the physical transport of the goods, it will receive official shipping documents, such as an invoice or packing slip. Once these documents are presented to the bank by the exporter, the bank will arrange for payment to be made. A bill of lading is then given to the importer

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Hedging

Any strategy or financial tool used to reduce the risk of loss resulting from financial transactions, such as converting one currency to another.

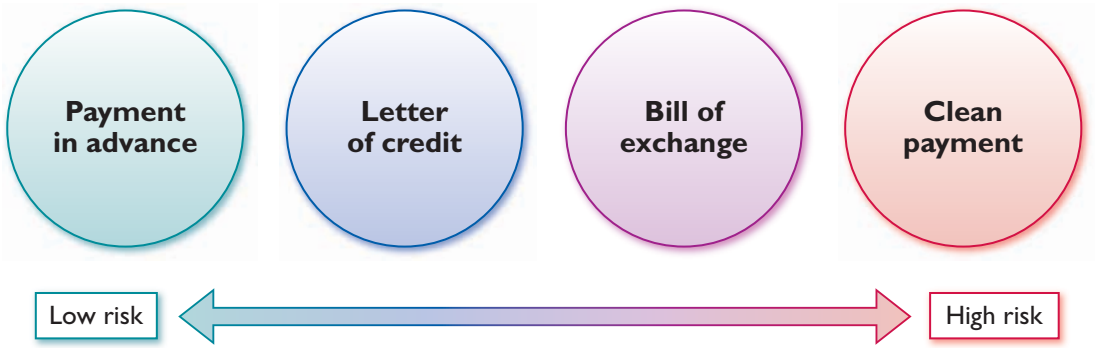


Figure 14.7 Level of risk of payment methods.

by the exporter, giving the importer legal ownership of the goods when they arrive. Once the importer holds the shipping documents, such as a bill of lading, the importer legally owns the goods.

Clean payment

The arrangement with the most risk is for the exporter to trust the buyer and run an open account or clean payment. The goods are shipped before payment is received. This method should only be used when there has been a long track record of promptly paid transactions and a high level of trust. The length of the credit period that is given will also depend on the strength of the relationship. A maximum of 180 days is acceptable.

It is very important for a global business to research and analyse the businesses that are purchasing, importing and distributing its products. Knowledge of the cash-flow position of these businesses that are customers will give a very good indication of their ability to pay their accounts. Credit rankings and ratings can be obtained from specialist firms and government organisations. In Australia expert advice concerning the ability of some overseas business to pay for imports from Australian businesses is available from Austrade. An effective strategy to reduce the risk from non-payment of exported goods is to assign one manager responsibility for tracking export payments and shipping through each distribution channel. Exporters should take out insurance to protect themselves from non-payment by customers, the goods not arriving at their destination, damage during transit and theft. It is possible to insure against an unfavourable change in exchange rates affecting the Australian exporter. The Australian Government will also offer insurance and assistance to Australian exporters developing new markets in more risky parts of the world that a private insurance company would not cover.

Activity 14.7 Comprehension

1. Identify the risks to an importer if a prepayment is used.
2. Define insurance. Explain how it can reduce financial risk.

Hedging

Hedging is any strategy used by a business to reduce financial risk. Global businesses can use hedging to eliminate the risks from the value of money changing. Global businesses enter into contracts to buy and sell foreign exchange to purchase inputs from businesses in other countries. The

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exchange rate can change significantly between the time a purchase contract is signed and the time payment is made. In addition, when profits are transferred from the nation in which they were earned to the headquarters of the global business, the currency will need to be converted. Unfavourable changes in the value of a country's currency can effectively increase costs and reduce profits. This is called transaction exposure. Hedging can be used to eliminate transaction exposure. Hedging can be done naturally by using subsidiaries. Hedging using subsidiaries involves a global business avoiding changing between currencies by having all transactions between its subsidiaries occur in the same currency. A subsidiary is a business that is owned by the global corporation that supplies inputs. For example, a toy manufacturer in the United States may own an electronics company in Malaysia. The electronics company exports parts to be put into the toys. Transactions are always in US dollars to reduce currency exchange risk.

Derivatives

A very common form of hedging is to use a **derivative**, which is a special contract between global businesses and suppliers. Derivatives, using contracts, are financial tools to reduce currency risk. The three main types of derivative contracts are:

- forward exchange contracts
- currency option contracts
- swap contracts.

By using a forward exchange contract the bank will guarantee the exporter a certain exchange rate on a certain date.

Derivative

A special contract between global businesses. It is a type of hedging and is used to reduce financial risks, such as that created by the appreciation and depreciation of currencies.

BUSINESS BITE

Neutron Scientific makes specialised measuring equipment for use in the food manufacturing industry. Each machine sells for over A$500 000. It sells its machines to food manufacturing firms in Australia. The business has to import parts from the United States. It then modifies the parts to make its measuring equipment. Neutron Scientific has signed a contract with its US supplier to deliver parts four times a year. The business needs to determine exactly how much it can expect to pay for its inputs so it can write its finance budget and make financial plans. Neutron Scientific will need to pay its supplier in March, July, October and December. If the value of the AUD depreciates, Neutron Scientific may have to pay the US company thousands more than it has planned for. Neutron Scientific will use hedging to reduce this currency translation risk. The business will use a derivative to hedge against the unfavourable currency movement. In this instance, a forward exchange contract is the most suitable derivative (financial instrument). Analysis by currency experts of the change in the value of the AUD over time expects the value to continue to depreciate. Neutron Scientific will organise a contract that sets the agreed value of the AUD in USD for each of its four payments. Regardless of what actually happens to the value of the AUD, Neutron Scientific and its supplier have a predetermined set exchange rate. The rates selected are US$0.68 on 31 March, US$0.82 on 31 July, US$0.91 on 31 October and US$0.89 on 31 December. Both businesses are now certain about what they will have to pay and receive, giving more certainty in their cash flow.

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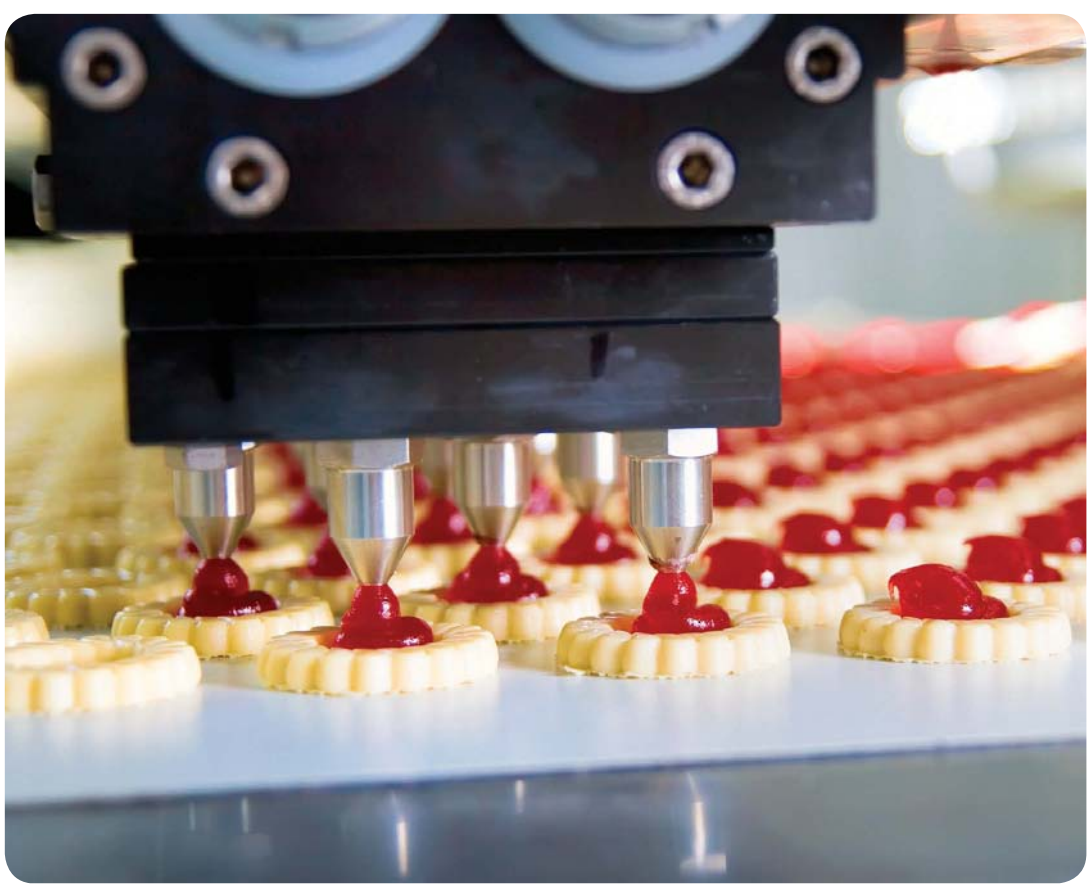
This rate will be paid regardless of what the exchange rate actually is on the agreed date. If a business purchases a currency option contract, it has the option to buy or sell foreign currency when the exchange rate movement is to its advantage. A swap contract allows two businesses to use an exchange rate on a particular day. This rate is called the spot rate. It is the price at which a currency can be purchased or sold for delivery in two business days. For example, an Australian business must pay its US supplier in USD. However, it has a shortage of USD but has plenty of euros to make the payment. A swap contract is written allowing the Australian business to pay the US supplier in euros at a spot rate. At a later specified date the US business and the Australian business swap the euros for USD at the same spot rate.

Activity 14.8 Comprehension

1. Define the term *hedging*.
2. Outline the strategies a global business may use to hedge against payment risks.
3. Explain the advantages of a currency option contract.

Activity 14.9 Comprehension

1. Outline what effect changes to the value of currencies can have on the financial planning of a global business.
2. Explain the role international banks may have in reducing payment risk.



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Chapter summary

- A business must always be liquid enough to pay its expenses and short-term liabilities when they are due.
- Cash-flow statements can be used to predict a business's cash inflows and outflows over a length of time to identify periods when the business may experience liquidity problems. By using budgets to identify these periods, cash can be managed to ensure that there will be enough on hand when required in the future
- Strategies available to manage cash flow in a business include spreading the distribution of payments, offering discounts for early payment to account customers and factoring.
- Cash inflow can be increased by factoring accounts receivable or offering discounts for early payment of credit accounts. Each will actually decrease the value of total current assets. However, cash will be available quicker.
- Working capital is the current assets used in day-to-day running of the business. Net working capital = current assets – current liabilities.
- Businesses may need to write off bad debts and carefully monitor their accounts receivable.
- Inventory includes raw materials, work-in progress and finished goods. Inventory must be carefully monitored to avoid lost or damaged stock.
- Businesses must control their current liabilities – these include accounts payable, short-term loans and overdrafts.
- By stretching accounts payable, a business can hold on to its money for longer and pay more urgent expenses on time.
- In order to manage profitability, both cost controls (fixed and variable, cost centres and expenses minimisation) and revenue controls relating to marketing objectives (sales forecasts, sales mix and pricing policies) should be used.
- Short-term loans should be used for short-term needs.
- Strategies to manage working capital include leasing and sale and leaseback.
- Fixed expenses do not change when a business produces more goods (for example, rent). While variable expenses vary as output varies.
- Global business needs to take into account exchange rates in their financial planning. Appreciation of the Australian dollar means imports will be cheaper and exports will be more expensive.
- Global business may borrow from financial markets in other countries and aim to borrow at the lowest interest rate.
- Methods of international payment include payment in advance, letters of credit, clean payments and bills of exchange.
- Hedging is used to reduce the financial risk in global transactions due to changes in the exchange rate.
- Derivatives, a form of hedging, includes forward exchange contracts, currency option contracts and swap contracts.

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Chapter revision task

Outline an appropriate cash-flow management strategy that a business could use for each of the following situations.

1. Gourmay Takeaway has experienced a cash shortfall for the months of December, January and February owing to an increased number of customers purchasing goods on account.
2. Fine Furniture requires cash to pay its annual insurance premium of $100 000.
3. Unseasonable weather has seen the warehouse of Treat's ice-cream become overstocked with food supplies.
4. Management of Quality Recruiters has decided to update its information technology equipment. The business does not have the substantial amount of money needed to purchase this equipment.
5. Tonnad and Associates Pty Ltd is a small law firm that has experienced increasing costs and frustration complying with changes to Australian taxation law. Currently the owner is spending too much time working out taxation issues and not enough time on legal cases.
6. Leaking Tap Plumbers has received a number of invoices due over the next eight weeks.

Multiple-choice questions

1. What are cash outflows the result of?
   - **(A)** Payments to suppliers and interest earned on investments
   - **(B)** Payments to suppliers and interest paid on loans
   - **(C)** Payments of dividends and issues of shares
   - **(D)** Investment activities and sales
2. Which of the following are examples of fixed costs?
   - **(A)** Leases, rent and salaries
   - **(B)** Leases, rent and wages
   - **(C)** Rent, telephone and electricity
   - **(D)** Inputs, raw materials and casual wages
3. What are cost centres used to determine?
   - **(A)** Which costs in the business are the highest
   - **(B)** The contribution to total costs of different sections of a business
   - **(C)** Which inputs are too expensive
   - **(D)** Which employees should be made redundant
4. What value can be used to determine the effectiveness of the day-to-day management of a business?
   - **(A)** The amount of cash held by the business
   - **(B)** The working capital or current ratio
   - **(C)** The value of all assets held by a business
   - **(D)** The value of all liabilities of a business

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5 What is the most liquid asset held by a business?
   (A) Cash
   (B) Debtors
   (C) Creditors
   (D) Work-in-progress

6 What does JIT in Business Studies stand for?
   (A) Justified in technology
   (B) Joint involved terminals for stock control
   (C) Just intensity technique for quality management
   (D) Just-in-time inventory management

7 In Business Studies, accounts payable is referred to by another term. What is this term?
   (A) Suppliers
   (B) Accounts receivable
   (C) Creditors
   (D) Debtors

8 It has been recommended to Kwei that he use factoring. Which of the following best explains what factoring is?
   (A) The selling of a business's current debtors to a specialist debt-collecting firm
   (B) The selling of a business's current liabilities to a specialist debt-collecting firm
   (C) Where a business reduces its total liabilities
   (D) Where a business increases its total assets

9 What is the most appropriate strategy for a financial manager to use to control the cost of loans?
   (A) Obtain short-term loans instead of long-term loans
   (B) Ensure that loans are used only to purchase non-current assets
   (C) Organise the repayment of loans over as many years as possible
   (D) Shop around for the lowest interest rates and most suitable repayment terms for the business

10 Why do currency fluctuations represent a financial risk to business?
   (A) Interest rates can increase without warning
   (B) Conversion from one currency to another can result in lower revenue and higher expenses
   (C) International banks impose transaction fees
   (D) Tourists will require more spending money

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Short-answer questions

1 Discuss the advantages and disadvantages of leasing equipment compared with buying.

2 Copy Table 14.7 and then complete it by calculating the closing balance for January to April and the opening balance for February, March and April for Greg's Motorcycle Warehouse Pty Ltd.

Table 14.7 Financial statement for Greg's Motorcycle Warehouse Pty Ltd

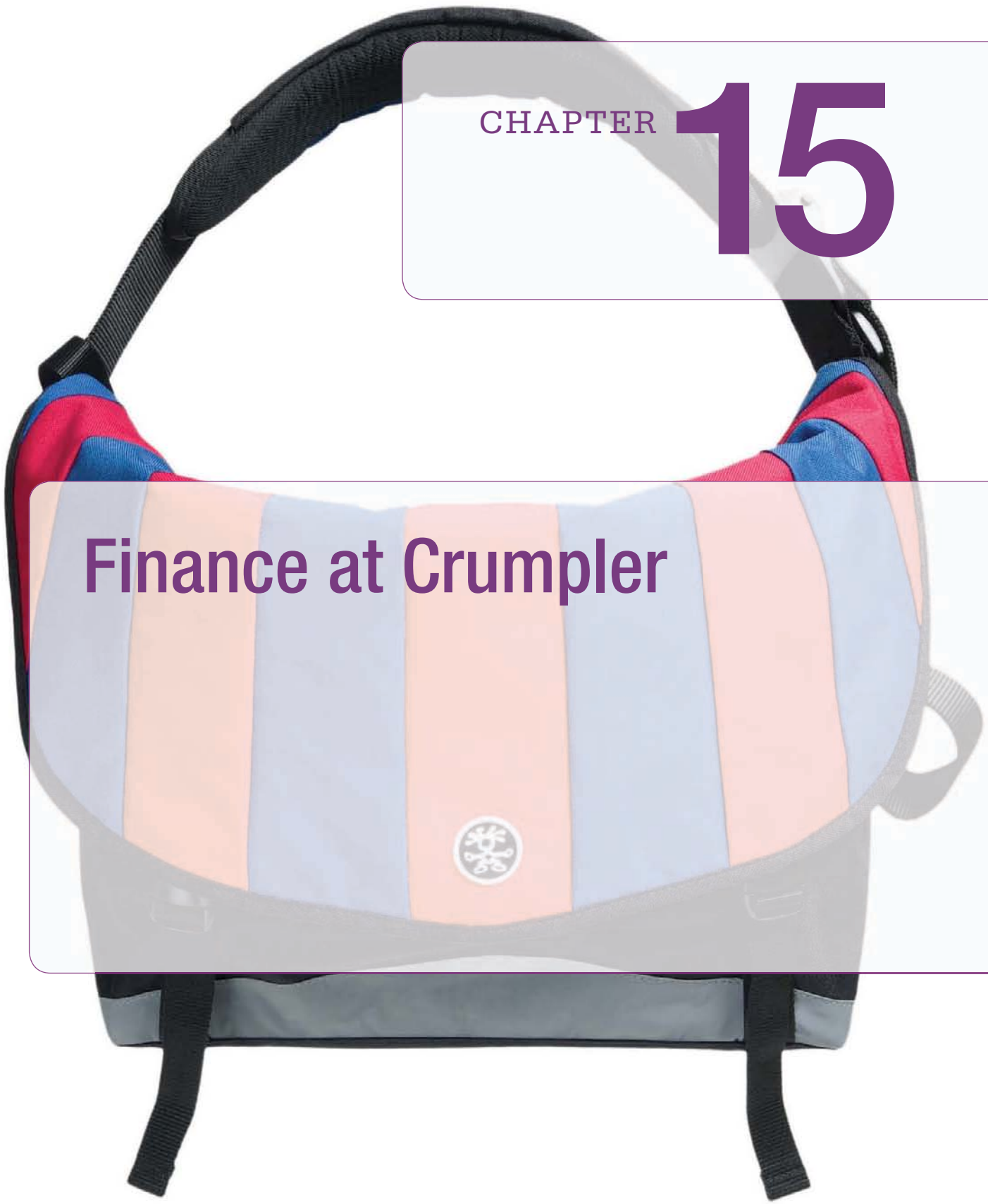
	Jan $	Feb $	Mar $	April $
Opening balance	*2 160*			
Sales Revenue	22 690	19 390	19 140	17 650
Less Operating Expenses				
Lease of premises	3 200	3 200	3 200	3 200
Wages	5 685	5 255	4 340	4 175
Utilities	1 380	1 435	1 120	1 030
Closing balance				

Extended-response question

Describe the financial strategies available to manage cash flow in a business and evaluate the importance of managing cash flow effectively.



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CHAPTER 15

Finance at Crumpler

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Introduction

Dave Roper and Will Miller had set up a few business ventures before finally settling with the Crumpler business. Each time, they increased their understanding of the importance of the financial management of the business process. The team started from scratch with very limited capital input and ultimately achieved in a private company entering into a global marketplace.

History

Dave Roper and Will Miller completed their high school studies at Hackney High School in Adelaide in 1988. Exhibiting entrepreneurial skills early, in the following year after finishing high school Roper and Miller set up their first business together. Roper and Miller established a 'City Mail' service that delivered mail between offices within the Adelaide CBD. They walked between offices delivering mail by hand. This provided business with a quick and efficient means of exchanging written communication (emails did not exist yet!).

Role of financial management

Strategic role of financial management

Roper and Miller had identified a niche in the communications market that was not being addressed by existing businesses in this market. They developed the business idea, however they had not undertaken enough research or planning to establish its viability. The new business offered mail delivery for 35 cents, which cut 3 cents off the price of Australia Post deliveries. Mail sorting was completed in the back of Miller's car, a Mazda 808 wagon. At this stage of the business, planning was very elementary. For them the concept of finance simply meant to get enough cash in to provide them with an income and for the business to be able to continue operations. After six months, City Mail had built up a solid customer base and delivered about 5000 letters a day. What started out as a part-time venture was now a full-time business. Using only internal sources of finance, Roper and Miller reinvested surplus funds and expanded their business. The business employed more people for deliveries and moved their operations from the Mazda wagon to a small shared office. This minimised expenses by subletting floor space and sharing one premises with other small businesses. This was taken on a month-to-month basis, making the arrangement very flexible and requiring only a month's notice to move out of this office. At this stage, Roper and Miller had not found it necessary to obtain any external debt finance and continued to operate on a cash basis. Legally they were a partnership and had not dealt with financial institutions other than through the use of a cheque account.

Influence of government

Unfortunately, this business contravened the *Australia Postal Corporation Act 1989* (Cth) amended 1995, which protected Australia Post from competition (this was a government-established monopoly) and City Mail was forced to close its present-style operations. After completing some research, they found that they could legally compete with Australia Post if their delivery charge was a least 10 times the cost of a standard letter. Miller and Roper readjusted their operations from letters to a parcel

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courier service and incorporated their business as a private company. The change of legal structure gave them the protection of limited liability.

Objectives of financial management

Growth

In order to differentiate themselves from other businesses, Miller and Roper designed a uniform and found a specialist cycle-wear company to make them. They distinguished themselves from other businesses by wearing pink lycra outfits and used bicycles for transport. The lycra outfits were paid for by cash on delivery (COD) and cash inflow paid for all other expenses. Within a year they had grown to a full-time staff of 40 couriers. Staff were employed as subcontractors and provided with their own bicycles. The bicycles were part of a couriers 'tools of trade'. The main goals set for the business at this time were to be able to provide themselves with a suitable wage and to cover business expenses. The owners would still need to do deliveries if there was too much work for the other employees.

Profitability

Operations expanded to include Sydney, with an annual turnover of approximately $3 million. As the business grew, the owners put more time into their business plan. The business was now potentially quite profitable.

Liquidity

The courier business provided monthly invoices to their clients and paid wages to their employees each week. Unfortunately, they had difficulty controlling their cash flow and within a year had severe liquidity problems. With a monthly invoice system, the business had poor control over its accounts receivable and clients would often take between 45 to 60 days before paying their accounts. With an accounts receivable turnover rate of six per year, customers on average would take 60 days (12 months divided by 6 = 2 months or 60 days) to pay their accounts. Roper and Miller went to the bank and presented their financial records to the manager in order to obtain a loan. However, still being very young and not having any assets to provide as security, their loan application was rejected. They could not effectively deal with the liquidity problem and they decided to sell their business to a larger courier company. This was effectively a takeover by a competitor. Unfortunately, Roper and Miller did not make any profit from the sale of the business. The new owners employed both Roper and Miller for a short time after the sale. They both learnt a lot about business in this time.

The processes of financial management – planning and implementing

Financial controls

In 1990 Roper and Miller moved to Melbourne. Both only 21 years old and armed with a bit more experience and improved business knowledge, they began a new courier service called Minuteman Messengers – this time including a minor partner who managed the accounting and administration side of the new business

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Figure 15.1 Minutemen Messengers.

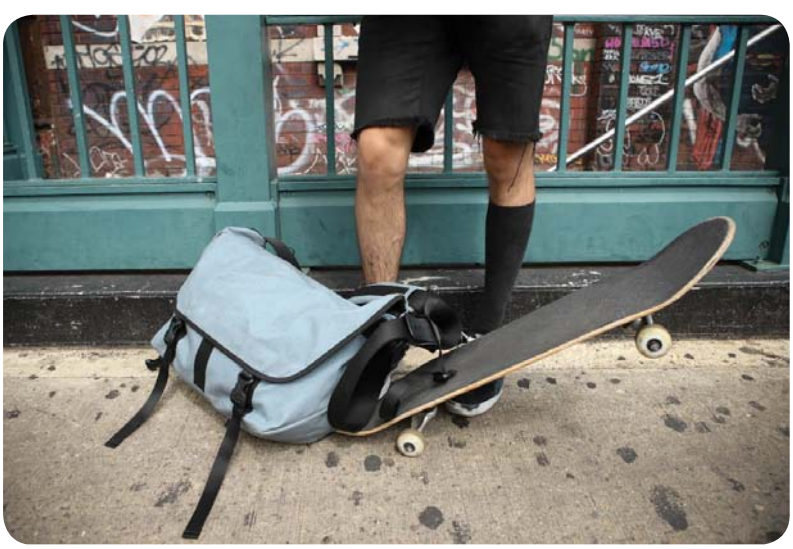


Figure 15.2 The Satchel.

and also introduced adequate financial controls into the business. This resulted in a greater understanding of the amount of cash available for expenses and a more solid basis for determining the timing of cash inflow. The new business set up in Melbourne, using inline skates as their method of transport. The skates were provided by the couriers themselves and all other establishment costs were financed through an initial bank loan of $30 000. This was the only debt finance secured by the business. Legal problems arose again and Melbourne City Council banned the – this time red-clad – couriers from using inline skates, declaring this an unsafe practice, especially for pedestrians using the city footpaths. In response to this problem, the business changed their transport method from the skates to bicycles. Again the couriers provided their own bicycles as part of their tools of trade.

Financial management strategies

Working capital management, liquidity

Roper and Miller were now in better control of their cash-flow situation. The initial loan provided them with a buffer between payment of wages and the receipt of funds from the payment of accounts by clients. Also, with a specific manager in charge of administration, cash flow was carefully monitored and controlled. Slow-paying accounts were quickly followed up. The business did not have inventory to control except for items such as stationery so very little cash was involved in stock and very little equipment needed to be supplied. The product was a service performed on a daily basis.

Stuart Crumpler worked part-time for Roper and Miller as a parcel deliverer. The couriers used a satchel-type carry bag to hold the parcels. Stuart Crumpler was not happy with the satchel and began designing improvements in the carry bag in his own time.

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Profitability management

Cost controls

At this stage of the businesses life, fixed expenses were really limited to lease payments for office space and the cost of the uniforms. The couriers provided their own bicycles, and wages varied based on the number of hours worked.

Roper and Miller could see the advantages the new satchel design had to offer and commissioned Stuart Crumpler to make them for the other bicycle couriers. Crumpler continued to work on improvements in both the look of the bag and to increase the efficiency of the bag itself.

Expense minimisation

Costs were kept to a minimum and Stuart Crumpler made the bags in his parents' garage. While designing the new bags, Stuart Crumpler also designed the original logo for the product in 1991.

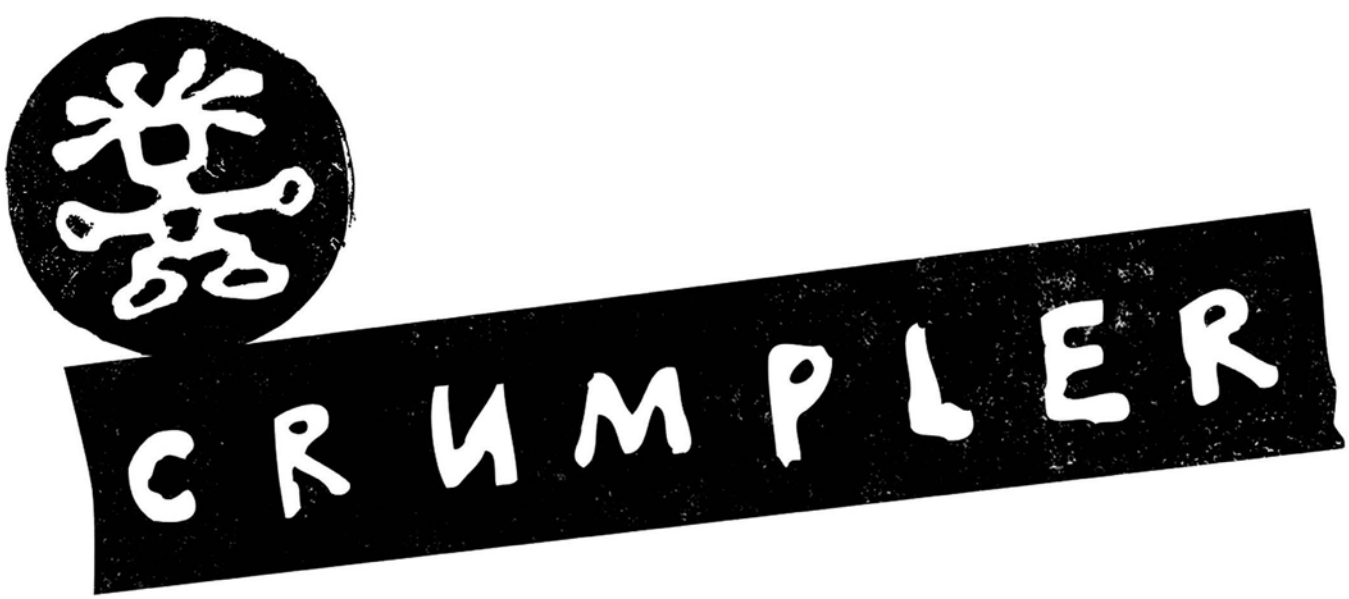
In late 1993, Roper, Crumpler and Miller decided to set up a new business together focusing on the courier bag. By this time the minor partner of Minutemen Messengers had gone his own way, leaving the business to successfully pursue academic life.

Their first order was for 20 bright-red canvas bags costing $60 each. Unfortunately, the red colour faded and the bag itself fell apart quickly. The Minutemen Messenger couriers were used to test the bags and each new batch incorporated the courier's suggestions for improvement. Keeping expenses to a minimum, Stuart Crumpler was still making square satchel bags on his grandmother's sewing machine in the garage.

In 1995 Crumpler, Roper and Miller registered their business as a **private company** called Crumpler Proprietary Limited and also registered the name as a trademark. Soon the courier bag was drawing interest from other people, including professionals, business people and bike riders, who began asking the group to make some bags that they could

Private company

An incorporated business that has limited liability and between 1–50 shareholders. It can not offer its shares to the general public and is not listed on the Australian Securities Exchange.



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Lease

A contract between the user of an asset who pays the owner of the asset for the use of the asset.

use. The bags soon developed demand on a commercial level. At this stage, Roper and Miller were still operating the Minuteman Messengers business.

Stuart Crumpler eventually moved his operations out of his parents' garage and to a small factory in Smith Street, Fitzroy, Victoria. The premises were acquired using a three-year lease at a cost of $35 000 per year. The contract included a 4% increase in **lease** payments each year. They also had a three-year option to renew the lease if required. Crumpler sold bags to people who ventured in off the street as well as to small bicycle shops. With the money from sales, they bought better equipment and improved materials, therefore any money they made was put straight back into the business. At this stage, in 1998, the courier business had grown to 60 couriers. At this time, businesses such as stockbrokers still had to settle trading money with paper transfers of documents.

Global financial management

In 1998 they took the bags to a trade fair in Germany and were given big orders for their popular bags. After the trade show, they began selling the bags on consignment to outdoor, street wear, bicycle and photographic stores. This meant that they still owned the bags and the stores paid them for the goods if they sold them. Finally, Roper and Miller decided to sell Minutemen Messengers and devote their time to Crumpler bags. The money paid to Roper and Miller for the sale of the Minutemen Messenger business was then loaned to the Crumpler business as start-up capital. They sold their Minutemen Messengers courier business to Ausdoc for a couple of million dollars. The sale was well timed and just before electronic document exchange was introduced. This technological development severely reduced the need for paper exchange, as the email era had begun. This would have presented a major threat to the Minutemen Messenger business. In the later 1990s Stuart Crumpler moved Crumpler's manufacturing section to Ballarat.

Cost controls

By 2001 there were six staff working at the factory and they outsourced some of the work to specialists in cutting and construction. In order to increase efficiency and to be more cost-effective, the manufacturing section of Crumpler was later moved offshore to Vietnam. This allowed the Crumpler team to use their skills and expertise in design, marketing and sales, and leave production to specialists. Crumpler went through a trial period with the production facility in Vietnam and the end product was better made than Crumpler had been able to make them. At this time, the Ballarat factory was having difficulty finding experienced sewing staff and the Ballarat plant was closed down. The contract arrangement with the factory in Vietnam soon turned into a joint venture. Crumpler actually puts in five major orders per year. These orders result from intensive analysis of sales data, distributor's needs and forecasting.

Crumpler has received government benefits from participating in Australia's EMDG grant scheme. These are export and marketing development grants.

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Growth – vertical integration

In order to grow their business, Miller, Roper and Crumpler decided to expand into the next stage of production through forward vertical integration and the setting up of their own retail stores, thus controlling the retail distribution of their increasingly popular product. Already becoming a well-known business in Melbourne, in 2000 they opened their first store in Sydney.

By planning ahead and saving for the future, more stores followed. Further expansion came by entering the global marketplace as their own retailers. The Sydney store was quickly followed with stores opening in New York, Singapore, Brisbane, Adelaide, Perth, Kuala Lumpur, Toronto, Manila, Mumbai and Jakarta, and – more recently – there are plans to open in San Francisco, Vancouver and Beijing. The majority of these stores are owned and run by the Crumpler business. Crumpler has entered into a joint venture with a long standing distributor to set up stores in parts of Asia, such as in Hong Kong, Singapore, Malaysia and Thailand.

As the business has grown, planning has become more important. In 2007, strategic plans included the launch of a whole new product range covering suitcases and other luggage, thus improving and widening their sales mix.

Private equity

Recently, German investors Siegfried Elgert and Jorg Bondenschatz joined the private company on an equal share basis. They initially joined the business as German distributors, then expanded to become the European distributors. Elgert



Figure 15.3 Expansion to other cities – Kuala Lumpur, Malaysia.

and Bondenschatz at this time also had their own business making promotional products and bags for Canon in Europe and were looking for contacts to establish a new brand in the European market. By joining the Crumpler team, Crumpler acquired complementary skills. Crumpler supplied the design, brand and marketing skills, and Elgert and Bondenschatz contributed distribution, sales and manufacturing skills. This combination facilitated the growth of the firm into the international markets in Europe and then the United States.

Growth strategy

In 2005 Crumpler exhibited at the International Consumer Electronics show with a trade show budget of $56 500. At this stage, the Crumpler business was worth approximately $30 million.

Crumpler's goal was to introduce major US retailers of electronic equipment to its brand and products. As a result of this display, Crumpler signed three major electronic companies for design and

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Payment in advance

Where the goods are actually paid for before they are supplied.

Cash-flow management

The management of cash flowing into the business as revenue and cash outflow when expenses are paid by the business. This is to ensure that the business maintains its liquidity.

manufacturing projects. This was worth approximately $1.2 million in revenue to Crumpler and introduced their business to the North American market.



Figure 15.4 Crumpler bags are practical and quirky and have great appeal to casual and office communities.

Trade shows do not only generate product sales – the Crumpler team also meets many of its prospective employees and future business contacts at these events. They meet retailers, agents, importers and distributors who they vet for suitability and begin a gradual relationship with them by introducing them to the business and by assessing their value to the future development of the business. As Crumpler becomes more well-known in Australia, more businesses, such as international department stores, buyers and distributors, approach Crumpler and want to sell their product.

Methods of international payment

Crumpler sells to exclusive agents internationally who represent the brand in their country. International distributors are offered discounts for **payment in advance** for orders as well as discounts for larger orders. Crumpler also receives similar offers from their suppliers. Thus, their financial manager can negotiate deals that benefit Crumpler's financial position, improve their **cash-flow management**, maintain their liquidity and improve their profitability. All international sales are completed in USD. Crumpler buys materials, pays for production and sells to distributors in USD. They maintain a USD account in Australia to minimise the need for currency exchange. Payments are made through wire transfer directly from clients' accounts to Crumpler's bank account. Crumpler does not deal in hedging or in derivatives.

Crumpler has diversified its range of products, adding its range of pouches and

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holders for mobile phones, MP3 players and electronic organisers to its camera, computer and travel bags. The Crumpler business has restructured and developed into Crumpler Europe and Crumpler Australia. Australia is responsible for sales and marketing in Australasia, Asia and the United States. Export sales have reached $6 million annually, with total sales approximately $12 million each year. As mentioned, additional stores are being introduced in San Francisco, Vancouver and Beijing. In 2010 the business employed 22 full-time staff and 55 casuals.

Record systems

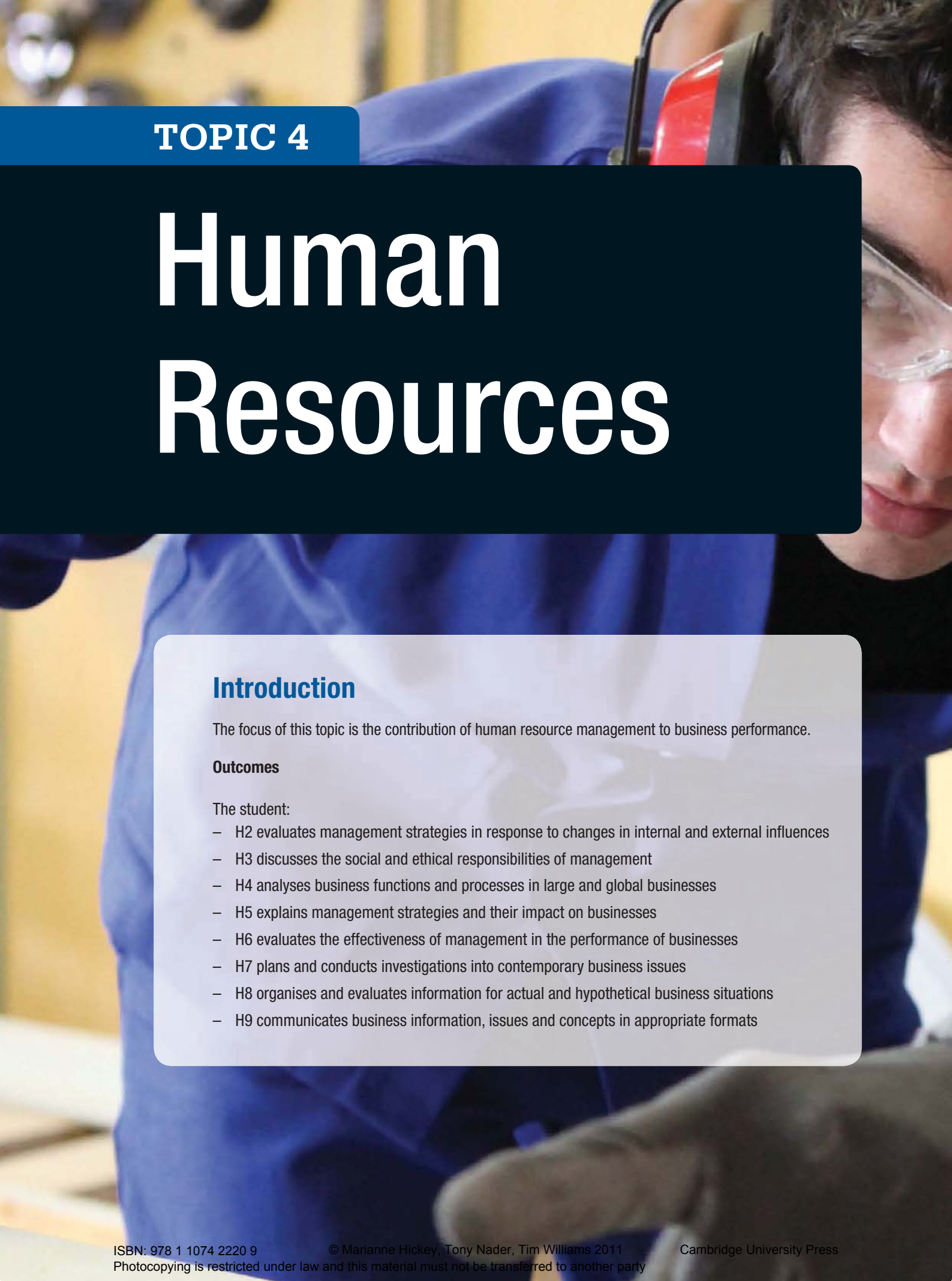
Crumpler has commissioned the business Reactive to design an online system that will be able to be used as a comprehensive administration tool for sales processing and inventory management for a dozen different regional offices. This would involve integrated payment systems and external inventory systems and be available in several languages. The system will also include local products, tax and shipping variations and a mix of regional and global content approval workflows. This system should ensure that they are able to develop an even closer link between sales and production. Making the process more efficient and cost-effective, and providing a better service to their distributors and customers. This will provide them with improved inventory controls and allow thorough and up-to-date analysis of their sales mix.

Conclusion

The majority of business activity is financed directly from cash flow. Crumpler has not needed to take out debt finance to fund expansion. Cash-flow controls have improved significantly since the business began. Their biggest expense is for materials and component parts needed to complete the production of their bags. Thorough and continuing research of the market enables Crumpler to be aware of all relevant suppliers and constantly monitor their supply prices. Each department of the business has regular meetings and constant reviews of design, cost controls and work-in-progress. Crumpler's finance department has cash and cost-flow controls in place and produces a cash-flow statement on a monthly basis. Over the 2009/10 period Crumpler has heavily invested in product design. They have employed specialist senior staff experienced in design, retail and marketing. These staff members have been concentrating on product improvements and the development of new products as well as plans for new stores. These plans will be costly in the short term and initially reduce the profitability of the business. However, Crumpler is secure in the belief that this decision will provide them with more profitable long-term growth.

Crumpler's strengths lie in a well-researched and designed product. They only deal with businesses whose income is in some way dependent on the success and sale of the Crumpler product. Crumpler does not have any debt finance, thus there are no issues to deal with at this stage and it is therefore not affected by changes in the level of interest rates. All growth has been financed through savings. Ultimately, the Crumpler team enjoy what they do. The high level of satisfaction and enjoyment in their work results in the energy and motivation to put their skills, talents and enough of their time into the business to make it a success.

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TOPIC 4

Human Resources

Introduction

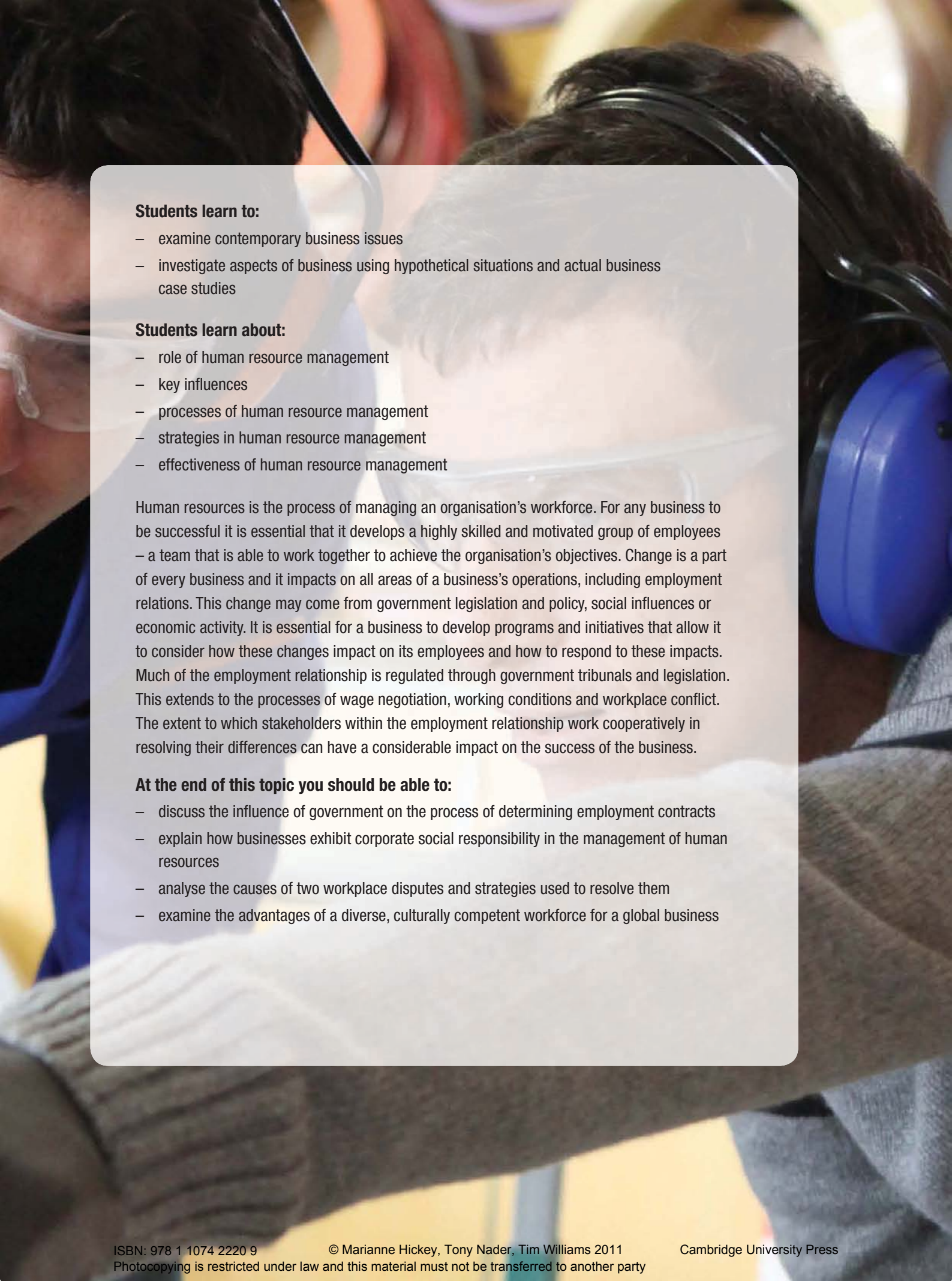
The focus of this topic is the contribution of human resource management to business performance.

Outcomes

The student:

- H2 evaluates management strategies in response to changes in internal and external influences
- H3 discusses the social and ethical responsibilities of management
- H4 analyses business functions and processes in large and global businesses
- H5 explains management strategies and their impact on businesses
- H6 evaluates the effectiveness of management in the performance of businesses
- H7 plans and conducts investigations into contemporary business issues
- H8 organises and evaluates information for actual and hypothetical business situations
- H9 communicates business information, issues and concepts in appropriate formats

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Students learn to:

- examine contemporary business issues
- investigate aspects of business using hypothetical situations and actual business case studies

Students learn about:

- role of human resource management
- key influences
- processes of human resource management
- strategies in human resource management
- effectiveness of human resource management

Human resources is the process of managing an organisation's workforce. For any business to be successful it is essential that it develops a highly skilled and motivated group of employees – a team that is able to work together to achieve the organisation's objectives. Change is a part of every business and it impacts on all areas of a business's operations, including employment relations. This change may come from government legislation and policy, social influences or economic activity. It is essential for a business to develop programs and initiatives that allow it to consider how these changes impact on its employees and how to respond to these impacts. Much of the employment relationship is regulated through government tribunals and legislation. This extends to the processes of wage negotiation, working conditions and workplace conflict. The extent to which stakeholders within the employment relationship work cooperatively in resolving their differences can have a considerable impact on the success of the business.

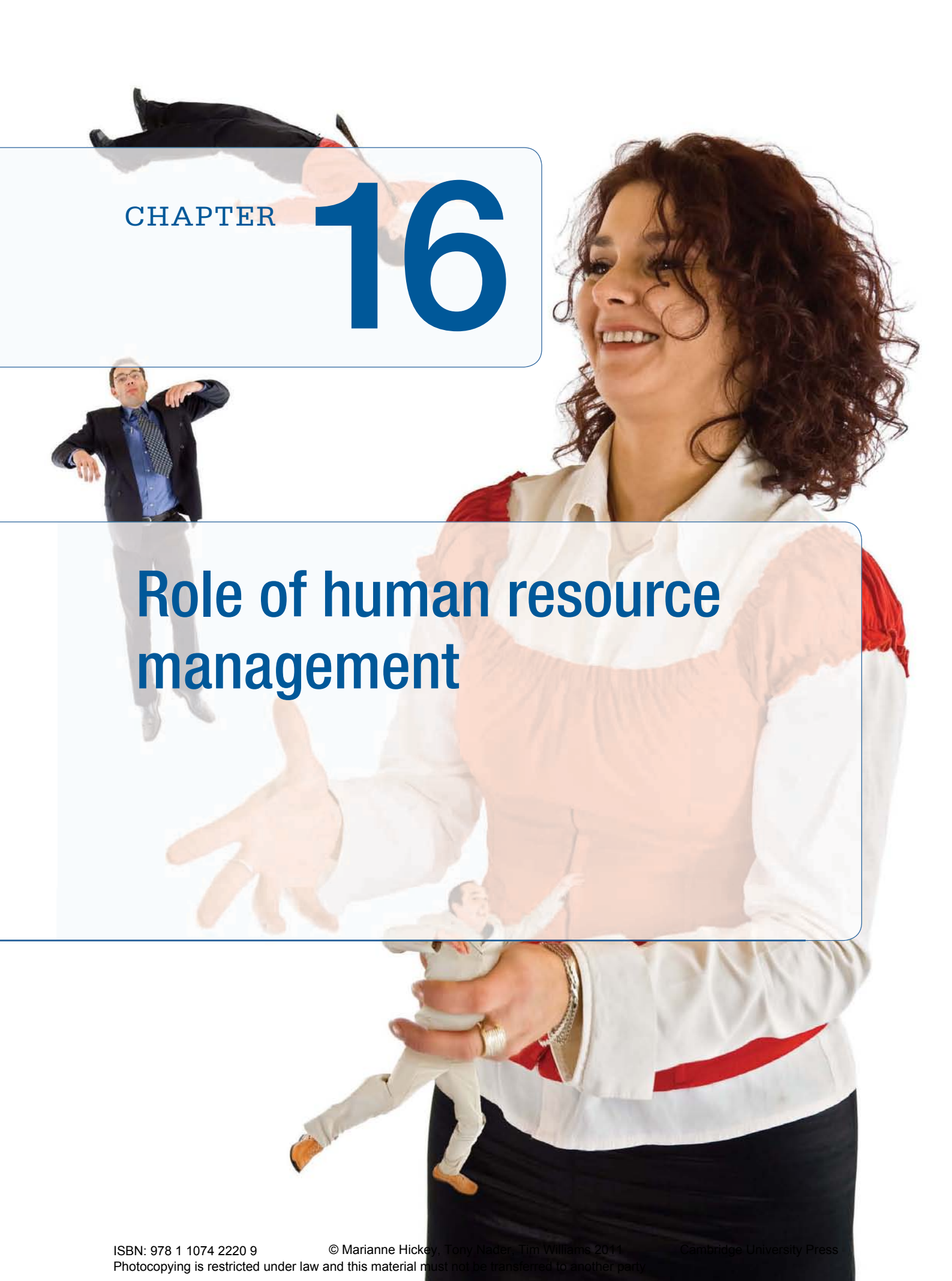
At the end of this topic you should be able to:

- discuss the influence of government on the process of determining employment contracts
- explain how businesses exhibit corporate social responsibility in the management of human resources
- analyse the causes of two workplace disputes and strategies used to resolve them
- examine the advantages of a diverse, culturally competent workforce for a global business

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CHAPTER 16

Role of human resource management



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The relationship between employers and employees is a fundamental part of any successful business. Many businesses acknowledge that to be successful they need to value the contribution of their employees, motivate them to work to the best of their ability and develop strategies to enhance their skills and abilities.

Human resources is the process of managing employees in a workplace. It involves:

- reviewing the goals of the business to ensure the business has the appropriate staff recruiting the necessary staff to provide the business with the skills and expertise needed to allow the business to operate successfully
- implementing programs aimed at constantly developing the skills and knowledge of all staff
- rewarding valued employees
- working within the legal framework that regulates the employment relationship in such areas as wage negotiation, occupational health and safety and unfair dismissal.

Strategic role of human resources

Human resource management refers to the approach taken by management to organisations' most valued assets – their staff. These are people working at the business who contribute to the achievement of the objectives of the business. The strategic role of human resource management is designed to assist businesses to better meet the needs of their employees, while at the same time promoting company goals.

Human resource management deals with many aspects of a business that affect its relationship with employees. These include recruitment, training and development, work incentives and firing. Strategic human resource management is the ability of senior managers within a business to develop proactive strategies in the management of its people. It requires managers to think ahead, and develop methods for the business to better meet the needs of its employees, and for the employees to better meet the needs of the business. By being proactive and adopting a long-term think approach, managers may seek to affect and improve a diverse range of human resource issues within the business. This includes the recruitment policies and practices, employment performance review techniques and training and development strategies.

The strategic role of human resource management is derived from the



Human resources

The process of managing employees in a workplace.

Human resource management

The process of managing staff within an organisation. It focuses on the relationship between the employer and the employee and how each of these stakeholders are able to work to achieve the goals of the business and their own individual goals.

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organisation's strategic plans and objectives. This plan will provide the basis for senior human resource managers to determine the long-term employment needs of the business.

The business must then determine if its existing employees have the skills to achieve its long-term goals. A plan is then established as a guideline for the company to determine the training and development needs of the business and the qualifications and skills base of external individuals who may be recruited to be employed by the business.

The next stage is for the business to retain the employees who have been hired and ensure their work is consistent with the expectation of the employer. It is expected that the efforts of staff help move the business in the desired direction. By doing this, the goals of the business can successfully be achieved.

The business must also develop appropriate performance review measures to examine the effectiveness and efficiency of their employees. These measures must be realistic, be mindful of the existing skills base of the employee and adopt benchmarks similar to that of the business's major competitors.

What are the benefits of adopting a strategic role to human resources?

Many businesses operating in Australia employ staff. That means that the business must consider the role of human resource planning has within their organisation. By adopting a strategic or long-term view to human resource management, a business should be able to achieve the benefits outlined in Table 16.1.

Table 16.1 Benefits of a strategic role of human resources

Benefits of a strategic role of human resources
• The development of a highly qualified workforce that fosters skill development and employee recognition
• The introduction of systems and procedures that deal effectively with workplace conflict and grievances
• The employment of a workforce relevant to the organisational needs of the business from a long-term perspective
• The workforce itself being the competitive advantage that the business has over its competitors

Activity 16.1 Comprehension

1. Describe the role of human resource management within a business.
2. Identify four characteristics of the strategic role of human resources and explain how they differ from the operational role of human resource managers.

Interdependence with other key business functions

A successful business is similar in some ways to a successful sporting team. Each player has a key role in ensuring the team plays well and wins the game. In business, while there is no game, it is important for each key business function to work effectively as a singular unit and as a team to ensure the business runs successfully. Each key business function must work effectively with other functions to ensure the goals of

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the business are achieved. The business becomes a team, where the four key players must work together to win the game. Each function works independently and with the other to ensure the success of the business.

The operations function refers to the physical production of a good or the provision of a service. In the case of manufacturing, inputs are combined to process or transform them into a finished product. These inputs may be raw materials or partly processed products. For example, a builder will require timber, concrete, glass, steel and gyprock to combine in order to build a house.

How is the operations function related to human resources?

The operations function is concerned with the process of manufacturing a particular good. They work closely with the human resource department to ensure that the business has recruited staff with the relevant skills and experience necessary to produce the product. The human resource department will monitor the performance of employees involved in the production of goods and services and, as such, training and development initiatives may also be implemented.

How is the marketing function related to human resources?

The human resource function is focused on the role of employees within an organisation. Staff must be motivated and skilled to develop products within the business that cater to the needs and wants of potential customers. It is through the marketing process that a business is able to determine the skills required for employees to produce the desired product. The features of the product would come through market research. In many instances, staff are the public face of the business. Their actions towards consumers will influence the decision of a consumer to purchase a product, return to the business and recommend the business to others.

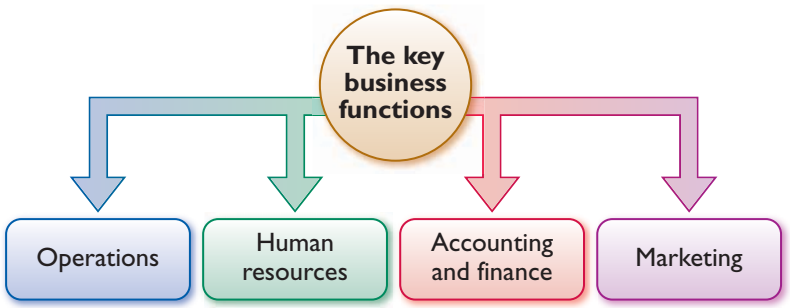


Figure 16.1 The key business functions.

How is the accounting and finance function related to human resources?

One of the key goals of human resources is to recruit skilled and highly motivated staff. This in turn benefits the profitability of the business. As such, budgets are often established within businesses that allocate funds towards training and development, workplace education issues such as affirmative action and occupational health and safety and remuneration. Human resources managers must work within these budgets to adequately provide for the needs for its employees.

Activity 16.2 Analysis

1. You have been employed as a consultant for Redan Building Services. Explain to heads of each key business function the role of human resource management.
2. Explain how a reduced budget allocation on training and development may adversely impact upon the business.

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Outsourcing

When a company takes a part of its business functions and gives it to another company to complete.

Outsourcing

The key function of any business is to deliver a quality product or service to its customers. Given this, businesses must also engage in the recruitment of staff, the development of training programs and the review of employee performance. Some businesses lack the funds or expertise to employ specialist human resource managers to manage the detailed yet diverse role that employment relations within a business encompasses. **Outsourcing** is a common business practice when a company takes a part of its business functions and gives that part to another company to complete.

Reasons for outsourcing

The human resources function

The human resources function:

- Provides the ability to access staff whose specialty is human resource management. These staff would have a much better understanding of issues related to employment relations and can advise the business on the most appropriate human resource strategies.
- Allows managers of the business to focus on the core business operations. This means that the focus of the business is on production and attending to the needs of its customers. Other issues such as recruitment and training and development are handled by an external business.
- Means the decision of a business to outsource its human resource function can generate cost savings. This reduces the need for the business to employ full-time staff, where in many instances, for smaller businesses, for example, a permanent human resource manager may not be required.

Issues concerned with outsourcing the human resources function

Issues concerned with outsourcing the human resources function include:

- One of the most significant concerns with outsourcing human resources is the chance that the company that the human resource function is outsourced to may lack an understanding of the key aspects of the business. This could include the business culture and existing workplace conflict issues.
- Good employee management practices remain essential. The key relationship between staff and their line managers must continue to be developed within the business itself, ensuring that the work on manager–staff relationships still has to be handled despite the outsourced business responsible for human resource issues.

The decision to outsource part or all of a business human resource function is one that must be carefully considered.



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BUSINESS BITE

In 2009 Telstra decided it needed to undergo a major transformation to meet its customers needs and to improve its operations as a business. To support this transformation, the organisation needed to reskill and educate its workforce.

Telstra did not have the time nor did the company feel as though it was well-equipped enough to upgrade its own learning function to support its business transformation. It called on the services of Australian-based Accenture to develop a training program as part of this transformation.

Source: www.hroaasiapacific.com/images/stories/food/CaseStudies/bersin_telstra_case_study_full_report.pdf

Contractors

The employment contract in the Australian workforce is between an employer and their employee. Many of the conditions outlined in this contract are controlled by various state and federal laws. These conditions apply to all workplaces. The growth of outsourcing and the increase in self-employment has meant that the traditional definition of an employee has changed. An employee can no longer be defined as an individual who offers his or her labour to a business in return for payment. If this were the case, is an individual who acts as a consultant to business in developing effective marketing strategies an employee? The law regards an employee to be a person who is subject to a contract of service. The employment contract is based on the employee offering his or her services on a regular basis and being subject to the lawful control and authority of the employer.

Table 16.2 Differences between employees and independent contractors

	Employee	Independent contractor
Length of employment	• Regular and continuous	• Fixed term
Income	• Subject to negotiated wage agreement or award conditions	• Fixed agreed rate
Workers compensation	• Insurance and protection are provided by the employer	• Must provide own insurance
Tax	• Employer is responsible for PAYG (pay as you go) tax deductions and superannuation	• Responsible for own tax requirements; is required to pay provisional tax
Legal entitlements	• Subject to government legislation; includes sick leave, maternity and paternity leave, annual leave and long-service leave	• No legal entitlements from the organisation seeking the contractor's service; there are no on-costs, such as workers compensation insurance, long-service leave and sick leave entitlements

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Contract for service

Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually a fixed period.

Contract of service

Exists where an employee offers his or her services to an organisation on a regular basis and is subject to the lawful control and authority of the employer.

The employer is able to tell the employee what job to do and how to do that job. The position of employment is ongoing and will not be terminated once a task has been completed. As well as employees, there are independent contractors. Their employment by one employer is not ongoing and an agreed fee is paid for the service provided by the contractor. The common legal definition for this type of employee is a person who is subject to a **contract for service**. Examples of contractors are builders, lawyers and electricians. The differences between people employed under a **contract of service** and independent contractors who work under a contract for service are outlined in Table 16.2.

Foreign contractors

Given the global nature of businesses today, many Australian organisations are easily able to access the use of foreign labour resources. Rather than establish human resource departments in these countries, Australian businesses are able to contract foreign businesses to provide a readymade workforce. This allows the Australian business to access the use of labour, without having to consider such issues as minimum labour requirements, occupational health and safety laws, and termimination.

Ethical Issue

Should Australian businesses deal with foreign contractors who may not follow labour law requirements in the foreign country, despite the cost-saving benefits that this may bring?

BUSINESS BITE

India is now the leading provider of call centres in the world. Its English-speaking and low-cost labour force is seen by many businesses, including Australian businesses such as Optus and ANZ, as a cost-effective tool.

But what if your bank's back office was in an Indian prison – and was manned by convicted criminals?

British financial institution, the Royal Bank of Scotland, has engaged the services of an Indian-based contractor to provide call centre service. The contractor currently uses inmates at Cherlapally Central Jail in the southern city of Hyderabad to help to process bank paperwork.

About 250 prisoners – convicted criminals and inmates awaiting trial – will carry out work for Indian banks and insurance companies. They will be trained to do basic tasks such as typing information from application forms into computer systems.

There is no suggestion that foreign banks use such services, however, given the nature of foreign contractors, many businesses can never be sure of who is actually working for them.

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Chapter summary

- Human resources is the process of managing an organisation's workforce. It involves:
  - reviewing the goals of the business to ensure the business has the appropriate staff recruiting the necessary staff to provide the business with the skills and expertise needed to allow the business to operate successfully
  - implementing programs aimed at constantly developing the skills and knowledge of all staff
  - rewarding valued employees.
- Working within the legal framework that regulates the employment relationship in such areas as wage negotiation, occupational health and safety and unfair dismissal.
- The strategic role of human resource management is designed to assist businesses to better meet the needs of their employees while at the same time promoting company goals.
- The strategic role of human resource management is derived from the organisation's strategic plans and objectives. This plan will provide the basis for senior human resource managers to determine the long-term employment needs of the business.
- Human resources is one of four key business functions. The other business functions are operations, marketing and finance. Each of these functions works closely with the other to achieve the goals of the business.
- Outsourcing is a common business practice when a company takes a part of its business functions and gives that part to another company to complete.
- Benefits of outsourcing include:
  - the ability to access staff whose specialty is human resource management
  - allows managers of the business to focus on the core business operations
  - the decision of a business to outsource its human resource function can generate cost savings.
- Issues concerned with outsourcing the human resources function:
  - the company that the human resource function is outsourced to may lack an understanding of the key aspects of the business
  - management within the business must still take some responsibility for the staff.
- Independent contractors exist in a situation where an individual's employment by one employer is not ongoing and an agreed fee is paid for the service.
- Rather than establish human resource departments in these countries, Australian businesses are able to contract foreign businesses to provide a readymade workforce.

Chapter-revision task

Create a mind map that defines the strategic role of human resource management. From this mind map, detail the relationship between human resource management and each of the other key business functions: marketing, finance, operations.

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Multiple-choice questions

1 Which of the following best describes the role of human resource management within a business?
- **(A)** The management of financial resources
- **(B)** The relationship between a business and its suppliers
- **(C)** The development of a marketing plan
- **(D)** The management of employees

2 Which of the following describes the strategic role of human resources?
- **(A)** The development of training and development initiatives within the business
- **(B)** The decision to recruit new staff as a result of a review of a business's long-term plans
- **(C)** A plan that provides the basis for senior human resource managers to determine the long-term employment needs of the business
- **(D)** The use of a foreign business to supply an existing group of workforce

3 Which of the following is a benefit of developing a strategic approach to human resources?
- **(A)** The development of a highly qualified workforce that fosters skill development and employee recognition
- **(B)** Increased employee motivation through greater incentives in the workplace
- **(C)** Decreased cost-savings due to the need for greater management supervision of employees
- **(D)** The workforce loses focus as being the competitive advantage that the business has over its competitors

4 Which of the following statements best describes the relationship between the human resources and operations functions of a business?
- **(A)** The operations department work closely with the human resources department to recruit and develop staff with the relevant skills and qualifications
- **(B)** The operations department produces goods and services within a budget developed by the human resources department
- **(C)** The operations department is responsible for the recruitment of staff, who then produce goods and services favourable to the needs and wants of consumers
- **(D)** The operations department develops goods and services from which the human resource function becomes responsible for promoting

5 Which of the following best describes the concept of outsourcing?
- **(A)** The process whereby a company takes a part of its business functions and gives that part to another company to complete
- **(B)** The process whereby a company completes all aspects of its operations internally
- **(C)** The process whereby a company recruits additional staff to assist during periods of high consumer demand
- **(D)** The process whereby a company produces goods for a distributor to then sell

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6 Which of the following statements best describes a benefit to the business of outsourcing the human resource function?

(A) The company that the human resource function is outsourced to may lack an understanding of the key aspects of the business

(B) The key relationship between staff and their line managers must continue to be developed within the business itself, without the assistance of the external company

(C) The decision of a business to outsource its human resource function can generate cost savings through increased employee supervision

(D) Staff of the external company would have a much better understanding of issues related to employment relations and can advise the business on the most appropriate human resource strategies

7 Which of the following aspects of human resources would a business not be able to outsource?

(A) Training and development

(B) Payroll administration procedures

(C) Supervision of staff

(D) Recruitment

8 According to Australian workplace laws, how is a contractor defined?

(A) Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a fixed period

(B) Exists where employment is ongoing and regular payments are received by the employee for continued work with the business

(C) Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a continued period of time

(D) Exists where employment is not ongoing and some regular payments are received by the employee for continued work with the business

9 Which of the following is a benefit of an Australian business employing the services of a foreign contractor?

(A) The contractor's employment with the business is not ongoing and allows the Australian business to be more flexible

(B) This allows the Australian business to access the use of labour, without having to consider such issues as minimum labour requirements, occupational health and safety laws, and termination

(C) The contractor is able to quickly access a supply of available workers without having to extensively recruit and train new staff

(D) This allows the Australian business to bypass domestic labour law requirements and make use of less expensive labour overseas

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10 Why would employers and employees have conflicting interests within the employment relationship?

(A) Employers are required by management to minimise labour costs within an organisation, while employees seek to gain the best possible return for themselves

(B) Labour is a cost to the business and, as such, employers seek to restrict wage growth while employees attempt to gain the best possible wage increase

(C) Employers are reluctant to offer working conditions that are above the prescribed legal minimum guidelines

(D) Employees often use their bargaining power and influence to disrupt the operations of a business

Short-answer questions

1 Explain three issues a business must examine when considering outsourcing its human resource function.

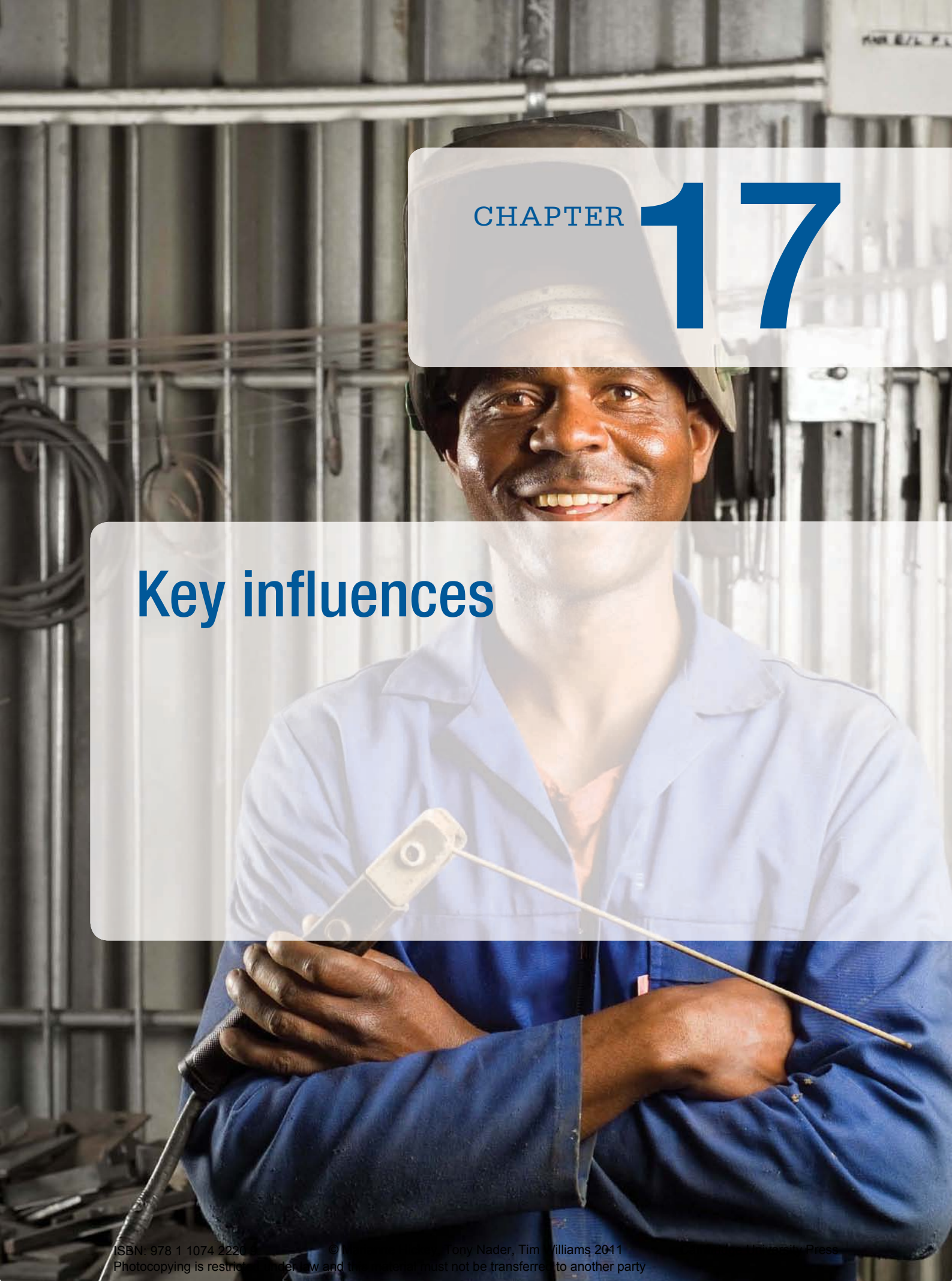
2 Outline the benefits to an Australian business of using a foreign contractor as opposed to an Australian-based contractor.

Extended response

Describe the strategic role that human resource management has within a business and analyse this role in its interdependence with other key business functions.



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CHAPTER 17

Key influences

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Employer

An individual or organisation that pays others to work for its business.

Human resource department

A specialist unit in a business that has as its main role the management of the issues involved in the employment relationship.

Employee

An individual who provides his or her skills to a business in return for a regular source of income.

Stakeholders

The employment relationship extends beyond that of the employer and the employee. The nature of employment relations in Australia means that a number of other stakeholders are also involved. Each stakeholder seeks to protect and promote its own interests.

Employers

An **employer** refers to the individual or organisation that pays others to work for its business. They are often the owners of the business and, as such, take responsibility for ensuring that the business has the appropriate staff to achieve the organisation's goals. In large businesses, the shareholders may appoint a group of managers to take on this responsibility. The managers consult with the owners to develop and implement strategies aimed at increasing the profitability of the business.

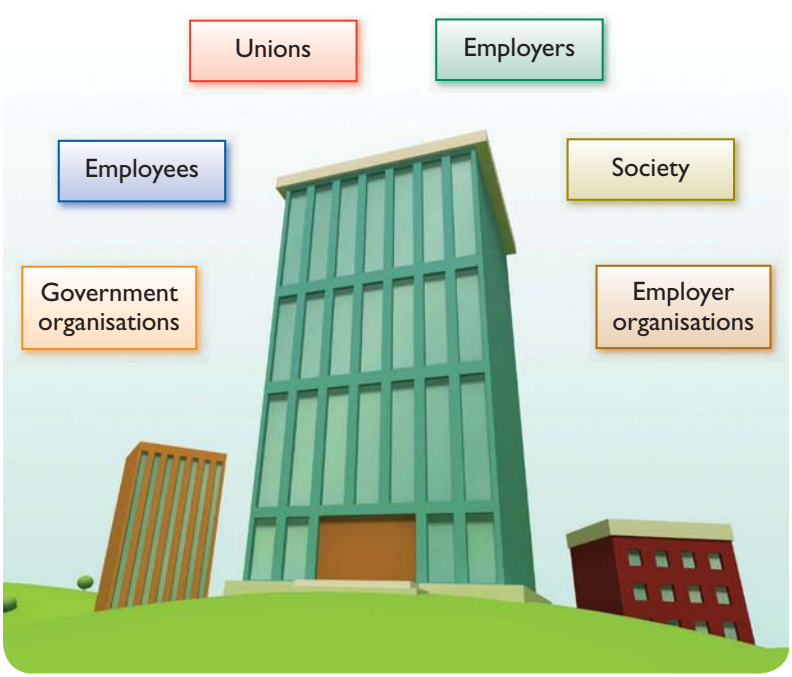


Figure 17.1 The six stakeholders in the employment relations process.

Many large businesses have developed specialist departments that manage the employment relations function. These units are known as human resource, employee relations or personnel departments. Some businesses employ a considerably large staff, while smaller businesses may use the services of fewer than five people. The Coles Group and Woolworths are two of Australia's leading businesses; combined, they employ more than 350 000 Australians each year.

Large businesses will have a **human resource department** whose focus is the management of employee-related issues in the workplace. This allows managers to specialise in different operations of the business. The role of the human resource department is to manage the issues involved in the employment relationship. A typical human resource department would:

- work with other departments to recruit the appropriate staff for the business
- ensure that the working conditions and benefits that the employees receive comply with federal and state government regulations
- implement a range of training and development programs to cater for the changing staffing needs of the business
- develop a number of rewards for employees to show them how valued they are in the business.

Employees

An **employee** refers to an individual who provides his or her skills to a business in return for a regular source of income. It is the responsibility of employees to complete their tasks in a manner that is lawfully described by the employer. Traditionally, employees have been regarded as

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the servants within the employment relationship and for their efforts they are rewarded with a wage or salary. Many businesses have now sought to include employees in the decision-making process. This provides employees with an increased sense of responsibility and empowerment within the organisation. It is believed that by providing employees with a greater role in the business, they work more efficiently and with increased motivation.

While income is still very important, many employees are seeking a greater recognition of the role that family and leisure have in their lives. Employees, with the assistance of trade unions, have encouraged employers to introduce a number of initiatives aimed at developing family-friendly practices, such as the provision of childcare centres, paid maternity leave and part-time work. Some businesses allow employees flexibility in starting and finishing times, while others are encouraged on some occasions to dress casually for work. A new innovation is to allow various staff members to work from home if they wish to do so. Advancements in technology through the internet, facsimiles and mobile phones have facilitated this development.



Figure 17.2 Employees: a key stakeholder in the employment relationship.

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BUSINESS BITE

The Wrigley Company was awarded a Special Commendation at the 2009-10 National Work-Life Balance Awards, in recognition of their achievements in delivering work-life balance initiatives in the manufacturing sector.

As Australia's major manufacturer and marketer of chewing gum, bubble gum, mints and sugar confections brands, the Wrigley Company is well-versed in the various challenges of the manufacturing industry.

Providing work–life balance for its employees is a challenge that the company has excelled in, by taking the approach that 'a healthy employee is a happy employee'.

Wrigley's health programs have a massive 90 per cent take-up rate amongst employees.

The company's ' Believe' program was set up to address a variety of health and lifestyle issues facing its staff. The program empowers employees by allowing them to manage their own work–life balance and opt in to any or all of the benefits available to them.

The company says that it has provided as many options as possible for employees and takes into account that work–life balance means different things to different people.

Some of the other work–life balance initiatives Wrigley offers are free private health cover for all employees, an Employee Assistance Program, study assistance and flexible working arrangements like part-time work, job sharing and telecommuting.

Wrigley addresses requests for flexible work arrangements on a case-by-case basis through a process of direct negotiation between employee and manager, a flexible approach, which has proved successful for the business.

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BUSINESS BITE

ANZ is one of Australia's leading financial institutions. Management has recognised the importance of human resources to the success of the business. The bank has recently developed a series of core values that it believes represents the manner in which all ANZ employees should conduct themselves.

Our values

Our values are a shared understanding of what we stand for as an organisation. They describe the things we are not willing to compromise on in any situation – with our customers, our shareholders, the community and each other.

Integrity

'Do what is right'

We are honest and ethical in everything we do. We are open and transparent and weigh up all aspects in making decisions.

Collaboration

'Work as one'

We work as one bank across all divisions and geographies, seamlessly, and we actively share our ideas and information across the organisation for the benefit of all stakeholders.

We ensure our priorities are focused on what's good for the organisation and we foster open dialogue and 'straight talking'.

Accountability

'Own your actions'

As individuals we each take responsibility for the way our stakeholders experience ANZ and we each make decisions in line with our economic, social, environmental and ethical responsibilities.

Respect

'Value every voice'

We treat all people with respect and dignity and we build trusted relationships with our diverse stakeholders.

We are passionate about supporting our customers, our communities and our people – their success is our success.

Excellence

'Be your best'

We relentlessly pursue excellence and take pride in everything we do. We challenge our thinking and look beyond the obvious.

Our values are embedded within ANZ through a range of support initiatives, including regular surveying of our staff about our values, culture and engagement and reporting on and responding to these results, teaching our values in global staff induction, providing support material that enables line managers to promote our values in their teams, and the alignment of our performance and recognition programs.

Current as at 1 March 2011

Source: www.anz.com.au/about-us/corporate-responsibility/more-mike/values

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Employer associations

Employer associations are organisations that aim to promote the interests of employers within the business environment. They lobby governments to develop policies that enhance the interests of the employer within the employee–employer relationship. Employer associations also consult with governments on changes to key policy issues, such as trade and industry assistance schemes. Examples of employer associations in Australia are the Business Council of Australia, Employers First and the National Farmers' Federation.

Ethical Issue

Employees receive an income for their work. As a result, it's expected that they will follow the instructions of their employer. Conflict, then, should not occur in the workplace. Do you agree with this view?

Given the complex nature of federal and state government workplace **legislation**, employer associations also advise and assist members on such matters as equal employment opportunity, dismissal, wage negotiation and legislative changes.

Unions

A union (or trade union) is an organisation that aims to protect and promote the interests of employees within the workplace. Unions assist employees with disputes in the workplace and act as a bargaining agent in wage negotiations. They also advise members on workplace rights, wage levels and occupational health and safety issues. Examples of unions include the Australian Liquor, Hospitality and Miscellaneous Workers Union, the NSW Nurses' Association and the Shop, Distributive and Allied Employees' Association.

The national union group in Australia is the Australian Council of Trade Unions (ACTU). It lobbies the government for improved working conditions and wage increases for Australian employees. The ACTU also works with other unions in providing submissions to Fair Work Australia for national wage case hearings. A national wage case is where trade unions, employers, employer associations and the federal government provide arguments to Fair Work Australia on the appropriate level of increase to the minimum wage.

Historically, the ACTU and federal Labor governments have worked together to improve wages and living standards. They have done this by focusing on compulsory employer-funded superannuation contributions, childcare subsidies and reduced income tax rates.

In early 2011, approximately 20% of Australian employees were trade union members. Union membership has been in steady decline since the mid-1980s. According to the ACTU, there are several reasons for this decline:

- With a move towards private-sector organisations providing services on behalf of the government, fewer people are now employed directly by government agencies and departments. The public sector has traditionally been a strong area of union representation.
- The move from a manufacturing-based economy towards one that is service focused has seen union representation decline because, traditionally, the service industry has not been unionised. In business, this is known as structural change.

Employer associations
Organisations that aim to promote the interests of employers within the business environment.

Legislation
Laws made by parliament.

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Shop steward

A union's representative in the workplace.

Award

A legal document that specifies the minimum working conditions that apply to all people employed in a common industry.

- A growing number of employees work on a part-time or casual basis. Fewer of these workers are likely to seek union representation compared with full-time employees. This is because the cost of joining a union is seen as quite high relative to part-time and casual weekly wages.
- Unions have not been as successful in attracting women as men to their organisations.

The union's representative in the workplace is known as a **shop steward**. This representative acts as the first point of contact between the union and its members within a workplace. This means that the shop steward is often the first person employees speak to when a dispute arises. Union representatives often deal with minor workplace disputes and have the responsibility of referring major grievance issues to the union itself. Unions employ industrial officers to assist members with any workplace concerns they may have. Employers have the right to refuse access to a union's industrial officers to conduct meetings with members on the workplace site.

Government organisations

The government is one of the most influential stakeholders in the employment relationship process. The federal government establishes the legal framework by which employers, employees and trade unions coexist and operate within the employment relationship. It is expected that these stakeholders will follow the regulations set by the government and tribunals.

Key terms related to government's role in employment relations

It is important to develop an understanding of some key terms to assist understanding of this topic.

What is an award?

An **award** is a legal document that specifies the minimum working conditions that apply to all people employed in a common industry. It covers matters such as wages, holidays, sick leave and overtime.

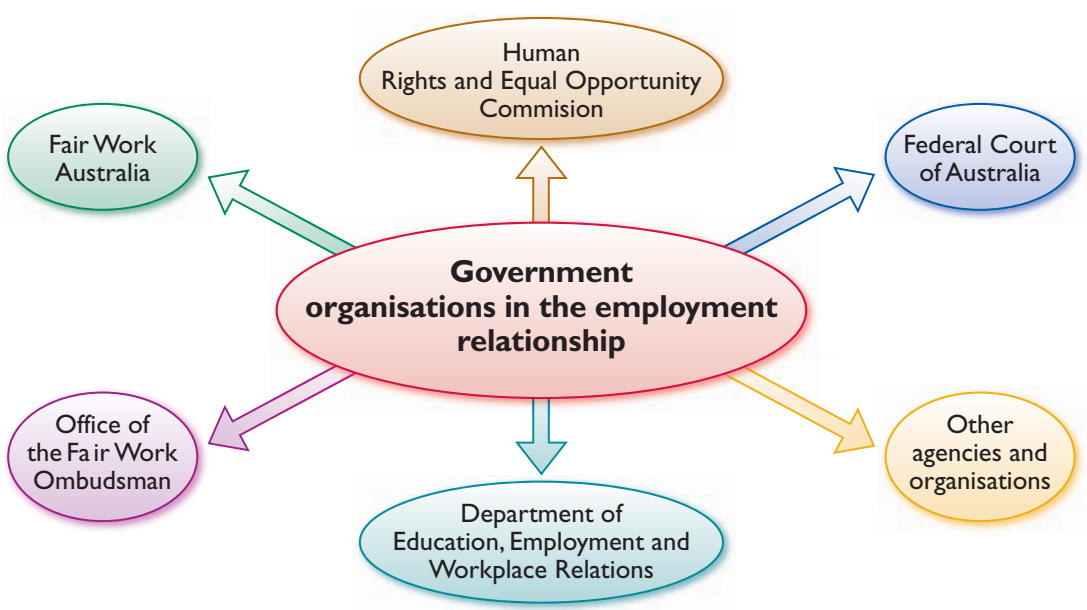


Figure 17.3 Government organisations in the employment relationship.

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What are working conditions?

Working conditions are the non-wage features of an employee's workplace contract. These include the hours of work, rostering issues, promotional policies and occupational health and safety issues.

What is a certified agreement?

A **certified agreement** is an agreement that is negotiated between an employer and all its employees. If requested, unions may assist employees in the negotiating process. Certified agreements are subject to the Better Off Overall Test. This type of wage agreement is also known as an enterprise agreement. The process of negotiating an enterprise agreement is called enterprise bargaining.

What is the Better Off Overall Test?

The Better Off Overall Test is used by Fair Work Australia to examine whether employees will be any worse off if they sign a new wage agreement rather than being employed under an award and relevant laws.

What is an industrial dispute?

An **industrial dispute** is a problem that arises between an employer and either a group of employees or an individual employee at a workplace. The problem could concern wage rates, working conditions, occupational health and safety issues or unfair dismissal, for example.

What is conciliation?

Not all disputes can be resolved by negotiation between the employer and the employee. **Conciliation** is used when Fair Work Australia offers some suggestions to help resolve the dispute. These recommendations are not legally binding. Fair Work Australia also assists in bringing the parties together to help reach a settlement.

What is arbitration?

When the disputing parties are unable to resolve their differences through conciliation, Fair Work may decide to arbitrate on the dispute. **Arbitration** involves a commissioner hearing the cases put forward by both parties and then making a decision, which is legally binding on both parties. This process is similar to a magistrate deciding on a case heard in a court.

Fair Work Australia

Fair Work Australia was established in 2010 by the *Fair Work Act 2009* (Cth). Fair Work's primary functions are to: encourage the prevention and settlement of industrial disputes between employers and employers through a process of conciliation and arbitration; determine minimum wages through national wage case hearings; arbitrate on unfair dismissal claims where the employee believes that his or her dismissal was 'harsh, unjust or unreasonable'; apply the Better Off Overall Test to certain wage agreements.

Federal Court of Australia

The Federal Court of Australia acts as an avenue for appeal regarding decisions made by the Fair Work Australia. It can also apply penalties to parties who breach legally binding decisions made by the Fair Work Australia.

Other agencies and organisations

The federal government is a signatory to various United Nations conventions

Working conditions
The non-wage features of an employee's workplace contract, such as hours of work and occupational health and safety issues.

Certified agreement
A wage agreement that is negotiated between an employer and all its employees.

Industrial dispute
A problem that arises between an employer and either a group of employees or an individual employee at a workplace.

Conciliation
Used when Fair Work Australia offers suggestions to help resolve an industrial dispute. These recommendations are not legally binding.

Arbitration
Involves a commissioner hearing the cases put forward by both parties in an industrial dispute and then making a decision, which is legally binding on both parties.

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that seek to protect the basic rights of all employees. The Human Rights and Equal Opportunity Commission was established in 1996 to enforce federal government legislation on discrimination in the workplace. Employees who believe they have been subjected to discrimination or sexual harassment within the workplace are able to lodge a formal complaint with the commission to seek compensation. The other main federal government organisation dealing with workplace issues is the Equal Opportunity for Women in the Workplace Agency (EOWA). The main responsibility of EOWA is to promote equal opportunity for women in the workplace and administer the *Equal Opportunity for Women in the Workplace Act 1999* (Cth).

Activity 17.1
Create a mind map

Create a mind map that highlights the key stakeholders in the employment relationship and the role of each stakeholder in this relationship.

Society

Although members of the community have no direct influence on the relationship between employers and employees within the workplace, it is becoming widely accepted that workplace practices are reflective of behaviours that are upheld within society. Issues such as perceived discrimination, harassment and unfair working conditions are becoming increasingly publicised. With strong media attention, businesses must be seen to respond in a manner that is consistent with the view of society.

BUSINESS BITE

In September 2010, Australian swimming champion Stephanie Rice commented on the performance of the South African Rugby team in a manner that involved a derogatory term to describe homosexuals. Jaguar Motors, a sponsor of Rice, quickly released Rice from her sponsorship duties with the business.

Legal

Change is an inevitable feature of any business. It is brought about by factors within the business's internal and external environments. The changing nature of social, political and economic forces in Australia has had a considerable impact on the employment relationship. Employers and employees now coexist in an environment where the most successful businesses are those that are able to respond effectively to these changes and ensure that all those in their workforce are willing to accept and embrace the changes.

The employment relationship is subject to considerable number of regulations and laws. Over the years, the government has established the legal framework by which employers and employees are encouraged to coexist cooperatively. Through the development of numerous laws and the involvement of various government organisations, the employment relationship is influenced by this key area of the business's external environment.

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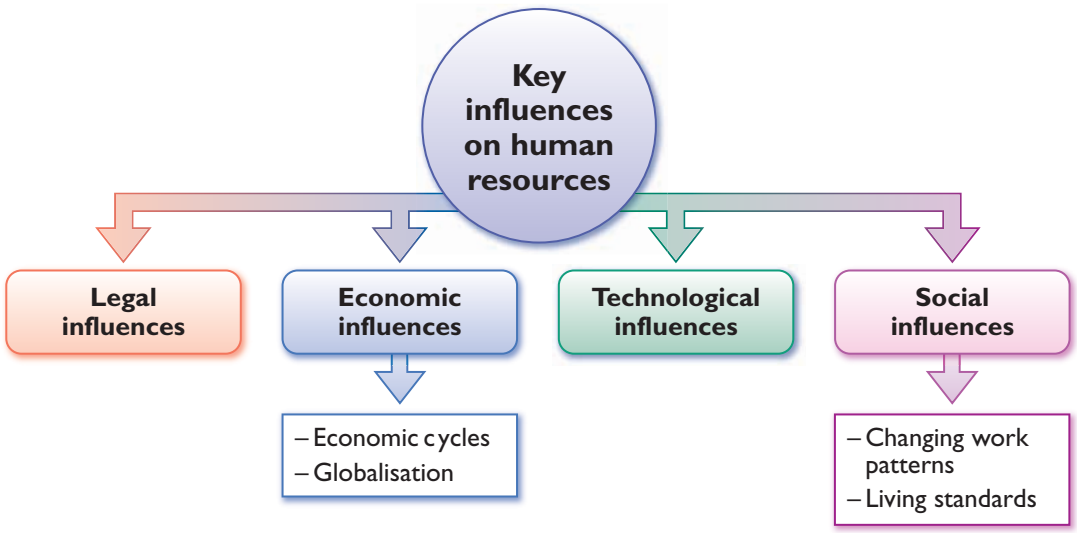


Figure 17.4 Key influences on human resources.

The employment contract

The employment contract in the Australian workforce is between an employer and their employee. Many of the conditions outlined in this contract are controlled by various state and federal laws. These conditions apply to all workplaces. The growth of outsourcing and the increase in self-employment has meant that the traditional definition of an employee has changed. An employee can no longer be defined as an individual who offers his or her labour to a business in return for payment. If this were the case, is an individual who acts as a consultant to business in developing effective marketing strategies an employee? The law regards an employee to be a person who is subject to a contract of service. The employment contract is based on the employee offering his or her services on a regular basis and being subject to the lawful control and authority of the employer. The employer is able to tell the employee what job to do and how to do that job. The position of employment is ongoing and will not be terminated once a task has been completed.



Figure 17.5 An independent contractor.

An employment contract creates rights and responsibilities for employers and employees. These rights and responsibilities are enforceable by laws, such as those governing:

- a safe workplace
- minimum wage entitlements
- anti-discrimination and equal opportunity initiatives.

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Duties of employers

Duty of care

The duty of care is one of the most important responsibilities of any employer. It refers to a business's legal obligation to provide all its employees with a safe and healthy workplace. Employees must be provided with the necessary skills, knowledge and equipment to minimise risks associated with their work within the business. The responsibility of an employer to provide a duty of care to their employees also extends to:

- warning employees of risks that may not usually arise, such as slippery floors and periods of excessive noise
- providing protective clothing.

Duty to pay the agreed wage

When an employee commences employment with a business, the business is legally obliged to pay the employee the correct, legal wage. While the law allows employees to be paid more, it prohibits employees being paid less than their award wage. Employees who are employed under individual workplace contracts must be paid the amount specified in that wage agreement. The failure of the employer to do so could result in the matter being taken to Fair Work Australia.

Duty to provide work

It is the responsibility of the employer to provide a constant source of employment to its full-time and part-time staff. Should the business not require an employee's labour, it must provide the employee with the opportunity to leave the business with financial compensation. These requirements are set out in Table 17.1. These figures are based on the federal minimum standard for redundancy payment. As a casual employee is contracted only by the hour, the employer is not obliged to provide casual employees with a constant source of work or financial compensation for loss of work.



Figure 17.6 Occupational health and safety is an important workplace issue.

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Table 17.1 Financial entitlements for redundant employees

Employee's period of continuous service with the employer on termination		Redundancy pay period
At least	**But less than**	
• 1 year	• 2 years	• 4 weeks
• 2 years	• 3 years	• 6 weeks
• 3 years	• 4 years	• 7 weeks
• 4 years	• 5 years	• 8 weeks
• 5 years	• 6 years	• 10 weeks
• 6 years	• 7 years	• 11 weeks
• 7 years	• 8 years	• 13 weeks
• 8 years	• 9 years	• 14 weeks
• 9 years	• 10 years	• 16 weeks
• 10 years		• 12 weeks

Long-service-leave entitlements seek to explain the redundancy pay entitlement for employees who have a period of 10 years' continuous service or greater. Please note that these are the minimum legal payments as outlined by Fair Work Australia (www.netlawman.com.au).

Duty of employees

Employees also are subject to a number of legal obligations by agreeing to offer their labour to a business.

Duty to obey lawful instructions and commands

When employed by a business, the employee is expected to follow the instructions of supervisors and senior management. These instructions must be lawful (that is, employees cannot be asked to do something illegal) and should not put the employee in a position of harm or risk. The instructions must also adhere to the conditions set out in the specific wage agreement.

Duty to work with skill

When an employee is hired by a business, it is expected that the employee will perform the task to the best of his or her ability. Employees have a duty to use their skills and knowledge in a competent manner.

Duty to disclose relevant information

An employee's performance in a business may be affected by a specific medical illness or pre-existing injury. If an employer has no knowledge of relevant information about an employee's health it may result in a serious workplace accident. It is essential that such information be disclosed to an employer as a precautionary measure. This duty raises the ethical issue of whether employees should disclose medical information about themselves that is not relevant to their position at work.

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Regulating the relationship between employers and employees

The employment relationship is subject to a considerable degree of government regulation. This regulation not only impacts on the method of wage negotiation and determination but also on issues affecting the day-to-day operations of the business, such as recruitment, workplace disputes and occupational health and safety. While parliament is responsible for developing these laws, it is the role of industrial tribunals and organisations to ensure that stakeholders in the employment relationship follow the rules and regulations outlined in this legislation.

Minimum wage rates

A minimum wage is an employee's minimum rate of pay for hours worked.

The minimum wages received by employees in the national workplace relations system are reviewed by Fair Work Australia annually, with any adjustments taking effect on 1 July each year.

Fair Work Australia is responsible for ensuring that employers and employees cannot agree to a rate of pay that is less than the applicable minimum wage.

Who determines minimum wages?

Minimum wages are generally determined once per year by a specialist Minimum Wage Panel of Fair Work Australia.

Any determinations made to vary minimum wages in modern awards or a national minimum wage order will apply from the first full pay period.

Why does the minimum wage differ?

Minimum wages under modern awards may include:

- wage rates for adults, in some cases, at different rates according to experience and qualifications
- wage rates for juniors, employees with a disability and employees to whom training arrangements apply.

What is the current national minimum wage?

The federal minimum wage is currently $15 per hour or $569.90 per 38 hour week (before tax).

Casual employees covered by the national minimum wage also get at least a 21% casual loading.

Awards

An award is a legal document that outlines the minimum wages and working conditions for all employees working in a particular industry. They apply to all the businesses in that industry and remain in force until they are either varied or cancelled by agreement among employers, employees, unions and Fair Work Australia. Awards are established through negotiations between dominant employers, employer associations and trade unions. Fair Work Australia may assist the parties in reaching a common agreement. Under the *Fair Work Act*, parties to a wage agreement (usually employers, employees and unions) may apply to Fair Work Australia to have the award changed. This allows the wage agreement to be altered to suit the individual circumstances of the business. The wages and working

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Minimum Employment Standards

What are the 10 NES entitlements?

The NES are set out in the *Fair Work Act 2009* (Cth) and comprise 10 minimum standards of employment. In summary, the NES involve the following minimum entitlements:

Maximum weekly hours of work: 38 hours per week, plus reasonable additional hours.

Requests for flexible working arrangements: Allows parents or carers of a child under school age or of a child under 18 with a disability, to request a change in working arrangements to assist with the child's care.

Parental leave and related entitlements: Up to 12 months unpaid leave for every employee, plus a right to request an additional 12 months unpaid leave, plus other forms of maternity, paternity and adoption-related leave.

Annual leave: Four weeks paid leave per year, plus an additional week for certain shift workers.

Personal/carer's leave and compassionate leave: 10 days paid personal/carer's leave, two days unpaid carer's leave as required, and two days compassionate leave (unpaid for casuals) as required.

Community service leave: Unpaid leave for voluntary emergency activities and leave for jury service, with an entitlement to be paid for up to 10 days for jury service.

Long service leave: A transitional entitlement for certain employees who had certain LSL entitlements before 1/1/10 pending the development of a uniform national long-service-leave standard.

Public holidays: A paid day off on a public holiday, except where reasonably requested to work.

Notice of termination and redundancy pay: Up to four weeks notice of termination (five weeks if the employee is over 45 and has at least two years of continuous service) and up to 16 weeks redundancy pay, both based on length of service.

Provision of a Fair Work Information Statement: Employers must provide this statement to all new employees. It contains information about the NES, modern awards, agreement-making, the right to freedom of association, termination of employment, individual flexibility arrangements, rights of entry, transfer of business, and the respective roles of Fair Work Australia and the Fair Work Ombudsman.

Source: Fair Work Ombudsman

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conditions outlined in the award variation cannot go below those outlined in the original award. The varied awards must also be approved by Fair Work Australia. Under current legislation, matters that may be included in an award agreement are limited. Examples include classification of employees; ordinary time hours of work, the times within which those hours of work may be performed, rest breaks and notices concerning variations to working hours; and rates of pay and classifications, including bonuses, penalty rates and redundancy payments. Such matters as limitations on the number of part-time workers, consultation with unions before dismissing employees and restructuring business operations, promotional procedures and policies are not included in the award agreement and are often subject to direct negotiation between the employer and the employee. With the introduction of wage agreements, which place greater emphasis on direct negotiation between an employer and an employee, there is greater opportunity to tailor remuneration to suit employees more appropriately. The current federal government believes that awards remain a benchmark against which the fairness of other wage agreements should be compared.



Figure 17.7 Awards are a safety net.

Agreements

In 1991, the federal government sought to encourage workplaces to develop their own wage agreements. This has meant a move away from a system where wage rates and working conditions are determined by a central government authority to a system that aims to meet the needs of individual businesses and their employees. Such wage agreements include certified agreements and Australian workplace agreements.

Certified agreements

Certified agreements, which are also known as enterprise agreements, are exclusive to a business and its employees. Unions may be involved in the negotiation of these agreements. Alternatively, employees may form their own work-based committees to represent staff in the negotiations. The agreement must be approved by a majority of staff, and employers must in no way have forced employees to accept the terms and conditions of the new agreement. Once an agreement has been negotiated, it will be presented to Fair Work Australia for approval. Fair Work Australia will determine whether the employees are either better or worse off by moving to this new agreement. The award that covers this business will be used as the benchmark for comparison. This process that is conducted by Fair Work Australia is referred to as the Better Off Overall Test. If Fair Work Australia believes that employees will be disadvantaged by the new terms and conditions, then the agreement will not be passed.

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Activity 17.2 Role-play

Spiros has been asked by his employer, Gramsec Securities, to consider signing a new individual workplace contract. As his union adviser, explain to Spiros what an Australian workplace agreement is, outlining the role of Fair Work Australia in relation to these agreements.

Types of employment contract

Most Australian employees are still on one of four types of employment contract:

- part-time
- permanent
- casual
- fixed-term.

Part-time employment

Part-time work involves an employee working a fixed set of hours per week, but usually less than those of a full-time employee. They may choose to work additional hours each week. Part-time employees are entitled to all the benefits of full-time staff, including sick and annual leave, holiday loading and various meal and uniform allowances. These are provided on a pro rata basis. This refers to the proportion of hours a part-time employee works compared with those of a full-time employee. Entitlements are based on this proportion.

Permanent employment

A permanent employee is a person who is provided with continuing employment within the organisation. Permanent employees work between 35 and 40 hours per week (depending on their wage agreement) and may be requested to work more hours than this. In some cases, if they are required to work beyond the specified ordinary time hours, they will be paid an overtime allowance as outlined in their wage agreement. Permanent employees are entitled to a minimum of four weeks' holidays per year and receive 1.1 weeks' long-service leave for each year of service to the business.

Casual employment

Casual employees are employed by a business for short periods of time. They must work for a minimum of between one to three shifts. The regularity of their employment is subject to the employer's demands. The employer is not obliged to provide regular, ongoing work. As casual employees do not receive holiday or sick leave entitlements, they are entitled to be paid 1.5 times the wage paid to a full-time, permanent employee doing the same type of work.

Ethical Issue

Should unions by law be required to assist employees in the development of AWAs given the legal complexities of such agreements?

Activity 17.3 Comprehension

1. Explain why a business may choose to employ staff on a casual basis.
2. Naomi is a part-time employee of AXAR Advertising. Explain how her entitlements will differ from those of her colleague Juan, who is a full-time employee.

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Fixed-term contracts

Fixed-term contracts are used by businesses that require the use of labour for only a specific period of time. Both parties are in agreement to this time period and the contract can only be altered with the consent of both parties. Should the employer seek to terminate the contract against the wishes of the employee, it is known as a breach of contract. In such a situation the employee has the right to pursue court action to recover lost income earnings. Similarly, employers may seek legal compensation if the contractor did not perform the task that the employer paid the contractor to do.

Occupational health and safety and workers' compensation

Occupational Health and Safety Act

Statistics shows that each day one person in Australia dies from a work-related injury. The safety of employees within the workplace is a paramount concern to the state government. The *Occupational Health and Safety Act 2000* (NSW) establishes the rights and responsibilities of employers and employees in regard to safety in the workplace. Employers must provide staff with a safe workplace and seek to minimise any potential risk that may arise. Businesses with more than 20 employees must have an occupational health and safety committee. The aim of these committees is to address any work-related health or safety concerns employees may have. While there is a considerable burden of responsibility on employers, employees must also cooperate in maintaining safety in the workplace.

Workers Compensation Act and Workers Compensation and Workplace Injury Management Act

The *Workers Compensation Act 1987* (NSW) and the *Workers Compensation and Workplace Injury Management Act 1998* (NSW) govern the process of employees gaining financial compensation for injuries sustained at work and their subsequent return to work. The aim of this legislation is to maintain the income of the injured employee and ensure that, once rehabilitated, the employee is able to return to work in some capacity.

Anti-discrimination legislation

Various anti-discrimination laws prohibit discrimination in the workplace on the grounds of gender, ethnicity, sexual preference, religion or disability. This legislation includes the *Sex Discrimination Act 1984* (Cth), *Racial Discrimination Act 1975* (Cth), *Human Rights and Equal Opportunity Commission Act 1986* (Cth) and the *Disability Discrimination Act 1992* (Cth). The Human Rights and Equal Opportunity Commission enforces anti-discrimination legislation. While such legislation exists to protect the interests of the employee, it is the responsibility of the employee to report claims if discrimination occurs. Fear, intimidation and harassment could discourage an employee from lodging a formal complaint with the Human Rights and Equal Opportunity Commission.

Activity 17.4 Summarise

Construct a table that summarises the differences between federal and state government workplace legislation.

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Economic

Economic cycle

The significance of a business to an economy cannot be understated. As petrol is to a car, business is to the economy. Business is the fuel that drives production, price changes, employment and our standard of living. The level of economic activity in an economy is primarily determined by the level of consumer and business spending within a given period of time and is a significant influence on the size of the Australian workforce. This level of consumption and investment changes over a period of time. These fluctuations in consumer and business spending are, collectively, known as the economic cycle.

Employment is a fundamental cornerstone of any economy. If employees are confident about their level of job security, they show an increased willingness to spend more of their income on consumer goods. This increased spending encourages business to demand more labour as a means of producing more goods and services. The main reason why more goods and services are often produced is because consumer demand has increased. This is commonly referred to as economic growth. High employment will generally result in increased consumer spending. This has a positive effect on business as increased revenue will often translate into higher profits. At some point, however, the government will attempt to ensure that this level of growth is sustainable and will not lead to other economic problems, such as inflation.

Impact of inflation

How does inflation impact on the employment relations function of business? Consider the following scenario. Consumer confidence in an economy is growing. This is reflected by an increase in consumer spending. As demand for goods increase, businesses react by increasing their levels of output and production. Some goods may take longer to produce. The demand for these products may see consumers become willing to pay a higher price for them. As prices rise, the cost of living increases. During periods of wage negotiations, employees will seek higher wages from their employer to compensate for this increase. Higher wages inevitably increase

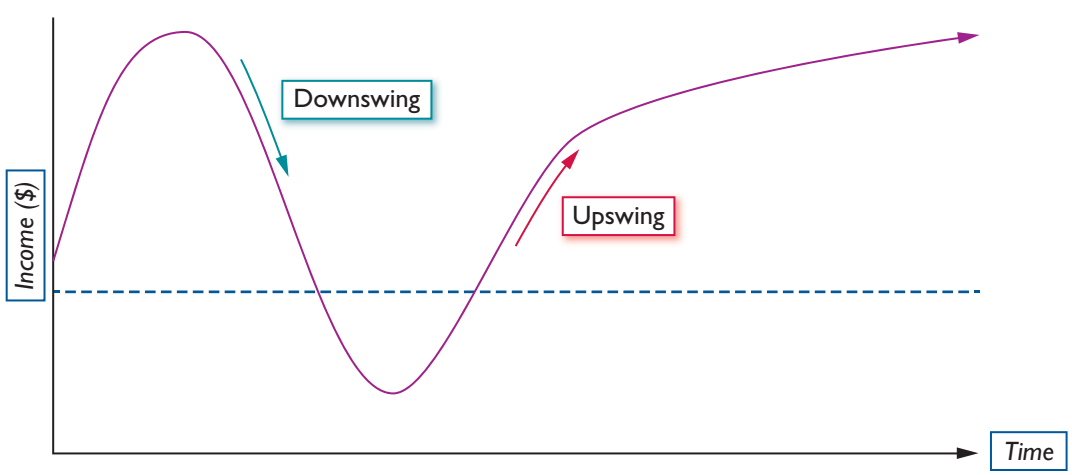


Figure 17.8 The economic cycle.

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Retrenched

Workers are retrenched when their services are no longer needed because the business they work for has downsized, closed a division or outsourced a function and therefore requires fewer workers.

the costs of production of any business. This could result in a business reducing the size of its workforce, with the remaining staff carrying an additional workload.

Globalisation

Globalisation refers to the integration of the world's economies into a single market where goods and services can be traded with ease. Many of the clothes we wear are made in foreign countries and many of the products we use are produced and supplied by large, foreign-owned businesses. Over the past 20 years, Australian businesses have faced increased competition from foreign businesses. The government has encouraged foreign-owned businesses to establish their operations in Australia to provide consumers with greater choice and lower prices. While these businesses often employ Australian staff, the impact of this increased competition has seen many Australian-owned businesses suffer. Unable to compete with lower prices, some Australian-owned businesses have ceased operations and, as a result, their employees have lost their jobs. The closure of Australian businesses also leads to retrenchments. Workers are **retrenched** when their services are no longer needed because the business they work for has downsized, closed a division or outsourced a function and therefore requires fewer workers. From an employment relations perspective, it is important for a business to follow the correct procedures in ensuring that employees receive their legal entitlements if they are retrenched. The multicultural nature of Australia's workforce is a direct consequence of globalisation. Many overseas citizens have come to Australia hoping to utilise and develop their skills and provide themselves and their families with improved opportunities. Managing a multicultural workforce poses many challenges for employment relations managers. The recognition of foreign qualifications and the development of workplaces that promote cultural tolerance and are free of discrimination and harassment are key issues that employment relations managers must deal with. It is widely accepted that the nationality of a manager should have no bearing on his or her ability to lead a business. Many of Australia's leading companies have been successfully managed by foreigners.

BUSINESS BITE

Popular Australian brands (such as Speedo, Berlei and Bonds) are now manufactured in Asian countries where labour costs are considerably lower than in Australia. This allows these businesses to remain competitive in an environment where considerable emphasis is being placed on minimising labour costs. The downside of this trend is the loss of employment in Australia's weakening textiles industry.



Figure 17.9 Many popular Australian brands (such as Speedo, Berlei and Bonds) are now manufactured in Asian countries where labour costs are considerably lower than in Australia.

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BUSINESS BITE

India is fast becoming the call centre capital of the world. More than 30% of Indian university graduates are unable to find work each year. They are attracted to work at call centres, which pay above-average annual incomes of between $3000 and $5000. The average annual income in India is forecasted by leading global economic forecaster the Economist Intelligence Unit to be US$655. This is very low compared with the average annual income in Australia, making it more cost-effective for an Australian business to divert its call centre function from Australia to India. The call centre representatives in India are trained in Australian figures of speech and provided with information about Australian customs and culture. While this practice is legal, the ethics surrounding it are questionable.



Figure 17.10 Globalisation has seen many workforces become global.

Activity 17.5 Discussion

Refer to the following graph. An economy is currently at point A in the economic cycle. As the economy moves to point B, discuss how this would impact on the size of a business's workforce.

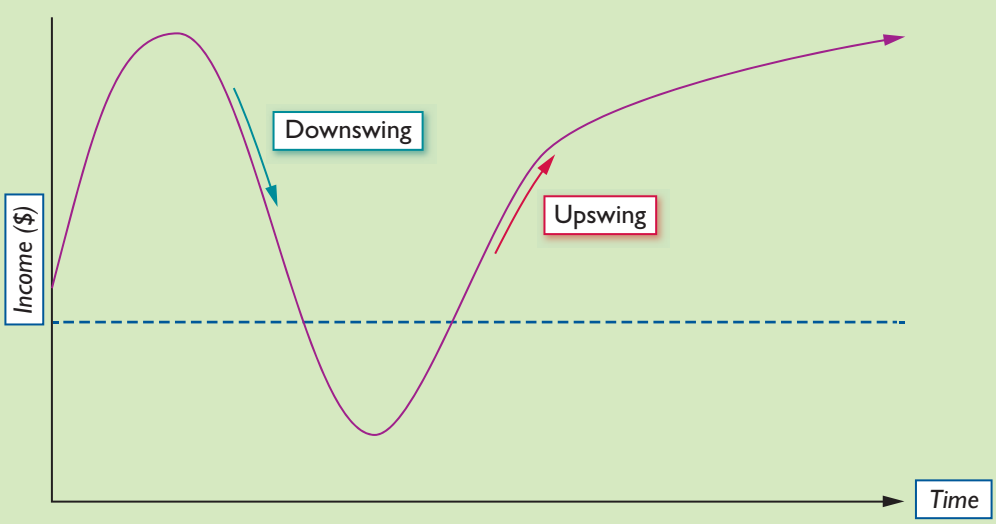


Figure 17.11 The economic cycle.

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Ethical Issue

While profit is important, a business should also consider its responsibilities to its employees. Therefore, Australian businesses should protect the interests of the Australian labour force by refusing to produce goods and services in low-cost labour countries. Do you agree with this view?

Technological

The growing influence of technology over all aspects of business operations is becoming much clearer in recent times. While technology seeks to improve the quality of products and the efficiency with which they have been produced, its impact upon the labour force has been subject to considerable debate.

Positive impacts of technology on human resources:

- allows the business to develop more efficient production techniques
- employees can be upskilled in the use of new workplace technologies
- encourages the employee to deliver the product/service in new and improved ways
- fosters a process of continued learning within an organisation
- reduces the repetitive nature of labour-intensive work
- fosters teamwork whereby staff become mentors to colleagues through the process of learning the new technologies.

Negative impacts of technology on human resources:

- loss of employment as technology itself becomes the main tool of production
- employee resistance to change as the workforce becomes reluctant to learning the use of new technologies
- reduced employee morale as the workforce feels their positions are less valued due to the growing importance of technology
- lower levels of employee empowerment and decision making as technology becomes a key driver in production methods.

While consumers seek products that feature innovation, the impact of technology in the Australian manufacturing sector is concerning. Recent data compiled by the Australian Bureau of Statistics show that the employment in the manufacturing industry is in decline. The growth of technology across these industries has no doubt facilitated the downwards trend.

Social

Australian workplaces are now characterised by greater diversity in the ethnic and cultural backgrounds of the workforce, the increased participation of women in the workforce and the desire by many employees to achieve a balance between work and family. Social influences such as these impact on the methods by which a business plans, organises and implements its employment relations functions.

Changing work patterns

The way in which Australians work has changed considerably over the past 10 years. Women now account for a greater proportion of the Australian workforce than ever before. Despite this, women are under-represented on the board of directors of Australia's leading businesses.

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According to Ruth Medd, Chair of the Women on Boards program, 'This means that women are under-represented in positions of power and influence in Australia. And more importantly it means that as a consequence Australia is failing to reach its full potential' (Women on Boards website).

The increased participation of women in the workforce has coincided with growth in the part-time work sector. With increased growth in the retail, hospitality and education sectors, more Australians, including women, have the opportunity to enjoy the flexibility of part-time or casual employment. Technological developments have facilitated the considerable decline in employment in Australia's manufacturing sector. According to data obtained from the Australian Bureau of Statistics, between 2009, the percentage of Australians employed in the manufacturing sector will decline by more than 1.2% per year. There are fewer unskilled jobs available within the market and businesses are more willing to introduce low-cost technological production methods at the expense of labour. The traditional hours of work from 9 am to 5 pm have also begun to disappear. Many businesses operate beyond these hours and allow consumers access to their products and services seven days a week. The changes to retail shopping hours, the growth of the hospitality sector and the emergence of call centres have seen a considerable increase in the number of employees working outside the traditional hours and on weekends. An example of how this trend could impact on the employment relationship would be the possibility of some businesses supporting the abolition of penalty rates for staff working outside the traditional 9 am–5 pm working hours.





Figure 17.12 Gail Kelly and Katie Page are two of the female CEOs across the Australian business landscape.

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Living standards

Education is undeniably a key factor influencing an individual's occupation. Less educated people, who lack skills and qualifications, may often be employed in industries with wage rates that are considered to be low.

Many would be scared to challenge their employers for fear of losing their jobs. Many of the jobs would be low-skilled groups and therefore not have a lot of power attached to them, such as factory-type jobs. As a result, a disparity between living standards across the community emerges.

Ethics and corporate social responsibility

The World Business Council for Sustainable Development defines corporate social responsibility (CSR) as 'the continuing commitment by companies to behave ethically and to contribute to economic development, while improving the quality of life of the workforce and their families, as well as the local community and society at large'.

It is being recognised amongst the business community that a good corporate citizen is about a company making lasting contributions to the community. This encourages businesses to consider social, economic and environmental concerns in its operations and decision making. While shareholders are a key aspect of the business, it must also consider the interests of all people who affect, or are affected by, the business. These stakeholders include employees, customers, suppliers, community organisations and local communities.

The key to a business's successfully demonstrating its commitment to CSR is ultimately through its actions. A business can do this by:

- investing in community projects
- supporting research initiatives
- introducing occupational health and safety measures
- adopting environmentally friendly practices, or
- drafting and applying a code of ethics to company operations.

Some examples

One of the ways in which Woolworths ('the fresh food people') undertake their CSR obligation is through their commitment to the environment. As part of this obligation, Woolworths created the 'greenbag' as a plastic bag alternative and also provides training to its 30 000 staff on how to 'fill the bag and not the environment'.

AGL (Australia's energy company) is another good example. It operates the 'energy for life' community investment program, which involves paying the winter energy bills for homeless shelters in NSW, Victoria and South Australia.

For McDonald's, the motto 'giving back' forms an 'integral part of everything [they] do'. One example of how McDonald's gives back to the community is through the Ronald McDonald House Charities. This provides seriously ill children with facilities and support that helps these kids to live a 'brighter, happier and healthier' life.

Source: www.actnow.com.au/Issues/Corporate_social_responsibility.aspx

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BUSINESS BITE

Back in 1998, while addressing Ford Motor Company stockholders, William Ford Jr said: 'I believe the distinction between a good company and a great one is this: A good company delivers excellent products and services, a great one delivers excellent products and services and strives to make the world a better place'.

Source: www.humanresourcesmagazine.com.au/articles/D1/0C06B8D1.asp?Type=60&Category=919

Corporate social responsibility and human resources

An effective corporate social responsibility program will impact upon the human resource function of a business. It enhances the reputation and standing of the business within the community and may be used to promote recruitment of staff for the business.

According to Sarah Stawiski, co-author of a report on the World Leadership Study: 'If an employee isn't happy, a strong CSR program isn't likely to tip the balance. Though a good social responsibility program won't reduce turnover, it can impact how employees view your organisation and the kind of ambassadors they will be when they come in contact with your customers, shareholders and community members. There are definitely positive benefits to be had'.

Strategies to promote corporate social responsibility within a workforce include:

- promote effective affirmative action and anti-discrimination programs within the workplace
- develop initiatives that reduce the business's impact upon the environment
- engage in strategies that promote work–life balance and enhance workplace flexibility
- encourage staff to volunteer their time to participate in community-building activities.

BUSINESS BITE

Doing the right thing

At Woolworths we are conscious of our responsibilities as a major retailer – serving millions of customers every day in communities across Australia and New Zealand.

We need to understand and manage our impacts, and take the opportunity to help achieve lasting and beneficial change that extends beyond our operations. Our operations impact the way we treat people, serve our customers, invest in local communities, provide returns to our shareholders, manage our supply chain and affect the environment.

This report aims to give the reader an insight into how we are performing in all these areas. Simply put, we aim to make sure Woolworths remains a company people want to invest in, work for and do business with, well into the future.

Source: Woolworths Limited 2008–9 Corporate Responsibility Report

Activity 17.6
Report Writing

Chalmers is one of the country's leading department stores. Management has decided to pursue a more active role in developing initiatives that promote corporate social responsibility. The focus of your report must be based on promoting the interests of human resources within the business.

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Chapter summary

- The six stakeholders in the employment relationship are employees, employers, unions, employer associations and government organisations.
- An employer refers to an individual or organisation that pays others to work for its business. The employer could be the owner of the business or, as is the case with larger businesses, a team of managers.
- Human resource departments are specialist departments that manage the employment relations function of a business.
- An employee refers to an individual who provides his or her skills to an organisation on a regular basis in return for an income.
- Many businesses now provide employees with non-financial rewards to encourage greater motivation and effort. Such rewards include a role in the firm's decision-making process and flexibility in starting and finishing times.
- Employer associations are organisations that aim to promote the interests of employers within the business environment. They do this by providing employers with advice on legal matters related to the employment relationship and by lobbying governments on issues affecting employers within the business environment.
- A union is an organisation that aims to protect and promote the interests of employees within the workplace. They assist employees in resolving disputes and act as a bargaining agent in wage negotiations.
- The government is one of the most influential stakeholders in the employment relationship. The key government organisations involved in this relationship are:
  - Fair Work Australia
  - Human Rights and Equal Opportunity Commission
  - Equal Opportunity for Women in the Workplace Agency.
- A contract of service is based on the employee offering his or her services to an organisation on a regular basis and being subject to the lawful control and authority of the employer.
- All employers have a duty of care to their employees. They must provide their staff with a safe working environment. It is also the legal responsibility of an employer to ensure that staff members receive the correct wage and other entitlements.
- Employees are required to obey the lawful instructions of employers. They must work to the best of their ability and disclose any relevant information that may impact on the performance of their work.
- Key pieces of employment legislation include:
  - *Fair Work Act 2009* (Cth)
  - *Occupational Health and Safety Act 2000* (NSW)
  - *Workers Compensation Act 1987* (NSW)
  - *Racial Discrimination Act 1975* (Cth)
  - *Sex Discrimination Act 1984* (Cth)
  - *Human Rights and Equal Opportunity Commission Act 1986* (Cth) and *Anti-Discrimination Act 1977* (NSW).

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- An award is a legal document that outlines the minimum wages and working conditions of all employees based on their work in a certain industry.
- Certified agreements are also known as enterprise agreements. They involve only one employer and its employees. These agreements must be examined and passed by Fair Work Australia before coming into effect.
- Certified agreements are subject to the Better Off Overall Test, ensuring employees are not worse off by signing the new wage agreement.
- There are four types of employment contract:
  - part-time
  - permanent
  - casual
  - fixed-term.
- The economy is a significant influence on employment relations. A strong economy is characterised by high consumer spending and increased sales. This can lead to stronger levels of employment.
- The growth of foreign businesses operating in Australia has encouraged many Australian businesses to become more efficient and competitive. They have done this by reducing costs, lowering prices and increasing their product range.
- The growth of technology in the manufacturing sector has seen many businesses reduce the size of their workforce and encourage existing staff to broaden their range of skills.
- Social changes are brought about through changes in society. Such influences in the employment relationship relate to the changing work patterns of Australians, such as the increased participation of women in the workforce and the growth of part-time and casual work.
- Corporate social responsibility (CSR) refers to the continuing commitment by companies to behave ethically and to contribute to economic development, while improving the quality of life of the workforce and their families, as well as the local community and society at large.

Chapter revision task

Create a report to business that identifies the key stakeholders involved in its operations. For each stakeholder, outline the role and identify how the stakeholder impacts upon the operations of the business. Make reference to how specific influences in human resource management impact upon each of the stakeholders.

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Multiple-choice questions

1 Changes in work patterns and population trends are reflective of which influence on employment relations?
- **(A)** Social
- **(B)** Economic
- **(C)** Legal
- **(D)** New organisational behavioural

2 The growth in part-time work in recent years has been accompanied by which other feature?
- **(A)** An increase in outsourcing and contract labour
- **(B)** Higher levels of labour mobility
- **(C)** An ongoing decline in unskilled jobs
- **(D)** An increasing number of women in the workforce

3 A downturn in consumer confidence and spending is reflective of which influence on employment relations?
- **(A)** Social
- **(B)** Economic
- **(C)** Legal
- **(D)** New organisational behavioural

4 How is an economy with low interest rates, increased consumer spending and higher output levels likely to impact on the employment relations process?
- **(A)** Increase employment opportunities
- **(B)** Increase business profit
- **(C)** Increase labour productivity levels
- **(D)** Increase the occurrence of industrial disputes

5 Which of the following is an impact of globalisation on the Australian economy?
- **(A)** The need to develop a cost-efficient and competitive labour force
- **(B)** The ability to extend recruitment practices to foreign countries
- **(C)** The need to achieve a culturally diverse workforce
- **(D)** The ability to access a greater range of raw materials and supplies

6 Growth in employment, wages and inflation is likely to occur during which stage of the business cycle?
- **(A)** Expansion
- **(B)** Boom
- **(C)** Downswing
- **(D)** Recession

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7 What is the key piece of federal government legislation regulating the employment relationship?
   (A) *Occupational Health and Safety Act 2000* (NSW)
   (B) *Human Rights and Equal Opportunity Commission Act 1986* (Cth)
   (C) *Workplace Relations Act 1996* (Cth)
   (D) *Fair Work Act 2009* (Cth)

8 Under the *Occupational Health and Safety Act 2000* (NSW), which stakeholder has the responsibility of providing a workplace that is safe and healthy for all parties?
   (A) Employees
   (B) Employers
   (C) Unions
   (D) Employer associations

9 Which of the following is an example of a business promoting its role as a socially responsible corporate citizen?
   (A) The rostering of staff over a 24-hour shift
   (B) Providing staff with christmas gifts
   (C) Encouraging staff to volunteer to assist with a local charity
   (D) Higher prices for products that do not promote healthy eating

10 How does an effective corporate social responsibility program benefit the human resource function of a business?
   (A) Promotes the reputation of the business
   (B) Increases customer awareness of the business
   (C) Promotes profitability within the business
   (D) Reduces costs within the business

Short-answer questions

1 Describe how changes in a country's economic conditions can impact on the employment relationship in that country.

2 List and describe three pieces of government legislation aimed at promoting a workforce that is more tolerant of differences.

Extended-response question

Analyse the extent to which social and economic influences impact on the employment relationship.

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CHAPTER 18

Processes of human resource management

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As technology, machinery and raw materials are available to businesses worldwide, the staff of a business has become a valuable asset. The service, skills, talents and expertise of the business's workforce is a real component that can provide the firm with a competitive advantage over other businesses. The role of employment relations is to provide the business with the workforce that it requires. It is the support function that aims to find, attract, develop and motivate the people who can provide services the business needs. This human element, the staff of the business, must be maintained and sufficiently motivated to give the business a competitive edge. Employment relations can be defined as the function that deals specifically with the relationships between the employer and the employees of the business. Employment relations managers are also called personnel, staffing or human resource managers. Employment relations managers are increasingly aware that employees' satisfaction with their employment often reflects on productivity and efficiency within a business. This relationship increases substantially when employees are given responsibility for making decisions that affect the manner in which they do their jobs. In the past, the people who worked in the human resource management (HRM) department of a business were seen as not adding value to the product or to the business's profitability and were often the first to be retrenched when cost-cutting took place. Today, however, the value of a high-quality HRM system is seen as a major component of a business's success. As a response to the growing importance placed on the human factor the government has passed many laws covering employment relations issues, including equal employment opportunity, anti-discrimination and occupational health and safety. Businesses must comply with these laws.

Human resource cycle
Acquisition, development, maintenance and separation of employees.

The human resource cycle

The work of the employment relations manager is ongoing. It involves a continuous **human resource cycle**, which involves acquiring people with skills for the job and the continued development of employees' knowledge and capabilities.

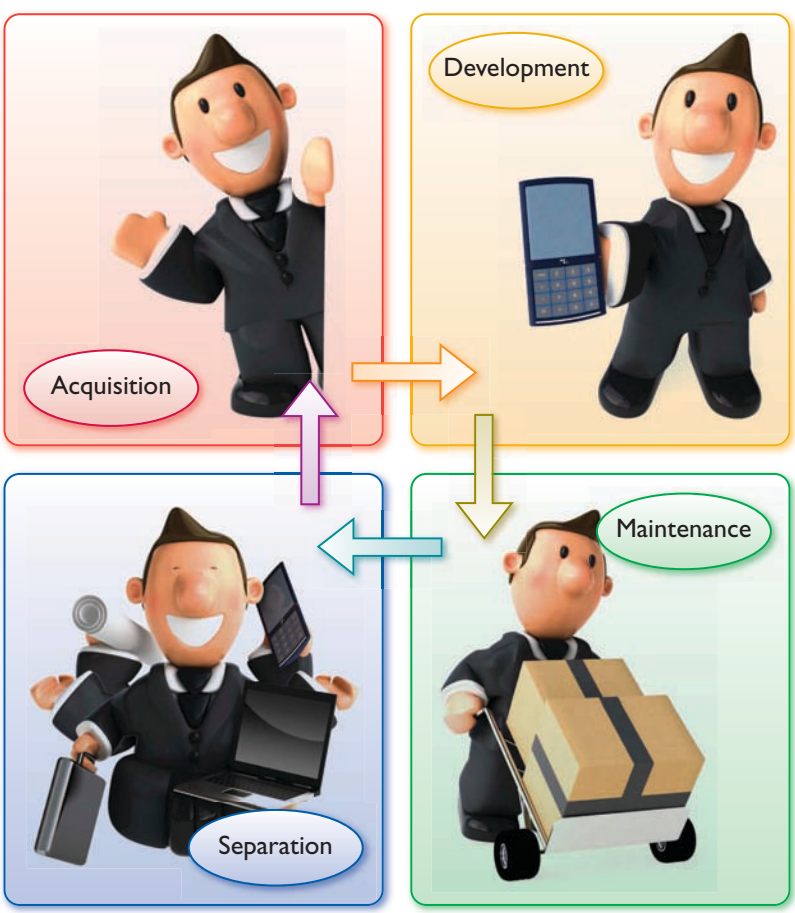


Figure 18.1 The human resource cycle.

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Acquisition
The stage in the human resource cycle that involves staffing needs, recruitment and selection.

Job description
Written statement describing the duties, tasks and responsibilities associated with a particular job.

Job specification
Written statement describing the key skills, experience and qualifications needed for a particular job.

Remuneration
How much a job is worth; that is, the pay and entitlements to be provided to the person employed to do the job.

The cycle also involves providing incentives for effective, reliable employees to remain motivated and stay with the business as well as setting up procedures for the removal of staff whose skills and attitudes are no longer relevant to the business.

Acquisition

Human resource planning includes strategies that meet the needs of the business today as well as in the future. The firm will have established its goals and the human resource department will examine whether it has the appropriate staff to meet the firm's needs. In order to do this effectively the business needs to:

- Identify the skills and number of employees required in the future – the department needs to take into account any changes the business is introducing (for example, new technology), the strategies the business has chosen to follow and its goals (such as expansion to other geographic areas).
- Analyse its existing workforce – the department can check through the employee information on its database to identify skills, training and even hobbies and special interests that can be utilised by the business.
- Compare the expected future needs of the business with the existing supply of staff.

These activities will assist the HRM department to relate present and future staffing needs to the business's existing workforce. The firm can then determine if there is a need to hire additional staff. **Acquisition** is the stage in the human resource cycle that involves:

- identifying staffing needs
- recruitment
- selection.

Identifying staffing needs

Identifying staffing needs is not as simple as employing more people. It is possible that the existing workforce may not be fully utilised. It may simply involve training existing staff to make them more able to cope with the changes that will be introduced or providing staff with an incentive program to entice them to be more productive and efficient. If this is not the case and more employees are needed, then the specific job needs to be identified and analysed. This should result in a **job description**, which is a written statement describing the duties, tasks and responsibilities associated with the job. After this, a **job specification** must be developed. It outlines the key skills, experience and qualifications needed for this particular job. Obviously the employment relations department would need to work closely with the other functional departments to determine this information. In the function of operations, for example, a welder may be needed on the factory floor. The job specification for the welder would be developed with the operations department. In order to acquire a new member of staff, the value of the job needs to be established and a **remuneration** figure attached. This involves determining how much the job is worth; that is, the pay and entitlements that will be provided to the person employed to do the job. Much of this will depend on conditions that have been established in the wage agreements with which the business must comply.

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Recruitment

The business can fill a vacancy by **recruiting** applicants:

- internally – from existing staff
- externally – from outside the business.

Businesses may look within the business to fill positions. This could involve a promotion for an existing staff member who has applied for the job and whose success would depend on merit, expertise and ability. This also provides an incentive for other staff to improve their performance as promotion would be seen as a reward for hard work. This method of recruitment can cause problems if other staff members feel that the person did not deserve the promotion. A promotion may create a need to fill the place of the promoted employee.

If the position cannot be filled from internal sources then the business can advertise externally for job applicants. There are various methods available to do this, including the following:

- The recruitment function can be outsourced to private employment agencies.
- Students or graduates may be recruited through interviews on university campuses, often targeting the top achievers in specific courses. This method is popular with some larger firms.
- Trainee positions may be offered to HSC students to complete 'cadetship' courses. These courses allow students to complete their academic qualifications while having a paid job with a reputable firm. The firm could provide these employees with practical knowledge and also assist them with their academic studies. Many accounting or law firms use this method of recruitment.
- Online career sites can be used. These sites are increasingly popular in recruitment.
- The position can be advertised in the job vacancy sections of local or major newspapers.
- The federal government agency Centrelink can be used. It offers a range of services to the community, including business and employer information.
- Current staff may be consulted to establish whether they know any people who are suitable for the job, such as family members, friends or acquaintances.
- At times, businesses may 'poach' or 'headhunt' employees from their competitors by offering them a better remuneration package.

Recruit

To accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

Considering your career?

Kowarzik Accountancy and Finance Open Night

Thursday 3rd December 5pm–9pm

Kowarzik Finance and Accountancy are Australia's leading recruiters of finance professionals, accountants and accounting support staff, and are the favoured recruitment agency for some of Australia's largest and most influential organisations. We are currently recruiting a variety of finance and accounting roles across Sydney and the surrounding suburbs, and will be holding discussions on your career path and vacant positions at all of our various Sydney branches on Thursday 3rd December.

Our Finance Support Division is currently seeking applicants for the following roles across Sydney:

Accounts Clerk	Accounts Payable	Accounts Receivable
Bookkeeping	Credit Controller	Assistant Accountants
Payroll	Accounts Supervisors	

For a further discussion and to make a confidential appointment please contact the office most convenient to you:

Burwood 9744 1333	City South 9280 7689
Chatswood 9411 3388	Hurstville 9580 9900
Liverpool 9601 7865	North Sydney 9957 6522
Parramatta 9635 4211	Sydney 8226 7888

Figure 18.2 Job placement through an employment agency.

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BUSINESS BITE

Ahmad Fahour is one of Australia's leading business people. He is currently the chief executive officer of Australia Post. Prior to his work there, Fahour worked for National Australia Bank. To encourage Fahour to join the NAB, from his then employer, Citibank, NAB paid Mr Fahour $3.9 million for simply agreeing to work for the bank.



Applicants would apply for the advertised job by a specific date and provide a résumé outlining personal information, such as employment history, skills and qualifications. The main aim of recruiting is to accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

Activity 18.1 Research

Use newspaper and internet research to complete the following tasks. In each case, try to establish the type of people the business is looking for. This may include skills and qualifications needed and may also relate to age, pay, location and hours of work.

a Identify jobs available in the specific area of work in which you are interested. The job should be geographically accessible to you and suitable for your current age group.

b Identify jobs available in the broader areas of your professional interest.

Beautician	Cosmetics	Childcare	Computer	Driver
Senior and 1st Year Apprentice – Full-time Award winning salon Hills area PH 9959 3456	Consultant positions available in department stores. No exp. required as training is provided. Fee applies. Phone: 9992 6754 BEAUTY TRAINING COLLEGE	EC Teacher and Assistant. Come and join the team at our new centre in Ashfield. Must have First Aid and experience in Childcare. Phone: 8882 3478	Operator required for strata Management Company at Kogarah, duties include accounts payable and receivable, banking, preparation or reports, and helping out when needed. Experience preferred. Post resume to Beta Strata Management, PO Box 243 Kogarah 2217. Fax to: 9839 5656	A full/part-time position available at wholesale nursery in Hornsby. Job requirements are: • Deliveries to Sydney metropolitan area • Must have MR driver's licence • Balance of time as nursery hand Contact Mitch 0418 993721

Figure 18.3 Job ads from a local newspaper.

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Selection

Selection is a screening process. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen. The more effective the selection process, the more likely it is that the best possible candidate will be selected.

The selection process may involve:

- application forms
- interviews
- assessment centres, which may be used to assess the suitability of applicants for more senior positions
- written tests, such as mathematics or English
- computer interviewing, where an applicant uses his or her own computer to answer questions set by the firm's recruitment department
- handwriting assessment, such as assessment for clarity, spelling, punctuation, neatness or personality where writing skills may be an important part of the job.

Which procedure is used will depend on the costs involved, the time that can be taken, any legal obligations and the nature of the job to be filled.

Some of the procedures may be completed at the same time, using the internet or conducted in person. Sometimes the selection process has several stages. In these instances, certain procedures will be used in the first round of interviews and then the same or different procedures will be used in the second round of interviews. Communication skills and ability to work with other people as a team are seen as increasingly important. In this case, selection procedures may take the form of a group interview situation, where the group is given a problem to solve. The individuals are assessed on their ability to interact with each other, to communicate ideas clearly and contribute to finding a solution to the problem. A selection process should reveal differences between candidates. It may be equally as important to eliminate the poorer candidates as the process continues. Some employment relations departments realise that good candidates may inadvertently be eliminated in the process; for example, if the candidate cannot spell very well and so does not perform well in the handwriting part of the selection process. Because of this, the department may try to evaluate the candidates on an overall basis. Many skills required for a job may be improved through training. However, it is difficult to teach someone 'people' skills. Once the business has decided on the successful applicant, the chosen person is formally offered the position. The selection process must be completed fairly quickly as a good applicant may have applied for several jobs and may have already been snapped up by the competition. After the offer has been made

Selection

A screening process in staff acquisition. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen.



Figure 18.4 A job interview in progress.

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Induction

Introduces new employees to the business, allows them to become familiar with the workings of the firm and provides them with information about the firm's day-to-day operations.

Training

Any activities that are aimed at improving an employee's present and future performance in the workforce.



Figure 18.5 Employees taking part in a training course.

and before the applicant accepts the offer, there may be a process of negotiation over pay and entitlement issues. Often, the successful applicant will complete a trial period of several months and be paid on a casual basis before being accepted by the business as a permanent member of staff. The selection process is also applied to part-time, casual or contract workers.

Staff development

The staff of a business can be its most valuable asset and provide it with a competitive advantage over other businesses in the industry. In order to maintain this edge the business ensures it continues to develop the skills and capabilities of its staff. Each business has a different way of operating; that is, has an individual culture. An **induction** procedure introduces the new employee to the business. It allows them to become familiar with the workings of the firm.

Training

Orientation or induction of new staff may involve a few days of training, explaining such matters as staff requirements, codes of conduct, rostering, grievance procedures, positions, work systems, techniques and computers. New employees should feel they know where they fit in and where the business is headed; that is, its goals. This enables them to be secure and comfortable in their position. All training should be regarded as non-threatening and offering new opportunities for skill development. **Training** includes any activities aimed at improving an employee's present and future performance in the workforce. It results in upgrading of skills, knowledge and competency levels in order to better meet the needs of the business.

Training methods can include:

- on-the-job training – including advisers, traineeships, apprenticeships and job rotation

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- off-the-job training – TAFE and university courses, in-services and seminars.

Trainees and apprentices need to be supervised while on the job. Work may proceed slowly while they are learning new skills. This practical component of the employee's training is backed up by the TAFE lectures and course material, which can often be far more theoretical in nature than the training the apprentice or trainee receives on the job. Traineeships and apprenticeships are successful systems used for plumbers, mechanics, electricians, chefs and other tradespeople. To increase employee expertise, businesses may organise lectures by guest speakers or their own specialists or arrange conferences. In some cases, testing can be used to maintain a high standard among employees or representatives of the firm.

Activity 18.2 Research

Further research the occupation you are interested in. Identify the courses or training that you would need to undertake to be qualified for this occupation. Also complete research on where you would need to go to gain these qualifications, how long the course would take to complete and the cost of the course.

Development

Development involves preparing employees for future responsibilities within the organisation due to a change in the business's strategies or a growth in its size or market share. Providing staff with a wider range of experiences in activities completed by the business results in greater flexibility and increased capacity for change to take place successfully. An example is a club's bar steward also acting as a cashier. Development is another aspect of staff training. Training and development of staff requires evaluation of training activities in order to measure their effect on staff performance. The success of training needs to be established to determine whether the program achieved its objectives. **Performance appraisals** can also be carried out. This requires a formal assessment of how well a person is working and would provide a basis for such matters as future training needs, pay rises, promotions and possible further development. In all cases, business must weigh up the costs of training and development undertaken by comparing it with the expected benefits provided to the business. When new technology is considered, training and development costs should be included in the evaluation. In many cases, some work time is lost when training takes place. Many occupations require ongoing training to keep up with developments in areas of technology, legal issues and health and safety of staff.

BUSINESS BITE

Many professional associations require their members to complete a certain number of hours of professional development each year. In the case of the Institute of Chartered Accountants, members must complete 40 hours of professional development annually.

In most instances, training and development results in increased motivation of employees, greater business flexibility, and improved use of technology and innovation.

Performance appraisal
A formal assessment of how well a person is working – the person's strengths. It provides a basis for such matters as future training needs, pay rises, promotions and possible further development.

Database
Used to maintain the records of a business.

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BUSINESS BITE

Learning and development

Optus strongly believes in developing and rewarding their existing employees and encourage our people to explore their potential. We offer many opportunities, activities and programs that can help our people grow their career and reach their goals:

- *The 'My Career' intranet site supports our people with their career aspirations and provides information on how to help plan and manage a career. It also provides job search and job alert functions to alert subscribers to vacancies as they become available.*
- *Through our 'My Learning' initiative, we're committed to ongoing career development to realise the full potential of all our people. This online learning and development tool gives our people the ability to track, plan and measure their progress, helping them achieve their goals.*
- *Our focus on leadership development helps our people adopt the approach that leadership behaviour is an attitude and not necessarily a role, title or position on an organisational chart. We have a number of programs available throughout our workplace that encourage leadership qualities in everyone.*
- *'Begin the Journey' is our company-wide induction program, which welcomes our new people, and helps them to settle into their roles and the organisation quickly and effectively.*
- *Our people can undergo self-assessment using our 'Technical Success Profile' tool helps identify capabilities, knowledge, skills, experience and personal attributes critical for effective performance in either their current role, or a role they would like to take on in the future.*
- *The Optus Engineering Cadet Program is a combination of on-the-job learning and TAFE studies for a three-year period. It provides education in leading telecommunications technologies, along with on-the-job experience and employment.*
- *The Graduate Development Program is designed to provide new university graduates with an in-depth knowledge of Optus and the broader telecommunications industry, whilst expanding their professional and leadership capabilities.*

Source: http://cardservices.optus.com.au/aboutoptus/About+Optus/Careers/Working+at+Optus/Learning+%26+Development

Maintenance

Maintenance of databases

A **database** is used to maintain the records of a business, including its employee information. A skills inventory is a database that contains information on the skills, expertise and qualifications of the current staff. The advantage of this register is to be able to call up or search for specific information when needed; for example, current staff with training in a specific skill to fill a particular position. This database could include personal information, such as marital status, medical history, home address and hobbies. This information may only be accessible by specific staff because of privacy issues. Thus, a security system (such as passwords) would need to be in place for database access.

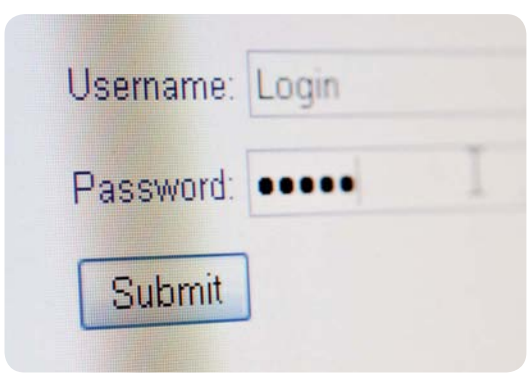


Figure 18.6 Passwords can be used to protect databases.

Maintenance of human resource staff

Firms invest considerable amounts of time and money into recruiting and selecting an appropriate new staff member to fill a vacant position. It also incurs the expense of induction of new staff and training in order to develop the skills of new and existing staff. All these steps are undertaken with

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the purpose of operating the business more efficiently and moving towards achievement of its goals. The firm needs to make sure it can keep the employees who are valuable to the development of the business. It does this through **maintenance**; that is, by providing the working conditions and work environment that motivate staff to be increasingly productive, gain satisfaction from their work and remain loyal to the firm. If the firm retains loyal and committed workers, a business will be able to:

- increase its productivity
- improve the level of morale among workers
- improve communication between management and workers
- reduce the level of absenteeism
- decrease costs through lower **staff turnover**.

A high level of staff turnover often indicates that worker morale is low and that employees may be dissatisfied with their job. A major cause of dissatisfaction may be low monetary benefits.

Monetary benefits

In Australia, minimum wage rates and minimum working conditions are set out in an award. These awards are based on specific occupational groups. Many workers have also entered into workplace contracts. These are known as Agreements.

The award for various occupations is influenced by specific factors, such as age, educational qualifications, job location, risk/danger involved and days/hours of work. Some firms provide over-award payments in order to gain benefits from their staff. Workers may feel greater motivation and be rewarded for improved productivity.

Maintenance

Providing the working conditions and work environment that motivate staff to be increasingly productive, gain satisfaction from their work and remain loyal to the firm.

Staff turnover

The rate at which employees leave a business.

Wage

An hourly rate of pay. It may include overtime payments for work outside of normal hours.

Salary

An annual rate of pay, divided into equal pay periods.



Figure 18.7 Employees sometimes receive monetary rewards in addition to their wage or salary.

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Non-monetary benefits

Include greater job variety, more flexible working hours, increased status in the workplace or community and intrinsic rewards.

Intrinsic reward

A reward that comes from within the person. In the case of employment, it could be the feeling of satisfaction that comes with doing a job well.

Wages received are based on hourly rates of pay and may include overtime payments for work outside of normal hours. **Salaries** involve an annual rate of pay, divided into equal pay periods. Both groups of workers (wage earners and salary earners) have taxation deducted from their earnings each pay period by their employer and sent to the federal government through the Australian Taxation Office (ATO). Professional people on a salary are often expected to continue working extra hours, if necessary, until the task is completed. This would occur, for example, in a firm's accounting department at the end of the financial year when it essential to present profit figures to the ATO. In some occupations, monetary benefits may be paid:

- According to sales – for instance, a real estate agent will receive a commission, which is a payment, based on the value of the sale, for the agent's services in selling the property.
- Based on an individual's output – payment of piece rates for fruit picking is an example. Fruit pickers are paid according to the number of crates of fruit they have picked.
- As bonuses – these are often paid at Christmas time or at the end of the financial year as an additional reward, above a wage or salary, for hard work.
- Through a shared ownership scheme – this may take the place of pay increases and provides the added incentive of workers 'owning' part of the business. Both Coca-Cola and Qantas have excellent employee share plan initiatives.
- As fringe benefits – examples are a company car, a housing loan at a low interest rate, a mobile phone, an expense account, discounted purchases from the business and additional superannuation payments.

Non-monetary benefits are often combined with monetary benefits to complete a remuneration package. This package represents payment to employees in exchange for their labour services. Non-monetary benefits may include greater job variety, more flexible working hours, increased status in the job or community, being allowed to manage yourself or access to an employee-subsidised cafeteria. Additionally, there are **intrinsic rewards**, which are those that come from within employees themselves. This type of reward includes satisfaction of a job well done, or a good inner feeling about the work you are involved in; for example, working for a charity or as a medical researcher. Remuneration packages are the total pay or reward to workers and managers for their labour services and may include both monetary and non-monetary benefits. They are designed to provide motivation to individual workers so that they make a 100% effort in their role in the business. People who receive satisfaction from their work often feel that their job is enjoyable and seems to take less effort than for those who are dissatisfied and find that time at work passes quickly. Rewards often provide the incentive that encourages the extra effort and the feeling that the job is worthwhile.

Some businesses provide certain employees with a negative response to, in a sense, coerce them to do the right thing by the business. These negative responses can be in the form of a reprimand or a warning of consequences that will follow. In severe cases, poor or unacceptable behaviour at work could result in a demotion (as in the army) or dismissal. In Australia, employees

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have gained many non-monetary benefits with the help of the union movement. Some of the benefits achieved are incorporated into the award system. Many people also negotiate special conditions in their own individual contracts with their employer. Some of the common benefits are:

- Employees are entitled to a period of annual leave. In Australia, this is usually four weeks' leave with full pay after working one year in the same job.
- Australian workers on awards are entitled to 17.5% loading on their annual leave. (Many wage agreements are moving away from this entitlement.)
- Additionally, after working full-time for the same firm for a continuous period of 10 years many people are entitled to long-service leave, which is at least eight weeks' paid leave.
- Employees are currently entitled to have an additional 9% of their annual wage or salary paid into a superannuation account by their employer. Superannuation is a form of fixed savings for employees' retirement.

For a firm, the cost of employing staff is not simply the wage or salary that they are paid. There are on-costs, which also need to be taken into account. These additional costs, or on-costs, include workers compensation insurance, sick leave, fringe benefits, superannuation and possibly payroll tax to the state government. Many of these are legal requirements.

Activity 18.3 Analysis

'Employees are motivated more by money than working conditions.' Construct a table that suggests three arguments supporting this statement and three arguments against this statement.

Separation

Separation involves the ending of the employment relationship. This separation may come from either the employee or the employer. It is the termination of the employment contract between the employee and the employer.

In many cases the staff of a particular firm may provide the business with a competitive advantage over other businesses in the same industry. It is very important that an employer is able to acquire and develop the right staff for the business and is able to maintain them by providing adequate incentives to keep them motivated, productive and satisfied with their work. In addition, a business needs to have ways to remove staff who do not contribute at a high enough level to be a valued human asset for the business. Separation may be on a voluntary basis, where the employee wishes to leave of his or her own free will. It may also be involuntary, where an individual member of staff is asked to leave.

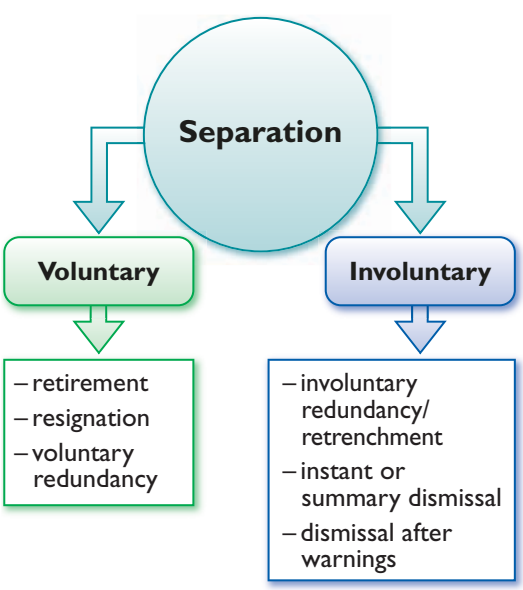


Figure 18.8 Separation can be voluntary or involuntary.

Separation

The ending of an employment contract. Separation may come from either the employee or the employer.

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Merger

The joining together of two businesses to form one business.

Takeover

One business buying a controlling interest in another business, such as by becoming a majority shareholder.

Involuntary separation

Occurs when the employer terminates the employment contract. This may include involuntary redundancy or dismissal.

Voluntary separation

Voluntary separation may take the form of retirement, resignation or voluntary redundancy.

Retirement

When an employee retires, the employee has decided to give up full-time or part-time work. In Australia, since new legislation was passed in the 1990s, there is no 'official' retirement age. In the past it was 65 years of age for males and 60 for females. The trend has been to retire earlier, in a person's mid to late 50s, thereby taking advantage of superannuation and possibly accumulated long-service leave. Many professional people (such as lawyers, doctors and accountants) continue to work into their 70s. People may retire due to ill health; some simply lack the motivation to continue working and some plan leisure activities, such as travelling. Several firms provide counselling for people who intend to retire to help them to plan their lifestyle changes. Australia has a 'greying' population; that is, older people make up an increasing proportion of the population. This factor combined with our increased life expectancy has meant that many capable and still productive people are available to business as a resource. Many of these older people have a great deal of experience and expertise in their field of work. It is recognised that the loss of this valuable resource is a disadvantage for many firms. A number of retired workers are now consultants and, in some cases, act as tour guides for groups of visitors to the business where they worked for some time.

Resignation

Some employees resign; that is, leave their jobs for reasons such as a need for change in their lives or moving interstate. In this case, the employee needs to provide the employer with notice of the intention to leave the job. The length of notice required depends on the industry involved and the employee's contract. In many occupations, on average, employees are required to give one to four weeks' notice.

Voluntary redundancy

Employees can nominate themselves for voluntary redundancy where their existing job is no longer required by the firm, possibly due to changes in technology, a **merger** or a **takeover**. These individuals may have been offered a redundancy package and find it in their financial interest to leave the job earlier then they had initially planned.

Some employees maybe required to leave their place of employment through the decision of management. This is known as **involuntary redundancy**. In this case, management decide which employees will no longer be required. This can occur as the skills of specific employees no longer suit the needs of the business.

Involuntary redundancy

A firm that has undertaken a merger or takeover may now have a duplication of tasks, resulting in redundancy of unnecessary staff. Redundancy is the termination of employment due to the firm closing down or the job no longer being required due to rationalisation, restructuring or new technology. In this case the actual 'skill' of the worker is outdated and no longer used in the industry. For example,

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an attendant at a petrol station used to work the bowser, whereas people now fill their own tanks with petrol. In order to terminate employment in this way the employer would need to make redundancy payments to employees based on seniority and years of service to the firm. The *Employment Protection Act 1982* (NSW) provides a minimum scale for severance payments for all permanent employees under NSW awards who work for an employer with more than 15 employees. Employers with fewer than 15 employees are exempt from these provisions. However, relevant state awards or agreements can provide greater entitlements than those provided for in the Act. More information can be found at the NSW Department of Commerce: Office of Industrial Relations website (www.industrialrelations.nsw.gov.au).

If a firm downsizes due to a drop in demand for its product or service or sells a division of its business then the firm may need to retrench staff. Retrenchment involves cutting back or reducing the number of staff. Some of these employees may be offered their jobs back if demand increases. In the 1980s and 1990s the banking sector undertook significant retrenchment programs due to increased competition, **deregulation**, mergers and major changes in technology.

The remaining employees are left insecure about their jobs and productivity could drop as a direct result of this. Their view of the retrenchments may differ from the view of the employer. Remaining employees may believe the employer has retrenched loyal staff due to cost-cutting and greed on the part of the business. Because of this many firms provide counselling or try to find retrenched workers jobs with other businesses.

BUSINESS BITE

Arnott's set up a program to assist its staff when it moved its Sydney factory from Homebush to Huntingwood, which is approximately 20 kilometres further west. A change in location of a business often presents problems for staff in terms of availability of transport, travelling distances and time taken to get to work. For some employees the move may result in a change in employment, difficulty finding new work, the need to cope with stressful situations and loss of income and financial security.

Deregulation

The government's removal or reduction in controls and regulations on an industry or sector of the economy or market in order to achieve greater competition.

Dismissal

Dismissal occurs when the employer terminates an employee's employment contract due to the unacceptable conduct or behaviour of the employee. It can take the form of:

- instant or summary dismissal
- dismissal after a series of warnings.

Instant or summary dismissal is the immediate termination of the employee's contract without notice. This would happen in instances of theft from the firm, gross negligence (extremely careless behaviour), absenteeism, drunkenness or misconduct by an employee. Dismissal after a series of warnings may follow incidents such as continual lateness or failing to perform the duties as required. In each case the employee may be issued with a written warning and provided with counselling or assistance to improve his or her behaviour. After three warnings the employer may dismiss the employee. The government has passed unfair dismissal legislation to

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protect employees from 'harsh, unjust and unreasonable' dismissals, such as in the case of discrimination. The employee can appeal the employer's decision to an industrial relations tribunal, such as the Australian Industrial Relations Commission. In many cases the employee is given the option to leave the business before being sacked. Businesses should have a written policy setting out procedures that managers follow in cases requiring discipline, dismissal or retrenchment of staff. Managers also need to be aware of the classification of their employees. Some of the main forms of classification are:

- casual
- part-time
- full-time.

Casual workers are hired on an hourly or daily basis. They receive an extra loading on top of the normal rate of pay to compensate them because they do not receive benefits, such as sick leave. This loading could be between 15% and 33% above the normal hourly rate for full-time workers and varies across occupations. Part-time employees work a regular number of hours per week but fewer than full-time hours. Part-time workers usually receive the flat hourly rate of full-time workers and are entitled to benefits on a pro rata, or proportional, basis. For example, if an employee works one-fifth of the load of a full-time worker, then the employee is entitled to one-fifth of the entitlements of a full-time worker. Full-time employees receive full weekly wages and conditions and may work between 35 and 40 hours or, on average, 38 hours per week depending on their occupation and award. Workers may also be classified as:

- on probation
- temporary.



Workers are often hired and given a probationary period of approximately 3–12 months to 'prove' themselves before they are made permanent. This gives the employer time to evaluate the employee's ability to fulfil the needs of the business. Temporary workers are those employed for short periods of time to replace an absent worker. This could be for one day or several months.

Ethical Issue

It is possible for a firm to act unethically by employing workers on probation knowing that it expects to dismiss the workers when the firm's workload decreases. Most employees on probation would assume that they have a chance of achieving a secure employment position.

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Chapter summary

- The processes involved in the human resource cycle, which involves the function of employment relations, are acquisition, development, maintenance and separation of the firm's workforce.
- For acquisition the business needs to be able to identify staff needs, recruit suitable applicants with the expertise and appropriate skills to complete the job and then select the best possible candidate.
- The development of staff includes all forms of training that aims to improve the employees' present and future performance in the workplace.
- Training results in upgrading of skills, knowledge and competency levels in order to better meet the needs of the business.
- Maintenance of staff is achieved through monetary and non-monetary benefits and achieves loyalty, job satisfaction and improved work relations.
- Separation may be voluntary, as in a worker's retirement or resignation, or involuntary through dismissal or redundancy/retrenchment.
- The employment contract includes employees' and employers' rights and responsibilities and is enforceable by law. Relevant laws include the *Workplace Relations Act 1996* (Cth), the antidiscrimination acts of the NSW and Commonwealth Governments, affirmative action acts and occupational health and safety acts.

Chapter revision task

Copy and rewrite the following sentences. Use your own knowledge and some assistance from the first letter provided to fill in the spaces.

- Employment relations deals with the relationship between e_____ and e_____.
- The human resources cycle begins with a_____, followed by d_____ and m_____ and ends with s_____ from the business.
- During acquisition staffing needs are i_____, r_____ and s_____ takes place.
- New employees are offered a r_____ package.
- The main idea behind recruiting is to accumulate a p_____ of potential candidates for the job.
- A d_____ is used to maintain the records of the business.
- Monetary and non-monetary benefits are included in the m_____ of a worker and also motivate workers.
- Monetary benefits include w_____ and s_____.
- Rewards of an i_____ nature come from within the employees themselves.
- The ending of the employment contract is called s_____ and may be voluntary (such as in r_____) or involuntary (as in s_____ d_____).

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- Employers' responsibility to their employees include a d_____ o_____ c_____ and to provide w_____ and pay the appropriate w_____.
- Discrimination is the u_____ treatment of a person, racial group or minority group and is based on p_____.
- EEO stands for e_____ e_____ o_____.

Multiple-choice questions

1 In a business the employment relations function deals with the relationship between which of the following?

(A) Consumers and employers
(B) Employers and employees
(C) Employees and staff
(D) Staff and consumers

2 What was the level of the superannuation guarantee levy in 2004?

(A) 3%
(B) 5%
(C) 7%
(D) 9%

3 What is the main objective of recruitment?

(A) To accumulate a pool of potential candidates for a job
(B) To select the most appropriate candidate
(C) To advertise a job vacancy
(D) To identify a vacant position

4 Which of the following would best describe the aim of training the staff of a business?

(A) Selecting the most appropriate candidate
(B) Improving an employee's ability to do one job
(C) Improving an employer's ability to perform in future jobs
(D) Improving an employee's ability for present and future performance

5 A firm contacts an employment agency and provides it with details of a job description. Which employment relations task will the agency be completing on behalf of this business?

(A) Time management
(B) Selection
(C) Recruitment
(D) Development

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6 What is the document that sets out minimum wage rates and minimum working conditions for a specific occupation?
   (A) Reward
   (B) Award
   (C) Occupation table
   (D) Employment ward

7 To which body in Australia is personal income tax paid?
   (A) NSW Government
   (B) Industrial Relations Commission
   (C) Australian Taxation Office
   (D) Australian Securities and Investments Commission

8 What are the stages in the human resource cycle?
   (A) Training, development, maintenance and selection
   (B) Separation, maintenance, training and development
   (C) Acquisition, selection, recruitment and separation
   (D) Acquisition, development, maintenance and separation

9 What does the superannuation guarantee rate mean?
   (A) An employee is entitled to this percentage of his or her annual wage to be placed into a superannuation account
   (B) Superannuation is guaranteed to make this rate of interest
   (C) It is the level of superannuation a person needs to have to retire
   (D) It is the rate of savings an employee needs to have

10 What does the term *separation* involve for a business?
   (A) Multiskilling
   (B) Division of labour between departments
   (C) Division of labour between a worker and management
   (D) The ending of the employment contract

Short-answer questions

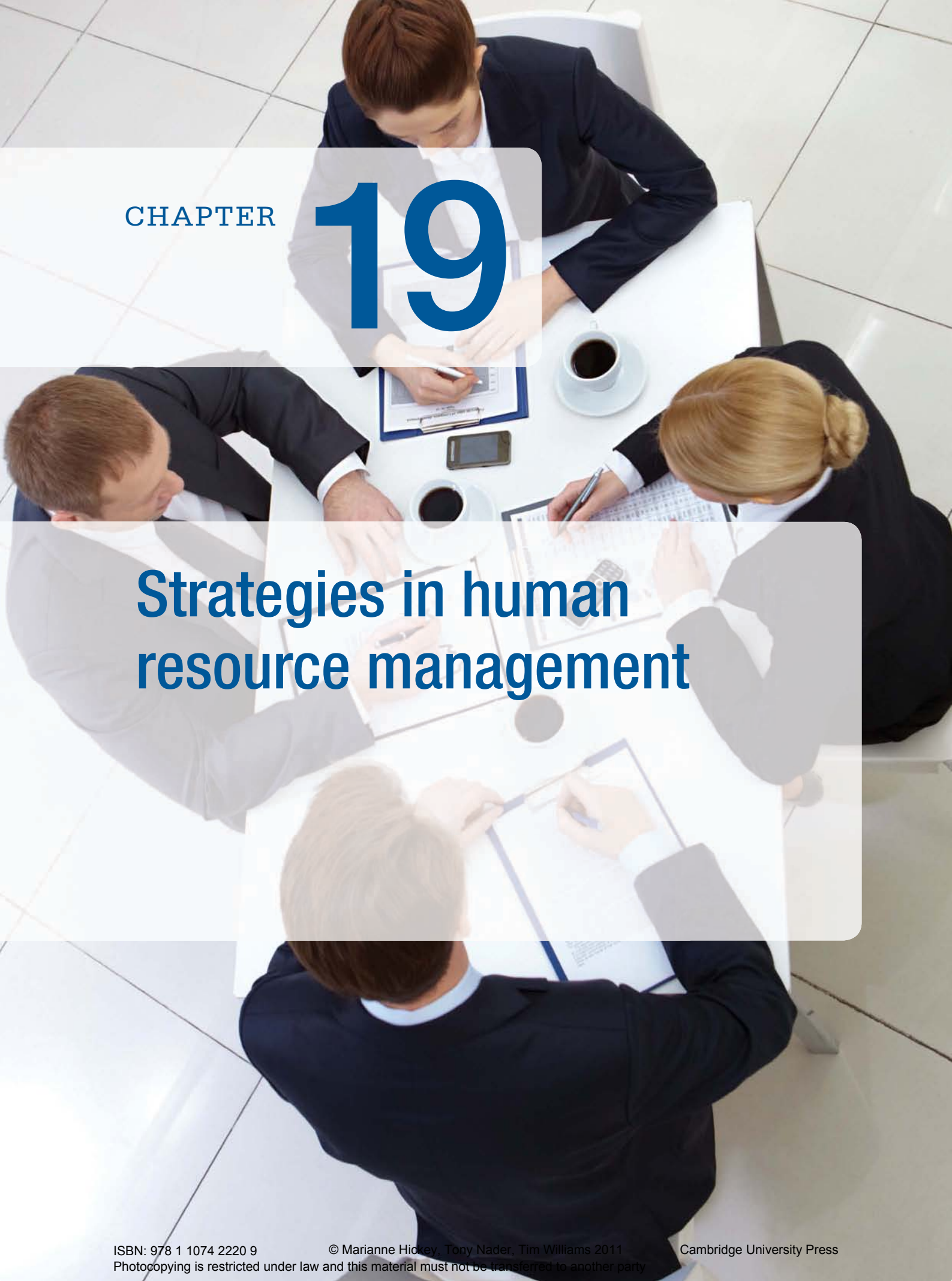
1 Identify and explain each stage of the human resource cycle.

2 **(a)** Distinguish between a right and a responsibility within the employment relationship.
   (b) Outline the rights and responsibilities of both the employee and the employer.

Extended-response question

Explain the role played by the employment relations function in the success of a business. Describe the stages of the human resources cycle. Outline the rights and responsibilities that should be taken into account.

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CHAPTER 19

Strategies in human resource management

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It is widely acknowledged that a fundamental aspect of any successful business is the role of employees. Management are increasingly recognising the value of an effective employment relations structure within a business. Businesses are seeking strategies to better manage employees across all aspects of the human resource cycle. This process of managing is broad and relates to many areas of the relationship between the business and its staff. It involves the manner in which employees are encouraged to participate in the decision-making process to more complex issues such as dispute resolution. The skill development of staff must also be considered, while management must examine strategies that effectively reward staff and recognise individual and team achievement. All these considerations are complex. Management should, however, seek to develop strategies that encourage and promote an effective and rewarding relationship between staff and the business.

Leadership style

Leaders form a fundamental role in human resource management. They make decisions, develop strategies for the development of the business and interact with employees. It is this process of interaction that is a key strategy in human resource management.

Increasingly, businesses are recognising the value of employees to their organisation. The employee and not the product are regarded as the competitive advantage. Hence, it is crucial for a leader to provide direction, implement plans and motivate staff in a manner that enhances employee workplace performance.

Leadership style is the manner and approach in which leaders of a business interact with staff. This interaction is based on:

- providing staff with directions and instructions
- implementing plans and organising staff
- motivating staff in a manner that promotes effective workplace performance.

It is crucial that the manner and approach leaders adopt within a business towards their employees inspire a positive culture within the organisation.

Types of leadership style

Respected business theorist Kurt Lewin indentified three different styles of leadership. Each form of leadership offers managers alternatives to the process of interacting with staff.



Figure 19.1 Leadership styles.

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Authoritarian leadership

This style of leadership is also known as autocratic leadership. Managers lead, based on the view that they are responsible for telling their employees what they want done and how to accomplish the task. There is no role for employees to contribute to the process of making decisions. This is the responsibility of managers or leaders within the organisation.



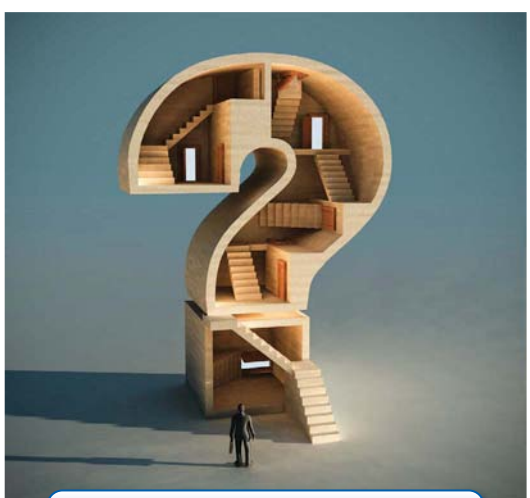
When can I use it?

- Decisions must be made quickly.
- Management have researched the issue and have the information to solve the problem.
- With employees learning a new job and requiring supervision and instruction.



Participative leadership

This style of leadership is also known as democratic leadership. The concept of inclusion is a fundamental aspect of this style of leadership. Participative leadership involves the leader including one or more employees in the decision-making process. Employees are consulted about what to do and how to do it. Given the involvement of staff in the decision-making process, the final decision making authority still rests with the leader.



When can I use it?

- Managers recognise that employees may have different yet effective ideas.
- The knowledge and skill base of staff are valued as part of the culture within the organisation.
- Managers are seeking to motivate staff and encourage a form of ownership over their work.
- Encouraging employees to become empowered.



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Delegative leadership

This style of leadership is also known as free-rein leadership. The leader allows the employees to make decisions. Given this, not all decisions then become the responsibility of employees. The process of effective delegative leadership involves a clear understanding between leaders and employees over who can make what decisions.



When can I use it?

- Employees have the relevant knowledge and skills to make the decisions.
- Managers trust the ability of employees to make the right decisions.
- Managers are seeking to motivate staff and encourage a form of ownership over their work.

An effective leader makes use of all three leadership styles. The most appropriate choice of style is dependent upon the knowledge and skills of staff, the extent of the decision being made, the time available and the existing personal relationship between the leader and staff.



Activity 19.1

For each of the following scenarios, propose an appropriate leadership style and list two reasons for this suggestions:

1. Bianca leads a group of seven employees, mostly new university graduates. She has a stable relationship with her staff and feels that they can work unsupervised. Bianca does feel, however, final decisions must be checked by her before implemented.
2. John manages a small business that is going through considerable change.
3. Teagan leads a team of responsible and able employees who are aware of their extent to make decisions within the workplace.

Job design

Job design is that function of human resource management where managers develop and specify the work activities of individuals or groups within the business environment. It involves the process of determining the type of tasks an employee will complete within the workforce.

Job design is a key strategy of human resource management.

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Job rotation

Where an employee is moved through a variety of tasks so as to increase their individual skill development and minimise boredom associated with repetitive tasks.

What are the objectives of an effective job design?

The objectives of effective job design seek to meet the needs of the business and the employee, hence its relevance as a key strategy in human resource management. When designing the nature of the task itself, management must consider the needs of the business. The task must be developed in a manner that will allow the employee to work to achieving the organisation's objectives.

Job satisfaction and enrichment are two key concepts that extend from the process of job design. Job satisfaction refers to the extent to which employees are satisfied working in their current position within the business, while job enrichment seeks to make use of employee's talents and abilities within the workplace. Human resource managers should seek to develop a job design that satisfies the employee's personal and workplace requirements. Job enrichment allows a business to develop tasks with the abilities of existing staff in mind. The task may also challenge the employee through increased problem-solving situations, thereby enhancing their skill development. Job enrichment reduces the boredom associated with many types of work. Effective job design often leads to increased productivity and efficiency within the workforce through increased job satisfaction. This can also be achieved through **job rotation**.

Activity 19.2

Using the four key considerations in developing a job design, create a job design for a fast-food store that is due to be opened. In your response you should focus on the role of employees.

Table 19.1 What must be decided during the job design process?

Who does the job?	• The business examines the characteristics of its workforce. The emotional and physical characteristics of the workforce must be considered, along with the skills and qualifications of employees.
What needs to be done?	• Managers determine the task that needs to be completed. This is generally a broad concept, without specifying individual procedures involved in the task.
Where the task must be completed?	• Managers must consider the physical elements of the business and consider the most appropriate area of the plant for the employee to complete their tasks.
When to complete the task?	• Depending on the nature of the task, employees are often working to deadlines. Managers must consider appropriate lead-in times to provide employees with sufficient time to complete the task.
How to complete the task?	• Managers must determine the individual processes involved in completing the task. This process involves the breaking down of the task into more simplified stages. Employee input into this process is often regarded as a valuable source of job satisfaction.

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Recruitment

Recruitment is a fundamental aspect of human resource management. It is that strategy whereby management seek to employ an individual for a vacancy that exists within the organisation.

Once the decision to recruit is made, an analysis of the job to be done must be completed. This is so that the selectors know what skill characteristics applicants must possess, what qualities and attitudes are desirable and what characteristics may act as a disadvantage.

Recruitment may be completed internally or externally.

Internal recruitment occurs when the position is filled by existing employees within the business.



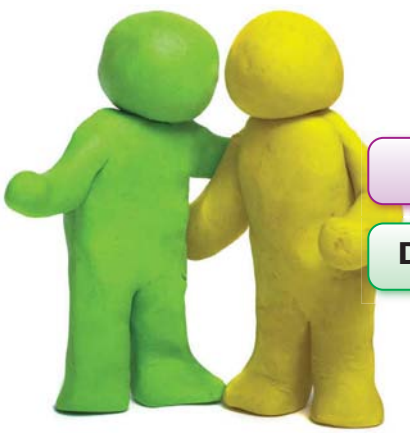
Benefits

Incentive for staff to improve their performance, promotions as seen as a reward for effective work, employee has existing understanding of the culture within the business.

Disadvantages

Staff overlooked for the position may lose motivation, the business may be denying itself new ideas by recruiting internally.

External recruitment occurs when the position is filled by an individual who has not yet worked for the business.



Benefits

Business is encouraging new ideas, new employee is not aware of existing issues within the business.

Disadvantages

May take time for the new employee to settle into the organisation, resentment from existing staff.

Some issues for the business to consider in the recruitment process:

- The need to replace staff must always be examined carefully. Management must consider if it able to spread the workload over existing employees. This has the benefit of upskilling existing employees and cost savings for the employer as the former staff member is not replaced.
- Given the complexities involved in human resource management, businesses should consider if the use of specialised recruitment firms are more relevant to their needs. This may allow a greater degree of expertise to be used in the recruitment process.

Activity 19.3

Management of a business has recently appointed an external candidate for a senior business within the firm. This has caused considerable resentment amongst existing internal staff who applied for the position. Advise management on the benefits of recruiting external candidates and examine possible reasons why external recruitment may cause further problems within an organisation.

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Formal training

When an employee takes on a role similar to students within the organisation and are shown how to apply themselves to the new operations of the business, then later assessed on their level of understanding.

Informal training

When an employee is either shown or modelled the correct skills through the use of a coach or mentor, or learning the work on the job.

Training and development

Training and development are an essential component to any successful business. They are the means by which a business is able to provide its employees with an avenue to develop and enhance their knowledge, skills and understanding of various activities related to the operations of the business. Effective training and development allow a business to successfully manage changes within its internal or external environment. An example of this would be operating new machinery. Training may take place through formal or informal means. **Formal training** involves employees taking on a role similar to students within the organisation. They are shown how to apply themselves to the new operations of the business and are later assessed on their level of understanding. Examples include lectures, seminars, trainee and apprentice schemes and external courses. **Informal training** occurs where the employee is either shown or modelled the correct skills. It could simply be through the use of a coach or mentor, or learning the work on the job. Training and development also provide employees with an opportunity to acquire the skills and experience they will require if they are to be promoted within the organisation or secure a position with another employer.

Induction

Induction is the process of providing new employees with the knowledge and skills necessary to ensure they are familiar with the organisation and day-to-day operations of the business. Essentially, it is a training program for new employees of an organisation or employees new to a position within the firm to quickly improve their productivity. It is also a common form of training within a business. Most induction programs provide employees with some history of the organisation and an overview of company policies (including policies concerning equal employment opportunity and occupational health and safety), work rules, codes of conduct and the employer's expectations. Employees are notified of leave arrangements, their starting and finishing times, appropriate dress codes and matters relating to union membership and grievance handling procedures. New employees may be assigned mentors, who are established employees within the business and will act as guides or points of reference for the new employee.

Activity 19.4

For each of the benefits described below, identify whether it is provided by training and development or by induction:

- improves employees' skills
- encourages an improved awareness of the organisation's practices
- provides the business with the human skills to move into new markets
- helps employees to seek promotional opportunities with their current employer or a different organisation
- makes employees aware of dispute resolution procedures
- provides new employees with mentoring from other employees in the organisation
- allows the business to constantly improve its operations.

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Performance management

Performance management refers to the process of recognising the efforts and contributions of employees to their work. It involves an ongoing process of communication between a supervisor and an employee based on achieving the objectives of the business and the goals of the employee. The communication process would include the following aspects:

- the clarification of expectations
- the setting of employee workplace objectives
- providing feedback
- evaluating employee performance.

The benefits of performance management:

- the employee has an improved understanding of how their role contributes to the success of the business
- the employee has a clear understanding of what needs to be done to be successful on the job
- the employer is able to identify any problems early, and assist the employee with improving their performance
- performance review and improvement is ongoing and allows the employee to be continually aware of their own personal goals and that of the business
- performance management cycle
- reviewing performance and providing feedback to employees is not an isolated event.

Performance management is an ongoing process that can be described through three key stages:

1 Planning.
2 Checking-in.
3 Assessment.

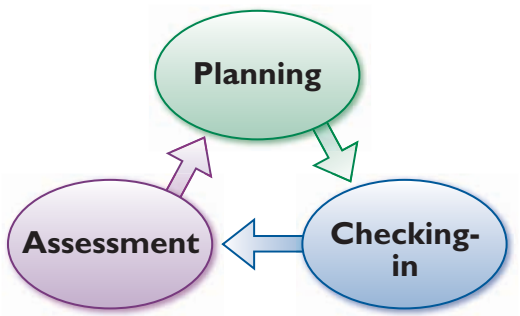


Figure 19.2 The performance management cycle.

Stage one: Planning

This is the first stage of the performance management cycle and is focused on goal-setting:

- Expectations are developed between the employer and the employee regarding what tasks should be completed in the role and how the task should be completed.
- Goals are established between the employer and the employee. These goals must be realistic and achievable. The employee should also know that these goals can be exceeded. The goals may be expressed in terms of quantity, cost, quality or overall employee performance.

Stage two: Checking-in

Once the performance objectives have been established, an employer should regularly observe an employee's performance to provide feedback. Management have a key responsibility to recognise and reward strong achievement and encourage improvement where needed:

- Improves communication between the management and employees.
- Increases employee motivation through recognition and rewards.
- Assists the employee to achieve performance objectives.

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Financial rewards
Rewards given to employees that involve an additional monetary payment beyond their minimum legal entitlements.

Stage three: Assessment

Assessment is the final stage of the performance management cycle. It is the process of measuring the employee's performance against the objectives established in the planning stage:

- Discuss employee accomplishments, their view on the current position, possible areas of improvement, and suggested changes to the task.
- Examine results against business and industry benchmarks.
- Suggest possible reasons for the achievement or non-achievement of goals.
- Develop new goals with changes to be implemented.

Activity 19.5

1 Identify the three stages of the performance management cycle.
2 Briefly describe why this structure is ongoing.

Rewards

An effective and efficient employment relations structure is one that incorporates the means to motivate all employees to work to their potential and cooperate with each other to achieve the goals of the business. Employees are often rewarded for their efforts through financial payments. Businesses are recognising that employee performance is also improved by providing employees with non-financial rewards. Many businesses use a combination of financial and non-financial rewards. It is important to note that some benefits that employees receive from their employer are actually a part of their legal entitlements and should not be seen as rewards. These benefits include the 9% superannuation contribution, sick and annual leave provisions and holiday loading.

Financial

Financial rewards are the most common system of rewards used in the workforce.

Financial rewards are additional monetary payments that are given to employees and are beyond the employee's minimum legal entitlements.

BUSINESS BITE

The Commonwealth Bank is one of many Australian companies who have successfully adopted an employee-share acquisition plan as a key strategy in its provision of financial rewards to its employees. Shares up to the value of $1000 will be distributed by the bank to its employees should the bank achieve at least 5% profit growth or 2% profit growth plus the consumer price index (whichever is greater) compared with the previous year. Such is the success of the plan that more than 26 000 of the bank's 31 000 employees choose to participate in it.

Non-financial

Not all employees would be motivated to put greater effort into their work in return for increased financial rewards. Some employees are motivated by other benefits associated with the job itself or working for the company. Non-financial rewards can be categorised as fringe benefits, status-related benefits and intrinsic rewards.

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Figure 19.3 Financial rewards.



Figure 19.4 Non-financial rewards.

Individual or group

Across many businesses in Australia today, employees are placed by managers in work teams. These teams, or groups, share similar goals and job descriptions.

Rewarding performance based on group achievement has a number of benefits:

- encourages a greater sense of team work
- employees become more motivated as they are working not only for themselves, but also for others
- improves communication between staff.

However, the process of rewarding performance based on group achievement may act as a detriment to the business as:

- not all employees may apply equal effort to the work process
- employees may have different personal goals that do not become recognised through team achievement
- conflict may occur within the group, restricting the ability of individual performing employees to be recognised.

Performance pay

Performance pay refers to the process of linking part of an employee's income to their performance at work. As the employee reaches targets and demonstrates improved performance, they will be rewarded through increased pay. This concept of performance recognition believes that employee motivation is derived through increased financial benefits.

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What are the benefits of performance pay?

Benefits of performance pay are:

- financial rewards are often a key motivator for employees. Performance may improve as employees are encouraged to work more effectively
- good employees are attracted to work for the organisation as they may regard performance pay a measure of their successful work attributes
- it encourages unmotivated and inefficient individuals to improve their performance.

Disadvantages of performance pay:

- there are many occupations where the performance of the employee is considerably influenced by external factors such as the attitudes of consumers, health and cultural concerns and general economic conditions and the performance of employees may be difficult to measure
- possibility of conflict may emerge due to the process of measuring performance
- performance pay assumes individuals are motivated by money, whereas some employees may simply seek non-financial rewards as their form of recognition.

Global

Cost, skills, supply

The environment in which Australian businesses compete is rapidly changing. More companies are entering international markets by exporting their products overseas, building production facilities in other countries and making use of foreign labour for technical expertise and cost savings.

Some businesses will want to employ labour that already has the skills it needs. Access to a cheaper workforce that possesses the required skills will be a key consideration for a business. A manufacturing business may want to hire low-paid scientists for new product development. A clothing company will need to hire a large number of workers who can operate sewing machines and work on a production line. An Australian business can redirect inquiry phone calls to a call centre in New Delhi, India. The calls will be answered in English by well-educated Indian employees who are paid less than their Australian equivalents.

A global business will have to balance the opportunity to reduce costs by accessing cheap labour against the cost of training labour with the skills required by the business. The ability of labour to learn new skills will be affected by the country's education system. Some governments are investing a significant amount of money into education to create a highly skilled but still cheaper workforce to attract foreign direct investment. One such country is India, where university graduates are providing a valuable source of less-expensive employees for the IT and electronics industry.

Workplace disputes

Dispute resolution processes

The process of resolving an industrial dispute can often be complex. It depends on the willingness of stakeholders to cooperatively work together to reach a settlement where all parties are satisfied with the final outcome. When a dispute first

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emerges, all stakeholders must be notified. Employees may be informed that their work practices are either inappropriate or not consistent with the expectations of the business or the employer will be informed that its staff has concerns regarding operational issues within the business. The culture and attitudes of management in responding to a dispute is crucial in determining the processes used to resolve the dispute. Some managers may be hostile to employees, displaying an unwillingness and reluctance to acknowledge the concerns of their staff. Other managers will adopt a more behavioural approach, listening to staff concerns and providing some feedback as to possible solutions to the dispute. The business adopting the autocratic style is likely to encounter more problems in resolving the dispute and may not have direct control over the final outcomes, as the dispute may be resolved by a government organisation whose decision is legally binding on all parties. The process of resolving an industrial dispute is outlined within the grievance procedure policy of the organisation.

It can be argued that, by their very nature, the interests of employers and employees conflict. Employers will seek to use the services of labour at the lowest possible cost, while employees will attempt to gain the best possible income and working conditions. Providing working conditions that meet the expectations of employees can often come at a high cost to a business. Other issues such as rostering leave entitlements, promotions and occupational health and safety can also cause conflict in the workplace.

A **grievance** is a dispute between parties. Many businesses have developed a grievance procedure policy, which outlines the process for resolving grievances in the workplace. It will specify the **grievance procedures**, which are the rules and procedures that employees, unions and employers must follow in order to resolve a dispute. Developing a grievance procedure policy for use in the employment relationship has many benefits. For instance, the policy:

- provides a clear outline of the issues that are regarded as workplace grievances
- illustrates the correct and appropriate processes to use when raising a complaint
- provides a mechanism that can be used to achieve a quick resolution of disputes.

When a dispute emerges some employees may feel the need to notify their trade union representative. Unions will inform employees of their legal rights and obligations in relation to the dispute. The union is also likely to offer assistance to employees to meet with management to seek a resolution.

Negotiation

The first stage in the process of dispute resolution is negotiation. Negotiation involves a discussion between both parties in an attempt to resolve the dispute. As discussed earlier, the attitudes of management in acknowledging the nature of the dispute and being prepared to listen to the concerns of employees is crucial at this stage in the resolution process. **Collective bargaining** is the common term used to describe negotiations over workplace disputes within an organisation. Depending on the nature of the dispute and the ability of managers to deal with the particular grievance, an employer association may also be called on to assist the employer

Grievance

A dispute between parties.

Grievance procedures

The rules and procedures that employees, unions and employers must follow in order to resolve a dispute.

Collective bargaining

The common term used to describe negotiations over workplace disputes within an organisation.

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with negotiations. The matter may be complex and the business may lack the necessary skills and staff expertise to handle the dispute appropriately. It is likely that a small to medium business with a small, or possibly no, human resources department will seek assistance from its employer association. Larger businesses are often able to employ experts in industrial relations law to deal with disputes.

Mediation

As it is often the employer and the employee who are in dispute, they may find it confronting to work with each other in attempting to reach a settlement. In some cases an independent party with no ties to either stakeholder may be requested to assist the conflicting stakeholders to reach a settlement. This party could suggest ideas or present issues in an alternative way. This process of resolution is known as **mediation**.



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Conciliation

Conciliation is an important part of the dispute resolution process. Should the parties to the dispute not be able to reach a settlement through negotiation or mediation, Fair Work Australia will be notified and requested to assist with a resolution. Fair Work Australia's role here is assist stakeholders in reaching an agreement where all concerned parties are satisfied with the final outcome. It will adopt a very similar approach to mediation. However, the conciliator will be from Fair Work Australia itself. When Fair Work Australia requests both parties attend conciliatory meetings, each party has a legal obligation to do so. While all parties must make every reasonable attempt to reach a settlement, the conditions of the agreement are not legally binding.

Arbitration

Arbitration is the final stage of the dispute resolution process. When a dispute reaches arbitration it is clear that the parties have not been able to reach an agreement and that some degree of hostility still exists. During the process of arbitration, lawyers representing the disputing parties will present their case to Fair Work Australia. This organisation will evaluate the arguments presented and reach a final decision. This decision is legally binding on all parties.

Mediation

Occurs where an independent party with no ties to either stakeholder is asked to assist the conflicting stakeholders to reach a settlement.



Figure 19.5 Mediation assists in reaching outcomes that will satisfy all stakeholders.

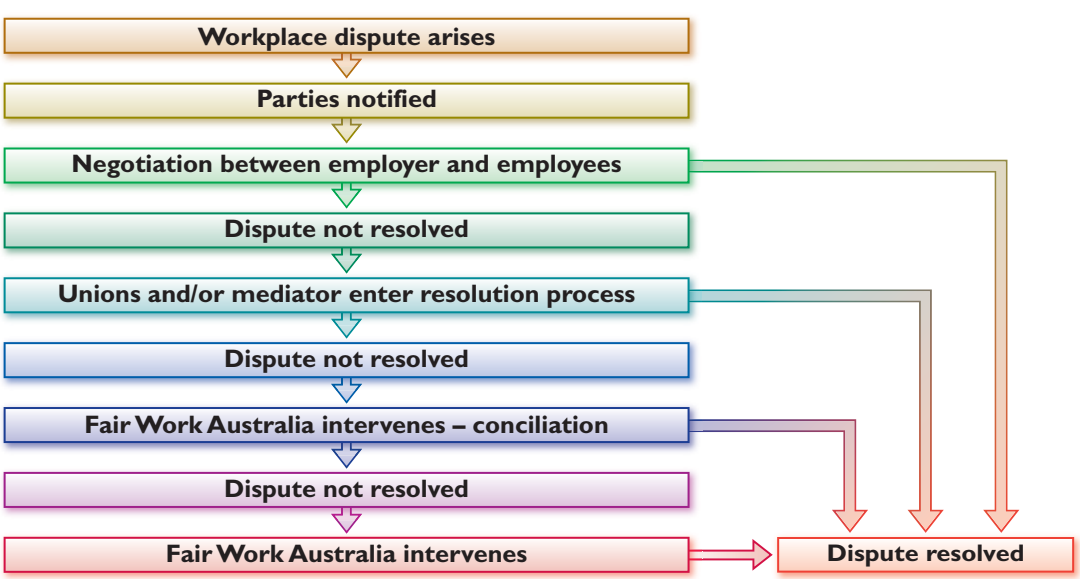


Figure 19.6 The dispute resolution process.

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Chapter summary

- There are three styles of leadership within a business:
  - authoritarian: managers lead based on the view that they are responsible for telling their employees what they want done and how to accomplish the task
  - participative: involves the leader including one or more employees in the decision-making process
  - delegative: the leader allows the employees to make decisions.
- Job design is that function of human resource management where managers develop and specify the work activities of individuals or groups within the business environment.
- Job satisfaction refers to the extent to which employees are satisfied working in their current position within the business.
- Job enrichment seeks to make use of employee's talents and abilities within the workplace.
- Job rotation is where an employee is moved through a variety of tasks so as to increase their individual skill development and minimise boredom associated with repetitive tasks.
- Recruitment is that strategy whereby management seek to employ an individual for a vacancy that exists within the organisation.
- Internal recruitment occurs when the position is filled by existing employees within the business.
- External recruitment occurs when the position is filled by an individual who has not yet worked for the business.
- Training develops employees' skills and knowledge. It can be formal or informal.
- Induction is the process of providing new employees with the knowledge and skills necessary to ensure they are familiar with the organisation and day-to-day operations of the business.
- Performance management involves an ongoing process of communication between a supervisor and an employee based on achieving the objectives of the business and the goals of the employee.
- Performance management involves three key stages: planning, checking-in and assessment.
- Financial rewards are given to employees that involve an additional monetary payment beyond their minimum legal entitlements.
- Some employees are motivated by other benefits associated with the job itself or working for the company. These are referred to as non-financial rewards.
- Rewarding performance based on group achievement has a number of benefits, including encouraging a greater sense of team work and improving employee motivation and communication between staff.
- The process of rewarding performance based on group achievement may act as a detriment to the business as not all employees may apply equal effort to the work process and individual members within the team may have different goals.
- Performance pay refers to the process of linking part of an employee's income to their performance at work.
- The location of skilled and unskilled labour will impact on the global business's decision about where to locate. It may wish to take advantage of cheap labour offered in developing countries.

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- A grievance procedure policy outlines the process for resolving disputes that may occur within the employment relationship.
- Negotiation involves a discussion between disputing parties in an attempt to resolve the dispute. It seeks to reach a settlement where all parties are satisfied with the outcome.
- Mediation involves the use of an independent third party seeking to assist the disputing stakeholders reach a common settlement.
- Conciliation occurs when the AIRC acts as a mediator in a dispute. In some cases, arbitration may be required. The outcome of arbitration is legally binding on all parties.

Chapter revision task

Create a mind map that outlines the main features of each leadership style used by business. Write a report to employees outlining the benefits of performance management structures. In this report explain the processes involved in greivance procedures for disputes between employees and employers.

Multiple-choice questions

1 Which of the following is a benefit to a business if managers lead using a participative style?
- **(A)** Employees may work more effectively as they are encouraged to take greater ownership over their work tasks
- **(B)** Employees are required to work with increased supervision due to the complexity of the task
- **(C)** Managers empower staff through clear lines of authority and decision-making channels
- **(D)** Managers become less inclusive of employees thereby developing stricter codes of conduct within the business

2 Which of the following best describes the concept of job enrichment?
- **(A)** Staff are moved from one task to another in order to increase variety and interest
- **(B)** Staff are paid increased amounts of money for completing their required task
- **(C)** A program through which management encourage productivity from employees
- **(D)** A program through which employees work with greater responsibility

3 Theton is a leading distributor of home entertainment products across Australia. Management have appointed an existing employee for a newly-created position within the organisation. Which of the following is a benefit of this form of recruitment?
- **(A)** The employee may bring new ideas to the business
- **(B)** Existing employees may become resentful
- **(C)** The employee lacks knowledge regarding the culture of the organisation
- **(D)** Existing employees may become more motivated

4 What benefits do training and development offer a business?
- **(A)** Provides employees with new skills
- **(B)** Encourages employees to seek promotions
- **(C)** Allows the business to diversify into new operations
- **(D)** Gives the business a better skilled and more efficient workforce

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5 A manager and an employee are in the process of establishing goals for a new task. Which of the following stages of the performance management cycle is described here?
   (A) Planning
   (B) Checking-in
   (C) Assessment
   (D) Goal-setting

6 Which of the following is a benefit of performance pay?
   (A) The performance of employees may be difficult to measure
   (B) Possibility of conflict may emerge due to the process of measuring performance
   (C) Some employees may simply seek non-financial rewards as their form of recognition
   (D) It encourages unmotivated and inefficient individuals to improve their performance

7 Why do businesses offer employees rewards?
   (A) To recognise the value of their efforts in the operations of the business
   (B) Because it is required by federal government legislation
   (C) To provide employees with an income to achieve a satisfactory standard of living
   (D) To minimise the possibility of industrial conflict

8 Which of the following issues is a main consideration for a business seeking to make use of foreign labour?
   (A) The economic conditions of the new country
   (B) Cultural factors impacting upon consumer trends
   (C) The ability to train and use technology
   (D) Language barriers

9 Along with the establishment of industrial tribunals, how else may governments influence the dispute resolution process?
   (A) By forcing employees to comply with the request of employers
   (B) By encouraging all stakeholders to reach a quick settlement
   (C) By passing laws influencing the dispute settlement process
   (D) By forcing parties to attend arbitration immediately upon a dispute arising

10 In the process of arbitration, the decision of Fair Work Australia is binding. What does this mean?
   (A) All parties must accept and follow the decision
   (B) Employers have the right to appeal the decision
   (C) The decision only serves as a guide in resolving the dispute
   (D) Employees are expected to abide by the ruling

Short-answer questions

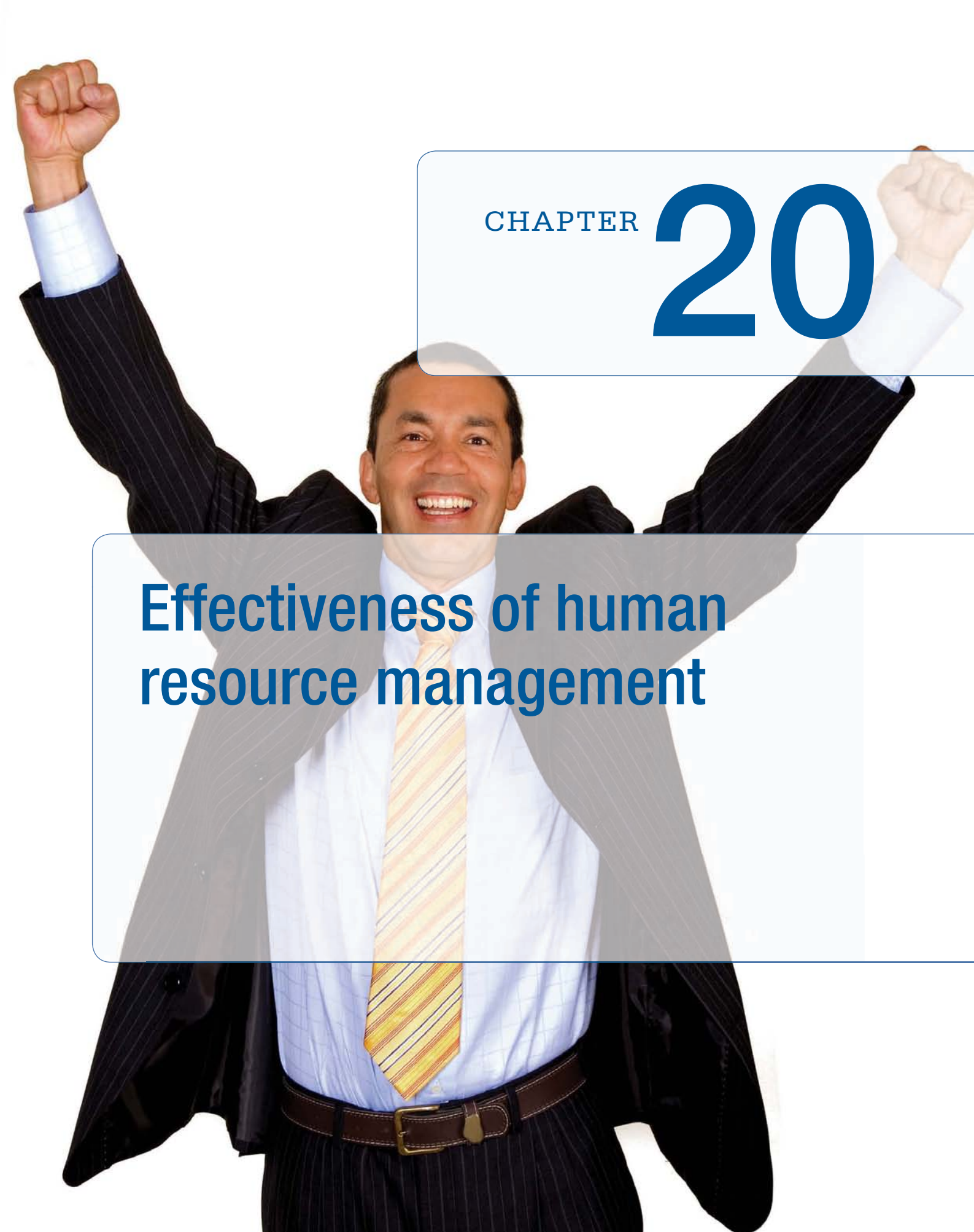
1 Outline the benefits to a business that has a grievance procedure.

2 Explain how leadership styles impact upon employee performance.

Extended-response question

Assess the role of rewards and training and development in effective performance management.

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CHAPTER 20

Effectiveness of human resource management

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Indicators

An effective human resource management function is one where management and employees work well together in their efforts to achieve the goals of the business. Also, the needs and interests of employees, as well as those of the business, are considered. The effectiveness of the employment relationship can be examined from a number of perspectives.

Corporate culture

Corporate culture refers to the culture within an organisation. It relates to the values and beliefs within a business and directly impacts upon the relationship between management and employees.

All successful businesses are able to translate their values and beliefs into actions. An effective corporate culture is one that is believed, demonstrated and acted upon by management and employees. In essence, it becomes the way staff perform their work.

Companies are encouraging employees to be more responsible and act and think like owners. They are also encouraging teamwork and the formation of teams, as a strong culture is one in which they work together effectively, share the same values, and make decisions to meet the organisation's primary goals and objectives.

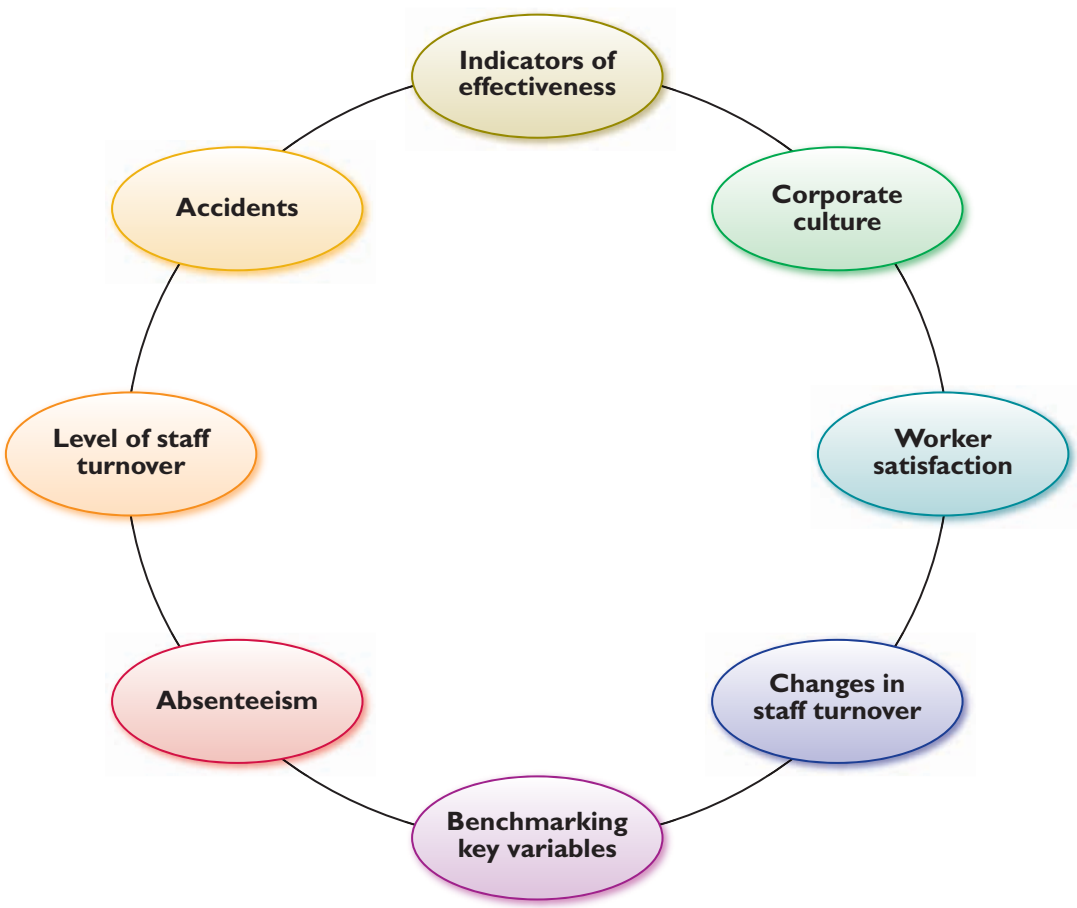


Figure 20.1 The effectiveness of the employment relationship.

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BUSINESS BITE

Our vision and values

*Westpac's **vision** is to be the leading financial services company in Australia and New Zealand. Putting the customer at the centre of everything we do will help achieve this goal.*

*We see our fundamental **purpose** as helping every customer achieve all their financial goals.*

*Our **ambition** is to earn all of our customers' business by delighting them with the service and support that we provide and by serving them as a single team. Our strategy focuses on customers in our core markets of Australia, New Zealand and throughout the Pacific, and is based on:*

- *developing a deep understanding of our customers' needs*
- *providing value-added solutions that seek to meet those needs*
- *deepening and building long-term customer relationships*
- *dramatically improving the experience they have with us.*

We have strong values, which are well embedded in our culture. We believe that the following values will help us deliver on our strategy:

One team

Working together as part of one team, keeping it simple and celebrating success.

Delighting customers

Knowing our customers and what matters most to them, being an advocate and creating powerful experiences to earn all our customers' business.

Achievement

Entails striving to be recognised as the best in our roles and rewarding those who step above their boundaries.

Integrity

Means earning the value and trust of our colleagues, honoring commitments and doing the right thing for our business and our community.

Valuing each other

Is about listening, showing respect for others and appreciating differences.

Source: www.westpac.com.au/about-westpac/the-westpac-group/company-overview/our-vision-values

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Absenteeism

An employee being unable to attend work for reasons such as illness or family responsibilities.

Benchmarking key variables

Benchmarking is the process of measuring an employee's performance against established standards. The benchmark for a manufacturing firm, for example, may be set at 100 units of a good made per week by each employee, with zero defects. These standards are often set by businesses that are regarded as leaders within their industry. Benchmarking is a form of control in an organisation. If employees are unable to meet performance goals on a regular basis, it will be clear that management must examine why this is occurring. The reason may be a lack of motivation or that the staff are not adequately trained.

Changes in staff turnover

Staff turnover refers to the rate at which employees leave a business. As discussed earlier, some employees leave their employment voluntarily to seek employment opportunities elsewhere or to retire. Others, however, are forced to leave owing to their misconduct or the need for retrenchments. A high level of staff turnover caused by voluntary separation is indicative of poor employment relations within a business. Employees are expressing their dissatisfaction by leaving. This dissatisfaction could arise from the culture of the business, management styles or the lack of acknowledgment and input that should be available to employees. High staff turnover is costly to a business. Costs are incurred through paying out a leaving staff member's entitlements, advertising a position, conducting a selection process and training the new staff member. Additional costs will also be incurred through such factors as the loss of the employee's experience and knowledge. Businesses also face the possibility of losing experienced and highly skilled staff to their competitors.

Absenteeism

Absenteeism refers to an employee being unable to attend work for reasons such as illness or family responsibilities. In Australia most employees receive full pay for up to 12 sick days per year. While most employees are absent for medical or family reasons, some employees use 'sick days' to express their dissatisfaction at the workplace. Employees may choose not to attend work on days when various events (such as meetings and training and development programs) are being held. Absenteeism is costly as it means that an employee's work is not done. This places additional demands on existing staff and may cause even greater hostility within the workplace. Absenteeism costs businesses more than $2.5 billion annually. The costs relate to needing to pay employees while they are off work, having to pay others to complete the absent staff member's work (either overtime payments to other staff or payments to a casual replacement brought in temporarily) and possible production losses.

Level of disputation

Disputes at a workplace reflect an unhappy workforce. The level and seriousness of the disputes and the frequency with which they occur indicate the extent to which employers are successfully managing the employment relations function. Obviously, the more disputes there are in a workplace, the less effective management is in managing the employment relations function. Employers would need to examine why the disputes are occurring and rectify the practices that cause disputes.

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Accidents

It is inevitable that within any organisation, human error may occur. Regrettably this error may result in concerns relating to occupational health and safety arising. Workplace accidents occur across all Australian workforces and may range from minor concerns such as cuts and bruises to more serious issues including permanent physical damage and death.

All workplaces across Australia must be aware of potential hazards. Management must then implement strategies to either eliminate or reduce these hazards. Effective human resource management ensures that occupational health and safety within a business is paramount.



Figure 20.2 Workplaces across Australia must be aware of potential hazards.

Worker satisfaction

Worker satisfaction is used to describe whether employees are happy and contented and fulfilling their desires and needs at work. Satisfied employees often work more efficiently and value the organisation that they work for. This concept of loyalty is reflected through happy employees who enjoy their work and co-exist within productive relationship with their supervisor.

Activity 20.1 Cloze

Rewrite the following passage, using the words listed in the box below to fill in the blanks.

five	management	work	leave
unhappy	employees	measuring	frequency
motivation	standards	best	against
dissatisfaction			

The effectiveness of the employment relationship can be examined from _____ key perspectives. Staff turnover refers to the rate at which employees _____ a business. High levels of staff turnover can be a result of voluntary separation. This would be indicative of poor employment relations within the business. _____ express their dissatisfaction by leaving the business. Some employees use 'sick days' to express their _____ at the workplace. Employees may choose not to attend _____ on days when various events (such as meetings and training and development programs) are being held. Disputes at a workplace reflect an _____ workforce. The level and seriousness of the dispute and the _____ with which they occur reflect the extent to which management is successful in dealing with the employment relations function. Quality refers to the extent to which employees are working to the _____ of their ability. It includes their attitudes and _____ and the level of effort placed in performing tasks. Benchmarking is the process of _____ an employee's performance _____ established standards. If employees are unable to meet these standards on a regular basis, it is clear that _____ must examine the reasons for this.

An effective human resource management structure will implement strategies to measure worker satisfaction. Based on the results of the data, management must then examine methods to improve worker satisfaction. This could range from a simple issue such as improved dining facilities to more long-term matters such as leadership styles.

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Chapter summary

- There are seven perspectives from which a business may measure the effectiveness of its employment relationship: staff turnover, absenteeism, level of disputation, benchmarking of key variables, accidents, corporate culture and worker satisfaction.
- Corporate culture refers to the culture within an organisation. It relates to the values and beliefs within a business and directly impacts upon the relationship between management and employees.
- Benchmarking is the process of measuring an employee's performance against established standards.
- A high level of staff turnover caused by voluntary separation is indicative of poor employment relations within a business. Employees are expressing their dissatisfaction by leaving.
- While most employees are absent for medical or family reasons, some employees use 'sick days' to express their dissatisfaction at the workplace.
- The level and seriousness of the disputes and the frequency with which they occur indicate the extent to which employers are successfully managing the employment relations function.
- Worker satisfaction is used to describe whether employees are happy and contented and fulfilling their desires and needs at work.
- All workplaces across Australia must be aware of potential hazards. Management must then implement strategies to either eliminate or reduce these hazards. Effective human resource management ensures that occupational health and safety within a business is paramount.

Chapter revision task

Create a mind map based on the key measures of effective human resource management. For each measure of effectiveness, define the measure and explain how it is used to assess human resource management effectiveness. List two benefits and two issues of concern that each measure may result in.

Multiple-choice questions

1 A business characterised by low levels of staff turnover would also have which other features of the employment relationship?

(A) High levels of employee satisfaction and low productivity
(B) Regular industrial disputes and poor worker morale
(C) High levels of productivity and good worker morale
(D) Low levels of employee satisfaction and irregular industrial disputes

2 Which of the following causes high staff turnover?

(A) Employees moving to other positions in the organisation
(B) Effective induction and training and development programs
(C) Autocratic management styles with minimal worker participation
(D) Implementation of flexible working conditions

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3 A group of employees have decided to put minimal effort into their work in direct protest against management's decisions to not upgrade lighting. Which measure of effectiveness could management use to determine the employees' response?
(A) Absenteeism
(B) Level of staff turnover
(C) Quality
(D) Benchmarking

4 Which measure of effectiveness clearly demonstrates problems in the employment relationship?
(A) Benchmarking
(B) Disputation
(C) Absenteeism
(D) Quality

5 Which of the following best describes the role of corporate culture within an organisation?
(A) The values within a business that are reflected through management behaviour and policies
(B) The values within a business that employees are expected to abide by
(C) The values within a business that all stakeholders are expected to follow
(D) The values within a business that are reflected through employee behaviour

6 Due a lack of concern regarding occupational health and safety, a number of employees have experienced workplace injuries. Which of the following indicators is reflected through this?
(A) Corporate culture
(B) Accidents
(C) Level of disputation
(D) Staff turnover

7 Which of the following would improve worker satisfaction within the workplace?
(A) Improved communication between employees and line managers
(B) Improved business profitability and reduced employee working hours
(C) Decreased labour costs and increased employee responsibilities
(D) Increased staff supervision and decreased work–life balance options

8 Ineffective staff training initiatives have seen employees in a business fail to achieve set sales targets for the past two months. Which indicator is this reflective of?
(A) Benchmarking of key variables
(B) Level of absenteeism
(C) Corporate culture
(D) Worker satisfaction

9 Management of a business are becoming increasingly concerned with the number of days of leave staff have been taking. Which indicator is this reflective of?
(A) Benchmarking of key variables
(B) Level of absenteeism
(C) Corporate culture
(D) Worker satisfaction

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10 Which of the following would improve the ability of staff to reach benchmarked standards within a business?

(A) Improved training and development strategies
(B) Decreased channels of communication within the business
(C) Increased monetary rewards
(D) Decreased promotional opportunities for junior staff members

Short-answer questions

1 Explain the importance of a strong and positive corporate culture to the success of a business from a human resource management perspective.

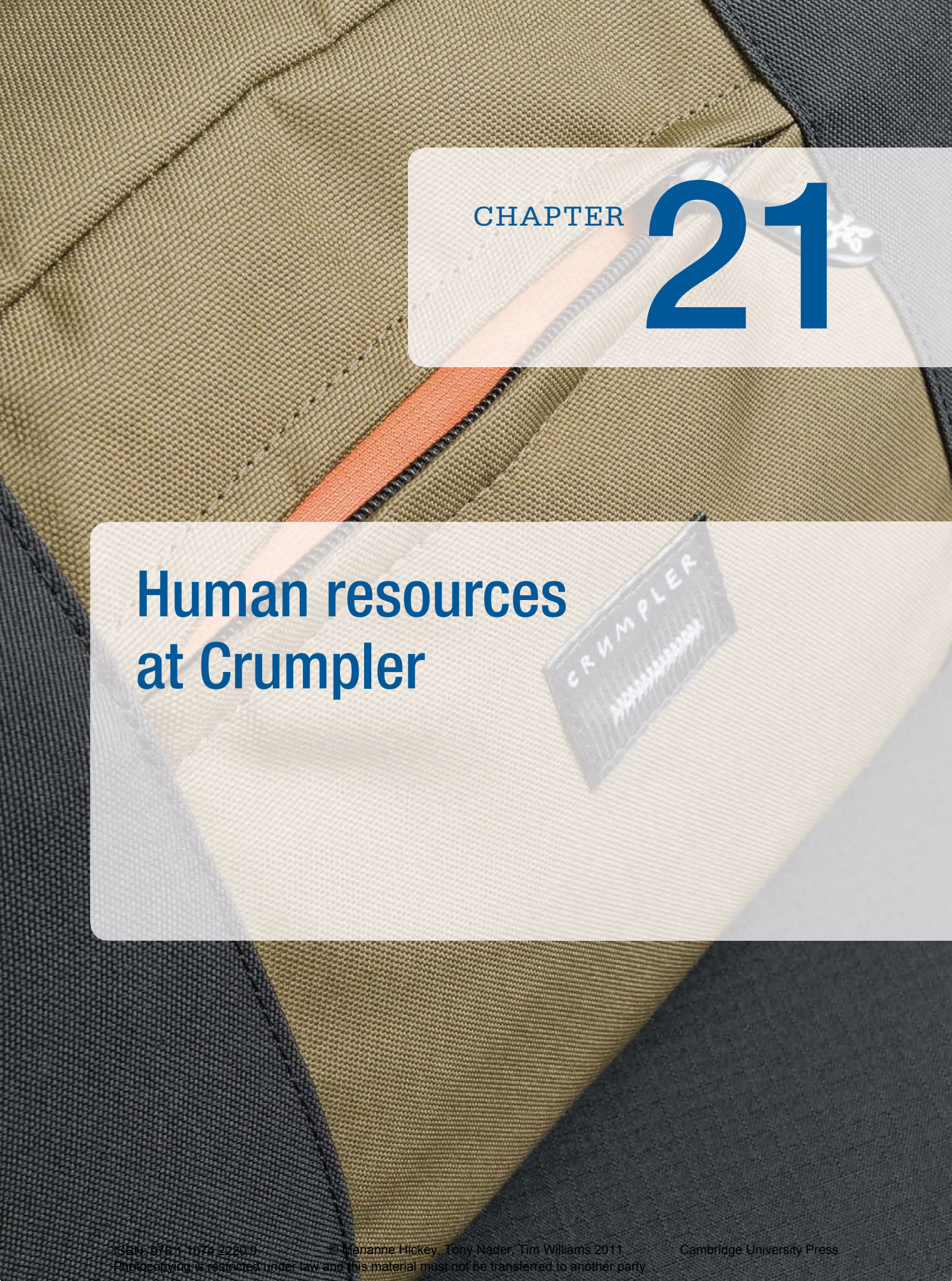
2 Describe how staff absenteeism may not be a key indicator of effective human resource management.

Extended-response question

Identify the importance to a business in examining indicators of effective human resource management and explain the role of each indicator in human resource management.



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CHAPTER 21

Human resources at Crumpler

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Introduction

Crumpler may have started as a three-man operation, but its success meant that it quickly grew to become a business with staff and employees. And like any business, it needs to manage its workforce, recruit and train staff, handle disputes and pay its employees. Like many businesses of its size, Crumpler has simpler and fewer human resource management requirements than a large company, but still must dedicate time and resources towards managing and working with staff.

The strategic role of human resource management

Crumpler is considered to be a small business. It has a workforce of approximately 20 full-time employees, as well as around 45 casual sales and warehouse staff. Given its size, it doesn't have a specific human resources department. Instead, the role of human resource management is conducted by senior management within the business.

Management

Recruitment, training and development and separation of staff is the responsibility of Will Miller, Dave Roper and Sam Davy (Crumpler's General Manager). These three individuals liaise with each other regarding the human resource needs of the business.

Position design

Crumpler management conceive and design positions to fill within the business based on its developing needs. Changing trends and technologies in design naturally bring a demand for new skilled staff, while marketing and retail staff are hired to meet increased demand from the market. Production and manufacturing staff are not required.

Outsourcing

Crumpler bags are manufactured in China. It is the responsibility of these foreign contractors to deal with their own human resource issues. All other aspects of Crumpler's business operations are handled by in-house Crumpler staff.

Key influences

Stakeholders

Crumpler is a member of the Australian Retailers Association. This is one of Australia's leading employer associations. It was originally founded in 1903 as the Master Retailers Association of NSW, and over more than 100 years has expanded to a national association that protects the interests of over 5000 independent and national retailers.

The ARA provides members like Crumpler with a number of services, such as business consulting, policy development, advocacy to government bodies and education. The ARA values are integrity, excellence, guardianship and respect.

For its part, Crumpler agrees to abide by ARA policies and codes of practice in areas such as privacy, fair dealing and business regulation. Among other things, this means that Crumpler agrees to make honest and accurate environmental claims in its advertising and marketing, follow the ARA's Code of Fair Trading when dealing with customers, and follow appropriate Occupational Health and Safety standards in

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the workplace. Complying with this policies allows Crumpler to remain stakeholders in the ARA and benefit from its services.

Economic influences

While some other businesses have been forced to reduce the size of their workforce due to the global economic slowdown, the management of Crumpler have not had to follow suit. Instead, they have invested heavily into resources at their headquarters and employed additional staff.

According to Dave Roper, the investment of hiring experienced, quality staff across the key areas of design, retail and marketing affects profits in the short term, but 'will pay handsome dividends into the future as we concentrate on developing new products and opening new stores'.

Technological influences

The relationship between Crumpler and technology is restricted to operations, design and production. Given Crumpler do not directly employee the staff who produce their bags, improvements in manufacturing technology have minimal impact on staffing or the business' workload, and they have never had reason to dismiss staff due to advances in technology.

Instead, management of the business have found that their staff benefit from technological advances, which can improve the productivity, efficiency and effectiveness of the workforce, such as when Crumpler acquired improved computer software programs to enhance the design process. This means that the influence of technology is almost always positive from a human resources perspective.



Processes of human resource management

Acquisition

Crumpler believes that acquiring good staff is an essential aspect to the success of the business. It is the responsibility of staff to design and sell the product – two ingredients for a successful business. Acquisition for Crumpler occurs through the traditional means of print media recruitment and, more recently, the use of online position advertising. Senior management shortlist and interview all full-time staff. Casual retail staff are recruited by the national retail manager.

One priority for Crumpler has been recruiting staff from different cultural and national backgrounds in order to get a wide range of perspectives and viewpoints and to lend variety and energy to their workplace.

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Training and development

Crumpler has no formal training program in place. However, staff are encouraged to seek training opportunities for subjects relevant to their day-to-day roles. This must be approved by senior management.

Maintenance

Each staff member is valued at Crumpler. Flexible working conditions are in place so that every employee has the chance to tailor their hours and conditions to their needs.

All full-time staff are entitled to bonus payments, subject to performance results throughout the year. A positive, friendly working environment also aids in staff maintenance. Full-time and casual staff come together each year for a national Christmas party, as well as smaller events and get-togethers in individual stores and offices. At one time, the business owners even considered putting a beer tap on every desk in the head office, leading to a giant keg in the basement!

In addition, all staff are entitled to generous discounts off the purchase price of Crumpler products, and each employee receives a free Crumpler bag (which they must use when at work).

Separation

Separation with staff at Crumpler is generally voluntary, and the business rarely if ever has disgruntled or unhappy employees. Management believe that by adopting a positive workplace culture based on the concept of fun, employees are less likely to leave the business. Casual staff members most often leave to pursue other opportunities.

Strategies in human resource management

Leadership style

Crumpler has successfully adopted the participative approach to leadership. All employees are encouraged to contribute their ideas and thoughts and take creative ownership of the business. The concept of fun is emphasised across all aspects of the human resource relationship. Rules and guidelines are in place, but are broad and flexible; the emphasis is on letting employees do their job with minimal interference.

Dave Roper said in an 2010 interview that 'we needed specific expertise to go forward, but we also just needed fresh ideas and new ways of doing things. Everyone has a say. It's been very invigorating for all of us, in terms of thinking about things in a different way'.

Disputes

Workplace disputes are rare at Crumpler, thanks to the participative approach and the positive working environment. When one does arise, it is usually due to concerns about workload or conditions. Disputes are settled within the company, rather than through external arbitration, through largely informal discussion with senior management, who seek to address all issues as soon as possible without resulting in more tensions.

At this stage, Crumpler management do not feel it necessary to precisely measure their effectiveness when dealing with staff, as the close working environment makes it clear as to whether disputes are settled and staff are satisfied.

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