JACARANDA

BUSINESS STUDIES IN ACTION

HSC COURSE | 6TH EDITION

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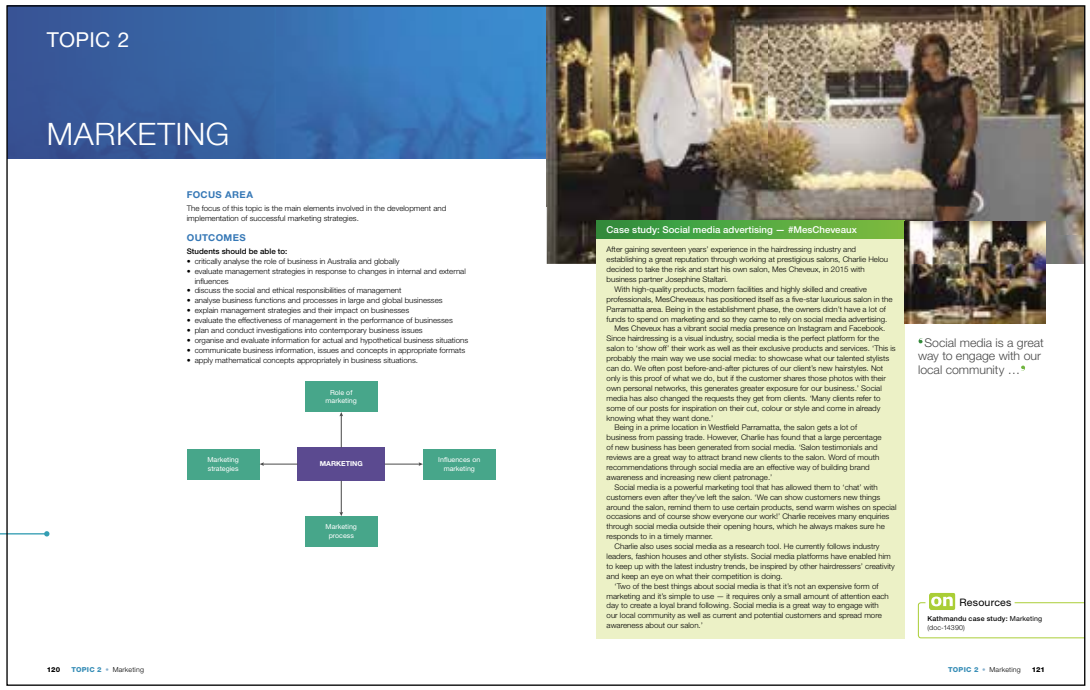
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HOW TO USE THIS BOOK

The following examples highlight the structure and main features of *Business Studies in Action HSC Course 6th Edition*. An electronic version of the textbook and a complementary set of targeted digital resources — the eBookPLUS — are available online at the JacarandaPLUS website (www.jacplus.com.au).

Each of the four topics has an opening double page that presents the focus area of the topic and lists the syllabus outcomes. A concept map allows students to visualise the key concepts in the topic. An engaging case study with photographs shows business in action.



TOPIC 2

MARKETING

FOCUS AREA

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

OUTCOMES

Students should be able to:

- critically analyse the role of business in Australia and globally
- evaluate management strategies in response to changes in internal and external influences
- discuss the social and ethical responsibilities of management
- analyse business functions and processes in large and global businesses
- explain management strategies and their impact on businesses
- evaluate the effectiveness of management in the performance of businesses
- plan and conduct investigations into contemporary business issues
- organise and evaluate information for actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats
- apply mathematical concepts appropriately in business situations.

Case study: Social media advertising — #MesCheveaux

After gaining seventeen years' experience in the hairdressing industry and establishing a great reputation through working at prestigious salons, Charlie Helou decided to take the risk and start his own salon, Mes Cheveux, in 2015 with business partner Josephine Staltari.

With high-quality products, modern facilities and highly skilled and creative professionals, MesCheveaux has positioned itself as a five-star luxurious salon in the Parramatta area. Being in the establishment phase, the owners didn't have a lot of funds to spend on marketing and so they came to rely on social media advertising.

Mes Cheveux has a vibrant social media presence on Instagram and Facebook. Since hairdressing is a visual industry, social media is the perfect platform for the salon to 'show off' their work as well as their exclusive products and services. 'This is probably the main way we use social media: to showcase what our talented stylists can do. We often post before-and-after pictures of our client's new hairstyles. Not only is this proof of what we do, but if the customer shares those photos with their own personal networks, this generates greater exposure for our business.' Social media has also changed the requests they get from clients. 'Many clients refer to some of our posts for inspiration on their cut, colour or style and come in already knowing what they want done.'

Being in a prime location in Westfield Parramatta, the salon gets a lot of business from passing trade. However, Charlie has found that a large percentage of new business has been generated from social media. 'Salon testimonials and reviews are a great way to attract brand new clients to the salon. Word of mouth recommendations through social media are an effective way of building brand awareness and increasing new client patronage.'

Social media is a powerful marketing tool that has allowed them to 'chat' with customers even after they've left the salon. 'We can show customers new things around the salon, remind them to use certain products, send warm wishes on special occasions and of course show everyone our work!' Charlie receives many enquiries through social media outside their opening hours, which he always makes sure he responds to in a timely manner.

Charlie also uses social media as a research tool. He currently follows industry leaders, fashion houses and other stylists. Social media platforms have enabled him to keep up with the latest industry trends, be inspired by other hairdressers' creativity and keep an eye on what their competition is doing.

'Two of the best things about social media is that it's not an expensive form of marketing and it's simple to use — it requires only a small amount of attention each day to create a loyal brand following. Social media is a great way to engage with our local community as well as current and potential customers and spread more awareness about our salon.'

'Social media is a great way to engage with our local community …'

on Resources

Kathmandu case study: Marketing (doc-14390)

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All HSC syllabus outcomes are covered in depth to provide a sound basis of knowledge to prepare students for HSC examination. BizWords, highlighted in the margin for easy reference, provide definitions of the bolded words in the text to build a comprehensive glossary. BizFacts present interesting and topical snippets of supplementary information to engage and extend students. 'Snapshot' case studies present profiles of a wide range of businesses and individuals, and the contemporary business issues they face.

BizWORD

Training *aims to develop skills, knowledge and attitudes that lead to superior work performance.*

Development *refers to enhancing the skills of the employee in line with the changing and future needs of the organisation.*

16.5 Training and development: current or future skills

Training aims to develop skills, knowledge and attitudes that lead to superior work performance. Training is critical in Australia today, as businesses report significant labour market problems, including a shortage of skilled labour, and a mismatch between what skills are needed and what is available. These problems act as a brake on investment, but can be overcome by business commitment to ongoing training.

Development is focused on enhancing the skills of the employee in line with the changing and future needs of the business. It also encourages employees to take advantage of opportunities to develop a career with the business. The business benefits by retaining the employee's experience and knowledge of the business, and by helping it maintain competitiveness.

SNAPSHOT



'… the best outcomes are achieved … when the organisation supports the employee's career planning.'

Case study: BDO Australia — career planning

Peter O'Sullivan is Head of People and Culture at BDO Australia.

In reality, careers often develop with little in the way of planning. For example, in professions or organisations where there are well-established career paths, people may progress through the ranks without understanding or considering the range of career options available to them. In other contexts where career paths are less clear, they may move from one role to the next in a reactive or haphazard fashion, without considering how each role helps equip them for a long-term career goal. This tendency to let careers just happen is reinforced when organisations see career planning and development as the sole responsibility of the employee.

At BDO, we recognise that the best outcomes are achieved for both parties when the organisation supports the employee's career planning. At the beginning of an accountant's career, this usually involves participation in a structured graduate program and supporting the employee through their studies towards their professional qualification. These are formative career years, and the investment by BDO and employee alike is significant.

Like most organisations, BDO has a formal process for performance appraisal and professional development planning, and our process involves six-monthly discussions and the documentation of short-term and long-term developmental and career goals. These discussions are significant signposts in the employee's career, providing the opportunity to reflect on achievements and progress, obtain feedback and seek guidance about future goals and next steps, and discuss ideas and options. In addition, on-the-job appraisal, coaching and mentoring are all important aspects of BDO's approach to career planning and development.

BDO also has a learning and development curriculum that encompasses a comprehensive suite of programs tailored to staff at various stages of their career. One of the more innovative programs is our Career Development Workshop. This program is targeted at accountants who have already completed their professional qualification and is largely focused on career planning. Participants reflect on their career progress to date; are provided with detailed information and multiple perspectives on the range of career options available to them both within and outside BDO; and given tools, frameworks and tangible support to develop their own individual career plan. The program recognises that not all of our staff will follow the traditional path to partner, and equips them to make more informed career decisions.

While it will always be up to our employees to take responsibility for driving their career, BDO encourages an approach to career planning and development in which the employee's supervising partner or other direct manager plays an active role. Other stakeholders such as senior partners, mentors, and human resources and learning and development team members also have important roles to play. Our approach is ultimately about providing as many opportunities as possible for reflection, meaningful discussion, learning, goal setting and planning. We want to make sure our people have a sense of control of their career and do not just 'let it happen'.

BizFACT

A recent report states key skills sought by employers of university graduates are both verbal and written skills required in communication, the ability to work in teams and influence others — so called 'soft skills'. However, other skills such as critical thinking, problem-solving, attention to detail and writing were also highly sought and were common across all jobs and industries.

SNAPSHOT QUESTIONS

1. **What** role does career planning usually play in people's professional lives?
2. **How** does BDO assist people at the start of their career?
3. **Outline** the role of performance appraisal and professional development at BDO.
4. **Explain** the features of the learning and development curriculum that assist staff at BDO.

studyON

Syllabus area 4 › Topic 4 › Concept 4

Training and development

Summary screen and practice questions

In choosing the nature of training and development, businesses need to use a systematic process to evaluate the needs of the business, the supply of these skills in the economy, the demand for these skills, and the changing nature of work and the general pattern of employment.

The shift to a largely service-based economy has seen many traditional skills, particularly those in manufacturing, become obsolete. Businesses need to consider the mix of skills they can develop internally and those for which they need to recruit.

Businesses will need to consider these options:

- invest in further in-house training and development
- recruit staff for specific skills
- retain experts who retire on a part-time basis
- retain women through flexible work structures such as part-time work
- share staff with other firms, or do work for other firms (**insourcing**)
- outsource functions to specialist firms or agencies, even overseas
- sponsor overseas migrants for areas of major shortages
- build networks or alliances with other firms with specialist skills or skills needed in the future.

BizWORD

Insourcing *refers to delegating a job to someone within the business, as opposed to someone outside the business.*

BizFACT

Countries with similar economies to Australia, such as Canada, have identified the following work trends for the future:

- *the complete transition to a service-based economy with primary sector jobs being fully automated*
- *growth in social professions such as teachers, nurses and homecare workers*
- *virtual work undertaken away from traditional workplaces that removes the need for commuting.*



FIGURE 16.5 Children born today will work in jobs that have not yet been invented. Coming soon are these new areas of job growth.

16.6 Performance management — developmental or administrative

Performance management addresses both individual and business performance. Successful individual performance will often translate into the business's strategic objectives being met.

BizWORD

Performance management *addresses both individual and business performance. Successful individual performance will often translate into the business's strategic objectives being met.*

472 TOPIC 4 • Human resources

Strategies in human resource management • CHAPTER 16 473

HSC 'key process verbs' are used consistently in all questions to prepare students for HSC examination. Questions are graded according to low-, middle- or high-order thinking skills. The 'key process verbs' are listed and defined in an appendix for ready reference.

6 Use a 'T' table to **summarise** the advantages and disadvantages of outsourcing. The 'T' table has been started for you.

Outsourcing	
Advantages	**Disadvantages**
1. Simplification: fewer activities performed within the business	1. Payback periods and costs: how long it takes to recoup costs

7 Carefully look at all the advantages and disadvantages you listed in question 6. If you were a business manager and owner, would you choose to use outsourcing or not? Provide reasons for your decision.

EXERCISE 4.4 EXTENSION

1 Use the Think, Pair, Share technique to **investigate** current issues concerning outsourcing.
(a) For two minutes, **outline** your ideas about the meaning of and the perceptions associated with outsourcing.
(b) Select a partner. For about five minutes share your ideas with your partner. Then have your partner share his or her ideas with you.
(c) In your pairs, **create** a definition for outsourcing.
(d) Next, **construct** a table that records shared views about outsourcing, using the following headings:
- Plus points — the favourable points about outsourcing
- Minus points — the unfavourable points about outsourcing
- Interesting points — the exciting or appealing points about outsourcing.

(e) **Analyse** these views and explain each point. It is important that you can support each point with reliable evidence (not unsubstantiated claims). Therefore, your final task is to search for evidence to **justify** each point.

2 Over the past few years, Qantas has outsourced a number of functions, including aircraft maintenance, information technology, and reservations and bookings, to both onshore and offshore companies. Use the internet to **investigate** and **assess** the possible impact of outsourcing on Qantas employees.

3 **Investigate** the use of co-sourcing and, through providing relevant business examples, state why it is increasingly popular.

4.6 Technology — leading edge, established

All businesses benefit from the thoughtful application of technology. The use of technology can be an operations strategy particularly if it helps the business to create a competitive advantage. Some businesses innovate and thereby create new technologies. Whether a business is leading the industry or market through innovation or adapting to use technology once it has already been established, it is clear that technology plays a crucial part in business success.

Technology in the operations function may be classified according to whether it applies to and improves inputs, transformations processes and outputs; or whether it makes the managerial and administrative functions smoother.

BizFACT
Bleeding edge technology refers to technology that is so new it has a greater degree of risk in terms of unreliability for those who adopt it.

BizWORD
Leading edge technology *is the technology that is the most advanced or innovative at any point in time.*

4.6.1 Leading edge technology

Leading edge technology is the technology that is the most advanced or innovative at any point in time. Operations managers can distinguish their operations processes by utilising the best available technologies. This can help businesses to create products more quickly and to higher standards, with less waste, and also help a business to operate more effectively.

Leading edge technologies, in both the use of inputs and processes, have assisted in making the publicly listed Australian company CSL Ltd one of the world's most innovative pharmaceutical companies. Similarly, Woolworths demonstrated considerable innovation and set the benchmark in Australia when it used leading edge technologies integrated with distribution centres.

Note that leading edge technologies are created by innovative processes and innovative thinking. When innovative inputs are created, new products can be made, which can change markets. Consider the current development of nanotechnologies and use of nanoparticles that allows for water to be purified when scooped into water bottles. This is revolutionising the cosmetics industry and has medical applications.



FIGURE 4.13 Nanotechnology is an example of leading edge technology. Nanotechnology is the manipulation of molecules and atoms at a 'nanoscale' — one nanometre is about a million times smaller than the diameter of a pinhead. This technology is expected to affect all parts of human life, including energy, food, healthcare, computers and consumer products.

Advice from algorithms — cutting edge technology

Leading edge technology is also called 'cutting edge' technology and refers to innovations that drive change in business. An example is the development of fintech and robo-advisors — two technologies being used by banks to assist customers make financial and investment decisions. These technologies are used with smartphones or through computer enabled access. The software development underpinning the technology uses computer algorithms to determine what investors seek and to give them various investment options based on their risk preferences, volume of investment, preferred term of investment, and so on.

By embedding options based on customer responses, the technology adapts to present choices aligned to the customer's needs. In this way, the advice can be accurate and specific, while being available 24-hours a day. This can reduce legal complications arising from financial advice given by financial advisers and can make the options far more tailored to individual customers. Over time the software will map a history of the customer's choices and thus be better able to help customers make informed choices about future investments.

SNAPSHOT QUESTIONS
1. **What** is an alternative name for leading edge technologies?
2. **How** do the fintech and robo-advisor algorithms work?
3. **Detail** three benefits of robo-advisors.

SNAPSHOT

"By embedding options based on customer responses, the technology adapts to present choices aligned to the customer's needs."

4.6.2 Established technology

Established technology is technology that has been developed and widely used, and is simply accepted without question. Such technologies include the use of computers and various software packages in managing business operations and functions. Established technologies are functionally sound and help to establish basic standards for productivity and speed. In the operations function, established technologies include:
- barcoding and point-of-sale (POS) data for inventory management
- robotics for complex and detailed manufacturing
- computer-aided design (CAD), computer-aided manufacturing (CAM) and

ng transformations processes

BizWORD
Established technology *is technology that has been developed and widely used and is simply accepted without question.*

- Superannuation funds are able to invest the contributions of members into a range of short- and long-term investments with the aim of maximising a return.
- The business sector increasingly uses superannuation funds for long-term investment in growth and development.
- The ASX acts as both a primary and secondary market for the sale of shares to the public.

EXERCISE 10.2 REVISION

1 Draw a table, as indicated below, to **summarise** the major participants in financial markets.

Financial institution	Financial instruments	Characteristics

2 Choose three financial instruments. **Investigate** current interest rates, maturity dates, and terms and conditions from a range of four institutions.
3 Using the internet, **identify** five investment banks that are currently operating in Australian financial markets.
4 **Explain** the role of financial markets in meeting the needs of businesses.
5 **Distinguish** between primary and secondary markets.
6 **Examine** an area of business banking that interests you, for example, at the National Australia Bank (NAB). Prepare a list of five points **summarising** what you learnt.

on Resources
Weblink: National Australia Bank (NAB)

EXERCISE 10.2 EXTENSION

1 It has been said that financial markets drive the financial and investment decisions of businesses. **Analyse** the accuracy of this statement.
2 Choose one of the major participants in financial markets. **Examine** the services offered to businesses. **Determine** current interest rates for borrowing and investing for businesses. **Compare** your investigations with other students.
3 **Investigate** the role of technology in improving financial market interactions for businesses. **Create** a report to management to **explain** how changing technology in financial markets can improve financial and investment decisions.

10.4 Influence of government

The government influences a business's financial management decision making with economic policies such as those relating to the monetary and fiscal policy, legislation and the various roles of government bodies or departments who are responsible for monitoring and administration. The following outlines the importance of two governmental influences on financial management for businesses.

10.4.1 The Australian Securities and Investments Commission (ASIC)

ASIC is an independent statutory commission accountable to the Commonwealth parliament. It enforces and administers the *Corporations Act 2001* and protects consumers in the areas of investments, life and general insurance, superannuation and banking (except lendin

The aim of ASIC is to a
cial markets and financial
law, collects information a
This includes the financia
annual reports.

ASIC have been given a wide range of powers to enforce the Corporations Act. If a business breaches the law, ASIC will investigate the matter and determine an appropriate remedy. They are able to pursue a variety of remedies depending on the seriousness of the misconduct, such as imprisonment and monetary penalties. Failure to comply with the Corporations Act also generates negative publicity for the business.

10.4.2 Company taxation

All Australian businesses that have been incorporated — that is, all private and public companies — are required to pay company tax on profits. This tax is levied at a flat rate of 30 per cent of net profit, unlike personal income taxes, which use a progressive scale. Prior to 2017, the company tax rate was 30 per cent, however, in the 2016–17 Budget, the government announced that it intended to progressively reduce the corporate tax rate to 25 per cent. From the 2016/17 tax year, the company tax rate was reduced to 27.5 per cent for small businesses with a turnover less than $10 million. The company tax rate will remain at 30 per cent for all other companies that are not small business entities. Company tax is paid before profits are distributed to shareholders as dividends.

The Australian Government has undertaken this process of reform of the federal tax system in order to improve Australia's international competitiveness and make Australia an even more attractive place to invest, thereby driving long-term economic growth. This will mean more jobs and higher wages for working Australians. The Australian company tax rate was previously reduced from 36 to 34 per cent in 2000/01 and then to 30 per cent in 2001/02.

studyON
Syllabus area 3 | Topic 2 | Concept 6
Government Summary screen and practice questions

BizFACT
The federal Liberal government has been trying to pass legislation to lower the tax rate from 30 per cent to 25 per cent for companies with a turnover of more than $50 million.

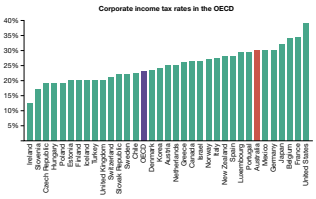


FIGURE 10.12 Australia's company tax rate in relation to other OECD countries

Source: The Organisation for Economic Co-operation and Development (OECD), https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

Straightforward explanations of complex concepts are reinforced by numerous up-to-date statistics and easy-to-read graphic organisers. Summaries throughout each chapter encourage a progressive revision of concepts. Links to *studyON HSC Business Studies* are included for students using this separate resource. Weblinks are provided to key business bodies and further resources.

TOPIC 4 HSC PRACTICE QUESTIONS

HSC-style practice questions are provided for each topic, comprising multiple choice, short response and extended response questions with appropriate marks allocated.

Human resources

MULTIPLE CHOICE QUESTIONS

1. An employer, for legal purposes, does which of the following?
(a) Exercises control over employees
(b) Determines the degree of supervision required for an employee
(c) Has the responsibility of the payment of wages
(d) All of the above
2. The four main elements of the human resource cycle/staffing process are which of the following?
(a) Acquisition, development, managing diversity and separation
(b) Acquisition, recruitment, motivation, maintenance and separation
(c) Acquisition, development, maintenance and separation
(d) Acquisition, development, maintenance and performance management
3. Which of the following would not be considered a potential advantage of outsourcing?
(a) Lack of quality control
(b) Access to experts
(c) Cost savings
(d) Expand capacity
4. Which of the following correctly describes awards?
(a) Collective agreements that set out wages and conditions of employees
(b) Legally enforceable formal agreements made by employer and employees at the industry level
(c) Collective agreements made at a workplace level with an employer
(d) Agreements made between an employee and an employer
5. Which of the following features are not part of an employment contract?
(a) Duties
(b) Location of the workplace
(c) Bonuses
(d) Trade union membership
6. Benefits employers gain from demonstrating corporate social responsibility in managing staff include which of the following?
(a) Improved staff retention and reduced absenteeism as staff feel more valued
(b) Business costs are reduced through reduced claims and fines
(c) Reduced training and marketing costs
(d) All of the above
7. Performance management includes which of the following?
(a) Developing strategies to improve the way a business operates to improve efficiency
(b) Systematically evaluating and managing employee performance in order to achieve the best outcome for the business
(c) Planning for future human resource needs both at the managerial and non-managerial level
(d) Designing a job and how it will interact with other jobs and employees in such a way as to motivate and retain an employee
8. Which of the following represents a non-monetary reward for employees?
(a) Bonuses
(b) Superannuation
(c) Allowances
(d) Challenging work
9. What is the term for an unresolved dispute that requires the Fair Work Commission to make a legally binding decision?
(a) Conciliation
(b) Grievance procedure
(c) Negotiation
(d) Arbitration
10. Which of the following are indicators used to evaluate the effectiveness of human resource management?
(a) Absenteeism, staff turnover, workplace injuries, industrial disputes
(b) Inventory turnover, sales per employee, industrial disputes, labour costs
(c) Workplace injuries, staff turnover, sales per employee, profit margins
(d) Industrial disputes, absenteeism, labour costs, marketing costs

SHORT RESPONSE QUESTIONS

1. (a) **Define** the term 'human resource management'. *2 marks*
(b) **What** is the role of human resource management in business? *4 marks*
2. (a) **Why** is work-life balance important for employees? *2 marks*
(b) **Propose** strategies for managing employees' work–life balance. *3 marks*
(c) An accountant is often late for work, his productivity has decreased and some clients have complained that he is slow to respond to their requests. As a human resource manager, **analyse** how you would handle this situation. *6 marks*
3. (a) **Outline** two ways in which governments influence human resource management. *2 marks*
(b) **Distinguish** between an enterprise agreement and an individual contract. *4 marks*
(c) **Explain** the workplace dispute resolution process. *6 marks*
4. (a) **List** three indicators of the effectiveness of human resource management. *3 marks*
(b) **Evaluate** strategies used to support more effective human resource management. *6 marks*
5. (a) **Describe** the process of human resource management. *2 marks*
(b) **Distinguish** between performance appraisal and performance management. *4 marks*
(c) **Propose** a set of guidelines an employer may use to eliminate discrimination in the workplace. *6 marks*

EXTENDED RESPONSE QUESTIONS

1. Cooper is the sales manager at Morgan's Cycles. At the weekly breakfast meeting he indicated there had been a substantial decrease in sales in the current financial year. He claimed the marketing staff were directly responsible for this decline and stated that consequently jobs may be lost. Many members of the sales team were disappointed with Cooper's comments and some were quite angry. The previous year's sales had exceeded the company's target but Cooper did not acknowledge it at the meeting.
Brian, the chief executive of the business, hears of the tension in the sales department and hires you to write a business report where you:
- **outline** the interdependence between marketing and human resources
- **recommend** strategies for more effective human resource management
- **evaluate** indicators of the effectiveness of human resource management.

2. David has been newly appointed as the human resource manager for a national golf club manufacturer. He meets with the managers of each of the key functional areas and notes that in particular there appears to be problems with the operations processes and that more generally workplace culture seems poor.
He has seen the outdated machinery in some parts of the factory and workers reported to him at the time that it produces equipment of low quality. Where newer machinery has been introduced there appears to be a mismatch between worker skills and the capacity to use the machines effectively. He has also heard there are often accidents in the factory. Workers appear dissatisfied and are threatening industrial action.
David contacts you to write a business report. In your report:
- **outline** the operations influences that may have affected the business
- **explain** how effective operations strategies will help the business sustain its competitive advantage
- **analyse** how understanding human resource processes can address the business's corporate culture.

3. **Assess** the advantages of a diverse, culturally competent workforce for a global business.
4. **Analyse** the causes of workplace disputes and the strategies used to resolve them.

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ABOUT THE AUTHORS

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TOPIC 1

OPERATIONS

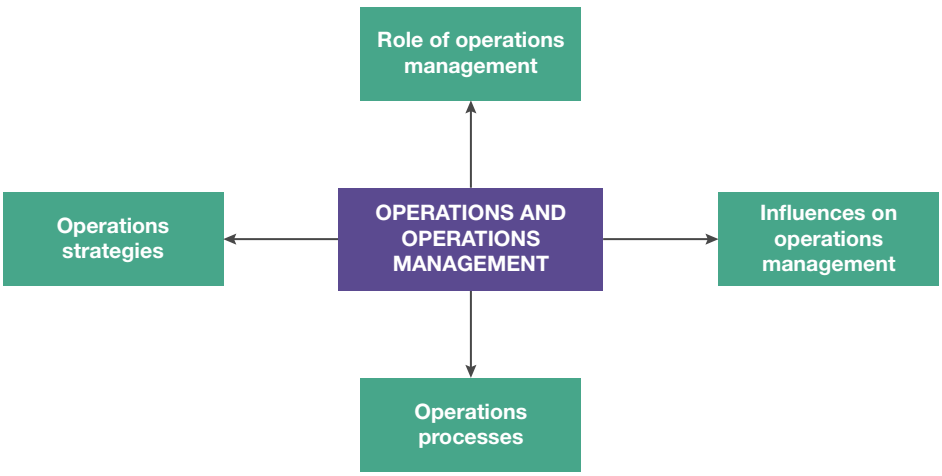
FOCUS AREA

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

OUTCOMES

Students should be able to:

- critically analyse the role of business in Australia and globally
- evaluate management strategies in response to changes in internal and external influences
- discuss the social and ethical responsibilities of management
- analyse business functions and processes in large and global businesses
- explain management strategies and their impact on businesses
- evaluate the effectiveness of management in the performance of businesses
- plan and conduct investigations into contemporary business issues
- organise and evaluate information for actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats.





Case study: Myer's operations — a summary

Myer, like many large Australian businesses, sells to thousands of Australian customers daily. The business has over 1200 suppliers and sources its stock from all over the world for its retail outlets in sixty locations across Australia. When stock is sourced from other countries it must be brought to Australia and then distributed to the store network nationally.

Aside from selling through the 'bricks and mortar' stores, Myer also has a strong online presence.

Myer has to manage the purchasing needs of over 130 million visits to stores made by customers annually. With over five million customers using their loyalty card, customers are significantly vested in the business and its continued success. This success is driven by an understanding of what customers expect, and sourcing accordingly.

Supply chain management is essential to the success of Myer. This involves the careful and close management of suppliers in dozens of nations to obtain the most sought-after global brands at the lowest available cost. The supply chain is supported by the use of distribution centres that stock more than 15 000 of the items purchased most often through the Myer online store. The establishment of new and additional distribution centres is ongoing for Myer in its attempt to reduce delivery lead times. Reduced delivery times are expected to provide customers with an experience that helps keeps them loyal to Myer.

A focus on cost reductions has lead Myer to adopt other cost saving measures including outsourcing its call centre and its online chat function (which pops up on screen when consumers engage in online buying).

'. . . success is driven by an understanding of what customers expect, and sourcing accordingly.'

on Resources

Kathmandu case study:
Introduction and operations
(doc-14389)

CHAPTER 1

Role of operations management

OVERVIEW

1.1 Introduction
1.2 Strategic role of operations management
1.3 Goods and/or services in different industries
1.4 Interdependence with other key business functions

1.1 Introduction

BizWORD

Operations *refers to the business processes that involve transformation or, more generally, 'production'.*

All businesses are involved in processes that involve transformation. **Operations** refers to the business processes that involve transformation or, more generally, 'production'. It is a term that applies both to the manufacturing and services sector. In manufacturing, operations refers to the processes involved in turning raw materials and resources into outputs of finished goods or products. Examples include a vehicle manufacturer turning steel into cars or an oil refiner converting crude oil into petrol or paraffin for candle making. In the services sector, operations refers to the processes involved in actually carrying out the service. Examples include the provision of professional advice by a solicitor and the washing, cutting and styling of hair by a hairdresser.

BizWORD

Transformation *is the conversion of inputs (resources) into outputs (goods and services).*

Value adding *is the creation of extra or added value as inputs are transformed into outputs.*

Apart from **transformation**, operations involves the creation of value by businesses. Both transformation and **value adding** will be discussed fully in chapter 3. Operations processes are broad and include aspects of all of the following activities undertaken in business:

- the production of goods and services
- production controls and associated quality controls on processes. Included in this are input management and capacity (volume of output) decisions.
- inventory controls
- supply chain management (SCM)
- logistics and distribution
- management decision making in terms of operational processes.

The operations function is an intrinsic aspect of business processes and overlaps with, and is interdependent to, all of the other business processes and key business functions. This is shown in figure 1.1.

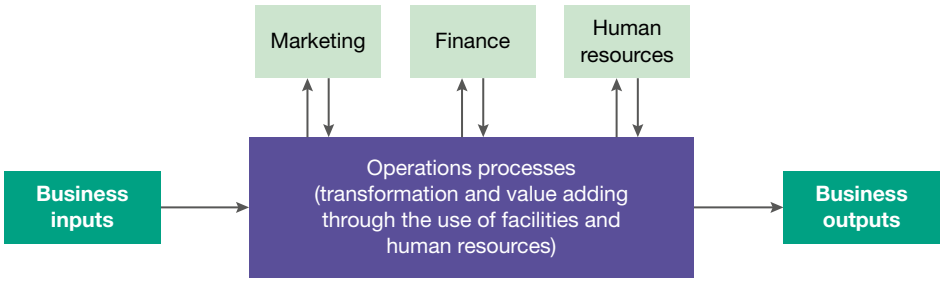


FIGURE 1.1 The overlap of operations with other key business functions

1.1.1 Operations — inputs and outputs

Operations can be described as those processes that help transform business inputs into business outputs. Business inputs include tangible things such as raw materials, land, human resources, capital in the form of facilities and technology, as well as intangible inputs such as ideas and information. Business outputs include the products (goods and services) made from the processes of transformation — that is, operations. This is shown in figures 1.2 and 1.3.

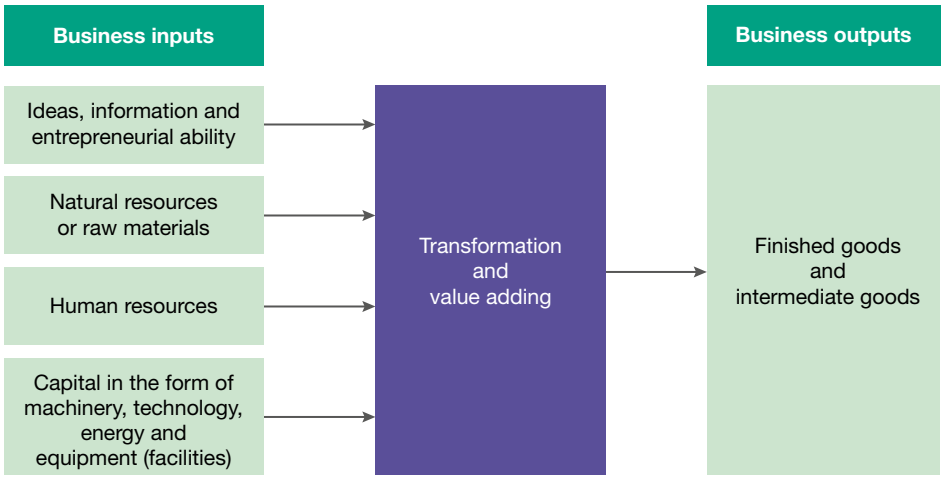


FIGURE 1.2 Transformation for a producer of goods

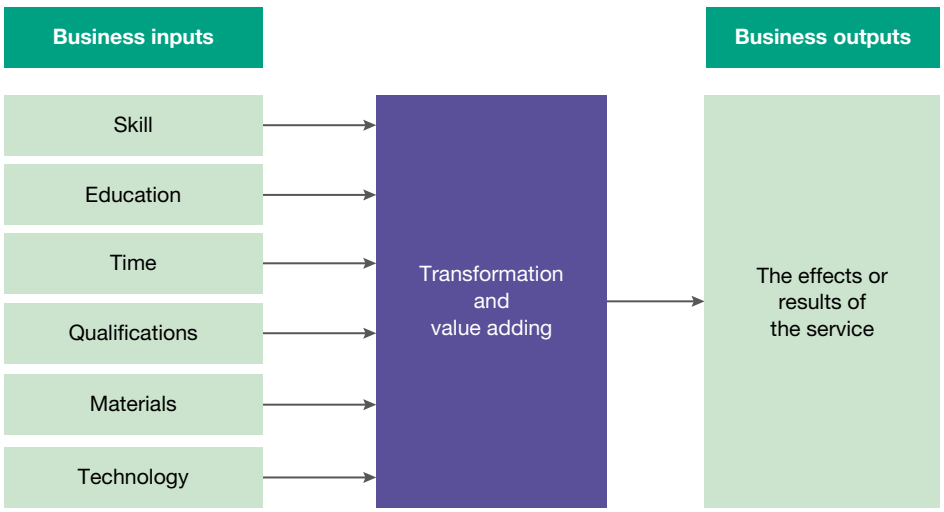


FIGURE 1.3 Transformation for a producer of services

1.1.2 Operations and the customer focus

Historically, in manufacturing businesses, the operations function was considered to be hidden in the sense that the customer was not relevant to production processes. Over time, however, with a focus on customers and customer relationships, this has changed. In contemporary business practice the customer and their needs are placed foremost. Customer needs, however, are not always obvious. It may be clear that customers want innovative products at low cost that improve quality

of life. However, it may not be clear that customers also desire firms to engage in processes that:

- minimise resources in their production — lean production utilises minimal resources, reducing waste and materials usage
- reflect fair value for any labour used in processes
- operate at low cost so as to maximise affordability
- integrate environmental awareness and a need for ecologically sustainable practices
- reflect changes in the needs of consumers over time.

The focus on waste minimisation, ecological sustainability and ethical conduct are increasingly shaping the operations function. One reason for this change is due to the rising expectations of consumers. Consumers tend to value businesses that are seen to be doing the right thing. The change also reflects the changing nature of communication. The development of social media such as Facebook, Instagram and Twitter has meant that consumers can report the practices of businesses widely. It also means that stakeholders such as lobby groups and interest groups can hold businesses to account for the impacts they make on society and the environment.

BizWORD

Lean production *aims to eliminate waste at every stage of production. It involves analysing each stage of the production process, detecting where inefficiencies are and correcting them.*

Minimising waste

Minimising waste, also called **lean production**, is an operations management approach designed to eliminate waste — 'lean' in this case means no excess. Waste is non-value adding, though it does add cost. If waste can be minimised then production processes are most efficient. There are several sources of waste in business, including the under use of labour, over production, errors and defects requiring remediation or creating lost product, under utilisation of machinery, slow lead times and waiting times within processes, and carrying of excess inventory. Each of these sources of waste adds cost but does not add value.



FIGURE 1.4 Jaguar, the high-quality British car brand, has also incorporated lean manufacturing into the way it produces its motor vehicles.

Reflect fair value for any labour used in processes

It is important to consumers that businesses operate fairly and compensate and treat employees appropriately. The growth of the fair trade movement is a direct result of consumers advocating for operations processes in production and supply to integrate notions of a fair price, decent working conditions, ethical sourcing and local sustainability.

Ethical sourcing

Businesses are increasingly engaging in a practice known as **ethical sourcing**. With ethical sourcing a business requires its suppliers to engage in ethical conduct such as the payment of fair wages and the use of environmentally friendly practices.

Historically, businesses did not concern themselves with the practices or standards of their suppliers; all that mattered was cost and reliability of supply. However, consumers are making more informed decisions about which businesses they will buy from and are concerned about how businesses source their supplies as well as the practices and standards used by businesses within a supply chain.

NGOs have drawn attention to the poor labour practices and damaging environmental impacts of businesses operating in low-cost nations such as Vietnam, Bangladesh and India. Consumers have expressed concern about these practices and are increasingly purchasing from businesses that refuse to support unethical practices. This includes if the unethical practices are perpetrated by businesses within the supply chain.

Numerous global brands now make it a contractual obligation for suppliers to disclose their labour standards and environmental impacts. In the event of a breach of the contractual obligation, global brands can use alternative suppliers. In this way, consumer choice affects corporate practice, which in turn affects supply chain and sourcing decisions.

An example of ethical sourcing requirements can be seen with respect to David Jones. David Jones have outlined a five-year ethical sourcing strategy, which includes ways to improve the conditions and wellbeing of people working along their supply chain. It also contains a focus on ethics in business, animal welfare and environmental sustainability. The new ethical sourcing strategy has been developed in collaboration with customers, buyers, suppliers and not-for-profit groups. This will be an ongoing process, involving annual engagement with stakeholders and formal reporting on progress of their own objectives and initiatives. It has also entailed David Jones creating a Supplier Code of Conduct. As they note on their ethical sourcing website:

> Critically, we will influence positive outcomes along our supply chain by adopting a collaborative approach that supports continuous improvement. We will be open and honest about the complexity of the challenges that lay ahead but we will also be very clear in relation to what we expect of our suppliers…

Operate at low cost so as to maximise affordability

All consumers seek to buy goods and services at low cost. Businesses aim to maximise profitability through generating sales revenue. In highly competitive markets, businesses try to capture market share by lowering costs; this will be reflected in lower prices. This need for consumers to buy affordable goods and services directly affects the operations function of business. In terms of a manufacturing enterprise, businesses will continually seek to minimise production costs so that the retail prices for consumers are as low as possible.

Global sourcing and astute supply chain management (SCM) are essential features of effective operations management. The ability to operate at low cost can depend on from where the product is sourced and how it is transported to the business. Access to low-cost suppliers can ensure that the business makes the final price to consumers as low as possible.

Operations processes adjust to shifting needs

The changing needs of consumers means that the operations function is continually adapting and changing. Improvements in technology mean that the capability and functionality of products is changing and the way people do things is also

BizWORD

Ethical sourcing *refers to business practices of sourcing from suppliers that engage in ethical conduct such as the payment of fair wages and the use of environmentally friendly practices.*

changing. This can be seen through advancements in communications and digital technologies. Businesses such as Apple, Samsung, Toyota and Google have all harnessed technology in innovative ways. These globally successful business and brands have been able to keep up with changes in consumer markets and in some cases drive changes in consumer markets.

SUMMARY

- Operations involves various processes that transform and add value to business inputs in the creation of outputs.
- Operations is informed by the business drive to maximise profits and also increasingly by the needs of consumers.
- Minimising waste, or lean production, is an operations management approach designed to eliminate waste.
- The growth of the movement to source ethically has grown as a direct result of consumers advocating for operations processes in production and supply to integrate notions of a fair price, decent working conditions and local sustainability.
- In terms of a manufacturing enterprise, businesses will continually seek to minimise production costs so that the retail prices for consumers are as low as possible.
- As consumers seek innovative goods, businesses will create innovative goods.

EXERCISE 1.1 REVISION

1. **Define** the term 'operations'.
2. **Clarify** the relationship between transformation and value adding.
3. **Distinguish** between business inputs and business outputs.
4. **Identify** five business inputs.
5. **Identify** the way in which businesses can transform inputs into business outputs.
6. **Demonstrate** how the operations function is starting to integrate a consumer perspective.
7. Draw a simple, step-by-step diagram **summarising** how five different areas of consumer concern impact on the operations function of a business.
8. With reference to a case study of a business, **demonstrate** the importance of the operations function.
9. **Explain** how new business opportunities can arise as technology changes.

EXERCISE 1.1 EXTENSION

1. **Investigate** how the operations management function supports the business in achieving its goals.
2. **Evaluate** how customer choice can influence a business to undertake business operations that are ecologically sustainable.
3. **Examine** the effect that stakeholders such as consumers are having on helping ensure that businesses engage in environmentally sustainable practices. **Create** a 500-word report, including references to at least two businesses.

1.2 Strategic role of operations management

BizWORD

Strategic *refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of the business.*

Operations management is an essential key business function that overlaps with the other business functions such as marketing, finance and human resource management (HRM). Each of these essential business functions has a **strategic** component. Strategic means 'affecting all key business operations'; that is, the strategic role of the operations management involves operations managers

contributing to the strategic direction or strategic plan of the business. This is shown in the Snapshot of Virgin Australia.

Case study: Virgin Australia — strategic directions

Commencing operations in Australia in 2000, Virgin Airlines is the second largest domestic carrier after Qantas. Virgin Airlines runs domestic flights between the Australian capital cities. Following a takeover of Skywest Airlines in early 2013 and the purchase of 60 per cent of Tiger Australia in mid-2013, Virgin Australia also has a strong presence in both domestic regional markets and in South-East Asia. The company also flies internationally through the South Pacific and to the USA, Middle East and Europe.

Decisions made in the operations function have a direct impact on the other key business functions. For example, the decision to acquire Tiger Australia had significant financial implications. The scale of Virgin Australia's operations is increasing and as the business acquires other airline brands, the operations function becomes more complex. Virgin Australia has therefore used technology to reduce duplication and to create operational efficiencies that save $200 million annually.

The increase in scale also means an increase in customer numbers. Evidence of this was seen in a growth in Velocity membership loyalty rates of 15 per cent in 2013. Apart from the operations decisions affecting the financial results and the marketing objectives, the growth in scale of operations has led to effects on the human resources function. Employment numbers have grown and the types of skills required have changed as the business invests in state of the art technology to effectively manage the global operations.

Virgin's business strategy is to grow domestically and globally. Virgin Australia is controlled by shareholders from other airlines including Etihad, Singapore Airlines, Hainan Airlines and Richard Branson's Virgin Group. The company aims to be the lowest cost operator in the international market, as well as in the domestic corporate, leisure and regional markets. Having already increased its passenger numbers from 20 million in 2014 to 24.2 million in 2017, the business is growing quickly.

In terms of strategy for the period 2017–20, Virgin Australia has simplified its aircraft fleet and rationalised its supply chain. It has also created a five-year strategic alliance with HNA Aviation, Hong Kong Aviation and HK Express in order to access the Chinese market. These changes enabled the business to turn a before-tax loss of $49.1 million in 2015 to a $41 million profit in 2016. The Chinese market is expected to offer significant growth and returns for Virgin Australia over the next five years.

SNAPSHOT QUESTIONS

1. **Outline** the nature of the airline market in Australia.
2. **Define** the term 'strategic'.
3. **Explain** how operations decisions have affected the finance, marketing and human resource function of Virgin Australia.
4. **Discuss** how an investment in technology can help to reduce costs in a business such as Virgin Australia.
5. **Explain** the importance of the new strategic alliances for Virgin Australia's growth over the next five years.

SNAPSHOT



'. . . company aims to be the lowest cost operator in the international . . . domestic corporate, leisure and regional markets'

What makes a role strategic is not so much the length of time, but rather the level with which it integrates and affects all key business areas.

Generally, the overarching goal of business is to maximise profits. In most businesses, this is done by focusing on two very important aspects of profit:

- revenue or income
- costs or expenses.

Revenue or income should be maximised so as to bring in the greatest possible volume of money. Conversely, costs need to be minimised in order to reduce the overall level of expenses incurred.

Financial and marketing aspects of business tend to specifically target the revenue side of the business. Costs, however, are not only left to the operations and human resource function. This is because all aspects of the business incur cost, even though all aspects are not generating revenue directly. This type of analysis of revenue and cost looks at the business as a series of **profit centres** and **cost centres**.

Profit centres are those aspects of the business that directly derive income. Cost centres are those that do not directly derive income but do incur cost. The operations function is a cost centre in a business. A strategic aspect of operations management is therefore the management of cost.

BizWORD

Profit centres *are those aspects of a business that directly derive revenue and profits.*

Cost centres *are particular areas, departments or sections of a business to which costs can be directly attributed.*

1.2.1 Cost leadership in the operations function

There are several different sources of operational costs in business. There are input costs, processing or transformation costs and the costs of getting products to markets. There are also costs associated with inventory management and quality management. Some of the different types of cost are shown in table 1.1.

TABLE 1.1 An overview of the types of cost within the operations function

Costs that are a feature of the operations function				
Input costs	**Labour costs**	**Processing costs**	**Inventory costs**	**Quality management costs**
• Facilities • Land • Resources • Interest on investment • Leases on machinery • Installation and testing • Energy	• Full-time and part-time employees • Casual employees • Subcontractors • Overtime • Recruitment and training • Redundancy • Rostering	• Machinery maintenance • Electricity • Scheduling • Product design • Template and tooling • Prototyping	• Back order • Logistics and distribution • Storage • Inventory management • Insurance • Deterioration • Shrinkage and theft • Damaged goods	• Prevention of loss through quality planning and training • Sampling and inspection of goods and processes • Error and remediation through warranty claims, sales returns and complaints • Machining errors, injury and machine downtime

BizWORD

Cost leadership *involves aiming to have the lowest costs or to be the most price-competitive in the market. A key aspect to cost leadership is that although trading with the lowest cost, the overall business should still be profitable.*

It should be clear from the table that there are numerous sources of cost that are incurred when undertaking operations processes. Therefore, an intrinsic aspect of strategic operations management involves cost leadership. **Cost leadership** involves aiming to have the lowest costs or to be the most price-competitive in the market. A key aspect to cost leadership is that although trading with the lowest cost, the overall business should still be profitable. This means that operations managers must find ways to minimise costs.

SNAPSHOT



'. . . if inventory is not continually moving then the cost is increasing.'

Case study: Walmart — cost leadership

Walmart has two different slogans: 'Every Day Low Prices' and 'Save money. Live better'. These slogans indicate Walmart's approach to cost that has made it a global example of successful cost leadership. Walmart will not engage in sales discounting, preferring to have the lowest prices daily and not needing to lower selling prices through discounting.

Walmart founder, Sam Walton, articulated the company vision as follows:

If we work together we'll lower the cost of living for everyone . . . we'll give the world an opportunity to see what it's like to save and have a better life.

In order to achieve the lowest prices possible Walmart has undertaken some significant decisions in the management of its supply chain and sourcing. Three aspects to Walmart sourcing and supply chain management are significant:

1. Walmart has over 100 000 suppliers. When it approaches, or is approached by, a supplier the business aims to negotiate large volumes of supply. In this way the supplier can obtain a guaranteed minimum return and the company can save

money because of economies of scale generated. The guarantee of supply means the business can ensure that stock levels are maintained.
2. Walmart management have realised that if inventory is not continually moving then the cost is increasing. This means that the movement of stock from the supplier to the actual stores is constant up to the point of sale. In order to manage this process, Walmart reduces its reliance on warehouses. Warehouses add cost and keep stock stationary. While some warehouses are necessary, they are strategically located to enable short lead times between the storage facility and retail outlets. The company has a sophisticated system of cross-docking (see BizFact on the right) that requires the use of leading edge technologies and the capacity to track the movement of all sourced items at all times.
3. The lack of warehouses had meant that Walmart could not keep up with Amazon, a direct competitor in the online retailing space. Walmart has recently set up warehouses in order to manage its growing e-commerce presence.

SNAPSHOT QUESTIONS

1. **Define** the term 'cost leadership'.
2. **Outline** two areas of operations to which Walmart applies cost leadership strategies.
3. **Summarise** three approaches taken by Walmart to reduce supply-side costs.
4. **Explain** how cross-docking can reduce inventory management costs.

The balance between cost and quality

There is a direct relationship between cost and quality. As the standard of materials, labour and other inputs rises, and the precision and speed of facilities and equipment rises, the prices of products made by the business will increase. Conversely, if the costs of inputs is very low then it is likely that the final prices will reflect the lower quality of inputs and processes. Operations managers and those who lead the other business functions will need to decide what level of quality is sought and hence what level of costs to incur. In this way they will need to decide what balance to create between costs and the desired quality.

Economies of scale and cost management

One aspect of cost leadership arises from a business creating economies of scale. **Economies of scale** refers to cost advantages that can be created because of an increase in scale of business operations. Typically the cost savings come from being able to purchase lower cost per unit of input and efficiencies created from the improved use of technology and machinery.



FIGURE 1.5 Rationalisation in the Australian dairy industry has resulted in lower overall costs and economies of scale. Since milk production has not grown over the past decade the industry has had to find means by which to create economies of scale by using existing facilities as efficiently as possible.

BizFACT

Cross-docking describes a process whereby stock from suppliers is transferred to distributors without the need for holding in between. Normally, businesses gather their source inventory at a warehouse or distribution centre. The stock is offloaded from the supplier, stored and then later retrieved for distribution to the retail outlets. Cross-docking means that most inventory is never stored in a warehouse, but is brought to a point where it can be directly transferred for shipment to retail outlets.

BizWORD

Economies of scale *refers to cost advantages that can be created as a result of an increase in scale of business operations. Typically the cost savings come from being able to purchase lower cost per unit of input and from efficiencies created through improved use of technology and machinery.*

SNAPSHOT



'Seeing an opportunity to reduce costs of labour, capital costs, taxation and environmental costs, the company decided to relocate production . . . '

Case study: Samsung — cost leadership in innovative manufacture

Samsung is well known for its production of smartphones. As the biggest competitor to Apple in the phone market, Samsung has led the way in terms of cost reductions. Seeing an opportunity to reduce costs of labour, capital costs, taxation and environmental costs, the company decided to relocate production from Korea and China to Vietnam, a regional neighbour, in 2016. The Vietnamese government assisted through allowing ten years of tax concessions. Samsung spent $2 billion on the relocation, but saved so much money that despite a product fault affecting overheating batteries in 2016 it still generated profits.

1.2.2 Goods/service differentiation

A second key strategy applied by operations managers is that of product differentiation. Products may be classified as either goods or services. The characteristics that distinguish goods and services are shown in table 1.2. Generally, services only come into being as the result of a need for that service; it does not exist prior to the need. Contrast this situation with that of goods. Typically goods already exist even before a person seeks them.

TABLE 1.2 Distinguishing between goods and services

Characteristics	Features of goods	Features of services
Tangibility and perishability	They are tangible. That is, they have a physical dimension in that they can be seen, moved, touched and stored. Some goods are perishable in that they may spoil if not used (e.g. fresh fruit).	Services are intangible. They only exist while they are being performed, although the effects may endure for long after the completion of the service.
Customisation	Goods tend to be standardised, though they can sometimes be customised.	Services are generally customised, though they may be standardised to a high degree.
Ownership	Goods can be owned and transferred between people through the sale of ownership.	Services cannot be owned.
Time between production and consumption	The length of time between the production of goods and their consumption can be considerable.	The production of services and the consumption of services are simultaneous.
Determination of value	Value can be independently ascertained through costing all inputs and adding a margin. Inputs can easily be determined: cost of labour, materials and transformation plus a margin for profit.	Value is highly subjective and depends what the market is prepared to bear. However, value will increase with the service provider giving high levels of skill, longer time, high levels of education and experience, and high levels of ability and expertise.

Sometimes goods and services are so closely aligned that it can be hard to distinguish them. Consider the following. You go to a fast-food provider and buy two pizzas. The pizzas are goods that are perishable and should be eaten while fresh. However, the goods cannot be separated from the service that comes with it: the way in which the customer is treated by the person taking the order, the customisation of the goods to meet the customer's specific requirements, the layout of the store and the skill of the chef preparing the ingredients.

Product standardisation and differentiation

Standardisation involves the making of products that are homogeneous or identical. Typically, this involves mass producing items in high volume, with no variety and at a low cost per unit. Standardisation is directly related to economies of scale.

Apart from cost leadership, operations managers can opt for a strategy of competing in markets based on product differentiation. **Product differentiation** means distinguishing products (goods or services) in some way from its competitors. There are different forms of product differentiation, and product differentiation will be different for goods and for services.

Product differentiation: goods

Goods can be differentiated in a number of different ways. At a basic level, colour variation can constitute product differentiation. Other sources of differentiation in goods include:

- *varying the actual product features*. Generally goods will come in one basic variety and then in other varieties of increasing complexity or options. Thus, a breakfast cereal at its most basic can be processed grain, or it can be a mix of the processed grain with added ingredients such as sugar, dried fruit and nuts. In reference to electronic goods, products are made with remarkable variation as a means of differentiating the market.
- *varying product quality*. This can be done by making a low-quality model that is very affordable and then increasing the quality (which will be reflected in the higher price). Sometimes the higher quality alternative may be sold under an alternative trade name so that the market perceives both products as being produced by different producers.
- *varying any augmented features*. This refers to add-ons or additional benefits associated with particular goods. Typically, augmented features are seen in electronic goods and motor vehicles. For example, a car manufacturer may allow consumers to buy a vehicle with the capacity to fit a spoiler, windscreen wipers on headlights, a built in GPS and self-parking (autopilot) systems. These are not standard features or variations on standard features, but rather additional features that can significantly vary a product.

From an operations perspective, a strategic approach assesses the different options and determines which ones can be undertaken with a cost leadership focus.

Product differentiation: services

Like goods, services can be differentiated in a number of different ways. Sources of differentiation in services include:

- *varying the amount of time spent on a service*. Time is a factor that differentiates between service-providers.
- *varying the level of expertise brought to a service*. If a person has a higher level of expertise then, as a service-provider, they can provide a more specialised service.
- *varying the qualifications and experience of the service provider*. Highly qualified and experienced service providers can significantly affect the quality of service provided. This will be an important factor for consumers when deciding between service providers.
- *varying the quality of materials/technology used in service delivery*. The use of computer-based technologies such as accounting software, CAD and CAM programs, medical technologies and ICTs can significant affect the quality of service provided and is a notable source of differentiation in the services sector.

Again, from the operations management perspective, a strategic approach to service delivery will require managers to assess how much emphasis to place on which aspects of the services mix to best meet customer needs while reflecting cost leadership principles.

BizWORD

Standardisation *refers to the making of products that are homogeneous or identical.*

Product differentiation *means distinguishing products (goods or services) in some way from those of competitors.*



FIGURE 1.6 The IT section of a multinational bank requires a highly specialised and differentiated service. Any security systems in place need to be flexible, adapt to the range of IT issues and threats (from identity theft, spam and industrial espionage) to routine processing matters and inquiries. Quality of systems, high level expertise, speed and security are necessary features of the IT security platform.

Cross branding

For both goods and services, differentiation can be created from cross branding or strategic alliances. This approach adds value to products (goods and services) by offering consumers added benefits from a cross-branding arrangement. Examples include the Woolworths–Caltex alliance and the Coles–Shell alliance. Here products are differentiated, but the differentiation is not from the product itself but rather from an external factor that the business has brought into the mix.

SUMMARY

- Operations management is an essential key business function that overlaps with the other business functions such as marketing, finance and human resources management (HRM).
- There are several different sources of operations costs in business. There are input costs, processing or transformation costs and the costs of getting products to markets.
- Cost leadership involves aiming to have the lowest costs or to be the most price-competitive in the market.
- Economies of scale refers to cost advantages that can be created because of an increase in the scale of business operations.
- Product differentiation means distinguishing products (goods or services) in some way from their competitors.
- Standardisation involves making homogeneous products and is usually a high-volume, low-cost approach to making goods or producing services.
- Sources of differentiation in goods include:
  - varying the actual product features
  - varying product quality
  - varying any augmented features.
- Sources of differentiation in services include:
  - varying the amount of time spent on a service
  - varying the level of expertise brought to a service
  - varying the qualifications and experience of the service provider
  - varying the quality of materials/technology used in service delivery.
- For both goods and services, differentiation can be created from cross branding or strategic alliances.

EXERCISE 1.2 REVISION

1 **What** does strategic mean?

2 **Demonstrate** how an operations decision can affect each key business function.

studyon

Syllabus area 1
Topic 1
Concept 1

Strategic role of operations management
Summary screen and practice questions

3 **Distinguish** between a profit centre and a cost centre.
4 **List** the five main sources of operational costs in business.
5 **How** do businesses realise cost leadership? Provide two examples to support your claims.
6 **Distinguish** between economies of scale and cost leadership. **Assess** the importance of both for business efficiency.
7 **Classify** the following as either goods or a service, justifying your choice:
- the work performed by an IT specialist
- an accountant's advice
- a stove
- an airline ticket
- a bottle of water
- a handbag
- a T-shirt
- time spent learning mathematics with a tutor
- a ticket to an Ed Sheeran concert.

8 **Define** the term 'product differentiation'.
9 **Describe** the difference between goods and services with reference to five features of each.
10 **Compare** how differentiation varies between goods and services.

EXERCISE 1.2 EXTENSION

1 Research and **analyse** the difference between standardisation and customisation and detail two benefits of each.
2 With references to products and brands, **evaluate** how cost leadership can provide customers with choice.
3 Businesses compete on cost and on differentiation (delivering quality products for the same price as competitors or delivering products faster than competitors). Match the following business activities with the intended outcome.

Business activity	Outcome
'Tailor' products to customers . . .	to compete on cost
Eliminate waste . . .	to compete on quality
Use automated production equipment . . .	to compete on speed of delivery
Strictly comply with design specifications . . .	to compete on cost
Respond quickly to changes in demand . . .	to compete on quality

1.3 Goods and/or services in different industries

The operations function within any business is shaped by the range and types of goods and services that are produced. Management of operations will differ for producing goods and producing services.

1.3.1 Goods in different industries

Operations decisions will vary for goods depending on whether they are **standardised goods** or **customised goods**. Standardised goods are those that are mass produced, usually on an assembly line. Standardised goods are uniform in quality and meet a predetermined level of quality. Customised goods are those that are varied according to the needs of customers. These goods are produced with a market focus rather than a production focus. The layout of operational processes

BizWORD

Standardised goods *are those that are mass produced, usually on an assembly line. Standardised goods are uniform in quality and meet a predetermined level of quality. These are generally produced with a production focus.*

Customised goods *are those that are varied according to the needs of customers. These goods are produced with a market focus rather than a production focus.*

BizFACT

The customisation of goods can be seen in the production of music and the shift away from CDs to the use of streamed music services such as Pandora, Apple Music, Tidal and Spotify. Using these online applications, customers can pay for and download the songs, musical genre and playlists they want. This is different to the purchase of a CD (or even vinyl records) where customers may not want some of the songs on a fixed album or playlist. Music streaming services allow customers to create their own playlists. From a business perspective such services are very lucrative as streaming services are subscription-based, incurring a monthly fee from patrons.

will vary depending on whether goods produced are undifferentiated or not. The choice of the process selection is strategic as it requires a high degree of cross-functional interaction and coordination. This means all four key business functions need to work together to achieve the operations outcome.

Goods may also be broadly classified as either perishable or non-perishable. The grocery sector is dominated by perishable goods (foods), whereas household and business goods are generally non-perishable. This means that operational processes will vary between sectors that produce perishable goods and those that produce non-perishable goods.

Perishable goods and operations processes

Operations processes will need to integrate the following factors:

- high standards of quality, safety and cleanliness in all operating processes
- very short lead times and distribution that is as quick and effective as possible
- appropriate and robust packaging and cold storage processes both through production and distribution.



FIGURE 1.7 Perishable goods have only a short life span as they are consumed quickly. They are relatively inexpensive and bought on a regular basis. The operational processes will reflect these characteristics.

Non-perishable goods and operations processes

Non-perishable goods are inherently more durable than perishable goods and therefore the issues of quality and inventory management arise for the operations function. Operations processes will need to integrate the following factors:

- manage all aspects of quality in the process, from sourcing through to production and distribution
- implement effective inventory management strategies and be highly responsive to market demand in order not to over produce.

Non-perishable goods may be found in many different industries. In the manufacturing sector there are motor vehicles, electrical appliances and audio-visual

products, computer-based technologies, clothing, footwear, household goods such as furniture and bedding, kitchen items, tools and so on. Although the variety of goods produced in different industries is huge, many of the operations processes are similar regardless of industry. Technology, however, can be industry-specific.

Intermediate goods

A feature of production processes is that sometimes goods may be processed more than once. This means that goods completed, having gone through one set of operations processes, may then become inputs into further processing. This is demonstrated in the following example: a manufacturer converts steel into tiny screws. These are finished goods for that manufacturer. These screws are then used in the manufacture of electronics goods as essential components. This process is shown in figure 1.8.

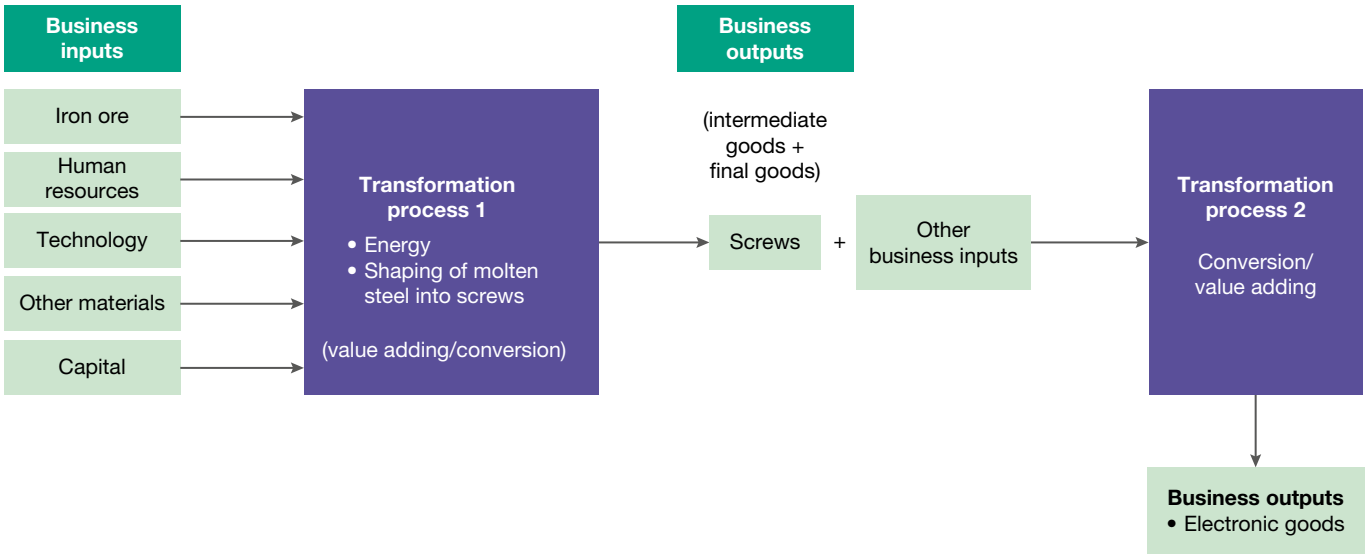


FIGURE 1.8 Intermediate and final goods processing

1.3.2 Services in different industries

As with goods, services can be both standardised and customised. The fast-food industry is an industry that aims to standardise the service. This differs from industries that are characterised by professionally educated and trained people. Accounting services, dental surgeries, medical services, legal services and so on are generally customised, unless the nature of the request from a client is standard. Thus, for example, most people visiting a general practitioner (GP) may receive a standard service, whereas a person visiting a medical specialist is highly likely to receive a customised service. Similarly, a person buying a house may receive standardised conveyancing services from a solicitor, whereas a person facing criminal charges will need legal assistance that is highly customised for their particular circumstances.

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Syllabus area 1
Topic 1
Concept 2

Goods and services
Summary screen and practice questions

Cost leadership and standardised products (goods and services)

When a product is standardised then costs associated with the production of the product can be minimised. This is clear with respect to goods. As stated earlier, standardised goods can be mass produced without variation and economies of scale can be achieved. However, it is also true of service delivery.

When a business offers a service, then it can bring a cost leadership to the service by standardising how that service is performed. This can be seen in the quick service meal industry (also called 'fast-food' industry). When a person enters a fast-food restaurant then they are subject to highly standardised processes in terms

of order taking and customer service. People delivering the service are trained so that they know exactly what to say and how to say it. This approach to services, where a standardised approach is created, is also evidenced in call centre work and other work where administrative processes are routine.

Self-service

Self-service means encouraging the customers to take the initiative to help themselves. Some industries seek to encourage self-service. Thus, the financial services sector and the travel industry encourage people to make their own transactions online. In this way, businesses can concentrate on customisation when a person cannot help themselves. However, an issue with self-service online is that of **drip pricing**.

BizWORD

Self-service *means encouraging the customers to take the initiative to help themselves.*

Drip pricing *means that a business advertises one price but in the process of a customer purchasing the service numerous additional charges and costs are added. The effect is that the final price can be much higher than the price advertised. Drip pricing has been an issue in relation to airline ticketing and travel products sold online.*

SUMMARY

- Goods and services are produced differently.
- Goods may be standardised (mass produced or an assembly line) or customised (varied according to the needs of customers).
- Goods may be perishable or non-perishable.
- The character of the goods will shape the nature of the operations processes.
- Intermediate goods have gone through one set of operational processes then become inputs into further processing.
- Services vary according to whether they are highly specialised or more customised.
- Services can be standardised and in so doing a cost leadership strategy is being applied.

EXERCISE 1.3 REVISION

1. **Distinguish** between the terms 'standardised' and 'customised'.
2. **How** may goods be customised?
3. **Identify** three goods that are perishable and three goods that are non-perishable.
4. **Describe** how operations processes will be shaped by the need to produce goods that are perishable.
5. **Outline** the role of intermediate goods in the production of other goods and the provision of services.
6. **State** how services can be both standardised and customised.

EXERCISE 1.3 EXTENSION

1. **Compare** and **contrast** the operations of a manufacturer and a service business.
2. With reference to an example, **assess** whether services can ever really be totally standardised.
3. **Evaluate** the effect of cost leadership on service provision and state whether it reduces the service level provided.

BizFACT

A business may be large enough to operate each of the key function areas. Alternatively, a business may choose to perform only one or two of the functions in which it is most competent, and hire the services of other businesses to perform the other functional areas. This is seen in the example of Colin's Cafe, a medium sized shopping centre coffee shop. Managers of this business decided to focus on and specialise in coffee retailing and coffee making. The business hires other businesses to do the accounts, to assist with finding skilled employees and to undertake marketing. The use of external providers in this way is known as outsourcing.

1.4 Interdependence with other key business functions

Figure 1.9 shows the range of functions that a business may have. Although a business can separate the key business functions into departments that perform their distinct roles, the functions are interdependent — each relies on the others to perform effectively. Another term for interdependent is cross-coordination.

Interdependence refers to the mutual dependence that the key business functions have on one another. This means that the various business functions work best when they work together. A soccer team might have highly specialised players, for instance a brilliant left wing, a superb fullback and a dynamic goalkeeper. However, despite their individual brilliance, a side will usually win when all players contribute to the game, each working with the others in the team, passing, communicating and

BizWORD

Interdependence *refers to the mutual dependence that the key business functions have on one another.*

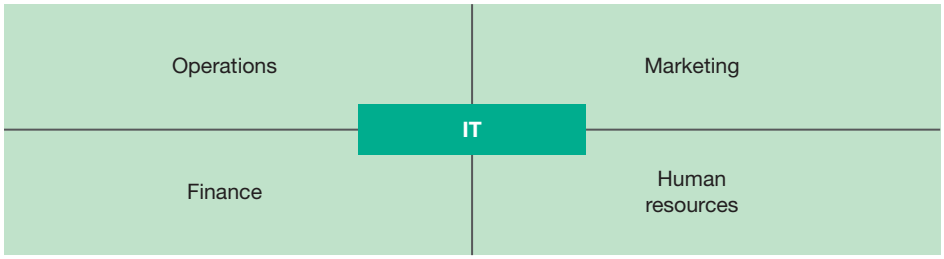


FIGURE 1.9 The range of typical business functions

playing for the same victory. In the same way, each section of the business may perform its specialised function extremely competently, but if together they do not work as a 'team' and aim for the same business goals, the business is not likely to achieve its objectives. Interdependence occurs when each key business function area is committed to the same business goals as the other key areas and they each work in a coordinated and collaborative way to achieve these goals as shown in figure 1.10.

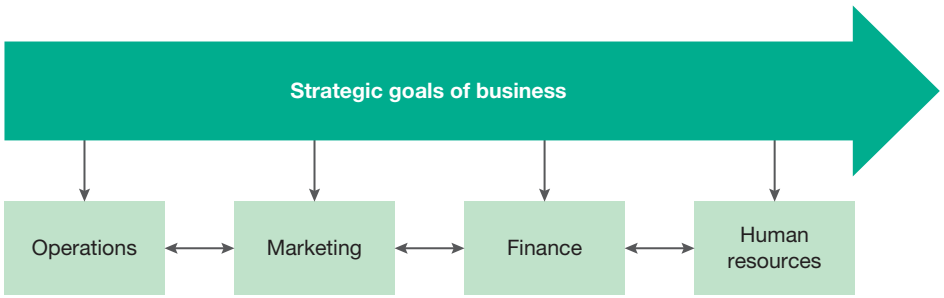


FIGURE 1.10 Interdependence and cross-coordination of business functions to achieve strategic goals

1.4.1 Tasks within the key business functions

In most businesses, closely related tasks are grouped together. Sales and marketing are grouped, finance and administration are grouped, and operations and research and development (R&D) are grouped. Consequently, the range of functions is generally reduced to four main functions as shown in figure 1.11.

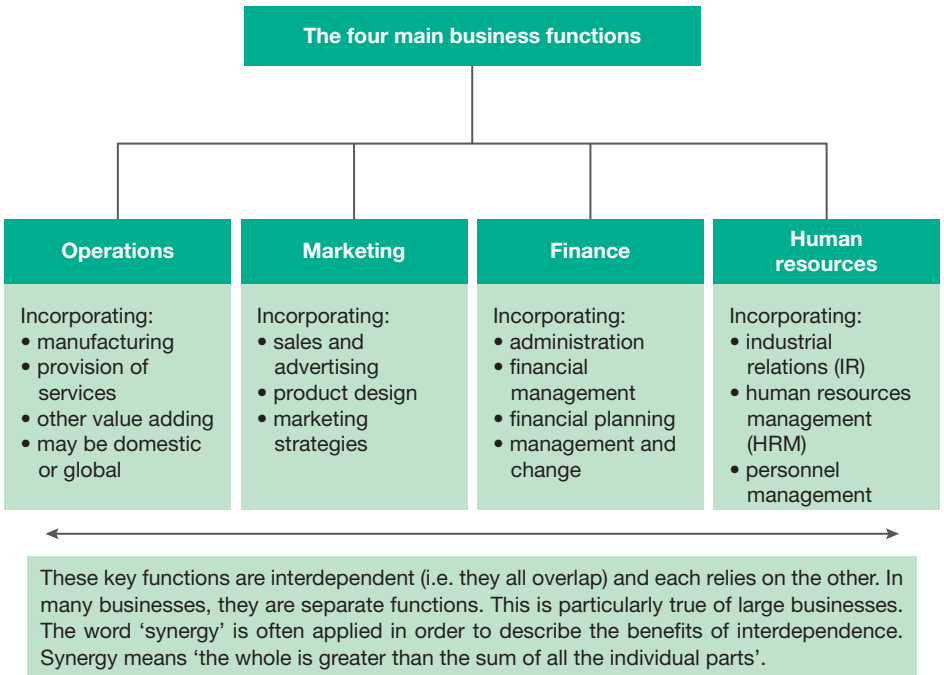


FIGURE 1.11 These key functions are interdependent.

BizFACT

Information technologies or 'IT' is sometimes a discrete department within a business. However, the activities of the IT section affect each key area of business as technology is pervasive through a business enterprise. Operations uses computer-based technology in planning and processing, scheduling, inventory management, quality management and all other aspects and activities. Marketing uses IT software to assess market trends, design products, design communications, create visual stimulus and so forth. Finance uses technology to record transactions and summarise trading into reports that can then be assessed. Finance also uses mathematical modelling to predict and evaluate.

Operations

Operations, as we have already discussed, refers to the business processes that involve transformation or, more generally, 'production'. It is a term that applies both to the manufacturing and services sector. In manufacturing, operations refers more specifically to the processes involved in turning raw materials and resources into outputs of finished goods or products.

Marketing

Marketing is about meeting the needs and wants of consumers through provision of products (both goods and services) at prices that the market is prepared to pay. Marketing is a highly specialised field of business that looks at all aspects of buying and selling, including the psychological processes that people go through when thinking about purchases. From the analysis of why people buy, to pricing, product development, promotion and distribution, marketers attempt to maximise the earning capacity of their businesses through sales. Marketing, and its associated activities, will be examined in more detail in chapters 5–8.

Marketing and operations are interdependent and their functions overlap. Marketing is concerned about the design of products, and their subsequent sale, to meet the needs of consumers. The operations function involves the acquisition or sourcing of products for resale or the sourcing of inputs for production. Thus, the requirement of product design (a marketing requirement) directly affects the operations function. In this way they can be seen to be interdependent.

Finance

This is the function that is concerned with recording and summarising financial transactions into a series of reports that can be easily interpreted. Reports such as income statements (also called revenue or profit and loss statements), which determine the amount of money the business has earned after its expenses have been paid, are very useful to managers and other stakeholders. Other key reports include balance sheets and budgets. These reports provide crucial information to decision makers both within and outside of the business. Finance and its associated activities will be discussed more fully in chapters 9–12.

BizWORD

Profitability *means the excess of revenue or income over expenses or costs.*

A key marketing objective is profitability. **Profitability** requires that a business maximise sales (revenue) and minimise costs (expenses). The operations function is that aspect of business that produces. If costs of production can be minimised then profit margins can be increased. Similarly, if operations processes focus on quality then the resulting products can be sold at higher prices and generate higher revenues. In this way it can be seen there is a direct relationship between operations management and financial management.

A further example can be seen with respect to a decision to invest in facilities and buy technology. Here the high financial costs can lead to faster processing speeds with less waste. Again the financial objective and the operations decisions are interdependent — each affects the other.

Human resources

The function of human resources is to deal with the people the business employs and the issues arising from their employment. It covers all aspects of employment resourcing and includes the acquiring, developing, maintaining and motivating of staff in addition to those processes involved when staff members leave the business — separation. This aspect of a business will be covered in more detail in chapters 13–17. Effective human resource management is vital because people. (human resources) are now recognised as the most important single resource a business has.

In most businesses these days the operations function is going through change. New technologies are enabling faster processing speeds and are changing the way that work is done. This has a direct effect on the human resources within a business. As the nature of work changes so too does the skills and qualities sought in employees.

Outsourcing is also changing the nature of operations and has a direct impact on human resources. The changing shape of businesses as brought on through the use of outsourcing means that communication between human resources can be more complicated and that there is an increasing reliance on technology.

The operations decision to outsource and to acquire technology directly shapes the nature of the workplace and the skills and qualities required of the human resources. In this way the key functions are interdependent.

BizWORD

Outsourcing *or contracting out business functions involves the use of third-party specialist businesses, for example, recruitment firms. It aims to take advantage of the specialist skills provided by them and to achieve a reduction in labour costs.*



FIGURE 1.12 Successful businesses recognise that they rely on the quality of their employees to achieve their goals of profit maximisation, growth and increased market share. People are the business's most valuable resource, so it is important to take care to recruit and maintain the best people.

1.4.2 The relationship between operations and the other key business functions

The relationship between operations and key business functions in two businesses

WILD HORSES CAFÉ

At the Wild Horses Café the owner, Jenni, knows that most sales of coffee are made in the morning and early afternoon. Her busiest days are Friday to Sunday and her café is closed on Mondays. Jenni ensures that she pays suppliers for her weekly order each Tuesday so that stock is delivered by Thursday morning. This requires Jenni to ensure she has cash on hand to pay for supplies when she orders. Jenni manages five part-time and casual staff and rosters more staff for work on the weekends and in the weekday mornings when she is busiest. She knows that the volume of orders directly affects income and requires appropriate staffing. Recently, in response to changing coffee tastes, Jenni expanded the range of coffee beans and flavours that she orders. This required leasing a larger coffee machine and purchasing an additional grinder. As a result of this expansion in product offerings, Jenni's café has experienced a surge in sales and she is currently hiring another barista and two new waitstaff.

ALDI

Aldi has been in the Australian market since 2001 and in 16 years has grown to become the third largest grocery supplier in Australia, having taken market share

SNAPSHOT



'. . . the volume of orders directly affects income and requires appropriate staffing.'

from Coles and Woolworths. Aldi operations was carefully planned as the managers knew that strategic growth would take about ten years. The long-term growth strategy meant that Aldi had to invest significant amounts of finance and capital into setting up supply lines and building warehouses to assist supplying the stores with both the perishable and durable goods it sells.

Aldi has attracted loyal customers through its 'special buys' promotions. These promotions involve selling household items at below cost twice a week. Aldi needs to source this stock and have it ready for sale at each of its nearly 500 stores nationwide. The operations function has to work closely with marketing and finance in sourcing what customers desire at a price they deem attractive. Aldi continues to grow rapidly despite having only 1450 product lines for sale. Coles and Woolworths are losing market share to Aldi even though each of these grocery brands has tens of thousands of consumer goods for sale in-store. The interdependence of key business functions, understood by smart managers (sourced by human resources) continues to build Aldi's brand in Australia.

SNAPSHOT QUESTIONS

1. **List** the four key business functions.
2. **How** does Jenni manage the interdependence of key business functions at Wild Horses Café?
3. **Explain** the importance of understanding interdependence between the key business functions to the success of Jenni's café.
4. **What** role has strategy played in the growth of Aldi in Australia?
5. **Discuss** the advantages of understanding interdependence of the key business functions to the growth of Aldi in Australia.

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Syllabus area 1
Topic 1
Concept 3

Goods and services in different industries
Summary screen and practice questions

SUMMARY

- The range of typical business functions is operations, marketing, finance and human resources.
- Interdependence refers to the mutual dependence that the key functions have on one another. This means that the various business functions work best when they work together.
- In most businesses, closely related tasks are grouped together — for example, sales and marketing, finance and administration, and operations and research and development.
- Operations refers to the business processes that involve transformation or, more generally, 'production'.
- Marketing is about meeting the needs and wants of consumers through provision of products (both goods and services) at prices that the market is prepared to pay.
- Reports such as income statements, which determine the amount of money the business has earned after its expenses have been paid, are very useful to managers and other stakeholders.
- The function of human resources is to deal with the people the business employs and the issues arising from their employment.

EXERCISE 1.4 REVISION

1 **What** is meant by the term 'interdependence'?
2 **List** the four key functions of a business.
3 **Explain** how interdependence occurs between the key business functions.
4 **State** the benefits of interdependence.
5 **What** is outsourcing?
6 **Why** do businesses use outsourcing?
7 **Summarise** the role of the (a) marketing, (b) finance, (c) human resources functions in a business.

on Resources

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Interactivity: Chapter crossword (int-7149)
Interactivity: Multiple choice quiz (int-7150)

EXERCISE 1.4 EXTENSION

1 **Evaluate** the role of business strategy and its importance to the coordination of the key business functions. In your answer **discuss** the concept of synergy.

2 **Assess** the role of IT across the range of business activities.

3 With reference to businesses that you are familiar with, **describe** and **analyse** how the various business functions overlap and are interdependent. Refer to examples to support your answer.

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Sit HSC exam

CHAPTER 2

Influences on operations management

OVERVIEW

2.1 Introduction
2.2 Main influences on operations management
2.3 Corporate social responsibility

2.1 Introduction

As we have already covered, operations management is a crucial key business function. As such, successful management of operations processes is essential to business success. To successfully manage the operations function, managers must deal with a range of external influences that impact on operations. These influences are shown in figure 2.1.

Influences on operations have a dual effect on businesses. First, they can cause the business to undergo change and to continually adjust to external factors. Responsiveness to change is a constant issue for business. A second effect is the threat and the opportunity that these influences represent to operations processes.

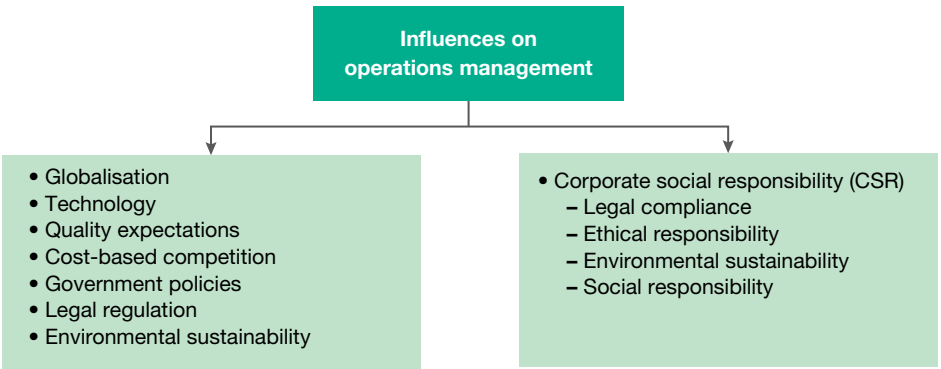


FIGURE 2.1 Influences on operations management

2.2 Main influences on operations management

In this section, we will explore the seven main influences on operations management shown in the left-hand side of figure 2.1. The effect of corporate social responsibility (CSR) will be examined in the latter part of the chapter.

2.2.1 Globalisation

Globalisation refers to the removal of barriers of trade between nations. Globalisation is characterised by an increasing integration between national economies and a high

BizWORD

Globalisation *refers to the removal of barriers of trade between nations. Globalisation is characterised by an increasing integration between national economies and a high degree of transfer of capital (facilities and/or machinery), labour, intellectual capital and ideas, financial resources and technology.*

degree of transfer of capital (facilities and/or machinery), labour, intellectual capital and ideas, financial resources and technology. From a business perspective, globalisation provides a source of market opportunities both from other nations and to other nations. Globalisation can also act as a threat to business as businesses that effectively apply cost leadership principles can undercut the market and dominate.

Globalisation and operations management

Globalisation is a very significant influence on operations management. Large businesses are increasingly orienting their practices towards the global market, with a view to meeting the needs of global consumers. Global consumers seek global brands and tend to seek standardised products. This significantly affects the operations function, which is then structured around a series of global production facilities. Figures 2.2 and 2.3 indicate how operations can be organised around the needs of a global market.

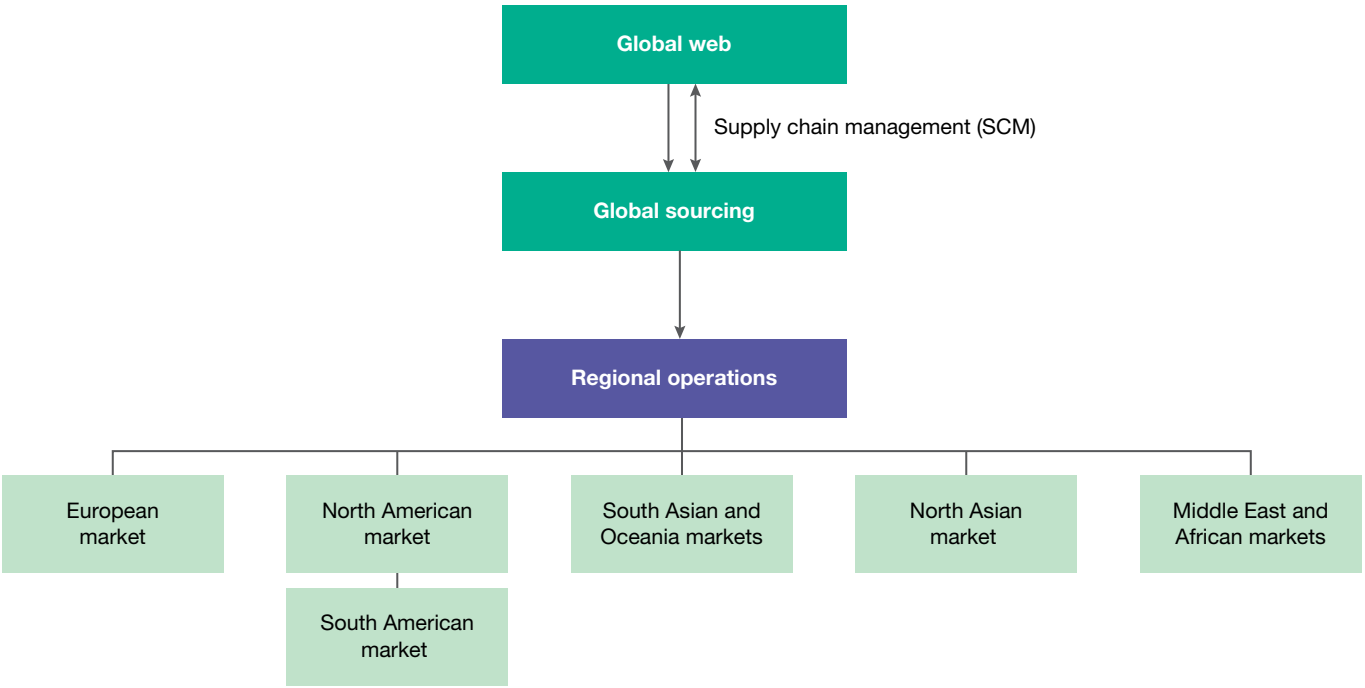


FIGURE 2.2 The organisation of operations to meet the needs of a global market based on the global web: a network of production sites located around the world

The following processes are all features of global businesses that seek to target global markets: product design, which must meet the needs of global consumers, the choice of location for manufacturing facilities, the management of quality, and logistics and inventory management processes.

The use of manufacturing plants for the production of goods means that a business can achieve massive economies of scale advantages. This is evident with businesses like Apple, which has product designed in the United States, but manufactured in China for a global market.

The production of services on a global scale within sectors such as financial services, travel and tourism services, software development and telecommunications also has significant implications on operations processes. AON is an insurer that has effectively created a global insurance brand from the sale of high-quality business insurance products and other business solutions. As stated in chapter 1, as far as possible, large-scale service-based businesses will seek to standardise services. See the following Snapshot for an example of standardised services in a tertiary industry.

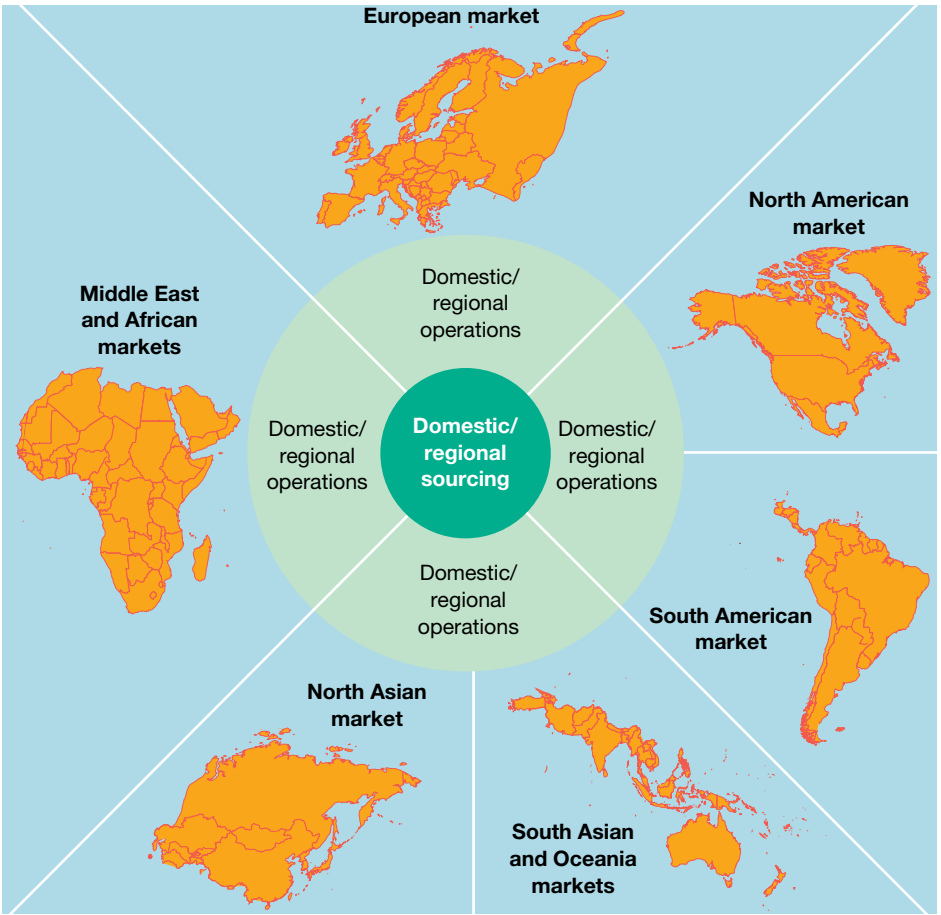


FIGURE 2.3 The hybrid global–local structure ('glocal' structure)

SNAPSHOT



'high internal standards and focus on quality . . .'

Case study: AON — global insurer

AON is a niche provider of insurance, human resources solutions and also of outsourcing for businesses. As a global business it operates in 120 nations and employs over 72 000 personnel. AON is mainly a broker for business insurance so it is not well-known in the Australian market, despite exceeding its goals for growth consistently since it entered the domestic market. AON's global brand has been enhanced hugely with its sponsorship of the Manchester United Football Club. According to AON media the company has 'been named repeatedly as the world's best broker, best insurance intermediary, reinsurance intermediary, captives manager and best employee benefits consulting firm by multiple industry sources'.

While AON operates in 120 different markets, it can standardise a large proportion of its product and then make slight variations that meet the specific needs of diverse local markets. In this way many of the 'back-end' business processes can be standardised. This makes AON a strong business partner for global businesses operating in multiple jurisdictions. The consistency of protocols, high internal standards and focus on quality make AON operations reliable and predictable. In this way AON is growing from strength to strength.

SNAPSHOT QUESTIONS

1. **What** does AON do?
2. **Explain** how standardisation can improve overall quality standards.
3. **Outline** the features that make AON's operations reliable.

Supply chain management (SCM) and the global web

A key aspect of operations management is that of supply chain management. Globalisation has had a significant effect on the operations function with respect to supply chain management. The **supply chain** refers to the range of suppliers a business has and the nature of its relationship with those suppliers. A business needs a very predictable and reliable supply chain that is highly responsive to changes in demand as experienced by the business. Sourcing, an essential aspect of supply chain management, is an operations strategy that requires finding the suppliers needed so that production processes can flow smoothly.

For large global businesses the integration of the range of suppliers creates a network sometimes called the **global web**. Global web refers to the network of suppliers a business has, chosen on the basis of lowest overall cost, lowest risk and maximum certainty in quality and timing of supplies. In supply chain management, the global web strategy is one in which the business aims to minimise costs across the range of its suppliers. Thus, a business will opt for a location with appropriate proximity to its suppliers. If a high proportion of suppliers are in one particular region, this may decide the location of the main operations processes.

BizWORD

Supply chain *refers to the range of suppliers a business has and the nature of its relationship with those suppliers.*

BizWORD

Global web *refers to the network of suppliers a business has chosen on the basis of lowest overall cost, lowest risk and maximum certainty in quality and timing of supplies.*

Case study: Zara — globalisation and its impact on operations

The popular brand Zara is owned by a company called Industria de Diseño Textil (Intidex). It was founded in 1974, opened its first store in 1975 and initially expanded into Europe and the United States before expanding into Latin America (1992) and Asia (2005). By 2017, Zara had over 2200 retail stores globally in 94 markets. Global sales were just under €11.6 billion in 2016.

The company is a part of what is called the 'fast fashion' industry. The fast fashion industry is divided into two types of business: those that manufacture their own clothes and those that source and brand clothes produced by other businesses. Zara's competitors H&M and GAP are companies that buy clothes from other manufacturers. Zara, however, grew through its development of localised production in Spain, Morocco, Portugal and Turkey. Though more recently, Zara has started to allow some offshore production, more than 65 per cent of all of its clothes are made in Europe or Morocco. Zara's founder Amancio Ortega believes that production proximity and quick logistics are two contributors to its global success.

All Zara stock, regardless of where it is made, must pass through the Spanish production and distribution plant. This main production and distribution facility employs over 6000 staff and uses very well-designed logistics and distribution lines. Clothes from here are distributed globally within 48 hours, meaning that there is no need for any local warehousing in the 94 markets where it retails.

Some of the source nations for fabrics include: Vietnam, Bangladesh, Morocco, China and Thailand. The company has about 1200 different suppliers and manages them through a highly centralised control of production. Sourcing globally reduces costs, as does keeping stock moving quickly rather than storing it.

Even though, more recently, Zara has started to outsource some production, it does not tend to mass produce and hence does not realise the economies of scale some other businesses might. Instead, it keeps production volumes low and moves them quickly to the market. It has also changed the production cycle by designing over 1000 new garments per month, rather than seasonally. The garments made from these designs are responsive to market trends as the business has over 200 designers that interact with consumers globally. New products are launched into Zara's global stores every two months.

Zara uses its global proximity to its markets and well-designed logistics to ensure that customers feel valued. Surveys indicate that on average Zara customers visit stores 17 times per year. This is a far higher number of store visits than those made by loyal customers to competing businesses.

SNAPSHOT



'Zara's founder . . . believes that production proximity and quick logistics are two contributors to its global success.'

SNAPSHOT QUESTIONS

1. **Explain** the benefit of globalisation to Zara's scale of production.
2. **What** is a benefit of making garments close to where they are sold?
3. **How** does well-designed logistics help Zara to minimise costs?

SUMMARY

- Globalisation is a reference to the removal of barriers of trade between nations. Globalisation is characterised by an increasing integration between national economies and a high degree of transfer of capital (facilities and machinery), labour, intellectual capital and ideas, financial resources and technology.
- Globalisation has significantly affected the operations function of large and global businesses.
- Globalisation affects consumers who seek global brands and this, in turn, shapes the operations function.
- Globalisation affects organisational design and the supply chain.
- For large global businesses, the integration of the range of suppliers creates a network, sometimes called the global web.
- The supply chain is also affected by whether the nation is innovative or whether it is a follower.

EXERCISE 2.1 REVISION

1 **List** eight key influences on operations management.
2 **What** does the term 'globalisation' mean?
3 **State** two features of globalisation.
4 **Recall** two opportunities that globalisation represents to the operations function in business.
5 **How** does globalisation affect the operations function of a business?
6 **Explain** the importance of supply chain management (SCM) to the operations function.
7 **How** does globalisation act as both an opportunity and a threat to businesses?
8 **Define** the term 'global web'.

EXERCISE 2.1 EXTENSION

1 Wendy's Windows must decide whether to establish a factory to make a component or to contract the manufacturing to an independent supplier. **Propose** the advantages and disadvantages of each option. **Recommend** which of the two options is more efficient. **Justify** your selection.

2.2.2 Technology

BizWORD

Technology *may be defined as the design, construction and/or application of innovative devices, methods and machinery upon operations processes.*

Technology plays a very important role in the application of the operations function of business. **Technology** may be defined as the design, construction and/or application of innovative devices, methods and machinery upon operations processes. Most people are very familiar with a wide range of technologies, both personal and household. Smartphones, laptop computers, desktop computers, gaming consoles, security devices, and so on are well understood and widely available forms of technology that most people interact with. Such technologies enable people to communicate more easily and enable improved business processes. In this way, technology can be seen to be both a range of devices as well as a range of enabling *processes* and applications.

Technology and operations management

Technologies can be applied to, and integrated with, the range of processes that characterise the operations function in business. At an administrative level, technologies such as those in table 2.1 assist with organisation, planning, decision making and control of operations processes. At a processing level, technologies are used in manufacturing, logistics and distribution, quality management, all aspects of inventory management, supply chain management and sourcing, as outlined in the Snapshot on Zazzle.

TABLE 2.1 An overview of some of the technologies used in operations processes

Technologies used in the administration of operations	Technologies used in the range of operations processes
• Use of planning technologies: materials requirement planning (MRP), Gantt charts, critical path analysis (CPA) and other scheduling and sequencing tools • Use of office technologies such as computers (desktop and laptop), scanners, facsimile machines, integrated telephone systems, mobile phones • Use of software such as wordprocessing, graphics packages, spreadsheeting programs, graphing programs, multimedia programs and desktop publishing programs	• The use of large machines in manufacturing plants such as those typical of assembly line production • The use of robotics in highly sophisticated production processes requiring great precision • Use of computer-aided design (CAD), computer-aided manufacture (CAM) and computer integrated manufacturing (CIM) technologies • Rapid manufacturing (RM) and tooling technologies

Case study: Zazzle — using technology to boost operations

Zazzle is a business that helps consumers make customised products. The web-based company launched in 2005 and has a private company legal structure. Its Head Office is in California, United States, with a newly established European base in Ireland.

Customers order their customised products online; Zazzle manufactures to order and so hires people based on their capacity for design. Annually the company hires thousands of people across three different manufacturing plants.

Zazzle seeks to make on-demand products within 24 hours from the receipt of an order. It manufactures and creates custom designs in each of the following product areas: invitations and cards, homewares, clothing, accessories, home and living, office, baby and kids, art, weddings and gifts. Under each of these broad product categories there are subcategories, examples of which are shown here for the clothing and accessories product lines.

Clothing includes t-shirts, underwear, shoes, tank tops, hoodies, activewear, jackets, dresses, maternity wear, sweatshirts, jerseys, leggings and polos.

Accessories includes bags, watches, keychains, jewellery, hats, buttons, wallets, sunglasses, compact mirrors, scarves, athletic headbands, luggage tags, ties, tie bars, lapel pins, cufflinks, button covers, belt buckles, luggage handle wraps, hair ties, money clips, nail art, passport holders, temporary tattoos and belts.

All of the design options are pre-set. For example, if a person wants a custom-designed frisbee, they can choose between five colour options and can upload their own image and text to go onto the frisbee. Alternatively, a customer may opt for an individually designed item that can be purchased after browsing.

For this niche business, the model relies on insightful business partnerships and innovative design strategies that utilise technology from ordering to despatch, and through product design and customisation. Other important aspects of technology use relate to the use of a shopping cart, adaptive databases that match a customer's previous purchasing choices with suggested options and secure payment systems. Distribution involved further investment in technology.

Zazzle has a number of licences with companies and trademarked brands such as Disney, Harry Potter, Sesame Street and Looney Tunes.

Customisation requires the use of innovative technology and a flexible and creative labour force. The company has spent millions of dollars on enabling technologies to help customers design almost every imaginable consumer good, from custom-made chocolate to customised jewellery.

SNAPSHOT



'. . . the model relies on insightful business partnerships and innovative design strategies . . .'

SNAPSHOT QUESTIONS

1. **When** did Zazzle set up, and **what** does it do?
2. **Provide** 12 examples of customised products Zazzle offers to the market.
3. **Describe** the importance of customisation to the market.
4. **What** impact does licensing from trademarked brands have on Zazzle?

2.2.3 Quality expectations

One of the key goals of the operations function of business is quality. The expectation of quality is a significant influence on the operations function of business. The International Standards Organization (ISO) defines quality as being 'the totality of features and characteristics of products (goods) and services that bears its ability to satisfy stated or implied needs'. However, for our purposes, **quality** may be understood to be a specific reference to how well designed, made and functional goods are, and the overall degree of competence with which services are organised and delivered.

Quality and expectations cannot be separated. People have an inherent belief in what the quality standards should be for products (goods and services) and their personal level of satisfaction with their experience of the product will indicate whether the quality has met with expectations or not.

BizWORD

Quality *may be understood to be a specific reference to how well designed, made and functional goods are, and the degree of competence with which services are organised and delivered.*

SNAPSHOT



'Quality products arise when a business has quality processes.'

Case study: Tiffany & Co. — quality expectations

Global high-quality jeweller Tiffany & Co. has been operating since 1837. The company's reputation is based on its very high-quality standards. The company is also known for the high quality of diamonds it sources and for its blend of conservatively contemporary designs.

The reputation of Tiffany & Co. has been enhanced through films and popular songs, for example, in the opening scene of the famous 1961 movie *Breakfast at Tiffany's* and other movies such as *Sweet Home Alabama* and *Sleepless in Seattle*. The quality of Tiffany & Co. products is such that if a product fails in terms of expected quality the company will replace, repair or refund at no cost every time.

Quality products arise when a business has quality processes. Tiffany & Co. has sourcing partnerships (for example, with De Beers diamonds, the world's highest quality diamond merchant) and internal processes that emphasise quality.

High quality has been the cornerstone of the reputation built up by Tiffany and Co., which has in turn generated an expectation by its customers that these standards will always be met.

SNAPSHOT QUESTIONS

1. Briefly **recount** the basis of Tiffany & Co.'s reputation.
2. **How** does Tiffany & Co. meet customer expectations?

studyon

Syllabus area 1
Topic 2
Concept 1

Influences on operations management
Summary screen and practice questions

Quality expectations and operations management

Within the operations management function, quality informs all operations processes. The expectations that people have of businesses determine the way that products are designed, created and delivered to customers. Clearly, this implies that operations processes must follow particular standards or prescribed minimum levels of excellence. Quality expectations in operations management may be summarised into several key things that customers look for in products — be they goods or services. These quality expectations for goods and services are listed and distinguished in figure 2.4.

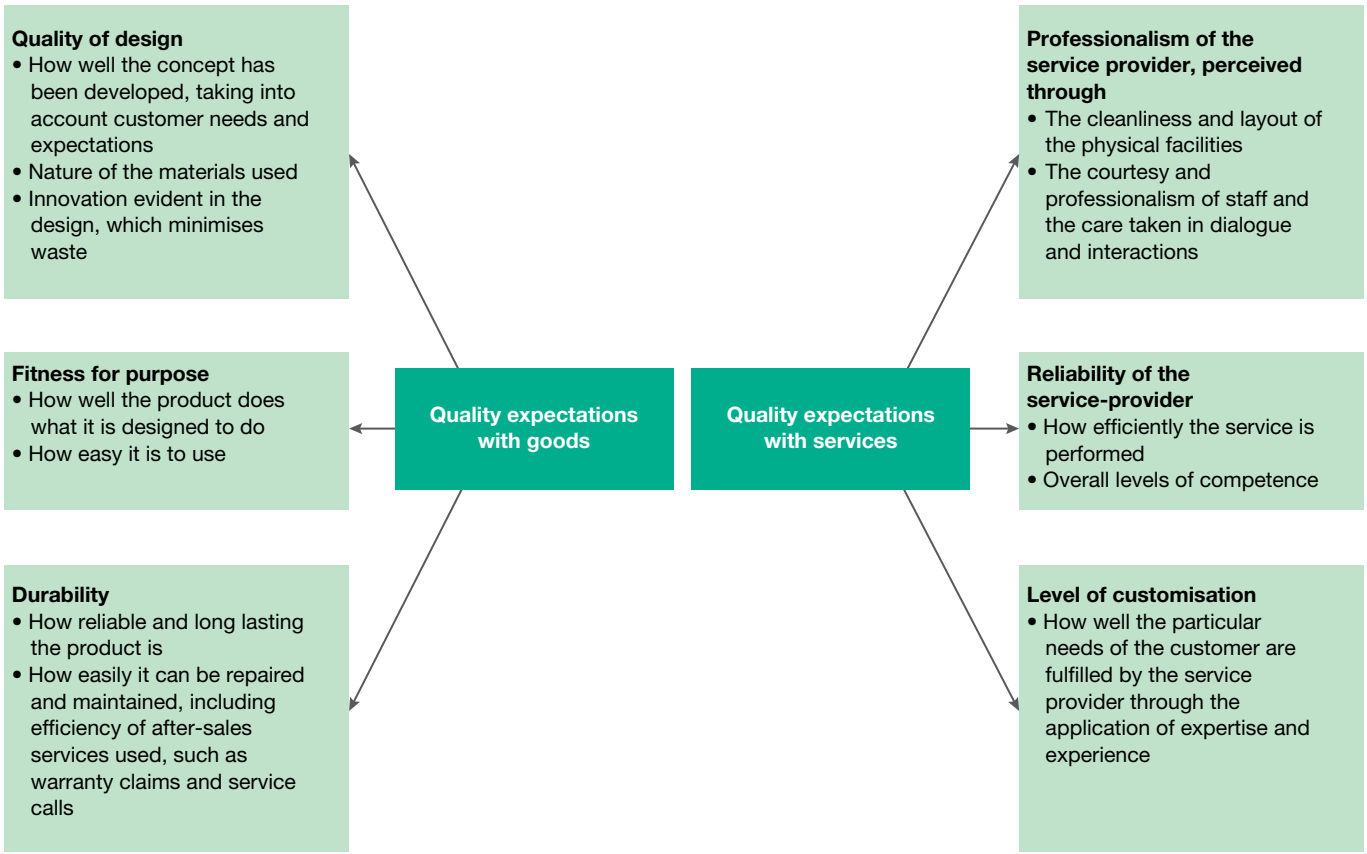


FIGURE 2.4 Distinguishing between quality expectations in goods and quality expectations in services

2.2.4 Cost-based competition

Another significant influence on the operations management function arises from the actions of competitors and the way such competitors price their products. As seen earlier in chapter 1, cost is a very significant element in business, and efficiency can be determined from assessing the cost structures in business. In highly competitive markets, cost-based competition can shape the operations function in competing businesses. **Cost-based competition** is derived from determining breakeven point (the level at which the firm's total revenue is exactly equal to its total costs) and then applying strategies to create cost advantages over competitors. Cost-based competition recognises that prices cannot keep increasing; therefore, reducing costs is a way to maximise profits when revenues are fixed. Mass customisation enables cost-based competition even when products are differentiated rather than standardised.

Cost-based competition and operations management

Cost-based competition is a feature of operations management when businesses bring a cost leadership approach to the operations function. That is, they focus on reducing costs to a minimum while maintaining profit margins.

In applying a cost leadership approach to operations management (see the following Snapshot), cost can be analysed from several different perspectives (recall table 1.1). Alternatively, costs may be divided into those which are fixed and those which are variable. **Fixed costs** are those that are not dependent on the level of operating activity in a business. This means that whether the business increases, decreases or maintains production these costs are unchanged. Examples of such costs are building leases and insurance costs. By contrast, **variable costs** are those that vary in direct relationship to the levels of operating activity or production. Such costs include labour costs and costs of energy.

BizWORD

Cost-based competition *is derived from determining breakeven point (the level at which the firm's total revenue is exactly equal to its total costs) and applying strategies to create cost advantages over competitors.*

BizWORD

Fixed costs *are those that not dependent on the level of operating activity in a business. Fixed costs do not change when the level of activity changes — they must be paid regardless of what happens in the business.*

Variable costs *are those that vary in direct relationship to the levels of operating activity or production. Such costs include labour costs and costs of energy.*

SNAPSHOT

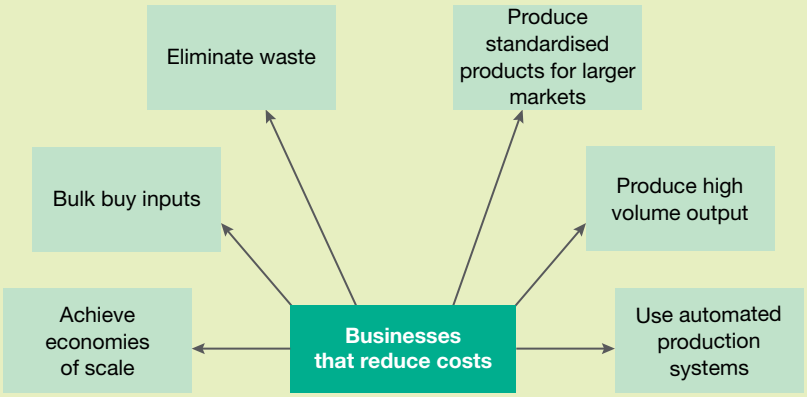
'large volume of turnover . . . enables economies of scale in the supply chain.'

Kmart, Target and Big W — cost-based competition

Cost-based competition can be seen by customers in the pricing applied by Kmart, Target and Big W — the three main department stores in Australia. When prices for the consumer are low, then the supply chain and procurement strategies applied within the operations functions are efficient.

Each of the three businesses draws inventory from low-cost nations overseas such as China, India and Vietnam. The large volume of turnover generated by each of the businesses enables economies of scale in the supply chain.

Reducing costs can be done a number of ways as shown in the diagram below.



Operations managers in businesses that compete on cost prioritise their decision making based on reducing costs and improving productivity by:

- ensuring stable production processes with limited interruption
- ensuring all resources are used to their optimum advantage
- constantly looking for opportunities to streamline production processes
- updating facilities and equipment with new, more efficient technology
- providing training and development to improve the skills and capabilities of employees.

SNAPSHOT QUESTIONS

1. **State** two strategies that can be applied by businesses to reduce supply side costs.
2. **Explain** how economies of scale can lower costs.
3. **Identify** four means by which operations managers can improve business productivity.

SUMMARY

- Technology plays a very important role in operations management — from administration, through to all operations processes.
- Management of quality expectations in both the manufacture of products and the delivery of services is an essential role and goal of operations management.
- Quality expectations differ between goods and services.
- Whether quality expectations relate to goods or services, in both cases they lead to consumers having a perception about the standard of products, and accordingly consumers will be prepared to pay a higher price for higher quality.
- Another factor affecting and shaping operations is cost-based competition. Here a business can apply cost leadership to reduce both fixed and variable costs.

EXERCISE 2.2 REVISION

1 **Define** the term 'technology'.

2 **List** four forms of technology found in the household.

3 **What** is the main advantage of using communications technologies?

4 **How** does technology affect the operations function of a business?
5 **Explain** how a person's expectations affect how they view quality.
6 With reference to a case study, **detail** the benefit of building quality expectations.
7 **What** is the relationship between quality and price?
8 Place the features of quality expectations, for both goods and services, from figure 2.4 into the order you think is most important to least important. **Justify** the order you chose.
9 **How** does cost leadership affect price?
10 **Clarify** how cost-based competition affects the operations function of business.

EXERCISE 2.2 EXTENSION

1 **Analyse** the meaning of quality with reference to one motor vehicle brand. Do this by tabulating the cost and features of different types of motor vehicles (some low priced and some high priced).
2 Compile a list of five major fuel outlets. **Evaluate** the effect of cost-based competition on fuel retailers (refer to brands).
3 (a) **What** is the difference between fixed and variable costs?
(b) **Explain** which costs vary as scale of production increases.
(c) **Assess** the circumstances under which fixed costs can vary. (*Hint:* Think of a situation where a business grows rapidly and needs additional facilities and machinery).

2.2.5 Government policies

All businesses operate in a political–legal environment. Political decisions affect the business rules and regulations, which, in turn, directly affect the management of various key business functions. Government policies change from time to time, most notably due to a change in government or a change in social expectations. Government policy is, therefore, a notable source of change and a significant influence on business operations. This can be seen in the BizFact on the government policy on an instant asset write-off for small businesses.



FIGURE 2.5 The instant asset write-off policy helps businesses to easily access technology.

Government policies and operations management

Government policies often impact on business. Policies such as taxation rates, required materials handling practices, work health and safety (WHS) standards, industry training requirement, public health policies, environmental policies,

BizFACT

Since 2015, and until at least the middle of 2018, the Commonwealth government had a policy of allowing small businesses to claim a tax deduction for asset purchases of under $20 000. Typically, a business buying assets would be allowed to 'expend' the asset through an accounting process called depreciation. Depreciation allows a business to reduce the value of an asset in order to reflect its true worth after use. In this way, a business can reduce tax through claiming non-cash expenses such as depreciation. This tax benefit would typically last between five and ten years, as assets lost value and were then replaced.

The new policy of allowing a small business to claim up to $20 000 of assets as an expense, instead of having to slowly depreciate the value over years, is very beneficial. This is because it helps businesses invest in computers, vans, office furniture and other assets but get an immediate tax benefit. The tax benefit arises because expenses are matched against business income and therefore reduce profitability and lower the amount of tax payable.

Small business owners and peak bodies such as the Australian Chamber of Commerce and Industry (ACCI) believe that the instant asset write-off policy encourages investment by business and makes it more efficient.

employment relations, trade and industry policies all have an impact on business operations. Since policies can inform law-making, and lead to business opportunities, operations managers need to be fully aware of the contemporary government policies and what they comprise.

2.2.6 Legal regulation

A highly significant external factor that affects the operations function of business is that of laws and regulations. The range of laws with which a business must comply are collectively termed 'compliance'. The regulations that shape business practices and procedures must be followed at the risk of penalty, hence the term compliance. The expenses associated with meeting the requirements of legal regulations are termed **compliance costs**.

Laws make clear the standards of society, and businesses are expected to comply with the standards of behaviour imposed by the legal regulations.

BizWORD

Compliance costs *are the expenses associated with meeting the requirements of legal regulations, i.e. abiding by all laws.*



FIGURE 2.6 Providing a healthy and safe workplace environment is an important part of an operation manager's responsibilities.

Legal regulation and operations management

All aspects of business must abide by the laws of business. Operations management has particular laws that influence how practices and processes are conducted. The operations function involves transformation and value adding. The transformation or conversion involves the use of any or all of labour, technology, finance, machinery and energy. The relevant laws will relate to labour and labour management, as well as the environment and public health including:

- work health and safety (WHS) — in the use of machinery and in interacting with the business environment. Safe and healthy working conditions require that employees be given appropriate safety training, use of protective equipment, and work with machines that abide by noise, pollution and safety standards
- training and development — in the use and application of technology and in the appropriate methods required to work effectively

BizFACT

National work health and safety laws took effect in January 2012 with the passing of the Work Health and Safety (WHS) Act 2011 (Cwlth).

- fair work and anti-discrimination laws — requiring that employees be treated with dignity and respect
- environmental protection — in the use of minimising pollution, eliminating and safely disposing of any toxic residues
- apply rules related to public health — including any fair trading rules which influence product safety standards and fitness for purpose of products.

The range of laws affecting business operations is shown in figure 2.7.

Racial Discrimination Act 1975 (Cwlth)
Sex Discrimination Act 1984 (Cwlth)
Workers Compensation Act 1987 (NSW)
Disability Discrimination Act 1992 (Cwlth)
Age Discrimination Act 2004 (Cwlth)
Anti-Discrimination Act 1977 (NSW)
Work Health and Safety (WHS) Act 2012 (Cwlth)
Environment Protection and Biodiversity Conservation Act (1999) (Cwlth)
Superannuation Guarantee Act 1992 (Cwlth)
Taxation Act 1953 (Cwlth)
Corporations Act 2001 (Cwlth)
Fair Work Act 2009 (Cwlth)

FIGURE 2.7 The range of laws affecting and shaping business operations in Australia

2.2.7 Environmental sustainability

Awareness of the negative effects of business operations on the environment has led to a call for businesses to adopt environmentally sustainable practices. **Environmental sustainability** (ecological sustainability) means that business operations should be shaped around practices that consume resources today without compromising access to those resources for future generations. There are three main aspects to environmental sustainability (ecological sustainability). These are the sustainable use of renewable resources, a reduction in the use of non-renewable assets and the application of the **precautionary principle**. Applying the precautionary principle requires that, where environmental impacts are uncertain, a business undertake actions that are most likely to cause least environmental impact.

Environmental sustainability and operations management

The operations management function is significantly affected by the rise in climate change awareness and the need to integrate a long-term sustainable view of resource management into business planning and practice. This can be seen in the move by businesses to reduce and minimise waste; recycle water, glass, paper and metals, and reduce their **carbon footprint**. The carbon footprint refers to the amount of carbon produced and entering the environment from operations processes.

BizWORD

Environmental sustainability *(ecological sustainability) means that business operations should be shaped around practices that consume resources today without compromising access to those resources for future generations.*

The **precautionary principle** *requires that, where environmental impacts are uncertain, a business undertake actions that are most likely to cause least environmental impact.*

Carbon footprint *refers to the amount of carbon produced and entering the environment from operations processes.*

on Resources

Video: Environmental sustainability and Ferguson Plarre Bakehouses (eles-1089)

SUMMARY

- Government policy is a source of change for business.
- Government policies affect operations management decisions.
- Policies from government can become laws and regulations.
- Businesses should comply with regulations including those relating to the environment.
- While some government policies restrict business practices, other policies encourage business and provide opportunities.
- Business operations are required to adopt environmentally sustainable practices to reduce their carbon footprint.

studyon

Syllabus area 1
Topic 2
Concept 2

Globalisation and technology
Summary screen and practice questions

EXERCISE 2.3 REVISION

1 **What** are government policies?
2 **Define** the term 'legislation' and provide two examples.
3 **Clarify** how legislation affects the operations function of a business.
4 **Why** are the laws with which a business must comply collectively termed 'compliance'?
5 **Recall** the relationship between legal regulation and compliance costs.
6 **Summarise** three relevant laws that relate to labour and labour management for the environment and public health.
7 **State** the three main aspects to environmental sustainability.
8 **How** does environmental sustainability affect the operations function of business?

EXERCISE 2.3 EXTENSION

1 **Determine** how the law can affect and shape operations management. Refer to information from the **Fair Work Ombudsman** website to assist in answering this question.
2 Select one of the laws listed in figure 2.7. **Evaluate** how the selected law would affect the cost and complexity of business.
3 **Examine** the notion of legal compliance. Explain how compliance adds cost to business but also regulates the conduct of business with reference to examples.
4 **Investigate** the government policy on small business instant asset write-offs. Answer the following questions.
   (a) **What** does the government classify as a 'small business' for the purpose of the policy?
   (b) **How** does the instant assets write-off work?
   (c) **Why** do business people like the instant asset write-off policy?
   (d) Should the government expand the instant asset write-off policy to include large businesses? **Justify** your response.

on Resources

Weblink: Fair Work Ombudsman

2.3 Corporate social responsibility

A relatively recent phenomenon, affecting all key areas of business, is **corporate social responsibility (CSR)**. Corporate social responsibility refers to open and accountable business actions based on respect for people, community/society and the broader environment. It involves businesses doing more than just complying with the laws and regulations. Formerly called the '**triple bottom line**', CSR places value on financial returns as well as social responsibility and environmental sustainability. This means that the driver of corporate decision making is not simply profitability, but rather something that more broadly reflects a range of community concerns and social expectations. Triple bottom line refers to the financial profitability, the social impact and the environmental impact of a business.

This can be seen with respect to Westpac Group in the following Snapshot.

BizWORD

Corporate social responsibility (CSR) *refers to open and accountable business actions based on respect for people, community/society and the broader environment. It involves businesses doing more than just complying with the laws and regulations.*

Triple bottom line *refers to the financial profitability, social impact and the environmental impact of a business.*

SNAPSHOT



Case study: Westpac Group — leader in CSR

The Westpac Group has been described as the most socially responsible bank in Australia. It has achieved a series of awards on account of its approach to sustainability and ethical business practices:

1992 First Australian bank to publish an environmental policy
1997 First Australian bank to create a formal community volunteering scheme
2000 Founding signatory to the UN Global Compact and launched the first socially responsible investment product in Australia
2002 Founding signatory to the Equator Principles and first Australian bank to publish a sustainability report

2014 Ranked number one in the Global 100 most sustainable companies in the world

2017 Westpac Group retained its position as the world's most sustainable bank in the 2017 Dow Jones Sustainability Indices (DJSI). This marks the fourth year in a row and tenth time it has achieved the global banking sector leadership position.

2017 progress highlights

Supporting gender equity

- Proportion of leadership roles held by women achieved the 2017 target of 50%, up from 48% in 2016.
- Introduced additional targets for our Board (30% women by end 2018) and General Managers (40% women by end 2017).
- In 2016, piloted an anonymous recruitment initiative to tackle unconscious bias by removing applicants' names, schools and other cultural indicators prior to applications being shortlisted for recruitment. In 2017, completed the roll-out of the inclusive leadership program to senior leaders. The program built upon the previous unconscious bias program, in place since 2013. Also designed a customised inclusive leadership program for middle management that will be delivered through an innovative approach introducing theories such as privilege and recognising bias.

Increasing flexible working arrangements

- Percentage of employees working flexibly increased from 63% in 2014 to 74% in 2016, with this figure remaining at 74% for 2017.

Reducing our environmental footprint

- Achieved 75% waste to recycling target following improvements in waste sorting, site audits and increased screening.
- Maintained carbon neutral status for the 4th year in a row.
- Achieved 6% improvement in electricity efficiency in commercial and retail sites, exceeding our 2017 target.
- Ranked world's most sustainable bank for 10th time in 2017 Dow Jones Sustainability Indices Review
  - — First ever Six Star Green Star rated bank branch
  - — Received Six Star Green Star rating for the St. George branch at Barangaroo — the first Green Star rating for an Australian bank branch and the highest ever rating for a retail outlet reflecting leading eco-efficiency practices

Source: Extracts from Westpac Sustainability Report 2016; Westpac Sustainability Report 2017

SNAPSHOT QUESTIONS

1. **List** three different areas where Westpac Group demonstrates an awareness of broader social, community and environmental concerns?
2. **Examine** the importance of increasing the number of women in senior leadership positions.
3. **How** could removing names from applicants affect recruitment outcomes?
4. **Create** a report on how Westpac may be described as the most socially responsible bank in Australia and one of the most responsible banks globally.

'. . . the most socially responsible bank in Australia.'

Corporate social responsibility and operations management

Corporate social responsibility (CSR) is a key concern in operations management for contemporary businesses. Operations management involves processes of transformation that draw from a range of inputs to make final products. The principles of CSR require a business to manage the effects of its activities on society/community and the environment, such that negative impacts are minimised. This requires that a business understand where and how its inputs are sourced so that it only draws from suppliers that adhere to appropriate standards. It also requires that a business shapes its processes in such a way as to minimise environmental damage and waste. The operations process can further integrate principles of CSR through managers ensuring recruitment practices draw from a diverse range of employees and are inclusive of people from all backgrounds.

2.3.1 The difference between legal compliance and ethical responsibility

All businesses should comply with all applicable laws and regulations. The government creates laws with an expectation that they will be followed. Penalties for breach of business laws act as a deterrent and can assist businesses to understand their obligations. Some businesses, however, go much further than simply adhering to the minimum requirements set out under the law; they demonstrate a commitment to ethical responsibility. The difference then between legal compliance and ethical responsibility is that legal requirements require businesses to follow the letter of the law — the prescribed standards of behaviour. Ethical responsibility sees businesses meeting all of their legal obligations and taking it further by following the intention and 'spirit' of the law.

Complying with legislation costs a business money, which, as was previously explained, is referred to as compliance costs. To go further than the requirements of legislation is even more expensive for businesses. In demonstrating ethical responsibility, a business is demonstrating that it values something more than just earning maximum profits because it is allocating money over and above what it costs to comply with the law.

Legal compliance and business operations

Compliance typically falls in a number of areas for business. These areas include, but are not limited to:

- labour law compliance, such as minimum wages, award wages, working hours, breaks, pay for various forms of leave, other on-costs associated with labour, workers compensation and WHS laws
- environmental and public health compliance, such as regulations stopping dumping, pollution (air, land and water), requiring certain standards of operating and of waste disposal
- business licensing rules, such as those requiring particular levels of training or certification and those placing conditions on operations (such as restricted working hours, zoning restrictions, and content and disclosure restrictions)
- taxation, such as levies and duties as well as taxes imposed on profits. Superannuation can be considered a form of taxation that is invested for retirement purposes. Taxation can be applied in such a way as to encourage particular practices or penalise particular activities
- trade practices and fair market dealings, which address issues of market power, misleading and unfair conduct, price collusion, monopoly behaviour, market concentration (competition) and product safety
- migration and rules around the use of offshore skilled labour, which aim to ensure minimum standards are applied to labour brought in from other nations.
- intellectual property, which addresses issues related to moral rights such as copyright, patents, trademarks, designs and other original ideas and artistic works.
- financial and accounting regulations and corporations law, which aim to standardise methods and rules around financial records and reports, as well as ensuring that company directors follow particular rules as fiduciaries. A **fiduciary** is a person in a position of financial trust with respect to others' money
- corporations law (also called 'Anti-trust' law), which imposes duties on directors and others who work in responsible positions within corporations.
- human rights, such as rules restricting discrimination on the grounds of disability, culture, sexual preference, gender, age or any other distinguishing feature.

Clearly, there are numerous laws that shape the conduct of business. When businesses conduct their operations, so that they are abiding by all relevant and applicable local, state and federal laws, they may incur significant costs. Given that the main goal of business is to generate maximum profit, it is easy to see why many

BizWORD

*A **fiduciary** is a person in a position of financial trust with respect to others' money.*

businesses opt for the lowest level of compliance permissible. This would mean that the business is incurring the lowest necessary compliance costs possible.

Outsourcing, compliance and business behaviour

One way that businesses aim to reduce compliance costs is by structuring their business operations so that different aspects are conducted by outside parties. The process known as **outsourcing** involves the use of outside specialists to undertake one or more key business functions. Outsourcing may be done onshore or offshore. **Onshore outsourcing** involves the use of domestic businesses as the outsourcing provider, whereas **offshore outsourcing** involves taking the activities to a provider in another country. Offshore outsourcing takes advantage of regulatory differences between nations.

This means that the compliance requirements are different between the nations chosen and allow the business to take advantage of significant cost savings. Lower taxation rates, lower standards of labour, weaker environmental and intellectual property regulations all enable businesses to reduce their compliance costs. Of course, the use of offshore outsourcing raises ethical issues concerning business behaviour. For example, should a business operate in nations with loose WHS laws when the costs saved can place employee welfare at risk? Or should a business outsource its operations to a third party that takes responsibility for compliance? This third party dealing can be a screen behind which many global businesses hide. In this way, breaches of compliance in other nations can be blamed on the party they have outsourced to.

BizWORD

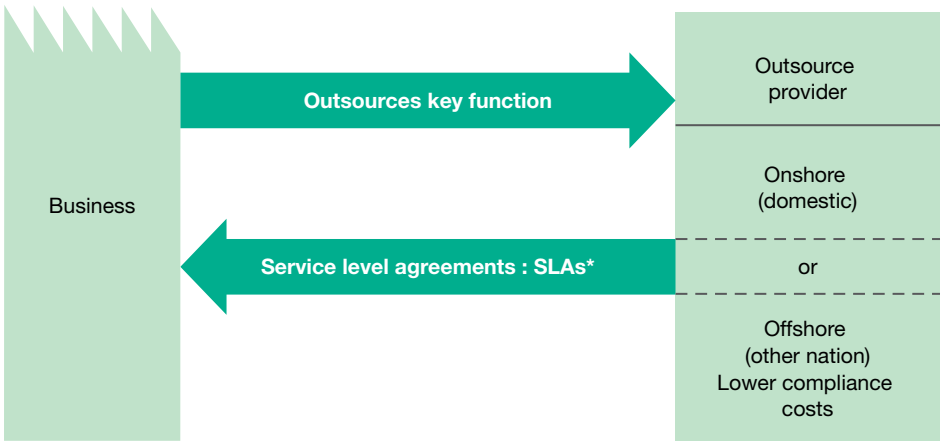
Outsourcing *or contracting out business functions involves the use of third-party specialist businesses, for example, recruitment firms. It aims to take advantage of the specialist skills provided by them and to achieve a reduction in labour costs.*

Onshore outsourcing *involves the use of domestic businesses as the outsourcing provider.*

Offshore outsourcing *involves taking the activities to a provider in another country.*



FIGURE 2.8 In some developing countries, sweatshop conditions exist, in which women and children work long hours in extreme heat for very low wages and with virtually no safety precautions. There is increasing pressure to ensure employees who work for low wages in many developing countries are not exploited by unscrupulous businesses.



* SLA: Contracted minimum standards of service

FIGURE 2.9 The way outsourcing is used by a business to reduce costs of compliance. *Note:* the use of service level agreements (SLAs) can be an ethical way to ensure the outsourcing provider adheres to high standards of conduct.

BizFACT

The main international body that discusses the workplace and sets guidelines and rules for work is the International Labour Organization (ILO). Information about the ILO can be read below.

Ethical responsibility

Ethical responsibility, as discussed earlier, involves businesses going beyond the law and taking into account broader social, community and environmental concerns. However, when laws and regulations differ between nations, it can be hard to know *how* to be ethical in given business situations. Under such circumstances, businesses may guide their decision making after consulting with special interest groups or following guidelines set down by international bodies. In manufacturing operations there can be significant international differences in standards for labour in terms of wages, health and safety, training and so on. A business may choose to follow international labour standards that come from the International Labour Organization (ILO).

About the ILO

The only tripartite U.N. agency, since 1919 the ILO brings together governments, employers and workers representatives of 187 member States, to set labour standards, develop policies and devise programmes promoting decent work for all women and men.

Mission and impact of the ILO

Promoting jobs, Protecting people

The International Labour Organization (ILO) is devoted to promoting social justice and internationally recognized human and labour rights, pursuing its founding mission that social justice is essential to universal and lasting peace.

As the only tripartite U.N. agency, the ILO brings together governments, employers and workers representatives of 187 member states to set labour standards, develop policies and devise programmes promoting decent work for all women and men.

Today, the *ILO's Decent Work Agenda* helps advance the economic and working conditions that give all workers, employers and governments a stake in lasting peace, prosperity and progress.

FIGURE 2.10 The role of the International Labour Organization (ILO)

Source: www.ilo.org/global/about-the-ilo/lang--en/index.htm; www.ilo.org/global/about-the-ilo/mission-and-objectives/lang--en/index.htm

The ILO holds annual conventions called the International Labour Conference and raises matters of importance to workplaces and the rights of employees. Such matters include:

- working women and maternity protection
- the provision of safe working conditions.

The workplace issues that are raised are put into a report. If two-thirds of the nations in the ILO agree to the report's recommendations, it becomes an International Labour Standard. Nations are expected to pass laws consistent with the International Labour Standards.

2.3.2 Environmental sustainability and social responsibility

As discussed previously, economic development must be accomplished sustainably — that is, using methods of production that conserve the Earth's resources for future generations. Economic growth should not occur at the expense of polluting and degrading the air, water and forests that are essential to supporting life on this planet. There needs to be a balance between economic concerns and environmental concerns — in other words, environmental sustainability.

Consequently, businesses are being asked to take increasing responsibility for the protection of the environment. The Earth is a fragile system, and needs high levels of support and informed intervention so that it may sustain itself. The social

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on Resources
Video: Di Bella Coffee and CSR (eles-2284)

conscience of responsible business owners (and, increasingly, government legislation) has led them to adopt policies of conservation, recycling and restoration. The principle of ecological sustainability requires businesses to evaluate the full environmental effects of their operations.

Additionally, the growing consumer expectation that products should be 'clean, green and safe' is changing management practices in a number of Australian businesses. By producing new and better products in an ecologically sustainable manner, the business focus coincides with stakeholder expectations.

In response to concerns about climate change, the community increasingly expects businesses to:

- adopt greenhouse abatement (reduction) measures
- encourage the development of long-term sustainable strategies.

Corporate social responsibility (CSR), as explained previously, refers to a business's management of the social, environmental, political and human consequences of its actions. A socially responsible business tries to achieve two goals simultaneously: (1) expanding the business and (2) providing for the greater good of society. It recognises that business activities have an impact on society and as such businesses need to give careful consideration to their actions. The central theme is 'above and beyond' making a profit and obeying the law.

Social responsibility is good business — customers eventually find out which businesses are acting responsibly and which are not. Customers can react and stop buying a business's product if they learn that the business is exploiting employees, accepting bribes or polluting the environment. At the same time, customers will reward socially responsible businesses by purchasing more of their products. Obviously, socially responsible business behaviour costs money in the short term but in the long run turns out to be to the company's own interest. The impact of customer choices on business behaviour can be seen in the following ethical sourcing Snapshot.

BizFACT

Unilever is a global business that produces numerous well-known global brands such as Rexona, Lynx, Lipton and Dove. The business has been under increasing pressure to incorporate broader social and ethical standards into its operations processes. Pressure from environmental groups led to a decision by the company to source only sustainably produced palm oil for its products. Unilever is now the Chair of the Roundtable of Sustainable Palm Oil (RSPO). Unilever has also responded openly and positively to Oxfam, which criticised the treatment by Unilever of its employees in Vietnam. The company is an example of being open to change and understanding the importance of social and ethical responsibility.

SNAPSHOT

Ethical sourcing — clothing manufacture

Consumers are increasingly concerned about the impacts on people and the environment — both directly and indirectly — from the manufacture of the clothes they buy. The production standards of businesses that are within another business's supply chain is of concern to the market. Non-government organisations are increasingly exposing the supply chains of global brands, thus allowing consumers to make informed decisions about whether they want to purchase the brands with full knowledge about the brand's sourcing behaviour. One organisation that compiles lists detailing the level of ethical sourcing of the retail brands is Baptist World Aid. This organisation compiles the *Ethical Fashion Report*.

The *Ethical Fashion Report*

How does it work?

The grades awarded by the Ethical Fashion Report are a measure of the efforts undertaken by each company to mitigate the risks of forced labour, child labour and worker exploitation in their supply chains. Higher grades are given to companies with labour rights management systems that, if implemented well, should reduce the extent of worker exploitation.

Our research team assesses each company's labour rights management system according to 40 specific criteria. These assessments consider three critical stages of the supply chain as a proxy for the entire supply chain: raw materials, inputs production and final manufacturing.

What is Behind the Barcode?

Behind the Barcode is a series of industry reports which seek to empower consumers to purchase ethically and, by doing so, encourage companies to ensure workers are protected and not harmed; that they are rewarded and not exploited; and that they can work free from the tyranny of modern slavery.



'Since the first edition of the *Ethical Fashion Guide* in 2013, an additional 32% of companies are working to trace where their fabrics are coming from . . .'

One of these industry reports is the *Ethical Fashion Report*. It is released with an accompanying *Ethical Fashion Guide*. The research published in the 2017 *Ethical Fashion Report* grades 330 fashion brands operating in Australia and around the world, and assesses the systems they have in place to protect the workers in their supply chain from exploitation, forced labour and child labour.

Does shopping 'ethically' really make a difference?

You would be amazed at the difference your purchasing decisions can make! Since the first edition of the *Ethical Fashion Guide* in 2013, an additional 32% of companies are working to trace where their fabrics are coming from:

2013 49% **2015** 61% **2016** 79% **2017** 81%

An additional 28% of companies are working to trace where their raw materials are coming from:

2013 17% **2015** 31% **2016** 39% **2017** 45%

An additional 31% of companies are investing in paying fairer wages to workers:

2013 11% **2015** 14% **2016** 32% **2017** 42%

So yes, your advocacy and choice to purchase ethically is making a real difference. We hope that you take this little guide with you whenever you shop, to empower you to make every day ethical purchasing decisions.

The *Ethical Fashion Report* can provide consumers with insights into the buying or sourcing practices of the businesses they purchase from. From this, consumers are better informed as to whether they would like to support those businesses. Since consumer decisions will affect the revenue of businesses, a potential loss of revenue will 'encourage' businesses to behave in ways that consumers deem acceptable.

Of course, in disclosing certain information and in behaving in ethical ways, businesses will incur additional costs. However, as a general rule, businesses that behave in ethical ways can also charge more for their products, as consumers are willing to pay more for such products. In this way, all parties benefit, including the consumer who will feel happy with the way their choices contribute to improving business practices.

Source: Extracts from Baptist World Aid, *2017 Ethical Fashion Guide*

SNAPSHOT QUESTIONS

1. **Describe** the purpose and importance of the *Ethical Fashion Report*.
2. **Explain** whether it is important for consumers to be aware of where and how the products they buy are made and sourced.
3. **Assess** the likely impact of consumers making informed decisions on the way consumers buy.

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Syllabus area 1
Topic 2
Concept 4

Government policy, legal regulations and environmental sustainability
Summary screen and practice questions

SUMMARY

- Corporate social responsibility (CSR) is an important influence on business and it integrates financial, social and environmental goals.
- Legal compliance refers to businesses abiding by the word of the law, whereas ethical responsibility encompasses a much broader integration of social, community and environmental concerns.
- Compliance costs are those associated with the cost of meeting the needs imposed by regulations. Compliance applies to a wide range of business activities.
- Sometimes businesses seek to avoid compliance by using outsourcing as a business strategy.
- Ethical business enterprises recognise that variation in laws can undermine social and ethical responsibility. Therefore, they may seek independent sources, such as the ILO and lobby groups, to create ways of applying ethical standards across the operations function.

- Environmental sustainability and social responsibility are features of an ethical approach to operations management.
- Economic development must be accomplished sustainably.
- Environmental sustainability refers to the economic, social and environmental performance of a business.
- Social responsibility refers to a business's management of the social, environmental, political and human consequences of its actions.

EXERCISE 2.4 REVISION

1 **What** is 'corporate social responsibility'?
2 **Identify** an alternative term for 'corporate social responsibility'.
3 **Recall** what corporate social responsibility places a value on.
4 **Distinguish** between legal compliance and ethical responsibility.
5 **Recall** the name given to the expenses associated with abiding by all laws.
6 **Summarise** four areas in which a business would have to demonstrate compliance.
7 **What** is one way that businesses use when aiming to reduce compliance costs?
8 **State** the main advantages to a business of off-shore outsourcing.
9 **Clarify** the ethical issues off-shore outsourcing raises concerning business behaviour.
10 **How** do compliance and ethical responsibility differ?
11 (a) **Recall** what the acronym ILO represents.
(b) **Identify** two matters relating to workplaces and the rights of employees that the ILO deals with.
12 **Explain** why businesses should be concerned with environmental sustainability.
13 **Account** for why there is growing consumer expectation for 'clean, green and safe products'.
14 **Identify** the two goals a socially responsible business tries to achieve.
15 **Determine** what the words 'above and beyond making a profit' suggest about a business's commitment to socially responsible practices.
16 Since an investment in CSR costs money, **what** is the impact on revenue and profitability if a business such as Westpac invests in CSR?
17 Reebok (a subsidiary of Adidas) and Levi Strauss place a great deal of importance on their corporate social responsibilities. Both companies have taken action against overseas suppliers based on their human rights and environmental codes of conduct. Undertake further research to **assess** their commitment to their social and environmental obligations. **Create** either an oral or written report and present it to the rest of the class.

EXERCISE 2.4 EXTENSION

1 With reference to a large business (such as Myer, BHP Billiton, Mobil or Virgin Airlines), **identify** six compliance costs specific to the business. You may need to research the corporate website of the relevant business. **Determine** how the costs you identified affect the business and its operations.
2 **Investigate** the role of the International Labour Organization (ILO). Use your research to **critically analyse** how ILO standards can affect the operations function of a business.

on Resources

- **Digital doc:** Chapter summary (doc-24804)
- **Interactivity:** Chapter crossword (int-7151)
- **Interactivity:** Multiple choice quiz (int-7152)
- **Weblink:** Reebok and Adidas sustainability
- **Weblink:** Levi Strauss
- **Weblink:** International Labour Organization

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Sit HSC exam

CHAPTER 3

Operations processes

OVERVIEW

3.1 Introduction
3.2 Inputs
3.3 Transformation processes
3.4 Outputs

3.1 Introduction

Imagine visiting a chocolate factory. Apart from a desire to sample some of the products, what you will see is an operations system in action. As was briefly explained in chapter 1, an operations system is used to transform inputs into outputs. It does this by using the 'input-transformation-output' process commonly referred to as the operations process. In a chocolate factory, this means using labour, energy, machinery and materials such as cocoa beans, milk and plenty of sugar to make chocolate. The Cadbury chocolate factory in Tasmania, for example, produces around 50 000 tonnes of chocolate a year! Most of the entire process of chocolate making is automated (done by machines) — just picture the huge vats of melting chocolate and caramel, conveyor belts transporting rows upon rows of chocolates with lots of workers in white coats (see figure 3.1).



FIGURE 3.1 Operations processes are at the heart of the success of all businesses. Production involves the skilful bringing together of a number of inputs, such as finance, equipment, management, technology, materials and people, to create the finished goods or services through a series of operations processes.

Operations processes are those processes involved directly with transformation. The processes may be broadly classified according to their role in transformation:

- inputs into transformation processes
- the actual processes of transformation
- outputs of the transformation process.

Figure 3.2 shows an overview of operations processes.

Inputs, transformation processes and outputs are all important and each of these features of operations has its own features and presents challenges for operations managers.

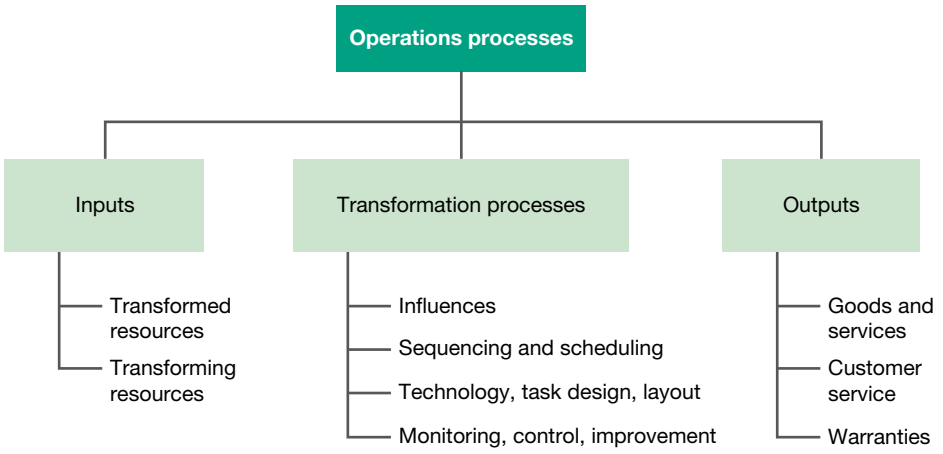


FIGURE 3.2 An overview of operations processes

3.2 Inputs

As was outlined in chapter 1, **inputs** are the resources used in the transformation (production) process. Some inputs are already owned by the business, while others come from suppliers.

BizWORD

Inputs *are the resources used in the transformation (production) process.*

3.2.1 Common direct inputs

Although many different types of inputs are used in the transformation process, generally there are four common direct inputs used by most businesses, including:

- labour
- energy
- raw materials
- machinery and technology (capital equipment).

BizFACT

In Business Studies, capital refers to the money provided by the owners to finance a business's activities. In Economics, capital refers to machinery and technology used to produce goods and services.

Labour

Human effort, both mental and physical, is a necessary input into operations processes. Jobs in the field of business operations include those in the areas of sourcing and supply chain, technical support and maintenance for machinery, inventory management and control, quality processes, production, logistics and distribution. Clearly labour is crucial to all aspects of business operations.

Energy

Energy, in the form of electricity or fuels, which can be converted into heat, movement, light, sound or other forms of energy, is an essential input into transformation. Energy is required to bring inputs to the business, to transform them and to distribute them to consumer markets. Indeed, value adding is directly proportional to the amount of energy expended. For example, the manufacture of a high value added product such as a motor vehicle requires large amounts of energy.

Raw materials

Raw materials are essential inputs into operations processes. The basic components of manufactured goods are wood, unprocessed agricultural products, natural resources in the form of minerals and fossil fuels, water, and so on. Raw materials are sourced through the supply chain and businesses will determine the volume of raw materials required against the level of demand for their finished goods.

BizFACT

Raw materials are also sometimes called 'direct materials'. However, raw materials are not always 'raw'. This is because some businesses use already processed materials as their inputs. Consider, for example, a clothing designer. The cloth used is already processed — the raw materials such as cotton have already been transformed into cloth. In this case, the 'raw' materials are partially processed (or 'intermediate') materials.



FIGURE 3.3 Most manufacturing plants consume large quantities of energy and rely on a reliable source of power. In recent years, businesses have begun to implement energy-saving measures to reduce their energy bills and greenhouse gases. As well, businesses are starting to access alternative energy supplies.

Machinery and technology

Machinery and technology are necessary to enable transformation processes, which are characteristic of operations. Machinery is used to process raw materials, as well as to design and make products. Machinery integrated with technologies can perform very complex tasks very quickly. Indeed, over time, there has been a concern about what is called **capital-labour substitution**. Capital-labour substitution means that the machinery and technology displace people by doing the work they do. This makes labour redundant. In reality, when machinery and technology are used in business, some labour may be lost but there is then a period of retraining that takes place as people acquire new skills relevant to use with new technologies.

BizWORD

Capital-labour substitution *means that the machinery and technology displace people by doing the work they do.*

3.2.2 Input classification

Now let us look in more detail at the inputs. Inputs may be divided into those that are transformed resources and those that are transforming resources. Figure 3.4 shows how the inputs can be classified.

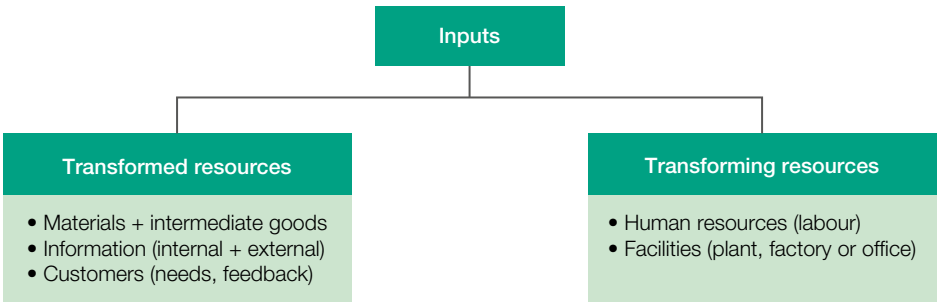


FIGURE 3.4 Inputs can be classified as transformed resources (resources that are changed or converted in the operations process) and transforming resources (resources that carry out the transformation process).

3.2.3 Transformed resources (transformed inputs)

Transformed resources are those inputs that are changed or converted in the operations process; they are transformed by the operations processes. Transformed resources are also considered the resources that give the operations process its purpose or goal. The transformed resources are:

- materials
- information
- customers.

BizWORD

Transformed resources *are those inputs that are changed or converted in the operations process.*

Materials

Materials are the basic elements used in the production process and consist of two types: raw materials and intermediate goods. When most people talk about 'materials', they are generally referring to raw materials such as oil, wood or steel. **Raw materials** are the essential substances in their unprocessed (natural or raw) state and usually come from mines, forests, oceans or recycled waste. However, materials can also refer to **intermediate goods**, which are goods manufactured and used in further manufacturing or processing.

The distinction here is that there is a range of materials that are *already* transformed but still become inputs into operations processes. Consider the following: computers need integrated circuits and digital memory capacity. Complex microchips are required to store memory and to enable computers to operate. The chips are outputs from businesses that transform various raw materials (plastics, silicon, copper) into microchips. These chips are both final outputs as well as inputs for further processing. A computer manufacturer will take these transformed resources and use them as essential inputs (components) in computers. This is shown in figure 3.5.

BizWORD

Materials *are the basic elements used in the production process and consist of two types: raw materials and intermediate goods.*

Raw materials *are the essential substances in their unprocessed state.*

Intermediate goods *are goods manufactured and used in further manufacturing or processing.*

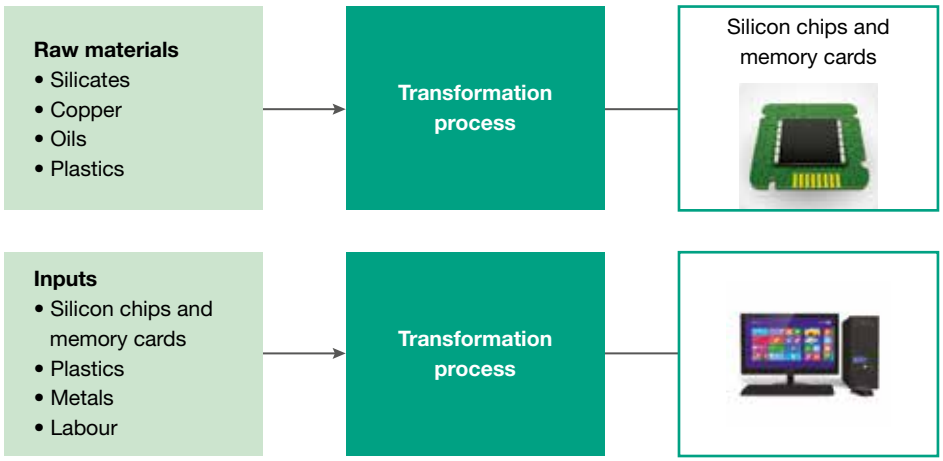


FIGURE 3.5 Transformed resources become inputs used in the production of other goods and services.

Similarly, in a service-based business, items such as stationery, computers, furniture and tools-of-trade are outputs of other businesses that become essential inputs to the delivery of services.

Information

Information is the knowledge gained from research, investigation and instruction, which results in an increase in understanding. The value of information lies mainly in its ability to influence behaviour or decision making.

Information can be a very important input into the operations process. Information can come from two sources: internal and external. Information acts as

BizWORD

Information *is the knowledge gained from research, investigation and instruction, which results in an increase in understanding.*

a transformed resource when it is used to inform how inputs are used, where they are drawn from, which suppliers and supplies are available, and so on. That is, the information is in a form that just needs to be understood or analysed, rather than compiled.

External information

This is information that comes from market reports, statistics from industry observers and industry bodies, official government statistics from the Australian Bureau of Statistics (ABS), media reports, academic papers and commentary, management journals and comparative studies. External information is an excellent and generally independent source for operations managers to use. It is very useful to integrate relevant information into operations processes. For example, information on the use of distribution centres will act as an input for inventory management. Similarly, information on new technologies can influence which machinery and technology is purchased and how it is applied to the operations function.

Internal information

BizWORD

Key performance indicators (KPIs) *are specific criteria used to measure the efficiency and effectiveness of the business's performance.*

Internal information comes from within the business and is gathered from internal sources such as financial reports, quality reports, and internal **key performance indicators (KPIs)** such as lead times, inventory turnover rates and production data. A further source of important internal information arises from customer feedback. This can come through an analysis of warranty data or from scanning social media threads. Internal information acts as a transformed resource when it informs processes and creates process improvements.

Customers

Customers are generally thought of as being relevant to outputs, not inputs. Therefore, it seems odd to think of them as a 'transformed resource'. Customers become transformed resources when their choices shape inputs. In the modern day, consumer orientation is essential to business (as discussed in chapter 1). A consumer orientation takes the preferences and interests of consumers as the starting point to production processes. In this way, the customer acts as an input and their desires and preferences act as a transformed resource.

BizWORD

Customer relationship management (CRM) *refers to the systems that businesses use to maintain customer contact.*

To better understand the desires and preferences of customers, businesses can implement a **customer relationship management (CRM)** program. CRM refers to the systems that businesses use to maintain customer contact. CRM software can be used to improve customer service, increase competitiveness and identify changes in consumer tastes.

The information can be retrieved and entered by employees from different functions within the business, such as marketing and finance, as well as operations. This approach improves services (many of which are now provided directly to customers), cuts production costs and the customer feedback makes the operations process more directly responsive to customer desires.

3.2.4 Transforming resources (transforming inputs)

BizWORD

Transforming resources *are those inputs that carry out the transformation process.*

The other collection of inputs to any operations processes are **transforming resources** which are those inputs that carry out the transformation process. They enable the change and value adding to occur. There are two main transforming resources, although energy and information may also be classified under this category. The two main transforming resources are:

- human resources
- facilities.

Human resources

Employees are said to be the single most important input into business. Staff who are well qualified, hard working and disciplined can bring great productivity and efficiency to business operations. The effectiveness with which human resources carry out their work duties and responsibilities can determine the success with which transformation and value adding occurs. This is because it is employees who coordinate and combine other resources such as machinery and technology, raw materials, and finance to produce goods and services. In this sense, employees are the most crucial of all inputs.

Let's use a simple case to illustrate. If a main business objective of a manufacturing company is to be the 'most efficient and reliable supplier', its human resource policies and practices should be aimed at attracting, retaining and motivating staff to ensure they are able to meet their customers' supply needs. Being efficient means having a reliable workforce that can do the job when required. To turn this objective into a reality, a strategy of improving employee skills through training and development may be used. In addition, setting performance objectives for individual staff members to improve their efficiency will help the business achieve its objectives. Other strategies that will assist the achievement of business objectives include adhering to work health and safety standards and ensuring staff motivation remains high.

Well-designed human resource management policies and practices can improve the performance of the operations processes. Well-considered job design, targeted and appropriate training, flexible work practices and open communication are all factors that assist in maximising operational efficiency, business performance and the capacity of the business to achieve the objectives.

Facilities

Once a business has determined the type of operations process to use, it will need to undertake a complex set of design-planning decisions involving the production facilities. **Facilities** refer to the plant (factory or office) and machinery used in the operations processes. Major decisions include the design layout of the facilities, the number of facilities to be used, their location and their capacity. In particular, the business needs to decide:

- whether the required facilities should be located in one or two large sites or divided among numerous smaller sites
- what impact zoning and other restrictions will have upon the facilities' size and location
- special conditions, such as energy and water requirements
- the most efficient plant design
- the optimum plant and process layout — the arrangement of machinery, equipment and people within the facility (process layout will be examined in more detail later in this chapter).

The plant and machinery can make a very significant difference to a business and its capacity to transform. Clearly the facilities can determine the nature of the operations environment. Modern facilities, which integrate modern technologies, are well lit, well designed and labour friendly, will be highly conducive to productive operations.

BizWORD

Facilities *refer to the plant (factory or office) and machinery used in the operations processes.*

SUMMARY

- The operations process refers to the input-transformation-output process.
- Inputs are the resources used in the transformation process and can be classified as either transformed resources or transforming resources.
- Transformed resources are those inputs that are changed or converted in the operations process and include:
  - materials: the basic elements used in the production process and consist of raw materials and intermediate goods

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Syllabus area 1
Topic 3
Concept 1

The operations process: inputs, transformation and outputs
Summary screen and practice questions

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Syllabus area 1
Topic 3
Concept 2

Inputs: transformed resources
Summary screen and practice questions

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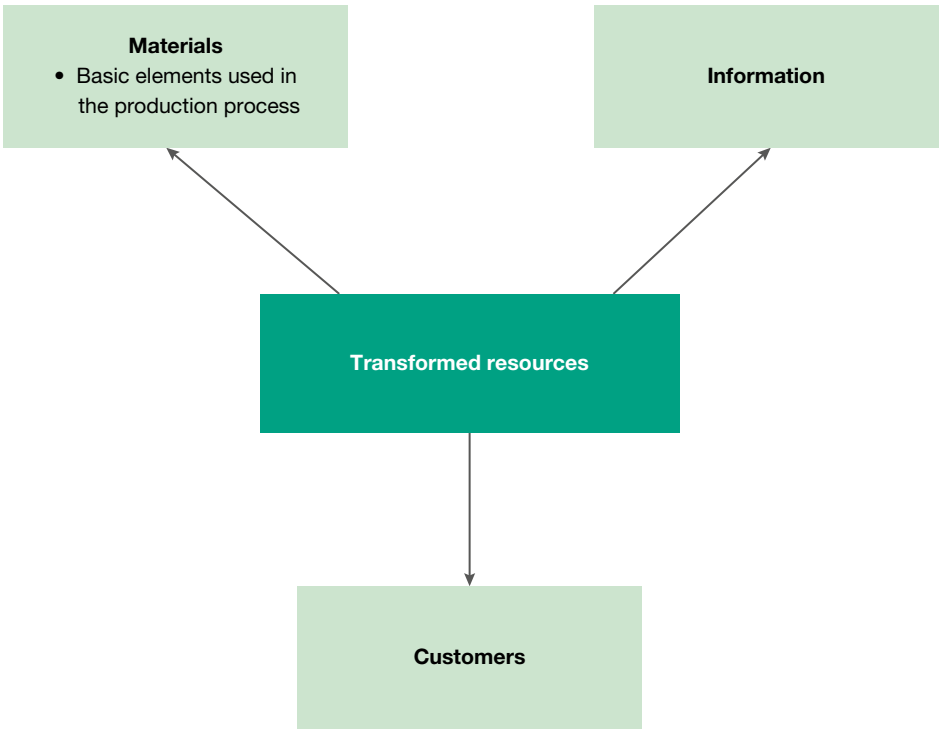
Syllabus area 1
Topic 3
Concept 3

Inputs: transforming resources
Summary screen and practice questions

  - information: the knowledge gained from research, investigation and instruction, which results in an increase in understanding
  - customers: their desires and preferences are the starting point to production processes.
- Transforming resources are those inputs that carry out the transformation process and include:
  - human resources: they coordinate and combine other resources to produce goods and services
  - facilities: the plant (office or factory) and machinery used in the operations process.

EXERCISE 3.1 REVISION

1 **What** are the three elements of an operations process?
2 **Outline** the 'input-transformation-output' process.
3 **Identify** the main inputs, transformation and outputs in an operations process such as that used by the Cadbury chocolate factory.
4 **List** the four common direct inputs and briefly **outline** each.
5 Referring to the making of takeway coffee, **construct** a diagram that **describes** the transformation process from taking the customer's order to the customer getting their coffee.
6 **How** do transformed resources and transforming resources differ?
7 Draw a concept map (started below) **summarising** the transformed resources used within the operations process.



8 **Explain** how materials may be either raw of intermediate in nature.
9 **How** can customers be classified as a 'transformed resource'?
10 **What** makes information a transformed resource, and how does it shape the operations processes?
11 Clearly **detail** the relationship between human resources and the effectiveness of operations.
12 **Define** the term 'facilities'.

13 **Recount** four decisions a business needs to consider in relation to facilities.

14 **Explore** how facilities can shape operations processes by researching two different types of production facilities

EXERCISE 3.1 EXTENSION

1 Through the use of case study and examples, **show how** the three elements that make up the operations process (inputs–transformation–outputs) are performed in all businesses. In so doing, **detail** how they are interrelated.

2 Ron's Roofing and Gutters is a large manufacturing business that employs 485 employees. **Explain** four ways Ron's management could use employees to maximise output.

3 **What** is 'capital-labour substitution'? Prepare either a written report of 400 words or an oral report of three minutes **assessing** the advantages and disadvantages of this system of production.

3.3 Transformation processes

The main factor shaping operations processes is **transformation**, which involves the conversion of inputs (resources) into outputs (goods or services). Samsung, for example, takes plastic, metal, glass and electronic parts and transforms them through design, manufacturing and assembly into numerous electronic products.

The term 'transformation' implies physical changes, but today it also includes the conversion of resources into services. For example, your school takes its main inputs — students, the syllabus, staff and buildings — and produces educated, employable graduates. Similarly, legal firms can utilise resources, experience and legal knowledge to transform a legal conflict into a resolution.

It is important to understand that the transformation process differs between manufacturing businesses and service businesses. A manufacturer transforms inputs into tangible products (goods that can be touched). A service organisation transforms inputs into intangible products (services that cannot be touched but that have effects that can be felt). The operations process of a manufacturer tends to be highly automated or mechanised. Manufacturers use machinery, robots and computers to transform inputs into outputs. Service providers rely heavily on interaction with the customer and their processes tend to be more labour-intensive; that is, staff are crucial to the operations. Service providers apply time, skill and experience in assisting consumers to improve their quality of life.

BizWORD

Transformation *is the conversion of inputs (resources) into outputs (goods and services).*

BizFACT

Many businesses continually work to improve the way they transform resources into finished products or services.

3.3.1 Transformation processes and value adding

Besides conversion of inputs into outputs, transformation processes are also directly involved with value adding. Costs are incurred when something created by manufacturing is processed or when a service is created. The addition of cost in transforming the inputs into a process, which will turn them into outputs, adds value. Thus, cost is often related to value. For example, the value of apple pies is greater than the cost of the inputs used to create those pies (flour, wheat, sugar and heat or energy to bake the mix). As inputs are added and processed into final goods for consumption, value is added. It is usually easy to see how value is added in a manufacturing situation. However, it can be much harder to see how value is added in the services sector, where value adding occurs through knowledge, skills and expertise.

An understanding of how costs are spent and value is added is very important. It helps to show the relationship between operations processes and financial goals. The processes incur cost. This cost is a financial expense. However, the expense leads to the creation of value. This means the products made can be sold for a price that both covers the cost and generates profit.

BizFACT

As a resource-rich nation, Australia has tremendous scope for growth through value adding. When we are referring to commodities, value adding refers to the process in which they have their value increased by processing, refining or transforming the original commodity before export — for example, the refining of iron ore into metal pellets or steel from the raw material. Value adding creates jobs in Australia.



FIGURE 3.6 The term 'transformation' implies physical changes, but today it includes process and service improvements. Training and accreditation boost skills and deliver services of greater overall quality and effectiveness.

There are several aspects to operations processes that are directly involved with the process of transformation. This is shown in figure 3.7.

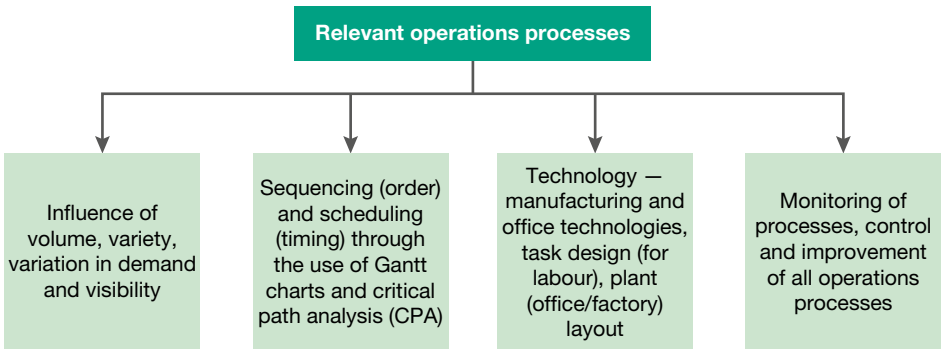


FIGURE 3.7 An overview of the operations processes relevant to transformation

3.3.2 The influence of volume, variety, variation in demand and visibility (customer contact)

A key aspect to operational processes relates to the question 'how much'? That is, in the process of transformation, decisions will need to be made about the following questions.

- How much to make — what volume of input to draw in and to process?
- How much variation — what range of outputs should be made in the process of transformation?
- How much variation in demand will there be — and how quickly can the operations processes respond to changes in demand?
- How much customer contact should there be and what, if any, role should it have on transformation processes?

BizWORD

Volume *refers to how much of a product is made.*

Lead time *is the time it takes for an order to be fulfilled from the moment it is made.*

The influence of volume

Volume refers to how much of a product is made. Volume flexibility refers to how quickly the transformation process can adjust to increases or decreases in demand. This responsiveness to the required changes in volume is essential to effectively managing **lead times**. Lead time is the time it takes for an order to be fulfilled from the moment it is made. If businesses cannot quickly adjust to changes in market demand, they can over produce, which may lead to wastage and increased

inventory costs. Alternatively, if back orders cannot be quickly fulfilled, it can lead to lost sales. A customer may, for example, go to a competing business. See the following Snapshot for an example.

Case study: Strong retail competitors in Australia — Zara, Uniqlo and H&M

Relatively new entrants in the Australian retail market have had an impact on the volume, variety and variation in demand experienced by more established businesses. Zara, Uniqlo and H&M are among the most highly sought-after clothing brands, leading to a loss of sales revenue for established brands such as Marcs, Willow and David Lawrence. Topshop, which initially experienced high sales volumes, has also lost turnover to so called 'fast fashion' (low-cost, high-volume sales of clothing).

Zara's, Uniqlo's and H&M's management of the four Vs characteristic of operations processes —volume, variety, variation in demand and visibility — is interconnected. Each of the brands is able to respond to increases in volume quickly — indicating highly responsive supply chain management. Variety, a key to success in fast fashion, is led by Zara and its high number of new designs entering the market each couple of months. Variety, as evidenced by a wide product range, can only be effectively managed when there is a very good understanding of consumer preferences.

Variation in demand, which used to be seasonal in respect to fashion, has now become characterised by shorter cycles, initiated by smart business practices. Thus, the release of new designs to market six times per year, instead of two to four times per year, helps maintain market demand.

Each of the businesses, Zara, H&M and Uniqlo, are placed in a highly visible location that has ready access to passing trade. Physically located in large shopping centres, each is also highly present (visible) on social media.

Accordingly, through effective operations processes and management of the four Vs, each of these businesses is reshaping the clothing retail sector in Australia.

SNAPSHOT QUESTIONS

1. **What** are the four Vs?
2. **Name** three businesses that are increasing sales volumes in Australia.
3. **How** does variation in demand affect the volume of product brought to the market by Zara and H&M?
4. **What** is the importance of visibility to clothing retailers?

SNAPSHOT



'. . . through effective operations processes and management of the four Vs, each of these businesses is reshaping the clothing retail sector. . .'

The influence of variety

The mix of products made, or services delivered, through the transformations process is sometimes called mix flexibility. **Mix flexibility** is known by consumers as product range or variety of choice. The influence of variety on transformation processes is: the greater the variety made, the more the operations process needs to allow for variation. This might sound like it is difficult to achieve and that a large plant may be required. However, this is not always the case as shown in the following Snapshot.

BizWORD

Mix flexibility *is the mix of products made, or services delivered through the information process.*

Whitegoods — mix flexibility

In Australia, Electrolux make the Electrolux, AEG-Electrolux, Simpson, Chef, Dishlex, Kelvinator and Westinghouse brands. These brands are attached to a range of household electrical whitegoods such as fridges, washing machines, ovens, dishwashers and dryers. Similarly, Whirlpool, a competitor, also makes this range of products. If you were to investigate the electronic components within the range of devices, you would find that there are many similarities: they heat and cool, have rotating parts and timers. So, despite the apparent diversity in these products, many of them are electronically very similar. In this way, the company

SNAPSHOT



‘. . . many of them are electronically very similar.’

behind the brands can sell a variety of products made with largely similar production processes.

SNAPSHOT QUESTIONS

1. **Identify** the brands manufactured by Electrolux.
2. **Account** for why there may be a wide range of products, but the production processes may be quite narrow.

The influence of variation in demand

As seen earlier, a variation in demand can impact significantly on transformation resources. An increase in demand will require increased inputs from suppliers, increased human resources, increased energy use and increased use of machinery and technology. However, increased demand may be hard to meet if:

- suppliers cannot supply quickly enough
- labour is not flexible enough, skilled or available
- the adopted machinery cannot adjust to increased capacity quickly, either because it is not designed to or because it breaks down
- increased energy and power are not able to be readily sourced.

A decrease in demand will also require operational flexibility as staff may need to have their hours reduced, production may need to slow to avoid inventory build up and suppliers may put on pressure due to contractual agreements.

Predicting demand

All businesses will try to forecast demand so that adjustments can be anticipated and a business can act accordingly. Annually, some variations are predictable: Christmas, for example, can be a time when high toy sales can be anticipated. Seasonal factors also cause predictable variations in demand; for example, more air conditioners will be sold in late spring in anticipation of summer than are sold in mid-winter.

The influence of visibility (customer contact)

Customer contact or ‘feedback’ can directly affect transformation processes. This is because customers and their preferences can shape what businesses make. Customer contact may be direct or indirect. Direct contact takes the form of customer feedback given through surveys, interviews, warranty claims, letters, wikis and blogs and verbal contact. Indirect feedback comes through a review of sales data that gives an indication of customer preferences and market share data, through an observation of peoples’ decision-making processes and through consumer reviews. Because businesses seek to maximise sales, customer contact is essential and ultimately shapes the transformation processes.

SUMMARY

- Transformation is the conversion of inputs (resources) into outputs (goods or services).
- Transformation differs between manufacturing businesses and service businesses.
- A manufacturer transforms inputs into tangible products.
- A service organisation transforms inputs into intangible products.
- Transformation processes also involve value adding.
- Transformation processes are influenced by:
  - volume: how much of a product is made
  - variety: the range of products made
  - variation in demand: the amount of a product desired by consumers
  - visibility: the nature and amount of customer contact (feedback).

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EXERCISE 3.2 REVISION

1 **What** does 'transformation' mean?

2 After reading the introduction to section 3.3, **recall** the most appropriate words from below to complete the following sentences.

outputs	manufacturing	intangible	adding
interaction	services	labour	conversion
physical	automated	tangible	customer

(a) The main concept of operations processes is transformation, which is the _____ of inputs (resources) into _____ (goods or services).
(b) The term 'transformation' implies _____ changes, but today it also includes the conversion of resources into _____.
(c) It is important to understand that the transformation process differs between _____ businesses and service businesses.
(d) A manufacturer transforms inputs into _____ products (goods which can be touched).
(e) A service organisation transforms inputs into _____ products (services which cannot be touched).
(f) The operations process of a manufacturer tends to be highly _____ or mechanised.
(g) Service providers rely heavily on _____ with the _____ and their processes tend to be more _____-intensive.
(h) Transformation processes are also directly involved with value _____.

3 **How** are transformation and value adding related?

4 **Propose** the process of value adding that occurs within a bakery that produces cakes and a range of breads and bread rolls.

5 **What** are the four Vs that relate to the transformation process?

6 'The transformation process is influenced by the four Vs: volume, variety, variation and visibility.' **Summarise** the influence of the four Vs by completing the following table. The first one has been started for you.

Influencing factor	Summary
Volume	• Refers to how much of a product is made.
Variety	
Variation (in demand)	
Visibility	

7 Imagine you are the operations manager for an ice-cream factory.
(a) **Explain** why it would be important to understand the concept of 'lead time'.
(b) **How** would you respond to the supply chain issues caused by seasonal changes in consumer demand? Share your answer with the rest of the class.
(c) **Detail** the importance of variety to the market and to the factory.

EXERCISE 3.2 EXTENSION

1 Research a manufacturing business such as ASICS or Samsung, finding out as much as you can about the transformation processes used in the business. **Synthesise** your findings and present them to the class.

2 **Investigate** what happens when a customer makes an online order for a delivered pizza at Domino's Pizza. Use this information to **create** a schematic diagram to **explain** the concept of 'lead time' with respect to Domino's Pizza.

3 **Analyse** the effect of customer contact on transformation processes. In your answer, **examine** the benefits of a business undertaking direct feedback methods such as surveys, wikis and blogs. You may refer to the Myer website or the David Jones website as a source of inspiration.

on Resources

Weblink: Domino's Pizza

BizWORD

Sequencing *refers to the order in which activities in the operations process occur.*

Scheduling *refers to the length of time activities take within the operations process.*

3.3.3 Sequencing and scheduling

Sequencing and **scheduling** are two very important aspects that assist with structuring and ordering the transformation processes. Sequencing refers to the order in which activities in the operations process occur. Scheduling refers to the length of time activities take within the operations process. An understanding of both sequencing and scheduling is necessary for operations managers. When planning operations processes that involve activities central to transformation, various scheduling tools will be used. The two main scheduling tools are Gantt charts and critical path analysis (CPA).

BizWORD

The **Gantt chart** *is a type of bar chart that shows both the scheduled and completed work over a period of time. It is often used in planning and tracking a project.*

Gantt charts

The **Gantt chart** was created by Henry Gantt in 1917. The Gantt chart outlines the activities that need to be performed, the order in which they should be performed and how long each activity is expected to take. Gantt charts are used for any process that has several steps and involves a number of different activities that need to be performed. A typical Gantt chart is shown in figure 3.9. This chart shows the steps an electronic store would take when setting up and preparing for an opening.

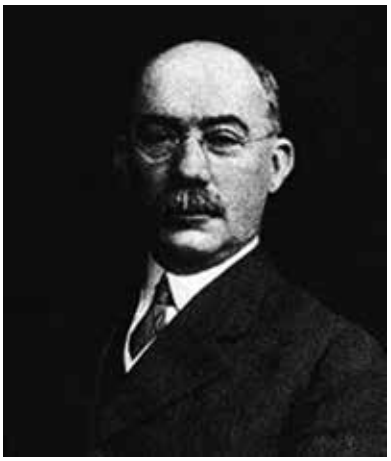


FIGURE 3.8 Henry Laurence Gantt (1861–1919) was an engineer and management consultant who developed Gantt charts — a visual tool to show scheduled and actual progress of projects. Considered as a routine project management tool today, it was quite a radical concept and an innovation of world-wide importance in the 1920s.

Gantt chart for opening of Stitched Up P/L 2018

Activity/sequence	August	September	October	November	December
Register business					
Obtain shop lease					
Refit shop					
Purchase stock and establish supply chain					
Design flyer and plan opening					
Flyers printed					
Preliminary advertising: letterbox drop					
Advertise for junior casual staff (×4)					
Contact Jemima's Clothing Distributors re: opening					
Final advertising					
Start trading					
Christmas sale					

FIGURE 3.9 Gantt chart showing sequence and scheduling (timing)

Gantt charts can be used for scheduling simple routine tasks such as completing a homework assignment and for larger, more complex projects such as building a dam. They can be used to schedule the work activities of one employee or a team of employees.

There are two main advantages of using Gantt charts. Firstly, they force a manager to plan the steps needed to complete a task and to specify the time required for each task. Secondly, they make it easy to monitor actual progress against planned activities.

Critical path analysis (CPA)

Critical path analysis (CPA) is a scheduling method or technique that shows what tasks need to be done, how long they take and what order is necessary to complete those tasks. A typical CPA is shown in figure 3.10.

BizWORD

Critical path analysis (CPA) *is a scheduling method or technique that shows what tasks need to be done, how long they take and what order is necessary to complete those tasks.*

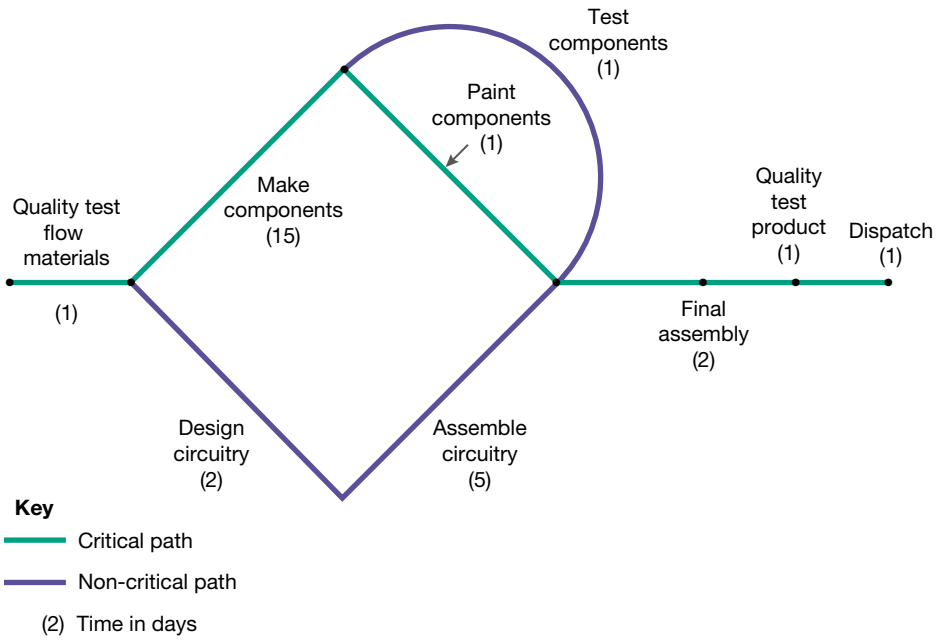


FIGURE 3.10 Critical path analysis (CPA) for the manufacture of an electronic switchgear

The critical path is the *shortest* length of time it takes to complete *all tasks* necessary to complete the process or project. Since all necessary tasks must be completed, in practical terms, the critical path will be the longest path through a process. You will see that some tasks can be performed simultaneously (for example, painting and testing components, or making the circuitry and assembling the components). Because *each activity* on the schedule must be completed to make the final product, the critical path is the path through the process that ensures all tasks have been completed. In this case, the critical path is:

(1) day	+ (15) days	+ (1) day	+ (2) days	+ (1) day	+ (1) day = 21 days
Quality test materials	Make components	Paint components	Final assembly	Quality test product	Dispatch

Note: the shortest path is *NOT* (1) + (2) + (5) + (2) + (1) + (1) = 12 days, because, though this appears to be the shortest processing path, it does not even allow time for the making of the components, which takes 15 days by itself.

It is clear from this type of analysis that scheduling enables a manager to see what needs to be done and allows the timing of tasks to be considered. With this information, a business will be able to see in what order activities need to be done. They will also be able to see which tasks can be done at the same time. In this manner, scheduling gives direction and organisation to operations processes, provides overall coordination and enables a means of control.

SUMMARY

- Sequencing and scheduling are essential activities in operations processes.
- Sequencing refers to the order in which activities in the operations process occur.
- Scheduling refers to the length of time activities take within the operations process.
- Two tools that assist with sequencing and scheduling are:
  - Gantt charts: a type of bar chart that shows both the scheduled and completed work over a period of time.
  - critical path analysis: a scheduling method that shows what tasks need to be done, how long they will take and what order is necessary to complete the tasks.

EXERCISE 3.3 REVISION

1 **How** do sequencing and scheduling differ?

2 **Construct** a flowchart showing the sequencing of your day commencing from when you arrived at school until you complete your last period.

3 **Outline** why your school timetable is both a sequencing and scheduling document.

4 **What** does a Gantt chart outline?

5 **Recall** the two main advantages of using Gantt charts.

6 **Look closely** at figure 3.9 and answer the following questions.

(a) **How** long will it take to do each of the following activities?

(i) Purchasing stock and establishing the supply chain

(ii) Shop refit

(iii) Contacting Jemima's Clothing Distributors regarding the opening

(b) **Identify** the least time-consuming activity.

(c) **Identify** the activities that can be performed concurrently.

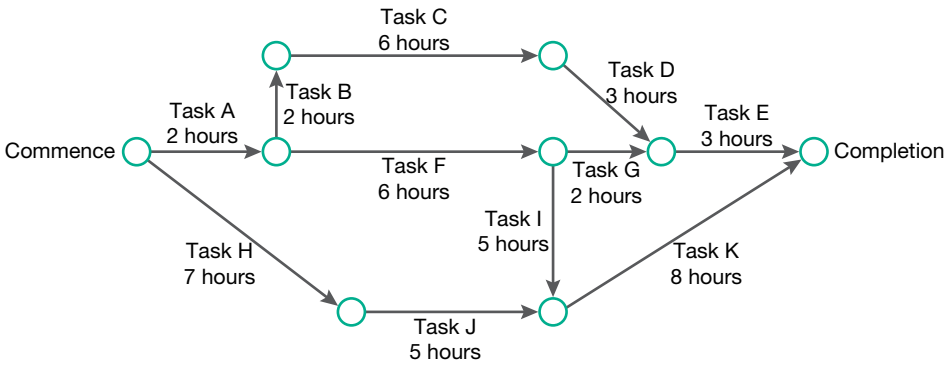
(d) **Clarify** the benefits to Stitched Up Pty Ltd of constructing a Gantt chart.

7 **What** is a critical path analysis?

8 **How** does a critical path analysis assist in transformation processes?

9 If there are predictable variations in demand based on seasonal factors, **how** will this affect a critical path analysis? **Justify** your response.

10 The diagram below shows a planning tool for the creation of an advertisement by Digital Production Enterprises.



(a) **Identify** the tool being used by Digital Production Enterprises.

(b) Which task determines when Task K will be performed?

(c) **Calculate** the shortest time for the completion of the task (show full working).

EXERCISE 3.3 EXTENSION

1 Using information from the internet, **examine** the evolution of the Gantt chart. **Assess** the value of a Gantt chart if you had to develop the Year 11 Business Studies assessment schedule.

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on Resources

Weblink: Gantt chart

2 **Determine** the advantages of using a Gantt chart instead of a critical path analysis for a project.
3 Imagine you want to build a motorised go-kart. **Create** a Gantt chart showing a list of activities and the time taken to complete them.
4 Contact a manufacturing business and survey the methods it uses to schedule and roster staff. Specifically **examine** peak periods of work and **determine** the best leave time for employees (i.e. from the business's viewpoint).

3.3.4 Technology

Generally, technology is the application of science or knowledge that enables people to do new things or perform established tasks in new and better ways. A pair of scissors, for example, is a piece of technology that allows for the more efficient cutting of materials. More specifically, business technology involves the use of machinery and systems that enable businesses to undertake the transformation process more effectively and efficiently. Most technology affects all aspects of business, assisting employees to work more productively.

Increasingly, businesses are feeling the need to acquire up-to-date technology in order to compete effectively. In the manufacturing sector, technology can be used to speed up (shorten) processes and enable fuller utilisation of raw materials. This makes the operations processes more cost effective. In the services sector, smart devices and office and communications technology have enabled whole markets to open up and allow for a small to medium business to trade globally.

The capital cost of technology is relatively high, so businesses need to decide whether to purchase technology or to lease it. Leasing is more common because it is cheaper (lease payments are tax deductible), which allows money saved to be spent elsewhere. Additional costs that accompany technology include set-up and siting, cabling and the loss of workers who may be displaced due to the acquisition of technology. For workers not displaced, there is the cost of training or retraining, continual upgrading of skills and time lost in adapting to new work techniques.

Office technology

You will be familiar with a range of business technology. The list of business technology items that are commonplace today includes:

- computer or tablet
- keyboard and mouse
- USB and other data storage devices such as external hard drives and Cloud storage
- modem
- mobile telephones/hands-free telephones/wireless enabled phones
- paging service and answering machines
- combined printer, photocopier, scanner and facsimile machine
- ability to electronically transfer funds (EFT) and EFTPOS machines.

Developments of the above types of technology have created the opportunity for people to do more work in less time, which means a greater range of tasks can be completed in their working time. These technologies have also enabled office workers to work at a great distance from the office. Increasingly people **telecommute** and work from home. Emails are checked from home, and research and meetings can be conducted online or through video/webcam chat. In many businesses, the 'virtual office' and 'paperless trading' are becoming a reality and, as office structures change, 'hot desking' is not uncommon. In the following Snapshot, you can see how technology is central to operations processes in a service-based business.

BizFACT

A pair of scissors is classified as low-technology (lo-tech) compared to computers and robotics, which are highly advanced and developed (hi-tech).

BizWORD

To **telecommute** *is to 'commute', or travel to work, electronically. This means that home or another location becomes the worksite and work is delivered via email or the internet.*

SNAPSHOT



'Email and mobile phone access enable her to reach clients with ease . . .'

Technology — the virtual office

Mehrnoosh has a full-time job for one of the major Australian banks, working in an innovation hub. She acts as an IT specialist and that job allows her the flexibility of working either onsite in central Sydney or offsite. Working remotely means that Mehrnoosh can run her own web design business. She started this business in high school and worked on it throughout her university studies. At university Mehrnoosh won awards for her studies in technology and she was even designated one of the 'young entrepreneurs of the year'.

Mehrnoosh finds that her work for the bank allows her the time to successfully run her own business. That business is growing. The technological advances, including the use of 'cloud'-based solutions, means that Mehrnoosh can access her work from anywhere. It also means that her staff can log into email, the customer database and social media accounts from remote locations. In effect, this means that when she or her staff are travelling, work can continue uninterrupted. Technology assists the process, as a series of notifications are sent to Mehrnoosh's phone. These notifications include payments made, customer inquiries, Facebook and phone inquiries, as well as when staff log into the business accounts and when they log off. The technology also means Mehrnoosh can perform her IT functions for both the bank and her own business regardless of whether she is onsite or offsite. Email and mobile phone access enable her to reach clients with ease and mean she is always available for inquiries arising in her banking job as well as her business.

SNAPSHOT QUESTIONS

1. **Identify** the kinds of technologies that will be used by Mehrnoosh.
2. **Describe** how the use of 'cloud'-based storage allows workplace flexibility.
3. **Why** does the use of technology enable flexibility and productivity despite a staff member not being at the work site?

BizFACT

Cloud computing is the provision of computer applications over the internet as a service to users of a particular website. Because the service provider hosts both the application and the data, the end user is free to use the service from anywhere.

BizWORD

Robotics *are used in engineering and specialised areas of research, as well as on assembly lines where a programmable machine capable of doing several different tasks is required.*

Manufacturing technology

Key manufacturing technologies are robotics, computer-aided design (CAD) and computer-aided manufacturing (CAM).

Robotics applies to highly specialised forms of technology, capable of complex tasks. Robots are used in engineering and specialised areas of research, as well as on assembly lines where a programmable machine capable of doing several different tasks is required. Robotics can shape transformation processes so that they are very high quality, of a consistently high standard, efficient and minimise waste.



FIGURE 3.11 Robotics are used in the car manufacturing industry.

Robotics allows a degree of precision and accuracy generally unmatched by human labour. In addition, robots work without complaint or demands for wage rises in conditions that would be repetitive, boring and often dangerous for employees. Robots and robotics, however, are very high-cost items that are unaffordable for most small and medium-scale manufacturers.

Computer-aided design (CAD) is a computerised design tool that allows businesses to create product possibilities from a series of input parameters. It is used in a range of business sizes and types. It is a computerised graphical design tool that generates three-dimensional diagrams from a set of given input data (parameters). Once the design has been created, it can be viewed from multiple angles. This assists both the designer and the end user to visualise what will be produced. This technology is very useful to transformation processes.

From the design, material usage can be calculated, as can time for the task to be completed. This enables the costing of the project to be quantified. If the cost is too high or the design is too limited, the input parameters can be altered to reflect these requirements. CAD programs are linked to printers so that 'hard', or paper, copies can be made and distributed to the client for assessment. Given the speed of CAD software, it is easy to customise a series of options that meets the client's or customer's needs. Normal drafting processes would cost much more and take longer (and be less accurate as an added bonus!). CAD software can go further still. It can design the sequence of steps that would need to be taken to create the desired product in the shortest possible lead time using the least amount of material.

Computer-aided manufacturing (CAM) is software used to allow the manufacturing process to become computer controlled. The CAD software can be linked to the CAM software to allow the instantaneous manufacturing of designs that are accepted by clients. CAM can also be used more broadly to calculate how much of each input resource would be required. The CAM software can store historic purchasing records to assist with present purchasing decisions.

BizWORD

Computer-aided design (CAD) *is a computerised design tool that allows businesses to create product possibilities from a series of input parameters.*

BizWORD

Computer-aided manufacturing (CAM) *is software that controls manufacturing processes.*

Technology in production and services

All car manufacturers use CAD and CAM when translating motor vehicle design into actual products. Architects and engineers also use these technologies. Toyota Motorsport, for example, uses a combination of CAD, CAM and CAE (computer-aided engineering) to create designs and to align production with design.

Service providers such as dentists are also increasingly using CAD. In the case of dental specialists, CAD and CAM can assist to repair damaged teeth, meaning that clients can have their dental problems addressed in one session rather than over repeat visits. This is because the technology can design and create veneers, inlays and dentures very quickly and accurately.

In undertaking the use of technologies such as these, businesses can ensure production standards are consistent, quality is maintained and wastage is minimal. For manufacturers, further benefits include direct communication between marketing (design) and operations (production), reduced lead times and minimal possibility of errors in translation between processes.

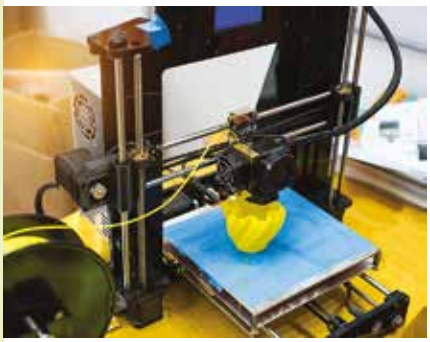
3D printing

Recently there has been significant development in 3D printing technologies. Such technologies allow a digital design to make an actual product through the use of polymers and other materials. The field of engineering and product design is being re-shaped through these new technologies that enable innovation and new methods of production to arise.

SNAPSHOT QUESTIONS

1. **What** do the acronyms CAD, CAM and CAE represent?
2. **How** are CAD, CAM and CAE utilised by businesses?

SNAPSHOT



'. . . undertaking the use of technologies . . . businesses can ensure production standards are consistent, quality is maintained and wastage is minimal.'

3. **Propose** two costs that would be associated with the use of integrated IT systems such as the use of computer integrated manufacture (CIM) technologies.
4. **Explain** the impact that 3D technologies could have on production processes.

SNAPSHOT



'the surfer can ensure the fins . . . are specific to the use of the board and the actual ocean conditions . . .'

Case study: Printing surfboard components

3D printers are now being used to print surfboard components such as fins. Due to the nature of the materials used in the manufacture of surfboards, 3D printers can be used to help surfers design and make their own customised fins. As the fin size and shape determine the manoeuvrability of the surfboard, surfers can design their own 3D printed fins to suit their purpose. In this way the surfer can ensure the fins they attach to their boards are specific to the use of the board and the actual ocean conditions — be it riding large waves in big surf or smaller waves in flatter surf. A further benefit of this new technology is that the fins are replaceable, lowering the cost of maintenance on boards. Clearly, 3D printing (also called additive manufacturing) brings significant possibilities to innovative market sectors.

The size of the market for fins is estimated to be worth over $70 million per annum in Australia alone. Thus, the creation of the 3D printed fin options takes advantage of a significant market opportunity.

SNAPSHOT QUESTIONS

1. **What** is an alternative name for 3D printing?
2. **Why** might surfers seek to take advantage of 3D printed surfboard fins?

BizWORD

Task design *involves classifying job activities in ways that make it easy for an employee to successfully perform and complete the task.*

3.3.5 Task design

Task design involves classifying job activities in ways that make it easy for an employee to successfully perform and complete the task. Task design overlaps the employment relations functions of job analysis, job description and person specification. It starts with an operations manager asking 'What needs to be done?' In the context of the business goals, task design is breaking down the work into a series of jobs in which each contributes to the final goal. (The steps involved in the task design process are shown in table 3.1.)

TABLE 3.1 The steps involved in the task design process

Step	Example
Define what needs to be done in a general statement	— A skilled competent electrician
Analyse the general job into specific duties	— Understand electrical circuits — Ability to work carefully and independently to prescribed electrical standards — Capacity to correctly install electrical devices and adjust capacity as required — Capacity to source correct parts and use in prescribed ways — Follow directions — Communicate clearly with builders and site managers
Allocate a degree of difficulty and a time element	— Supervision: 10 minutes supervision per hour — Difficulty: 8/10
Match tasks to existing state/federal awards (base)	— $30/hour first year licensed electrician
Articulate the task via job descriptors and a pay scale to allow for a range of experiences in a range of work settings. (This indicates the types of skills/experience and qualifications needed to successfully complete the task.)	— Licensed electrician $73 000 p.a. Duties: to plan and install a range of electrical items and associated circuitry into a range of building types (residential, commercial and educational).

Typically, there is a separation between manufacturing and administrative operations. In task design, it is necessary to group skills and competencies because this helps when obtaining staff. A prospective employee will be screened against these skills and competencies to ensure a match. For example, an intelligent and skilled barista who has no experience in electrical installations is unlikely to be a proficient electrician.

Attracting the right candidate for the task or job is the final part of a process that starts with task design and ends with selection, that is:

Task design → Job description → Person specification → Recruitment → Selection

A business may formalise the task design process while a job is already being done. Under these circumstances it is usual for the task to be analysed to see whether it could be done more efficiently. This involves a process called job analysis, and requires determining who does what in the business and why. The purpose of job analysis is to improve the business's productivity.

Skills audit

Sometimes, a business already has available staff. However, the staff may not have the requisite skills. Under these circumstances the managers may wish to conduct a skills audit. The **skills audit** is a formal process used to determine the present level of skilling and any skill shortfalls that need to be made up either through recruitment or through training.

BizWORD

Skills audit *is a formal process used to determine the present level of skilling and any skill shortfalls that need to be made up either through recruitment or training.*

Workplace layout

There are a number of different ways to organise the physical layout of a workplace. The method adopted by managers will depend on the type of manufacturing operations or services performed by the business. The way in which machinery and technology is orientated and arranged in the operations plant will strongly shape the operations processes. There are alternative ways to lay out machinery, depending on what is being made and what volume of production is required. The alternative layout options are the:

- process layout
- product layout
- fixed position layout.

BizFACT

Britax Childcare Pty Ltd manufactures child car restraints, and imports strollers and prams. As an innovative business, it installed new ergonomic workstations designed for the assembly areas to ensure that any part needed by operators was presented directly to them. The working environment, operator efficiency and flow of materials dramatically improved.

Process layout

The **process layout** is the arrangement of machines such that the machines and equipment are grouped together by the function (or process) they perform. The process layout is sometimes called functional layout. This type of layout is typical of hospitals, for example, where areas are dedicated to particular types of medical care, such as maternity wards and intensive care units.

BizWORD

The **process layout** *is the arrangement of machines so that the machines and equipment are grouped together by the function (or process) they perform.*

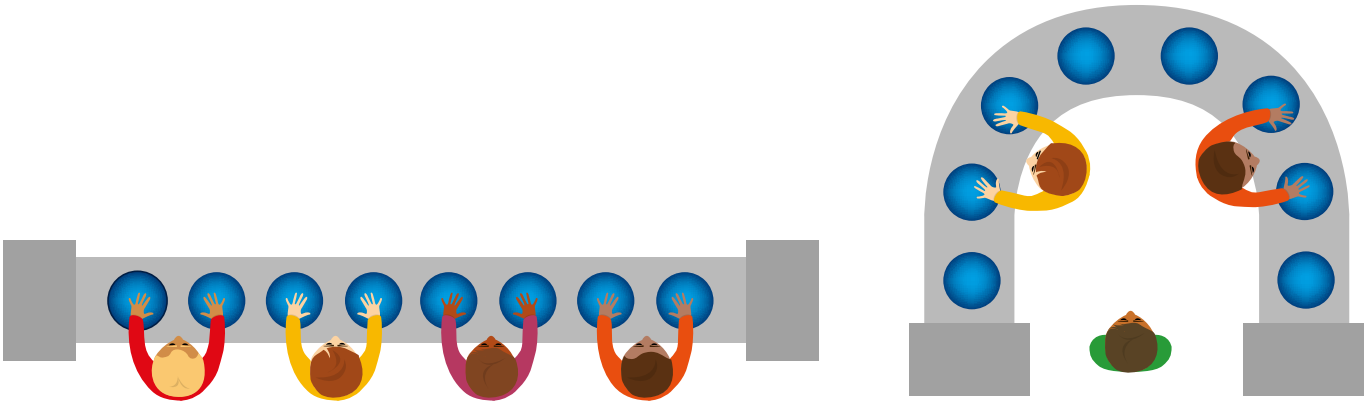
Process layout for intermittent production

Process production deals with high-variety, low-volume production. In this process, each product has a different sequence of production and the production is intermittent, moving from one department to another. The necessary machinery is arranged according to this sequence. This approach also lends itself to 'job lots' — that is, the manufacture of parts in small quantities. Many small to medium-sized manufacturers employ this process. In service businesses, such as banks or insurance companies, process layout is used to accommodate the handling of customers with different needs.

A feature of this approach, often used by businesses, is the creation of work cells or work teams (see figure 3.12). Cellular or team-based work arrangements can be used to create combinations of machinery and equipment to produce a single product or a range of similar products.

BizWORD

Process production *deals with high-variety, low-volume production.*



Current layout — straight lines make it hard to divide tasks.

Improved layout — workers have improved access. Fewer workers are needed.

FIGURE 3.12 Various work cell layouts

BizWORD

Product production *(mass production) is characterised by the manufacturing of a high volume of constant quality goods.*

Product layout *is where the equipment arrangement relates to the sequence of tasks performed in manufacturing a product.*

Product layout

Product production (mass production) is characterised by the manufacturing of a high volume of constant quality goods. An assembly line is the most common layout for this type of production because it aims to achieve the best possible combination of personnel and machine use — 'assembly line balancing'. This type of layout is referred to as **product layout** where the equipment arrangement relates to the sequence of tasks performed in manufacturing a product. Work stations are arranged to match the sequence of operations, and work flows from station to station. Operations managers must set times for the assembly task, which requires an understanding of not only the nature of the task but also the tools and skills required. Examples of this process are the assembly of motor vehicles or the production of television sets. Emphasis is placed on sequencing the flow from one work cell to another.



FIGURE 3.13 An assembly line production method is the best example of a product layout.

BizWORD

Project production *deals with layout requirements for large-scale, bulky activities such as the construction of bridges, ships, aircraft or buildings.*

Fixed position layout *is an operational arrangement in which employees and equipment come to the product.*

Fixed position layout

Project production deals with layout requirements for large-scale, bulky activities such as the construction of bridges, ships, aircraft or buildings. With project production, it is more efficient to bring materials to the site; workers and equipment come to the one work area.

A **fixed position layout** is where a product remains in one location due to its weight or bulk.



FIGURE 3.14 Project production — the inputs are brought to the site.

Office layout

Again, the focus of an office layout is to enable the work to be performed efficiently (with minimal unnecessary disruption and time wastage) in a safe office environment. Typically an office space is organised around discrete **workstations**. This may be seen as the approach applied to a service-based business.

Office layout is tailored to meet the needs of the business. In a manufacturing business the office layout is often informal. It may even overlook the factory floor so that managers can supervise from their desk. In an accountant's office, clients need to feel welcome as they seek advice and information. In a doctor's surgery, privacy is a concern for patients so the layout of the surgery reflects this.

An office needs to be designed in a way that allows for smooth workflow; it should also provide a space (lunch room, games room) that enables employees to take a break from the work environment if required.

BizWORD

Workstations *are the desk areas required by office workers, usually fitted with access to a computer monitor, keyboard, telephone, mouse and mouse pad, storage, and close access to a printer and scanner.*



FIGURE 3.15 An office layout is often organised around discrete workstations as well as break-out zones.

studyon

Syllabus area 1
Topic 3
Concept 6

Technology, task design and process layout
Summary screen and practice questions

SNAPSHOT

'When employees and managers are equal in this way there can be improved internal communications, trust and understanding between people.'

Open offices — the latest trend in office design

In recent years there has been a movement towards the creation of open offices and collaboratively shared spaces. This means that the idea of individual offices, work cubicles and closed off rooms has been replaced with a design where everyone within an office can see everyone else in the office. Open design is a feature of most modern office spaces.

Benefits of an open design are that people within a workplace can get to know one another and therefore collaboration and teamwork can be fostered. The removal of internal barriers also saves money on the creation of walls and means that less floor space can accommodate more staff. A further benefit is the loss of a personal desk space through the application of an idea called 'unassigned seating', meaning that a sense of entitlement is removed. When employees and managers are equal in this way there can be improved internal communications, trust and understanding between people.

Increased creativity in how people work is also said to arise from the change from traditional office spaces. This is because people can decide where they sit and how they work, meaning their level of personal control or autonomy increases. This makes employees feel more valued.

However, open offices do have issues associated with them. Some employees find it difficult to concentrate on work due to disturbance from noise and visual distractions. Sometimes employees feel a loss of personal privacy, which can compromise their feeling of safety. These issues can lead to productivity loss and increased absenteeism.

Open spaces also suffer from another issue: the level of order and cleanliness can decline.

However, studies of workplaces in Australia and internationally have shown that overall the benefits outweigh the drawbacks. Nevertheless, a new design is starting to emerge where elements of traditional office spaces and open offices are being integrated in a hybrid design.

Flexible design — hybrid spaces: privacy and openness

Hybrid offices allow a business to retain the best elements of a traditional office — quiet, private spaces — with the flexibility and openness of the open office. Increasingly, businesses are opting for a balance between the traditional and the modern in order to best meet the varying needs of employees, workplace demands and business goals.

SNAPSHOT QUESTIONS

1. **What** is an open office?
2. **Why** do many people prefer an open office to a more traditional style office?
3. **Outline** four benefits of an open office.
4. **How** can open offices create issues for employees?
5. **Justify** the type of office that is likely to be the most productive for employees and managers.

3.3.6 Monitoring, control and improvement

All operations processes should be monitored for their effectiveness. The main transformational processes should be subject to control. This requires effective monitoring and a focus on continuous improvement. Monitoring and control lead to improvements when there is a focus on quality and standards.

Monitoring

Monitoring is the process of measuring actual performance against planned performance. During operations processes monitoring is crucial. Monitoring involves

BizWORD

Monitoring *is the process of measuring actual performance against planned performance.*

the measuring of all aspects of operations, from supply chain management and the use of inputs, through to transformation processes and outputs.

Monitoring typically is arranged around the needs to measure key performance indicators (KPIs). KPIs are predetermined variables that are measured so that appropriate controls to operations processes can be made.

Monitoring of the KPIs gives operations managers a chance to measure how the business is going and to assess performance against targeted levels of performance.

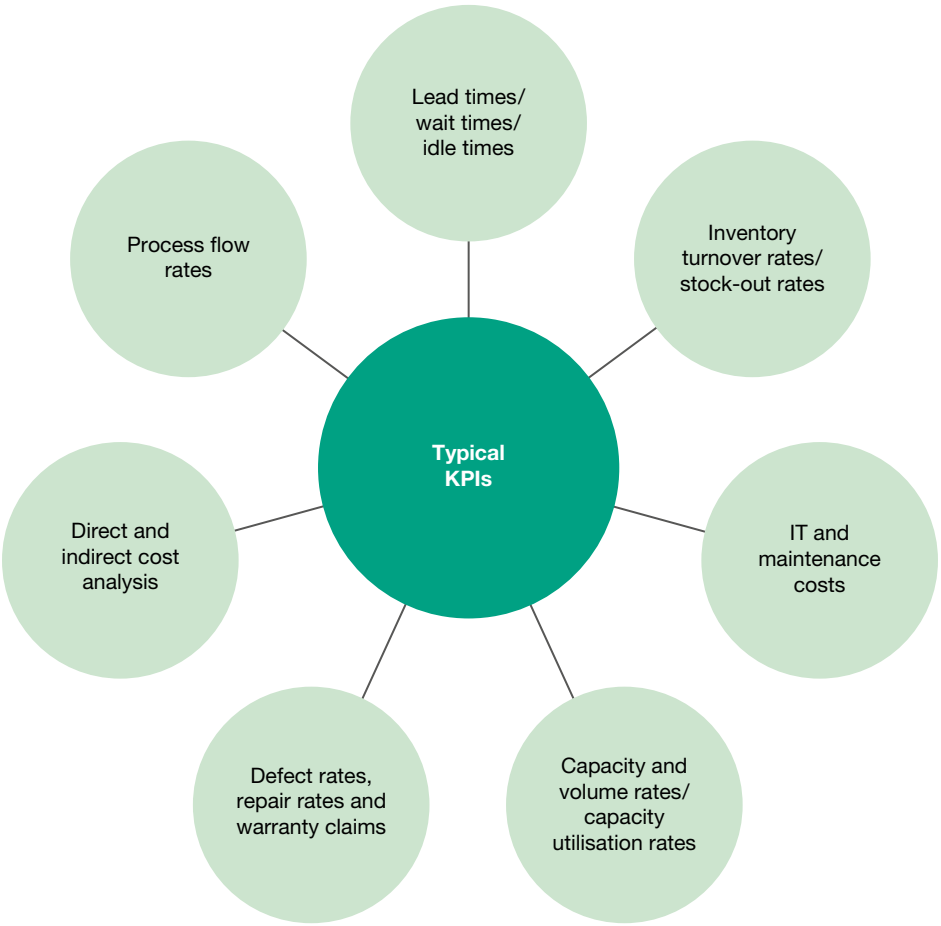


FIGURE 3.16 Key performance indicators (KPIs) are measured as part of the monitoring process.

Control

Control occurs when KPIs are assessed against predetermined targets and corrective action is taken if required. This means controlling compares what was intended to happen with what has actually occurred. If there is a discrepancy between performance and goals, changes and improvements can be made. All operations managers should exercise strict controls over the transformation processes. This can be done by setting challenging but reasonable performance targets. The business performance is then closely measured and those measurements are regularly scrutinised. The regular performance review is crucial because it should indicate any issues and, where possible, intervention or corrective action may need to be taken.

Control requires operations managers to take corrective action. That is, the operations manager will make changes to the transformation process such as redesigning the facilities layout or adjusting the level of technology in order to correct

BizWORD

Control *occurs when KPIs are assessed against predetermined targets and corrective action is taken if required.*

BizWORD

Improvement *refers to systematic reduction of inefficiencies and wastage, poor work processes and the elimination of any bottlenecks.*

A **bottleneck** *is an aspect of the transformation process that slows down the overall processing speed or creates an impediment leading to a backlog of incompletely processed products.*

the problem. Improvements in processes are often framed around quality. Quality controls, assurance and improvements are addressed fully in chapter 4.

Improvement

Improvement refers to systematic reduction of inefficiencies and wastage, poor work processes and the elimination of any bottlenecks. A **bottleneck** is an aspect of the transformation process that slows down the overall processing speed or creates an impediment leading to a backlog of incompletely processed products. Improvement typically is sought in time, process flows, quality, cost and efficiency.

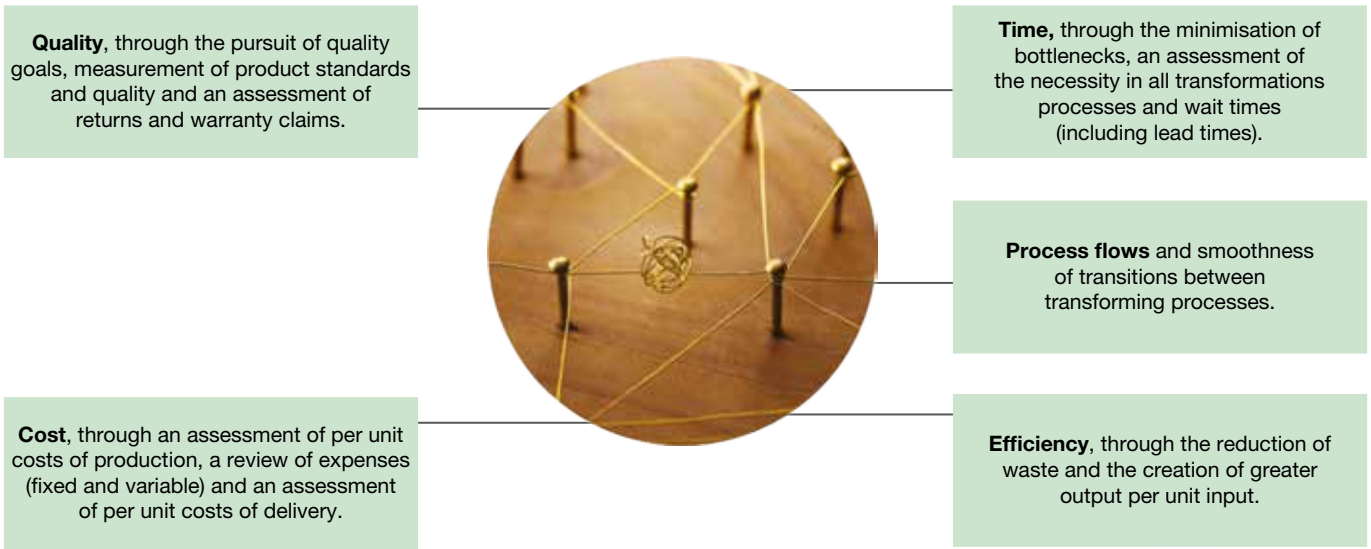


FIGURE 3.17 Improvement refers to systematic reduction of inefficiencies and wastage, poor work processes and the elimination of any bottlenecks.

Continuous improvement

The concept of continuous improvement involves an ongoing commitment to achieving perfection. Although the goal of perfection will never be reached, striving for improvement is important to the business culture. The process becomes one of setting higher and higher standards in the continual pursuit of improvement. Japanese business culture applies the term *kaizen* to describe this process. 'Zero defects' is also a term used by some businesses.

SUMMARY

- Technology is the application of science or knowledge that enables people to do new things or perform established tasks in new and better ways.
- Business technology involves the use of machinery and systems that enable businesses to undertake the transformation process more effectively and efficiently.
- Office or administrative technologies include a range of computer, communications devices and software applications.
- Manufacturing technologies include:
  - robotics: a programmable machine capable of doing several different tasks
  - computer-aided design (CAD): a computerised design tool that creates products from a series of input parameters
  - computer-aided manufacturing (CAM): software that controls manufacturing processes
  - 3D printing: allows a digital design to make an actual product through the use of polymers and other materials.

studyon

Syllabus area 1
Topic 3
Concept 7

Monitoring, control and improvement
Summary screen and practice questions

- Task design — classifying job activities so that employees can successfully perform and complete the task — is an essential aspect of transformations processes.
- Task design involves job analysis and can be done after a skills audit has been conducted.
- There are three different forms of layout for manufacturing plants.
  - Process layout: machines and equipment are grouped together by the function (process) they perform.
  - Product layout: machines and equipment relate to the sequence of tasks performed in manufacturing a product, for example assembly line arrangement.
  - Fixed position layout: employees and equipment come to the product.
- Modern office layout uses a workstation arrangement and in many cases an open office format.
- All operations should be monitored against KPIs for their effectiveness.
- Control occurs when corrective action is taken if there is a discrepancy between performance and goals.
- Improvements lead to reduction in inefficiencies such as bottlenecks.
- Continuous improvement involves ongoing commitment to achieving perfection.

EXERCISE 3.4 REVISION

1 **What** is the difference between technology and business technology?

2 **How** does technology improve the transformation process in the (a) manufacturing sector and (b) service sector?

3 **State** two benefits and two costs of manufacturing technology.

4 **Why** is robotics set to be used increasingly by businesses?

5 **Identify** two benefits and two costs of robotics.

6 **Match** each term with the correct definition.

Term	Definition
Computer-aided design (CAD)	(a) software that control manufacturing processes
Robotics	(b) a computerised design tool that allows businesses to create possibilities from a series of input parameters
Computer-aided manufacturing (CAM)	(c) highly specialised forms of technology capable of complex tasks allowing a degree of precision and accuracy unmatched by human labour
3D printers	(d) allow a digital design to make an actual product through the use of polymers and other materials

7 **Detail** how technology can be used to optimise the transformation process in large-scale businesses. Include the terms 'computer-aided design', 'computer-aided manufacturing' and 'robotics' in your answer.

8 **What** is task design and **why** is it important?

9 Look closely at table 3.1. Use it and your own knowledge to **summarise** the steps involved in the task design process.

10 **Why** does Flight Centre carefully plan the layout of its stores?

11 **What** are the most important factors to consider when determining which layout to use?

12 Consider the layout of the last three stores you have visited. **State** which aspects of layout enhanced the customer experience and which could be improved.

13 **Distinguish** between process layout and product layout.

14 **Which** form of layout would suit the building of a bridge across a wide river and **why**?

15 **Outline** the usual layout for an office.

16 **Define** each of the following terms: monitoring, control and improvement.

17 **How** would you monitor the performance of a retailer? **Support** your answer with reference to relevant examples.

18 From the list of KPIs shown in section 3.3.6 select which two you consider to be the most important. **Justify** your selection.

19 **Explain** why controls are important in the operations process.

20 **Outline** two corrective actions you could implement if sales returns and warranty claims were increasing.

21 (a) **What** would happen if a person visited a store to buy an item they wanted and the store had run out of stock?
(b) **Propose** two improvements you would implement to overcome the bottlenecks in supply that lead to lost sales.

22 **Recommend** why a business should always strive for continuous improvement.

23 **How** can a business improve both its (a) quantity and (b) efficiency?

EXERCISE 3.4 EXTENSION

1 **Demonstrate** how the use of technology can increase speed, accuracy and overall quality of the transformation process.

2 **Compare** the types of technology Telstra and Toyota use. **Explain** why the technologies they use are different.

3 'Costs are high, people seem expendable and the work environment is too clinical — apart from that technology is wonderful!' **Discuss**.

4 **Investigate** the operations needs that influence:
(a) process layout
(b) product layout
(c) fixed position layout.

5 Gemma has recently bought a fitness centre. She plans to renovate the premises and change the layout of the equipment. **Determine** the most suitable layout and **justify** your recommendation. **Create** a sketch for Gemma of the recommended layout. You may wish to use a multimedia application.

6 **Evaluate** the role of monitoring and controlling when it comes to creating improvements in transformation processes.

on Resources

Weblink: Telstra

Weblink: Toyota

3.4 Outputs

BizWORD

Outputs *refer to the end result of the business efforts — the good or service that is provided or delivered to the customer.*

Essentially **outputs** are the result of a business's efforts — the final good or service that is delivered or provided to the consumer (see section 1.1). So far, we have drawn a distinction between service and manufacturing operations; but in many cases, businesses carry out both types of operation. Mazda Australia, for example, separates its vehicle manufacturing operation from its customer service operation, although both elements are critical to the business's overall success. The operations manager must be able to link transformation processes to the activities performed by other areas of the business. Output must always be responsive to customer demands. Issues of quality, efficiency and flexibility must be balanced against the resources and strategic plan of the business.

The most obvious output of the operations process is the goods made or services provided. However, there are other, more subtle outputs. Customer service refers to how well a business meets and exceeds the expectations of customers in all aspects of its operations. Warranties are businesses' promises to correct any defects in their products or in the services they deliver. Combined, customer service and

warranties imply that the inputs and transformations processes are subject to scrutiny as the outputs will be assessed by consumers.

3.4.1 Customer service

You will recall from chapter 1 that a customer focus increasingly shapes operations processes. This means that inputs, transformations processes and outputs are all aimed at meeting or exceeding customer expectations. In its totality, this is **customer service**. If a customer expresses dissatisfaction with a product on account of it being defective, not meeting quality expectations, finds wait times/lead times too long or returns the product or makes a warranty claim, then the operations processes need review.

BizWORD

Customer service *refers to how well a business meets and exceeds the expectations of customers in all aspects of its operations.*



FIGURE 3.18 Customers are the life-blood of any business. Without a customer base, a business will not be able to survive. Customer service, therefore, should always be of prime concern for any business.

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Syllabus area 1
Topic 3
Concept 8

Outputs of transformations processes
Summary screen and practice questions

Central to customer service is to make sure the right good or service is delivered or provided at the right place at the right time. Recent market research has shown that businesses that provide superior customer service can:

- charge an average of 10 per cent more for the same goods and services
- grow twice as fast as their competitors
- increase their market share and profits.

To keep existing customers and attract new ones, the business needs to talk and listen to the customers — research has shown that one dissatisfied customer usually tells 11 others, who in turn will tell another five.

Customer service can no longer be regarded as merely explaining the refund policy or providing a complaints department. Rather, it is an attitude that should be adopted by all departments and employees within the business. Exceeding customers' expectations is likely to be the key in developing long-term customer relationships. Of course, such services must be able to be delivered. Failure to do so will drive customers away.

BizFACT

The word 'customer' in Japan translates to mean 'honoured guest'. Australian businesses must remember that an 'honoured guest' will lead to repeat sales.

3.4.2 Warranties

A good way to assess the effectiveness of operations processes is to measure the number of **warranty** claims. Warranty claims are made against goods that have defects

BizWORD

A **warranty** *is a promise made by a business that they will correct any defects in the goods they produce or services they deliver.*

arising from an issue in transformation. Although a small proportion of warranty claims are false, the number of claims made against a business on a particular product line or product range will give an indication of problems in the processing. Consider the example of the 2016 and 2017 recall of cars carrying Takata airbags and sold in Australia. The recall of tens of thousands of cars led to the replacement of the faulty bags. However, the rectification costs money. Operations managers need to trace the source of the fault in manufacturing and rectify it. In this way, the warranty claims lead the business to improve transformation processes.

SUMMARY

- The outputs of transformations processes include:
  - the goods made or services provided
  - customer service
  - warranties.
- Customer service refers to how well a business meets or exceeds the expectations of consumers.
- Exceeding customers' expectations is likely to be the key in developing long-term customer relationships.
- Warranties are an agreement to fix defects in products. An assessment of warranty claims can help a business to adjust transformations processes so that they become more effective.

EXERCISE 3.5 REVISION

1. **List** the three outputs of an operations process.
2. **What** is the aim of customer service?
3. 'Businesses that offer high levels of customer service have a much greater chance of success.' **Explain** why this is so.
4. **Describe** how customer service influences operations processes.
5. If good customer service is so important to the success of a business, **investigate** why customers often complain about the level of service they receive. Share your answer with the rest of the class.
6. **Why** is measuring the number of warranty claims a good way to assess the effectiveness of operations processes?
7. **Research** the recall of cars carrying Takata arbags. With reference to Takata and consumer warranties, **explain** the importance of honouring warranties to business success.

EXERCISE 3.5 EXTENSION

1. **Analyse** the effect of customer service on inputs, transformation processes and outputs.
2. From your own experience, **demonstrate** a business that offers (a) exceptional customer service and (b) poor customer service.
3. Using information from the **Australian Competition and Consumer Commission (ACCC)** website, **distinguish** between 'express warranty', 'manufacturer's warranty' and 'extended warranty'.

on Resources

- **Digital doc:** Chapter summary (doc-24805)
- **Interactivity:** Chapter crossword (int-7153)
- **Interactivity:** Multiple choice quiz (int-7154)
- **Weblink:** Australian Competition and Consumer Commission (ACCC)

studyon

Sit HSC exam

CHAPTER 4

Operations strategies

OVERVIEW

4.1 Introduction
4.2 Performance objectives
4.3 New product or service design and development
4.4 Supply chain management
4.5 Outsourcing — advantages and disadvantages
4.6 Technology — leading edge, established
4.7 Inventory management
4.8 Quality management
4.9 Overcoming resistance to change
4.10 Global factors

4.1 Introduction

To achieve operations goals and broader business goals, operations managers can apply numerous operations strategies. An overview of the operations strategies that can be applied are shown in figure 4.1. Note that the full range of operations activities is subject to the strategies. You can see that the strategies relate to inputs, sourcing and supply chain management and transformation (or throughput) processes that involve technology, quality management and inventory management as well as outputs.

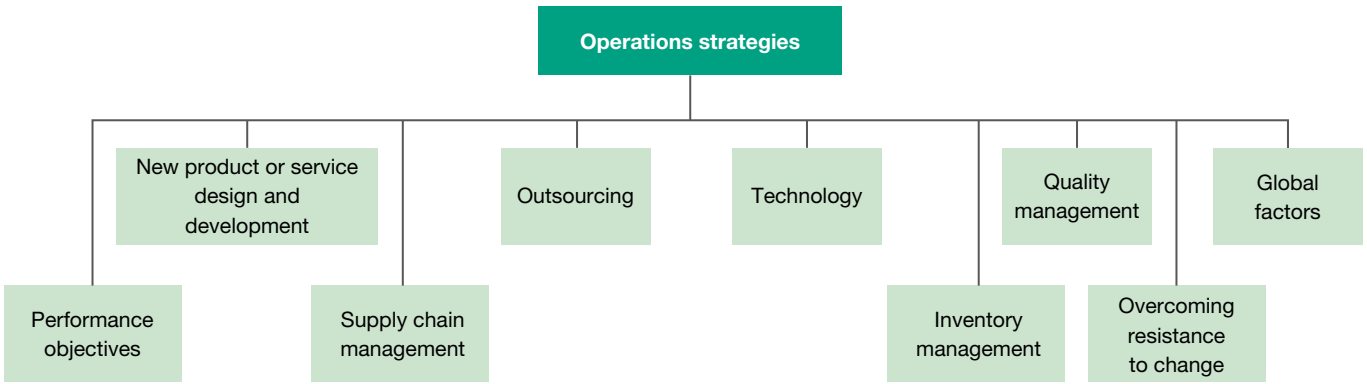


FIGURE 4.1 An overview of operations strategies

As with all strategies or tactics, the starting point is a set of goals or performance objectives. These performance objectives help define what inputs are required and influence all aspects of the transformation processes.

4.2 Performance objectives

When dealing with the operations function of business, particular performance objectives are targeted by managers. **Performance objectives** are goals that relate to particular aspects of the transformation processes. These objectives or targets will be set so that the business becomes more efficient, productive and profitable. The performance objectives help to inform all of the strategies that are discussed in this chapter. The operations strategies seek to achieve one or more of the performance objectives detailed below. The six main performance objectives that can be allocated to particular key performance indicators (KPIs) are:

- quality
- flexibility
- speed
- customisation
- dependability
- cost.

BizWORD

Performance objectives *are goals that relate to particular aspects of the transformation processes.*

4.2.1 Quality

As a performance objective, quality has many aspects, some of which are addressed later in this chapter. Quality is often determined by consumer expectations, which are used to inform the production standards applied by the business. Quality performance objectives include:

- quality of design
- quality of conformance
- quality of service.



FIGURE 4.2 Mercedes-Benz — an example of an organisation that competes on quality

Quality of design

Quality of design arises from an understanding of consumers and their preferences. It extends to how well a product is made or a service is delivered. Design begins prior to the creation of a product. Design determines the inputs, and how the transformation processes will be arranged and will perform in relation to the production of the good or service. Typically, a high-quality design for a good will be clear from the high-grade materials used in manufacturing, the care and presentation of the good, how aesthetically pleasing and functional the good is, and how robust and long-lasting it is. Well designed and produced goods will normally attract a high price. As a performance objective, a business needs to decide the quality of product it will deliver to the market. As high-quality inputs add cost,

this will be reflected in a higher price that some consumers may not want to pay. In the electronics market, this is evident as shown in the following Snapshot.

SNAPSHOT



'Both Apple and Samsung are noted for their quality.'

Apple and Samsung — quality and price

While Apple is the most recognisable smartphone brand, it is not the most-sold or most-purchased brand (see table 4.1); Samsung makes the most-used mobile smartphone. Both Apple and Samsung are noted for their quality. High quality is achieved when a business focuses on its operations processes and implements strategies to achieve performance objectives such as quality. Global brands such as Apple and Samsung invest huge amounts of money into product design and into product development and testing. The large volume of investment and the focus on innovation means that these brands can charge a premium price that reflects the cost of investment as well as the quality of the products.

TABLE 4.1 Worldwide smartphone sales to end users by vendor in 1Q17 (thousands of units)

Vendor	1Q17 units	1Q17 market share (%)	1Q16 units	1Q16 market share (%)
Samsung	78 671.4	20.7	81 186.9	23.3
Apple	51 992.5	13.7	51 629.5	14.8
Huawei	34 181.2	9.0	28 861.0	8.3
Oppo	30 922.3	8.1	15 891.5	4.6
Vivo	25 842.2	6.8	14 001.0	4.0
Others	158 367.7	41.7	156 654.2	45.0
Total	**379 977.3**	**100.0**	**348 224.2**	**100.0**

Source: Gartner, 'Gartner says worldwide sales of smartphones grew 9 percent in first quarter of 2017', May 2017

SNAPSHOT QUESTIONS

1. **Explain** how quality affects the reputation of a product.
2. **Explain** how quality and price are related.

BizWORD

Quality of conformance *is the focus on how well the product meets the standard of a prescribed design with certain specifications.*

Quality of conformance

Quality of conformance is the focus on how well the product meets the standard of a prescribed design with certain specifications. The specifications do not have to require high-quality inputs. Quality of conformance is a measure of how consistently products achieve compliance (conformance with) the desired specifications regardless of the standard of the specifications. Consider this: a Mercedes Benz vehicle combines very high-quality design with high standards of conformance. A cheap plastic toy is of very low-quality design but if it meets the low-quality design specifications, it would have a high standard of conformance, indicating a certain quality of process.

Quality of service

Quality of design and quality of conformance can be applied to the design and delivery of services. In this sense quality refers to:

- how reliable the service is
- how well the service meets the specific needs of the client
- how timely or responsive the service delivery is.

Quality is a crucial aspect that distinguishes products in the market. Quality management is examined in more detail later in the chapter.

4.2.2 Speed

Speed refers to the time it takes for the production and the operations processes to respond to changes in market demand. Speed requires that changes in input levels and processing times can be made in response to consumer demand.

As a performance objective, speed aims to satisfy customer demands as quickly as possible. Therefore, goals for speed include:

- reduced wait times
- shorter lead times
- faster processing times.

To achieve these goals requires a reduction in procedural and technical bottlenecks and smooth internal communications. A procedural bottleneck can occur when internal processes that ensure smooth operations are not followed. Consider the following Snapshot.

BizWORD

Speed *refers to the time it takes for the production and the operations process to respond to changes in market demand.*

Case study: FurnDesign — avoiding bottlenecks

FurnDesign Pty Ltd accepts orders for handmade furniture. The sketches from the clients must be scanned then emailed, and FurnDesign turns these sketches into computer-generated images. All emails come into a common inbox and are generally held there until viewed by the salespeople. The senior salesperson and designer, Johnson, has requested his staff to send his clients' emails to him directly. However, his staff often forget to pass his emails onto him and Johnson forgets to check the common inbox. When this happens, the business has the potential to lose sales, and unfortunately, has already lost three this year. This is a procedural bottleneck that can be overcome with training. To avoid technical bottlenecks, FurnDesign has formed an alliance with another furniture maker and will send excess orders to that business when demand is so high that their own capacity is full. This change required staff training to ensure they follow procedures carefully.

SNAPSHOT QUESTIONS

1. **Explain** the difference between procedure and technical bottlenecks.
2. **Explain** how the procedural bottleneck can be overcome.

SNAPSHOT



'This is a procedural bottleneck that can be overcome with training.'

4.2.3 Dependability

Also called reliability, **dependability**, as a performance objective, refers to how consistent and reliable a business's products are. Dependability, in respect of goods, refers to how long the products are useful before they fail. One measure of dependability is measured by warranty claims. A highly durable product is a dependable product. Perishable products can also be dependable if they are of consistent and predictable standard.

In respect of services, dependability refers to consistency of service standards and reliability. A measure for service dependability is the number of complaints received; the fewer the complaints the more dependable the service.

BizWORD

Dependability, *as a performance objective, refers to how consistent and reliable a business's products are.*

4.2.4 Flexibility

Also called adaptability, **flexibility** refers to how quickly operations processes can adjust to changes in the market. For example, changes in market demand cause a pressure on capacity. However, it may take three months for the business to change capacity. Similarly, it can take a business months to create a new product or extend a product line. It is important to note that time and flexibility are related; the faster the processing time the greater the likelihood that processes can be adjusted quickly.

BizWORD

Flexibility *refers to how quickly operations processes can adjust to changes in the market.*

Flexibility can be best achieved by increasing the capacity of production. This can be done by using plant and machinery better. Alternatively a business can buy new technologies that increase flexibility and capacity. Another option is changing the product design, thus creating a broader variety. These options enable the business to better meet a broader range of consumer desires.

With services, flexibility can be achieved through increasing the number of service providers, increasing the provider's skill level and through improving the level of technology used when providing the service.

4.2.5 Customisation

BizWORD

Customisation *refers to creation of individualised products to meet the specific needs of the customers.*

Most products tend to be standardised; however, over time customer preferences are creating a custom option for goods. **Customisation** refers to creation of individualised products to meet the specific needs of the customers. Services are generally customised, although aspects of services can be standardised as seen in the fast-food sector.

A customer orientation to operations might imply that over time businesses would push operations processes towards customisation. However, while there is greater choice for consumers these days than at any time in history, standardisation of products is still the most widely used option. Variations in product features such as colour, size and functionality offer some level of differentiation between products. Consequently, the production of many of today's goods and services are based on the principle of **mass customisation**; a process that allows a standard, mass-produced item such as a motor vehicle or computer, to be personally modified to specific customer requirements. However, full customisation is rare and can only be offered when products (goods or services) are created after an order specifying the requirements is received. The cost of customisation is higher than the cost of mass producing standardised products. For this reason, only businesses with a product that can be easily adapted tend to customise unless the actual business model is one of a customised approach to all products.

BizWORD

Mass customisation *is a process that allows a standard, mass-produced item to be personally modified to specific customer requirements.*

SNAPSHOT



'. . . a unique mass production strategy . . .'

on Resources

Weblink: Adidas

Case study: Adidas — mass customisation

Adidas has come up with a unique mass production strategy. It undertakes mass customisation. In order to do so Adidas varies the standard product offerings for a range of shoes and clothing. Allowing people to personalise their purchase through detailing their specific size requirements, Adidas enables consumers to experience the benefits of mass customisation. The customisation aspect of Adidas is called 'miAdidas' — a reference to the individual consumer's chance to order customised (personalised) products. The level of personalisation can extend to varying the size (length and width) of shoes for either foot and can opt for colour, style and size variations in clothing. However, in order to allow production processes to adapt to variation in orders the number of variations or choices is limited. In this way the process may be termed 'constrained customisation'.

SNAPSHOT QUESTIONS

1. **What** is mass customisation?
2. **How** does mass customisation affect sales?
3. **Describe**, through visiting the miAdidas website, the range of customisable options available for consumers.



FIGURE 4.3 In what may sound like a contradiction in terms, many businesses are integrating mass production/standardisation principles with customisation: mass customisation. Most vehicle manufacturers use this process in their production and operations processes. Customers can add optional extras to suit their personal tastes.

4.2.6 Cost

Cost as a performance objective refers to the minimisation of expenses such that operations processes are conducted as cheaply as possible. When a business sets up its operations processes, often the costs incurred determine the price. Over time, businesses seek to become more efficient and thus allocate costs better. The acquisition of new technologies can help a business to lower costs, use inputs better and minimise wastage. All of these reduce operational costs. Moreover, a business will also seek to reduce supplier costs, manage inventory to reduce holding and movement costs, and find distribution methods that are most cost and time effective.

All of the performance objectives will be allocated particular targets or goals, and will be measured against the achievement of those targets. In this way, the performance objectives are expressed as KPIs, with particular levels associated with each. Although not all performance objectives can be fully realised all the time, a business will have targets for each of them and will allocate resources to target the performance objective that is most likely to have the best impact on the bottom line or business profitability.

BizWORD

Cost *as a performance objective refers to the minimisation of expenses so that operations processes are conducted as cheaply as possible.*

SUMMARY

- Operations strategies are based around the need to achieve performance objectives.
- Performance objectives are goals that relate to particular aspects of the transformation function and can be allocated to particular key performance indicators (KPIs) in the following areas.
  - Quality, including:
    - design — how well a good is made or a service is delivered
    - conformance — how well the good or service meets a prescribed design with a certain specification
    - service — how reliable, suitable and timely the service delivery is
  - Speed: the time it takes for the production and the operations processes to respond to changes in market demand
  - Dependability: how consistent and reliable a business's goods or services are
  - Flexibility: how quickly operations processes can adjust to changes in the market

studyon

Syllabus area 1
Topic 4
Concept 1

Performance objectives
Summary screen and practice questions

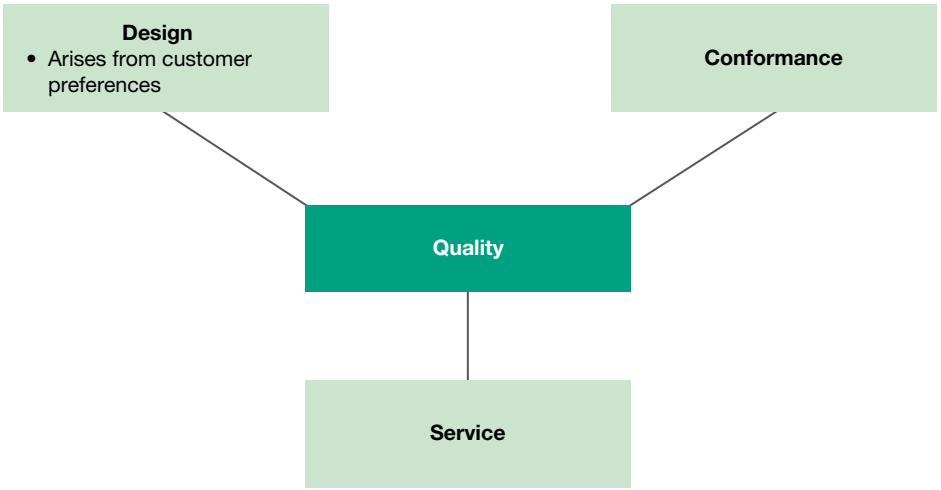
  - Customisation: the creation of individualised goods or services to meet the specific needs of the customers
  - Cost: the minimisation of expenses so that operations processes are conducted as cheaply as possible
- Each of the performance objectives will be allocated targets or goals.

EXERCISE 4.1 REVISION

1 **What** are six performance objectives used by operations managers?

2 (a) **Identify** a performance objective for a business that makes cars.
(b) **How** can a service-based business, such as an accountant, use performance objectives?
(c) **When** are performance objectives necessary for a business?

3 Complete a concept map to **summarise** the three quality performance objectives. The concept map has been started for you.



4 **Demonstrate** what is meant by the term 'speed' in relation to operations processes.

5 **Recall** three goals for speed.

6 **Demonstrate** the impact of a bottleneck on speed in operations processes.

7 **What** is the relationship between dependability and the number of warranty claims or complaints received about a product?

8 **Describe** how flexibility of processes is linked to market demand.

9 **Why** is full customisation of products rare?

10 **Account** for why many businesses offer mass customised products.

11 **Identify** three operations strategies a business can use to reduce cost.

EXERCISE 4.1 EXTENSION

1 **Assess** the role of performance objectives in achieving maximum productivity.

2 In small groups, use the brainstorm technique to **determine** what happens when the product's performance:
(a) does not meet customer expectations
(b) meets customer expectations
(c) exceeds customer expectations.
Select a spokesperson to share your group's comments with the rest of the class.

3 Using the table that follows, **propose** how the performance objectives you have learned about can be used to evaluate the operations processes.

Key performance indicator	How the KPI can be used to evaluate the operations processes
Quality	
Speed	
Dependability	
Flexibility	
Customisation	
Cost	

4.3 New product or service design and development

An important strategy for the operations processes of business is the creation, or design and development, of new products (goods and services). The design, development, launch and sale of new products enables a business to grow and to attain a competitive advantage.

4.3.1 Product design and development

There are different approaches to product design and development. The first arises from a specific approach to product development. The preferences and desires of consumers, as identified by market research, determine which products are designed and developed.

The second arises from changes and innovations in technology that enable new, appealing products to be made because they use advanced technologies, which give products greater functionality. This is the approach that Apple and Samsung both use. Apple's major strength is that it maintains complete control over the design and development of both software and hardware, unlike many other companies that outsource product design to save on cost.

The steps in the product design and development process are shown in figure 4.5. This figure details some of the important considerations arising in product design and development.



FIGURE 4.4 One of the main reasons for Apple's continued success is because they understand the power of product design and development. Apple has established a reputation as a company that produces extraordinary products that grab the attention, and loyalty, of customers.

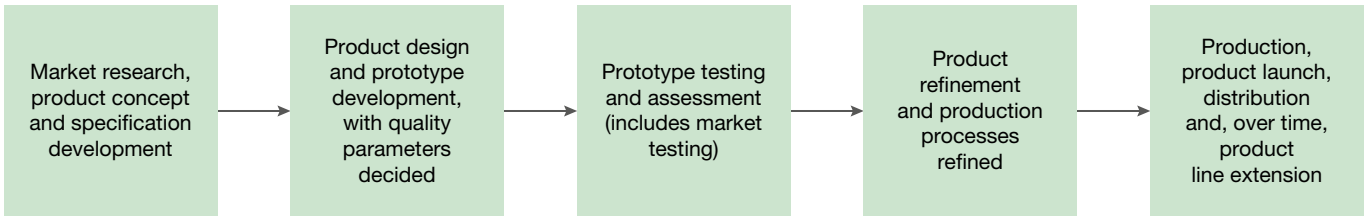


FIGURE 4.5 The steps in the product design and development process

Important considerations when designing and developing a product are quality, supply chain management, capacity management and cost. These factors must be taken into account throughout the design and development process. Supply chain management, as a factor, is an important consideration, because a new product will draw from suppliers and may extend the range of supplies sought, the timing or the volume of supplies. Quality is a factor that must be considered because in this market-orientated production, the customers will demand particular quality, and certain attributes and features. Furthermore, any new product will have an impact on capacity and may increase the use or range of present resources, or require an investment in new technology and machinery. Finally, cost must be considered. Cost arises from the addition of value through processing. Cost can be determined from the amount of inputs, time and energy used in processing. Value is directly related to cost but also includes the customer's perception of product utility. **Product utility** is defined as the usefulness and value that a product has from the consumer's point of view. These four factors (quality, supply chain management, capacity management and cost) should be considered by operations managers while proceeding through all aspects of product design and development.

BizWORD

Product utility *is defined as the usefulness and value that a product has from the consumer's point of view.*

4.3.2 Service design and development

Services differ from goods in that they are intangible and as they are produced they are also 'consumed'. Service design, being customised in nature, has always taken the position of the customer or client as the starting point in design. However, some services do not require interaction with the customer or client (or have very limited interaction) and therefore they tend to be largely standardised in nature. For example, consider the work of a shelf packer in a grocer, a short-order cook in a fast-food outlet and a casual petrol station attendant. Contrast this work with the work of an accountant, lawyer, medical specialist or journalist. Each of the latter professions will customise their work to the needs of a client.

When designing services, important aspects must be considered. These include what the **explicit service** will be, what the anticipated **implicit service** will be and what, if any, goods will be required with the delivery of the service. Cost will be determined once the previously mentioned features have been determined.

BizWORD

Explicit service *is also called the tangible aspect of the service being provided, such as the application of time, expertise, skill and effort.*

Implicit service *is based on a feeling and is therefore intangible. The implicit aspects of a service are the psychological wellbeing — the feeling of being looked after — that comes with the provision of the service.*

Explicit service is also known as the tangible aspect of the service being provided such as the application of time, expertise, skill and effort. Implicit service is based on a feeling and is therefore intangible. The implicit aspects of a service are the psychological wellbeing — the feeling of being looked after — that comes with the provision of the service. In design, both the explicit and implicit aspects need to be addressed. All clients or customers using a service need to feel that their particular needs are being met. Therefore, when it comes to design, the service, level of skill, time and expertise must be considered so that as the service is being delivered, the customer knows that they have been specifically catered for. This would give implicit satisfaction.

Services using goods

Sometimes in the delivery of services, goods may be required. For example, a surgeon performing knee surgery will require swabs, bandages, sutures, medical equipment, an operating theatre and so on. Similarly, a tutor may need specialised books, access to a networked computer, paper and stationery. These additional aspects must be considered when designing and developing a service. The additional aspects can also assist the delivery of a service. For example, technological breakthroughs in equipment can create a range of services that did not previously exist, as shown in figure 4.6.



FIGURE 4.6 New services arise from technological breakthroughs. For example, developments in laser technology have led to the creation of new types of businesses that adopt such technologies. Laser technology is used in eye correction surgery, cosmetic surgery, hair removal and skin treatments.

SUMMARY

- A business needs to design and develop new products and services.
- Two different approaches determine product design and development:
  - consumer preferences
  - changes and innovations in technology.
- Important factors in new product design and development include:
  - quality
  - supply chain management
  - capacity management
  - cost.
- Service design and development differs from the design and development of products as services are intangible and 'consumed' as they are produced.
- A service can be:
  - explicit — the application of time, expertise, skill and effort
  - implicit — the feeling of being looked after.

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Syllabus area 1
Topic 4
Concept 2

New product/service design and development
Summary screen and practice questions

EXERCISE 4.2 REVISION

1 **Distinguish** between two approaches that can be used for product design and development.
2 **Why** is Samsung such a successful business? In your answer refer to some of Samsung's products and their approach to innovation.
3 **Describe** the four factors that must be given consideration when undertaking new product design and development.
4 **Why** are customers (or clients) important to the design and development of services?
5 (a) **Contrast** explicit service with implicit service.
(b) **Outline** the relationship between explicit service and implicit service.
6 **What** is the importance of design as a factor that influences the price of goods and services?

EXERCISE 4.2 EXTENSION

1 Research the designs created by a furniture-maker, clothing brand or car manufacturer and **assess** how well that producer takes into account customer needs when making designs. Make direct reference to a range of products in their portfolio.

2 'The best designs are those that accommodate what people need now and should need in the future. Thus they anticipate how the thinking of people is changing.' With reference to actual examples, **evaluate** the accuracy of this statement.

4.4 Supply chain management

BizWORD

Supply chain management (SCM) *involves integrating and managing the flow of supplies throughout the inputs, transformation processes (throughput and value adding) and outputs in order to best meet the needs of customers.*

All businesses need suppliers. Supplies are an essential input into operations processes. **Supply chain management (SCM)** involves integrating and managing the flow of supplies throughout the inputs, transformation processes (throughput and value adding) and outputs to best meet the needs of customers. The supply chain is more than just sourcing, although sourcing is a very important aspect of the supply chain. Since the supply chain is also influenced by what is sold and what is returned, supply chain management involves both sourcing (supply-side) as well as logistics and distribution (see figure 4.7).

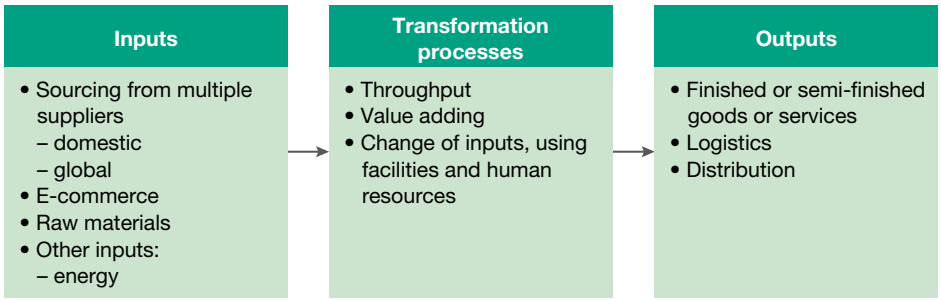


FIGURE 4.7 A representation of the supply chain for contemporary business

The supply chain for a product can be understood by starting with the final product and then tracing backwards through all processes that add value, all the way to inputs. This process demonstrates that the supply chain includes production processes, suppliers of raw materials, energy, labour, distribution and all sources (domestic and global). This type of analysis of supply, which is a 'top-down' or systems approach, is necessary when creating strategies for supply chain management.

There are three key aspects to supply chain management. In order of processing, these are:

- sourcing, including global sourcing
- e-commerce
- logistics.

4.4.1 Sourcing

BizWORD

Sourcing *refers to the purchasing of inputs for the transformation processes.*

Also called 'procurement' or 'purchasing', **sourcing** refers to the purchasing of inputs for the transformation processes. Sources or inputs are drawn from a range of suppliers. When determining which sources to use (choosing a supplier), a business will need to do each of the following.

- Assess consumer demand so that the volume of inputs required is known.
- Determine the quality of inputs that match the quality of the products that the business would like to deliver to the market in produced goods.
- Assess how responsive (flexible) and timely the supplier is with respect to changes in demand.
- Evaluate the cost of supplies/inputs from the supplier against other suppliers offering supplies of similar quality.

Sourcing strategy typically revolves around these four factors as shown in figure 4.8.

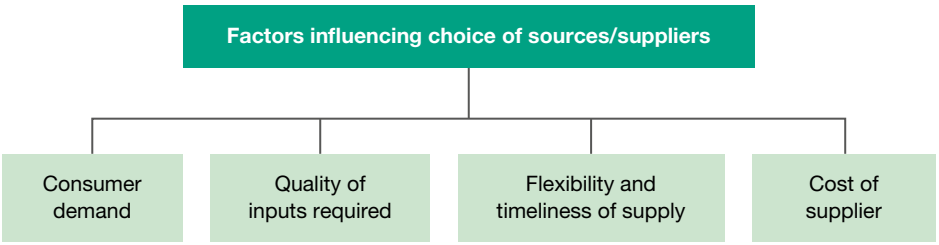


FIGURE 4.8 The factors influencing choice of sources/suppliers

Sourcing and packaging

For some years now 'shelf ready' packaging has been use by supermarkets. Shelf ready packaging means that the product is sold in the cartons they were transported in; the cartons can be opened to display product without removing the product from them. This saves the retailer time in stocking goods on the shelves in store and ensures that supplies are presented as desired by the manufacturer.

In addition, suppliers to the main supermarkets will actually measure the size of the fridges used in store. This information is used to determine how best to package product in order to fit as much stock as possible on the fridge shelves. In this way, the suppliers support the retailers, while ensuring they get as much exposure in store as possible.

SNAPSHOT QUESTIONS

1. **What** is meant by shelf ready packaging?
2. **Provide** examples of products you have seen that are displayed in shelf ready cartons.

SNAPSHOT

'This information is used to determine how best to package product in order to fit as much stock as possible . . .'

4.4.2 Global sourcing

Businesses are increasingly utilising technologies and structuring their operations in such a way as to take advantage of global sourcing. **Global sourcing** is a broad term that refers to businesses purchasing supplies or services without being constrained by location. In the supply chain management activity, global sourcing means buying or sourcing from wherever the suppliers are that best meet the sourcing requirements. Global sourcing carries particular benefits and also can create particular challenges. For example, particular benefits include cost and expertise advantages, and access to new technologies and resources. Challenges arising with global sourcing include the possible relocation of aspects of operations, the increased cost of logistics, storage and distribution, managing different regulatory conditions between nations, and the increasing complexity of overall operations when sourcing from diverse locations. Global sourcing is broadly discussed later in this chapter.

BizWORD

Global sourcing *is a broad term that refers to businesses purchasing supplies or services without being constrained by location. In the supply chain management activity, global sourcing means buying or sourcing from wherever the suppliers are that best meet the sourcing requirements.*

4.4.3 E-commerce

E-commerce involves the buying and selling of goods and services via the internet. With reference to supply chain management, e-commerce is relevant to particular forms of sourcing. The impact of e-commerce may be explained with reference to the business and its sourcing, and the customer and their orders that are received electronically.

BizWORD

E-commerce *involves the buying and selling of goods and services via the internet.*

Business sourcing and e-commerce (e-procurement)

Many businesses have their supply chain managed through electronic ordering. **E-procurement**, or the use of online systems to manage supply, allows suppliers direct access to the business's level of supplies. When stock falls to a pre-determined

BizWORD

E-procurement, *or the use of online systems to manage supply, allows suppliers direct access to the business's level of supplies.*

BizWORD

B2B *refers to direct access from one business (the supplier) to another (the buyer), allowing the supplier to assess the needs of the buyer and meet them in a timely manner.*

point, the supplier will supply even without a formal request from the buyer. This process is enabled by what is called business-to-business arrangement (B2B). **B2B** refers to direct access from one business (the supplier) to another (the buyer), allowing the supplier to assess the needs of the buyer and meet them in a timely manner. Both Woolworths in Australia and Walmart in the United States are examples of businesses that use e-procurement.

E-commerce and the consumer

BizWORD

B2C *is the selling of goods and services to consumers over the internet, with payment usually by credit card.*

The increasing use of e-commerce by consumers also has an effect on the supply chain. Businesses may opt to sell directly to consumers in transactions called business-to-consumer — **B2C**. Alternatively, technology may allow specialist sites to sell or auction to customers. An example is Agoda.com, which sells accommodation to travellers on behalf of hotels. A business that sells direct to consumers via the internet or that allows other internet-based businesses to do so clearly must be able to manage supplies that are affected by this diversity of ordering options. In this case, it should be clear that stock levels must be managed well and information exchanged frequently so that accurate stock levels can be presented to prospective customers.

BizFACT

Note that e-commerce has had a significant impact on physical distribution. Consumers in Australia and other nations are increasingly shopping and buying online. This means that distribution from the business to the consumer must be quick, efficient and secure.



FIGURE 4.9 The internet is revolutionising how businesses and consumers interact. When the Australian dollar trades at high levels, then online purchases are relatively cheap. Sometimes purchasing from other nations can be lower than half the cost of purchasing from a local retailer and freight may be free. This represents a very significant challenge for domestic retailers.

4.4.4 Logistics

BizWORD

Logistics *is a term broadly referring to distribution but includes transportation (including transportation modes), the use of storage, warehousing and distribution centres, materials handling and packaging.*

Distribution *refers to the ways of getting the goods or services to the customer.*

The third supply chain strategy involves the use of logistics. **Logistics** is a term broadly referring to distribution but also includes:

- transportation (including transportation modes)
- the use of storage, warehousing and distribution centres
- materials handling and packaging.

Distribution

Distribution refers to the ways of getting the goods or services to the customer. A business may use different forms of physical distribution. These are shown in figure 4.10.

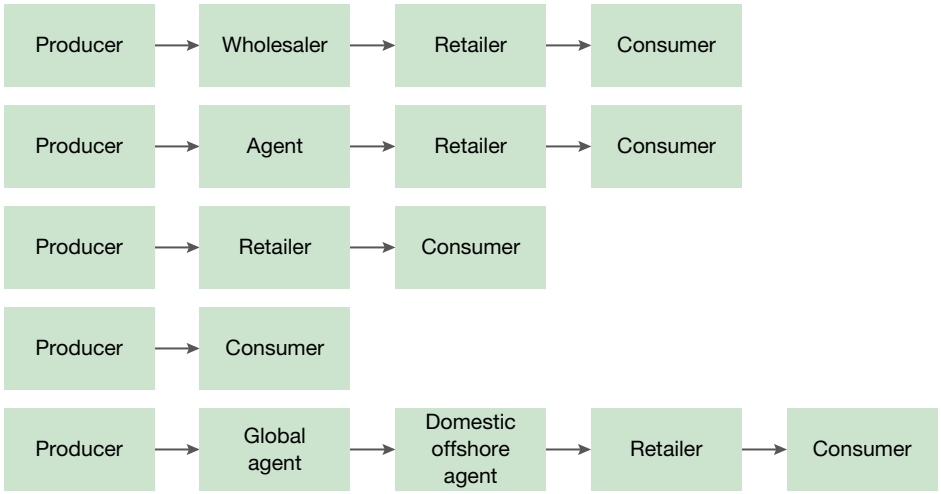


FIGURE 4.10 The different forms of distribution channel or channel choices that may be used in physical distribution

Transportation and distribution

This aspect of logistics is concerned with the physical movement of inventories. Various modes of transportation can be used and each has its own strengths and weaknesses, as shown in table 4.2.

TABLE 4.2 A comparison of different modes (forms) of transport used in distribution

Mode of transport	Speed	Distance	Cost	Capacity
Bicycle or motorbike courier	High in inner city areas	Low (under 10 km)	Low	Documents and files
Van	Moderate	Up to 100 km	Moderate	Up to 500 kg
Truck	Moderate	Up to 4 000 km	Moderate	Large items, up to 20 tonnes
Train	Slow/moderate	Up to 8 000 km	Low/moderate	High volume, up to 40 000 tonnes/train
Aeroplane	High	Up to 40 000 km	Very high	Moderate volume of between 100 and 150 tonnes
Ship	Slow/moderate	Up to 40 000 km	Low	Large coal carriers, up to 200 000 tonnes, but oil carriers may be able to carry twice this weight

The type of product and the cost of transportation will determine the mode of transportation selected. Some products, due to their nature, can be transported only by particular modes (for example, coal and crude oil, which can be transported only by freighter on the seas or by train on land), whereas for other products there is a variety of choices (for example, native Australian flowers).

Storage, warehousing and distribution centres

Storage involves finding a secure place to hold stock until it is required. When dealing with inventories or stocks, a business must address the issues of storage, warehousing and the use and location of distribution centres. Storage for inventory is necessary when there are numerous outlets through which stock is sold and when demand is variable and needs a responsive supply chain. However, storage is a factor that must be addressed by most businesses some or all of the time. Storage may be long term or short term and may have particular characteristics that help preserve the product. For example, cold storage is used for perishable goods and assists to increase the shelf-life of the product. Storage is closely associated with warehousing, although storage does not require the use of warehouses.

BizWORD

Storage *involves finding a secure place to hold stock until it is required.*

There are alternative inventory options such as just-in-time (JIT), which minimise storage and associated costs. JIT is discussed later in the chapter.

BizWORD

Warehousing *is defined as the use of warehouses for the storage, protection and, later, distribution of stock.*

BizFACT

Major retailers such as Aldi, Coles and Woolworths use a network of distribution centres to assist with inventory management, distribution and costs management. The location of the centres is very carefully assessed and they are often highly technologically advanced facilities. The location of the centres is designed to lower lead times and also avoid stock out (shortages).

BizFACT

In the very competitive supermarket sector, Coles has undertaken two innovations that affect how it distributes product. The first is the creation of a 'dark store' that services the online market. The second is the use of Deliveroo — a business that can distribute product within thirty minutes of the order. Both these developments were in response to increased competition and, it is argued, the entry of Amazon into the Australian market.

Warehousing

Warehousing is the use of a facility for the storage, protection and, later, distribution of stock. Warehouses, also called distribution centres or distribution hubs, are places for holding inventories and therefore particular costs are associated with warehousing including the cost of:

- the premises
- insurance and security for the stock
- stacking and moving the stock
- carrying excess stock or redundant stock if not sold
- shrinkage costs and losses from theft or reasons not accounted for
- stock subject to damage (e.g. water damage) if not correctly stored.

Despite the costs associated with warehousing, it can be very useful as a storage point for durable items that may need to be transported with little notice. Although there is a management trend to lower costs through lean production and reducing inventories, warehousing can actually save costs if used well.

Distribution centres (DCs)

A distribution centre is slightly different to a warehouse in that it is not intended for long term storage. Rather, distribution centres are strategically located so as to minimise the time it take to supply stock to retail outlets. The use of distribution centres is an important operations strategy and requires mangers to balance the cost of such centres with the time saved in logistics. Distribution centres may be air conditioned and/or have cold storage facilities, and they may also be co-located with transportation hubs.



FIGURE 4.11 The main purpose of distribution centres is the short-term storing, handling and wholesale distribution of goods. They have easy access to either a railway hub or a major road network. They allow a business to consolidate local operations and centralise the distribution hub, providing operational efficiencies and cost savings.

Materials handling and packaging

A final aspect of logistics concerns materials handling and packaging. Materials handling is an important aspect of the movement and storage of goods, and therefore particular standards and methods of operating need to be applied. This is because some products require particular skills, care or attention when being moved. For example, delicate glassware needs to be transported and stored carefully, and it needs to be packaged in a way that protects it from damage. Similarly, some goods can be dangerous (such as chemicals and fuels) and their transportation and

storage can carry particular hazards. The government has regulations that require dangerous goods be stored and handled in particular ways, and it also requires packaging to be of a particular standard and to carry warnings.

SUMMARY

- Supply chain management (SCM) involves the management and flow of supplies throughout all input, transformations processes and outputs.
- There are three key aspects to SCM: sourcing (including global sourcing), e-commerce (including e-procurement) and logistics.
- Sourcing, in the context of SCM, involves the purchasing of inputs for transformations processes.
- Global sourcing involves the use of global markets for the purchasing of any supplies; however, in the context of SCM, global sourcing refers to where and how supplies are sourced within the limitation of geography.
- E-commerce enables businesses to source through online links to suppliers through business-to-business (B2B) processes and also enables customers direct access to products through business-to-consumer (B2C) processes.
- Logistics refers to the physical distribution and transportation of products. The use of warehouses and distribution centres is crucial to the successful management and movement of inventories.

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Syllabus area 1
Topic 4
Concept 3

Supply chain management
Summary screen and practice questions

EXERCISE 4.3 REVISION

1 Match the term by **recalling** the correct definition.

Term	Definition
Supply chain management	a. Involves the buying and selling of goods and services via the internet
B2B	b. The distribution, transportation, storage, warehousing, and materials handling and packaging
Sourcing	c. Involves assessing the number of suppliers in order to reduce the number of suppliers to the least amount
E-commerce	d. Businesses purchasing supplies of services without being constrained by location
E-procurement	e. Involves integrating and managing the flow of supplies throughout the inputs, transformations and outputs
Global sourcing	f. The purchasing of inputs for the transformation process
Supplier rationalisation	g. The use of online systems to manage supply, which allows suppliers direct access to the business's level of supplies
Logistics	h. Business-to-business transactions

2 **Why** is it vital that the supply chain be well managed?

3 **Identify** three key aspects of supply chain management.

4 **What** are the four factors a business should consider when sourcing (choosing a supplier)?

5 **Outline** the benefits and challenges of global sourcing.

6 Complete the sentences below by **identifying** the correct term from the following list:

consumers chain e-procurement stock information supply

(a) Many businesses today have their supply _____ managed through electronic ordering referred to as _____.

(b) The increasing use of e-commerce by _____ has an effect on the _____ chain.

(c) When a business engages in e-commerce, _____ levels must be managed well and _____ exchanged frequently so that accurate stock levels can be presented to prospective customers.

7 **Determine** the most suitable method of transportation for the following items. **Justify** your answer.
(a) Coal from the Hunter Valley to China
(b) Motor vehicles from the factory to a retailer
(c) A legal document from one office to another within the same city
(d) A small parcel from Sydney to London
(e) Food from a local fast-food restaurant to a household
(f) Cartons of fresh and packaged food from a warehouse to the local supermarket

8 With reference to appropriate examples, provide a brief **summary** of storage, warehousing and distribution centres.

9 **What** is the importance of materials handling and packaging?

EXERCISE 4.3 EXTENSION

1 **Assess** the role and importance of transportation and distribution in effective supply chain management.



2 The Wordle (or word cloud) above is created from the text in this section. As you can see, the words in the cloud are arranged at random and there is no 'right' way to read it. Some words stand out due to their size. This means that those words were used more frequently than others. Therefore, we might expect that the bold and big words relate to the most important information in the text. Select five words from the Wordle that you believe can be used to summarise the main point made in the text. **Justify** your choices.

4.5 Outsourcing — advantages and disadvantages

Outsourcing involves the use of external providers to perform business activities. The theory behind outsourcing is that when a service is performed by an external provider that specialises in a particular business function, it will do so at a lower cost and with a greater effectiveness than the same task done within the business hierarchy. The term 'outsourcing' is often called business process outsourcing (BPO). Business process outsourcing is a term that captures a range of outsourced business processes including:

- operations such as manufacturing, value-adding manufactures, design, merchandising, sourcing, distribution and logistics
- human resources including employee remuneration, employee counselling, pensions, data management, training and development, and travel and expenses management
- administrative work including data entry and 'back office' work
- information technology (IT) including data work, desktop outsourcing and network outsourcing (remotely hosted software applications).

Other types of outsourcing include:

- finance and accounting outsourcing (FAO) including preparation of financial accounts and reports, analytics and taxation compliance
- knowledge process outsourcing (KPO) including the outsourcing of managerial work such as marketing strategy, public relations and management decision making
- legal process outsourcing (LPO) including paralegal support, legal support (including drafting, research and counsel) and other legal services (such as patents and trademarks).

As can be seen, a very wide range of business functions and activities can be outsourced. The different forms of outsourcing that may be used by business are shown in table 4.3.

TABLE 4.3 A summary of the different forms of outsourcing with reference to examples

Forms of outsourcing	Onshore	Offshore
Captive or in house (do-it-yourself)	Commonwealth Bank of Australia (CBA), Sydney	Dell or Intel in Penang, serving all of Dell or Intel globally
Non-captive (outsourced to third parties through the market) External providers/vendors	Unilever India, using Capgemini in Bangalore and Dairy Farm in Hong Kong using Capgemini	British Airways (UK) using WNS Global Services (Mumbai, India) or General Motors using AT&T (Americas)

4.5.1 The outsourcing decision

Before a business decides to use outsourcing as an operations strategy, operations managers need to assess whether the use of outsourcing is viable. The factors that must be considered when assessing whether and when to use outsourcing are:

- Whether to outsource or not: this requires assessing whether the use of outsourcing is cheaper and more efficient than performing the work in house.
- If deciding to outsource, the managers must decide which geographical location is favoured.
- The managers must also decide which vendors to use.
- If the decision is to outsource then details such as the management of the outsourcing contract, the length of contract, the KPIs and service levels are required.

Four different outsourcing options can be used, as shown in table 4.4.

TABLE 4.4 The various outsourcing options

Outsourcing option	Name of outsourcing option	Features of the outsourcing option
Option 1	Creation of shared services centres (SSC)	This is an in-house outsourcing option that involves the creation of an in-house centre that performs work for multiple subsidiaries.
Option 2	Use of 'fee-for-service' arrangement	A low-risk, short-term strategy that involves engaging a supplier for fixed services at a pre-determined price. It allows the business to test the outsourcing market prior to making a change.
Option 3	Joint ventures	The business engages an outsourcing services provider but the provider is also free to outsource to other businesses in the same industry. An example of such a provider is WNS Global Services (Mumbai, India), which British Airways used for ticketing. WNS Global Services now provides ticketing for at least 26 other major airlines including Virgin Atlantic.
Option 4	Use of a 'build-operate-transfer' approach	This involves offshore outsourcing and involves contracting with external organisations. The use of contracts that detail agreed levels of service against pre-determined KPIs is a feature. The relocation of services to a new offshore location (build-operate) is then transferred to an independent vendor that the company contracts.

The incidence of outsourcing, either domestically or globally, is increasing worldwide, with business structures changing to benefit from lower cost and greater efficiency. Outsourcing can be highly beneficial for businesses, but it also can present a number of significant challenges or issues.

SNAPSHOT



'. . . the same consumers who criticise businesses that use outsourcing as an option often take advantage of the lower prices that result.'

Outsourcing — for and against

The term outsourcing describes a range of different types of arrangements where a business takes on contractors to do work that can be performed by the business. Outsourcing may be *onshore* (in the same nation), *near-shore* (in a close nation within the region) or *offshore* (a third nation that can be outside of the immediate region). Technological advances have enabled a high degree of outsourcing. As all facets of business can be outsourced, technology can enhance communications and allow for management of outsourced activities.

Outsourcing brings a number of benefits, including cost savings, the capacity to have specialised support, the simplification of business processes and improvements in quality. This can be seen in the outsourcing of financial processes to India by Australia's 'big four' banks that have become both increasingly efficient and also profitable.

However, outsourcing has also been criticised. For example, when Bonds decided to outsource there was a perception by Australian consumers that quality would be compromised. Moreover, the loss of domestic employment caused negative publicity. Nevertheless, the same consumers who criticise businesses that use outsourcing as an option often take advantage of the lower prices that result. For example, Virgin and Optus customers benefit from discounted telecommunications costs in part as a result of the use of outsourcing of the call centre to the Philippines.

SNAPSHOT QUESTIONS

1. **What** is outsourcing?
2. **List** two advantages of outsourcing.
3. If a business utilises outsourcing, **what** two issues may arise?
4. **When** is it appropriate for businesses to use offshore outsourcing?

Co-sourcing

This is a variation on outsourcing where the two parties are fully involved in managing the success of the particular aspect of business. In this regard, the work is not done by an external party, but rather by an external expert who works within the business as a contractor. Co-sourcing is increasingly popular as it helps the business take better control over what is given to a specialist third party. Co-sourcing is used by Myer with its technology partner OracleCMS.

4.5.2 Advantages of outsourcing

The advantages or benefits of outsourcing are the following.

- *Simplification*. This arises from reducing the number of activities performed within the business.
- *Efficiency and cost savings*. Access to cheaper labour, regulatory differences and skilled labour in offshore locations all lead to cost savings for business.
- *Increased process capability*. This comes from access to improved technologies and highly skilled labour. Improved process capability means products are produced and delivered to the market with improved levels of service.
- *Increased accountability*. This is achieved through the use of service level agreements (SLAs), which contractually bind the vendor to pre-determined targets on KPIs
- *Access to skills/resources lacking within the business*. A business outsourcing to a nation such as India or Vietnam, may well find that there is access to highly skilled and disciplined labour at low cost. This gives a double saving as there is then no need to spend money on training and developing labour resources.
- *Capacity to focus on core business or key competencies*. The use of outsourcing enables a business to focus on that which it cannot outsource: its vision, purpose, sustainable advantage through innovation, and so on.
- *Strategic benefits*. There are four important aspects to this.
  - The first benefit arises from using outsourcing to get around trade barriers. For example, global businesses may offshore into different Chinese provinces to become a 'local' supplier and hence get around barriers that prevent foreign companies from trading.
  - A second benefit is that the use of a vendor that outsources for others within the same industry can bring the benefit of expertise gained from outsourcing to competitors.
  - A third benefit arises from trading in different time zones. The use of India, Malaysia, the Philippines, Vietnam and China for processing work allows businesses in Australia, USA and Europe to conduct operations during the day and to have processing work done overnight by the outsourcing vendor.
  - A fourth benefit is that strong partnerships between the business and the outsourcing vendor can lead to the vendor suggesting innovative solutions to the business that may increase the business efficiency and productivity over time.
- *Improvements to in-house performance*. A business using outsourcing and therefore focusing on core competencies can improve in-house performance as it can really focus on making internal changes that reduce cost and improve profitability.

These advantages are very significant and businesses that undertake outsourcing do not readily reverse the decision. However, there are also issues arising with the use of outsourcing, which businesses must address or overcome if they are to realise the benefits of outsourcing as a strategy.



FIGURE 4.12 There are many advantages of outsourcing to offshore locations, as well as issues that businesses need to address in order to realise all of its benefits.

4.5.3 Disadvantages of outsourcing

The challenges and issues facing businesses that use outsourcing include the following.

- *Payback periods and cost*. This refers to how long it takes to repay the cost of organising outsourcing and make the required organisational changes. Over time businesses will experience cost savings; however, it could take two or three years. If a business reduces internal inefficiencies, businesses may become more efficient and productive without using outsourcing.
- *Communication and language*. This is an issue between the business and the outsourcing vendor, and is a key issue in managing the relationship. When negotiating to outsource, the business might focus too much on the decision to outsource rather than consider the ongoing relationship with the vendor (which typically lasts three to five years). This can lead to confusion over expectations. Moreover, as outsourcing often occurs across two or more regions, there can be cultural differences, language differences and differences in the way business issues and problems are managed. This can lead to a misalignment between the business and the outsourcing vendor. There may also be misunderstandings about what the agreed service levels are and what KPI measures are acceptable.
- *Loss of control of standards and information security*. When a business opts to outsource, it can feel a loss of control over standards and also over how information is used. Recent issues have occurred where a Chinese manufacturer of toys for the Mattel brand (a leading United States of America toy brand) did not adhere to the design specifications outlined in the SLA and used too much lead in toys. Similarly, Australian banks have found privacy within outsourced operations in India may not be as secure as it is was when the functions were performed in-house.
- *Hierarchies*. A business using outsourcing may be aiming to eliminate costs associated with hierarchies, yet managing complex outsourcing agreements can create its own hierarchies, thereby maintaining business inefficiency.
- *Organisational change and redesign*. Outsourcing may be accompanied by a high level of business change and organisational redesign. There may be downsizing, causing the loss of domestic employment. An option can exist for job migration for employees who may be losing work to gain employment in the outsourcing

vendor business. However, even if desired, work permits/work visas may prevent this from being an option.

- *Loss of corporate memory and vulnerability*. A significant disadvantage arises from the reliance on the outsourcing provider. Key knowledge of processes and solutions may be lost with the transfer of business processes to outside parties. To counter this, some businesses such as the banks create 'shadow teams' to retain corporate knowledge and, if required, processing capability. Business may also require that the outsourcing vendor have strategies in place in case there is a regional crisis (such as an earthquake) that severely disrupts communication and leads to information losses.
- *Information technology*. As the use of outsourcing grows so too does the need for supporting information technology (IT). There is a cost and time associated with the use and adaptation of IT to the specific requirements of the business and the outsourcing vendor. The cost and time can significantly reduce any financial advantages accruing in the short term with the use of outsourcing.

It should be clear that although outsourcing is one of the operations strategies that may be pursued, the use of outsourcing needs to be carefully assessed as it can present significant challenges and problems if not well managed.

SUMMARY

- Outsourcing involves taking to market those internal business processes and activities that can be done better and at lower cost when given to external vendors.
- The term 'outsourcing' is often called business process outsourcing (BPO) and captures a range of outsourced business processes including:
  - finance and accounting outsourcing (FAO)
  - knowledge process outsourcing (KPO)
  - legal process outsourcing (LPO).
- The outsourcing decision should consider several factors and can involve the use of different options.
- Numerous advantages are associated with outsourcing:
  - simplification
  - efficiency and cost savings
  - increased process capability
  - increased accountability
  - access to skill/resources lacking within the business
  - provides a capacity to focus on core competencies, thus improving in-house performance and several strategic benefits.
- The disadvantages associated with outsourcing include:
  - the cost and uncertainty associated with payback
  - issues with communication and language
  - loss of control of standards and information security
  - loss of corporate memory and costs associated with IT, organisational change, redesign and management of hierarchies.

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Syllabus area 1
Topic 4
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Outsourcing
Summary screen and practice questions

EXERCISE 4.4 REVISION

1 **State** the theory behind outsourcing.
2 **Clarify** four different outsourced business processes.
3 **Examine** table 4.3. **Distinguish** between onshore and offshore outsourcing.
4 **What** are the factors that a business must consider when assessing whether and when to use outsourcing?
5 **Detail** the four outsourcing options that may be applied.

6 Use a 'T' table to **summarise** the advantages and disadvantages of outsourcing. The 'T' table has been started for you.

Outsourcing	
Advantages	**Disadvantages**
1. Simplification: fewer activities performed within the business	1. Payback periods and costs: how long it takes to recoup costs

7 Carefully look at all the advantages and disadvantages you listed in question 6. If you were a business manager and owner, would you choose to use outsourcing or not? Provide reasons for your decision.

EXERCISE 4.4 EXTENSION

1 Use the Think, Pair, Share technique to **investigate** current issues concerning outsourcing.
   (a) For two minutes, **outline** your ideas about the meaning of and the perceptions associated with outsourcing.
   (b) Select a partner. For about five minutes share your ideas with your partner. Then have your partner share his or her ideas with you.
   (c) In your pairs, **create** a definition for outsourcing.
   (d) Next, **construct** a table that records shared views about outsourcing, using the following headings:
   - Plus points — the favourable points about outsourcing
   - Minus points — the unfavourable points about outsourcing
   - Interesting points — the exciting or appealing points about outsourcing.

   (e) **Analyse** these views and explain each point. It is important that you can support each point with reliable evidence (not unsubstantiated claims). Therefore, your final task is to search for evidence to **justify** each point.

2 Over the past few years, Qantas has outsourced a number of functions, including aircraft maintenance, information technology, and reservations and bookings, to both onshore and offshore companies. Use the internet to **investigate** and **assess** the possible impact of outsourcing on Qantas employees.

3 **Investigate** the use of co-sourcing and, through providing relevant business examples, state why it is increasingly popular.

4.6 Technology — leading edge, established

All businesses benefit from the thoughtful application of technology. The use of technology can be an operations strategy particularly if it helps the business to create a competitive advantage. Some businesses innovate and thereby create new technologies. Whether a business is leading the industry or market through innovation or adapting to use technology once it has already been established, it is clear that technology plays a crucial part in business success.

Technology in the operations function may be classified according to whether it applies to and improves inputs, transformations processes and outputs; or whether it makes the managerial and administrative functions smoother.

BizFACT

Bleeding edge technology refers to technology that is so new it has a greater degree of risk in terms of unreliability for those who adopt it.

BizWORD

Leading edge technology *is the technology that is the most advanced or innovative at any point in time.*

4.6.1 Leading edge technology

Leading edge technology is the technology that is the most advanced or innovative at any point in time. Operations managers can distinguish their operations processes by utilising the best available technologies. This can help businesses to create products more quickly and to higher standards, with less waste, and also help a business to operate more effectively.

Leading edge technologies, in both the use of inputs and processes, have assisted in making the publicly listed Australian company CSL Ltd one of the world's most innovative pharmaceutical companies. Similarly, Woolworths demonstrated considerable innovation and set the benchmark in Australia when it used leading edge technologies integrated with distribution centres.

Note that leading edge technologies are created by innovative processes and innovative thinking. When innovative inputs are created, new products can be made, which can change markets. Consider the current development of nanotechnologies and use of nanoparticles that allows for water to be purified when scooped into water bottles. This is revolutionising the cosmetics industry and has medical applications.

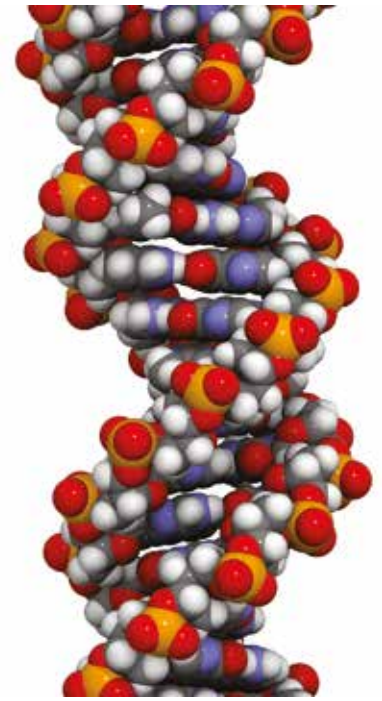


FIGURE 4.13 Nanotechnology is an example of leading edge technology. Nanotechnology is the manipulation of molecules and atoms at a 'nanoscale' — one nanometre is about a million times smaller than the diameter of a pinhead. This technology is expected to affect all parts of human life, including energy, food, healthcare, computers and consumer products.

Advice from algorithms — cutting edge technology

Leading edge technology is also called 'cutting edge' technology and refers to innovations that drive change in business. An example is the development of fintech and robo-advisors — two technologies being used by banks to assist customers make financial and investment decisions. These technologies are used with smartphones or through computer enabled access. The software development underpinning the technology uses computer algorithms to determine what investors seek and to give them various investment options based on their risk preferences, volume of investment, preferred term of investment, and so on.

By embedding options based on customer responses, the technology adapts to present choices aligned to the customer's needs. In this way, the advice can be accurate and specific, while being available 24-hours a day. This can reduce legal complications arising from financial advice given by financial advisers and can make the options far more tailored to individual customers. Over time the software will map a history of the customer's choices and thus be better able to help customers make informed choices about future investments.

SNAPSHOT QUESTIONS

1. **What** is an alternative name for leading edge technologies?
2. **How** do the fintech and robo-advisor algorithms work?
3. **Detail** three benefits of robo-advisors.

SNAPSHOT

'By embedding options based on customer responses, the technology adapts to present choices aligned to the customer's needs.'

4.6.2 Established technology

Established technology is technology that has been developed and widely used, and is simply accepted without question. Such technologies include the use of computers and various software packages in managing business operations and functions. Established technologies are functionally sound and help to establish basic standards for productivity and speed. In the operations function, established technologies include:

- barcoding and point-of-sale (POS) data for inventory management
- robotics for complex and detailed manufacturing
- computer-aided design (CAD), computer-aided manufacturing (CAM) and computer-integrated manufacturing (CIM) for integrating transformations processes

BizWORD

Established technology *is technology that has been developed and widely used and is simply accepted without question.*

- information processing technologies and information technologies (IT) for administration, logistics, input modelling, demand analysis and distribution
- flexible manufacturing systems (FMS) for transformations processes.

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Syllabus area 1 | Topic 4 | Concept 5

Technology
Summary screen and practice questions

SUMMARY

- The thoughtful application of technology helps a business create a competitive advantage.
- Leading edge technology — the most advanced or innovative at any point in time — can help businesses to:
  - create more products quickly and to higher standards
  - reduce waste
  - operate more effectively.
- Established technology — that is widely accepted and used — helps to establish basic standards for productivity and speed.
- Both forms of technology give businesses efficiencies, productivity gains and a capacity to improve operations processes.

EXERCISE 4.5 REVISION

1. **What** is the difference between leading edge and established technology?
2. **List** two leading edge technologies and two established technologies you have seen used by businesses.
3. **Outline** two benefits of leading edge technology.
4. **How** are innovation and technology related?
5. 'Businesses need to acquire leading edge technology in order to compete effectively.' **Discuss**.
6. **Recall** four forms of established technology.

EXERCISE 4.5 EXTENSION

1. **Examine** the work of Micromine, a Perth-based global provider of innovative software solutions and services for the mining and exploration industry. **Determine** the benefits to a mining or exploration business in using Micromine's cutting edge technology.
2. Use newspaper reports from the internet to **investigate** the use of leading edge technology in either a manufacturing business such as a pharmaceutical business or a service business such as a bank. **Create** either a 300-word report or three-minute oral presentation and present your information to the rest of the class. Alternatively, present this as a PowerPoint presentation.

on Resources

Weblink: Micromine

4.7 Inventory management

BizWORD

***Inventory** or **stock** refers to the amount of raw materials, work-in-progress and finished goods that a business has on hand at any particular point in time.*

Inventory or **stock** refers to the amount of raw materials, work-in-progress and finished goods that a business has on hand at any particular point in time. Inventory management is another crucial facet of operations management, and the strategies applied to the management of inventory will have a significant impact on transformations processes.

There is some debate in management and business about the definition of stock or inventory and also the advantages and disadvantages of holding stock. Some business managers think of stock as being any unused or underutilised resources. Stock is the product either in partial or full transformation, which has yet to be sold. It therefore represents the difference between what is supplied to the business as product inputs and what leaves as outputs.

4.7.1 Advantages of holding stock

All businesses will carry some stock. The issue of importance to business is exactly how much to carry. There are several advantages associated with holding stock:

- Consumer demand can be met when stock is available. This may prevent the consumer from seeking to buy from an alternative business. This is a risk reduction strategy.
- If a particular product line runs out, an alternative can be offered, thereby generating income for the business instead of a lost sale.
- It reduces lead times between order and delivery.
- Stocks give the opportunity for a business to generate immediate revenue. It is very hard to generate revenue from partially transformed inputs.
- Stocks can be distributed to distribution centres, which then rapidly transport the products to places as indicated by demand.
- A store of stock allows the business to promote use of products in non-traditional or even new markets.
- Older stock can be sold at reduced prices and thereby encourage cash flow and also attract sales of other products.
- Stocks are an asset and are of value to the business, reflecting well on the balance sheet.
- Making products in bulk may reduce costs as there are economies of scale in purchasing inputs. This could be cheaper than the cost of holding the stock once it is made.

4.7.2 Disadvantages of holding stock

Despite there being many advantages of holding stock, the trend is to hold as little stock as possible and to adopt a 'make-to-order' approach. That is, there are many perceived disadvantages of holding inventory. These include:

- the costs associated with holding stock (see figure 4.14), including storage charges, spoilage, insurance, theft and handling expenses.
- the invested capital, labour and energy cannot be used elsewhere as it has been used to create the stock
- the cost of obsolescence, which can occur if stock remains unsold.



FIGURE 4.14 The costs associated with holding stock in warehouses can be as high as 30 per cent of the value of the stock.

4.7.3 Inventory valuation methods

Businesses that buy stock need to decide how much to carry in inventories. At the end of an accounting period, it is important that the value of unsold stock be determined. It is also very important to know the value of stock sold so that profit can be correctly determined. However, how do you calculate the value of

the remaining stock — the inventory valuation — if the price of the goods making it up change during the accounting period? There are different approaches to inventory valuation. The main inventory valuation techniques include:

- **LIFO (last-in-first-out)**
- **FIFO (first-in-first-out).**

Each of these will now be examined with reference to this example: Assume that a business buys and re-sells mobile phones. It purchases 1000 mobile phones in a batch for $100 each. Call this stock 'Batch A'. Assume half of Batch A stock is sold for $150 each. There are 500 mobile phones left in stock. A second batch, Batch B, of 1000 mobile phones is then purchased at a cost of $110 each. This takes the stock up to 1500 mobile phones. Another 900 mobile phones are sold, but this time at a price of $160. This leaves 600 phones in stock. A third batch, Batch C, of 500 phones is purchased at $120 each. The business sells 800 phones for $180 each, leaving stock of 300 phones at the end of the period.

Batch A

Purchase 1000 phones @ $100. Total cost is $100 000.

Batch B

Purchase 1000 phones @ $110. Total cost is $110 000.

Batch C

Purchase 500 phones @ $120. Total cost is $60 000.

Total sales = (500 × $150) + (900 × $160) + (800 × $180)
= $75 000 + $144 000 + 144 000 = $363 000

BizWORD

The **LIFO (last-in-first-out)** *method of pricing inventory assumes that the last goods purchased are also the first goods sold and therefore the cost of each unit sold is the last cost recorded.*

The **FIFO (first-in-first-out)** *method of pricing inventory assumes that the first goods purchased are also the first goods sold and therefore the cost of each unit sold is the first cost recorded.*

BizFACT

The advantage of using LIFO is that the prices used to calculate the cost of sales, and therefore the gross profit, are more recent and therefore more closely reflect their economic value. However, in times of falling prices, LIFO overstates profits and maximises taxes.

BizFACT

In general, neither LIFO nor FIFO is necessarily better. The important point to remember is that during periods of price changes, two businesses (performing equally well in most respects) could legitimately report differing profit levels depending upon the inventory valuation method used. Because the inventory valuation method has such a powerful impact on gross profit, a business must state in the footnotes to its financial accounts which method is used.

LIFO (last-in-first-out)

A total of 2200 items were sold. In businesses applying a LIFO approach, the business would apply cost on a last-in-first-out basis, meaning the stock bought last would assume to have been sold first. This would give the following cost:

The last group of 500 phones would be assumed to have sold first. Therefore, 500 of the phones would attract a cost of $120 each for a total cost of $60 000. The second last purchased cost would apply to the next 1000 phones sold. This gives the cost of that 1000 at $110 each, totalling $110 000. The first stock sold is assumed to have sold last, meaning the remaining 700 phones that sold would be given the first cost of $100 each for a total of $70 000.

Under this analysis, the total cost of goods sold is $60 000 + $110 000 + $70 000 = $240 000 and the unsold stock has a value of 300 units × $100 = $30 000.

FIFO (first-in-first-out)

A total of 2200 items were sold. In businesses that apply a FIFO approach, the business would apply cost on a first-in-first-out basis, meaning the stock bought first would assume to have been sold first. This would give the following cost:

The first group of 1000 phones would be assumed to have sold first. Therefore, 1000 of the phones would attract a cost of $100 each for a total cost of $100 000. The second purchased cost would apply to the next 1000 phones sold. This gives the cost of that 1000 at $110 each, totalling $110 000. The last stock sold is assumed to have sold last, meaning the remaining 200 phones that sold would be given the first cost of $120 each for a total of $24 000.

Under this analysis, the total cost of goods sold is $100 000 + 110 000 + $24 000 = $234 000 and the value of unsold stock 300 × $120 = $36 000.

4.7.4 LIFO and FIFO — their impact

Clearly, the method of valuation affects both the calculation of the value of the goods sold (which in turn affects gross profit) and also the value of the unsold stock.

Operation managers can apply either of these methods or a weighted averaging approach as all are allowed under accounting standards. However, if LIFO is used, it may overstate cost and understate gross profit (especially when the cost of purchased goods rises over time). Moreover, it may undervalue stocks on hand at the end of the period. Alternatively, under a FIFO approach, stock costs may be understated and profits overstated. Moreover, stocks at the end of the period may be overvalued.

4.7.5 Just-in-time (JIT)

One means of managing stock is to apply a **just-in-time (JIT)** approach, which aims to overcome the problem of end-of-period stock valuation: a lean production method. This is because a JIT approach aims to have the business make only enough products to meet demand. A JIT approach also allows retailers to display a wider range of products as they need to store less and can order in response to consumer demand. This, therefore, saves money as there are no expensive holding and insurance costs. Moreover, shrinkage costs and losses due to obsolescence are also minimised. However, a JIT approach requires a very flexible operations function with flexible processing. It also requires a very high ability to respond quickly to changes in market demand as well as reliable supplier deliveries which must be received at the appropriate time.

Just-in-time is *not* an inventory valuation technique. It is a method of managing the flow and storage of stock. This means that the use of JIT is not separate from the valuation strategies — they are not alternatives. A business can use LIFO or FIFO and also be applying the JIT method of inventory management.

BizWORD

Just-in-time (JIT) *is an inventory management approach which ensures that the exact amount of material inputs will arrive only as they are needed in the operation process.*



FIGURE 4.15 Inventory control software provides managers with precise knowledge of quantities and locations of stock, which is essential when using a just-in-time stock management system.

SUMMARY

- Inventory or stock refers to the amount of raw materials, work-in-progress and finished goods that a business has on hand at any particular point in time.
- Inventory management is a key operations strategy.
- There are advantages associated with holding stock, including being able to respond quickly to changes in demand and allowing development of new markets that can supply stock quickly.
- There are also disadvantages that come with carrying stock, including the costs and tying up of money that could be applied elsewhere.
- There are alternative inventory valuation methods, including LIFO (last-in-first-out) and FIFO (first-in-first-out).
- At the end of an accounting period, it is important that the value of unsold stock be determined.

BizFACT

Although the just-in-time approach was first used by the Ford Motor Company, it was adopted and publicised by Toyota as part of its production system.

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Syllabus area 1
Topic 4
Concept 6

Inventory management
Summary screen and practice questions

- The method of valuation affects the calculation of the value of the goods sold, the value of the unsold stock and the gross profit.
- Businesses are seeking to become 'lean', meaning they emphasise low cost.
- Lean businesses apply a just-in-time (JIT) approach to inventory management, which means to make to order.

EXERCISE 4.6 REVISION

1 **What** is inventory management?
2 Provide an alternative name for inventory.
3 Select what you consider to be the four most important advantages of holding stock. **Justify** your selection.
4 **Summarise** three disadvantages of holding stock.
5 **What** do the acronyms LIFO and FIFO represent?
6 On 1 May Zegna Shoes orders 200 pairs of joggers at $30 apiece and sells 150 pairs for $50. Eight weeks later, Zegna Shoes orders 100 more pairs at a new price of $35 and sells 60 of these at $55. By the end of the accounting period 210 of the 300 pairs are sold. **Calculate** the total cost of sales (cost of stock), total sales and gross profit using the (i) LIFO and (ii) FIFO simplified cost analysis methods.
7 **Contrast** the use of LIFO and FIFO in terms of their effect on profitability and stock valuation.
8 **How** does the just-in-time approach to inventory management improve productivity and reduce costs?
9 **Determine** the potential problems that you can see with the just-in-time approach. Summarise your answer.

EXERCISE 4.6 EXTENSION

1 Chan is the operations manager of a large clothing manufacturer. Recently the business has found itself in financial trouble as retail customers begin to recognise it as being a very poor supplier. The clothes are rarely delivered on time, and always in the wrong quantities. The main problem for Chan is that the materials for some clothing lines keep running out. Some lines just won't sell and the storage areas are full of materials for those lines.
   (a) **Determine** the costs of having too many materials in storage.
   (b) **Predict** what problems can occur when there are not enough materials on hand.
   (c) Suggest any other materials management approaches you think would help Chan to optimise the clothing operations. **Justify** your answer.
2 'Management's goal is to minimise total inventory costs by balancing inventory carrying and ordering costs.' **Distinguish** between carrying costs and ordering costs. Provide examples of each in your answer.
3 Imagine you are the business reporter for a daily newspaper. You are asked to **create** a 300-word article including one captioned image about inventory management, with an emphasis on the just-in-time approach. The article will be posted online. The headline of your article is 'Take stock — the untold story'.

4.8 Quality management

BizWORD

Quality management *refers to those processes that a business undertakes to ensure consistency, reliability, safety and fitness of purpose of product.*

'Quality' is a term used to describe the degree of excellence of a product or service, and its fitness for a stated purpose. **Quality management** refers to those processes that a business undertakes to ensure consistency, reliability, safety and fitness of purpose of product. In operations, quality management includes quality controls at each stage of processing. There are numerous approaches to achieving quality within businesses, but many of the more common contemporary approaches include:

- quality control — inspection, measurement and intervention
- quality assurance — application of international quality standards
- quality improvement — total quality management and continuous improvement.



FIGURE 4.16 Amazon, a world-leading online retailer, uses a quality management approach known as Six Sigma.

4.8.1 Quality control (QC)

Quality control (QC) reduces problems and defects in the product by using inspections at various points in the production process.

In the first instance, a business needs to have defined quality standards and parameters. These standards need to be broadly applied across the range of products and processes. Once the standards have been set, a range of tests needs to be designed to assess the quality of products and processes against the standards. Pre-determined quality targets would be set, and any failure to meet the targets would need to be assessed and appropriate action taken to correct any issue that has caused quality standards to fall below expectation. This reactive approach needs to be balanced against a more proactive approach that encourages a continuous improvement model.

Quality control management may require that labour is appropriately trained to apply quality standards throughout working processes.

BizWORD

Quality control (QC) *involves the use of inspections at various points in the production process to check for problems and defects.*

Quality control — customer service

The salesperson was on her phone when the customer arrived. The customer was looking for a pair of shoes for a job interview and was feeling a little anxious about buying a pair that would match the workplace culture. As the customer browsed through the available pairs on display, the salesperson scrolled through the phone, messaging and smiling to herself. The customer was trying to make eye contact in order to get some service. At one stage the salesperson looked up but only briefly as the phone buzzed, causing the salesperson to smile and reply to a message.

The customer found a pair of shoes that were perfect for the interview. The shop, as it turned out, had a very unusual range and there were several pairs that the customer wanted to buy. However, the salesperson was still preoccupied on her phone. The customer eventually walked to the counter and said, 'Hi . . . I think you have awesome stock here and I would love to buy three or four pairs of the shoes you sell . . .'

The salesperson looked up momentarily but her eyes flicked back to her phone. The customer continued, 'However the quality of your service here is the worst I have ever experienced. I have watched you message and laugh while I am here with money ready and willing to buy. There is no-one else in this store to help me. The quality of the stock you sell is brilliant but I will never buy from a store with such hopeless customer service!'

SNAPSHOT QUESTIONS

1. **What** are the two distinct elements of service in the Snapshot?
2. **How** do quality of product and quality of service relate to one another?
3. **How** could the experience of quality have been improved from the customer's perspective?

SNAPSHOT



'. . . the quality of your service here is the worst I have ever experienced.'

BizFACT

In a speech in 1890, Mahatma Gandhi said, 'A customer is the most important visitor on our premises. He is not dependent on us. We are dependent on him. He is not an interruption of our work. He is the purpose of it. He is not an outsider of our business. He is part of it. We are not doing him a favour by serving him. He is doing us a favour by giving us the opportunity to do so.'



FIGURE 4.17 Certification of the ISO 9000 Quality Management System series is easily recognised by the 'five ticks' Quality Endorsed Company Standards Mark.

BizWORD

Quality assurance (QA) *involves the use of a system to ensure that set standards are achieved in production.*

Inspection and quality control

To ensure output meets required standards, many businesses carry out inspections of all or part of the total volume of production. When an inspection is conducted, the goods or services under inspection can be passed as 'okay' or 'defective'. This is an *attribute inspection*, which might answer questions such as: does an electric switch turn off and on? Does a hinge open and close? Does a water container have any leaks? In service businesses, an inspection of employee performance may be conducted. A bank may inspect teller accuracy, courtesy, speed and efficiency; and a supermarket may check operator scanning rates.

4.8.2 Quality assurance (QA) — international quality standards

Quality assurance (QA) involves the use of a system to ensure that set standards are achieved in production. This is done through taking a series of measurements and assessing them against pre-determined quality standards. Quality assurance is a proactive approach to quality rather than a reactive one. This means that a business emphasises quality in the design of a product and brings it to the market with a level of quality that provides comfort to prospective buyers. Aspects of quality that are important to QA include:

- the notion of 'fitness for purpose' or how well a product does what it is designed to do
- the desire to achieve 'right first time' so that products do not need to be reworked, which wastes time, energy and other resources.

A series of quality assurance standards has been developed in response to the impact of globalisation and the international emphasis on quality. Such standards can be applied universally, which means that a component from Korea that meets the accepted international standard is theoretically of the same quality as a similar component from an Australian manufacturer. Given that several different manufacturers in different countries could produce components for a plasma television, such standards are an important quality control mechanism for 'global' companies.

A widely used international standard is the ISO 9000 series of quality certifications (see figure 4.17). 'ISO' stands for International Organization for Standardization. ISO standards are voluntary but many businesses comply with their requirements to enhance their domestic and international competitiveness.

SNAPSHOT

'The owners took advantage of a gap in the market'

Case study: Coco & Lucas' Kitchen

Australian business Coco & Lucas' Kitchen was inspired by the need to create a range of healthy foods for children. The owners took advantage of a gap in the market for children aged 3–12 years and created a range of high-quality and well-packaged foods that have the following features.

- Gluten & lactose free
- All natural ingredients
- No preservatives
- No artificial flavours or colours
- Made in Australia
- Handmade
- 100% Aussie meat
- Truly recyclable packaging
- No GM ingredients
- Frozen, locked in full of goodness
- Contains more than 25% protein

Some of the products made by the business include spaghetti bolognaise, cottage beef pie, honey soy chicken and penne pasta. These products are handmade from local ingredients and are packaged so that children can take these products to school to eat at lunch.

The business concept was inspired by the owner's need to make food for her nephew who had lactose and gluten intolerance. Accordingly, Coco & Lucas' Kitchen created Australia's first 'junior foodies'range that is gluten and lactose free.

The business focuses on using high-quality ingredients and handmade processing that is done within Australia. Coco & Lucas' Kitchen supplies products to Australian supermarkets and was recognised for its quality and innovation at the 2017 World Food Innovation Awards being nominated in each of the following categories:

- Best convenience food innovation
- Best children's food
- Best new brand or business (which it won) and
- Best frozen food.

SNAPSHOT QUESTIONS

1. **What** was the inspiration behind the Coco & Lucas' Kitchen range of foods for children?
2. **Discuss** whether there is a need for the foods made by Coco & Lucas' Kitchen.
3. Research and **outline** the importance of quality and innovation to the development of Coco & Lucas' Kitchen.

4.8.3 Quality improvement (QI)

Quality improvement (QI) focusses on two aspects: continuous improvement and total quality management.

Continuous improvement

Continuous improvement is the belief that over time processes will be made more efficient and effective. Improvement may be a monumental breakthrough achieved through innovation all at once or it may be incremental and gradual over time. The basis of successful improvements in quality is the inclusion of staff into improvement processes. That is, all staff are encouraged to demonstrate initiative and to suggest areas where improvements can be made. In this way, all processes can be improved simultaneously and 'ownership' for improvement extends to all.

As a strategic aspect of operations management, a focus on improvement is likely to help a business to obtain and maintain a competitive advantage as outlined in the following Snapshot.

BizWORD

Continuous improvement *is an ongoing commitment to improving a business's goods or services.*

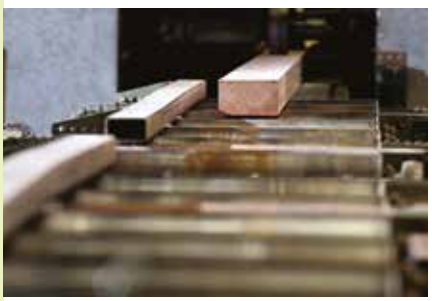
Six Sigma

Six Sigma is a quality management approach which was originally developed by US telecommunications company Motorola in the mid-1980s. Six Sigma is used to identify and remove the causes of problems in the operations process, so that a business produces only 3.4 defective parts per million opportunities. This translates to a perfection rate of 99.9997 per cent. It uses typical quality management methods, including statistical tools to measure variations in the operations processes, empowerment of staff and training, a commitment to improving quality through the whole business and continuous improvement.

A special team of people within the business is established. This is composed of staff who have been given Six Sigma training, and are able to coordinate others in adopting methods to improve quality. A five-step process to problem solving applies to Six Sigma, commonly referred to as DMAIC.

Six Sigma is a relatively old approach to business process improvement, but is still widely used in many Australian businesses. Qantas and ANZ are examples of large Australian businesses that use methods from Six Sigma to achieve process improvements. Both of these businesses used Six Sigma to identify and remove non-productive or non-value adding processes and activities. The focus on cost

SNAPSHOT



'. . . businesses use Six Sigma to identify and remove non-productive or non-value adding processes and activities.'

BizWORD

Six Sigma *is a quality management approach that seeks to identify and remove the causes of problems in the operations processes, achieving virtually defect-free production.*

efficiencies and productivity through the use of Six Sigma has led to process improvements at Coca-Cola Amatil (CCA), the Flight Centre Travel Group (FCTG) and National Australia Bank (NAB).

SNAPSHOT QUESTIONS

1. **Explain** what is involved in the Six Sigma approach.
2. **Identify** what aspects of Six Sigma make it a quality management approach.
3. **Deduce** whether Six Sigma seems like an original approach to you or whether it is just another form of TQM.

BizWORD

The **total quality management (TQM)** *concept focuses on managing the total business to deliver quality to customers.*

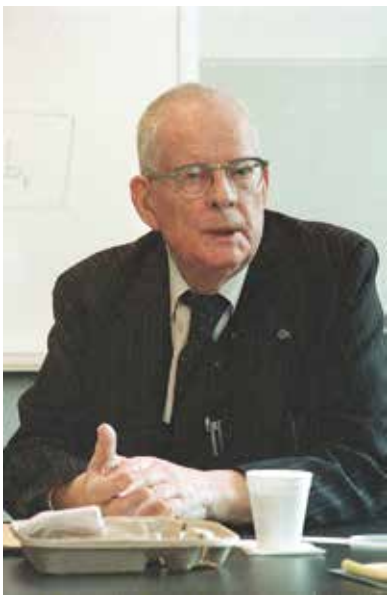


FIGURE 4.18 W. Edwards Deming's approach instils quality values throughout every activity in a business, with frontline employees closely involved in the process.

studyon

Syllabus area 1
Topic 4
Concept 7

Quality management
Summary screen and practice questions

Total quality management (TQM)

Some businesses approach the issue of quality management by assigning this responsibility to a particular department. The Japanese discovered that this approach implied that only specific personnel were responsible for quality. The **total quality management (TQM)** approach is a 'holistic' approach, however, in that quality becomes both a commitment and the responsibility of every employee of the business. Originally developed by W. Edwards Deming, it is an ongoing, business-wide commitment to excellence that is applied to every aspect of the business's operation. He advocated a shift away from an inspection-oriented approach to quality control towards an emphasis on employee involvement in the prevention of quality problems. Build the product right in the first place and you avoid the expense of inspection and the waste of rejected products, he insisted. Improving quality, said Deming, can also help businesses increase their market share (as a result of better quality and lower priced products). To achieve TQM objectives requires four elements: benchmarking, employee empowerment, a focus on the customer and continuous improvement.

SUMMARY

- Quality management refers to those processes that a business undertakes to ensure consistency, reliability, safety and fitness of product purpose.
- The most common quality management approaches are:
  - quality controls — inspection, measurement and intervention
  - quality assurance — application of international quality standards such as the ISO 9000 series
  - quality improvements — continuous improvement and total quality management.
- A focus on continuous improvement is an ongoing commitment to improving a business's goods or services.
- Innovation, employee involvement and quality are closely aligned and indicate quality working processes.
- Total quality management (TQM) focuses on managing the total business to deliver quality to customers.
- To achieve TQM objectives requires four elements: benchmarking, employee empowerment, a focus on the customer and continuous improvement.

EXERCISE 4.7 REVISION

1 **What** is 'quality management'?
2 **List** three different approaches to quality management.
3 **What** quality controls would a consumer make when purchasing clothing?
4 **Outline** the steps involved in the quality control approach.
5 **Why** is quality control important in the manufacture of pharmaceutical products?
6 **How** does the quality assurance system operate?

7 **Account** for the development of an international quality standard.
8 **Clarify** what the term ISO represents.
9 **Outline** the concept of continuous improvement.
10 **Why** is TQM characterised as a 'holistic' approach to quality management?
11 **What** is the central focus of W. Edwards Deming's TQM concept?
12 **Recommend** why a business should adopt a TQM program.
13 **Determine** why the successful implementation of a TQM program depends on commitment from everyone in the business.
14 **Recall** how continuous improvement can occur.
15 View a **Standards Australia** video from their website and select a case study that interests you.
   (a) **Identify** the key benefits to the company of adopting standards developed by Standards Australia.
   (b) **Explain** how Standards Australia helped the business develop.

on Resources

Weblink: Standards Australia

EXERCISE 4.7 EXTENSION

1 Imagine you are responsible for quality management within the school canteen. **Identify** which quality management approach you would adopt. **Justify** your decision.
2 **Analyse** the effectiveness of a focus on continuous improvement on work processes.
3 Use business magazines, newspapers and the internet to **examine** quality failures of Samsung, Volkswagen and Takata. **Create** a 300-word report on the issues faced by the chosen business. In your report, mention the impact on the business's reputation, revenue and profitability.

4.9 Overcoming resistance to change

A notable influence on operations strategy arises from the need to manage and be responsive to change. All businesses are subject to change from the external environment. Legislative and regulatory changes, changes in economic conditions, social changes over time and technological breakthroughs all impact on the business and shape its operations. Moreover, change can also come from within the business through the initiative of staff or the application of technology and a focus on innovation.

When changes arise from external sources, a business must learn to adapt. This may require a significant internal realignment. Change can often be resisted as it can cause uncertainty and uncertainty can be stressful. In economic terms, uncertainty represents risk and most people are adverse to risk. Thus, a business needs to apply particular skills to help manage change processes.

Resistance to change arises from two principal sources within a business:
- financial
- psychological/emotional.

The most important step in overcoming resistance to change is to ensure that managers understand the main reasons why change is resisted. Once these factors have been identified, managers can put in place strategies to overcome the resistance.

BizFACT

Theories of human behaviour reveal that for most of us, personal change is achieved only with a great deal of effort. Over the last decade, management has realised that change also represents a serious obstacle for businesses.

4.9.1 Financial costs and resistance to change

One major cause of a resistance to change from managers and business owners is that of financial costs. The main financial costs associated with change include the:
- cost of purchasing new equipment
- cost of redundancies
- costs of retraining employees

BizFACT

According to change management consultant Mr McCulloch, it is essential managers ask one fundamental question when introducing changes: 'Am I giving as clear a picture as I can of the what, when, how and why of the changes?'

- costs associated with structural reorganisation of the business, including changes to plant and equipment layouts.

Each of these costs to a greater or lesser extent can be a cause for concern by business owners and operations managers who need to manage change.

Purchasing new equipment

A major cost associated with change is that of the investment in plant and equipment. The purchase of equipment such as machinery and technology is considered a capital cost. Such costs are usually quite high and the cost can be recouped through use (which adds value in transformation processes) and through depreciation. Although the purchase of new equipment can be high, there can be very significant market advantages from making the capital investment. In so doing, a business may find some key operational goals are better achieved, such as:

- improved processing flexibility
- improved processing speeds and shorter lead times
- more consistency in production
- higher overall quality of processing
- reduced wastage and losses from equipment failure.

Prior to making the investment in new equipment, it is highly likely that operations managers will assess the cost of purchase against the cost of leasing new equipment and technology. Leasing does not require a high upfront payment, but it can be more expensive as an ongoing operational cost.

BizWORD

Redundancy *refers to employees losing their jobs, where the employees' job or work no longer needs to be done. It may be necessary due to a lack of work, as in the case of a fall in demand for a product or service, or the position may have been restructured or replaced by technology.*

BizFACT

During 2017 the LEGO Group experienced a massive downturn in revenue arising from lower than forecast sales. The major concern for LEGO was that it had recently allocated increased investment expenditure to new factories in anticipation of increased demand. Following the unexpected downturn in sales the business announced the loss of 1400 jobs from the manufacturing plants globally.

Redundancy payout

Redundancy is defined as a loss of work arising from job skills that are no longer required or relevant to the workplace. Redundancy means that employees lose their jobs. This leaves those employees to seek jobs elsewhere in the same industry or to retrain and 'upskill' so that they have more relevant job skills in related or alternative industries. A significant cost associated with redundancies is the redundancy payout. Redundancy payout is the money that is given to employees when they are forced out of work because their job skills are no longer relevant. Typically, redundancy payouts are quite high because the value of the payout depends on:

- the length of employment the employee has had with the business. Under legislation a certain number of weeks of pay must be paid when a person is made redundant
- the level of pay the employee is on prior to being made redundant
- the amount of unused leave that the employee has accrued (including annual leave and long service leave)
- any outstanding wages.

Redundancy costs can be very substantial because the cumulative effect of the payments that must be made can be high. This is especially the case when many employees are made redundant. This typically occurs when capital, in the form of machinery and technology, replaces labour in what is called 'capital-labour substitution'.

Retraining

This cost arises from change that causes a reorganisation of the business's internal hierarchy or from the acquisition of technology. In the first instance, job roles may change requiring employees to acquire different work skills. This can be achieved through training. In the second situation, the purchase of technology often requires training or retraining on new software. Retraining may be performed on the job or off the job.

Reorganising plant layout

As was explained in chapter 3, plant refers to the facilities in which the machinery is arranged. Typically the plant layout is organised around the needs of the product and the transformation processes required to create the products. Minor changes may have little or no effect on plant layout. However, major changes such as the complete re-engineering of systems often require extensive reorganisation of the layout within the facility. There can be high costs associated with reorganising the plant. One cost is incurred when transporting, placing and bringing power to the new plant and equipment. Further costs are incurred in the downtime when transferring from the old machinery to the new machinery and when testing new equipment, machinery and technology. Further costs come with losses of productivity, arising from staff orientating themselves with new work processes and arrangements.

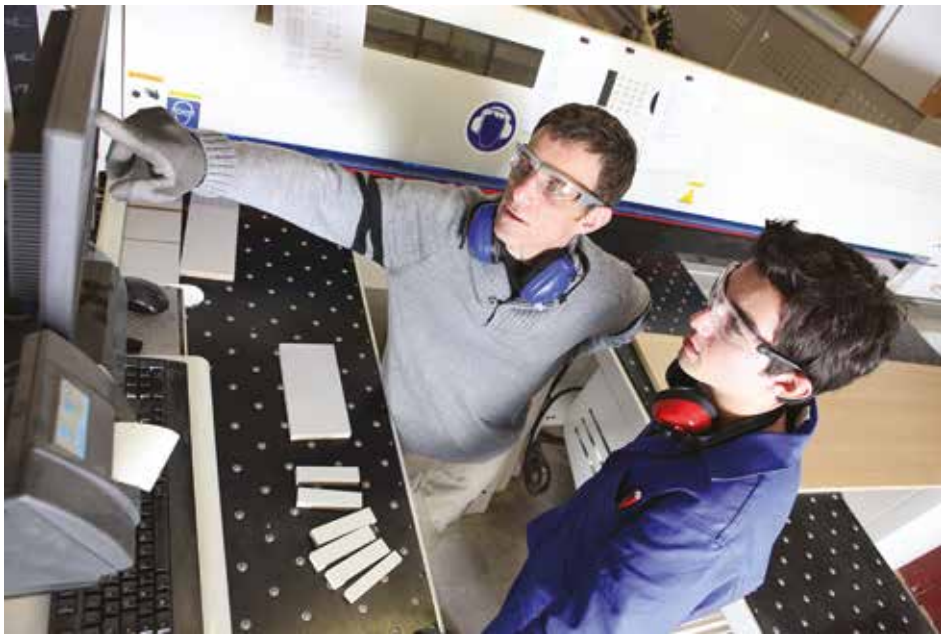


FIGURE 4.19 To improve efficiency and productivity, the installation of new equipment may require reorganisation of the plant layout. As well, as new technology is introduced, employees must be retrained. The full benefit of new technology cannot be realised without expenditure on training and development.

4.9.2 Psychological resistance to change — inertia

Another source of resistance arises from what is called **inertia**. Inertia is a term that describes a psychological resistance to change. A feeling of uncertainty or fear of the unknown, when change is imminent or pressing, can lead people to resist. This feeling is common to most people. You may be familiar with the reaction of a parent who is in the car when their P-plate teenager is driving. The parent will often suggest a different route even if the one taken by the teenager is quicker. This is an everyday example of resistance to change. How much more resistance would be felt by people who feel like their job prospects may be threatened, who fear loss of career opportunities or who find new technology and equipment intimidating.

Although inertia is not a financial resistance to change, when people do not change or adapt then the business can feel financial effects of that resistance.

BizWORD

Inertia *is a term that describes a psychological resistance to change.*

4.9.3 Strategies to overcome resistance to change

Identifying the reasons for resistance to change are important because the resistance needs to be carefully managed if businesses are to successfully adapt to circumstances and situations that change. Change is constant and in small ways business processes are continually being refined and adapted over time. Even though change is continuous, sometimes there is major change and that acts like a discontinuity. Such change must be planned and it needs astute management.

Successful managers are the ones who anticipate and adjust to changing circumstances rather than being passively swept along or, worse still, being caught unprepared. Such people are *proactive* — they initiate change rather than simply react to events, rather than *reactive* — those who wait for a change to occur and then respond to it.

To be constructive, changes must:

- occur at a pace at which they can be absorbed by, and integrated into, the business
- be evaluated thoroughly to assess their overall impact. Poorly managed changes normally result in employee resistance, tension and lost productivity.
- be introduced into a workplace culture that supports employee participation.



FIGURE 4.20 Employees who are not informed about why changes are necessary will ultimately resist such changes and turn to the rumour mill for information — most of which will be incorrect gossip.

4.9.4 Change management strategies

To manage significant change, a business should formalise its approach to change management. This can be done by applying the following steps for change management.

- Identify the source(s) of change and assess whether there is a need to accommodate change through adjustments to business processes. Generally the sources of change are external and the business is responding to the threat that change can pose.
- Lower the resistance to change through communicating with employees about the need for change and getting widespread support for the change.
- There may be a need to use **change agents** (internal staff or external professionals). If staff are included in the process of creating a culture of change and setting goals, they will generally be more supportive.
- It may be necessary to apply change models such as Kurt Lewin's unfreeze-change-refreeze model or the more contemporary Kotter's eight-step change model (see the following Snapshot), which has been applied by businesses.

Adapting to change through overcoming the financial and psychological resistance can help businesses to create sustainable competitive advantage even when faced with what appear to be threats.

BizWORD

A **change agent** *is somebody who initiates change or facilitates the change process.*

Change management — models for business

Kurt Lewin's unfreeze/change/refreeze model

Suppose someone gave you a plastic cup filled with clear, solid ice. At the bottom of the cup is a twenty-cent piece lying heads up. Now, suppose you want the twenty-cent piece to be frozen in a tails-up position. What can you do to bring about this desired change? There is only one practical solution. You let the ice in the cup thaw (unfreeze), reach in and turn the coin over (change) and then freeze (refreeze) the cup of water. This is how Lewin recommended that change be handled in organisations. Lewin outlined each of the steps as follows.

1. *Unfreezing*. This process breaks down the forces supporting the existing system and prepares the business for change.
2. *Change*. The new procedures and behaviours must be communicated and implemented.
3. *Refreezing*. This requires that the manager offers positive reinforcement to make sure the change lasts.

John Kotter's eight-step model

Management researcher John Kotter maintains that the change management process consists of the following eight steps.

1. *Establish a sense of necessity*. Examine the current business environment to highlight impending threats or potential opportunities.
2. *Form a guiding group*. Establish a team of people to act as facilitators.
3. *Create a vision*. Provide employees with a clear, shared sense of direction that will allow them to achieve a common objective.
4. *Communicate the vision*. Communicate the vision with all those the change will affect to build cohesion between employees to dispel fear of the unknown.
5. *Empower people to fulfil the vision*. People who have the opportunity to be actively involved in the change process generally develop a sense of ownership.
6. *Recognise and reward achievements*. Recognition and reward should be given to encourage further risk taking and reinforce the positive aspects of embracing change.
7. *Consolidate improvements*. As the change process proceeds, assemble the benefits attained into the business's operating procedures and systems.
8. *Institutionalise the changes*. Make a clear statement to show the connections between the new procedures and the success of the business.

SNAPSHOT QUESTIONS

1. **Identify** and briefly **outline** the three steps involved in Lewin's unfreeze/change/refreeze change model.
2. **Why** would a change program without proper 'unfreezing' have limited chance of success?
3. **What** are Kotter's eight steps for managing change?
4. **Explain** whether a structured approach to managing change is necessary.
5. **Determine** how an understanding of these models assists a manager who wants to introduce changes into the business.

SNAPSHOT



'Communicate the vision with all those the change will affect . . .'

SUMMARY

- Generally, the sources of change are external and the business is responding to the threat that change can pose.
- Resistance to change can be a major obstacle to the realisation of operations goals. Overcoming the resistance to change is a necessary aspect of change management.
- There are two principal sources of resistance to change: financial and psychological (inertia).
- The financial costs of change include:
  - the cost of purchasing new equipment and technology
  - the cost of redundancies

studyon

Syllabus area 1
Topic 4
Concept 8

Overcoming resistance to change (influence)
Summary screen and practice questions

  - the cost of retraining employees
  - the costs associated with structural reorganisation.
- Inertia can be due to a feeling of uncertainty or fear of the unknown.
- Resistance to change can be overcome by a business identifying the source(s) of change and assessing whether there is a need to accommodate change.
- Lowering the resistance to change through communicating a need for change will result in widespread support for the change.
- Change agents initiate change or facilitate the change process.
- Kurt Lewin's or John Kotter's change models help manage change effectively.

EXERCISE 4.8 REVISION

1 **What** are two sources of resistance to change?

2 Complete the following table to **summarise** the financial costs which create resistance to change. The first one has been started for you.

Financial cost	Explanation
1. Purchasing new equipment	• Capital costs are usually quite high
2. Redundancy payout	
3. Retraining	
4. Reorganising plant layout	

3 **Recall** the kinds of resistance to change you have observed recently. **Propose** how they could have been overcome.

4 **What** is the effect of psychological uncertainty on change management processes?

5 **List** three factors that create constructive change.

6 **Summarise** three steps a business can follow when it wants to manage large change.

7 **Describe** the role of a change agent.

8 'The most important step in overcoming resistance to change is to ensure that managers understand the main reasons why change is resisted.' **Discuss**.

EXERCISE 4.8 EXTENSION

1 Select a major change in your life and complete the following:
(a) **Determine** the reasons why you liked or disliked the change. Share your thoughts.
(b) **Classify** the reasons that were common among the group.
(c) **Explain** what this tells you about the strategy a manager could best use to help overcome resistance to change.

2 When the new CEO for Bradley Southport Limited attempted to make some major changes, she encountered resistance among some senior level managers. **Analyse** why these managers may have resisted the changes.

3 **Outline** and **evaluate** Kotter's eight-step change model.

4 Assume you have been appointed managing director of an engineering business that is facing increased competition from products made overseas and needs, therefore, to improve productivity. **Create** a plan for overcoming employee resistance to the changes that are necessary to increase production.

on Resources

Weblink: Kotter International

4.10 Global factors

Several global factors present opportunities when assessing the operations strategies available for operations managers. These opportunities may be classified as:
- global sourcing
- economies of scale
- scanning and learning
- research and development (R&D).

4.10.1 Global sourcing

An aspect of global sourcing was introduced in section 4.4 when we looked at supply chain management. Recall, global sourcing is a broad term that refers to businesses purchasing supplies or services without being constrained by location. Although a key aspect of global sourcing involves procurement for the supply chain, the concept is much broader than simply a supply chain management strategy. Global sourcing as an operations strategy involves the sourcing of any business operations that gives the business cost advantages. In this broad meaning, global sourcing includes any business operations outsourced.

Most non-core business activities can be outsourced as we saw when we explored the notion of outsourcing (see section 4.5). Global sourcing ensures that the outsourcing decision is exposed to the global market so that the best decision is made based on cost, efficiency, productivity, technical ability and an ability to operate over more hours of the day.

The benefits of global sourcing include cost advantages, access to new technologies, advantages of expertise and labour specialisation, access to other resources and the ability to operate over extended hours. Challenges arising with global sourcing include the possible relocation of aspects of operations, the increased cost of logistics, storage and distribution, managing different regulatory conditions between nations, and the increasing complexity of overall operations when sourcing from diverse locations. One of these complexities is financial and the other is contractual. Financial concerns arise from the risk associated with exchange rate fluctuations. Contractual concerns arise from language and cultural variations, and regulatory differences and misunderstanding created by poorly negotiated SLAs.



FIGURE 4.21 To remain competitive, businesses are forced to find ways to reduce costs of production and to improve their goods or services. One solution is global sourcing, which enables the business to find suppliers who have lower prices, higher quality products and more advanced technology.

4.10.2 Economies of scale

Economies of scale refers to cost advantages that can be gained by increasing the size, or scale, of production. This means that businesses can lower their per unit input costs. Economies of scale becomes a global factor when businesses respond to increases in demand and volume that necessitate making higher product volumes. Clearly, any individual nation has a limited population to sell to. When a business expands into global markets, the need to source globally becomes a strategic decision. Similarly, the need to sell to global markets becomes a decision based on scale advantages. As the scale of production increases, the costs per unit falls. This means that profitability can rise. Moreover, product lifecycles are extended, which means there is greater added value on production.

Economies of scale arise in several different areas of business. There are clear production advantages of producing high volumes. Economies of scale can also be derived on capital investment and the improved use of technologies. For very large multinational corporations (MNC), economies of scale can arise in marketing, with global branding and global advertising saving costs on duplication. Further economies of scale can be created in the field of human resources (HR) through the application of training, and development and range of HR strategies globally.



FIGURE 4.22 Assisted by improvements in communication, transport and technology, large businesses are able to achieve economics of scale, which are the savings resulting from mass production.

4.10.3 Scanning and learning

All businesses can benefit from scanning the global environment and learning from the best practice of businesses around the world. Much of contemporary business practice is influenced by the post–WWII industrial success of Japanese businesses, which emphasised quality, care and continuous improvement (**kaizen**). Management journals, industry and business associations, conferences and other forums act as opportunities for business people to learn from one another. Another source of learning comes from staff members and managers who have worked in other businesses and in other nations. Diversity of experience helps businesses learn how to handle any issue with flexibility and insight.

BizWORD

Kaizen *is Japanese for 'improvement'. It emphasises continuous improvement in all areas of a business, from the way the CEO manages to the way assembly line workers perform their jobs.*

SNAPSHOT



'. . . scanning and learning helps to change and improve business practices.'

Scanning and learning — supermarket wars

Also called 'environmental scanning', the processes of scanning and learning occur when businesses watch what other businesses are doing and then adapt in order to compete more effectively. This can involve watching other businesses within the same industry or learning from businesses in different industries.

Scanning and learning has been a feature of the supermarket wars in Australia. From how businesses create their supply chains through to the investment in self-scan checkout technologies, the major supermarkets are continually using environmental scanning to improve the customer experience.

When Coles invested in self-scan technology, Woolworths followed with an improved iteration. When Aldi created strong supplier relationships that threatened both Coles and Woolworths, it forced the larger supermarket chains to re-evaluate their supply chain management practices. Aldi brought its success from operating in different markets overseas to the Australian market.

In this way, scanning and learning helps to change and improve business practices.

These is some suggestion that the arrival of Amazon may affect the supermarkets but this has been largely dismissed by industry observers. The arrival of Amazon

will probably affect Australian goods retailers more than the supermarket industry. Nevertheless, all of the main supermarket retailers are increasing their investment in online selling as a defensive response to a possible threat.

SNAPSHOT QUESTIONS

1. **What** is an alternative term for 'scanning and learning'?
2. **How** does scanning and learning affect business practices?
3. **Research** and **outline** changes that have occurred in customer retail shops as a consequence of scanning and learning.

4.10.4 Research and development (R&D)

Innovative companies spend time and money on research and development (R&D). R&D helps businesses to create leading edge technologies, and to create innovative products and solutions. Government encourages R&D, and may offer taxation incentives and grants. These incentives and grants assist businesses to invest and allocate resources into R&D. Companies like CSL Ltd and 3M spend huge amounts of money in R&D, developing innovative products to better meet the needs of consumers. A central aspect of R&D is ascertaining what consumers want and assisting to create products that meet their needs.

studyon

Syllabus area 1
Topic 4
Concept 8

Global factors (as opportunities)
Summary screen and practice questions

SUMMARY

- Four key global factors affect operations strategy and provide opportunities for operations managers: global sourcing, economies of scale, scanning and listening, and research and development (R&D).
- Global sourcing is a broad reference to sourcing business supplies or services without being constrained by location and it therefore includes all outsourcing.
- Economies of scale can lead to significant cost saving in various aspects of the business enterprise.
- Scanning and listening can be a very valuable operations management tool as it can help managers adapt best practice to the business operations.
- R&D can make a very big difference to the level of innovation, quality and competitive advantage of a business.

EXERCISE 4.9 REVISION

1. **What** are four global factors that affect operations strategy and provide opportunities for operations managers?
2. **Why** do businesses source globally?
3. **State** the benefits and challenges associated with global sourcing.
4. **Distinguish** between financial and contractual concerns associated with global sourcing.
5. **Define** the term 'economies of scale'.
6. **What** is the relationship between economies of scale and profitability?
7. **Clarify** why an effective manager should continuously scan the business environment.
8. **Detail** the importance of R&D as an operations strategy.

on Resources

- **Digital doc:** Chapter summary (doc-24806)
- **Interactivity:** Chapter crossword (int-7155)
- **Interactivity:** Multiple choice quiz (int-7156)
- **Weblink:** CSL Limited

studyon

Sit HSC exam

EXERCISE 4.9 EXTENSION

1 **Examine** the concept of economies of scale. Contrast this with economies of scope. **Determine** why many large businesses adopt both of these operational strategies.

2 'A global web (supply chain) strategy reduces costs of production by creating a network of cost-effective facilities located around the globe all contributing to the final product. Its benefits outweigh its costs.' (Adzumi Saito, Operations & Logistics Manager, ZenTech Industries.) **Assess** the accuracy of this statement. In your answer **explain** how a global web strategy results in reduced production costs.

3 **Evaluate** the importance of research and development to CSL Limited.

Operations

MULTIPLE CHOICE QUESTIONS

1. Which of the following is a list of performance objectives?
(a) Quality, speed, dependability and cost
(b) Quality, flexibility, customisation and profit
(c) Speed, cost, flexibility and choice
(d) Dependability, customisation, profit and choice

2. Which is *not* an important aspect of quality?
(a) Control
(b) Assurance
(c) Process
(d) Improvement

3. What is the correct order of steps in the product design and development process?
(a) Market research, product design and prototype, prototype testing, product distribution and product refinement
(b) Market research, product design and prototype, prototype testing and assessment, product and production processes refined, product distribution and launch
(c) Market research, product refinement, prototype testing and assessment, product development, product launch and product line extension
(d) Product design and prototype, prototype testing and assessment, product refinement, market research and production, distribution and specification development

4. Which is *not* a trend in supply chain management (SCM)?
(a) Cost minimisation
(b) Supplier rationalisation
(c) Responsive supply chain processes
(d) Forward vertical integration

5. Which is an essential aspect of logistics?
(a) Creating a budget for new machinery
(b) Materials handling and packaging
(c) Checking the quality of outputs
(d) Undertaking a skills audit

6. What is a cost associated with warehousing?
(a) Costs of new machinery
(b) The expenses associated with borrowing
(c) Insurance and security of the stock held
(d) The time saving in distribution

7. Which is *not* a form of outsourcing?
(a) Business process outsourcing (BPO)
(b) Finance and accounting outsourcing (FAO)
(c) Knowledge process outsourcing (KPO)
(d) Marketing processes outsourcing (MPO)

8. Which is an example of established technology?
(a) Laptop computers
(b) Nano particle technology
(c) Bluetooth technology that can cross the globe
(d) None of the above

9. What is a disadvantage of carrying stocks of unsold inventory?
(a) If a particular product line runs out, an alternative can be offered thereby generating income for the business instead of a lost sale.
(b) It reduces lead times between order and delivery.

(c) Stocks give the opportunity for a business to generate immediate revenue. It is very hard to generate revenue from partially transformed inputs.
(d) The cost of obsolescence

10. Which of the following is *not* a financial cost associated with change?
(a) Redundancies
(b) Inertia
(c) Purchase of new equipment
(d) Retraining

SHORT RESPONSE QUESTIONS

1. (a) **Define** the term 'operations'. *2 marks*
(b) **Distinguish** between inputs, transformations processes and outputs in operations processes. *6 marks*

2. (a) **What** is meant by total quality management? *2 marks*
(b) **Demonstrate** the main differences between quality control and quality assurance. *6 marks*
(c) **How** can quality management make a business more competitive? Refer to actual examples. *10 marks*

3. (a) **Identify** the main advantages and disadvantages of holding stock. *3 marks*
(b) **What** is the importance of inventory management? *5 marks*
(c) **Evaluate** which inventory management system is preferable for a medium-sized manufacturing business: LIFO (last-in-first-out) or FIFO (first-in-first-out). *10 marks*

4. (a) **Examine** three examples of ethically and socially responsible issues that may arise in operations management. *6 marks*
(b) **Assess** the benefits and costs of operations managers acting in an ethical and socially responsible manner. *12 marks*

5. (a) **Identify** the main types of layout. *3 marks*
(b) **Deduce** what an operations manager needs to consider when selecting the optimum facilities design and layout. *6 marks*

EXTENDED RESPONSE QUESTIONS

1. 'Inventory is a redundant concept in this modern world of flexible businesses and adaptable business processes.' **Discuss** this statement with reference to the advantages and disadvantages of holding stock, and **analyse** different approaches to inventory management.

2. Intense competition in the internet service provider (ISP) industry has forced WireFree Technology, a Sydney-based ISP serving the metropolitan areas of Sydney and Wollongong, to evaluate its operational management systems.

Prepare a report that could be given to WireFree Technology's management team. In your report, you should:
(a) **Outline** the concepts of cost leadership and product differentiation.
(b) **Propose** three operations management strategies WireFree Technology could implement to improve its competitive position.

3. **Identify** the main influences on operations management and **evaluate** three operations management strategies that can be implemented in response to the influences.

4. Strategies that businesses use to maximise their operations can be divided into five areas. These are: facilities design and layout; materials management; quality management; technology; and outsourcing. Select three areas from this list. **Identify** and **explain** one operations management strategy from each of the three areas selected.

5. **Demonstrate** the importance of outsourcing and global sourcing to modern business and **assess** the effect of outsourcing as a response to overcoming resistance to change.

on Resources

Digital doc: Sample HSC Business Report (doc-14150)

Kathmandu history

In 2017, outdoor clothing and equipment company Kathmandu celebrated 30 years of operation. Its first store opened in Melbourne in 1987 but was quickly followed by a New Zealand branch in Christchurch. For the first 10 years, however, the company was satisfied to remain a small, specialist outdoor retailer that for the most part made its own products in New Zealand.

When they first started, adventure clothing and equipment offered limited protection for people interested in exploring nature and its varying weather conditions and landscapes and for those keen to test themselves against the elements. Kathmandu's founders Jan Cameron and John Pawson saw a market opportunity to satisfy the demand of these types of travellers and set about producing fleece and thermal apparel that were lighter and quicker drying than others available and which were far more suited to this growing form of travel. The addition of a third partner Bernard Wicht in 1992 brought expertise honed from his time working with prominent outdoor clothing brands such as Goretex.

Together they worked to ensure Kathmandu was ready to take advantage of a market that was increasingly keen to buy its innovative products. Operations quickly evolved with a clear desire to design sustainable and adaptive products. Keen to encourage repeat sales it also established one of the world's first loyalty programs, the Summit Club, in 1994.

By 2000, Kathmandu had become a vertically integrated retailer that sought to develop its own branded products, conscious of the need for quality materials at low costs that would be sold via its own retail distribution network. Also at this time, the company sought to test the overseas potential of its brand in the United Kingdom, to support its existing Australian and New Zealand stores. On the back of its expansion it was acquired by a private consortium of investors who introduced a new management team that would continue to take the business forward. It also introduced the first of many community initiatives through its association with Red Cross, Outward Bound New Zealand and the Australian Himalayan Foundation. Its work with the Australian Himalayan Foundation, for example, has raised thousands of dollars, delivered LuminAID lanterns to villages that have unreliable power sources and paid for the education of nearly 1000 school students. It is these activities and its community involvement that drive the company to be more than just sustainable and one where it gives more to the community than it takes out.

By 2008 the rise of the internet allowed for the development of its online operations that would support increasing interest in mail order purchases by customers unable to visit its stores.

In 2009 the business was floated on both the Australian Securities Exchange and the New Zealand Stock Exchange and with that a more formal business organisation was created which supported a growth in staff numbers, commitment to developing an efficient and contemporary IT platform and wider distribution network.

Fast forward to the present and the business's global chain of travel and adventure stores continue to focus on crafting high-quality, sustainable products with the adventure tourist in mind. It operates 163 stores (115 in Australia, 47 in New Zealand and 1 in the United Kingdom) and employs 2000 staff. It has expanded its online sales and is developing wholesale partners in the United Kingdom and Germany.

Kathmandu's extensive range of apparel (60%) and equipment (40%) is aimed at both the experienced and first-time traveller. Corporate responsibility remains a

priority and the focus on ensuring healthy and safe working environments, effective supply chain management, waste minimisation and environmental conservation are all foremost in management decision making.

Original.
Sustainable.
Engineered.
Adaptive.

These are the four underlying principles that Kathmandu believes are reflected in every item that carries its brand name and are the key to design and manufacturing of all of its products. They are words that sum up what the company is all about. In its own words:

> We act with people and the planet in mind — from the creative minds of our designers to the careful hands of our suppliers, to backs of our customers all around the world. We believe that adventure begins when you pack your bag. **We are Kathmandu.**

QUESTIONS

1. **Outline** the first 10 years of Kathmandu's development.
2. **What** gap in the market was identified by the Kathmandu founders?
3. **Explain** how Kathmandu could be described as a vertically integrated company.
4. **List** some of the community partnerships established by the company.
5. **How** did listing as a public company change the business's focus?
6. **Why** is Kathmandu more than just a travel equipment and apparel store?
7. Visit the **Kathmandu** website to provide examples of its products that reflect the four principles of 'Original. Sustainable. Engineered. Adaptive.'

on Resources

Weblink: Kathmandu

Role of operations management

Kathmandu's products are continuously adapted so they can meet the rigours of challenging weather conditions, diverse terrain and the demands of its customers.

The main activities of the business are designing, marketing and retailing apparel and equipment for outdoor, travel and adventure through wholly owned subsidiaries in New Zealand, Australia and the United Kingdom. It is both a producer of goods (via its contractors) and a service provider (retail and online stores) — it is a vertically integrated supplier. It is also in the process of consolidating wholesale distributors in the United Kingdom, China and Germany.

It seeks to 'inspire adventure in everyone'.

> As a product and brand led business, we are focused on engaging our customers by creating distinctive, sustainable, quality products and by promoting our brand authenticity.
>
> *Xavier Simonet, Kathmandu CEO, Annual Report 2017*

This statement and the business's values are all about encouraging everyone — and anyone — to get out there and get going. Those values are:

- **Integrity** We conduct our business in an ethical and honest manner, and always strive to do the right thing.
- **Openness & Directness** We act with transparency to create a productive environment that eliminates bureaucracy and encourages efficiency.

- **Passion & Determination** We love what we do, we believe in what we create, we go the extra mile and we get the job done.
- **Resourcefulness** We celebrate ingenuity and inventiveness. We encourage a 'can-do' attitude and a 'hands-on' approach.
- **Love of Travel & Adventure** This forms the heart and soul of Kathmandu. All our daily business revolves around travel and adventure.
- **Environmental Action** We believe in protecting the outdoors and are committed to minimising our environmental footprint.

Kathmandu, 'Values that drive us', www.kathmandu.com.au

Kathmandu demonstrates cost leadership, as management strives to continue improving efficiency through investment in information technology (IT) infrastructure, automation and emphasising more cost-effective social media during promotional periods. Additional cost advantages are achieved through optimising the use of retail labour in respect to its stores.

The range of goods sold in its stores and through its website is extensive and includes outdoor travel clothing and equipment aimed at the experienced and/or the first time traveller.

Goods are designed in-house and this decision enables Kathmandu to make full use of the experience of its staff to offer contemporary fashion. Management also makes use of customer feedback to create well-made original products.

Quality and performance are central to Kathmandu's apparel and equipment; therefore, resources, including the product team, are devoted to design, technical efficiency, quality and strong relationships with suppliers that ensures a range of apparel and equipment that meets the needs of its extensive customer base. Its products can be broadly differentiated into apparel and equipment.

Its apparel includes:

- waterproof, fleece and down jackets
- thermal wear
- shirts and trousers
- merino wool clothing
- footwear and socks.

Its equipment includes:

- assorted packs
- bags
- sleeping bags
- tents
- travel and camping accessories.

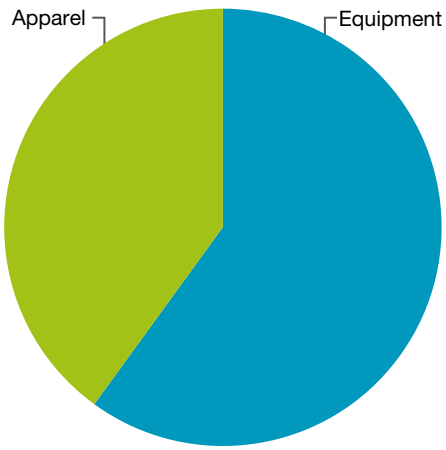


FIGURE 1.1 The breakdown of Kathmandu's production split



FIGURE 1.2 Kathmandu's apparel and equipment

Interdependence of operations with other areas of the business

Interdependence across key functional areas is a feature of the business and in the most recent annual report the Chief Executive Officer's (CEO) view of the future was especially optimistic as he mentioned the role of all areas of the company.

The business continues to focus on distinctive, sustainable, quality products and opening new stores. These qualities are also a key feature of the marketing strategies used by the business to grow sales. Marketing recognises the importance of quality and innovative products and how the company maintains its brand authenticity (quality products associated with the Kathmandu brand). Maintaining gross margins and delivering operating efficiency, particularly through effective cost leadership, are essential to the development of Kathmandu apparel and equipment. Human resources involves an ongoing commitment to ensuring that employees develop skills and have opportunities for career development across all areas of the business. This helps ensure they have the capacity to adapt to a changing retail environment and thus move the company forward. The synergy displayed across the key functional areas ensures a competitive business, that according to its CEO, will maintain its focus on continued growth in core markets.

Influences on operations

A range of influences, many external, have an impact on the successful operation of Kathmandu. Its pillars for growth include the desire to take advantage of its strong brand awareness and opportunities for sales growth via global expansion in strategically viable markets. Europe (outdoor lifestyles associated with some countries and diverse climates) and China (market size and increasing affluence) present the best opportunities for growth. Technology remains important as management allocates resources to its online platform to improve usability and functionality. Kathmandu seeks to use an 'omni-channel' approach that allows its

customers one range irrespective of where they choose to shop. An effective digital platform also allows for a 'soft expansion' into international markets, as online sales require fewer bricks and mortar stores, which is also compatible with cost savings.

Cost-based competition in the form of efficiency in the management of its supply chain operations, ongoing automation and digital platforms are also prominent influences on operations.

Sustainability is a core business goal and centres on management's desire to minimise both its waste and its environmental footprint. Operational efficiency is closely aligned with sustainability. The company's commitment is reflected in:

- award recognition in 'larger business sustainability leadership'
- elimination of harmful chemicals
- recycling of plastic bottles into finished products
- increased use of sustainable cotton
- increased recycling rate.

Kathmandu has released a comprehensive sustainability report that identifies its desire to:

> … act with people and the planet in mind — from the creative minds of our designers to the careful hands of our suppliers, to the backs of our customers all around the world.

Moreover, sustainability and other aspects of what the company sees as its basis for its competitive advantage are embodied in its four driving principles:

- Original
- Sustainable
- Engineered
- Adaptive

Kathmandu seeks to make its biggest statement through corporate social responsibility. This includes protecting worker's rights, better understanding its supply chain and minimising its waste to lower its environmental impact. Management recognises the challenges it faces in this area and identifies three key focus areas in its Community Investment Strategy. The areas are empowering customers, supporting community-based projects and, in particular, contributing to social change in Nepal (the region that it claims inspires its brand). More specifically this involves:

- partnerships — the development of programs in educational and financial aid, animal and heritage conservation, disaster and poverty relief
- clothing recycling — the ability of customers to donate used clothing through the Red Cross, which is then sold via one of the charity's shops to raise money for local and international humanitarian work.

Operations processes

Inputs: transformed resources

Inputs, in the form of transformed resources, include the materials that are required to produce Kathmandu's apparel. For example, fabrics are chosen to minimise environmental impacts and are driven by customer feedback. The priority of preferred materials at Kathmandu is:

1. responsible down
2. recycled polyester
3. sustainable cotton
4. approved fabrics and trims (minimal chemicals)
5. responsible wool
6. materials that minimise water use

7. preferred man-made cellulosics
8. materials that seek to reduce ocean plastics.

All materials have an impact on the environment so it is a matter of selecting those that minimise the effects. Serious consideration is given to each material's impact on climate change, water use, pollution and resource depletion. For example, the emergence of the business occurred at a time when manufactured fleece was just gaining prominence as an alternative to wool in material technology. It was much faster drying than wool as well as being lighter and warmer — all qualities much sought after by outdoor enthusiasts. In 1994, after years of research Kathmandu released Ecofleece, a recycled fleece fabric. Concern at the finite nature of fossil fuels used in the manufacture of polyester fabrics and a mounting number of plastic bottles made the decision to switch to Repreve, a brand of recycled polyester, an easy one.

Further, Kathmandu has consolidated its collaboration with the Responsible Wool Standard (RWS), a voluntary global standard that addresses the welfare of sheep and the land that they live on. Its goal is to introduce RWS products to stores by summer 2019. This process involves ongoing dialogue with its entire supply chain from farmers, spinners, knitters and garment factories to support the transition and to assure that animal welfare remains a priority.

Kathmandu's customers are broadly categorised into six core groups:

- young and serious (aspirational achievers)
- young and casual (fun seekers)
- middle aged and serious (experienced enthusiasts)
- middle aged and casual (family adventurers)
- older and serious (rediscoverers)
- older and casual (appreciators).

The importance from an operations perspective is to ensure the product team develops products that are both technical and stylish to meet these market segments' needs and that knowledge of the core groups is disseminated in-store so that staff selling techniques are also adapted to the different segments.

Inputs: transforming resources

Transforming resources includes its human resources in the 157 supplier factories globally, including 142 in China, 8 in Vietnam and 7 in Taiwan.

Kathmandu sources its materials from a number of countries including China, Pakistan, Vietnam, Taiwan, South Korea and New Zealand.

Key supplier facts include:

- 140 global suppliers (85% in China)
- 8.5 years is the average tenure working with suppliers
- 40 audits (including 2 unannounced)
- 35 corrective action suppliers for suppliers
- 5 per cent turnover of suppliers.

Transformation processes

The role of the four Vs – volume (large-scale production), variety (both technical, functional and fashion conscious), variation in demand (although predominantly a winter brand an emphasis on a summer range is also marketed extensively) and visibility (increased e-commerce and in-store customer experience through more effective visual merchandising in store and product presentation) is significant to the success of the business.

The increased role of information technology in further developing online sales growth (especially globally) and the use of an experienced, customer-driven in-house

design process allows for technical and original products — it is the basis of its competitive advantage and one that Kathmandu anticipates will provide the platform for further success.

Outputs

Retail store teams seek to personify the company's ethos to every customer they serve. The core purpose is to inspire adventure in all and sell products that encourage everyone to get out there and get going. It is the basis for same-store sales growth (increased sales that occurs within the store as opposed to sales across all stores) recorded in the most recent financial report.

The New Zealand Support Office is where products are developed by equipment and apparel designers and merchandisers, as well as being home to members of the other functional areas of finance, operations, marketing and human resources. In Australia there is similar representation of the key functional areas in its Melbourne office, but also employees that focus on store development, online, visual merchandising and IT divisions.

All product warranties are provided in accordance with statutory consumer guarantee requirements in accordance with the Australian Consumer Law.

Operations strategies

Kathmandu's range of products reflect their performance objectives of high quality, quick to market and mass customisation at a low cost. Quality and performance are integral to new product design and development. This is the focus of ongoing investment in improved design and technical development, which has broad appeal to its customer base.

Supply chain management

Supply chain management is an ongoing commitment that seeks to establish stronger relationships with contractors. Better selection processes have resulted in 100 per cent of new suppliers being screened using social criteria. This and previous strong selection criteria have resulted in enduring relationships with an average tenure of suppliers of 8.5 years and only 5 per cent turnover. Kathmandu has recently partnered with compliance partner *Elevate* to improve supplier relationships even further. This process involves developing best practice strategies that encourage supplier compliance. In addition it will empower these contractors to create their own corrective action plans and where necessary work jointly with their staff in dealing with workplace challenges. This will in turn support workplace processes that increase their profits, increase staff retention and improve efficiency.

Case study: Khusi beanie — protecting worker's rights

Nepalese knitters were specifically used to produce the Khusi beanie in an attempt to allow them to gain independence in a region where women are still unable to match the literacy and employment rates of men.

It was important that the project emphasise the importance and significance that the company places in supply chain accountability. The beanies were knitted at home by community-based groups and then sent to a factory for completion and packaging. The factory had never been audited by an overseas company before, so Kathmandu sent auditors in and they did find some issues of non-compliance. A corrective action plan (CAP) was agreed on to ensure that the project maintained integrity and that workers' rights were protected.



FIGURE 1.3 The Khusi beanie workers



FIGURE 1.4 The world of Kathmandu

Supply chain

Outsourcing is the main focus of Kathmandu's product manufacturing process across the globe with an emphasis in China, where 85 per cent of its products are made. The main advantages of such a process are a low-cost, high-quality product. It does, however, have some disadvantages such as the need for a policy of responsible purchasing that ensures it does not put undue pressure on suppliers

to provide goods in unreasonable timeframes and the use of workplace audits to ensure compliance. Recently, Kathmandu teamed up with its outdoor industry competitors and worked with them as supply chain partners to initiate one shared audit for the manufacturing firms used by them all. This collaborative action was aimed not only at reducing costs but also alleviating audit fatigue for the supplier and freeing up more time to address problems.

Inventory management

Inventory management is a key metric for the business's management. Recent financial data indicates that stock levels fell by an average of 7.6 per cent per store, and the focus of high turnover remains a priority. This was made possible through investments in planning software that enabled more accurate buying and to reflect store differences. The seasonal nature of stock ensures effective stock holding processes.

Quality management

Quality management, including a commitment to continuous improvement, is central to Kathmandu's growth strategies, especially in the Australia and New Zealand markets. This will take the form of elevating brand awareness through design and innovation especially in respect to adventure travel. In addition, the business's desire for improved quality can be seen through growing social media and digital channels, better customer service such as a range of products available both in-store and online, new stores and improved customer service.

Global factors: global sourcing

The need for an effective and responsible supply chain management process is expected across all businesses, but especially those involved in global sourcing. Kathmandu seeks to protect the human rights and improved working conditions for its contract workers. This involves greater transparency and working in partnership with suppliers. To this end, the Outdoor Industry Association (OIA) Sustainability Working Group is a collaborative group of more than 300 outdoor brands and suppliers who work cooperatively to identify and employ more effective business practices.

> The global supply chain is complex and interconnected. The power of the OIA Sustainability Group is bringing outdoor companies together to share learnings and find solutions as an industry.
>
> *Kathmandu, Sustainability Report 2017, p. 12*

Kathmandu segments its supply chain according to the problems it observes and its willingness to work in harmony with factory owners. Therefore, if there is a supplier that is unprepared to acknowledge it has workplace issues and is reluctant to work with Kathmandu to facilitate change, then it is likely to terminate its business arrangement. Favoured suppliers are those that act with integrity, honesty and openness and it is these factories that work with Kathmandu to build strong employee relationships.

Kathmandu also has a responsible purchasing policy that recognises the importance of not putting undue pressure on factories through product development delays that may result in less time to produce apparel and equipment and in turn increase overtime and subcontracting. It also engages in best buying practice via ethical sourcing. Disappointed that decades of factory audits have failed to improve the lives of workers in global supply chains, the business has in the last four years embarked upon the process of accreditation with the Fair Labour Association (FLA).

Workers are encouraged to email Kathmandu with any concerns they may have (especially important in China where trade unionism is not supported) but at time of writing there was yet to be anyone using the facility, so the business started to engage the social media site WeChat as a means of engaging with contracted workers in China.

Kathmandu's commitment to a compliant and ethical global supply chain resulted in the decision to appoint two full-time workers dedicated to improved working conditions. In 40 recent audits, 10 were found to be non-compliant with its code of conduct.

Other global factors

Economies of scale are achieved in accordance with the need to remain competitive in the retail apparel space. Sourcing high-quality, mass produced goods from low-cost suppliers in a global business environment assists with achieving this.

Scanning and learning and research and development are important and while continuing to invest heavily in its own product development resources, Kathmandu has established partnerships with industry associations. These partnerships assist it with measuring and improving its progress in relation to sustainable and ethical practices in the production of its apparel and equipment. Its partner groups are shown in figure 1.5.



FIGURE 1.5 Kathmandu's partner organisations

CASE STUDY QUESTIONS

1. **Identify** the main activities of Kathmandu.
2. **Outline** the features of operations management apparent in this case study.
3. **Why** are values important in the operations process?
4. **Assess** the role of operations and the other key business functions.
5. **List** the types of apparel and equipment produced.
6. **What** are the influences affecting the operations function?
7. **Summarise** the operations process.

8 **What** are three operations strategies that could be considered particularly important? Select one and **explain** how it assists Kathmandu sustain its competitive advantage.

9 **What** are the global factors affecting the business?

10 **Analyse** the role of Kathmandu's partner groups in assisting it to face the challenges of operating as a global company.

TOPIC 2

MARKETING

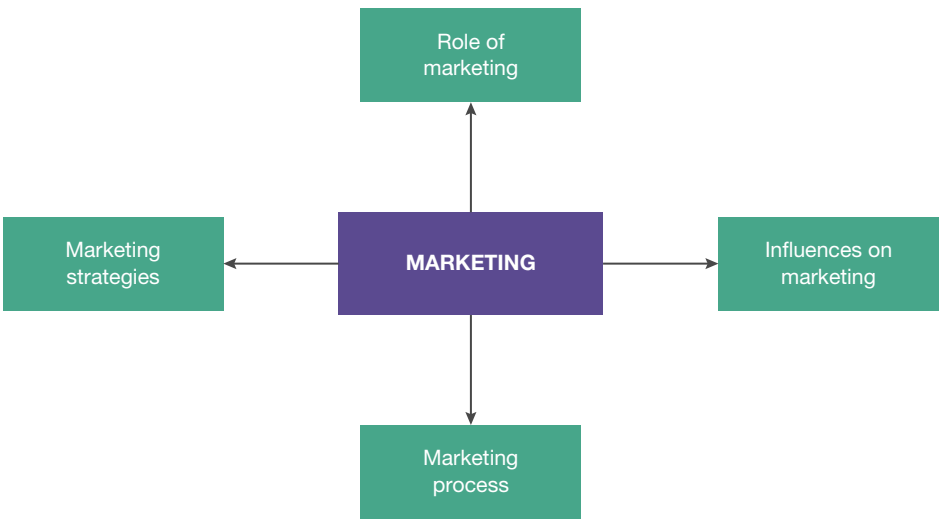
FOCUS AREA

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

OUTCOMES

Students should be able to:

- critically analyse the role of business in Australia and globally
- evaluate management strategies in response to changes in internal and external influences
- discuss the social and ethical responsibilities of management
- analyse business functions and processes in large and global businesses
- explain management strategies and their impact on businesses
- evaluate the effectiveness of management in the performance of businesses
- plan and conduct investigations into contemporary business issues
- organise and evaluate information for actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats
- apply mathematical concepts appropriately in business situations.





Case study: Social media advertising — #MesCheveaux

After gaining seventeen years' experience in the hairdressing industry and establishing a great reputation through working at prestigious salons, Charlie Helou decided to take the risk and start his own salon, Mes Cheveux, in 2015 with business partner Josephine Staltari.

With high-quality products, modern facilities and highly skilled and creative professionals, MesCheveaux has positioned itself as a five-star luxurious salon in the Parramatta area. Being in the establishment phase, the owners didn't have a lot of funds to spend on marketing and so they came to rely on social media advertising.

Mes Cheveux has a vibrant social media presence on Instagram and Facebook. Since hairdressing is a visual industry, social media is the perfect platform for the salon to 'show off' their work as well as their exclusive products and services. 'This is probably the main way we use social media: to showcase what our talented stylists can do. We often post before-and-after pictures of our client's new hairstyles. Not only is this proof of what we do, but if the customer shares those photos with their own personal networks, this generates greater exposure for our business.' Social media has also changed the requests they get from clients. 'Many clients refer to some of our posts for inspiration on their cut, colour or style and come in already knowing what they want done.'

Being in a prime location in Westfield Parramatta, the salon gets a lot of business from passing trade. However, Charlie has found that a large percentage of new business has been generated from social media. 'Salon testimonials and reviews are a great way to attract brand new clients to the salon. Word of mouth recommendations through social media are an effective way of building brand awareness and increasing new client patronage.'

Social media is a powerful marketing tool that has allowed them to 'chat' with customers even after they've left the salon. 'We can show customers new things around the salon, remind them to use certain products, send warm wishes on special occasions and of course show everyone our work!' Charlie receives many enquiries through social media outside their opening hours, which he always makes sure he responds to in a timely manner.

Charlie also uses social media as a research tool. He currently follows industry leaders, fashion houses and other stylists. Social media platforms have enabled him to keep up with the latest industry trends, be inspired by other hairdressers' creativity and keep an eye on what their competition is doing.

'Two of the best things about social media is that it's not an expensive form of marketing and it's simple to use — it requires only a small amount of attention each day to create a loyal brand following. Social media is a great way to engage with our local community as well as current and potential customers and spread more awareness about our salon.'



'Social media is a great way to engage with our local community …'

on Resources

Kathmandu case study: Marketing (doc-14390)

CHAPTER 5

Role of marketing

OVERVIEW

5.1 Introduction
5.2 What is marketing?
5.3 Strategic role of marketing goods and services
5.4 Interdependence with other key business functions
5.5 Production, selling, marketing approaches
5.6 Types of markets

5.1 Introduction

At the beginning of the last summer holiday, two Year 12 students placed advertisements in their local paper announcing a gardening service they had just started. They also conducted a letterbox drop of selected streets within their neighbourhood and posted a message on the local community e-notice board. The students wanted to inform potential customers about their business. These two young businesspeople were involved in marketing, whether they realised it or not.

Meanwhile, Coca-Cola is introducing the biggest changes to their marketing **strategy** in its history. Coca-Cola is overhauling its global marketing and brand strategy by uniting all Coke trademark brands into one global creative campaign.

Both of these examples show that marketing is undertaken by businesses — regardless of size — with the intention of generating sales by satisfying customers' needs and wants.

BizWORD

Strategies *are the actions that a business takes to achieve specific goals.*



FIGURE 5.1 As one of the most recognisable brands in the world, Coca-Cola remains an industry leader in relation to both product sales and marketing. The key to their success is their ability to advertise an emotion or feeling, as opposed to just a product. Their advertisements make people feel a certain way; they make it seem like having their products will bring happiness and generate other positive feelings.

As consumers, we are constantly exposed to all aspects of the marketing process. For example, as you were travelling to school today you probably did not realise that you were observing many different features of marketing. You almost certainly observed many types of advertisements. Your mobile phone may have registered a message regarding a store's special offer. You perhaps noticed delivery vans transporting goods to retailers or customers. Distinctive company logos such as McDonald's 'golden arches' or Nike's 'swoosh' were possibly conspicuous. You may have even bought something. Similar to the students at the beginning of this section, you have been participating in the process of marketing whether or not you were aware of it.

Certain aspects of the marketing process are easily identifiable, and our culture has become immersed in product promotion, especially advertising (see figure 5.2).

BizFACT

The average consumer is exposed to an estimated 3000 advertising messages every day.



FIGURE 5.2 Which current advertisement has most impressed you? What product is it advertising? You can probably answer these questions easily. This is because you have been influenced by advertising. Everywhere you look businesses are using advertising to influence consumer buying behaviour.

5.1.1 Marketing fundamentals

Marketing is vital to the existence of a business. Just because someone invents a new product or improves an existing one does not guarantee customers will buy it. Without some form of marketing, customers may not even be aware of a product's existence regardless of how 'record breaking', 'new and improved' or 'revolutionary' it may be.

Statistics reveal that more than 70 per cent of new products launched on the market fail in the first year of operation, mainly as a result of poor marketing. Businesses make few sales if they do not market their products successfully, eventually ending in failure. At the same time, many products that would seem insignificant and unimportant have become best-selling 'essential' items as a result of a well-managed and professional marketing plan. Who would have ever thought that brown, sugary, fizzy water with addictive qualities would become the global product it is today.

Case study: Apple sets the benchmark in marketing

Apple's success has been a direct result of their marketing, which is why they were voted the overall winner of the CMO Survey Award for Marketing Excellence for five consecutive years. Their marketing has become a benchmark for other companies who aspire to reach similar heights of recognition, revenue and market share. So why is Apple a great marketer?

Apple's marketing strategies are not complex and are kept as simple as possible. Their advertisements don't include feature lists, price, information on where to buy their products, voice-overs or special effects. Instead, they are very straightforward, using simple language and graphics to translate their message. Apple doesn't

SNAPSHOT



‘Their marketing has become a benchmark for other companies …’

overwhelm customers with jargon, choices and options, their products are sleek and minimal and their product names are short and easy to remember. Apple studies their customers and speaks to them in their own language.

One of Apple’s best marketing tactics is their ability to create mystery around new product launches. They withhold information, leak rumours and keep what they are doing under wraps, which generates even more excitement and mystique until the big unveiling. Their ‘fanboys’ and ‘fangirls’ camp out for days on end to be the first in line for their latest product. Apple has built one of the most hardcore fan bases of any brand and of any time. They created a brand personality and culture that inspires devotion among millions of customers around the world.

Apple has created this loyal following because they have been able to reach their customers at an emotional level. Their advertisements show happy people having a great time with their products rather than focusing on product details and features. They create advertisements that make their customers believe their products will make their life better, easier, more fun and cooler.

Free product placement in television shows and movies is another effective marketing strategy Apple pursues. In 2011 their products appeared in 891 television shows and in 40 per cent of movie box office hits. In 2014 they were the recipient of a Brandcameo Product Placement Award for getting more screen time in more top movies than any other brand. The obvious advantage of product placement is that it increases brand awareness and gives their brand airtime with respectable opinion leaders.

Apple engineers their products to be so unique that people view their product name to be the product itself; for example, people don’t buy a tablet, they buy an iPad. Very few brands have become so ingrained in the vocabulary that they’re synonymous with the products themselves. These are only some of the marketing strategies that have turned the company from near bankruptcy to an industry leader.

SNAPSHOT QUESTIONS

1. **Explain** the impact marketing has had on Apple.
2. **Evaluate** the effectiveness of three of Apple’s most successful marketing strategies.

5.2 What is marketing?

BizWORD

Marketing *is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives (American Marketing Association).*

A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers.

There are many definitions used to describe **marketing**. The most commonly accepted definition comes from the American Marketing Association: ‘Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives.’

A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers. At the heart of these activities is the most fundamental question all businesses should continually ask: ‘What do customers want to buy — now and in the future?’ This is the essence of marketing — finding out what the customers want then attempting to satisfy their needs.

These definitions reveal the four main features of marketing. Marketing:

- involves a wide range of activities
- is directed at a wide range of goods, services and ideas
- stresses the importance of satisfying exchanges — that is, something in return
- is not limited to the activities of businesses.

Many people when asked which word they associate with the term ‘marketing’ respond with ‘selling’. They think that marketing is just a fancy name for selling. However, the two words have different meanings. Selling involves a set of activities that salespeople undertake to assist the customer’s buying decisions. In this sense, selling is part of the marketing process, but marketing takes a much broader view and is more involved than selling. Actually, the current view of marketing is

such that it does not even have to involve the selling of a good or service — for example, not-for-profit organisations such as community activist groups and charities attempt to market certain ideas or causes.

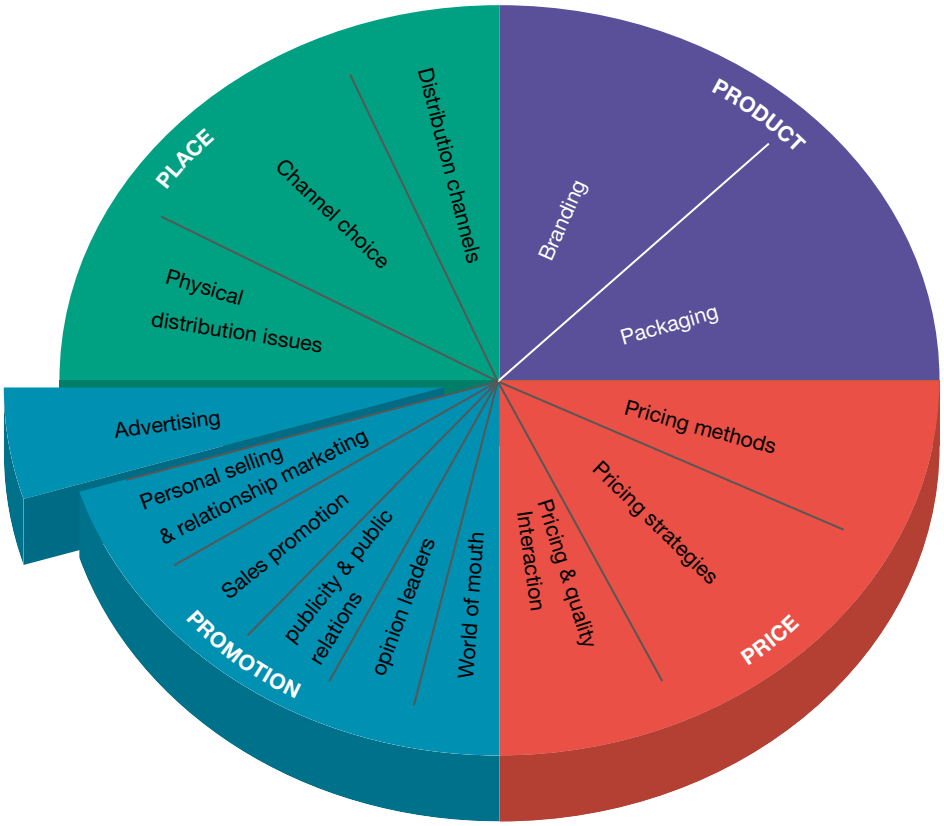


FIGURE 5.3 A good way to distinguish between advertising and marketing is to think of marketing as a pie. Inside that pie you have four slices for each of the four marketing strategies: product, price, promotion and place. Advertising is only one piece of the promotional slice in the strategy. All of these strategies must work together toward achieving the business's objectives.

Many people also mistakenly believe that marketing is the same as advertising. This is because advertising is highly visible and everywhere, which makes it easy to associate the two. The definitions reveal, however, marketing to be a far more multifaceted activity. As you will discover in chapter 8, advertising, though highly influential, is just one part of the promotion strategy, which in itself is one of a number of marketing strategies. While in the past businesses adopted a sales-oriented approach to marketing, the current marketing approach places the customer at the centre of all marketing activities. This current approach focuses on satisfying consumer's needs and wants, being socially responsible and building long-term and cost-effective relationships with customers.

5.3 Strategic role of marketing goods and services

As outlined previously, each of the key business functions has a **strategic** component. Generally, the overarching goal of business is **profit maximisation**. The strategic role of marketing therefore is to translate this goal into reality. To achieve this goal, a marketing plan must be prepared that sets out a series of actions or strategies that can be used to attain greater sales and in so doing be able to achieve this strategic goal. For example, through its sophisticated marketing plan, Coca-Cola has built on its highly recognisable brand name. In its first year, about 10 servings of Coke were sold per day. Today, Coca-Cola is sold in over 200 countries with 1.9 billion servings consumed every day. Marketing is therefore a powerful strategy available to help achieve a business's goals.

BizWORD

Strategic *refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of the business.*

Profit maximisation *occurs when there is maximum difference between the total revenue coming into the business and total costs being paid out.*

Marketing today places a strong emphasis on viewing the business through the customers' eyes, that is, customer-oriented marketing. The business needs to see itself as a customer-satisfying process rather than a production process (see the following Snapshot).

SNAPSHOT



'… view your business in terms of the needs and wants of your customers.'

Marketing — a customer-oriented approach

Marketing is much more than placing an advertisement in the local media. It is a way of thinking. Everything you do in your business should be directed towards putting the customer at the centre of your thinking. To do this successfully requires adopting a customer-oriented approach to marketing. You need to view your business in terms of the needs and wants of your customers. As competition intensifies, it will be your marketing philosophy that will help your business face the competition and succeed. This is because a customer-oriented business will want to create goods and services that customers want to buy.

Customers are the lifeblood of any business, so they must be encouraged to stay loyal to the business. This means that, at every level of the business, employees should work towards customer satisfaction by establishing positive relationships with customers.

Seven tips to becoming a marketing driven business:

1. Place your customers, not your goods or services, at the centre of all you do.
2. Talk to your customers. Ask them what could be improved, what they like and dislike.
3. Think about ways to build loyalty with your customers.
4. Differentiate your products in ways that will make them special in the eyes of your customers.
5. Regularly communicate with your current and potential customers.
6. Develop a unique and recognisable brand or image that reflects the special qualities of your business.
7. Always deliver your promises.

SNAPSHOT QUESTIONS

1. **Clarify** what is meant by a customer-oriented approach to marketing.
2. 'For businesses that adopt a customer-oriented approach, the customer relationship does not end with the sale; it begins there.' **Discuss**.
3. Which of the 'seven tips' do you think is the most important? **Justify** your selection and share your answer with other class members.

Without a marketing strategy, financial disaster is inevitable. Many new inventions become commercial failures because they have not been marketed adequately. To develop customer awareness and demand, and thus form a customer base, an organised marketing campaign is necessary, starting with the development of a marketing plan.

5.3.1 The marketing plan

When new products are developed, often the business can become too product focused. If businesses want to achieve their financial goal of making a profit, their product needs to generate sales. This requires them to develop a **marketing plan** detailing the strategies they will need to put into place to sell their products.

To achieve the goal of profit maximisation, the marketing plan should be the focus of both short-term and long-term planning for three reasons:

1. The marketing plan outlines the strategies to be used to bring the buyer and seller together. The business needs to be able to identify:
   - where the market is
   - who will buy the product
   - why they will buy the product
   - how often they will buy the product.

BizWORD

The **marketing plan** *is a document that lists activities aimed at achieving particular marketing outcomes in relation to goods or services. The plan provides a template for future action aimed at reaching business goals, such as profit maximisation.*

2. The core of marketing is satisfying existing customer wants, which should lead to repeat sales.
3. Marketing is the revenue-generating activity of any business. Nothing is achieved until a sale is made.

A successful business develops a marketing plan based on careful research and design. The customer should always be the central focus of the marketing plan. Any business that does not develop and maintain a customer base soon goes out of business. It is the role of the marketing plan to make sure a customer base is created and maintained.

The marketing plan, therefore, plays a crucial strategic role in the overall success of the business. If the business plan is the 'road map', then the marketing plan contains the signposts showing which direction to take (figure 5.4).



FIGURE 5.4 The marketing plan shows which direction to take and which strategy to implement, so as to bring the buyer and seller together.

SUMMARY

- Marketing is undertaken by businesses with the intention of generating sales by satisfying customers' needs and wants.
- As consumers, we are constantly exposed to all aspects of the marketing process.
- Statistics reveal that more than 70 per cent of new products launched on the market fail in the first year of operation, mainly as a result of poor marketing.
- Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives.
- A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers.
- Marketing is a multifaceted activity involving much more than merely selling or advertising.
- A common business goal is profit maximisation. The strategic role of marketing is to translate this goal into reality.
- Marketing today places a strong emphasis on viewing the business through the customers' eyes, or customer-oriented marketing.
- To develop customer awareness and demand, and thus form a customer base, an organised marketing campaign is necessary, starting with the development of a marketing plan.
- The marketing plan is a document that lists activities aimed at achieving particular marketing outcomes in relation to a good or service.

studyon

Syllabus area 2
Topic 1
Concept 1

Strategic role of marketing
Summary screen and practice questions

- A successful business develops a marketing plan based on careful research and design.
- The customer should always be the central focus of the marketing plan.

EXERCISE 5.1 REVISION

1 **Recall** the intention of the marketing undertaken by the Year 12 students and Coca-Cola.
2 **Identify** three marketing strategies that may have influenced you to purchase a good or service.
3 **Clarify** what the main reason is for approximately 70 per cent of all new products failing shortly after their launch.
4 **Define** the term 'marketing'.
5 **State** the four main features of marketing.
6 **Distinguish** between 'selling', 'advertising' and 'marketing'.
7 **How** has the definition of marketing provided in this chapter been different to your previous understanding of the term?
8 (a) **Identify** a common financial business goal.
(b) **Explain** the role marketing plays in achieving this goal.
9 **State** the main role of the marketing plan.
10 **Recall** the correct term from the list below and complete the following sentences.

marketing	customer	strategies	satisfy
financial	maximisation	generate	wants

(a) The main emphasis in marketing today is the _____-oriented approach.
(b) This means the business wants to _____ customers' needs and _____ rather than merely produce products.
(c) To achieve the _____ goal of profit _____, a business needs to _____ sales.
(d) A _____ plan details the _____ that a business needs to put in place to sell its goods or services.

11 'Businesses that neglect the importance of marketing will experience diminished sales and reduced profits.' **Discuss**.

EXERCISE 5.1 EXTENSION

1 Use the library and the internet to **examine** and **create** a 300-word report on the marketing of PepsiCo. Mention similarities and differences between the marketing of PepsiCo and that of its main rival, Coca-Cola.
2 'Selling is merely getting rid of existing stock, whereas marketing takes a much broader view. Successful marketing involves bringing the buyer and seller together and making a sale.' **Assess** the accuracy of this statement.
3 **Investigate** how the role of marketing has changed over time.

on Resources

Weblink: PepsiCo
Weblink: Coca-Cola

5.4 Interdependence with other key business functions

BizWORD

Interdependence *refers to the mutual dependence that the key business functions have on one another.*

Interdependence refers to the mutual dependence that the key business functions have on one another. Marketing therefore does not occur in isolation, but relies on the other functions for its success.

During the 1950s, businesses began to slowly accept that they were not solely producers or sellers, but in the business of satisfying customers' wants. This shift in focus

to a customer-oriented approach brought about significant changes to marketing, especially the need to undertake market research and develop a marketing concept.

The **marketing concept** is a philosophy that states all sections of the business are involved in satisfying a customer's needs and wants while achieving the business's goals. The business should direct all its policies, plans and operations towards achieving customer satisfaction. The marketing plan, therefore, needs to become integrated into all aspects of the business (see figure 5.5), with marketing strategies playing a major role in all business activities.

BizWORD

*The **marketing concept** is a business philosophy that states that all sections of the business are involved in satisfying a customer's needs and wants while achieving the business's goals.*



FIGURE 5.5 At every level of the business, employees should have as their primary focus the satisfaction of the customer. This requires the integration of the marketing plan in the four key business functions — operations, finance, human resources and marketing — in order to achieve the business's main goal of profit maximisation.

studyon

Syllabus area 2
Topic 1
Concept 2

Interdependence with key business functions
Summary screen and practice questions

To be effective, therefore, the marketing concept must be embraced by all employees of the business, not only by those involved in marketing activities.

The marketing manager cannot work in isolation and often has to work with other managers in the business to ensure the success of the marketing plan. For example, if the success of the marketing plan means having a good or service ready by a certain date, the operations plan will need to be in place to make sure that happens. If, for example, a business makes Christmas puddings, it is no good delivering the puddings after 25 December! Financial planning must also 'connect' with the marketing plan. It is important to remember that marketing costs money; and finances must be available if, for example, the business wishes to embark on an expensive advertising campaign. The marketing manager will also have to work with the human resource manager to ensure that the right staff are employed to create the good or service that is desirable to customers.

5.5 Production, selling, marketing approaches

The focus of businesses today is to develop a marketing plan based on the marketing concept — that is, an emphasis placed on customer satisfaction. However, marketing did not always have this as its main aim. As figure 5.6 shows, the focus of marketing strategies has changed dramatically over the years.

The idea of the marketing concept evolved in the early 1960s. Prior to this, there were two different approaches to marketing: production and sales.

BizFACT

All businesses should focus on satisfying the needs of their customers.

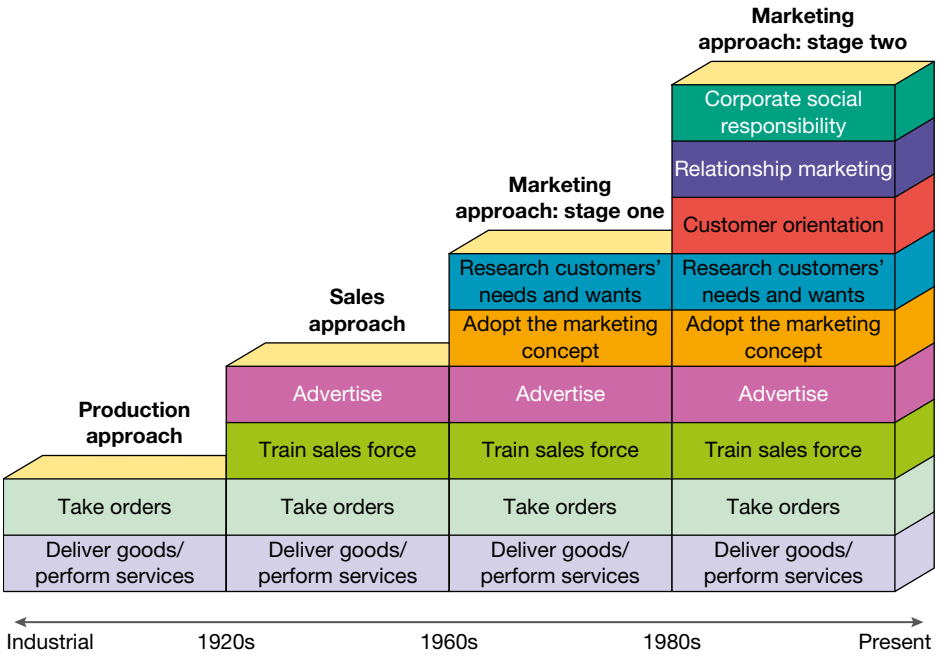


FIGURE 5.6 The evolution of marketing. Marketing has changed dramatically, evolving from the old-fashioned concept of simply producing goods and performing services and making them available for customers, to today's highly sophisticated and competitive marketing strategies, which involve aggressively seeking specific markets and customer needs to fill.

5.5.1 The production approach — 1820s to 1920s

BizWORD

The **production approach** *focused businesses on the production of goods and services.*

The **production approach** focused businesses on the production of goods and services. Consequently, until the 1920s, most businesses considered marketing simply as a spin-off of production. The attitude towards marketing is best explained by a catchphrase common during this time: 'If we make it, they will buy it'.

The Industrial Revolution created a tremendous burst of industrial output, which saw demand for goods (and some services) exceed the production capabilities of many businesses. Up until World War I, businesses concentrated their efforts on the production of goods and services (see figure 5.7). Businesses were usually able to sell all their output. Production design was based more on the demands of mass production techniques than on customer needs and wants. Business was production-oriented. Henry Ford, for example, focused on ways to produce motor vehicles more quickly and cheaply, confident that the people would buy them. Marketing consisted of simply taking orders and delivering the products.



FIGURE 5.7 The assembly line, mass production and the division of labour made it possible to produce goods (and services) more efficiently. This reinforced the belief during the production approach era: 'If we build it, they will buy it'.

5.5.2 The selling approach — 1920s to 1960s

After World War I, production became more efficient and productivity increased. Slowly the output of businesses started to catch up with demand. High-quality, mass-produced products came on to the market, and competition between businesses increased. No longer could a business rely on selling all it produced. Because customers' basic needs were satisfied, businesses had to develop a new marketing approach — one that was sales-oriented in an attempt to beat the competition and gain new customers.

The **sales approach** emphasised selling because of increased competition. To stimulate demand for their goods and services, businesses increased their spending on advertising, making use of newly developed electronic communications systems such as radio and film. Businesses faced the challenge of persuading customers to buy a specific brand. Sales representatives were hired and trained. Salespeople personally reached thousands of people and, in some instances, used high-pressure tactics to convince consumers to buy products. However, marketing still continued to play a secondary role to other functional areas such as production and finance.

Even though marketing was becoming more refined, most businesses were still neglecting the needs of the customer. Instead of researching what the customer wanted, they were producing what the company could make and getting their sales representatives to create demand. It was not until about the 1960s that businesses started to consider the customers' needs.

BizFACT

Throughout the sales approach era, the manager of the marketing department was usually given the title of sales manager.

BizWORD

The **sales approach** *emphasised selling because of increased competition.*



FIGURE 5.8 The use of door-to-door sales representatives became common practice for many businesses during the sales approach era. It was the equivalent of today's online marketing: the business comes to where the customer is located and makes a sales pitch.

5.5.3 The marketing approach: stage one — 1960s to 1980s

The marketing approach began with the economic boom after World War II, as businesses began to practise marketing in its current form. The method of achieving business success changed from focusing on production or pushing goods and services on customers, to placing the customer at the centre of all marketing activities. The **marketing approach** focuses on finding out what customers want — through market research — and then satisfying that need.

For the first time, most Australian families had **discretionary income**, more income than what was needed to obtain the necessities of life. They used this extra income to satisfy their needs and wants with different kinds of goods and services. For example, consumers started spending more on travel and recreation. Producers now had to learn how to satisfy wants as well as needs; something else was needed if products were to sell as well as previously. The emphasis shifted to the development of a marketing concept. As was outlined in the previous section, the marketing concept is based on four principles. It must be:

- customer-oriented
- supported by integrated marketing strategies
- aimed at satisfying customers
- integrated into the business plan so as to achieve the business's goals.

As a result, the marketing approach is characterised by the importance placed on identifying and satisfying customer needs and wants *prior* to producing the goods or services — the motivation being that the business would produce what the customer desired, and the customer would then buy the good or service. Marketing now became central to all aspects of a business, and satisfying customer needs became the responsibility of all employees, regardless of whether employees were financial controllers, operations specialists, human resource officers or sales representatives/consultants.

BizWORD

The **marketing approach** *focuses on finding out what customers want — through market research — and then satisfying that need.*

Discretionary income *refers to disposable income that is available for spending and saving after an individual has purchased the basic necessities of food, clothing and shelter.*

5.5.4 The marketing approach: stage two — 1980s to present

Changing economic and social conditions over the last three decades have seen a modification to the marketing approach.

Corporate social responsibility (CSR)

With growing public concern over environmental pollution and resource depletion came a shift in the emphasis of marketing plans. Marketing managers now realise that businesses have a corporate social responsibility (CSR). External pressure from customers and environmental organisations, as well as political forces, is presently influencing the marketing plans of many businesses. One major change has been the increase in demand for ecologically sustainable products.

SNAPSHOT



'. . . sustainability … an integrated part of everything they do'

Case study: Woolworths — corporate social responsibility

In 2017, Woolworths released *Corporate Responsibility Strategy 2020* in recognition of the responsibilities they carry and the impact they have on their customers, team members, suppliers, shareholders, communities and environments. The strategy outlines 20 corporate responsibility and sustainability goals and commitments that the supermarket is committed to achieving by 2020. The overarching aims are to close the gender pay gap, encourage diversity, improve environmental sustainability and build trusting relationships with key stakeholders.

Woolworths launched its first sustainability strategy ten years ago in 2007. They feel they've been successful in achieving one of their main aims from that first strategy, which was to make sure that sustainability wasn't seen as standalone work, but as an integrated part of everything they do. Every employee is made aware that they each have a role to play in achieving these corporate responsibility commitments and in making Woolworths a great business to deal with.

As proof that they are taking their commitment to environmental sustainability seriously, in 2017 Woolworths announced that they would phase out all single-use plastic bags to shoppers over 12 months. This will have a significant impact on environmental sustainability considering they hand out more than 3.2 billion plastic bags every year to customers. This decision will also affect all retailers in the Woolworths Group including Big W, BWS and Dan Murphy's. In addition to phasing out plastic bags, Woolworths is committed to reducing plastic use in all parts of their supply chain, especially in fresh produce and fresh meat.

SNAPSHOT QUESTIONS

1. **How** have Woolworths become more socially responsible? Use information from their corporate website to help you answer.
2. **Explain** why Woolworths have made this commitment to corporate responsibility.
3. **Propose** other strategies Woolworths could implement to be more socially responsible.

on Resources

Weblink: Woolworths

BizWORD

Customer orientation *refers to the process of collecting information from customers and basing marketing decisions and practices on customers' wants and interests.*

Customer orientation

If you purchased a digital television today, there is a one in three chance it was made in South Korea and a 25 per cent chance it was made by Samsung. The secret to Samsung's phenomenal success is that it is a business with a strong **customer orientation**: collecting information from customers and basing marketing decisions and practices on customers' wants and interests (see figure 5.9).



FIGURE 5.9 Samsung adopts a customer-oriented approach to marketing. They strive to identify what their customers want, then do their best to meet their needs and requirements with the products and services they offer. Samsung excels in customer service as well as after-sales service.

For businesses that adopt a customer orientation approach, the customer relationship does not end with the sale; it begins there. Companies such as Samsung will strive continuously to not only simply meet but also exceed customer expectations. Samsung, similar to many other businesses, constantly strives towards achieving and maintaining high levels of **customer satisfaction**.

BizWORD

Customer satisfaction *measures how goods and services supplied by a business meet or exceed customer expectation.*

Case study: Nike — customer orientation

For many years, Nike adopted a production-oriented approach to marketing and believed the way ahead was through product innovation. While this worked for them for some time, eventually the company realised that the only way forward was to change focus from the design and manufacture of products (where Nike had always excelled) to the consumer.

In the beginning, Nike's performance-oriented product innovations led to the development of shoes and products that customers wanted to wear. However, in the mid-1980s after competition intensified, Nike realised that they could no longer just rely on selling innovative products and a new approach was needed. Therefore, instead of having the product as their main focus, they put the consumer in the spotlight and learned to be market-oriented. Since this change of approach, Nike resumed its domination of the athletic shoe industry and still maintains the highest global market share.

Nike previously believed that everything started in the lab, but they've since come to realise that everything begins with the consumer. While technology is still important, it's the consumer who needs to lead innovation. Nike therefore puts a lot of focus on finding out exactly what consumers want and then they innovate and create a product that meets their needs. They put customers at the centre of everything that they do.

In order to discover what their consumers value, Nike invests in extensive market research. They spend time in stores and watch what happens, they get reports from dealers, conduct focus groups, track responses to their ads, go to amateur sports events, spend time at gyms and tennis courts and talk to people. Their obsession with meeting consumers' needs is what has led to their success.

SNAPSHOT



'. . . they put the consumer in the spotlight . . .'

Their website is another place where Nike gets valuable information about how customers are using their products as well as an insight into their needs. This where consumers can upload data about their recent runs and see the history of their runs on maps. They can share this information with others as well as get tips and post information about upcoming events. Nike has given their customers a reason to want to return to their website every day and engage with the company.

SNAPSHOT QUESTIONS

1. **Outline** Nike's initial approach to marketing.
2. **State** the strategies Nike has implemented that illustrate how the company has adopted a market approach.
3. **Assess** Nike's current approach to marketing.

Relationship marketing

BizWORD

Relationship marketing *is the development of long-term and cost-effective relationships with individual customers.*

It is no longer sufficient for a business to just market its goods and services in the hope of attracting new customers. What is also required is a business to keep its existing customers satisfied. **Relationship marketing** is the type of marketing that does this. It places a high priority on customer retention and continual satisfaction. The core of relationship marketing is customer loyalty — so as to generate repeat sales — which can be achieved through reward programs, customer care or good after-sales service. If, for example, you purchased a mobile phone plan and the telecommunications provider gave you excellent pre- and after-sales service, and also a customer reward program, you would probably continue purchasing the service from the provider. You may even recommend the service provider to your friends.

Relationship marketing will be discussed in more detail in chapter 8.

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Syllabus area 2
Topic 1
Concept 3

Evolution of marketing
Summary screen and practice questions

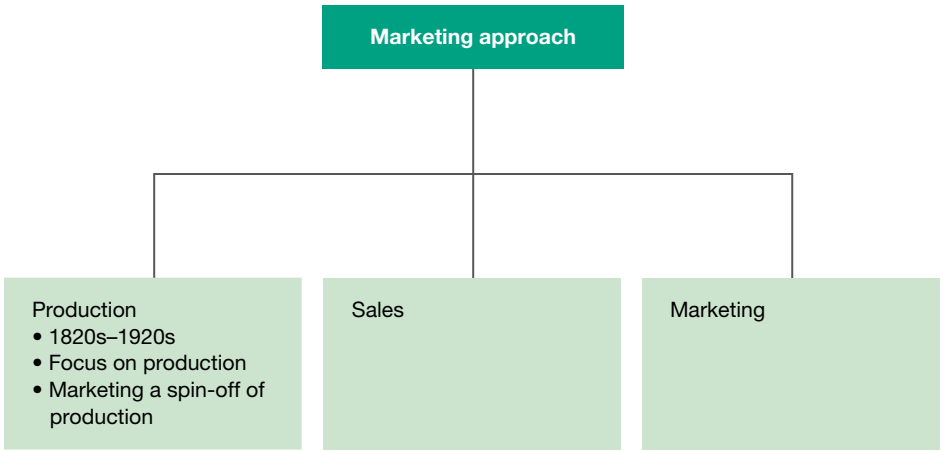
SUMMARY

- The shift to a customer-oriented approach brought about significant changes to marketing.
- The marketing concept is a philosophy that states all sections of the business are involved in satisfying a customer's needs and wants while achieving the business's goals.
- The marketing plan needs to become integrated into all aspects of the business, with marketing strategies playing a major role in all business activities.
- The production approach (1820s–1920s) focused businesses on the production of goods and services.
- Production design was based more on the demands of mass production techniques than on customer needs and wants.
- The sales approach (1920s–1960s) emphasised selling because of increased competition.
- Businesses faced the challenge of persuading customers to buy specific brands.
- The marketing approach (1960 to present) focuses on finding out what customers want — through market research — and then satisfying that need.
- The emphasis shifted to the development of a marketing concept based on four principles:
  - customer-oriented
  - supported by integrated marketing strategies
  - aimed at satisfying customers
  - integrated into the business plan so as to achieve the business's goals.

- Changing economic and social conditions over the last three decades have seen a modification to the marketing process including:
  - social responsibility: especially in regards to ecological sustainability
  - customer orientation: the process of collecting information from customers and basing marketing decisions and practices on customers' wants and interests
  - relationship marketing: the development of long-term and cost-effective relationships with individual customers.

EXERCISE 5.2 REVISION

1. **Define** the term 'marketing concept'.
2. 'The marketing manager cannot work in isolation and often has to work with other managers in the business to ensure the success of the marketing plan.' **Discuss**.
3. The marketing concept is a business philosophy adopted by many modern businesses. Read the following three pairs of statements and write into your notebook the statement that represents the business that has adopted the marketing concept philosophy. **Justify** your selection.
   (a) Business A: 'Perhaps we should start stocking Clear View Mineral Water again. A lot of customers are asking for it.'
   Business B: 'We will only stock Clear View Mineral Water when it decides to give us a better deal than Natural Springs.'
   (b) Business A: 'Our sales are falling. We will have to think about laying off someone.'
   Business B: 'Our sales are falling. We will have to undertake some market research to find out why.'
   (c) Business A: 'Please give generously with your donations, no matter how small. You never know when you or your children may need some help.'
   Business B: 'Please help with your donations. Our charity is short of money.'
4. **Construct** a concept map (started below) **summarising** the three marketing approaches.



5. 'To disregard the "quality of life" issues when developing a marketing plan could lead to a customer backlash.' In small groups, use the brainstorm technique to **analyse** this statement. Share your group's answer with the rest of the class.
6. **Distinguish** between the terms 'customer orientation' and 'customer satisfaction'.
7. **Account** for why a business would want to adopt a customer-oriented approach to marketing.
8. **Recall** the aim of relationship marketing.
9. Conduct a class survey to establish the number of loyalty programs that class members belong to. **Discuss** their effectiveness from the customers' viewpoint. **Create** a 100-word report of the discussion.

EXERCISE 5.2 EXTENSION

1 **Determine** why the marketing concept is difficult for some businesses to implement.
2 'Marketing is not the sole responsibility of the marketing manager, but all managers.' **Assess** the accuracy of this statement using examples.
3 'Relationship marketing is only successful if the business has access to detailed information about its customers.' **Evaluate** this statement.

5.6 Types of markets

BizWORD

A **market** *is a group of individuals, organisations or both that:*
- *need or want products (goods or services)*
- *have the money (purchasing power) to purchase the product*
- *are willing to spend their money to obtain the product*
- *are socially and legally authorised to purchase the product.*

For the purposes of this topic, a **market** is defined as a group of individuals, organisations or both that:
- need or want a product (goods or service)
- have the money (purchasing power) to purchase the product
- are willing to spend their money to obtain the product
- are socially and legally authorised to purchase the product.

A group that does not have these four features is not considered to be a market.

In general use, the term 'market' usually refers to the total population, or mass market, that purchases products. Our definition is more specific and refers to individuals or groups who wish to buy *specific* products. There are many markets in an economy. Based on the characteristics of the individuals and groups that make up a specific market, it is possible to divide markets into six main types of markets: resource, industrial, intermediate, consumer, mass and niche (see figure 5.10).

Because marketing plans and strategies vary depending on the intended market, marketing managers need to understand the main characteristics of these six different types of markets.

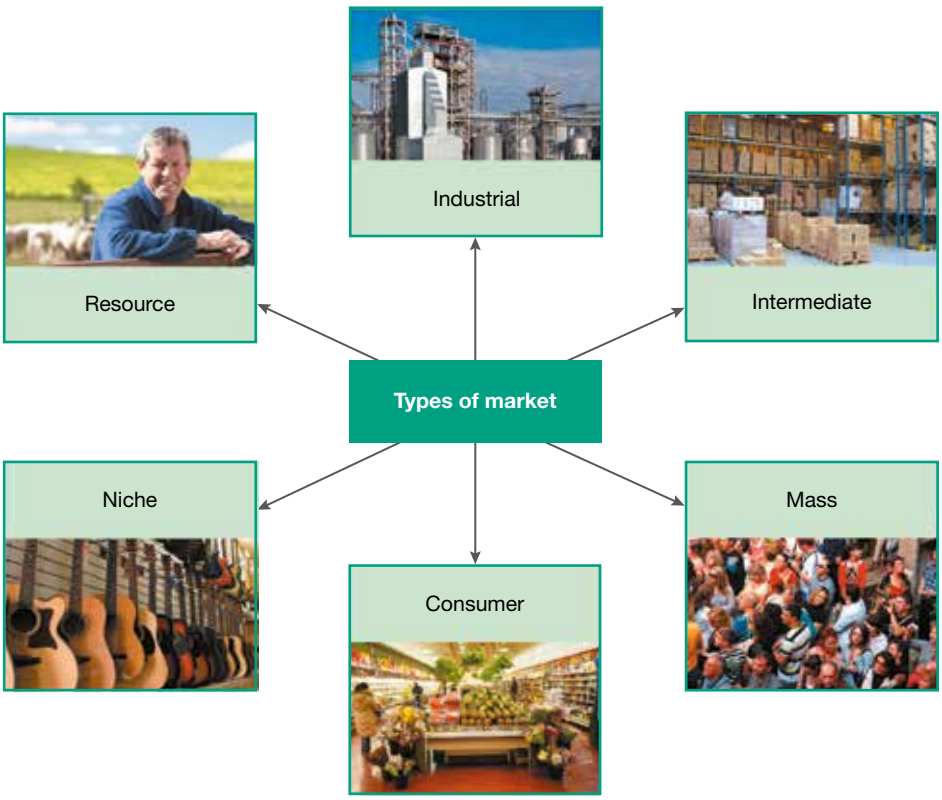


FIGURE 5.10 The six different types of markets

5.6.1 Resource market

The **resource market** consists of those individuals or groups that are engaged in all forms of primary production, including mining, agriculture, forestry and fishing. As a group, this market in Australia is made up of over 165 000 enterprises or customers and has a large purchasing power. Farmers, for example, purchase machinery, seed and fertiliser.

BizWORD

*The **resource market** consists of those individuals or groups that are engaged in all forms of primary production, including mining, agriculture, forestry and fishing.*

5.6.2 Industrial market

In Australia, there are more than 932 000 businesses in the industrial market; these businesses are either secondary or tertiary. An **industrial market** includes industries and businesses that purchase products to use in the production of other products or in their daily operations. Tip Top Bakery, for example, buys flour to make bread, and Sony buys plastics and metals to produce televisions.

BizWORD

*The **industrial market** includes industries and businesses that purchase products to use in the production of other products or in their daily operations.*

5.6.3 Intermediate market

The **intermediate market** consists of wholesalers and retailers who purchase finished products and sell them again to make a profit. The vast majority of goods sold to consumer markets are first sold to an intermediate market. Resellers are an intermediate market.

In Australia, the total intermediate market is made up of approximately over 187 000 retailers and over 61 000 wholesaling intermediaries. Subway, for example, is a retailer that buys goods to make into sandwiches and salads for sale to consumers.

BizWORD

*An **intermediate market** consists of wholesalers and retailers who purchase finished products and resell them to make a profit.*

5.6.4 Consumer market

Consumer markets are the markets with which we are most familiar. Each time we go shopping at the local supermarket, we are part of the consumer market. **Consumer markets** consist of individuals — that is, members of a household who plan to use or consume the products they buy. Consumers do not intend to use the products to make other goods and services. Each of us is part of numerous consumer markets for products such as housing, clothing, food, entertainment, appliances, music recordings, cars and personal services.

BizWORD

Consumer markets *consist of individuals — that is, members of a household who plan to use or consume the products they buy.*



FIGURE 5.11 According to various studies, Australian consumers tend to have high consumption habits. European trends are popular and Australian consumers are 'early adopters', that is, they readily purchase new technologies. Australians are increasingly concerned with their health and the environment. Therefore, there has been an increased demand for fresh and organic foods, environmental investment and products linked to energy-saving technology.

Marketing managers examine closely the behaviour of consumers so they can better understand what motivates an individual to purchase a particular product. They also try to influence consumer buying behaviour by developing a mix of marketing strategies.

5.6.5 Mass market

BizWORD

In **mass markets**, *the seller mass-produces, mass-distributes and mass-promotes one product to all buyers.*

Fifty years ago, marketing managers commonly spoke about the 'mass market'. In other words, there was a large demand for a standard product. In **mass markets**, the seller mass-produces, mass-distributes and mass-promotes one product to all buyers. The business does not target its products to a specific group of buyers. The assumption is that all customers in the market have similar needs and wants.

The Model T Ford was the first motor vehicle to be mass-produced and sold to the mass market. When the Model T Ford was first released onto the American market in 1908, production could not keep up with demand. Henry Ford changed the production methods so that the assembly process was cut from 12.5 hours to 93 minutes. Henry Ford's 'famous' marketing slogan was that the customer could have the car in any colour he or she wished, 'as long as it was black'. This meant customers' wishes were not considered. A business could adopt this attitude in the early periods of industrialisation because consumers' wants could not be fulfilled; most items that were produced could easily be sold. (The production approach philosophy was dominant at this time.)

Very few products today are marketed to the mass market. Basic food items, electricity and water are three current examples. Due to greater choice, higher personal incomes and customers seeking more individualised products, the mass market has been replaced by segmented or niche markets.



FIGURE 5.12 The main benefits of serving the mass market are the scope and cost efficiency of doing business on such a large scale. Advertising messages broadcast over mass media give a business the ability to achieve economies of scale and appeal to a very large audience in a single showing. However, the advantages of mass marketing can only be achieved if the product in question is a commodity or is beneficial to people across a wide range of demographics.

5.6.6 Niche market

BizWORD

A **niche market**, *also known as a concentrated or micro market, is a narrowly selected target market segment.*

At the other end of the spectrum to the mass market is a **niche market**, also known as a concentrated or micro market. The mass market is divided into smaller market segments consisting of buyers who have specific needs or lifestyles. This smaller group of consumers becomes the 'target' market, towards which marketing managers 'aim' their marketing efforts. For example, in any newsagent you will see row upon row of magazines, each appealing to a specific niche market — male, female, young, old, high income, low income, urban, rural, outdoor lifestyle, indoor lifestyle and so on (see figure 5.13). Market segmentation is discussed in more detail in chapter 7.



FIGURE 5.13 Niche magazines target highly specialised interests. They target extremely narrow audiences and appeal to the specific values of limited segments of people. For example, Meredith publishes a wide range of specialist publications that cater to women. While they publish more popular magazines such as *Better Homes & Gardens* and *Fitness*, they also publish special interest titles such as *Beautiful Kitchens & Baths, Do It Yourself, Country Gardens, Quilting and Diabetic Living.*

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SUMMARY

- A market is a group of individuals, organisations or both that:
  - need or want a product
  - have the money to purchase the product
  - are willing to spend their money to obtain the product
  - are socially and legally authorised to purchase the product.
- Marketing plans and strategies vary depending on the intended market.
- Marketing managers need to understand the main characteristics of these six different types of markets.
- There are six main types of markets.
  - Resource market: agricultural businesses
  - Industrial: secondary and tertiary businesses

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Syllabus area 2 | Topic 1 | Concept 4

Types of markets
Summary screen and practice questions

- Intermediate: wholesalers and retailers
- Consumer: individuals and households
- Mass: vast numbers of individuals
- Niche: small target market

EXERCISE 5.3 REVISION

1 **Define** the term 'market'.
2 **How** does this definition of market differ from the general use of the term?
3 **Identify** the six different types of markets.
4 **Distinguish** between the resource and industrial markets.
5 **Why** is Subway considered to be part of the intermediary market?
6 **Recall** the correct word to complete the following sentences. The words can be found by reading the '5.6.4 Consumer market' section.
   (a) Each time we go shopping at the local _____, we are part of the _____ market.
   (b) Consumer markets consist of _____ — that is, _____ of a household who plan to use or _____ the products they buy.
   (c) Marketing managers examine closely the _____ of consumers so they can better understand what _____ an individual to purchase a particular product.
   (d) Marketing managers also try to _____ consumer buying _____ by developing a mix of marketing _____.
7 **Demonstrate** the difference between the mass market and a niche market.
8 Indicate, using an 'M' or 'N', whether the following products are sold in a mass or niche market. **Justify** your selection.
   (a) Rolls Royce cars
   (b) Mount Franklin water
   (c) *BRW* magazine
   (d) Fruit and vegetables
   (e) BP petrol
   (f) Billabong wetsuits
   (g) PlayStation games
   (h) Sunbeam shearing combs

EXERCISE 5.3 EXTENSION

1 'Regarding purchasing power, organisational buyers such as businesses and government departments are generally considered to be more rational than ultimate consumers.' **Propose** reasons why this is so. **Compare** your answers with other members of the class.
2 **Compare** and **contrast** the main features of a mass market and a niche market.
3 **Determine** whether a furniture manufacturer would need a different marketing strategy for a large retail chain such as Myer than for a single furniture store owned and operated by one person. **Justify** your answer.

Resources

Digital doc: Chapter summary (doc-24807)
Interactivity: Chapter crossword (int-7157)
Interactivity: Multiple choice quiz (int-7158)

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Sit HSC exam

CHAPTER 6

Influences on marketing

OVERVIEW

6.1 Introduction
6.2 Factors influencing customer choice
6.3 Consumer laws
6.4 Ethical influences

6.1 Introduction

Marketing is a key business function that impacts on business success. To successfully manage the marketing function, managers must deal with a range of influences that impact on marketing. These influences are shown in figure 6.1.

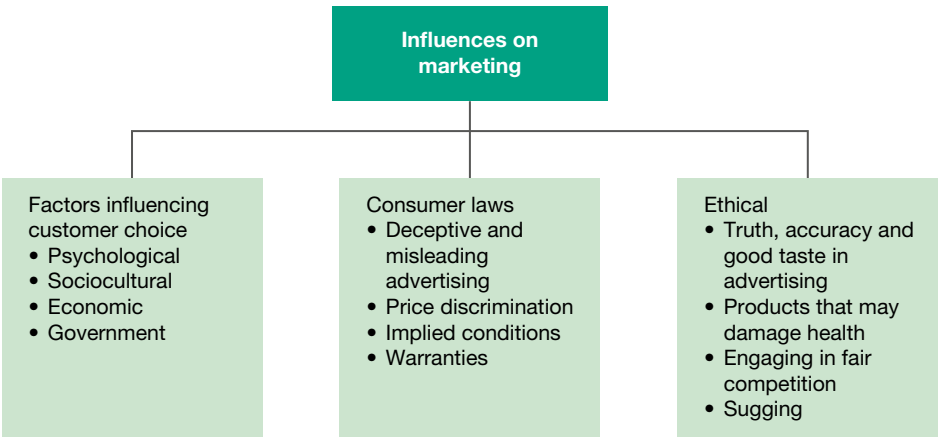


FIGURE 6.1 Influences on marketing

6.2 Factors influencing customer choice

BizWORD

Customer choice (buying behaviour) *refers to the decisions and actions of customers when they search for, evaluate, select and purchase goods and services.*

Marketers closely examine the behaviour of customers (consumers) to understand what motivates an individual to purchase a particular product — **customer choice (buying behaviour)**. They want to know why the customer selects one product and rejects another. As well, businesses try to influence customer choice by modifying their marketing strategies to appeal to the customer's motives.

While market research asks questions such as 'Who are our customers?', 'What do they buy?', 'When do they buy?' and 'How often do they buy?', customer behaviour asks 'Why do they buy?'.

If businesses are aware of the factors that influence customer choice, they can predict customer trends and how they may react to particular marketing strategies.

Consumer buying behaviour — different types of products

Over the years marketers have suggested numerous theories to explain what it is that persuades individuals to buy certain products. One of the most common ways of examining consumer buying behaviour is in terms of how consumers make decisions.

A consumer's buying behaviour will differ when they purchase different types of products. For low-priced, regularly purchased products, such as bread or ice-creams, a consumer generally buys out of habit, involving very little research or decision-making effort. A consumer will use some decision-making effort for purchases made occasionally, or when more information is needed about the product, such as when purchasing clothing or footwear. When buying an expensive, unfamiliar product or a product that is seldom purchased, such as a motor vehicle or home, the consumer will use comprehensive decision making.

One of the main reasons for the difference in the level of involvement in the buying process is due to the level of perceived risk. As the level of perceived risk increases, consumer involvement levels are likely to rise. Ultimately, however, the decision-making process that almost everyone uses when making a purchase can be summed up in the following simple formula:

Consumer choice = capacity to pay + attitude towards the brand

SNAPSHOT QUESTIONS

1. **Demonstrate** how consumers' buying behaviour will differ when they purchase different types of products.
2. **Explain** the relationship between consumer involvement and the level of perceived risk. Support your answer with a relevant example.

SNAPSHOT



'As the level of perceived risk increases, consumer involvement levels are likely to rise.'

Have you ever stopped to consider what influences your buying decisions? Why do you purchase certain products and not others? Over the years, marketers have suggested numerous theories to explain what it is that persuades individuals to buy products. One of the most common ways is by examining the four main factors which influence customer choice (see figure 6.2).

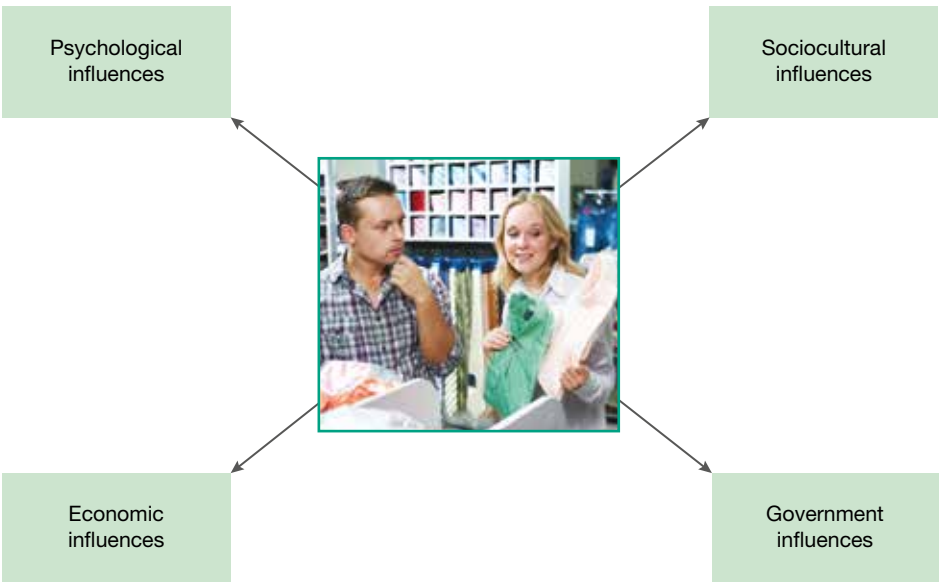


FIGURE 6.2 The four main factors influencing customer choice

BizFACT

Successful marketing begins with understanding why and how customers behave as they do.

6.2.1 Psychological influences

BizWORD

Psychological factors *are influences within an individual that affect his or her buying behaviour.*

Psychological factors are influences within an individual that affect his or her buying behaviour. Five main psychological factors influence customer choice. These are perception, motives, attitudes, personality and self-image, and learning.

Even though these psychological factors operate internally, they are also very much affected by sociocultural forces outside the individual.

Perception

BizWORD

Perception *is the process through which people select, organise and interpret information to create meaning.*

What an individual perceives may be very different from reality; people see and hear the same things differently. For example, one person sees a Ferrari motor vehicle as a sign of achievement; another sees it as ostentatious. This is the result of perception. **Perception** is the process through which people select, organise and interpret information to create meaning. Usually there is a range of perceptions across different individuals.

As individuals we often act on our perceptions of reality rather than reality itself. Consequently, marketing managers are extremely aware that they must create a positive or favourable perception about their product in the mind of the customer. Customers will not normally purchase a product that they perceive as inferior. The perception customers have of a product is often the result of some type of advertising that attempted to create a certain 'image' of the product — images such as trendy, luxurious, classy, fun and rebellious. In reality, the product may not necessarily have such qualities. It may be more to do with how consumers perceive the product.

Motives

BizWORD

A **motive** *is an individual's reason for doing something.*

A **motive** is an individual's reason for doing something. The main motives that influence customer choice include comfort, health, safety, ambition, taste, pleasure, fear, amusement, cleanliness and the approval of others. As with the customer's perception of the product, advertising also attempts to influence an individual's motives (for instance, the desire to emulate a sporting hero). That is, advertising attempts to motivate the customer to buy the product.

Attitudes

BizWORD

An **attitude** *is a person's overall feeling about an object or activity.*

An **attitude** is a person's overall feeling about an object or activity. Customer attitudes to a business and its products generally influence the success or failure of the business's marketing strategy. Negative attitudes to a business or its products often force the business to change its strategies.

Personality and self-image

BizWORD

An individual's **personality** *is the collection of all the behaviours and characteristics that make up that person.*

BizWORD

An individual's **self-image** *relates to how a person views himself or herself.*

An individual's **personality** is the collection of all the behaviours and characteristics that make up that person. To some extent, personality will influence the types and brands of product a person buys. For example, the style of car, clothing or jewellery that a person buys may reflect their personality.

Coupled with personality is an individual's **self-image**: how a person views himself or herself. Self-image is a major determinant of what products we buy. We all have an image of who we are, and we reinforce this image through our purchases. The tendency to believe 'you are what you buy' is widespread among certain types of individuals, especially young people. Marketers will make the most of an individual's desire to express their identity through what they buy by highlighting the image value of their products. This is why celebrities and sportspeople are regularly used to endorse a product; people want their self-image to be a reflection of those who they regard as important and influential (see figure 6.3).



FIGURE 6.3 Celebrities and sportspeople are often used to endorse products because people aspire to be like them. If a consumer idolises a certain celebrity who supports a particular brand or is seen in advertisements promoting a new product, that consumer will associate it with their success, beauty and skill and will subconsciously believe that using that product will give them the same traits they admire.

Learning

Customers have direct experience of many new products. When they do, they are also learning. Consequently, much of customer behaviour is learned. **Learning** refers to changes in an individual's behaviour caused by information and experiences. For example, learning occurred the first time a customer tasted Coca-Cola! Learning may also be based on indirect experiences. If a customer sees an advertisement for Coca-Cola that shows other people enjoying a new flavour, the customer might assume that they would like it also.

To market products successfully, a business must assist customers to learn about them. Therefore, successful marketing strategies may assist customer learning that encourages **brand loyalty** (see the following Snapshot).

BizWORD

Learning *refers to changes in an individual's behaviour caused by information and experiences.*

BizWORD

Brand loyalty *occurs when a favourable attitude towards a single brand results in repeat sales over time.*

SNAPSHOT

Brand loyalty — a learned behaviour



According to Yasmin Saghafi, marketing manager for Tricon Consultancy, marketers can successfully use positive learned experiences to build brand loyalty. 'Behaviour that results in a satisfying or pleasing outcome will tend to be repeated', she says. 'For example, when a customer buys a packet of Tim Tam biscuits and likes them, he or she is more likely to buy Tim Tam biscuits again.' Yasmin explains that this type of experience (learning) relates to habit formation and that there is a close link between habits and brand loyalty. 'Actually, the customer will keep buying the brand because of the positive reinforcement of previous actions.'

Yasmin outlines that customers will continue purchasing a particular brand until it no longer provides satisfaction, at which point they will either switch to another brand or, in the case of Tim Tams, stop eating chocolate biscuits altogether. 'Brand loyalty cannot be taken for granted,' she reinforces. 'Customers have become less brand loyal than they once were because brands have become increasingly similar, thereby making it easier for customers to switch among brands.'

> '. . . marketers can successfully use positive learned experiences to build brand loyalty.'

SNAPSHOT QUESTIONS

1. **Define** the term 'brand loyalty'.
2. **Explain** the relationship between positive learned experiences, habits and brand loyalty.
3. **Identify** a brand that you are loyal to and **account** for your loyalty.
4. **Recall** why customers have become less brand loyal than they once were.
5. **Determine** why marketers need to understand how learning influences brand loyalty.

6.2.2 Sociocultural influences

Whereas psychological influences are internal forces, **sociocultural influences** are forces exerted by other people and groups that affect customer behaviour. There

BizWORD

Sociocultural influences *are forces exerted by other people and groups that affect an individual's buying behaviour.*

are four main sociocultural factors. They are social class, culture and subculture, family and roles, and reference (peer) group.

Social class

In our society, the factors generally used to determine a person's **social class** — often referred to as **socioeconomic status** — are education, occupation and income. Social class influences the type, quality and quantity of products a customer buys. People from a high socioeconomic status background, for example, are usually willing to buy products that are perceived to be prestigious. Higher income earners may purchase luxury cars that symbolise their status, and are more likely to shop in upmarket retail stores.

BizWORD

Social class *or* **socioeconomic status** *refers to a person's relative rank in society, based on his or her education, income or occupation.*



FIGURE 6.4 Marketers realise that socioeconomic status plays a significant role in customer behaviour. These days, many women are prepared to spend more on a handbag than on a holiday or even a car! Why are luxurious handbags so desirable? It's partly because they've become symbolic of a woman's status and earning power.

Culture and subculture

Culture is all the learned values, beliefs, behaviours and traditions shared by a society. Culture influences buying behaviour because it infiltrates all that we do in our everyday life. It determines what people wear, what and how they eat, and where and how they live. For example, in response to the greater desire for nutritious and healthy foods, many low-fat, sugar-free and fibre-enriched processed food products are now marketed.

BizFACT

A research company, Brainchild, found that 30 per cent of the 600 children it surveyed said their parents asked them for advice when choosing the family car.

Family and roles

All of us occupy different roles within the family and groups within the wider community. These roles influence buying behaviour. For example, although women's roles are changing, market research shows that most women still make buying decisions related to healthcare products, food and laundry supplies. Studies have shown that teens are a household's chief influencer and their opinion on purchases is often sought by parents worldwide. The main categories in which teens wield the most influence are clothes, shoes, music, books, food and beverages, household goods, travel and spending on family excursions. Around three-quarters of teens said they influenced how their parents spent on these categories.

BizWORD

A **reference** *or* **peer group** *is a group of people with whom a person closely identifies, adopting their attitudes, values and beliefs.*

Reference (peer) groups

A **reference** or **peer group** is a group of people with whom a person closely identifies, adopting their attitudes, values and beliefs. A customer's buying behaviour may change to match the rest of the group's beliefs and attitudes. For example, if a close friend tells you of a bad experience at a particular shop, you will probably change your buying

behaviour based on this information. Alternatively, if your peer group wears distinctive clothing, you probably make clothing purchases based on this influence.

6.2.3 Economic influences

Economic forces have an enormous impact on both businesses and customers. They influence a business's capacity to compete and a customer's willingness and ability to spend. Economies do not always experience constant growth. Rather, the level of economic activity fluctuates from boom to recession. Each of these two distinct phases influences the marketing environment in the following ways (see figure 6.5).

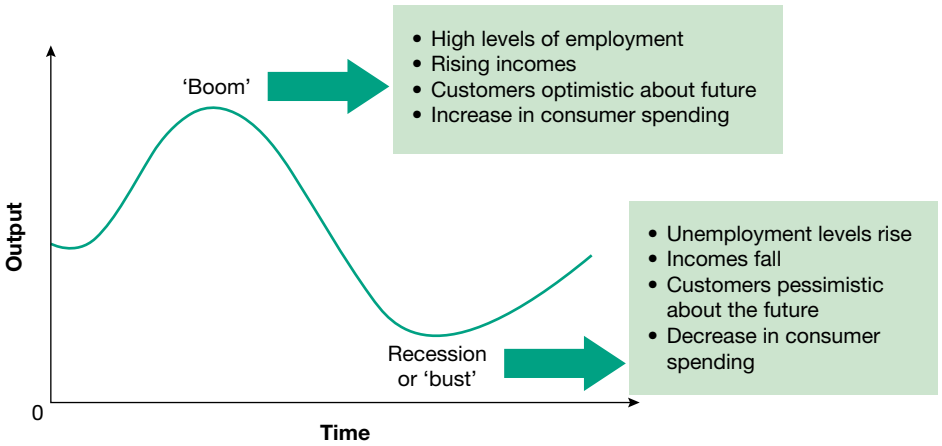


FIGURE 6.5 Economic influences on customer choice

Boom

A boom is a period of low unemployment and rising incomes. Businesses and customers are optimistic about the future. Businesses increase their production lines, and attempt to increase their market share by intensifying their promotional efforts. Customers are willing to spend because they feel secure about their jobs and source of income.

The marketing potential during such a phase is large, with sales responding to all forms of promotion.

Recession

A recession sees unemployment reach high levels and incomes fall dramatically. Customers and businesses lack confidence in the economy and if this phase lasts for a long time, a mood of deep pessimism persists. Customer and business spending reach very low levels. Such caution and pessimism result in customers reducing their spending. Customers become more price-conscious. They look for value and products that are functional and long-lasting. Marketing plans should, therefore, stress the value and usefulness of a product. As well, marketing plans during this time should concentrate on maintaining existing market share. Survival becomes the main business goal.

BizFACT

In the period after the global financial crisis of 2008–09, average levels of savings in Australia rose to 10 per cent per household. People became more cautious about spending money. Marketing becomes a lot harder in these circumstances.

6.2.4 Government influences

Governments use a number of economic policy measures to influence the level of economic activity. Depending on the prevailing economic conditions, the government will put in place policies that expand or contract the level of economic activity. These policies directly or indirectly influence business activity and customers' spending habits, and therefore will influence the marketing plan.

The influence of government regulations has a more direct and immediate impact on the marketing plans of a business. Regulatory forces consist of laws (statutes)

BizFACT

In 2017, Prime Minister Malcolm Turnbull announced the government's intention to ban gambling advertising before 8.30 pm during live sporting events. This was intended to address problem gambling and to make watching sport more family-friendly. While this was welcomed by many parents, it faced a strong backlash from many sporting codes and networks who would stand to lose a lot of revenue.

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Syllabus area 2
Topic 2
Concept 1

Factors influencing customer choice
Summary screen and practice questions

and regulatory bodies that can influence business behaviour. Such regulatory forces exert a significant influence over the marketing activities of businesses because the breaking of these laws or regulations may result in financial penalties.

A number of laws, such as the *Competition and Consumer Act 2010* (Cwlth) (formerly the *Trade Practices Act 1974*), *Sale of Goods Act 1923* (NSW) and the *Fair Trading Act 1987* (NSW), have been passed that influence marketing decisions.

SUMMARY

- Marketers closely examine the behaviour of customers (consumers) to understand what influences customer choice.
- Customer choice is influenced by four main factors.
  1. Psychological:
     - influences within an individual that affect his or her buying behaviour
     - psychological factors include the buyer's perceptions, motives, attitudes, personality and self-image, and learning.
  2. Sociocultural:
     - influences exerted by other people and groups that affect an individual's buying behaviour
     - sociocultural factors include the buyer's social class, culture and subculture, family role, and peer groups.
  3. Economic:
     - economic forces that influence a business's capacity to compete, and a customer's willingness and ability to spend
     - the level of economic activity fluctuates from boom to recession.
  4. Government:
     - policies that directly or indirectly influence business activity and customers' spending habits
     - laws such as the *Competition and Consumer Act 2010* (Cwlth), *Sale of Goods Act 1923* (NSW) and the *Fair Trading Act 1987* (NSW) that influence marketing decisions.

EXERCISE 6.1 REVISION

1 **Define** the term 'customer choice'.
2 Of the five psychological influences that affect customer choice, select which you think is the most important. **Justify** your answer.
3 **How** does an individual's perception of a product influence their buying behaviour?
4 **How** and why do marketing managers attempt to alter consumer perception?
5 'The tendency to believe "you are what you buy" is widespread among certain types of individuals, especially young people.' **Interpret** what is meant by this statement.
6 **How** might an understanding of customers' learning processes affect a marketing plan? Use an example to support your answer.
7 **Distinguish** between the sociocultural and psychological factors that influence customer choice.
8 **Demonstrate** in what ways social class affects a customer's choice.
9 **Describe** a subculture to which you belong. **Identify** purchases that are unique to your subculture.
10 **Explain** how family roles such as carer or provider affect customer choice.
11 **Identify** some of your own reference groups. **Outline** how reference groups influence customer choice.
12 Collect a number of print advertisements from a magazine. **Identify** the psychological and/or sociocultural influence to which each advertisement is appealing.
13 **Summarise** the impact that economic conditions may have on business, consumers and the marketing plan.

14 **How** do government policies and regulations influence the marketing environment?
15 **Outline** some of the services of NSW Fair Trading.

EXERCISE 6.1 EXTENSION

1 'Through knowledge of customer buying behaviour, marketing managers can learn to manipulate customers to purchase their products.' **Assess** the validity of this statement.
2 'Perception is reality; what we think is true about a product does not matter.' **Critically analyse** this statement.
3 Suppose research at Apple reveals that potential customers are apprehensive about buying an iPad for home use. **Determine** what strategies you might recommend to Apple to reduce customer apprehension.

on Resources

Weblink: NSW Fair Trading 1

6.3 Consumer laws

Since the 1960s, the broad area of business law that relates to dealings between consumers and businesses has been subject to radical and fairly continuous change. Governments, both federal and state, have introduced laws to improve the protection and rights of consumers, and to clarify the rights and responsibilities of businesses.



FIGURE 6.6 The ACL sets out consumer rights that are called consumer guarantees. These include your rights to a repair, replacement or refund as well as compensation for damages and loss and being able to cancel a faulty service. If a business sells a customer a product that fails to meet one or more of the consumer guarantees, the customer is entitled to a remedy — either a repair, replacement or refund and compensation for any consequential loss — depending on the circumstances.

6.3.1 The Australian Consumer Law

In 2011, a single, national consumer law — the Australian Consumer Law (ACL) — was introduced, which replaced 17 existing national, state and territory consumer laws (see figure 6.7). The ACL applies in the same way to all Australian consumers and businesses regardless of where the business operates or where consumers shop. At the same time, the name of the *Trade Practices Act 1974* was changed to the *Competition and Consumer Act 2010*.

Marketers do not have to be skilled lawyers, but they should be familiar with the laws that regulate their activities. Ignorance of the law is no defence. Marketers must also ensure they are aware of any changes to the laws as those changes apply to their particular business. Their responsibility is to understand and apply laws

BizFACT

The ACL will benefit the Australian community by giving Australian consumers the same rights and protections wherever they are in Australia.

within their businesses where needed. They may need to introduce changes, such as an alternative advertising promotion, a repackaging of a product or a change in the credit policy for customers. Whatever the change, a business must ensure it is up to date with the current laws and that it applies them to all marketing practices.

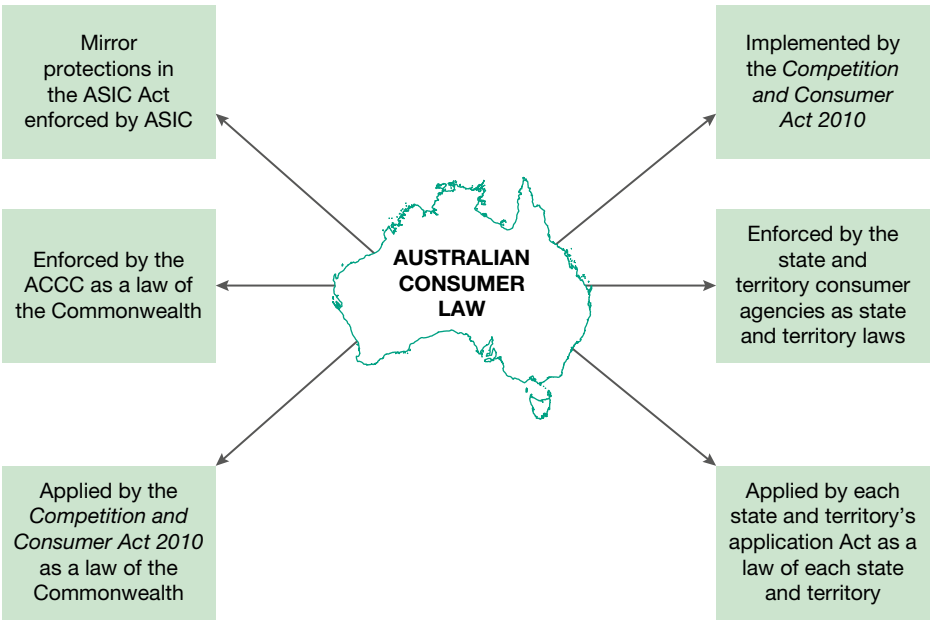


FIGURE 6.7 From 2011, the ACL replaced different national, state and territory laws that set out consumer rights and business obligations when selling goods and services with a single, national set of rules. The ACL is an application law, which will be applied and enforced as a law of each jurisdiction in Australia.

6.3.2 Competition and Consumer Act 2010

The *Competition and Consumer Act 2010* (Cwlth) — formerly the *Trade Practices Act 1974* (Cwlth) — is one of the most important pieces of legislation affecting marketing and business practices in Australia. The Act has two major purposes:

1. to protect consumers against undesirable practices, such as misrepresenting the contents of products, their place of production, and misleading and deceptive advertising
2. to regulate certain trade practices that restrict competition. The government also wants to ensure a number of businesses are operating at any one time in the same market to encourage competition.

The Competition and Consumer Act (CCA) applies to virtually all businesses in Australia, including the commercial activities of government. The CCA is enforced and administered by the Australian Competition and Consumer Commission (ACCC), each state and territory's consumer agency, and the Australian Securities and Investments Commission (ASIC) in respect of financial services.

BizFACT

One of the main roles of the ACCC is to pursue complaints regarding breaches of the Competition and Consumer Act. Some of the ACCC's leading cases from 2016 were against Colgate-Palmolive, Australia and New Zealand Banking Group Limited (ANZ), Macquarie Bank Ltd (Macquarie), Flight Centre, Medibank, Reckitt Benckiser (manufacturer of Nurofen) and Woolworths Ltd.

Breaches of the Act

A breach of any of the consumer protection provisions of the Competition and Consumer Act can result in the ACCC — or the relevant consumer agency — taking civil or criminal proceedings against the business or individual concerned. The CCA allows the courts to impose penalties of up to $1.1 million for companies and $220 000 for individuals for **unconscionable conduct** and other breaches of the Act. In addition, the consumer can sue the business for compensation. When legal fees and the damage to the business's reputation are included, the cost of breaching the CCA can be substantial.

BizWORD

Unconscionable conduct *is any practice by a business that is not reasonable and often illegal.*

The ACCC now has the power to issue an on-the-spot infringement notice (fine) to manufacturers making false claims about their products. The changes mean that the ACCC can fine a company up to $12 600 (or $126 000 for a listed corporation) and an individual up to $2520 for each infringement of the CCA without having to undertake court action.

The ACCC can also now issue 'public warning notices' to warn consumers of suspected illegal activity. Previously, the ACCC had to gather evidence and then seek a temporary court injunction (ban), while the suspected illegal activity continued.

Businesses must ensure that they are up to date with the current laws and that they apply them to all marketing practices. The following are some of the undesirable and misleading practices that are illegal under the Competition and Consumer Act.

6.3.3 Deceptive and misleading advertising

Of all the unfair trading practices, false or misleading advertising can be the most serious because of the influential nature of advertising. Advertisements must not use words that are deceptive or claim that a product has some specific quality when it does not. Such actions convey a false impression of the exact nature of the product. Even though the Competition and Consumer Act makes deceptive or misleading advertising illegal, a number of methods are still used by some businesses. Examples of deceptive and misleading advertising under the Competition and Consumer Act include:

- *fine print*. Important conditions are written in a small-sized print and are therefore difficult to read.
- *before and after advertisements*. Consumers may be misled by 'before' and 'after' advertisements, where the comparison is distorted so that 'before' images are worsened and 'after' images enhanced.
- *tests and surveys*. Some advertisements make unsubstantiated claims; for example, stating '9 out of 10 people' prefer a product when no survey has been conducted.
- *country of origin*. Accuracy in labelling is important; for example, 'made in Australia' and 'product of Australia' have two distinct meanings.
- *packaging*. The size and shape of the package may give a misleading impression of the contents.
- *special offer*. Advertisements may be misleading or deceptive if they imply that a special offer is available for only a limited period, when in fact the offer is continuously available.



FIGURE 6.8 In 2017, the Federal Court fined Virgin $200 000 and Jetstar $545 000 for breaching the ACL. The court found that specific advertised airfares displayed on their websites and mobile sites were false or misleading. Jetstar and Virgin's 'drip pricing' techniques drew consumers into an online purchase process with a headline price, but failed to adequately disclose the additional fees and charges that would apply.

BizFACT

The ACL is currently being reviewed due to the relatively low penalties that have been imposed on companies for breaches. Choice has argued that fines under the ACL are too low to act as a strong deterrent against corporate misbehaviour because they are only a fraction of what a large company can make from misleading their customers. Under legislative changes maximum financial penalties would be increased from $1.1 million to at least $10 million per breach.

BizFACT

In 2016, the Federal Court ordered Snowdale Holdings Pty Ltd to pay a penalty of $750 000 for making false and misleading representations that their eggs were 'free range' after discovering that most of their hens were not able to go outside due to the farming conditions.

BizWORD

Bait and switch advertising *involves advertising a few products at reduced and, therefore, enticing prices to attract customers. When the advertised products quickly run out, customers are directed to higher priced items.*

Dishonest advertising *is when an advertisement uses words that are deceptive or claims that a product has some specific quality when it does not.*

Two of the most common deceptive and misleading advertising techniques are:

- ***bait and switch advertising***. This involves advertising a few products at reduced and, therefore, enticing prices to attract customers. When the advertised products quickly run out, customers are directed to higher priced items.
- ***dishonest advertising***. Advertisements must not use words that are deceptive or claim that a product has some specific quality when it does not. Such actions convey a false impression of the exact nature of the product (see the following Snapshot). As well, price reduction, specials or free-gift offers must all be genuine. Advertisements that could deceive, even though no one may actually be deceived, are also to be avoided.

SNAPSHOT



'. . . fined $6 million for misleading consumers.'

Case study: Nurofen — misleading consumers

In December 2017, the makers of Nurofen were fined $6 million for misleading consumers. The Australian Competition and Consumer Commission (ACCC) took the pharmaceutical giant Reckitt Benckiser, the manufacturer of Nurofen, to court for its Specific Pain products. The ACCC alleged that their packaging and website highlighting back pain, period pain, migraines and tension headaches painkillers, misled consumers into thinking the tablets were each formulated to specifically treat different kinds of pain despite the tablets being chemically identical.

In addition, while Nurofen Specific Pain products were similar to the other standard Nurofen tablets, the ACCC discovered that the retail price for this range was significantly higher than other comparable products and were double the price of Nurofen's standard tablets.

The ACCC alleged that the representations made by the company were false and misleading because the tablets in all four of their Specific Pain range were identical and contained the same active ingredient despite claiming on their packaging to treat different kinds of pain. The active ingredient used in their Specific Pain products treat a wide variety of pain conditions and were not more effective at treating the specific type of pain described on their packaging and website than other Nurofen products.

Reckitt Benckiser must now pay a $6 million dollar fine as well as the ACCC's legal costs. This is the highest corporate penalty awarded for misleading conduct under Australian consumer law. The Federal court imposed this penalty due to the substantial consumer loss suffered and the need for deterrence. The ACCC was satisfied with the outcome given the longstanding and widespread nature of the conduct as well as the significant sales and profits that were generated from these products.

SNAPSHOT QUESTIONS

1. **Why** was Reckitt Benckiser fined?
2. **Assess** the impact this decision will have on the company, shareholders, customers and competitors.

BizWORD

Price discrimination *is the setting of different prices for a product in separate markets.*

6.3.4 Price discrimination

Price discrimination is the setting of different prices for a product in separate markets. The difference in price is possible because:

- the markets are geographically separated, for example city and country prices
- there is product differentiation within the one market, for example different electricity prices for domestic and business users.

The Competition and Consumer Act prohibits price discrimination if the discrimination could substantially reduce competition. This prohibition also applies to discounts given, credits, rebates, services and payment arrangements. This means that a business cannot give favoured treatment to some customers while denying it to others. Price discrimination is legal in some circumstances, however; for example, if differences exist in the cost of getting the product to different markets and if there are slight differences in the product itself.

Case study: Uber — price discrimination

Uber is changing the way it calculates fares, moving to a system that charges what customers are "willing to pay", based on factors like whether you are travelling to a wealthy suburb. But while this change has been met with mild outrage, it is actually a very common practice called "price discrimination".

Price discrimination is a firm's attempt to capture the difference between the value a consumer puts on a product and how much they actually pay. Firms do this by charging different prices to different consumers and exploiting differences in willingness to pay.

While this sounds like it comes at the expense of consumers, economic theory shows that society as a whole can benefit if certain conditions are met. For example, if Uber's new pricing means it can enter new markets or reduce customer waiting times, price discrimination could increase society's overall welfare.

Price discrimination takes many forms, such as Coca-Cola's infamous vending machines that increase soft drink prices as the outside temperature increases, or charging more for pink razors.

Cheap movie tickets on Tuesdays are another example of price discrimination, as are the different priced tickets at the theatre and concerts. Pharmaceutical companies charge different prices in different countries, and car dealers negotiate and give out discounts.

The airline industry is often regarded as the champion of price discrimination. It price discriminates on almost every aspect of a fare - from the time a booking is made to the type of seat booked, and, of course, the actual route flown.

The only surprise is that Uber hasn't implemented such a system before now. Its success has, in large part, been driven by a business model that so cleverly mimics a free-functioning market, notably with its "surge pricing".

What is price discrimination?

Price discrimination is the practice of charging different "types" of consumers different prices for the same product or service.

Broadly, "type" might be based on an observable characteristic (age, gender or residency status for example) or some unobservable characteristic that is revealed through the consumer's actions or preferences (coupon discounts, early bird specials, happy hour deals and so on).

Regardless of the mechanism, the objective is to exploit the different "willingness to pay" (WTP) between consumers and thereby increase profits. WTP describes the maximum amount a consumer *would* pay for a particular product or service. Given consumers differ in incomes and other circumstances, this presents an opportunity that firms may exploit through price discrimination.

Economists generally refer to three types of price discrimination – first degree, second degree, and third degree.

First degree generates the most profit. It involves each consumer paying the maximum price they are willing to pay and the firm extracting all of their WTP.

With the exception of some internet auctions, pure first degree price discrimination isn't very common. But we can see versions of it where consumers pay a fixed fee in addition to ongoing fees (such as residential water pricing), and where a single price covers both access and (limited) consumption (such as internet services with data limits). If properly designed, these alternative pricing systems mimic first degree price discrimination by capturing the maximum profit available.

Second degree price discrimination involves providing discounts for bulk purchases. While generally not achieving the same level of profits as first degree, the profits from second degree price discrimination still dominate over simple uniform pricing (where one price is charged to all consumers).

This type of pricing doesn't require a consumer to necessarily be identified by an observable characteristic, rather they reveal their "type" through their purchases. For example, a consumer who buys a 24-pack of soft drink cans at the supermarket generally receives a discount (per can) over the shopper who buys a single can.

SNAPSHOT



'. . . the objective is to exploit the different "willingness to pay" (WTP) between consumers . . .'

Third degree price discrimination involves selling the same good or service to different segments of a market, based on willingness to pay. This is implemented using some identifiable consumer attribute, such as geography or age. An example would be train operators charging different prices to adults and students.

Price discrimination based on geography

It is this third type of price discrimination that Uber is adopting. Although some customers will object to paying different amounts for the same distance travelled, Uber is certainly not the first company to exploit a geographic dimension when it comes to pricing decisions.

Many other businesses similarly base pricing decisions on location and (implicitly) the WTP of consumers in the markets they serve. For example, cafes, restaurants and bars operating in popular tourist destinations often charge substantially more than similar venues in neighbourhood locations. Although this may, to some extent, reflect higher costs, that typically doesn't explain the entire difference.

The subtle point is what economists refer to as "net prices", which occur only when price differences for different versions of the same good are not reflected in different costs.

So is Uber's plan to charge prices according to the customers' locations something that should cause users to take to the streets in mass protest, or at the very least raise concerns of regulators? Probably not. After all, it isn't as if Uber is itself a monopoly. There are always taxis as an alternative. But, of course, the taxi industry has always been partial to a little price discrimination itself. It just isn't as good at it.

Source: Jordie McKenzie 'The economics behind Uber's new pricing model', *The Conversation*, 25 May 2017

SNAPSHOT QUESTIONS

1. **Describe** price discrimination.
2. **Outline** the three types of price discrimination.
3. **Explain** why Uber will be engaging in price discrimination.

BizWORD

Implied conditions *are the unspoken and unwritten terms of a contract.*

BizWORD

Consumer guarantees *provide consumers with rights to certain remedies from retailers and manufacturers where goods purchased fail to comply with the consumer guarantee provisions in the ACL.*

BizWORD

Acceptable quality *means that products must be safe, lasting and with no faults, look acceptable and do all the things someone would normally expect them to do.*

6.3.5 Implied conditions — consumer guarantees

Implied conditions are the unspoken and unwritten terms of a contract. These conditions are assumed to exist regardless of whether they were especially mentioned or written into a contract.

With the introduction of the *Competition and Consumer Act 2010*, new national **consumer guarantees** were introduced, which replaced the previous statutory implied conditions and warranties of the Trade Practices Act. The consumer guarantees provide consumers with rights to certain remedies from retailers and manufacturers where goods purchased fail to comply with the consumer guarantee provisions in the ACL.

Under the ACL, when you buy products and services they come with automatic guarantees that they will work and do what you asked for. If you buy something that isn't right, you have consumer rights.

The following consumer guarantees on products and services apply.

- Products must be of **acceptable quality**, that is:
  - safe, lasting, with no faults
  - look acceptable
  - do all the things someone would normally expect them to do.

Acceptable quality takes into account what would normally be expected for the type of product and cost.

- Products must also:
  - match descriptions made by the salesperson, on packaging and labels, and in promotions or advertising
  - match any demonstration model or sample you asked for
  - be fit for the purpose the business told you it would be fit for and for any purpose that you made known to the business before purchasing

  - not carry any hidden debts or extra charges
  - meet any extra promises made about performance, condition and quality, such as lifetime guarantees and money back offers
  - have spare parts and repair facilities available for a reasonable time after purchase unless you were told otherwise.
- Services must be:
  - provided with acceptable care and skill or technical knowledge and taking all necessary steps to avoid loss and damage
  - fit for the purpose or give the results that you and the business had agreed to
  - delivered within a reasonable time when there is no agreed end date.

Consumers can claim a remedy from the retailer if the products do not meet any one or more of the consumer guarantees. The retailer cannot refuse to help you by sending you to the manufacturer or importer.

Consumers can claim a remedy from the supplier if the services do not meet any of the consumer guarantees in relation to services. Remedies include cancelling a service and in some cases compensation for damages and loss.



FIGURE 6.9 Women's activewear company Lululemon was fined $32 400 for alleged false and misleading representations about consumer guarantee rights. The company made representations on their website that all sale items were 'yours for keeps, so no returns and no exchanges'. This statement suggests that consumers are not entitled to a remedy under any circumstances. Under the ACL, people are automatically entitled to a remedy if a product fails to meet a consumer guarantee or develops a fault, even if the product was purchased on sale.

6.3.6 Warranties

All businesses have certain obligations with regard to the products they sell. These obligations are designed to offer a degree of protection to the customer if the good is faulty or if the service is not carried out with due care and skill. One important obligation is to provide a warranty. A **warranty** is a promise made by a business that they will correct any defects in the goods that they produce or in the services that they deliver; that is, it is a promise to repair or replace faulty products. The use of warranties can be a good marketing tool. For example, if your business offers longer warranties than your competitors, then this will give customers the impression that your good is of superior quality.

In recent years, government legislation has made it necessary for businesses to state, clearly and simply, the terms and conditions of the warranty. A warranty assures the customer that the business has confidence in the quality of its product and will repair or replace any faulty items. A warranty can be used as an aggressive marketing tool if it includes superior options to those of a competitive product.

BizWORD

*A **warranty** is a promise made by a business that they will correct any defects in the goods they produce or services they deliver.*



FIGURE 6.10 In 2017, the ACCC initiated proceedings against Apple over allegations they misled consumers about their warranty rights under the ACL. The ACCC alleges that Apple represented to consumers with faulty products that they were not entitled to a free remedy if their device had previously been repaired by a third party (e.g. for a cracked screen), even if the repair was unrelated to the fault. Consumer guarantee rights should not be extinguished simply because a consumer had their goods repaired by a third party.

False or misleading statements concerning the existence, exclusion or certain conditions of the warranty are prohibited under the Competition and Consumer Act. In particular, the legislation clearly outlines the rights of consumers with regard to refunds and exchanges.

Refunds and exchanges (returns)

A business is required by law to offer a refund:

- if the products provided are faulty
- do not match the description or a sample
- fail to do the job they were supposed to do.

There is no obligation to offer a refund if the customer has simply changed their mind, has found the same product at a cheaper price in another store, or damage has occurred after the purchase was made.

It is also important that accurate signs regarding refunds and exchanges are displayed. Signs such as 'no refunds given' or 'no refunds on sale items' are meaningless. The Competition and Consumer Act gives consumers certain rights and remedies. A more accurate sign would read either 'no refunds given if you change your mind' or 'no refunds or exchanges unless your purchase is defective'.

studyon

Syllabus area 2 | Topic 2 | Concept 2

Consumer laws
Summary screen and practice questions

SUMMARY

- In 2011, a single, national consumer law — the Australian Consumer Law (ACL) — was introduced.
- *The Competition and Consumer Act 2010* protects consumers against undesirable business practices and prohibits various unfair (restrictive) business practices.
- The Competition and Consumer Act is administered and enforced by the Australian Competition and Consumer Commission (ACCC) and relevant state and territory consumer agencies.
- Breaches of the Competition and Consumer Act can result in the ACCC taking civil proceedings against the business or individual engaged in unconscionable conduct.
- The main restrictive trade practices are:
  - deceptive and misleading advertising — creating a false impression in an attempt to influence customers

  - price discrimination — the setting of different prices for a product in separate markets.
- The Australian Consumer Law introduced a single set of statutory consumer guarantees that replaced the previous system of implied conditions and warranties.
- Implied conditions are unspoken and/or unwritten terms of a contract.
- Consumer guarantees provide consumers with rights to certain remedies from retailers and manufacturers where goods purchased fail to comply with the consumer guarantee provisions in the ACL.
- A warranty is a promise to repair or replace faulty products.
- A business is required by law to offer a refund if the products provided:
  - are faulty
  - do not match the description or a sample
  - fail to do the job they were supposed to do.

EXERCISE 6.2 REVISION

1 **Why** should marketers be familiar with consumer laws?

2 **State** the two main aims of the Competition and Consumer Act.

3 **Recall** the federal government authority that administers and enforces the Competition and Consumer Act.

4 **Define** the term 'unconscionable conduct'.

5 **Summarise** the penalties that can be applied for breaches of the Competition and Consumer Act.

6 **Discuss** the advantages of the ACCC being able to issue on-the-spot infringement notices and public warning notices.

7 **Explain** why it is important for a marketer to comply with the consumer protection provisions of the Competition and Consumer Act.

8 In small groups:
(a) **discuss** whether the fines for business owners who breach the Competition and Consumer Act are adequate.
(b) **propose** some alternative punishments.
Select a spokesperson to present your responses to the rest of the class.

9 Select what you consider to be the two most serious examples of deceptive and misleading advertising. **Justify** your selection.

10 In each of the following examples, **state** whether there has been a breach of the Competition and Consumer Act. If so, **describe** the type of breach found.
(a) A company advertises a particular brand of television and states that it is at a cheaper price than a competitor. This statement is false.
(b) A company advertises jumpers and claims that they are made in Australia, when in fact they are made in Hong Kong.
(c) A company offers its customers a 10 per cent discount if they provide the names and addresses of five potential customers for the company.
(d) A company advertises that the special deal is for one week only, when in fact it plans to extend it to two months.
(e) A company advertises a motor vehicle as having low mileage, when in fact it has travelled 200 000 kilometres.

11 **State** under what circumstances price discrimination is considered a breach of the Competition and Consumer Act.

12 (a) **Define** the term 'consumer guarantees'.
(b) **Identify** the features a product must possess to be considered of acceptable quality.

13 **Distinguish** between a warranty and a refund.

14 **Identify** under what circumstances a business is required to offer a refund.

15 **Why** are disagreements over warranties and refunds a common source of consumer complaints?

EXERCISE 6.2 EXTENSION

1. Arrange for a representative from the Consumer, Trader and Tenancy Tribunal (CTTT) or the New South Wales Department of Fair Trading to address your class about the role of consumer laws and their impact upon marketing strategies. **Create** a list of interview questions and send them to the representative before the visit. After the visit, **construct** a report and arrange for a copy to be sent to the representative.
2. Go to the **Australian Competition and Consumer Commission (ACCC)** website.
   (a) **Summarise** the role and major activities of the ACCC.
   (b) Select a recent news release that interests you and **evaluate** the response of the ACCC.
3. You have been employed as a business reporter with the local newspaper. Your editor has asked you to **create** a 300-word article about bait and switch advertising scams. The headline of your article is 'Don't get hooked — the bait and switch scam'. To help you commence your investigation, find case studies from NSW Fair Trading. Share your article with other class members.

on Resources

- **Weblink:** Australian Competition and Consumer Commission (ACCC)
- **Weblink:** NSW Fair Trading 2

6.4 Ethical influences

In marketing, as with all business practices, there are ethical and legal dilemmas involved. Although the many laws regulating marketing strategies prescribe legal standards, ethical standards are more difficult to define. Ethical behaviour refers to conduct that goes beyond the legal requirements. While some of the marketing strategies outlined below might be legal, they are still considered wrong or unethical.

6.4.1 Ethical criticisms of marketing

Critics of marketing argue that the industry does not always adopt ethical practices. They believe it often blurs the lines between what is ethically right and wrong. The main ethical criticisms of marketing include the following.

1. *Creation of needs — materialism.* **Materialism** is an individual's desire to constantly acquire possessions. Critics of product promotion feel that most businesses, especially large businesses, use sophisticated and powerful promotional strategies (particularly advertisements) to persuade and manipulate customers to buy whatever the firm wants to sell.
2. *Stereotypical images of males and females.* In most advertisements it tends to be the male who uses the power tools, or who watches sport with his mates. Females, on the other hand, are portrayed preparing meals, cleaning the house or caring for the children.
3. *Use of sex to sell products.* There is often an overuse of sexual themes and connotations to sell products. Unrealistic images are portrayed as attainable. Advertisers use sex appeal to suggest to consumers that the product will increase the attractiveness or charm of the user. Although many people are sceptical of such claims, advertisements that use sex appeal can have subtle and persuasive impacts (see figure 6.11).
4. *Product placement.* The inclusion of advertising in entertainment is a promotion strategy referred to as **product placement**. Generally, the insertion of these products is subtle: an Omega watch on the celebrity's arm or an Apple laptop when a computer is used; while at other times they are prominently displayed. Businesses are keen to use this promotional technique because it allows them to reach savvy, but advertisement-weary, consumers. However, critics of product placement argue that, because of its 'concealed' nature, this type of advertising blurs the line between what is advertising and what is entertainment.

BizWORD

Materialism *is an individual's desire to constantly acquire possessions.*

BizFACT

From 2018, TV advertisements that play on gender stereotypes, or that mock people who fail to conform to them, will not be permitted by the UK's Advertising Standards Authority. There have been calls for Australia to follow suit.

BizFACT

Dell, Samsung, Apple, Ford and Chevrolet got the most value out of product placements in 2016. They each received an advertising value of between US$6–16 million. Ford appeared in more movies than any other brand.

BizWORD

Product placement *is the inclusion of advertising in entertainment.*

5. *Invasion of privacy*. The recent growth in online advertising is raising a number of ethical issues, with the most serious being the tracking of web users and using this information to target them with advertisements. Collection of data in this way may breach consumer privacy. Presently, because most websites infer consent (the consumer agrees to their web searches being tracked unless the person opts out by ticking a box), many consumers are unaware that data is being collected on them. This behavioural data is collected and resold by data exchange companies and then used by businesses for target advertising purposes.

Ultimately, marketing managers should never forget that the business exists because of its customers. By satisfying customers a business may operate profitably. Dishonest or unethical marketing strategies eventually drive customers away.

BizFACT

Many consumers overlook the fact that loyalty cards collect information on their individual buying habits. Do you really want your supermarket to know what you drink or how often? Or are you prepared to sacrifice this privacy for the benefits a reward program offers?



FIGURE 6.11 In 2017, Billabong was criticised for their use of stereotypical images on their website to promote their apparel. The photos of men were of them actually surfing, while the company used sexualised images of women for their female apparel. This sexualisation negatively affects perceptions of women's talent and ability as well as their psyche. It perpetuates the idea that surfing is a male sport and that a woman's place is frolicking around on the beach.

6.4.2 Truth and accuracy in advertising

Advertising can represent real ethical dilemmas. Exaggeration in advertising seems to be the rule of thumb. You need only to watch TV, listen to the radio or read magazines to see examples of over-the-top advertisements. Ethical businesses should ensure their advertising is truthful as they can be held morally responsible for misleading the public by using an untruth in an advertisement. For example, the use of terms such as 'special', 'great value', 'low fat', 'light' and 'once in a lifetime' can be interpreted in many different ways (see figure 6.12 and the following Snapshot).

The main unethical marketing practices include untruths due to concealed facts, exaggerated claims, vague statements and invasion of privacy.

BizWORD

Advertising *is a paid, non-personal message communicated through a mass medium.*



FIGURE 6.12 When you look at product labels, you may think 'low fat', 'reduced fat', 'fat free' or 'light' are going to be healthier options, but quite the opposite is true. Just because a product is labelled in this way, doesn't mean that it's lower in calories. In fact, most low fat foods will add sugar, refined carbohydrates and chemicals to make up for the loss in taste. Many companies market their foods in this way to increase sales from people who think they can eat twice as much as before and not worry about gaining weight.

SNAPSHOT



'The marketer may interpret the word "special" to mean that the product has a distinct or particular character . . .'

Advertising — what does 'special' mean?

What precisely does the word 'special' mean when it is displayed above a product for sale? Most customers would take this to mean the item is for sale at a cheaper than normal price. However, this may not necessarily be the case. The marketer may interpret the word 'special' to mean that the product has a distinct or particular character, that it can perform a particular function, or that it is different from what is ordinary or usual. The interpretations can easily be confused. If the marketer uses this word attempting to knowingly mislead customers, then this would be classified as unethical behaviour. If the marketer wants to advertise the fact that the product is available at a bargain price, then the words 'on special' would have a clearer meaning.

When consumers discover that advertisements are untrue or inaccurate, they may feel cheated and stop buying the product. They may also decide to complain to the relevant government agencies, in which case the bad publicity this generates can do untold long-term damage to a business's reputation.

SNAPSHOT QUESTIONS

1. **Outline** how you would interpret the word 'special' if you saw it displayed above a particular product.
2. **Explain** why the use of the word 'special' might be considered unethical.
3. **Discuss** the impact if a business creates advertisements that are untrue or inaccurate.

Untruths due to concealed facts

Many customers are aware that advertising takes liberties with the 'truth'; they do not perceive advertisements to be believable or honest. An advertised product may not make a consumer more successful, glamorous, sexy, happy, healthy or wealthy. However, the unethical practice of concealed facts — pieces of information purposefully omitted from an advertisement — can severely harm the trust customers have in a product or a business.

Exaggerated claims

Exaggerated claims — referred to as **puffery** — cannot be proved. For example, a claim that a certain shampoo or toilet paper is superior to any other on the market cannot be confirmed by consumers. In a recent example, a brand of sparkling mineral water advertised the fact that the bubbles were 'natural' and bottled at source. This was shown to be misleading for the bubbles were added later during the bottling process.

BizWORD

Puffery *is exaggerated praise or flattery, especially when used for promotional purposes, that no reasonable person would take as factual.*

Vague statements

Another type of unethical advertising practice involves the use of vague statements — statements using words so ambiguous that the consumer will assume the advertiser's intended message. These 'weasel' words — deliberately misleading or ambiguous language — are by their nature vague and allow the marketer to deny any intention to mislead or deceive. For example, *helps* is a common weasel word, as in 'helps fight against', 'helps restore' or 'helps to make you feel'. Although some marketers regard such statements as acceptable, others do not.

6.4.3 Good taste in advertising

What is considered to be in 'good taste' is highly subjective. Some consumers may regard an advertisement as offensive, while others might view it as inoffensive. For example, Italy's largest clothing manufacturer, The Benetton Group, prides itself on creating advertisements and advertising campaigns that are unique, artistic, occasionally confronting and centred on passing a comment about a contemporary issue. There is usually common agreement as to what society considers acceptable and marketers must be aware of community sensitivities. Many consumers would regard The Benetton Group advertisements as highly creative and inoffensive.

However, as with many creative pursuits, and advertising is no exception, there are always some marketers wanting to push the boundaries. Nivea was recently forced to pull an advertisement after it was the subject of intense consumer backlash. The skin-care brand shared an advertisement on it's Facebook page for its 'invisible' antiperspirant, which showed a photograph of a woman with dark hair sitting in a white robe, taken from behind her. Underneath the image was the slogan in all caps WHITE IS PURITY. The company was forced to remove the advertisement the same day after a number of social media users complained about the post's racist connotations due to Nivea's assertion of whiteness being 'pure'. While Nivea alleged the ad was only intended to be posted to its Nivea Middle East page, they still withdrew the ad after a large number of people protested and hijacked the online campaign.



FIGURE 6.13 In 2016, one of the most complained about ads was from BCF (Boat Camping Fishing). The ad showed a group of men, women and children enjoying outdoor activities, accompanied by the jingle 'Boating, camping, fishing is BCFing fun'. The ad was not considered to be in good taste and received 248 complaints due to the use of inappropriate language.

Within society, there is recognition of the growing role that mass media is playing in children's lives, and the fact that advertisers and marketers are now targeting children more than ever. One area of marketing to children that has received widespread publicity in Australia in recent years is the sexualisation of children in advertising. According to the Australia Institute, a leading progressive Australian think tank, sexualisation of children in the media 'leads to a range of risks for children'. In their report *Letting Children be Children*, they highlight that premature sexualisation of children can result in increased risk of depression, self-esteem and identity disorders, and premature sexual activity.

BizFACT

Fairfax Media's subsidiary Domain was sued by their main competitor REA Group (who runs Realestate.com.au) over their advertising campaign in 2016, which claimed that Domain was 'the highest rated property app' with the 'best property listings'. The judge in the Federal Court ruled that most of the content did not breach consumer laws and were entirely reasonable claims or just 'advertising puffery'.

BizFACT

In 1976 the Australian Government banned all forms of electronic and print advertising of cigarettes.

SNAPSHOT



‘Critics said the ads . . . would put women off going to UltraTune stores’

Case study: UltraTune criticised for ‘sexist’ rubber catsuit ad campaign

Car service franchise UltraTune has been criticised on social media for the latest in a series of advertisements featuring rubber-clad models, with complaints they show “gratuitous sexualisation”.

Critics said the ads, featuring two women dressed in rubber catsuits, would put women off going to UltraTune stores.

But Ultratune executive chairman Sean Buckley told the ABC the ads were a bit of fun that people have taken too seriously.

Both ads feature a voiceover read by a male with a deep voice.

One advertises a competition to win tickets to Wimbledon and has a voiceover saying “Get into rubber and get into Wimbledon” while showing the two models posing with tennis racquets.

The other, for a tyre brand, has a voiceover saying “We’re into rubber” and shows the rubber-clad pair posing with an impact wrench and a four-way lug wrench.

A television ad, published on YouTube on January 8, has the tagline “avoid unexpected situations” and shows the same women driving a car that stops on a level crossing.

The car is destroyed by a train, but the women, wearing knee-length dresses, are shown walking away from the burning vehicle.

“They’re joking, fun, humorous, have some Hollywood theatrics,” Mr Buckley told the ABC.

He said the level crossing ad was designed to highlight dangerous situations that could result if a vehicle was not maintained, and were meant to attract attention.

“I agree we’ve copped some flak, but the idea we would want to alienate part of our customer base, that’s just ridiculous,” he said.

“People should lighten up.”

One comment on YouTube said although there were very good mechanics at UltraTune, the advertisements may be alienating women.

The post, by Chris Van Wyk, said: “Maybe you should try to appeal to people who traditionally don’t work on their cars themselves, maybe, for example, make Ultratune seem appealing to young women who are often apprehensive about going to the mechanic alone as they often feel they are being ripped off or taken advantage of.

“You could show how your businesses are actually safe and respectful places, where women and female customers will be treated as equals rather than as things to be leered at and made fun of.”

On Twitter, Coralie Alison from Collective Shout, an organisation campaigning about the objectification and sexualisation of girls in media and advertising, posted a poll asking if the Nexen ad should be binned.

After 24 hours, 79 per cent of 115 votes were for the removal of the ad.

Some Facebook users also accused UltraTune of deleting their posts, and warned other users that the same would happen to them.

Natalie Cargill said she made a post which was no longer visible.

She said she would repeat her deleted post, describing the level crossing ad as having “a very low level of human decency”.

Mr Buckley said the only comments removed from Facebook contained directly offensive language including the terms “whores” and “prostitutes”, and that “we’re not going to put up with insults to staff made by keyboard warriors.”

Previous ads cleared by Advertising Standards Board

The company is no stranger to criticism over its advertising.

In 2014, a televised ad showing two women demanding service at an UltraTune dealership while dressed in a rubber catsuit and a rubber dress was investigated by the Advertising Standards Board (ASB).

UltraTune responded to the complaints saying that the ad was filmed in black and white to emphasise that it was deliberately exaggerated and unrealistic in its

nature, that the women are fully clothed, in full control and in a position of power and authority at all times, and that the ad was "tongue in cheek".

Mr Buckley said UltraTune wanted a controversial ad to draw attention to its tyre business after investing heavily in new equipment and securing new suppliers, and "we certainly got that."

The advertisement received 181 complaints, making it the sixth most complained about ad of the year.

Mr Buckley said the use of rubber costumes in the 2014 ad was to draw attention to the tyres, and the same was true of the new ads.

He said the company has grown its tyre sales substantially since the ad was broadcast.

The ASB cleared the ad, saying that the actions of the women were "exaggerated and unrealistic in a humorous way and are only mildly sexually suggestive".

In January 2015 the ASB dismissed complaints against pop-up advertising on the UltraTune website, referring to the 2014 ruling and repeating its findings.

The pop-up ads showed the same women in a range of outfits and including text such as "So what's stopping you?" while advertising tyres, and "You're looking hot and bothered" while advertising airconditioning servicing.

Source: Jonathan Hepburn, 'UltraTune criticised for 'sexist' rubber catsuit ad campaign; company denies alienating female drivers', ABC.net.au, 25 January 2016

SNAPSHOT QUESTIONS

1. **Outline** why UltraTune been criticised?
2. **Explain** the impact these ads have had on UltraTune.
3. **Describe** UltraTune's justification for the ads.
4. **Demonstrate** the difference between legal compliance and ethical responsibility using UltraTune as an example.
5. **Recommend** some ways that people could demonstrate their opposition to UltraTune.
6. Imagine you are a reporter for a current affairs program. **Construct** interview questions you could ask the CEO of UltraTune in relation to their marketing.

6.4.4 Products that may damage health

The marketing of junk food, which is often portrayed as an essential part of a balanced diet, is an area presently being criticised by nutritionists and health advocates, especially as childhood obesity rates approach epidemic proportions (see figure 6.14).

Nutritionists argue that the self-regulatory advertising codes, such as the *Responsible Children's Marketing Initiative* and the *Australian Quick Service Restaurant Industry Initiative for Responsible Advertising and Marketing to Children* (which allow fast-food companies to advertise certain products in children's television programs only if they meet specific nutritional guidelines) aimed at reducing junk-food marketing, are not working. For example, only advertisements screened during designated children's programs or 'designed for children' are covered by the code of nutritional guidelines. It does not, however, cover television programs popular with children, such as *Neighbours* and *Home & Away*, and fast-food companies.

As well as industry established codes, the federal government sets restrictions on children's advertising. In Australia, no advertising is allowed during programs for pre-school children.

Digital advertising of junk food to children

The proliferation of smartphone apps and social-networking sites such as Facebook, Bebo, Twitter and MySpace provide marketers with new and largely unregulated ways of advertising junk food to children. This form of advertising raises new ethical issues (see the following Snapshot).

BizFACT

The ACCC initiated proceedings against Heinz in relation to their Little Kids Shredz products alleging Heinz made false and misleading representations about these products being healthy options for young children despite the fact they contain over 60 per cent sugar. The ACCC alleges that the images on their packages of fresh fruit and vegetables, as well as statements such as '99% fruit and veg' and 'nutritious foods' represent to consumers that the products are of equivalent nutritional value to fruit and vegetables.

BizFACT

Leading health organisations have been lobbying the government to introduce a 20 per cent tax on sugary drinks to tackle obesity, which they believe poses a greater risk to the nation than smoking. They also want unhealthy food advertising on free-to-air television to be banned between 5.30 pm and 9.30 pm when the greatest numbers of children are watching.



FIGURE 6.14 To achieve their aim of slashing sugar by 10 per cent across their best selling products by 2018, Nestlé recently tweaked the ingredients and reduced the sugar content of KitKats, claiming consumers won't be able to taste the difference.

SNAPSHOT



'Children . . . an easy target for marketers.'

BizFACT

One-in-three television advertisements during children's program times in Australia is for food that is high in fats, sugars and salt.

BizFACT

There has been a sharp increase in mobile and smartphone ownership by Australian children. Research released by Telstra in 2015 revealed that 68 per cent of children aged 3 to 17 own a smartphone and spend an average of 21 hours and 48 minutes per week on the devices. More than half of those who own smartphones also own a tablet.

'app'alling marketing

The Parents Jury Fame and Shame Awards are held yearly to name the best and worst examples of food advertising aimed at children. The awards aim to raise awareness of the persuasive and misleading tactics marketers use to target young consumers.

The Shame Award for Pester Power is awarded to food marketing campaigns that use techniques to appeal to children, leading them to nag their parents for unhealthy food. In 2017, Coca-Cola's 'Brotherly Love' television commercial took out this award. This ad features a young boy and his relationship with his cool, Coke-drinking big brother. The ad attracted a number of complaints around issues surrounding marketing sugary drinks to children and condoning bullying.

McDonald's has frequently won the Pester Power award and in 2015 they were named 'the worst of the decade' for being the company that was most often nominated for marketing junk food to kids over the previous 10 years. They are usually nominated for these awards due to the marketing of their Happy Meals.

In 2012, a new award was introduced — the Digital Ninja Award — to address the growing concern about industry use of digital marketing targeted to children and teens. This award is given to a brand that has used digital media in the most obvious way to target children, gaining their attention and driving active participation in the brand, encouraging pester power. Children now have access to multiple forms of social and digital media, which has made them an easy target for marketers.

In 2016, Milo took out the Digital Ninja Award for their MILO Champions activity tracker and app aimed at children aged 6 to 12 years. The activity tracker syncs with the MILO Champions app, tracking activity and nutrition, leading children to believe that MILO is an integral part of healthy living despite being almost 50 per cent sugar. In 2015, McDonald's won this award for their Happy Readers promotion. In 2014, there was a tie between Coca-Cola Amatil's Fanta Flavour Lab, which rewarded children with points for purchases, and McDonald's Emlings app targeted at children aged 4 to 8 years. Prior to that KFC's Snack in the Face app took out the prize in 2013. The inaugural winners in 2012 were Chupa Chups' Lol-a-coaster and Hungry Jack's Makes it Better apps.

SNAPSHOT QUESTIONS

1. **Outline** the role of the Parents Jury Fame and Shame Awards.
2. **Summarise** previous winners of the awards.
3. **Examine** why ethical behaviour is important and the impact these awards have on the recipients.

6.4.5 Engaging in fair competition

Competition in the marketplace is a fact of life. Businesses compete against each other to attract the greatest number of customers. Those businesses that compete successfully will usually increase their sales revenue and profit.



FIGURE 6.15 Telstra was fined $18.5 million for blocking their competitors from installing broadband equipment at their telephone exchanges, which they are legally required to do under their carrier licence. Their competitors need access to Telstra exchanges to install their own broadband infrastructure. Telstra told their competitors there wasn't any room at the exchanges and took unreasonable lengths of time to grant them access, which limited their ability to compete in the broadband market.

The amount of competition in the marketplace can be intense so there is a temptation for some businesses to engage in unfair marketing strategies. For example, businesses should be fair when referring to their competitors in their marketing and their advertisements should not insult or make false assertions towards their competitors.

The *Competition and Consumer Act 2010* requires businesses to compete fairly and contains provisions relating to fair competition. Part IV of the Act aims to deter certain anti-competitive behaviour that limits or prevents competition.

Some examples of anti-competitive conduct that is prohibited include the following.

- *Cartel conduct.* A cartel exists when businesses agree to act together instead of competing against one another. This agreement is designed to increase the profits of the cartel members while putting other companies out of business. For example, it is illegal for competitors to agree to fix, control or maintain prices.
- *Anti-competitive agreements.* Contracts or arrangements containing provisions that substantially lessen competition in a market are prohibited.
- *Misuse of market power.* This prohibits corporations who have a substantial degree of market power from taking advantage of that market power for the purpose of damaging a competitor or to prevent a business from entering into the market.
- *Exclusive dealing.* This occurs when one person or business trades with another and then imposes restrictions on them; for example, where a business will only supply products on the condition that the purchaser agrees to buy goods or services from a particular third party.
- *Resale price maintenance.* Suppliers can recommend that resellers charge a certain price for particular products; however, they cannot stop resellers from charging below that price. It is illegal for suppliers to pressure other businesses to charge their recommended retail price or to stop them from selling goods or services below a specified price.
- *Mergers.* While most mergers are legal and can be very beneficial, they are prohibited if it can be demonstrated that they have the effect of substantially lessening competition in a market.

6.4.6 Sugging

Have you ever been approached by someone in a shopping centre and asked to complete a short survey? Perhaps you have been contacted by telephone and surveyed about a particular product only to discover the person was really trying to sell you something? If so, then you have just been 'sugged'. **Sugging**, **s**elling **u**nder the **g**uise of a **s**urvey, is a sales technique disguised as market research.

BizWORD

Sugging, ***s****elling* ***u****nder the* ***g****uise of a* ***s****urvey, is a sales technique disguised as market research.*



FIGURE 6.16 The Australian Market & Social Research Society Limited (AMSRS) is a not-for-profit organisation dedicated to increasing the standard of market and social research in Australia. If you are unsure about whether a survey was genuine market research you can visit the AMSRS website to check if the company is a recognised research organisation. They also investigate complaints and can issue sanctions for those companies found to be sugging.

BizFACT

Three questions you could ask to determine if a call is a legitimate survey are:

1. *Are you selling anything?*
2. *Will my participation in this survey result in anyone contacting me to try to sell me anything?*
3. *Will my name and personal information be sold or provided to anyone who will contact me to try to sell me anything?*

BizWORD

Self-regulation *is a system by which a business or industry controls its own activities rather than being publicly regulated by an outside organisation such as the government.*

BizFACT

A complaint about a Bakers Delight advertisement was upheld by the Advertising Standards Board (ASB). The advertisement depicted a four-pack of finger buns covered in M&Ms beneath the wording 'School lunches? Problem solved'. The ASB found that the ad undermined the promotion of healthy balanced diets and breached a section of the AANA Food Code.

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Syllabus area 2
Topic 2
Concept 3

Ethical influences
Summary screen and practice questions

Although this technique is not illegal, it does raise several ethical issues, including invasion of privacy and deception.

Sugging also has long-term negative consequences for market research. The cooperation of consumers is becoming more difficult with response rates to surveys and questionnaires steadily declining. Current indications are that about one-third of individuals now refuse to participate in telephone, online and personal surveys because of suspicion that the survey is really a case of sugging.

6.4.7 A marketing code of ethics

In 2012 a code of ethics was developed for marketers in relation to advertising — the Australian Association of National Advertisers (AANA) Code of Ethics 2012. If consumers feel that an advertisement breaches the code, they can make a complaint to the Advertising Standards Bureau (ASB). The role of the ASB is to ensure that the Code of Ethics is followed. They do this by administering a national system of advertising **self-regulation** through the Advertising Standards Board and the Advertising Claims Board. Both of these boards are part of the dispute resolution mechanism that deals with consumer complaints about most forms of advertising.

Consumers can complain to the ASB who will then consider and assesses any complaints in light of the codes. They then reach a decision by way of simple majority. If a complaint is upheld, then the advertiser is requested to remove or amend the offending advertisement as soon as possible.

Many consumer organisations argue that a self-regulatory system for advertising standards is ineffective because the ASB lacks the authority to enforce the Code of Ethics. The critics believe that advertising standards should be regulated by the government, otherwise there may be a temptation by marketers to ignore industry-established guidelines.

6.4.8 The importance of ethical behaviour

Why is ethical behaviour important? The benefits of ethical behaviour are becoming increasingly evident and include the following.

- Ethical behaviour can lead to significant marketing and business opportunities. Ethical businesses enjoy regular publicity in the media, in journals and on the internet. This creates a positive image of the business.
- Ethical behaviour can attract customers to the business and increase customer loyalty. Customers will reward ethical businesses by purchasing more of their products. An increasing number of consumers are becoming more ethically minded and will actively purchase products or brands that they believe are ethical. This in turn leads to increasing sales and profits.
- It can have a positive effect on employment relations. Productivity, staff retention and absenteeism rates can improve as more employees will want to stay with the business. It will also enable the business to attract the most talented employees.
- It may attract more investors and be more appealing to stakeholders.
- Ethical behaviour can improve a business's reputation.

Customers eventually find out which businesses are acting ethically and which are not. Unethical behaviour, by comparison, will go against the company's image and may damage a business's reputation. Customers may react and boycott certain products if they learn that the business is acting unethically. There have been many examples of businesses who have acted unethically, leading to negative publicity and a refusal by certain customers to purchase products from them. Unethical behaviour may also make the business less appealing to stakeholders.

6.4.9 The importance of government regulation

Why is government regulation important? Government regulations relating to marketing are important as they:

- protect consumers
- protect businesses
- increase consumer trust and confidence in businesses. This results in people buying more products, which is good for the economy
- promote and stimulate competition and fair trade, which benefits consumers, businesses and the community in general
- encourage businesses to do the right thing
- promote competition and creates a more equal playing field.

SUMMARY

- Critics of marketing argue that the industry does not always adopt ethical practices and that it sometimes blurs the lines between what is ethically right and wrong.
- The main ethical criticisms include:
  - creation of needs — materialism
  - stereotypical images of males and females
  - use of sex to sell products
  - product placement
  - invasion of privacy.
- Dishonest or unethical marketing practices ultimately drive customers away.
- False or misleading advertising is not only unethical, it is also illegal.
- Unethical marketing practices relating to truth and accuracy in advertising can range from:
  - untruths due to concealed facts
  - exaggerated claims — puffery
  - vague statements.
- Marketers should ensure that their advertisements are not offensive and are in good taste.
- Marketers have been heavily criticised by consumer and health groups for promoting products that damage health, especially junk food.
- Social-networking sites and smartphone apps are used by marketers to digitally advertise junk food to children.
- Much of this digital advertising is presently unregulated.
- There may be a temptation for marketers to engage in strategies that can limit or prevent competition. The *Competition and Consumer Act 2010* requires businesses to engage in fair competition.
- Sugging — selling under the guise of a survey — is not illegal, but it raises several ethical issues including invasion of privacy and deception.
- The Australian Association of National Advertisers (AANA) Code of Ethics 2012 was developed to regulate marketing.
- The role of the Advertising Standards Bureau is to receive complaints relating to the Code and to ensure that acceptable advertising standards are followed.
- Ethical behaviour and complying with government regulations is important in marketing.

EXERCISE 6.3 REVISION

1 In a recent survey of 350 Australian and overseas marketing managers, 64 per cent responded 'yes' to the question: 'Is it reasonable behaviour to bend the law if you do not actually break it?' **Propose** how you would answer this question.

2 **Define** the term 'materialism'.

3 As a class, **discuss** whether advertising creates unrealistic expectations that many consumers can never attain. Record the main points on the board. Write a paragraph in your notebooks **summarising** the points recorded.

4 **Discuss** whether you think advertising:
(a) leads or reflects the change in gender roles
(b) could be criticised for over-emphasising sex to sell products.

5 **Why** are businesses keen to use product placement?

6 **Justify** whether you consider product placement an ethical or unethical marketing strategy. **Compare** your answer with that of other class members.

7 **Demonstrate** how the following advertising strategies may mislead consumers.
(a) 'Before' and 'after' advertisements
(b) Puffery
(c) 'Weasel' words

8 **Propose** three reasons why the collection of consumer behavioural data, by tracking web users, could be considered unethical.

9 Even though Nivea's advertisement (section 6.4.3) was withdrawn, it created a great deal of attention—which is one of the main purposes of advertising. **Justify** whether you agree or disagree with this statement.

10 (a) Using the format shown in the following table, **examine** five advertisements and record your observations. Choose two advertisements that you think were the most effective. **Justify** your selection.

Name of company	Product	Marketing strategy used	Effectiveness rating 1–5

(b) **Determine** whether any of the advertisements you viewed were unethical. Give reasons for your answer.

11 In small groups, use the brainstorm technique to **critically analyse** the ethical issues involved in:
(a) advertising to young children during morning television programs
(b) using sexual overtones and imagery in advertisements.

12 'Digital advertising to children should remain unregulated and allow the fast-food industry to develop its own set of guidelines.' **Discuss**.

13 **Construct** a concept map **summarising** examples of anti-competitive practices.

14 Find the Australian Association of National Advertisers Code of Ethics.
(a) **Clarify** the objectives of the Code of Ethics.
(b) **Identify** the four AANA Codes.

15 Research the Advertising Standards Bureau online to answer the following questions.
(a) **Outline** the steps involved if a consumer wants to make a complaint about an advertisement they find offensive.
(b) **Examine** a determination made by the Advertising Claims Board and evaluate the outcome.

16 **Why** are ethical behaviour and government regulation important in marketing?

on Resources

- **Weblink:** Australian Association of National Advertisers (AANA)
- **Weblink:** Advertising Standards Bureau

on Resources

- **Digital doc:**Chapter summary (doc-24808)
- **Interactivity:** Chapter crossword (int-7159)
- **Interactivity:** Multiple choice quiz (int-7160)

EXERCISE 6.3 EXTENSION

1. **Examine** what advertising standards must be met before an advertisement can be aired on television. **Discuss** why we have advertising standards and **determine** whether there are any areas where advertising certain types of products should be subject to stricter regulation.
2. You have been asked by your manager to place a 'special' sign on a number of items, but the price is not to be lowered. **Assess** whether this is an ethical or unethical practice. As an employee, **determine** what you could do. **Compare** your answer with that of other class members.
3. Research the Australian Competition and Consumer Commission (ACCC) to answer the following questions.
   (a) **Outline** what information the ACCC provides about advertising.
   (b) **How** does knowledge of this information influence marketing promotion practices?
4. **Discuss** whether a marketing manager should refuse to produce a product that could have harmful side effects, even though consumers are demanding the product. **Compare** your answer with that of other class members.
5. If you were the marketing manager for a food company account, **investigate** which you would prefer: government regulation of food additives or a voluntary industry code. In your answer provide advantages and disadvantages for each alternative.

on Resources

Weblink: Australian Competition and Consumer Commission (ACCC)

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CHAPTER 7

Marketing process

OVERVIEW

7.1 Introduction
7.2 Situational analysis — SWOT analysis and product life cycle
7.3 Market research
7.4 Establishing market objectives
7.5 Identifying target markets
7.6 Developing marketing strategies
7.7 Implementation, monitoring and controlling

7.1 Introduction

As outlined in chapter 5, a marketing plan gives a purpose and direction to all the business's activities. Everyone in the business needs to know the plan, so all departments are working towards achieving the goal. For this reason, it is referred to as an integrated marketing plan. The marketing plan needs to 'mesh' with the business's operational plan, financial plan and human resources plan.

The steps involved in developing a marketing plan are shown in figure 7.1.

BizFACT

The acronym SMEIDI will help you remember the steps involved in developing a marketing plan.

***S**ituational analysis*
***M**arket research*
***E**stablishing marketing objectives*
***I**dentifying target markets*
***D**eveloping marketing strategies*
***I**mplementation, monitoring and controlling*

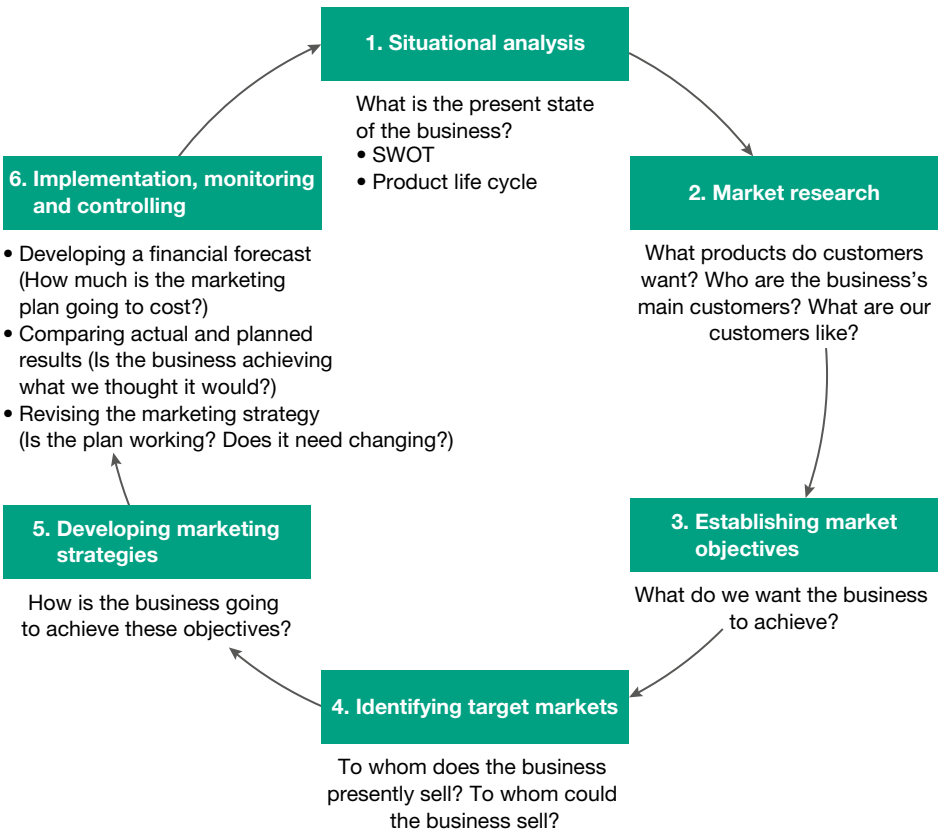


FIGURE 7.1 Steps involved in developing a strategic marketing plan. Strategic marketing planning provides a mechanism for businesses to gain a clear picture of where the business is at present, and where it could be in the future. In this sense, it is the 'road map' for marketing.

There is no set format for developing a marketing plan. Each plan will reflect the individual characteristics of the business. However, all marketing plans should have two features in common. They should be:

- realistic in the light of the situational analysis
- achievable within the business's resources and budgets.

7.2 Situational analysis — SWOT analysis and product life cycle

The most crucial step of the marketing plan is that management has a precise understanding of the business's current position and a clear picture of where it is heading. That is, a situational analysis must be undertaken based on meaningful market research. Two methods of analysis include a SWOT analysis and a product life cycle.

7.2.1 SWOT (strengths, weaknesses, opportunities and threats) analysis

Changes in the external environment can dramatically alter the course of a business. For this reason, a business must constantly monitor these changes, looking for any opportunities to exploit and any threats to avoid.

Internal forces operate from inside the organisation and are largely within the control of the business. These internal forces are unique to each business and, by analysing them, management can assess the strengths and weaknesses of the business.

To develop a clear understanding of both the external and internal environments, a SWOT (strengths, weaknesses, opportunities and threats) analysis should be conducted. A **SWOT analysis** involves the identification and analysis of the internal strengths and weaknesses of the business, and the opportunities in, and threats from, the external environment. It provides the information needed to complete the situational analysis and gives a clear indication of the business's position compared with its competitors. The marketing plan should be modified to reflect this information.

BizWORD

A **SWOT analysis** *involves the identification and analysis of the internal strengths and weaknesses of the business, and the opportunities in, and threats from, the external environment.*

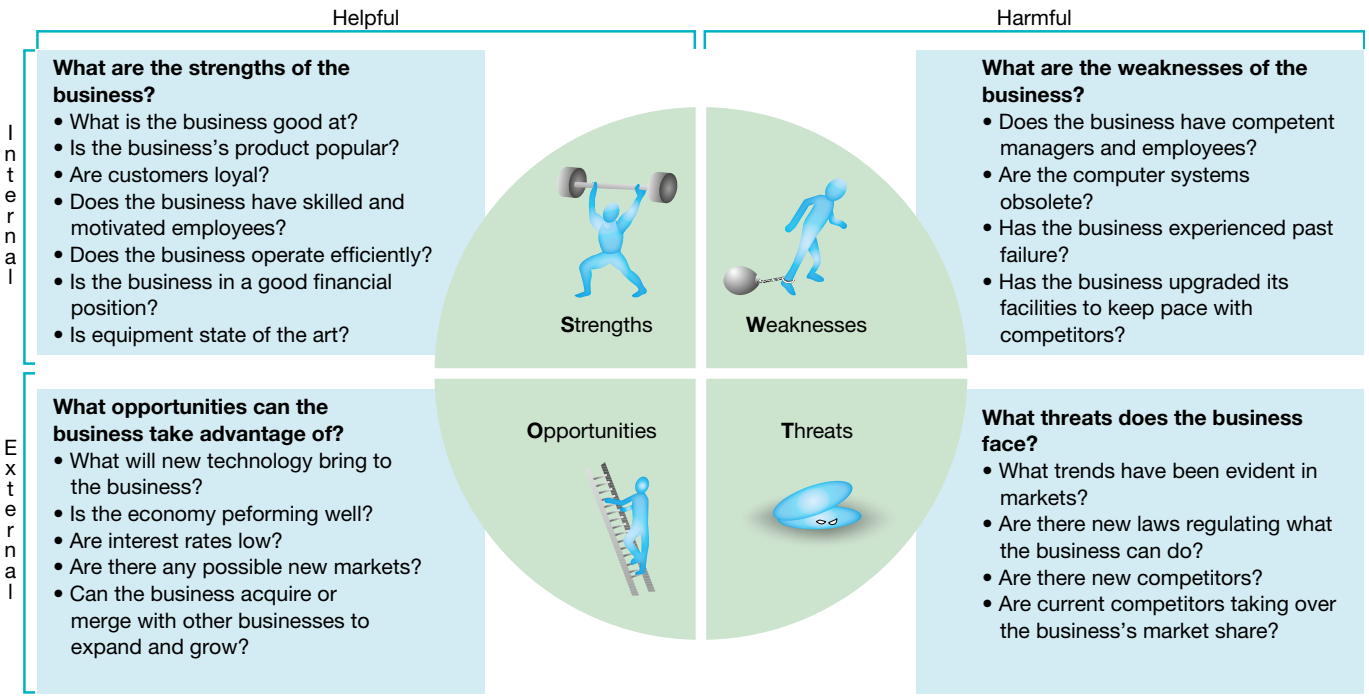


FIGURE 7.2 A SWOT analysis is a powerful tool that can be used at all stages of the marketing planning process.

Once the SWOT analysis has been conducted, an assessment of the product's position on the product life cycle should be carried out. This is necessary because different marketing strategies will need to be used at different stages of a product's life.

7.2.2 Product life cycle

BizWORD

The **product life cycle** *consists of the stages a product passes through: introduction, growth, maturity and decline.*

The **product life cycle** consists of the stages a product passes through: introduction, growth, maturity and decline (see figure 7.3). Many businesses start because of someone's great idea to produce a product (a good or service) that is new and perhaps superior to what is available. From that tiny seed, a successful business may grow; but like all good things, there is eventually an end to the cycle. Your parents and grandparents were familiar with many products that you would consider old-fashioned relics from the past, such as black and white television sets or cut-throat razor blades. Products such as these experienced the same cycle of introduction, growth, maturity and decline that products continue to experience today.

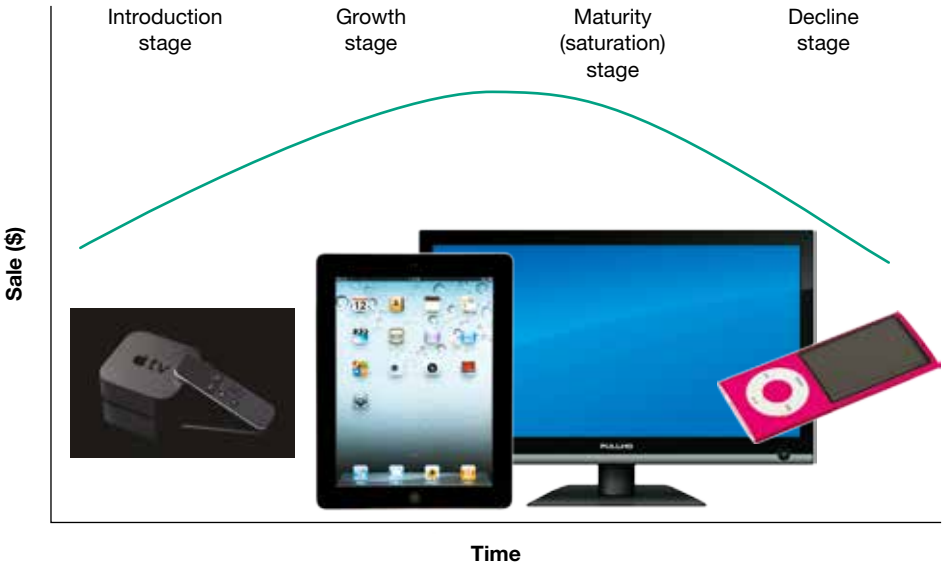


FIGURE 7.3 A business must be able to launch, modify and delete products in response to changes in the product life cycle. Failure to do so will result in declining sales and reduced profits. This diagram shows Apple TV players are in the introduction phase of the product life cycle and there is growth in the iPad business with frequent updates to its size, weight and features. Sales in plasma screen televisions may start to fall as new technology improves upon existing products. Finally, the iPod Nano and Shuffle have been discontinued by Apple.

At each stage of the product's life cycle a different marketing strategy is necessary.

Table 7.1 outlines the marketing strategies relevant to the different stages of the product life cycle.

TABLE 7.1 Marketing strategies relevant to different stages of the product life cycle

	Introduction stage	Growth stage	Maturity stage	Decline stage
Description	The business tries to increase consumer awareness and build a market share for the new product.	Brand acceptance and market share are actively pursued by the producers of the product.	Sales plateau as the market becomes saturated.	Sales begin to decline as the business faces several options.
Product	Brand and reliability are established.	Quality is maintained and improved and support services may be added.	Features and packaging try to differentiate the product from those of competitors.	Product is maintained with some improvements or rejuvenation. Cut the losses by selling it to another business.

	Introduction stage	Growth stage	Maturity stage	Decline stage
Price	Price is often noticeably lower than competitors' prices in order to gain a market foothold.	Price per unit of production is maintained as the firm enjoys increased consumer demand and a growing market share.	Price may need to be adjusted downwards to hold off competitors and maintain market share.	Price is reduced to sell the remaining stock.
Promotion	Directed at early buyers and users. Communications seek to educate potential customers about the merits of the new product.	Promotion now seeks a wider audience.	Continues to suggest the product is tried and true — it's still the best.	Promotion is discontinued.
Distribution	Distribution is selective, which enables consumers to gradually form an acceptance of the product.	Distribution channels are increased as the product becomes more popular.	Incentives may need to be offered to encourage preference over rival products.	Distribution channels are reduced and product is offered to a loyal segment of the market only.

Why do some products decline?

Products end for various reasons (see the next Snapshot). These include the changing public perception of what is fashionable at certain times. New technologies are constantly being introduced and with them come new products replacing old ones. New products also sometimes reduce demand for older ones. Fluctuations in the level of economic activity constantly result in shifts in customer spending habits.



FIGURE 7.4 Some tech products that seemed innovative when they were first released and have now experienced a decline in sales due to the increasing popularity of smartphones and tablets include MP3 players, e-readers, landline phones, personal computers, digital cameras and GPS units.

Presently, consumer behaviour is dramatically changing as a result of the need to reduce carbon emissions and greenhouse gases to prevent even more devastating climate change. Today, for example, car manufacturers are a good example of large-scale global manufacturers that are confronted with the unpleasant reality that consumers are more globally aware. They will no longer continue buying unsustainable products the way they once did.

BizFACT

After 11 years, Coca-Cola decided to discontinue Coke Zero due to the decline in the consumption of diet sodas because of consumer concerns they contain too much sugar. The company replaced Coke Zero with a new product, Coca-Cola No Sugar.

SNAPSHOT

Case study: iPod Nano and Shuffle — product life cycle, 2001–17

> 'the iPhone … gradually lead to the decline of music players …'

Most successful products begin with companies searching for a solution to a problem. The iPod wasn't the first MP3 player — they had been around since the mid-1990s — the 'problem' was that the early models only stored few songs, were big and heavy, had difficult-to-navigate interfaces and took a long time to transfer songs. In 2000, Steve Jobs, Apple's CEO, decided they should develop their own MP3 player to overcome the inadequacies of the current players, so he assembled a team of engineers to design the iPod line.

The iPod was developed in less than a year and the first version was released on 23 October 2001. It was smaller and easier to use than its competitors, had an effective design, a very simple interface as well as a 1000-song capacity due to its 5GB hard drive. The initial reaction wasn't overly optimistic, with some people claiming it was too expensive (it cost $399) and not the 'breakthrough' it was hyped to be. Its price and Mac-only compatibility caused sales to be relatively slow until 2004.

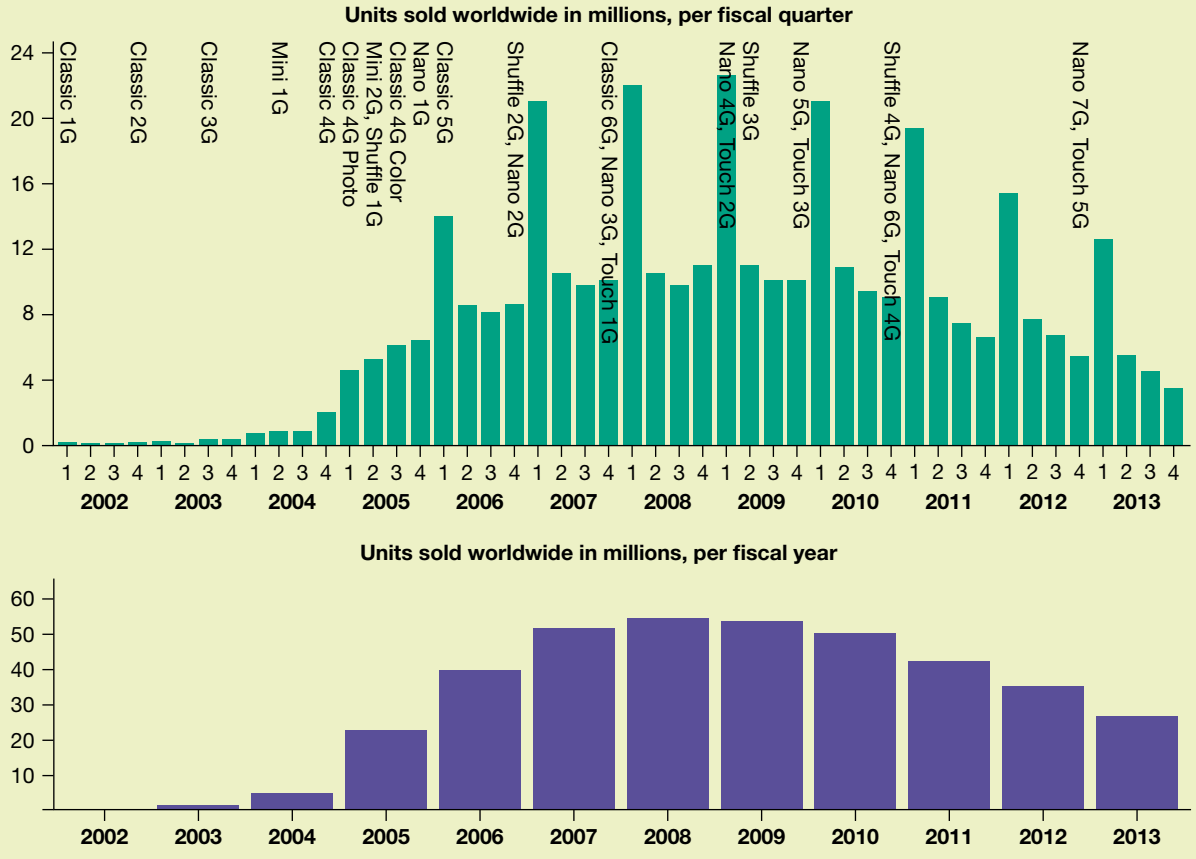
The iPod began to experience some growth in 2002 due to the newer models being Windows-compatible. To promote this new feature, Jobs got his friends in the music business to help launch the new software. In 2003, sales continued to slowly increase after Apple introduced the iTunes Music Store and Oprah declared the iPod as one of her 'Favourite Things'. By June that year the one millionth iPod was sold.

2004 lead to an exponential growth in sales. This growth can be attributed to the launch of the new iPod mini, Apple's significant investment on new advertising and promotional campaigns for the iPod as well as the fact that car manufacturers began to offer built-in iPod integration.

Apple introduced the iPod Shuffle in 2005, which could plug directly into a computer through an on-board USB. In that same year, the iPod Nano was launched, which included a colour screen and came with 1GB, 2GB, 4GB capacities. Over the years, the iPod Nano and Shuffle went through several design modifications — at first, both devices were slightly box-shaped and plain coloured before eventually getting longer, sleeker and being offered in a variety of bright colours.

In June 2007, iPod sales started to plateau and the product entered the maturity phase. This was due to Apple's release of the iPhone, which gradually led to the decline of music players in general. In response, Apple discontinued some iPod models, dropped their price significantly and, in September that year, introduced the iPod touch, which contained the features of an iPhone without the monthly phone charges.

iPod sales chart



From 2009, iPod sales were in decline. For five years, sales continued to fall each quarter despite it still being the top-selling MP3 player in the world. Up until 2010, Apple sold more iPods than iPhones; however, by 2014, iPod sales only accounted for 1 per cent of Apple's total revenue. In 2013 Apple didn't introduce any new iPods, which lead to an even bigger decline in sales. This is because sales usually peaked each time Apple released a new iPod.

The decline of iPod sales cannot be attributed solely to the introduction of iPhones (which were more versatile than iPods) but also to the rising popularity of other smartphones that offered similar music features and to the rise of music streaming services.

So in 2017, after nearly 16 years on the market and 400 million units sold, Apple pulled the iPod Nano and Shuffle off the shelves, which signifies the end of Apple's standalone music players. Only the iPod Touch lives on.

SNAPSHOT QUESTIONS

1. Use the stages of the product life cycle (introduction, growth, maturity and decline) as your headings. Under each heading write a brief sentence to **summarise** how the iPod passed through each stage.
2. **Outline** the key marketing strategies that Apple used to respond to the challenges of each stage of the product life cycle.
3. **Explain** the factors that lead to the decline of the iPod.

SUMMARY

- A marketing plan gives a purpose and direction to all the business's activities.
- The steps involved in the marketing process are:
  - situational analysis
  - market research
  - establishing marketing objectives
  - identifying target markets
  - developing marketing strategies
  - implementation, monitoring and controlling.
- A situational analysis provides a precise understanding of the business's current position and where it is heading.
- A SWOT (strengths, weaknesses, opportunities and threats) analysis provides the information needed to complete the situational analysis and assesses the business's position compared with its competitors.
- The product life cycle consists of the stages a product passes through: introduction, growth, maturity and decline.
- At each stage of the product's life cycle a different marketing strategy is necessary.

studyon

Syllabus area 2 | Topic 3 | Concept 1

Marketing plan
Summary screen and practice questions

EXERCISE 7.1 REVISION

1 **Clarify** why everyone in the business needs to know the marketing plan.

2 **Identify** the two features all marketing plans should have.

3 **Examine** figure 7.1, then copy the table below into your notebook. Complete the table by **recalling** and then writing against each step the appropriate statement from those given below. The first step has been completed for you.

Developing a marketing plan	Statement
Step 1: Situational analysis	The business currently has a market share of 28 per cent. The market is growing but new competitors are likely to enter the market.
Step 2: Market research	
Step 3: Establish market objectives	
Step 4: Identify target markets	
Step 5: Develop marketing strategies	
Step 6: Implement, monitor and control the plan	

Statements

(a) The business will design a new promotional campaign featuring younger women. Direct selling methods will also be introduced.
(b) The market share percentage will be examined every three months. If the results are negative, then the objectives will be reviewed.
(c) The business is to increase its market share to 35 per cent within the next 12 months.
(d) The business presently sells to 35- to 45-year-old females across all income groups. However, the product could be made to appeal to the 25 to 35 age group.
(e) The business needs to collect information about existing and potential customers.

4 **State** what the acronym SWOT represents.
5 **Outline** the value of a SWOT analysis when reviewing the business's situation.
6 **Define** the term 'product life cycle'.
7 **Outline** the four stages of the product life cycle and provide an example of a product in each stage.
8 **Identify** at which stage of the product life cycle the following products are located.
(a) CD
(b) Personal computers
(c) 3D televisions
(d) Tablet devices
9 **Explain** why the marketing strategies should change as a product advances through the stages of its life cycle.
10 **Compare** the marketing strategies for a product in the growth stage with one in the decline stage.
11 **State** the main reasons why the sale of many products eventually decline.

EXERCISE 7.1 EXTENSION

1 With a partner to share the task equally, **create** an exciting visual presentation on the life cycle of a product of your choice. You must present your work to the rest of the class (maximum time for presentation: 5 minutes).
2 'Knowledge of the product's life cycle can provide valuable insights into ways the product can be managed to enhance sales and profitability.' **Assess** the accuracy of this statement.
3 Interview a person born in the two decades after 1945. Ask them these questions:
(a) What is a product you fondly recall that no longer exists?
(b) What was the logo used to promote the product?
(c) Can you describe the advertisements?
(d) Was the product useful to you?
(e) Was the product expensive?
(f) What became of it? Why did it decline?

Construct a brief report (approximately 250 words) on the interview. Alternatively, use the interview to **create** a 5-minute PowerPoint or visual presentation to the rest of the class.

7.3 Market research

Imagine you have just been given an assessable task for your Business Studies class. If you want to achieve satisfactory results, it is important that you undertake some type of research. The research could consist of reading books and magazines, conducting surveys, accessing internet sites, carrying out experiments and talking to people. Marketing managers also have to undertake research of their market.

Market research is the process of systematically collecting, recording and analysing information concerning a specific marketing problem.

Just as a well-researched assessable task will lead to better results, marketing strategies perform best when they are based on accurate, up-to-date, detailed and relevant information. Being well-informed about all aspects of the market, especially the buying behaviour of existing and potential customers, places the business in a stronger position.

BizWORD

Market research *is the process of systematically collecting, recording and analysing information concerning a specific marketing problem.*

Case study: Market research is at the heart of IKEA's expansion

Market research is at the heart of IKEA's expansion. This focus came about as a result of the problems they encountered when entering the US market due to their lack of research. Since then, IKEA has invested a lot of time conducting marketing research and studying consumers. This is especially the case when they make the decision to expand to new countries with cultures distinctly different from their own.

IKEA founder Ingvar Kamprad was a firm believer in conducting his own market research (i.e. primary research). Before entering a new market, the company carries out their own market analysis instead of relying on conventional research involving market studies. IKEA finds this to be more practical and intuitive as it allows the business to gain access to extensive amounts of cross-cultural data.

IKEA found that surveying people doesn't always give them the right answers. Many people say things that are not entirely accurate and what they actually do may be very different to what they say. This could be because people respond to questions in a way they think they're supposed to or answer in a way that makes them sound better; often this is because people are not always fully aware of how they behave.

To overcome this, IKEA have developed a number of research methods that go deeper and give them a better understanding of how people actually behave and what they actually want and need. Their researchers take a firsthand look at customers themselves. They frequently do home visits and set up cameras in people's homes, filming them for a number of days (with their permission). Through their research they want to come closer to people's everyday lives and reality. First their researchers watch the footage and analyse it and then they sit with their subjects and get them to watch the footage. Their subjects are often surprised as they are often not aware of how they actually behave.

The following are two examples of how IKEA's research led to the development of new products to better meet consumer's needs:

- IKEA recently studied over 8000 people across eight cities to observe their morning routines. What they found was that, regardless of the city, many people find the process of picking out their outfit for the day stressful, with women spending more time on this than men. Based on this data, IKEA invented a freestanding mirror called the Knapper that has a rack on the back to hang clothes and jewellery. This mirror is meant to help customers assemble an outfit (including clothes and accessories) the night before to cut down on morning anxiety.
- Other research revealed that more and more of the world's population are living in cities with smaller living spaces. This lead to the creation of more multifunctional products such as their new range of 'wireless chargers' — a range of products that blend in with people's homes and make it possible to charge mobile devices where they need them most, without having to chase after outlets or hide messy cables.

SNAPSHOT QUESTIONS

1. **Outline** some of the market research techniques used by IKEA.
2. **Assess** IKEA's most successful method of market research (i.e. filming people in their homes).
3. **How** has market research contributed to IKEA's success?

SNAPSHOT



'Their researchers take a firsthand look at customers themselves.'

BizFACT

One of the main reasons products fail is inadequate market research.

Releasing a new product onto the market is risky. Minimising the risk is the main purpose of market research. By collecting and assessing information about the needs and wants of consumers, a more accurate and responsive marketing plan can be designed and, therefore, reduce the risk of market failure. Market research attempts to identify and outline both marketing opportunities and problems as well as evaluating the implementation of the marketing plan.

Without adequate, reliable and correct information, businesses expose themselves to market embarrassments, which could result in the product failing to sell.



FIGURE 7.5 The founders of Twitter originally designed a podcasting platform called Odeo. Soon after, Apple launched iTunes podcasting, so the founders invested significant time researching other opportunities to build on the platform they'd already created. They eventually decided to create a portal where people could share what they were up to. With this idea in mind, the founders researched existing social networking sites and surveyed users to discover what they didn't like about those sites. In 2006 Twitter was born.

7.3.1 The three steps of the market research process

To obtain accurate information, marketing managers usually follow a three-step approach (see figure 7.6).

You will probably be familiar with this process as it uses similar steps to those needed to complete a research assignment.

Step	Explanation
1. Determining information needs	The problem is clearly and accurately stated to determine what needs to be measured and the issues involved. This is a crucial step.
2. Collecting data from primary and secondary sources	At this stage, the researchers know the facts that are needed and those that are already available. Plans must be made to gather missing data. Information may be collected by telephone, personal surveys and online, as well as by personal observation or from private data sources.
3. Analysing and interpreting data	Facts by themselves do not always provide a solution to the marketing problem. They need to be analysed and interpreted to determine what they mean.

FIGURE 7.6 The three steps of the market research process

Determining information needs

The information collected must be relevant to the issue or problem being investigated. The best method to determine the relevance of data is to constantly ask questions concerning its ultimate use. Information is useful if it:

- results in marketing strategies that meet the needs of the business's target market
- assists the business to achieve its marketing objectives
- may be used to increase sales and profits.

Ideally, marketing managers should treat information in the same way as other resources within the business, and weigh up the costs of collecting information against the benefits it provides.

Data collection — primary and secondary sources

Marketing data refers to the information — usually facts and figures — relevant to the defined marketing problem. Normally, market researchers use a combination of two types of data: primary and secondary data (see figure 7.7.)

BizWORD

Marketing data *refers to the information relevant to the defined marketing problem.*

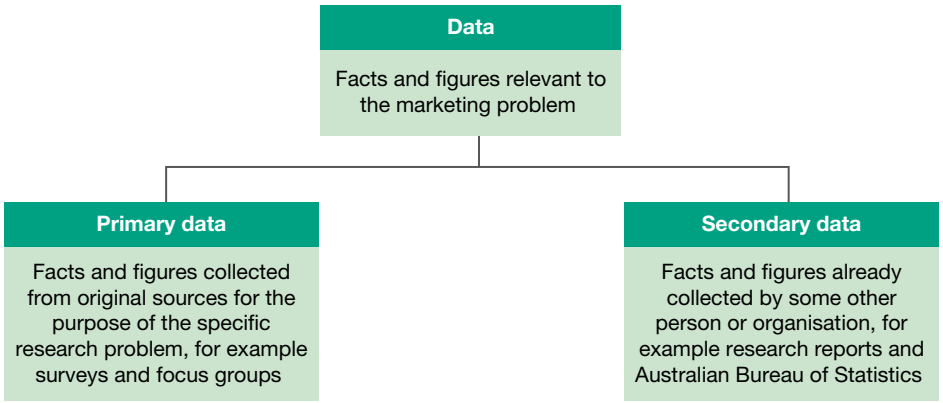


FIGURE 7.7 Two types of marketing data: primary and secondary

Primary data

Primary data are the facts and figures collected from original sources for the purpose of the specific research problem. This information can be collected by the business itself, a process that may be time consuming and expensive. Many businesses outsource this activity.

BizWORD

Primary data *are the facts and figures collected from original sources for the purpose of the specific research problem.*

The main advantage of primary data is that their collection is directed at solving a specific marketing problem. Their main function is to find out exactly what the customer is thinking.

Three main methods are used to gather primary data.

1. *The survey method*. Conducting a **survey** means gathering data by asking or interviewing people. Surveys may be carried out by:
   - personal interviews — face-to-face interviews conducted in public places
   - focus groups — small groups of people who meet with the researchers
   - electronic methods of collection — telephone, mail and internet
   - questionnaires — a set of specific questions requiring a response from the person.

   The main benefit of a survey is that it gathers first-hand information that provides details of customers' opinions. However, gathering information through surveys is becoming more difficult because respondent rates are declining. To overcome this problem, marketing companies are using electronic methods of collecting information about consumer behaviour, as outlined in the previous chapter.
2. *The observation method*. Observation involves recording the behaviour of customers. No interviews are involved and direct contact with respondents is avoided. Instead, the actions of the customers are systematically observed. Such methods can raise serious ethical issues, especially with regard to privacy.

BizWORD

Conducting a ***survey*** *means gathering data by asking or interviewing people.*

BizFACT

Online surveys are increasingly being used by businesses to conduct market research. This is because they are faster, cheaper and easier to use for both participants and researchers.

Information may be gathered through:
- personal observation, such as when a researcher poses as a customer in a store
- electronic observation, using camera or counting machines. For example, the scanner and cash register at a store checkout counter can record data on sales and customers' purchase patterns (see figure 7.8).



FIGURE 7.8 The development of computerised technology has enhanced market research and enabled companies to gather even more data much quicker and cheaper than before.

BizFACT

The Queen Victoria Building shopping precinct uses security monitors to evaluate foot traffic into and past shops at different times of day.

This method of data collection has become very popular over recent years, especially with the development of computerised technology. It is now possible for a business to access its loyalty program, customer spending habits and customer database all at once, through the use of smart cards and bar coding (see the following Snapshot).

Such observation methods can be highly accurate, but their main limitation is that they explain only *what* happens, not *why* it happens.

3. *The experiment method.* Experiments involve gathering data by altering factors under tightly controlled conditions to evaluate cause and effect. Market researchers do this to determine whether changing one of the factors (a cause) will alter the behaviour of what is being studied (the effect). Experiments carried out in the field are called test marketing.

SNAPSHOT



Loyalty cards? How retailers get your data

Although called 'loyalty cards', these cards are not always about winning the loyalty of customers. The real value-added for companies is the data they generate for the company.

From micro-businesses to large transnational corporations, many retailers are developing rewards programs and encouraging customers to sign up. But, for all the points, offers and discounts customers receive, who is actually getting the better end of the deal? The reality is that many programs are likely to benefit companies more than consumers.

Due to the competitive nature of the retail industry, retailers are always looking for ways to differentiate themselves and gain more customers. By offering loyalty cards, businesses are giving customers an incentive to keep going back to their store. Just like the old adage 'Nothing in life is free', a business isn't going to give their consumers something for nothing in return. Consumers therefore need to consider what's in it for the retailer.

So what do retailers get out of loyalty programs? Loyalty programs provide retailers with an abundance of information and data. When people initially sign up, the

company can find out a great deal of demographic data about their customers such as age, gender and address. In addition, each time a customer's card is scanned, the transaction is recorded and over time the business can gather data about customer preferences and their shopping habits, including the location, timing and frequency of their purchases. Retailers then use that information to build a profile of each customer so they can promote specific goods or services they are more likely to buy in a way that most appeals to them.

SNAPSHOT QUESTIONS

1. **Outline** the benefits of loyalty cards for consumers.
2. **Explain** why businesses use loyalty cards.

'… many programs are likely to benefit companies more than consumers.'

Secondary data

Secondary data comprises information that has already been collected by some other person or organisation. It is referred to as secondary because it is information that has been collected for some other purpose; for example, census data and household expenditure surveys gathered by government and private organisations. With the advent of computer databases, an abundance of secondary data are available to market researchers.

There are two types of secondary data. These are:

- ***internal data***. This is information that has already been collected from internal sources — that is, from inside the business. Such data include customer feedback, sales and management reports, and research reports.
- ***external data***. This is published data from sources outside the business. Examples include magazines, industry association newsletters, internet sources and private data collection agencies. Probably the best known are the numerous reports produced by the Australian Bureau of Statistics (ABS).

BizWORD

Secondary data *is information that has already been collected by some other person or organisation.*

BizWORD

Internal data *refers to information that has already been collected from inside the business.*

External data *refers to published data from outside the business.*



BizFACT

The Roy Morgan Research Centre monitors what a targeted group of customers read, when and what they watch on television, what they buy, where they buy, and what they think of different products.

FIGURE 7.9 The Australian Bureau of Statistics (ABS) is Australia's official statistical organisation. They provide businesses with a range of resources to assist them with their planning and research activities. The ABS also provides a range of services to small businesses. They assist them with market research, profiling customers and planning. They can provide businesses with a wide range of data on their industry, their community, and the social and economic climate, as well as hints and tips.

Data analysis and interpretation

Once the data has been gathered, conclusions need to be drawn. Raw data is of little value until it has been analysed and interpreted. **Statistical interpretation analysis** is the process of focusing on the data that represents average, typical or deviations from typical patterns.

BizWORD

Statistical interpretation analysis *is the process of focusing on the data that represents average, typical or deviations from typical patterns.*



FIGURE 7.10 In the late 1950s, Xerox Corporation's market research indicated only a small market existed for an automatic photocopier. Luckily for Xerox, management had a 'gut feeling' that the researchers' conclusions were wrong and they decided to launch the product anyway. The photocopier was an instant success and the rest is history.

The first step in drawing conclusions (analysis and interpretation) is to tabulate the data — that is, display the information in table format. The use of a spreadsheet computer program greatly simplifies this task. Cross-tabulation will allow comparisons to be made between individual categories. For example, cross-tabulation could show how men and women display different shopping habits, or the differences between the purchasing behaviour of high- and low-income earners.

This interpretation will largely be based on the marketing manager's judgement, experience and intuition. For this reason, it is preferable to involve a number of people in the interpretation of data so as to gain a wider perspective and, therefore, avoid the error of personal bias.

SUMMARY

- Market research is the process of systematically collecting, recording and analysing information concerning a specific marketing problem.
- To obtain reliable and accurate information, marketers follow a three-step approach.
  - Step 1: Determining information needs. The problem is clearly stated to determine what needs to be measured and the issues involved.
  - Step 2: Collecting data from primary and secondary sources. Data are collected by mail, telephone and personal surveys, personal observation or from private data sources.
    - Primary data: information from original sources. Example: interviews and surveys
    - Secondary data: information collected by other organisations. Example: industry reports and Australian Bureau of Statistics
  - Step 3: Data analysis and interpretation. Determine what the data means.
    - Statistics are processed to determine if responses show trends or patterns that can be used in the business.

EXERCISE 7.2 REVISION

1 **Define** the term 'market research'.
2 **Explain** why it is important for businesses to undertake market research.
3 **Outline** the three steps of the market research process.

studyon

Syllabus area 2
Topic 3
Concept 2

Market research: collecting data
Summary screen and practice questions

studyon

Syllabus area 2
Topic 3
Concept 3

Market research: using data
Summary screen and practice questions

4 Complete the following sentences by **recalling** the correct term from the list below.

resources	data	information
investigated	relevant	questions

(a) Information collected must be _____ to the problem being _____.
(b) The best method to determine the relevance of the _____ is to constantly ask _____ concerning its ultimate use.
(c) Marketers should treat _____ in the same way as other _____ within the business.

5 **Define** the term 'marketing data'.
6 **Distinguish** between primary and secondary data.
7 **Identify** the four methods used for gathering survey data. **State** under what circumstances each should be used.
8 **Account** for the increased use of electronic scanners to collect data.
9 **Distinguish** between the survey, observation and experiment methods of data collection.
10 **Compare** internal and external secondary data.
11 **Explain** the purpose of analysis and interpretation of data.
12 Investigate The Realise Group online to **identify** the services this market research and mystery shopping company offers its clients. Select and **summarise** one of the company's services.

on Resources

Weblink: The Realise Group

EXERCISE 7.2 EXTENSION

1 Choose a business partner in your class. Assume both of you are managers in an ice-cream manufacturing business. **Analyse** how you might use different types of market research (surveys, focus groups, observations and experiments) to determine customer reaction to a new kind of ice-cream.
2 Think about your school, or a business for which you work part-time.
(a) **Outline** how the organisation collects and processes marketing information.
(b) **Explain** what the information is used for.
(c) **Propose** what secondary sources could be used to supplement this data.
3 As the owner of a supermarket, you believe you could sell more strawberries by displaying them loose on a tray, rather than packaging them in punnets.
(a) **Describe** an experiment to test this idea.
(b) **Determine** the difficulties in conducting the experiment.

7.4 Establishing market objectives

BizWORD

Marketing objectives *are the realistic and measurable goals to be achieved through the marketing plan.*

The next step in the marketing process is the formulation of marketing objectives. **Marketing objectives** are the realistic and measurable goals to be achieved through the marketing plan. It is of little value for a business to plan and implement a marketing strategy without first deciding what it wants to achieve. This decision is considered the most important step in the marketing planning process. The marketing objectives should be closely aligned to the overall business goals, but more customer-oriented than the goals for the entire business. They are also concerned with products and markets.

Three common marketing objectives include:

- increasing market share
- expanding the product range
- maximising customer service.

Such objectives can be measured, and should include specific targets to be met — for example, 'increase market share by 10 per cent within the next 12 months'.

BizWORD

Market share *refers to the business's share of the total industry sales for a particular product.*

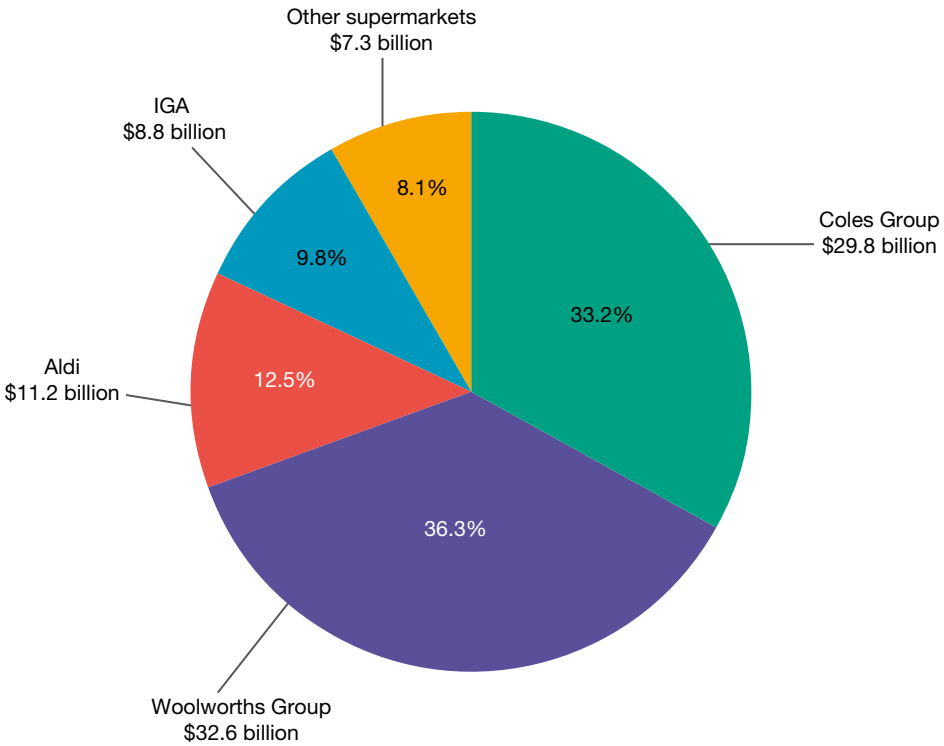
BizFACT

According to Net Market Share (2017), Google is the market leader in search engines with close to 80 per cent global market share. The average number of daily searches on Google is 4 464 000 000.

7.4.1 Increasing market share

All marketing plans aim to achieve a specified market share. **Market share** refers to the business's share of the total industry sales for a particular product. Businesses often develop an extensive product range, using many different brand names to gain an extra few percentage points of market share. The metropolitan free-to-air (FTA) commercial television broadcasters Nine Network, Seven Network and Network Ten, for example, are constantly trying to increase their market share of the viewing public as measured by the 'rating' of a program. The 'rating' is an estimate of the number of television sets tuned in to a program. The network with the highest ratings for any program can charge advertisers more for a commercial spot. Consequently, each network is constantly battling for the largest share of the total viewing audience. To achieve this, networks offer a range of products (television programs) to attract the largest number of viewers. With the development of digital television broadcasting in Australia, the FTA television stations created sub-brands of their primary channels. Consequently, they have been able to divide (segment) the TV viewing audiences into more narrowly divided market groups. The motive behind offering these different sub-brands is to broaden the appeal, attract new customers (viewers) and consequently increase market share.

Increasing market share is an important marketing objective for businesses that dominate the market, because small market gains often translate into large profits.



Note: Dollars and percentages may not add to totals due to rounding.

FIGURE 7.11 Woolworths and Coles dominate the grocery market sector (valued at close to $90 billion), with 36 per cent and 33 per cent market share respectively. Due to their large combined market share, they have faced heavy criticism from the ACCC who recently began investigating potential breaches of competition laws, including misuse of market power. Over the past few years their market share has been declining due to intense pressure from competitors such as Aldi and IGA.

BizWORD

Product mix *is the total range of products offered by a business.*

7.4.2 Expanding the product mix

The total range of products offered by a business is referred to as the business's **product mix** (see figure 7.12). Businesses are usually keen to expand their product mix, as this will increase profits in the long term. The same product mix will not remain effective for long because customers' tastes and preferences change over time, and demand for a particular product may decrease.

To develop the ideal product range, businesses must understand customers' needs. Each item in a product line should attempt to satisfy the needs of different target markets.



FIGURE 7.12 The product mix of Beau's Floral Studio. While floral arrangements are the main product, most florists have expanded their product mix to include gifts, vases, aromatherapy oils, helium party balloons, caneware and scented candles.

7.4.3 Maximising customer service

Of all the objectives examined so far, maximising customer service is perhaps the most important. **Customer service** means responding to the needs and problems of the customer. High levels of customer service will result in improved customer satisfaction and a positive reaction from customers towards the products they purchase. This establishes a sound customer base with the possibility of repeat purchases.

The old saying 'the customer is always right' is still correct today. Customers are the lifeblood of any business. To keep existing customers and attract new ones, the business needs to talk and listen to the customers. Research has shown that one dissatisfied customer usually tells eleven others, who in turn will each tell another five.

Customer service can no longer be regarded as merely explaining the refund policy or providing a complaints department. Rather, it is an attitude that should be adopted by everyone within the business.

The strategies a business can use to maximise customer service include:

- asking customers what they want
- training employees and rewarding them for excellent customer service
- anticipating market trends by conducting research
- finding out what competitors are offering and then reviewing the product mix
- establishing and maintaining long-term relationships with customers
- encouraging employees to focus their attention on the customer's needs (customer-oriented) and not just on making a sale (sales-oriented).



FIGURE 7.13 Newstead Financial Planning's philosophy is to exceed the customer's expectations by providing outstanding levels of service. It trains its employees in the 'above and beyond' principle of customer service — do those extra things to show the customer the business cares about them.

BizFACT

In an effort to increase their market share, Aldi boosted its grocery selection by adding as many as 250 new products to its range of about 1450 items in 2017.

BizWORD

Customer service *refers to how well a business meets and exceeds the expectations of customers in all aspects of its operations.*

BizFACT

In 2013, Roy Morgan hosted an awards night presenting awards to 39 businesses that were considered to have achieved outstanding levels of customer satisfaction. Among the winners were Commonwealth Bank of Australia, who was named Best Major Bank of the Year, Sussan for Best Clothing Store of the Year, Myer for Best Department Store of the Year, The Good Guys for Best Furniture/Electrical Store of the Year and JB Hi-Fi who took out best Music/Book Store of the Year.

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Syllabus area 2
Topic 3
Concept 4

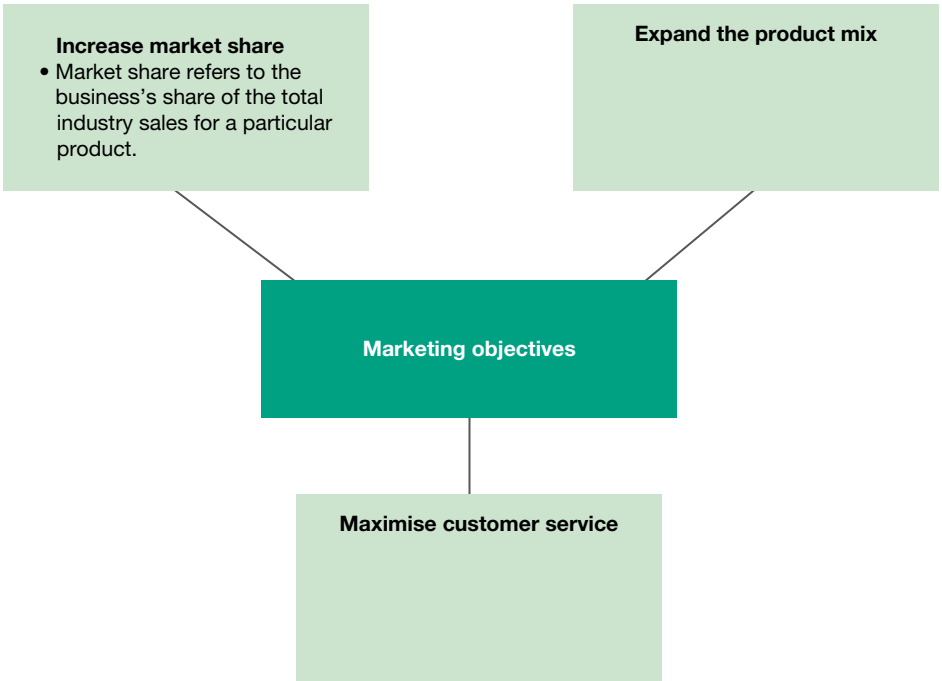
Establishing marketing objectives
Summary screen and practice questions

SUMMARY

- Marketing objectives are the realistic and measurable goals to be achieved through the marketing plan.
- The marketing objectives should be more customer oriented than the goals for the entire business, and should include specific targets to be met — for example, 'Increase market share by 5 per cent over 12 months'.
- Marketing objectives include:
  - Increase market share. Market share refers to the business's total share of the total industry sales for a particular market.
  - Expand the product range. Product mix is the total range of products offered by a business.
  - Maximise customer service. Customer service means responding to the needs and problems of the customer.

EXERCISE 7.3 REVISION

1 **Construct** a concept map (started below) **summarising** the three main marketing objectives.



2 In the following examples, **identify** which marketing objective the business is trying to achieve.
(a) The business introduces a customer feedback form to measure the level of customer satisfaction.
(b) The business decides to undertake an extensive promotional campaign in an attempt to attract new customers.
(c) The business decides to offer a wider variety of products.

3 **Explain** why businesses wish to increase their market share.

4 (a) **Define** the term 'product mix'.
(b) **Explain** why businesses are usually keen to increase their product mix.

5 **Explain** the relationship between customer satisfaction and profits.

EXERCISE 7.3 EXTENSION

1 'The most important step in the marketing plan process is the formulation of the marketing objectives.' **Evaluate** the accuracy of this statement.

2 Develop a strategic marketing plan for your school's canteen. **How** could the canteen maximise its customer service? **Predict** what major problems it would face in trying to expand off campus.

3 'There are only two ways to create and maintain outstanding business performance. First, take exceptional care of the customer and, second, develop new products. It is that simple.' **Analyse** the relationship between customer service, product mix and market share.

7.5 Identifying target markets

Because you are a senior high school student, you're part of a major target market — the teenager/young adult market. A **target market** is a group of present and potential customers to which a business intends to sell its product. The customers within the target market share similar characteristics such as age, income, lifestyle, location and spending patterns. The teenage/young adult market, for example:

- consists of people between 15 and 19 years of age
- has more disposable income than in the past
- is more willing to spend on themselves, especially designer brands and electronic devices
- makes up only 5 per cent of the Australian population but purchase approximately 25 per cent of all takeaway food
- spends on average $1100 a year on clothes.

Consequently, marketers want to tap into this highly profitable target market.

Sometimes a business may be able to identify a primary and a secondary target market. A **primary target market** is the market segment at which most of the marketing resources are directed. A **secondary target market** is usually a smaller and less important market segment (see figure 7.14).

BizWORD

*A **target market** is a group of present and potential customers to which a business intends to sell its product.*

BizWORD

*The **primary target market** is the market segment at which most of the marketing resources are directed.*

*A **secondary target market** is usually a smaller and less important market segment.*



FIGURE 7.14 Stationery retailer Smiggle ('between a smile and a giggle') has children and young teens aged from 4 to 14 as its primary target market. Its brightly coloured products are regarded as an essential fashion accessory by this age group. It is said that its secondary target market are the grandparents of young Smiggle fans!

A business's primary target market will generate most of its revenue. These are the customers who are loyal to a particular business and make repeat purchases. Research has found that a small percentage of customers are usually responsible for the majority of sales. This is referred to as the 80/20 principle, according to which 80 per cent of sales comes from 20 per cent of a business's customer base. The secondary target market should not, however, be ignored, for while the number of customers may be small, it does provide an alternative in case there is a loss of customers from the primary target market.

7.5.1 Why identify and select a target market?

A business identifies and selects a target market so it can direct its marketing strategies to that group of customers. This allows the business to better satisfy the wants and needs of the targeted group. This occurs because the business is able to:

- use its marketing resources more efficiently, which is likely to result in the marketing campaigns being more cost effective and time efficient
- promotion material is more relevant to the customers' needs, and is more likely to be noticed
- better understand the consumer buying behaviour of the target market
- collect data more effectively and make comparisons within the target market over time
- refine the marketing strategies used to influence customer choice.

Businesses can choose one of three approaches to identifying and selecting a consumer target market: the mass marketing approach, the market segmentation approach or the niche market approach (see figure 7.15).

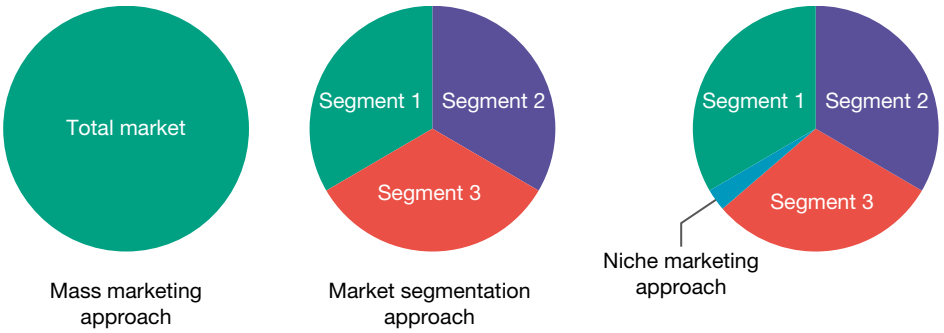


FIGURE 7.15 Identifying and selecting a market to be the target market

7.5.2 Mass marketing approach

As outlined in chapter 5, seventy years ago, marketers commonly spoke about 'mass market'. In other words, there was a large demand for a standard product. In a mass market, the seller mass-produces, mass-distributes and mass-promotes one product to all buyers. The Model T Ford, for example, was the first motor vehicle to be produced and sold to the mass market. A **mass marketing approach** seeks a large range of customers.

The mass marketing approach assumes that individual customers in the target market have similar needs. The business therefore develops a single marketing mix and directs it at the entire market for the product. This means there is one type of product with little or no variation, one promotional program aimed at everyone, one price, and one distribution system used to reach all customers.

BizWORD

*A **mass marketing approach** seeks a large range of customers.*

BizFACT

One of the main objectives of conducting market research is to identify the business's target market for its products.

7.5.3 Market segmentation approach

Few businesses can sell their products to the entire market — the market is just too big. Therefore, a business will divide the market into distinct segments. A business that is marketing motor vehicles, for example, would not direct its marketing efforts towards every person in the total vehicle market. Some people might want only a sports car; others might want a four-wheel drive. The business would thus direct its efforts towards a particular segment of the total market for motor vehicles.

Market segmentation occurs when the total market is subdivided into groups of people who share one or more common characteristics. Once the market has been segmented, the business selects one of these segments to become the target market. Segmenting a market enables a business to design a marketing plan that meets the needs of a relatively uniform group. Marketing segmentation is explained in more detail in chapter 8.

BizWORD

***Market segmentation** occurs when the total market is subdivided into groups of people who share one or more common characteristics.*

7.5.4 Niche market approach

An extension of the market segmentation approach is that of the niche market, which is a narrowly selected target market segment. In a sense, it is a segment within a segment, or a 'micro-market'. For example, an exclusive fashion boutique can carve out a niche market and, therefore, avoid direct competition with large department stores. In the last few years, some hotels have developed a niche market for their own 'boutique' beers, brewed on the premises. Such businesses market to a narrow, specific customer base (see figure 7.16).

The needs of customers in these markets are often neglected by large businesses because it is rarely profitable for them to alter their marketing mix to cater for very small groups.



FIGURE 7.16 In 2011, BMW entered the relatively young niche in the automotive industry — the electric car market — with their launch of the i3. This car targets relatively young upscale urban consumers who strongly support sustainable living.

SUMMARY

- A target market is a group of present and potential customers to which a business intends to sell its product.
- Sometimes a business may be able to identify a primary and a secondary target market.
- A business identifies and selects a target market so it can direct its marketing strategies to that group of customers.
- Businesses can choose one of three approaches to identifying and selecting a consumer target market:
  - mass marketing approach — the seller mass-produces, mass-distributes and mass-promotes one product to all buyers
  - market segmentation approach — the total market is subdivided into groups of people who share one or more common characteristics
  - niche market approach — a narrowly selected target market segment.

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Syllabus area 2
Topic 3
Concept 5

Identifying target markets
Summary screen and practice questions

EXERCISE 7.4 REVISION

1 **Why** would marketers want to target the teenage/young adult market?
2 **Distinguish** between primary and secondary target markets and give an example of each.

3 Complete the following sentences by **recalling** the correct word from the list below.

customers	primary	segmentation
niche	characteristic	narrowly
target	subdivided	present

(a) A _____ market is a group of _____ and potential _____ to which a business intends to sell its product.
(b) Sometimes a business may be able to identify a _____ and a secondary target market.
(c) Market _____ occurs when the total market is _____ into groups of people who share one or more common _____.
(d) An extension of the market segmentation approach is that of the _____ market, which is a _____ selected target market segment.

4 **Why** do businesses identify and select a target market?

5 **Compare** the mass marketing approach with the segmented marketing approach.

6 **Why** is market segmentation the most common marketing approach used by businesses today?

7 **How** are market segmentation and target market linked?

8 **Explain** the relationship between market segmentation and niche market.

EXERCISE 7.4 EXTENSION

1 In pairs, conduct a survey of 30 people to find out what television shows they enjoy watching. Using a database, **classify** the respondents by age and gender. **Analyse** your results and present them to the rest of the class.

2 **Examine** a business of your choice and answer the following:
(a) **Identify** the primary and secondary target markets of the business you have chosen.
(b) **Calculate** the importance of these markets to the business.
(c) **Identify** the variables the business owner uses to segment the target market.
(d) **How** does market segmentation help the owner to achieve long-term goals?

7.6 Developing marketing strategies

BizWORD

Marketing strategies *are actions undertaken to achieve the business's marketing objectives through the marketing mix.*

Once the business has undertaken a situational analysis, conducted market research, established the marketing objectives, and identified and selected a target market, the next process of the marketing plan is to develop marketing strategies to achieve the marketing objectives. **Marketing strategies** are actions undertaken to achieve the business's marketing objectives through the marketing mix.

7.6.1 Marketing mix — the four Ps

BizWORD

Marketing mix *refers to the combination of the four elements of marketing, the four Ps — product, price, promotion and place — that make up the marketing strategy.*

One of the most useful ways of understanding how to develop a marketing strategy is to examine each of the elements of the marketing mix. The **marketing mix** refers to the combination of the four Ps — product, price, promotion and place/distribution. A business has control over the four Ps and uses them to reach its target market. Additionally, the business has control over other business resources — such as information, finances and employees — that may also be used to achieve marketing objectives.

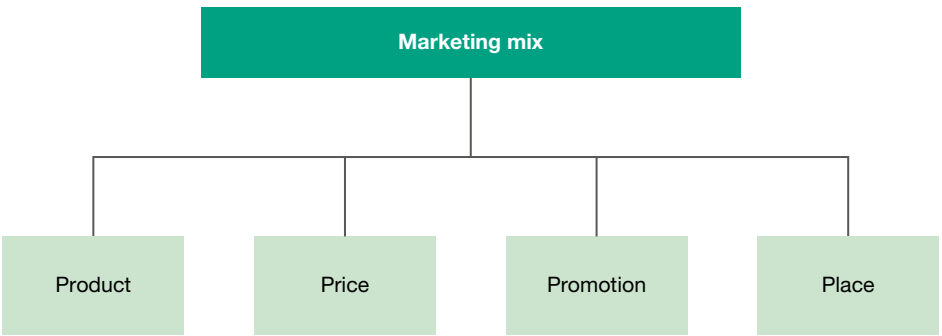


FIGURE 7.17 The four Ps, also known as the marketing mix, is probably the most well-known term in marketing and considered to be the essential elements for any marketing campaign.

Once the four Ps have been established, the business must then determine the emphasis it will place on each of the variables. This will largely be determined by where the product is positioned or its stage in the product life cycle. For example, a product that is being marketed with an image of exclusivity and prestige will require a marketing mix totally different from a no-frills, generic item. A different marketing mix will also be required for a product in its introductory stage than when it reaches the decline stage.

The following section will provide a brief introduction to the main marketing strategies based on the 'four Ps' of marketing. This information will be examined in greater detail in chapter 8. Also in chapter 8, you will be introduced to the extended marketing mix, which includes people, processes and physical evidence — the seven Ps of marketing.

BizFACT

A business may vary its marketing mix when it wants to reach different target markets.

7.6.2 Products (goods and/or services)

This element of the marketing mix involves much more than just deciding which product to make. The business also needs to determine such features as the product's quality, packaging/labelling, design, brand name and guarantee. The product is a combination of all these variables.

Customers will buy products that not only satisfy their needs and wants but also provide intangible benefits such as a feeling of security, prestige, satisfaction or influence. Much careful planning needs to be undertaken when developing the product strategy.

7.6.3 Price

Selecting the 'correct' price — the amount of money a customer is prepared to offer in exchange for a product — can sometimes be difficult. The major pricing decision is whether to set a price above, below or about even with the competitors' price. Of course, a business must consider other factors too, such as the costs of production and level of consumer demand. Price does not just refer to what the price is, but rather, the method or strategy the business uses to decide its prices.

7.6.4 Promotion

A promotion strategy details the methods to be used by a business to inform, persuade and remind customers about its products. The main forms of promotion include advertising, personal selling and relationship marketing, sales promotion, publicity and public relations.

Changes in technology, especially advances in information and communication technology (ICT), are having a significant impact on how businesses promote their products. The internet, for example, has become an effective advertising tool used by businesses to deliver specific messages to its target market.



FIGURE 7.18 Michael from Belle Property relies heavily on the internet and social media to grow his business and build his reputation as a local market leader. Real estate websites and his own personal website are an effective way of marketing listings, and social media is a great way for him to connect with his community, clients and potential buyers and sellers. Content he regularly posts includes information about listings and sales, industry trends and updates, testimonials, live videos, community events, cross-promotion of other local businesses and contests.

7.6.5 Place/distribution

This element of the marketing mix deals with the channels of distribution: the ways of getting the product to the customer. This process usually involves a number of intermediaries or 'go betweens', such as the wholesaler or retailer. Apart from the retailer, the other intermediaries are often invisible; that is, the customer knows little about their role and operation.

The number of intermediaries chosen will determine how widely the product will be distributed. The business may wish to keep supply of the product restricted to a few specialised outlets, which is the distribution method usually selected by expensive products. For example, Gucci and Louis Vuitton fashion accessories are available in only a few selected locations. Alternatively, distribution may be as wide as is practically possible, which is the method used by Coca-Cola. Its distribution channels include retail stores, supermarkets, vending machines, restaurants, clubs, hotels, cafes and fast-food outlets. Today, you can buy a Coca-Cola product anywhere from London to Beijing, Cape Town to Santiago.

SUMMARY

- Marketing strategies are actions undertaken to achieve the business's marketing objectives through the marketing mix.
- The marketing mix refers to the combination of the four Ps — product, price, promotion and place/distribution.
- Once the four Ps have been established, the business must then determine the emphasis it will place on each of the variables.
- A product is a good or service that can be exchanged for money.
- The price is the amount of money a customer is prepared to offer in exchange for a product. It refers to the method or strategy the business uses to decide their prices.
- Promotion describes the methods used to inform, persuade and remind customers about a business's products.
- Place is the element of the marketing mix that deals with the channels of distribution: the ways of getting the product to the customer.

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Syllabus area 2
Topic 3
Concept 6

Developing marketing strategies
Summary screen and practice questions

EXERCISE 7.5 REVISION

1 **Explain** the link between marketing strategies and marketing mix.
2 **Outline** the four Ps of the marketing mix.
3 **State** what determines the emphasis a business places on each of the four Ps of the marketing mix.
4 **Summarise** briefly the four Ps of the marketing mix by completing the table below. The first one has been started for you.

Marketing mix element	Key features
Product	• Goods or service exchanged for money
Price	
Promotion	
Place	

EXERCISE 7.5 EXTENSION

1 'The four Ps are the variables that marketing managers can control, unlike the variables in the marketing environment.' **Discuss**.
2 Referring to a business you are familiar with, **examine** and **evaluate** the promotion methods used for one of their products.

7.7 Implementation, monitoring and controlling

A marketing plan is a meaningless piece of paper until the plan is implemented. **Implementation** is the process of putting the marketing strategies into operation. Implementation involves the daily, weekly and monthly decisions that have to be made to make sure the plan is effective.

The previous elements of the marketing plan outlined what had to be done and why it had to be done, whereas the implementation stage is the *how*, *where* and *when* it is to be done. This is a crucial part of the process.

To implement the marketing plan effectively, a number of basic questions need to be answered:

- Is the plan fully integrated with all other sections of the business?
- How should the business be structured and organised?
- Have effective lines of communication been established between the marketing department and all other departments?
- Who are the best people for the various tasks needed to implement the plan?
- Are the marketing personnel motivated and focused on achieving the marketing objectives?
- Are all other employees familiar with the marketing objectives and marketing strategies?

The implementation stage is quite difficult, especially as unforeseen situations may arise that put in jeopardy the success of the entire marketing plan.

Once the marketing plan has been implemented, it must be carefully monitored and controlled. **Monitoring** means checking and observing the actual progress of the marketing plan. This requires the marketing department personnel, as well as other employees, to gather information and report on any important changes, problems or opportunities that arise during the life of the marketing plan (see figure 7.19).



FIGURE 7.19 Media monitors observe our media channels 24 hours a day, providing daily reports that help businesses compare their media success to that of their competitors. This kind of information helps businesses to evaluate the success of marketing strategies such as their advertising campaigns.

The information collected during the monitoring stage is now used to control the plan. **Controlling** involves the comparison of planned performance against actual performance and taking corrective action to make sure the objectives are

BizWORD

Implementation *is the process of putting the marketing strategies into operation.*

BizWORD

Monitoring *is the process of measuring actual performance against planned performance.*

BizWORD

Controlling *involves the comparison of planned performance against actual performance and taking corrective action to make sure the objectives are attained.*

attained (see figure 7.20). To achieve this, the marketing manager needs to constantly ask two questions regarding the marketing plan:

1. What does the business want the marketing plan to achieve; that is, what are the objectives?
2. Are these objectives being achieved?

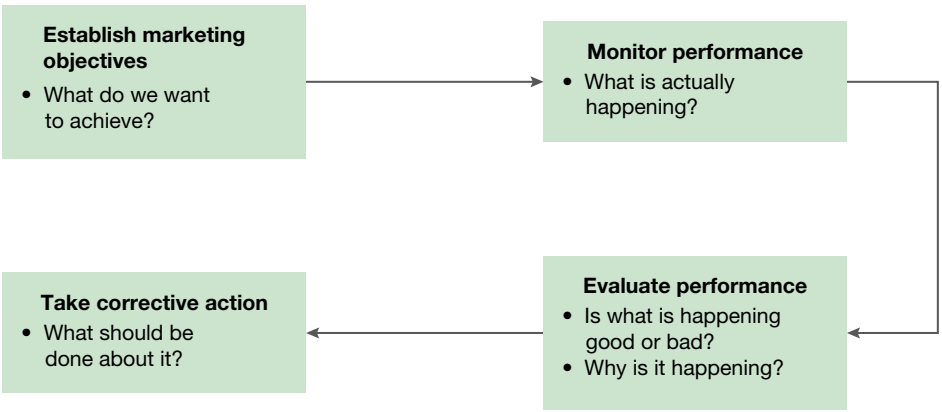


FIGURE 7.20 Once marketing objectives have been established, they must be monitored to ensure they are being met; otherwise corrective action must be taken.

The first step in the controlling process requires the business to outline what is to be accomplished; that is, to establish a key performance indicator (KPI). A KPI is a forecast level of performance against which actual performance can be compared. For example, a KPI could be:

- increase monthly sales by 5 per cent
- improve sales revenue per salesperson by 10 per cent over the next six months.

The second step in the controlling process is to compare or evaluate actual performance against the KPI. Budgets, sales statistics and cost analyses can be used to evaluate results. For example, a marketing manager could compare each salesperson's results with his or her sales quota. It is only by establishing KPIs and then comparing them with actual performance that a marketing manager can evaluate the effectiveness of the marketing plan.

7.7.1 Developing a financial forecast

BizWORD

Financial forecast *is the business's predictions about the future.*

When evaluating alternative marketing strategies, a business must develop a **financial forecast** that details the costs and revenues for each strategy. By measuring the sales potential and revenue forecasts (benefits) for each strategy, and comparing these with the anticipated expenditures (costs), a business is in the best position to decide how to allocate its marketing resources. Once this information has been gathered, it is possible to determine the most appropriate course of action using a cost–benefit analysis.

Although financial forecasting allows the marketing manager to undertake a cost–benefit analysis, the results are always open to individual interpretation.

Until a detailed analysis of the forecast cost and revenue is undertaken, a business is making decisions based merely on 'gut feelings', which is an inappropriate approach in today's competitive environment.

BizFACT

Research costs will include researcher, executive personnel and support staff time, computer usage, interviews, printing, testing, special equipment and any incentives to be offered to interviewees.

Developing a financial forecast requires two steps:

1. *Cost estimate*. How much is the marketing plan expected to cost? Costs of the marketing plan can be divided into four major components: market research; product development; promotion, including advertising and packaging; and distribution.
2. *Revenue estimate*. How much revenue (sales) is the marketing plan expected to generate? Forecasting revenues will be based on two major components: how

much consumers are expected to buy and for what price, and what sales staff predict they will sell. As time goes by, actual revenue can be compared with the forecast revenue data to determine the effectiveness of the marketing strategy.

Marketing costs are easier to forecast than revenue, because these activities are largely controlled by the business. Calculating the projected marketing revenue is much more difficult because of changes in the external environment, over which the business has little or no control. However, being able to accurately analyse both projected costs and revenues allows the business to forecast profit levels.

7.7.2 Comparing actual and planned results

Three key performance indicators used to measure the success of the marketing plan are:

1. sales analysis
2. market share analysis
3. marketing profitability analysis.

Sales analysis

A **sales analysis** uses sales data to evaluate a business's current performance and the effectiveness of a marketing strategy. The more the sales figures are broken down, the clearer the picture becomes, as can be seen by examining table 7.2.

BizWORD

Sales analysis *is the comparing of actual sales with forecast sales to determine the effectiveness of the marketing strategy.*

TABLE 7.2 Sales analysis: sales revenue by territories — 1st quarter

Sales territory	Sales quota ($)	Actual sales ($)	Difference ($)	% change (– decrease + increase)
1	50 000	58 000	8 000	+16.0
2	80 000	85 000	5 000	+6.3
3	70 000	76 000	6 000	+8.6
4	65 000	72 000	7 000	+10.8
5	90 000	94 000	4 000	+4.4
Total sales revenue	355 000	385 000	30 000	+8.4

To calculate the difference, use the formula Actual sales – Sales quota.

To calculate the % change, use the formula $\frac{\text{Difference}}{\text{Sales quota}} \times 100$.

BizFACT

The use of computerised sales has made the collection, storage, retrieval and analysis of sales data much easier. Computerised sales reports can be prepared, showing:

- *daily, weekly, monthly, quarterly and yearly sales reports*
- *product line sales*
- *credit as opposed to cash sales analysis*
- *sales reports for individual sales representatives*
- *company division sales reports*
- *any combination of the above.*

A cursory glance at the bottom line of table 7.2 shows that the total sales revenue has increased by $30 000 or 8.4 per cent above the quota — a pleasing result and confirmation that the marketing plan is a success.

The main strength of sales analysis is that sales figures are relatively inexpensive to collect and process. Their main weakness, however, is that data for sales revenue do not reveal the exact profit level; such information can only be gleaned from further investigations of total expenditure.

Market share analysis/ratios

Just as sales can be analysed, so too can a business's market share. By undertaking a market share analysis, a business is able to evaluate its marketing strategies as compared with those of its competitors. This evaluation can reveal whether changes in total sales, either increases or decreases, have resulted from the business's marketing strategies or have been due to some uncontrollable external

factor. For example, if a business's total sales revenue declined but its market share remained stable, then the marketing manager can assume that overall industry sales have fallen, perhaps due to a downturn in the economy. However, if a business's total sales revenue and market share have declined, then the marketing strategies need to be reviewed. Businesses place a great deal of importance on analysing market share statistics — a 1 per cent fall in market share can represent millions of dollars in lost sales.

Marketing profitability analysis

Sales and market share analyses, while useful, do not present the full picture. This can be done only by analysing the marketing costs involved with each marketing strategy. Using a **marketing profitability analysis**, the business breaks down the total marketing costs into specific marketing activities, such as advertising, transport, administration, order processing, and so on.

By comparing the costs of specific marketing activities with the results achieved, a marketing manager can assess the effectiveness of each activity. This evaluation also helps in deciding how best to allocate marketing resources in the future.

BizWORD

Marketing profitability analysis *is a method in which the business breaks down the total marketing costs into specific marketing activities.*

7.7.3 Revising the marketing strategy

Once the results of the sales, market share and profitability analysis have been calculated, the business is now in a position to assess which objectives are being met and which are not. Based on this information, the marketing plan can be revised (modified). Revision of the marketing plan is equally as important as all the other steps involved in creating successful marketing strategies.

Changes in the marketing mix

Because the marketing plan is operating in a dynamic business environment, the marketing mix will constantly need to be revised. Changes that could be introduced include:

- *production modifications*. No product is perfect. Businesses that continually upgrade their products will be able to maintain a competitive advantage.
- *price modifications*. Prices fluctuate due to a variety of reasons. Therefore, the price component of the marketing mix will need to be revised in response to changes in the external business environment.
- *promotion modifications*. Promotion costs will be high when a new product is first launched onto the market. During the later stages of the product's life cycle, promotion costs may stabilise and even fall during the decline stage. Promotion strategies will, therefore, need to change over time corresponding to the life cycle of the product.
- *place modifications*. As a product's success increases, the distribution channels will need to be expanded to cater for the growing market. New overseas markets may be tapped, while old markets may decrease due to demographic changes. With the development of electronic communications, new distribution channels, such as the internet, may be used.

New product development

The product life cycle tells us that all products have a life span of somewhere between five to 10 years. Therefore, if a business wants to achieve long-term growth, it must continually introduce new products. For example, if Sony had stopped product development at the transistor radio, it would probably be out of business today. However, Sony, like many other large businesses, spends vast

BizFACT

If a business wants to achieve long-term growth, it must continually introduce new products.

amounts on research and development to stay at the forefront of technology and introduce new products.



FIGURE 7.21 R&D helps keep products innovative, which assists companies achieve a competitive advantage. Samsung invests in R&D more than any other technology company, having spent more than $13 billion in 2016. This investment allows them to develop and produce some of the most sought-after electronic parts and is a major contributing factor to their success.

Product deletion

To maintain an effective product mix, a business will have to eliminate some lines of products. This is called **product deletion**. Outdated products may create an unfavourable image and this negativity may rub off on other products sold by the business. Most businesses find it difficult to delete a product, especially if it has been successful for a long time. However, when a product is in the decline stage, a decision will eventually have to be made to either delete or redevelop the product.

BizWORD

Product deletion *is the elimination of some lines of products.*

BizFACT

Car manufacturers continuously delete models due to poor performance or the introduction of new models. In 2013 Mazda made the decision to discontinue the CX-7 and Tribute to make way for the CX-5. The CX-5 is more fuel efficient, has more cargo capacity and overall interior volume than the CX-7 and is better able to compete more directly with other small SUVs.

SUMMARY

- Implementing the marketing plan means putting the marketing strategies into operation.
- Once the marketing plan has been implemented, it must be carefully monitored and controlled.
- Monitoring means checking and observing the actual progress of the marketing plan.
- Controlling involves the comparison of planned performance against actual performance and taking corrective action to make sure the objectives are attained.
- When evaluating alternative marketing strategies, a business must develop a financial forecast that details the costs and revenues for each strategy.
- Developing a financial forecast requires two steps.
  - Step 1: Estimate the cost of the marketing plan.
  - Step 2: Estimate the revenue (sales) the marketing plan is expected to generate.
- Three key performance indicators used to measure the success of the marketing plan are:
  - sales analysis
  - market share analysis
  - marketing profitability analysis.
- The marketing plan can be revised by:
  - changes in the marketing mix
  - new product development
  - product deletion.

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Syllabus area 2
Topic 3
Concept 7

Implementation, monitoring and controlling
Summary screen and practice questions

Resources

Weblink: iSentia

EXERCISE 7.6 REVISION

1 **Why** is the implementation stage as important as developing marketing objectives?

2 (a) **Distinguish** between 'monitoring' and 'controlling'.
(b) **How** are the two processes linked?

3 Research online to **examine** the function of the company iSentia.
(a) **Outline** the role of iSentia.
(b) **State** iSentia mission.
(c) Select a 'Products and Services' that interests you and **explain** how a business would use this product or service.

4 **Recall** the two questions a marketing manager needs to ask in the controlling process.

5 **Summarise** the two steps involved in developing a financial forecast.

6 **Why** is it easier for a business to forecast marketing costs than revenue?

7 A business has a sales potential of $90 000 but achieves actual sales of only $25 000.
(a) **Deduce** what this signifies.
(b) **Propose** what the business should do next.

8 'Any business that fails to conduct a sales analysis will not be able to assess the effectiveness of its marketing strategies.' **Discuss**.

9 **Examine** the following market share results for Electronic Appliances Ltd.

Year	Sales revenue ($ million)	Market share (%)
2016	28	18
2017	25	18
2018	33	14

(a) **Explain** how it is possible for sales revenue to decrease between 2016 and 2017 but market share to remain the same.
(b) If you were the marketing manager, **calculate** with which year's results you would be most pleased. **Justify** your answer.

10 **Distinguish** between 'sales analysis' and 'market share' analysis.

11 **Clarify** the importance of a marketing profitability analysis.

12 **Summarise** four changes that could be made to revise the marketing mix.

13 **Distinguish** between 'new product development' and 'product deletion'. Provide examples in your answer.

EXERCISE 7.6 EXTENSION

1 **Account** for why a business's marketing performance should be constantly evaluated. **Investigate** some methods that can be used to measure the effectiveness of a marketing plan.

2 You have just been appointed marketing manager for Apollo Tracksuits Pty Ltd. One of your first tasks is to analyse total industry sales and product line sales revenue breakdown, as shown in tables 7.3 and 7.4.

TABLE 7.3 Apollo Tracksuits Pty Ltd — company sales and total industry sales, 2013–2017

Year	Apollo sales ($ millions)	Industry sales ($ millions)	Apollo market share (%)
2013	5	38	
2014	7	44	
2015	10	81	
2016	9	70	
2017	12	89	

TABLE 7.4 Apollo Tracksuits Pty Ltd — product line sales, 2014

Product	Sales quota ($ millions)	Actual sales ($ millions)	Difference ($)	(%)
Techno Tracks	2	1		
Weekenders	3	1.5		
Sports Plus	2	2		
Image Track	2	2.5		
No Sweat Tops	3	3		

(a) **Calculate** a market share analysis by completing table 7.3. **Create** a report on your results.
(b) The actual sales and sales quota figures for each product are shown in table 7.4. Complete the table. **Deduce** what these figures indicate.
(c) **Determine** what suggestions you would make to improve the actual sales performance.

Resources

Digital doc: Chapter summary (doc-24809)
Interactivity: Chapter crossword (int-7161)
Interactivity: Multiple choice quiz (int-7162)

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Sit HSC exam

CHAPTER 8

Marketing strategies

OVERVIEW

8.1 Introduction
8.2 Market segmentation
8.3 Product/service differentiation and positioning
8.4 Products — goods and/or services
8.5 Price and pricing methods
8.6 Promotion
8.7 Place/distribution
8.8 People, processes and physical evidence
8.9 E-marketing
8.10 Global marketing

8.1 Introduction

BizWORD

The **extended marketing mix** *refers to the combination of people, processes and physical evidence with the four main elements of the marketing mix.*

As mentioned in chapter 7, the marketing mix consists of four major elements: product, price, promotion and place. Reference was also made to the three Ps of marketing — which when combined with the original four Ps creates the **extended marketing mix**. The three Ps have become increasingly significant due to the expansion of service-based businesses within the economy. Together, these seven Ps (see figure 8.1) make up the strategies of marketing and become the centrepiece of the marketing plan.

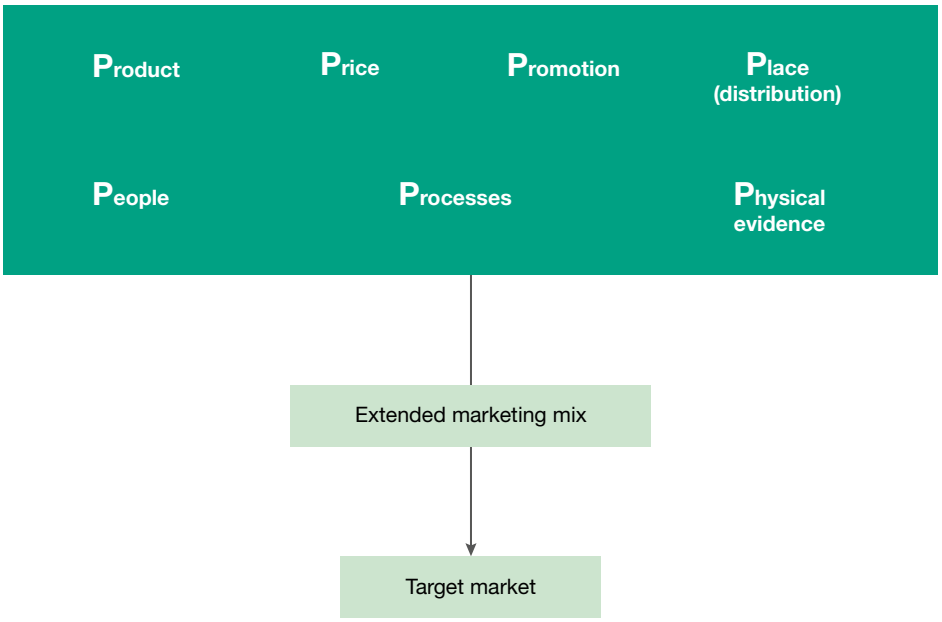


FIGURE 8.1 The seven Ps of the extended marketing mix. The marketing mix may be varied when a business wants to reach different target markets.

As figure 8.1 shows, there are many possible ways to satisfy the needs and wants of target customers. A product can have many different features and quality levels. The packaging can be of different colours or materials. Service levels can be altered. The brand name can be modified. Various promotional methods may be used. Different prices can be charged and price discounts offered. Various distribution channels can be used ranging from a single outlet to intensive coverage of the entire market.

The main goal of a marketing manager is to develop and maintain a marketing mix that precisely matches the needs of the customers in the target market.

8.2 Market segmentation

As was outlined in chapter 7, **market segmentation** involves dividing the total market into segments. Once the market has been segmented, the marketing manager selects one of these segments to become the target market (see figure 8.2). Often a business will implement a specific marketing mix to each target market that the business wants to sell to.

BizWORD

Market segmentation *occurs when the total market is subdivided into groups of people who share one or more common characteristics.*

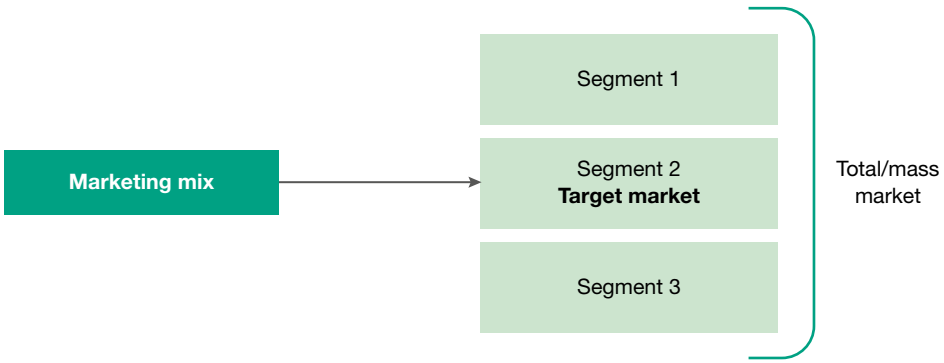


FIGURE 8.2 Selecting a market segment to be the target market

The ultimate aim of market segmentation is to increase sales, market share and profits by better understanding and responding to the desires of the different target customers (see the following Snapshot).

Case study: eBay — identifying 'geo-tribes'

eBay has employed a segmentation of its users to promote its behavioural targeting abilities using 15 'geo-tribes' or named consumer archetypes for advertisers to target.

With the assistance of RDA Research, the online auction site conducted a geo-demographic and needs-based segmentation so that marketers can target consumers based on characteristics such as socioeconomic status, lifestage and needs.

The rationale behind the segmentation was to bring commonly used offline segmentation approaches to the online world, according to eBay's head of advertising, JJ Eastwood, an initiative that hadn't been undertaken before.

'Marketers who are familiar with offline geo-demographical and needs-based segmentation, but have struggled to map them to digital campaigns, now have a tool that brings offline audience segmentation to online advertising', Eastwood says.

'Ecommerce is now a $30 billion industry here in Australia and marketers are looking for opportunities to connect with consumers while they shop online. Therefore it's important that as we bring new advertising partners on-board, we connect them with the right audience and in turn our customers receive advertising messages that are both relevant and meaningful to them.'

The initiative launched with an educational campaign and microsite to introduce marketers to the geo-tribes, which include the following.

1. **Rockafellas:** Affluent mature families, 7.0% eBay consumers/7.0% Australian population

SNAPSHOT



'. . . we connect them with the right audience and in turn our customers receive advertising messages that are both relevant and meaningful to them.'

2. **Achievers:** Ambitious younger and middle-aged families, 13.2% eBay consumers/10.1% Australian population
3. **Fortunats:** Financially secure retirees and pre-retirees, 3.5% eBay consumers/6.5% Australian population
4. **Crusaders:** Career oriented singles and couples, 7.3% eBay consumers/4.8% Australian population
5. **Preppies:** Mature children of affluent parents, 6.4% eBay consumers/3.7% Australian population
6. **Independents:** Young singles and couples, 6.6% eBay consumers/5.0% Australian population
7. **Suburban splendour:** Middle class mature families, 7.5% eBay consumers/8.3% Australian population
8. **Twixters:** Mature children living at home, 6.9% eBay consumers/4.2% Australian population
9. **DebtStars:** Financially extended younger families, 14.6% eBay consumers/10.6% Australian population
10. **Boomers:** White collar post-family pre-retirees, 4.8% eBay consumers/7.0% Australian population
11. **True blues:** Blue collar mature families and pre-retiree singles, 4.4% eBay consumers/6.4% Australian population
12. **Struggleville:** Struggling young and middle-aged families, 10.5% eBay consumers/7.3% Australian population
13. **Grey power:** Better-off retirees, 1.4% eBay consumers/5.1% Australian population
14. **Survivors:** Retirees living on minimal incomes, 1.4% eBay consumers/8.9% Australian population
15. **Slender meanz:** People living in underprivileged circumstances, 4.5% eBay consumers/5.1% Australian population

The microsite incorporates an interactive tool for marketers to generate a free report based on age, gender and geographic location that can be linked to the offline world by allowing marketers to look up where the archetypes are most likely to live.

During an introduction phase, eBay claims to have achieved a four-fold increase in click-through rates and reports from clients of a two-fold increase in return on investment as a result of the geo-tribes targeting.

SNAPSHOT QUESTIONS

1. **Identify** the variables eBay used to segment the market.
2. **Explain** why eBay decided to segment its users.
3. **Justify** which geo-tribe you would fall under.
4. **Assess** the marketing value of this new strategy.

BizWORD

A **segmentation variable** *is the characteristics of individuals or groups that are used by marketing managers to divide a total market into segments.*

8.2.1 Segmenting consumer markets

A **segmentation variable** is the characteristics of individuals or groups that are used by marketing managers to divide a total market into segments. The consumer market can be segmented according to four main variables: demographic, geographic, psychographic and behavioural (see table 8.1).

TABLE 8.1 Common variables for segmenting customer markets

Demographic	Geographic	Psychographic	Behavioural
• Age • Gender • Education • Occupation • Income • Social class • Religion • Ethnicity	• Region • Urban • Suburban • Rural • City size • Climate • Landforms	• Lifestyle • Personality • Motives • Socioeconomic group • Consumer opinions and interests	• Purchase occasion • Benefits sought • Loyalty • Usage rate • Price sensitivity

Demographic segmentation

Demographic segmentation is the process of dividing the total market according to particular features of a population, including the size, age, sex, income, cultural background and family size. Due to the ease with which these demographic variables can be measured, their use is widespread amongst marketers.

Age and gender are two of the most widely used demographic variables for segmentation purposes. The marketing of sparkling and still beverages is typical of this (see figure 8.3). Coca-Cola, for example, targets 18- to 24-year-old males with the energy drink *Mother*. The more health conscious adult market is served with *Diet Coke, Coca-Cola No Sugar, Deep Springs Natural Mineral Water* or *Nestea Iced Tea*. *Fanta* has as its primary target market 15- to 24-year-olds who want to enjoy life and have fun. *Mount Franklin* is aimed at younger females and families, whereas *Powerade* and *Pump* have as their core market 18- to 34-year-olds who are always on the go.



FIGURE 8.3 Coca-Cola offers a range of sparkling and still beverages for different target markets segmented primarily according to age and gender. In other markets, including clothing, magazines, books, alcoholic drinks and even motor vehicles, gender has also been a key demographic variable.

BizWORD

Demographic segmentation *is the process of dividing the total market according to particular features of a population, including the size of the population, age, sex, income, cultural background and family size.*

BizFACT

Nike recently began targeting the Middle East female fitness market with the introduction of a performance hijab for Muslim women. The company adapted itself and its products to meet the consumer needs of this growing market. With 1.6 billion Muslims around the world, Nike's new range will appeal directly to this new segment.

Geographic segmentation

Geographic segmentation is the process of dividing the total market according to geographic locations. Businesses may divide the consumer market into regions because consumers in different geographical locations have different needs, tastes and preferences. Consequently, the marketing mix may differ from one geographic region to another. The leading agribusiness company Landmark, for example, operates a national network offering rural supplies in around 400 rural locations. Although most of its marketing mix elements will be common across all locations, regional variations require modifications to suit the particular rural activities.

Sometimes the size of the city can be an important segmentation variable. One franchise fast-food business will not locate in cities of less than 25 000 people. Climate also has an impact on segmenting markets for businesses selling heating and cooling systems as well as clothing. Consumers in Jindabyne will need snow chains and heavy outdoor clothing, but consumers in Port Macquarie are more interested in lightweight clothing.

BizWORD

Geographic segmentation *is the process of dividing the total market according to geographic locations.*

Psychographic segmentation

Psychographic segmentation is the process of dividing the total market according to personality characteristics, motives, opinions, socioeconomic group and lifestyles. When segmenting a market according to psychographic variables, a business would research a consumer's brand preferences, favourite music, radio and television programs, reading habits, personal interests and hobbies, and values.

BizWORD

Psychographic segmentation *is the process of dividing the total market according to personality characteristics, motives, opinions, socioeconomic group and lifestyles.*

BizFACT

Personality and self-concept have been found to influence the clothes, hair styles, make-up, entertainment and motor vehicles that individuals will purchase.



FIGURE 8.4 Psychographic segmentation groups people according to how they spend their time, activities, interests, opinions and attitudes.

BizFACT

The shampoo industry uses psychographics to segment the market. The attitudes and values of customers are important when segmenting the market and many companies develop specific products to target certain lifestyles and values. For example, L'Oreal's purchase of the Body Shop in 2006 enabled them to appeal to a growing segment of customers wanting organic and animal-friendly products.

Psychographic variables focus on why people behave the way they do. An average Toyota Corolla owner compared with an average Porsche Cayman S owner, for example, will respond quite differently about the cost of vehicle maintenance, insurance and accessories.

Psychographic variables can be used by themselves to segment a market, or they can be combined with other types of segmentation variables. However, unlike demographic variables, psychographic variables can sometimes be difficult to accurately measure, especially personality characteristics and lifestyle.

Behavioural segmentation

BizWORD

Behavioural segmentation *is the process of dividing the total market according to the customers' relationship to the product.*

Behavioural segmentation is the process of dividing the total market according to the customers' relationship to the product. This includes customers' knowledge of, attitude towards, use of, or benefits sought from the product. A total market, for example, may be divided into users and nonusers. Users can then be classified as heavy, moderate or light. To encourage light and moderate users to purchase more of its products, a business may have to redesign the product, set special prices and implement special promotion activities.

BizFACT

Several products are aimed at providing the benefits sought by the customer. For instance, many shampoo brands create products to satisfy different needs, for example, anti-dandruff, detangler, volumising, moisturising.



FIGURE 8.5 The loyalty of the customer can also be used for behavioural segmentation. The best example of this is in the hospitality industry where hotels, restaurants and airlines provide their best service to their most loyal customers.

Identifying what the customers want from the product — the benefits sought — is an important aspect of behavioural segmentation. By determining the benefits desired, marketers can design products that directly satisfy these desires.

8.3 Product/service differentiation and positioning

Walk into any supermarket to buy a loaf of bread and you are faced with a wide selection from which to choose: white, wholemeal, sliced, unsliced, gluten-free, vitamin enriched, thick for toasting and so on. Providing so many different types of breads is a deliberate marketing strategy and is an example of **product/service differentiation**. This occurs when products that are the same or similar are made to appear different from and/or better than those of their competitors. By achieving this, the seller is able to gain a little more control in the marketplace, especially with price.

BizWORD

Product/service differentiation, *in its broadest sense, is the process of developing and promoting differences between the business's products or services and those of its competitors.*

8.3.1 Points of differentiation

The difference could be as simple as changes to the packaging or labelling; or more complex, such as offering top-quality service, greater convenience, more features and better **value for money**, or products or services that are environmentally friendly. These factors all play a part in persuading consumers to perceive the product or service as being superior to all similar products or services and, therefore, influencing them to buy it. Examples include jeans with designer labels, washing detergent with brightener additives and an exclusive restaurant that offers full-table service.

BizWORD

Value for money *is the desire to obtain the best quality, features and performance for a given price of a product.*

Four important points of differentiation are customer service, environmental concerns, convenience, and social and ethical issues.

Customer service

Market research shows that consumers:

- *desire 'personalised' service:* products that are tailored to their individual needs and wants. Customers may require many different services before, during and after the purchase
- *require 'caring' service:* to be treated honestly, courteously and efficiently
- *want high quality and value:* a business needs to establish favourable conditions for service by offering fair prices and high-quality products.

BizFACT

A continual flow of differentiated products such as Diet Coke, Coca-Cola Zero, Mother and Vanilla Coke has kept the Coca-Cola Company number one in the Australian soft-drink market in recent years.

Customer service can be a powerful marketing tool and a true point of differentiation in today's business environment.

Consumers expect a high level of customer service. Pre-sales and after-sales service are very important to consumers purchasing expensive items such as cars or electrical appliances.

Failing to provide excellent customer service will result in lost sales and damage the business's competitive position. Customer service should be the main feature to position a business head and shoulders above its competition. Simply meeting basic customer needs is not considered enough in today's marketplace. Businesses should always strive to exceed customer expectations.

Customer service may also include the presentation of the premises, the atmosphere, or the range of products that set a business apart and capture the consumer's interest.

Environmental concerns

People are becoming more concerned with 'quality of life' issues, especially the physical environment. Businesses that create pollution may risk losing customers; whereas businesses that adopt a 'green' philosophy and produce environmentally friendly products may see their sales increase.

THE ICONIC

THEICONIC.COM.AU

FIGURE 8.6 THE ICONIC has differentiated itself from other online retail sites by establishing a competitive advantage through convenience, broad product and brand assortment, and customer experience. It offers three-hour and same-day delivery to major cities across Australia and New Zealand, next-day delivery to metro areas in Australia and New Zealand, which has made them one of the most popular e-tailers in Australia and New Zealand.

Convenience

Because today's consumers are busy, they will often select products that are convenient to use. For example, many consumers do not have a lot of time for meal preparation. In response, food manufacturers have developed a range of convenience food products. The packaging and cooking requirements are designed to make the preparation as convenient as possible.

Social and ethical issues

A growing number of consumers are becoming more ethically minded and will actively purchase products or brands that they believe do not exploit workers, producers or the environment. These consumers want to know more about the way goods are made, including the conditions in the factories and where they come from.

Ethical consumerism provides businesses with opportunities to satisfy the demands of this growing number of consumers. For example:

- In response to the dislike of genetically modified (GM) foods by some consumers, various producers are labelling their products as GM-free.
- The **Fair Trade movement** is gaining in influence with consumers increasingly prepared to pay more for guarantees of fair labour practices and sustainable, organic products. The FAIRTRADE Mark (see figure 8.7), which represents an independent certification system, is one example of assuring fair labour practices.
- The cosmetic industry is delivering more natural products, not tested on animals.

BizWORD

Ethical consumerism *involves buying products that are not harmful to the environment, animals and society.*

Fair Trade movement *is an alternative method of international trade that promotes environmentalism, fair wages, alleviation of global poverty and a fair price for farmers and workers.*

FAIRTRADE

FIGURE 8.7 The FAIRTRADE Mark assures consumers that disadvantaged producers in the developing world receive a fair price for their commodities.

8.3.2 Product/service positioning

Closely tied to product/service differentiation is the practice of **product/service positioning**. This refers to the technique in which marketers try to create an image or identity for a product/service compared with the image of competing products or services.

Product/service positioning is something that is done in the minds of the target market: it is how potential buyers perceive the product. Some brand names, such as Rolex, Ferrari, No Frills and Supre, can immediately evoke an image of the product's quality. This image gives the product its position within the market.

In highly competitive markets, sales may be difficult to secure. For this reason, a business will attempt to create an image that differentiates its product/service from the others. Many businesses invest considerable resources in the positioning of their product/service. The business will decide on the image it wishes to create for a product/service and will use other elements of the marketing mix to shape and maintain this image.

Whenever a new product is launched, the marketing manager needs to have clearly determined the desired positioning of the product/service. This will be achieved through the product/service's name, price, packaging, styling, promotion and channels of distribution. Combined, these individual characteristics create the image of the product/service.

Many companies have made a strategic decision to reposition themselves in their market (see figure 8.8 and the following Snapshot). Repositioning focuses on changing what customers associate with the brand and sometimes competing brands. Some reasons companies reposition themselves include changing market conditions, decline in sales, desire to focus on a new target market, new competition and to overcome negative customer perceptions of the brand.

BizWORD

Product/service positioning *refers to the technique in which marketers try to create an image or identity for a product compared with the image of competing products.*



FIGURE 8.8 In an attempt to shake off its reputation as a maker of low-priced, low-quality pizzas, Domino's launched a new menu, reducing the size of their pizzas as well as increasing the prices of some pizzas. This was an attempt by the company to reposition its brand.

SNAPSHOT



‘. . . hoping to realign the brand to appeal to a wider range of buyers . . .’

Case study: Holden repositioning itself in the automotive market

When you think of Holden, Bathurst and blokes come to mind.

From the early days of the iconic Torana and Gemini, to the more recent times of the Monaro and Commodore Ute — Holden has forever been a brand for the boys — or, dare I say it, the ‘bogans’ of Australia.

The roaring lion, the red and white flags and roaring V8 engines — the Holden brand has been exclusive to a select pool of fanatics since inception.

But bosses say that ‘rev head’ demographic is no longer part of their new age “modern Australia” strategy, with the car manufacturer hoping to realign the brand to appeal to a wider range of buyers — particularly women.

But, as Holden gears up to close its last car factory in Adelaide in October before opting for imported vehicles — the manufacturer is facing its biggest battle yet — changing a deep-rooted perception of the iconic Australian brand.

This year, Holden unveiled a new plan for winning over a new breed of buyer, and extinguishing public indifference to the brand.

“Research has shown that 64 per cent of Australians are indifferent about the Holden name and this proves that our brand image is our biggest hurdle,” executive director of marketing at Holden, Mark Harland, told *Behind the Wheel*.

“We need to get Holden back on people’s radars.”

At the media launch of the new Holden Astra sedan this month, which is one of several new vehicles to be included in its 2017 portfolio, Holden’s general manager of marketing, communications and digital, Natalie Davey, said breaking away from its former brand had been a big challenge.

“If you think about Holden ... we are iconic as an Australian brand,” Mrs Davey told news.com.au.

“That icon from yesteryear was around meat pies, kangaroos and Holden. But if you think about modern Australia today, we haven’t remained prominent to that, which is where we are catching up.”

In 2015, Holden posted its lowest sales in 23 years. But with women influencing up to 70 per cent of all car purchases, it is hoping the rebrand will lure more females into dealerships.

Earlier this year, Holden released a targeted Facebook ad made especially to acknowledge how women felt when purchasing a vehicle.

“Going into a dealership can sometimes I feel, maybe, as a woman, be a little bit intimidating. It’s a bit of a boy’s club,” a young blonde woman said to camera in the advert.

“I feel like the car industry portrays women quite unfairly. You always see a man driving the car in the adverts. I feel like it doesn’t really represent who I am as a woman,” another brunette added.

The commercial ended with the tagline ‘Change is coming’ alongside the Holden Spark.

Mrs Davey said the advertising and marketing rebrand, which included a change in logo and social media approach to the brand, has been a big step.

“We have a long and proud heritage in Australia, but there is a deep perception of the brand,” she explained.

“I grew up with Holden — the V8 supercars, Bathurst, the utes and Commodores. We have all grown up with the Holden of yesterday, and it’s not something we can brush off overnight.

“We know changing perception is a long term plan, but we want to evolve to include all audiences.

“This isn’t about not wanting our loyal customers anymore. We want to build that appeal beyond the heartland.

“We want to show today’s Australia we have vehicles for everybody.”

Source: Vanessa Brown, ‘Car manufacturer Holden reveals why it had to reposition itself in the automotive market’, news.com.au, 6 July 2017

SNAPSHOT QUESTIONS

1. **Outline** Holden’s previous positioning in the automotive market.
2. **Explain** why Holden wants to reposition itself.
3. **How** has Holden begun to appeal more to women?

SUMMARY

- The marketing mix consists of four major elements: product, price, promotion and place.
- Combined with these four Ps are people, processes and physical evidence to create the extended marketing mix.
- Together, these seven Ps make up the strategies of marketing and become the centrepiece of the marketing plan.
- The main goal of a marketing manager is to develop and maintain a marketing mix that precisely matches the needs of the customers in the target market.
- Marketing segmentation involves dividing the total market into segments.
- A business selects one of these segments to become the target market.
- The ultimate aim of market segmentation is to increase sales, market share and profits by better understanding and responding to the desires of the different target customers.
- The consumer market can be segmented according to four main variables:
  - demographic — features of a population
  - geographic — urban, regional and rural locations
  - psychographic — personality characteristics
  - behavioural — customers' relationship to the product.
- Product/service differentiation, in its broadest sense, is the process of developing and promoting differences between the business's products or services and those of its competitors.
- Product positioning refers to the technique in which marketers try to create an image or identity for a product/service compared with the image of competing products/services.

studyon

Syllabus area 2
Topic 4
Concept 1

Market segmentation and product/ service differentiation
Summary screen and practice questions

studyon

Syllabus area 2
Topic 4
Concept 2

Market segmentation: product service positioning
Summary screen and practice questions

EXERCISE 8.1 REVISION

1 **Identify** the seven marketing elements that make up the marketing mix.

2 **State** the link between market segmentation and target market.

3 **Recall** the ultimate aim of marketing segmentation.

4 **Summarise** the four main ways of segmenting consumer markets.

5 Here are five different market segments:
(a) young married couple, no children
(b) female teenager, part-time worker
(c) older single person, female, retired
(d) younger single person, male, working
(e) male teenager, full-time student.

Listed below are 10 products/services. Copy the list into your notebook and, beside each item, **determine** the most appropriate market segment letter (a–e) for that product/service. In some cases, you may want to write more than one letter. Compare your answers with those of the rest of the class.
(a) Financial advice _____
(b) Ballet tickets _____
(c) Bus tour _____
(d) Dolly magazine _____
(e) Health insurance _____
(f) Apple iPad _____
(g) Rover lawnmower _____
(h) School textbook _____
(i) Smartphone _____
(j) Furniture _____

6 **Outline** the purpose of product/services differentiation.

7 For two specific products/services with which you are familiar, **describe** how they are differentiated from their competitors.

8 **How** can a business use customer service as a point of differentiation?

on Resources

Weblink: Fair Trade

9 'Environmentally friendly products are just a clever promotional strategy to make purchasers feel good.' **Justify** whether you agree or disagree with this statement.

10 **Examine** the ways the Fair Trade movement is committed to selling and production practices that are ethically responsible.

11 In small groups, choose a product/service with which you are familiar and **demonstrate** the types of positioning strategies used to promote it. Share your answer with the rest of the class. You may wish to prepare this as a PowerPoint presentation.

EXERCISE 8.1 EXTENSION

1 **Determine** why the mass marketing approach has declined in recent years. **Discuss** whether this means there is no place for mass marketing. **Justify** your answer.

2 Once the total market is segmented, a business selects a target market. **Demonstrate** the different ways in which a market may be segmented. **Why** does having a clear understanding of the target market improve the efficiency of the marketing plan?

3 **Create** an A4 print advertisement for a new model mobile phone that highlights its 'exclusive' features. You may wish to use desktop publishing software to present the advertisement with text and graphics.

8.4 Products — goods and/or services

When you buy a book or new phone you are purchasing a good. They are real, physical objects that can be touched and owned; they are *tangible*. Financial advice, television programs and sporting events provide an *intangible* service for our use or enjoyment, not for our ownership. However, services are products just the same. **Products** are goods or services that can be offered in an exchange for the purpose of satisfying a need or want.

BizWORD

***Products** are goods or services that can be offered in an exchange for the purpose of satisfying a need or want.*

8.4.1 Tangible and intangible products — total product concept

It is convenient to group products as tangible goods or intangible services. In reality, it is not quite so simple. Most products are combinations of tangible and intangible components. Dinner at an expensive restaurant, for example, provides tangible elements (food and drinks) and intangible elements (efficient service, live music and a pleasant atmosphere). Consequently, when customers purchase products, they buy both the tangible and intangible benefits (attributes) — a **total product concept**. In other words, a product is a 'collection of satisfactions', which might include a variety of things such as the package, the brand name, the warranty and the after-sales service.

BizWORD

*The **total product concept** refers to the tangible and intangible benefits (attributes) a product possesses.*

The term 'product', therefore, is a much broader concept than most people understand. Usually when people talk about products, they refer to what a company produces, such as motor vehicles or entertainment. And yet the intangibles that come with these products are also important. They can be used to differentiate one business's product from that of its competitor.

Often, with mass-produced products, it is on the differences in the intangible benefits that product competition is based. For example, cars are basically a means of transportation used to get from one place to another. If this was all they were, then there would be only one model. But a car contains a vast array of intangibles that are used to differentiate each model, such as image, reputation, style and safety record. Viewing the car in terms of a total product concept clearly shows that no two cars are exactly the same (see figure 8.9). All products, then, are a combination of tangible and intangible attributes.

BizFACT

The relationship between a business and its customers is based mainly on the product — goods and/or services.



FIGURE 8.9 Australians have developed expensive taste in cars. Sales of luxury branded cars grew by 11 per cent in 2016. Many people are buying luxury cars because it not only satisfies their needs and wants, but also provides intangible benefits such as a feeling of prestige, importance or influence. Mercedes-Benz is currently the most popular luxury vehicle brand.

8.4.2 Branding

Read the list of brand names in figure 8.10 and test yourself: what products do you associate with each brand name? Your score was probably 20 out of 20. You have just experienced the power of *brand name recognition*. The 20 businesses that market these brands have spent a lot of money making sure customers instantly recognise their brand name and the products associated with them. A **brand** is a name, term, symbol, design or any combination of these that identifies a specific product and distinguishes it from its competition. A **brand name** is that part of the brand that can be spoken. It may include letters (BMW motor vehicles); numbers (4711 perfume); numbers and letters (3M tapes); or pronounceable symbols, such as the ampersand (&) in Johnson & Johnson.

Apple	Kellogg's	McDonald's	Coca-Cola	Vegemite
Uncle Tobys	Arnott's	Samsung	Google	Weet-Bix
Holden	Sorbent	Telstra	KFC	Speedo
Colgate	Cadbury	Qantas	Nike	Sony

FIGURE 8.10 Examples of brand names

Benefits of branding

Branding provides benefits for both buyers and sellers. Branding helps consumers:

- identify the specific products that they like. Without branding, a consumer selection would be quite random because buyers could have no guarantee that they were purchasing what they preferred

BizWORD

*A **brand** is a name, term, symbol, design or any combination of these that identifies a specific product and distinguishes it from its competition.*

*A **brand name** is that part of the brand that can be spoken.*

BizFACT

According to BrandZ Top 100 Global Brands report for 2017, the top 5 most valuable brands in the world (in order) are Google, Apple, Microsoft, Amazon and Facebook.

BizFACT

If the brand name becomes well recognised, the business will also enjoy a carry-over effect when new products are introduced. This gives it a distinct competitive advantage

- evaluate the quality of products, especially when a consumer lacks the expertise to judge a product's features
- reduce their level of perceived risk of purchase. A respected and trusted brand will provide reassurance that the consumer is making the right choice
- gain a psychological reward that comes from purchasing a brand that symbolises status and prestige.

Branding helps businesses:

- gain repeat sales because consumers recognise the business's products
- introduce new products onto the market because consumers are already familiar with the business's existing brands
- with their promotional activities because the promotion of one product indirectly promotes all other similarly branded products
- encourage customer loyalty. This has the added benefit to the business of being able to charge a higher price for the product.

For these reasons, a brand name can be a powerful marketing tool. It is also why businesses spend a great deal of time, money and effort creating and protecting their brand name. McDonald's, for example, is one business that aggressively protects its brand name — which is a registered **trademark** — against infringement. It has brought legal proceedings against a number of businesses with 'Mc' names because it fears that the use of the 'Mc' will give consumers the impression that these businesses are owned or endorsed by McDonald's. The symbols, ©, TM or R at the end of a brand name signify that the name or symbol is copyright protected or a registered trademark.

BizWORD

*A **trademark** signifies that the brand name or symbol is registered and the business has exclusive right of use.*

Branding — symbols and logos

A **brand symbol** or **logo** is a graphic representation that identifies a business or product, as shown in figure 8.11.

BizWORD

*A **brand symbol** or **logo** is a graphic representation that identifies a business or product.*



FIGURE 8.11 Brand symbols or logos assist in the easy recognition of a product. Can you guess which brands these iconic logos belong to?

A brand symbol does not have to duplicate the words in the brand name. The three-pointed star of the Mercedes-Benz and Coca-Cola's distinctive narrow-waisted bottle are famous brand symbols. Some businesses encourage the instant recognition of their brand symbol rather than their brand name. Perhaps the most famous example of this technique is the 'golden arches' symbol used by McDonald's. Nike's 'swoosh' symbol has also become a brand symbol with a high recognition value. Notice how in some advertisements the brand name does not appear at all, only the brand symbol. This is a clever and subtle method used to reinforce the meaning of the symbol and associate it with a brand name.

BizFACT

Brand counterfeiting is especially detrimental because the usually inferior counterfeit product weakens the consumers' trust in the brand and their loyalty to it.

Branding strategies

Brands are usually classified according to who owns them. When a manufacturer owns a brand name it is referred to as a **manufacturer's brand** or **national brand**. Common examples of manufacturer's brands include Sunbeam appliances, Kraft

BizWORD

***Manufacturer's brand** or **national brands** are those owned by a manufacturer.*

foods and Billabong clothing. These brands have high appeal with customers because they are recognised across the country, are widely available and offer reliability with constant quality.

A **private** or **house brand** is one that is owned by a retailer or wholesaler. These products are often cheaper because the retailer or wholesaler can buy at lower costs. For example, Myer sells products from its own label, including Reserve, Basque, Urbane, Blaq, Bauhaus, Wild Rhino and Miss Shop.

Generic brands are products with no brand name at all. Carrying only the name of the product and in plain packaging; these generic brands have been available in supermarkets since the mid 1970s. Examples include Black and Gold (Metcash Trading Ltd), No Frills (Metcash Trading Ltd), Essentials and Select (Woolworths), Coles Smart Buy (Coles) and Just Organic (Aldi).

BizWORD

*A **private** or **house brand** is one that is owned by a retailer or wholesaler.*

BizWORD

***Generic brands** are products with no brand name at all.*



FIGURE 8.12 In 2016 Woolworths' new CEO replaced the labels on their Homebrand products with the name Essentials. This is due to increased competition from Coles and Aldi. To improve the quality and value of their generic brand they didn't change the products at all — just the labels — as analysts found that the red and white logo was perceived as too low quality. They also introduced a high-end home brand range called Woolworths Select.

8.4.3 Packaging

Packaging involves more than simply putting the product in a container or placing a wrapper around it. **Packaging** involves the development of a container and the graphic design for a product.

BizWORD

***Packaging** involves the development of a container and the graphic design for a product*

To assist sales, the packaging of a product is sometimes as important as the product itself. Well-designed packaging will give a positive impression of the product and encourage first-time customers. For example, tasteful packaging can create an image of luxury, sensuality and exclusiveness, helping to promote the product. In addition, packaging:

- preserves the product
- protects the product from damage or tampering
- attracts consumers' attention
- divides the product into convenient units
- assists with the display of the product
- makes transportation and storage easier.

Apart from performing these practical functions, packaging also acts as a form of communication. Consumers see certain colours and draw conclusions about the product even before they read the label. For example, a red soft-drink can means cola; green means lemon-lime. Dishwashing liquid in a yellow container is considered 'lemony' and a household cleaner in a green package is associated with an environmentally-friendly product. Many products packaged in black or gold portray an image of luxury and sophistication.

BizFACT

The Root Glass Company of Indiana created the famous Coca-Cola contoured bottle in 1915. It was designed to help Coca-Cola stand out from other drinks at the time, and the design brief was to ensure that the bottle was recognisable even in the dark.

Sometimes, the shape of the packaging can become part of the product itself. That is, consumers readily associate a unique shape with a specific product. For example, one of the most easily recognised shapes in the soft-drink market is the distinctive 'pinched in at the waist' Coke bottle. In 1977, Coca-Cola gained trademark protection by the United States Patent Office. Coca-Cola argued that the 'distinctively shaped contour' had become so well known it had taken on trademark status. Coca-Cola is also the registered owner of a number of Australian trademarks for its famous Contour Bottle. Due to the strong consumer association with the unique bottle design, Coca-Cola has aggressively protected its trademark shape.



FIGURE 8.13 The size of many popular items have decreased in the last five years, while prices have stayed the same. This trend has been called 'shrinkflation' since the price is, in effect, inflated as consumers pay the same amount for less. Higher prices are more noticeable than shrinking packages, which is why many companies have followed this trend.

SNAPSHOT



'. . . a lot of the sensation actually comes from the packet.'

The influence of packaging on customers

Woolworths has a new CEO and his big idea to save the struggling supermarket chain is . . . changing the labels on the Homebrand products.

Woolies is getting flayed by Coles and especially by Aldi. Shoppers and shareholders alike are more than ready for the big supermarket to start fighting back with fire.

The new CEO's plan is to ditch the Homebrand labelling, and give everything the name Essentials instead.

So to improve the quality and value, they're not planning on changing the products at all. Just the labels.

Analysts say Homebrand, with its plain red and white logo, was seen as too low quality. (Aldi's private label brands, by contrast, look anything but generic. If anything they look a lot like the major brands.)

And the funny thing is, this trick will almost certainly work on all of us. Because the way human brains work is totally suggestible. When we eat or drink a food, a lot of the sensation actually comes from the packet.

The best example is from Coca-Cola. This brand is super sensitive to consumer perception, (as you have to be when you've been selling brown sugar water at a high price for over a century).

But in 2011, they made a misstep. They ran a Christmas promotion in the US, changing their cans to white instead of the usual red. Consumers revolted. They complained to Coke the soda tasted different, and the company swiftly switched back to the safety of traditional red.

Packaging is the great magic trick performed for consumers. We think it's just to wrap up the contents. Instead it's a huge part of the experience.

Not just the buying experience or the unwrapping experience. Packaging can make us rate the product differently even after we've used it, and make us go back and buy again.

At Oxford University in the UK, a psychology professor called Charles Spence has done countless experiments on this phenomenon and made hundreds of discoveries. For example, if you serve strawberry mousse in a white container, it tastes 10 per cent sweeter than if it comes in a black container. Or, coffee tastes half as intense if you serve it glass instead of in a white cup.

Red makes things taste sweet, blue makes things taste saltier, round things taste sweeter than square, etc, etc. There is a huge catalogue of linkages between shape and colour and taste. (This explains why a company like Cadbury has trademarked their exact shade of the colour purple — they know how much their flavour depends on it.)

Professor Spence gets funding for research from big companies who want to change their packaging to make the experience better for consumers. He has already changed the sound a deodorant spray makes, so the men's Axe deodorant makes a much louder, tougher sound than a woman's spray.

And, according to one report, he's undertaking an experiment into whether changing the sound of a drink can when you open it affects the subjective experience of its flavour.

This is why Woolies simple plan to change their packaging can make such a big difference.

Packaging might not matter so much for a pineapple, say, or a baguette. But it matters enormously for things that have no real shape of their own, like beverages, canned food, and cereals and spreads — and those are the sort of things that are often home brand.

The fact packaging adds so much value is lost on some environmentalists — they rage against packaging as though it is purposeless.

They aren't necessarily wrong that it is wasteful, but the source of the problem is not evil corporations. It is our own brains mixing up flavour and texture and colour cues into an overall impression that means packaging will probably be a big part of product marketing, forever.

Is it smart to fight against the fact your brain gets a lot of flavour from the packaging? Only sometimes. Understanding how packaging works means you can let yourself be tricked when it helps you save money or eat less sugar, and fight against the effects if it is trying to rip you off.

As for Woolworths, we should probably hope their simple trick with the Essentials line works. To be honest, cheap generic brands have often been good products all along, but we've had bad experiences with them, because the packets looked terrible.

Studies show experts often prefer home brands — chefs tend to buy home brand flour and nurses prefer to buy home brand pain killers. They really are often just as good. If this is what it takes to make us buy more of it we would probably all be better off.

Source: Jason Murphy, 'Why Woolies had to kill Homebrand', news.com.au, 29 March 2016

SNAPSHOT QUESTIONS

1. **Why** have Woolworths changed the labels on their Homebrand products?
2. **State** where most of the sensation comes from when we eat or drink food.
3. **How** can packaging affect a customer's experience?
4. **Identify** the types of products that are most influenced by packaging.

BizWORD

Labelling *is the presentation of information on a product or its package.*

A **label** *is that part of the package that contains information.*

Labelling

Another important part of a product's package is labelling. **Labelling** is the presentation of information on a product or its package. A **label** is that part of the package that contains this information. Marketers can use labels to promote other products or to encourage proper use of products and therefore greater consumer satisfaction with products. Usually the label will provide information about ingredients, operating procedures, shelf life, package size or country of origin (see figure 8.14).



FIGURE 8.14 To help reduce confusion among consumers regarding country of origin labelling, the Australian Government introduced new food labelling requirements in 2016 to make it clearer where products are produced, grown, made or packed. The labels also tell consumers what percentage of the ingredients come from Australia.

BizFACT

Food labels must identify the:

- *name or description of the food*
- *batch number*
- *name and Australian address of the supplier*
- *list of ingredients*
- *date mark*
- *nutrition information panel*
- *country of origin*
- *warning and advisory statements.*

All labels must be truthful. In Australia, there are number of statutes (laws) and government regulations specifying information that *must* be included in the labelling for certain products (see the BizFact on the left).

These regulations are aimed at protecting the consumer from misleading or deceptive claims and the unsafe use of products. They also make it easier for consumers to compare products.

8.4.4 Why goods and/or services are central to both marketing and operations

The good or service is the central point on which both marketing and operations must focus. Operations managers need to determine how to make the product or provide the service and then marketing plays a key role in determining the appearance of the product and its functions, as well as communicating with the market.

The operations function is central to any business because it produces the goods and/or services; without a good or service, the business would not exist. Simply producing a product, however, doesn't necessarily result in sales. The operations department therefore relies on the marketing department to carry out market research so they can produce a product that will satisfy customer's needs. Operations also rely on marketing to inform the market, distribute products, determine a price and persuade people to purchase the products.

SUMMARY

- A product is a good or service that can be offered in an exchange for the purpose of satisfying a need or want.
- Most products are combinations of tangible and intangible benefits — the total product concept.
- With mass-produced products, competition is often based on the differences in the intangible benefits.

studyon

Syllabus area 2
Topic 4
Concept 3

Product/service: branding and packaging
Summary screen and practice questions

- A brand is a name, term, symbol, design or any combination of these things that identifies a specific product and distinguishes it from its competition.
- A brand name is that part of the brand that can be spoken.
- A brand symbol or logo is a graphic representation that identifies a business or product.
- To guard against other businesses using its brand name or symbol, a business can apply to have the name registered.
- Manufacturer's or national brands are those owned by a manufacturer.
- A private or house brand is one that is owned by a retailer or wholesaler.
- Generic brands are products with no brand name at all.
- To assist sales, the packaging of a product is sometimes as important as the product itself.
- Marketers can use labels to promote other products or to encourage proper use of products and therefore greater consumer satisfaction with products.

EXERCISE 8.2 REVISION

1 Think of a product you have recently purchased. **Identify** the tangible and intangible benefits you gained from the product.

2 **Why** do marketing managers prefer to use the term 'total product concept' rather than simply 'product'?

3 **Explain** what is meant by imagining a product as a 'collection of satisfactions'.

4 **Why** do businesses spend so much money attempting to establish a brand name and brand symbol?

5 Create a 'T' table to **summarise** the benefits of branding for (a) consumers and (b) businesses. The 'T' table has been started for you.

Benefits of branding	
Consumers • Identify favourite products	Businesses

6 **Identify** which benefit of branding you consider to be the most important for the (a) consumer and (b) business. **Justify** your selection.

7 When deciding on a brand name and brand symbol, **outline** some of the considerations that a marketer must take into account.

8 **Evaluate** each of the following brand names. Indicate the strong points of each name.
(a) Nokia mobile phones
(b) Apple computers
(c) LG electronic products.

9 **Summarise** the different types of branding strategies a business can use. Provide an example of each.

10 **Explain** why packaging is critical to the success of a product.

11 Select three differently packaged goods and **explain** why you think the manufacturers chose to package the goods in such a way.

12 **How** can packaging and labelling be used as marketing strategies?

13 Find examples of packaging awards winners. The **Australian Institute of Packaging** website is a useful starting point. **Analyse** two of the designs and, for each one, write a 150-word paragraph on how these address a marketing plan.

14 Using an example, **explain** why goods and/or services are central to both marketing and operations.

on Resources

Weblink: Australian Institute of Packaging

EXERCISE 8.2 EXTENSION

1 'With mass-produced products, it is often on the differences in the intangible benefits that product competition is based.' **Evaluate** the accuracy of this statement. Provide examples to support your answer.
2 **Distinguish** between Product of Australia, Australian Made and Grown in Australia.
3 'Branding, packaging and labelling combine to create a powerful set of marketing strategies.' Use examples to **evaluate** the accuracy of this statement.

on Resources

Weblink: Australian Made

8.5 Price and pricing methods

BizWORD

Price *refers to the amount of money a customer is prepared to offer in exchange for a product.*

Price refers to the amount of-money a customer is prepared to offer in exchange for a product. Many businesses have difficulty selecting the 'correct' price for their products. A price set too high could mean lost sales unless superior benefits are offered. A price set too low may give customers the impression that the product is 'cheap and nasty'. Somewhere between these extremes is a correct price for a product.

In any market, businesses will attempt to gain some control over the price by differentiating their products. Once this happens, the business has more leverage over the price. For example, clothes with designer labels, such as Nike, Bardot, Roxy and Billabong, are the result of product differentiation strategies. These labels can set higher prices for their garments than clothing sold under the Target or Kmart brand labels.



FIGURE 8.15 Of all the marketing mix elements, price is probably the most flexible. Businesses can adjust prices much more easily than they can modify the product, redesign the promotional campaign or change the distribution system. Price can be adjusted quickly in response to competitors' actions or changes in the marketplace.

BizFACT

Woolworths plans to gradually move its entire range of products to round number pricing and has already begun progressively rounding some prices to numbers with a zero at the end. Round prices will make the shopping experience simpler for consumers as it will make it easier for them to remember and add up prices as well as compare prices of products.

8.5.1 Pricing methods

Overall, a business's pricing decisions are influenced by a variety of internal and external factors. As a starting point, the business's marketing objectives and costs of production provide an indication of what it should charge for its products. Then, the business must consider such factors as the amount of competition in the marketplace, government regulations, the location of the product on its life cycle and the level of economic activity.

There are three main pricing methods: cost-based, market-based and competition-based. These pricing methods provide a 'basic' price for each product. Pricing strategies are then used to adjust the basic price, depending on the marketing objectives and conditions within the marketplace.

BizWORD

Cost-based pricing *is a pricing method derived from the cost of producing or purchasing a product and then adding a mark-up.*

Mark-up *is a predetermined amount (usually expressed as a percentage) that a business adds to the cost of a product to determine its basic price.*

Cost-based pricing

Cost-based pricing is the simplest of the three methods. As a starting point, the business determines the total cost of producing (or purchasing) one unit of the product. The business then adds an amount to cover additional costs (overheads such as interest payments, insurance, transport) and to also provide an adequate profit margin. That amount is referred to as the **mark-up** and is usually expressed as a percentage. The total of the cost plus the mark-up is the selling price of the product. The formula is as follows.

Cost + Cost × Mark-up percentage = Price

For example, if a manager of a clothing store buys 100 blouses at $50 each and applies an 80 per cent mark-up on cost, the price to the consumer will be $90 per item. This same percentage mark-up might be applied to all products in the store.

Cost-based pricing is a very simple and straightforward pricing policy and is used mainly by wholesalers and retailers. However, it has two major drawbacks.

1. Difficulty in accurately determining an appropriate mark-up percentage. If the percentage is too high, the product will be overpriced and possibly not sell. If the mark-up is too low, the business is losing profit they could have easily obtained.
2. The product is priced after production and associated costs are incurred without taking into account the other elements of the marketing mix or the state of the market.

Market-based pricing

Instead of using costs to determine price, businesses sometimes set prices according to the level of **supply** and **demand** — whatever the market is prepared to pay. **Market-based pricing** is a method of setting prices according to the interaction between the levels of supply and demand. When demand for a product is greater than its supply, there will be a *shortage* in the market. This will force up the price of the good. For example, if 100 prospective buyers attend an art auction but there is only one particular type of painting (product) offered for sale, the price will rise. As the price rises, buyers will progressively drop out of bidding until the final buyer is successful. Conversely, when the supply of a product is greater than its demand, a *surplus* will exist in the market. The price of the product will consequently fall. This is why bananas are cheaper, for example, during the summer months.

The prices of products, therefore, are constantly changing in relation to fluctuations in the levels of supply and demand. Market-based pricing is critically important not only as a pricing method in itself, but also as a basis for the other pricing methods. However, this method can be difficult to apply because the levels of supply and demand will constantly change.

BizFACT

A breakeven analysis can assist a marketing manager to determine the appropriate mark-up percentage.

BizWORD

Supply *is the quantity of a product businesses are willing to offer for sale at a particular price.*

Demand *is the quantity of a product consumers are willing to purchase at a particular price.*

Market-based pricing *is a method of setting prices according to the interaction between the levels of supply and demand — whatever the market is prepared to pay.*



FIGURE 8.16 Levels of supply and demand for accommodation in the snow fields, for example, fluctuate dramatically between summer and winter seasons, and prices rise and fall accordingly.

Competition-based pricing

Most products are available from more than one business. When making a major purchase, many consumers compare prices. Businesses, therefore, need to consider the competition when making their pricing decisions. **Competition-based pricing** is where the price covers costs (cost of raw materials and the cost of operating the business) and is comparable to the competitor's price.

Competition-based pricing is often used when there is a high degree of competition from businesses producing similar products. Once a business has established a base price, it can then decide to choose a price either:

- below that of competitors. This policy of undercutting the competition is often used as a way of breaking into an established market.
- equal to that of competitors. Following the price established by a **price leader** is an easy option for a business because it avoids having to undertake market research to find out what the consumer would actually pay. As well, it also avoids the risks of price competition/war.
- above that of competitors. This is a favoured practice by businesses who wish consumers to perceive the product as superior, which appeals to the status-conscious buyer.

BizWORD

Competition-based pricing *is where the price covers costs (cost of raw materials and the cost of operating the business) and is comparable to the competitor's price.*

BizWORD

A **price leader** *is a major business in an industry whose pricing decisions heavily influence the pricing decisions of its competitors.*

8.5.2 Pricing strategies

Once the basic price has been set using the preferred pricing method(s), the business then fine-tunes this price in line with its pricing strategy. Various pricing strategies can be used, and it is common for a business to use several at once, even for the same product. The extent to which a business uses any of the following strategies depends primarily on:

- its marketing objectives
- the life cycle of the product
- the market for the product
- the degree of product differentiation
- the level of economic activity.

Of course, as with all areas of business, the pricing strategies used by marketers will have to be modified depending upon changes within the external business environment, especially the influence of technology. For example, the growing influence of the internet and the expansion of e-commerce have weakened some business's control over prices. Consequently, marketers have been forced to modify their traditional pricing strategies. One example is the widespread use of **bundle pricing** common with the telecommunications businesses, as evidenced by the advertisements from mobile phone companies, internet providers and cable television operators offering all kinds of packages.

BizWORD

Bundle pricing *is where customers gain a 'package' of goods and services in addition to the tangible good they purchased.*

Price skimming *occurs when a business charges the highest possible price for the product during the introduction stage of its life cycle.*

Price skimming

Price skimming occurs when a business charges the highest possible price for the product during the introduction stage of its life cycle. Some consumers are willing to pay a high price for a product's novelty features because of the prestige or status that ownership gives. Early purchasers (adopters) of innovative electronic equipment fall into this category. The business essentially 'skims the cream' off the market. The objective is to recover the costs of research and development as quickly as possible, before competition enters the market.

Price skimming, as Apple discovered, can sometimes not go as planned. Within twelve weeks of its introduction, Apple dropped the price of its 8GB iPhone by $200. The situation resulted in a negative backlash from early adopters. Apple subsequently tried to make amends by offering a $100 Apple Store credit for those who paid the higher price.

BizFACT

Whenever Sony launches a new and innovative product, they use the price skimming strategy. They set the price high when a product is first launched to make as much money as they can from those customers who will pay almost any price to get the latest gadget and then they decrease the price gradually over time.

Price penetration

At the opposite extreme to price skimming is price penetration. **Price penetration** occurs when a business charges the lowest price possible for a product. The strategy aims to quickly achieve a large market share for a product — sometimes called 'mass-market pricing'. The objective is to sell a large number of products during the early stages of the life cycle and thus discourage competitors from entering the market or from taking market share from existing businesses. The main disadvantage of this strategy is that it is more difficult to raise prices significantly than it is to lower them. Consequently, a business may be locked into a low sales revenue until it substantially modifies the product at a later stage.

BizWORD

Price penetration *occurs when a business charges the lowest price possible for a product or service so as to achieve a large market share.*

Loss leader

A **loss leader** is a product sold at or below cost price. For a special promotion, many businesses, especially retail stores, deliberately sell a product at a loss to attract customers to the shop. Although the business makes a loss on this product, it hopes that the extra customers will buy other products as well. The psychology behind this strategy is that once the consumers are in the store, they will usually buy other products and spend more than what attracted them into the store to begin with. The business can recover the loss on the low-price item from the sale of the other items or services that the consumer buys.

BizWORD

A **loss leader** *is a product sold at or below cost price.*



FIGURE 8.17 Supermarkets frequently use the loss leader pricing strategy as evidenced by the promotion of weekly specials. Often these heavily discounted items are located next to higher priced, more appealing products or at the end of the aisles with the lower prices clearly displayed.

This successful pricing strategy is often used when the business:

- is overstocked or a product is slow to sell
- wants to increase the traffic flow in the expectation of gaining new customers
- wants to build a reputation of having low prices.

However, the main danger of this practice is that if it is done incorrectly the business can actually lose money.

Price points

Price points (or price lining) is selling products only at certain predetermined prices. This pricing strategy is used mainly by retailers, especially clothing stores and boutiques. The business chooses a limited number of key prices or price points for selected product lines. For example, a jeweller may offer a line of watches priced at $55, $75 and $95 regardless of how much they cost at wholesale. In practice, this means the store would not apply a fixed mark-up to the products.

BizWORD

Price points *(or price lining) is selling products only at certain predetermined prices.*

Using this pricing strategy makes it easier for the customer to find the type of product they need. It also makes it easier for the business to encourage the customer to 'trade up' to a more expensive model.

8.5.3 Price and quality interaction

You have probably heard the expression 'You get what you pay for'. To marketing managers, this saying describes the price–quality relationship. Normally, products of superior quality are sold at higher prices. This is usually due to the higher manufacturing cost involved in producing them.

This perceived price–quality relationship helps determine the image customers have of products or brands. Therefore, if a business charges a low price for a product, customers may perceive the product as 'cheap'. Charge a high price and the product develops an aura of quality and status (see figure 8.18). This pricing strategy is referred to as **prestige** or **premium pricing** and is designed to encourage status-conscious consumers to buy the product. Premium or prestige pricing is based on the tendency for consumers to assume that expensive products are of superior quality and distinction. If a business that uses premium pricing lowered their prices dramatically, it would damage their reputation because it is inconsistent with the perceived images of such products.

BizWORD

Prestige *or* **premium pricing** *is a pricing strategy where a high price is charged to give the product an aura of quality and status.*

BizFACT

Premium pricing is common for service industries, where the consumer cannot see the product in advance and relies on price to indicate its quality.



FIGURE 8.18 A Grattan Institute report in 2015 found that 'prestige' universities cost students up to twice as much in course fees. Their research showed that the elite Group of Eight (Go8) universities charge up to twice as much as regional universities in some disciplines, which illustrates how much more some students are willing to pay to attend a prestige institution.

This price–quality relationship does not apply to all products. Usually, high-priced and infrequently purchased items such as cars, homes and furniture display a stronger price–quality relationship than frequently purchased products such as grocery items. As well, consumers may believe that high prices reflect either expensive packaging or market exploitation. This may lead to a reduction in sales because the consumer perceives there to be little actual difference between the quality of a low- and high-priced item. Sometimes, a premium price is set artificially high to imply a prestigious or quality image when, in reality, the quality may not be much superior to cheaper alternatives.

SUMMARY

- Price refers to the amount of money a customer is prepared to offer in exchange for a product.
- There are three main pricing methods:
  - Cost-based (mark-up) pricing is a pricing method derived from the cost of producing or purchasing a product and then adding a mark-up.

studyon

Syllabus area 2
Topic 4
Concept 4

Pricing methods
Summary screen and practice questions

  - Market-based pricing is a method of setting prices according to the interaction between the levels of supply and demand.
  - Competition-based pricing is where the price covers costs (cost of raw materials and the cost of operating the business) and is comparable to the competitor's price. A business can select a price that is below, equal to or above that of the competitors.
- Once the basic price has been set using the preferred pricing method, the business then fine-tunes this price in line with its pricing strategy.
- The four main pricing strategies include:
  - price skimming, which occurs when a business charges the highest possible price for the product during the introduction stage of its life cycle
  - price penetration, which occurs when a business charges the lowest price possible for a product or service to achieve a large market share
  - loss leader, which is a product sold at or below cost price. Although the business makes a loss on this product, it hopes that the extra customers will buy other products as well.
  - price points (or price lining), which is selling products only at certain predetermined prices.
- Normally, products of superior quality are sold at higher prices.
- Prestige or premium pricing is a pricing strategy where a high price is charged to give the product an aura of quality and status.

studyon
Syllabus area 2 | Topic 4 | Concept 5
Pricing strategies
Summary screen and practice questions

studyon
Syllabus area 2 | Topic 4 | Concept 6
Price and quality interaction
Summary screen and practice questions

EXERCISE 8.3 REVISION

1 Complete the following sentences by **recalling** the correct term from the list below. The answers can be found in the introduction to this section.

exchange	correct	high	low
money	customers	selecting	sales

Price refers to the amount of _____ a customer is prepared to offer in _____ for a product. Many businesses have difficulty _____ the 'correct' price for their products. A price set too _____ could mean low _____ unless superior benefits are offered. A price set too _____ may give _____ the impression that the product is 'cheap and nasty'. Somewhere between these extremes is a _____ price for a product.

2 **Identify** the three main pricing methods.

3 **Why** are retailers likely to adopt the cost-based method to pricing?

4 **State** the formula used to calculate the price using the cost-based method.

5 As the managers of a furniture store, you have just received a shipment of new media units. The units cost you $385 each and your usual mark-up is 75 per cent.
(a) **Calculate** the final selling price.
(b) **Explain** what you would do to the price if your business has exclusive distribution of this highly fashionable product.

6 **Outline** the two major drawbacks of cost-based pricing.

7 **How** is market-based pricing determined?

8 **Recall** the three alternatives that are available to businesses that adopt the competition-based method of pricing.

9 **Explain** why a business would use competition-based pricing.

10 **Why** do some businesses use bundle pricing?

11 **State** what motives might lead a business to adopt a price skimming strategy.

12 **Identify** a possible problem with using price skimming.

13 **Deduce** under what conditions a phone manufacturer would adopt (a) a price skimming approach and (b) a price penetration approach for a new product.

14 **Recall** the main disadvantage of price penetration.

15 **Account** for why a business would use the loss leader pricing strategy.

16 **How** might buyers' perceptions of price influence pricing decisions?

17 **Discuss** whether you agree with the statement 'You get what you pay for'. Provide examples to **justify** your answer.

18 Imagine you are a marketing consultant. A client has asked you to make recommendations regarding the price of five, as yet, unbranded new products. You are trying to decide whether to recommend price skimming, price penetration, loss leader or price points pricing strategies. Complete the following table and **justify** your recommendation.

Unbranded new product	Recommended pricing strategy	Justification for this strategy
1. Imported leather lounges		
2. A range of costume jewellery		
3. Bottled water		
4. Mobile phone		
5. T-shirts		

EXERCISE 8.3 EXTENSION

1 **Define** the term 'non-price competition'. **Compare** the characteristics of price and non-price competition. **Predict** under what conditions a business would be most likely to use non-price competition.

2 **Explain** why some customers are prepared to pay a high price for a product, although other customers would not buy the product even if the price was low. **Extrapolate** what this tells you about the relationship between price and customer tastes and preferences.

3 **Why** do many department stores use a mark-up of about 50 per cent, when some discount variety stores operate on a mark-up of 20 per cent?

4 Compare the prices of five identically branded electronic products in three competing stores.
(a) **State** whether the prices are the same or different.
(b) **Account** for the similarities and/or difference.

8.6 Promotion

BizWORD

Promotion *describes the methods used by a business to inform, persuade and remind a target market about its products.*

To sell more of its products, a business has to change customers' behaviour through information or persuasion. This is achieved through promotion. **Promotion** describes the methods used by a business to inform, persuade and remind a target market about its products.

Promotion attempts to:

- attract new customers by heightening awareness of a particular product
- increase brand loyalty by reinforcing the image of the product
- encourage existing customers to purchase more of the product
- provide information so customers can make informed decisions
- encourage new and existing customers to purchase new products.

8.6.1 Elements of the promotion mix

Many people confuse promotion with advertising because of its visibility and frequency. However, advertising is just one of the four elements of the promotion

mix. A **promotion mix** is the various promotion methods a business uses in its promotional campaign (see figure 8.19).

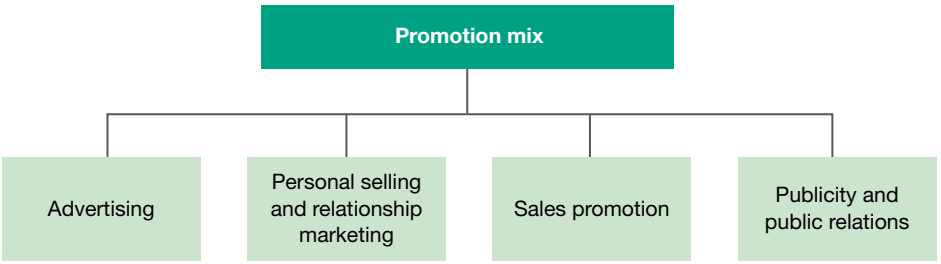


FIGURE 8.19 Depending on the type of product and target market involved, two or more of these elements are combined to form the promotion mix.

Advertising

Which current advertisement has most impressed you? What product is it advertising: soft drink, food, clothes, a car or something else? Why did it impress you? You can probably answer these questions without too much thought. This is because you have been influenced by advertising. Everywhere you look businesses are trying to sell consumers their products.

As previously explained, advertising is a paid, non-personal message communicated through a mass medium. Because of the myriad of products available, advertising is an essential tool for successful marketing. A successful advertising campaign can result in increased sales and profit for a business. The form and presentation of advertisements have changed over time (see figure 8.20), but the purpose of advertising — to inform, persuade and remind — has remained constant.

The main advantage of advertising is that it provides businesses with the flexibility to reach an extremely large audience or to focus on a small, distinct target market segment.



FIGURE 8.20 Digital advertising expenditure has been significantly increasing at the expense of other mediums. For example, advertising expenditure on newspapers and magazines has been declining over the past few years. They fell 18 and 17.1 per cent respectively in 2016.

Advertising media

Advertising may take many forms, from buying time on national television, to inexpensive leaflets or posters, to internet banner advertisements. All businesses need to develop the most cost-effective means to advertise their products. **Advertising media** is a term for the many forms of electronic and print communication used to reach an audience. The six main advertising media are as follows.

- *Mass marketing* — television, radio, newspapers and magazines
- *Direct marketing catalogues* — catalogues mailed to individual households

BizWORD

Promotion mix *is the various promotion methods a business uses in its promotional campaign. Methods include:*

- *advertising*
- *personal selling and relationship marketing*
- *sales promotions*
- *publicity and public relations.*

BizFACT

In Australia, businesses spend approximately $13.5 billion a year on various forms of advertising. $6 billion is spent on internet advertising, which is the largest category.

BizWORD

Advertising media *refers to the many forms of communication used to reach an audience.*

- *Telemarketing* — the use of the telephone to personally contact a customer
- *E-marketing* — the use of the internet to deliver advertising messages
- *Social media advertising* — online advertising using social media platforms such as Facebook and Twitter
- *Billboards* — large signs placed at strategic locations

BizFACT

Choosing the most appropriate advertising media for the message is critical.



FIGURE 8.21 Digital billboard advertising is one of the fastest growing advertising mediums, while print, television and radio advertising mediums are declining. Digital billboards are an effective way of raising brand awareness with research showing that they reach more customers than videos on the internet or Facebook. Not only do they reach more customers, a recent study found that travellers who passed digital billboards could recall the specific message displayed 89 per cent of the time.

Which type of advertising media a business selects depends on a number of variables including the:

- type of product and its positioning
- size of the target market and its characteristics
- business's marketing budget
- cost of the advertising medium
- product's position on the product life cycle.

Sometimes a business will undertake an extensive advertising campaign that involves a number of advertising media in order to create a saturated coverage of a wide target market. This is the advertising strategy used, for example, when a new movie is released. There will be celebrity publicity events, electronic and print advertisements, billboards and e-marketing using pop-up banners and social media advertising.

SNAPSHOT



Traditional advertising in decline

As consumers continue to increase engagement with mobile devices for daily activities, there has been a huge switch in advertising behaviour. Companies are increasingly spending more money on online advertising as opposed to traditional media. Digital platforms are on the rise and in 2017 digital ad spending surpassed traditional advertising for the first time.

Currently, nearly two billion Australian advertising dollars go into online media. Digital is now the dominant player in terms of advertising dollars spent, which indicates a significant change in how people consume content. In Australia in

2016, digital advertising expenditure grew 15 per cent and is predicted to grow at an average rate of 20 per cent a year to 2019. Social media advertising is the fastest growing component of digital advertising. It grew 51 per cent in 2016 and is predicted to keep growing. Expenditure on television advertising, however, declined by 4 per cent in 2016 and print advertising declined by approximately 15 per cent.

The Magnum Opus Partners Awareness Survey, carried out by Think Global Research polled Australians on their ability to recall brands and advertising. Their findings revealed that Australian consumers are underwhelmed by advertising and that the move towards digital has resulted in a decline in product and brand awareness. They found 57 per cent of people surveyed could not recall a single ad they remember feeling positive about.

Over the next few years, it is predicted that marketers will increasingly migrate their advertising dollars away from traditional media and will continue to embrace digital media. There will be increasing pressure on companies to embrace digital marketing strategies as traditional advertising continues to be less effective.

SNAPSHOT QUESTIONS

1. **Outline** the factor that led to the switch in advertising behaviour.
2. **Explain** the latest trends in advertising spending.

'. . . digital ad spending will surpass traditional advertising . . .'



FIGURE 8.22 Coles spends over $53 million each year on advertising. They use a variety of advertising media in order to create a saturated coverage. For example, they advertise on television, radio, newspapers, magazines, billboards, social media and weekly catalogues.

Personal selling

Personal selling involves the activities of a sales consultant directed to a customer in an attempt to make a sale; it involves the human aspect of promotion. For some businesses — such as those offering expensive, complex or highly individual products — personal selling is *the* main promotional strategy. These products in particular require the personal contact of a sales representative to familiarise the customer with the product.

Although personal selling is an expensive promotional method, businesses are willing to spend the money on it because it offers three unique advantages. They are:

- The message can be modified to suit the individual customer's circumstances.
- The individualised assistance to a customer can create a long-term relationship resulting in repeat sales.
- The sales consultant can provide after-sales customer service in relation to product features, installation, warranties and servicing.

The success of the marketing plan often depends on the competency of the business's sales force, without which sales and revenue would soon decrease.

BizWORD

Personal selling *involves the activities of a sales representative directed to a customer in an attempt to make a sale.*

BizFACT

The sales consultant develops a relationship with the customer. By listening to the customer's needs and then offering informed recommendations, customer satisfaction is increased, resulting in repeat business and building a good reputation for the business.

Relationship marketing

Customers want more individualised treatment. In response, businesses are looking for ways to develop long-term, cost-effective and strong relationships with individual customers, a process known as **relationship marketing**. The ultimate aim is to create customer loyalty by meeting the needs of customers on an individual basis, thereby creating reasons to keep customers coming back.

A highly successful relationship marketing strategy is loyalty programs. A **loyalty program** is a rewards-based program offered by a business to customers who frequently make purchases. This was introduced during the early 1990s with the Fly Buys loyalty reward program operated by the Coles Group. In 2007 the Woolworths Everyday Rewards scheme was introduced. These schemes offer rewards to those loyal customers who spend specified amounts or make repeat purchases. Relationship marketing can provide a business with a competitive advantage.

BizWORD

Relationship marketing *is the development of long-term and cost-effective relationships with individual customers.*

A **loyalty program** *is a rewards-based program offered by a business to customers who frequently make purchases.*

BizFACT

A recent marketing industry survey found that four in five shoppers tend to buy more from businesses whose loyalty cards they hold, and 55 per cent say that when choosing between two similar companies they'll usually pick one with a loyalty program.



FIGURE 8.23 Loyalty programs, such as the IKEA FAMILY card, help maintain a customer relationship. IKEA FAMILY is IKEA's free loyalty program that provides cardholders with special offers and benefits, including discounts and entry into weekly draws.

SNAPSHOT



'. . . shoppers have grown tired of endlessly collecting points . . .'

Are customers tiring of loyalty programs?

Customers tiring of points loyalty programs

The larger issue facing Woolworths and others is there is no exclusivity when every supermarket, department store, dress shop and coffee cart offers you a membership card. As a result, shoppers have grown tired of endlessly collecting points to eventually redeem on gifts, discounts or possibly a flight. Studies show that a third of members never redeem points.

Retailers imbedded loyalty programs to encourage repeat shopping, protect themselves from price wars and most importantly collect valuable shopping data. The first retailer in Australia to offer a loyalty program was Fly Buys, a joint venture between Coles Myer (now Wesfarmers) and Loyalty Pacific, 20 years ago.

Then, shoppers were quick to sign up, with the promise of "free" flights in return for their loyalty and of course their valuable personal shopping data, which included brands purchased, location, frequency and demographics.

Back then, the only way retailers could accurately track and target shoppers was through loyalty card usage, and while this still happens today, retailers have other more efficient channels, such as linked credit cards, like Coles Credit Card (Mastercard) and Woolworths Money (Visa).

As shoppers are more frequently "tapping and going", retailers can now access a wider range of data, outside of simply their loyalty program members. Such programs also allowed retailers to distract shoppers from focusing on price by simply getting shoppers to focus on the 'prize' than the price.

Need for speed

Points fatigue occurs when shoppers are faced with months, if not years, of collecting points to ultimately redeem on a desired item or reach that elusive gold or platinum level. Today, shoppers are seeking immediacy and customisation.

Recently, [UK supermarket chain] Morrisons moved away from its complex "price match" loyalty scheme to a more simplified program where shoppers now earn five loyalty points for every £1 they spend.

Once a shopper earns 5,000 points they immediately to receive a £5 voucher. Other retailers are also moving away from long-term points accruing programs to deliver instant and non-monetary rewards to shoppers, such as free newspapers or coffee.

The UK's Waitrose recently re-launched their loyalty program of "pick your own offers", where shoppers can choose from a list of 1000 relevant products and immediately save 20%. Over time, the list changes, and shoppers get to select new products. The scheme has seen more than 850,000 shoppers sign up.

Non-monetary loyalty

The other problem with existing loyalty programs is that retailers have confused "loyalty" with "rewards". Loyal shoppers will always consider their favourite brands and stores first and frequent them consistently. True loyalty programs should also strengthen the relationship between the retailer and customer.

UK retailer Marks and Spencer [M&S] recently moved away from their strictly points-based shopping frequency scheme to reward shoppers for other positive behaviours, such as completing online surveys, writing online reviews or referring friends.

The program of "non-monetary" rewards — such as invitations to exclusive food and drink master-classes or fashion parades — demonstrates shoppers are seeking more than just generic deals and discounts. The program also allows M&S to demonstrate its corporate social responsibility credentials, with shoppers earning "sparks" points for donating unused clothing when purchasing new outfits, termed "shwopping".

Source: Extracts from Gary Mortimer, 'Woolies new loyalty program offers a glimpse into the future', *The Conversation*, 27 October 2015

SNAPSHOT QUESTIONS

1. **Why** have many consumers grown tired of loyalty programs?
2. **Define** 'points fatigue'.
3. **Recommend** strategies marketers could use to make their loyalty programs more effective.

Sales promotion

A business may decide to offer a direct inducement to customers in an attempt to sell more of its product. This type of promotion is referred to as **sales promotion** and aims to:

- entice new customers
- encourage trial purchase of a new product
- increase sales to existing customers and repeat purchases.

Sales promotion techniques are used primarily to increase the effectiveness of other promotion activities, especially advertising. Examples of special promotions include:

- *coupons*. These offer discounts of a stated amount on particular items at the time of purchase. Coupons work best for new or improved products.
- *premiums*. A **premium** is a gift that a business offers the customer in return for using the product. For example, a food producer may offer customers a cookbook as a premium.

BizWORD

Sales promotion *is the use of activities or materials as direct inducements to customers.*

BizWORD

A **premium** *is a gift that a business offers the customer in return for using the product.*

- *refunds*. Part of the purchase price is given back to those customers who send in a voucher with a specific proof of purchase. In recent years, refunds have become widely used on power tools and kitchen appliances (see figure 8.24).
- *samples*. A sample is a free item or container of a product. For example, when you visit a supermarket, you will often find a sales representative encouraging you to taste a product such as cheese, fruit, biscuits or cake.
- *point-of-purchase displays*. Special signs, displays and racks are supplied and installed by the manufacturer in retail outlets. They are usually located at the end of aisles in supermarkets to gain consumer attention and make more efficient use of floor space.

BizFACT

It is the role of public relations personnel to design, implement and manage the publicity events of the business.



FIGURE 8.24 Manufacturers of electrical equipment, computers and white goods sometimes offer cash back promotions to encourage customers to buy their products. These offers are usually limited in time and have special conditions that have to be met in order to get the money.

Publicity and public relations

What's worse than being talked about? Not being talked about! Businesses rely on being in the public eye. Most businesses use publicity and public relations as a means of increasing sales and, therefore, profits. **Publicity** is any free news story about a business's products. It differs from advertising in that it is free and its timing is not controlled by the business. The main aims of publicity are to:

- enhance the image of the product
- raise awareness of a product
- highlight the business's favourable features
- help reduce any negative image that may have been created.

BizWORD

Publicity *is any free news story about a business's products.*

BizWORD

Public relations (PR) *are those activities aimed at creating and maintaining favourable relations between a business and its customers.*

Public relations (PR) are those activities aimed at creating and maintaining favourable relations between a business and its customers. PR exposes a business or idea to an audience by using often unpaid third parties as outlets. This can be done by working with the media, by making speeches on special occasions or by some attention-seeking gesture such as a donation or a give-away sale that is reported by others. This means that PR is often more effective than paid advertising. Sometimes PR can even work out to be cheaper.



FIGURE 8.25 A 'spin doctor' is the name given to someone communicating their perspective of an issue to the public and trying to persuade the public that their perspective is correct. Some public relations practitioners have been criticised and labelled as 'spin doctors' for only presenting facts that are favourable to the business instead of 'telling it how it really is'.

There are four main ways in which public relations activities can assist a business in achieving its objective of increased sales.

1. *Promoting a positive image:* reinforcing the favourable attitudes and perceptions consumers have regarding the business's reputation
2. *Effective communication of messages:* using advertising, sales promotions, publicity and personal selling to convey information about the business and its products
3. *Issues monitoring:* protecting sales by providing an early warning of public trends that could affect the business's sales. Remedial action can be taken before much harm is done to sales.
4. *Crisis management:* protecting a business's reputation as a result of negative or unfavourable rumours and adverse publicity, which, if left unchecked, might result in a loss of sales

True or false: all publicity is good publicity?

While publicity is all about trying to create a favourable image, the downside is that you can't control what is said about your business or your product or service. Therefore, businesses need to ensure that what they publicise can withstand public scrutiny.

The advent of social media has delivered a new army of critics and commentators, all of whom have the ability to disseminate their opinion about businesses. Is the saying 'there's no such thing as bad publicity' a myth? The following are two examples of companies that have attracted ongoing negative media coverage and publicity.

In 2011, following industrial disputes and the grounding of their entire fleet Qantas launched a Twitter campaign in an attempt to win back some positive publicity. The competition invited followers to win a first class gift pack by tweeting about their dream luxury experience and include the hashtag #QantasLuxury. Within minutes the #QantasLuxury was filled with angry customers who took the competition as an opportunity to share their gripes and spread their negative experiences. Qantas suffered a social media backlash when most of the 19 000 responses were not what they were hoping for.

In 2017, MAC promoted a giveaway on Instagram offering customers a free full-sized lipstick to celebrate National Lipstick Day at selected David Jones and Myer stores. All fans had to do was show up; and thousands of them did, only to be left empty-handed when the giveaway ran out of stock within minutes of the stores opening. Hundreds of outraged social media users took to Instagram to vent their frustration about how the promotion was handled.

In the case of Kyle and Jackie O, however, the view that 'all publicity is good publicity' appears to hold true. The two radio hosts have often attracted negative publicity for saying something offensive. Each time this happens media outlets

SNAPSHOT



'. . . you can't control what is said about your business . . .'

are quick to report on their latest outrageous comments, then the next day they apologise, which again becomes a separate 'news' story with the cycle feeding itself for days on end. Is this part of their marketing strategy: to spark media coverage through their controversial comments? If so, then it's certainly working because the pair have been Sydney's top-rating FM breakfast show for many consecutive years.

SNAPSHOT QUESTIONS

1. **State** whether you agree with the saying 'all publicity is good publicity'. **Justify** your answer.
2. **Discuss** the use of publicity as a marketing strategy.

8.6.2 The communication process

Marketing managers must be able to communicate clearly, efficiently and succinctly to their target markets. If the communication process becomes distorted or inefficient, the message becomes distorted. The resulting miscommunication may mean lost sales. Without effective communication, promotion is wasted.

Marketing managers can use a variety of channels to communicate a message. A **channel** is any method used for carrying a message. Two of the most common channels used for promotional communication include print and electronic media advertising. Any interference or distraction that affects any or all stages in the promotional communication process is referred to as **noise**. Examples of noise include faulty printing, competing messages, inappropriate language or images, jargon, misinterpretations or — perhaps one of the most common — people having conversations and fetching refreshments during commercial breaks.

Often customers may be more willing to purchase a product if the message is communicated via a respected and trusted channel, such as an opinion leader, or by word of mouth.

BizWORD

*A **channel** is any method used for carrying a message.*

BizWORD

***Noise** is any interference or distraction that affects any or all stages in the communication process.*

Opinion leaders

An **opinion leader** is a person who influences others. Their opinions are respected and they are often sought out for advice.

Marketing managers use opinion leaders as information outlets for new products or to endorse an existing one. Actors, athletes, musicians and models are regarded by some groups as opinion leaders and many businesses use celebrity endorsement as part of their marketing strategies (see figure 8.26).

BizWORD

*An **opinion leader** is a person who influences others.*

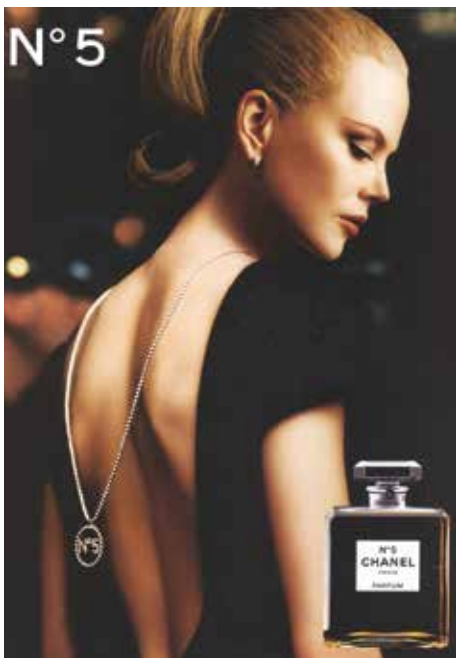


FIGURE 8.26 Celebrity branding or celebrity endorsement involves using a well-known person to use their wide appeal to become a brand ambassador to help market a product. They also act as promotional models in selected marketing campaigns. Nicole Kidman, for example, is a brand ambassador for products such as Swisse health supplements, Neutrogena, Etihad and Chanel No. 5 perfume.

Celebrity endorsement is a powerful marketing tool when the target audience align themselves with the ambassador chosen. Having that endorsement can open up a huge following. This is because ambassadors usually have a large social media following — a referral from them can be powerful and the company can gain instant followers and engagement. If businesses choose to use this strategy, however, they need to remember that their brand and image will be aligned to the ambassador; therefore, if that person's reputation becomes tarnished for whatever reason, this will affect the business's reputation.

In 2017, healthfood snack business Slim Secrets secured the services of Angelique Kerber, who won the previous

year's Australian Open and US Open titles, as their brand ambassador. Since the company philosophy is more about having a healthy and active lifestyle, as opposed to weight management, they thought someone in the sports industry would be a perfect fit. Kerber emerged as an ideal choice for the brand because they believe she is a great role model for the health and fitness industry and an inspiration for women portraying a healthy body image.

Slim Secrets' turnover was more than $2 million in 2016. They were hoping for at least a 50 per cent increase in 2017 due to the increased worldwide interest and brand recognition. Kerber has already posted about Slim Secrets to her more than 835 000 followers on Facebook, 274 000 on Twitter and 270 000 on Instagram. Traffic to the Slim Secrets website is up, the business's social reach has increased and their products are being noticed in overseas markets where they do not have a presence.

Word of mouth

Consumers tend to trust word-of-mouth communication more than business-sponsored commercials, especially if the message is being communicated by a friend or opinion leader. This is because the receiver places more trust in someone they know as opposed to a business advertising its products. When people influence each other during conversations it is called **word-of-mouth communication**.

Businesses are increasingly using social media platforms such as Facebook and Twitter to engage in a form of word-of-mouth communication. Friends' recommendations can be a powerful influence, especially when there are many competing products from which to choose.

BizWORD

Word-of-mouth communication
occurs when people influence each other during conversations.

Social influencers

Many companies are aware that word-of-mouth is one of the most valuable forms of marketing — studies have shown that it influences 20 to 50 per cent of all purchasing decisions — so it's no surprise that in the new world of digital relationships, many companies have been teaming up with social media influencers across multiple platforms to promote their goods.

A social media influencer is a user of social media who has established credibility in a specific field and can thus influence their audience. Lots of brands, particularly in the fashion and lifestyle fields, have ditched sponsorship deals with big-name celebrities in favour of regular people with powerfully engaged social media followers.

Research from Twitter has shown that 49 per cent of consumers seek advice regarding purchases from social media influencers and 20 per cent of the people surveyed stated that a tweet from an influencer encouraged them to share their own recommendation. What is even more significant is that almost 40 per cent of Twitter users said they had made a purchase based on an influencer's endorsement.

Many companies are spending millions of dollars each year on influencer marketing. On top of sending free products, some companies pay influencers per post so that they can try their products and then post about them. For many brands, this does not cost as much as celebrity endorsement.

Kmart is one of the latest brands to take advantage of social media influencers to help promote their products. To overcome the stigma about buying cheaper products, Kmart recruited an army of Instagram women to promote their homewares range. The company values the opinions of these influencers so highly that they've actually become unofficial, unpaid consultants. Although these women are not paid, they are often invited to exclusive events and receive free items. This new strategy has resulted in increased publicity and demand for certain products.

SNAPSHOT QUESTIONS

1. **Define** a social media influencer.
2. **Why** are companies using social media influencers to promote their business or products?

SNAPSHOT



'. . . many companies have been teaming up with social media influencers . . .'

8.6.3 Why a mix of promotional strategies is important in the marketing of goods and services

Since each element of the promotion mix has different benefits, it's important for businesses to use a mix of promotional strategies in order to cater to the needs of everyone in their target market. Businesses should not simply aim to satisfy one type of buyer; the aim of promotion is to attract as many potential customers as possible. Since different elements of the promotion mix will appeal to different types of customers, businesses need to use a combination.

Also, the different elements of the promotion mix may each play a part in influencing the same customer in different ways and assist them with their decision to purchase a product. For example, suppose you are interested in buying a mobile phone. Because of your interest, you may start paying attention to advertisements on the television or in magazines. You may search the internet to find out more about different phones, their features and prices. You may also contact sales people from different stores or post on Facebook asking your friends their opinion. Based on all this information, you may then decide to purchase a specific brand.

Which aspect of the promotional mix led you to decide on that particular brand? While some aspects may have been more influential than others, all the elements played a role in making your decision. Therefore, to get a better response from a target market, businesses need to adopt as many different components of the promotion mix as possible. These components should be coordinated and complement each other to help achieve the marketing objectives.

SUMMARY

- Promotion describes the methods used by a business to inform, persuade and remind a target market about its products.
- Promotion mix is the various promotion methods — advertising, personal selling and relationship marketing, sales promotions, and publicity and public relations — a business uses in its promotional campaign.
- Advertising is a paid, non-personal message communicated through a mass medium. The purpose of advertising is to inform, persuade and remind.
- Personal selling involves the activities of a sales representative directed to a customer in an attempt to make a sale.
- Relationship marketing is the development of long-term and cost-effective relationships with individual customers.
- Sales promotion is the use of activities or materials as direct inducements to customers.
- Publicity is any free news story about a business's products.
- Public relations (PR) are those activities aimed at creating and maintaining favourable relations between a business and its customers.
- Marketing managers can use a variety of channels to deliver a message including print and electronic media advertising.
- Often customers may be more willing to purchase a product if the message comes via a respected and trusted channel, such as an opinion leader, or by word of mouth.
- It's important for businesses to use a mix of the promotional strategies in order to meet the different needs of their target market.

EXERCISE 8.4 REVISION

1 **Define** the term 'promotion'.
2 **Recall** what promotion attempts to achieve.
3 **Identify** the four elements of the promotion mix.
4 **Recall** the main advantage of advertising.

studyon

Syllabus area 2
Topic 4
Concept 7

Promotion mix
Summary screen and practice questions

studyon

Syllabus area 2
Topic 4
Concept 8

Promotion: communication process
Summary screen and practice questions

5 **Identify** the five main types of advertising media.
6 Select which advertising media you consider to be the most effective if a business wants to communicate with (a) a mass market and (b) a niche market. **Justify** your selection.
7 **Why** is it important to identify the target market when designing an advertising program?
8 Find a recent Nerada Tea commercial online. **Assess** the advertisement in terms of communicating with its target market.
9 **Propose** which form of advertising media you would choose for the following products. **Justify** your choices.
(a) Nike sports shoes
(b) School textbooks
(c) A hairdressing salon
(d) Toys for children
(e) Dell computers
10 **Why** do some marketers prefer to use personal selling as a promotional strategy?
11 **How** can personal selling be more persuasive than advertising?
12 In small groups, use the brainstorm technique to:
(a) **account** for the recent popularity with consumers of loyalty reward programs.
(b) **determine** the benefits to a business of this type of relationship marketing.
13 **State** the aims of sales promotion.
14 In your opinion, select the two most effective sales promotion techniques for sales promotion. **Justify** your answer.
15 **Distinguish** between publicity and public relations.
16 'Advertising is what you pay for and publicity is what you pray for.' **Explain** what this statement means.
17 **Summarise** the four main ways in which public relations can assist a business to increase its sales.
18 'Public relations should be viewed as a two-way communication process.' **Explain** the meaning of this statement.
19 In small groups, **identify** the different public relations activities your school uses to communicate with parents. Choose a spokesperson to share the group's answers with the rest of the class. The first items on your list can be newsletters and formal assemblies.
20 **Explain** why efficient communication is important to marketing managers.
21 **Account** for the use of opinion leaders in the promotion of a product. Provide three examples from current promotional campaigns.
22 **Propose** what you think are the strengths and weaknesses of the following promotion strategies. Share your answer with the rest of the class.
(a) A manufacturer of a new type of disposable razor gives out thousands of free razors at a football grand final.
(b) A lifestyle magazine runs its own lottery-style promotion for five weeks in which first prize is $20 000 worth of furniture.
(c) To boost sales, a computer manufacturer relies on word-of-mouth communication.
23 Using an example, **assess** why a mix of promotional strategies is important in the marketing of goods and services.

on Resources

Weblink: Nerada Tea

EXERCISE 8.4 EXTENSION

1 Recently, you were elected to serve as a promotional organiser for a soccer tournament. The tournament will match several well-known celebrity teams from New South Wales against the best local players. Tickets will sell for $30 per person and your goal is to attract a large number of supporters. All proceeds will be given to a local charity. As you **create** a promotional plan, **determine** what segmentation variables will be most important. **Propose** the buying motives you will use to appeal to your target market.

2 In small groups, **create** a media release to advertise the opening of a new clothes store in your local area. Include the following details:
   - name, telephone number and address of the store
   - date of opening
   - hours of business
   - range of stock
   - any opening special
   - store logo.
3 Referring to a business you are familiar with, **analyse** and **evaluate** the promotion methods used for one of its products.

8.7 Place/distribution

BizWORD

***Place** or **distribution** are activities that make the products available to customers when and where they want to purchase them.*

The fourth 'P' of the marketing mix is '**place**' or **distribution**. Once a business manufactures a product, it must see that the product gets into the customers' hands. For this to happen successfully, an efficient distribution system is required. Distribution is necessary because most products are not used by the same business that makes them. This textbook, for example, was transported and warehoused a number of times between the authors, publisher, printer, wholesalers and retailers before it reached you, the consumer.



FIGURE 8.27 The delivery of a product to a customer is the final stage in the distribution process. Every business must undertake some form of distribution.

BizWORD

***Distribution channels** or **marketing channels** are the routes taken to get the product from the factory to the customer.*

8.7.1 Distribution channels

Distribution channels or **marketing channels** are the routes taken to get the product from the business to the customer. This process usually involves a number of intermediaries, such as the wholesaler, broker, agent or retailers. Apart from the retailer, the other intermediaries are often 'invisible', with the customer knowing very little about their role and operation.

Traditional distribution channels

The four most commonly used channels of distribution are described below.

1. *Producer to customer.* This is the simplest channel and involves no intermediaries. Virtually all services, from tax advice to car repairs, use this method.
2. *Producer to retailer to customer.* A retailer is an intermediary who buys from producers and resells to customers. This channel is often used for bulky or perishable products such as furniture or fruit.

3. *Producer to wholesaler to retailer to customer.* This is the most common method used for the distribution of consumer goods. A wholesaler is an intermediary who buys in bulk, from the producer, then resells in smaller quantities to retailers.
4. *Producer to agent to wholesaler to retailer to customer.* An agent distributes products to wholesalers but never owns the product. Agents are paid a commission by the producer. Usually agents are used for inexpensive, frequently used products. A business that does not have any sales representatives will often use an agent instead.

Innovative distribution methods — non-store retailing

Businesses are always looking for different ways to distribute their products. The purchasing of products from a store or a supplier is the oldest and most common form of distribution. **Non-store retailing** — that is, retailing activity conducted away from the traditional store — is gaining in popularity. Methods such as door-to-door selling, mail-order catalogues, party-plan merchandising and vending machines have been used for a number of years. However, with rapid changes in electronic communication, businesses are beginning to exploit types of electronic marketing (e-marketing) as alternative methods. Two of the most rapidly developing methods are e-commerce and m-commerce.

1. *E-commerce* refers to the buying and selling of goods and services via the internet. The web is revolutionising the way consumers shop. Consumers who are 'time poor' prefer the convenience of shopping online. Other consumers like being able to shop around for the cheapest price or have the opportunity to select from a wide range of products at a time that suits them. Back in 2000, less than 1 per cent of retail sales came from e-commerce. However, online sales have climbed each year since then, and by 2016 online sales made up about 8 per cent of total retail sales. This will be discussed in more detail in section 8.9.
2. *Mobile commerce (m-commerce)* refers to the buying and selling of goods and services through wireless handheld devices such as smartphones and tablets. While m-commerce is actually still only a small proportion of commerce generally, it is a very fast-growing proportion.

BizFACT

The Iconic does not have a traditional distribution channel. To cut delivery and distribution times, their suppliers list their products on The Iconic site but their stock is sent directly to consumers rather than to The Iconic's distribution centre. The Iconic's app, which has been downloaded on more than one million devices so far, is now the e-tailer's primary sales channel, and its growing marketplace.

BizWORD

Non-store retailing *is retailing activity conducted away from the traditional store*



FIGURE 8.28 The steady rise of online sales has led to the 'retail apocalypse' — a US term that refers to the closing of a large number of retail stores. Thousands of retail stores have closed and retail bankruptcies have been happening at a record pace. Could this be the end of bricks-and-mortar retailers?

As more people use the internet for shopping, the traditional distribution channels will be modified. Some retailers and wholesalers may be bypassed as customers deal directly with manufacturers. Electronic post and parcel delivery channels will be used more extensively to meet the increasing demand.

8.7.2 Channel choice — including intensive, selective and exclusive

BizWORD

Market coverage *refers to the number of outlets a firm chooses for its product.*

How a business chooses the channel of distribution best suited to its product depends largely on the location of the business's market or market coverage. **Market coverage** refers to the number of outlets a firm chooses for its product.

BizFACT

Different channels of distribution are used to get the 'right' product in the 'right' quantity to the 'right' location at the 'right' time

A business can decide to cover the market in one of three ways as follows, the difference being the intensity of coverage.

1. *Intensive distribution.* This occurs when the business wishes to saturate the market with its product. Customers can shop at local outlets and be able to purchase the product. Many convenience goods, such as milk, lollies and newspapers, are distributed this way.
2. *Selective distribution.* This involves using only a moderate proportion of all possible outlets. Clothing, furniture and electrical appliances are often distributed using this method. The customer is prepared to travel and seek out a specific retail outlet that stocks a certain brand.
3. *Exclusive distribution.* This is the use of only one retail outlet for a product in a large geographic area. This method of distribution is commonly used for exclusive, expensive products.

Figure 8.29 illustrates the three levels of market coverage.

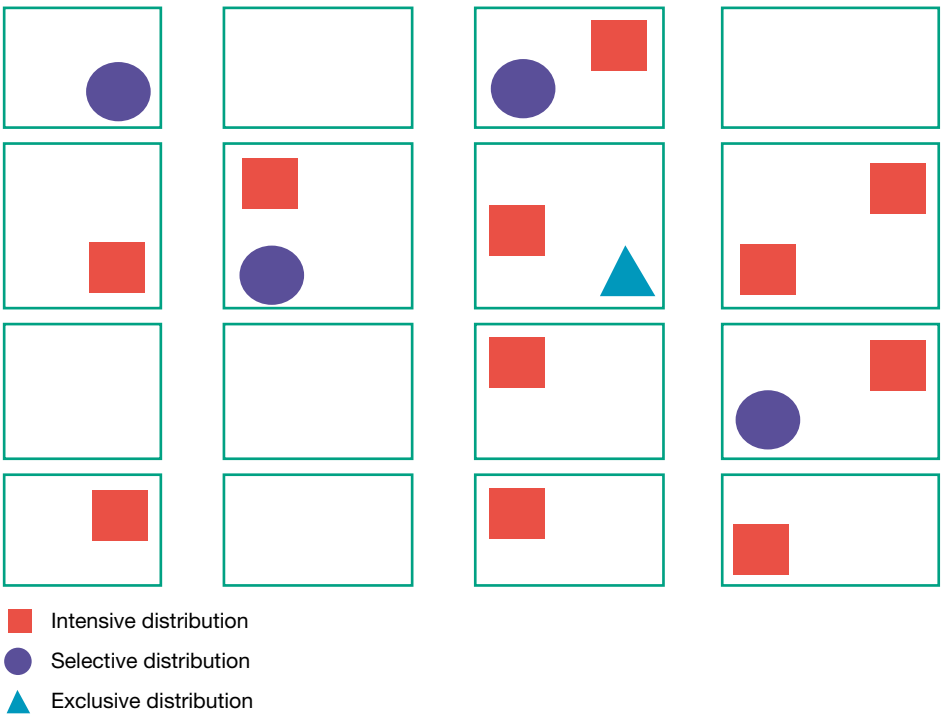


FIGURE 8.29 The boxes here represent the different customer groups that make up a market. The coloured shapes within the boxes represent the type of distribution method used to achieve market coverage. The square shape appears in many of the boxes because this distribution of product reaches a range of different customers.

8.7.3 Physical distribution issues

BizWORD

Physical distribution *is all those activities concerned with the efficient movement of the products from the producer to the customer.*

Physical distribution is all those activities concerned with the efficient movement of the products from the producer to the customer. Physical distribution is therefore the movement of the products themselves through their channels of distribution. It is a combination of several interrelated functions, including transportation, warehousing and inventory control.

Transport

An intricate network of transportation is required to deliver the vast array of products on supermarket shelves. Developments in packaging and transportation now permit Australian native flowers, for example, to be picked then sold in Tokyo within 24 hours.

The method of transportation a business uses will largely depend on the type of product and the degree of service the business wishes to provide. The four most common methods of transportation are rail, road, sea and air.

Warehousing

Warehousing is a set of activities involved in receiving, storing and dispatching goods. A warehouse acts as a central organising point for the efficient delivery of products.

Inventory

Customers find it frustrating when a product they wish to purchase is 'out of stock', and a business that repeatedly allows this to happen will lose sales and market share. To avoid this, businesses may implement an **inventory control** system. If a business carries too much stock on its inventory, it will experience high storage costs. However, too little stock results in lost sales or 'stock-out costs'. The goal of inventory is to find the correct balance between these two situations.

BizWORD

Inventory control *is a system that maintains quantities and varieties of products appropriate for the target market.*



FIGURE 8.30 Due in large part to the huge growth in online sales, there has been an increasing demand for industrial warehouses. It is predicted that by 2018, industrial warehouses will be in excess of 200 000 square metres in size. To cope with the sheer size, centres will need sophisticated facilities, such as automated picking and sorting systems. Robots will be used extensively, requiring very little human interaction.

SUMMARY

- Place or distribution are activities that make the products available to customers when and where they want to purchase them.
- Channels of distribution or marketing channels are the routes taken to get the product from the factory to the customer.
- The four most commonly used channels of distribution are:
  - producer to customer
  - producer to retailer to customer
  - producer to wholesaler to retailer to customer
  - producer to agent to wholesaler to retailer to customer.
- Non-store retailing is retailing activity conducted away from the traditional store, including e-commerce and m-commerce.

studyon

Syllabus area 2
Topic 4
Concept 9

Place: distribution channels
Summary screen and practice questions

studyon

Syllabus area 2
Topic 4
Concept 10

Place: physical distribution
Summary screen and practice questions

- Market coverage refers to the number of outlets a firm chooses for its product.
- A business can decide to cover the market in one of three ways:
  - intensive distribution: when the business wishes to saturate the market with its product
  - selective distribution: using only a moderate proportion of all possible outlets
  - exclusive distribution: only one retail outlet for a product in a large geographic area.
- Physical distribution is all those activities concerned with the efficient movement of the products from the producer to the customer.
- Warehousing is a set of activities involved in receiving, storing and dispatching goods.
- Inventory control is a system that maintains quantities and varieties of products appropriate for the target market.

EXERCISE 8.5 REVISION

1 **Define** the term 'place'.
2 **Clarify** the importance of distribution in the marketing process.
3 **Propose** a distribution channel for the sale of:
(a) a daily newspaper
(b) a washing machine
(c) an imported motor vehicle
(d) office furniture.
4 Traditional shopping transactions involve a number of organisations in the supply chain: producer to warehouse to wholesaler to retailer to consumer.
Create a flowchart to show how an e-commerce transaction could take place.
5 In small groups, use the brainstorm technique to **identify** the advantages and disadvantages to a business of selling via the internet. Select a spokesperson to share the group's comments with the rest of the class.
6 From the following products, **determine** those that are intensively, selectively or exclusively distributed.
(a) Coca-Cola
(b) Ferrari motor vehicles
(c) Billabong clothing
(d) Streets ice-cream
(e) Samsung televisions
(f) Rare coins
7 **Why** would a business select an exclusive rather than an intensive distribution strategy?
8 **Determine** which method of transportation would be most appropriate for the following products: road, rail, air or boat. **Justify** your answer.
(a) Coal to Japan
(b) Wheat to the silo
(c) Sheep to the market
(d) Fresh fruit to Tokyo
(e) Iron ore from the mine to the port
(f) Pepsi to the supermarket
9 **Identify** the activities involved in warehousing.

EXERCISE 8.5 EXTENSION

1 Investigate the operation of an online retailer (e-tailer) such as The Iconic, Red Balloon or Amazon. **Evaluate** the three sites visited, reporting on:
(a) ease of navigation
(b) layout of the home page
(c) methods of payment
(d) ease of product selection

on Resources

Weblink: The Iconic
Weblink: Red Balloon
Weblink: Amazon

(e) return and refund policy
(f) delivery charges and options.

2 (a) 'Holding either too little or too much stock is to be avoided.' **Discuss**.
(b) **Propose** a system a business can adopt to prevent either situation.

8.8 People, processes and physical evidence

So far we have discussed the four Ps of the marketing mix, which is considered the basic cornerstone of marketing. This traditional approach was developed in the age of marketing dominated by the rapid growth in manufacturing during the 1950s to 1960s. Consequently, these four Ps are considered appropriate for tangible products (goods) such as clothing, electronic appliances, perfumes and motor vehicles. However, as the service sector within the economy expanded, this traditional approach to marketing was viewed as somewhat outdated. Therefore, three more Ps have been added — people, processes and physical evidence (see figure 8.31) — which apply especially to intangible products (services) such as tourism, entertainment and hospitality. Extending the marketing mix by adding people, processes and physical evidence to the usual 4P's connects the marketing function much closer to both human resource management and operations, thus illustrating the interdependence between these functions.

BizWORD

It is important to acknowledge that even goods have a service component surrounding them such as after-sales service.

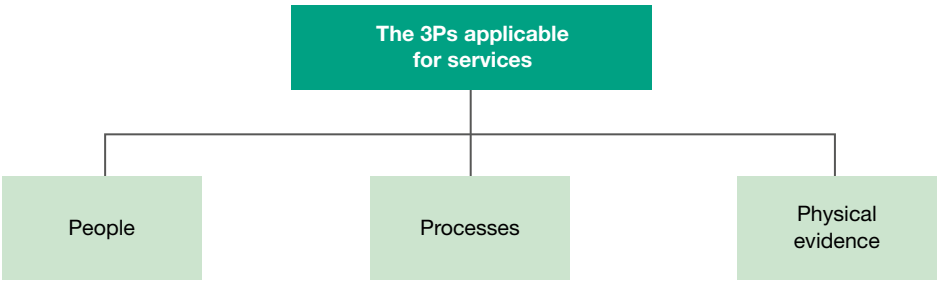


FIGURE 8.31 The three extra Ps of the extended marketing mix. Although the three Ps' role in the success of the marketing process may not be as obvious as the original four Ps, they play an unassuming yet important role in ensuring the success of the product.

8.8.1 People

As services are performed by people, it is essential that the business use appropriately recruited, qualified and trained employees. The **people** element refers to the quality of interaction between the customer and those within the business who will deliver the service. It is therefore important that businesses recruit and select the right workers and then train them appropriately on on how to perform the service and leave a good impression.

BizWORD

*The **people** element refers to the quality of interaction between the customer and those within the business who will deliver the service.*

Consumers base their perceptions and make judgements about a business based on how the employees treat them. For example, in a hotel or restaurant, the employees are actively involved in delivering the marketing message because they are the 'human face' of the business. How the staff speak to customers, deal with enquiries and handle complaints are all part of the marketing experience and of critical importance. Consequently, all businesses should develop a culture of customer focus and put it into practice. Of course, the customers' experience must match reality. A large telecommunications business, for example, which claims to be customer focused, will not succeed if the reality is that it takes 30 minutes to speak to a consultant at a call centre and the consultant then displays no interest.

People are the most important element in any service or experience. The interaction between the employees, especially frontline or customer service staff, and customers can determine the success of any marketing campaign.



FIGURE 8.32 First impressions count — research on consumer buying behaviour suggests that it takes approximately only 15 seconds for customers to make a judgement about a business, which will then influence whether or not they decide to purchase from them.

8.8.2 Processes

When you order a meal from a McDonald's restaurant it will be delivered within a few minutes. Behind this efficient delivery system is a set of well-planned and well-organised processes. When employees provide a service, such as McDonald's employees, they rely on a delivery system — a set of processes — to perform their task. **Processes** refers to the flow of activities that a business will follow in its delivery of a service. Businesses need to ensure that their processes and procedures are customer friendly and that they satisfy customer needs.

Without a tangible product, the processes must be highly efficient to achieve customer satisfaction. Consider all the processes involved in booking a flight online. The airline's website is used to enter the details. A confirmation email will be automatically generated providing a booking reference. An electronic boarding pass can be downloaded and printed. A day prior to the flight, a seating allocation can be done online. The delivery system that allows this to happen is part of the process element of marketing.

Any business that has inefficient processes will lose customers and damage its reputation. A pizza delivery business, for example, must not deliver cold pizza; a restaurant should not keep customers waiting for hours between courses; gas and electricity accounts should be sent on time; a bank statement must be accurate.

BizWORD

Processes *refers to the flow of activities that a business will follow in its delivery of a service.*

BizFACT

Convenient methods of payment, such as PayPass, PayWave or Afterpay provide an efficient process to assist in the marketing strategy.

8.8.3 Physical evidence

Imagine you go to a restaurant. You are very satisfied with the product, price, people and process, but the cutlery was dirty, the chairs were uncomfortable and the menu was difficult to read. You would probably not eat there again because of this physical evidence. **Physical evidence** refers to the environment in which the service will be delivered. It also includes the location of where the service is being provided and the materials needed to carry out the service such as signage, brochures, business cards, business logo and website. Customers make judgements about the business based on these features.

Unlike tangible goods, it is difficult for a business's marketing services to provide customers with a 'try before you buy' sample unless a free trial is offered. Customers initially buy services on trust and they make judgements about the business based on the physical evidence. Consequently, a business should provide high-quality physical evidence to create an image of value and excellence (see figure 8.33).

BizWORD

Physical evidence *refers to the environment in which the service will be delivered. It also includes the location of where the service is being provided and the materials needed to carry out the service such as signage, brochures, business cards, business logo and website.*



FIGURE 8.33 A luxury hotel uses material cues — physical evidence — so that the customer will form a good impression of the business.

Case study: PACK & SEND — people, processes and physical evidence

PACK & SEND is Australia's leading and most recognised parcel courier and freight delivery reseller.

CEO and founder Michael Paul established the company with his wife in 1993 after noticing that businesses and consumers were looking for one-stop-shop solutions for sending anything, anywhere —that also included a convenient packaging service. The three extra P's of the extended marketing mix have played a crucial role in the success of this business, so much so, that two of them have become part of their five core values guiding their actions and decisions in striving to achieve their purpose. One of their core values is:

People are the cornerstone of our success
We promote an environment of teamwork, mutual respect and growth in learning and personal development.

We recognise that the company's success depends upon the initiative taken individually and the ability to work as a team. Therefore, we believe in recruiting quality people, mentoring and training for performance, engaging them with the brand values, listening for feedback and leading with integrity.

Michael Paul considers internal factors, such as business culture and employees, to be the key difference between successful businesses. He believes it is important that the management team nurture a culture that truly values people, regardless of their position, because a supportive team culture can be one of the company's greatest strengths. This culture will help align all the stakeholders around the vision, mission and values of the brand.

Another one of PACK & SEND's core values, which relates to 'processes' is:

Systems are the foundation of great organisations
We believe the true product of our business is not what we sell but how we sell it. That is, the true product of our business is the business itself – the systems.

We recognise that the success of our organisation is dependent on all people in the business following a system. Therefore, we believe in the systemisation of all areas of our business for uniform application across our network – so that we can achieve higher productivity and customers can always experience a consistent superior service.

PACK & SEND operates an international franchise model. Systemisation is therefore very important because at the core of a franchise's success is a tried, tested, and

SNAPSHOT

PACK SEND
Anything. Anywhere.

'People are the cornerstone of our success.'

perfected system that can then be duplicated over and over again. 'Systemising helps a franchisor keep track of metrics and identify what works and what doesn't, enabling them to pinpoint the areas in which it makes strategic sense to invest more. Systemisation is also essential to create a business model that is a format for success which of course improves many processes such as employee training and allows new franchisees to easily pick up where their predecessors left off.'

The variety of processes PACK & SEND have established in the delivery of their services contribute to the aim to always satisfy customer's needs. PACK & SEND are the only couriering and logistics company where customers can engage with the brand via three channels: by visiting one of their 100+ retail service centres, phoning the company's call centre or online.

In relation to 'physical evidence', even though the company offers an online booking system, they still advocate physical points-of-presence with more than 100 retail service centres in Australia, New Zealand and the United Kingdom. The company feels that these service centres play a big part in improving delivery services for e-commerce customers. 'Important e-commerce solutions like convenient product returns, alternate delivery points and convenient parcel drop-off points are all logistics services that are reliant on a national retail footprint. While it's true that most people have been keen adopters of the Internet, there's nothing like being able to walk into a store and have a conversation with someone. Physical retail spaces offer convenience, multisensory consumer experiences (the desire to see, touch and feel products), personal consultancy and a friendly face on the other side of the counter.'

SNAPSHOT QUESTIONS

1. **How** do PACK & SEND look after their 'people'?
2. **Why** is systemisation so important to PACK & SEND?
3. To **what extent** are physical points-of-presence important for online businesses?

studyon

Syllabus area 2
Topic 5
Concept 1

People, processes and physical evidence: e-marketing
Summary screen and practice questions

SUMMARY

- Three more Ps have been added that apply especially to intangible products (services): people, process and physical evidence.
- The people element refers to the quality of interaction between the customer and those within the business who will deliver the service.
- Consumers base their perceptions and make judgements about a business based on how the employees treat them.
- Processes refers to the flow of activities that a business will follow in its delivery of a service.
- Without a tangible product, the processes must be highly efficient to achieve customer satisfaction.
- Physical evidence refers to the environment in which the service will be delivered. It also includes materials needed to carry out the service such as signage, brochures, calling cards, letterheads, business logo and website.
- A business should provide high-quality physical evidence to create an image of value and excellence.

EXERCISE 8.6 REVISION

1 **Identify** the three extra Ps of the extended marketing mix.

2 **Why** is it important to extend the marketing mix in the current business environment?

3 **Deduce** whether the extension of the marketing mix means that some of the traditional Ps are less relevant today.

4 **Explain** why all businesses should develop a culture of customer focus and put it into practice.

5 Select which of the traditional Ps of the marketing mix you consider most likely associated with customer service. **Justify** your answer.

6 Think of a business where the 'people' element was outstanding. **Clarify** what made the interaction so positive.

7 **Define** the term 'processes'.

8 **Investigate** the main processes involved with the following businesses.
(a) M and S Davidson Accountant
(b) Billabong café
(c) Theatre Royal
(d) Excelsior Hotel

9 **Identify** six elements an airline could use as physical evidence to create a positive image.

10 **Why** is it important for a business to display favourable physical evidence?

EXERCISE 8.6 EXTENSION

1 In small groups, use the brainstorm technique to **determine** the (a) people and (b) processes involved in a business that offers inclusive tours of Europe.

2 **Recommend** a set of five processes a business would need to adopt to resolve issues when customers complain about a faulty product.

3 'Most goods have a service component surrounding them. Consequently, businesses selling goods such as motor vehicles or electrical appliances must take into consideration the extended marketing mix.' **Evaluate** the accuracy of this statement. Provide examples in your answer.

8.9 E-marketing

Technology has driven the push to market products to customers worldwide. Businesses now have access to global markets through setting up websites that can promote products and then dispatch them to the other side of the globe within 24 hours of ordering. With rapid changes in electronic communication and the development of the 'information superhighway', marketers are beginning to exploit all types of e-marketing. **E-marketing** (electronic marketing) is the practice of using the internet to perform marketing activities.

BizWORD

E-marketing *(electronic marketing) is the practice of using the internet to perform marketing activities.*



FIGURE 8.34 Australians spent an estimated $32 billion over the internet in 2017, with media and takeaway food dominating online sales growth. Around 4 in 10 people bought at least one product online during an average month.

Recent surveys have shown that Australian businesses, especially retailers, have been slow to adopt e-marketing, with many offering product information, but no opportunity for customers to actually purchase online. The big risk for Australian businesses is that consumers seeking the convenience of online shopping will purchase from overseas retailers and completely bypass local businesses. Australia is now the world's third biggest per capita online consuming nation, and customers are increasingly expecting businesses to have an online component. Technology not only provides a faster, more efficient way of doing business, it can also be a very effective way of attracting new customers.

BizFACT

Internet marketing, web marketing and online marketing are frequently interchanged and can often be considered synonymous.

SNAPSHOT



'. . . 79 per cent of Australians use social media compared with only 47 per cent of SMEs.'

E-marketing and SMEs

The Sensis Social Media Report is an annual survey of consumers, small and medium-sized enterprises (SMEs) and large businesses on how they use social networking sites. According to their 2017 report, 79 per cent of Australians use social media compared with only 47 per cent of SMEs. These figures illustrate that over half of Australian SMEs are not using e-marketing and that businesses in general have been very slow to adopt the platform.

Of those consumers surveyed who do use social media, 59 per cent accessed it every day. Facebook is the most popular platform, with 94 per cent of social media users, then Instagram (46 per cent), Snapchat (40 per cent) and Twitter (32 per cent).

Only 26 per cent of small businesses and 42 per cent of large businesses advertise on social media. Out of those businesses, Facebook was the most preferred channel with 90 per cent, then Twitter (24 per cent), Instagram (23 per cent) and LinkedIn (20 per cent).

Since 2010, the number of people that follow a business on a social media network has been growing exponentially. In addition, over 50 per cent of people surveyed recommended a business on these platforms and two thirds of consumers stated that they were more likely to trust a brand if it interacts with consumers in a positive way on social media. The moral of the story: in this new digital age, traditional marketing methods alone are no longer enough. Consumers are eager to connect with brands on social media. If a business wants to be successful, they need to be where the customer is; if not, they're missing the boat.

SNAPSHOT QUESTIONS

1. **Identify** how many consumers use social media in comparison to businesses.
2. **Justify** why SMEs are encouraged to use social media advertising.
3. **Why** you think businesses have been slow to adopt social media advertising?

8.9.1 E-marketing technologies

The main technologies presently available for e-marketing include web pages, podcasts, SMS, blogs, Web 2.0 and location marketing.

Web pages

A web page conveys information in the form of a combination of text, graphics, animation and video. A number of related web pages linked together form a website. When searching for the website of a particular business, the user will normally be directed first to that business's home page. This contains basic information about the business and a number of links to other web pages within the website that can provide detailed information about the location of the business premises (including maps and photographs), available products and online ordering facilities. A well-designed home page is a powerful marketing tool.

BizFACT

According to the ABS only 47.1 per cent of businesses have a website. Breaking this figure down, approximately 63 per cent of micro businesses, 41 per cent of small businesses and 19 per cent of medium businesses still don't have a web presence.

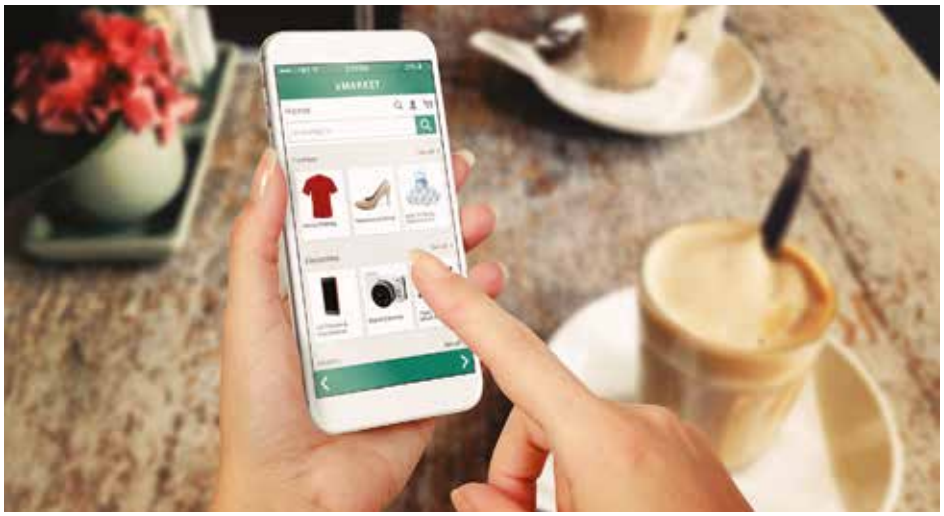


FIGURE 8.35 Since Australians are spending more and more time online through a number of difference devices, it is important that businesses tailor their online content for tablets and smartphones. With 67 per cent of mobile internet users stating they are put off if a business doesn't have a mobile website, it's crucial that companies ensure their sites and content will load properly or they may exclude a large segment of the market.

Podcasts

Podcasting involves the distribution of digital audio or video files over the internet. As a general rule, a podcast is directed to a number of users who subscribe to that particular podcasting service, and who receive regular updates.

Business's main use of podcasts is for marketing and advertising purposes. Many independent podcasters sell advertising time in the same way as commercial radio stations. If a particular podcast is aimed at the same audience as the target customers of a business, podcast advertising can be a very effective way of reaching those customers. For example, a sporting goods store may choose to advertise through a podcaster aiming at triathletes; a specialist food store owner could look at advertising on a podcast aimed at vegetarians and vegans.

BizWORD

Podcasting *involves the distribution of digital audio or video files over the internet.*

SMS

SMS has distinct advantages over email in that messages are delivered automatically to one or more recipients without the need for them to dial in or log on. Text messages can also be used to alert regular customers of any special deals on offer and notify suppliers of the arrival of a goods shipment.

Blogs

A **blog** is an online diary or journal. It is usually possible to add comments, ask questions, provide feedback or share opinions on a blog. A business can use blogs in a number of ways.

Many businesses set up external blogs, which allow for communication between the business and its existing and potential customers. A blog of this type can be used to announce new products or changes in trading hours, and to gather feedback and comments from a variety of stakeholders. As a public relations exercise, an external blog can have the following advantages for a business:

1. It allows the business owner and employees to establish a reputation for expertise, by providing detailed information on products and services.
2. New ideas for products and services can be put to the public to gain comment and feedback.
3. A blog by its nature is informal, so it can present a human face to the public and build trust with customers.

BizWORD

A **blog** *is an online journal that can be added to by readers.*

Web 2.0

The term 'Web 2.0' refers to the transformation of the world wide web into a more creative and interactive platform for information sharing, rather than just a means

of retrieving information. The development of social networking sites such as Twitter and Facebook, video sharing sites such as YouTube and information sharing sites such as Wikipedia have made it easier for individuals and businesses to create and share many different types of content on the web.

Just as businesses can make use of blogs to enhance their relationship with stakeholders, networking sites can provide a powerful public relations tool. The key benefit is the low cost. Rather than hire a web-page designer, the technology allows an amateur to upload home video footage, photographs and other graphics on to a networking site, where it can be viewed by existing and potential customers. Networking sites also accept paid advertising that links to the site's search engine, and so can be used for social media advertising (see figure 8.36).



FIGURE 8.36 A growing number of companies have been using paid advertising on YouTube and Google's display ad network. However, in 2017 many brands suspended their spend with Google after an investigation found many ads were appearing alongside extremist or offensive content. The global Google boycott caused massive brand damage to the company as well as having an impact on their revenue.

BizFACT

Barneys luxury department store in New York's Chelsea neighbourhood, launched a mobile app to help customers navigate the store. When consumers open the app they see two prompts: the first is to permit push notifications and the second is to allow Barneys to use the customers' location. If a user grants access, they will receive notifications related to the store, for example, what's in stock. However, they will also receive recommendations for dining and sightseeing in the Chelsea neighbourhood.

BizWORD

Social media advertising (SMA) *is a form of online advertising using social media platforms such as Facebook, YouTube and Twitter to deliver targeted commercial messages to potential customers.*

Location-based marketing

The ability for mobile devices to track and report a person's location has enabled businesses to tailor marketing messages based on a person's location. Location-based marketing allows businesses to adapt and deliver targeted marketing messages to customers based on where they are located through mobile devices. By knowing where consumers are, brands are able to tap into daily habits and encourage consumers with relevant offers and messages based on their location. Customers receive these marketing messages by using their mobile to search for local businesses on the internet or 'check in' to a particular place through an online location-based service.

8.9.2 Social media advertising (SMA)

Over the past few years, businesses have been increasingly using social media to advertise their products. Businesses are becoming increasingly aware that **social media advertising (SMA)** can have positive results, especially when used in combination with traditional advertising methods. The main advantages of SMA are that it is:

- inexpensive in comparison to traditional advertising methods
- easy to use and monitor
- an effective method to gain exposure
- possible for marketers to accurately measure the **reach** (the number of people exposed to the message) and **frequency** (the average number of times someone is exposed) of SMA.

However, the main disadvantage of SMA is that marketers do not have complete control over what online consumers write about the business. Users have the freedom to discuss, review, criticise and even ridicule a product or a specific business.

The reason for this not-so-quiet revolution in marketing and advertising is that marketers realise they must go to where the customers are to be found. Facebook, for example, has over 2 billion monthly users.

In 2010, Twitter unveiled a new platform making Twitter.com more advertisement friendly. The new platform started carrying sponsored tweets from advertisers at the top of some of its pages, creating a richer media experience. In the first 24 hours after Coca-Cola sent out a sponsored tweet promoting a product, the tweet was seen 86 million times. This produced a frequency rate of approximately 6 per cent compared with the average of 0.02 per cent of users with a standard online advertisement.

In the early days, online advertising was very much like an outdoor billboard. Now, due to the rapid advances in technology, SMA is more engaging and inclusive. Businesses are getting customers they have reached via a social network platform to, in turn, reach out to other potential customers. Online customers are not simply being targeted for advertising; in many cases they are contributors in the creation and distribution of advertising. In this way, the SMA enables businesses to constantly build relationships with their customers (see the following Snapshot).

BizWORD

*The **reach** of an advertisement measures the number of people exposed to the message.*

*The **frequency** of an advertisement measures the average number of times someone is exposed to the message.*



FIGURE 8.37 In 2016, Instagram launched a new feature called Instagram Stories, which allows users to share multiple photos and videos that appear together in a slideshow format. The content disappears after 24 hours and won't appear on your profile or in your feed. Many businesses are now incorporating Instagram Stories in their marketing to help boost customer engagement, deliver special offers and show their products in action.

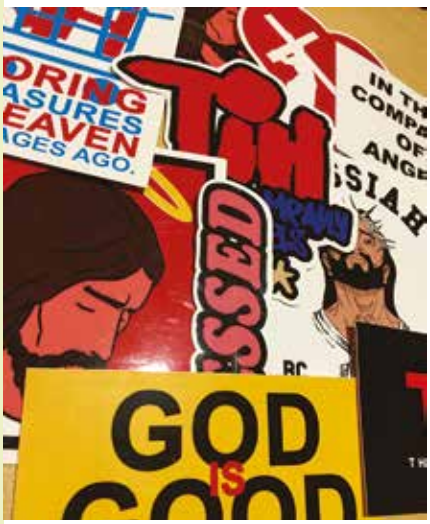
SNAPSHOT

Case study: Social media advertising — This is Heaven

Kevin Yumul is the owner and founder of This is Heaven, an online business specialising in streetwear and design. He started the business in 2017 because he identified a gap in the market for streetwear that expresses Christianity and positive messages about Jesus Christ.

He began the business with a single t-shirt design and over a six-month period he increased his product range to include nine different Christian t-shirt designs as well as hoodies, hats, stickers and tote bags. Facebook and Instagram are his main forms of promotion.

Kevin set up a business page on Facebook, which enables him to interact and engage with present and potential customers and generate awareness about his products and business. Many business owners simply use social media to post updates and alert followers about upcoming products. These kinds of posts tend to be top-down, one-way communication and fail to take advantage of the incredible marketing potential that social media offers by making customer communication a two-way street. The real value happens when social media communication turns into a dialogue — when businesses use social media to have a conversation with their customers. Some of the ways Kevin engages with consumers on social media are by posting photos of them wearing or using his products and by responding promptly to each post, comment and message. 'By directly engaging with customers, you can establish a real connection with them. It's a great way to improve customer satisfaction and for you to learn about what customers love about your business as well as gaining insights on how you can improve.'



'the analytics . . . give him meaningful statistics on his social media marketing.'

Another way consumers can interact with This is Heaven is through testimonials and reviews. These recommendations help generate publicity and trust due to the unbiased nature of the posts. Many consumers look at reviews before purchasing, so having customer-generated testimonials helps build credibility. Reviews also boost traffic to his site and have a huge influence on the page's visibility and internet search engine results. This is because the more times a business is mentioned, the higher they will appear in search results.

Kevin's preferred social media site, however, is Instagram, since statistics have shown that this is where his target market is most present. Kevin posts photos and videos of his new products and designs approximately 4–5 times a day. He strategically posts at certain times each day based on when the data has shown his target audience is more active. Kevin also uses Instagram Stories, which allows him to share unlimited photos, videos and promotions to an album that disappears after 24 hours (like Snapchat). The biggest benefit of Instagram Stories is that he can post as much content as he wants without the fear of over posting or overexposure. In addition, Kevin uses Instagram to run competitions where customers are required to repost a photo on their Instagram page with the hashtag #thisisheaven. This is an effective way to gain greater exposure and brand recognition.

Kevin also uses both platforms to undertake paid advertising for his business. One of the greatest benefits of Facebook and Instagram that Kevin has found are the analytics, which give him meaningful statistics on his social media marketing. These tools give him valuable data about each ad as well as other information such as who his followers are, when they're online, how many people viewed each post and their location. For example, Kevin discovered that his promotional video reached 20 000 people, was viewed by 5000 people and resulted in 124 people clicking the link to his website. The data also revealed details about the demographics of those who viewed the video. The analytics tools allow business owners to truly understand their audience and then create content that targets their market more effectively.

Based on the data generated, Kevin also pays for Instagram sponsored ads — a feature on Instagram that allows users to create an ad, select a target audience, set a budget and determine how long the adverts will run for. Kevin allocates a budget of between $600 and $700 and then Instagram directs the post to people that fit the target audience he has selected. The analytics revealed that these ads have reached approximately 40 000 people, which has generated even greater exposure for his business.

SNAPSHOT QUESTIONS

1. **Identify** the source of inspiration that led to Kevin's business idea.
2. **Why** is two-way communication important when using social media advertising?
3. **Discuss** the use of customer testimonials and reviews.
4. **Assess** the impact social media advertising has had on Kevin's business.

BizFACT

Facebook and Google are set to continue their dominance of the global digital advertising market. Google is predicted to make over $72 billion in ad revenue in 2017 and Facebook will make over $33 billion. Combined, that equates to almost half of the world's total digital ad spend.

Of course, as with traditional advertising, SMA raises concerns including issues of privacy, accuracy, honesty and consumer trust. A number of legal issues are presently evolving, such as establishing age limits for users — Facebook and YouTube specifically prohibit use by children under the age of 13 — and the proliferation of fake and unofficial 'fan pages'.

It is expected that SMA will expand rapidly over the next few years as new, highly interactive mobile platforms and networks increasingly gain consumer acceptance.

SUMMARY

- With rapid changes in electronic communication, marketers are beginning to exploit all types of e-marketing.
- E-marketing is the practice of using the internet to perform marketing activities.
- Technology not only provides a faster, more efficient way of doing business, it can also be a very effective way of attracting new customers.

- The main technologies presently available for e-marketing include web pages, podcasts, SMS, blogs and Web 2.0.
- A web page is a powerful marketing tool.
- Podcasting involves the distribution of digital audio or video files over the internet.
- Business's main use of podcasts is for marketing and advertising purposes.
- Text messages can also be used to alert regular customers of any special deals on offer and notify suppliers of the arrival of a goods shipment.
- Many businesses set up external blogs, which allow for communication between the business and its existing and potential customers.
- The development of social networking sites has made it easier for individuals and businesses to create and share many different types of content on the web.
- Social media advertising (SMA) is a form of online advertising, using social media platforms such as Facebook, YouTube and Twitter to deliver targeted commercial messages to potential customers.
- SMA enables businesses to constantly build relationships with their customers.

EXERCISE 8.7 REVISION

1 **Define** the term 'e-marketing'.

2 As a class, use the brainstorm technique to **propose** reasons why (a) large Australian retailers have been slow to adopt e-marketing (b) online shopping is very popular with Australian customers.

3 **Recall** the most appropriate word from the list below to complete the following sentences.

SMS	Web 2.0	websites	podcast
blog	world wide web	home pages	

The _____ is the total of all publicly accessible _____ and _____. The use of the internet to distribute audio or digital files is known as a _____, while an online journal that can be accessed and added to by readers is called a _____. The transformation of the internet into a more interactive form has led to the use of the term _____. A business can easily communicate with customers about delivery of orders by the use of _____.

4 **Explain** how each of the following could be used in e-marketing.
(a) Web pages
(b) Podcasts
(c) SMS
(d) Blogs
(e) Web 2.0

5 Select one of the five technologies listed in question 4, and **examine** it in more detail using the internet. Prepare a short report (200–300 words) for presentation to the class. Your report should include:
- origins of the technology
- changes that have occurred in the availability and use of the technology
- examples of e-marketing use by at least two businesses.

6 **Define** the term 'social media advertising (SMA)'.

7 (a) **State** the main (i) advantages and (ii) disadvantages of SMA.
(b) **Justify** which you consider to be the more important: the advantages or disadvantages.

8 **How** does SMA enable businesses to constantly build relationships with their customers?

9 In small groups, use the brainstorm technique to **predict** the future of SMA.

10 Using the **Coca-Cola Facebook** and **Twitter** websites as sources, **investigate** the potential of SMA to achieve the marketing objective of increasing market share.

on Resources

Weblink: Coca-Cola Facebook
Weblink: Coca-Cola Twitter

on Resources

Weblink: Australian Communication and Media Authority

11 Using the **Australian Communication and Media Authority** website as a reference, answer the following questions about the e-marketing code of practice.
(a) **Clarify** what the code of practice aims to do.
(b) **Identify** who the code applies to.

EXERCISE 8.7 EXTENSION

1 It is clear that e-marketing is growing rapidly, and more and more businesses are embracing it. A successful online presence goes beyond simply setting up a website. Imagine you are a business consultant and a number of your clients want assistance with how to operate a successful online business. **Create** a booklet that could be used by a number of different types of businesses, and which includes advice on the following:
- setting up, maintaining and improving a website
- promoting the website
- improving online market share
- establishing online payment options.

2 **Demonstrate** why it is important to preserve confidentiality of customer information gathered through e-marketing strategies.

3 'Technology has opened up a whole new channel for marketers to market products to consumers that they don't really need.' **Evaluate** the accuracy of this statement.

8.10 Global marketing

A business's marketing plan must be modified and adapted to suit overseas markets. Within each foreign market, the business will be faced with a marketing environment and target markets that differ from the domestic scene. The extended marketing mix needs to be adapted accordingly.

8.10.1 How globalisation has affected marketing management

BizWORD

A **transnational corporation (TNC)** *is any business that has production facilities in two or more countries and that operates on a worldwide scale.*

BizFACT

General Electric once had a shipment of electrical goods refused entrance to Saudi Arabia because the electrical cords were six feet long instead of the required 6.6 feet (2 metres).

Many **transnational corporations (TNCs)** adopt a global marketing approach that involves developing marketing strategies as if the entire globe were one large market — a standardised approach. Alternatively, some businesses believe the marketing mix should be customised to take into account differences among countries' cultures, religion and tastes. Despite the process of globalisation, most businesses still view overseas markets as different in some way to domestic markets. This results in a degree of uncertainty and increased risk in developing global marketing strategies.



FIGURE 8.38 In 2016, Coca-Cola made a decision to overhaul its global marketing strategy by unifying their four core brands (Coke Zero, Diet Coke, Coke Life and Coca-Cola) under one single strategy. Through this 'one brand' strategy, the company will be moving away from multiple brand campaigns, to one single iconic campaign and their global advertisements, which will use universal storytelling to connect with consumers around the world, will air in multiple countries.

Irrespective of which approach is adopted, all businesses marketing on a global scale need to rely on market research to understand the complexities of the global marketing environment before they can design the marketing mix. It is essential to analyse overseas markets to an even greater depth than is necessary for domestic markets. Many businesses have failed because they entered global markets without first gathering adequate market intelligence.

What should a business know before it decides to engage in global marketing? First, it needs information to make specific marketing decisions, such as the price to charge, the type of packaging necessary, the distribution channel to use and any product characteristics needing modification. Second, information about the country's economic, political, social and cultural features should be gathered.

8.10.2 Global branding

We are surrounded by global products all carrying global brand names. **Global branding** is the worldwide use of a name, term, symbol or logo to identify the seller's products.

Businesses are increasingly using global branding for a number of reasons:

- It can be cost effective because one advertisement can be used in a number of locations.
- It provides a uniform worldwide image.
- The successful brand name can be linked to new products being introduced into the market.

A successful brand is one of the most valuable resources a company has. For example, the value of Nokia, Sony, McDonald's, Coca-Cola, Mercedes Benz, Kellogs and Nike is indisputable. Global branding equates to global recognition, irrespective of the language barrier (see figure 8.39).

Once a business has established its name, it will usually attempt to market the brand globally. Even if the business has to modify the product to suit local conditions, such as when Fuji Xerox changes the language keys on the control panel of their photocopiers or when Ford modifies the steering wheel from left- to right-hand drive, the companies will not alter the brand name on their products.

BizWORD

Global branding *is the worldwide use of a name, term, symbol or logo to identify the seller's products*



FIGURE 8.39 McDonald's golden arches are the most recognised symbol in the world; in fact they are more recognisable than the Christian cross. A survey of people across multiple countries showed that 88 per cent of people could identify the McDonald's logo as opposed to only 54 per cent who could name the Christian cross.

BizFACT

Apple's iPhone is available in over 100 countries and is the same design regardless of region. Apple does not customise their phones in terms of features and looks; they have a standardised design and the same range of products for all countries (except for the power source and carrier's specifics).

8.10.3 Standardisation

As global marketing increases, businesses are faced with a difficulty: should they use a standardised or customised marketing strategy, or a combination?

A **standardised approach** is a global marketing strategy that assumes the way the product is used and the needs it satisfies are the same the world over. Therefore, the marketing mix will be the same in all markets — a globalisation of the marketing mix. It is a case of 'one marketing plan fits all'. Examples of standardised products are electrical equipment, mobile phones, soft drinks, music, cosmetics, movies and fast foods.

BizWORD

A **standardised approach** *is a global marketing strategy that assumes the way the product is used and the needs it satisfies are the same the world over.*

This strategy has obvious cost savings for businesses. Production runs can be longer, thereby achieving economies of scale; research and development costs are reduced; spare parts and after-sales service are simplified; promotion strategies can be standardised; and any evaluation and modification of the plan is a much simpler task.

8.10.4 Customisation

In spite of the advantages of a standardised approach, when entering an overseas market, many businesses find it necessary to either modify the existing marketing mix or develop a new one. In doing so, they are adopting a customised approach. A **customised approach** (also called a **local approach**) is a global marketing strategy that assumes the way the product is used and the needs it satisfies are different between countries.

Adopting this philosophy requires the marketing plan to be customised according to the economic, political and sociocultural characteristics of the target country (see the BizFact about PepsiCo.).

Of course, it is possible for a business to adopt a middle path — that is, a combination of the two approaches. One company to successfully achieve this is McDonald's. Although it has standardised its name, logo, production methods and much of its menu, there are local variations. McDonald's has the McArabia in the Middle East (a flatbread sandwich), macaroons in France, the McSpaghetti in the Philippines, a green chilli cheeseburger in Mexico and bulgogi burgers in South Korea.

Over the last decade, as the scale of globalisation has intensified, it has become apparent that the standardisation approach is being used more frequently than the customised approach.

BizFACT

Sunbeam Corporation released a mist-producing hair curling wand called 'Mist-Stick' in the German market. After an expensive advertising campaign, Sunbeam discovered that 'mist' means 'excrement' in German.

BizWORD

A **customised** *or* **local approach** *is a global marketing strategy that assumes the way the product is used and the needs it satisfies are different between countries.*

BizFACT

PepsiCo makes local soft drinks like Shani, a blackberry- and currant-flavoured soda, which is popular in the Middle East during Ramadan, the Muslim holy month.

SNAPSHOT



'. . . the IKEA catalogue is customised to suit different countries . . .'

Case Study: IKEA — standardised versus customised marketing

IKEA adopts a partially standardised global marketing strategy by selling highly standardised products intended for the global market. While they adopt this approach toward their products, their main promotional tool, the IKEA catalogue, is customised to suit different countries around the world. This is because a kitchen in Australia, for instance, will look very different to a kitchen in Japan or Germany.

IKEA showrooms and catalogues display products by grouping them in actual room settings so that it's easy for customers to re-create what they see in their own home. When designing their catalogues, the furniture company uses a team of ethnographers to travel across the globe to see what life is like in each country. Based on this, IKEA drastically changes the room settings to suit different regions so that their catalogues appeal to the correct audience in each country. They therefore use lots of different layouts to localise the rooms in their brochures. For example, in the Chinese catalogues, the kitchens are a lot smaller. In Saudi Arabia, women and girls have been photoshopped out of many catalogues.

SNAPSHOT QUESTIONS

1. **Identify** those aspects of the marketing mix that IKEA standardises and customises.
2. **Why** does IKEA customise their catalogues?

8.10.5 Global pricing

BizWORD

Global pricing *is how businesses coordinate their pricing policy across different countries.*

One of the major challenges facing transnational corporations is **global pricing**: how to coordinate their pricing policy across different countries. It is one of the most critical but complex issues that global businesses have to deal with because price is the only element of the marketing mix that generates revenue. All other elements involve costs. Therefore, a business's global pricing strategy is a major determinant of profits. Accurate pricing decisions must be made if the business's overseas expansion is to be successful.

A global business can implement one of three global pricing strategies.

Customised pricing

Customised pricing occurs whenever consumers in different countries are charged different prices for the same product. In determining the price for an overseas market, many global businesses practise the *cost-plus method* to cover the added costs of exportation. Such costs include transportation, taxes, warehousing and **tariffs**. A cost-plus method to pricing products for global markets is usually the most commonly used method because of the added expense associated with exporting.

BizWORD

Customised pricing *occurs whenever consumers in different countries are charged different prices for the same product.*

A **tariff** *is a tax on an imported product.*

Market-customised pricing

This strategy allows for even more flexibility than the customised pricing strategy. **Market-customised pricing** sets prices according to local market conditions. To avoid competition from a domestic business, the global business may need to adopt a market-customised pricing strategy that allows marketers to vary the price depending on the level of demand and competition within the overseas market. In a competitive market, for example, the price charged may have to be lower than in a market where the business has a monopoly.

Additionally, the price charged in other countries is also influenced by foreign currency exchange rates (see the BizFact on the right). Fluctuations in the exchange rate can change the prices charged across countries and is a major risk for global businesses.

BizWORD

Market-customised pricing *sets prices according to local market conditions*

BizFACT

The exchange rate tells us how much a unit of one currency is worth in terms of another. For example, if A$1 = US$0.70 that means one Australian dollar is worth 70 US cents. Conversely, one US dollar would be worth A$1.43.



FIGURE 8.40 Apple, Microsoft and Adobe, who adopt market-customised pricing for their products, have faced strong criticism for charging Australians more for music, movies and TV shows. They defended these higher prices by claiming that every market is different and they have to take into account factors such as freight charges, local sales taxes, levies, import duties and competition as well as the fact that the entertainment industry in Australia charges a higher price for media delivered to Australia.

Standard worldwide price

Standardised pricing is the practice of charging customers the same price for a product anywhere in the world. It will succeed only if the foreign marketing costs remain low enough not to affect overall costs. Two major risks are associated with this strategy:

1. A domestic business may undercut the standardised price.
2. Changes in the exchange rate may negatively impact on the exported price.

BizWORD

Standardised pricing *is the practice of charging customers the same price for a product anywhere in the world.*

8.10.6 Competitive positioning

Competitive positioning relates to how a business will differentiate its products. It centres on how a business will carve out a place in the competitive marketing

BizWORD

Competitive positioning *relates to how a business will differentiate its products.*

environment. As in a domestic market, a global business must clearly show how its products are better than the competitors' products. Without differentiation, it takes more time, money and effort to encourage potential customers to purchase a business's products. To differentiate successfully, and avoid competing on price only — a difficult situation to sustain over the long term — the business should strive to develop product leadership, positive customer relationships and operational excellence.

Ultimately, to develop and maintain a competitive position in an increasingly challenging environment, businesses must gain a deep understanding of their dynamic environments in which they operate, and form their strategies according to evolving conditions.

SUMMARY

- A business's marketing plan must be modified and adapted to suit overseas markets.
- All businesses marketing on a global scale need to rely on market research to understand the complexities of the global marketing environment before they can design the marketing mix.
- Global branding is the worldwide use of a name, term, symbol or logo to identify the seller's products.
- A standardised approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are the same the world over.
- A customised approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are different between countries.
- It is possible for a business to adopt a middle path — that is, a combination of the two approaches.
- Global pricing is how businesses coordinate their pricing policy across different countries.
- Customised pricing occurs whenever consumers in different countries are charged different prices for the same product.
- Market-customised pricing sets prices according to local market conditions. This strategy allows for even more flexibility than the customised pricing strategy.
- Standardised pricing is the practice of charging customers the same price for a product anywhere in the world. It will succeed only if the foreign marketing costs remain low enough not to affect overall costs.
- Competitive positioning relates to how a business will differentiate its products. It centres on how a business will carve out a place in the competitive marketing environment.

studyon

Syllabus area 2
Topic 5
Concept 2

Global marketing and branding
Summary screen and practice questions

studyon

Syllabus area 2
Topic 5
Concept 3

Standardisation and customisation
Summary screen and practice questions

EXERCISE 8.8 REVISION

1 **Identify** the two approaches a business can take towards its global activities.
2 **Recall** what a business should know before it decides to engage in global marketing.
3 **Define** the term 'global branding'.
4 **State** the three main reasons why businesses use a global branding strategy.
5 **Distinguish** between a standardised and customised global marketing strategy. Provide examples in your answer.
6 **Account** for why McDonald's would use a combination of a standardised and a customised marketing strategy.
7 **Summarise** the three global pricing methods.
8 **Explain** which global pricing method you consider to be the most flexible.
9 **How** does competition in the overseas market affect global pricing?

10 ‘Consumers are not standardised globally; therefore, with global brands, you either get lowest common denominator advertising or you get advertising that’s right somewhere, but wrong elsewhere.’ **Discuss** this statement.

EXERCISE 8.8 EXTENSION

1 ‘Standardisation of production is of greater benefit to the producer than the consumer. It allows transnational conglomerates to treat the world as one single market, irrespective of social and cultural differences.’ **Evaluate** the accuracy of this statement. Provide examples to support your answer.

2 Proctor & Gamble (P&G) is a large United States company that provides consumer products of more than 80 brands worldwide. Its main products include cleaning products, detergents, pet supplies, pharmaceutical and personal care products. Research online and **examine** its corporate structure. **Determine** the benefits to Proctor & Gamble of adopting global business units (GBUs) and market development organisations (MDOs).

3 A manufacturer of shoes has decided to export to China. The marketing manager assumes that with such a large population a lot of shoes can be sold. **Assess** whether China might be a good or bad market opportunity.

on Resources

Digital doc: Chapter summary (doc-24810)

Interactivity: Chapter crossword (int-7163)

Interactivity: Multiple choice quiz (int-7164)

eLesson: Innovation and Smiggle (eles-1053)

Weblink: Proctor & Gamble

studyon

Sit HSC exam

Marketing

MULTIPLE CHOICE QUESTIONS

1. A business has developed a new tablet. Management has set a high price during the introduction stage.
Which type of pricing strategy is this business using?
(a) Skimming
(b) Cost-based
(c) Penetration
(d) Market-based

2. A car manufacturer seeks a variety of component parts as inputs from different suppliers in order to produce their final product.
This business would belong to which market?
(a) Consumer
(b) Industrial
(c) Niche
(d) Resource

3. A lounge manufacturer sells their products through large department stores.
Which channel choice is the manufacturer using?
(a) Competitive
(b) Exclusive
(c) Intensive
(d) Selective

4. Techtronics Limited is a producer of computers and consumer electronics. Updating technology is the main business strategy at Techtronics, with most employees having an engineering orientation. Management spends a great deal of time on design and manufacturing processes rather than on researching customers' needs.
Which of the following statements is true?
(a) Techtronics is practising the selling approach.
(b) Techtronics is practising the marketing approach.
(c) Techtronics is practising the production approach.
(d) Techtronics is practising the customer orientation approach.

5. A business has used a competition to try to increase sales for one of their products.
Which element of the promotion mix is this an example of?
(a) Advertising
(b) Public relations
(c) Sales promotion
(d) Relationship marketing

6. Which of the following best describes a market niche?
(a) A market niche is a broadly selected target market segment.
(b) A market niche is a narrowly selected target market segment.
(c) A market niche involves a business directing its marketing efforts to an international target market.
(d) A market niche involves a business directing its marketing efforts to two or more target market segments.

7. What are the three new elements that have been added to the extended marketing mix?
(a) Place, processes and physical evidence
(b) Processes, physical evidence and people
(c) Physical evidence, people and product
(d) People, product and processes

8. What does the worldwide use of a name or logo to identify the seller's products refer to?
   (a) Customisation
   (b) Standardisation
   (c) Global branding
   (d) Competitive positioning
9. Which of the following is a legal influence on marketing?
   (a) Warranties
   (b) Truth and accuracy
   (c) Engaging in fair competition
   (d) Products that may damage health
10. At which stage of the marketing process is a SWOT analysis conducted?
   (a) Market research
   (b) Situational analysis
   (c) Establishing market objectives
   (d) Developing marketing strategies

SHORT RESPONSE QUESTIONS

1. (a) **Define** the term 'marketing'. *2 marks*
   (b) **Explain** why marketing needs to be an evolutionary process. *4 marks*
   (c) 'The marketing concept should be integrated into all key business functions.' **Evaluate** the accuracy of this statement. *10 marks*
2. (a) **Identify** the stages of the product life cycle. *2 marks*
   (b) **Demonstrate** why a business must be able to launch, modify and delete products in response to changes in the product life cycle. *6 marks*
3. (a) **Outline** how a marketing plan would reflect a business's socially responsible philosophy. *3 marks*
   (b) **Discuss** whether a marketing manager should take into account any social consequences of a marketing campaign. *5 marks*
   (c) 'Viral marketing is particularly insidious and open to unethical marketing practices.' **Critically evaluate** the accuracy of this statement. Provide examples in your answer. *10 marks*
4. (a) Briefly **describe** the three Ps of the extended marketing mix. *3 marks*
   (b) **Examine** why the extended marketing approach is important in the current business environment. *6 marks*

EXTENDED RESPONSE QUESTIONS

1. Recently, you were elected to serve as promotional organiser for a touch football tournament. The tournament will match several well-known celebrity teams from New South Wales against the best local players. Ticket sales will sell for $30 per person and your objective is to attract a large number of supporters. All proceeds will be given to a local charity. Develop a promotional plan by actioning the following:
   (a) **Identify** what market segmentation variables would be most important.
   (b) **Investigate** the buying motives to which you would appeal.
   (c) **Determine** how you would use each element of the promotion mix.
2. 'Once the basic price has been set using the preferred pricing method, the business then fine tunes this price in line with its pricing strategy. A business also uses a number of non-price competition strategies to achieve its marketing objectives.' **Explain**.
3. 'Through knowledge of consumer behaviour gained by in-depth market research, marketing managers can manipulate the consumer to buy their products.' **Critically evaluate** this statement.
4. 'Marketing is a system of business activities designed to plan, price, promote and distribute something of value for the benefit of the customer at a profit.' With reference to a business you have studied, **assess** the accuracy of this statement.

on Resources

Digital doc: Sample HSC Business Report (doc-14150)

Role of marketing

The desire to be both a technical product and a fashion-based brand has enabled Kathmandu to broaden its market appeal. However, this also makes it more vulnerable to competition. Other businesses with a presence in Australia such as Rebel, Lorna Jane and more recently Decathlon, along with traditional competitors such as Macpac, Paddy Pallin and The North Face, also operate in the same retail space, which ensures that to survive Kathmandu must continue to evolve.

Despite the challenges posed by the current competitive retail environment, the business recently recorded an increase in sales, same-store sales growth, online sales and loyalty club members.

Marketing is an important focus of the overall sustainability of retail businesses generally and Kathmandu is no different in this regard. In the most recent financial report, its chief executive officer identified the importance of a range of strategic marketing initiatives that drive the company. These include:

- brand distinctiveness through product design and innovation
- inspiring customer engagement through its loyalty program Summit Club
- increasingly devoting resources to social media and its digital channels
- refining promotions to increase foot traffic and basket size (number of purchases per visit) during important trading periods
- making the entire range of its products available both in store and online — a so-called 'channel agnostic' approach to distribution
- developing existing stores through more effective visual merchandising, product presentation and an improved customer experience
- developing global sales opportunities.

These initiatives are designed to continue engaging customers and, when aligned with distinctive, sustainable and superior quality products, create greater brand authenticity (reliability and confidence in the company's products). This will consolidate and grow core markets as well as allowing the exploration of global marketing opportunities.

Interdependence of marketing with other key business functions

The use of an effective marketing approach will also require an interaction with the other key functional areas to ensure the operations function meets customer expectations through new and innovative products, cost control and automation. The finance function will need to use management strategies that ensure adequate funding for any marketing initiatives and human resources needs to foster a team-driven approach that encourages workers who embody the spirit, culture and attitude of the brand to generate innovative and competitive products.

Kathmandu employs a consumer-led marketing approach that targets specific market segments and focuses on how to maximise the return from each of these segments. This approach (where customer requirements are a priority) is reflected strongly in its desire to establish sustainable (ongoing, long-term) relationships that reward loyalty. The adventure travel focus (for example, trekking, camping and cycling) of the business can also be considered a niche that offers substantial opportunities for growth.

Influences on marketing

A well-developed understanding of its customers and their sociocultural characteristics (age, income, education, lifestyle) and other influences such as the prevailing economic conditions (four successive quarters of same-store sales

growth despite current difficult trading conditions and when several apparel retailers have closed) have an impact on management decision making across the business.

Kathmandu abides by the relevant federal consumer laws especially in respect to warranties. Its extensive returns and exchanges policy reflects this:

> Kathmandu provides quality outdoor gear for travel and adventure that is built to last. We believe you will be fully satisfied with your Kathmandu product.
>
> We are committed to complying with all obligations under consumer law. Any rights you have under this policy in relation to your Kathmandu product are additional to any rights you may have under consumer laws.

The process for seeking redress to assist consumers according to their purchase method is illustrated in figure 2.1.



FIGURE 2.1 Return and exchange process at Kathmandu

Further, the website provides a number of opportunities for customer contact to further enhance the customer experience as shown in figure 2.2.



FIGURE 2.2 Contact details to assist Kathmandu customers

Its ethical approach to marketing extends to truth, accuracy, good taste in advertising and ensuring its products are safe while engaging fairly with its competitors.

For example, all products must meet compliance requirements under the 2010 Australian Consumer Law (ACL) and consumer guarantees in respect to acceptable quality of goods including that it match any descriptions or samples, meet extra promises about performance and have satisfactory repair facilities available should purchased goods require it.

Marketing process

Situational analysis

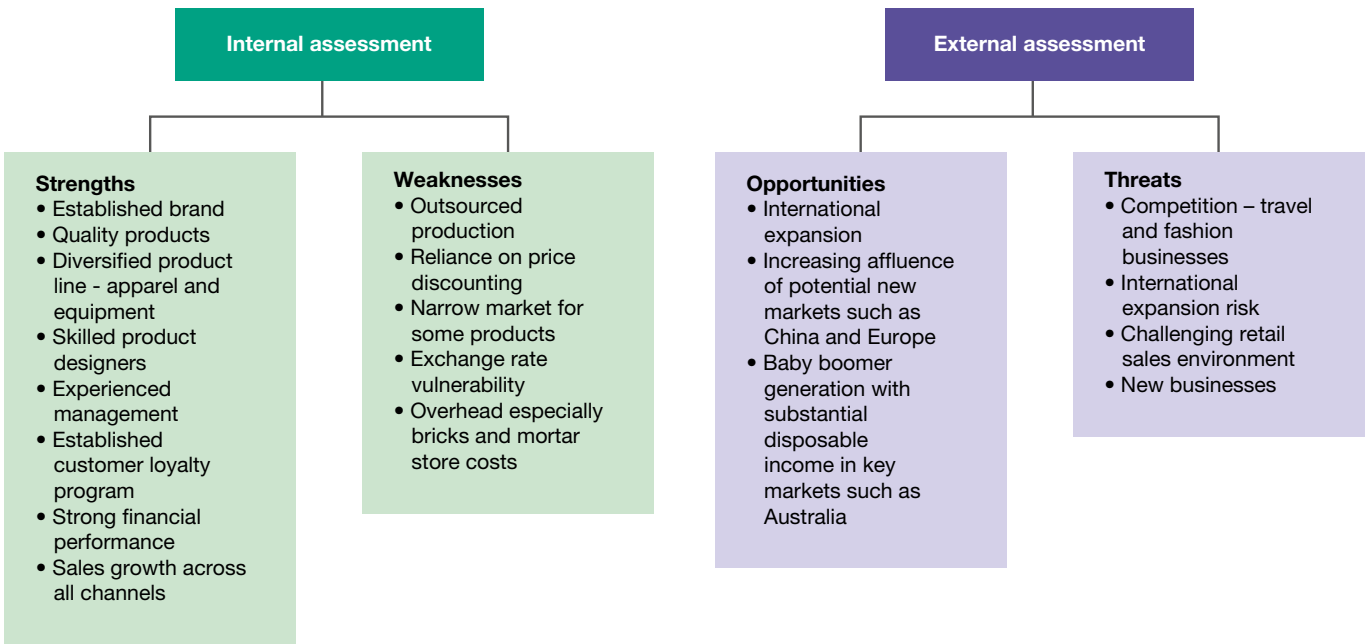


FIGURE 2.3 SWOT analysis. Kathmandu is in the mature stage of the product lifecycle for much of its products. This phase has involved the business investing heavily in marketing strategies and adapting products to sustain its competitive advantage.

Market research

The market research process provides insight into customer requirements with respect to their product expectations. Kathmandu uses its loyalty program, the Summit Club, to provide metrics that can be used to both improve existing products and drive new lines. In particular the Summit Club database gives insight into:

- who is buying the active products
- when they made the purchase
- the most popular stores
- other products purchased at the same time.

This allows the marketing team to create focus groups to better understand the areas that it needs to improve. Recent insight gained from such discussions led to a new business strategy for the active range to encourage sales to young customers. This has resulted in a more contemporary range with an emphasis on trail running. Further, Kathmandu consolidated this newly acquired knowledge with a targeted sponsorship of New Zealand's most iconic adventure race and engaged known trail runners as ambassadors for the new range. Consequently, product awareness and sales in these product categories have grown.



- GORE-TEX® 3-layer fabric: rugged, durably waterproof and windproof
- Fully waterproof and seam-sealed with a Durable Water Repellent (DWR) finish – which encourages water to roll off the surface
- Fully windproof, breathable and abrasion resistant
- Backpack-friendly, water-resistant front check pockets
- Two-way adjustable hood with wired hood peak allows free movements even when cinched
- Hood rolls away into collar
- Fleece-lined collar and chin guard for added comfort
- Water-resistant, two-way centre-front zip with internal storm guard
- Water-resistant, two-way pit-zips for ventilation
- Articulated fit for full range of movement with adjustable hem, waist and cuffs
- Internal check pocket with cord port for media device

FIGURE 2.4 Jardin Women's GORE-TEX 3 Layer Waterproof Jacket v2

Market objectives

More specific marketing objectives comprise increased brand awareness, new product development, pricing and promotion strategies, increased Summit Club membership, enhanced use of social media and digital channels, new store openings, improved in-store customer experience and global expansion. A strong environmental position that focuses on sustainable products is also a prominent feature.

Target markets

Kathmandu's target market is broad and is reflected in its diversity of products. Kathmandu has categorised its market into the following groups:

- young and serious (aspirational achievers)
- young and casual (fun seekers)
- middle aged and serious (experienced enthusiasts)
- middle aged and casual (family adventurers)
- older and serious (rediscovers)
- older and casual (appreciators).

The range of marketing strategies used by Kathmandu is varied and influenced by factors such as the time of year. For example, there are traditional Christmas sales in major cities like Sydney and Melbourne and it has diversified into a summer range of clothing (it is often thought of as a predominantly winter brand).

It attempts to differentiate it products through contemporary style, functionality and quality and this has proven effective as demonstrated by growing sales. Their product differentiation is exemplified in its current range of clothing by a 5-in-1 rain jacket that has a number layers, removable sleeves and hood (see figure 2.4). Another example is a highly adaptable backpack (see figure 2.5).



The 65L Entrada Backpack is an ideal lightweight pack for travellers. From the handy, detachable 15L Gluon Ora daypack to the luggage-style opening, the Entrada is designed for your overseas experience. It has a comfortable, easily adjustable harness, lockable zips and a storm flap over the main zip to protect you from the weather.

- Detachable 15L Gluon™ Ora day-pack
- Luggage-style opening
- Easily adjustable RS2 harness
- Lockable zips & storm flap over the main zip for extra weather protection
- Duffle style carry straps
- Bottle pocket & mesh pocket interior

FIGURE 2.5 Entrada 65L Backpack v2

Marketing strategies

Product differentiation and positioning

A brand-driven approach (the consumer associates the brand with quality) has been the focus of recent marketing strategies including its most recent winter campaign. The theme of 'gear that adapts' was consistent with its overall 'adaptive gear for inspired travel and adventure' approach, which was supported by a strong narrative of how its products were highly adaptable to different landscapes, climate and individuals no matter the circumstances. It reached 2.7 million people, attracted 1.8 million views and had 35 000 website visits — easily meeting brand key performance indicators.

Its products have a heavy ecological emphasis, particularly in relation to the finite nature of resources used in the manufacturing process. For example, materials to be used in apparel are considered according to the impact their manufacturing process may have on the environment and most products are made of 'preferred fibres and materials'. This strategy has three pillars: lead (driving innovation), connection (building supplier and industry partnerships) and inform (transparency with customers), as reflected in the *2017 Sustainability Report*:

> Down is preferred because of its warmth and that it is a natural product – it is a waste product from goose farming. Often synthetic alternatives require the use of petrochemicals, however, Kathmandu recycles 33% of its synthetic insulation. This process allows manufacturing in a more environmentally safe process.

Importance of packaging

Packaging is also a consideration for any business in the retail space. An emphasis on visually appealing packaging at Kathmandu has taken second place behind eliminating waste including zero-waste to landfill by 2018. Figure 2.6 shows the breakdown of in-store packaging waste.



FIGURE 2.6 Store waste breakdown

Kathmandu has introduced biodegradable polybags that can be recycled. The Sydney and Melbourne stores have employed the plastic upcycling service RedGROUP that collects soft plastics to be reused as raw material for recycled plastic products such as outdoor furniture, bollards and decking.

> **GREENER, MORE EFFICIENT PACKAGING**
> We produce a staggering 8 million hangtags per year. These had been produced by 120 different suppliers. This year we undertook a major overhaul of our packaging that started with an audit of all our packaging requirements. Once we had a complete picture, we could approach one supplier to take over the production. We chose Avery Dennison because they have a global network that will allow printing to be done close to garment factories and because they understand global packaging compliance requirements. Avery Dennison is also a leader in sustainability. Their Greenprint packaging audit looks at six factors— fossil material, trees, water, energy, CO_2 and waste. Greenprint tools help assess the footprint of packaging options and compare them to other options. Across our vast packaging requirements, even small improvements can make a huge difference to the overall impact.
>
> **PACKAGING WINS**
> As members of the Australian Packaging Covenant, we are scored every year. The industry average is 3.2 out of 5. This year we scored 4.7 (up from 4.5 last year) and won two awards, which reflect our work on waste management and consolidating our product packaging
>
> *Kathmandu, Sustainability Report 2017, p. 49*

Price

Pricing strategies used by Kathmandu are heavily influenced by those offered by competitors. They are also driven by a cost-based approach as reflected in to the desire to establish cost-effective relationships with suppliers. It offers similar products at varying price points often with minor price differences to reflect additional qualities for those that require it. For example, in its quest to cater for all aspects of its market the Retreat 80 3-person tent is a basic tent designed for the occasional camper, offered in contrast to the Retreat 150 Module Tent, which offers more for the seasoned camper.

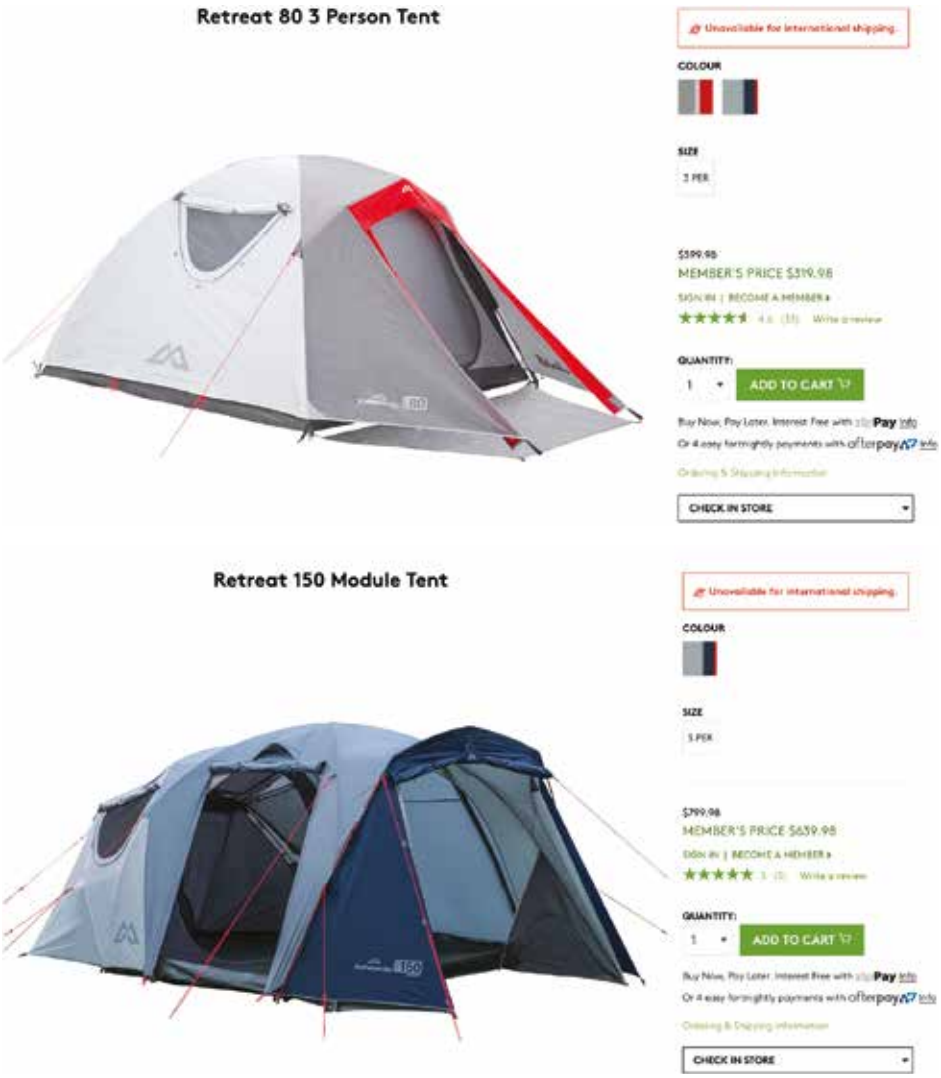


FIGURE 2.7 Different price points for tents

Kathmandu emphasises a strong association between price and quality in its marketing. In practice, this is implemented in all of its products through such things as inspections of distribution centres and investigations should a customer raise quality concerns. The values of brand authenticity and distinctive, sustainable products are strongly adhered to.

Promotion

Promotion such as advertising on television has a role in developing product association and in turn generating increased sales, especially during traditional retail sales periods such as mid-year and after Christmas. Personal selling is a focus of the company and Kathmandu ensures staff have a mix of relevant skills when employing people as customer service representatives in store. This is supplemented by extensive staff training such as practical in-store programs involving group and individual selling techniques. This has led to retail store teams being more capable of identifying customer traits and being able to adjust their selling techniques accordingly.

Other examples of relationship marketing include online-only deals that are exclusive to registered customers, are offered for a limited time and do not apply in store. Promotional codes for exclusive deals can only be applied to online purchases.

The Summit Club

The Summit Club is perhaps the company's main method of establishing effective customer relationships. 1.7 million members have joined by paying membership to the club (it is currently a one-off $10 fee) but it is free for students and those aged over 60 years. It encourages customers who love travel and the outdoors to become members. Membership offers the opportunity to participate in local and international adventures such as Himalayan treks and community volunteer opportunities. In addition, members get discounts up to 20 per cent for all full-priced gear and 10 per cent for other gear. They also earn points with every purchase, have exclusive access to Summit Club days, VIP offers and promotions and are supported by an online help centre.

Kathmandu uses the membership of the Summit Club as a database for the company to better align its products and marketing to its customers' needs, and it is acknowledged by management as an opportunity to better engage with customers.

Publicity and public relations

Kathmandu seeks to gain publicity through a number of channels. It sponsors Summit Club members who seek outdoor clothing and equipment that will assist them with an adventure or project that is consistent with the company's values. These projects include inspirational adventures, culturally engaging projects and outcome-oriented projects that contribute to environmental conservatism.

It has also sponsored outdoor events including being the naming rights sponsor of New Zealand's most iconic adventure race — the Kathmandu Coast to Coast.

The communication process used by the business includes the appointment of a number of brand ambassadors that are leaders in their chosen fields. One example is Tim Jarvis an explorer, environmental scientist and adventurer, who is perhaps best known for his Antarctic expeditions. In 2013 he retraced the 1916 journey of polar explorer Sir Ernest Shackleton, seen by many as one of the greatest survival journeys of all time, using similar equipment, clothing and technology.

Kathmandu's *Summit* magazine is also an important way of communicating seasonal products every quarter. It charts the travels of adventurists (often opinion leaders), recommends gear and assorted travel tips as well as tracking personal journeys all aimed at the lifestyle traveller at that particular time of the year.

E-marketing

Kathmandu is exploring more effective ways to take advantage of social media and digital technologies, shifting to more of an e-marketing based approach. It has modelled its plan on that used by similar retailers and is mostly targeting younger age groups who are more willing to engage with such digital platforms. Early indications are positive that its strategy is working and has potential for continued success, as identified in the recent growth of online sales. Kathmandu is also keen to use its website to gauge the potential of overseas interest in its products and the opportunity for access to bigger markets and sales.

While Kathmandu has invested heavily in its in-store presence and continues to upgrade where necessary to maximise the customer experience, it has also expressed the desire to complement this with its expanded online capacity.

Place and distribution

In respect to the distribution of its product Kathmandu has employed an omnichannel approach that it hopes enables it to better meet customer expectations both online and in-store. This has included an upgrade in the website's capacity to deal in multiple currencies, international shipping on many products and a click-and-collect trial in the United Kingdom. It also continues in its desire to engage with customers both in Australia and internationally through its app, ratings and reviews of products and now has a team devoted to online marketing.

Inventory management also extends to Kathmandu's Outlet store. Out-of-season stock, products with minor faults and discontinued products are offered at heavily discounted prices in locations such as factory outlet centres.

It seeks to target a somewhat selective market, driven by its understanding of the factors influencing purchases — although as previously mentioned it breaks this market down further into age and personality groups.

The other aspects of marketing strategies relate to the importance of recently recorded in-store sales growth due to improving visual merchandising and its focused and efficient sales team.

Global marketing

From its origins in New Zealand, Kathmandu has always had a global perspective. Its continued successful expansion into overseas markets will be based on a sound global marketing strategy. It has arranged distribution with large outdoor retail and wholesale networks in Europe and expanded online sales into China. Much of this expansion has been due to its capacity to leverage its successful brand and online presence developed in Australia and New Zealand, which has encouraged a so-called 'soft' expansion into locations where it sees market potential. Despite its strength in traditional brick-and-mortar stores, Kathmandu sees its online sales potential as its main entry into global markets and is building its IT infrastructure around a hassle-free experience for customers regardless of their location.

Products are identical in different markets with scope for differentiation at this stage of its global expansion difficult. Pricing is comparable, however, as the northern and southern hemispheres experience different seasons at any one time an in-season product here in Australia that is sold for a premium may be at the end of the season in the UK, thus requiring a discounted price to allow for new stock. This may account for slight price differences as seen in the following example. The product on the left is available on the UK site for between approximately $60–130 and in Australia the discounted member's price is $199.98.



FIGURE 2.8 Price differences between southern and northern hemispheres

Kathmandu has started selling its brand-name products through two overseas outdoor retailers, SportScheck, the leading outdoors retailer in Germany, and Go Outdoors in Britain.

The vertically integrated retailer has also launched a global website, kathmanduoutdoor.com to complement its Australian, New Zealand and UK e-commerce sites, and in early 2018 was setting up shop on Alibaba's TMall Global, a cross-border marketplace that enables international brands to sell directly to Chinese consumers and is seen as way of entering the competitive global travel and adventure apparel and equipment retail market in China.

CASE STUDY QUESTIONS

1. **Identify** Kathmandu's main competitors in Australia.
2. **Outline** the strategic marketing initiatives used.
3. **Explain** the role of ethical behaviour and government regulation in marketing.
4. **Evaluate** the marketing strategies used by Kathmandu.
5. **How** is a mix of promotional marketing strategies used?
6. **Analyse** the marketing plan used.
7. **How** can global marketing be used to expand the market?

TOPIC 3

FINANCE

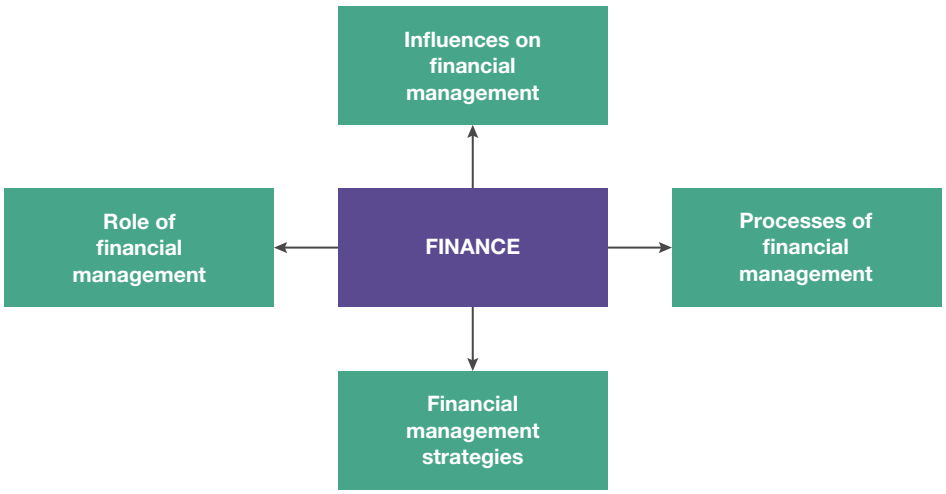
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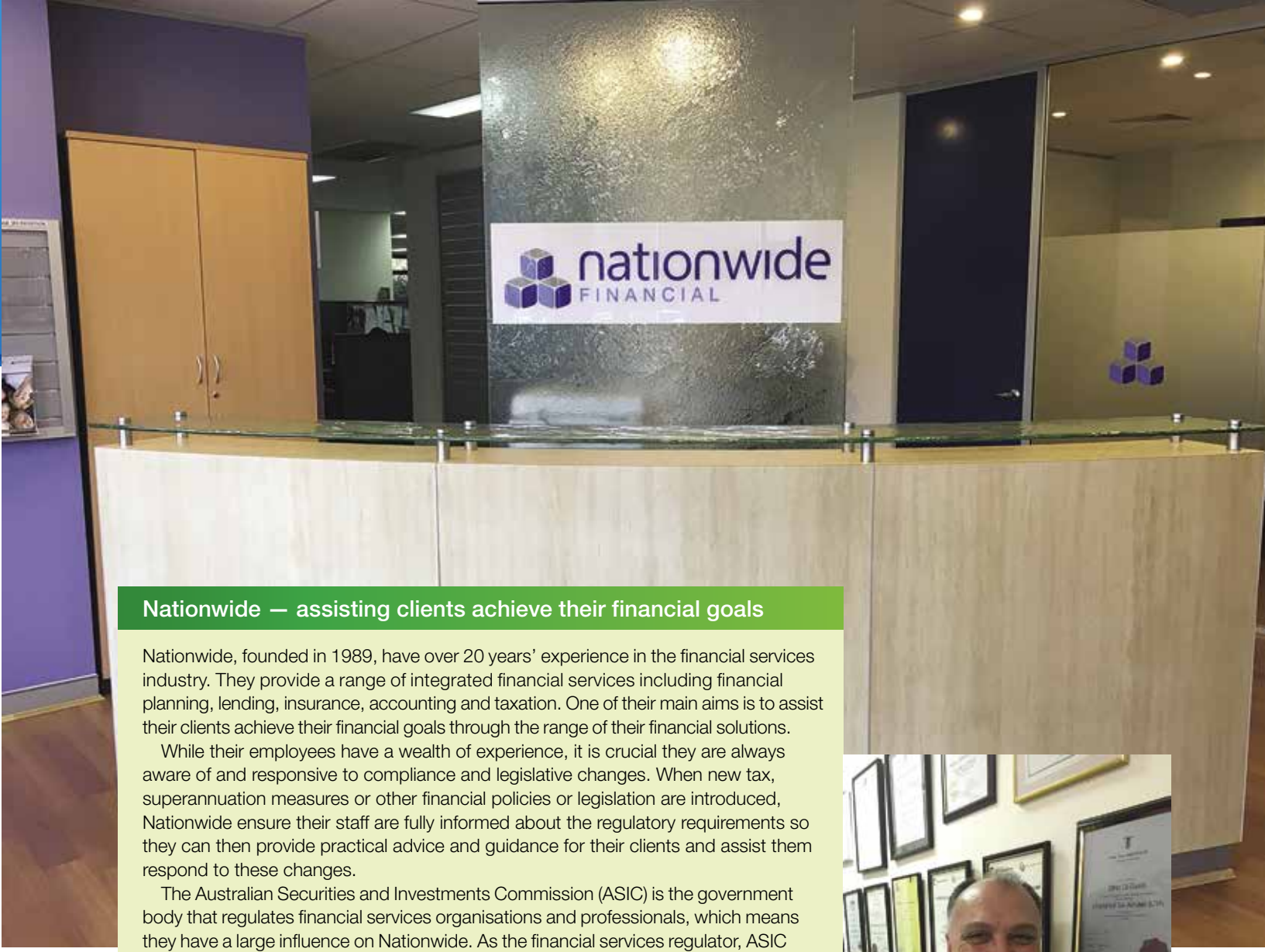
The focus of this topic is the role of interpreting financial information in the planning and management of a business.

OUTCOMES

Students should be able to:

- evaluate management strategies in response to changes in internal and external influences
- discuss the social and ethical responsibilities of management
- analyse business functions and processes in large and global businesses
- explain management strategies and their impact on businesses
- evaluate the effectiveness of management in the performance of businesses
- plan and conduct investigations into contemporary business issues
- organise and evaluate information for actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats
- apply mathematical concepts appropriately in business situations.





Nationwide — assisting clients achieve their financial goals

Nationwide, founded in 1989, have over 20 years' experience in the financial services industry. They provide a range of integrated financial services including financial planning, lending, insurance, accounting and taxation. One of their main aims is to assist their clients achieve their financial goals through the range of their financial solutions.

While their employees have a wealth of experience, it is crucial they are always aware of and responsive to compliance and legislative changes. When new tax, superannuation measures or other financial policies or legislation are introduced, Nationwide ensure their staff are fully informed about the regulatory requirements so they can then provide practical advice and guidance for their clients and assist them respond to these changes.

The Australian Securities and Investments Commission (ASIC) is the government body that regulates financial services organisations and professionals, which means they have a large influence on Nationwide. As the financial services regulator, ASIC licenses and monitors Nationwide to ensure they meet the standards set out in various pieces of legislation and certifies that they are operating efficiently, fairly and honestly.

As a large proportion of Nationwide's clientele are companies, they are obligated to pay company tax. Nationwide's tax professionals provide guidance on how their clients can maximise their financial position, in particular, through tax planning. They help businesses achieve their full potential through the recommendation of tax effective strategies and assist them in structuring their business more efficiently so they can manage the amount of tax they pay.

Another service provided at Nationwide is investment planning, which means that global market influences have an impact on the advice and recommendations Nationwide provide. Nationwide's staff periodically analyse the issues and trends affecting the global economy and predict how this will have an impact on their clients.

Since the global financial crisis, there has been a lot of business uncertainty. The uncertainties in the global economy have also had an impact on the liquidity and profitability of some of Nationwide's corporate clients. To manage this, staff assist clients in implementing effective working capital management strategies in an effort to help them improve their cash flow and current ratio.

One of Nationwide's aims is to assist companies maximise profitability. To achieve this, Nationwide uses updated accounting software that allows them to prepare detailed financial statements. They also use a variety of tools to perform ratio and benchmarking analysis to assist businesses review their current position. Through the scope of their integrated financial solutions they are able to help their clients achieve their financial goals and grow their wealth.



'The uncertainties in the global economy have had an impact on the liquidity and profitability of Nationwide's clients.'

on Resources

Kathmandu case study: Finance (doc-14391)

CHAPTER 9

Role of financial management

OVERVIEW

9.1 Introduction
9.2 Strategic role of financial management
9.3 Objectives of financial management
9.4 Interdependence with other key business functions

9.1 Introduction

BizWORD

Financial management *is the planning and monitoring of a business's financial resources to enable the business to achieve its financial objectives.*

Financial management is the planning and monitoring of a business's financial resources to enable the business to achieve its financial objectives. Financial management is crucial if a business is to achieve its financial goals. The mismanagement of financial resources can lead to problems.

9.2 Strategic role of financial management

BizWORD

Strategy *refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of the business.*

Businesses have specific goals they wish to achieve in relation to investment in capital (machinery and technology), training staff, marketing and the expansion of operations. The strategies that a business adopts work towards achieving its goals both in the short and longer term. **Strategy** refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of



FIGURE 9.1 The strategic role of financial management refers to the specific planning and management of a business's financial resources in order to assist the business achieve its objectives.

the business. Developing a **strategic plan** as part of a business's financial management will ensure that the business survives and grows in the competitive business world. Strategic plans encompass a long-term view of where the business is going, how it will get there and a monitoring process to keep track of progress along the way.

The long-term or strategic role of financial management is to ensure that a business achieves its goals and objectives. This can only be accomplished if the business's finances are managed effectively.

The strategic role of financial management includes:

- setting financial objectives and ensuring the business is able to achieve these goals
- sourcing finance
- preparing budgets and forecasting future finances
- preparing financial statements
- maintaining sufficient cash flow
- distributing funds to other parts of the business.

BizWORD

Strategic plan *encompasses the strategies that a business will use to achieve its long-term goals.*



BizFACT

Thirty-three per cent of small businesses fail due to poor management of financial resources.

FIGURE 9.2 Money (finance) is needed both to start a business and to keep it operating. Many businesses have failed because they mismanaged their financial resources. Proper financial management, however, can ensure that objectives and goals are achieved.

Strategic planning of **financial resources** is essential to a business's success and growth (see the following Snapshot).

BizWORD

Financial resources *are those resources in a business that have a monetary or money value.*

SNAPSHOT

Financial plans



Businesses that put together a realistic financial plan are more likely to gain the finance they need to grow and endure the difficulties that inevitably crop up.

Most business owners will create a business plan that sets out the desired goals and direction of the business. While no two business plans are alike, most business plans will include some common elements such as goals, operational plans, marketing plans and human resource plans. The financial section of the business plan, however, is one of the most fundamental sections of the plan. This is because the other sections of the plan won't mean a thing if they can't be justified with the correct figures.

'The financial section of the business plan … is one of the most fundamental sections of the plan.'

There are two very important reasons why business owners need a financial plan. They will need to have a financial plan if they intend on seeking finance. Financial institutions, investors or other lenders are going to want to see evidence that supports the fact that the business is likely to grow and make a profit, and that it will be able to make repayments.

The other reason that a financial plan is crucial is to help the owners predict how their business will do. The financial plan will give them an indication as to whether the business will be viable or whether they are wasting their time and/or money.

What should the financial section of a business plan include? To begin with, the financial plan should include financial projections. For example, it should include a sales forecast, an expenses budget, cash flow projection, income projection, a balance sheet and a break-even analysis. While there is a temptation to be overly optimistic when forecasting in an attempt to attract investors, it is important that the owners be realistic.

Once the financial plan has been created, it is important that owners continuously review and revise their plan and don't forget about it. The owners or financial managers should continuously work out the actual figures and compare them with their projections. They should then use those comparisons to revise their financial plan for the future.

SNAPSHOT QUESTIONS

1. **Identify** some common elements of a business plan.
2. **Why** is the financial plan the most important element of the business plan?
3. **Outline** what should be included in the financial plan.

studyon

Syllabus area 3
Topic 1
Concept 1

Strategic role of financial management
Summary screen and practice questions

9.3 Objectives of financial management

For a business to achieve its longer term goals it must have a number of short-term, specific objectives. The objectives of financial management are to maximise the business's:

- profitability
- growth
- efficiency
- liquidity
- solvency.

The responsibility of financial management is to make decisions about the best way to achieve those objectives. This will involve identifying and evaluating alternative courses of action and making recommendations.

9.3.1 Profitability

BizWORD

Profitability *means the excess of revenue or income over expenses or costs.*

Profitability is another important financial objective of management. Profitability is the ability of a business to maximise its profits. Profits satisfy owners or shareholders in the short term but are also important for the longer term sustainability of a firm.

To ensure that profit is maximised, a business must carefully monitor its revenue and pricing policies, costs and expenses, inventory levels and levels of assets. Profitability will be examined in more detail in chapter 11.

9.3.2 Growth

BizWORD

Growth *is the ability of the business to increase its size in the longer term.*

Growth is the ability of the business to increase its size in the longer term. Growth of a business depends on its ability to develop and use its asset structure to increase sales, profits and market share. Growth is an important financial objective of management as it ensures that the business is sustainable into the future.



FIGURE 9.3 In order to achieve their global target of generating €50 billion in sales by 2020, IKEA set an objective of increasing growth by 8 per cent each year. To achieve this, the furniture store will be expanding into India and China, where they plan on opening 25 stores by 2025.

9.3.3 Efficiency

Efficiency is the ability of a business to minimise its costs and manage its assets so that maximum profit is achieved with the lowest possible level of assets.

Efficiency generally relates to the operations or revenue-producing activities of the business. Achieving efficiency requires a firm to have control measures in place to monitor assets. A business that aims for efficiency must monitor the levels of inventories and cash and the collection of receivables. Efficiency will be examined in more detail in chapter 11.

BizWORD

Efficiency *is the ability of a business to minimise its costs and manage its assets so that maximum profit is achieved with the lowest possible level of assets.*

9.3.4 Liquidity

Liquidity is an important financial objective of management. Liquidity is the extent to which a business can meet its financial commitments in the short-term (less than 12 months). A business must have sufficient cash flow to meet its financial obligations or be able to convert current assets into cash quickly, for example, by selling inventory.

Controls over the flow of cash into and out of the business ensure that it has supplies of cash when needed. Cash shortfalls and excess or idle cash must be avoided as both involve loss of profitability for a business. Liquidity will be examined in more detail in chapter 11.

BizWORD

Liquidity *is the extent to which a business can meet its financial commitments in the short term (less than 12 months).*

9.3.5 Solvency

Solvency is the extent to which the business can meet its financial commitments in the longer term (more than 12 months). Solvency is particularly important to the owners, shareholders and creditors of a business because it is an indication of the risks to their investment.

Solvency indicates whether a business will be able to repay amounts that have been borrowed for investments in capital (such as equipment and machinery and/or premises). A good indicator to measure solvency is to use **gearing**,

BizWORD

Solvency *is the extent to which the business can meet its financial commitments in the longer term (more than 12 months).*

Gearing *is the proportion of debt (external finance) and the proportion of equity (internal finance) that is used to finance the activities of a business. Gearing ratios determine the firm's solvency.*

which measures the percentage of the assets of the business which are funded by external sources. This way, it measures the business's reliance on outside finance. Solvency (as measured by the level of gearing) is examined in more detail in chapter 11.

9.3.6 Short-term and long-term financial objectives

studyon
Syllabus area 3
Topic 1
Concept 2
Objectives of financial management
Summary screen and practice questions

The financial objectives of a business are based on the goals of its strategic plan, which can be translated into both the short and long term.

- *Short-term financial objectives* are the tactical (one to two years) and operational (day-to-day) plans of a business. These would be reviewed regularly to see if targets are being met and if resources are being used to the best advantage to achieve the objectives. For example, if management has a goal to achieve a 15 per cent increase in profit for the next 10 years, the tactical plans might involve purchasing additional machinery, updating old equipment with new technologies, expanding into new markets and providing new services.
- *Long-term financial objectives* are the strategic plans of a business. They are determined for a set period of time, generally more than five years. They tend to be broad goals such as increasing profit or market share, and each will require a series of short-term goals to assist in its achievement. The business would review their progress annually to determine if changes need to be implemented.

9.3.7 Potential conflicts between short-term and long-term financial objectives

Many business objectives complement each other and meet the needs of a broad range of stakeholders. However, sometimes potential conflicts can arise between short-term and long-term financial objectives. For example, a common financial long-term objective is growth. The decision to expand would have the support of managers, employees, suppliers and the local community. However, expansion is often associated with increased costs and gearing, which will lead to lower overall profits in the short term. This decision may therefore cause conflict with the business owners or shareholders as well as investors. In the longer term, however, most business owners would be pleased to support an expansion if it increases the overall value of the business.

Another example that illustrates the conflict between short-term and long-term financial objectives would be the decision to invest in research and development. Investing in research is very expensive and it might take many years to achieve useful results. Therefore, it is a strategy that is bad in the short term, but in the long run, can make the company lots of money.

The conflict between short-term versus long-term results is critical in business. This is because in order to achieve long-term profitability, businesses need to invest in human and physical resources. Many of these resources cost money and will take a long time to pay off, therefore minimising the business's ability to meet their short-term obligations.

Reconciling these conflicting goals is not always easy and short-term thinking by managers may discourage important long-term investment in the business, which could have led to increased profits. Financial managers must constantly assess the achievement of the specific objectives and attempt to satisfy as many goals as possible.

Case study: Wesfarmer's — conflict between short-term and long-term objectives

Can you sacrifice temporary pleasure for long-term gain? Just as you will encounter many opportunities for short-term pleasure that may delay or prevent you from achieving your long-term goals, many business managers sacrifice the long-term health of their business to achieve quick results.

In contrast to this trend, Wesfarmers (which owns companies such as Coles, Bunnings, Officeworks and Target) announced that it would sacrifice short-term profit growth by reducing prices across all their retail businesses in order to guarantee long-term sales growth and shareholder returns. In order to stay competitive, the company will continue to cut prices, which will result in less profit in the short-term. This short-term sacrifice should, however, lead to longer term growth.

According to the managing director, Richard Goyder, 'We'll continue to invest in pricing … if that moderates our profit increases that's fine as far as I'm concerned because we'll build a strong business'. 'We will always run the group with a long term view — it would be easy to pull some levers and increase short-term profit but that would be bad, something we've never done and never will', Mr Goyder said. 'We won't do what the UK (grocers) did … if you (focus on) short-term profits you end up with a big problem', he said.

'Both [Coles and Bunnings] could ratchet up prices and we could get earnings growth up, but the businesses would long-term suffer, and that's definitely not the way we do things.'

Source: Quoted material from Sue Mitchell, 'Wesfarmers sacrifices short-term profit for long-term growth', *The Sydney Morning Herald*, 19 February 2015

SNAPSHOT QUESTIONS

1. **Identify** your long-term goals as well as the obstacles that could give you short-term satisfaction but will delay you from achieving those goals.
2. **How** does Wesfarmers deal with the conflict between short-term and long-term objectives?

SNAPSHOT



'… short-term sacrifice should … lead to longer term growth …'

9.4 Interdependence with other key business functions

The key business functions include:

- operations
- marketing
- finance
- human resources.

Interdependence refers to the mutual dependence that the key functions have on one another. They key functions work best when they overlap and employees work towards common goals. Each function area depends on the support of the others if it is to perform at capacity.

The marketing, operations and human resources departments rely on financial managers to allocate them adequate funds i.e. the operations department requires funds to purchase inputs and carry out their transformation processes, the marketing department requires funds to undertake the various forms of promotion and the human resources department requires funds in order to pay for staff.

In return, the finance department also relies on the other three key business functions. The finance department relies on operations to produce the products, on

BizWORD

Interdependence *refers to the mutual dependence that the key business functions have on one another.*

marketing to promote the products and on human resources to manage staff. Each of these functions helps the business generate sales and therefore provide income to the finance department.

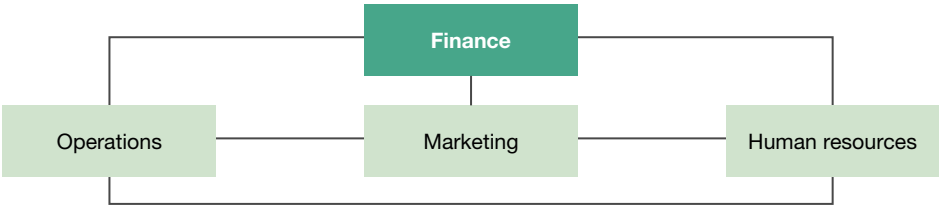


FIGURE 9.4 Without finance there would be very little business. Finance (funding) flows to each functional area within a business, which enables it to achieve its goals.

SUMMARY

- Financial management is the planning and monitoring of a business's financial resources in order to allow the business to achieve its financial objectives.
- The long-term or strategic role of financial management is to ensure that a business achieves their goals and objectives.
- The goals of a business can include increasing market share and profits. These goals are translated into objectives that aim to provide greater details and outcomes. This means they can be measured and evaluated for current and future plans.
- The main objectives of financial management include profitability, growth, efficiency, liquidity and solvency.
- The short-term objectives of a business include both tactical and operational plans of a business, which would be reviewed regularly to determine if targets are being met.
- The long-term objectives of a business include strategic plans of a business and are set for periods of more than five years. They form the basis on which all short-term goals are established.
- While many business objectives complement each other, sometimes, potential conflicts can arise between short-term and long-term financial objectives.
- Interdependence of the key business functions means that each function is not able to operate in isolation successfully — it relies on the others to perform its role in achieving the broader goals of a business.
- Finance plays a crucial role in funding extra resources.

EXERCISE 9.1 REVISION

1. **Define** the terms 'financial management'.
2. **Outline** the benefits of developing a strategic plan as part of a business's financial management.
3. **Construct** a concept map **summarising** the strategic roles of financial management.
4. **State**, with examples, the objectives of financial management.
5. **Outline** the relationship between short-term and long-term financial objectives.
6. **Why** is the financial function critical to the long-term success of a business? In your answer, refer to the interdependent nature of the key business functions.
7. **Demonstrate** potential conflicts between short-term and long-term financial objectives.

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Syllabus area 3
Topic 1
Concept 3

Interdependence with key business functions
Summary screen and practice questions

on Resources

Digital doc: Chapter summary (doc-24811)
Interactivity: Chapter crossword (int-7165)
Interactivity: Multiple choice quiz (int-7166)

EXERCISE 9.1 EXTENSION

1 Using an example, **outline** a conflict between a short-term and long-term objective and **recommend** a strategy that management could adopt to reconcile this conflict.

2 Use the internet to **examine** the annual reports of three businesses.
(a) **Identify** two goals.
(b) **Describe** the strategies used to achieve these goals.
(c) **Propose** reasons why some of the goals may not have been achieved in that financial year.

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CHAPTER 10

Influences on financial management

OVERVIEW

10.1 Introduction
10.2 Sources of finance — internal and external
10.3 Financial institutions
10.4 Influence of government
10.5 Global market influences

10.1 Introduction

The influences on the financial management of a business include a range of external factors such as the domestic government's economic decisions and legislation, and the global economy, which has become a major influence on not just the financial function but all aspects of business operations. Internal factors also have an impact on the financial management of a business and these are more directly controlled and monitored by management through its short- and long-term planning. Figure 10.1 outlines the main influences on the financial management of a business.

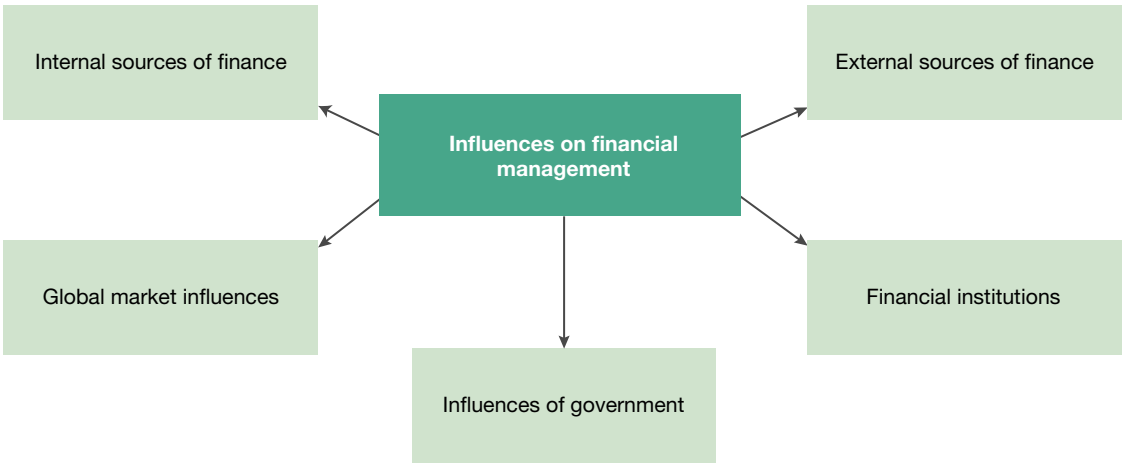


FIGURE 10.1 Influences on financial management

10.2 Sources of finance — internal and external

A business cannot establish itself and thrive without funds to enable it to pursue its activities. The range of activities in which a business is involved during its life cycle includes the initial set-up — whether establishing a new business or buying one that is already established — and might include expanding its range of products,

introducing a new product, expanding the number of outlets, upgrading its systems and technology, employing more staff and building a new warehouse.

In the establishment phase of a business, owners and/or shareholders usually contribute funds. In later years, when a business is in the growth stage, a number of options can be considered regarding sources of funds and how those sources will be used. Sources of funds may be internal or external (see figure 10.2). Finding the appropriate source of funds for the business's needs involves **financial decision making**, which means that relevant information must be identified, collected and analysed to determine an appropriate course of action.

BizWORD

Financial decision making *requires relevant information to be identified, collected and analysed to determine an appropriate course of action.*

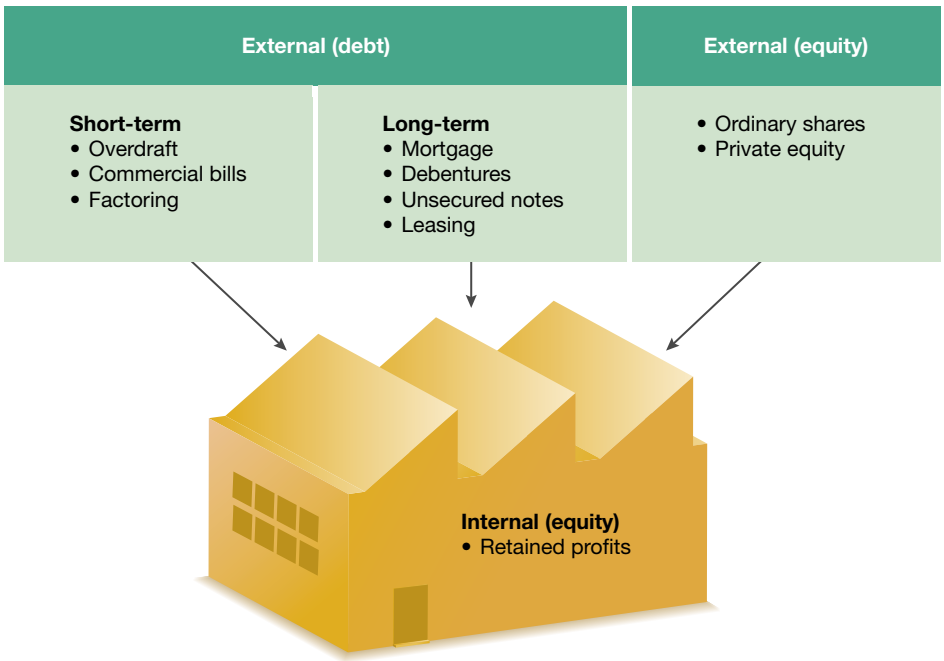


FIGURE 10.2 Internal and external sources of funds

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Syllabus area 3
Topic 2
Concept 1

Internal sources of finance
Summary screen and practice questions

10.2.1 Internal sources

Internal finance refers to funds generated from inside the business. For example, profits can be retained to finance expansion.

BizWORD

Internal finance *refers to funds generated from inside the business. For example, profits can be retained to finance expansion.*

Retained profits

The most common source of internal finance is retained earnings or profits in which all profits are not distributed, but are kept in the business as a cheap and accessible source of finance for future activities. Most businesses keep some of their profit in the form of retained earnings. In Australian businesses, approximately 50 per cent of profits on average are retained to be reinvested.

10.2.2 External sources

External finance refers to the funds provided by sources outside the business, including banks, other financial institutions, government, suppliers or financial intermediaries. Finance provided from external sources through creditors or lenders is known as **debt finance**.

Using debt as a source of finance means that the business relies on outside sources rather than the owners to finance the business. The increased funds for the business should mean increases in earnings and hence profits. Regular repayments on the borrowings must be made so firms have to generate sufficient earnings to make the payments. There is an increase in risk for businesses using debt as the

BizWORD

External finance *is the funds provided by sources outside the business, including banks, other financial institutions, government, suppliers or financial intermediaries.*

Debt finance *relates to the short-term and long-term borrowing from external sources by a business.*

interest and bank and government charges have to be paid on top of the principal borrowed. However, Australia's tax system has promoted debt financing for businesses by providing tax deductions for interest payments.

Types of external debt include short- and long-term borrowing (see figure 10.3). The advantages and disadvantages of debt and equity financing, as well as matching the terms and sources of finance to business purpose, will be examined in more detail in chapter 11.

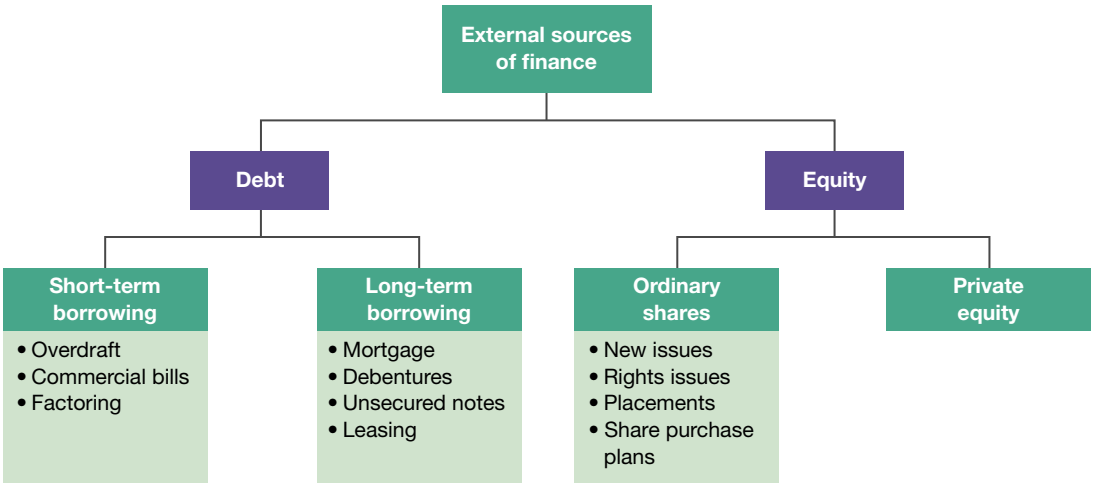


FIGURE 10.3 External sources of finance — debt and equity

Debt: short-term borrowing

Short-term borrowing is provided by financial institutions through overdrafts, commercial bills and bank loans. This type of borrowing is used to finance temporary shortages in cash flow or finance for working capital. Short-term borrowing generally refers to those funds that will be repaid within 12 months. Short-term debts are recorded as current liabilities on the balance sheet.



FIGURE 10.4 Credit cards are another form of short-term debt finance that many businesses use to meet their short-term obligations. Seventy-nine per cent of small business owners use credit cards as a source of financing.

Overdraft

An **overdraft** is one of the most common types of short-term borrowing. A bank allows a business or individual to overdraw their account up to an agreed limit and for a specified time, to help overcome a temporary cash shortfall. Overdrafts assist businesses with short-term liquidity problems, for example a seasonal decrease in sales. Costs for overdrafts are minimal, and interest rates are lower than on other forms of borrowing. As interest rates are usually variable, interest is paid on the daily outstanding balance of the account. Banks usually require the agreed limits to the overdraft to be maintained at a high level and require some security. Overdrafts are repayable on demand, although this is not common.

Many businesses prefer overdrafts to short-term bank loans because bank loans do not have the same flexibility as overdrafts.

BizWORD

*With an **overdraft**, the bank allows a business or individual to overdraw their account up to an agreed limit and for a specified time, to help overcome a temporary cash shortfall.*

Commercial bills

Commercial bills are primarily short-term loans issued by financial institutions, for larger amounts (usually over $100 000) for a period of generally between 30 to 180 days. The borrower receives the sum immediately and promises to repay the money with interest at a future time; that is, the full amount borrowed doesn't have to be repaid until the end of the term.

Commercial bills are flexible both in relation to the interest that needs to be paid and the repayment period. These types of loans are usually secured against the business's assets and are generally rolled over until the borrower has the funds to repay the loan in full.

BizWORD

***Commercial bills** are primarily short-term loans issued by financial institutions, for larger amounts (usually over $100 000) for a period of generally between 30 to 180 days.*

Factoring

Factoring is a short-term source of borrowing for a business. It enables a business to raise funds immediately by selling accounts receivable at a discount to a firm that specialises in collecting accounts receivable (a finance or factoring business). Factoring is an important source of short-term finance because the business will receive up to 90 per cent of the amount of receivables within 48 hours of submitting its invoices to the factoring company. By having immediate access to funds, the business will improve its cash flow and gearing. The business does not have to worry about the collection of accounts or the costs involved in this process. However, it must be remembered that the full amount will not be received for accounts.

A factoring company may offer its services with or without recourse.

- 'Without recourse' means that the business transfers responsibility for non-collection to the factoring company.
- 'With recourse' means that bad debts will still be the responsibility of the business.

Factoring involves greater risk than other sources of short-term borrowing such as overdrafts and commercial bills because of the likelihood of unpaid debts. It is a relatively expensive source of finance because the business is usually responsible for debts that remain unpaid, and commission is paid on the debt. In the past, factoring was used as a last resort but this attitude has changed in the last decade, and factoring is seen as a legitimate means of financing the activities of a business.

BizWORD

***Factoring** is the selling of accounts receivable for a discounted price to a finance or factoring company.*

SNAPSHOT





'SMEs are increasingly using factoring as a source of finance...'

Case study: OSCAR Natural — factoring and invoice discounting

Small and medium-sized enterprises (SMEs) increasingly use factoring as a source of finance despite the fact it costs more than traditional forms of funding. Factoring is particularly appealing to the construction, manufacturing, agriculture and mining, transport and storage, wholesale trade and labour hire markets as they have traditionally extended longer payment cycles to their clients, which ties up funds.

OSCAR Natural is a company that produces natural shaving products. The owner, Oscar de Vreis, used factoring from the outset to fund his business.

> Without factoring stockists pay your invoice on 60 or 90 days. A factoring firm will advance you between 70 per cent and 85 per cent of the value of the invoice as soon as it's issued so you can keep in sync with your cash flow. The more successful you are the more you need it because you need the funds to order stock.

While Oscar admits that factoring is more expensive than an overdraft, he prefers this type of funding because, unlike some other forms of debt finance, he doesn't need to provide security or give up any equity in the business.

There are some drawbacks with factoring, however.

> The biggest headache with factoring is that the admin team at the factoring company reconcile the payments and inevitably they make errors and have occasionally applied payments to the wrong invoices.

Once Oscar's company became more profitable, he was offered invoice discounting. This is very similar to factoring but it is only offered to more established companies that have a high turnover rate.The main difference between factoring and invoice discounting is that the business, not the lender, collects payments from customers, which means that their customers will not be aware that they have taken on cash flow finance. With invoice discounting, the finance company pay a certain percentage of the invoice amount (generally 80–90 per cent of the total) but it's up to the business to collect the payments as normal and then repay the lender (with fees and interest charges). Oscar prefers this method of finance as it enables him to maintain his standards of customer service and keep a direct relationship with his debtors.

SNAPSHOT QUESTIONS

1. **Discuss** factoring.
2. **Describe** invoice discounting.
3. **Explain** why Oscar prefers invoice discounting over factoring.

study on

Syllabus area 3
Topic 2
Concept 2

External sources of finance: short-term debt
Summary screen and practice questions

Debt: long-term borrowing

Long-term borrowing relates to funds borrowed for periods longer than 12 months. Long-term borrowing is usually used to purchase major assets such as buildings and equipment, and the assets often serve as security on the loan. Despite some risks, long-term borrowing is a common source of financing for businesses.

Long-term debts are recorded as non-current liabilities on the balance sheet.

Mortgage

BizWORD

*A **mortgage** is a loan secured by the property of the borrower (business).*

A **mortgage** is a loan secured by the property of the borrower (business). The property that is mortgaged cannot be sold or used as security for further borrowing until the mortgage is repaid. Mortgage loans are used to finance property purchases, such as new premises, a factory or office. They are repaid with interest, usually through regular repayments, over an agreed period of time.

Debentures

BizWORD

***Debentures** are issued by a company for a fixed rate of interest and for a fixed period of time.*

Debentures are issued by a company for a fixed rate of interest and for a fixed period of time. Companies provide them as a way to raise funds from investors, as opposed to financial institutions. A debenture is a promise made by a company to

repay money that has been lent to the business. An investor lends money to a company and in return the company issues a debenture with a promise to make regular interest payments for a defined term and then repay the loan at a particular date in the future.

Companies that borrow offer security to the lender usually over the company's assets. On maturity, the company repays the amount of the debenture by buying back the debenture. The amount of profit made by a company has no effect on the rate of interest because debentures carry a fixed rate of interest. Debenture products must have a prospectus. This will tell investors everything they need to know about the company, how they will use the funds and the terms of the investment. Finance companies raise much of their funds through debenture issues to the public.

Unsecured notes

An **unsecured note** is a loan from investors for a set period of time. Unsecured notes are not secured against the business's assets and therefore present the most risk to the investors in the note (the lender). For this reason it attracts a higher rate of interest than a secured note. Companies sell unsecured notes to generate money for their initiatives, such as share repurchases and acquisitions.

BizWORD

*An **unsecured note** is a loan from investors for a set period of time. Unsecured notes are not secured against the business's assets.*



FIGURE 10.5 In 2006 Fincorp, a property investment group, wanted to raise $500 million dollars by issuing debentures and unsecured notes to public investors. They offered investors 9.75 per cent a year. Some people ended up losing hundreds of thousands of dollars when the company collapsed in 2007 owing $200 million to 8000 investors. Those who invested in secured debentures got some of their money back but those who invested in unsecured notes have so far not received a cent.

Leasing

Leasing is usually a long-term source of borrowing for businesses. It involves the payment of money for the use of equipment that is owned by another party. A variety of business assets are suitable for leasing, including business cars, plant and machinery, equipment, computers and software.

BizWORD

Leasing *involves the payment of money for the use of equipment that is owned by another party.*

BizFACT

A motor vehicle leased for two weeks would be leased as an operating lease. The leasing firm would be responsible for repairs to the motor vehicle; and if the vehicle was returned earlier than two weeks, there would be an adjustment to the lease payment.

A motor vehicle leased for three years would be leased as a financial lease. The firm leasing the motor vehicle would be responsible for insurance and maintenance of the vehicle, and the term of the lease would be close to the economic life of the vehicle.

Leasing enables an enterprise to borrow funds and use the equipment without the large capital outlay required. Costs and benefits of the financial asset are transferred from the lessor to the lessee. The lessee uses the equipment and the lessor owns and leases the equipment for an agreed period of time. A long-term lease cannot usually be cancelled.

Since the 1960s, leasing as a source of finance has been used widely in Australia. The main participants in lease finance have been finance companies. Businesses choose the equipment, arrange for the finance company to purchase it, then lease it from the finance company, which retains ownership for the period of the lease. There are two types of leases, operating and financial (see the BizFact).

- Operating leases are assets leased for short periods, usually shorter than the life of the asset. The owner carries out the maintenance on the asset. Operating leases can be cancelled, often without penalty.
- Under the conditions of a financial lease, the lessor purchases the asset on behalf of the lessee. Financial leases are usually for the life of the asset. Lease repayments are fixed for the economic life of the asset, usually between three and five years. Plant, vehicles, equipment, furniture and fittings are leased as financial leases. There are usually penalties for cancellation of financial leases. Leasing assets for long periods as financial leases is cheaper than leasing them as operating leases.

Some of the advantages of leasing as a source of finance include:

- It assists a business with their cash flow; this is because the cash outflows or payments related to leasing are spread out over several years, hence saving the burden of a one-off significant cash payment.
- The costs of establishing leases may be lower than other methods of financing.
- If some assets are leased a business may be in a better position to borrow funds.
- It provides long-term financing without reducing control of ownership.
- It permits 100 per cent financing of assets.
- Repayments of the lease are fixed for a period so cash flow can be monitored easily.
- Lease payments are a tax deduction.
- Payment usually includes maintenance, insurance and finance costs.

However, a disadvantage of leasing is that interest charges may be higher than for other forms of borrowing.

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Syllabus area 3
Topic 2
Concept 3

External sources of finance: long-term debt
Summary screen and practice questions



FIGURE 10.6 Small business owners often don't have the funds available to purchase business assets outright without affecting their cash flow. This is why leasing has become an attractive source of finance. According to the Alleasing Equipment Demand Index, Australia's SMEs have an estimated $91.8 billion in leased plant and equipment assets, excluding real estate.

Corporations are required by law to reveal significant leases in their published financial statements or in notes to the financial statements.

Equity

Equity as an external source of funds refers to the finance raised by a company through inviting new owners. For example, this can be done by issuing shares to the public through the Australian Securities Exchange (ASX). This is used as an alternative to debt funding. Equity as a source of external finance includes:

- ordinary shares (new issue, rights issue, placements, share purchase plan)
- private equity.

BizWORD

Equity *as an external source of funds refers to the finance raised by a company through inviting new owners.*



FIGURE 10.7 In 2017, the Australian Government amended the *Corporations Act 2001* allowing companies to access crowd-sourced equity funding (CSEF) (refer to BizFACT). The government introduced these changes to make it easier and less expensive for small businesses to raise equity and to remedy the shortage of finance options available for SMEs and start-ups.

BizFACT

Crowd-sourced equity funding (CSEF) is an innovative type of fundraising that allows a large number of individuals to make small financial investments (up to $10 000) in exchange for an equity stake in the company. CSEF is similar to other forms of crowdfunding in that it enables companies to raise funds through an online portal. The difference is that investors receive a share of the company rather than a product or service. Eligible companies will be able to raise up to $5 million a year this way.

Ordinary shares

Ordinary shares are the most commonly traded shares in Australia. The purchase of ordinary shares by individuals means they have become part-owners of a publicly listed company. This means they get voting rights according to the number of shares that they have as well as payments called **dividends**. When shareholders purchase shares in a company, they are providing a source of finance (equity) for that business. The value of the share is determined by a company's current or future performance.

BizWORD

A **dividend** *is a distribution of a company's profits (either yearly or half-yearly) to shareholders and is calculated as a number of cents per share.*

The following terms refer to variations in the type or issue of ordinary shares.

- *New issue* — a security that has been issued and sold for the first time on a public market e.g. the Australian Securities Exchange. New issues are sometimes referred to as primary shares or new offerings. An initial public offering (IPO) is when a company issues shares to the public for the first time. Usually, businesses will be required to issue a prospectus, which is a document that contains relevant details about the company so that investors can make informed decisions.
- *Rights issue* — the privilege granted to shareholders to buy new shares in the same company. This occurs after the IPO and provides existing shareholders with the opportunity to purchase more shares. Usually the current shareholders will have the right to purchase new shares in proportion to the number of shares they currently own. The shareholder does not have to take up the rights issue.
- *Placements* — allotment of shares made directly from the company to investors. In other words additional shares are offered at a discount to their current trading price to special institutions or investors. This discount is intended to persuade specific investors to invest in the company.
- *Share purchase plan* — an offer to existing shareholders in a listed company to purchase more shares in that company without brokerage fees. The shares can also be offered at a discount to the current market price. Share purchase plans allow companies to issue new shares to current shareholders without issuing a prospectus. They can only issue a maximum of $15 000 in new shares to each shareholder.

Private equity

Private equity is the money invested in a (private) company not listed on the Australian Securities Exchange (ASX). The aim of the private company (like the publicly listed companies who sell ordinary shares) is to raise capital to finance future expansion/investment of the business.

SNAPSHOT



'the float… will enable them to achieve their long-term strategic plans.'

The benefits of equity financing

When starting a new business or expanding an existing one, you must decide whether you want to borrow money or sell ownership interest to equity investors. Before selecting an option, it is important that you understand the pros and cons of each option.

Equity financing refers to raising funds by selling shares in a company to investors. As opposed to debt financing, any money raised through equity doesn't have to be paid back in instalments with interest. Instead, investors contribute money to the business and then become partial owners of that business, which means they are entitled to a share of the company's profits over time.

For small businesses, however, the most common source of equity is friends and family. Unlike debt, investments made by friends and family can be paid back after the business starts to make money. This may not be until after a number of years. These investments are usually made when businesses are starting out because the owners may experience difficulties obtaining debt finance since they don't have a track record and there is a high risk of business failure.

Daniel Tartak is the chief executive of Bingo Industries, a waste management and recycling company that has its corporate headquarters in the western Sydney suburb of Auburn. In 2005, Tony Tartak, Daniel's father, bought the business for less than $1 million dollars. At that time it was just a small skip bin collection company with four trucks, 100 skip bins and six employees. Five family trusts owned by various members of the extended Tartak family each

owned 20 per cent of the company. Over twelve years, the family gradually built the company up into a large family business with 158 trucks and 10 recycling centres.

Daniel Tartak, who has always been involved with the family business, began running Bingo in 2015 after his parents retired. To achieve his aim of expanding the company into a national firm within five years, Daniel listed his company on the ASX in 2017. The company raised $420 million in proceeds from the float. The Tartak family will retain 104.7 million shares worth $188 million at the issue price, which means they retain only 30 per cent of the company. However, they will collect $348 million in cash from the float, which will enable them to achieve their long-term strategic objectives.

The type of financing businesses seek depends largely on the nature of the business. If a business is just getting started, they may consider a loan from family, friends or even a bank. As they grow, equity funding may become an option, but only if the owners are willing to give up a portion of their company.

SNAPSHOT QUESTIONS

1. **Outline** the disadvantages of debt financing.
2. **Discuss** equity financing.
3. **Explain** how equity financing is helping Bingo Industries achieve their long-term strategic plans.

SUMMARY

- Internal finance refers to funds that are generated from inside the business. For example, profits can be retained to finance expansion.
- External finance is the funds provided by sources outside the business, such as financial institutions, governments and suppliers.
- External sources of finance are broadly categorised as either debt or equity — each will influence the financial management decision of a business.
- Debt finance can be short-term borrowings such as overdrafts, commercial bills and factoring; or long-term borrowings such as mortgages, debentures, unsecured notes and leasing.
- Equity refers to the cash raised by a company through:
  - issuing ordinary shares to the public for purchase through the ASX
  - private shares (equity) in companies not listed on the ASX.
- Different types of ordinary shares include:
  - new issue
  - rights issue
  - placements
  - share purchase plan.

studyon

Syllabus area 3
Topic 2
Concept 4

External sources of finance: equity
Summary screen and practice questions

EXERCISE 10.1 REVISION

1 **Outline** the difference between internal sources and external sources of finance.

2 **Define** the term 'retained profits'.

3 **Explain** why equity finance can be the most difficult type of finance to obtain.

4 **Why** do you think most businesses keep approximately half of their profit in the form of retained earnings?

5 Thomas, who owns a hairdressing business, prefers to use retained earnings to expand his business rather than taking on a new partner. **Interpret** the reasons for this.

6 **Identify** the main sources of external finance.

7 **Discuss** the use of an overdraft to meet short-term financial commitments.

8 **Clarify** the main features of commercial bills.

9 **Identify** and **explain** the sources of finance from the following balance sheet.

Current Assets		
Cash	$33 000	
Receivables	12 000	
Inventories	4 700	$49 700
Non-current Assets		
Land and buildings	98 000	
Plant and equipment	18 000	116 000
Total Assets		165 700
Current Liabilities		
Creditors	8 700	
Non-current Liabilities		
Borrowings	12 000	20 700
Net Assets		145 000
Owners' Equity		
Capital	140 000	
Profits	5 000	145 000

10 (a) **Define** the term 'factoring'.
(b) **Why** has factoring become an important source of finance for business?
(c) **Discuss** factoring.

11 **Distinguish** between a debenture and an unsecured note.

12 **Define** the term 'leasing'.

13 'Leasing is a cheap, flexible and important source of finance for businesses'. **Discuss** this statement, **outlining** the uses, advantages and disadvantages of leasing.

14 BJs Supermarket is considering whether to purchase or lease a new supermarket. The lease requires that BJs pays for maintenance, insurance and rates if the store is leased. The annual lease payment is $100 000 (payable in advance) for four years. The purchase price of the supermarket is $350 000 and funds would need to be borrowed if the store was purchased. **Construct** a report for BJs supermarket on the best alternative for the business, **outlining** the advantages and disadvantages of both leasing and purchasing the supermarket.

15 Leo has purchased a number of computers and new software for his photographic equipment business in anticipation of increasing sales on the internet. This has not occurred and Leo is having difficulties paying bills on time. **Recommend** to Leo the best sources of finance for the business to overcome the problems. **Justify** your answers.

16 **Construct** a concept map **summarising** the variations in the type or issue of ordinary shares.

on Resources

Weblink: Austrade

Weblink: Australia Private Equity and Venture Capital Association (AVCAL)

EXERCISE 10.1 EXTENSION

1 **Examine** the sources of funds provided by Austrade and Australia Private Equity and Venture Capital Association (AVCAL) that are available to businesses.

2 **Analyse** a range of annual reports of businesses to determine their sources and applications of funds. **Construct** a table to **summarise** your findings.

10.3 Financial institutions

Financial institutions collect funds and invest them in financial assets. They provide financial services and focus on dealing with financial transactions such as investments, loans and deposits. While most businesses acquire funds from a bank, finance is also available from a variety of other institutions, such as investment banks, finance companies, superannuation funds, life insurance companies, unit trusts and the Australian Securities Exchange.

10.3.1 Banks

Banks are the major operators in financial markets and are the most important source of funds for businesses. Banks receive savings as deposits from individuals, businesses and governments, and, in turn, make investments and loans to borrowers.



FIGURE 10.8 There is intense competition between banks. To entice businesses to bank with them, banks now offer a wide variety of products and services for businesses; for example, low fees, merchant facilities such as EFTPOS and BPay, debit and credit cards, business loans, internet banking, business insurance, overdraft facilities and advice.

Most of the funds provided through financial markets come from banks that operate on their own behalf or on behalf of other corporations, although other financial institutions also operate in the financial market.

Banks are the largest form of financial institution in Australia, although their share has declined as the financial markets have become deregulated. They perform an increasingly wide range of roles rather than specialising in one area, and have subsidiaries in superannuation and mutual, and other funds. Banks are supervised by the Reserve Bank of Australia.

BizFACT

There are currently 54 banks operating in Australia. The four largest banks are ANZ Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation.

10.3.2 Investment banks

Investment banks provide services in both borrowing and lending, primarily to the business sector, for example, Macquarie Bank. They provide a wide variety of different types of loans for businesses and can therefore customise loans to suit the business's specific needs. Investment banks sometimes impose conditions when providing loans. For example, they may require some equity in the business borrowing the funds. Investment banks:

- trade in money, securities and financial futures
- arrange long-term finance for company expansion
- provide working capital
- arrange project finance
- advise clients on foreign exchange cover
- advise on mergers and takeovers

- provide portfolio investment management services
- underwrite corporate and semi-government issues of securities
- operate unit trusts including cash management trusts, property trusts and equity trusts
- arrange overseas finance.

10.3.3 Finance companies

BizFACT

There are currently 105 registered finance companies in Australia. However, their share of business loans has been shrinking in recent years.

Finance companies are non-bank financial intermediaries that specialise in smaller commercial finance. They provide mainly short-term and medium-term loans to businesses through consumer hire-purchase loans, personal loans and secured loans. They are also the major providers of lease finance to businesses. Some finance companies specialise in factoring or cash flow financing.

Finance companies raise money through share issues (debentures). Debentures are for a fixed term and carry a fixed rate of interest. Lenders have the security of priority over the firm's assets in the event of liquidation. In other words, the finance company is entitled to sell the assets of the business to recover the initial loan if the business fails. Finance companies can provide businesses with quick access to funds, although the interest rate will usually be higher. Finance companies (and insurance companies) are regulated by the Australian Prudential Regulation Authority (APRA) (see figure 10.9).



FIGURE 10.9 The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies and most members of the superannuation industry. APRA is funded largely by the industries that it supervises.

10.3.4 Life Insurance companies

Life insurance companies are also non-bank financial intermediaries who provide cover and a lump sum payment in the event of death. Policy holders pay regular premiums and the insurer guarantees to pay the designated beneficiary a sum of money upon death of the insured person or under other circumstances specified in the contract.

Life insurance companies provide both equity and loans to the corporate sector through receipts of insurance premiums, which provide funds for investment. The funds received in premiums, called reserves, are invested in financial assets.

10.3.5 Superannuation funds

BizWORD

Superannuation *is a scheme set up by the federal government, which requires all employers to make a financial contribution to a fund which will provide benefits to an employee when they retire.*

Superannuation funds have grown rapidly in Australia over the past 25 years due to tax incentives and compulsory superannuation, which was introduced by the government in 1992. **Superannuation** is a scheme set up by the federal government, which requires all employers to make a financial contribution to a fund that will provide benefits to an employee when they retire.

Employers are required by the government to make superannuation contributions for all employees aged between 18 and 69 who are paid more than $450 before tax in a calendar month. They are also obligated to make contributions for people under 18 who work more than 30 hours a week (and still earn more than $450 in the calendar month). Employers must pay an amount equal to 9.5 per cent

of their employee's salary into a super fund account. This is on top of the employee's salary or wages. Over the course of their working life, these contributions add up.

Superannuation funds invest the money received from superannuation contributions in many things, such as company shares, property and managed funds. They do this so that their members will earn investment returns on the money.

Superannuation guarantee — future plans

There are laws about how much superannuation employers must contribute to their employees' superannuation fund. This is called the superannuation guarantee. The superannuation guarantee began in 1992 with the passing of the *Superannuation Guarantee (Administration) Act 1992*. When this law was first introduced, the superannuation guarantee was only 3 per cent (4 per cent for employers who had an annual payroll greater than $1 million). Over the next ten years, higher levels of contributions were phased in, until it reached 9 per cent in 2002–03.

In 2010, the Australian Labor Party (ALP) announced that they planned to gradually increase the superannuation guarantee contributions from 9 per cent to 12 per cent by 2019. Under new laws passed by the Liberal government, the planned rate of increase will slow. The superannuation guarantee rate will remain at 9.5 per cent for another five years, increasing to 10 per cent from July 2021. It will not reach 12 per cent until July 2025, another seven years from what was set out in the previous laws.

The table below details the planned gradual increase to the SG rate over a period of 10 years.

Financial year	SG rate
2012–13	9%
2013–14	9.25%
2014–15	9.5%
2015–16	9.5%
2016–17	9.5%
2017–18	9.5%
2018–19	9.5%
2019–20	9.5%
2020–21	9.5%
2021–22	10%
2022–23	10.5%
2023–24	11%
2024–25	11.5%
2025–26	12%

This planned increase was originally introduced to address issues raised by Australia's ageing population: the number of Australians aged over 65 is projected to increase from 3 million to 8.1 million by 2050. In addition, those people approaching retirement will spend more time in retirement than past generations. These reforms will therefore boost the retirement incomes for Australian workers.

SNAPSHOT QUESTIONS

1. **Define** 'superannuation guarantee'.
2. **Justify** why the government introduced a reform to the superannuation guarantee.
3. **Assess** the impacts of this reform on individuals, employers and the government.

SNAPSHOT



'There will be a phased increase in superannuation guarantee contributions.'

10.3.6 Unit trusts

Unit trusts (also known as mutual funds) take funds from a large number of small investors and invest them in specific types of financial assets. Unit trusts invest in any mixture of cash, Australian or international shares, fixed interest securities (such as government bonds) or property. In recent years some unit trusts have also invested in gold, silver, oil and gas. Unit trusts are usually connected to a management firm that manages a diversified investment portfolio for its investors.

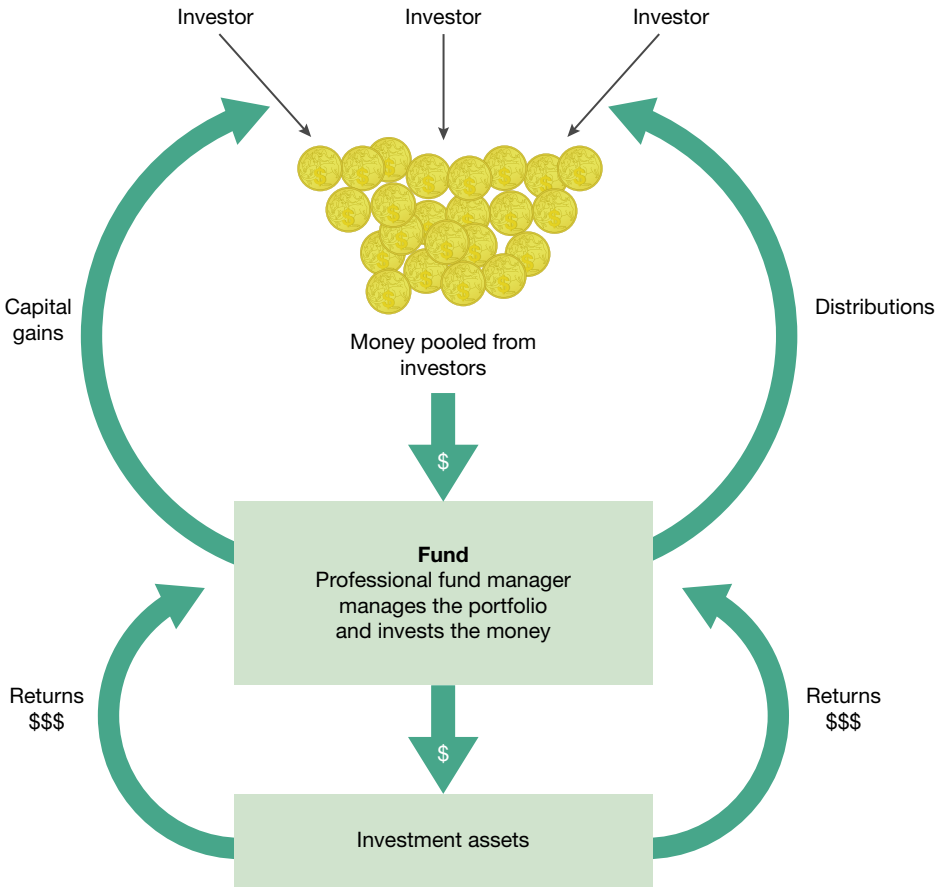


FIGURE 10.10 How unit trust funds work

BizWORD

The **Australian Securities Exchange (ASX)** *is the primary stock exchange group in Australia.*

10.3.7 Australian Securities Exchange

The **Australian Securities Exchange (ASX)** was created by the merger of the Australian Stock Exchange and the Sydney Futures Exchange in July 2006 and is the primary stock exchange group in Australia. The ASX is a market where shares are bought and sold.

The ASX functions as a market operator, clearing house and payments system facilitator. It oversees compliance with its operating rules and promotes standards of corporate governance among Australia's listed companies. The ASX offers products and services including:

- shares
- futures
- exchange traded options
- warrants
- contracts for difference
- exchange traded funds
- real estate investment trusts
- listed investment companies
- interest rate securities.

The biggest stocks traded on the ASX include BHP Billiton, CBA, Rio Tinto, Suncorp and Telstra.

Importantly for businesses, the ASX acts as a **primary market**. This primary market enables a company to raise new capital through the issue of shares and through the receipt of proceeds from the sale of securities.

The ASX also operates as a **secondary market**. The secondary market is where pre-owned or second-hand securities, such as shares, are traded between investors who may be individuals, businesses, governments or financial institutions. Transactions in this market do not increase the total amount of financial assets — the secondary market increases the liquidity of financial assets and, therefore, influences the primary market for securities.



FIGURE 10.11 The most common ways to buy and sell shares is on the share market using a full service broker, an online trading account or from the company itself when it offers shares through a public float. An online broking service allows investors to make their own investment decisions for lower fees. A full service broker will charge more; however, they can also give advice on what to buy and sell.

BizWORD

Primary markets *deal with the new issue of debt instruments by the borrower of funds.*

Secondary markets *deal with the purchase and sale of existing securities.*

SUMMARY

- The main financial institutions are:
  - banks
  - investment banks
  - finance companies
  - life insurance companies
  - superannuation funds
  - unit trusts
  - Australian Securities Exchange.
- Banks are the major operators in financial markets and are the most important source of funds for business.
- Investment banks provide services in both borrowing and lending, primarily to the business sector.
- Finance companies are non-bank financial intermediaries that specialise in smaller commercial finance.
- Life insurance companies are also non-bank financial intermediaries who provide cover and a lump sum payment in the event of death.

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Concept 5
Financial institutions
Summary screen and practice questions

- Superannuation funds are able to invest the contributions of members into a range of short- and long-term investments with the aim of maximising a return.
- The business sector increasingly uses superannuation funds for long-term investment in growth and development.
- The ASX acts as both a primary and secondary market for the sale of shares to the public.

EXERCISE 10.2 REVISION

1 Draw a table, as indicated below, to **summarise** the major participants in financial markets.

Financial institution	Financial instruments	Characteristics

2 Choose three financial instruments. **Investigate** current interest rates, maturity dates, and terms and conditions from a range of four institutions.

3 Using the internet, **identify** five investment banks that are currently operating in Australian financial markets.

4 **Explain** the role of financial markets in meeting the needs of businesses.

5 **Distinguish** between primary and secondary markets.

6 **Examine** an area of business banking that interests you, for example, at the National Australia Bank (NAB). Prepare a list of five points **summarising** what you learnt.

on Resources

Weblink: National Australia Bank (NAB)

EXERCISE 10.2 EXTENSION

1 It has been said that financial markets drive the financial and investment decisions of businesses. **Analyse** the accuracy of this statement.

2 Choose one of the major participants in financial markets. **Examine** the services offered to businesses. **Determine** current interest rates for borrowing and investing for businesses. **Compare** your investigations with other students.

3 **Investigate** the role of technology in improving financial market interactions for businesses. **Create** a report to management to **explain** how changing technology in financial markets can improve financial and investment decisions.

10.4 Influence of government

The government influences a business's financial management decision making with economic policies such as those relating to the monetary and fiscal policy, legislation and the various roles of government bodies or departments who are responsible for monitoring and administration. The following outlines the importance of two governmental influences on financial management for businesses.

10.4.1 The Australian Securities and Investments Commission (ASIC)

ASIC is an independent statutory commission accountable to the Commonwealth parliament. It enforces and administers the *Corporations Act 2001* and protects consumers in the areas of investments, life and general insurance, superannuation and banking (except lending) in Australia.

The aim of ASIC is to assist in reducing fraud and unfair practices in financial markets and financial products. ASIC ensures that companies adhere to the law, collects information about companies and makes it available to the public. This includes the financial information that companies must disclose in their annual reports.

ASIC have been given a wide range of powers to enforce the Corporations Act. If a business breaches the law, ASIC will investigate the matter and determine an appropriate remedy. They are able to pursue a variety of remedies depending on the seriousness of the misconduct, such as imprisonment and monetary penalties. Failure to comply with the Corporations Act also generates negative publicity for the business.

10.4.2 Company taxation

All Australian businesses that have been incorporated — that is, all private and public companies — are required to pay company tax on profits. This tax is levied at a flat rate of 30 per cent of net profit, unlike personal income taxes, which use a progressive scale. Prior to 2017, the company tax rate was 30 per cent, however, in the 2016–17 Budget, the government announced that it intended to progressively reduce the corporate tax rate to 25 per cent. From the 2016/17 tax year, the company tax rate was reduced to 27.5 per cent for small businesses with a turnover less than $10 million. The company tax rate will remain at 30 per cent for all other companies that are not small business entities. Company tax is paid before profits are distributed to shareholders as dividends.

The Australian Government has undertaken this process of reform of the federal tax system in order to improve Australia's international competitiveness and make Australia an even more attractive place to invest, thereby driving long-term economic growth. This will mean more jobs and higher wages for working Australians. The Australian company tax rate was previously reduced from 36 to 34 per cent in 2000/01 and then to 30 per cent in 2001/02.

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Syllabus area 3 Government
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Concept 6

BizFACT

The federal Liberal government has been trying to pass legislation to lower the tax rate from 30 per cent to 25 per cent for companies with a turnover of more than $50 million.

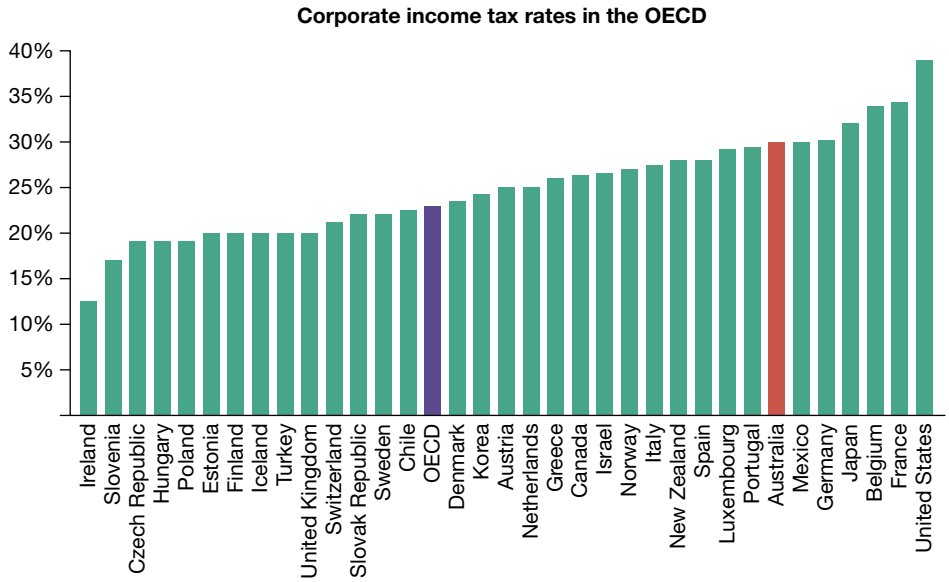


FIGURE 10.12 Australia's company tax rate in relation to other OECD countries

Source: The Organisation for Economic Co-operation and Development (OECD), https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

10.5 Global market influences

Financial risks associated with global markets are greater than those encountered domestically, but such risk-taking is necessary to implement a business strategy.

Largely uncontrollable financial influences include the availability of funds, interest rates and the global economic outlook. 'Uncontrollable' means that

these influences are part of the external business environment and may not be significantly controlled by the business. However, a business can put in place appropriate financial management strategies to minimise the negative effects.

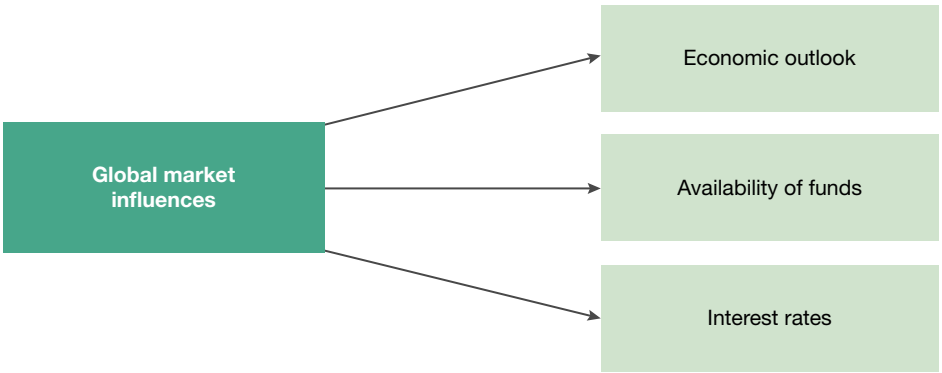


FIGURE 10.13 Global influences on financial management

One very significant influence in the past two decades is the impact of globalisation on world financial markets. Globalisation has created more interdependence between economies and their business (and financial) sector which relies on trade for expansion and increased profits.

10.5.1 Global economic outlook

BizWORD

The **global economic outlook** *refers specifically to the projected changes to the level of economic growth throughout the world.*

The **global economic outlook** refers specifically to the projected changes to the level of economic growth throughout the world. If the outlook is positive (that is, world economic growth is to increase) then this will have an impact on the financial decisions of a business. This may include:

- increasing demand for products and services. For a country such as Australia, this would mean businesses will need to increase production to meet demand and therefore require funds to purchase equipment, employ or train staff, or expand the size of the business.
- a decrease in the interest rates on funds borrowed internationally from the financial money market. This results mainly from a decrease in the level of risk associated with repayments. As business sales increase, so too do profits. (Although, increased demand for funds can actually cause interest rates to rise!)

However, a poor economic outlook will have an impact on financial decisions of a business in the opposite way to those mentioned previously.

The World Bank forecast that the global economy would grow 3.1 per cent in 2018. While global growth will pick up slowly, it still remains below historical norms. Some factors that will have an impact on the global economy include:

- an increase in manufacturing and trade
- increasing consumer confidence
- increased investment spending
- uncertainty surrounding the economic policies of the US administration and their global ramifications
- uncertainty resulting from the Brexit referendum resulting in the United Kingdom withdrawing from the European Union
- expected slowing in the growth in the Chinese economy
- increase in commodity and oil prices
- financial risks from high and rising credit growth and house price increases.

BizFACT

Research from the McKinsey Global Institute in 2017 found that global cross-border capital flows — including lending, purchases of equities and bonds, and foreign direct investment — have fallen by 65 per cent since the global financial crisis in 2007, from $12.4 trillion to $4.3 trillion. Half of that decline reflects a sharp reduction in cross-border lending and other banking activities.

10.5.2 Availability of funds

The **availability of funds** refers to the ease with which a business can access funds (for borrowing) on the international financial markets. The international financial markets are made up of a range of institutions, companies and governments that are prepared to lend money to individuals, companies or governments who may need to raise capital. Various conditions and rates apply and these will be based primarily on:

- risk
- demand and supply
- domestic economic conditions.

The global financial crisis that occurred in 2008–09 had a major impact on the availability of funds for all companies and institutions. It caused a sharp increase in interest rates that was a reflection of the high level of risk in lending.

BizWORD

Availability of funds *refers to the ease with which a business can access funds (for borrowing) on the international financial markets.*

10.5.3 Interest rates

Interest rates are the cost of borrowing money. The higher the level of risk involved in lending to a business, the higher the interest rates. A business that plans to either relocate offshore or expand domestic production facilities to increase direct exporting will normally need to raise finance to undertake these activities. Traditionally, Australian interest rates tend to be above those of other countries, such as the United States and Japan. Therefore, Australian businesses could be tempted to borrow the necessary finance from an overseas source to gain the advantage of lower interest rates. However, the real risk here is exchange rate movements. Any adverse currency fluctuation could see the advantage of cheaper overseas interest rates quickly eliminated. In the long term, the 'cheap' interest rates may end up costing more.

BizWORD

Interest rates *are the cost of borrowing money.*

10.5.4 Analyse the influence of government and the global market on financial management

There are a variety of implications for businesses in relation to the influence of the government:

- Legislation will influence the decisions businesses make about their finances.
- Businesses need to ensure they comply with legal obligations.
- Legislation impacts on the choice of legal structure as different obligations are imposed on different types of businesses.
- If businesses don't comply with regulations, ASIC can pursue a range of remedies, which will influence a business's finances.
- Negative publicity could result for businesses who do not comply with government regulations.
- Taxation regulations will affect business's financial decisions as some decisions might be better for taxation purposes.
- Taxation regulations require sound financial management so the business will have adequate financial resources available for when their taxation obligations are due.

There are also various implications for businesses in relation to the influences of the global market:

- The global economic outlook will have a direct effect on the demand for Australian exports; that is, a positive outlook will increase demand for Australian products whereas a negative outlook will decrease demand.
- The availability of funds will impact on whether Australian businesses can access the money they need to expand.

- Overseas interest rates will also affect Australian businesses who borrow funds from overseas. If interest rates and/or exchange rates change, then this could lead to an increase in repayments and therefore a reduction in profits.

SUMMARY

- The government influences the financial management of business through the implementation of economic policies (fiscal and monetary), and through the implementation of current and changing legislation.
- The Australian Securities and Investments Commission (ASIC) aims to reduce fraud and unfair practices in financial markets and financial products.
- Companies and corporations in Australia pay company tax on profits.
- Globalisation has created more interdependence between economies and their business (and finance) sectors, which relies on trade for expansion and increased profits.
- Global market influences increasingly affect business financial decisions, and this is specifically evident in the availability of funds for loans and the interest rates charged for these loans.
- The changes to the global economic outlook relate specifically to changes in the economic growth rates of individual economies throughout the world.
- The need to maximise profits and the capacity to source funds internationally will affect financial management decisions.

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Syllabus area 3
Topic 2
Concept 7

Global market influences
Summary screen and practice questions

EXERCISE 10.3 REVISION

1 **Describe** the role of ASIC and briefly **discuss** its importance as a regulator of financial markets.
2 **Explain** the influence of company tax on financial management.
3 (a) **Identify** three global market influences.
(b) **Why** are these influences considered 'uncontrollable'?
4 **How** could a negative global outlook affect the financial decisions of a business?
5 **Outline** factors that will affect a business's ability to access funds globally.
6 **Outline** the risk to Australian businesses of borrowing finance from an overseas source to gain the advantage of lower interest rates.
7 **Explain** the impact of the global market on the financial management decisions of businesses throughout the world. Use examples in your response.
8 **Summarise** the implications for businesses in relation to the influences of government and the global market.
9 Answer the following questions by referring to the graph in figure 10.12.
(a) **Identify** which OECD country has the lowest company tax rate.
(b) **Identify** which country has the highest company tax rate. What is the tax rate?
(c) **Compare** Australia's tax rate to other OECD countries.

on Resources

- **Digital doc:** Chapter summary (doc-24812)
- **Interactivity:** Chapter crossword (int-7167)
- **Interactivity:** Multiple choice quiz (int-7168)
- **eLesson:** Floating Intrepid Travel (eles-1045)
- **Weblink:** Australian Securities and Investments Commission (ASIC)

EXERCISE 10.3 EXTENSION

1 Use the internet to **determine** three financial impacts of the global financial crisis on business.
2 Using information from the **Australian Securities and Investments Commission (ASIC)** website, **construct** a concept map that **summarises** the roles and powers of ASIC.

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CHAPTER 11

Processes of financial management

OVERVIEW

11.1 Introduction
11.2 Planning and implementing
11.3 Debt and equity financing
11.4 Matching the terms and sources of finance to business purpose
11.5 Monitoring and controlling
11.6 Calculating financial ratios and strategies to improve performance
11.7 Identifying the limitations of financial reporting
11.8 Ethical issues related to financial reports

11.1 Introduction

An important part of financial management is establishing effective financial processes to monitor the financial health of the business and ensure the organisation meets its objectives. The main financial processes include:

- planning and implementing
- monitoring and controlling
- calculating financial ratios
- identifying limitations of financial reports
- identifying ethical issues related to financial reports.

11.2 Planning and implementing

Financial planning is essential if a business is to achieve its goals. Financial planning determines how a business's goals will be achieved. Figure 11.1 shows the process of financial planning and implementing.

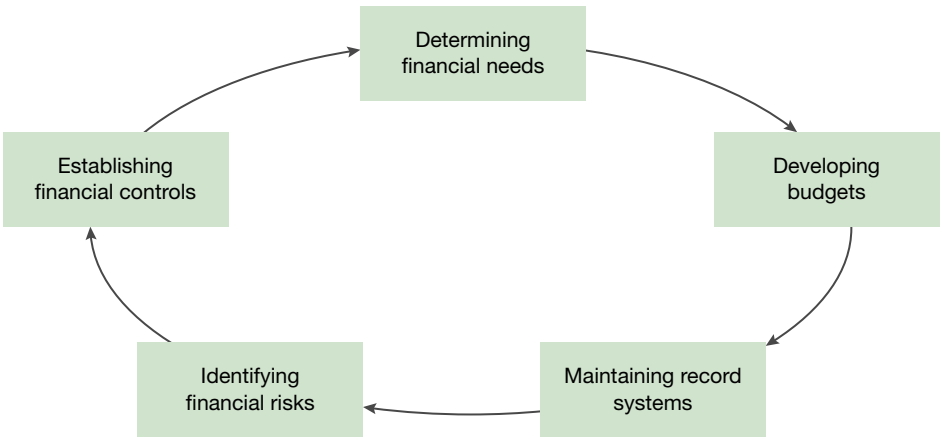


FIGURE 11.1 The planning and implementing cycle

11.2.1 Financial needs

To determine where a business is headed and how it will get there, it is important to know what its needs are. Important financial information needs to be collected before future plans can be made. This financial information includes balance sheets, income statements, cash flow statements, sales and price forecasts, budgets, bank statements, weekly reports from departments, break-even analysis, reports from financial ratio analysis and interpretation.

The financial needs of a business will be determined by:

- the size of the business
- the current phase of the business cycle
- future plans for growth and development
- capacity to source finance — debt and/or equity
- management skills for assessing financial needs and planning.

A business plan might be used when seeking finance or support for a project from a bank or other financial institution or other potential investors. These institutions need a guarantee that their financial commitment to the business will be successful. A business plan sets out finance required, the proposed sources of finance and a range of financial statements. The types of information included in a business plan's financial statements depend on the audience for the business plan — employees, owners, lenders or potential investors. Financial information is needed to show that the business can generate an acceptable return for the investment being sought and should, therefore, include an analysis of financial performance, income statement, cash flow statement, balance sheet and financial ratio analysis reports.

BizFACT

The form and content of the financial information in business plans vary but include some or all of the following:

- *income statement*
- *cash flow statement*
- *balance sheet*
- *cost-volume-profit analysis*
- *financial ratios.*

11.2.2 Budgets

Budgets provide information in quantitative terms (that is, as facts and figures) about requirements to achieve a particular purpose. Budgets can be drawn up to show:

- cash required for planned outlays for a particular period
- the cost of capital expenditure and associated expenses against earning capacity
- estimated use and cost of raw materials or inventory
- number and cost of labour hours required for production.

Budgets reflect the strategic planning decisions about how resources are to be used. They provide financial information for a business's specific goals and are used in strategic, tactical and operational planning.

BizWORD

Budgets *provide information in quantitative terms (facts and figures) about requirements to achieve a particular purpose.*



FIGURE 11.2 Budgets are important financial management tools. They enable managers to plan for the future, monitor past and present performance, and coordinate the plans made by different sections of the business.

BizFACT

Budgets provide the facts and figures for planning and decision making, and enable constant monitoring of progress and problem areas. They signal where things are not going according to plan so that adjustments can be made, and show where achievement towards objectives has occurred.

Budgets enable constant monitoring of objectives and provide a basis for administrative control, direction of sales effort, production planning, control of stocks, price setting, financial requirements, control of expenses and of production cost.

Budgets are used in both the planning and the control aspects of a business. As a control measure, planned performance can be measured against actual performance and corrective action taken as needed.

A budget is an important part of the planning process and various factors need to be considered in preparing it, such as:

- review of past figures and trends, and estimates gathered from relevant departments in the business
- potential market or market share, and trends and seasonal fluctuations in the market
- proposed expansion or discontinuation of projects
- proposals to alter price or quality of products
- current orders and plant capacity
- considerations from the external environment — for example, financial trends from the external environment, availability of materials and labour.

Budgets are often prepared to predict a range of activities relating to short-term and longer term plans and activities. Budgets can be classified as operating, project or financial budgets.

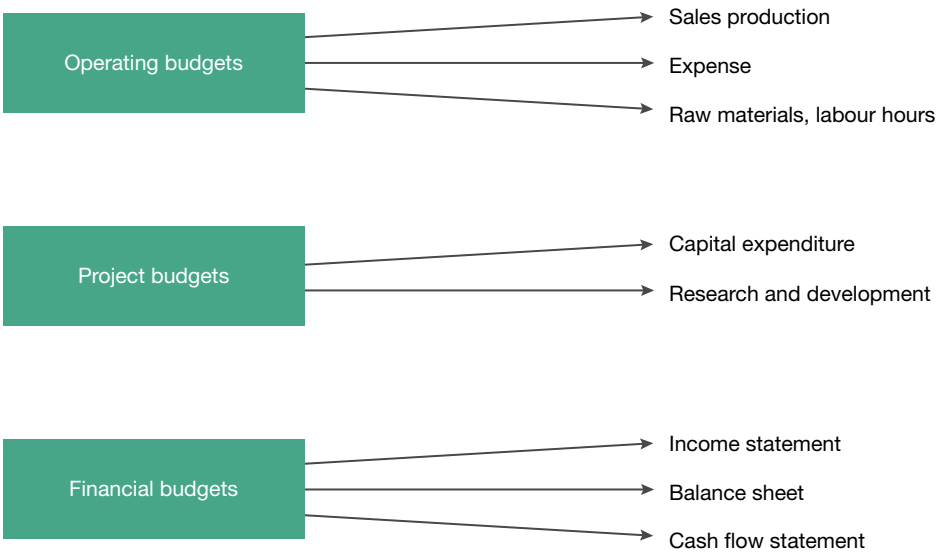


FIGURE 11.3 Operating, project and financial budgets

BizWORD

Operating budgets *relate to the main activities of a business and may include budgets relating to sales, production, raw materials, direct labour, expenses and cost of goods sold.*

Project budgets *relate to capital expenditure and research and development.*

Financial budgets *relate to financial data of a business and include the budgeted income statement, balance sheet and cash flows.*

Operating budgets relate to the main activities of a business and may include budgets relating to sales, production, raw materials, direct labour, expenses and cost of goods sold. Information from operating budgets is used in preparing budgeted financial statements.

Project budgets relate to capital expenditure, and research and development. Capital expenditure budgets in a business's strategic plan include information about the purpose of the asset purchase, life span of the asset and the revenue that would be generated from the purchase. Information from project budgets is included in the budgeted financial statements.

Financial budgets relate to the financial data of a business. The predictions of the operating and project budgets are included in the budgeted financial statements. Financial budgets include the budgeted income statement, balance sheet and cash flows. The income statement and balance sheet reflect the results of operating activities and the cash flow statement shows the liquidity of a business.

Budgeted Income Statement
for 3 months ended 30 June 2018

Sales	250 000
less cost of goods sold	195 000
Gross profit	55 000
less selling and administrative expenses	22 000
Net profit	33 000

Sales budget

	April $	May $	June $	Total $
Sales	85 000	90 000	75 000	250 000

Selling and administrative expenses budget

	April $	May $	June $
Fixed costs			
Advertising	2000	2000	2000
Rent	500	500	500
	2500	2500	2500
Variable costs			
Salaries	2800	3000	3400
Delivery	1500	2000	1800
	4300	5000	5200
Total	6800	7500	7700

FIGURE 11.4 Budgeted income statement including sales and expense predictions

11.2.3 Record systems

Managers need to set up a record system that allows them to record all the information they need. **Record systems** are the mechanisms employed by a business to ensure that data are recorded and the information provided by record systems is accurate, reliable, efficient and accessible (see the following Snapshot). Management bases its decisions on the information when needed and must have guarantees that the information is accurate and reliable.

Minimising errors in the recording process, and producing accurate and reliable financial statements are important aspects of maintaining record systems. The double entry system of accounting is an important control aspect. By recording all items twice, the entries can be seen to balance, and checks to find errors can be carried out quickly.

Record keeping — financial management

Good business records help owners manage their business and make sound business decisions. In fact, record keeping isn't just good business practice; it's also a legal requirement. Businesses are required by the Australian Taxation Office (ATO) to keep certain records for a minimum of five years.

Businesses need to create a record keeping system that is simple, reliable, accurate and able to provide information in an accessible format when they need it. They can choose to operate a manual or electronic system.

Manual record keeping systems consist of paper-based journals. The journals are divided into separate sections for receipts, payments, bank reconciliation, wages and superannuation, inventory and others. Under this system, financial managers record business transactions manually in the appropriate sections for each month. Manual record keeping is less expensive to set up and data loss is less of a risk.

BizWORD

Record systems *are the mechanisms employed by a business to ensure that data are recorded and the information provided by record systems is accurate, reliable, efficient and accessible.*

BizFACT

According to statistics released by ASIC, poor record keeping is a major cause of business failure. This is why it is so important that businesses use an accounting program to manage records well.

SNAPSHOT



‘Good business records help owners manage their business and make sound business decisions.’

Businesses can also choose to record financial information electronically, using an electronic spreadsheet or a software accounting package. Electronic record keeping systems are a more efficient way of keeping financial records. Computer programs allow financial managers to easily generate orders, reports, invoices, financial statements, pay records, and so on.

A variety of accounting software programs has been developed to assist businesses with their records. Many accounting programs also allow users to email and send financial information to clients, suppliers or to the ATO. Electronic systems require less storage space and make it easier for businesses to meet their tax and legal obligations.

Businesses that use electronic record systems should ensure that their records are secure and that they create a backup system to ensure their records are not lost. They also need to be familiar with accounting principles and may need training to understand how the software works.

SNAPSHOT QUESTIONS

1. **Outline** the benefits of a good record keeping system.
2. **Distinguish** between a manual and an electronic record keeping system.
3. **Create** a table summarising the advantages and disadvantages of both manual and electronic record keeping systems.

BizWORD

Financial risk *is the risk to a business of being unable to cover its financial obligations.*

11.2.4 Financial risks

Financial risk is the risk to a business of being unable to cover its financial obligations, such as the debts that a business incurs through borrowings, both short term and longer term. If the business is unable to meet its financial obligations, bankruptcy will result.

There are many questions that a business must answer in relation to financial risk:

- Should the business borrow to expand its operations?
- Will shareholders/owners be prepared to contribute to the business or will expansion be financed through borrowings?
- Should the business use its excess funds to purchase assets or invest on the short-term money market?
- Will interest rates go up?
- What about changing exchange rates?

In assessing financial risk for a business, consideration must be given to:

- the amount of the business's borrowings
- when borrowings are due to be repaid
- interest rates
- the required level of current assets needed to finance operations.

If the business is financed from borrowings there is higher risk. The higher the risk, the greater the expectation of profits or dividends.

To minimise financial risk, businesses must consider the amount of profit that will be generated. The profit must be sufficient to cover the cost of debt as well as increasing profits to justify the amount of risk taken by owners and shareholders. Consideration must also be given to the liquidity of a business's assets. If a business has short-term debt, it must have liquid assets so that debts including interest payments and the repayment of principal on loans can be covered. Careful consideration is needed to ensure that financial risk are minimised for a business.

11.2.5 Financial controls

Financial problems and losses prevent a business from achieving its goals. The most common causes of financial problems and losses are:

- theft
- fraud

- damage or loss of assets
- errors in record systems.

Theft and fraud include unnecessary or over-purchase of stock for personal use, conflict of interest, misuse of expense accounts, false invoices, theft of inventory or assets and credit card fraud.

Financial problems can be caused by both management and employees. **Financial controls** ensure that the plans that have been determined will lead to the achievement of the business's goals in the most efficient way.

The policies and procedures of a business are designed to ensure they are followed by management and employees. Control is particularly important in assets such as accounts receivable, inventory and cash. Some common policies and procedures that promote control within a business are:

- clear authorisation and responsibility for tasks in the business
- separation of duties — for example, one person is responsible for ordering and another for receiving inventories; one person writes the cheques and another signs the cheques
- rotation of duties — for example, staff are skilled in a number of areas and can rotate duties
- control of cash, such as the use of cash registers, cash banked daily, no money kept on premises overnight, payments made by cheque not cash
- protection of assets — for example, buildings are kept locked, a registry of assets is maintained, regular checks of inventory are carried out and security surveillance systems are installed
- control of credit procedures, such as following up overdue accounts and customer credit checks.

Budgets and variance reporting are financial controls used in businesses. As previously outlined, budgets are an important planning tool as they assist a business to estimate resource requirements for a specified future period to predict what will be achieved by a business. For example, preparing a cash budget enables a business to predict cash shortages.

BizWORD

Financial controls *are the policies and procedures that ensure that the plans of a business will be achieved in the most efficient way.*

SUMMARY

- Financial planning is essential if a business is to achieve its goals. Financial planning determines how a business's goals will be achieved.
- The financial planning and implementing process consists of: determining financial needs, developing budgets, maintaining record systems, identifying financial risks and establishing financial controls.
- Financial needs are essential to determine where a business is headed and how it will get there; it is important to know what its needs are.
- Budgets provide information in quantitative terms (facts and figures) about requirements to achieve a particular purpose.
- Budgets are often prepared to predict a range of activities relating to short-term and longer term plans and activities.
- Budgets can be classified as operating, project or financial budgets.
- Record systems are the mechanisms employed by a business to ensure that data are recorded and the information provided by records systems is accurate, reliable, efficient and accessible.
- Financial risk is the risk to a business of being unable to cover its financial obligations, such as the debts that a business incurs through borrowings, both short term and longer term.
- To minimise financial risk, businesses must consider the amount of profit that will be generated.
- The most common causes of financial problems and losses are:
  - theft
  - fraud

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- damage or loss of assets
- errors in records systems.

- Financial controls ensure that the plans that have been determined will lead to the achievement of the business's goals in the most efficient way.

EXERCISE 11.1 REVISION

1 **Outline**, with examples, the financial elements of the planning cycle.
2 **Identify** the factors that determine businesses' financial needs.
3 **Explain** why the preparation of financial information is essential as part of the business plan.
4 **Identify** the financial information that should be collected by a business when determining its future financial needs.
5 **Summarise** the different types of budgets and their importance in financial planning.
6 **Explain** the importance of record keeping to a business's financial success.
7 **State** the relationship between risk and the level of borrowings by a business.
8 **Recommend** reasons for implementing financial controls.
9 Write a memo to the manager of a web design company **explaining** how budget and variance analysis will assist the business.
10 Study the comparative report below and answer the following questions. (Note that a variance of 10 per cent is acceptable for this business.)

From the information in the comparative report, **recommend** where you think the performance of the business can be improved. **Justify** your recommendations.

Comparative Report — receipts and payments

	Budgeted $	Actual $	Variance $
Receipts			
Sales			
— Cash	3 000	3 000	—
— Accounts receivable	8 000	8 800	+10%
Total receipts	11 000	11 800	+7%
Payments			
Purchases			
— Cash	1 500	1 400	–6%
— Accounts payable	2 000	2 400	+20%
Wages	500	600	+20%
Insurance	100	100	—
Advertising	300	350	+17%
Total payments	4 400	4 850	+10%

EXERCISE 11.1 EXTENSION

1 'Sound planning is crucial to achieving the financial objectives of a business.' **Discuss**.
2 **Identify** the stages in the planning cycle. **Investigate** and **demonstrate** each stage using examples from your own knowledge of local businesses.
3 Using the following information on Kennedy's Gardening Supplies, answer the questions below.

Kennedy's Gardening Supplies

	2018 $	2019 $	2020 $
Forecast cash position	85 000	150 000	185 000
Forecast profits	40 000	75 000	90 000
Forecast net assets	350 000	390 000	410 000

Kennedy's is requesting an increase of overdraft facility from 2017 of $80 000 and a loan of $50 000 to fund their expansion.

(a) **Determine** what further financial information you would require in the business plan of Kennedy's Gardening Supplies.
(b) **Propose** how Kennedy's might prepare their information for their funding application to the bank.

4 Computerised accounting software programs are able to streamline the accounting process. **Examine** one such program and **evaluate** its key features, including the type of data that need to be entered and the type of reports that can be produced.

11.3 Debt and equity financing

As outlined in chapter 10, the finance for a business comes from both internal and external sources, and most businesses use a combination of both. External or **debt finance** is a liability to a business as it is money owed to external sources. **Equity finance** relates to the internal sources of finance in the business. Businesses must carefully consider whether to use debt or equity finance and how much of each is needed.

BizWORD

Debt finance *relates to the short-term and long-term borrowing from external sources by a business.*

Equity finance *relates to the internal sources of finance in the business.*



FIGURE 11.5 A balancing act — how much debt is too much? Borrowing the right amount of debt can make the difference between a business struggling to survive and one that is able to respond to changes in the external business environment. While debt provides businesses with the necessary funds, too much debt can cripple a business. Factors to consider when determining how much debt businesses take on include the industry risk, projected income and an analysis of cash flow.

BizFACT

If a business uses a high level of debt finance it takes a greater risk than if it uses equity finance. The amount of risk is affected by how much the business has borrowed, when loans have to be repaid and the required level of current assets for the business. The higher the risk of an investment, the higher the return to the business. Risk and return are interrelated and determine what makes up the share prices of corporations.

11.3.1 Debt finance

Debt can be attractive to businesses because funds are usually readily available and interest payments are tax deductible, therefore reducing the cost of debt financing. The amount of debt used by Australian businesses varies, but short-term borrowing (one year or less) is an important source of funding for businesses.

Risk and return must be carefully considered when determining whether debt or equity finance is used. For example, there is a greater level of risk associated with borrowing, and consideration has to be given to the impact of borrowing on the future profitability and financial stability of the business. Some advantages and disadvantages of debt finance are shown in table 11.1.

TABLE 11.1 Advantages and disadvantages of debt finance

Advantages of debt	Disadvantages of debt
• Funds are usually readily available and can be acquired at short notice.	• There is an increased risk if debt comes from financial institutions because interest, bank charges and government charges may increase.
• Increased funds should lead to increased earnings and profits.	• Security is required by the business.
• Interest payments are tax deductible.	• Regular repayments have to be made.
• Flexible payment periods and types of debt are available.	• Lenders have first claim on any money if the business ends in bankruptcy.
• It will not dilute the current ownership in the business.	• Debt can be expensive, e.g. interest must be paid.

11.3.2 Equity finance

In the case of equity finance, shareholders' funds represent the highest proportion of total funds to finance business operations and assets. Equity finance is the most important source of funds for companies because it remains in the business for an indefinite time, because funds do not have to be repaid at a set date as with debt financing. Equity is generally safer than debt, but equity requires sufficient profits to be made so that the business can continue to operate. Equity funds provide confidence to creditors and lenders, who are more willing to lend to a business if there are equity funds. They act as a safety net for unexpected downturns or changes in the business's activities. The advantages and disadvantages of equity finance are shown in table 11.2.

BizFACT

A simple example can illustrate the effective use of debt. Jai saved $500 of his own money to begin a skateboard company. He borrowed $1000 on short-term (30-day) loan to buy the parts to make the skateboards. He sold the skateboards for cash as soon as they were completed and made repayments on the loan. He then borrowed a further $2000, bought more parts, made more skateboards and paid off more of the loan. This process continued and the business grew. Jai matched the purpose of the finance to the appropriate source and used debt to finance his business success.

TABLE 11.2 Advantages and disadvantages of equity finance

Advantages	Disadvantages
Does not have to be repaid unless the owner leaves the business	Lower profits and lower returns for the owner
Cheaper than other sources of finance as there are no interest payments	The expectation that the owner will have about the return on investment (ROI)
The owners who have contributed the equity retain control over how that finance is used	Long, expensive process to obtain funds this way
Low gearing (use resources of the owner and not external sources of finance)	Ownership is diluted, i.e. the current owners will have less control
Less risk for the business and the owner	



FIGURE 11.6 Studies have shown that many small business entrepreneurs will often use their families' finances to fund their business. Others will seek external funding such as a loan from family or friends, a loan from a financial institution, equity or venture capital funds.

When deciding which type of finance to use, businesses will firstly compare debt with equity finance (see table 11.3) and then take into account what the finance is needed for: its purpose. That is, they must match the terms and sources of finance to business purpose.

TABLE 11.3 Comparison of debt and equity finance

Debt	Equity
• Lenders have prior claim in the event of liquidation.	• Shareholders have a residual claim on assets.
• Debt must be repaid by periodic repayments.	• Equity has no maturity date.
• Interest payments are tax deductible.	• Dividends are not tax deductible.
• Lenders usually require a lower rate of return.	• Shareholders require higher return due to higher risk.
• Interest payments are fixed.	• Dividend payments are not fixed and may be reduced through lack of funds.
• Debt providers have no voting rights.	• Equity holders have voting rights.

Case study: Flowrite Plumbing — self-financing a business

No matter what line of business you go into, you will need start-up capital to get your business going. While many entrepreneurs use some form of debt to finance their operations, self-financing is also commonly used by some business owners. This is where entrepreneurs invest their own money into the business without external help or credit. This is often referred to as 'bootstrapping', from the famous saying about pulling yourself up by your bootstraps.

After many years of experience in the plumbing industry, Anthony Daoud and John Franji decided to take the risk of starting their own business. They began Flowrite Plumbing in 2015. Rather than get a loan, they both decided to save up and use their own funds to pay for their establishment costs.

> 'If you have the resources to do it, you will benefit from complete financial and creative control over your business. You don't have to worry about periodic loan repayments, interest or creditors chasing you for money, especially if it takes a while for your business to start generating a positive cash flow.

SNAPSHOT



‘It ensures you keep your business operating at a sustainable level …’

It's also very hard to get funding when you're starting out and don't have a history. We didn't want to waste time putting together a formal glossy business plan to convince lenders to give us money and we didn't want to use our personal assets as security and put our personal assets at risk. Funding the business yourself means that you get to keep all the profits. The only disadvantage is that your budget and growth is dictated by your own personal finances.'

In the beginning, they each contributed just over $10 000 each, which they used to pay for tools, computers, office equipment and two vans. They distributed payments for other expenses, such as workers compensation and car insurance, and set up monthly repayments. They then waited until they started to have a positive cash flow to purchase more items, for example, they bought more tools, uniforms and signage with the cash that was generated from retained profits.

'If you fund a business yourself, you're forced to live within your means and you only purchase things like new equipment etcetera when you're sure you can afford them. It ensures you keep your business operating at a sustainable level and since it's your own money, you tend to be more careful and avoid excessive spending.'

The only form of short-term debt they use is trade creditors to purchase materials. Trade credit is an agreement between the supplier and the business which allows a business to delay payment for goods and services that have already been delivered. They use four different suppliers for their materials who each give them 30 days credit. John and Anthony use this source of finance to better manage their cash flow. They purchase the materials they need for a job on credit and then give their customers only 14 days to pay them. This ensures they are paid before their own repayments are due to their suppliers meaning they don't have to use any of their own money to make the repayments.

SNAPSHOT QUESTIONS

1. **Define** bootstrapping.
2. **Discuss** self-financing.
3. **Explain** trade credit.

BizFACT

Small businesses have a number of sources available when seeking debt finance, but the range of sources is not as great as with larger businesses because lenders are concerned about risk and security. The larger the equity capital on a business, the more secure the financial structure of the business and the more likely will be the opportunities to borrow. Lenders prefer to lend to firms with strong equity capital because this is an indication of the stability of the business and the commitment of the owners.

BizFACT

The structure of the business will also influence decisions about finance. For example, companies can raise funds by issuing shares to the public or by issuing debentures, whereas unincorporated businesses cannot.

11.4 Matching the terms and sources of finance to business purpose

Small businesses regularly face a number of decisions related to achieving their financial objectives, for example, the purchase of new equipment, stock and premises. Small businesses must find the source of finance that is most appropriate to fund the activities arising from these decisions.

The terms of finance must be suitable for the purpose for which the funds are required. The use of short-term finance to fund long-term assets, for example, causes financial problems because the amount borrowed must be repaid before the long-term assets have had time to generate increased cash flow. The use of long-term finance to fund short-term situations or assets means the business is still paying the mortgage long after the situation is resolved or the stock has been sold, and profits will be reduced.

Therefore, finance managers should match the length or term of the loan with the economic lifetime of the asset the finance is being used to purchase. This means that short-term finance should be used to purchase short-term assets and long-term finance should be used for long-term assets. For example, inventory, which is a current or short-term asset, could be purchased with trade credit whereas a new building, which is a non-current asset, should be purchased with a mortgage (see figure 11.7).

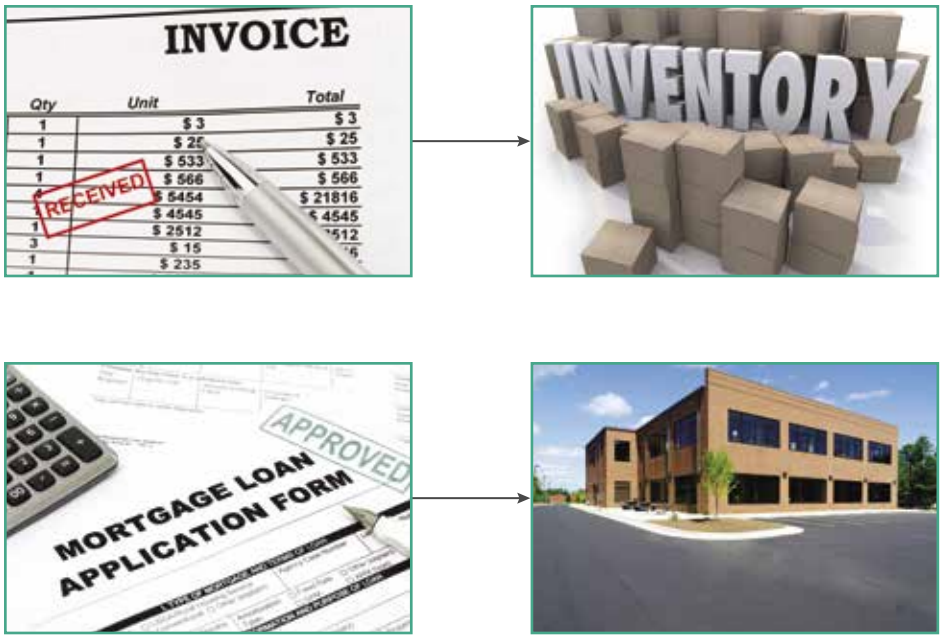


FIGURE 11.7 When matching the terms and sources of finance to business purpose, finance managers should use short-term finance for short-term assets and long-term finance for long-term assets.

BizFACT

Availability of finance is affected by a business's credit rating because the credit rating indicates the business's 'track record' in meeting its financial commitments. The higher the credit rating, the greater number of available sources. Banks are more willing to supply funds for businesses with a high credit rating.

SUMMARY

- Finance for a business can come from either external or internal sources.
- External (or debt finance) is a liability as it is owed to sources external to the business. Equity finance relates to internal sources of finance.
- Most businesses have a combination of both internal and external finance.
- Although repayments of interest to an external provider of funds are costs to the business, debt finance can be attractive as it is readily available and interest payments can be tax deductible.
- Equity finance is the most important source of funds for a business as it remains in the business for an indefinite time and does not need to be repaid on a set date.
- When a business identifies and plans to meet its financial objectives, it is necessary to match the terms of finance with its purpose. This means that short-term finance should be used to purchase short-term assets and long-term finance should be used for long-term assets.

EXERCISE 11.2 REVISION

1. **Distinguish** between debt and equity finance.
2. **Clarify** the relationship between risk and the source of finance.
3. **To what extent** do the advantages outweigh the disadvantages of (a) debt finance and (b) equity finance?
4. **Why** is equity finance considered the least risky source of funds for companies?
5. **Why** is it important to match the term of a loan to the life of the asset for which the finance was obtained?
6. **Recommend** the type of finance you would suggest for the following. **Justify** your answer.
   (a) Payment of inventory
   (b) Purchase of a new motor vehicle
   (c) Diversification of the business over the next five years
   (d) Takeover of a competitor
   (e) Expansion to double the volume of sales
   (f) Purchase of new plant and equipment

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Syllabus area 3
Topic 3
Concept 2

Financial controls: debt, equity and source of funds
Summary screen and practice questions

EXERCISE 11.2 EXTENSION

1 Using information from websites, magazines, banks and other financial institutions, collect five advertisements offering different types of finance and funding. **Compare** them under the following headings. Share your results with other class members.

Source	Interest rate	Borrowing limit	Terms	Other advantages

2 **Examine** a range of annual reports and note some examples of the matching of sources of funds to expenditure.

3 Miguel operates a small graphic art business from home, but, with increased business activity, he is ready to expand into larger premises. He anticipates he will need $100 000 for the expansion. **Explain** to Miguel, in a memo, the risk and return factors involved in expanding his business.

11.5 Monitoring and controlling

The process of monitoring and controlling is essential in all aspects of business functions, especially in the processes of financial management. This is because inconsistent methods of review and systems of control will have an immediate impact on the viability of the business and requires managements to monitor the internal and external factors that will impact financially on business operations. This may include changes to the economic outlook, internal production methods and changes to workplace laws.

The main financial controls used for monitoring include:

1. cash flow statements
2. income statements
3. balance sheets.

These statements indicate how effectively finance is being used in a business. They also provide information on whether the business has sufficient funds to meet unforeseen circumstances.

BizWORD

A **cash flow statement** *is a financial statement that indicates the movement of cash receipts and cash payments resulting from transactions over a period of time.*



FIGURE 11.8 All businesses must have sufficient funds to carry out their daily functions. According to statistics released by ASIC, 41 per cent of small businesses that failed stated that inadequate cash flow was the driving factor.

11.5.1 Cash flow statements

A **cash flow statement** is one of the key financial reports that are part of effective financial planning. It provides the link between the income statement and balance sheet, as it gives important information regarding a firm's ability to pay its debts on time.

The cash flow statement indicates the movement of cash receipts and cash payments resulting from transactions over a period of time. It can also identify trends and can be a useful predictor of change.

Users of cash flow statements include creditors and lenders of finance, as well as owners and shareholders, who can assess the ability of the business to manage its cash. Potential shareholders check that a business has had positive cash flows over a number of years. A fluctuating pattern of cash flows might point to difficulties in the business.

Cash flows can be a better predictor of a business's status than profitability. A statement of cash flows can show whether a firm can:

- generate a favourable cash flow (inflows exceed outflows)
- pay its financial commitments as they fall due—for example, interest on borrowings, repayment of borrowings, accounts payable
- have sufficient funds for future expansion or change

- obtain finance from external sources when needed
- pay drawings to owners or dividends to shareholders.

In preparing a cash flow statement, the activities of a business are generally divided into three categories — operating, investing and financing activities.

Operating activities are the cash inflows and outflows relating to the main activity of the business — that is, the provision of goods and services. Income from sales (cash and credit) make up the main operating inflows plus dividends and interest received. Outflows consist of payments to:

- suppliers
- employees
- other operating expenses (insurance, rent, advertising, etc.).

Investing activities are the cash inflows and outflows relating to the purchase and sale of non-current assets and investments. These assets and investments are used to generate income for the business. Examples include the selling of an old motor vehicle, purchasing new plant and equipment or purchasing property.

Financing activities are the cash inflows and outflows relating to the borrowing activities of the business. Borrowing inflows can relate to equity (issue of shares or capital contribution from owner) or debt (loans from financial institutions). Cash outflows relate to the repayments of debt and cash drawings of the owner or payments of dividends to shareholders.

A cash flow statement is usually prepared from the income statement and balance sheet, as these summarise the transactions of the business. Remember that only cash transactions are included in the cash flow statement. An example of a cash flow statement is given in figure 11.9.

BizFACT

Managing cash flow effectively is not very difficult. It requires planning, accurate and up-to-date records, and commitment.

Burgess Enterprises Ltd
Cash Flow Statement for year ended 30 June 2018

Cash flows from operating activities	
Receipts from customers	30 000
Payments to suppliers and employees	(25 000)
Dividends received	4 000
Interest received	8 000
Interest paid	(5 500)
Net cash provided by operating activities	11 500
Cash flows from investing activities	
Proceeds from sale of assets	85 000
Payment of plant and equipment	(150 000)
Net cash from investing activities	(65 000)
Cash flows from financing activities	
Proceeds from issues of shares	90 000
Proceeds from borrowings	40 000
Repayments of borrowings	(15 000)
Dividends paid	(25 000)
Net cash from financing activities	90 000
Net increase in cash	36 500
Cash at the beginning of the reporting period	15 000
Cash at the end of the reporting period	51 500

Add all the cash receipts from operating activities and subtract the cash payments.

Add all the cash receipts from investing activities and subtract the cash payments.

Add all the cash receipts from financing activities and subtract the cash payments.

Add net cash provided from operating activities + net cash provided from investing activities + net cash provided from financing activities.

Cash at beginning of year + net increase in cash (this amount will then become the new 'cash at the beginning of the year' for the next period).

FIGURE 11.9 An example of a cash flow statement. Brackets ( ) are used to show cash payments.

11.5.2 Income statements (statements of financial performance)

BizWORD

The **income statement** *is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.*

The **income statement** is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.

The income statement shows:

- operating income earned from the main function of the business, such as sales of inventories, services and non-operating revenue earned from other operations, such as interest, rent and commission
- operating expenses such as purchase of inventories, payment for services and other expenses incurred in the main operation of the business, such as advertising, rent, telephone and insurance.

The difference between the income and expenses is the profit or — if expenses exceed income — the loss. The first step in completing a statement of financial performance is to record the income earned by a business. A café, for example, earns income by selling food and drinks. The second step is to record the **cost of goods sold**, which is the money spent on purchases of raw materials or finished goods for resale, and to use this figure to calculate **gross profit**. The gross profit/loss is the amount remaining when the cost of goods sold is deducted from revenue. The third step is to calculate **net profit**. The word 'net' means all expenses have been deducted. A net profit/loss is the amount remaining when operating expenses are deducted from gross profit.

To earn revenue, a business will have a variety of **expenses**. Common expenses include wages and salaries, payments for telephone, electricity, postage, motor vehicle expenses and so on. Expenses can be broken down into three types, which are shown in table 11.4.

BizWORD

The **cost of goods sold** *is the value of stock that a business has sold to its customers.*

Gross profit *is that part of a business's profit that represents operating income minus cost of goods sold.*

Net profit *is the difference between the gross profit and expenses.*

Expenses *are simply costs. Specifically, expenses are the costs incurred in the process of acquiring or manufacturing a good or service to sell and the costs (direct and indirect) associated with managing all aspects of the sales of that good or service.*

BizFACT

The income statement shows the operating efficiency of the business. It can be used to answer the following questions:

- *Is income high enough to cover expenses?*
- *Is the mark-up on purchases sufficient?*
- *Is the business making a good profit?*
- *Are the expenses in proportion to the revenue they are earning?*
- *Is inventory turnover appropriate for the business?*

TABLE 11.4 Income statement (or statement of financial performance) expense breakdown by type

Expenses*		
Selling	**Administrative**	**Financial**
• Commission • Salaries • Wages • Advertising • Delivery expenses • Electricity • Depreciation on shop fittings	• Stationery • Office salaries • Rent • Rates • Telephone • Depreciation on buildings • Audit fees • Accountant's fees • Insurances	• Interest payments • Lease payments • Dividends • Insurance payments
Selling expenses:	Costs related to the process of selling the good or service; can be directly traced to the need for sales	
Administration expenses:	Costs directly related to the general running of the business	
Finance expenses:	Costs associated with borrowing money from outside people or organisations and to minimising business risk	

*Costs of goods sold (COGS): this expense includes *only* the cost of stock sold and is shown separately in the income statement (or statement of financial performance).

An example of an income statement is given in figure 11.10.

Can also be referred to as Sales or Revenue. This represents the total value of all the goods/services sold.

Gross profit = Operating income/Sales – COGS

COGS = Opening stock + Purchases – Closing stock

Income Statement
for the year ended 30 June 2018

	2015 $	2016 $	2017 $
Operating income	81 200	83 500	78 800
Cost of goods sold			
Opening inventory	11 280	11 300	11 240
Purchases	53 000	55 200	48 000
	64 280	66 500	59 240
Closing inventory	11 300	11 240	11 100
	52 980	55 260	48 140
Gross profit	28 220	28 240	30 660
Expenses			
Selling	7 800	9 200	8 900
Administrative	4 400	4 400	7 000
Interest	3 000	3 500	3 000
	15 200	17 100	18 900
Operating profit before tax	13 020	11 140	11 760
Tax	4 500	3 900	4 100
Operating profit after tax	8 520	7 240	7 660
Extraordinary items (after tax)	4 300	4 600	3 900
Operating profit and extraordinary items after tax	12 820	11 840	11 560
Retained profits (1 July)	25 000	31 000	35 000
	37 820	42 840	46 560
Dividends paid	3 400	2 900	3 800
Retained profits (30 June)	34 420	39 940	42 760

Retained/Net profit = Gross profit – Expenses

FIGURE 11.10 An example of a cash flow statement. Brackets ( ) are used to show cash payments.

By examining figures from previous income statements, managers can make comparisons and analyse trends before making important financial decisions. They can see whether expenses are increasing, decreasing or remaining the same, why profits have increased or decreased and in which areas there has been significant change.

11.5.3 Balance sheets (statements of financial position)

A **balance sheet** represents a business's assets and liabilities at a particular point in time and represents the net worth (equity) of the business. It shows the financial stability of the business. The balance sheet is prepared at the end of the accounting period.

BizWORD

A **balance sheet** *represents a business's assets and liabilities at a particular point in time, expressed in money terms, and represents the net worth of the business.*

BizWORD

Assets *are items of value owned by the business.*

Liabilities *are claims by people other than owners against the assets (items of debt), and represent what is owed by the business.*

Owners' equity *is the funds contributed by the owner(s) and represents.*

The balance sheet shows the level of current and non-current assets, and current and non-current liabilities, including investments and owners' equity.

- **Assets** are items of value owned by the business. Current assets can be turned into cash within 12 months, whereas non-current assets are not expected to be turned into cash within 12 months.
- **Liabilities** are claims by people other than owners against assets, and represent what is owed by the business. Current liabilities must be repaid within 12 months, whereas non-current liabilities must be met some time after the next 12 months.
- **Owners' equity** is the funds contributed by the owner(s) and represents the net worth of the business.

An example of a balance sheet is given in figure 11.11.

Balance Sheet as at 30 June 2018

Assets	**$m**	**Liabilities**	**$m**
Current Assets		**Current Liabilities**	
Cash	86.3	Accounts payable	438.3
Accounts receivables	578.5	Overdraft	253.3
Inventories	100.8	**Total Current Liabilities**	691.6
Total Current Assets	756.6	**Non-current Liabilities**	
Non-current Assets		Borrowings	1347.4
Investments	589.3	**Total Non-current Liabilities**	1347.4
Property, plant and equipment	2182.2		
Intangibles	189.8	**Total Liabilities**	2039.0
Total Non-current Assets	2961.3	**Owners' Equity**	
		Capital	988.4
		Reserves	75.2
		Retained profits	624.3
Total Assets	3726.9	**Total Owners' Equity**	1687.9

FIGURE 11.11 An example of a balance sheet

The balance sheet shows the financial stability of the business. Analysis of the balance sheet can indicate whether:

- the business has enough assets to cover its debts
- the interest and money borrowed can be paid
- the assets of the business are being used to maximise profits
- the owners of the business are making a good return on their investment.

The balance sheet shows the return on the owners' investment, the sources and extent of borrowings, the level of inventories, and so on. The figures also show whether the business has sufficient assets to continue to make profits in the longer term, how much of the assets are financed from outside borrowings, whether the business can expect to meet its financial obligations in the short and longer term, and how the year's figures compare with the previous year.

It is important that the presentation of figures in the balance sheet allows clear interpretation so that interested parties can draw meaningful conclusions and make important decisions about the business. Figures from previous years' balance sheets can also be analysed and presented to show the decision makers the trends and changes in the business that need to be investigated.

An example of a comparative balance sheet is given in figure 11.12.

Balance Sheet
as at 30 June 2018

	Consolidated	
	2017 $m	2018 $m
Current Assets		
Cash	4.8	20.6
Accounts receivable	102.0	81.6
Investments	14.9	—
Inventories	36.0	31.5
Total Current Assets	157.7	133.7
Non-current Assets		
Receivables	59.3	64.7
Investments	284.7	293.5
Inventories	17.3	79.5
Property, plant and equipment	831.4	882.9
Intangibles	5.1	5.6
Total Non-current Assets	1197.8	1326.2
Total Assets	1355.5	1459.9
Current Liabilities		
Creditors and borrowings	190.0	118.2
Provisions	59.6	51.7
Total Current Liabilities	249.6	169.9
Non-current Liabilities		
Creditors and borrowings	238.7	417.6
Provisions	210.2	208.4
Total Non-current Liabilities	448.9	626.0
Total Liabilities	698.5	795.9
Owners' Equity		
Capital	132.3	182.7
Reserves	228.3	235.1
Retained profits	161.9	111.7
Equity attributable to owners of the chief entity	522.5	529.5
Reserve account	134.5	134.5
Total owners' equity	657.0	664.0

FIGURE 11.12 An example of a comparative balance sheet

Balance sheet — the accounting equation and relationships

The **accounting equation**, which forms the basis of the accounting process, shows the relationship between assets, liabilities and owners' equity.

Assets are what is owned by a business; liabilities and owners' equity are what is owed by a business. The business and the owner are separate; therefore, owners'

BizWORD

*The **accounting equation**, which forms the basis of the accounting process, shows the relationship between assets, liabilities and owners' equity.*

equity is what is to be repaid (hopefully with increased profits) by the business to the owner. The accounting equation shows that the assets of the business may be financed by either the owners or by parties external to the business.

The balance sheet shows the outcome of the accounting process. The accounting equation can be represented in different ways but, because it is an equation, it must always be equal.

BizFACT

It is important to remember that the accounting entity assumption means that financial information records for a business are kept separate from those of the owner.

Assets = Liabilities + Owners' equity
Owners' equity = Assets – Liabilities
Liabilities = Assets – Owners' equity

The balance sheet can be displayed in different forms to show the different ways of expressing the accounting equation. In the first example (figure 11.13), the balance sheet represents the accounting equation Assets = Liabilities + Owners' equity.

Balance Sheet as at 30 June 2018

	$	$
Current Assets		
Cash	30 400	
Inventories	4 100	92 500
Accounts receivable	58 000	
Non-current Assets		
Plant and equipment	68 000	
Land and buildings	85 000	153 000
		$245 500
Current Liabilities		
Accounts payable	82 000	
Non-current Liabilities		
Loan	25 000	107 000
Owners' Equity		
Capital	100 000	
Net profit	38 000	138 500
		$245 500

FIGURE 11.13 A balance sheet showing Assets = Liabilities + Owners' equity

The accounting equation shows the effect of the business's operations on owners' equity. Owners' equity comprises two elements: capital, or funds contributed by the owner or owners to the business, and retained profits (see figure 11.14).

Owners' Equity	
Paid up capital	285 000
Reserve for contingencies	37 000
Retained profits	33 000
	$355 000

FIGURE 11.14 Owners' equity showing proportion of capital and retained profits

The balance sheet and income statement show the outcomes of the accounting process on the accounting equation. The revenue statement shows the resulting profit from revenue, less expenses. The profit (or loss) figure is transferred to the owners' equity as retained profits.

SUMMARY

- Monitoring and controlling is essential for maintaining business viability, and affects all aspects of business operations — especially financial management.
- The main financial controls used for monitoring include cash flow statements, income statements and balance sheets.
- A cash flow statement provides the link between the income statement and the balance sheet. It provides information about a firm's ability to pay its debts on time.
- The cash flow statement specifically records the movement of cash receipts and cash payments that result from transactions over a given time, for example a month.
- Creditors, lenders, owners and shareholders all use a cash flow statement to assess the ability of the business to manage its cash and identify trends in cash flow over time.
- The income statement is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.
- Profit is the difference between revenue and expenses.
- A balance sheet represents a business's assets and liabilities at a particular point in time, expressed in money terms, and represents the net worth of the business.
- The accounting equation, which forms the basis of the accounting process, shows the relationship between assets, liabilities and owners' equity.

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Syllabus area 3
Topic 3
Concept 3

Monitoring and controlling
Summary screen and practice questions

EXERCISE 11.3 REVISION

1 **Why** must businesses monitor and control all business functions?

2 **Identify** the three main financial controls.

3 **Identify** three stakeholders who would most likely view a cash flow statement.
Outline the key information they would be looking for.

4 **Summarise** the three categories of activities of a cash flow statement.

5 **Clarify** the purpose of income statements.

6 If the income statement shows operating efficiency, **explain** the relationship between income and expenses regarding this financial control.

7 Answer the questions using the balance sheet below.

Balance Sheet of Biq & Son
as at 30 June 2018

Current Assets		**Current Liabilities**	
Cash at bank	3 000	Accounts payable	9 500
Inventories	2 500	**Non-current Liabilities**	
Accounts receivable	8 500	Loan	50 000
Non-current Assets			
Furniture	2 500	**Owners' Equity**	
Vehicle	16 500	Capital	100 000
Land and buildings	140 000	Profit	13 500
	173 000		173 000

(a) **Explain** why the balance sheet is written 'as at 30 June 2018'.
(b) **State** who the business owners are and what their original investment was.
(c) **What** is the value of the owners' investment on 30 June 2018?
(d) **Propose** how the assets of the business were financed.
(e) **Determine** how much is owed by the business.
(f) **Recommend** how the business will pay its debts.
(g) Would you offer credit to this business? **Justify** your response.

8 **Distinguish** between a balance sheet and an income statement.

9 **Outline** the difference between an asset and a liability.

10 Your friends Tony and Yung have a small business making novelty party accessories. They have been running the business for three months and it appears to be going well. They want to know if they are making a profit or a loss. You agree to help them. They provide you with the following information. **Construct** an income statement to **calculate** their profit or loss.

- Raw materials and supplies to make the novelties cost them $2000.
- At the end of the month they still have $700 worth of raw materials and supplies.
- During the month, they sold 1000 of their novelty products for $5 each.
- They paid their friends Sandy and Max $300 to help them.
- They sent flyers to department stores advertising their product, and this cost them $220.
- They paid the telephone bill ($340) and courier for delivery ($90).

11 **Why** is the accounting equation important?

12 **Identify** the most appropriate terms to complete the following accounting equation.

Assets = _____ + _____

13 **Calculate** the missing amounts in the following table (financial year is 1 July–30 June).

	Business A	Business B	Business C
Assets 1 July	275 000	221 000	—
Liabilities 1 July	135 000	—	353 000
Owners' equity 1 July	—	114 000	206 000
Assets 30 June	293 000	—	481 000
Liabilities 30 June	141 000	153 000	—
Owners' equity 30 June	—	189 000	242 000
Sales	484 000	521 000	—
Cost of goods sold	385 000	—	292 000
Gross profit	—	174 000	145 000
Expenses	—	135 000	105 000
Net profit	39 000	—	—

14 Using the information from question 13, answer the following questions. **Justify** your answers.

(a) Which owner is making the highest gross profit?
(b) Which owner is making the highest net profit?
(c) In which business would you invest and why?
(d) In what information would employees be interested?
(e) Each business has applied for a loan of $50 000 from a bank. Which business is most likely to be successful in their application?

15 Given the following information for July 2018, **construct** a cash flow statement for Eat Well Pty Ltd.

Closing cash balance at end of June	$15 400
Monthly wages	$ 3 200
Weekly rent	$ 500
Fortnightly loan repayment	$ 550
Proceeds from issue of shares	$75 650
Receipts from customers	$32 440
Payments to suppliers	$ 5 800

Interest received	$ 2 600
Proceeds from sale of equipment	$18 700
Dividends paid	$24 000

16 **Calculate** the value of purchases, the gross profit, cartage and net profit for the income statement below.

Income Statement
for the year ended 30 June 2018

	$	$
Operating income		258 400
Cost of goods sold		
Opening inventory	57 300	
Purchases	—	
Closing inventory	12 700	154 500
Gross Profit		—
Expenses		
Selling:		
— Advertising	22 300	
— Cartage	—	
Administrative:		
— Rent	14 000	
— Insurance	3 000	
Financial:		
— Bad debts	2 200	50 200
Net Profit		—

17 Using the balance sheet below, **calculate** the value of Total Non-current Assets, Debtors and the Mortgage.

Balance Sheet
as at 30 June 2018

	$		$
Current Assets		**Current Liabilities**	
Cash	7 800	Creditors	2 500
Debtors	—	Overdraft	4 670
Stock	17 600	Credit cards	4 750
Total Current Assets	28 650	**Total Current Liabilities**	11 920
Non-current Assets		**Non-current Liabilities**	
Property	579 460	Mortgage	—
Equipment	8 600		
Total Non-current Assets	—	**Total Non-current Liabilities**	
		Owner's Equity	
		Capital	53 000
	—	Retained profits	75 340
Total Assets	616 710	**Total Owner's Equity**	128 340

EXERCISE 11.3 EXTENSION

1 Financial management is concerned not so much with what has happened in the past but with what is going to happen in the future. **Discuss** this statement.

2 **Examine** the financial reports of a number of businesses. **Identify** for which business would you be most interested in working. **Determine** what other information you might need to help you make a decision.

3 **Create** a list of questions to which the following groups of people might seek answers from a business. The first one is done for you.

Group	Questions
Creditors	Is your cash flow sufficient to pay your account on time?
Bank	
Employee	
Owner	
Investor	
Customer	

11.6 Calculating financial ratios and strategies to improve performance

Many important questions cannot be answered by simply 'looking' at the financial statements of a business. Financial statements summarise the activities of a business over a period of time and must be analysed to increase understanding of the implications of those activities.

Analysis is an important part of the accounting process. It involves working the financial information into significant and acceptable forms that make it more meaningful and highlighting relationships between different aspects of a business. Analysis involves comparing similar items in the income statement and balance sheet.

The main types of analysis are vertical, horizontal and trend analysis.

- Vertical analysis compares figures within one financial year; for example, expressing gross profit as a percentage of sales and comparing debt to equity.
- Horizontal analysis compares figures from different financial years; for example, comparing 2017 and 2018.
- Trend analysis compares figures for periods of three to five years.

The methods of analysis involve calculations of figures, percentages and ratios. Ratios are one of the main tools used to analyse financial information and assist in answering more clearly the questions relating to profits, solvency, efficiency, growth and liquidity. But analysis without **interpretation** is meaningless. Interpretation is making judgements and decisions using the data gathered from analysis.

The type of analysis chosen will depend on the reasons that the information is required and the decisions to be made from the information. Users of information may be interested to compare figures, percentages or ratios for departments, different products, different branches or against the industry. They may also wish to monitor trends over a number of years or make comparisons between items within a financial statement, selling expenses and sales.

Analysis of financial statements is usually aimed at the areas of:

- liquidity
- gearing
- profitability
- efficiency.

BizWORD

Analysis *involves working the financial information into significant and acceptable forms that make it more meaningful, and highlighting relationships between different aspects of a business.*

Interpretation *is making judgements and decisions using the data gathered from analysis.*

BizFACT

Careful analysis can provide signals regarding the success of the business or impending problems. For example, management may be interested to know:

- *how effectively assets have been used in a business*
- *why an increase in advertising expenses has not generated more sales revenue than anticipated*
- *why sales have decreased over the past two years*
- *why overdrafts have continued to increase.*

BizWORD

Liquidity *is the extent to which a business can meet its financial commitments in the short-term (less than 12 months).*

11.6.1 Liquidity

Liquidity is the extent to which the business can meet its financial commitments in the short term, which usually refers to a period of less than 12 months.

The business must have sufficient resources to pay its debts and enough funds for unexpected expenses. To assess a business's liquidity, its managers must assess whether the business can pay its debts when they are due. Is there sufficient cash and a level of assets and inventories that can be converted to cash quickly to repay the firm's debts — that is, the firm's accounts payable, interest and loans?

The holding of outstanding debts means the business has less cash to earn revenue. The quicker the firm receives cash from its accounts receivable, the quicker those funds can be used to earn revenue. Current assets and current liabilities determine the liquidity or short-term financial stability of a business. The firm must be careful to ensure that it has enough current assets that could be used to generate cash quickly, but not so much that the resources are not being used for producing revenue.

There are a number of ratios to show liquidity (short-term financial stability), calculated from balance sheet figures. An example is the current ratio (or working capital ratio).

BizFACT

Current assets and current liabilities determine the liquidity or short-term financial stability of a business.

Current ratio (working capital)

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

The current ratio measures a business's ability to pay back their current liabilities with their current assets. The higher the current ratio, the more capable the business is of meeting their short-term obligations.

It is generally accepted that a ratio of 2:1 indicates a sound financial position for a firm. That is, the firm should have double the amount of current assets to cover its current liabilities. However, an 'acceptable' ratio will also depend on a number of factors, such as the type of firm, how other firms in the industry are operating and factors in the external environment (see the BizFACT on the right). In other words, the current ratio gives only a limited indication of the ability of the business to meet its short-term liabilities. The nature and composition of current assets may vary considerably. It is not a good idea to give rule-of-thumb standards for the current ratio.

BizFACT

Many firms operate successfully with current ratios of less than 2:1. Firms that sell finished goods and keep large levels of inventories need a higher ratio than firms selling on credit rather than cash. Large businesses in the food industry, for example, Woolworths, use a lower ratio of approximately 0.6:1. Businesses in service industries, such as doctors and dentists who rely on cash payments for their services, also do not need as high a ratio and operate on ratios of less than 2:1.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{300\,000}{195\,000} = 1.54$$

Comment: This firm has $1.54 of current assets to cover $1 of current liabilities. A ratio of less than 1:1 indicates there are insufficient assets to pay current commitments or liabilities. If this firm has previously operated successfully, it may find a ratio of 1.54:1 acceptable. However, if this is not the case, the firm may have to sell non-current assets to cover liabilities, which will reduce its capacity to earn profits; or it may have to borrow in the short term and incur higher interest repayments. In most instances, a firm would be unwise to allow this ratio to fall below 1.5:1.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{450\,000}{150\,000} = 3{:}1$$

Comment: This firm has $3 of current assets for every $1 of current liabilities. This indicates that the firm is in a sound financial position — that is, it is liquid and will be able to pay for its debts in the short term. If the firm has a high demand for its product, for example, food products, there may be reason to reduce the level of its current ratio. Even for a firm that has a low demand, for example, jewellery, its working capital may be too high. Too high a ratio can mean that current assets are not being used fully. Action is needed to ensure that sufficient use is being made of the assets in the business.

FIGURE 11.15 Examples of current ratio

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Syllabus area 3
Topic 3
Concept 4

Financial ratios: liquidity
Summary screen and practice questions

A variety of strategies can improve a business's liquidity. Section 12.2 on working capital management examines these strategies in greater detail. Other strategies businesses could use to improve liquidity include factoring, selling non-essential non-current assets and using those funds to reduce current liabilities, or injecting more equity into the business to pay off liabilities.

11.6.2 Gearing (solvency)

The capital structure of a business is determined by the mix of debt and equity, and the proportion of each is known as gearing (or solvency).

Gearing ratios determine the firm's **solvency** — that is, its ability to meet its financial commitments in the longer term. Potential investors and creditors are interested in gearing ratios, as they show whether the creditors will be paid or whether investors can expect a good return on their money.

Gearing measures the relationship between debt and equity. Gearing is the proportion of debt (external finance) and the proportion of equity (internal finance) that is used to finance the activities of a business. The degree of gearing depends on the type of industry and management of the business. An industry that carries higher risk but is likely to generate large profits (for example, mining) may have a higher debt to equity ratio — that is, it is highly geared. Manufacturing industries with strong markets often have high debt as the potential for profit is greater.

Gearing is an important consideration for businesses as the more highly geared the business (that is, those that have a higher proportion of debt to equity), the greater the risk for the business but the greater potential for profit.

Debt affects stakeholders and potential investors because the high risk involved may discourage investment.

BizWORD

Solvency *is the extent to which the business can meet its financial commitments in the longer term (more than 12 months).*

Gearing *is the proportion of debt (external finance) and the proportion of equity (internal finance) that is used to finance the activities of a business. Gearing ratios determine the firm's solvency.*



FIGURE 11.16 An average debt to equity ratio depends on economic factors and the industry in which a company operates. The average debt to equity ratio for companies listed on the ASX is 0.47:1

The business's level of gearing is an important decision. Factors such as risk, return and degree of control over the enterprise influence the level of leverage that is appropriate for a business.

In balancing the gearing of a business, consideration must be given to the level of control by owners. For example, profits earned must be sufficient to cover interest payments. If funds are not available to meet interest charges and accounts are not paid, lenders and creditors have the right to claim payment from the business.

There is no optimal level of gearing for a business, although it is rare for a company to have no gearing. A business must consider:

- return on investment
- cost of debt
- size and stability of the business's earning capacity
- liquidity of the business's assets (the greater the cash flow and the more liquid the assets, the more likely the interest charges will be paid)
- purposes of short-term debt.

A number of ratios show solvency (long-term financial stability), calculated from balance sheet figures. An example is the debt to equity ratio.

Debt to equity ratio

$$\text{Debt to equity ratio} = \frac{\text{Total liabilities}}{\text{Total equity}}$$

The debt to equity ratio shows the extent to which the firm is relying on debt or outside sources to finance the business. This ratio is an important control aspect for management because the relationship between debt and equity must be carefully balanced. A ratio of greater than 1 means that the business has less equity than debt. A ratio of between 0 and 1 means that the business has more equity than debt.

The higher the ratio, the less solvent the firm. That is, the higher the ratio of debt to equity, the higher the risk. The firm must look carefully at interest rates, business confidence and economic indicators to determine if the balance between debt and equity is appropriate for its particular business or industry. A highly geared firm — a firm that uses more debt than equity — carries more risk with regard to longer term financial stability. Investors would be less attracted to a firm with a higher debt to equity ratio because this indicates a greater financial risk.

Financial ratios — gearing

A highly geared business offers greater potential for profit. For example, Ruby has $50 000. One financial institution is willing to lend her 50 per cent of the purchase price of a new clothing store. She has $100 000 to spend on a store. If another financial institution is willing to lend her 95 per cent she can buy a $1 000 000 store.
Scenario 1 — financial institution lends 50 per cent
Ruby's $50 000 = 50 per cent ($50 000 + $50 000 = $100 000)
Scenario 2 — financial institution lends 95 per cent
Ruby's $50 000 = 5 per cent
($50 000 + $950 000 = $1 000 000)

The more highly leveraged business of scenario 2 offers greater possibilities for Ruby because (a) debt finance is tax deductible, (b) she owns a larger asset and (c) the increased size of the business will lead to increased business activity and profits.

SNAPSHOT QUESTIONS

Using the information on Ruby's financial options for borrowing (and your own knowledge), **assess** the impacts of gearing on a business. **Discuss** the different levels of gearing while remembering impacts can be both positive and negative.

SNAPSHOT



To improve a business's gearing, they will need to look at ways of either reducing their debt or increasing equity. In an attempt to decrease debt businesses could sell non-essential assets to pay off their debts, or they could even re-negotiate their loans to spread their payments over a longer period. Alternatively, the business could lease assets as opposed to purchasing them. Strategies to increase equity include retaining more profits, or injecting more equity funding by either selling more shares (if a public company) or inviting new owners.

BizFACT

The financial sector as a whole has one of the highest debt to equity ratios. This is because banks borrow large amounts of funds to then loan large amounts of money. A debt to equity ratio of higher than 2:1 is quite common in this industry. Other industries that have a higher debt to equity ratio are capital-intensive industries, such as large manufacturing companies and the airline industry, who commonly use high levels of debt.

The type of business will determine how highly geared a business can be. For example, a business that is less influenced by economic fluctuations can be more highly geared. A shop selling essential food items will not be affected by economic downturns so it can carry more debt than a business that sells luxury items.

An interesting question is posed by the debt to equity ratio. Should the owners of a business have as much at stake as the creditors (that is, should the ratio be at least 1:1)? Different firms have different financial structures and the attitude of the owners to financial risk determines what levels of debt to equity are appropriate for the business. The debt to equity ratio also has a direct effect on the short-term and immediate solvency of a business. The greater the owners' financial interest in the business, the more solvent in the short term the business is likely to be. Ultimately, the level of solvency in a business reflects its financial structure — that is, its control of debt and equity. This is important for the long-term survival of the business.

Balance Sheet for Young's Store as at 30 June 2018

	$	$
Current Assets		
Cash	20 000	
Accounts receivable	50 000	
Inventories	80 000	150 000
Non-current Assets		
Delivery vehicles		50 000
		200 000
Current Liabilities		
Accounts payable		20 000
Non-current Liabilities		
Mortgage		30 000
Owners' Equity		
Capital	140 000	
Add net profit	10 000	150 000
		200 000

$$\text{Debt to equity ratio} = \frac{\text{Total liabilites}}{\text{Owners' equity}}$$
$$= \frac{50\,000}{150\,000}$$
$$= 0.3{:}1 \text{ or } 33\tfrac{1}{3}\%$$

Comment: The firm has $0.33 in external debt (liabilities) for every $1 of internal debt (owners' equity). A ratio of 1:1 indicates a sound financial position so this company is in a safe position. Depending on the type of firm, the industry and past trends, the firm could possibly increase its rate of external debt.

FIGURE 11.17 An example of a debt to equity ratio

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Financial ratios: gearing
Summary screen and practice questions

11.6.3 Profitability

Profitability is the earning performance of the business and indicates its capacity to use its resources to maximise profits. Profitability depends on the revenue earned by a business and the ability of the business to increase selling prices to cover

purchase costs and other expenses incurred in earning income. The ability of the business to generate profits is its most important financial objective.

A number of parties are interested in a business's profitability:

- Owners and shareholders want to know whether the firm is earning an acceptable return on their investment.
- Creditors want to know whether they will be paid and should offer credit in the future.
- Lenders want to know whether the principal on the loan and interest will be repaid and whether to lend to the firm in the future.
- Management uses profitability to decide on the need for adjustments to policies.

The amount of profit is determined by a number of factors, such as the volume of sales, the mark-up on purchases and the level of expenses. Financial information must be examined to see where changes have occurred and where changes need to be made in the future.

The income statement is used to measure the profitability or earning capacity of the firm. Three profitability ratios are the:

- gross profit ratio
- net profit ratio
- return on equity ratio.

Gross profit ratio

Gross profit is the difference between sales revenue and the direct cost of goods sold. It represents the amount of sales that is available to meet expenses resulting in net profit. A fall in the rate of gross profit may mean a fall in the amount of net profit. The amount of that decrease depends on such factors as price reductions due to specials or sales, mark-downs on out-of-date stock, theft of stock, errors in determining prices, changes in the mark-up policies or changes in the mix of sales.

The gross profit ratio (shown below) gives the percentage of sales revenue that results in gross profit. It is one way that a business can measure profitability. A business's gross profit must be sufficient to pay the expenses of a business and still provide a profit for the small business owner. It is important to note that the gross profit ratio is only calculated by businesses that sell stock and not service businesses; that is, it is only used by those businesses that purchase goods from suppliers and sell them at a higher price to customers.

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Sales}}$$

The gross profit ratio shows changes from one accounting period to another, and indicates the effectiveness of planning policies concerning pricing, sales, discounts, the valuation of stock and so on. If the ratio is low, alternative suppliers may need to be sourced and competitors investigated. Since all the other expenses incurred by businesses such as wages, electricity and advertising are deducted from the gross profit to determine net profit, the net profit ratio therefore gives a more accurate indication of the profitability of a business.

Net profit ratio

Net profit represents the profit or return to the owners, which is revenue less expenses. For sole traders and partnerships, net profit represents a return on their contribution to the business. It is usual for a company to return part of net profit to shareholders as dividends and retain a part for future expansion.

BizFACT

In 2013 economic and business forecaster IBISWorld revealed the most profitable industries with the lowest barriers to entry. The top five industries and their respective average net profit ratios were: dating services (21%); accommodation for short-term rentals (18.3%); smartphone app development (50%); painting and decorating services (22%); and tiling and carpeting services (23%).

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Sales}}$$

The net profit ratio shows the amount of sales revenue that results in net profit. The costs or expenses after gross profit must be low enough to generate a net profit. The amount of sales must be sufficiently high to cover the costs or expenses of the firm and still result in a profit. Since businesses vary greatly, there is no set figure for profit ratios. A business would be aiming at a higher gross and net profit ratio. Comparisons need to be made with a business's past performance, their competitors and the industry average.

Strategies to improve the gross profit and net profit ratios are examined in greater detail in section 12.3 on profitability management. Businesses need to focus on strategies to reduce costs and increase revenue.

This means that for every dollar of sales revenue the business earned, it retained 20 cents as gross profit. Another way of looking at this ratio is that cost of goods sold consumed 80 cents of every dollar of sales revenue.

Income Statement for Young's Corner Store, 2017

	$	$
Revenue	100 000	
less Cost of goods sold	80 000	
Gross profit		20 000
less Selling expenses	3 000	
less Administrative expenses	1 500	
less Financial expenses	500	5 000
Net profit		15 000

$$\text{(a) Gross profit ratio} = \frac{\text{Gross profit}}{\text{Sales}} = \frac{20\,000}{100\,000} \times 100 = 20\%$$

$$\text{(b) Net profit ratio} = \frac{\text{Net profit}}{\text{Sales}} = \frac{15\,000}{100\,000} \times 100 = 15\%$$

This means that for every dollar of sales revenue the business earned, it retained 15 cents as net profit.

FIGURE 11.18 Examples of profitability ratios

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Concept 6

Financial ratios: profitability
Summary screen and practice questions

Return on equity ratio

$$\text{Return on equity ratio} = \frac{\text{Net profit}}{\text{Total equity}}$$

The return on equity ratio shows how effective the funds contributed by the owners have been in generating profit, and hence a return on their investment. The return for the owners has to be better than any return that could be gained from alternative investments, such as bank investments. If return on equity rises due to increased leverage (debt) the improved result should be seen as carrying increased risk.

$$\text{Return on equity} = \frac{\text{Net profit}}{\text{Total equity}}$$
$$= \frac{15\,000}{150\,000} = 0.1\% \text{ or } 10\%$$

Comment: This means that for every $1 of equity contributed by the owners, they receive 10 cents in return. In this example, a return of 10 per cent would be seen as a reasonable investment. Depending on other information, the owner would need to consider alternatives for investment, such as bank interest rates.

FIGURE 11.19 An example of a return on equity ratio

BizFACT

As a general rule, most investors would want at least 10 per cent return. This is because most investors would not risk investing in a business when they could get the same return by investing their money in a bank or in government bonds, for example.

Owners are interested not only in the return for the current year but also in comparing the current year's return with previous years and against industry averages. It is also useful to compare the return with alternative investment considerations; for example, interest earned through a financial institution.

The higher the ratio or percentage, the better the return for the owner. If returns compare favourably, owners might consider expansion or diversification of the business. If the return is unfavourable, the owners would consider alternative options, including selling off the business.

11.6.4 Efficiency

Efficiency refers to the ability of a business to use its resources effectively in ensuring financial stability and profitability of the business. Efficiency relates to the effectiveness of management in directing and maintaining the goals and objectives of the firm. The more efficient the firm, the greater its profits and financial stability.

BizWORD

Efficiency *is the ability of a business to minimise its costs and manage its assets so that maximum profit is achieved with the lowest possible level of assets.*

Expense ratio

$$\textbf{Expense ratio} = \frac{\textbf{Total expenses}}{\textbf{Sales}}$$

The expense ratio compares total expenses with sales. The ratio indicates the amount of sales that are allocated to individual expenses, such as selling, administration, cost of goods sold and financial expenses. The expense ratio indicates the day-to-day efficiency of the business. A business aims to keep expenses at a reasonable level.

Management use this ratio to determine where the highest expenses are from and why the ratio has either increased or decreased. For example, if the selling expense ratio has increased, it may be that advertising costs have not generated the expected increase in sales. Alternatively, a decline in the financial expense ratio may be a result of lower interest rates or less debt being used by the firm.

As businesses vary greatly, there is no rule of thumb for the expense ratio. The expense ratio should be examined carefully. Businesses need to compare their results with their past performance and industry averages. Obviously the lower the percentage, the better. If the expense ratio is too high, then the business would need to look at ways of monitoring and controlling their expenses and avoiding unnecessary expenses.

Accounts receivable turnover ratio

$$\textbf{Accounts receivable turnover ratio} = \frac{\textbf{Sales}}{\textbf{Accounts receivable}}$$

Accounts receivable turnover ratio measures the effectiveness of a firm's credit policy and how efficiently it collects its debts. It measures how many times the accounts receivable balance is converted into cash or how quickly debtors pay their accounts. By dividing the ratio into 365, businesses can determine the average length of time it takes to convert the balance into cash. If a firm's accounts receivable turnover is 84 days but its credit policy allows 30 days before payment, the firm would need to examine its cash flow, its credit policies, its credit collection procedures and costs, and its policies relating to doubtful debts.

If a business is not efficient in collecting their accounts receivable they need to implement strategies to improve this, such as charging interest on overdue payments, offering discounts for early payments or being more selective when granting credit.

BizFACT

The average time taken by Australian businesses to pay their invoices is 44.4 days.

Income Statement for Young's Corner Store, 2017

	$	$
Revenue	100 000	
less Cost of goods sold	80 000	
Gross profit		20 000
less Selling expenses	3 000	
less Administrative expenses	1 500	
less Financial expenses	500	5 000
Net profit		15 000

Additional information: Accounts receivable = $10 000

(a) Expense ratio (selling expenses) $= \dfrac{\text{Selling expenses}}{\text{Sales}}$

$= \dfrac{3000 \times 100}{100\,000} = 3\%$

(b) Expense ratio (administrative expenses) $= \dfrac{\text{Administrative expenses}}{\text{Sales}}$

$= \dfrac{1500 \times 100}{100\,000} = 1.5\%$

(c) Expense ratio (financial expenses) $= \dfrac{\text{Financial expenses}}{\text{Sales}}$

$= \dfrac{500 \times 100}{100\,000} = 0.5\%$

(d) Accounts receivable turnover ratio $= \dfrac{\text{Sales}}{\text{Accounts receivable}}$

$= \dfrac{100\,000}{10\,000} = 10$

$\dfrac{365}{10} = 36.5 \text{ days}$

Comment: Depending on the type of business and past trends, the firm has made a reasonable gross and net profit and their expense ratios are quite low. For every $1 returned as sales, 3 cents is absorbed by selling expenses, 1.5 cents by administrative expenses and 0.5 cents by financial expenses. While this is quite low, these figures would need to be compared to previous years' results.

Debt collection figures indicate relative efficiency in the collection of debts. Debts are being repaid on an average of 36.5 days (assuming that the firm has a billing cycle of 30 days). There is no meaningful average for this ratio, mainly because credit terms differ among businesses. Businesses should therefore compare this result to their credit policy to see if customers are taking too long to pay. As a general rule, however, a high accounts receivable turnover ratio can be improved by demanding payment of overdue accounts.

FIGURE 11.20 Examples of efficiency ratios

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Financial ratios: efficiency
Summary screen and practice questions

TABLE 11.5 Types of financial ratio

Ratio	Formula	Example on page	Analysis of which aspect of the financial statement	What does analysis of this ratio show about a business?	Interpretations of ratio results
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	317	Liquidity	Shows the short-term financial stability of a business (i.e. its ability to meet its short-term financial commitments)	It is generally accepted that a ratio of 2:1 indicates a sound financial position (i.e. a firm should have double the amount of assets to cover its liabilities).
Debt to equity ratio	$\frac{\text{Total liabilities}}{\text{Total equity}}$	320	Gearing (Solvency)	Shows the extent to which the firm is relying on debt or outside sources to finance the business	The higher the ratio, the less solvent the firm (i.e. the higher the ratio of debt to equity, the higher the business risk).
Gross profit ratio	$\frac{\text{Gross profit}}{\text{Sales}}$	322	Profitability	Shows the percentage of sales revenue that results in gross profit	The higher the ratio the better. If the ratio is low, alternative suppliers may need to be sourced and competitors investigated.
Net profit ratio	$\frac{\text{Net profit}}{\text{Sales}}$	322	Profitability	Represents the profit or return to the owners	A firm will be aiming for a high net profit ratio. A low net profit ratio indicates strategies to reduce expenses and increase revenue need to be investigated.
Return on equity ratio	$\frac{\text{Net profit}}{\text{Total equity}}$	323	Profitability	Shows how effective the funds contributed by the owners have been in generating profit and so the return on investment (ROI)	The higher the ratio or percentage, the better the return for the owner, although comparisons need to be made with alternative investments.
Expense ratio	$\frac{\text{Total expenses}}{\text{Sales}}$	324	Efficiency	Each of the categories of expenses is compared with sales. The ratio indicates the amount of sales that are allocated to individual expenses such as selling, administration, COGS and financial expenses.	Expense ratios indicate day-to-day efficiency of the business. Expense ratios need to be kept at a reasonable level, and management must monitor each type of expense in relation to sales. Higher expense ratios may be the result of poor management.
Accounts receivable turnover ratio	$\frac{\text{Sales}}{\text{Accounts receivable}}$	324	Efficiency	Measures the effectiveness of a firm's credit policy and how efficiently it collects its debt	High turnover ratios indicate the business has efficient debt collection.

11.6.5 Assess business performance using comparative ratio analysis

Figures, percentages and ratios do not provide a complete picture for analysis. For analysis to be meaningful, comparisons and benchmarks are needed. Judgements are then made by comparing a firm's analysis against other figures, percentages and ratios. This is known as comparative ratio analysis and is important for firms. Comparisons can be made in a number of ways. Businesses could compare ratios with their results from previous years, with similar businesses and against common industry standards or benchmarks.

Ratios provide a 'snapshot' at a particular point in time and should be used carefully along with other information. Sales and stock levels may vary significantly throughout

BizFACT

Comparisions can be made over different time periods, against standards, or with similar businesses.

a year so financial information will also vary. It is important to look at trends in the financial information over several years. Figures from at least the previous two years can indicate directions or trends and make ratio analysis more meaningful.

BizFACT

Coca-Cola Amatil revealed a 29.3 per cent decline in net profit in 2017 compared with the previous period. This decrease in profitability has been attributed to the decline in consumption of soft drinks, increased competition and price pressure in its water business as well as the refusal of their two major suppliers, Coles and Woolworths, to stock their full range of beverages.

Income Statement

	2015		2016		2017	
	$	%	$	%	$	%
Sales	100 000	100	120 000	100	150 000	100
less Cost of goods sold	40 000	40	40 000	33	50 000	30
Gross profit	60 000	60	80 000	67	100 000	67
less Other expenses	20 000	20	30 000	25	45 000	30
Net profit	40 000	40	50 000	42	55 000	37

Although sales have increased steadily, cost of goods sold has risen only slightly over the three-year period. Cost of inventories may have decreased due to the suppliers being used or more efficient stock control methods being developed. Expenses have shown no great variation, with figures of 20 per cent, 25 per cent and 30 per cent of sales for the three-year period, resulting in a steady profit percentage (40 per cent, 42 per cent and 37 per cent respectively).

FIGURE 11.21 An example of profitability trends over a number of years

Analysis can also include budget figures so that predicted figures can be compared against actual figures, usually over short time periods such as per month. This information is usually available for interested parties within a firm rather than for external stakeholders.

Income Statement

	Actual		Budget	
	$	%	$	%
Sales	75 000	100	100 000	100
less Cost of goods sold	42 000	56	55 000	55
Gross profit	33 000	44	45 000	45
less Other expenses	20 000	26	35 000	35
Net profit	13 000	17	10 000	10

Although actual sales is considerably less than budget, the reduced amount for expenses has led to an increased profit against sales (17 per cent rather than 10 per cent).

FIGURE 11.22 An example of comparing budget to actual figures

Comparison with other businesses and benchmarking — comparing results against standards that have been developed for a particular industry — are common. However, care must be taken to ensure that the same things are compared. Also, each firm has differences, and finding comparable firms may be difficult. Benchmarks are useful but are merely a guide. For example, financial gearing is often used to compare firms, so that if the industry average of debt to equity was 80 per cent and a particular firm had 40 per cent, then it would need to examine the risks and analyse the reasons for the differences.

In the past, Australian businesses have mainly used Australian standards but, with the globalisation of business, world standards are more commonly used for benchmarking.

Inter-business comparisons are useful and firms may access relevant business statistics from a number of sources, including the Australian Bureau of Statistics. They must ensure information is up to date and accurately reflects industry norms.

SUMMARY

- The financial statements of a business must be analysed to gain a thorough understanding of the activities of a business. The analysis involves comparing similar figures contained in the financial statements and balance sheets.
- The main types of analysis include: vertical (within one year), horizontal (between different years) and trend (over a period of 3–5 years).
- The analysis of financial statements is usually aimed at the areas of financial stability (liquidity and gearing), profitability and efficiency.
- Liquidity is the extent to which the business can meet its financial obligations in the short term. This means a business must have enough resources to pay its debt and cover unexpected expense.
- Current assets and current liabilities determine the liquidity or short-term financial stability of a business.
- A current ratio of 2:1 indicates a sound financial position.
- Gearing measures the relationship between debt and equity.
- Gearing is the proportion of debt (external finance) and the proportion of equity (internal finance) that is used to finance the activities of a business.
- Profitability is the earning performance of the business and indicates its capacity to use resources to maximise profit.
- The income statement is used to measure the profitability or earning capacity of the business. Figures from this statement are used to calculate the gross profit and net profit ratios.
- The return on equity ratio shows how effective the funds contributed by the owners have been in generating profit, and hence a return on their investment.
- Efficiency is the ability of the business to use its resources effectively to ensure financial stability and profitability. It relates specifically to management's ability to achieve its goals and objectives.
- The two main ways to calculate efficiency include the expense ratio and the accounts receivable turnover ratio.
- The expense ratio indicates the amount of sales allocated to individual expenses. The accounts receivable turnover ratio measures how effective a business is in collecting its debts.
- Figures, percentages and ratios do not provide a complete picture for analysis. For analysis to be meaningful, businesses need to make comparisons with their past performance, similar businesses and against common industry standards.

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Concept 8

Comparative ratio analysis
Summary screen and practice questions

EXERCISE 11.4 REVISION

1 **How** are financial reports analysed and interpreted?
2 **Explain** how financial reports are analysed and interpreted.
3 **Describe** the purposes of analysing financial ratios.
4 **Construct** a table listing the types of financial ratios under the following headings (the first one has been completed for you).

Financial management objective	Type of ratio	Financial statement	Purpose
Liquidity	Current ratio	Balance sheet	Short-term financial stability

5 **Determine** the ratio that would help to answer the following questions.
(a) Are assets being used efficiently?
(b) Is the business able to pay its debts in the short term?
(c) Is the business able to pay its debts in the long term?
(d) Are owners/shareholders receiving value for their investment?
(e) Are credit policies of the business being used effectively?
(f) How is the business being financed?

6 Using the information below, **create** a report for Bobbie and Lee at the end of their first year in business as 'T-shirts and More', commenting on:
(a) return on owners' equity (Bobbie and Lee invested $50 000 in the business)
(b) gross profit ratio
(c) net profit ratio.

Income Statement for T-shirts and More, 2018

	$	$	$
Sales of T-shirts			40 000
less Cost of goods sold			25 000
Gross profit			15 000
less Selling expenses			
Advertising	1 000		
Wages	3 300	4 300	
less Administrative expenses			
Telephone	1 400		
Rent of premises	1 500	2 900	7 200
Net profit			7 800

7 Using the following information, **create** a report commenting on the efficiency of accounts receivable of Blossoms Tyres. **State** the reasons for the trend. **Determine** what comment you would make if the business was Blossoms Trucks rather than Blossoms Tyres.

Average days sales uncollected			
2014	2015	2016	2017
104 days	110 days	120 days	120 days

8 The following ratios were calculated for Ventura Ltd. **Outline** what trends are indicated by the ratios and **propose** possible causes of the trends.

	2016	2017
Current ratio	2:1	1.5:1
Profit %	15	12%
Debt: equity	1:1	1.5:1%
Accounts receivable turnover	35 days	50 days

9 Using the information from the income statement below, answer the questions below.
(a) **Calculate** and comment on the expense ratio for 2016 and 2017.
(b) **Recommend** what expenses (if any) you would cut in 2018. Give reasons.
(c) **Describe** what the trend in advertising expenses has been as a percentage of sales over the last two years.
(d) **Discuss** the profitability of the business for the past two years.

Income Statement for year ended 30 June 2017		
	2016	2017
	$	$
Sales	130 000	135 000
less Cost of goods sold	80 000	82 000
Gross profit	50 000	53 000
less Expenses		
Advertising	20 000	23 000
Rent	13 000	13 500
Interest — short term	1 200	1 200
Motor vehicle expenses	8 500	10 100
Net profit	7 300	5 200

10 Look at the income statement and balance sheet for Business Z.
(a) **Discuss** the profitability of Business Z.
(b) **Discuss** the gearing of Business Z.
(c) **Summarise** your recommendations for the following year.

Income Statement, Business Z			
	2015	**2016**	**2017**
Sales	80 000	74 000	95 000
less Cost of goods sold	57 500	54 000	73 800
Gross profit	22 500	20 000	21 200
less Administrative and finance expenses	16 500	15 000	16 500
Net profit	6 000	5 000	4 700

Balance Sheet, Business Z			
Inventory	80 000	72 500	87 500
Non-current Assets	70 000	77 500	62 500
	150 000	**150 000**	**150 000**
Overdraft	35 000	38 000	32 000
Other Current Liabilities	35 000	32 000	38 000
Capital	80 000	80 000	80 000
	150 000	**150 000**	**150 000**

11 Use the balance sheet and the industry averages below to answer the questions that follow.

Balance Sheet as at 30 June 2018		
Current Assets		
Cash	300	
Accounts receivable	1 200	
Inventory	3 000	4 500
Non-current Assets		5 500
		10 000

(continued)

(continued)

Current Liabilities		
Accounts payable		1 000
Non-current Liabilities		5 000
Owners' Equity		
Contributed capital	1 000	
Retained earnings	3 000	4 000
		10 000

Industry averages	
Current ratio	2:3
Debt: equity	2:3
Accounts receivable turnover 55 days	
Return on owners' equity 30%	

(a) **Calculate** the current ratio, debt to equity ratio, return on equity ratio and accounts receivable ratio (sales $15 000 of which 60 per cent were on credit).
(b) Using the industry averages, **identify** the strengths and weaknesses of the firm's financial position and **determine** where improvements would need to be made.

12 You have been given the following analysis of the financial reports of JY Enterprises. **Create** a report for management giving your interpretation of the data under the headings 'Liquidity', 'Gearing' and 'Profitability'.

	2014 $	2015 $	2016 $	2017 $
Current Assets				
Inventory	90 000	100 000	100 000	150 000
Accounts receivable	120 000	140 000	150 000	150 000
Non-current Assets	250 000	250 000	300 000	200 000
Total Assets	**460 000**	**490 000**	**550 000**	**500 000**
Current Liabilities				
Overdraft	40 000	50 000	60 000	60 000
Accounts payable	80 000	100 000	110 000	120 000
Non-current Liabilities	100 000	120 000	150 000	150 000
Total Liabilities	**220 000**	**270 000**	**320 000**	**330 000**
Owners' Equity				
Capital	150 000	150 000	150 000	150 000
Retained earnings	90 000	70 000	80 000	20 000
	240 000	**220 000**	**230 000**	**170 000**
Current ratio	210 000 / 120 000 = 1.75	240 000 / 150 000 = 1.6	250 000 / 170 000 = 1.48	300 000 / 180 000 = 1.67
Debt to equity ratio	220 000 / 240 000 = 0.92	270 000 / 220 000 = 1.22	320 000 / 230 000 = 1.4	330 000 / 170 000 = 1.94
Return on equity ratio	90 000 / 240 000 = 0.38	70 000 / 220 000 = 0.32	80 000 / 230 000 = 0.35	20 000 / 170 000 = 0.12

13 **Why** is it difficult to compare businesses over time?

14 **Why** do businesses compare their results with industry standards and benchmarks?

15 **Explain** why it is often difficult to compare ratios for businesses with industry averages.

EXERCISE 11.4 EXTENSION

1. 'The objectives of financial management often conflict with one another.' **Explain** this statement.
2. 'Financial analysis is the beginning of an investigation of a business.' **Discuss**.
3. **Examine** a range of financial reports from a business.
   (a) **Calculate** liquidity, gearing, profitability and efficiency ratios using figures from the reports.
   (b) **Create** a report commenting on the ratios.
4. Use the internet to find the most recent annual report and financial statements of three companies.
   (a) **Determine** their operating profit (or loss), total assets and total liabilities.
   (b) Print screenshots of the sites where you found the results and share them with others in the class. **Compare** your results.

BizFACT

The law requires accuracy, transparency and disclosure of all financial details to the stakeholders and it is always in the interest of a business to conduct itself ethically.

11.7 Identifying the limitations of financial reporting

Financial reports and ratio analysis provide information on the state of the business and indicate trends in its operations. However, caution needs to be exercised when analysing financial reports because they may not give a completely accurate assessment of a business's financial position. Businesses often work hard to make their financial reports look good. Therefore, investors need to exercise caution when examining these reports. Misleading information impacts on business decision making and puts the business at risk. The following issues must be considered when analysing financial reports.

TABLE 11.6 Limitation of financial reports

Issue	Description
Normalised earnings	Normalised earnings are earnings that have been adjusted to take into account changes in the economic cycle or to remove one off or unusual items that will affect profitability. This is done to give a more accurate depiction of the true earnings of a company. This makes it easier to compare profitability figures for a business from one year to the next, and against other businesses. An example is the removal of a land sale, which would achieve a large capital gain.
Capitalising expenses	This refers to an accounting method where a business records an expense as an asset on the balance sheet rather than as an expense on the income statement. This does not accurately represent the true financial condition of the business as it understates the expenses and overstates the profits as well as the assets of the business. Examples of capitalising expenses include research and development, and development expenditure.
Valuing assets	This is the process of estimating the value of assets when recording them on a balance sheet. This can be difficult for financial managers or accountants to estimate, especially for non-current assets. Sometimes when an asset is recorded on a balance sheet, its value is written as its historical cost. Historical cost is an accounting method where assets are listed on a balance sheet with the value at which they were purchased. The main advantage of using the historical cost is that the cost can be verified. The disadvantage is that this value may distort the business's balance sheet, meaning that it will not accurately represent the true worth of the business's assets. This is because the original cost of an asset may be different from its current market value. Some non-current assets, such as land, typically increase in value over time. Other non-current assets, such as vehicles or machinery, may actually lose value over time. This is known as depreciation.

(continued)

BizFACT

Calculating, and adjusting, the value of a company's goodwill is the issue that takes up the most time and effort of auditors of ASX 200 listed firms. Research by KPMG found that the valuation, and possible impairment, of goodwill and other intangible assets such as brand value were listed as a key audit matters by around two-thirds of companies.

BizFACT

Intangible assets are difficult to quantify and put a value on. One of the most commonly valued intangible assets are brand names. In 2017 the Apple brand, worth $170 billion, topped Forbes' annual study of the most valuable brands in the world for the seventh straight year. Google ranked second at $101.8 billion, then Microsoft ($87 billion), Facebook ($73.5 billion) and Coca-Cola ($56.4 billion).

BizWORD

Debt repayments *refer to either money owed to the business or by the business.*

TABLE 11.6 *continued*

Issue	Description
Valuing assets	With assets that typically lose value over time, businesses have to estimate how much value they lose every year. Financial managers are allowed to depreciate assets using accounting standards so that the value of the assets on the balance sheet presents a more accurate picture of the business. While there are rules governing how depreciation is calculated, financial managers are free to choose from several methods, which may mislead some investors. This is therefore a limitation when interpreting financial reports because the depreciation rate is an estimate and this may give a false impression about how much the business is actually worth. Another limitation of financial reports is that some assets are very difficult to value. Intangible assets are items of value to a business, but they do not physically exist; for example, goodwill, trademarks, patents and brand names. While these assets are of value to the business, sometimes they are not included on a balance sheet because their value is too difficult to work out since there is no set formula for their calculation. If financial managers decide to include these assets on the balance sheet, there may be a temptation to overvalue them to make the business appear more financially stable than it really is.
Timing issues	When analysing a financial report, limitations can arise due to timing issues. One of the basic accounting concepts is the matching principle. Under the matching principle, expenses incurred by a business must be recorded on the income statement for the accounting period in which the revenue, to which those expenses relate, is earned. In other words, when an accountant records revenue, they should also record at the same time any expenses that were directly related to that revenue. For example, a real estate agent may have sold a property in June. They receive a 2% commission for sales, but their employer did not pay them until July. This expense should be recorded in June. When this principle is followed, the revenue earned will match the costs that were incurred to earn that revenue. The matching principle results in the presentation of a more accurate representation of the financial position of a business.
Debt repayments	When analysing a financial report, the gearing ratio is often used to determine whether businesses are at risk of meeting their long-term financial commitments. A business that is highly geared may be alarming for some stakeholders. However, while a highly geared business has increased risk, their potential for profit is greater. For example, higher levels of debt to fund growth can lead to increased profits in the future. Financial reports, when considered in isolation, can therefore be limited. Financial reports can be limited because they do not have the capacity to disclose specific information about **debt repayments** such as: • how long the business has had or has been recovering the debt • the capacity of the business or its debtor to repay the amount/s owed (What if a debtor is close to bankruptcy and will not be able to repay a debt?) • the adequacy of provisions and methods the business has for the recovery of debt (Larger businesses have the ability to outsource debt recovery by hiring an agent to undertake this process, but smaller business may not have the resources to do the same as it is costly and time consuming.) • what provision the business has in place for doubtful debts and how this is evident in the financial reports • whether debt repayments have been held over until another accounting period, therefore giving a false impression of the situation • when the debts are due. The recording of debt repayments on financial reports can be used to distort the 'reality' of the business's status and this may be undertaken to provide a more favourable overview of the business at that point in time.
Notes to the financial statement	Notes to the financial statements report the details and additional information that are left out of the main reporting documents, such as the balance sheet, income statement and cash flow statement. They contain information that may be useful to stakeholders to help them

Issue	Description
Notes to the financial statement	make sense of these financial statements and to explain them. These notes contain important information such as the accounting methodologies used for recording and reporting transactions that can affect the bottom-line return expected from an investment in a company. They may also contain further details about how the figures in the financial statements were calculated and the procedures that were used to develop them.

Case study: Bega Cheese — normalised earnings

A crash in global dairy prices and strong demand for milk has hit the Bega Cheese bottom line.

Bega Cheese announced yearly earnings of $12 million profit after tax, down 81 per cent on the previous year.

Executive chairmen of Bega Cheese, Barry Irvin, said it had been a challenging year for the dairy industry.

"The reality is it was an extraordinarily challenging year for global commodity prices for dairy products," he said.

"I think in terms of the way we would look at the business, we would look at the underlying profitability and the normalised result.

"You'll have to remember that last year's result included the benefit of the sale of our Warrnambool Cheese and Butter shares, which of course made a significant contribution to the bottom line last year.

"On a normalised basis, without the impact of the Warrnambool Cheese and Butter shares and the Milk Sustainability and Growth Program in there, that sees the profit down about 26 per cent.

"That really does show the impact that global commodities had on the business last year."

Despite the global market being flooded with dairy products, there is still hot competition between processors in Australia.

This meant that the crash in global dairy prices was not able to be passed on as big price cuts to local farmers.

"As we came into FY15, there was great competition for milk and all companies offered a strong price at the upper end of the commodity cycle and of course no one was predicting the commodity drop would be quite as big as we saw this year," Mr Irvin said.

"Prices have come off to farmers in the last three years, falling from $7 down to $6 and this season an opening price of $5.60 for milk solids.

"But there is still strong competition for milk and all companies are trying to give some stability to farmers, because we are still looking forward to business growth in the future."

Mr Irvin acknowledged that the milk prices on offer in Australia were not in sync with the global market.

"It is a fair comment to say that Australian milk prices are not aligned with global milk prices," he said.

"Compared to New Zealand, we do have a different mix with the domestic consumer goods market and just the size of the domestic market here,

"It's not the case that the international market should reflect *all* of the impact of the global commodity prices but the reality is it should reflect *some.*"

Source: Joshua Becker, 'Bega Cheese defends investment in extra production after global dairy crash hits yearly profit', *ABC News*, 28 August 2015

SNAPSHOT QUESTIONS

1. **Outline** the external factors in the business environment that have had an impact on Bega Cheese.
2. **How** have normalised earnings affected the company's profit figures?

SNAPSHOT



'. . . the sale of our Warrnambool Cheese and Butter shares . . . made a significant contribution to the bottom line . . .'

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Syllabus area 3
Topic 3
Concept 9

Limitations of financial reports
Summary screen and practice questions

11.8 Ethical issues related to financial reports

Financial managers and accountants who prepare financial reports should ensure the decisions they make are ethical and that they act with the highest standards. They have an ethical and legal obligation to ensure financial records are accurate. Any attempt to engage in creative accounting to portray a more favourable but inaccurate financial picture should always be avoided. In recent years, unethical practices have been highlighted and increasingly questioned (see figure 11.23).



FIGURE 11.23 Sigma Pharmaceuticals is the owner of some of Australia's best known pharmacy brands such as Amcal and Guardian. In 2016, the former chief executive, Elmo de Alwis, and former chief financial officer, Mark Thomas, received a 12-month suspended prison sentence and $25 000 fine each for falsifying Sigma's books and providing false information to the company's board and auditor. They were sentenced after admitting they overstated Sigma's revenue in 2010 by $15.5 million dollars and its profits by $9.6 million. Due to their breaches, Sigma suffered a loss of approximately $59.3 million. Sigma is now suing the two former executives and are seeking compensation, damages and costs associated with their crimes.

It is generally accepted that financial management decisions must reflect the objectives of a business and the interests of owners and shareholders. For example, an area in which ethical considerations are important is in the valuing of assets, including inventories and accounts receivable. Such valuations influence the level of working capital and, hence, the short-term financial stability of a business. If inventories and accounts receivable are overvalued (the business makes no provisions for bad or doubtful debts), working capital will be high and indicate an untrue working capital figure for a business.

If debt funds are used extensively to finance activities in a business, although debt funds may be used to increase profits, there is added risk for shareholders. The impact of debt funds on risks to shareholders is an ethical issue that must be considered.

In preparing budgets, the expenditures and revenues are estimated. The common practice in business of overestimating expenditures and understating revenues to allow for unexpected and uncertain events is an ethical issue for a business.

Ethical considerations are closely related to legal aspects of financial management. Legislation is in place to guard against unethical business activity but there is often a time lag between the recognition of a problem and its implementation through law.

Laws relating to corporations include the responsibilities of directors and requirements for disclosure for corporations. For example, in relation to financial management, directors have a duty to:

- act in good faith
- exercise power for proper purpose in the name of the corporation

- exercise discretion reasonably and properly
- avoid conflicts of interest.

The Australian Securities Exchange (ASX) corporate governance council officiates the requirements of corporations listed with the ASX and their responsibilities in regard to compliance with law, disclosure and transparency of company details to shareholders and the public.

11.8.1 Examine ethical financial reporting practices

Some ethical issues related to financial reports include audited accounts, record keeping, GST obligations and reporting practices.

Audited accounts

In all activities of a business the goals of the business remain paramount. Planning, monitoring, control and corrective action are all part of the process. The **audit** is an independent check of the accuracy of financial records and accounting procedures, and it has an important role in this process.

BizWORD

*An **audit** is an independent check of the accuracy of financial records and accounting procedures.*

Potential users of information include financial institutions, owners and shareholders and potential investors who rely on the independent check of the auditor before making decisions about the business.

Audits are an important part of the control function and are generally used to examine the financial affairs of a business. There are three types of audits:

1. *Internal audits*. These are conducted internally by employees to check accounting procedures and the accuracy of financial records.
2. *Management audits*. These are conducted to review the firm's strategic plan and to determine if changes should be made. The factors affecting the strategic plan may include human resources, production processes and finance.
3. *External audits*. These are a requirement of the *Corporations Act 2001* (Cwlth). The firm's financial reports are investigated by independent and specialised audit accountants to guarantee their authenticity. The auditor issues a statement indicating that the firm's records and financial reports are accurate, to the best of the auditor's knowledge, and give a true and fair view of the state of affairs, and that they comply with Australian auditing standards. In 2005, businesses were required to adopt new international accounting standards or international financial reporting standards (IFRS). These standards aimed for greater transparency and accountability for all businesses regardless of size. Globally standardised accounting also assists transnational corporations.

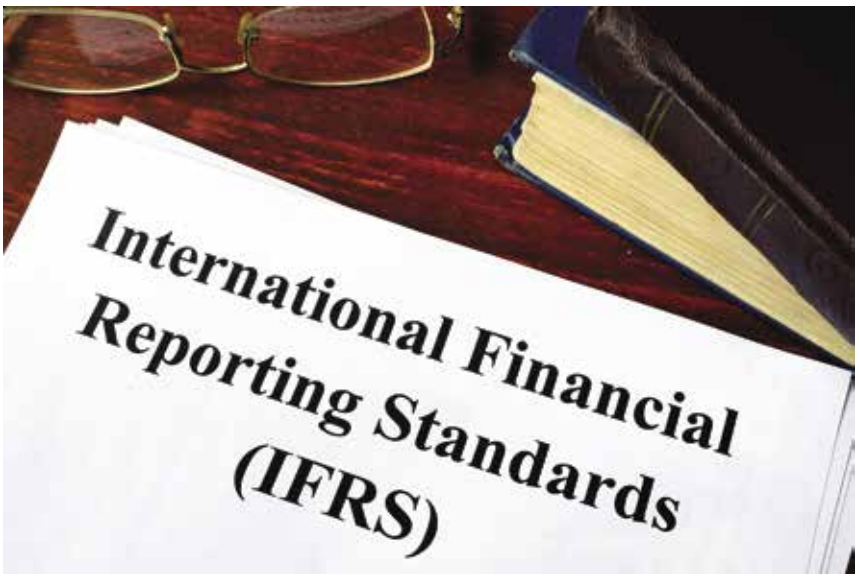


FIGURE 11.24 Accounting standards are a set of principles that companies follow when they prepare their financial statements, ensuring that companies' financial performance are published in a standardised way. The International Financial Reporting Standards (IFRS) Foundation is a not-for-profit organisation that was established to develop and promote a single set of high-quality, enforceable and globally accepted accounting standards — IFRS Standards.

Internal and external audits assist in guarding against unnecessary waste, inefficient use of resources, misuse of funds, fraud and theft. Audits are carried out on the financial records of a business to see if they are prepared in line with accepted accounting standards and that records provide accurate information for users. They check the control procedures of a business by physically checking assets. For example, cash is counted, the condition and amount of the inventory is

BizFACT

In 2017, Caltex initiated internal workplace audits of its entire franchise network after suspicions were raised about wage fraud. The audit revealed that almost 80 per cent of its franchisees were underpaying their staff. Many franchisees have since left the network after being terminated. The company has also established a $20 million assistance fund to support those employees who were underpaid.

checked, and accounts receivable and non-current assets are checked. Records are checked to see if they match the physical count.

External auditors are used to provide an annual audit of accounting practice and procedures. In small businesses, external auditors are usually used only if the business is for sale or as a check against theft and fraud. An external audit is conducted by an independent accounting business. Such businesses employ highly trained certified public accountants (CPAs) who provide expert accounting and financial management services. When they are satisfied, the auditor certifies that the financial data presented in the business's financial reports is in accordance with generally accepted accounting standards and practices.

Record keeping

All accounting processes depend on how accurately and honestly data is recorded in financial reports. Source documents must be created for every transaction, even those in which cash has changed hands. There is a temptation in some cases to receive payment in the form of notes and coins, and not record the transaction. If cash received in this way is not recorded, it will not show up as business revenue, and will reduce the business's profit for the year, possibly resulting in a lower tax burden. While reducing the tax burden in this way may be tempting, the Australian Taxation Office (ATO) regularly monitors business operators, and those found to be evading their taxation responsibilities can receive fines far in excess of the amount they may believe they have saved in tax. Prosecutions for tax evasion can harm the reputation of the business, and alienate customers who wish to deal with honest and ethical businesses.

BizFACT

Proper financial records must be kept for a minimum of five years.



FIGURE 11.25 Unethical financial practices can sometimes slide into unlawful activities. The hidden costs of unethical financial practices can range from loss of reputation, sales and profits for the business, to the imprisonment of the employees who knowingly engaged in criminal conduct.

Reporting practices

Not only are accurate financial reports necessary for taxation purposes, but other stakeholders are entitled to access to a business's financial information. Shareholders in a private company are legally entitled to receive financial reports annually, even if the company is a small business and the shareholders are family members. To pretend that profit is lower than it should be is to attempt to defraud the ATO. This is not only illegal and unethical, but can have other negative consequences. Should the business wish to raise additional capital from existing

shareholders or from a bank, understating profit may make it more difficult to persuade those sources of finance to lend to the business. If a business decided to sell the business as a going concern, any purchaser would want to see financial reports for a number of years prior to the sale. Understating profit or overstating the value of assets may prove counter-productive when a potential buyer subjects the reports to close scrutiny.

Unethical financial practices — tax minimisation

"Technically legal, morally bankrupt" — that is the key finding of a new study into the tax operations of the biggest multinationals doing business in Australia.

The study put together by a team of researchers at the University of Technology, Sydney found 76 of the largest multinationals in Australia pay an effective tax rate of 16.5 per cent, roughly half corporate tax rate of 30 per cent.

The report argued that, had the full tax rate been paid, the federal budget bottom line would have been boosted by $5.36 billion in 2013 and 2014.

The study originally looked at the top 100 multinationals and eliminated 24 firms that were found to have experienced genuine – not artificially inflated – losses.

Big pharmaceutical companies were the most effective at driving down their tax rates, paying on average just 5.7 per cent, while technology companies managed it down to 7.5 per cent and energy companies 20 per cent.

The study noted there were two principal ways of slashing tax rates: profit alienation and debt loading.

- Profit alienation is the technique favoured by 'Big Pharma' and high-tech enterprises. The valuable intellectual property rights for the drugs and IT operations are held in low or zero tax jurisdictions. The profits made in Australia are then used to pay the parent company for the use of its expensive intellectual property.
- Debt loading – also known as thin capitalisation – is the domain of the energy and resource sector. To reduce tax bills the foreign multinational company finances its Australian subsidiary with unusually high interest rates. Profits made here are then funnelled back offshore to repay the loans and recorded as a loss in the form of an interest payment on a loan.

The UTS study cited energy giants Chevron and ExxonMobil as paying no tax on their combined revenue of over $12 billion.

"Chevron borrowed over $2.5 billion from foreign subsidiaries, many in known low or no tax jurisdictions," the UTS research found.

"The interest payments on these loans added up to 62.5 per cent of their sales revenue in 2014 and 45 per cent in 2013.

"The result? Chevron paid no tax in 2013–14."

Top foreign multinationals operations in Australia 2013–2014

Sector	Number of companies	Ave % tax paid on profits	Ave tax shortfall per company	Total corporate tax shortfall
Technology, electronics & media	48	7.5%	$45,418,089	$2,180,068,255
Pharmaceuticals & health	13	5.7%	$35,777,183	$465,103,385
Energy	15	20.0%	$181,364,419	$2,720,466,283
All	76	16.2%	$70,600,499	$5,365,637,923

Source: ASIC 'Copy of financial statements and report', Form 388 / UTS
Note: Effective tax rate is based on Generally Accepted Accounting Principles (GAAP)

SNAPSHOT



'. . . 76 of the largest multinationals in Australia pay an effective tax rate of 16.5 per cent . . .'

However, it should be noted that Chevron and Exxon, along with Shell, are joint venture partners in Australia's single biggest resource project — the $US55 billion Gorgon LNG project — which has suffered massive cost overruns and delays and finally started shipments last month.

The big users of "profit alienation" include tech giants Apple and Google, as well as drug companies Glaxosmithkline, Roche, Pfizer and the consumer goods conglomerate Proctor and Gamble.

The UTS researchers found Apple managed to get its effective tax rate down to just 1.2 per cent with the aggressive use of the profit alienation strategy known as the "Double Irish with Dutch Sandwich".

"Apple Inc subsidiaries sell products to one another at prices so high that they make little to no commercial sense — save for aggressive tax minimisation," the study argued.

"Apple's net profit margins in Australia are typically 75 per cent lower than the corporation's global margins."

The issue of multinational tax minimisation and profit shifting is increasingly gaining a higher political profile and is likely to form a prominent part of the economic debate through the upcoming election campaign.

Source: Stephen Letts, 'Tax minimisation: foreign multinational average just 16pc rate', *ABC News*, 20 April 2016

SNAPSHOT QUESTIONS

1. **Summarise** some of the key findings from the study conducted by researchers at UTS.
2. **How** have some companies minimised their tax debt?
3. **Assess** the impact of these tax minimisation strategies.

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Syllabus area 3
Topic 3
Concept 10

Ethical issues relating to financial reports
Summary screen and practice questions

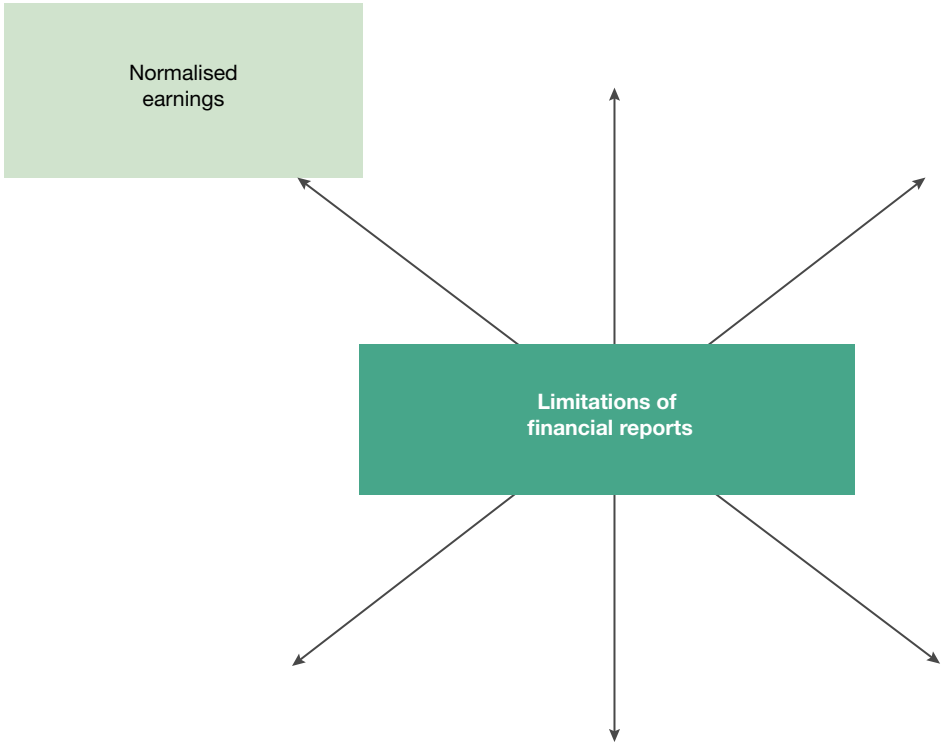
SUMMARY

- There are limitations to financial reports. They can be misinterpreted and can be misleading, both of which will impact on the decision making of management and potentially put the business at risk.
- The limitations of financial reports are:
  - normalised earnings: earnings that have been adjusted to take into account changes in the economic cycle or to remove one off or unusual items that will affect profitability
  - capitalising expenses: an accounting method where a business records an expense as an asset on the balance sheet rather than as an expense on the income statement
  - valuing assets: the difficulties in estimating the value of assets when recording them on a balance sheet
  - timing issues: when revenues and expenses are recorded
  - debt repayments: financial reports don't have the capacity to disclose specific information about debt repayments
  - notes to the financial statement: these report the details and additional information left out of the main reporting documents.
- Businesses have an ethical and legal responsibility to provide accurate financial records.
- Laws relating to corporations regulate the conduct of directors and the requirement for disclosure of all information to be accurate.
- An audit is an independent check of the accuracy of financial and accounting procedures and is an important part of the control function of the business.
- All accounting processes depend on how accurately and honestly data is recorded in financial reports.
- Accurate financial reports are necessary for taxation purposes as well as for other stakeholders.

EXERCISE 11.5 REVISION

1 **Why** is it important for investors to be aware of the limitations of financial reports?

2 Complete the following concept map **identifying** the limitations of financial reports. Provide a brief **summary** of each. The concept map has been started for you.



3 **Explain** the importance of ethics in financial management.

4 A business decides to undervalue its inventories and accounts receivable to indicate a favourable working capital ratio and, therefore, the short-term financial stability of the business. **Discuss** the advantages and disadvantages of this decision and its ethical implications.

5 Is it ethical to overestimate budgets to allow for uncertain or unknown risks? **Justify** your answer.

6 **Explain** the role of the ASX in the supervision of business.

7 **Outline** the role of audits in financial management.

8 **Distinguish** between internal audits, management audits and external audits.

9 **Clarify** why financial record keeping should be accurate and honest.

EXERCISE 11.5 EXTENSION

1 'Analysis of financial information identifies only symptoms, not causes.' Do you agree or disagree with this statement? **Justify** your response.

2 In pairs, use the internet to research and report on businesses that are involved in some form of legal action due to their unethical financial management practices. **Determine** how the business may have avoided this litigation if it had acted ethically.

3 'Timely and valid internal and external audits are a primary safeguard against unethical financial behaviour.' **Assess** the accuracy of this statement.

4 Outline the role of Auditing and Assurance Standards Board (AUASB) Australia using the internet to find information. **Determine** why the federal government would be involved in maintaining auditing assurance standards.

5 KPMG is one of the world's leading professional services companies specialising in audit, taxation and business advice. Use the internet to **examine** KPMG's financial statement audit services.

on Resources

- **Digital doc:** Chapter summary (doc-24813)
- **Interactivity:** Chapter crossword (int-7169)
- **Interactivity:** Multiple choice quiz (int-7170)
- **Weblink:** Auditing and Assurance Standards Board (AUASB)
- **Weblink:** KPMG

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CHAPTER 12

Financial management strategies

OVERVIEW

12.1 Introduction
12.2 Cash flow management
12.3 Working capital (liquidity) management
12.4 Profitability management
12.5 Global financial management

12.1 Introduction

There are a variety of strategies financial managers can implement to address issues of concern. Effective strategies businesses can use to address issues relating to cash flow, working capital, profitability and global financial management will be addressed in this chapter.

12.2 Cash flow management

BizWORD

Cash flow *is the movement of cash in and out of a business over a period of time.*

Cash flow is the movement of cash in and out of a business over a period of time. If more money goes out than comes in, or if money must be paid out before cash payments have been received, there is a cash flow problem. Matching cash flow in with cash flow out is essential.

By keeping records of cash flow, you know how much cash you have in your wallet or in the bank at a given time. However, this record does not tell you what debts you have or what is owed to you by others. The issue is the same for a business, which is why budgets are an important tool for managing cash flows. Examples of cash inflows and outflows are given in table 12.1.

TABLE 12.1 Some examples of a business's inflows and outflows of cash

Inflows	Outflows
Sales	Payments to suppliers — raw materials/ finished goods, etc.
Cash payment for accounts receivable	Interest on loans
Commissions received	Operating expenses — wages/salaries, raw materials/finished goods
Sales of assets	Drawings
Proceeds from issue of shares	Purchase of assets
Interest received (investments/ loans, etc.)	Loan repayments
Dividends received	

12.2.1 Cash flow statements

Cash flow statements are examined in detail in chapter 11, section 11.5.1. Remember though, the statement of cash flow indicates the movement of cash receipts and cash payments resulting from transactions over a period of time. It can also identify trends and can be a useful predictor of change.

12.2.2 Management strategies

A business may have temporary shortfalls of cash. Many businesses use overdrafts to cover these shortages. Banks allow the business to overdraw their account to a set limit with the payment of competitive interest rates. Shortfalls of cash over longer periods are of greater concern for a business as insolvency or bankruptcy may result.



FIGURE 12.1 The cash flow cycle describes how money flows through a business. Think of a business's cash balance like a bathtub. If you want the water in the tub to rise, you need to add more water and keep it from going down the drain. The more water that flows in and the less that flows out, the higher the level of water in the tub. Cash inflows and outflows work the same way.

The receipt of cash into a business does not necessarily coincide with payments of cash coming in. Management must implement strategies to ensure that cash is available to make payments when they are due — for example, to the Australian Taxation Office, suppliers for accounts payable, employees for wages, owners and shareholders for profits and dividends, banks and financial institutions for interest on loans or overdrafts, and leasing payments.

Distribution of payments

An important strategy involves distributing payments throughout the month, year or other period so that large expenses do not occur at the same time and cash shortfalls do not occur. Distributing payments throughout the year means there is a more equal cash outflow each month rather than large outflows in particular months. A cash flow projection can assist in identifying periods of potential shortfalls and surpluses.

Discounts for early payment

Another cash flow management strategy is offering debtors a discount for early payments. This strategy is most effective when targeted at those debtors who owe the largest amounts over the financial year period. This is not only beneficial for the debtors who are able to save money and therefore improve their cash flow, but it also positively affects the business's cash flow status.

Factoring

Factoring is the selling of accounts receivable for a discounted price to a finance or specialist factoring company. The business saves on the costs involved in following up on unpaid accounts and debt collection. Factoring is growing in popularity as a strategy to improve working capital. Factoring was examined in more detail in chapter 10, section 10.2.2.

BizFACT

The five most common reasons small and medium-sized enterprises (SMEs) experience cash flow problems are: slow paying debtors, rapid or unsustainable growth, failure to perform credit checks on debtors, tightened lending restrictions making it more difficult to get credit and seasonality (companies that make or sell seasonal goods often run out of funds during quieter times of the year).

BizFACT

Factoring has been an increasingly popular strategy used by Australian businesses to improve their liquidity. Figures released by the Debtor and Invoice Finance Association (DIFA) show that overall debtor finance (which includes both factoring and invoice discounting) totalled over $60 billion in 2015.

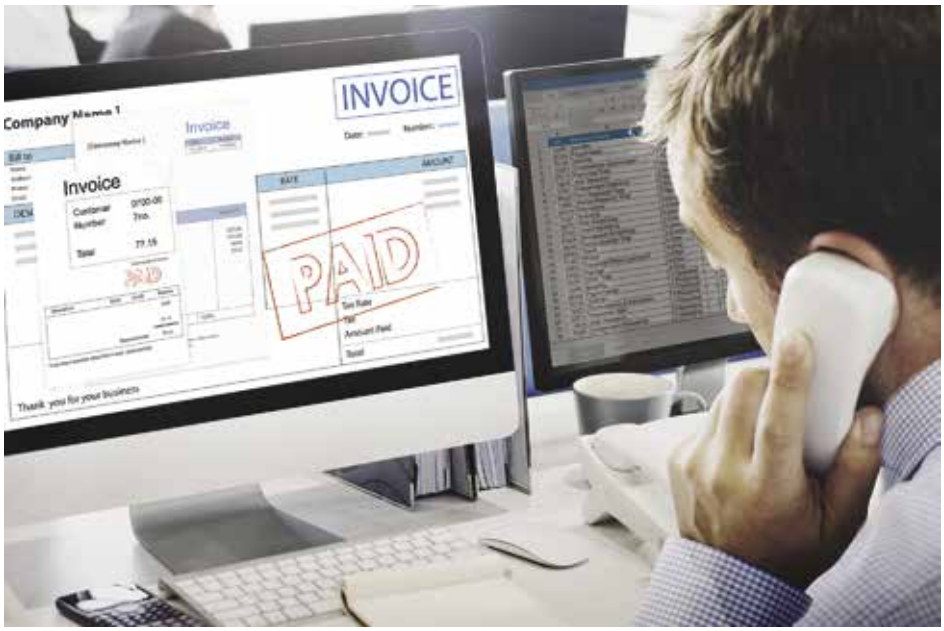


FIGURE 12.2 Invoice discounting, which is very similar to factoring, is a growing strategy used by businesses to manage cash flow. The difference between them is that with factoring the finance company is responsible for collecting the debts owed, whereas with invoice discounting the business chases their own payments in the usual way so that customers won't be aware of the arrangement.

studyon

Syllabus area 3
Topic 4
Concept 1

Cash flow management
Summary screen and practice questions

SUMMARY

- Cash flow is the movement of cash in and out of the business over a period of time. Management is required to make sure payments are made and received without creating a cash flow problem.
- A cash flow statement provides important information regarding a firm's ability to pay its debts on time.
- A cash flow statement can assist in identifying periods of potential shortfalls and surpluses.
- Management strategies for cash flow include:
  - distributing payments throughout the year so that cash shortfalls don't occur
  - using discounts for early payments
  - factoring.

EXERCISE 12.1 REVISION

1. **Define** the term 'cash flow'.
2. Choose a business you are familiar with and **identify** three cash inflows and three cash outflows for that business.
3. **Clarify** what information can be obtained from a cash flow statement.
4. **Demonstrate** why a cash flow statement is so important for a business.
5. **How** do the strategies of (a) distribution of payments and (b) discounts for early payment help improve cash flow?
6. **Recall** the purpose of factoring and **outline** how it influences cash flow.
7. Patane Motorcycle Tours runs both short and long trips throughout the year, although the warmer months, from September to April, generate the most revenue. Cash flow problems often arise in July as repairs are carried out on the bikes, and registration and insurances fall due. **Propose** ways for Patane Motorcycle Tours to manage their cash flow.
8. Judith runs a landscape gardening business and has come to you for financial advice. You find that she is reluctant to offer discounts for cash. **Explain** the reasons for and against offering discounts for cash and **recommend** some financial advice for Judith's business.

EXERCISE 12.1 EXTENSION

1 'Profit is not the same as cash in the bank.' **Analyse** this statement.
2 **Examine** cash flow statements from a number of businesses and **determine** the source of their cash flows. Comment on the management of cash flow for each business.

12.3 Working capital (liquidity) management

Short-term liquidity is important for businesses. It means a business can take advantage of profit opportunities when they arise, as well as meet short-term financial obligations, pay creditors on time to claim discounts, pay tax and meet payments on loans and overdrafts. A business must have sufficient liquidity so that cash is available or **current assets** can be converted to cash to pay debts. The lack of short-term liquidity could necessitate the sale of non-current assets, including long-term investments such as property and equipment, to raise cash. In the longer term, this can lead to reduced profitability for owners and shareholders.

Creditors place importance on a business's liquidity as they seek guarantees that their accounts will be paid. Failure to pay debts on time can alienate a business's creditors and suppliers who incur extra debt collection costs and lose confidence in the business.

Working capital is the term used in businesses to describe the funds available for the short-term financial commitments of a business. **Net working capital** is the difference between current assets and **current liabilities**. It represents those funds that are needed for the day-to-day operations of a business to produce profits and provide cash for short-term liquidity. The working capital cycle for businesses is illustrated in figure 12.3.

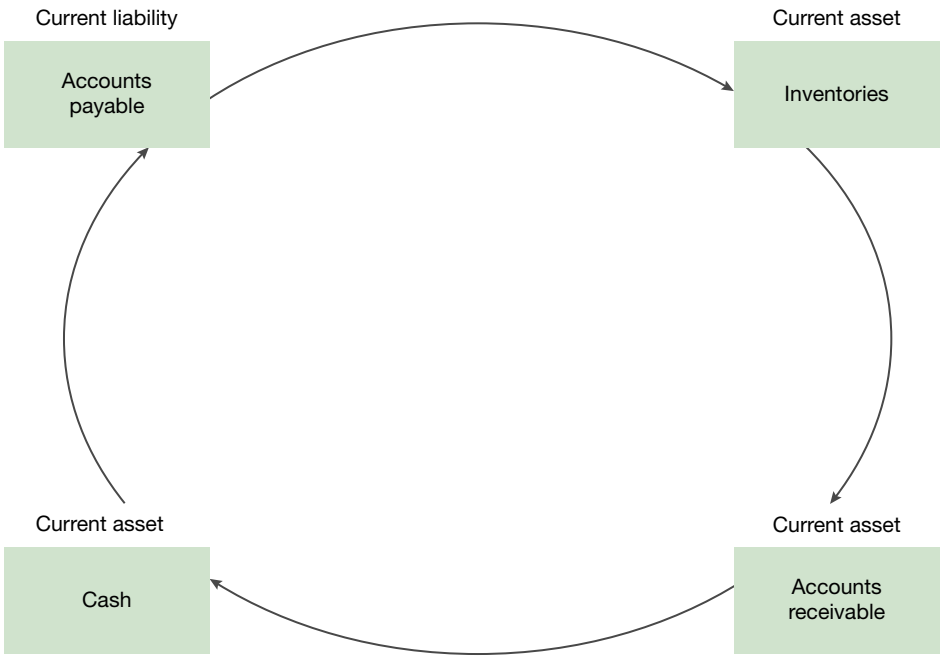


FIGURE 12.3 The working capital cycle. This refers to the length of time it takes a business to convert its net current assets and current liabilities into cash, that is, the time it takes from when a business purchases inventory to resell (or raw materials if they manufacture their products) to when they receive the cash once it's sold.

Through the operating cycle of a business, current assets are constantly changing as inventories are sold, cash is paid out and payments are received. Working capital is often the major asset of a business and current assets may make up approximately

BizWORD

Current assets *are assets that a business can expect to convert into cash within 12 months. They usually include cash and accounts receivable.*

BizWORD

Working capital *is the funds available for the short-term financial commitments of a business.*

Net working capital *is the difference between current assets and current liabilities. It represents those funds that are needed for the day-to-day operations of a business to produce profits and provide cash for short-term liquidity.*

Current liabilities *are liabilities that a business must repay within the short term. They usually include overdraft and accounts payable.*

40 per cent of a business's assets. Therefore, their use and management requires planning and constant monitoring.

Business failure can result from poor management of working capital. Insufficient working capital means there are cash shortages or liquidity problems and the situation forces businesses to increase their debt, find new sources of finance or sell off non-current assets. On the other hand, an excess of working capital means that assets are earning less than the cost to finance them.

Working capital management involves determining the best mix of current assets and current liabilities needed to achieve the objectives of the business. Management must achieve a balance between using funds to create profits and holding sufficient funds to cover payments. The more efficient a business is in organising and using its working capital, the more effective and profitable it will be.

BizWORD

Working capital management *is determining the best mix of current assets and current liabilities needed to achieve the objectives of the business.*

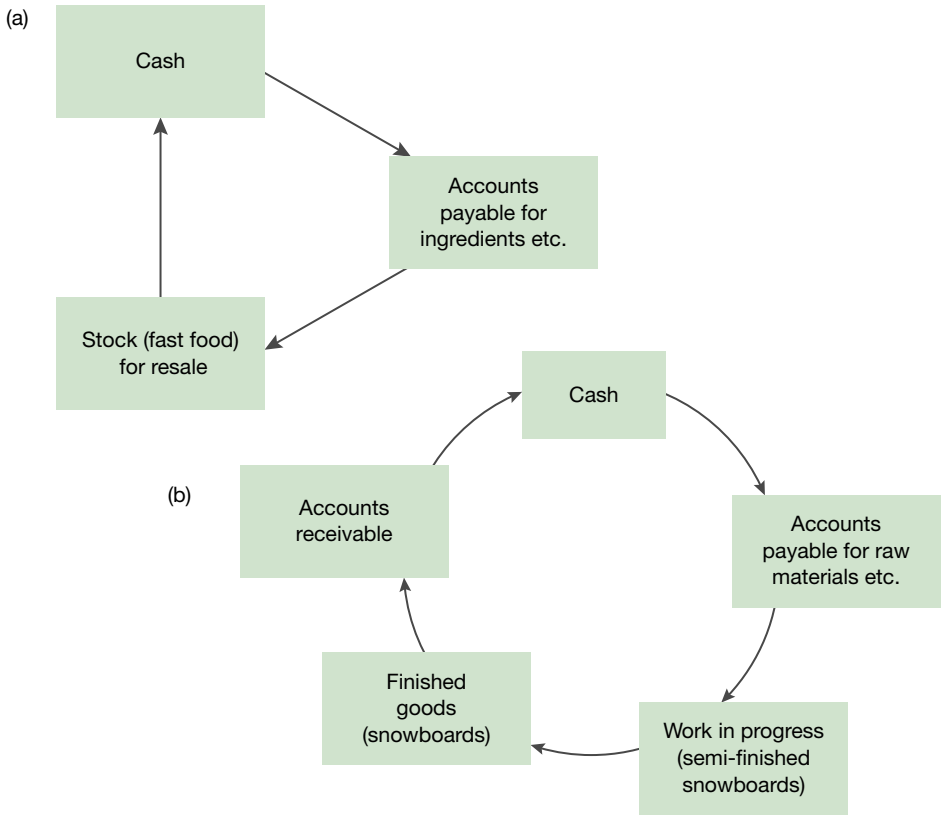


FIGURE 12.4 The requirements for working capital vary for each business. (a) A food outlet requires a relatively low level of working capital as its cash flow cycle is short. (b) A snowboard manufacturer requires a higher level of working capital as the cash flow cycle — between paying for raw materials and receiving payment for finished goods sold — is longer.

BizFACT

Many businesses are profitable and yet they have a cash flow problem. Profit does not equal cash and cash does not equal profit. Many profitable businesses get into difficulty because they have a working capital problem.

12.3.1 The current (working capital) ratio

As outlined in chapter 11, the current (working capital) ratio shows if current assets can cover current liabilities. That is, it helps to determine whether a business is managing cash flows so that it can pay its immediate debts. The ratio indicates the amount of risk taken by a business in relation to profitability and liquidity, and can help determine whether the business's financial structure is acceptable. For example:

$$\text{Current (working capital) ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= \frac{500\,000}{250\,000}$$

$$= 2{:}1 \text{ or } 200\%$$

In this example, the ratio indicates that, within the next 12 months, twice the amount of assets need to be sold to generate cash to meet the short-term debts of the business for the same period.

A high current ratio may indicate the business has invested too much in current assets that bring in a small return. Profitability may be reduced as the business has chosen to reduce its risk of not being able to pay its debts by having a higher current ratio. A low current ratio may mean that the business is more profitable if it is investing its resources in longer term assets and generating more profits. However, there is a risk that the business may not be able to pay its current liabilities.

A current ratio of 2:1, or 200 per cent, is generally acceptable, but ratios vary depending on the industry, the type of business, the efficiency of the business in being able to convert current assets into cash, and the relations with creditors and banks that are sources of cash. Each business determines an appropriate current ratio, but the careful monitoring of working capital is important for the survival of a business. Figure 12.5 shows the importance of working capital management.

	2016	2017
Current Assets	$m	$m
Bank	3.4	0
Accounts receivable	30.6	34.8
Short-term investments	6.7	4.2
Inventory	21.6	25.1
	62.3	64.1
Current Liabilities		
Overdraft	0	4.6
Accounts payable	22.3	20.4
Short-term loans	17.8	19.2
	40.1	44.2
Working capital	22.2	19.9

Working capital = Current assets – Current liabilities

2016 = 62.3 – 40.1

= $22.2m

2017 = 64.1 – 44.2

= $19.9m

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$2016 = \frac{62.3}{40.1}$$

= 1.55:1 (155%)

$$2017 = \frac{64.1}{44.2}$$

= 1.45:1 (145%)

- Current assets have increased in total over the two periods but at a slower rate than current liabilities. Working capital has fallen by $2.3m ($22.2m – $19.9m).
- There has been an increase in current liabilities ($17.8m to $19.2m).
- Current ratio has changed from 1.55:1 (155 per cent) to 1.45:1 (145 per cent). Management must decide whether this ratio and trend is acceptable.
- Bank has moved from a surplus to an overdraft ($0 to $4.6m). This would need to be evaluated in terms of the costs.
- Accounts receivable has increased ($34.8m – $30.6m = $4.2m) by over 10 per cent ($4.2m/30.6m = 13.7 per cent).
- Accounts payable has fallen ($22.3m to $20.4m).

(*continued*)

(*continued*)

- Short-term investments have fallen ($2.5m from $6.7m to $4.2m).
- Short-term loans have increased ($1.4m from $17.8m to $19.2m).

It would appear that short-term loans are balanced by accounts payable and short-term investments with accounts receivable. Management must examine this in the light of past experience and business policy.

Inventories have increased significantly ($3.5m from $21.6m to $25.1m). The reasons for this change should be investigated.

Although the current ratio has declined a little, there is sufficient liquidity (current assets) to fund current liabilities.

FIGURE 12.5 An example of current (working capital) ratio

12.3.2 Control of current assets

Management of current assets is important for monitoring working capital. Excess inventories and lack of control over accounts receivable lead to an increased level of unused assets, leading in turn to increased costs and liquidity problems. Excess cash is a cost if left idle and unused. On the other hand, insufficient inventories and tight credit control policies may also lead to problems.

Control of current assets requires management to select the optimal amount of each current asset held, as well as raising the finance required to fund those assets. The costs and benefits of holding too much or too little of each asset must be assessed. Working capital must be sufficient to maintain liquidity and access to credit (overdraft) to meet unexpected and unforeseen circumstances.

Cash

Cash is critical for business success, and careful consideration must be given to the levels of cash that are held by a business. Cash ensures that the business can pay its debts, repay loans and pay accounts in the short term, and that the business survives in the long term. Supplies of cash also enable management to take advantage of investment opportunities, such as the short-term money market.

Planning for the timing of cash receipts, cash payments and asset purchases avoids the situation of cash shortages or excess cash. Cash shortages can, however, occur due to unforeseen expenses and they are a cost to the business. Money may need to be borrowed, incurring interest and perhaps set-up costs.

Businesses try to keep their cash balances at a minimum and hold marketable securities as reserves of liquidity. Reserves of cash and marketable securities guard against sudden shortages or disruptions to cash flow. An overdraft might also be arranged to allow a business to overdraw its account to an agreed overdraft amount.

Receivables (accounts receivable)

The collection of **receivables** is important in the management of working capital. Consequently, a business must monitor its accounts receivable and ensure that their timing allows the business to maintain adequate cash resources. The quicker the debtors pay, the better the firm's cash position. Procedures for managing accounts receivable include:

- checking the credit rating of prospective customers
- sending customers' statements monthly and at the same time each month so that debtors know when to expect accounts
- following up on accounts that are not paid by the due date
- stipulating a reasonable period, usually 30 days, for the payment of accounts
- putting policies in place for collecting bad debts, such as using a debt collection agency.

The disadvantage of operating a tight credit control policy is the possibility that customers might choose to buy from other firms. The costs and benefits must be weighed up carefully by management.

BizWORD

Receivables *are sums of money due to a business from customers to whom it has supplied goods or services. Receivables are recorded as accounts receivable.*

BizFACT

Poor credit collection policies can increase delays in the receipt of money from accounts receivable and more working capital is needed to cover the shortfall. Non-current liabilities or owners' equity may be needed. The use of long-term liabilities to finance short-term liquidity problems may cause problems for the business in the longer term, as reduced finances mean less profit.

Aged debtors report

Name	Reference no.	Total	30 days	60 days	90 days	> 90 days
Isabella Faro	4671	150.00	150.00	0.00	0.00	0.00
Michael Gray	4784	405.00	405.00	0.00	0.00	0.00
John Flemming	4379	225.00	1650.00	0.00	0.00	1875.00
Anthony Tran	4469	280.00	280.00	0.00	0.00	0.00
Cathy Otter	4832	49.00	49.00	0.00	0.00	0.00
Totals		**1109.00**	**2534.00**	**0.00**	**0.00**	**1875.00**

FIGURE 12.6 One way some businesses manage their receivables is to prepare an aged debtors report. This lists any customers (debtors) that owe the business money, how much they owe the business and how long the payment is overdue. This makes it easy for a business to identify slow payers so that they do not issue them with additional credit until they've paid their outstanding debts.

Inventories

Inventories make up a significant amount of current assets, and their levels must be carefully monitored so that excess or insufficient levels of stock do not occur. Too much inventory or slow-moving inventory will lead to cash shortages. Insufficient inventory of quick-selling items may also lead to loss of customers, and hence lost sales.

Inventory is a cost to the business if it remains unsold: the holding of too much stock means unnecessary expenses (for example, storage and insurance costs). The rate of inventory or stock turnover differs depending on the type of business. For example, a fruit and vegetable merchant has a high turnover and pays for inventory close to the time of sale, whereas a motor vehicle dealer has a much slower stock turnover and usually pays for inventory well before a sale is made.

Businesses must ensure that inventory turnover is sufficient to generate cash to pay for purchases and pay suppliers on time so that they will be willing to give credit in the future.

12.3.3 Control of current liabilities

As previously explained, current liabilities are financial commitments that must be paid by a business in the short term. Minimising the costs related to a firm's current liabilities is an important part of the management of working capital. This involves being able to convert current assets into cash to ensure that the business's creditors (accounts payable, bank loans or overdrafts) are paid.

Payables (accounts payable)

A business must monitor its **payables** and ensure that their timing allows the business to maintain adequate cash resources. The holding back of accounts payable until their final due date can be a cheap means to improve a firm's liquidity position, as some suppliers allow a period of interest-free trade credit before requiring payment for goods purchased. It may also be possible to take advantage of discounts offered by some creditors. This reduces costs and assists with cash flow. Accounts must, however, be paid by their due dates to avoid any extra charges imposed for late payment and to ensure that trade credit will be extended to the business in the future.

Control of accounts payable involves periodic reviews of suppliers and the credit facilities they provide, for example:

- discounts
- interest-free credit periods
- extended terms for payments, sometimes offered by established suppliers without interest or other penalty.

BizFACT

Afterpay is a fairly recent digital service that makes it possible for customers to buy something now and pay it off in fortnightly instalments. The money owed by customers will form part of a business's receivables. Unlike lay-by, customers will get the product straight away and, if they meet the regular repayments, they won't be charged interest. Missing an instalment, however, will result in a $10 fee. This checkout method is quickly gaining popularity in Australia.

BizFACT

The inability to properly manage working capital led to the demise of Dick Smith. An investigation into the collapse found that the company had been purchasing excessive amounts of inventory that was worth less than what they could sell it for. Dick Smith had paid too much for stock that they couldn't sell profitably and their subsequent cash flow shortage made them insolvent.

BizWORD

Payables *are sums of money owed by the business to other businesses from whom it has purchased goods and services. Payables are recorded as accounts payable.*



FIGURE 12.7 According to ASIC poor financial control, including poor bookkeeping, was cited by 33 per cent of owners as the cause of business failure. Business owners need to set up an effective record system so they can accurately trace their accounts payable to ensure they know how much they owe each supplier and they make their payments on time. Failure to properly manage and track payables can lead to late payment penalties, damaged supplier relationships and even business failure.

BizFACT

Businesses view trade credit as cost-free finance. For example, if a business buys goods from a supplier and the account is due for payment in 30 days, the business has 30 days of cost-free finance.

Alternative financing plans should be investigated with suppliers, such as floor plan and consignment finance. Motor vehicle dealers have slow stock turnover and often use floor plan or floor stock finance. This means that suppliers agree to provide the motor vehicles for a period of time before payment is due. Consignment financing is a similar arrangement — goods are supplied for a particular period of time and payment is generally not required until goods are sold. Goods supplied may also be returned if they are not sold within the designated period.

As there are costs involved in providing and receiving credit, businesses may negotiate reduced prices if credit card facilities are used. Costs and benefits in using credit must be determined in the control of accounts payable.

SNAPSHOT



‘. . . nearly three-quarters of all business invoices are paid late.’

Delaying payment to suppliers to improve working capital

The holding back of accounts payable until their due date is one working capital management strategy that firms can use to improve their liquidity. However, many organisations are taking this one step further by paying their invoices late and delaying the payment of suppliers as long as possible. According to the ACCC, many large businesses have adopted this policy in an effort to manage their working capital. In fact, their research revealed that nearly three-quarters of all business invoices are paid late.

A report on trade credit and late payments in Australia was conducted by Dun & Bradstreet in 2017. Their analysis revealed that late payments have increased to their highest level, with businesses waiting an average of 44.9 days for payment. They also found that larger businesses were the slowest to pay invoices. The average late payment time for businesses in 2017 was 15.3 days late but for large businesses, this figure rose to 18.3 days late.

Many large companies have begun to tell their suppliers that their payment schedules will be extended from 30 days to sometimes up to 90 days or beyond. Some examples of high profile businesses delaying payments include Unilever and Nestlé, who average 90 days for repayment, and Kellogg’s who have stretched their payment terms out to a staggering 120 days.

Woolworths has also faced some criticism recently due to their policy of delaying payments to most of their food and grocery suppliers. It currently takes them on average 51 days to settle debts with their suppliers and they are planning to extend this to 60 days in an attempt to improve their own working capital.

While this strategy will help Woolworths improve their liquidity, it has angered many of their suppliers who have admitted that they continuously have to chase invoices to secure payment. It takes Woolworths on average 22 days to sell their products,

so many suppliers feel this practice is unnecessary and that they are effectively being used as a cheap source of finance.

This policy by large corporations has become increasingly common but many small businesses have been too afraid to challenge their big customers and so have accepted whatever payment terms are offered. Kate Carnell, the Australian Small Business and Family Enterprise Ombudsman has recently called for the federal government to lead a campaign to ensure small businesses are paid on time and to introduce laws compelling large businesses to pay suppliers within 30 days. She has also urged the government to introduce additional recommendations requiring large businesses to publicly disclose their payment terms and their performance in relation to those terms.

SNAPSHOT QUESTIONS

1. **Identify** the average time it takes businesses to collect invoice repayments.
2. **Explain** the strategy many large businesses have adopted to improve their working capital.
3. **Assess** the impact of late payments.

Loans

Businesses may need to borrow funds in the short term for a number of purposes. Funds may be required to cover the sale and purchase of property, unforeseen circumstances, and import and export commitments. Short-term loans and bridging finance are important sources of short-term funding for businesses.

Management of loans is important, as costs for establishment, interest rates and ongoing charges must be investigated and monitored to minimise costs. Short-term loans are generally an expensive form of borrowing for a business and their use should be minimised. Control of loans involves investigating alternative sources of funds from different banks and financial institutions. Positive, ongoing relationships with financial institutions ensure that the most appropriate short-term loan is used to meet the short-term financial commitments of the business.

BizFACT

Approximately 23 per cent of SMEs have used a business loan. However, access to loans is a significant barrier for many Australian small businesses. Studies have shown that new businesses rely more heavily on credit cards, family and personal secured bank loans to fund their venture. Interest rates on SME loans are generally higher than those for large businesses and mortgages, which reflect the higher costs and risks associated with bank lending.

Overdrafts

As previously explained, overdrafts are a convenient and relatively cheap form of short-term borrowing for a business. They enable a business to overcome temporary cash shortages. Features of overdrafts differ between banks, but generally involve an arrangement with the bank that the business's account can be overdrawn to a certain amount. Banks may demand the immediate repayment of the overdraft, although this is rare, especially if the business has a good record and a positive relationship with the bank.



FIGURE 12.8 Approximately 19.6 per cent of SMEs use an overdraft, making it still a significant method of financing short-term cash flow. While many owners are tempted to use an overdraft to cover a temporary cash shortfall, they need to be careful of the high interest, charges and variety of fees associated with this form of credit.

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Syllabus area 3
Topic 4
Concept 2

Working capital management: control of assets and liabilities
Summary screen and practice questions

Banks require that regular payments be made on overdrafts and may charge account-keeping fees, establishment fees and interest. Interest payable for an overdraft is usually less than that for a loan. Bank charges do, however, need to be carefully monitored, as charges vary depending on the type of overdraft established. Businesses should have a policy for using and managing overdrafts and monitor budgets on a daily or weekly basis so that cash supplies can be controlled.

12.3.4 Strategies for managing working capital

Businesses use a number of strategies to manage working capital, which is required to fund the day-to-day operations of a business. Strategies for working capital management include:

- leasing
- sale and lease-back.

BizWORD

Leasing *involves the payment of money for the use of equipment that is owned by another party.*

Leasing

Leasing involves the payment of money for the use of equipment that is owned by another party. A lease is a contract between the lessor (owner of the asset) and the lessee (user of the asset) that lets the lessee rent an asset for a period of time in exchange for periodical payments.

Some advantages of leasing include:

- The cash outflows (payments) related to leasing are spread over several years as opposed to the one-off large initial cash outflow that would occur if the business had to purchase the asset outright. This helps improve working capital.
- It allows the business to make use of good quality assets, which might have been unaffordable or expensive if they had to purchase them outright.
- Lease payments are considered operating expenses and are therefore tax deductible.
- It allows businesses the flexibility to upgrade to new and better assets as and when it is necessary without having to make a large cash outlay purchasing new equipment once an asset becomes outdated.
- It reduces the risk of technological obsolescence since the leased asset can be upgraded.
- Depending on the terms of the agreement, it reduces the risk of unpredictable costs associated with the repairs and maintenance of equipment.
- The lease payments help with cash flow forecasting and budgeting as the payments are fixed for a specified time. Businesses will know at the outset what the payments will be for the duration of the lease and the repayments won't fluctuate over time like other forms of borrowing.

BizFACT

In 2015, Woolworths raised $15.3 million through the sale and lease-back of 10 Woolworths Petrol stations. The rationale was to use the cash that was tied up in owning the assets and the funds raised for other developments across the business. The petrol stations were sold with long-term leases to Woolworths. 7-Eleven also raised more than $200 million in sale and lease-back deals.

BizFACT

Village Roadshow, Gold Coast theme park owner, made a decision in 2017 to sell the land that is home to Warner Bros. Movie World and Wet'n'Wild theme parks. They were hoping to make $100 million on the sale. As part of the deal, Village Roadshow will lease back the land so they can continue operating the parks for at least the next 30 years.

BizWORD

Sale and lease-back *refers to the process of selling an owned asset to a lessor and then leasing the asset back through fixed payments for a specified period of time.*

Sale and lease-back

Sale and lease-back refers to the process of selling an owned asset to a lessor and then leasing the asset back through fixed payments for a specified period of time. The lessor retains ownership of the asset as part of the agreement. The biggest advantage of sale and lease-back is that it helps improve a business's liquidity since it enables the business to receive a large cash injection from the sale of the asset, which can then be used as working capital if the business is experiencing a cash shortfall. The business still continues to benefit from the use of the asset. This strategy shares many of the same advantages as leasing.

Cash cows fund China dairy firm that defied stock market slump

By Lisa Pham (Bloomberg) — 25 May 2016 — with assistance from Moxy Ying

In the creative world of Chinese lending, there's a new trade in town: the cow leaseback.

China Huishan Dairy Holdings Co., which operates the largest number of dairy farms in the country, is selling about a quarter of its herd — some 50,000 animals — to Guangdong Yuexin Finance Lease Co. for 1 billion yuan (US$152 million) and then renting them back.

With an estimated US$1.3 trillion of risky loans in the country, Chinese banks are becoming more cautious about lending, forcing some companies to look for new ways to borrow. Finance leasing has been growing in popularity, especially for purchases of equipment.

But cows?

'It's not very common to use cows as collateral', said Robin Yuen, an analyst at RHB OSK Securities Hong Kong Ltd. 'The value of a cow would fluctuate depending on milk prices and other factors, so it's a risky asset for lenders. It would be hard to do forced selling — there's no liquid market for a large number of cows.'

In Huishan Dairy's case, an increasingly common one in a China of rising debts, slumping commodity prices and the propensity of Chinese executives to use their shares as collateral for private loans.

…

That's fine if the shares are rising, but in the volatility of the past year, many stocks slumped, prompting lenders who held them as guarantees for loans to demand the borrower supply more collateral.

'Huishan Dairy seems to be selling cows and leasing them back in order to raise money now, because they've been using cash to buy back shares', said RHB's Yuen, who has a 'sell' rating on the stock. 'The chairman wants to prop up the share price for reasons that are unclear. It could be a way to get better terms for share pledged-based loans, which he's done before.'

Company Chairman Yang Kai has been building up his stake in the company to almost 74 per cent, according to the latest disclosure of interests to the stock exchange. 'Yang pledged shares he owned to Ping An Bank Co. to finance the buybacks', RHB said in a research note on 28 January 2016.

Meanwhile, the company itself spent HK$1.93 billion (US$249 million) buying back 820.2 million shares in the six months ended September, equivalent to almost twice its cash from operations for the same period.

…

The share buybacks helped Huishan Dairy's share price jump 72 per cent since the beginning of July, even as Hong Kong's benchmark Hang Seng Index fell 22 per cent.

Still, keeping the stock price buoyant drained cash as milk prices were slumping and the company's debts were rising. Huishan had 10.4 billion yuan of bank loans at the end of September, with more than half needing to be repaid within a year. The value of short-term bank loans had more than doubled compared to six months earlier.

Whole milk powder prices, meanwhile, have plunged, with the latest GlobalDairyTrade auction price of US$2252 a metric ton on 17 May 2016 down 57 per cent from a peak in April 2013.

So the company turned some of its cows into cash, leasing them back through a unit at an annualised interest rate of as much as 6.2 per cent, with an option to repurchase the cattle at the end of the five years.

. . .

As dairy cows are typically slaughtered after about five years, when their production declines, the agreement included provisions to cull and replace animals regularly.

'Huishan Dairy's gearing was more than 60 per cent last year, so it's not a bad idea for the company to get a loan for working capital', said Anson Chan, an analyst

SNAPSHOT



'. . . there's a new trade in town: the cow leaseback.'

at Daiwa Capital Markets, who also recommends investors 'sell' the shares. 'The interest rate for the finance lease is lower than the company's current bank loans.'

The growth of finance leasing in China is partly a reflection of the broadening of the nation's banking system. 'Most contracts involve the leaseback of equipment', said Shujin Chen, a banking analyst at DBS Vickers Hong Kong Ltd. They totalled about 4 trillion yuan at the end of 2015, with the percentage of equipment purchased by finance leasing at about 7 per cent to 8 per cent, compared to only 1 percent in 2008, she said.

'Finance leases offer tax advantages, asset flexibility and cash flow certainty', Chen said in an e-mail. In China they account for around 4 per cent to 5 per cent of bank loans, compared with about 22 per cent in 2013 in the United States, where cow leasing has fallen out of favour.

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SNAPSHOT QUESTIONS

1. **Outline** how Huishan Dairy Holdings Co. manages their working capital.
2. **Assess** the impact of the strategy outlined in question 1.

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Syllabus area 3
Topic 4
Concept 3

Working capital management strategies
Summary screen and practice questions

SUMMARY

- Working capital refers to the funds available for the short-term financial commitments of a business.
- Net working capital is the difference between current assets and current liabilities. It represents those funds that are needed for the day-to-day operations of a business to produce profits and provide cash for short-term liquidity.
- Control of current assets refers to the management process that determines the optimal amount of each current asset held. This includes:
  - *cash*. Careful consideration must be given to the levels of cash that are held by a business.
  - *receivables*. A business must monitor its accounts receivable and ensure their timing allows the business to maintain adequate cash resources.
  - *inventories*. The level of inventory must be carefully monitored so that excess or insufficient levels of stock do not occur.
- Control of current liabilities refers to the management process that determines the optimal amount of each current liability held. This includes:
  - *payables*. A business must monitor their accounts payable and ensure their timing allows the business to maintain adequate cash resources.
  - *loans*. Businesses may need to borrow funds in the short-term for a number of purposes. The management of these loans is important.
  - *overdrafts*. This is a relatively cheap and convenient form of short-term borrowing that can be used to cover a temporary cash shortage.
- Other strategies for managing working capital include:
  - leasing — a contract between the lessor (owner of the asset) and the lessee (user of the asset) that lets the lessee rent an asset for a period of time in exchange for periodical payments
  - sale and lease-back — the process of selling an owned asset to a lessor and then leasing the asset back through fixed payments for a specified period of time.

EXERCISE 12.2 REVISION

1 **Distinguish** between working capital and net working capital.

2 **Why** is working capital important to a business?

3 'Too much working capital is as bad as not enough working capital.' **Interpret** this statement.

4 **Construct** a diagram to **demonstrate** the working capital cycle of a business that sells computers and computer software, and provides repair services for

computer hardware. The business generates $3 million in sales, $1 million in repairs; it has inventory valued at $500 000, accounts receivable to the value of $230 000, accounts payable to the value of $44 000 and $58 000 in cash.

5 **Why** is the current (working capital) ratio important?

6 **Outline** working capital management strategies businesses can implement to control their current assets.

7 **Outline** working capital management strategies businesses can implement to control their current liabilities.

8 **Discuss** the working capital management strategy of leasing.

9 **Explain** how sale and lease-back can improve a business's working capital.

10 (a) **Clarify** what a current ratio of 3.5:1 (350 per cent) represents.
(b) **Explain** whether this is a satisfactory or unsatisfactory ratio. (N.B. Take care with this question.)

11 **Why** is the management of cash so important to a business?

12 KJ Carpet Cleaning operates on a cash-only basis.
(a) **Describe** the working capital cycle for KJ Carpet Cleaning.
(b) **Determine** what the advantages and disadvantages are of cash only for KJ.

13 Simon and Kim's Drafting Services has a wide client base and 90 per cent of their fees are on credit. Simon and Kim allow 90 days payment of their drafting services.
(a) **Identify** what potential problems in relation to their credit policy that Simon and Kim's Drafting Services might experience.
(b) **Propose** the recommendations you would make to the business.

14 Using the information for a soft toys manufacturer below, answer the following questions.
(a) **Calculate** the amount of working capital for the business.
(b) **Outline** the apparent success of managing accounts receivable (all sales are on credit).
(c) **Identify** the amount of inventory in relation to working capital.
(d) **Identify** the amount of cash retained in the business.
(e) **Propose** the recommendations you would make to management in relation to the management of current assets.
(f) **Calculate** the current ratio and comment on the level of the ratio.
(g) If the ratio for the previous two periods was, respectively, 220 per cent and 240 per cent, **deduce** the trend.
(h) **Calculate** the current liabilities of the business and **recommend** how to manage its liabilities in the future. (Hint: consider that the business may choose to expand in size.)

Financial status of soft toy manufacturer	
Cash	5 900
Inventory	2 800
Accounts receivable	2 500
Plant and equipment	45 000
Accounts payable	4 200
Long-term loans	20 000

15 Answer the following questions by referring to the aged debtors report in figure 12.6.
(a) **Identify** which debtor owes $49.
(b) **Identify** which debtor is taking the longest to repay their debt. How many days is their repayment overdue?
(c) **How** much money is 30 days overdue?

EXERCISE 12.2 EXTENSION

1 'Over-investment in working capital ties up cash flow.' 'Under-investment in working capital reduces profits.' **Analyse** these statements.

2 **How** do inflation and fluctuating business cycles affect working capital?

3 **Explain**, with examples, how cash flow relates to working capital management.

4 **How** might a business have a high current ratio but experience difficulties in finding cash to pay its suppliers?

5 **Create** a report to management with recommendations on controlling assets to manage working capital.

6 Find information online about the services of the Commonwealth Bank.
(a) **Create** a concept map that includes the main services provided by this institution to financially assist businesses. (Hint: this includes a lot more than just loans.)
(b) Use the calculator provided on the Commonwealth Bank website to compare the business credit card options. **Recommend** and **justify** one credit card option for a small business of 20 employees.

on Resources

Weblink: Commonwealth Bank

12.4 Profitability management

BizWORD

Profitability management *involves the control of both the business's costs and its revenue.*

Profitability management involves the control of both the business's costs and its revenue. Accurate and up-to-date financial data and reports are essential tools for effective profitability management.

12.4.1 Cost controls

Most business decisions — for example, to open a new store or buy a new piece of machinery — are influenced by costs. The costs associated with a decision need to be carefully examined before it is implemented.

Fixed and variable costs

Before a business can control its costs, management must have a clear understanding of what those costs are. As outlined in chapter 2, businesses generally have fixed costs and variable costs.

BizWORD

Fixed costs *are those that are not dependent on the level of operating activity in a business. Fixed costs do not change when the level of activity changes — they must be paid regardless of what happens in the business.*

Variable costs *are those that vary in direct relationship to the levels of operating activity or production in a business. Such costs include labour costs and costs of energy.*

Fixed costs are not dependent on the level of operating activity in a business. Fixed costs do not change when the level of activity changes — they must be paid regardless of what happens in the business (see figure 12.9). Examples of fixed costs are salaries, depreciation, insurance and lease. (In reality, fixed costs can change — for example, if new premises are needed then leasing costs will increase — but, once the changes are made, the costs again become fixed.)

Variable costs are those that vary in direct relationship to the levels of operating activity or production in a business. Such costs include labour costs and costs of energy (see figure 12.9). For example, materials and labour used in the production of a particular item are variable costs, because they are often readily identifiable in a business and can be directly attributable to a particular product.

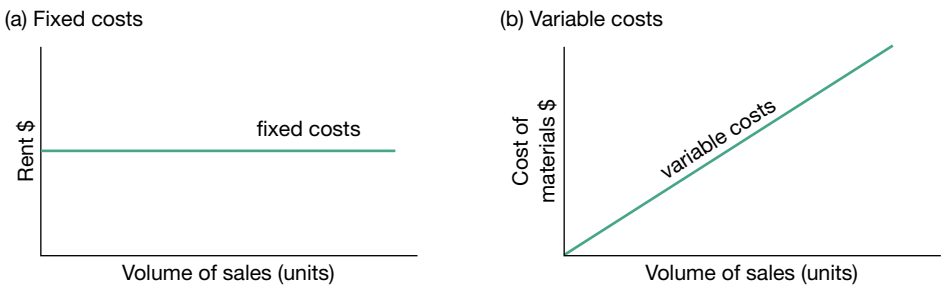


FIGURE 12.9 A simplified illustration of (a) fixed costs and (b) variable costs

Monitoring the levels of both fixed and variable costs is important in a business. Changes in the volume of activity need to be managed in terms of the associated changes in costs. Comparisons of costs with budgets, standards and previous periods ensure that costs are minimised and profits maximised.

Cost centres

A business's costs must be accounted for and management needs to be able to identify their source and amounts. A number of costs can be directly attributable to a particular department or section of a business, and these are termed **cost centres**. A cost centre is a department within a business that is responsible for a particular set of activities that benefits the organisation. By treating the cost centre as a separate unit, the business can measure how much they are spending on that function each year. It allows management to measure, budget and control costs for each specific function.

The use of cost centres helps management utilise resources more efficiently as it gives them a better understanding of how those resources are being used. The main function of a cost centre is to track expenses. Monitoring expenses through the use of cost centres allows for greater control of total costs. Examples of cost centres include the IT department, human resources department, accounting department and maintenance staff. Cost centres are not limited to departments, however, in some instances there may be several cost centres within one department. For instance, within the manufacturing department, each assembly line could be a cost centre.

BizWORD

Cost centres *are particular areas, departments or sections of a business to which costs can be directly attributed.*

studyon

Syllabus area 3
Topic 4
Concept 4

Profitability management: cost controls
Summary screen and practice questions

Expense minimisation

Profits can be weakened if the expenses of a business are high, as they consume valuable resources within a business. Guidelines and policies should be established to encourage staff to minimise expenses where possible. Savings can be substantial if people take a critical look at costs and eliminate waste and unnecessary spending.

Case study: IKEA cutting costs

While many retailers devote a lot of time trying to figure out how to charge more for their goods, IKEA's success has been based on the relatively simple idea of minimising costs. They pursue a cost leadership strategy and are constantly trying to do everything a little simpler, more efficiently and cost effectively.

Five ways IKEA minimises costs include:

- *design.* IKEA's designs are simple, functional and efficient to manufacture in large mass-produced batches. IKEA uses fewer low-cost materials and their pieces are designed to include minimal parts in order to cut down on supplier and manufacturing costs.
- *supplier partnerships.* IKEA established long-term partnerships with their suppliers and order supplies in high volumes to take advantage of economies of scale and keep costs down.
- *packaging*. All their pieces are designed so that they can be packaged efficiently. IKEA pioneered the flat-pack model for their furniture. Their furniture is sold in pieces that are placed into convenient and efficient flat packages, which take up less room in trucks and maximise the number of products that can be shipped. Since their packages are flat, trucks are filled to maximum capacity, which saves on fuel and transportation costs. They also save on storage costs since each piece of furniture takes up less space in their warehouse.
- *location*. IKEA stores are generally located outside major city centres (although within driving distance) where huge spaces of land can be acquired cheaper.
- *production*. IKEA mass produces a limited number of products in order to achieve economies of scale.

SNAPSHOT QUESTIONS

1. **Summarise** IKEA's expense minimisation strategies.
2. **Explain** the effect of these strategies on IKEA's profitability.

SNAPSHOT



'. . . IKEA's success has been based on . . . minimising costs.'

12.4.2 Revenue controls

BizFACT

Budgets and cost-volume-profit analysis are the tools used in the control of revenue.

Revenue is the income earned from the main activity of a business. For most businesses, revenue comes from sales or, in the case of a service business, from fees for professional services or commission. In determining an acceptable level of revenue with a view to maximising profits, a business must have clear ideas and policies, particularly about its marketing objectives including the sales objectives, sales mix or pricing policy.

Marketing objectives

Marketing strategies and objectives should lead to an increase in sales and hence an increase in revenue. Sales objectives must be pitched at a level of sales that will cover costs, both fixed and variable, and result in a profit. A cost-volume-profit analysis can determine the level of revenue sufficient for a business to cover its fixed and variable costs to break even, and predict the effect on profit of changes in the level of activity, prices or costs.

Changes to the sales mix can affect revenue (see figure 12.10). Businesses should control this by maintaining a clear focus on the important customer base on which most of the revenue depends before diversifying or extending product ranges or ceasing production on particular lines. Research should be carried out to identify the potential effects of sales-mix changes before decisions are made.



FIGURE 12.10 Changes to the sales mix can affect revenue. In 2016, McDonald's introduced its all-day breakfast menu. Same-store sales increased over 5 per cent after this alteration to the sales mix was introduced. The menu change clearly paid off.

BizFACT

Profit is what remains after all business costs have been deducted from sales revenue.

Pricing policy affects revenue and, therefore, affects working capital. Pricing decisions should be closely monitored and controlled. Overpricing could fail to attract buyers, while underpricing may bring higher sales but may still result in cash shortfalls and low profits. Factors that influence pricing include:

- the costs associated with producing the goods or services (materials, labour, overheads)
- prices charged by the competition
- short- and long-term goals — for example, if the business aims to improve market share over a five-year period, prices may be reduced
- the image or level of quality that people associate with the goods or services
- government policies.

Profitability — pricing

Working out the best price to charge for your products or services can be one of the biggest challenges you face, particularly when starting out. Price too low, and you'll be out of business before you know it; price too high, and you're out of the market. Get your pricing just right, however, and you'll maximise your profits.

There's no magic formula that can help you to price perfectly, but there are several basic principles, and if you take the time to apply them, you can hit the sweet spot.

Selling yourself short

Underpricing is rife in small businesses, particularly service businesses with low overheads. The logic goes that if you can afford to charge less, you should.

Stephen Craft, who runs a specialist financial copywriting business, learnt this the hard way. Despite writing about finance for a living, he made the same pricing mistake as many other small businesses:

'When I first ran my own business, I set my rates by looking at similar small businesses,' he says. 'I had lower overheads, so I figured that I could undercut them and still come out ahead. Later, I went to work in-house for one of my largest clients. Then I discovered what they were really willing to pay for what I did — and it was a lot more than I'd been charging.

'It turned out that my competitors were not who I thought they were [other small businesses]. My client had been comparing me to big companies with high overheads and heavy workloads. For my client, the big attraction of my business was speed and responsiveness. Not price.'

Apples vs oranges

The key point here is to know what you're really selling. Is it your product or service? Or is it something else, like convenience, speed or reliability? In other words, what is your unique selling proposition (USP)?

Quite simply, price is not always the most important factor for a customer. Once you understand your USP and your customer, you can charge accordingly. Value might mean improving your service, rather than charging lower prices.

You need to know how sensitive your market is generally to changes in price. Can you increase prices without losing business? Or can you drive extra sales with a small reduction in prices? Are you in a niche market where your customers are not particularly price-sensitive?

You also need to determine whether you're running a low-margin, high-turnover business or a high-margin, lower-turnover business. The former will be priced for sales, the latter for profit.

The numbers game

Once you've got a handle on your USP, and your market, it's time to look at the numbers.

First you need to know your costs. Your pricing may ultimately be determined by other factors discussed already in section 12.4.2, but your costs are a crucial benchmark. Your variable costs are the cost price of a product (or an hour's wages, for a service business). Your fixed costs include things like rent, wages, interest payments and all the other bills you have to pay. Don't forget to include the real costs of labour, such as leave, Super, and so on. And don't discount your own time.

Your break-even point is when revenues (the income from your sales) exactly cover your expenses. Everything over that is profit.

Profit margins

In the end, what you're after is profit. Depending on the type of business you're in, you should know what's a realistic profit margin. So when you price your products or services, you add mark-ups to their total cost (that's both fixed and variable costs) to give you the profit margin that you want. (*Note:* mark-up is what you add to the cost; margin is a percentage of the selling price.)

SNAPSHOT



'Quite simply, price is not always the most important factor for a customer.'

Table 1 shows the mark-up you need to apply (as a percentage of cost price) to achieve your desired margin.

Of course, you can't just decide that you want a 50 per cent profit margin. Whatever profit margin you're aiming for, you need to know that the market will take it.

TABLE 1 The mark-up you need to apply (as a percentage of cost price) to achieve your desired margin

Margin % of selling price	Mark-up % of cost price
5	5.3
10	11.1
15	17.1
20	25
25	33.3
30	42.9
35	53.9
40	66.7
45	81.82
50	100

'In most cases, you can't just increase your prices on a whim.'

Discounting: yay or nay?

In most cases, you can't just increase your prices on a whim. Likewise, you should think hard before discounting. There are going to be times for many businesses when discounting is appropriate — you may be happy to charge a lower hourly rate for a client who is going to pay a retainer or bring a lot of business, or you may discount to clear end-of-season stock. But be clear-headed — if you have to cut prices to win a customer, is this a customer you want?

If you're discounting to drive sales, you need to know how much your sales have to increase after a price cut for you to break even. Table 2 can help with this.

TABLE 2 Price discounts: percentage increase in sales to break even after a price cut

	Current gross profit margin							
Price cut (%)	**10**	**20**	**30**	**40**	**50**	**60**	**70**	**80**
5	100.0	33.3	20.0	14.3	11.1	9.1	7.7	6.7
10		100.0	100.0	33.3	25.0	20.0	16.7	14.3
15		300.0	100.0	60.0	42.9	33.3	27.3	23.1
20			200.0	100.0	66.7	50.0	40.0	33.3
25			500.0	166.7	100.0	71.4	55.6	45.5
30				300.0	150.0	100.0	75.0	60.0
35				700.0	233.3	140.0	100.0	77.8
40					400.0	200.0	133.3	100.0
45					900.0	300.0	180.0	128.6
50						500.0	250.0	166.7

Source: © 'The price is right or is it?', by Tiffany Hutton, *Dynamic Business Magazine*, March 2011, pp. 28

A final word

In the end, your pricing decisions have to be your own. Don't be tempted to follow the pricing strategy of a competitor — no matter how similar they may appear, your business is unique, with its own cost structures and customer base, so it deserves its own pricing strategy.

SNAPSHOT QUESTIONS

1. **Outline** what is meant by underpricing and **explain** why it is detrimental to long-term success for a business.
2. **Explain** the importance of a business understanding its unique selling position (USP) and how this relates to pricing and profit.
3. **Explain** how the pricing process is ultimately decided by a business.
4. **Outline** the meaning of profit margin and how this relates to the market in which the business operates.
5. **Explain** discounting and **identify** the factors that must be considered before a business undertakes this as a pricing option.

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Syllabus area 3
Topic 4
Concept 5

Profitability management: revenue controls
Summary screen and practice questions

12.5 Global financial management

12.5.1 Comparing the risks involved in domestic and global financial transactions

The growth of global business has resulted in economic expansion for many countries, as well as bringing extra concerns.

Financial risks were examined in section 11.2.4. Global businesses, however, bring extra concerns and risks for financial managers — in particular, currency fluctuations/exchange rates, interest rates, methods of international payment, hedging and derivatives.

Financial risks associated with global expansion are greater than those encountered domestically, but such risk taking is necessary for the business strategy to be implemented.

Largely 'uncontrollable' financial influences include currency fluctuations, interest rates and overseas borrowing. 'Uncontrollable' means that these influences are part of the external business environment and may not be significantly controlled by the business. However, a business can put in place appropriate financial management strategies to minimise their negative effects.

One of the most difficult financial influences to manage is currency (exchange rate) fluctuations.

BizFACT

A number of larger financial institutions offer a range of services to facilitate the financial management of global business.

12.5.2 Exchange rates

Countries have their own currency, which they use for domestic purposes. This means that when transactions are conducted on a global scale, one currency must be converted to another. For example, if an Australian business (importer) purchases machinery from Japan, the Japanese firm (exporter) will want to be paid in Japanese yen, not Australian dollars. Similarly, if a Japanese tourist visits Australia, he or she will pay for accommodation, restaurant meals and other products in Australian dollars, not yen. Therefore, in all global transactions it is necessary to convert one currency into another. This transaction is performed through the **foreign exchange market**, commonly abbreviated to **forex** or **fx**, which determines the price of one currency relative to another.

BizWORD

*The **foreign exchange** (**forex** or **fx**) **market** determines the price of one currency relative to another.*

Foreign exchange dealers around the world are constantly buying and selling each other's currency. In this way, the price or value of each country's currency is established. This value or price is called the exchange rate.

The **foreign exchange rate** is the ratio of one currency to another; it tells how much a unit of one currency is worth in terms of another. For example, if A$1 = US$0.70, that means one Australian dollar is worth 70 US cents. Conversely, one US dollar would be worth A$1.43.

BizWORD

*The **foreign exchange rate** is the ratio of one currency to another; it tells how much a unit of one currency is worth in terms of another.*



FIGURE 12.11 Foreign exchange trading involves the buying of one currency and the selling of another currency in an attempt to make a profit. This is done by speculating on the value of one currency in comparison to another. Foreign currencies can be traded because exchange rates fluctuate all the time. Foreign exchange trading is very complex and risky since it is extremely difficult to predict movements in currencies.

Effects of currency fluctuations

BizWORD

An **appreciation** *is an upward movement of the Australian dollar (or any other currency) against another currency.*

Exchange rates fluctuate over time due to variations in demand and supply.

Such fluctuations in the exchange rate create further risk for global business. For example, suppose that the value of the Australian dollar rises from US$0.70 to US$0.95. This upward movement of the Australian dollar (or another currency) against the US dollar is called an **appreciation**. (Of course, this means that the

value of the US dollar has decreased against the Australian dollar, with one US dollar being worth A$1.05.)

The impact of this currency fluctuation is twofold:

1. A currency appreciation raises the value of the Australian dollar in terms of foreign currencies. This means that each unit of foreign currency buys fewer Australian dollars. However, one Australian dollar buys more foreign currency. Therefore, an appreciation makes our exports more expensive on international markets but prices for imports will fall. The result of the appreciation, therefore, reduces the international competitiveness of Australian exporting businesses.
2. A currency depreciation has the opposite impact. A depreciation lowers the price of Australian dollars in terms of foreign currencies. Therefore, each unit of foreign currency buys more Australian dollars. The result is that our exports become cheaper and the price of imports will rise.

A depreciation, therefore, improves the international competitiveness of Australian exporting businesses.

Currency fluctuations, therefore, significantly impact on the profitability of global businesses. When revenues and expenses are transferred between nations, the exchange rate can either increase or decrease their value. Currency fluctuations will also affect the business's ability to meet their financial objectives.

BizFACT

In 2017, the Australian dollar increased above US$0.80, its highest level since 2015. This result was a combination of the US dollar getting weaker against most other major currencies, as well as a renewed demand for Australia's raw commodities, in particular iron ore. The Australian dollar was also stronger against the Japanese yen.

12.5.3 Interest rates

A business that plans to either relocate offshore or expand domestic production facilities to increase direct exporting will normally need to raise finance to undertake these activities. A global business has the option of borrowing money from financial institutions in Australia, or they can borrow money from financial markets overseas. Traditionally, Australian interest rates tend to be above those of other countries, especially the United States and Japan. Thus, Australian businesses could be tempted to borrow the necessary finance from an overseas source to gain the advantage of lower interest rates.

However, the real risk here is exchange rate movements. Any adverse currency fluctuation could see the advantage of cheaper overseas interest rates quickly eliminated. In the long term, the 'cheap' interest rates may end up costing more. Changes in interest rates will therefore have a major impact on a business's profitability if they have borrowed money from finance markets overseas.

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Syllabus area 3
Topic 4
Concept 6

Global business management: issues
Summary screen and practice questions

12.5.4 Methods of international payment

One of the most crucial aspects of global financial management is to select an appropriate method of payment. Payment can be complicated by the fact that the business may be dealing with someone they have never seen, who speaks another language, uses a different monetary system, who abides by a different legal system and/or who may prove difficult to deal with if problems occur later on. One major worry for the exporter is that if the products are shipped before payment is received, there may be no guarantee that the importer will pay.

On the other hand, the buyer is faced with a similar situation. The importer may worry that if payment is sent before the products are received, there is similarly no guarantee that the exporter will send the products. This dilemma is as old as global business itself. Neither party completely trusts the other.

To solve this problem, a method of payment using a third party, who both parties trust, is required. This third party is normally a bank, which acts in an intermediary role. Figure 12.12 provides a simple explanation of the payment procedures when a product is exported from Australia to Japan. Note how both parties agree to the contract price being written in US dollars.

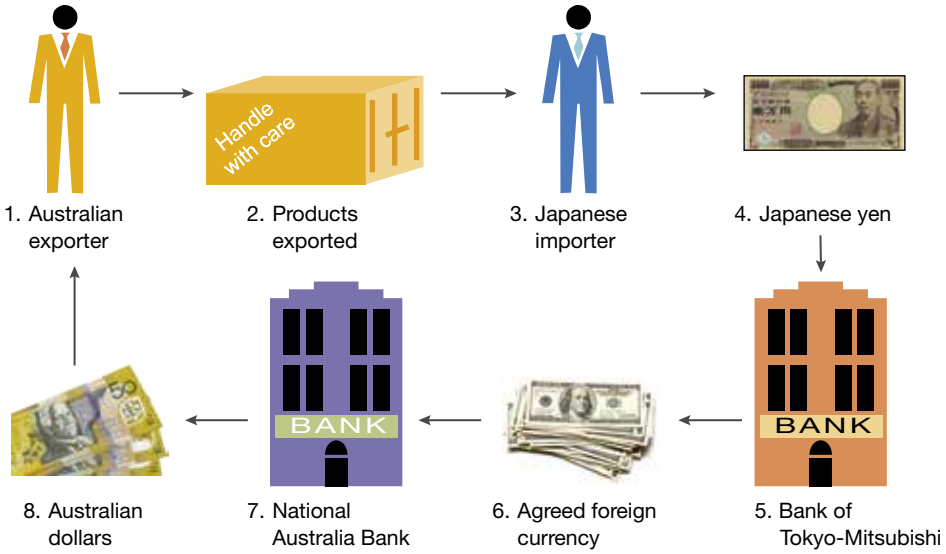


FIGURE 12.12 Simple international payment system showing the intermediary role of banks

There are four basic methods of payment from which a business can select:

- payment in advance
- letter of credit
- clean payment
- bill of exchange.

The option selected will largely depend on the business's assessment of the importer's ability to pay — that is, the importer's creditworthiness. Of course, as with all financial transactions, each method carries varying degrees of risk, especially when credit payments are involved (see figure 12.13).

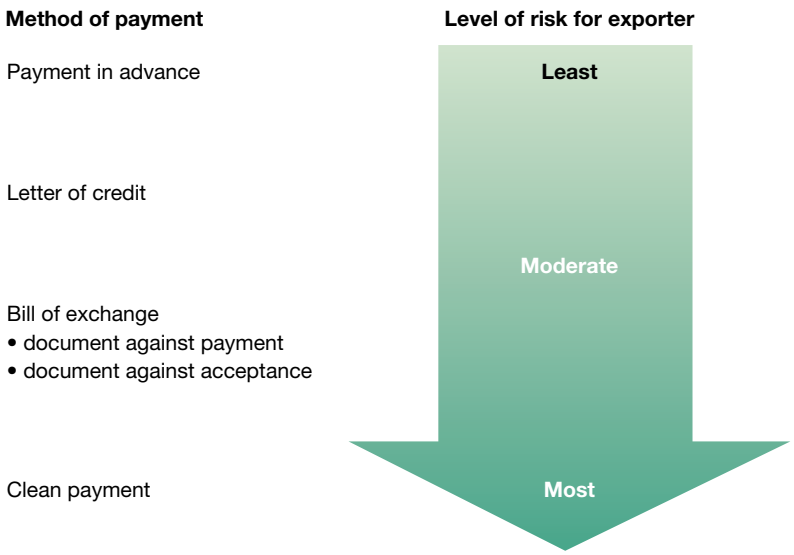


FIGURE 12.13 Degree of credit risk for different methods of international payment

The following section discusses the different methods of payment in order of increasing risk to the exporter.

BizWORD

The **payment in advance** *method allows the exporter to receive payment and then arrange for the goods to be sent.*

Payment in advance

The **payment in advance** method allows the exporter to receive payment and then arrange for the goods to be sent. This method exposes the exporter to virtually no risk and is often used if the other party is a subsidiary or when the credit worthiness

of the buyer is uncertain. However, very few importers will agree to these terms because it exposes them to the most risk. Furthermore, they have no guarantee that they will receive what they ordered.

Letter of credit

In order to ensure that payment will be received, sometimes exporters will require the importer to have a letter of credit confirmed by a secure bank. A **letter of credit** is a document that a buyer can request from their bank that guarantees the payment of goods will be transferred to the seller. The letter of credit is issued by the importer's bank to the exporter promising to pay them a specified amount once certain conditions have been met. In order for the payment to occur, the seller has to present the bank with the necessary documents proving shipment of the goods.

In all but exceptional circumstances, once the bank has made such a commitment it cannot be withdrawn. In the event that the buyer cannot make the payment, the bank will then be required to cover the purchase. Therefore, the bank will only issue a letter of credit if they know the buyer will pay. Some banks require buyers to deposit or have enough money to cover the payment or else they allow the buyers to use a line of credit.

Only payment in advance offers less risk and, for this reason, a letter of credit is very popular with exporters. This is because it relies on the overseas bank rather than the importer.

BizWORD

*A **letter of credit** is a document that a buyer can request from their bank that guarantees the payment of goods will be transferred to the seller. The letter of credit is issued by the importer's bank to the exporter promising to pay them a specified amount once certain conditions have been met.*

Clean payment

A type of **clean payment** is an open account payment method. Under this method, the exporter ships the goods directly to the importer before payment is received. The importer therefore doesn't send the payment until after they receive the goods. The goods are usually shipped with an invoice requesting payment at a certain time after delivery. This is typically 30, 60 or 90 days. The time the exporter gives the buyer to pay for the goods is called the credit term. This method is usually only used when the exporter is confident that the importer will pay by the agreed time. This method of payment is obviously one of riskiest for exporters; however, it is one of the most advantageous options for an importer.

BizWORD

*A **clean payment** occurs when the exporter ships the goods directly to the importer before payment is received.*

Bills of exchange

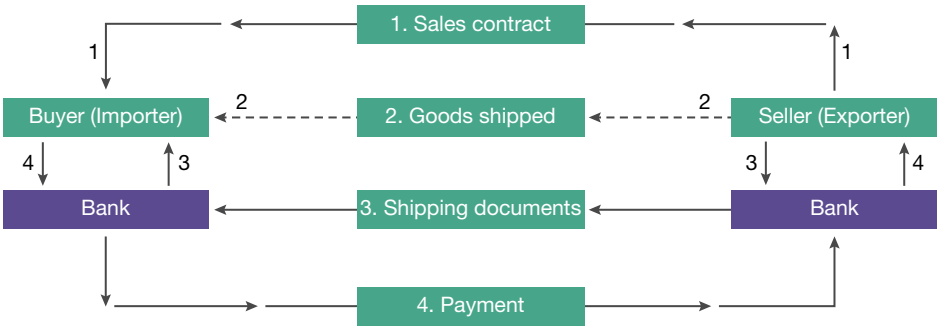
A bill of exchange is a document drawn up by the exporter demanding payment from the importer at a specified time. This method of payment is one of the most widely used and allows the exporter to maintain control over the goods until payment is either made or guaranteed.

There are two types of bill of exchange.

1. *Document (bill) against payment*. Using this method, the importer can collect the goods only *after* paying for them. The exporter draws up a bill of exchange with his or her Australian bank and sends it to the importer's bank along with a set of documents that will allow the importer to collect the goods. The importer's bank hands over the documents only after payment is made. The importer's bank then transfers the funds to the exporter's bank.
2. *Document (bill) against acceptance*. Using this method, the importer may collect the goods *before* paying for them. The same process applies as with documents against payment, except the importer must sign only acceptance of the goods and the terms of the bill of exchange to receive the documents that allow him or her to pay for the goods at a later date.

BizFACT

Countertrade is becoming more popular as a trading or payment system, similar to bartering.



1. Seller and buyer agree terms and enter into a sales/purchase contract.
2. Goods are shipped.
3. Seller presents shipping documents through the banking system. Generally buyers are unable to take delivery of the goods until they have these shipping documents (this does not normally apply to airfreights shipments).
4. Per contracted payment terms, the buyer pays immediately (a 'sight' payment, sometimes known as Docs against Payment — D/P) or formally agrees to pay at a future date (a 'term' payment, sometimes known as Docs against Acceptance — D/A). Upon payment or acceptance documents are released to the buyer to enable them to obtain the goods.

FIGURE 12.14 How bills of exchange work

The risk of non-payment or payment delays when using a bill of exchange is always greater than for a letter of credit. However, documents against acceptance expose the exporter to much greater risk than documents against payment. The risk with documents against payment is that the importer may not collect the documents nor pay for the goods. With documents against acceptance there is the risk the importer may delay payment or not pay at all.

12.5.5 Hedging

When two parties agree to exchange currency and finalise a deal immediately, the transaction is referred to as a spot exchange. Exchange rates determining such 'on-the-spot' transactions are referred to as spot exchange rates. The **spot exchange rate** is the value of one currency in another currency on a particular day. Therefore, when an Australian tourist in Tokyo goes to a bank to convert her dollars into yen, the exchange rate is the spot rate for the day.

Although there are situations when it is necessary to use a spot rate, it may not be the most favourable rate. As explained previously in this section, exchange rates can change constantly. Such currency fluctuations can be a cause of real concern since they can increase costs for businesses and therefore lead to a reduction in profits. However, it is possible for businesses to minimise the risk of currency fluctuations. This process is referred to as **hedging**. Hedging refers to the process of minimising the risk of currency fluctuations to help reduce the level of uncertainty involved with international financial transactions.

BizWORD

*The **spot exchange rate** is the value of one currency in another currency on a particular day.*

BizWORD

***Hedging** is the process of minimising the risk of currency fluctuations.*

BizFACT

Michael Heyman, who runs Roman Camping Equipment, regularly hedges his currency exposure. Heyman sources camping products from overseas to sell in his store for a set price. If he doesn't hedge, some products may end up costing more than the prices he has set, which will mean he ends up losing money. Without hedging, Heyman will not know his costs and this will affect his profit margin.

Natural hedging

A business may adopt a number of strategies to eliminate or minimise the risk of foreign exchange exposure. In this way the business provides itself with a natural hedge. For example, the range of natural hedges adopted by Kohler BioGenetics Limited includes:

- establishing offshore subsidiaries
- arranging for import payments and export receipts denominated in the same foreign currency; therefore, any losses from a movement in the exchange rate will be offset by gains from the other
- implementing marketing strategies that attempt to reduce the price sensitivity of the exported products

- insisting on both import and export contracts denominated in Australian dollars. This effectively transfers the risk to the buyer (importer).

Financial instrument hedging

Apart from such natural hedges there are a growing number of financial products available, called derivatives, that can be used to minimise or spread the risk of exchange rate fluctuations.

12.5.6 Derivatives

To minimise the financial risks involved with exporting, financial institutions are continually developing new types of products, collectively referred to as derivatives. **Derivatives** are simple financial instruments that may be used to lessen the exporting risks associated with currency fluctuations.

To help understand how hedging and derivatives work, it is comparable to having a fixed interest rate on a loan. Since interest rate movements are hard to predict, a fixed rate allows people to lock in a rate on their loan to protect themselves against future interest rate rises. This also helps them plan their finances because they will know exactly how much they will be repaying. The disadvantage is that they won't be able to benefit from falling interest rates if they occur.

Derivatives, if used unwisely, can be as dangerous as the risks against which they are supposed to protect.

The three main derivatives available for exporters include:

- forward exchange contracts
- option contracts
- swap contracts.

BizWORD

***Derivatives** are simple financial instruments that may be used to lessen the exporting risks associated with currency fluctuations.*

Forward exchange contract

A **forward exchange contract** is a contract to exchange one currency for another currency at an agreed exchange rate on a future date, usually after a period of 30, 90 or 180 days. This means that the bank guarantees the exporter, within the set time, a fixed rate of exchange for the money generated from the sale of the exported goods.

For example, imagine a business sells $50 000 worth of their products to a Japanese customer, with the invoice payable in 30 days. Derivatives will allow them to lock in the value of that sale by selling Japanese yen and buying Australian dollars for a fixed rate, to be settled at the same time the invoice will be paid, thus locking in the value of the currency.

BizWORD

*A **forward exchange contract** is a contract to exchange one currency for another currency at an agreed exchange rate on a future date, usually after a period of 30, 90 or 180 days.*

BizFACT

Market research shows that many small- to medium-sized exporters hesitate in taking on large deals because of exchange rate concerns. A large order can often put an exporter under great financial pressure, especially if they are unfamiliar with the process of hedging.

Options contract

Foreign currency options provide another strategy for risk management. An **option** gives the buyer (option holder) the right, but not the obligation, to buy or sell foreign currency at some time in the future.

Option holders are protected from unfavourable exchange rate fluctuations, yet maintain the opportunity for gain should exchange rate movements be favourable.

BizWORD

*An **option** gives the buyer (option holder) the right, but not the obligation, to buy or sell foreign currency at some time in the future.*

Swap contract

Since its introduction in the 1980s, swaps have become a very popular financial instrument for businesses wanting to hedge. A **currency swap** is an agreement to exchange currency in the spot market with an agreement to reverse the transaction in the future. It involves a spot sale of one currency together with a forward repurchase of the currency at a specified date in the future; for example, swapping

BizWORD

*A **currency swap** is an agreement to exchange currency in the spot market with an agreement to reverse the transaction in the future.*



FIGURE 12.15 A currency swap contract is a mutual exchange in which the contracting parties agree to exchange cash flows.

$50 million Australian dollars for US dollars now and an agreement to reverse the swap within three months.

Businesses also use currency swaps when they need to raise finance in a currency issued by a country in which they are not well known and are, therefore, forced to pay a higher interest rate than would be available to a better-known borrower or a local business.

For example, a medium-sized Australian business may need Japanese yen, but even though it is a reputable business and has a good credit rating, it may not be well known in Japan. If it can find, or if a broker or bank can team it with, a Japanese business that wants Australian dollars, the swap would work as follows. The Australian business would borrow Australian dollars in Australia, where it is well known and can arrange a loan at cheaper interest rates; the Japanese business would borrow yen in Japan for the same reason. They would then agree to swap the currencies and repay each other's loan; that is, the Japanese business would repay the Australian dollar loan, while the Australian business would repay the Japanese yen loan.

The main advantage of a swap contract is that it allows the business to alter its exposure to exchange fluctuations without discarding the original transaction.

SUMMARY

- Profitability management involves the control of both the business's costs and its revenue.
- Cost controls involve:
  - understanding and monitoring the levels of both fixed and variable costs
  - accounting for and identifying the source and amount of costs through the use of cost centres
  - ensuring that expenses are minimised.
- Revenue controls are also part of profitability management and specifically address policies about a business's marketing objectives, including the sales objectives, sales mix or pricing policy.
- Global financial management refers to strategies that can be adopted to deal with the financial risks and influences on global businesses.
- Fluctuations in the exchange rate create risks for global business. Depreciation and appreciations will impact on both import and export levels and the payments made to overseas businesses or financial intermediaries.
- Domestic and international businesses will source funds internationally and will therefore need to consider the interest rates offered on borrowings. The repayment of this debt must also allow for fluctuations in currency.
- The main methods of international payment include:
  - payment in advance — allows the exporter to receive the payment and then arrange for the goods to be sent
  - letter of credit — a document that a buyer can request from their bank that guarantees the payment of goods will be transferred to the seller. The letter of credit is issued by the importer's bank to the exporter promising to pay them a specified amount once certain conditions have been met
  - clean payment — occurs when the exporter ships the goods directly to the importer before payment is received
  - bill of exchange — a document drawn up by the exporter demanding payment from the importer at a specified time.
- Hedging is the process of minimising the risk of currency fluctuations. Hedging helps reduce the level of uncertainty involved with international financial transactions.
- Derivatives are simple financial instruments that may be used to lessen the exporting risks associated with currency fluctuations.

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Syllabus area 3
Topic 4
Concept 7

Global business management: methods of payment
Summary screen and practice questions

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Syllabus area 3
Topic 4
Concept 8

Global business management: hedging and derivatives
Summary screen and practice questions

EXERCISE 12.3 REVISION

1 **Define** the term 'profitability management'.
2 **Distinguish** between fixed and variable costs.
3 **Why** should a business monitor the levels of both fixed and variable costs?
4 **Outline** the advantage of attributing costs to specific cost centres.
5 **How** can expenses can be minimised?
6 **Recall** the importance of revenue controls in achieving profit maximisation.
7 **Explain** how (a) sales objectives, (b) sales mix and (c) pricing policy can affect the level of profit.
8 **Identify** four factors that make operating globally more complex than operating in a domestic market.
9 **Why** are financial influences often classified as 'uncontrollable'?
10 **Outline** the role played by the foreign exchange market.
11 **Define** the term 'exchange rate'.
12 Using the following exchange rates, **determine** whether the rates (a) to (d), when taken sequentially, show the Australian dollar depreciating or appreciating.
(a) A$1 = US$0.85
(b) A$1 = US$0.70
(c) A$1 = US$0.63
(d) A$1 = US$0.52
13 **Explain** the effect of (a) depreciation and (b) appreciation on the prices of exports and imports.
14 **Outline** how a lack of mutual trust between the exporter and importer may be overcome.
15 Use the following table to **summarise** the four basic methods of payment for exports and how each method works. The first one has been completed for you.

Method of payment	How it works
1. Payment in advance	• Exporter receives payment and then sends goods • No risk for exporter • Few importers use this method
2. Letter of credit	
3. Clean payment	
4. Bill of exchange: (a) against payment (b) against acceptance	

16 **Define** the terms 'spot exchange rate' and 'hedging'.
17 **Propose** three natural hedge strategies a business could implement.
18 An Australian business manager would like to export Ugg boots. However, she is concerned about currency fluctuations. **Discuss** how this risk could be reduced.
19 **Compare** a forward exchange contract, an option contract and a swap contract.

EXERCISE 12.3 EXTENSION

1 Your business enters into a contract to pay a certain amount of foreign currency to someone in six months. Who bears the risk of currency fluctuation? **Explain**.
2 Futures and options are two other types of derivatives. **Investigate** how these two financial instruments help reduce the risk of exporting.
3 Find information online about the services of Westpac Bank.
(a) **Create** a concept map of the services offered to a business in relation to foreign exchange and international business.

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Digital doc: Chapter summary (doc-24814)
Interactivity: Chapter crossword (int-7171)
Interactivity: Multiple choice quiz (int-7172)
Weblink: Westpac Bank

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Sit HSC exam

(b) Locate the currency converter and **determine** the following conversions of Australian dollars to other foreign currencies.
   1. A$2.4 million = _____ Fijian dollars
   2. A$22.6 million = _____ Swedish kronor
   3. A$13.1 million = _____Thai baht

4 **Discuss** some of the issues an Australian business may need to consider when dealing with international trade and currencies.

Finance

MULTIPLE CHOICE QUESTIONS

1. Which of the following are examples of external sources of funds?
(a) Private equity, overdraft and leasing
(b) Overdraft, leasing and factoring
(c) Leasing, factoring and new issues
(d) Factoring, new issues and mortgage

2. A business has decided to source its finance externally. What would be the main advantage of this?
(a) It would improve their gearing.
(b) The interest payments would be tax deductible.
(c) It would be cheaper than other sources of finance.
(d) It would result in less risk for the owner and the business.

3. Which ratio can be used to measure a business's efficiency?
(a) Current ratio
(b) Expense ratio
(c) Debt to equity ratio
(d) Return on equity ratio

4. Which of the following strategies could be used to manage working capital?
(a) Leasing and factoring
(b) Factoring and selling
(c) Leasing and marketing
(d) Inventory control and selling

5. Which of the following are important aspects of financial planning and implementing?
(a) Developing budgets and financial controls
(b) Financial controls and account management
(c) Account management and maintaining record systems
(d) Maintaining record systems and staff management

6. What is an advantage of equity?
(a) Dividends must be paid.
(b) There is a lower level of gearing.
(c) Regular repayments must be made.
(d) Interest payments are tax deductible.

7. Which of the following indicates the effectiveness of a firm's credit policy?
(a) Expense ratio
(b) Current ratio
(c) Net profit ratio
(d) Accounts receivable turnover ratio

8. Refer to the following information.

Financial information for Bella Pty Ltd

	$ million
Sales	650
Cost of goods sold	45
Expenses	470

Calculate the net profit ratio.
(a) 21%
(b) 35%
(c) 72%
(d) 93%

9. Which method of international payment represents the least risk for an exporter?
   (a) Clean payment
   (b) Letter of credit
   (c) Bill of exchange
   (d) Payment in advance
10. Which of the following would be an advantage of hedging?
   (a) It allows businesses to export more easily.
   (b) It increases a business's access to foreign markets.
   (c) It allows businesses to increase the use of derivatives to expand.
   (d) It decreases the financial risk associated with currency exchanges.

SHORT RESPONSE QUESTIONS

1. The debt to equity ratio of Pantry Plus is currently at 0.44:1.
   (a) **Outline** what is meant by debt to equity ratio. *4 marks*
   (b) **Recommend** strategies that could be implemented by Pantry Plus to address this situation and **justify** your recommendations. *8 marks*
2. Georgia has decided to open a fashion and makeup business that caters for girls/women with a specific focus on tweens, teens and early twenties. She is currently creating her business plan and must now make financial decisions about her business.
   (a) **Propose** three sources of finance relevant to her business. *3 marks*
   (b) **Identify** and **explain** the role of the government in her financial management considerations. *6 marks*
   (c) **Analyse** the financial risk factors in long-term external finance for Georgia. *10 marks*
3. Slickwheels Pty Ltd is a medium-sized Australian business that specialises in the production of skateboards. Slickwheels is experiencing difficulties in relation to working capital management.
   (a) **Define** the term 'working capital'. *2 marks*
   (b) **Explain** *one* control of current assets and *one* control of current liabilities that could be implemented immediately to assist financially. *4 marks*
   (c) **Propose** *one* working capital strategy that may assist the business to manage this financial situation effectively. *4 marks*
4. Refer to the following balance sheet.

	$	$
Current Assets		
Cash	7 000	
Receivables	6 000	
Inventories	2 000	15 000
Non-current Assets		
Property, plant and equipment		18 000
Total Assets		33 000
Current		
Liabilities		14 000
Creditors		
Net Assets		19 000
Owners' Equity		
Capital	16 500	
Net Profit	2 500	19 000

(a) **Calculate** the current ratio of this business. *4 marks*
(b) **Propose** two strategies that could be used to manage its current ratio. *4 marks*
(c) **Assess** how an overdraft of $2000 would affect the current ratio. *8 marks*

5. 'The Australian dollar has risen to a yearly high of US$1.10. Only six months ago it was trading at 85.4 US cents.'
(a) **Define** the term 'exchange rate'. *2 marks*
(b) **Demonstrate** the main risks to an Australian exporting business of excessive fluctuations in exchange rates. *6 marks*
(c) **Evaluate** two strategies a business can implement to help minimise the risk of exchange rate fluctuations. *10 marks*

EXTENDED RESPONSE QUESTIONS

1. A high debt to equity ratio financed by both short-term and long-term borrowing has led to a decision by a firm to downsize its operations. **Discuss** the effects of such a decision on stakeholders in the business.

2. The following have been identified by management:
- difficulties in matching cash inflows with outflows
- declining liquidity
- declining accounts receivable turn over and expense ratios.

Management is considering a wider use of technology in its interactions with markets. Write a report to management **recommending** a range of strategies to improve the position of the business.

3. Wax and Wayne is an Australian (private) company that manufactures retro and custom-made surf boards. The company has always been focused on the domestic market but with the increasing worldwide profile of surfing and an expansion in the demographic of the sport they have decided to (slowly) expand into the South East Asian market. This first stage of expansion will require a substantial financial commitment. Write a report to the management of Wax and Wayne **determining** the financial aspects of the company that need to be considered in making this decision.

4. A business decides to undervalue its inventories and debtors to indicate favourable liquidity and thus better short-term financial stability of the business. **Outline** the advantages and disadvantages of this decision and **assess** its ethical implications.

5. Verada Constructions Limited is an Australian public company specialising in commercial property development. Verada wants to expand its operations by diversifying into residential property development. It is estimated that, to achieve this goal, it will require $85 million of additional finance. Write a report to the management **outlining** the internal and external sources of finance available for such a project. **Determine** which source you consider to be the most appropriate. **Justify** your selection.

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FIGURE 3.1 Effective financial management helps ensure business success.

Role of financial management

The importance of the finance function at Kathmandu is best reflected in the 2017 annual report where in large green font on the second page the financial highlights of the previous year can be found. This is common practice for public companies where the financial imperative appears to drive the business and its success proudly communicated to stakeholders.

The strategic role of financial management is that the company continues to remain viable as assessed by management's ability to achieve its objectives of profitability, growth, efficiency, liquidity and solvency. This assessment is a significant component of the recent annual report provided by Kathmandu as shown in the following statement from the CEO:

> … we again improved our financial performance in a challenging and competitive retail environment. … achieve[d] strong same store sales driven by innovative new products and inspiring digital content. In addition … continued cost control and working capital efficiency resulted in very solid profit growth … We ended the year with lower inventory and low net debt.

This statement not only reflects the satisfactory financial performance of the business but also the interdependence required across functional areas to ensure its ongoing success. Offering the right type of products demanded by its customers, managing the marketing mix and utilising the skills of employees when combined with astute financial management ensures that the business is better placed to meet its financial objectives.

Influences on financial management**

Most recent data indicates $150 000 000 in retained profits for Kathmandu, which is an increase in 10 per cent from the previous year. These funds can be used at management discretion across the business including retiring external (often interest-bearing) debt.

The company utilises a range of debt options in both the short and long term and this means that interest accrues on any borrowings. In Kathmandu's most recent financial result, record low levels of net debt have reduced financial costs such as those related to interest. This indicates less reliance on borrowed funds to fund its operations.

In terms of equity finance the company lists on both the Australian Securities Exchange (ASX) and the New Zealand Stock Exchange (NZX) (its code is KMD) and is identified by each exchange as a retailer of apparel and equipment for travel and adventure. Further, prospective shareholders are able to purchase shares accordingly. Dividends paid to existing shareholders include franking credits, however, the firm does not have a dividend re-investment plan.

Short-term external funds are available through major Australian and New Zealand financial institutions. This is in the form of unsecured debt and, given the current low interest rates, offers a relatively cheap source of funds should the business wish to borrow, especially as it investigates overseas expansion and upgrading its digital platforms.

Kathmandu is governed by the rules that apply to listed public companies as determined by the Australian Securities and Investments Commission (ASIC). Additionally corporate governance principles recently introduced in Australia and

* The Kathmandu annual report uses NZ$ in its financial data. In this case study, all financial figures have been calculated using an exchange rate of A$1 = NZ$1.05.

New Zealand led to structural changes within Kathmandu in accordance with the increased ethical expectations of public companies. Australian Taxation Office legislative requirements that apply to corporations such as Kathmandu result in the company having existing taxation liabilities of $3 158 000.

A slower retail sector in more recent times, significant for its distinct lack of consumer confidence, means that Kathmandu's recent financial performance went against many market expectations. It managed to lift sales by 4.6 per cent and its net profit by 13.5 per cent, its second successive year of profit growth. Reduced debt levels and a decline in effective interest rates have reduced finance costs, which is important in a price-driven and heavily competitive retail market.



FIGURE 3.2 In an overall sluggish retail market sector, Kathmandu's recent positive financial performance went against many market expectations.

Processes of financial management

The financial needs of the company are addressed via management's analysis of financial reports, which are prepared annually. Record systems must meet accounting requirements as set out in Australia's corporate legislation. With respect to financial risk (for example, the financial loss if a customer fails to meet its contractual obligations), minimal exposure is apparent according to the existing levels of receivables and debtors.

The cash flow statement for the most recent accounting period indicates a surplus of funds ($3.5 million). This cash flow amount comprises receipts from sales, payments to suppliers, purchase of property, plant and equipment, dividends paid and the repayment of outstanding loans. Operating expenses increased slightly but as percentage of sales it declined. This was achieved through reduced labour costs in the retail area, better use of advertising expenditure toward promotional periods and increased use of low-cost digital channels.

The income statement indicates a net profit of $34 million mostly attributed to an increase in sales to $445 million — representing same-store sales growth of 5.5 per cent — and a decline in net debt of 81.3 per cent. Better inventory

management was also achieved through more effective stock turnover and more accurate buying policies.

The balance sheet indicates an increase in gross profit of 3.7 per cent, with cheaper sourcing contracts, new product development and improved stock control all playing a part. Physical infrastructure costs increased. This was attributed to the automation of warehousing facilities and the extensive financial commitment made in 'bricks and mortar' retail ventures including new stores, relocations and refurbishments, as well as costs such as those imposed by effective website design.

Financial ratios and management strategies

The method of preparation of financial statements used by Kathmandu is one that ensures each is easy to understand for stakeholders generally, but particular effort has been made to ensure the data are accessible and useful to shareholders. The intention is to present the information simply so that the financial drivers of the company are easily identifiable.

The financial statements have also been prepared in accordance with generally accepted accounting practice (GAAP), other financial reporting standards and international financial reporting standards (IFRS). The firm PricewaterhouseCoopers was the appointed auditor of the financial statements to ensure compliance with accepted accounting conventions.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 JULY 2017

	SECTION	2017 NZ$'000	2016 NZ$'000
Sales		445,348	425,593
Cost of sales		(169,165)	(159,232)
Gross profit		276,183	266,361
Selling expenses		(143,740)	(139,285)
Administration and general expenses		(61,613)	(62,278)
		(205,353)	(201,563)
Earnings before interest, tax, depreciation and amortisation		**70,830**	**64,798**
Depreciation and amortisation	3.2/3.3	(13,826)	(13,917)
Earnings before interest and tax		**(57,004)**	**50,881**
Finance income		(28)	26
Finance expenses		(2,058)	(3,582)
Finance costs – net	4.1.1	(2,030)	(3,556)
Profit before income tax		**54,974**	**47,325**
Income tax expense	2.3	(16,935)	(13,804)
Profit after income tax		**38,039**	**33,521**

FIGURE 3.3 Kathmandu consolidated statement of comprehensive income for FY 2017

The company is also required to appoint an audit and risk committee whose responsibility it is to:

- oversee the process of financial reporting, internal control, continuous disclosure, financial and non-financial risk management and compliance and external audit
- monitor Kathmandu's compliance with laws and regulations and its own codes of conduct and ethics
- encourage effective relationships with and communication between the Board, management and Kathmandu's external auditor.

The balance sheet and income statement, shown in figures 3.3 and 3.4, are used to make the liquidity, gearing, profitability and efficiency calculations.

CONSOLIDATED BALANCE SHEET

FOR THE YEAR ENDED 31 JULY 2017

	SECTION	2017 NZ$'000	2016 NZ$'000
ASSETS			
Current assets			
Cash and cash equivalents	3.1.2	3,537	6,891
Trade and other receivables	3.1.3	6,284	5,031
Inventories	3.1.1	89,206	95,436
Total current assets		**99,027**	**107,358**
Non-current assets			
Property, plant and equipment	3.2	61,026	61,609
Intangible assets	3.3	279,014	280,083
Total non-current assets		**340,040**	**341,692**
Total assets		**439,067**	**449,050**
LIABILITIES			
Current liabilities			
Trade and other payables	3.1.4	56,735	51,084
Derivative financial instruments	4.2	7,034	7,529
Current tax liabilities		3,475	1,212
Total current liabilities		**67,244**	**59,825**
Non-current liabilities			
Derivative financial instruments	4.2	265	604
Interest bearing liabilities	4.1	10,431	43,691
Deferred tax	2.3	34,027	33,247
Total non-current liabilities		**44,723**	**77,542**
Total liabilities		**111,967**	**137,367**
Net assets		**327,100**	**311,683**
EQUITY			
Contributed equity – ordinary shares	4.3.1	200,209	200,191
Reserves	4.3.2	(23,002)	(24,541)
Retained earnings		149,893	136,033
Total equity		**327,100**	**311,683**

FIGURE 3.4 Kathmandu consolidated balance sheet for FY 2017

Liquidity

The information for the assessment of the business's ability to meet short-term financial obligations can be assessed by the current ratio. The current ratio for the business in FY 2016 and 2017 was as follows.

- 2016: $\frac{107\,358}{59\,825} = 1.79$

  For every $1 of current liabilities the business had $1.79 of current assets.

- 2017: $\frac{99\,027}{67\,244} = 1.47$

  For every $1 of current liabilities the business has $1.47 of current assets.

It would appear that the business had lower liquidity in 2017 than 2016. If we assume a preferred figure of $2 of current assets for every $1 of current liabilities, the firm appears to be operating in a satisfactory position in that it is able to meet current financial obligations.

Most significant in these outcomes is the reduction in inventories over the two-year period. This is consistent with the management goal of more effective inventory control including better stock selection, which in turn accounts for the increase in sales. Working capital management strategies such as better control of current assets and current liabilities in particular reduced debt repayments for loans and the monitoring of receivables and payables has been quite effective.

Gearing

The following information has been extracted from the balance sheet and shows the company in a sound position. It is measured using the debt to equity ratio.

- 2016: $\frac{137\,367}{311\,683} = 0.44$

  For every $1 of debt there is $1.44 of equity.

- 2017: $\frac{111\,967}{327\,100} = 0.34$

  For every $1 of debt there is $1.34 of equity.

There has been a reduction in debt over the period, which is once again a feature of the successful performance of the company. The reduction in interest-bearing liabilities (including long-term loans) has decreased by $30 million and was a focus of the management as it sought to reduce the company's exposure to debt and to take advantage of a low commercial interest rate environment.

Profitability

Gross profit ratio

The following information was extracted from the income statement through the gross profit ratio.

- 2016: $\frac{266\,361}{425\,593} = 0.62$

  For every $1 of sales there is 62¢ of gross profit.

- 2017: $\frac{276\,183}{445\,348} = 0.62$

  For every $1 of sales there is 62¢ of gross profit.

The increase in sales is reflected in a higher gross profit, but a higher cost of sales driven by higher sales has meant that the gross profit ratio has not changed. The concerted effort by management to rein in costs including both fixed and variable costs, as well as efforts to minimise expenses such as those related to advertising and in-store labour, is apparent.

Net profit ratio (Net profit before taxation)

The following information was extracted from the income statement through the net profit ratio.

- 2016: $\frac{33\,521}{425\,593} = 0.078$

  For every $1 of sales there is 7.87¢ of net profit.
- 2017: $\frac{38\,039}{445\,348} = 0.085$

  For every $1 of sales there is 8.50¢ of net profit.

A higher net profit ratio reflects the increase in sales and an increase in selling expenses. This increase in selling expenses would appear justified given the increase in sales and its effect on profit. These changes and a reduction in administration and financial expenses can be attributed to the improved net profit ratio.

Return on equity ratio

The following information was extracted from the balance sheet through the return on equity ratio.

- 2016: $\frac{33\,521}{327\,100} = 0.1025$

  The business generates 10.25¢ net profit for every $1 invested in the business.
- 2017: $\frac{38\,039}{327\,100} = 0.1162$

  The business generates 11.62¢ net profit for every $1 invested in the business.

The return on equity ratio is reflected in the improved net profit position and also the higher dividend paid to shareholders. This would also appear to be a satisfactory return for many shareholders especially if compared to other forms of investment.

Profitability management has been a feature of the company's performance and has been attributed to the growth in sales and management's ability to minimise costs particularly those in relation to human resources through a more efficient use of capital equipment and labour.

Efficiency

Expense ratio

The following information was extracted from the income statement through the expense ratio.

- 2016: $\frac{205\,145}{425\,593} = 0.48$

  Expenses account for 48¢ of every dollar of sales.
- 2017: $\frac{207\,411}{445\,348} = 0.46$

  Expenses account for 46¢ of every dollar of sales.

Accounts receivable ratio

The following information was extracted from the income statement and the balance sheet. The accounts receivable ratio for the most recent trading periods is:

- 2016: $\frac{425\,593}{5031} = 84.59$

  Payment is received every 4 days (365/71).
- 2017: $\frac{445\,348}{6284} = 70.87$

  Payment is received every 5 days (365/71).

Efficiency is reflected in the consistent management of expenses and the overall increase in sales. The effective management of accounts receivable is particular noted with very little in the way of outstanding accounts receivable. This is also reflected in the company's positive cash flow position. Substantial cash inflow (as generated by sales) was more than adequate when compared to cash outflow from operating activities (and the cost savings achieved through effective management).

If these financial results are compared across the two years, it appears that Kathmandu's management has every reason to be pleased with its performance when compared to the previous accounting period. All key indicators including sales, gross profit and dividends have increased and this is reflected in a higher share price. In addition operating expenses and net debt have both declined.

KEY PERFORMANCE INDICATORS			2017	2016
Sales	↑	4.6%	**$445.3m**	**$425.6m**
Same store sales growth			*5.5%*	*4.4%*
Gross profit	↑	3.7%	**$276.2m**	**$266.4m**
Gross margin			*62.0%*	*62.6%*
Operating expenses	↑	1.8%	**$205.4m**	**$201.6m**
Operating expenses % of sales			*46.1%*	*47.4%*
Dividend	↑	18.1%	**13.0cps**	**11.0cps**
Net Debt	↓	(81.3)%	**$6.9m**	**$36.8m**
Share Price	↑	26.1%	**$2.27**	**$1.80**

FIGURE 3.5 Kathmandu key performance indicators

The rise of ethical expectations in respect to financial reporting has expanded to include corporate governance.

> The Board and management … are committed to ensuring the Company adheres to best practice governance principles and maintains the highest ethical standards. The Board is responsible for the overall corporate governance of the Company, including adopting the appropriate policies and procedures and seeking to ensure Directors, management and employees fulfil their functions effectively and responsibly.

Financial management strategies

The financial management decisions at Kathmandu in relation to global considerations means that it enters into forward exchange contracts to manage the risk associated with the purchase of currencies denominated across different exchange rates. The company operates internationally and is exposed to foreign risk arising from changes in the value of currencies such as the Australian dollar, New Zealand dollar and the Great British pound.

Other financial influences such as interest rate swaps are used to exchange a floating rate of interest for a fixed rate of interest. The objective is to minimise the effect of interest rate volatility and in turn the impact upon the company's financial results.

The company is also exposed to changes in interest rates on its borrowings and fluctuations in exchange rates on its foreign currency (mostly United States dollar) purchases and as such uses financial instruments such as derivatives to hedge this exposure.



FIGURE 3.6 Kathmandu operates internationally, which means it is exposed to foreign exchange risk from changes in the value of currencies.

CASE STUDY QUESTIONS

1. **Outline** the performance of Kathmandu with respect to strategic financial objectives.
2. **Compare** the use of internal and external sources of finance.
3. **Analyse** the government and global market influences on financial management at Kathmandu.
4. Use the monitoring and controlling statements — cash flow, income statement and balance sheet — and the results for each to **assess** business performance in respect to liquidity, gearing, profitability and efficiency results from 2016 and 2017. Can you identify strategies for improvement?
5. **Examine** the ethical approach to financial reporting practices.
6. **Outline** the global financial management issues.
7. **Compare** the risks involved in domestic and global financial transactions.

TOPIC 4

HUMAN RESOURCES

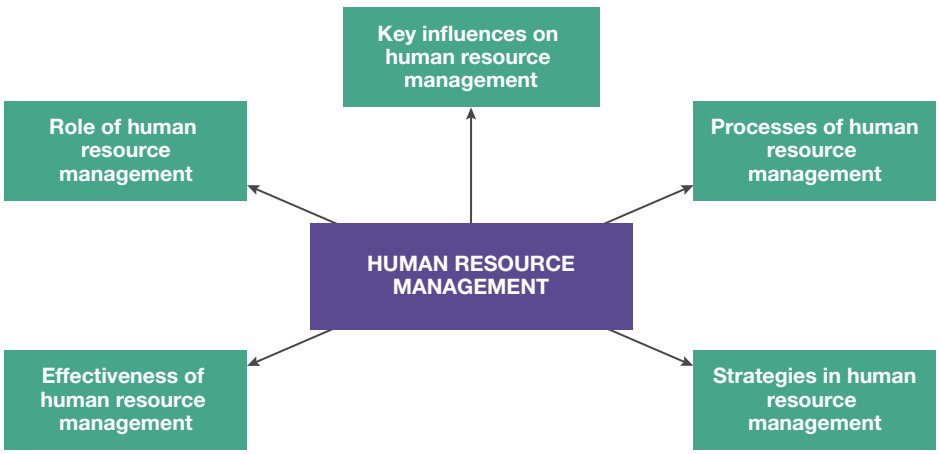
FOCUS AREA

The focus area of this topic is the contribution of human resource management to business performance.

OUTCOMES

Students should be able to:

- evaluate management strategies in response to changes in internal and external influences
- discuss the social and ethical responsibilities of management
- analyse business functions and processes in large and global businesses
- explain management strategies and their impact on businesses
- evaluate the effectiveness of management in the performance of businesses
- plan and conduct investigations into contemporary business issues
- organise and evaluate information for actual and hypothetical business situations
- communicate business information, issues and concepts in appropriate formats.





Justin's next big gig

Justin had worked in the television industry for many years in a range of roles extending from research to production. Many of the programs he worked on were no longer being produced in-house by his employer but were outsourced to private contractors.

Faced with an uncertain future in the television industry and an attractive redundancy package from his employer, Justin considered a career change. He was not sure what that change would involve and having secured some financial security through his decision to take the redundancy thought that he would bide his time doing some casual work.

He heard much about the new 'gig', or share, economy that included car ride/share services, food delivery, asking for people to bid for handyman jobs around the house or renting out a room (or even your whole house) and felt that opportunity beckoned.

He was most intrigued by the car ride concept, which was proving to very popular among many of his sons' friends. Customers use an 'app' to connect to a car service and before you know it the driver is at your door ready to take you on your way. As a taxi driver during his university days he thought he might have something to offer and soon signed up.

Some minor detailing to his relatively new car, an induction program, connecting to the car service company's IT network and he was ready for his first customer. An hour here and there driving people around the city, soon became a solid 20–30 hours a week mostly at a time that suited him.

A year later and Justin has gone on to earn enough money to make a comfortable living and has no interest in returning to his former career. He enjoys the flexibility that his new job offers and his wife likes the idea that he can help out at home, particularly with two teenage boys around, while she continues to work full time.

While making the most of his 'mid-life crisis', Justin has expressed some concerns about the future of jobs like his in the rapidly emerging gig economy. The nature of the arrangement with his current employer is short term and is yet to offer the same assurances as his previous employment contract in regard to minimum wages, leave entitlements, unfair dismissal and work health and safety.

In the meantime though Justin continues to develop his customer service skills, earn a good wage and ponder his biggest decision — what will be his next big gig?

'He enjoys the flexibility that his new job offers . . . '

on Resources

Kathmandu case study: Human resources (doc-14392)

CHAPTER 13

Role of human resource management

OVERVIEW

13.1 Introduction
13.2 The strategic role of human resource management
13.3 Interdependence with other key business functions
13.4 Outsourcing

13.1 Introduction

Human resource management refers to the management of the total relationship between an **employer** and **employee** in order to achieve the strategic goals of the business. The term is often used as a substitute for industrial relations, employment relations or workplace relations. Human resource management is a strategic approach that incorporates all aspects of managing the employer–employee relationship in the workplace. It includes functions such as recruitment, equal employment opportunity, training, development, separation and how each can be aligned to achieve business goals.

Effective human resource management sees an employee as an asset rather than a cost, and encourages open communication and goal orientation. It accepts that legitimate differences exist in workplaces but aims to reduce conflict through appropriate procedures and relationships.

BizWORD

Human resource management
refers to the management of the total relationship between an employer and employee.

An **employer**, *for legal purposes:*
- *exercises control over employees*
- *has responsibility for payment of wages or salaries*
- *holds the power to dismiss employees.*

An **employee** *is a worker under an employer's control. Control may involve:*
- *the location of the workplace*
- *the way in which the work is performed*
- *the degree of supervision involved.*

13.2 The strategic role of human resource management



FIGURE 13.1 Employees are a business's most valuable resource.

Businesses need to continually examine ways to improve competitiveness and profitability. Consequently an increasing number of businesses take a strategic (or big picture) approach to managing employees by:

- seeing an effective workforce as a way of adding value to all areas of their business performance
- focusing on the use of specific human resource management strategies to retain, reward and motivate effective and skilled employees to achieve the business's objectives.

Businesses with effective practices manage change more effectively and this enhances their ability to gain a sustainable competitive advantage. In recent years, governments have also tried to assist businesses in becoming more competitive by creating a more flexible legal framework for human resource management.

Over the next decade, the major strategic challenges for human resource management are:

- developing and retaining talented staff
- improving leadership development
- managing an ageing workforce
- the increased role of technology
- ethics and corporate social responsibility
- increased contracting out (outsourcing) of employment.

SUMMARY

- Human resource management (HRM) refers to the management of the total relationship between an employer and employee in order to achieve the strategic goals of the business.
- In recent years, governments have tried to assist businesses in becoming more competitive by creating a more flexible legal framework for human resource management.

EXERCISE 13.1 REVISION

1 **Outline** the role of human resource management.
2 **Distinguish** between an employer and an employee.
3 **State** the importance of the human resource management role in business success.

EXERCISE 13.1 EXTENSION

1 **Investigate** the challenges facing human resource managers over the next decade.
2 Research and **analyse** the factors leading to the success of two of the companies currently considered the best human resource managers in the world.

studyon

Syllabus area 4
Topic 1
Concept 1

Strategic role of human resources
Summary screen and practice questions

13.3 Interdependence with other key business functions

Human resource managers themselves often understate the **interdependence** between human resources and the other key business functions. For some human resource managers their role in achieving the business's strategic goals is not clearly apparent. Human resource managers are like the managers of any other functional area in that they have a responsibility to achieve these goals.

In respect to finance, an effective human resource policy within an organisation is linked to profitability gains, share price increases and higher incidence of long-term survival. The link between human resources and marketing is apparent in stronger relationships between the business and its customers. In operations, those businesses that invest strongly in the relationship between them and their employees are more likely to see a better performance by their employees. The consequence

BizWORD

Interdependence *refers to the mutual dependence that the key business functions have on one another.*

BizFACT

The companies that are currently considered as the best in the world at managing employees are Apple, Google, Facebook, Coca-Cola, Deloitte, AT&T, Walt Disney & Co., Marriot International, Comcast Corp., Goldman Sachs and Apple. Each of these companies invests heavily in attracting and developing the best workforce. They measure, evaluate, report and take action on regular performance indicators that rank equally with financial performance indicators.

of this relationship is that the level of service experienced by the customer is more likely to be a positive one that generates greater customer loyalty and over time, a stronger competitive advantage for the business.

A concerted effort to improve opportunities for employee training and development and/or rewards has a positive correlation with employee productivity in the operations process. As the manager of a large Australian business recently noted, 'If we take care of our employees they take care of delivering our products, which leaves our customers satisfied which is reflected in our bottom line'.

Most specialist human resource managers are responsible for:

- human resource planning and job design
- acquisition: recruitment, selection and placement
- development: induction, training, career development and performance appraisal
- maintenance of staff: wellbeing, legal responsibilities and communication
- performance management and rewards
- separation
- managing diversity, including the implementation of gender equity and anti-discrimination legislation.

Specialist human resource managers are now more involved in negotiations with unions, establishing and negotiating agreements and preparing for tribunals than they were in the past.

Where the human resources manager is part of the senior executive, he or she collaborates in executive decisions about strategic issues, such as a change in product, service or organisation of work. This role increasingly involves awareness of global trends and labour market issues, industrial relations policies, risk management strategies, and high-level organisational and human resources auditing. Developing a strategic human resources plan, using this information, is a key function. It is then translated into operational plans for implementation. Specialist human resource functions are also increasingly outsourced to consultants.

SNAPSHOT



The interdependence between human resources and other key business functions

Google's human resources driving business growth and development

At Google, human resources is central to driving business growth and development According to Google, it is people that:

> . . . keep Google going and growing. Our People Operations [POps] team (known elsewhere as HR) and administrative staff are the curious and creative colleagues that anchor us to our foundations and help us shoot for the moon. The POps team lives by the mantra 'find them, grow them, keep them,' and is dedicated to staffing, development, and a distinct and inclusive culture. Not just coworkers, we're proud Google colleagues who help our company thrive.

Google's people reflect the type of culture it has built from the outset and continues to develop. Its workplace promotes strong staff involvement and high levels of engagement through a common purpose that embraces the company's vision and goals. The workplace is designed to encourage interaction between staff that often manifests in new ideas for products. Its people-first culture has enabled Google to rank in the top 50 of the world's global companies and be recognised as one of the best employers.

As Google demonstrates, it is the link between human resources and the other functional areas of the business that need to be managed to ensure a synergy and ultimately business success.

Source: Extracts from https://careers.google.com/fields-of-work/people

Bank of Queensland's human resources and operations

With respect to the human resources and operations functions, many companies acknowledge the importance of corporate social responsibility in the management of its staff. For example, the Bank of Queensland sees a harmonious work environment as integral to business success. It identifies the responsibility it has to its employees and the importance of the employee/management relationship in respect to the diversity of staff in its branches who reflect the multicultural character of the nation. It pursues the best employees in a recruitment and selection process that is both fair and equitable and provides employees with a formal program of support through confidential counselling. It has an ongoing commitment to professional learning and development, offering flexible work arrangements such as part-time, work from home and job share options and additional benefits such as health information, discounts on loans and travel.

Flight Centre's human resources and marketing

At Flight Centre the selling process is integral to business success, and the right people are vital if this is to be achieved — meaning human resources and marketing functions are integrally linked. The *people* aspect of marketing strategies encompasses the role of sales people providing quality service as a means to give a business a competitive advantage. Personal selling and developing enduring customer relationships is essential as illustrated by Flight Centre's emphasis on people:

> Flight Centre's primary strength is the focus on its people. We have 19,000 people across the globe and we will keep growing. Our company purpose is bigger than just profit alone. Our purpose is to open up the world for those who want to see.

Human resources and finance: cutting costs

As staffing is a major cost associated with the operation of a business, there is a clear link between human resources and finance. Workers contribute to the production of the goods and services demanded by customers and this in turn generates income for the business. In a competitive environment that demands effective cost control and maintaining or even reducing labour costs is seen as essential to a business's financial wellbeing.

Changes in the manufacturing sector in the last 30 years has resulted in the closure of factories and in some cases their relocation overseas. For example, the decline in the automotive industry and subsequent impact on its staff had much to do with financial decisions. Businesses engaged in other sectors, such as telecommunications including Telstra, banking including NAB, Westpac and ANZ, and aviation including Qantas, have either moved operations offshore or are considering how best to facilitate this, primarily with a financial motivation.

The common theme to the changes outlined above is the desire to cut costs, especially those in relation to labour. Australia's higher wage rates, means that, for example, an administrative worker is six times more expensive to hire in Australia than the Philippines and other employment expenses such as superannuation have an impact on many business's profitability. Estimates are that operational costs can be reduced by up to 60 per cent by relocating production offshore, with wages accounting for 20 per cent of those savings, which can affect financial results significantly.

SNAPSHOT QUESTION

Explain the interdependence between human resources and the other key business functions at each of the businesses in this Snapshot.

SUMMARY

- In large businesses, a specialist human resources team or manager is responsible for the business's human resource management.
- Most specialist human resource managers are responsible for:
  - human resource planning and job design
  - acquisition — recruitment, selection and placement

studyon

Syllabus area 4
Topic 1
Concept 2

Interdependence with key business functions
Summary screen and practice questions

- development — induction, training, career development and performance appraisal
- maintenance of staff — wellbeing, legal responsibilities and communication
- performance management and rewards
- separation
- managing diversity, including the implementation of gender equity and anti-discrimination legislation.

- Where the human resource manager is part of the senior executive, he or she collaborates in executive decisions about strategic issues, such as a change in product, service or organisation of work.
- Many firms outsource specialist human resource management functions.

EXERCISE 13.2 REVISION

1 Read the topic 4 introduction 'Justin's next big gig' and complete the following exercises.
   (a) List the human resources terms identified and provide a meaning for each.
   (b) Identify the factors that gave rise to Justin's career change.
   (c) What is the 'gig economy'?
   (d) Outline the concerns raised by Justin about jobs like his.
   (e) Discuss the rise of the gig economy for Australia's next generation of workers.

2 Consider the following changes in global markets: global economic downturn, growth in online retailing and services, and the rise in outsourcing. **Explain** why human resource managers must be aware of such changes in the business environment.

3 **Explain** why human resources continues to evolve from a support to a core function.

EXERCISE 13.2 EXTENSION

1 **Analyse** the ways in which human resource managers may respond to the three situations described in revision question 2.

2 **Investigate** the activities human resource managers may undertake at a strategic, tactical and operational level in a business.

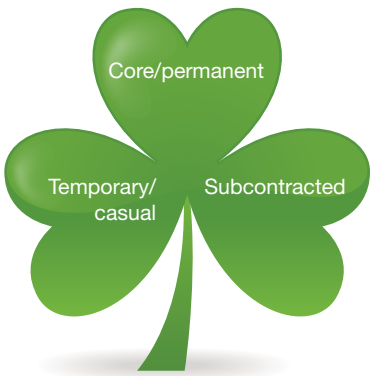


FIGURE 13.2 The Shamrock Organisation is an increasingly common organisational structure today. Firms have a core, permanent workforce; a flexible casual/ temporary workforce and another workforce who are contracted (outsourced) specialists.

BizWORD

Outsourcing *or contracting out business functions involves the use of third-party specialist businesses, for example, recruitment firms. It aims to take advantage of the specialist skills provided by them and to achieve a reduction in labour costs.*

13.4 Outsourcing

Many changes in work patterns today are driven by a business's need to reduce costs and improve productivity. Globalisation and rapid technological change have led to increased pressure to be competitive. These factors have fostered the development of new organisational structures, with the growth of contracting out or outsourcing business functions. Outsourcing or contracting out business functions involves the use of third-party businesses such as recruitment firms. It aims to take advantage of the skills provided by the specialist and to achieve a reduction in labour costs. An example of an organisational structure that includes outsourcing, the Shamrock Organisation, is shown in figure 13.2.

Outsourcing is often used to obtain a superior service, better functional quality and a lower cost service than would be provided internally (see figure 13.3). Outsourcing, particularly offshore (global subcontracting), may significantly reduce costs for some businesses. Major areas being outsourced in Australia (domestic outsourcing) are property and facilities management, financial processes such as payroll, administration support services, internal auditing, call centres, maintenance and, most commonly, human resources functions.

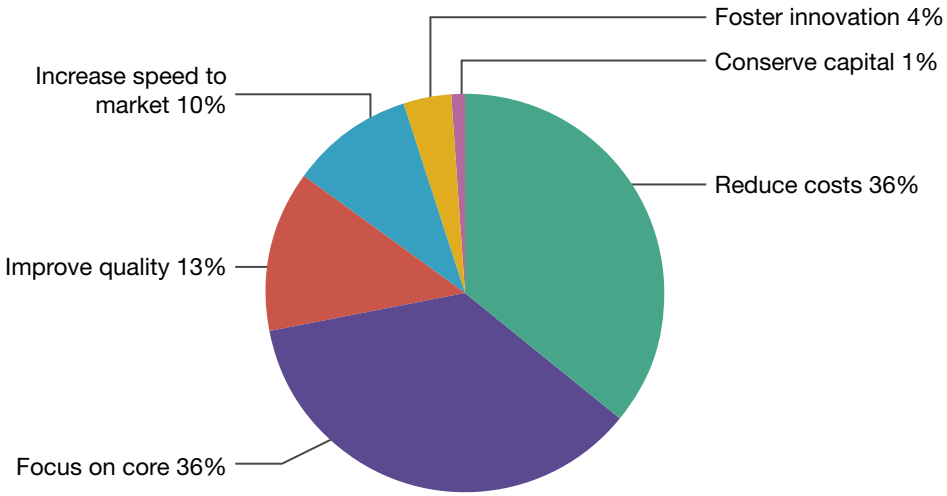


FIGURE 13.3 Top reasons for outsourcing

13.4.1 Outsourcing human resource functions

Outsourcing allows firms to focus more on their core business as they grow, while experts in human resources assist by planning for growth, development and management of staff during this phase.

Outsourcing may also be used to review business practices and implement strategies to transform the business using 'independent' consultants with no perceived internal 'agenda'.

TABLE 13.1 Most commonly outsourced human resource functions and areas

Human resource functions commonly outsourced	Human resource areas commonly outsourced for review or development
Recruitment	Human resources information systems (HRIS)
Induction	Change management
Leadership training	Training needs evaluation
Mediation	Compensation (wages and salaries) systems
Outplacement	Performance management systems
Payroll	Succession planning
	High performance coaching
	Employee surveys
	Written policies and programs
	Training and development
	Benchmarking

13.4.2 Using contractors

Today, **contractors** are primarily used by most businesses to create costs savings or to access greater expertise and capabilities to improve competitiveness. Contractors can be obtained for most business functions, but they are particularly used for processing functions. These are the functions that are repetitive and easily measured, which makes it easy for businesses to determine the cost savings and productivity gains.

Contracting is generally recommended for non-core functions, allowing staff to focus on the broader aspects of managing a firm.

Although there are many successful examples of outsourcing, there are risks, which increase as the proportion of a firm's activities are outsourced. The major risks include cost overruns (or cost increase), loss of quality, difficulty coordinating activities, and difficulty monitoring quality and performance in outsourced activities.

BizWORD

*A **contractor** is an external provider of services to a business. It may be an individual or a business.*

In one major Australian firm, outsourcing maintenance to avoid industrial problems led to a loss of its competitive advantage. Where it had previously been proactive in managing maintenance, it became more reactive in the hands of its contractors and breakdowns in production proved to be costly.

TABLE 13.2 Features of the most common forms of outsourcing

Form of outsourcing	Features
Labour hire/employment agency	• Workers are employees provided to the host company. • Superannuation, insurance and workers' compensation are managed by the labour hire company.
Labour hire/employment agencies/ dependent contractors	• Workers are dependent contractors. Labour hire company may act as a broker. • They do not have control over their working procedures. They are prevented from subcontracting their work and from working for multiple clients.
Independent contractors	• They operate their own business and set the terms and conditions of employment. • They are engaged by a client under a commercial contract to perform the services without having the legal status of an employee. • Most independent contractors make their own superannuation, insurance and workers' compensation arrangements.
Outsourced suppliers	• They supply goods and services to a range of businesses. • They are owner managers who supervise their own employees. • They control their own work procedures and can work for multiple clients. • They manage superannuation, insurance and workers' compensation arrangements for their employees.

Experience shows that businesses should set clear and legally binding terms, timeframes and conditions in a contractor agreement to avoid conflict and expensive litigation further down the track. This includes confirming responsibility for superannuation, insurance and workers' compensation.

BizFACT

Around 2 million people are self-employed and 1 million are independent contractors in Australia.

Domestic subcontracting

Domestic subcontracting is very common today and avoids the need to employ additional 'in-house' staff, along with all the overhead expenses involved. It allows firms to focus their resources on essential business activities, leaving some of the detailed support- or compliance-related activities to experts, such as payroll management or order fulfilment. Others seek the benefits of fresh ideas and perspectives such as leadership development. This makes it particularly attractive to small to medium-sized businesses lacking the capacity to undertake internal auditing, compliance updates, research or manage some functions at the professional 'best practice' level of larger firms. Using this expertise, therefore, has the potential to improve the quality and productivity of a business's service without the resource scale normally required to achieve this level.

SNAPSHOT

AUSTRALIAN BUSINESS SOLUTIONS GROUP

'OnePeople HR has had particular success with its Aboriginal and Torres Strait Islander mentoring program.'

Case study: Australian Business Solutions Group

Australian Business Solutions Group (ABSG) seeks to assist businesses through the provision of expert specialist services across a number of functional areas including human resources. The aspects of human resources that it offers support for include performance management, workplace agreements and mediation as well as the processes of recruitment, selection, maintenance and separation.

One particular area of expertise offered by ABSG is its OnePeople HR program. This initiative assists businesses in the recruitment of top Aboriginal and Torres Strait Islander (ATSI) talent by providing businesses with expert strategies in

locating suitable candidates whether they are seeking them on a permanent or temporary basis.

OnePeople HR has had particular success with its Aboriginal and Torres Strait Islander mentoring program. It provides specialist training to existing management to promote higher engagement of ATSI employees through:

- developing strategies to improve staff retention
- increasing the number of Indigeneous managers
- strengthening existing staff relationships
- promoting diversity in the workplace.



SNAPSHOT QUESTIONS

1. **List** the human resource services that ABSG offers.
2. **What** is OnePeople HR?
3. **Outline** the advantages to a business of programs such as the Aboriginal and Torres Strait Islander mentoring program.

Global subcontracting

During the last decade, many firms under pressure from global competition turned to offshore contractors in countries such as India and the Philippines to reduce costs. Others used outsourcing as a first step toward operating in a new market overseas, to get more acquainted with market needs before expanding with a greater physical presence in the market.

Outsourcing may take two forms.

1. *Process outsourcing* is the dominant form of outsourcing of repetitive, easily measured and documented work — for example, recruitment, multi-country payroll management, customer complaints, food preparation for an airline or garment manufacture for an Australian fashion company.
2. *Project outsourcing* is most commonly found in areas such as human resources, marketing, design, information technology (IT) and research. Project outsourcing involves much greater use of intellectual property and strategic business knowledge; it tends to operate in a longer time frame, is more difficult to measure and the quality cannot be fully anticipated, thus carrying more risk.

Global outsourcing carries some risks, including:

- difficulty controlling the quality and reliability of the service
- cultural differences such as language or accent issues, which may impact on customer service
- security issues such as opportunities for sharing of confidential company information and client poaching
- the lack of remedies for breach of contract or other legal matters under foreign legal systems

BizFACT

Deloitte's 2016 Global Outsourcing Survey revealed that outsourcing is expected to see ongoing growth across all functional areas, particularly IT, Finance and Human Resources. The reasons for this growth are that outsourcing was seen as a cost-cutting tool, which enabled the business to focus on core activities, promoted higher levels of customer service, allowed access to intellectual capital and assisted with organisational change.

- the often high labour turnover particularly experienced in call centres
- well-qualified employees may be replaced by less qualified staff, causing the quality of the service to decline.

These disadvantages need to be weighed up against the benefits of major cost savings and potential productivity benefits.

Many in the field believe that if the function to be outsourced can be clearly identified, measured, managed and supported by a binding legal framework then it may be more suited to outsourcing.

The advantages and disadvantages of outsourcing in a global market

Potential advantages

- Expand capacity/ flexibility
- Improve quality
- Save costs
- Access new networks
- Conserve capital
- Allows business to focus resources on main activities
- Help in managing complex issues
- Transform culture
- Improve legal compliance
- Train staff
- Access experts, by practice management systems and research



Potential disadvantages

- Less integrated organisation
- Quality may fall
- Consultants may not understand your culture
- Costs may increase
- Hidden costs
- Morale and motivation may be damaged
- Less face-to-face client contact
- Reduce business learning through reliance on experts
- Loss of security and confidentiality of information

FIGURE 13.4 Advantages and disadvantages of global outsourcing of human resources

SNAPSHOT



Global subcontracting in action

The Philippines and India are seen as the focus of the call centre industry globally. The emphasis on a cultural commitment to service and the widespread use of English are seen as two reasons for the growth of call centres and, more recently, other business support services such as IT in these two countries.

In one case there are about 800 000 workers in a cluster of office blocks in central Manila. The call centre industry has been the source of much employment growth here and across a number of similar cities throughout Asia. These workers benefit from higher incomes and, increasingly, a more middle class lifestyle than other local workers.

Australian businesses such as Telstra, Qantas and ANZ have taken advantage of the opportunity to contract out customer service to cities in the Philippines and India but success has been mixed.

Those in support of outsourcing activities such as call centres indicate that the benefits can be measured in employment growth and improved living standards in host countries. Its critics, however, believe that outsourcing compromises conditions and opportunities of workers back in Australia often leading to job losses and if not monitored can result in lower labour standards for overseas contract workers.

The multibillion dollar call centre industry is just one of the functions contracted out by Australian companies and accounts for a substantial proportion of the Philippine economy. Improvements in technology and multinational companies increasingly

keen to take advantage of lower wage costs, higher levels of education among workers and opportunities to grow sales are changing the more traditional view of call centres.

The long-term prospects of the call centre industry, however, are not as assured as they once were for host countries. Improvements in software enable workers to process calls more quickly with IT programs designed to address customer issues more efficiently. Robots will also free up operators from the more tedious customer service enquiries. This provides opportunities for those employees with stronger communication skills to focus on the more financially lucrative selling of products, but what of those unable to adapt to the higher expectations of employers? For many it may mean the type of structural change faced by workers in other countries and in other industries that have had to adjust to having their jobs replaced by technology.

Source: Adapted from Tim Harcourt, 'Call centres and compromise: the changing face of outsourcing', *The Conversation*, 26 March 2014

SNAPSHOT QUESTIONS

1. **List** the reasons for the emergence of the Philippines and India as call centre specialists.
2. **Outline** examples of the advantages and disadvantages of outsourcing call centre operations globally.
3. **Assess** the long-term prospects for the call centre industry in the Philippines and India.

SUMMARY

- New business structures are developing in response to global competition.
- Outsourcing business functions to reduce costs, obtain specialist support and improve productivity is increasing.
- Many firms outsource specialist human resource functions such as recruitment and payroll.
- There has been a rapid growth in independent contractors, such as labour hire companies.
- Businesses generally find that outsourcing is most effective internationally when the business functions being outsourced are suitable for teleworking.
- There are benefits and risks in contracting, from lower costs, to the problem of loss of direct customer contact, and consistent quality and performance in outsourced activities.
- Many in the field believe that if the function to be outsourced can be clearly identified, measured, managed and supported by a binding legal framework then it may be more suited to outsourcing.

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Syllabus area 4 | Topic 1 | Concept 3

Outsourcing
Summary screen and practice questions

EXERCISE 13.3 REVISION

1 **What** is 'outsourcing'?

2 **Clarify** what is meant by the term 'Shamrock Organisation'.

3 **Identify** the most appropriate term from the list to complete the following sentences.

quality	internally	costs	lower	offshore	superior

Outsourcing is often used to obtain a _____ service, better functional _____ and a _____ cost service than that would be provided _____. Outsourcing, particularly global subcontracting, may significantly reduce _____ for some businesses.

4 **Examine** figure 13.3 and list the four most common reasons for outsourcing.

5 **Identify** six human resource functions that are often outsourced.

6 You are a human resource manager for a construction business that has 568 employees. The general manager has asked you to consider using contractors for a number of business functions including machine maintenance and accounts preparation. Prepare a report.
(a) **Outline** the costs and benefits of using contractors. Present your information in a 'T' table format as shown below. The 'T' table has been started for you.

Using contractors	
Costs	Benefits
	• Creates savings

(b) **Assess** the value of using contractors.

7 **Outline** the key features needed in agreements for successful outsourcing.

8 **Distinguish** between domestic and global subcontracting.

9 **Examine** figure 13.4. **Justify** which you consider to be the more persuasive: the potential advantages or potential disadvantages of global outsourcing of human resources.

10 **Why** is outsourcing important to the evolution of human resource management?

EXERCISE 13.3 EXTENSION

1 Research the human resources processes and practices of one of the companies listed in the BizFACT in section 13.3. **Compare** and **contrast** these in a tabular form.

2 'The role of human resources has been evolving for many years now. What was once the "personnel" department has been replaced by a sophisticated key business function with management keen to have a say in the strategic planning process.'
Human resources specialist at TA Industries

Analyse the ways in which the role of human resource management is changing.

3 'I am sick and tired of ringing a call centre only to have to wait for half an hour, finally getting someone to talk to only to be transferred to another operator, getting cut off and having to start all over again.' Write a report on the advantages and disadvantages of outsourcing call centres.

4 **Propose** a range of business activities that would be suited for outsourcing to either domestic or global contractors.

5 **Predict** the future of both domestic and global outsourcing.

6 **Discuss** the ways in which human resource managers can ensure that high standards in quality and customer service are maintained as business structures evolve on a global scale.

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Digital doc: Chapter summary (doc-24815)

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Interactivity: Multiple choice quiz (int-7174)

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CHAPTER 14

Key influences on human resource management

OVERVIEW

14.1 Stakeholders in the human resource management process
14.2 Legal influences — the current legal framework
14.3 Economic influences
14.4 Technological influences
14.5 Social influences
14.6 Ethics and corporate social responsibility

14.1 Stakeholders in the human resource management process

BizWORD

Stakeholders *are any individual or group that has a common interest in or is affected by the actions of an organisation.*

Stakeholders are any individual or group that has a common interest in or is affected by the actions of an organisation.

Stakeholders have a common interest in the survival and success of the business. However, not all their interests are shared — conflict can arise due to differences and competing interests (see figure 14.1).

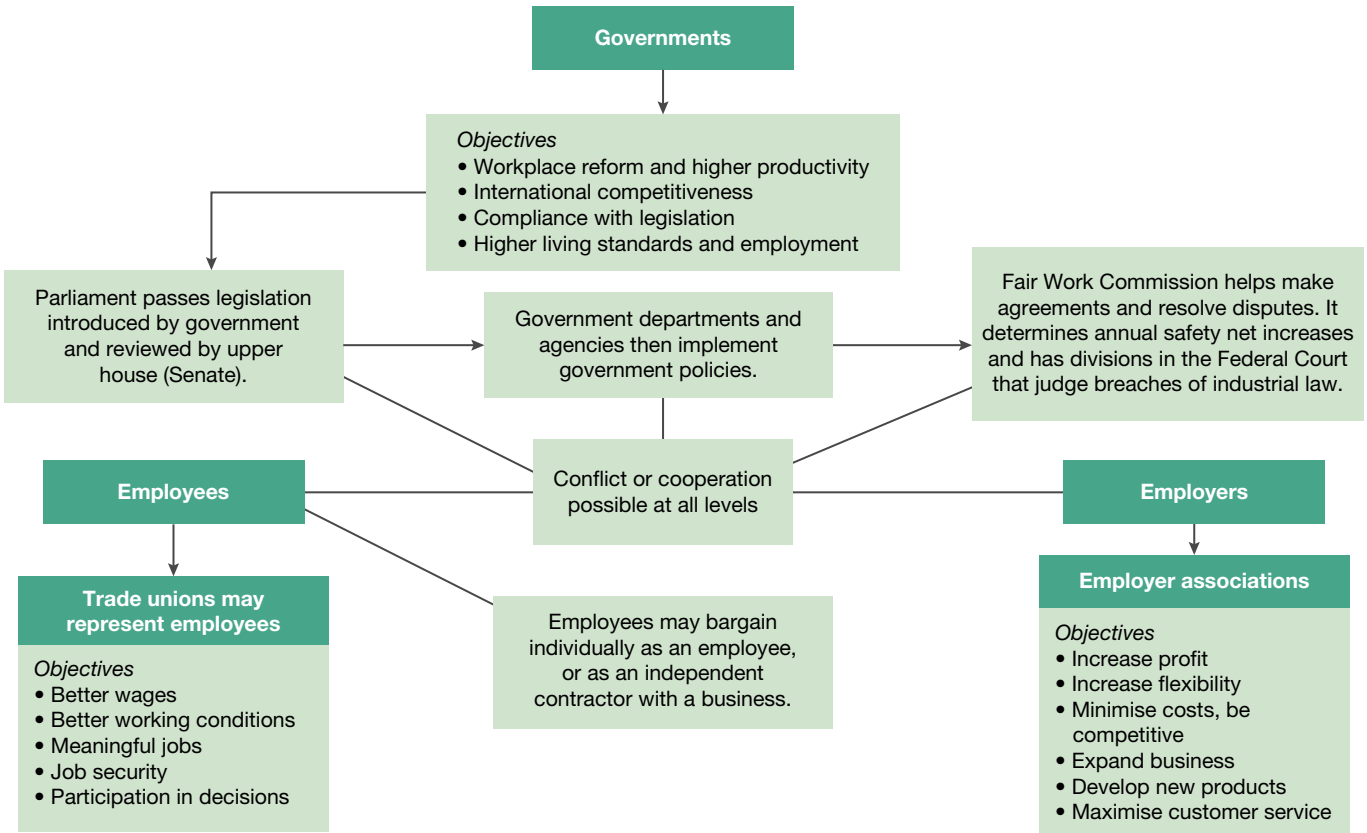


FIGURE 14.1 Stakeholders in the human resource process and their interests

14.1.1 Employers

Employers, for legal purposes, are those who exercise control over employees, have responsibility for the payment of wages and/or salaries and have the power to dismiss employees. They handle human resource management issues on a daily basis. Some spend over half their work day on matters related to this area, including involvement in developing programs that focus on improving business performance. Employers' responsibilities are increasing, as recent legislation today encourages them to negotiate agreements and resolve disputes at the individual workplace. However, employers have been widely criticised in many management surveys for failing to tackle issues in managing employees effectively. A recent survey of more than 7600 people found 'people management' to be the most serious failing of business leaders in Australia, and was cited 2.5 times more frequently than any other management failing. Improving management training in Australia is therefore important in improving human resource management.

BizWORD

Employers *are those who exercise control over employees, have responsibility for the payment of wages and/or salaries and have the power to dismiss employees.*

14.1.2 Employees

Employees are workers under the control of an employer. This control includes the workplace location, the way that the work is to be performed and the extent to which supervision will be exercised. Employees today are, on average, more highly educated than in the past. They become bored very quickly and demand more challenging, interesting work, involvement in decision-making processes and autonomy at their workplace. Many feel driven to build their career through a succession of jobs in a range of different organisations.

Following periods of extensive downsizing in recent years, employees no longer trust one business to look after their needs. As a result, the practice of 'churning' — moving frequently from one job to another in different organisations — is increasing, particularly in service industries. Businesses hoping to retain and motivate skilled staff need to put extra effort into developing their career and training plans, rewards and opportunities for greater employee involvement. Around one-third of employees are also keen to get more work–life balance, including to spend more time with their families.

The structure of work has changed over the last decade and affects employees' access to work. For example, many older workers, women and younger inexperienced people struggle to obtain full-time jobs, particularly in the knowledge-based service sector. These people have become our 'flexible', casual workforce. Australia has experienced close to full employment for a long time, despite a global economic downturn.

BizWORD

Employees *are workers under the control of an employer. This control includes the workplace location, the way that the work is to be performed and the extent to which supervision will be exercised.*

studyon

Syllabus area 4
Topic 2
Concept 1

Stakeholders: employees and employers
Summary screen and practice questions



FIGURE 14.2 The increased mobility of workers means that businesses have to develop strategies to retain them.

BizFACT

In the May 2009 Federal Budget, the Australian Labor government announced the Age Pension age would increase to 67 years from 2023, remaining at 65 for anyone born before July 1952. In the May 2014 Federal Budget, the Australian Coalition government announced that from 1 July 2025, the Age Pension age would continue to rise by six months every two years to gradually reach a qualifying age of 70 years by 1 July 2035.

BizWORD

Employer associations *are organisations that represent and assist employer groups. They are usually respondents to the awards covering the employees of their members, and covering employers in the same or related industry.*

A **log of claims** *is a list of demands made by workers (often through their union) against their employers. These demands cover specific wages and conditions. Employers may also serve a counter-log of claims on the union.*

The number of Australians aged 65 years and over is projected to double by 2055 and their participation rates will increase from 5 per cent to 17 per cent. Women will also have a more substantial role to play in the workforce and it is expected that their participation rates will grow by 4 per cent in the next 20 years.

Many unions have responded to worker fears and have made some employment issues — such as job security and limitations on the use of casuals — a priority in negotiating agreements. A significant number of employees do, nevertheless, enjoy the flexibility of job sharing, and part-time and casual work to manage family commitments.

14.1.3 Employer associations

Employer associations were originally created by employers as a counter-party to unions, to represent employers in the making of awards through the conciliation and arbitration system established in 1904. They assisted employers in formulating policies and processed **logs of claims** served on their members by unions. Their main role today is to act on behalf of employers (especially small businesses) in collective bargaining sessions and before industrial tribunals, courts, commissions and committees. They:

- provide advice (especially to small businesses) on such matters as awards, unfair dismissals and discrimination issues
- make submissions to safety net wage cases
- negotiate agreements
- lobby governments and other organisations with the views and interests of employers, industries and trade.

Unlike unions, employer associations represent employers on a broader range of issues beyond human resource and industrial relations matters.

Employer associations may function as professional bodies, such as the Australian Medical Association, or as marketing bodies, for example, dairy cooperatives and Meat and Livestock Australia. Others are associations with an industrial relations function within their services, such as the Australian Chamber of Commerce and Industry (ACCI), and the Australian Industry Group (Ai Group) representing the Australian Chamber of Manufactures and the Metal Trades Industry Association (see the following Snapshot).

SNAPSHOT



'The focus of the Ai Group is to ensure that business views are represented to all levels of government.'

The Australian Industry Group (Ai Group) — representing business

The Australian Industry Group (Ai Group) is Australia's peak industry association and represents more than 60 000 businesses. It encompasses a number of different industry sectors including manufacturing, engineering, transport, IT, telecommunications and construction.

The focus of the Ai Group is to ensure that business views are represented to all levels of government. This includes matters relating to work health and safety, workplace relations, human resource management and workers' compensation.

The Ai Group identifies the following services as being integral to what it offers to members:

- how to deal with employees making a bullying complaint
- the introduction of new laws relating to payments to unions and their representatives
- access to online webinars regarding recent industrial relations matters before the Fair Work Commission
- state-specific industrial information
- current economic data relevant to Australian businesses
- case studies of real industrial issues.

SNAPSHOT QUESTIONS

1. **Describe** the role of the Ai Group.
2. **Examine** the current focus areas of the Ai Group.
3. **Justify** the importance of employer associations for society.

14.1.4 Trade unions

Trade unions are organisations formed by employees in an industry, trade or occupation to represent them in efforts to improve wages and the working conditions of their members. The key factors and stages in their development in Australia are summarised in figure 14.3.

The system for resolving industrial disputes, established in 1904 in Australia, gave unions a powerful role in human resources. It provided unions with an official bargaining position in the making of industrial agreements. Through test cases, unions won major improvements in terms and conditions of employment. These established key principles that flowed on to other workers.

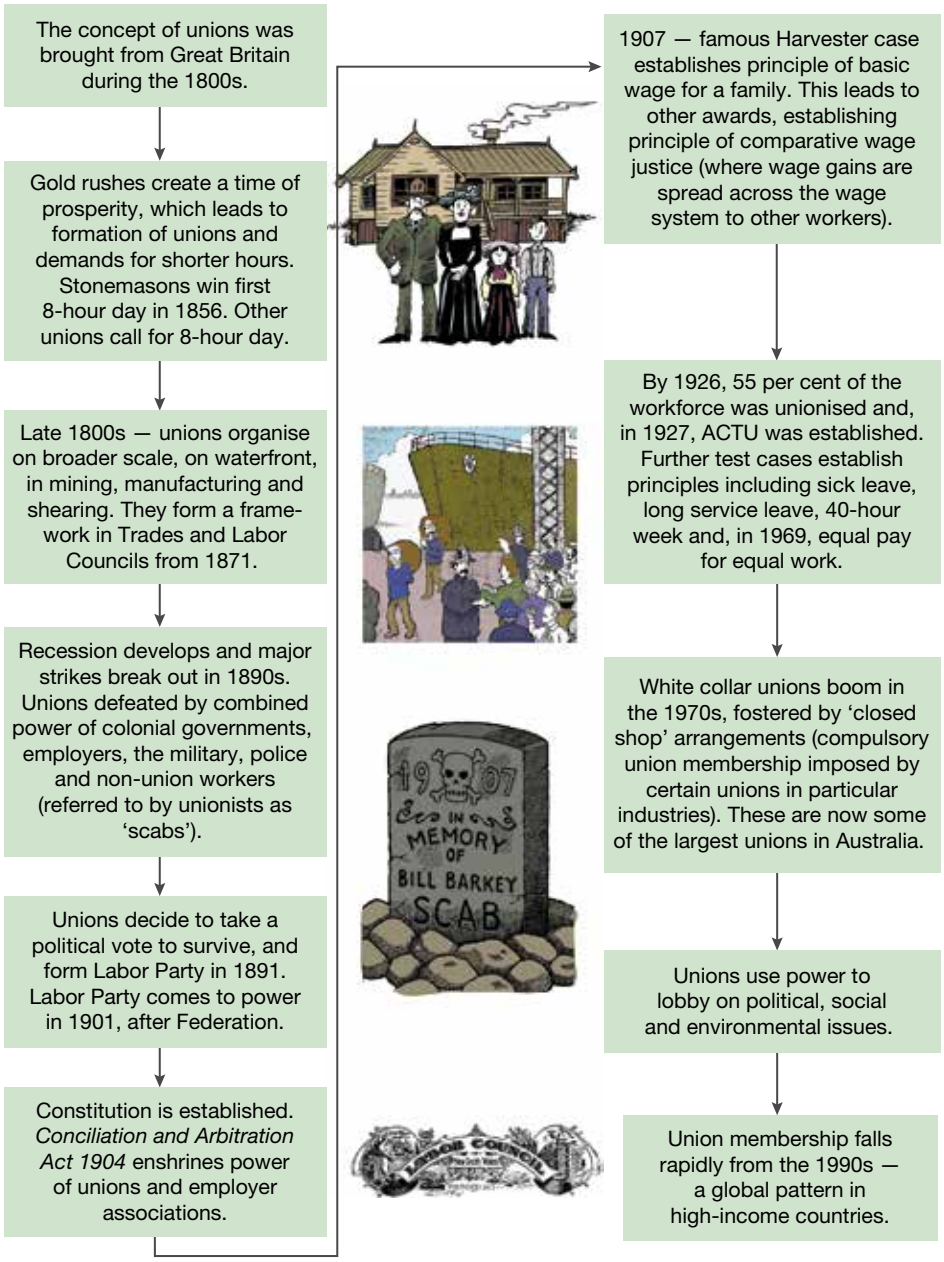


FIGURE 14.3 The development of trade unions in Australia since 1800

Union membership peaked at 51 per cent in 1976, falling to 46 per cent of all employees in 1986. It has fallen dramatically since, as seen in figure 14.4, reaching the current level of 15 per cent of the workforce, where it has remained steady for the last few years. In addition:

- 16 per cent of full-time and 12 per cent of part-time employees belong to a trade union

BizWORD

Trade unions *are organisations formed by employees in an industry, trade or occupation to represent them in efforts to improve wages and working conditions of their members.*

BizFACT

The peak trade union body is the Australian Council of Trade Unions (ACTU). Some of the larger unions include the following.

- *Australian Services Union (ASU)*
- *Australian Workers' Union (AWU)*
- *Australian Manufacturing Workers' Union (AMWU)*
- *Construction, Forestry, Mining and Energy Union (CFMEU)*
- *Finance Sector Union (FSU)*
- *Maritime Union of Australia (MUA)*
- *Transport Workers' Union of Australia (TWU)*
- *Textile, Clothing and Footwear Union of Australia (TCFUA)*

- 38 per cent of government workers compared with 9 per cent of private industry workers are trade union members
- the highest levels of trade union membership are in education and training (37 per cent) and the industries with the lowest levels of union membership are real estate services and professional, scientific and technical services with 3 per cent
- 68 per cent of workers have never belonged to a trade union.

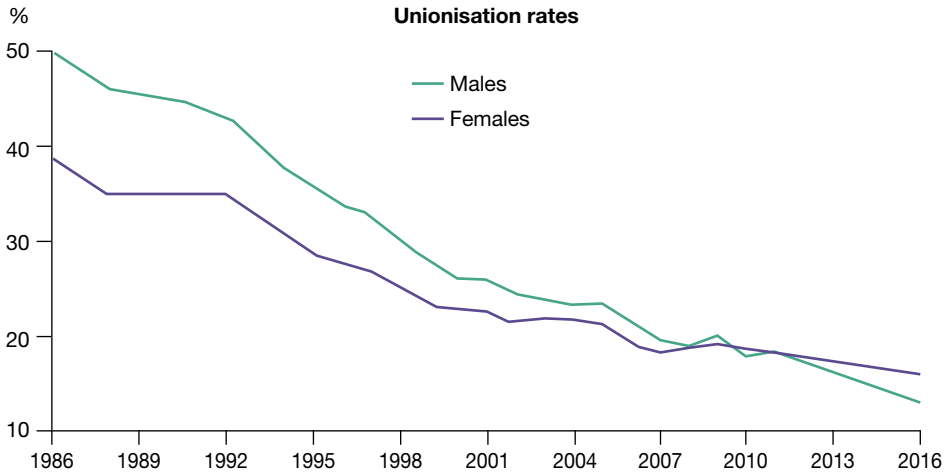


FIGURE 14.4 Trade union membership in Australia has fallen dramatically.

Having contributed so much to winning employee rights over the last decades, unions are now under pressure globally as membership declines to historically low levels. In response, unions are expanding their range of services and becoming more active in recruiting to regain membership numbers. As well as providing representation in disputes, the range of services offered by a union to members might now include free or discounted legal services, superannuation schemes, cheap home loans, training programs through TAFE, insurance, cheap holiday units to rent, income protection against illness or accident, work health and safety (WHS) advice, and many more.

The major reasons for the decline in union membership are shown in figure 14.5.

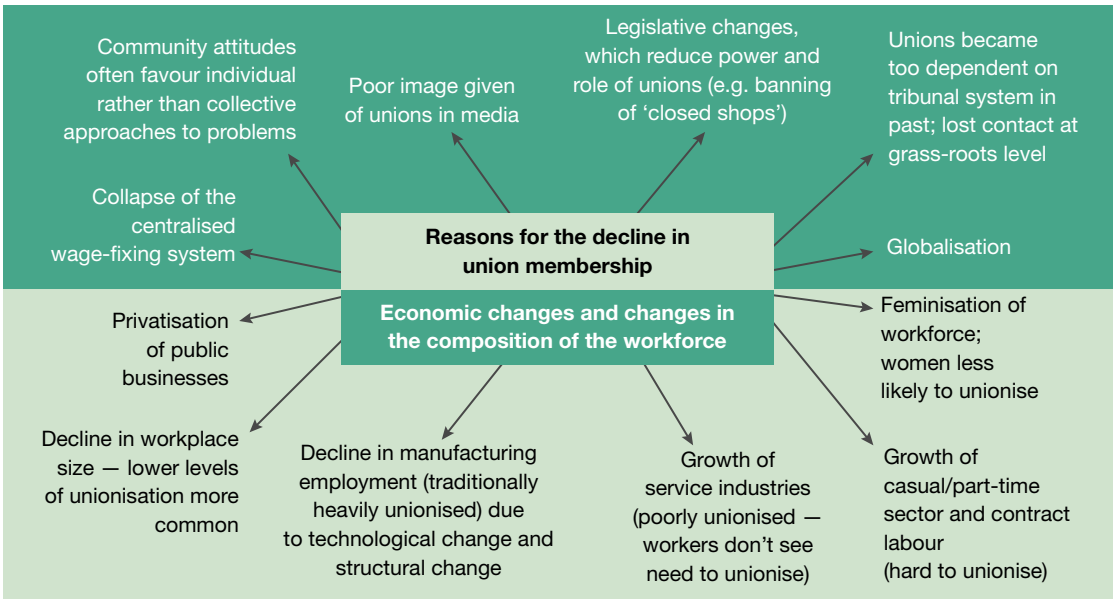


FIGURE 14.5 Reasons for the decline in union membership

Case study: Finance Sector Union (FSU) Australia

The FSU has existed for almost 100 years and is a not-for-profit organisation for members. Its role involves:

- industry negotiations with employers and/or employer groups
- representation in Fair Work Commission/state industrial tribunal matters
- presence when dealing with workplace issues
- providing information regarding workplace rights and obligations
- lobbying state and federal governments
- promoting issues of concern to relevant organisational bodies
- conducting workplace research
- offering a range of services to assist members and their families, for example, insurance, retail benefits and superannuation.

Most recently it was successful when it achieved a judgement that ensured its members who had been underpaid $16.7 million in superannuation and other entitlements by a major bank were compensated. The FSU has also indicated that it would support any move to undertake a Royal Commission into misconduct in the banking industry.

SNAPSHOT QUESTIONS

1. **Outline** the role of the FSU.
2. **Explain** how the FSU represents the views of its members.
3. **Evaluate** how effective the FSU has been in its most recent case against a major bank.
4. Do unions such as the FSU have a role in today's workplace? **Discuss**.

SNAPSHOT



'The FSU has been in operation for over 100 years.'

14.1.5 Governments and government organisations

Governments are important stakeholders in the human resource management process. Over time, they have significantly affected the industrial relations system as a result of their key roles, as follows.

- *Legislator.* Our elected representatives pass laws in parliaments (state and federal), which provide the legal framework for industrial relations. Legislation has also led to the growth of the judicial system, and the institutions and processes used by employers and employees to conduct bargaining and resolve disputes.
- *Employer.* Federal and state governments employ almost one-third of Australian workers, as teachers, nurses, clerks, police officers, postal workers, transport workers and in other roles. They are often regarded as pacesetters in terms of responsible industrial relations policies, having introduced practices such as maternity leave, flexitime and affirmative action for women that were eventually adopted in the private sector.
- *Responsible economic manager.* Governments operating at the macro level are keen to ensure non-inflationary, stable economic growth and a high standard of living for all Australians. At times there may be conflict between governments' economic goals, which impact on industrial relations. For example, a decision to cut spending through reductions in the size of the public service in order to reduce a budget deficit may conflict with its desire to maintain employment.
- *Administrator of government policies on industrial relations.* Through the departments and agencies established, governments are able to implement the legislation they enact. This is achieved through publishing information and guidelines providing advice to the government and the public and investigating breaches of legislation.

BizFACT

A global union grouping brings together three global trade unions representing 55 million workers in over 100 countries.

The key areas of action for these international unions include developing trade union networks in multinational companies, climate change and sustainable development, and building stronger unions in developing countries.

BizFACT

The Australian Government department responsible for industrial relations matters is the Department of Jobs and Small Business. This department is responsible for national policies and programs that assist people locate and maintain employment as well as work in safe, fair and productive workplaces.

- *Representative of Australia in the international arena, in foreign affairs, trade and international labour matters.* Australia is a foundation member of the International Labour Organization and has been represented on its governing body. As a result of its membership of such organisations, the government generally implements legislation based on the treaties and conventions it signs with international organisations. Social justice legislation passed in relation to discrimination, and human rights originated in these treaties and conventions.



FIGURE 14.6 Governments (both state and federal) perform many roles that have an impact on the human resources process; for example, the roles of legislator, employer, economic manager, policy administrator and representative of Australia on the international stage.

Governments have attempted to increase their power to regulate the industrial relations system through use of the External Affairs and Corporations powers (among others) given under the Constitution of Australia. Recent government policy has focused on reducing the powers of industrial tribunals and encouraging decentralised bargaining in the workplace (enterprise).

Since and the introduction of the Fair Work Australia Act, all the states, except Western Australia, referred their industrial relations powers to the Commonwealth. The aim of the federal government was to create a national system, which would simplify industrial relations so that employers were not forced to negotiate under multiple jurisdictions and to stop employees and unions from 'shopping around for the best deal'. These arrangements were intended to reduce business costs through creating greater certainty and efficiency in dealing with industrial matters.

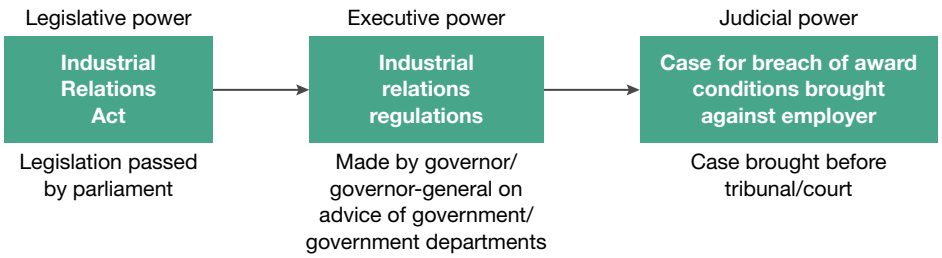


FIGURE 14.7 The functions of government (state or federal) in workplace relations

BizWORD

Statutes *are laws made by federal and state parliaments; for example, laws relating to employment conditions.*

Statutes

Statutes are laws made by federal and state parliaments; for example, laws relating to employment conditions (see table 14.1). Until recently, Australia has operated a dual system of industrial relations since federation. This has arisen as the Constitution awards the Commonwealth Government limited powers to make laws

about industrial issues and allows the states to make laws about matters not covered under the Constitution, known as residual powers.

These statutes provide the framework for awards and agreements and the resolution of disputes, and require employers to:

- meet WHS requirements
- maintain workers' compensation insurance
- provide all employees with superannuation, annual leave and long-service leave
- ensure employment practices in the workplace are free from discrimination on the basis of age, sex, physical or mental disability, marital status, family responsibility, pregnancy, union membership, political opinion, race or social origin
- give each new employee, covered by the national industrial relations system, a Fair Work Information Statement. This statement provides basic information about employee rights.

TABLE 14.1 Federal legislation

Law or test case	Date	Features
Conciliation and Arbitration Act	1904	Gave the Conciliation and Arbitration Commission power to prevent and settle industrial disputes extending beyond the limits of the state.
Harvester case	1907	Established the basic wage for full-time male worker with wife and two children.
Equal Pay case	1969	Principle of equal pay for equal work established for women.
Trade Practices Act	1974	Secondary boycotts (provisions) made illegal. Jurisdiction for this later moved to Australian Industrial Relations Commission, as ILO (International Labour Organization) report suggested it interfered with the right to strike.
Racial Discrimination Act	1975	Discrimination in employment on the basis of race, colour, national or ethnic origin prohibited.
Maternity Leave case	1979	Test case on maternity leave won by ACTU.
Sex Discrimination Act	1984	Prohibited sexual harassment and discrimination on basis of sex, marital status and pregnancy.
Affirmative Action (Equal Opportunity for Women) Act	1986	Required all private sector employers and all higher education institutions to implement affirmative action programs for the employment of women and to submit annual reports on their progress.
Industrial Relations Act	1988	Award restructuring introduced under the structural efficiency principle (SEP).
Parental Leave test case	1990	Federally covered male employees given opportunity to take leave to mind newborn children, etc.
Industrial Relations Reform Act	1993	Improved safety net provisions for employees, through the award system and minimum entitlements. Improved arrangements for direct bargaining through both certified enterprise agreements (between employers and unions) and enterprise flexibility agreements (non-union individual agreements). Protection against unfair dismissal.
Workplace Relations Act	1996	Revised framework for enterprise bargaining, allowing for collective and individual agreements, with or without union involvement. Tighter restrictions on industrial action. Limited arbitration role for AIRC.
Fair Work Act	2009	National framework for industrial relations implemented. Covers most private employees. All states refer powers with exception of WA. Ten National Employment Standards set. Collective bargaining emphasised.

BizFACT

Section 51 (xxxv), the most important section of the Constitution for industrial relations, gave the federal government the power to: '. . . make laws for the peace, order and good government of the Commonwealth with respect to: . . . (xxxv) Conciliation and arbitration for the prevention and settlement of industrial disputes extending beyond the limits of any one State'. The effect of this Section was that:

- *a dispute (actual or pending) must exist before the tribunal could intervene*
- *the dispute must be an 'industrial matter'*
- *the dispute must extend beyond one state.*

Australia has a dual industrial relations framework whereby all private sector employees are covered by a federal industrial relations system and public sector workers in several states, including New South Wales, remain in state-based system.

This system, implemented under the *Fair Work Act 2009*, is administered by the federal government. It covers all employees of **constitutional corporations** in all states and most private employees formerly covered under state awards and enterprise agreements. The system gives employers and employees the same workplace rights and obligations, regardless of the state they work in.

Key elements of the framework include:

- a national framework for industrial relations covering most private employees of all states except Western Australia
- ten National Employment Standards (NES) developed to provide basic protections to employees
- collective bargaining and good faith bargaining required by all parties
- modern awards for specific industries and occupations
- enterprise bargaining continued
- annual National Wage Case sets minimum wage
- protection from unfair dismissal
- Fair Work Commission administers the *Fair Work Act 2009* and the Fair Work Ombudsman is responsible for promoting unified, supportive and productive workplace relations that comply with the Fair Work laws.

The 122 **modern awards** cover most employees in a wide range of industries, and replace thousands of previous state and federal awards. Together with the NES and the national minimum wage order, they make up a safety net for employees covered by the national workplace relations system. They do not replace enterprise awards, which are made with a specific enterprise.

BizWORD

*A **constitutional corporation** is one that falls under section 51(xx) of the Constitution of Australia — identified as foreign corporations and trading or financial corporations formed within the limits of the Commonwealth.*

BizWORD

*A **modern award** is an industry or occupation-based award that covers all private sector employers and employees who perform work that falls within their scope. They replace all existing national system awards (except those applying to a single enterprise). They do not cover employees earning higher incomes.*

Industrial tribunals and courts

Industrial tribunals exist at the federal and state levels to enforce laws established by governments. The Fair Work Commission today plays a role in ensuring that the bargaining process and any associated industrial action occur according to law.



FIGURE 14.8 A cartoonist's interpretation of the role of tribunals

The Fair Work Commission follows in the footsteps of the longstanding Australian Industrial Relations Commission (AIRC), formerly the Australian Conciliation and Arbitration Commission. Its primary functions include settling disputes through conciliation, supervising the making of agreements or **awards** and **award simplification**, hearing appeals and handling unfair dismissal cases. The Fair Work Commission assists in resolving disputes involving employers, employees,

BizWORD

*An **award** refers to the legally enforceable minimum terms and conditions that apply to a business or industry.*

***Award simplification** is the process of reducing the number of matters in each award and eliminating inefficient work practices.*

unions and employer associations who are covered by the national workplace relations system. Through these functions and specific cases, the Fair Work Commission determines questions about future rights of employees and employers.

Much of the Fair Work Commission's work is conducted by individual members or groups of members who are responsible for specific industries or disputes, and are skilled in mediation, conciliation and arbitration. The Fair Work Commission members come from a diverse range of employment backgrounds and must have knowledge or experience in one or more of the fields of workplace relations, economics, social policy, business, industry or commerce.

A panel of seven senior members, the Fair Work Commission's Expert Panel, is responsible for hearing annual wage cases and setting minimum wages for employees in the national workplace relations system.

Breaches of the Fair Work Commission's orders can lead to fines of up to $12 600 for individual workers or $63 000 for a corporate entity.

Federal Court

The Federal Court of Australia is a judicial court. Under the Constitution, only courts have the **judicial power** to determine disputes about existing rights and to make decisions about these matters. The Federal Court has a division that enforces industrial relations legislation by administering court actions that arise under Australian industrial laws. It handles cases relating to industrial action and breaches of industrial laws, interprets industrial legislation, and is able to impose penalties for the breach of an award or order, and discrimination or victimisation under industrial and human rights legislation. It also has the power to approve the disamalgamation (splitting up) of unions, declare unauthorised action taken during a dispute and hear cases under the *Corporations Act 2001*.

Other government agencies

A number of other federal and state government agencies are also stakeholders in the human resources process. For example, the roles of the Australian Human Rights Commission (HREOC), the Workplace Gender Equality Agency (WGEA) and state organisations such as the Anti-Discrimination Board are to implement particular areas of government legislation.

In the area of WHS the federal *National Occupational Health and Safety Commission Act 1985* established the National Occupational Health and Safety Commission, now Safe Work Australia. Safe Work Australia began operating as an independent statutory agency in 2009. Its primary responsibility is to improve WHS and workers' compensation arrangements across Australia.

Recognising the need to standardise and harmonise WHS systems around Australia, the federal government developed, in collaboration with each state government through the Australian Chamber of Commerce and Industry (ACCI) and the Australian Council of Trade Unions (ACTU), a new framework for a national occupational and WHS system.

14.1.6 Society

In 1948, the General Assembly of the United Nations, consisting then of 56 countries, passed the Universal Declaration of Human Rights, recognising the importance of work to people's lives, and the need for fair and just conditions and rights for those at work (see figure 14.9).

One of the most significant issues for any voter is their job. If there are threats to employment or conditions at work, whether as a result of planned legislation, economic conditions, pressure arising from global competition or adverse social impacts, voters make their views clearly known. The relationship between

BizFACT

A full panel (bench) of at least three Fair Work members, including a Deputy President, is needed to:

- *hear matters of significant national interest such as test cases on matters, concerning family leave, superannuation and public holidays, and establish principles for making and varying awards*
- *certify multiple business agreements*
- *hear appeals against orders, or cancel and suspend awards and orders*
- *arbitrate after a bargaining period is terminated.*

BizWORD

Judicial power *refers to the power of courts to interpret and apply laws.*

employers and employees has often been a battleground, as reflected in frequent disputes and changes in legislation in Australia over the last decades.

There are two key articles in the UN Declaration of Human Rights that deal with work — **Article 23** and **Article 24**.
Key points include:

- The right to work
- The right to freely choose your employment
- Fair conditions of work
- Equal pay for equal work.
- Just and favourable (i.e. fair) remuneration
- The right to form and join a trade union
- The right to leisure and rest i.e. limits on working hours and some holidays.

FIGURE 14.9 Key points from Articles 23 and 24 from the Universal Declaration of Human Rights

As global competition increases the pressure on businesses to become leaner, the need for more efficient operations, global business consolidation and rationalisation of production has increased. Multinational corporations increasingly use contractors to supply or manufacture key components or services, creating opportunities globally for suppliers with the most cost effective operations. Often the process of relocating production offshore, or shifting production regularly to lower cost locations, leads to dislocation and structural unemployment in the communities left behind. For other communities, there is constant pressure to 'do more with less', to work longer hours and to accept hard working conditions to retain jobs.

Community demands for safety and wellbeing at work have increased over recent decades, as has the pressure to eliminate discrimination against female, indigenous and disabled members of the working community.

For businesses, it means an ongoing battle between the need for the business to find ways to reduce its biggest cost — labour — as pressure increases from global competition, and the needs of employees, particularly those with dependent families.

studyon

Syllabus area 4
Topic 2
Concept 2

Stakeholders: unions, government and society
Summary screen and practice questions

SUMMARY

- The major stakeholders in the human resources process are employers, employees, employer associations, trade unions, government and government agencies, and industrial tribunals and courts.
- Each stakeholder has perspectives that may conflict or be shared with those of other stakeholders, leading to conflict or cooperation.
- Stakeholders are increasingly operating at a variety of scales and developing global networks in response to the globalisation of business.
- Membership of trade unions has declined dramatically over the last decades at a global level in response to many factors, including the shift to less hazardous work in the increasingly dominant service sector.
- To simplify industrial relations and improve efficiency, a national system of industrial relations has been created.
- Government statutes provide the framework for employment conditions.
- Since January 2010, Australia has shifted to a dual industrial relations framework with most workers covered by a federal award and some workers, mostly public servants, teachers and essential service employees such as police and nurses continuing with state-based awards.
- The system is implemented under the *Fair Work Act 2009*.

- Industrial tribunals and courts enforce the employment laws.
- The Fair Work Commission is the national industrial tribunal that replaced the Australian Industrial Relations Commission. Its powers have been expanded to allow it to hear and settle disputes, supervise agreement making and award simplification.
- Other government agencies are also stakeholders in the human resources process including the Australian Human Rights Commission (HREOC).
- Society has a number of expectations regarding employment conditions.

EXERCISE 14.1 REVISION

1. **Identify** the major stakeholders in the human resource management process.
2. **What** are the major objectives of employers and trade unions in the human resource management process?
3. In small groups, use the brainstorm technique to **identify** the advantages and disadvantages of employers being given greater power to make agreements for a specific individual, workplace or enterprise.
4. **Summarise** the major factors changing the nature of work today.
5. With employees being more educated today, **evaluate** the need for unions.
6. **Summarise** the aim of the federal government in introducing the *Fair Work Act 2009.*
7. 'Since January 2010, Australia has shifted to a dual federal and state industrial relations system.' **Explain**.
8. **State** the main elements of the *Fair Work Act 2009*.
9. **Describe** the role of the Fair Work Commission.
10. **Explain** the impact of increased global competition on (a) employers and (b) employers.

EXERCISE 14.1 EXTENSION

1. **Evaluate** the potential success of global links developed by unions.
2. Visit the **Fair Work Ombudsman** website and **assess** the value of this website in providing information about workplace rights and rules.
3. After researching online, **explain** the issue of shifting to a national system of work health and safety.

on Resources

Weblink: Fair Work Ombudsman

14.2 Legal influences — the current legal framework

The employment contract creates obligations for both employer and employee, and all businesses operate within a legal framework of common law and statute law — that is, law passed by federal and state parliaments in Acts.

Legislation covers the nature of employment contracts and agreements; dispute-settling methods (as a result of our international agreements); protection of human rights in employment; and employer responsibilities for tax payments on behalf of employees. Employee welfare is provided for through WHS legislation and specific legislation such as the Superannuation Guarantee, under which all employers are obliged (either under awards or the legislation) to pay superannuation contributions for employees, whether or not they are on awards.

Changing community and worker expectations on **social justice** (equal employment opportunity, anti-discrimination), safety and environmental issues are increasingly reflected in legislation and work practices.

Following the election of the Rudd Labor government in 2007, a new legislative framework for industrial relations was enacted through the *Fair Work Act 2009*.

BizWORD

Social justice *in the workplace involves businesses being responsible or behaving in a fair and ethical manner towards their employees, customers and the broader community.*

Unregistered individual common law contracts of employment, casual work and independent contracting remain common options for individual employment arrangements, with many employees indicating they are offered employment under these conditions on a 'take it or leave it' arrangement. These arrangements shift the responsibility of organising employment conditions, such as sick and carers leave, onto the employee. This has led to community concerns about the 'financialisation' and 'privatisation of risk' occurring, as responsibility for support is shifted from governments and employers to employees. 'Flexibility' works for employers, but less so for employees.

We have, nevertheless, shifted from a strongly **centralised industrial relations system** in the 1980s to a **decentralised** and more fragmented system today, based increasingly on bargaining at the workplace (enterprise) level.

Successive Australian federal governments since the 1980s have supported a decentralised view of industrial relations. The Fair Work legislation referred to above was aimed at ensuring that the government's role in determining the details of employment contracts would be limited to creating the legal framework that facilitated the negotiation of enterprise agreements, the National Employment Standards, minimum wage hearings and awards.

BizWORD

A **centralised industrial relations system** *is a collectivist approach in which disputes are referred to industrial tribunals, such as the Fair Work Commission, for conciliation and arbitration.*

In a **decentralised industrial relations system**, *employers and employees negotiate wages and working conditions in the individual workplace, through collective or individual bargaining and without the involvement of tribunals.*

The influence of government on the process of determining employment contracts

The Department of Jobs and Small Business is the federal government's official industrial relations watchdog. Its role is to ensure that national policies and programs are operational, maintain and find employment for Australians and ensure safe, fair and productive workplaces.

At the state level the task falls to the NSW Industrial Relations (NSW IR) whose responsibility it is to monitor wages, employment rights, obligations and employment conditions for its public servants and other workers such as teachers, police officers, nurses and essential service workers. It actively participates as a partner in the Commonwealth's national workplace relation's framework.

The workplace relations system is essentially independent, although there are a number of organisations that fall under the responsibility of the Department of Jobs and Small Business. These are:

- Fair Work Commission
- Fair Work Ombudsman
- Safe Work Australia
- Comcare
- Asbestos Safety and Eradication Agency
- Workplace Gender Equality Agency
- Fair Work Building and Construction.

The main aim of the department is to act as a support that ensures employers and employees operate in a flexible and modern workplace within a national workplace relations system that ensures the maintenance of clear and enforceable minimum national employment standards.

To this end the current workplace relations system maintains that employment contracts between employees and employers cannot provide for less than the legal minimum set out in the National Employment Standards (NES), awards or enterprise agreements. All employees are covered by the NES whether they have signed a contract or not — the contract cannot leave them worse off than their minimum legal entitlements.

More recently, successive Australian federal governments (and to some extent most state governments) have sought to decentralise the industrial relations system. The most recent change, in the form of the *Fair Work Act 2009* ensured that the government's role in determining the details of employment contracts would be indirect and limited to ensuring that it maintains the above organisations.

This process seeks to guarantee that employees and employers, whether through a written or verbal contract, can be assured there are procedures in place to rectify concerns that their arrangements do not accord with the existing framework.

14.2.1 The employment contract

The most basic relationship in employment and the workplace is between employer and employee. An **employment contract** is a legally binding, formal agreement between employer and employee. Every employee has a contract with an employer. A written contract gives more protection to both parties than a verbal contract, as disputes often occur over contracts if working arrangements are not clear and it is one person's word against another. Usually employment contracts will be of two forms: contracts of indefinite duration and contracts of a fixed term.

BizWORD

An **employment contract** *is a legally binding, formal agreement between employer and employee.*

Contracts of an indefinite duration are the most common type of employment contract and allow for the employee to remain employed by the business until either the employee or the employer gives notice that they wish to terminate the employment. The relevant laws or the contract itself determines the period of notice.

Contracts of a fixed term are ones that expressly define a date or upon completion of a specific task; for example, the employee is engaged for a period of 12 months and the contract does not exist beyond that period, or the employee's period of work will cease to exist at the completion of a project and the relationship comes to an end.

A written contract encourages the parties to clarify the key duties and responsibilities of a job (see figure 14.10).

Dear Blake

This letter confirms your appointment to the Overboard Surf Store as its new Manager. Your employment commences on 25 July 2018 under the following conditions:

1. Your conditions of employment as full-time Manager are established in the Overboard Enterprise Agreement.
2. You will carry out all duties as a manager (as attached) within the store, together with any other duties as may reasonably be directed and requested by the employer.
3. Your wages will be subject to review by the company on the basis of individual performance assessment undertaken on a six monthly basis. Your annual salary will commence at $80 000 per annum.
4. During the first month of probationary employment, your employment may be terminated by either party giving immediate notice.
5. You will be given half a day's paid absence per week for six weeks to complete our management course.

Please complete the acceptance of this offer on the attached form.
Our store's policies and Enterprise Agreement are attached for your information. Please note the termination provisions.
We look forward to a rewarding relationship in the future and welcome you to our organisation.

Yours faithfully,
I Tuncay
Irem Tuncay
General Manager
Overboard Surf Company

FIGURE 14.10 An example of an employment contract

The contract does not need to be written, but it is valid and legally enforceable when:

- the parties involved intend to create a legal relationship
- one party offers and the other accepts the offer

BizFACT

Independent contractors are typically self-employed and have a contract for services (between a principal and a contractor) as opposed to the contract of service that employers have with employees on individual contracts of employment. Independent contractors do not have the same rights as employees, have control over their work, are responsible for their own tax payments and may work for a number of businesses. By using independent contractors, firms bypass many of the requirements of a contract of employment, such as sick leave entitlements and maternity leave provisions.

In the event of a dispute between a business and a contractor, a 'control test' is used by the courts in cases where the extent of the employer/employee relationship is unclear. If an independent contractor is working for a company and the company clearly had the right of continuous, dominant and detailed control over the contractor, the company could be seen as acting as an employer. Further evidence of the employer–employee relationship can be found in regular payments of salary or wages, regular and specific hours of work, and deduction of PAYG tax.

- both parties obtain a benefit
- both parties have the capacity to contract; for example, they are old enough to make the contract
- consent is genuine and not pressured
- the offer does not contravene any public interest.

Employment contracts need not be overly complex, but a correctly drafted employment contract will be of benefit to both parties in the long term. Attention to detail at the outset ensures that expensive litigation and negative public relations is avoided. A well-written employment contract ensures that the employment relationship commences on the right footing and should contain the essential terms shown in figure 14.11. Independent contractors also have an employment contract, although it is a little different from the conventional employer-employee contact (see the BizFACT on independent contractors).

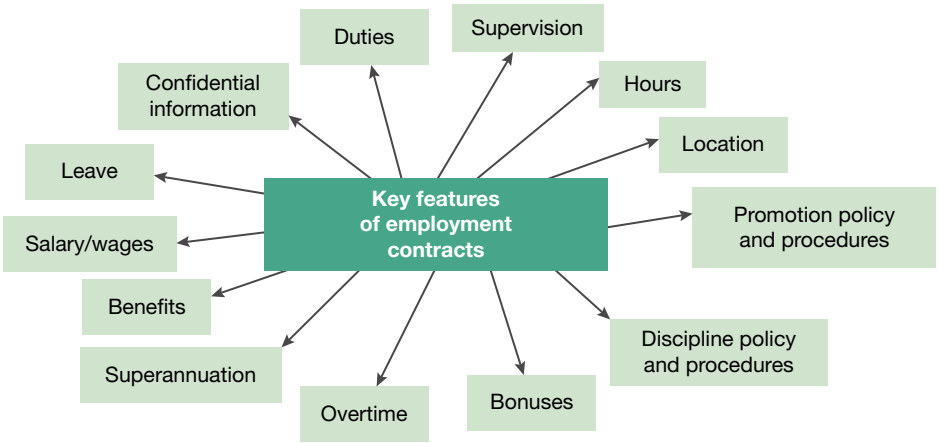


FIGURE 14.11 Key features of employment contracts

Apart from statutes, the employment contract and other aspects of human resources are governed by common law, awards and agreements.

SNAPSHOT



Case study: Avalon Airport — contract dispute

When George Haros accepted an offer from Linfox to be its Business Manager at Avalon Airport, leaving a secure and long-term relationship elsewhere, he contended that a range of representations had been made to him with respect to the security of the role (at least three years), the longevity of the role (as long as the current GM/MD remained in post) and the exclusivity of the role (only he and the GM/MD would discharge the business management/commercial function). He argued in the Federal Court that all of these representations were misleading and deceptive and contrary to what was then the provisions of the *Trade Practices Act 1974* (now replaced by the *Competition and Consumer Act 2010*). After some four months employment, he was retrenched after his position was determined to be 'redundant'.

His claims were rejected at first instance and on appeal. The Full Bench found on the facts that Haros:

- was himself a qualified lawyer with experience in employment law
- had negotiated the terms of and had signed a written contract which provided for a probation period and termination on three months' notice
- had confirmed that contract to be the 'entire agreement' between the parties, superseding any previous 'negotiations, representations, warranties or Commitments . . . ' (*Haros v. Linfox Australia* [2012] FCAFC 42).

On that basis, it was held that:

> Mr Haros did not seek, and was not given, employment for a fixed term; he accepted the position on terms that were negotiated freely; he was under no

disability in negotiation, but was an astute lawyer with relevant experience in employment law; he reviewed the draft contract; he did not demur to any of the terms proposed by Linfox; he proposed additional terms which were accepted; and he signed the contract, thereby representing to Linfox that he approved its content or was willing to take the chance of being bound by those contents . . . He was not misled or deceived, so that he was not induced by any such representations to accept Linfox's offer of employment.

The Court also found that although Linfox had frequently used language such as 'potential' and 'opportunity' in describing the role, these terms did not, in this context, equate to 'a promise of any certainty'.

SNAPSHOT QUESTIONS

1. **Outline** the guarantees that Mr Haros believed were given to him regarding the nature of his employment.
2. **Identify** what law Mr Haros believed the company was breaking.
3. **Explain** how the matter was dealt with by the Federal Court.

Common law

The **common law** is developed by courts and tribunals. Unlike statutes, it is not made by a parliament. Under common law, judges make decisions based on the facts of a case, guided by precedent (decisions made in the past). The body of common law (also known as case law) is therefore developed from decisions made over time by judges.

Under common law, both parties — employers and employees — have basic obligations in any employment relationship, regardless of whether it is in a formal or informal contract. The obligations of each party are reflected in the rights of the other party.

BizWORD

*The **common law** is developed by courts and tribunals.*

Employer obligations and rights

Employer obligations include the following.

- *Providing work*. Employers are not allowed to 'stand down' employees if there is no work. They are not generally required to provide work if there is none; however, they must pay the correct wages.
- *Payment of income and expenses*. Employers are required to pay the income (including wages, commission, fees) stipulated in the award, enterprise agreement or contract, and reimburse employees for expenses legitimately incurred as a result of performing their work.

Employers also have rights in the workplace. These include:

- Employees working with care and responsibility, especially in respect to WHS
- Employees carrying out their work according to their agreement/award, including good customer relations and accountability for money or property
- Being notified according to agreement/award of an employee's intention to take their leave entitlements
- Receiving formal advice of a workers intention to leave the business in accord with the award/agreement
- Meeting requirements of industrial relations legislation. This includes
  - providing a workplace and work practices, such as **equity** policies and promotion that are free from discrimination, as required by the sex discrimination, anti-discrimination and equal employment opportunity legislation of the federal and state governments
  - ensuring that workers are protected against unfair dismissal, where this legislation applies. Employers only have the right to dismiss employees who do not obey lawful instructions (insubordination); neglect their duties; are guilty of theft or dishonesty; exhibit wilful or serious misconduct; fail to meet the conditions of the employment contract; and fail to perform satisfactorily over time

study on

Syllabus area 4
Topic 2
Concept 3

Legal: employment contracts, common law, FWC
Summary screen and practice questions

BizWORD

Equity in the workplace *is the provision of equal opportunities for all employees to gain access to jobs, training and career paths.*

- Duty of care. Employers are legally bound under the federal and state Work Health and Safety Acts to provide reasonable care for the safety of the employees by:
  - providing a safe system of work, without risks to health
  - providing and maintaining premises that do not unreasonably expose an employee to risk of injury
  - providing resources, information, training and supervision necessary to ensure the health and safety of workers
  - protecting workers against risks arising out of their work activities.

Employee obligations and rights

All employees are obliged to observe the following:

- Carry out duties in a way that is beneficial to the business.
- Ensure that they maintain confidentiality and not use information such as sales figures in a way that is detrimental to the operation of the business.
- Account for all money that comes into the business.
- Take reasonable care and act safely in the workplace.
- Follow written and verbal procedures and policies.
- Be honest, fair and work with integrity in all dealings with both colleagues and customers.
- Obey lawful commands that are considered reasonable even if they may not be part of their primary responsibilities.
- Complete forms related to taxation and its deduction from income.
- Give appropriate notice of termination of employment in accordance with the relevant award.

BizFACT

Before you start work you should find out as a minimum:

- *what your duties and conditions are*
- *whether your job is full-time, part-time or casual*
- *what your wages and allowances are*
- *your job classification/title*
- *whether there is a probationary period.*

You should not generally be required to work for a trial period if you will not be paid for that period, unless it is part of an approved training course.



FIGURE 14.12 Employers and employees have common law duties for WHS.

Employees also have certain rights when carrying out their work. These include:

- being paid for all the time they work, including overtime where applicable
- receiving the minimum set out in the award or enterprise agreement
- having all pay recorded by the employer (some awards/agreements state that employees must receive a pay slip)
- receiving extra pay such as loading for casuals and penalty rates for work outside of usual hours
- receiving allowances for tools and uniforms if applicable
- having access to paid and unpaid leave entitlements.

Minimum employment standards

Ten National Employment Standards have been developed in consultation with business, unions and the community. They must be provided by employers and state minimum conditions for employees. They have been planned to provide a greater safety net for employees, particularly for the most vulnerable and low-paid employees in the workforce. They provide the basis from which modern awards and enterprise agreements are constructed.

National Employment Standards

1. **Maximum weekly hours of work** — 38 hours per week, plus reasonable additional hours
2. **Requests for flexible working arrangements** — parents or carers of children under 18 are allowed to request a change in working arrangements to assist with the child's care.
3. **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, and other forms of leave
4. **Annual leave** — four weeks paid leave per year, plus an additional week for certain shift workers
5. **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.
6. **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
7. **Long service leave** — a transitional entitlement for employees who had certain LSL entitlements before 1/1/10 pending the development of a uniform national long service leave standard.
8. **Public holidays** — a paid day off on a public holiday, except where reasonably requested to work
9. **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
10. **Provision of a Fair Work Information Statement** — employers must provide this statement to all new employees about major employment matters and bodies.

FIGURE 14.13 National Employment Standards

Minimum wage rates

The minimum wage rate in Australia is an employee's base rate of pay for the number of ordinary hours that they have worked and is generally determined by a modern award, enterprise agreement or the national minimum wage. The minimum wage rate is reviewed by a specialist Minimum Wage Panel of the Fair Work Commission each year and will take effect from the first pay period after 1 July of that year. Both employees and employers cannot agree upon a pay rate that is less than the minimum wage.

BizFACT

In July 2017, the Fair Work Commission handed down an increase in the national minimum wage to $694.90 (before tax) for full-time workers or $18.29 per hour plus 25 per cent loading for casuals.

Employees under 21 years of age receive a percentage of this hourly minimum, depending on their age.

Case study: The underpayment of Australia's Workers

The issue of the underpayment of some of Australia's approximately 12 million workers has become so common that in Victoria nearly 80 per cent of hospitality employers did not comply with the federal award system between 2013 and 2016. Further, almost one-third of eligible Australian workers did not receive some or all of their superannuation entitlements.

The concern is that there is a lack of resources to pursue the issue of underpayment of workers and that instead a proposal in a recent Senate enquiry

SNAPSHOT



‘. . . in Victoria nearly 80 per cent of hospitality employers did not comply with the federal award system between 2013 and 2016.’

recommended a certification scheme that rewards employers that have committed to complying with employment regulations. This could be used by compliant businesses as a marketing strategy to show that their business meets legal requirements and remove some of the demands on finding non-compliant employers.

The range of businesses identified as underpaying workers includes Myer, Woolworths, Coles, Aldi — all through their supply chains — and franchises 7-Eleven, Caltex and Domino’s Pizza.

Evidence suggests those businesses that operate in very competitive industries such as hospitality and retail are most likely to engage in ‘wage theft’, which is especially rife where supply chains contract out work (that is often further sub-contracted) and makes good governance more difficult.

In order for the businesses to survive in these minimum-cost environments, conditions often result in workplaces that exploit employees. This is especially apparent in actions that seek to cut wage costs through manipulating timesheets, ignoring penalty rate entitlements or, in some cases, forcing employees to pay back part of their wages in cash.

In a recent case a restaurant owner in Perth employed a worker from Bangladesh who was sponsored by the owner’s company to work as a cook on an employment visa. The cook was contracted to a salary of $54 000 in return for a 6- or 7-day work week that often meant more than 50 hours. After his $1634 pay per fortnight the worker was then required to withdraw cash and pay back $434 of his wages to his sponsor/employer. The worker was also refused work after he tried to return after an injury sustained in the restaurant. The injured worker provided a workers’ compensation claim for his injury and was duly sacked.

After seeking assistance from the Fair Work Ombudsman it was discovered that the worker was in fact short-changed $38 822 over the course of his employment with the restaurant. The owner of the restaurant now faces penalties of tens of thousands of dollars.

This is one example of the Fair Work Ombudsman’s pursuit of companies involved in labour exploitation. It also sought payment of outstanding wages and penalties to the tune of $27 million in 2016. Although significant, it is felt that this represents only a portion of the wage theft from that many victims, often because vulnerable workers are fearful to come forward.

One industry not prepared to see workers exploited is the cleaning industry. Stakeholders have developed the Cleaning Accountability Framework. The industry had discovered that 21 per cent of its businesses were engaging in worker exploitation through misuse of contracts and underpayment of workers. The new program ensures that cleaning business standards are verified in respect to wages and entitlements, work health and safety and general working conditions. The appropriate standard is then verified by an independent auditor and certification awarded. For those not meeting the standard, pursuit of contracts will be more difficult as well as potential brand damage.

Source: Adapted from Sarah Kaine, Emmanuel Josserand, Martijn Boersma, ‘How to stop businesses stealing from their employees’, *The Conversation*, 7 September 2017

SNAPSHOT QUESTIONS

1. **What** are the main issues outlined in the article?
2. **Identify** the proposed scheme to address the issues.
3. **List** the businesses identified as under paying workers. Why does it occur?
4. **Analyse** the case of the Bangladeshi restaurant worker subject to workplace exploitation.
5. **How** did the Fair Work Ombudsman assist the Bangladeshi restaurant worker?
6. **Evaluate** the proposed Cleaning Accountability Framework as a strategy to address workers exploited in that industry.

Awards

An award is a determination that explains the legally enforceable minimum terms and conditions that apply to a business or industry. ‘Modern awards’ are a key feature of the current industrial relations system that sought to simplify some

2400 older existing awards into industry or occupation-based categories. This was undertaken to reduce the confusion surrounding proper minimum employment entitlements. Examples of awards include the Fast Food Industry Award 2010 and the Hair and Beauty Industry Award 2010.

Currently 122 modern awards apply to all employees covered by the national workplace relations system, except for some managers or higher income earners that are not covered by a modern award. The contents of modern awards are as follows:

- base pay rates
- conditions and requirements for different types of employment (for example, full-time, part-time or casual)
- overtime and penalty rates
- allowances (such as travel allowances)
- leave and leave loading
- hours of work (for example, rosters, making changes to working hours)
- requirements for annual wage or salary arrangements
- superannuation entitlement
- conditions and procedures for consultation, representation and settling disputes
- outworkers
- redundancy conditions.

The conditions in the modern award apply on top of the minimum conditions in the National Employment Standards (NES). Awards are used as the basis for the negotiation of enterprise bargaining.

Modern awards also have a 'flexibility term' that allows employers and employees to negotiate changes to some of the conditions in the modern award. These are called **Individual Flexibility Agreements (IFA)**. They allow an employer and an employee to come to an agreement that varies the modern award or enterprise agreement in order to address individual circumstances. The arrangement must not undermine minimum employee entitlements and must leave the employee better off (usually assessed financially) on the IFA compared to the award or enterprise agreement.

The IFA can only address the following areas:

- arrangements for when work is performed, such as working hours
- overtime rates
- penalty rates
- allowances, and
- leave loading.

BizWORD

Individual Flexibility Agreements (IFA) *allow an employer and an employee to come to an agreement that varies the modern award or enterprise agreement to address their individual circumstances.*



FIGURE 14.14 Award coverage is high in hospitality, retail and community services.

For example, Chicka works at Famous Johnny's Fishing and Tackle on the mid-north coast, NSW. His son Sal is a keen fisherman who sometimes takes a few risks when he goes rock fishing and Chicka thinks it's a good idea for him to accompany Sal when he goes. Chicka asks his supervisor Zoe if it would be possible for him to leave an hour early so that he can escort Sal every Tuesday afternoon on his fishing jaunts.

Chicka knows he would be finishing ahead of his regular finishing time, but indicates that he's happy to stay back another afternoon to make up the time. Zoe explains to Chicka that his enterprise agreement contains an IFA that allows for him to finish early one day and then make up the time later in the week. Chicka is happy with such a flexible arrangement and his employer does not lose out as he still works the same hours.

SNAPSHOT



'The extra pay was seen as recognition . . . that workers sacrificed the benefits of time spent with family and friends . . .'

Modern awards — changes to penalty rates

The four-yearly review of modern awards was handed down by the Fair Work Commission (FWC) in early 2017. The focus of its decision was the need to modify weekend and public holiday penalty rates. There was much discussion about the merits or otherwise of changing entitlements for those (often younger) workers toiling away outside more traditional work hours.

Many casual staff had become accustomed to the additional rates of pay that had been a feature of Australia's workplaces for more than 100 years. The extra pay was seen as recognition that many social events (including religious services) are organised for Sundays and public holidays and that workers sacrificed the benefits of time spent with family and friends if they worked to provide services for others on those days.

The FWC received thousands of submissions from both industry and union groups as well as individuals regarding the proposed changes to penalty rates. Ultimately its decision was to:

- reduce Sunday penalty rates for those covered by the fast-food, hospitality, retail and pharmacy awards
- phase in changes over a number of years; to be finalised by 1919 or 2020
- cut penalty rates for full-time and part-time workers in retail and pharmacy from 200 per cent to 150 per cent of current rates and for casuals from 225 per cent to 175 per cent
- change penalty rates for full-time or part-time workers in the fast-food industry from their current Sunday rate of 150 per cent to 125 per cent and for casuals from 175 per cent to 150 per cent
- decrease penalty rates for hospitality workers so that Sunday pay rates will fall from 175 per cent to 150 per cent.

While the transitional nature of many of these reductions will be gradual, changes for public holidays would begin immediately. The changes across the aforementioned industries mostly resulted in a reduction in penalty rates from 250 per cent to 225 per cent for full-time and part-time workers and from 275 per cent to 250 per cent for casuals.

The FWC decision affects approximately 4 per cent of Australia's workforce and is aimed at assisting the small business sector (including franchisees) in particular, which had indicated that existing penalty rates were a financial burden that made opening on weekends and public holidays costly.

Those against the cut including major unions suggested that those workers affected by the changes to penalty rates would now need to work extra hours to make up for the loss.

Source: Adapted from Michelle Grattan, 'Sunday penalty rates to be phased down', *The Conversation* 5 June 2017; Shirley Jackson, 'Cutting Sunday penalty rates will hurt young people most', *The Conversation*, 23 February 2017

SNAPSHOT QUESTIONS

1. **What** was the decision made by the FWC?
2. **Why** were penalty rates originally introduced?
3. **Summarise** the changes to the industries affected by the FWC decision.
4. **List** the advantages and disadvantages of the changes to penalty rates for the industries identified above.

Enterprise agreements

Enterprise agreements are **collective agreements** made at a workplace (enterprise) level between an employer and a group of employees about terms and conditions of employment. They offer broader terms and conditions than a modern award, and are an alternative to a modern award.

Under the *Fair Work Act 2009*, there are three types of enterprise agreements.

- *Single-enterprise agreements* — made between a single employer and a group of employees. They can involve more than one employer in limited cases (e.g. where two or more employers are engaged in a joint venture).
- *Multi-enterprise agreements* — made between two or more employers and groups of their employees. This may occur if they share common funding, operate collaboratively and have a common regulatory system, such as a group of hospitals.
- *Greenfields agreements* — single-enterprise and multi-enterprise agreements relating to a genuine new enterprise of the employer(s) that are made before any employees to be covered by the agreement are employed. Greenfields agreements are made with one or more relevant unions.

The key features of enterprise agreements are:

- They may cover rates of pay, penalty rates and overtime, allowances, hours of work, personal and annual leave, any matters related to the relationship between the employer and the employees, plus their representative organisations involved, and how the agreement will operate, including a nominal expiry date.
- They must be approved by the Fair Work Commission, who must be satisfied that the agreement
  - has been made with the genuine agreement of those involved
  - passes a **'better off overall test' (BOOT)** compared to the modern award
  - does not include any unlawful terms or designated outworker terms
  - covers a representative group of employees
  - covers matters that may be included in an enterprise agreement
  - has a specified nominal expiry date (within four years of the Fair Work Commission's approval)
  - includes a dispute settlement procedure, including an option for disputes to be brought before an independent person, such as the Fair Work Commission, for arbitration if the parties agree to it
  - includes a flexibility clause and a consultation clause, allowing for variations if required
  - provides opportunities for employees to be represented by a bargaining representative and to bargain in good faith during the negotiation of an agreement.

To ensure that the parties bargain in good faith, there are strict rules relating to the enterprise bargaining process. They must make a serious attempt to negotiate the issues in a timely and fair manner, and genuinely make an effort to consider all proposals tabled.

BizWORD

Enterprise agreements *are collective agreements made at a workplace level between an employer and a group of employees about terms and conditions of employment.*

Collective agreements *are made between a group of employees (or one or more unions representing employees) and an employer or group of employers.*

BizFACT

The most common method of setting pay for full-time employees is by collective agreement, such as an award or enterprise agreement.

BizWORD

The **better off overall test (BOOT)** *requires that each of the employees to be covered by the agreement is better off overall than under the relevant modern award.*

Other employment contracts

As the nature of work changes, greater variety is occurring in the types and features of employment contracts available.

Individual common law employment contracts

These **individual contracts** of service cover employees not on federal agreements or specific state agreements, particularly for those earning higher incomes.

Individual contracts are more common in the private sector, particularly in non-union enterprises, in partly or wholly owned foreign firms, in the wholesale trade, and in property and business services. They are also more common at the

BizWORD

Individual contracts *exist when an employer and an individual employee negotiate a contract covering pay and conditions.*

professional and managerial level and for workers currently earning more than $142 000 per year. This figure changes annually.

Such contracts may be written or verbal. Many are informal and offer much less protection than other agreements. Although around half vary significantly from their related awards, they are generally required to provide conditions that equate with minimum provisions of related awards; if they do not, they are in breach of the law.

Comparing the process of negotiating enterprise/collective agreements with the negotiation of individual contracts

Enterprise agreements between one or more federal system employers and employees are negotiated by the parties through the collective bargaining process and for the most part at the enterprise (any kind of business, activity, project or undertaking) level.

According to the Fair Work Act an enterprise agreement should include:

- terms about the relationship between the parties to the agreement
- deductions from wages for any purpose authorised by the employee
- how the agreement will operate, a nominal expiry date that is no longer than four years from Fair Work Commission approval
- dispute settlement procedure about matters relating to the modern award or National Employment Standards
- reference to Individual Flexibility Agreements (IFA)
- consultation terms in the event of any major changes likely to affect employees significantly.

Enterprise agreements are an example of a registered agreement that can apply to one business or a group of businesses. Although no longer possible, Australian Workplace Agreements (AWAs) could previously be made with individual employees. In the event that there is an agreement it must be formally approved and registered by the Fair Work Commission.

The process of making an enterprise agreement is summarised in figure 14.15 and complies with the framework identified under the Fair Work Act, which assists employers and employees in this process.

BizFACT

The Fair Work Commission permits an official to:

- *investigate suspected breaches of the* Fair Work Act 2009 *and other workplace laws*
- *investigate breaches relating to textile, clothing and footwear industry outworkers*
- *hold a meeting with employees*
- *exercise rights under work health and safety laws.*

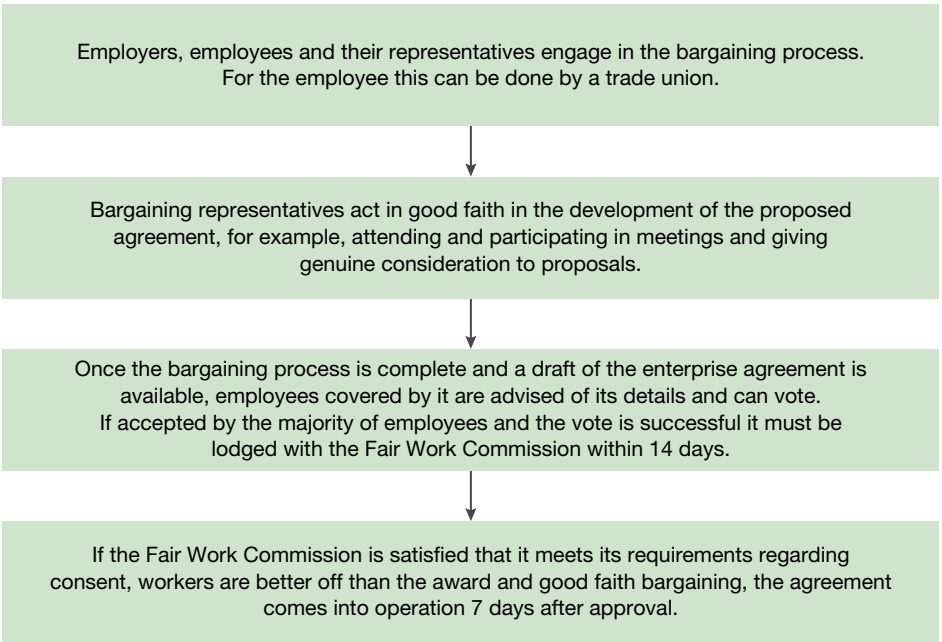


FIGURE 14.15 The process of making an enterprise agreement

For most workers the process outlined in figure 14.15 applies. However, all employees do have an individual contract with their employers and this

determines the rights and obligations of both parties. This contract must meet the minimum requirements under the Fair Work Act, which includes the conditions identified in the National Employment Standards (NES) and the national minimum wage.

While many employees will be protected by an award or enterprise agreement, there is provision for those not covered and who do not fit the usual enterprise agreement mould.

These employees are considered to be award and agreement free. In the event that this occurs, an employment contract will apply to them. This contract must include remuneration, hours of work, breaks and overtime, public holidays, leave and termination of employment and must not leave them worse off than the minimum entitlements.

For example, Simon is a senior manager of a group of hotels in the inner west of Sydney. His salary is $150 000 per year. While there is provision for some management to be covered in the relevant hospitality award this does not apply to Simon because he is considered a senior manager. As such Simon had to establish his entitlements when he commenced work with the hotel group through his employment contract and the Fair Work Act. While not covered by the award his contract must still meet minimum requirements of the NES even if he agreed to less. For example, his contract states that he is entitled to five days of sick leave per year, however, he would be still entitled to 10 days paid leave, which includes personal/carer's leave as per the NES.

Awards have not usually covered managers like Simon and other professionals such as accountants, IT specialists and those in the human resources field. They often earn high incomes and more traditional awards do not apply to them. Currently the measure of the high-income threshold is $142 000, but changes annually. The employee must have accepted a guarantee of such earnings, which can include a cash and non-monetary benefit upon commencement.

Independent contractors

Independent contractors, often known as consultants or freelancers, undertake work for others; however, they do not have the same legal status as an employee. This is a growing area of employment comprising 9 per cent of the workforce.

Independent contractors generally undertake a contract, service or project for another business, and work for multiple clients. Contractors tend to have a set term or specific project for their contract, control their own work and may delegate some of their work to others. They generally submit an invoice on completion of a task, stage or project.

The Fair Work Commission provides a clear set of criteria, developed through past test cases, to determine whether someone is a contractor or employee. A contractor carries most of the risk on a job undertaken, including covering their own superannuation, tax, insurances and leave. This is why many employers prefer to rely on independent contractors as it allows employment risks such as sickness to be shifted to the person undertaking the work.

Contracts for casual work

Since 1990, casual employment has increased from 16 per cent of the workforce to 35 per cent in 2017. **Casual employees** have contracts with employers for short-term, irregular or seasonal work. Their work period may vary, they are paid on an hourly or daily basis, and are not entitled to paid leave. Most casuals are female or young people, and often students. Many employers prefer casual staff as it reduces costs for recruitment and dismissals and other **on-costs**. They often receive a 20–25 per cent loading (extra pay) to compensate them for their lack of entitlements and job security. If they are employed regularly, or for a long

BizWORD

Independent contractors, *often known as consultants or freelancers, undertake work for others; however, they do not have the same legal status as an employee.*

BizFACT

Independent contractors are most commonly found in the construction industry, where 41 per cent of male workers are contractors. Contractors also work as consultants in professional, scientific and technical services; and in transport and storage, often as owner–drivers in road transport. Thirty-two per cent of female contractors are professionals.

BizWORD

Casual employees *are in employment that is short term, irregular and uncertain; they are not entitled to paid holiday or sick leave.*

On-costs *are additional costs involved in hiring an employee, above the cost of their wages. These costs traditionally add around 25 per cent of the cost of the wage and include sick leave, holiday leave, leave loading, superannuation, retirement and redundancy payments, and other costs.*

period of time, they may be eligible for some benefits such as superannuation and long-service leave.



FIGURE 14.16 A high proportion of casual employees are young people.

Many casual employees find they miss out on training and promotion, experience fluctuating income, and have difficulty obtaining credit. They are also more likely to experience workplace accidents and are less committed to the organisations that employ them.

Part-time contracts

The trend towards part-time work is increasing in Australia, with 29 per cent of all employees now employed on a part-time basis. During the global financial crisis employers reduced work hours for some employees in response to the downturn. This trend has continued and with the rise of two income households and the desire for a greater work–life balance, part-time contracts will continue to grow. Around 25 per cent of part-time employees are underemployed and would like more work. Forty-three per cent of women work part-time compared to 13 per cent of men.

Part-time employees have a continuing employment contract and work less than 38 hours per week. Unlike casual employees, they do have access to the employment entitlements offered to full-time employees, but on a pro rata basis (in proportion to the percentage of time they work compared to a full-time employee).

SNAPSHOT



Employment contracts — a mixed bag

Fifi, Moshe and Ozkan, old high school mates, are having a coffee in a local shopping centre, while discussing issues related to their jobs. Moshe works as a casual employee for a clothing store and is studying full time at university. Fifi is a supervisor at the local bank and Ozkan runs the local pet shop and boarding kennels.

Ozkan: All this legal stuff is giving me a headache!

Fifi: What legal stuff?

Ozkan: I have to make sure all my staff are being treated as it says in the award or we will be fined again.

Fifi: Why is it such a problem?

Ozkan: Have you seen an award? It goes on for pages, with lots of details about hours, rates for juniors, leave arrangements, shift length (which got us into trouble last

time), consultation procedures and arrangements for managing change (which I must admit I ignored last time). I've also got to worry about work health and safety all the time, like slips and trips. What kind of work arrangements have you got?
Fifi: I'm on an enterprise agreement. I'm a bit luckier than the others though because my boss pays me a little more than the award. I'm prepared to work long hours and the customers like my style, apparently.
Ozkan: How much did you pay the customers to tell the bank that?
Moshe: What do the other supervisors think?
Fifi: Well, they don't really know I'm paid more. Some of them seem to think I do earn a bit more, but I haven't told them how much I'm getting.
Ozkan: I bet the others would love to know that. They must be so cooperative with you at work.
Fifi: Well, they gossip a bit, but I just get on with my work. I don't care about the others that much; they're not that friendly and they don't talk to me much.
Ozkan: (rolls eyes) I wonder why. Do you think any others get paid more?
Fifi: No, someone in management told me I'm the highest paid.
Ozkan: Do you think any deserve more?
Fifi: There is one guy who does a great job, but his English is not quite where it needs to be, so he is not paid the extra amount.
Moshe: That sounds like a bit of discrimination to me. I bet if he were a union member the union would sort that out.
Fifi: Oh, unions just make trouble.
Moshe: Mate, the reason your safety and leave conditions are so good is due to all the groundwork unions did in the past! There was a time when you could have been sent to jail for going on strike. You just take it all for granted!
Fifi: Yes, we needed unions then. But I don't see the need for them now in this sort of job. It would be different if I were a miner. How does it all work in your job?
Moshe: Well, I'm in the union just in case I need help one day, even though I'm a casual. How are you going to cope if you have a problem? You haven't got much bargaining power. What if you and Eren have kids? How will your letter help you then? I'm on a casual rate, which is okay as I get 25 per cent more per hour than full-timers to make up for all the benefits I miss out on, such as sick and long service leave. There is no way I would stay a casual in the long term because you can't get credit easily, so there goes the car or home loan.
Ozkan: You don't get training or career development either. We've found that if you have too many casuals coming and going, no one knows what's going on, mistakes happen and can't be followed up.
Moshe: Yeah. It's hard to survive on a yo-yo income too. If your employers don't need you, they don't call you. If they don't want you anymore, they just reduce your hours and you can't do anything about it. And, of course, if you get sick, bad luck!
Ozkan: Well, maybe awards and agreements aren't so bad after all. At least all my staff get on well, their hours are regular and they get minimum wage increases regularly.
Fifi: Yeah, but you know workers on awards are the lowest paid workers of all! Lots of them are women too — women often seem to work in award-based, poorly paid occupations.
Ozkan: Yeah, but you have hardly any protection if you have a problem at work with your deal. At least they have their rights down on paper. The owner is talking to the union about developing an enterprise agreement for all the staff so we can add more incentives, such as more flexible working hours for staff who are parents or carers. I must admit, they try to be helpful. Sarita is allowed time off when her dad needs to be taken to the hospital and I'm sure Jenna uses most of her sick days to look after her kids. It's tough at times because the animals bark and howl if we don't feed them on time!
Fifi: Yeah, yeah — a likely story!

'I have to make sure all my staff are being treated as its says in the award . . .'

'The reason your safety and leave conditions are so good is due to all the groundwork unions did . . .'

SNAPSHOT QUESTION

Use the internet and **examine** the information given in the Snapshot to complete the following table.

Agreement	Main features	Advantages	Disadvantages
Collective agreement	Legally binding document stating minimum terms and conditions of employment		
Enterprise agreement		Can be tailored to fit needs of employee(s) and employer	
Contract for employment	Independent contractors		
Casual employment	25 per cent loading		

studyon

Syllabus area 4

Topic 2

Concept 4

Legal: minimum standards and wages, awards, enterprise agreements

Summary screen and practice questions

SUMMARY

- From 2007, under the Labor government, most Australian states and territories formed a national system for industrial relations to improve efficiency through more uniform laws and regulations.
- Australia had a centralised system of industrial relations until 1991 when enterprise bargaining was introduced.
- All employees are covered by an employment contract, even if it is not written.
- A written contract provides more comprehensive protection than a verbal contract.
- Independent contractors are self-employed and do not have the same rights as employees.
- Workplace relations are governed by common law, statutes made by parliament through legislation, and awards and agreements supervised by industrial tribunals.
- All employees and employers have legal rights and responsibilities.
- Employers must pay income and work expenses, comply with industrial laws, and provide a safe workplace for employees.
- Employees must obey lawful and reasonable demands made by the employer, use care and skill in their work, and act in good faith and in the interests of the employer.
- Under the national system, from 2010, ten minimum employment standards were established to provide a safety net for employees, particularly the low paid.
- Replacing many functions formerly conducted by the Australian Industrial Relations Commission, the Fair Work Commission was set up to manage awards and agreements, hear and help resolve industrial disputes, determine annual minimum wage cases, and supervise award restructuring.
- Employee wages and conditions are primarily determined by awards, enterprise agreements and minimum employment standards.
- From 2010, minimum wage rates for ordinary hours worked have been determined by:
  - award or agreement that covers the employee
  - the national wage minimum for employees not covered by awards or agreements and reviewed annually by the Fair Work Commission.
- Awards are legally binding documents containing the minimum terms and conditions of employment.
- Enterprise agreements are collective agreements made at the workplace (enterprise) level between an employer and a group of employees about terms and conditions of employment.

- Individual contracts of service exist when an employer and an individual employee negotiate a contract covering pay and conditions.
- Independent contractors, often known as consultants or freelancers, undertake work for others but do not have the same legal status as an employee.
- The government, both federal and at state level, has the role of ensuring that Australia has a flexible, modern workplace that supports a national industrial relations framework with clear and enforceable minimum national employment standards.

EXERCISE 14.2 REVISION

1 **Distinguish** between a centralised and a decentralised industrial relations system.
2 **Define** the term 'employment contract'.
3 **State** the conditions that need to exist for an employment contract to be valid and legally enforceable.
4 **How** is common law is used to determine employment conditions?
5 Complete the table below to **summarise** the obligations of employers and employees in an employment relationship. The first one has been started for you.

Obligations in an employment contract under common law	
Employers	Employees
• Provide work: cannot 'stand down' employees if there is no work	

6 **Justify** the requirement to 'act in good faith' as an employee.
7 **Why** are the National Employment Standards necessary?
8 Select what you consider to be the two most important National Employment Standards. **Account** for why you think they were included.
9 **Outline** how minimum wage rates are determined.
10 **Examine** the current minimum wage rates, which can be found on the **Fair Work Commission** website. In July 2011, the national minimum wage was $589.30 per week (before tax), or $15.50 per hour. **Compare** this with the current rate and account for the difference.
11 Apart from wage rates, **identify** seven factors contained in an award.
12 **Describe** the process that occurs if an employee reports a breach of an award.
13 (a) **Define** the term 'enterprise agreement'.
(b) **Why** are they sometimes referred to as collective agreements?
14 **Create** a PowerPoint presentation that compares the major types of agreements. Write a profile for each type of agreement, illustrating the typical type of person who would use each agreement.
15 'Employee wages and conditions are primarily determined by awards, agreements and minimum national standards.' **Explain**.
16 **What** are the features of the 'other employment contracts'?

EXERCISE 14.2 EXTENSION

1 More than half of all newly hired employees do not discuss their conditions of employment with their employer before starting work. Many of these are young or less educated people.
(a) **Create** a short script with your classmates to help a young person ask a prospective employer about their conditions of employment.
(b) **Identify** the major items that should be in an employment contract. Next to each, **explain** why these are necessary.
(c) Use information from the **Fair Work Commission** website to **investigate** pay and conditions.
(d) **Analyse** the risks of failing to discuss conditions of work with a new employer.
(e) **Explain** how membership of a trade union may help you avoid these risks.

on Resources

Weblink: Fair Work Commission

on Resources

Weblink: Department of Jobs and Small Business

BizFACT

On 1 June 2011 the New South Wales government passed the Work Health and Safety (WHS) Act 2011. *Many aspects of the original OHS legislation have been carried over to the new WHS Act. WHS has as its core the safety and protection of employees.*

BizFACT

In 2017 there were 178 worker deaths in Australia compared to 195 in 2015. Agriculture, forestry, fishing, transport, postal and warehousing represent the industries with the highest worker fatalities.

2 Using information from the **Department of Jobs and Small Business** and **Fair Work Commission** websites, answer the following questions.
(a) **Identify** the key features provided on each website.
(b) **Evaluate** each website from the perspective of an employee or an employer.

14.2.2 Work health and safety (WHS)

Growing community and worker awareness of safety and environmental issues, along with ballooning compensation costs in recent decades, have prompted both federal and state governments to improve work health and safety (WHS). In 1985, the Commonwealth Government, concerned at the high levels of injury, accidents and disease in the workplace, introduced the *National Occupational Health and Safety Commission Act 1985*.

Safe Work Australia, formerly WorkSafe, was established to conduct research and develop national standards, codes of practice and common approaches to WHS legislation, which are endorsed by state governments. However, due to constitutional limitations, the ability to enact and enforce WHS legislation has always been passed to the states. Common law supports legislation developed by the states, by requiring that employers provide competent staff and a reasonably safe system of work. Since then, Safe Work Australia has worked with state governments to harmonise WHS laws. This is intended to lead to a national system of WHS and workers' compensation, which will improve productivity by reducing the compliance costs of businesses and improve the quality of WHS conditions for all Australians.



FIGURE 14.17 Workplace accidents resulting in death are most common in transport, postal and warehousing industries.

Legislation on WHS covers employees, employers and the self-employed. In New South Wales, under the *Work Health and Safety (WHS) Act 2011*, the following are required:

- Employers must ensure the health, safety and welfare at work of all employees by providing a safe system of work; ensuring that plant and substances are used, handled, stored and transported safely; giving employees the necessary information

about the plant and substances, and training and supervision in their work; maintaining the site in a safe condition; and ensuring that the goods they design, make, supply, install or repair will not injure or damage the health of others.

- All employers must take out workers' compensation insurance, or face imprisonment or a substantial monetary fine. The compensation scheme generates its funds via the premiums paid by employers, and provides medical and financial support to injured workers. The premium paid will depend on the industry that the business is in, the amount of wages paid to workers, the costs of any claims made by injured workers and the dust diseases levy.
- Employers must take steps to ensure that people on-site who are not employees are not exposed to risks arising from work being undertaken.
- Employees are required to take reasonable care for the health and safety of others, to cooperate with employers and comply with WHS requirements.
- Employees who engage in bullying, skylarking or interfering with machinery or any other behaviour that puts other employees at risk are breaching their duties and could be fined.
- Health and safety committees must be established at workplaces with more than 20 employees if requested by a majority of employees or if directed by SafeWork NSW.
- SafeWork NSW inspectors may inspect the workplace, collect information, and issue improvement and prohibition notices under the *Factories, Shops and Industries Act 1962 (NSW)*. This may, in some cases, mean that work ceases.
- SafeWork NSW must be notified of any deaths or serious injuries in the workplace, and any plans to carry out dangerous work.
- Corporations may be fined up to $3 million and individuals $300 000 and/or 5 years' prison sentence for serious breaches, which is where the duty holder exposes a person to the risk of death or serious injury.

SafeWork NSW recommends employers use a six-step approach to WHS to prevent accidents, disease, injuries and work-related ill health (see figure 14.18).

BizFACT

Q: Who is responsible for work health and safety?

- *Employers*
- *Manufacturers*
- *Designers and suppliers*
- *People in control of workplaces*
- *People who erect and install plant and equipment*
- *Employees*

A: Everyone!



FIGURE 14.18 A six-step approach to WHS

SNAPSHOT

'Destination Zero is a core focus . . . to ensure there is no harm to its people, environment or the communities it serves.'

Case study: Woolworths and health and safety

Organisational management at businesses such as the Woolworths Group and its range of companies is expected to consider work health and safety in its corporate responsibility report, which is often a component of annual reporting requirements. To this end it constantly assesses how to ensure safety for both workers and customers. Its current initiative Destination Zero is a core focus that considers ways to ensure there is no harm to its people, environment or the communities it serves. Its aim is embodied in the philosophy, 'No task is so urgent and no service so important that we cannot take time to do it safely'. This commitment is reflected in:

- continued reductions in 'lost time' (time lost through workplace injury)
- National Safety Council of Australia highly commended award for introducing safer loading docks for the delivery of groceries
- reduced manual handling injuries through more ergonomic technology when workers engage in heavy lifting
- improved safety in its band saws that cease operating when it comes into contact with a special glove used by the operator
- use of an external contractor to conduct an independent risk analysis of stores
- improved employee nutrition and health through staff Lunch and Learn sessions that were also uploaded to the wellbeing website for staff unable to attend
- Employee Assistance Program that offers confidential counselling in partnership with external specialists.

SNAPSHOT QUESTIONS

1. **Where** does Woolworths refer to its policy on worker health and safety?
2. **Outline** the concept of 'Destination Zero'.
3. **What** are some examples of 'safety first' approach at Woolworths.
4. **Research** Woolworths' recent performance in respect to lost time through workplace injury and report on it.

BizFACT

It is an offence to dismiss an employee or alter an employee's job to his or her detriment because the employee has pursued a WHS matter. Managers must visibly and actively support supervisors in solving WHS issues.

Unions also play an active role in WHS. The Australian Council of Trade Unions (ACTU) conducts its own surveys; for example, a recent study of around 10 000 employees, about employment security and working hours, found that 49 per cent of employees suffered health problems because of their working arrangements, including stress (76 per cent) and continual fatigue (72 per cent), and 25 per cent experienced accidents or near misses.

In best practice businesses, management undertakes regular safety audits, benchmarks their performance and implements comprehensive safety programs. Policy statements, safety signs and reminders are visible, and there is regular ongoing training for staff who are aware of safety rules and prepared for emergencies.

14.2.3 Workers' compensation

BizWORD

Workers' compensation *provides a range of benefits to an employee suffering from an injury or disease related to their work. It is also provided to families of injured employees when the injury/disease was caused by, or related to, their work.*

State legislation covers employees for **workers' compensation** matters, unless they are Commonwealth Government employees. In New South Wales, workers' compensation matters are administered by the State Insurance Regulatory Authority (SIRA) and Insurance & Care NSW (icare). SIRA regulates workers compensation to ensure an equitable system and support workers with injuries related to their employment.

icare assists with insurance and care services for people injured in the workplace to improve their quality of life and where possible assists with their return to work. In accordance with regulations all employers must:

- take out a policy with a licensed insurer. Under recent legislation, there has been a strong focus on getting injured employees back to work as soon as possible.
- keep time and wages records, a register of injuries, and complete accident and internal investigation forms, or face substantial financial penalties or six months jail

- notify insurers of significant injuries within 48 hours
- establish, in consultation with the insurer and the employee's doctor, an injury management plan and a return-to-work plan for all injured workers, when fit for 'suitable duties'. Failure to display and comply with the plan (which may include employing a rehabilitation coordinator) may result in increased premiums for the employer, or loss of benefits for the employee (if they don't comply).
- pass on compensation monies to the person entitled as soon as possible. Premiums are closely linked to the number, frequency and size of claims, so it is in the employer's interest to focus on achieving high standards for WHS.

Employees must notify their employer as soon as possible of an injury or work-related illness. Compensation (financial benefit) is provided to employees (and/or their dependants) suffering injuries or illnesses (including psychological illnesses) substantially developed from their work.

The workers' compensation system supports injured workers through providing the benefits and assistance needed to recover and return to safe, ongoing work, if that is possible.

Benefits are payable if employees experience total or partial incapacity to perform work; there is a need for medical, hospital or rehabilitation treatment; or if there is permanent or partial loss of use of parts of the body. This includes facial disfigurement and damage to body organs, including bowel injuries. A lump sum payment and weekly payment to dependants are payable if a worker dies as a result of the injury. If an employee on a journey to or from work substantially increases the risk by deviating from or interrupting the journey, benefits may not be payable.

An injured employee may claim compensation, a lump sum payment or sue for common law damages for negligence. Compensation today is subject to thresholds and caps on claims. It is paid for:

- loss of wages for time off work
- medical and rehabilitation expenses, and the cost of associated travel and modifications to the home or vehicle
- permanent impairment or loss of use of a part of the body
- pain and suffering if the damage is assessed as being over $10 000.

Legal assistance may be provided to support a claim.

Benefits may not be payable if employees have deliberately injured themselves, or are solely responsible for the injury through their wilful misbehaviour or misconduct. Permanent disablement or death in these circumstances does, however, allow the payment of benefits.

Since 2000, legislative amendments have been successively introduced, some in response to a massive blow-out in the value of compensation awarded. For most employees, 'provisional liability payments' are made for up to 12 weeks after an injury, and claims for medical expenses compensation up to $5000 are accepted generally on the basis of verbal or written notification. Formal claims are generally made for matters extending beyond this period or for medical costs greater than $5000, and should be made within six months of the date of injury or accident, unless the claim relates to serious or permanent injury, death or disablement. In such cases the time limit is extended.

Eligibility for lump sum payments and the calculation of these payments under statutory law is now based on the principle of thresholds for degree of body 'permanent impairment' (loss of use, rather than disability). Through the workers' compensation system, injured workers may be entitled to weekly payments, lump sum payments for permanent impairment (and pain and suffering), payment of medical bills, the provision of legal support to pursue a claim and intensive rehabilitation assistance.

BizFACT

In New South Wales, an employer may be breaking the law if an injured employee is dismissed within six months of being injured or their position offered to a replacement employee within two years of the date of injury without the employee being first advised that she or he might not be reinstated. Full-time injured employees unfit for work receive their award wage for 26 weeks and then a fixed rate until they are fit for some work.

If a worker suffers an injury in the workplace, the employer, injured worker, insurer and treatment provider each have responsibilities to ensure that the injured worker is provided with benefits and assistance to recover and return to work.

Weekly payments are structured in such a way that they are consistent with the policy of assisting employees back to work. To facilitate this there is a higher payment in the first 13 weeks. Most workers return to work at this time and it also serves to provide workers with an incentive to return to work.

Workers' payments will cease after 2.5 years, unless there is total incapacity for work. Payments will then cease for those with total incapacity after 5 years, unless there is 20 per cent whole person impairment. Previously, payments continued until the person was able to return to work or until their retirement.

Workers will also receive payments from day one (95 per cent), with a further drop to 80 per cent at 14 weeks (although they retain 95 per cent if working at least 15 hours a week). Payments remain at 80 per cent (or 95 per cent) until they cut out altogether.

The maximum penalty for a false claim under the NSW Workers Compensation Act is $5500 or 12 months' imprisonment, and for insurers who delay commencing payments penalties up to $50 000 apply.

Visit the **WorkCover NSW** website for more information.

on Resources

Weblink: WorkCover NSW



FIGURE 14.19 Workers' compensation provides payments for employees that are injured or become ill and are unable perform their duties at work.

BizFACT

The Workers Compensation Commission is a free service and conducts face-to-face conferences or teleconferences to resolve issues between injured workers and employers.

Common law redress

Employees may take action against an employer when the employer or another employee has been negligent or breached their duty, if the employee has a permanent body impairment of more than 15 per cent and if the injury occurred at least six months prior to the claim. Common law action has been taken for serious diseases such as those caused by asbestos (see the following Snapshot). Such claims are heard in the district or supreme courts (depending on the size of the claim), and once an employee has successfully achieved a settlement, there are no further payments. If employees are unsuccessful in their actions,

they will continue to receive workers' compensation as required under statutory law.

Legal advice must be considered before seeking damages obtained under common law redress. Employees injured may not claim both damages at common law and lump sum compensation for permanent impairment under statutory law.

Case study: James Hardie Industries — compensation for asbestos victims

The James Hardie Industries asbestos case has been called Australia's largest corporate scandal.

Hardie has been Australia's largest asbestos manufacturer. Asbestos is a building material present in one-third of homes and buildings built before 1970. Asbestos-related diseases such as mesothelioma and other asbestos-related lung diseases are expected to affect 30 000 Australians in the future. Seven thousand, five hundred Australians have already died from mesothelioma.

The James Hardie asbestos compensation issue has been controversial.

Two members of Hardie's senior management resigned in 2004, including its CEO, under pressure from a commission of inquiry, which found it had not fully told the truth to the New South Wales Supreme Court, and its management had been less than honest with the Australian Securities Exchange and the community on the issue of asbestos. It had not put enough money into a compensation fund to compensate future claims, and its chief financial officer was prepared to be deceitful where asbestos was concerned. Claims alleged that Hardie management had deliberately restructured operations to a Netherlands base to avoid their obligations for compensation of victims of asbestos. The two members of senior management who resigned are alleged to have received executive payouts totalling $10 million.

Under pressure from victims' lawyers, the ACTU and other groups, James Hardie signed a landmark agreement in December 2004, providing asbestos sufferers with compensation valued at over $4 billion, over a 40-year period.

James Hardie's then CEO, Meredith Hellicar, hailed the agreement as a 'compassionate' outcome, which is 'fair and equitable for all parties' and she hoped it 'convinces the Australian community that we are seriously committed to that responsibility'. The company placed payments into a special purpose fund for current and future victims, at 35 per cent of its free cash flow. A key feature of the agreement is recognition by all parties that ongoing James Hardie viability is essential to long-term benefits for its victims.

When this agreement was later shown to leave the victims underfunded by around $1 billion, further action was taken against the non-executive directors by ASIC. The action failed in the NSW Court of Appeal in December 2010.

SNAPSHOT QUESTIONS

1. **Why** did management behave in such an unethical manner for so long?
2. Do you think the Hardie executives who resigned as a result of the commission of inquiry into their management practices should have been paid $10 million? **Justify** your response.
3. **What** are the reasons for the capping of annual payments at 35 per cent of the company's free cash flow?

SNAPSHOT



'The James Hardie asbestos compensation issue has been controversial.'

SUMMARY

- Work health and safety (WHS) legislation is in the process of being made uniform around Australia to improve business productivity.
- The relevant act in New South Wales is the *Work Health and Safety Act 2011*.

- Employers must provide a safe system of work, and ensure employees are trained and supervised in their work.
- All employers must take out workers' compensation insurance.
- Employees are also responsible for taking reasonable care for the health and safety of others.
- In New South Wales three organisations — SafeWork NSW, the State Insurance Regulatory Authority (SIRA) and Insurance and Care NSW (icare) — are the organisations responsible for WHS, workers compensation, and insurance and care services for injured workers respectively.
- Common law redress can be sought where the employer or another employee has been negligent or breached their duty, leading to serious injury or death.

EXERCISE 14.3 REVISION

1. Look at figure 14.17 and **identify** some safety concerns associated with the workplace.
2. **What** are the WHS risks faced by people in the following jobs: auto mechanic, teacher, ship refueller, scientist, process worker in a textile factory, hairdresser, miner, bank officer, police officer, truck driver, airline pilot?
3. **Investigate** and **discuss** the most common factors contributing to accidents at work.
4. **Construct** a table listing employer and employee responsibilities for workplace safety.
5. Management may use a range of strategies to evaluate the effectiveness of WHS programs; for example, safety tours of a plant, reviewing specific aspects on a random basis, risk assessments for changes in the workplace and specific job safety analysis. **Propose** some additional strategies that you would use.
6. The industries in which accidents and injuries are most likely to occur are manufacturing, transport and storage, agriculture, forestry and fishing. **Investigate** safety risks in these industries.
7. Male employees who are either young or aged between 45 and 49 are more likely to experience injuries and accidents at work. **Propose** reasons for the high number of accidents within these two groups.
8. Substance abuse is becoming a problem in many workplaces in which employees experience stress. **Discuss** whether employers have the right to drug test employees.
9. **Identify** the organisation responsible for managing workers' compensation.
10. **Identify** the cost of failing to take out workers' compensation if you are an employer.
11. **Why** were legal limits on compensation introduced from 2000?
12. **Describe** the main ways in which injured employees are assisted today under workers' compensation.
13. **How** can an employee seek common law redress?

EXERCISE 14.3 EXTENSION

1. A high-volume, internet-based financial services business operates 24 hours a day. Some of its 100 staff work a rotating night shift, while others take turns to be 'on call'. The majority of staff operate from 7.30 am to 6–7.00 pm, although official working hours are 9 am to 5 pm.
   (a) Using this example, **identify** the factors that could lead to high levels of stress.
   (b) **Discuss** how high levels of staff stress could affect the business.

(c) **Explain** why substance abuse could be a problem in this business. **Recommend** to the business some points to deal with substance abuse.

2 Use information from WorkCover NSW to **investigate** recent issues and updates related to workers' compensation matters.

14.2.4 Anti-discrimination

Discrimination occurs when a policy or a practice disadvantages a person or a group because of a personal characteristic that is irrelevant to the performance of the work. It includes harassment (offending behaviour or intimidation) and vilification (a public act which is discriminatory and incites hatred).

Anti-discrimination legislation has been enacted to protect employees from direct and indirect discrimination (see figure 14.20) in recruitment, selection, training, promotion, remuneration, termination and opportunities to access any other employment benefits or practices. To prevent discrimination and to avoid large fines, employers need to:

- comply with legislation
- audit all policies and practices to ensure they do not discriminate.

Employers and managers working in human resources need to be familiar with the following legislation:

- *Human Rights and Equal Opportunity Commission Act 1986* (Cwlth)
- *Affirmative Action (Equal Employment Opportunity for Women) Act 1986* (Cwlth)
- *Sex Discrimination Act 1984 (Cwlth)* and the *Anti-Discrimination Act 1977* (NSW).

The agencies available to support the legislation are the Australian Human Rights Commission, the Workplace Gender Equality Agency and the Anti-Discrimination Board (NSW).

Under discrimination laws it is illegal to take adverse action in employment on the grounds of a person's:

- race, sex, sexual preference, colour or age
- physical or mental disability
- religious faith or political opinion
- social origin or national extraction
- marital status and carer responsibilities
- pregnancy or potential pregnancy.



FIGURE 14.20 Direct and indirect discrimination

Protection has been further enhanced under the Fair Work Act. It allows freedom of association for members or non-members of a union and protection in a wider range of employment aspects. This may include dismissing an employee, damaging their ability to do their job, changing an employee's job to their disadvantage, treating one employee differently to other employees, refusing to employ a

BizWORD

Discrimination *occurs when a policy or a practice disadvantages a person or a group of people because of a personal characteristic that is irrelevant to the performance of the work.*

BizFACT

In 2014, the Fair Work Ombudsman was successful in its first court case relating to discrimination on the basis of age. The case involved a Brisbane restaurant employee who had been dismissed upon turning 65. The employer was fined $20 790.

potential employee, and not offering a potential employee all the terms and conditions normally in a job. People who suffer discrimination may take a range of actions internally, formally or informally (see figure 14.21).

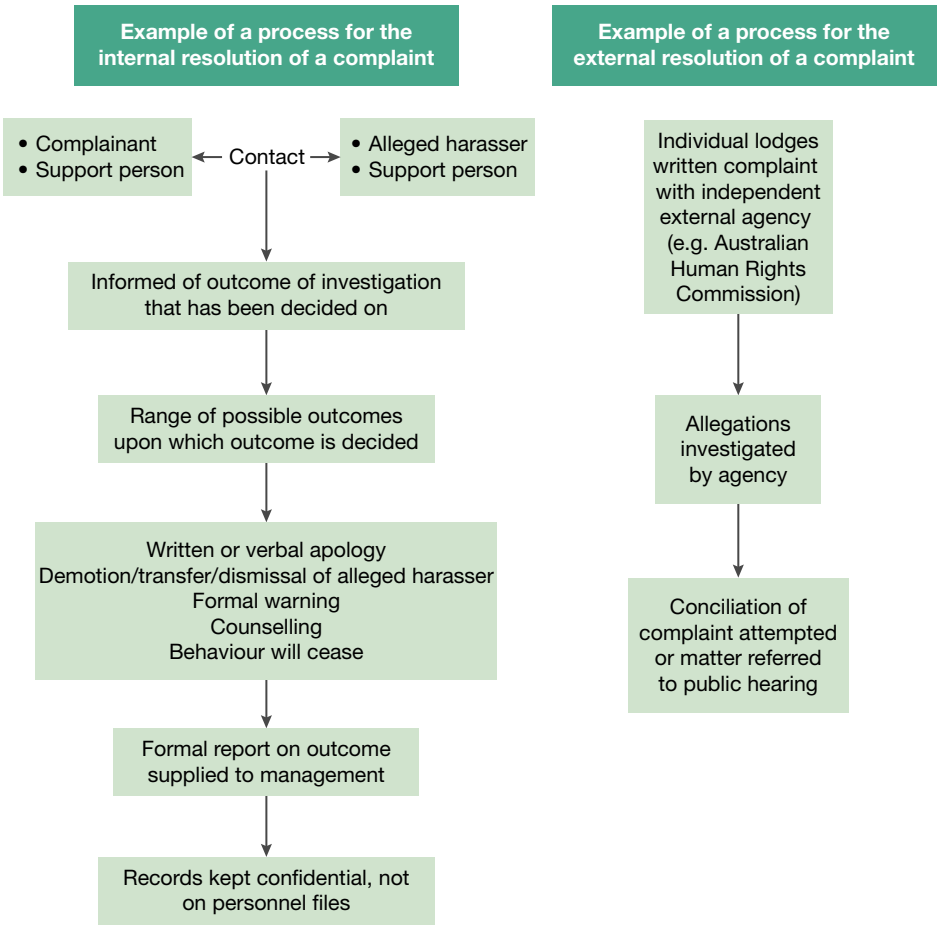


FIGURE 14.21 Options available in resolving a complaint of discrimination

BizFACT

Typical outcomes from a complaint may include:

- *a formal apology*
- *counselling*
- *official warnings*
- *mediation or conciliation*
- *disciplinary action.*

Outcomes will be influenced by the evidence, previous incidents, the wishes of the person experiencing discrimination, and the severity and frequency of the discrimination or harassment.

BizFACT

An employer may be held liable if any of the following discriminates against or harasses an employee: an employee or a group of employees, agents, contract worker, partner, director, supervisor, manager or trade union representative.

Strategies used increasingly by businesses to eliminate discrimination include:

- committing to a workplace free from discrimination
- writing and communicating policies to prevent discrimination and harassment, including a code of conduct
- making sure all policies and procedures are clearly documented and accessible to employees, offer informal and formal options, and guarantee timely responses, confidentiality and objectivity
- training managers and staff in cultural diversity issues and ways to prevent or deal with discrimination and harassment, primarily using face-to-face and interactive training programs
- appointing a grievance officer and specifying grievance procedures involving issues such as sexual/racial harassment
- regularly evaluating record keeping, implementation and effectiveness of policies, workplace culture and action taken to resolve complaints.

All employers are required to take reasonable steps to eliminate discrimination. Whether reasonable steps have been taken is considered on a case-by-case basis, as a large corporation is clearly capable of a different level of action than a small business. Employer associations and anti-discrimination agencies can help businesses develop a strategy that ensures consistency and fairness in handling of complaints.

Age discrimination in the workplace

Almost a third of Australians perceived some form of age-related discrimination while employed or looking for work in the last 12 months — starting as early as 45 years of age, our study finds.

We conducted a national survey of 2,100 men and women aged 45 years and over, and 100 telephone interviews. The most common form of perceived discrimination was negative assumptions about older workers' skills, learning abilities or cognition.

Survey participants also reported limited or no opportunities for promotion or training, working in an organisation that undervalued them and difficulty securing work due to age.

Our findings align with previous research from the Australian Human Rights Commission where 27% of Australians aged 50 years and over had recent experience of age-based discrimination in the workplace. In this survey the most common forms were limited employment, promotion or training opportunities and perceptions that older people have outdated skills or are too slow to learn new things.

Older adults in our study described a subtle pressure from their colleagues and management to stop working in order to "make room for the younger generation". This was regardless of their experience, enduring capabilities or working preferences.

Workers also faced patronising attitudes, where employers or colleagues assumed they would struggle to pick up new technology or work systems quickly, due to their age. Some survey participants felt they were not afforded the same promotional or training opportunities as their younger colleagues.

Experiences differed for men and women in our survey. Men were more likely to suggest discrimination based on assumptions about their physical abilities or working pace, and women reported the organisation they worked for undervaluing older workers as a group.

To avoid discrimination interviewees reported using strategies such as minimising health conditions, concealing their age or maintaining a "youthful" appearance.

Although there has been some research into industry specific experiences of age discrimination, there are limited comparisons in research of prevalence and type of discrimination between industries.

Our data indicates that age related discrimination traverses all industries in worrying proportions. Industries where age discrimination was particularly common included construction, administrative services, education, manufacturing, essential services, information technology and professional service industries.

Hiring and firing of older workers

Over two thirds of retirees in our study, who had experienced age related discrimination, attributed their retirement to involuntary factors such as "having no choice", redundancy or dismissal. Negative experiences at work (with a colleague, management or client) or dissatisfaction with organisational changes were often the trigger events for retirement.

Older job seekers reported being candidly or surreptitiously rejected through recruitment processes on the basis of age alone. Education, training and a steady working history were not guaranteed to help study participants in their search for employment.

Some interviewees had found it necessary to accept work for which they felt overqualified. Job seeker services in particular were considered ill-equipped to assist older, highly experienced and often well-educated adults.

These findings are in line with similar research in which study participants interpreted suggestions from potential employees that they were over qualified or experienced for a role, to mean they were "too old".

Our interviewees believed that younger managers can feel intimidated by older workers. This may be based on concerns regarding an older employee's ability to take instruction from somebody younger, learn new work methods and technologies or readily adopt change.

SNAPSHOT



"The most common form of perceived discrimination was negative assumptions about older workers' skills, learning abilities or cognition."

Why we should fight age discrimination

Beyond the moral and ethical issues of how older adults are treated, the experiences recorded in our study can have tangible implications for individuals and employers.

The government is trying to reduce dependency on the aged care pension by encouraging workers to stay in the workforce longer and accumulate sufficient superannuation (and other assets). Employment in high quality work can support and protect the health of men and women as they age.

But adults who feel devalued in their workplace, or unable to find suitable employment, are more likely to enter retirement earlier than anticipated and less inclined to re-enter the workforce.

Our survey results also suggest that people experiencing work-related ageism tend to report poorer health, lower household incomes and lower total superannuation fund balances, than those who have not had this experience.

Mature aged workers bring with them a range of favourable characteristics such as stability, reliability, loyalty, experience, wisdom and maturity. One way to tackle work related ageism is to firstly address negative perceptions regarding the competency of older workers.

This may be best addressed by employment services and human resource staff who are often on the front line of helping these workers find suitable employment. These workers can be skilled to respond to the needs of mature age job seekers. The introduction or reinforcement of policies supporting diversity in the workplace is another important step to support older worker participation.

Source: Justine Irving 'Age discrimination in the workplace happening to people as young as 45: study', *The Conversation*, 26 April 2017

SNAPSHOT QUESTIONS

1. **What** percentage of Australians have experienced age-related discrimination?
2. **List** the common forms of age-related discrimination experienced by those interviewed.
3. **How** does the age-related discrimination identified in this Snapshot agree with the research carried out by the Australian Human Rights Commission?
4. **Outline** how the experiences of men and women were different in respect to age-related discrimination.
5. **List** the industries where age-related discrimination is of greater concern.
6. **Describe** the link between the retirement and age-related discrimination.
7. **Explain** the costs and benefits to society of having an older workforce.

BizWORD

Equal employment opportunity (EEO) *refers to equitable policies and practices in recruitment, selection, training and promotion.*

Affirmative action *refers to measures taken to eliminate direct and indirect discrimination, and for implementing positive steps to overcome the current and historical causes of lack of equal employment opportunity for women.*

14.2.5 Equal employment opportunity

Equal employment opportunity (EEO) refers to equitable policies and practices in recruitment, selection, training and promotion. EEO ensures that the best person for the job is chosen, the business gains the person with skills and abilities most appropriate to its needs, and a more positive work environment is promoted.

The level of equity in a business is reflected in the extent to which women and minority groups have access to different occupations and positions within the business. It is also reflected in the grievances expressed or legal action undertaken on the grounds of discrimination or sex-based harassment.

Employers with more than 100 employees, and all higher education institutions, are obliged to develop an **affirmative action** program in consultation with employees, and to provide a progress report to the Workplace Gender Equality Agency (WGEA).

The *Equal Opportunity for Women in the Workplace Act 1999* has been replaced by the *Workplace Gender Equality Act 2012* and aims to promote and improve gender equality and outcomes for both women and men in the workplace.

WGEA was created to reflect this new focus and achieves this by:

- advising and assisting employers to promote gender equality in the workplace
- reviewing compliance with the legislation
- providing research findings and educational programs to improve gender equality outcomes
- establishing a workplace profile and analysing the issues in the specific workplace
- reporting on the actions taken by the employer to address priority issues
- describing action plans for the following period and evaluating the strategies used.

Businesses are then assessed as complying or not complying with requirements.

The aim of the program is to remove discriminatory employment barriers and take action to promote equal opportunity for women in the workplace.

Businesses also need to comply with the discrimination provisions in the Fair Work Act, which includes broader provisions relating to most areas of employment. The Fair Work Commission must now take action (including making orders) to ensure that no existing or proposed award or enterprise agreement discriminates on a wide variety of grounds.

WGEA recommends that businesses focus on six areas to improve equity within their business: recruitment, promotion and separation; access to all occupations and areas; equitable total remuneration; training and career development; work and life balance; sexual harassment and working relationships.

The aim of gender equality in the workplace is to achieve equal outcomes for both women and men. In order to achieve this, workplaces:

- must provide equal pay and conditions for women and men for work of equal or similar value
- should remove anything that prevents the full participation of women in the workforce
- must facilitate access to all jobs and industries, including leadership roles for women and men
- must eliminate discrimination on the basis of gender, particularly in relation to personal responsibilities including family and caring for both women and men.

Gender equality in the workplace is important as it encourages stronger applicants, especially women, entices more highly educated (often female) applicants, reduces costs associated with staff turnover, and encourages varied perspectives and views which results in stronger business performance, both internally and nationally.

BizFACT

Firms failing to lodge a report or submitting a report that does not comply with the Act may be publicly named in a report tabled in parliament that also receives significant media publicity. They are also excluded from government contracts and industry assistance grants.

BizFACT

Most gender discrimination happens in the recruitment stage, according to WGEA.

Case study: Chevron and the advantages of a diverse, culturally competent workforce for a global business

The US multinational energy company Chevron has operated since the end of the nineteenth century. In recent years it has been recognised for its commitment to the work health and safety, human rights, development and diversity of its workforce. Its Australian operation is a wholly owned subsidiary, Chevron Australia Pty Ltd. It, like its parent company, understands its role as an ethical employer and invests in community programs, often in the area of the country where its projects are located.

It is particularly committed to pursuing programs that provide for a diverse and culturally competent workforce that it attributes to:

- recruitment and outreach programs that target underrepresented groups such as women and indigenous people
- diversity councils, employee networks and personnel development committees
- an emphasis on diversity of thought, education, origin, gender, skills and experience.

SNAPSHOT



‘. . . understands its role as an ethical employer and invests in community programs . . .’

A recent initiative has been its education programs that aim to increase the number of women in engineering roles in Western Australia. The Women in Engineering Program seeks to provide women with the skills and confidence to pursue engineering careers in the oil and gas industries and its Women in Future Leadership Program aims to equip women with basic employment skills relevant to the energy industry. The programs provide female students with an environment where they can gain insights into engineering from a female perspective with access to mentors and successful female engineers. Each program attempts to give insight into how to break down barriers that often prevent women from choosing a career in engineering, including options for part-time work that support women with existing family responsibilities.

SNAPSHOT QUESTIONS

1. **What** are Chevron's main business interests?
2. **List** reasons for Chevron's diverse workforce.
3. **Identify** its recent education programs and their objectives.
4. Go to Chevron's career page on their website and view some of the worker experiences. **List** the advantages of such a workforce for the business.

on Resources

Weblink: Chevron careers

studyon

Syllabus area 4
Topic 2
Concept 5

Legal: WHS, workers' compensation, EEO, anti-discrimination
Summary screen and practice questions

SUMMARY

- Discrimination occurs when a policy or a practice disadvantages a person at work because of a personal characteristic that is irrelevant to the performance of their work.
- All employers must implement anti-discrimination legislation, as well as audit all policies and practices to avoid large fines, legal orders and damages, and loss of reputation.
- Anti-discrimination legislation is supported by government agencies, including the Australian Human Rights Commission, the Workplace Gender Equality Agency and the Anti-Discrimination Board (NSW).
- Equal employment opportunity refers to equitable policies and practices in recruitment, selection, training and promotion.
- Affirmative action refers to measures taken to eliminate direct and indirect discrimination and for implementing positive steps to overcome the current and historical causes that result in a lack of equal employment opportunity for women.
- There is significant gender inequity in management roles in Australia.
- All employers with more than 100 employees, and all higher education authorities, must report annually, unless exempted, on equal opportunity programs they develop in consultation with employees and progress achieved.
- Businesses that do not comply are likely to be named in parliament, and excluded from government contracts and industry assistance grants.
- Strategies commonly used to resolve a complaint of discrimination include apology, counselling, official warning, mediation, conciliation or disciplinary action.
- Developing a code of practice and making equal opportunity awareness a criterion in promotion and performance appraisal are two of the practical strategies that can be used to improve affirmative action and gender equity.

EXERCISE 14.4 REVISION

1 **What** is meant by the term 'discrimination'?
2 **Identify** the grounds under which a discrimination complaint may be made.
3 Look at figure 14.20 and **distinguish** between direct and indirect discrimination.

4 **Recall** a range of possible outcomes for a discrimination complaint.
5 **Why** are most employers keen to avoid such complaints?
6 Select the strategy you consider to be the most effective in eliminating discrimination in business (see page 420). **Justify** your selection.
7 **Outline** the consequences for employers who do not comply with the legislation.

EXERCISE 14.4 EXTENSION

1 Tamara has recently applied for a promotion. She informs her manager that she is pregnant and will be taking parental leave in three months. Tamara fails in her application for promotion. Although she is highly qualified for the job, Tamara's manager advises her that she was not promoted because she will be able to do the job for only a short time before she goes on parental leave.

   Tamara comes to see you, an adviser at the Australian Human Rights Commission. **Explain** the advice you would give Tamara. To help, use information available from the **Australian Human Rights Commission** website.
2 **Evaluate** the legal requirement for large employers to provide a regular equal opportunity report.
3 **Create** a script in which you support a group of women experiencing sexual discrimination at work. **Propose** strategies to resolve the problem.

on Resources

Weblink: Australian Human Rights Commission

14.3 Economic influences

14.3.1 The economic cycle

The demand for labour (employees) is determined by the demand for goods and services within the economy. If labour shortages develop during periods of economic growth, such as during a peak or during the expansion phase in the business cycle, shown in figure 14.22, employers compete for employees by offering higher wages. Unions may use their stronger bargaining power to demand significant wage increases, which may then put upward pressure on costs and prices, creating inflation. During downturns in the economic cycle, as indicated in a trough, or the recession phase of the business cycle, the demand for goods and services falls. Businesses are forced to reduce the size of their workforce (downsize) and limit their capacity to provide significant wage increases.

BizFACT

Subdued wage growth has plagued the Australian economy for the past two years. Low pay increases persist and growth is at its slowest since the end of the twentieth century. Among reasons for the sluggish growth are the need for Australia's economy to become more competitive, technological change, higher rates of casual employment, global trends and existing spare capacity in some sectors.

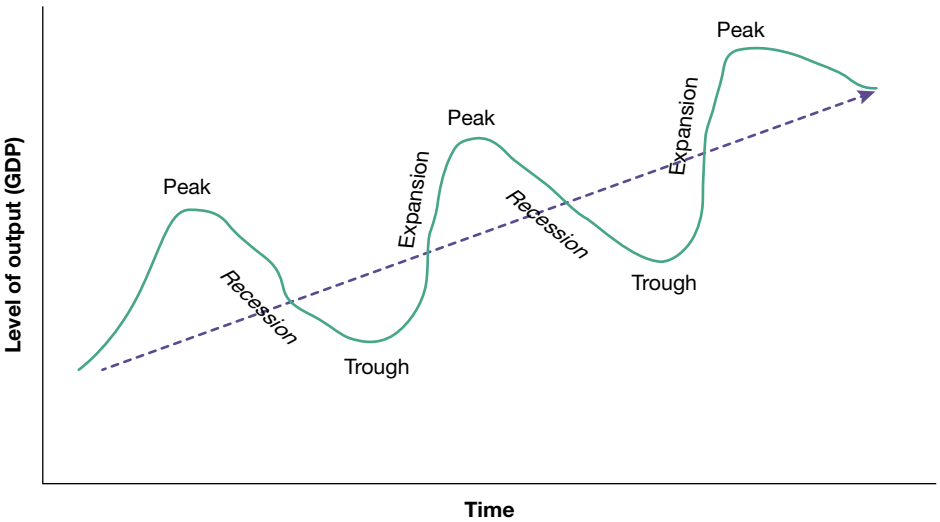


FIGURE 14.22 The business cycle

BizWORD

Structural change *refers to a change in the nature and pattern of production of goods and services within an economy. This includes a significant growth in the level of services in an economy compared to other sectors.*

BizFACT

Australia's transitioning economy needs to plan for tomorrow's employees. Literacy, numeracy and STEM education are vital to those who will be affected by industry and professional change due to automation.

Structural change

Structural change occurring in the economy has led to a rapid employment growth in the services sector, which accounts for 86 per cent of total employment.

Employment is growing in property, business, retailing, trades, tourism, educational services, hospitality, and community and personal services. Some of these industries have been traditionally dominated by women. As each sector grows, recruitment, selection and remuneration become important industrial issues. With an ageing population, flexible staffing arrangements, retention and mentoring increase in importance. Effective training and staff empowerment are also critical to business success in such customer service-based industries.

In manufacturing, removal of protective tariffs and quotas has increased business exposure to international competition. The subsequent fall in employment in manufacturing has been hastened by rapid technological change.



FIGURE 14.23 As the economy undergoes structural change, opportunities in some industries are created, leading to job creation. For example, tourism is a rapidly growing industry. Unfortunately, jobs are lost in industries that can no longer compete.

studyon

Syllabus area 4
Topic 2
Concept 6

Economic influences
Summary screen and practice questions

14.3.2 Globalisation

Globalisation of business has increased the level of international competition. Australian businesses compete every day with 'local' subsidiaries of transnational corporations. Many restructure, outsource non-core functions or subcontract production in order to compete effectively. Corporations, both domestic and transnational, are increasingly prepared to relocate production units in other cities, states or countries where dispute levels, labour and regulatory costs are much lower. In such an environment, there is an increased need to attract and retain motivated and effective core staff, and make continuous improvements in productivity, costs, innovation, quality and customer service. Enterprise bargaining has allowed many employers to trade-off restrictive/inefficient work practices for wage increases in industrial agreements. Business profitability has improved significantly.

Training in the management of multicultural workforces, with differing approaches to power, authority and the role of groups/individuals, is increasing with the globalisation of business.

There is also an increasing role for international organisations, such as the International Labour Organization and trade blocs (for example, the European Union and the World Trade Organization), to promote trade between countries that adhere to social justice principles (such as bans on child labour).

14.4 Technological influences

As outlined in topic 1, technological change is the major source of improvements in productivity, communication and competition between businesses. It is causing the nature of production and services to change, and new jobs to be created, while others are made redundant. Many businesses are re-engineering and restructuring as networks, often offshore, make increasing use of 'virtual teams' using video technology. A suite of electronic communications options allow firms to operate 'anywhere, anytime' and to harness staff through telecommuting. This has provided a major opportunity for businesses to access employees at home, increasingly those in developing nations who would otherwise be disadvantaged through traffic congestion or distance from the business office. Use of new communications technology does increase the need for ongoing training programs and new protocols to ensure that work–life balance is maintained in an environment in which society often expects people to be 'always on call'.



FIGURE 14.24 Technological change underpins productivity improvements, however, it can have a negative effect on achieving a work–life balance.

14.5 Social influences

14.5.1 Changing work patterns

Over the last two decades there has been a dramatic growth in part-time and casual work, largely due to growth in the finance, retail, hospitality and community service industries. Most part-time workers do not want to work additional hours and part-time work offers them flexibility in balancing their work and personal lives. Work patterns are changing and commentators refer to this trend as 'labour fragmentation'.

In recent years there has been an obvious drift away from traditional full-time employment towards part-time employment. In 1979 only 16 per cent of the workforce identified themselves as part-time employees, but by 2012 this had grown to 29 per cent. Part-time work is especially common among women.

BizFACT

Communications technology can change the workplace structure. For example, a cleaning company that relies totally on mobile phone communication may be able to virtually eliminate its main office. However, it may need to increase its social activities, or plan special team meetings to promote commitment and communication to the business and its identity.

BizFACT

Approximately 6 million Australians will require training in digital literacy by 2025 and at least 100 000 IT workers by 2022 to compete globally.

studyon

Syllabus area 4
Topic 2
Concept 7

Technological influences
Summary screen and practice questions

BizFACT

The 2016–17 NSW Intergenerational Report (Future State NSW 2056) *provides insight into how the state may look 40 years from now, with respect to demographic, workforce and housing trends. It identifies issues that the government of the day should consider in order to ensure the highest possible living standards for its citizens.*

Its key findings in respect to influences on human resources were:

- *growing services sector*
- *more flexible work patterns including outsourcing*
- *portfolio careers, telecommuting and remote working*
- *increased work opportunities beyond the traditional retirement age, especially women*
- *decreasing workforce participation for the 15–24 years age group as they stay longer in education*
- *increased skill levels for workers*
- *job growth in the aged care sector.*

Businesses in search of greater flexibility in the workplace are more likely to offer part-time options that are greeted favourably by workers in search of a better work–life balance. Other workers may be interested in undertaking additional education and training and/or want to ease themselves into retirement and are also keen to take advantage of such arrangements.

Other changes such as a 'casualisation' of the workforce are evident in changing work patterns and as businesses seek a more flexible workforce. The proportion of casual workers grew from 17 per cent in 1992 to approximately 35 per cent today.

Despite being popular in industries such as retail and hospitality, many casual workers would prefer to work additional hours. While casual workers are in search of more flexible work arrangements such as those provided by casual work, most would like to receive paid holiday or sick leave.

Career flexibility and job mobility

Career flexibility and job mobility have increased. Workers are taking more control over their own careers. Around 14–16 per cent of employees are considered job mobile, and only 44 per cent of full-time employees have worked for their current employer for more than five years. The most mobile employees are aged 20–24, Australian-born, or of English-speaking background, and found in retail or hospitality industries. Many leave full-time positions after developing specialist skills and experience to become independent contractors or consultants.

Creative and knowledge-based fields like education, design, writing and information technology provide the most flexibility in the workplace and many workers in these occupations, especially women, are seeking part-time, casual, flexible work day and work-from-home options. Both businesses and the government are recognising the need to address these demands and in doing so are providing increased options for employees.

BizWORD

The **participation rate** *refers to the percentage of a given group of individuals of working age who are employed or actively seeking work.*

The **ageing of the workforce** *refers to the growth in the average age of the population, due to sustained low fertility and increasing life expectancy. As a result, there are proportionally fewer children under 15 in the population, and more people in older age groups.*

Increased participation rates for women

The increase in the **participation rate** over the past three decades has been due to the increased participation by women and older people in the workforce. Since 1980, the participation rate of females aged 25–54 has increased by over 20 per cent, reflecting changing social expectations, increased education levels, improved access to child care and more flexible work arrangements.

The participation rate of people aged 55 and over has increased by 10 per cent as people have incentives to work longer, better employment opportunities, increased employment opportunities in the physically less demanding services sector, and better health and longer lives.

BizFACT

Australia's female participation rate for women is 4 per cent lower than countries like New Zealand and Canada. Effective policies to increase female involvement in the workforce, such as childcare availability, flexible hours and removing discrimination, would substantially increase the size of the economy.

Ageing of the workforce

Ageing of the workforce is likely to see a significant shortage of skills in the community over the next few years. Flexible working arrangements, including job share, part-time and contracting, will be critical in utilising this ageing workforce, particularly women, who are concentrated in health, education, and society and culture. Businesses and government will need to respond by upskilling the population, creating incentives to encourage staff to postpone retirement and implementing appropriate human resource strategies to transfer skills to those remaining in the workforce. Removing discrimination in the recruitment of older workers, providing opportunities to update skills, and offering targeted health and safety programs will also be essential.

Early retirement

Early retirement from full-time work is popular today. The average age of retirement from full-time work has increased to an average age of 53 years (58 for males and

47 for females); however, participation in part-time work is much higher, suggesting older employees are using a gradual withdrawal approach to retirement. The most common reasons are eligibility for superannuation or for health reasons. A growing number of people are returning to work in a part-time capacity following retirement for financial reasons or to relieve boredom.

BizFACT

Compulsory retirement is now illegal unless someone is on a federal award/agreement that states a compulsory retirement age.

14.5.2 Living standards

Australians have one of the highest living standards in the world today. These high standards include work health and safety, regular wage increases, performance bonuses, fringe benefits, leave and superannuation benefits, which they remain keen to preserve. Australians are aware of the pressure from global competition on these hard-won benefits and our living standards. All political parties recognise the importance of these conditions to the average Australian at work, and are unlikely to challenge these rights in the future.

Companies who seek to undercut conditions through excessive outsourcing and casualisation of the workforce, or by shifting production or operations offshore to reduce costs and increase profits, will be challenged by unions keen to avoid erosion of our living standards. Casualised workers suffer from higher levels of stress due to difficulty in purchasing assets, including homes, and managing finances and debt with unstable or uncertain income.



FIGURE 14.25 Australians love extended shopping hours, but at what cost?

Social expectations in terms of home ownership, holidays and ownership of consumer goods are an important factor in the rising participation of women in full-time and part-time work, and in the rising retirement age for women.

Conflict between our desire for high living standards, achieved through our work–life balance, is evident in many surveys. We enjoy shopping on weekends and on holidays, which is reflected in liberalised trading hours.

Concerns are, however, frequently raised about the loss of weekends for families working flexible hours and shifts. The blurring of work and home lives, because of electronic communications such as email and mobile phones, is creating an expectation that employees and businesses will be 'always on'. Others cite the lack of support for carers in our community. Governments have responded by implementing legislation to encourage workplaces to become more

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family friendly, through providing carer's leave, job share, part-time and flexible working hours.

A recent report, *Shifting Risk: Work and Working Life in Australia*, prepared for the ACTU, indicates Australians had major concerns about their living standards and working life over the last few years. They are concerned about:

- increasing income inequality in Australia, as growth in real wages has lagged behind profit growth in recent years, and the widening gap between average male and female wages
- the casualisation of the workforce, with two million Australians now working part-time or casually, and the pressure this creates on family finances and life
- increasing pressure to manage the finances in their lives as governments retreat from welfare and encourage individual responsibility for retirement, healthcare, education and debt management
- a lack of work–life balance, with long working hours and loss of holidays and weekends with families.

Australians are keen to have 'quality jobs' that are safe, meaningful, secure and productive; where they are respected and consulted by their employer, and earn enough for a decent standard of living.

BizFACT

There is an increasing global trend for women to be the family's breadwinner and thus improve its financial security. Increased female participation rates, male unemployment or underemployment and the desire to achieve career goals are thought to be behind the greater contribution of women to family finances. The traditional male-breadwinner and female-homemaker view is being challenged and the social consequences of such a change will be an important research topic in human resources in the years ahead.

14.6 Ethics and corporate social responsibility

A wide range of human resource issues arise in the workplace (see figure 14.26) and, if they are not handled in an ethical, legal or socially responsible manner, they can lead to poor morale, low productivity, heavy costs and industrial disputes. **Ethical business practices** are those practices that are socially responsible, morally right, honourable and fair.

BizWORD

Ethical business practices *are those practices that are socially responsible, morally right, honourable and fair.*

BizFACT

Corporate Social Responsibility (CSR) refers to the way that a business considers the financial, environmental and social impacts of its decisions and is often referred to as its 'triple bottom line'. The human resource policies and procedures of a business are often an integral component of its CSR.

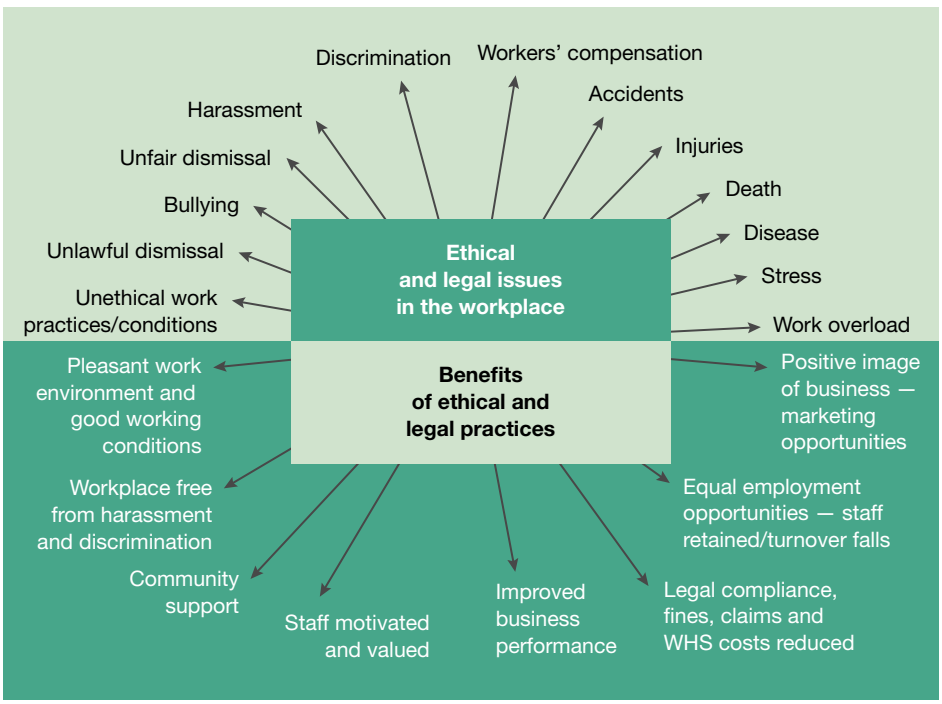


FIGURE 14.26 Some ethical and legal issues arising in the workplace and the benefits of dealing with them successfully

14.6.1 How businesses exhibit corporate social responsibility in the management of human resources

A socially responsible, ethical employer recognises that:

- a pleasant working environment and good working conditions are valuable in motivating and retaining staff
- performance and motivation are maximised when staff feel secure, confident in their work, recognised, safe, equally valued and rewarded for their efforts
- an effective workplace benefits from good working relationships and teamwork
- the business depends on community support, as a source of staff and as a source of business (that is, customers) and resources
- management should be committed to an ethical workplace culture
- customers eventually find out which businesses are acting responsibly and which are not.

An ethical framework must be developed for the workplace, in collaboration with the major stakeholders. This framework may include a **code of conduct** and a **code of ethics**. Key principles may include ensuring equity in workplace processes, legal compliance and commitment to customers.

The benefits accruing from ethical practices are becoming increasingly evident from research and include the following:

- Staff retention and absenteeism rates improve as staff feel more valued and motivated.
- Business costs (such as recruitment and training) are reduced and business performance is enhanced.
- There are significant marketing and business opportunities — **best practice** employers enjoy regular publicity in the media, in journals and on the internet.



FIGURE 14.27 Managers are important role models for ethical and responsible behaviour.

BizFACT

A recent study indicated that 90 per cent of business students would be willing to forgo a percentage of their income to work for an ethical business.

BizWORD

A **code of conduct** *is a statement of acceptable and unacceptable behaviours in a business.*

A **code of ethics** *is a statement of a firm's values and principles.*

BizWORD

Best practice *refers to business practices that are regarded as the best or of the highest standard in the industry.*

14.6.2 Working conditions

An ethical employer can be expected to achieve safe and fair working conditions that improve the welfare of employees. This is achieved through:

- compliance with social justice and industrial legislation covering areas of WHS anti-discrimination and equity in all aspects of human resources.
- providing a safe and healthy working environment, safe working practices and equipment, appropriate supervision and training in safety and health, without which, workplace incidents may occur (see the following Snapshot)

- creating challenging, interesting and meaningful work to stimulate intrinsic rewards for staff
- improving communication, and fostering teamwork and empowerment of staff
- providing study leave and training opportunities to reduce skills obsolescence and improve access to management positions
- offering equitable and open rewards and benefits subject to clear criteria
- offering flexible working hours and conditions that promote a balance between work and life
- a strategic plan supported by management that incorporates specific ethical responsibilities
- implementing change through collaboration with staff
- establishing a **code of practice** for customers, employees and suppliers
- evaluating and benchmarking its performance to ensure it is operating at best practice.

BizWORD

*A **code of practice** is a statement of the principles used by a business in its operations. It generally refers to practices that are seen as ethical or socially responsible.*

SNAPSHOT

Working conditions — ethical and legal issues

A case was brought to a local court in Sydney in which a 19-year-old pizza deliverer charged his employer with assault. The pizza store manager allegedly:

- locked him in the freezer for almost half an hour, ignoring his pleas to be released because of his asthma
- tied the teenager to the bonnet of his car while he drove it back and forwards
- sprayed a fire extinguisher under the door of a toilet cubicle where the teenager was hiding
- hit the teenager in the head, jammed his ankle in a door and cut his face with a wristwatch during a scuffle.

In court, the 27-year-old manager defended his actions, claiming they were part of the teenager's 'initiation' into the company. The manager was found guilty on four counts of criminal assault. He was fined $650 and placed on a 12-month $500 good behaviour bond.

SNAPSHOT QUESTIONS

1. **Identify** the ethical and legal issues arising from the treatment of the pizza deliverer.
2. As a class, **discuss**:
   (a) the adequacy of the penalty
   (b) why some employees engage in 'intiation' ceremonies.



'The manager was found guilty on four counts of criminal assault.'

Working conditions have come under focus over the last two decades as businesses have increasingly responded to global competition and sought to develop practices that improve efficiency and save on labour costs, which are generally around 60 per cent of most businesses' costs.

This pressure to become competitive has been reflected in the rapid growth of 'precarious employment' — employment that is predominantly casual and part-time — in which employees lack job security; are unable to obtain credit; often work multiple jobs and long shifts; and have no leave entitlements. Many are poor and suffer 'travel poverty', commuting long distances to work and on heavily congested highways.

BizFACT

Investments that are acknowledged as 'ethical', have also experienced success, particularly when large occupational investment groups pressure their pension funds to invest in ethical businesses.

Exploitation of adult workers through outworking and subcontracting locally and offshore is often raised as a major ethical issue. Many are concerned about the nature and extent of child labour globally, and what they see as a constant 'race to the bottom' to secure the cheapest cost of labour. Businesses argue that many jobs involve a high level of skill and education and only those jobs that are unskilled and offer a major labour cost differential are shifted offshore. They argue that shareholder pressure for ongoing profits requires them to constantly search for

more efficient approaches to managing their most costly resource — employees. These factors are behind businesses' decision to shift offshore.

Businesses are sensitive to consumer concerns due to the success of consumer lobby groups and actions, and media scrutiny.

Ethical businesses have responded by demonstrating corporate social responsibility through such strategies as regularly undertaking audits of their factories abroad, and by working with agencies to support ethical practices in their local and offshore operations. In the clothing industry, traditionally renowned for 'sweatshops', businesses seek accreditation from agencies such as Ethical Clothing Australia and Fair Wear Foundation.

Ethical Clothing Australia — CSR in action

Marina is a journalist writing about Ethical Clothing Australia for a new TV fashion program and website.
Steph, Fina, Georgie, Matt and Rocco are friends interviewed by Marina, while out at a club.
Marina: Do you know where your clothes are made?
Steph, Matt: No idea!
Georgie: I made my own! Aussie Aussie Aussie, Oi Oi Oi!
Marina: Do you know any labels made in Australia?
Steph: Aussiebum?
Marina: Yes, and designers that produce under the labels Pure Pod, MHOO MHOO and Vodim. All committed to producing 100 per cent Australian made, ethical fashion. We have heard that sales of Aussiebum went up hugely when the story about that other major 'Aussie' business moving its production offshore appeared. They sacked nearly 2000 staff in the move.
Marina: As future fashion designers, are you aware of how and where our clothes are made?
Rocco: (Pulling at Fina's label) I'll check out your label Fina! Aha! Made in Vietnam.
Fina: It's cheap, and it's all I can afford right now. I should really be thinking about why it is so cheap. I guess even a child could have made this overseas. Now you make me feel guilty.
Rocco: Well, I know that around 92 per cent of all clothes sold in Australia are imported.
Marina: Well, Fina, your dress was made by someone probably earning less than $3.60 per hour, according to something I saw on the ABC the other day. It can be as little as 1 per cent of the selling price of the clothes.
Georgie: How come you know so much about this Rocco?
Rocco: My Business Studies teacher in high school used to work in the fashion industry, and I actually listened in class, not like you, always texting when the teacher wasn't looking.
Marina: Do you think we can assume all the clothes made here are made ethically too?
Fina: I have some friends who run a business here; they design the clothes and then get a contractor to make them. They only do small runs, so they don't get their stuff made overseas.
Marina: Do they know about the conditions worked by the garment workers?
Fina: I don't know how much they ask.
Marina: How many of you are aware that many of the clothes made here are subcontracted to garment workers working at home often earning only $8 per hour?
Steph: Yeh, I know. I have a friend whose mother does it at home; she works around 15 hours a day. She often works on shirts where she gets paid $3 per shirt and it takes 30 minutes to make. She has to stay home because her mum is

SNAPSHOT



'Well, I know that around 70 per cent of American clothes are made in China, and I think it is around 50 per cent here.'

BizFACT

Ethical Clothing Australia is a not-for-profit organisation funded by the the Victorian Government that works for a more transparent textile, clothing and footwear (TCF) industry to ensure that consumers and buyers can identify and support ethically made Australian TCF goods.

unwell, so it's all she can do. She has bad eyesight now and her hands are a mess from the constant strain on her fingers.
Matt: There are sweatshops everywhere, but what can we do about it?
Steph: Well, she could join the union. I've told her but she does not want to cause trouble.
Marina: Are you aware of the Ethical Clothing Australia (ECA) program? It is encouraging businesses who use ethical clothing practices to use labelled swing tags on the clothes. All they have to do is get accredited. ECA helps 'map' your supply chain and verifies that all workers within it are receiving their legal entitlements. This means anyone who wants to buy from companies who treat employees fairly can see from the swing tag. Fashion brands like Cue and Veronika Maine and footwear businesses like R.M. Williams are all supporting it. If companies see that consumers are supporting ethical companies, here and overseas, and that they are getting government contracts and media attention, others will follow. Would you stay in touch with our website on this in future? What will you all do when you finish your course?
Georgie: Well, I'll be hassling the company I work for to do that or do it myself. I certainly will be asking about it when I buy clothes in future. I don't want to be buying things made by kids, and I want anyone who makes my clothes to get a fair deal.
Steph, Fina, Matt and Rocco: We will be following what your website and the ECA suggest too.

SNAPSHOT QUESTIONS

1. **What** are the major concerns that consumers have about the fashion industry in Australia?
2. **Create** and conduct a short survey of those around you to **investigate**:
   (a) general views about labour practices in the clothing industry
   (b) the level of support for more ethical practices in the clothing industry.
3. **Summarise** your conclusions and share them with the class.

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Syllabus area 4
Topic 2
Concept 9

Ethics and corporate responsibility
Summary screen and practice questions

SUMMARY

- Economic factors have a major impact on the demand for labour and the pressure on wage growth. This affects the role of human resource management in planning to acquire or reduce staff, and in negotiating awards and agreements.
- Globalisation has increased competitive pressures on businesses, with many increasingly recruiting or outsourcing functions offshore.
- Technological change allows many employees to work from home or offshore, and assists business in providing 24-hour support.
- The workforce is increasingly more flexible in working arrangements, with a recent dramatic increase in part-time and casual work.
- The community is increasingly concerned that this flexibility is leading to difficulties for families in balancing their work and life responsibilities.
- Major social factors affecting the workforce today include increased participation of women and an ageing of the workforce.
- Global organisations are increasingly focused on promoting trade between countries and organisations that support ethical employment practices.
- Ethical business practices are those practices that are socially responsible, morally right, honourable and fair.
- Many businesses are realising the benefits of a more committed workforce and good public reputation achieved through embracing the ethical principles of corporate social responsibility.

EXERCISE 14.5 REVISION

1 The influences on human resource management include legal, economic, social, technological and ethical influences. Read the following scenarios, which each describe a change in workplace employment practices. **Identify** the type of influence that may have caused each change and **discuss** the likely impacts each may have.

(a) An agreement is introduced to allow continuous production and changes in work practices.
(b) Employees are more highly educated today, and seek greater challenges and rewards from work.
(c) Affirmative action awareness is made a criterion for promotion to management positions.
(d) Training in the management of employee complaints of discrimination is provided.
(e) A call centre operating out of Fiji is set up to handle customer service calls.
(f) Three hundred assembly line workers are being retrenched as their jobs are redundant. The human resource management manager may offer younger staff the opportunity to 'up-skill' for jobs in other areas of the business.
(g) Australian staff in the Vietnam office are being given cultural awareness training.
(h) Two employees work out of Australia and four work out of the United Kingdom in a 'virtual team'. They hold regular video conferences to develop and improve product design.

2 **Match** the correct terms with the appropriate definitions.

multiskilling, restructuring, outsourcing, productivity, feminisation of workforce, corporate social responsibility, code of conduct.

(a) Occurs when a firm changes its organisational structure and functions, often closing down sections or removing jobs that are no longer needed or too expensive for the business to operate
(b) Involves employees learning new tasks, which allows them to carry out a wider range of tasks in the workplace
(c) The efficiency of production of goods and services; officially output per unit of input per employee
(d) The increasing participation of women in the workforce
(e) Firms hire businesses or consultants to carry out tasks such as accounting or marketing for them on a contract basis
(f) A statement of acceptable and unacceptable behaviours in a business
(g) Employers making decisions that consider the welfare of employees and the community

3 **How** is structural change affecting the workforce?

4 **Describe** three impacts of globalisation on the management of human resources.

5 **Discuss** the impact of technology on employees.

6 (a) For three minutes, **identify** your ideas about the meaning of and the perceptions associated with 'changing work patterns'.
(b) Select a partner. For about five minutes share your ideas with your partner. Then have your partner share his or her ideas with you.
(c) In your pairs, **create** a table that records shared views about changing work patterns using the headings: Positive views, Neutral views and Negative views.
(d) **Analyse** these views and **explain** each. It is important that you can support each explanation with reliable evidence (not unsubstantiated claims).

7 'Having one of the highest living standards in the world has costs and benefits particularly in relation to working conditions.' Jesse Hancock, consultant, HRM Direct. **Discuss**. In your answer refer to the *Shifting Risk: Work and Working Life in Australia* report.

8 In small groups, use the brainstorm technique to **determine** the human resource management issues that may arise due to economic, technological and social influences. Share your answer with the rest of the class.

on Resources

Weblink: Shifting Risk: Work and Working Life in Australia

on Resources

Weblink: Ethical Clothing Australia

on Resources

Weblink: Selected company websites

on Resources

Digital doc: Chapter summary (doc-24816)

Interactivity: Chapter crossword (int-7175)

Interactivity: Multiple choice quiz (int-7176)

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Sit HSC exam

9 Write a report for a business magazine entitled *Managing people ethically*.
Explain all the reasons corporate social responsibility and ethical practice is important for business today. Give examples from the cases provided in this chapter.

10 **Investigate** companies who are accredited for ethical clothing practices. The **Ethical Clothing Australia** website may help.

11 **Discuss** what students at school can do to encourage ethical employment practices in the clothing industry.

EXERCISE 14.5 EXTENSION

1 Collect information from annual reports, often under the heading of Sustainability, to **determine** how more businesses today are using a human resource management approach to managing people. Using the information, **construct** three cartoons that show a human resource management approach to managing people and three cartoons that show where a human resource management approach is not being used.

2 Use the internet to **investigate** trends in gender equity in Australia. Visit sites such as the Workplace Gender Equality Agency (WGEA). **Why** has gender equity improved slowly over time?

3 Rachel is a human resource consultant. Pretend you are Rachel and write a response to each letter. **Compare** your answers with your classmates.

Dear Rachel
I have just taken over my parents' piggery. I have been away studying physics at uni and have no idea about managing a pig farm. There are eight staff members, and some of them have slackened off a lot over the last few months. Two had a big punch-up yesterday. I'm at my wit's end. How do I start managing all these people? Can I just sack the ones who are the main problem? Who can help me?
Peter

Dear Rachel
I recently got work in a large supermarket chain. They told me I had to do two days' trial to see if I was any good at the job, and then they took me on probation for six months. They have not paid me for those two days, and I have only been paid twice. The owner often makes disgusting comments about me. He does the same thing with the other employees too. I really need this job, but I want to be paid on time and not be harassed by my boss. What do I do?
Latife

Dear Rachel
The toy company I work for is outsourcing the production of electronic dogs to India. Luckily, I am being retrained, but some will lose their jobs. Why doesn't the government stop this?
Victoria

4 Write a report **analysing** the current state of labour practices in the global clothing industry and why these are a concern for society.

5 **What** are the reasons behind the demise of the Australian car industry? **Discuss** the implications of this for Australian workers.

6 'Coles has developed a 2020 inclusion strategy aimed at building an inclusive workplace where all team members feel supported.' Wesfarmers Annual Report 2017
Research the issue of sustainability in the Wesfarmers annual report and analyse the strategies used by management to develop an inclusive culture across its range of businesses.

CHAPTER 15

Processes of human resource management

OVERVIEW

15.1 Introduction
15.2 Acquisition
15.3 Development
15.4 Maintenance
15.5 Separation

15.1 Introduction

Human resource management is focused on acquiring, developing, maintaining and managing staff productively to achieve the business's goals. This involves managing the relationship between employer and employees effectively to develop and retain talented, competent, productive employees. Employees who feel committed to the business are empowered to respond quickly and positively to change.

Human resource management also involves managing the separation of staff, both voluntary and involuntary, in an ethical, transparent and fair manner, which will also assist in maintaining trust and commitment of remaining staff.

The four main human resource (HR) cycle/staffing process are:

- **acquisition**
- **development**
- **maintenance**
- **separation**.

The four main human resource elements are summarised in figure 15.1.

BizWORD

Acquisition *is the process of attracting and recruiting the right staff for roles in a business.*

Development *refers to enhancing the skills of the employee in line with the changing and future needs of the organisation.*

Maintenance *is the process of managing the needs of staff for health and safety, industrial relations and legal responsibilities, including compensation and benefits, of all staff.*

Separation *is the process of employees leaving voluntarily or through dismissal or retrenchment processes.*

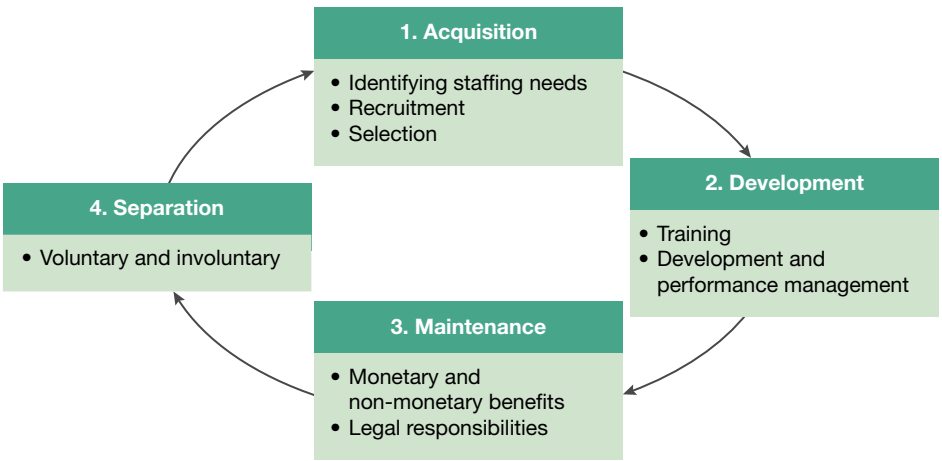


FIGURE 15.1 The four main elements of the human resource cycle/staffing process

15.2 Acquisition

Acquiring the right staff is a critical process in managing human resource management processes. Acquisition involves analysing:

- *the internal environment* — particularly the business's goals and culture. The focus may be on cost containment, growth, downsizing, improved customer service or quality, or other internal goals. This influences the demand for specific skills now and in the future, and will help define the types of staff who will be a good fit for the organisational culture
- *the external environment* — including economic conditions, competition, technology, and legal, political and social factors.

Once the needs have been determined, options may be considered. These may include managing for a shortage or surplus of staff. Other options to strategically develop elements of the human resource plan are shown in figure 15.2.

BizFACT

The threat of labour shortages due to the ageing population is increasing the need for businesses to develop more part-time and flexible options for older staff keen to continue working.

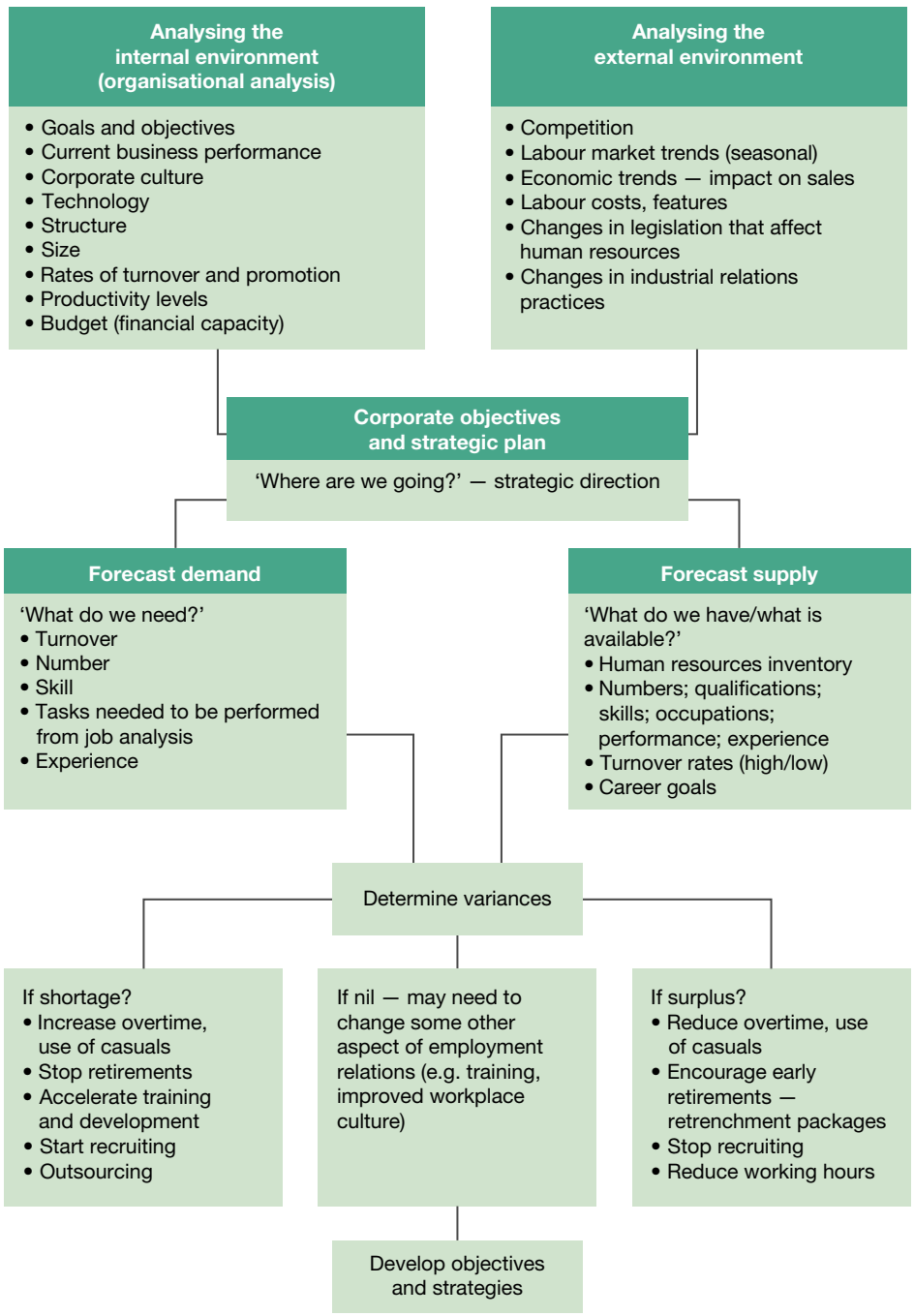


FIGURE 15.2 Acquiring the right staff is a critical process in human resource management. It requires an analysis of the internal and external environment to determine the needs of the business.

Job analysis and job design are required to meet the needs of new positions. These are undertaken through staff interviews, observations, and reports from performance appraisals and evaluations. Job specifications and descriptions can then be developed and prepared for applications through external or internal recruitment.

BizWORD

Recruitment *is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost.*

Employee selection *involves gathering information about each applicant and using that information to choose the most appropriate applicant.*

Placement *involves locating the employee in a position that best utilises the skills of the individual to meet the needs of the business.*

15.2.1 Recruitment, selection and placement

Recruitment is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost. **Employee selection** involves gathering information about each applicant and using that information to choose the most appropriate applicant.

Effective recruitment and employee selection involves:

- evaluating and hiring qualified job applicants who are motivated and have values and goals aligned with the business and its culture
- a fair, non-discriminatory and legally compliant selection policy and process
- giving applicants a realistic understanding of their job description and responsibilities
- using strategies that will prove useful for later selection and **placement** decisions. Smart businesses are using tools to identify gaps in skills and recruiting strategically to fill these gaps
- using strategies that are aligned with other human resource strategies and the business's needs. If the business is seeking to increase gender equity, there should be female representation on the selection panel, equitable remuneration and benefit packages, and training and promotion opportunities.

15.3 Development

Effective development programs ensure that experienced and talented staff are retained. They enhance employees' motivation and commitment to the business through promotion opportunities over the longer term. Research shows that employees who feel competent in performing their jobs and are recognised for their achievements are more motivated and satisfied at work. They achieve higher levels of performance.

BizFACT

Today, many enterprise agreements focus on improving the functional flexibility of the workforce through multiskilling, job rotation, removal of restrictive work practices, reductions in work classifications and demarcations, job enlargement, and job enrichment. Ongoing training and development are key ingredients in this process.

Training and development needs change as an employee's career develops. In the early stages, employees may focus on gaining qualifications. As they move from one employer to another, younger employees focus on experiencing a variety of roles to determine their interests and talents. Later, the development of specialist or managerial competencies may become important as employees move into senior positions. Talented staff may need to be fast-tracked. For employees over 40, the focus may be on upgrading knowledge, mentoring or training, managing work–life balance and transition to retirement planning.

Development focuses on enhancing the skills of the employee through:

- further professional learning
- mentoring or coaching
- performance appraisal and management to allow them to take advantage of opportunities to develop a career with the business.

A major role of the human resource manager is to establish effective training and development programs, train managers to implement them, and then evaluate training programs to determine whether performance has improved as a result of these programs.

15.3.1 Induction

An effective induction program is carefully planned to introduce a new employee to the job, their co-workers, the business and its culture. Supervisors, co-workers and the human resource department (if a larger business) may be involved in the process. Most employees who leave a business depart in the first three months;

therefore, the need for support is greatest when an employee is in a new job. A well-prepared induction program:

- gives employees a positive attitude to the job and the business
- builds a new employee's confidence in the job
- stresses the major safety policies and procedures, and explains their application
- helps establish good working relationships with co-workers and supervisors.

Victoria Legal Aid — induction

New employees at Victoria Legal Aid (an organisation that helps people with legal problems) must participate in an induction training program. The purpose of the program is to welcome new employees to the organisation and 'settle' them into the workplace. The program provides employees with a greater understanding of their role in the organisation and helps employees to become familiar with their new workplace quickly, in order to become productive as soon as possible. The induction program starts with a broad introduction to the organisation by the managing director and divisional manager. Human resource issues will be discussed, in particular ergonomics and salary packaging. Computer training and a visit to the VLA library are also included in the induction process.

SNAPSHOT QUESTIONS

1. **What** is the purpose of the induction program at Victoria Legal Aid?
2. **List** the people involved in the induction program.
3. **Identify** the human resource issues addressed in the program.

SNAPSHOT



'The program helps employees . . . to become productive as soon as possible.'

15.3.2 Training

The aim of training is to seek a long-term change in employees' skills, knowledge, attitudes and behaviour in order to improve work performance in the business. It is essential in overcoming business weaknesses, building on strengths and maintaining staff commitment. A focus on acquiring new skills and knowledge helps a business adapt to change and stay ahead of the competition.

Most businesses today offer training in some form, whether as a requirement for competency in the role or as a tool to develop and expand workers' skills. Around half of employees who have worked for their employer for more than one year receive some kind of education or formal training. The majority of employees who attend a formal course or study for an educational qualification receive some assistance from their employer.

A business's ability to remain competitive can be affected by the extent of training it offers. A lack of training, for example, may be damaging in the long run because it could result in higher turnover rates as staff seek development in other businesses.

The key features of an effective training program include the following.

Step 1

Assess the needs:

- of the individual (skills, knowledge, attitudes, both long and short term)
- of the job (competencies required)
- of the business (for example, culture, goals, standards, service levels).

Step 2

Determine the objectives of the training program for the business, job and individual. Management input and support at this stage is critical to a successful training program.

Step 3

Consider the internal and external influences. Internal influences include the attitude of employees to training, staffing, and financial and physical resources available to operate the program. External influences include any new research on relevant training issues and government programs or support available for training.

BizFACT

Key skills needed by employees today are:

- *communication*
- *teamwork*
- *problem solving*
- *initiative and enterprise*
- *self-management.*

BizFACT

Training at the communications company Motorola is high on the agenda. Every Motorola employee must complete at least 40 hours of training a year.

Step 4

Determine the process — that is:

- the content of the training program
- the learning principles to be applied, including participation, repetition, demonstration and feedback
- the learning methods to be applied, such as simulation training, lectures, online modules
- the location of the training program, whether on-site, off-site or online
- the participants involved — employees, supervisors, human resource manager, external consultants.

Step 5

Evaluate the training program. Strategies include tests and surveys, both prior to training and after training; performance appraisal; observation; benchmarking of key indicators, such as defects, customer complaints and accident rates. The training program can be evaluated over time in terms of the changes in key indicators, including cost of sales, sales volumes and labour turnover.



FIGURE 15.3 Training keeps businesses competitive. Multiskilled employees are better able to adapt to a rapidly changing technological environment, are more productive, and gain the opportunity for promotion.

15.3.3 Organisational development

Today, organisational structures are less hierarchical and flatter in structure. Team- and project-based structures, some even virtual, are widely used. Businesses with flatter structures benefit from employees' ability to develop shared ideas and solutions to problems. It can improve efficiency, effectiveness and response to customer needs.

Flatter structures may have improved employee autonomy and efficiency; however, they have also reduced promotional opportunities. Human resource managers, therefore, need to use strategies to help motivate and retain talented staff. Strategies can include:

- **job enlargement** — increasing the breadth of tasks in a job
- **job rotation** (multiskilling) — moving staff from one task to another over a period of time
- **job enrichment** — increasing the responsibilities of a staff member
- **job sharing** — where two people share the same job

BizWORD

Job enlargement *involves increasing the breadth of tasks in a job.*

Job rotation *involves moving staff from one task to another over a period of time in order to multiskill employees.*

Job enrichment *involves increasing the responsibilities of a staff member.*

Job sharing *occurs when two people share the same job.*

- self-managing teams — teams in which roles and decisions are determined by their members
- mentoring and coaching — where a leader or more experienced member of staff provides advice and support to another person developing skills in the area.

15.3.4 Mentoring and coaching

Mentoring and coaching are increasingly used to motivate and develop staff with leadership potential. Mentoring is a mutually agreed role, which suits experienced staff keen to transfer knowledge and skills through succession planning. It is more focused on building a personal relationship that encompasses the life experience of both parties. Often those being mentored select their mentors and are free to accept or reject the advice offered.



FIGURE 15.4 Mentoring is a more mutually rewarding personal relationship.

Coaching is focused on improving skills and performance, and on helping individuals manage specific work roles more effectively. Coaches may be provided by the business, or may be sought by those seeking further development.

The major differences between mentoring and coaching are illustrated in table 15.1.

TABLE 15.1 The major differences between mentoring and coaching

	Mentoring	Coaching
Focus	Individual life development, preparation for future roles	Performance enhancement by building skills and capabilities, overcoming weaknesses, resolving specific issues
Role	• Facilitator, guide, based on sharing advice and experience • Personal relationship, more like a friend	• Specific to employee's work function • Assists employee in setting goals and finding solutions
Function	Provide advice that may assist in improving the way someone manages issues and situations	Share skills, knowledge, styles and techniques that are relevant to employee needs
Time frame	No time frame	Specific time frame

(continued)

TABLE 15.1 *continued*

	Mentoring	Coaching
Structure	Unstructured	More structured
Benefits	• Individual, through personal growth, potential improvement in performance • May also benefit business • Enhances morale	• Business, through improved teamwork, performance and productivity • May enhance morale

15.3.5 Performance appraisal

BizWORD

Performance appraisal *is a process of assessing the performance of an employee, generally against a set of criteria or standards.*

Performance appraisal is a systematic process of analysing and evaluating employee performance for strengths, weaknesses and opportunities for development. It is also used to assess an employee's suitability for promotion (future leader or manager) and their potential value to the business's success. A wide range of tools are available to evaluate employee performance (see table 15.2), and many businesses use a mix of strategies for different circumstances and levels of seniority.

TABLE 15.2 Performance appraisal tools

Performance appraisal tool	Advantages	Disadvantages
Behaviour observation scales — supervisor observes and records evidence of behaviour and performance over time	• Allows ongoing collection of a range of evidence • Can provide feedback easily	• May focus too much on negative elements • May be adversely affected if supervisor not familiar with job • Open to personality clashes
Interview — formal discussion between supervisor and employee	• Can be flexible and detailed • Allows for questions and discussion	• As supervisor has reward and promotion power over employee, the employee may struggle to be open in discussion.
Management by objectives — objectives set for the employee, performance rewarded according to results	• Rewards achievement • Goal setting can motivate employees to find new and better ways to work.	• Inflexible, does not consider strategies to deal with issues • Open discussion can be limited as supervisor has reward power. • Rating criteria may be set too high or low.
Critical incident method — records how employee responds in specific situations and times, tends to be used for employees who are supervisors	• More objective, record of behaviours can be verified and has legal value • Useful for analysing frequency of behaviours	• Costly to administer • Negative incidents more likely to be reported • Clinical supervision not popular
Graphic rating scale — employee performance is rated on a range of descriptors and traits such as enthusiasm, reliability, cooperation, ability to plan, quantity and quality of work undertaken	• Easy to understand and conduct • Many elements can be examined, and can be easily used for comparison.	• Open to supervisor bias • Traits hard to change • Each characteristic has equal weighting.
Essay evaluation method — supervisors write a report on employee's strengths and weaknesses	• Allows detailed feedback	• Subjective — supervisor may be biased, vague, may leave company open to claims of discrimination
Performance ranking method — employees ranked from best to worst	• Simple	• Not a fair consideration against similar criteria, open to bias
360-degree feedback — employees receive feedback anonymously from peers or managers	• Honest feedback	• Open to personal conflicts and rivalry • May not be constructive • Time consuming

Performance appraisal involves four main objectives:

1. to provide feedback from management to employees regarding work performance
2. to act as a measurement against which promotion and pay rises can be determined
3. to help the business monitor its employee selection
4. to identify employees' training and development needs.

If most employees continually perform below expectations, the business's recruitment and selection process may need to be changed, or extra training and development may be required. Although many managers are uncomfortable with the idea of evaluating employees, effective performance appraisal is a crucial function of good management.

Care needs to be taken by those conducting the appraisal. They need to ensure the criteria are job related, the appraising staff have been trained and that there is no discrimination in the process. In cases of performance issues, it is important those appraising performance give an employee a separate, formal written notice if their performance is unsatisfactory, and provide advice and opportunities for them to improve over a fixed time frame.



FIGURE 15.5 Employees value the opportunity to challenge and discuss aspects of a performance appraisal.

Employees are more likely to value a performance appraisal if they are given a chance to discuss their performance and to challenge their evaluation. When employees believe the process is constructive and fair, and will help them improve their future performance, it will be perceived as a more useful experience. This needs to be factored into the performance appraisal system.

SUMMARY

- The major elements of human resource management are: acquisition, development, maintenance and separation.
- A strategic approach to human resource management is proactive, considers the short- and long-term business needs, and uses a systematic approach that integrates all the human resource strategies to achieve the business goals.
- Acquisition involves analysing the internal and external environment of a business.
- An effective induction program is carefully planned to introduce a new employee to the job, their co-workers, the business and its culture.
- Recruitment involves locating and attracting the right quantity and quality of staff to apply for employment vacancies.
- Employee selection involves gathering information about each applicant and using that information to choose the most appropriate applicant.
- Placement involves locating the employee in a position that best utilises their skills to meet the needs of the business.

studyon

Syllabus area 4 | Topic 3 | Concept 1

Acquisition
Summary screen and practice questions

studyon

Syllabus area 4 | Topic 3 | Concept 2

Development
Summary screen and practice questions

- Development involves enhancing the skills of the employee through training, mentoring, coaching and performance management so they develop a career with the business.
- Effective induction and training equips a new employee with the skills to carry out their job and work effectively with co-workers within the business and its culture.
- Ongoing training should be part of every workplace. Changes in the business environment, including new technology and global competition, are increasing the need for training.
- Businesses are using flatter structures to improve efficiency and competitiveness by creating more opportunities for employees to innovate and participate in solving business problems.
- Organisational development involves developing strategies such as job rotation to increase employee participation, motivation and retention.
- Performance appraisal is used to evaluate employee performance, and identify areas for mentoring, coaching, leadership development or performance management to enable the employee to contribute most effectively to a business's success.

EXERCISE 15.1 REVISION

1 **Identify** the four elements of the human resource cycle/staffing process.
2 **What** are the main elements of the acquisition process?
3 **Distinguish** between selection and placement.
4 **Clarify** the benefits of training and development.
5 **Why** is induction necessary for all employees new to a business?
6 In small groups, **construct** a table listing all the forms of training and development a business can use and the advantages and disadvantages of each approach.
7 **Outline** the strategies a human resource manager can use to help motivate and retain talented staff.
8 (a) **Define** the term 'performance appraisal'.
(b) **How** can performance appraisals assist in the development of employees?
(c) **Why** must this process be managed in a constructive manner?
(d) **Why** is performance review useful for employers in assessing the effectiveness of its management of human resources?
9 **Identify** and **describe** the forms of performance appraisal that you would prefer used on yourself in a workplace. **Justify** your choice.

EXERCISE 15.1 EXTENSION

1 Imagine you are an employee of a large restaurant, working at night while studying during the day. A 360-degree feedback appraisal from an anonymous co-worker is critical of your work effort and skills, and states you lack interest in customer needs.
(a) **Evaluate** the value of a 360-degree feedback system and its likely impact on your performance.
(b) **Justify** an alternative method.
(c) Consider the value of your school report as an appraisal tool of your performance. **Discuss** your conclusions with a classmate.
2 Write a speech you would make to the engineering firm Solar Structures as a new human resources manager **explaining** the need to develop a 'learning culture'.
3 You have been contracted to investigate the high rate of staff turnover at Solar Structures Pty Ltd. **What** process would you use to investigate this issue? **Recommend** some changes you would make to assist the firm in reducing staff turnover.
4 **Justify** the system you would implement in a hospital to ensure effective performance appraisals of the nursing staff.

15.4 Maintenance

In human resource management, maintenance focuses on the processes needed to retain staff and manage their wellbeing at work. Maintenance of staff involves looking after staff wellbeing, safety and health, managing communications effectively, and complying with industrial agreements and legal responsibilities.

Staff wellbeing is maximised through encouraging staff to participate in decision making, and giving employees some control over their work lives. A range of employee participation strategies, including involvement in teams, collective bargaining, workplace surveys and activities, fosters involvement in decision making. Effective communication strategies support employee participation and a strong workplace culture. Employees also have the right to a healthy and safe work environment, where work-related stress and unproductive conflict are minimised.

Offering family friendly programs that support work–life balance is critical in workplaces where staff are increasingly asked to do 'more with less'. These include flexible job roles such as job sharing, multiskilling, telecommuting, part-time work and flexible working hours to suit family needs. Employees also expect that industrial agreements, and payroll obligations and benefits are met.



FIGURE 15.6 Family friendly programs such as telecommuting, part-time work and flexible working hours support the work–life balance of employees.

BizFACT

Many larger workplaces also recognise the impact of personal problems on employee performance and wellbeing. Work-based programs, such as the Employee Assistance Program (EAP) schemes, are widely available to provide additional support for staff and their family members with problems such as conflicts with others at work, family or marital difficulties, substance abuse, gambling problems, anxiety or depression. Using this service is just a matter of a phone call, and it is confidential.

15.4.1 Communication and workplace culture

Effective workplace relationships depend heavily on the strength of a business's communications systems. Poor communication is often reflected in workplace conflict and high turnover rates.

Common methods of communication include regular team meetings between managers, or supervisors, and employees; staff bulletins and newsletters; staff seminars; social functions; suggestion boxes and staff surveys; and email and intranet.

Email is often criticised for being a source of misunderstandings and tension if protocols are not established for constructive communications and timelines for feedback. Expectations that staff will attend to email at home is a common source of workplace conflict, which needs to be managed carefully to avoid burnout of staff and grievances developing.

Strategies that focus on building trust and direct communication between people are critical in preventing conflicts and escalating issues. As well, such strategies help in building a positive workplace culture. Larger and creative firms are

redesigning the layout of their offices to create spaces for people to meet together in one or two central locations for breaks and meetings. The longstanding daily 'walk around' by management, particularly when it involves positive interactions with staff, is still effective.



FIGURE 15.7 Office layouts can be designed to create spaces for people to meet together for breaks and meetings. Often these meetings are on lounges, rather than at a desk, or in modules that can be adapted to changing needs.

Recognition of staff achievements is critical in building a positive workplace culture. Communications with employees should always be constructive, even when there are problems with employees.

15.4.2 Employee participation

The nature of workplace communication is changing with the increasing use of email and increased opportunities for employee participation. Firms encourage employee participation to improve communication, empower employees and



FIGURE 15.8 Employee participation provides a constructive path to business success.

BizFACT

The death of the owner of C-Mac industries, a sheet metal fabricating firm in Sydney's western suburbs, resulted in employees facing the prospect of the business closing permanently. Staff kept the business operating by successfully undertaking to purchase it rather than facing the uncertainty of finding an outside buyer.

Source: Employee Ownership Australia and New Zealand

develop their commitment to improving quality and efficiency. Employees are being trained to make some decisions 'on the spot', either to solve problems or provide incentives to retain customers, as customers demand quicker and more efficient service.

Businesses benefit from employee experience and knowledge on the job, and improvements they suggest are often critical to a business's competitiveness and success.

The value and effectiveness of employee participation depends on the training, knowledge and skills of the employees involved. The use of suggestion boxes is often included as an example of employee participation. However, more effective participation is fostered through regular team meetings/briefings to discuss customer feedback, company trends and issues — these build a sense of shared purpose and company identity.

A range of employee participation strategies are described in table 15.3.

TABLE 15.3 Employee participation strategies

Participation strategy	Explanation
Participation through membership of the board of directors	This strategy allows an employee or senior employee to represent staff on the board. This strategy presents conflicts of interest for the employee, who often becomes alienated from other employees.
Participation through ownership	Employees buy shares in their company, which may result in increased commitment. However, ownership and participation involve different objectives and may lead to a conflict of interest, particularly as ownership increases in scale.
Joint consultative committees	Also called works committees, these are formally established groups consisting of employees and management representatives, and may or may not include union representatives. Their original purpose was to provide management with the views of employees on a range of issues, enhance communication and improve efficiency and productivity. In NSW, these have been mandatory for larger workplaces for work health and safety (WHS).
Participation in collective bargaining	It is a requirement that a majority of employees be involved in developing an enterprise agreement. The advantage is that under good faith bargaining principles all parties are required to make an effort to resolve issues through negotiation and conciliation. This ensures that employees and employers have clear opportunities to learn from each other's experience and to negotiate outcomes beneficial for both groups.
Team briefings	Teams provide an excellent opportunity for employees to share knowledge, skills and experience; to find solutions to problems and develop innovations.
Employee surveys and feedback from performance interviews	Many businesses use a range of surveys and reports from staff to seek valued feedback on ways to improve business performance.

15.4.3 Benefits

Benefits are often a litmus test of the workplace culture as they are available to all staff. They may be monetary in value or non-monetary, and the extent of benefits available will reflect the resources of the business and the nature of its activities.

All employers are also required to pay superannuation for employees who are aged between 18 and 70, and who earn a minimum of $450 per month as a casual, part-time or full-time employee.

Typical benefits include flexible working arrangements, paid training opportunities, travel allowances, health insurance, subsidised gym membership, housing and company car.

SNAPSHOT



'all employers must make a financial contribution . . .'

Superannuation — money for later, but paid for now

Under the federal Superannuation Guarantee scheme, all employers must make a financial contribution to a fund for employees' superannuation (otherwise known as super) that employees can access when they retire. Employers are not required to provide superannuation for employees aged under 18 years (unless they work more than 30 hours a week), employees paid less than $450 per month and employees working outside Australia.

The employer's main obligation is to make a financial contribution — from 1 July 2015, 9.5 per cent of an employee's earnings for their ordinary hours of work — to their employees' superannuation account. As with taxation, employers are required to keep records of all superannuation-related transactions, including payments contributed, payroll and employee records, and the level of entitlement of each employee.

SNAPSHOT QUESTIONS

1. **Outline** the requirement of the federal Superannuation Guarantee scheme.
2. **List** the people who are entitled to superannuation payments on their behalf.
3. **Identify** the employer's main obligation to employees.
4. **List** the types of records employers are expected to maintain.

BizWORD

Fringe benefits tax (FBT) *is a tax employers must pay on certain benefits they provide to their employees or their employees' associates, such as a family member. It is based on the taxable value of the various fringe benefits provided.*

Businesses carefully consider the value of these benefits in terms of retention of staff and workplace culture, as they are expensive and some attract an employer-paid **fringe benefits tax (FBT)**. Benefits that may be considered for FBT include airline transport, expense accounts, board and accommodation, housing loans, living-away-from-home allowance, car parking, property and entertainment allowance.

Some examples of workplace benefits are shown in table 15.4.

TABLE 15.4 Examples of workplace benefits in three Australian businesses

Rio Tinto's Iron Ore	Orica	Westfield Australia
• Residential allowances • Fly-in, fly-out commute allowances • Additional superannuation investment choice and insurance benefits • Housing assistance • Salary packaging • Employee incentive scheme • Subsidised gym membership • Savings-related share option scheme • Relocation assistance • Remote area holiday travel allowance • Subsidised private medical insurance • Discount offers from key suppliers	• Flexible working arrangements • Attractive package for health insurance • Insurance discounts • Employee assistance program • Specialist leadership training and development support • Dulux staff card • Novated car leases • Mobile phone plan • Employee share plan • Paid family leave — up to six weeks, some paternity leave • 20 days unpaid leave • Ford car program • 'Dare to Share' charity program	• Regular training packages and programs • Career progression — domestic and international • Sponsor a friend recruitment program • Social club organises activities at a discount, including opera and theatre tickets, fun parks, dinners • Study assistance, online textbooks • Employee assistance program • Salary sacrifice program • Intranet product and service exchange • Business improvement awards

Flexible and family friendly work arrangements

Around one-third of Australian employees cite a need for work–life balance as a major consideration in future work choices. Employers are responding with more flexible working arrangements to attract and retain talented staff. These arrangements are reflected in the New Employment Standards, and are also a key feature in many industrial agreements today. Typical features of a family friendly workplace are shown in figure 15.9.

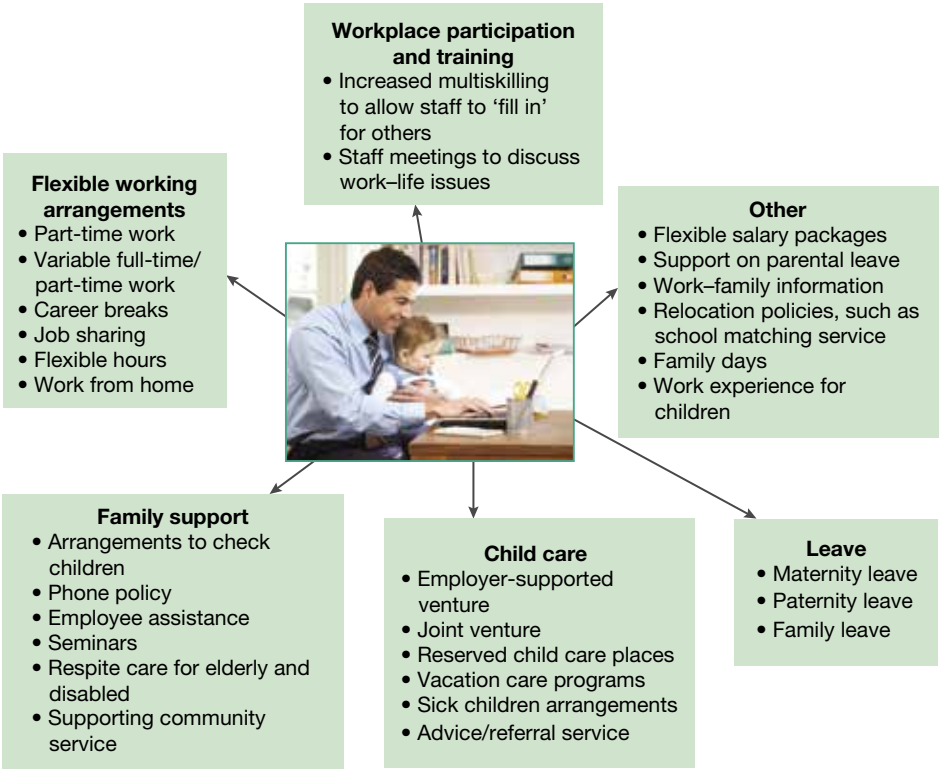


FIGURE 15.9 Features of a family friendly workplace. Opportunities for home-based work and family friendly working hours allow employees to balance work and family responsibilities more effectively.

Flexible working conditions allow businesses to work more efficiently, or allow employees to balance work and family responsibilities more effectively (see the BizFact on the left). For example, some employer–employee agreements allow opportunities for home-based work, which gives employees more flexibility during working hours. It is becoming more practical as the electronic methods of communication and technology improve.

Typical flexible working conditions include:

- flexible remuneration (reward) options
- flexible working hours
- flexible study/work arrangements
- career break schemes
- job sharing — involves two employees voluntarily sharing one permanent full-time job. This arrangement has been very popular with women returning to the workforce after having children, but requires commitment and communication to be effective
- work-from-home arrangements (rostered days off, telecommuting, a compressed work week)
- family leave
- part-year work arrangements (often suit competitive sportsmen and women).

Family friendly programs are effective in retaining staff in the longer term as they recognise the interdependence of work and family life, and reduce problems involved in managing family responsibilities. Employees are able to leave and later re-enter the workforce, thus reducing separation, recruitment and training costs for new employees. Such programs also create a positive image of the firm within the community.

BizFACT

Flexible working hours are a common feature of enterprise agreements and individual contracts. Maxiflex allows employees to build up sufficient hours to take a day off. Employers are usually allowed to nominate the day off. Flexitime allows an employee to nominate start and finish times to suit their needs.

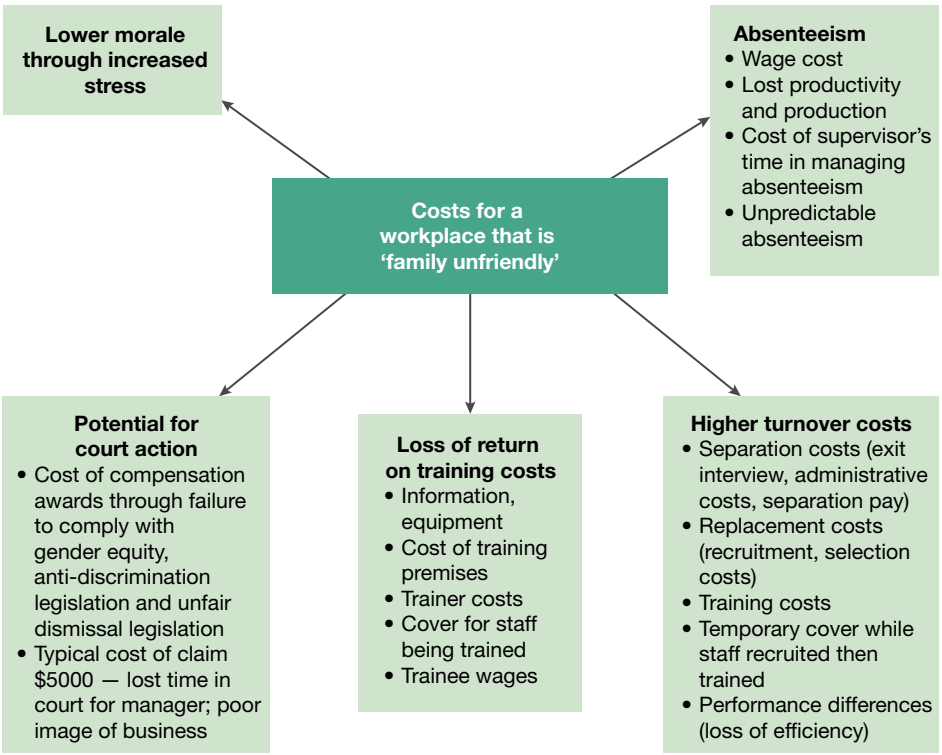


FIGURE 15.10 Costs for a workplace that is 'family unfriendly'

15.4.4 Legal compliance and corporate social responsibility

All employers are required by law to ensure that human resource procedures and policies comply with existing legislation, including anti-discrimination and sex discrimination legislation, WHS taxation, social justice legislation, and industrial relations legislation and agreements.

BizFACT

A female employed by a New South Wales club was awarded $15 000 for sexual harassment she endured from her male supervisor. Despite the fact that the club had policies in place to deal with harassment, these were assessed to not be comprehensive enough to deal with such matters. The club was aware of previous incidents involving the manager, but had not acted upon them thoroughly enough. The club was also criticised for not training its staff in how to deal with issues of harassment and discrimination in the workplace



FIGURE 15.11 Human resource managers may be called on to mediate in employment relationships.

Bullying and sexual harassment, along with conflict between employees and high workloads, are major causes of stress at work. These issues are behind

high levels of staff stress, absenteeism, turnover, and low productivity and morale. Creating a workplace where staff treat each other in a respectful, professional, fair and considerate manner is essential for employee wellbeing and retention of productive staff.

A major focus of maintenance is for human resource managers to minimise the exposure of the business to risk by implementing a range of proactive and preventative strategies in health and safety, anti-discrimination and conflict resolution. Problems that arise over misconduct in employment relationships, particularly regarding sexual harassment, bullying and discrimination, can be very costly and damaging to the business and destroy individuals.

Bullying is common in industries where there are a high number of vulnerable employees such as apprentices, young staff or migrant workers. It can be minimised by:

- providing information about workplace bullying, which covers common forms such as verbal abuse, spreading rumours, exclusion, ignoring someone, physical intimidation or violence, or initiation
- inducting and training employees in company policy, procedures to deal with bullying, and consequences of bullying
- providing training to increase cultural awareness
- promoting a culture that is based on open communication, respect, fairness and trust
- ensuring management is committed to resolving bullying and grievances
- having mentoring or buddy systems for new and young employees
- having a member of staff, appointed by the staff, to handle complaints and grievances.

BizWORD

Workplace bullying *is a form of harassment involving unwelcome and uninvited behaviour that is offensive to 'reasonable' people. The more noticeable forms of workplace bullying are intimidation, humiliation, verbal abuse, pushing, touching, fondling or threatened and actual acts of violence.*

Workplace bullying — *Brodie's Law*

Dealing with **bullying** in the workplace is one conflict that needs to be handled carefully. Bullying may take the form of yelling, offensive language, excluding or isolating employees, giving employees impossible tasks to perform or assigning them meaningless tasks.

A 2010 Productivity Commission report found the total cost of bullying and harassment to be about $14.8 billion a year. In 2010, a case of bullying in the workplace was decided in the Magistrates' Court against the owner of Cafe Vamp in Hawthorn. The owner pleaded guilty to failing to provide and maintain a safe working environment, and the company was fined $220 000. The employees who perpetrated the bullying were also convicted and fined. In this case, bullying resulted in the employee, Brodie Panlock, committing suicide. The Victorian legal system at that time had no provision to charge those responsible for the bullying that ultimately led to Brodie's suicide under existing criminal law. Instead, any offender was convicted and fined under provisions of the Occupational Health and Safety Act.

In 2011 a new anti-bullying law, nicknamed *Brodie's Law*, was enacted that meant perpetrators of serious bullying (including workplace bullying) could face up to ten years' imprisonment, if convicted.

Managers have a legal and a moral obligation to ensure that bullying is appropriately dealt with in the workplace. Education about bullying is one step in the right direction and ensuring that proper grievance procedures are in place to handle bullying complaints when they occur can help avert a crisis.

SNAPSHOT QUESTIONS

1. **Outline** the forms bullying might take.
2. **Explain** how bullying in the workplace could result in lost productivity.
3. **Explain** measures that can be used to deal with bullying in the workplace.

SNAPSHOT



'Managers have a legal and moral obligation to ensure bullying is appropriately dealt with . . .'

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Syllabus area 4 | Topic 3 | Concept 3

Maintenance
Summary screen and practice questions

SUMMARY

- Maintenance focuses on the processes needed to retain staff and manage their wellbeing at work.
- Staff wellbeing is maximised through encouraging staff to participate in decision making, and giving employees some control over their work lives.
- Effective workplace relationships depend heavily on a business's communications systems. Poor communication is often reflected in workplace conflict and high turnover rates.
- Businesses benefit from employee experience and knowledge on the job, and improvements they suggest are often critical to a business's competitiveness and success.
- Benefits are an integral element in building workplace culture. They may be monetary in value or non-monetary.
- Employers are responding to employees' desire for a work–life balance with more flexible working arrangements.
- An important role of the human resource manager is ensuring the policies comply with legislation including anti-discrimination and sex discrimination legislation, WHS, taxation, social justice legislation and industrial relations legislation and agreements.

EXERCISE 15.2 REVISION

1 **Define** the term 'maintenance'.

2 (a) **Propose** a list of all the workplace elements that would be effective in maximising staff wellbeing.
(b) **Compare** your list with another student and **analyse** the similarities and differences.

3 **What** are the most common forms of communication used in a workplace? **Evaluate** the importance of each method for effective communication and for building a positive workplace culture.

4 **Discuss** the role an intranet can play in improving workplace communications and culture. **Identify** elements that should be included in a high-quality workplace intranet. **Justify** your response.

5 **Describe** the benefits of employee participation and team structures for employers.

6 Study table 15.3. As an employee, select the two participation strategies you would like to be involved in. **Justify** your selection.

7 **Distinguish** between monetary and non-monetary benefits.

8 Study table 15.4. **Account** for why these three businesses provide an extensive range of workplace benefits. Share your answer with the class.

9 **Propose** likely benefits to the employer of a family friendly workplace.

10 **How** do specific human resource strategies, such as employee participation, teamwork, flexible working conditions, training and rewards, benefit both the employee and employer? Present your answer in table format.

11 **Identify** the major legal areas of responsibility for a human resource manager.

12 **Describe** the costs of sexual harassment and bullying in the workplace.

13 In small groups, **propose** strategies businesses need to implement in order to minimise workplace bullying and sexual harassment.

EXERCISE 15.2 EXTENSION

1 'The critical issues for human resource managers today are raising productivity, improving customer satisfaction, providing quality products and services, and aligning human resource strategy to business goals.'
Human resource manager at Jack's Candles Ltd
Imagine you are the human resources manager at Jack's Candles Ltd, **explain** how you would address these issues.

2 Use the internet to research employee share ownership plans (ESOP) in Australia. **Analyse** why ESOPs are less common in Australia than overseas. **Assess** the potential benefits to Australian firms of ESOPs.

3 As CEO of Pets Play, a manufacturer of pet accessories with turnover of $50 million and 150 employees, you are finding it hard to keep your young staff once they begin having families.
   (a) **Create** a list of family friendly initiatives you may be able to afford to offer.
   (b) **Explain** how four of these initiatives may help you retain staff.
   (c) **Determine** the processes you would use to become a more family friendly workplace.
   (d) **Identify** three policies a firm could implement to reduce absenteeism. **Justify** your answer.
   (e) **Propose** strategies you could implement to promote your family friendly initiatives and become an employer of choice.

15.5 Separation

Separation, where an employee leaves a business, may be voluntary or involuntary. Voluntary separation may take the form of resignation, relocation, voluntary **redundancy** or retirement. Involuntary separation may take the form of contract expiry, **retrenchment** or dismissal. To avoid claims of discrimination and adverse effects on the morale and productivity of remaining staff, involuntary separation must be managed carefully and in compliance with legislation, awards and agreements.

Situations where redundancy occurs include closure of the workplace site, completion of the project on which the employee worked, lack of contracts or orders for work, a downturn in demand from customers or a need to reduce staff due to financial difficulties in the business. Documentary evidence would be required for these reasons, for example the company's financial statements.

It is important to consider a range of matters in determining who will be retrenched. These may include length of service, standard of performance, future potential and whether some staff may be willing to leave voluntarily.

BizWORD

Redundancy *and* **retrenchment** *refer to employees losing their jobs, where the employees' job or work no longer needs to be done. It may be necessary due to a lack of work, as in the case of a fall in demand for a product or service, or the position may have been restructured or replaced by technology.*



FIGURE 15.12 Separation is the ending of the employment contract. At this stage the HR department needs to fulfil all the legal requirements and complete the necessary documentation accurately and speedily.

Notice and leave entitlements given must comply with legislation and industrial agreements. Managers should consult with staff prior to termination and support them with outplacement to ensure a smooth transition that does not adversely affect the remaining employees' morale. It is best to sever staff who are leaving

BizFACT

Increasing numbers of mining and manufacturing businesses are closing in regional Australia and the consequence is long-term unemployment for many workers.

BizFACT

High-earning employees who earn over the threshold, under the Fair Work Act ($142 500 in 2017, annually indexed), do not have access to unfair dismissal laws unless they are covered by a modern award or enterprise agreement when they are dismissed; that is, in terms of undertaking the duties the award covers and their actual classification.

immediately and pay out their notice. It is rare to see retrenched or redundant staff leave cheerfully, even when the separation is handled in a professional and caring manner.

When an employee's employment is terminated, the employer must provide a written statement confirming the termination and date of determination.

Most awards and agreements have common provisions relating to termination, change and redundancy that cover matters including the procedures for retrenchment, amount of notice to be given or pay in lieu of notice and severance pay. These supplement and override legislation if conditions are more favourable.

15.5.1 Dismissal

Staff may be dismissed for a number of reasons. Summary dismissal is an instant form of dismissal that applies to employees involved in gross or serious misconduct, such as theft. Termination for misconduct must meet the test of being fair and reasonable, given the circumstances. The Fair Work Commission will generally determine whether the reasons were sound and well founded, and whether the employer had made reasonable efforts to investigate the allegations and allowed the employee the right to respond. If there is any doubt, payment of notice in lieu will generally avoid an unfair dismissal claim for serious misconduct.



FIGURE 15.13 Theft from an employer is grounds for summary dismissal. In certain situations the HR manager may need to notify police if a criminal action is believed to have occurred.

Dismissal can also be based on poor performance or redundancy due to organisational restructuring, a downturn in business or technological change making a job redundant. In recent years, businesses have tried to reduce costs and improve productivity through reducing staff numbers, flattening management structures and making greater use of technology. Widespread restructuring and managerial policies are major factors contributing to industrial disputes and unfair dismissal claims.

Employers need to prove that they have followed all the processes required before dismissing an employee.

In the case of poor performance, businesses are required to:

- give employees a written warning about their poor performance over a period of time
- give them advice and support so they have the opportunity to improve
- notify employees of the reason for the termination and an opportunity to respond.

BizFACT

Under National Employment Standards entitlements the notice of termination and redundancy pay states that up to 4 weeks' notice of termination (plus an extra week if the employee is over 45 and has been in the job for at least 2 years) and up to 16 weeks redundancy pay must be given.

In the case of redundancy, the employer may be asked to show that:

- the employee's job was no longer needed; that the redundancy is genuine
- no appropriate work was available elsewhere within the organisation
- the employee was consulted about alternative redeployment options within the business.

15.5.2 Unfair dismissal

Selecting staff for dismissal can be risky and requires awareness of legislation and industrial agreements. Documentation of processes undertaken is also required to avoid claims of **unfair dismissal**.

The Fair Work Commission provides these grounds for unfair dismissal claims for employees covered by the national system.

'An unfair dismissal occurs where an employee makes an unfair dismissal remedy application and Fair Work Commission finds that:

- the employee was dismissed, and
- the dismissal was harsh, unjust or unreasonable, and
- the dismissal was not a case of genuine redundancy.'

Employees are able to claim unfair dismissal if:

- the business has more than 15 employees, either full-time or the equivalent, who have been employed for more than six months. This includes casuals with six months service.
- the processes for dismissal have not been carried out correctly.

The claim may be resolved through informal conferences, telephone conferences (the most common method) or by a formal hearing. Reinstatement will be the remedy for a claim that is upheld, unless it is not in the interests of either of the parties, in which case compensation may be ordered. A cap of six month pay is the maximum compensation, but most cases would not reach this level.

An employer has the right to object to a claim on the basis that it is vexatious or frivolous, not submitted in an appropriate time frame, not reasonably likely to succeed, not a case of unfair dismissal or that the person making the claim is not eligible.

Businesses can be badly hit by such claims. Many have found the need for a lengthy procedural approach frustrating, particularly the need to give employees time to improve their performance after a warning has been given.

Many businesses have preferred to avoid the risk by hiring casuals and contractors. Other businesses have tightened their employment contracts (often called 'corporate pre-nuptial agreements') and included job descriptions, probation periods and measurable targets to allow for dismissal of staff if required. They are keen to avoid unfair dismissal claims, which create adverse publicity for the business internally and externally, with the potential to lose customers. For many it has been regarded as cheaper and less time consuming to settle the claim, regardless of whether or not it is valid. Many have needed to consult specialists in the area of termination to avoid these problems.

BizWORD

Unfair dismissal *occurs where an employee is dismissed by their employer and they believe the action is harsh, unreasonable or unjust.*

BizFACT

The Fair Work Commission will judge a claim on whether a termination/dismissal is lawful, harsh, unjust or unreasonable, and will take into account the procedures followed, whether the grounds were reasonable, the circumstances of the business, whether human resources expertise was available, whether the employee was provided opportunities to respond or have a support person, and any other matters the Fair Work Commission deems relevant.

SUMMARY

- Separation occurs when an employee either chooses to leave an employer voluntarily through resignation, voluntary redundancy or retirement, or involuntarily through retrenchment or dismissal.
- Dismissals may occur due to serious misconduct, poor performance or redundancy due to organisational restructuring.
- Employers need to take great care in following all the legal processes involved in dismissing an employee to avoid costly claims of unfair dismissal.
- Unfair dismissal occurs where an employee is dismissed by their employer and they believe the action is harsh, unreasonable or unjust.

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Syllabus area 4
Topic 3
Concept 4
Separation
Summary screen and practice questions

EXERCISE 15.3 REVISION

1 **Distinguish** between voluntary and involuntary termination, giving examples of each.
2 **Why** must involuntary separation be managed carefully?
3 **What** are the acceptable situations for redundancy?
4 **State** the matters that need to be considered when determining who will be retrenched.
5 **List** some of the entitlements of employees who are made redundant.
6 **Outline** the issues a HR manager must be aware of when dismissing an employee.
7 **Explain** the role of the Fair Work Commission in handling unfair dismissal cases.
8 **Outline** the ways in which businesses are responding to the risk of unfair dismissal claims.

EXERCISE 15.3 EXTENSION

1 **Evaluate** current dismissal laws from the perspectives of both employers and employees.
2 You are appointed human resource manager for a bank with a high level of turnover of female staff, and low rates of return from maternity leave. **Create** a speech for the executive team **explaining** the likely reasons and the best practice strategies needed to create a positive workplace culture that is free from bullying and is also family friendly.
3 **Investigate** recent unfair dismissal claims and **summarise** the main reasons the claims have been upheld or dismissed.
4 Interview two employees in a business that you know about the methods used for communication with and between staff. **Evaluate** the strategies used and recommend additional or alternative methods that could improve communication or employee participation.
5 **Create** a PowerPoint presentation on human resource management. **Identify** and **justify** two strategies considered effective for managing each of the following human resource functions: acquisition, development, maintenance or separation.

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CHAPTER 16

Strategies in human resource management

OVERVIEW

16.1 Introduction
16.2 Leadership styles
16.3 Job design — general or specific tasks
16.4 Recruitment — internal or external, general or specific skills
16.5 Training and development: current or future skills
16.6 Performance management — developmental or administrative
16.7 Rewards — monetary and non-monetary, individual or group, performance pay
16.8 Global strategies: costs, skills, supply
16.9 Workplace disputes

16.1 Introduction

Effective human resource management requires the management of staff to be aligned with the strategic goals of the business. The strategic management of staff and a successful workplace culture will attract, motivate and build employees' commitment and performance in a business.

16.2 Leadership styles

BizWORD

Leadership style *refers to ways that managers communicate with their employees to inspire and motivate them to work together to achieve an organisation's goals.*

Leadership style refers to ways that managers communicate with their employees to inspire and motivate them to work together to achieve an organisation's goals. Rarely does a 'one size fits all' approach to leadership work so it is necessary to consider a number of different styles. The leadership styles can be considered through a continuum as illustrated in figure 16.1.

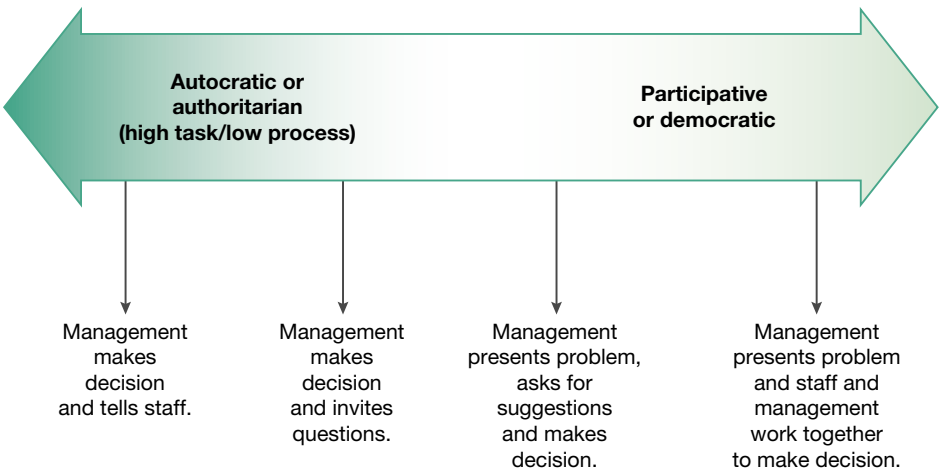


FIGURE 16.1 One theory of leadership style — the continuum

Managers who make decisions quickly and in many cases without input from staff characterise an autocratic leadership style. This leadership style works well with unskilled and/or inexperienced workers where the work is highly organised and controlled. This inflexibility can, however, lead to problems such as higher levels of absenteeism and staff turnover. It does work well in situations such as in the defence forces where leaders are expected to make difficult decisions without the need for consultation or discussion.

The autocratic leadership style is sometimes aligned with a transactional management style where workers' compliance is recognised through financial reward that is often linked to meeting organisational goals. It suits those driven by financial reward, but is often linked to lower levels of job satisfaction.

The autocratic leadership style has its origins in the Classical school of management where employees' work could be more scientifically measured and the most efficient and productive methods applied.

At the end of the continuum is the participative or democratic style. This leadership style is characterised by a more consultative approach between managers and workers that encourages them to be more engaged in the decision-making process. This style of leadership is linked to transformational leadership where managers have higher expectations of workers and this leads to higher levels of engagement.

This higher level of involvement in the decision-making process gives workers a greater sense of ownership of the final decision and also results in higher levels of job satisfaction and productivity.

This approach works well when the emphasis is on higher quality output rather than efficiency. It may lead to a longer decision-making process as time is given over when management consults with staff. Further, where workers are inexperienced or disaffected their lack of engagement may be of little assistance to the decision-making process and this too can be considered as problematic.

The participative or democratic approach also encompasses a more behavioural approach to the management of workers. It therefore addresses the role of motivation, conflict and relationships. Workers are seen as a resource that can be developed over time.

Australians tend to appreciate a leadership style that encourages management and staff to work together in achieving goals, rather than be led in front. Australian workers respond better to higher levels of expertise and leaders that have gained other workers' respect are far more likely to achieve business goals.

The most appropriate uses for these styles are shown in table 16.1.

BizFACT

Studies of Australian leaders stated that they traditionally value egalitarianism, mateship and a fair go, but have a history of discrimination and value individual, rather than group rewards. They are seen as decisive, of high integrity, performance orientated, and demonstrating humanity. In international studies, however, they do not want to stand out from their peers.

BizFACT

For managers who really want to be constructive the advice is to:

- *seek advice from others about your style. Listen to your employees' feedback.*
- *think about the behaviours you want to develop*
- *be a good role model*
- *support your employees.*

TABLE 16.1 Leadership styles

Leadership style	Example phrases	When the style works best
Directive • Emphasis on immediate compliance from employees • Other labels: autocratic, dictatorial, coercive	Do it the way I tell you. I believe that people should do what I tell them.	In a crisis, to kick start a turnaround or with problem employees
Visionary • Emphasis on long-term vision and leadership • Other labels: big picture, authoritative	I enjoy mobilising people towards a bigger picture. I believe I am firm but fair, giving employees clear direction, motivating by persuasion and giving feedback on task performance.	When changes require a new vision, or when a clear direction is needed
Affiliative • Emphasis on the creation of harmony • Other labels: harmoniser	I believe in people before tasks — emotional bonding.	To build buy-in or consensus or to get input from valuable employees

(continued)

TABLE 16.1 *continued*

Leadership style	Example phrases	When the style works best
Participative/democratic • Emphasis on group consensus and generating new ideas • Other labels: democratic	I believe in building support and commitment.	To build buy-in or consensus or to get input from valuable employees
Pacesetting • Emphasis on accomplishment of tasks to high standards	I expect self-direction and excellence.	To get quick results from a highly motivated and competent team
Coaching • Emphasis on the professional growth of employees • Other labels: developmental	I develop others for the future.	To help an employee improve performance or to develop long-term strengths

Source: Workforce Planning and Policy Directorate, South Australia, Department of Further Education, Employment, Science and Technology, 2010

SNAPSHOT



'. . . not to say a manager and leader cannot be the same person, however, the roles should be viewed separately.'

Leadership versus management — is there a difference?

There are a number of accepted characteristics that are considered essential for all leaders. It may be true that not all leaders will have all these traits but a good leader is able to compensate for this by being capable of identifying such qualities in their staff and being able to use their skills for the benefit of the organisation. The characteristics of effective leaders include:

- self-awareness — the ability to identify your own strengths and weaknesses
- decisiveness — the ability to make decisions quickly
- fairness — treating workers equally
- enthusiasm — motivating your team with a positive outlook
- integrity — earning respect from staff
- knowledge — the ability to understand your job including changes that take place and that change requires a response
- creativity and imagination — generating new and innovative ideas
- endurance — persevering with a task or difficult situation until it is resolved.

Alternatively, some of the qualities observed in less effective leaders include:

- poor communication — may lead to misunderstandings
- reluctance to delegate — can result in resentment and low productivity
- nepotism — favouring certain staff that can lead to poor morale.

Often there is a view that management and leadership are the same. It is increasingly the case rather that the roles are viewed as being quite separate. A leader inspires, motivates and encourages their team to strive to achieve the business's vision; a manager is more involved in the day-to-day operational activities required to run the business. To this end the manager will:

- ensure that products meet customer expectations
- evaluate existing operations processes
- address work health and safety requirements
- plan, implement and monitor budgets.

That is not to say a manager and leader cannot be the same person, however, the roles should be viewed separately. A leader can only implement the business's vision if there is an effective and efficient management structure in place; the leader is then free to be effective without getting tied down in more operational matters.

Recently, indications in the Australian corporate environment are that many employees are dissatisfied with the leadership provided by many managers. The main issue for many workers is that managers seem to lack strategic planning initiatives and, in particular, fail to anticipate the rise of disruptive changes in markets such as the emergence of the 'share economy'. Moreover, management often appears unable to identify opportunities and how to adapt to the dynamic business environment. If these challenges are to be met, leadership and management skills must be developed sooner rather than later.

SNAPSHOT QUESTIONS

1. **List** some of the positive character traits found in effective leaders.
2. **Identify** some of the less effective qualities observed in leaders.
3. **Analyse** the characteristics of leaders you have observed at the school, community, politics or business level. List the positive qualities you identified in them.
4. **Distinguish** between a leader and a manager.
5. Is it possible for a manager and a leader to be the same person? **Discuss**.
6. **What** challenges are faced by leaders and managers in the Australian corporate environment?

SUMMARY

- A range of strategies are used to align the management of staff with the goals of the firm, including leadership styles.
- Leadership styles can be considered across a spectrum from an autocratic approach to a participative or democratic approach.
- Leadership styles which are most effective in Australia are more egalitarian and empowering and less directive than in other countries.
- Australian employees tend to be critical of the quality of Australian leadership and are seeking constructive workplace cultures where employers are supportive and focused on developing the skills and talents of employees in challenging and meaningful tasks and projects.

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Syllabus area 4
Topic 4
Concept 1

Leadership style
Summary screen and practice questions

EXERCISE 16.1 REVISION

1. **Distinguish** between an autocratic and democratic/participative leadership style.
2. Select two leadership styles you believe are most effective in creating a positive workplace culture. **Justify** your choice.
3. **Discuss** the use of a directive leadership style in business.
4. **How** does culture influence leadership style in Australia today?
5. **Discuss** the major challenges faced by leaders and human resources managers in assisting in the implementation of change today.

EXERCISE 16.1 EXTENSION

1. **Evaluate** the significance of 'leadership styles' on employee performance.
2. **Analyse** how an Australian leader may need to adapt to managing staff overseas.
3. Interview a manager about their day's activities. **Construct** a table listing these activities and **describe** the most appropriate leadership style for each of these activities.

16.3 Job design — general or specific tasks

Job design is the number, kind and variety of tasks that a worker is expected to carry out in the course of performing their job.

Tasks are often routine, repetitive and inflexible and reflect a relatively simple approach. Specific tasks in job design are best represented through the Scientific management approach developed by Fredrick Taylor who identified that there was one best way of doing a job and that worker skills should be matched to the job requirements. It is based on specialisation and is an efficient process that often uses low-skilled, cheap labour.

BizWORD

Job design *is the number, kind and variety of tasks that a worker is expected to carry out in the course of performing their job.*

In recent times, however, job design has been expanded to incorporate a more general approach with a greater variety of tasks to be performed by workers. This is sometimes referred to as job enlargement; that is, the horizontal expansion of the job by adding similar level responsibilities. The main objective of the provision of a wider variety of tasks is to improve worker engagement, satisfaction and ultimately productivity. Managers must, however, avoid simply adding tasks for the sake of it and should recognise that there is some benefit from a specialised approach.

The common elements of a well designed job are shown in figure 16.2. It is known that employees are more motivated and likely to share ideas if they have autonomy, have clear task identity (know what they have to do), are well trained and feel competent, and receive feedback that allows them to be recognised and develop further. Feedback is demotivating when it is controlling, although feedback that is informative and constructive is motivating. Employees are also more motivated when they are able to plan, schedule and determine how to do a job.

BizFACT

Common methods used in job design today are developing broader, more generalised and flexible jobs, so they can attract, motivate, retain and use labour more flexibly and efficiently.

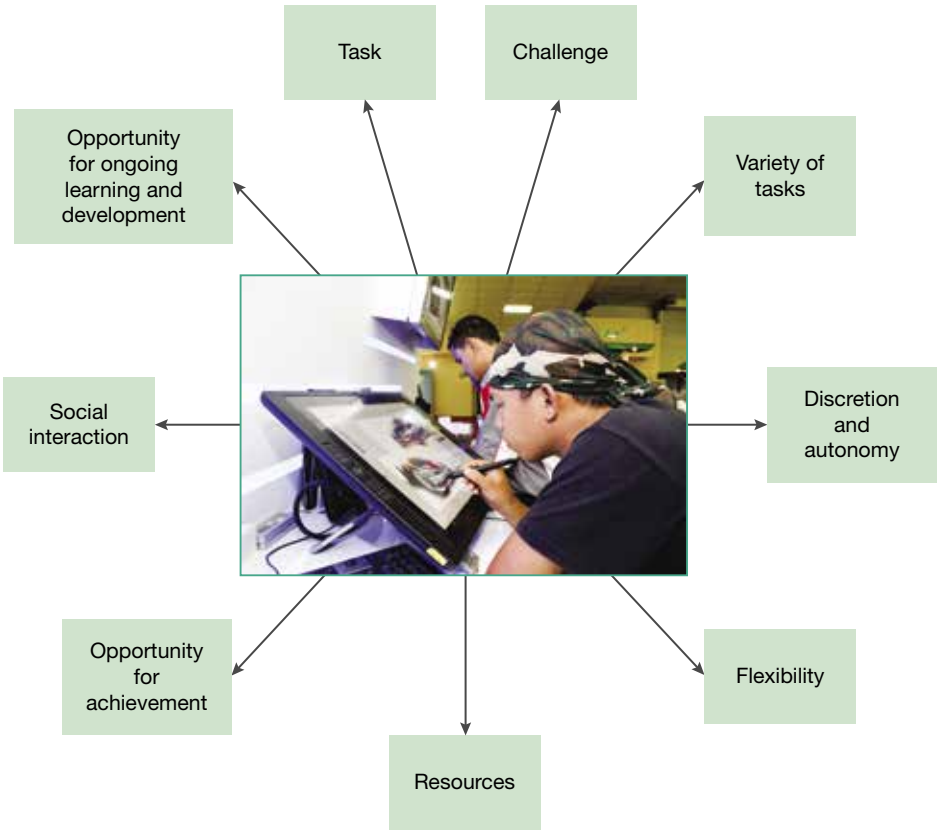


FIGURE 16.2 Core elements of a well-designed job

SNAPSHOT



Job design — intrinsic rewards

In the past, job specialisation — where production was broken down into distinct tasks that were performed by individual employees — often resulted in employee boredom and dissatisfaction. To counter this effect, three job design approaches have been used based on intrinsic rewards — the good feeling that one gets from doing something well.

1. *Job rotation*. Employees switch, for a period of time, from one job to another. This provides variety and gives employees a more comprehensive view of the organisation or the production process.
2. *Job enlargement*. Employees are given more things to do within the same job. This provides job variety and a greater challenge for employees.

3. *Job enrichment*. Employees are given more control and independence over how they do their work. This makes the job more interesting and challenging and provides motivating opportunities for self-satisfaction.

SNAPSHOT QUESTIONS

1. **What** is job specialisation?
2. **Define** intrinsic rewards.
3. Choose one of the three job design approaches and **explain** what you understand by it.

SUMMARY

- Job design is the number, kind and variety of tasks that a worker is expected to carry out in the course of performing their job.
- Job design (specific tasks) is best represented through the Scientific management approach developed by Fredrick Taylor that identified one best way of doing a job and that worker skills should be matched to job requirements.
- Job design (general tasks) refers to a greater variety of tasks to be performed by workers. The main objective of the provision of a wider variety of tasks is to improve worker satisfaction and productivity.

EXERCISE 16.2 REVISION

1 **What** is the purpose of job design in human resource management?

2 **Identify** the steps involved in effective job design.

3 **Discuss** the different approaches to job design.

4 **Outline** examples of how three methods of job design could be applied in (a) a school administrative office, (b) a theatre and (c) a football club in order to meet the needs of the employees or business.

5 **Explain** why specialised job design often reduces job satisfaction.

EXERCISE 16.2 EXTENSION

1 **Evaluate** the use of team structures in job design today.

2 **Determine** the issues associated with designing specialist jobs.

3 Interview someone you know about their job. **Assess** the quality of their job design.

4 (a) **Create** a job design for someone within a business you know.
(b) **Evaluate** the process of job design you used.

16.4 Recruitment — internal or external, general or specific skills

Recruitment is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost. Effective recruitment and selection allows the most appropriate applicant to be selected. The most visible aspect of the recruitment process is the job advertisement (see the following Snapshot).

Outback Trackers — seeking a General Manager

Outback Trackers provides guided tours, including walking, camping and canoeing expeditions and scenic flights, through the breathtaking Northern Territory. Outback Trackers is wholly owned and operated by Indigenous Australians, who share their extensive knowledge of the terrain and history of the region while expertly guiding you through the stunning scenery.

BizFACT

Research indicates that it can take employees 50 per cent longer to complete tasks when they are required to multitask and it is also a major cause of work-related stress.

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Syllabus area 4 | Topic 4 | Concept 2

Job design
Summary screen and practice questions

BizWORD

Recruitment *is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost.*

SNAPSHOT



'Salary: $100 000 + accommodation + superannuation'

Outback Trackers is seeking a General Manager to be part of this exciting company. The primary responsibility of this role is to oversee the everyday management of Outback Trackers, including staff and operational management, budgeting and management reporting, and ensuring the highest product quality and service standards. Excellent interpersonal and communication skills are essential to build upon and enhance effective working relationships. You'll be able to multitask and work under pressure while maintaining stringent attention to detail. You will have excellent oral and written communication skills, as well as the ability to work closely with all teams, including Operations and Marketing, to build the success of the company and drive it forward into the next decade and beyond.

Location: Head office located in Darwin, with teams located throughout the Northern Territory

Salary: $100 000 + accommodation + superannuation

SNAPSHOT QUESTIONS

1. **Identify** all the tasks involved in this job.
2. **Identify** and **justify** the major characteristics you would be looking for in an applicant for this position.
3. **Explain** how job analysis may have been undertaken for this job.
4. **Evaluate** this job in terms of the criteria for a well-designed job.
5. **Assess** the reward package for this job.

BizFACT

Attracting the right candidates to the job is an ongoing process. Many organisations actively seek to build their 'employer brand', creating an image of their company as a great place to work for both current and prospective employees. Recently, recruiting company Hays conducted an employment brand survey of over 408 Australian jobseekers. The results of the survey show that Google, Rio Tinto, Apple and Virgin were most frequently nominated as organisations people would like to work for.

The sources and methods used will depend on the recruitment goals and policies of the business, such as a preference for internal recruitment, the conditions of the labour market, the location of the business, the financial or other resources of the business, and the specifications of the job to be filled, for example whether general skills or specific skills are needed. Internal recruitment may be used as a strategy to motivate and reward employees. Most businesses use a mix of internal and external recruitment, and require a mix of general and specific skills.

A poor selection process leads to increased costs and lower productivity by increasing (among other things):

- training costs (if poorly qualified staff are selected)
- job dissatisfaction, lower performance, industrial unrest/labour turnover if the business or the job does not meet the expectations of candidates selected
- the absenteeism rate if staff feel inadequate for the job/business or feel excessive work pressure
- accident or defect rates, fines if inappropriate/untrained staff are selected
- claims of discrimination if the process is not undertaken appropriately.

BizWORD

Internal recruitment *involves filling job vacancies with people from within the business.*

External recruitment *involves filling job vacancies with people from outside the business.*

BizFACT

Most firms still use résumés, applications and interviews as their major tools in the recruitment process. Interviews prove most useful for determining behaviour and cultural fit. The internet is the most common method used to advertise positions vacant.

16.4.1 Internal or external recruitment

Internal recruitment sources include employees, former applicants and former employees, and they may be invited to apply through intranet postings, staff records, promotion lists, word of mouth, email and other methods. Employee referrals are popular, when accompanied by an employee bonus, and useful for bringing in staff with the right 'cultural fit'.

External recruitment employees may be obtained through traditional methods such as newspaper advertisements, online advertisements and referrals through recruitment agencies, company websites, trade unions, trade shows, management networks, professional associations, schools, radio and television.

The fastest growing recruitment methods today are social networking sites, such as Facebook, Twitter, LinkedIn and niche blogs; and virtual reality sites, such as Second Life. Some firms cite online company videos as having response rates of up to 18 per cent, far exceeding that of other recruiting strategies. They are very successful when used on smart phones, with videos often going 'viral'. This is important for businesses that need to be constantly recruiting, such as technology, mining and hospitality companies.

Outsourcing the search for the most suitable candidate

Many business owners use external recruitment agencies as a way of decreasing the time involved in searching for a new employee. They pay an agency to interview applicants and recommend a short list of potential employees or an employee suitable for the available position.

There are a number of reasons for this trend, including the:

- growing demands on businesses to comply with increasingly complex employment legislation. Business owners find it beneficial to access specialist advice rather than risk breaching employment law
- availability of online recruiters. Recent statistics show that employers have widely embraced e-recruitment agencies
- desire by business owners to concentrate on their core business
- difficulty in attracting candidates due to the low level of unemployment
- ready databases of possible employees and the skill to sort candidates that external recruiters generally have.

However, the principal reason for using an external recruitment agency is related to the cost of a poor recruitment decision, which is generally believed to be around two or three times the annual salary of the person recruited. A poor recruitment and selection process leads to increased costs and lower productivity by increasing (among other things):

- training costs if poorly qualified staff are selected
- job dissatisfaction, lower performance, industrial unrest or labour turnover if the business or the job does not meet the expectations of candidates selected
- the absenteeism rate if staff feel inadequate for the job or feel under excessive work pressure
- accident or defect rates if untrained or inappropriate staff are selected.

SNAPSHOT QUESTIONS

1. **What** is outsourcing?
2. **How** do businesses use external recruitment agencies to search for new employees?
3. **Outline** reasons for the use of external agencies in the recruitment process.
4. **What** is the likely outcome of a poor recruitment decision?
5. **How** does the selection of the wrong employee increase costs and reduce productivity?

SNAPSHOT



'. . . the principal reason for using an e-recruitment agency is related to the cost of a poor recruitment decision . . .'



FIGURE 16.3 Social networking sites and company videos viewed on mobile phones are the fastest growing recruitment methods today.

The advantages and disadvantages of internal and external recruitment are shown in table 16.2.

TABLE 16.2 Advantages and disadvantages of internal and external recruitment

Internal recruitment — advantages	External recruitment — advantages
Motivational for staff, see development opportunity	Wider applicant pool
Builds commitment and loyalty	New ideas, perspectives and skills may produce better solutions to business issues
Business only needs to hire at base level	Get specific skills needed, save on training
Employees know the culture, operations — productivity maintained	Dilutes internal politics
Can lead to a succession of promotion opportunities in line with succession planning	More diversity in employment — equal employment opportunity
Recognises and rewards staff for effort and achievement	Builds organisational 'brand' through publicity
Cheaper than external recruitment, less chance of a failure as staff are observed in operation, strengths and weaknesses are known	Can shape new employee to business
Internal recruitment — disadvantages	**External recruitment — disadvantages**
Can reinforce negative culture	Risk of unknown staff
Can lead to rivalry for positions	Lost productivity in initial phases of orientation and induction phase
Need established framework for training and merit-based appraisal system	New employee may not fit culture, and may not be accepted by internal rivals
Often attracts a significant number of internal applicants, need to manage unsuccessful applicants who will be demotivated, can lead to poor working relationships	Takes a lot of effort and time
Little value added, no new skills	Risk of legal claims

Many firms consider internal potential candidates first and move to external recruitment when appropriate internal staff are not available. Some positions, such as sales staff, need to be filled immediately and will require a significant campaign, although others can be managed over a longer period at a lower cost.

The recruitment process needs to be managed very carefully and applicants given a realistic job preview during the process, using videos, samples or descriptions of the actual work to avoid expensive acceptance errors, where new employees find the work does not match their expectations and leave the position. Background checking and contact with referees is critical to verify qualifications and experience provided.

16.4.2 General or specific skills

General skills

BizWORD

General skills *include flexibility and versatility, social confidence, positive attitude, motivation, and the ability to work as a team and/or independently.*

Many businesses focus on attracting staff with general skills, attitudes and behaviours that are a good cultural fit for their business. The job can then be customised to suit the recruits who can be trained and developed according to the business's needs. Key **general skills** include flexibility and versatility, social confidence, a positive

attitude, motivation, ability to work as a team or independently, leadership and decision-making styles, willingness to learn, and ability to work under pressure. These behavioural 'soft' skills, are often critical in building a successful workforce, and are not really 'learned', whereas specific skills can be taught.

General skills are important because many jobs today require individuals to work independently and undertake many different tasks. General skills, therefore, are not as narrowly defined as in the past and they are generally more service oriented, making social and information skills increasingly important. Such skills are necessary not only to gain employment but also to progress within a business. Human resource managers value these skills within individuals because they generally indicate that the employee has a capacity and willingness to learn.



FIGURE 16.4 Australia tends to suffer from a skills shortage, so employers are more likely to consider hiring for general skills, such as flexibility and versatility, and upskilling internally.

Increasingly, as online recruiting grows, businesses use their websites to promote their 'brand', the values and culture of their business. They also post generic position statements for positions that regularly come up, and for which many potentially attractive recruits exist. This strategy widens the pool of potential talent available to a business, particularly when coupled with online innovative strategies, such as employee resources.

Specific skills

Most businesses are concerned about skill shortages and still need to target employees with **specific skills** to fill gaps in their business.

Sophisticated software is available to support workforce and recruitment planning. Both short- and long-term strategies need to operate parallel to ensure that businesses have staff with the required skills.

Many businesses are recruiting overseas or using outsourcing and overseas recruitment to overcome skill gaps in their businesses, particularly through skilled migration programs such as the Temporary Skill Shortage visa (formerly 457 visa).

While the need for chefs, skilled tradespersons, building professionals and engineers is well known, there is a significant shortage developing in more highly skilled and professional areas including specialist project management skills.

BizWORD

Specific skills *are highly specialised and are required for some jobs within science, technology and engineering sectors.*

BizWORD

Employee poaching *is the practice of enticing employees to work for another business.*

Industry sources have been critical of Australian firms for not investing in training their staff for developing workforce needs and changing organisational structures. They believe a greater part of the load needs to be shouldered by the very companies complaining about not having enough skilled workers. **Employee poaching** is frequently used.

SNAPSHOT



'. . . significant shortage of trained and qualified people to service the growing number of tourists. . .'

study on

Syllabus area 4	**Recruitment**
Topic 4	Summary screen and practice questions
Concept 3	

Australia needs to invest if it wants tourism

Tourism has been the good news story for Australia's economy over the past year. The latest numbers show 8.2 million international tourists visited Australia in the year to November. This is an 11.4% increase on the year before. Domestic tourism also grew 7% during this period.

Australia's inbound tourism growth is almost triple the world average of 3.9%. Much of this growth came from NE Asia and North America with China, South Korea, Japan and the USA among Australia's fastest growing source markets.

There are a few reasons for this. Including a lower Australian dollar, record low airfares and a perception of safety in an increasingly unsafe world.

But while tourism looks bright for Australia, this rapid growth has revealed underlying problems. There is a significant shortage of trained and qualified people to service the growing number of tourists, and infrastructure in parts of the industry has failed to keep up with tourism demand.

If Australia wants to continue enjoying the benefits of its tourism boom, it needs to address these issues.

Skills

A Tourism Australia report, warned back in 2015 that there was a shortage of 38,000 people in all areas of the tourism industry. If there were no major policy changes this could blow out to over 120,000 people by 2020.

You may think that tourism is made up of unskilled jobs such as waiters, room cleaners, kitchen staff and bellhops. Important as these jobs are, the tourism industry requires people at all skill levels. These include airline pilots, tour guides, computer programmers and a myriad of other jobs. For every ten unskilled positions there is also one at management and supervisory level.

Many of the 2,000 tourism businesses surveyed in the Tourism Australia research found it difficult to recruit appropriately experienced or trained staff to fill vacancies.

The industry has addressed some of these issues by hiring or retaining more experienced employees, some of whom had come out of retirement. Many unskilled positions are being filled by foreign workers on 457 [now Temporary Skill Shortage] visas . . . especially for many of the industry's seasonal jobs.

But there is an urgent need to upgrade and promote tourism and hospitality training at all levels of education. The TAFE sector, which has traditionally been a major source of vocational training, has seen its funding cut by successive governments in recent years. TAFE's place has been largely taken by high fee private colleges. However, many of their students are international students and a significant portion of them will take their new skills back to their home countries.

Infrastructure

There are three urgent infrastructure needs in the Australian tourism industry.

First, there is a shortage of upmarket (4 & 5 star) hotel accommodation in Australia's major gateway and business cities (Sydney, Melbourne, Brisbane and Perth). While the overall hotel occupancy rate for Australia is about 65% the

occupancy rates for luxury and business hotels in these key cities is closer to 90%. This means during peak periods it is almost impossible to find a 4–5 star hotel room in a major CBD.

The shortage of upmarket accommodation has been a contributing factor to a stagnant market in business travel to Australia. This is a stark contrast to the strong growth of holiday travel.

Second, according to Cruise Lines International Association the Australian cruise market has grown more than six fold in the past decade. This rapid growth has created a shortage of port facilities, especially in Australia's most popular cruise embarkation and destination port, Sydney. Unless Sydney is able to offer a third dedicated cruise terminal soon, growth opportunities will be limited.

Finally, a longer term issue is the glacial progress towards a high speed rail link between Brisbane and Melbourne via Sydney and Canberra. To date, Australia's major airports have successfully managed the growth of international and domestic passenger numbers and new airline services. However, high speed rail could relieve pressure on airports. Australia has spent decades debating the pros and cons of high speed rail, while rail China builds 1,500 kms of track every year.

What to do about it

Tourism is a balancing act between creating demand and ensuring the supply of both human resources and infrastructure. Clearly, there is still much to achieve to strike the balance.

The private sector is chipping away at the shortage of upmarket accommodation in Australia's major cities, with several thousand new hotel rooms due to come online over the next few years. However, unlike many of Australia's neighbours, such as Singapore and Malaysia, Australia offers few development and investment incentives to develop accommodation.

Both federal and state governments need to invest more resources in promoting tourism careers, tourism education and training at both the vocational and higher education levels. This includes means-based assistance for young Australians to undertake training and education at nationally accredited training and educational institutions.

Tourism has been treated by Australian governments as a cash cow, with little investment. The fragmented nature of the industry has meant it has lacked the political clout of industries such as mining or agriculture.

As one of Australia's fastest growing sectors, tourism is long overdue for a level of government investment which matches its contribution to economic growth and employment.

Source: 'Australia needs to invest if it wants the tourism boom to continue', *The Conversation*

SNAPSHOT QUESTIONS

1. **Outline** the contribution that tourism has made to the Australian economy.
2. **How** does that contribution compare with global trends?
3. **List** the countries that provide most of Australia's tourism growth.
4. **Account** for the improvement to inbound tourism.
5. **What** is the underlying problem resulting from this tourism growth?
6. **List** the jobs generated from the tourism boom and classify them as skilled or unskilled.
7. **Discuss** the strategies that have been used to fill the shortage in tourism workers.
8. **Outline** the changes to infrastructure needed in the tourism industry. **Why** is this needed?
9. **How** is the government and private sector currently dealing with the issues that have arisen due to the tourism growth?

BizWORD

Training *aims to develop skills, knowledge and attitudes that lead to superior work performance.*

Development *refers to enhancing the skills of the employee in line with the changing and future needs of the organisation.*

16.5 Training and development: current or future skills

Training aims to develop skills, knowledge and attitudes that lead to superior work performance. Training is critical in Australia today, as businesses report significant labour market problems, including a shortage of skilled labour, and a mismatch between what skills are needed and what is available. These problems act as a brake on investment, but can be overcome by business commitment to ongoing training.

Development is focused on enhancing the skills of the employee in line with the changing and future needs of the business. It also encourages employees to take advantage of opportunities to develop a career with the business. The business benefits by retaining the employee's experience and knowledge of the business, and by helping it maintain competitiveness.

SNAPSHOT



'. . . the best outcomes are achieved . . . when the organisation supports the employee's career planning.'

BizFACT

A recent report states key skills sought by employers of university graduates are both verbal and written skills required in communication, the ability to work in teams and influence others — so called 'soft skills'. However, other skills such as critical thinking, problem-solving, attention to detail and writing were also highly sought and were common across all jobs and industries.

Case study: BDO Australia — career planning

Peter O'Sullivan is Head of People and Culture at BDO Australia.

In reality, careers often develop with little in the way of planning. For example, in professions or organisations where there are well-established career paths, people may progress through the ranks without understanding or considering the range of career options available to them. In other contexts where career paths are less clear, they may move from one role to the next in a reactive or haphazard fashion, without considering how each role helps equip them for a long-term career goal. This tendency to let careers just happen is reinforced when organisations see career planning and development as the sole responsibility of the employee.

At BDO, we recognise that the best outcomes are achieved for both parties when the organisation supports the employee's career planning. At the beginning of an accountant's career, this usually involves participation in a structured graduate program and supporting the employee through their studies towards their professional qualification. These are formative career years, and the investment by BDO and employee alike is significant.

Like most organisations, BDO has a formal process for performance appraisal and professional development planning, and our process involves six-monthly discussions and the documentation of short-term and long-term developmental and career goals. These discussions are significant signposts in the employee's career, providing the opportunity to reflect on achievements and progress, obtain feedback and seek guidance about future goals and next steps, and discuss ideas and options. In addition, on-the-job appraisal, coaching and mentoring are all important aspects of BDO's approach to career planning and development.

BDO also has a learning and development curriculum that encompasses a comprehensive suite of programs tailored to staff at various stages of their career. One of the more innovative programs is our Career Development Workshop. This program is targeted at accountants who have already completed their professional qualification and is largely focused on career planning. Participants reflect on their career progress to date; are provided with detailed information and multiple perspectives on the range of career options available to them both within and outside BDO; and given tools, frameworks and tangible support to develop their own individual career plan. The program recognises that not all of our staff will follow the traditional path to partner, and equips them to make more informed career decisions.

While it will always be up to our employees to take responsibility for driving their career, BDO encourages an approach to career planning and development in which the employee's supervising partner or other direct manager plays an active role. Other stakeholders such as senior partners, mentors, and human resources and learning and development team members also have important roles to play. Our approach is

ultimately about providing as many opportunities as possible for reflection, meaningful discussion, learning, goal setting and planning. We want to make sure our people have a sense of control of their career and do not just 'let it happen'.

SNAPSHOT QUESTIONS

1. **What** role does career planning usually play in people's professional lives?
2. **How** does BDO assist people at the start of their career?
3. **Outline** the role of performance appraisal and professional development at BDO.
4. **Explain** the features of the learning and development curriculum that assist staff at BDO.

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Syllabus area 4
Topic 4
Concept 4

Training and development
Summary screen and practice questions

In choosing the nature of training and development, businesses need to use a systematic process to evaluate the needs of the business, the supply of these skills in the economy, the demand for these skills, and the changing nature of work and the general pattern of employment.

The shift to a largely service-based economy has seen many traditional skills, particularly those in manufacturing, become obsolete. Businesses need to consider the mix of skills they can develop internally and those for which they need to recruit.

Businesses will need to consider these options:

- invest in further in-house training and development
- recruit staff for specific skills
- retain experts who retire on a part-time basis
- retain women through flexible work structures such as part-time work
- share staff with other firms, or do work for other firms (**insourcing**)
- outsource functions to specialist firms or agencies, even overseas
- sponsor overseas migrants for areas of major shortages
- build networks or alliances with other firms with specialist skills or skills needed in the future.



FIGURE 16.5 Children born today will work in jobs that have not yet been invented. Coming soon are these new areas of job growth.

BizWORD

Insourcing *refers to delegating a job to someone within the business, as opposed to someone outside the business.*

BizFACT

Countries with similar economies to Australia, such as Canada, have identified the following work trends for the future:

- *the complete transition to a service-based economy with primary sector jobs being fully automated*
- *growth in social professions such as teachers, nurses and homecare workers*
- *virtual work undertaken away from traditional workplaces that removes the need for commuting.*

16.6 Performance management — developmental or administrative

Performance management addresses both individual and business performance. Successful individual performance will often translate into the business's strategic objectives being met.

BizWORD

Performance management *addresses both individual and business performance. Successful individual performance will often translate into the business's strategic objectives being met.*

Job design, recruiting the best staff, training and development and rewards are all features of performance management.

The world's most admired businesses all view performance measures for human resources as equal to financial performance measures, and regularly evaluate such reports at board level, clearly indicating that managing people effectively is critical to business success. Figure 16.6 summarises the value of performance management.

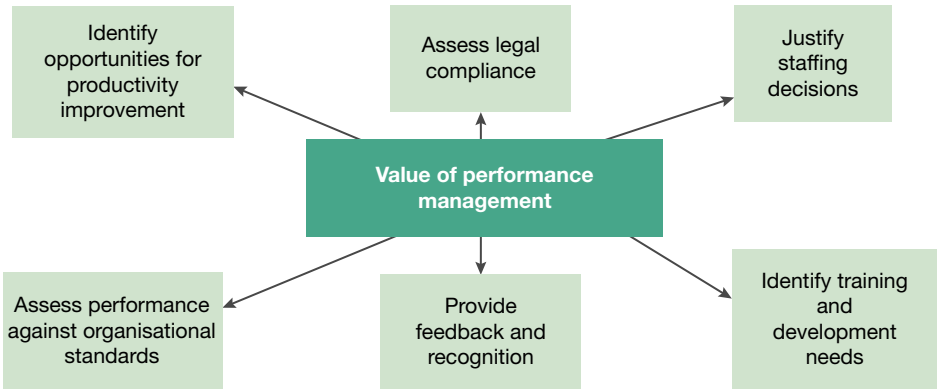


FIGURE 16.6 The value of performance management

Performance appraisal and management systems can be designed to meet two purposes for a business: developmental and administrative.

Developmental

The **performance management (developmental)** model is focused on using data to develop the individual skills and abilities of employees, so they improve their effectiveness in their roles, overcome weaknesses and are prepared for promotion. This is best achieved through year round periodic feedback and shared discussion that is both empathetic and goal focused.

Administrative

The **performance management (administrative)** model provides information, often following an annual appraisal, which can be used by management for planning in human resource functions such as training, development, rewards, pay levels, benefits and performance improvement. The focus is on collecting data to manage the HRM function more efficiently and ensure that individual and business goals are aligned and strategic goals are met.

BizWORD

The **performance management (developmental)** *model improves individual performance through establishing objectives such as reaching sales targets that are consistent with achieving the organisation's goals.*

The **performance management (administrative)** *model assesses the progress of the business in meeting its strategic goals and where necessary identifying the areas for improvement, such as establishing new goals or employee performance.*

SNAPSHOT



Regular feedback equals successful performance appraisal

While the end of the financial year provides businesses with an opportunity to do a 'stocktake' on their financial performance, equally important, but often overlooked, are regular reviews of the team's performance.

It is often said employees are the most important asset. If this is accepted, it would also stand to reason that people leaders would also review the performance of their employees.

. . .

Performance reviews [or appraisals] are a key aspect of keeping your team engaged and 'buying in' to what the business is trying to achieve. However, for some — both people leaders and employees — performance appraisals can be seen as a tiresome and difficult process, but it need not be.

When both parties know what is expected of them, a performance review should not contain any nasty surprises. However, lack of clear expectations is often where problems begin.

Most employees have a strong work ethic and want to do well . . . Notwithstanding, feedback from peers and people leaders is an important gauge for what an employee is doing well and what areas need development.

It is important to remember that feedback should not happen only at the end of the year in the form of an official performance appraisal. Feedback should happen regularly to ensure all parties are on the same page and any issues can be addressed quickly.

This four step process of performance management has traditionally worked well for setting employees up to achieve the best possible results.

Step 1. Ensure expectations are clear, for no other reason than employees are typically more productive when they know what is expected of them and when. These expectations may be set on a weekly basis but also typically cover a longer term, say half yearly or yearly. Some employers fall into the trap of assuming that their staff know what is expected of them. As a people leader, it is your responsibility to be clear.

Step 2. Assess performance regularly. Some people leaders complete an annual performance review and think their job as a people leader is done. Of course, an annual performance review is important to discuss what has been achieved over the year, but performance should be assessed on a regular basis to make sure projects are on track, milestones are being met and any queries resolved. A monthly catch up is a good starting point, to review . . . not only what is being achieved, but also . . . how it is being achieved.

Step 3. Provide feedback on a regular basis. Ideally, you should not need a formal catch up to provide feedback, but it is imperative that feedback is provided when performance is assessed. Feedback should include recognition of the effort, improvements and achievements throughout the past month, quarter or year, which is an excellent motivator for many employees. This is also the time to provide constructive feedback for development areas. Providing constructive feedback to highlight and bridge performance gaps, if delivered in the right way, can be equally motivating, as most employees want to continually improve their knowledge and skills.

Step 4. Continuous development will keep employees engaged and will ultimately result in increased productivity. Development planning looks not only at what the employee needs to do to complete their current role, but also helps to up-skill them for their next role. Development means different things to different people, but typically encompasses learning new skills on the job, mentoring, new responsibilities or stretch targets and formal courses.

Source: Extracts from 'The benefits of performance reviews', 12 June 2014, https://probonoaustralia.com.au

SNAPSHOT QUESTIONS

1. **What** is performance management?
2. **List** the advantages of an informal and frequent discussion with employees.
3. **How** can performance appraisal contribute to an employee's professional development?
4. Use an appropriate graphic template to design a document that **summarises** the four-step process of performance management.

'Performance reviews . . . are a key aspect of keeping your team engaged and 'buying in' to what the business is trying to achieve.'

16.6.1 Benefits of effective performance management

The benefits of effective performance management from a developmental and administrative perspective are identified in table 16.3.

The key elements of performance management is the creation of a shared vision of the strategic direction of the business between employees and employers, the establishment of performance objectives and a formal review process.

BizFACT

Under the Fair Work Act (2011) all employees can bring an action for unfair dismissal. It is important for employers to be able to provide documented evidence of poor performance and how this has been communicated to the employee.

TABLE 16.3 Benefits of performance management

Developmental benefits	Administrative benefits
• Assists with human resource planning • Can plan to overcome gaps or weaknesses found in performance • Shows the effectiveness of current selection processes and whether staff recruited match the cultural fit and skills required for the organisation • Identifies training and development or legal compliance needs • Evaluates rewards and benefits programs • Communicates expectations, helps build trust, promotes long-term organisational development. • Helps identify, motivate and retain talented staff for leadership succession • Identifies and documents poor performance, and links it with training and improvement strategies • Helps build best practice culture	• Higher productivity • Better financial performance • Comparison of contribution to organisation and performance against agreed standards • Helps assess rewards and benefits linked to performance • Builds self-efficacy as contributions recognised — important in motivation and retention • Identifies strengths and weaknesses, creating opportunities for training and development, coaching or mentoring • Creates opportunity for employee to provide feedback • Initiative recognised and rewarded • Fosters promotion on merit • Employee focus is aligned with organisational strategy

Establishing a link between performance evaluation and employee development will ensure that staff remain motivated and both they and the organisation benefit.



FIGURE 16.7 To be valued by employees, performance management requires active listening, regular feedback by all parties involved, and mutually agreed and beneficial action plans.

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Syllabus area 4
Topic 4
Concept 5

Performance management
Summary screen and practice questions

16.7 Rewards — monetary and non-monetary, individual or group, performance pay

A well-planned reward system is a key strategy in attracting, motivating and retaining employees. A rewards system can reinforce strategies to facilitate change or support desirable corporate values, such as a focus on the customer.

Monetary and non-monetary rewards

Rewards can be **monetary** or **non-monetary**, as shown in figure 16.8, and evidence suggests a business's reward policies assist to reinforce its culture, values and achieve strategic objectives. A business's sustainable competitive advantage is also linked to a **remuneration** system that seeks to encourage and reward employees. Rewards are seen as a significant tool in motivating staff to higher levels of performance.

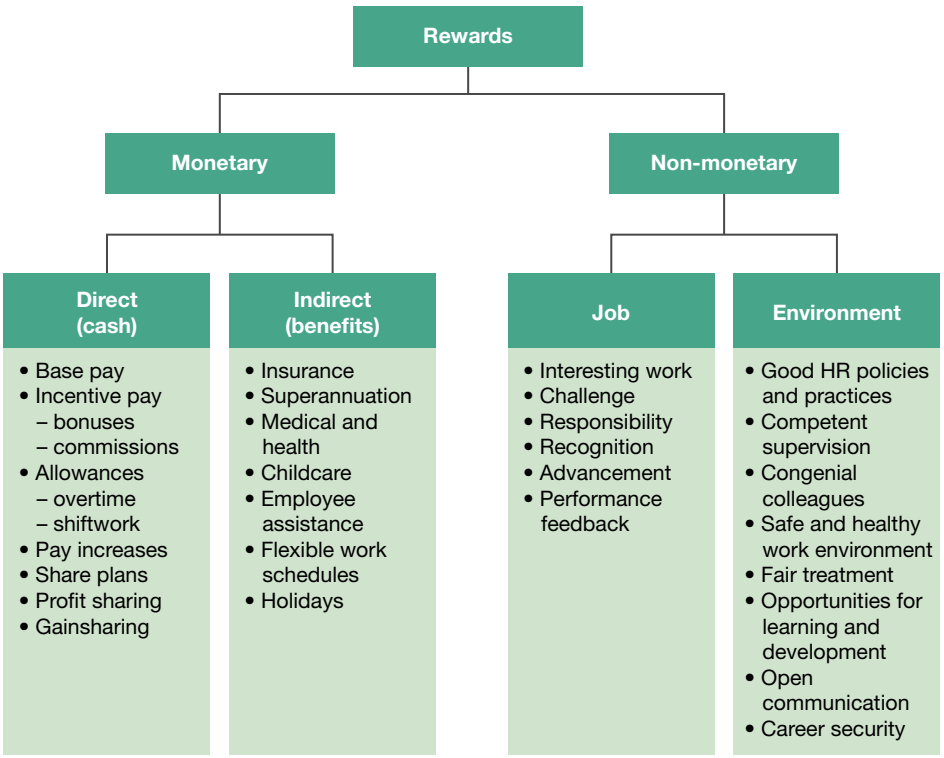


FIGURE 16.8 Types of employee rewards

BizWORD

Monetary rewards *are those reflected in pay or having financial value.*

Non-monetary rewards *are those that do not have a financial value, such as social activities or retirement planning.*

Remuneration *refers to both the financial (e.g. pay) and non-financial (e.g. career security) benefits that employees receive in return for their work effort.*

BizFACT

Employers need to analyse both financial and non-financial rewards to maximise employee engagement and performance. The demographic characteristics of a diversified workforce (gender, age, ethnicity, occupation) all have an impact upon selecting the most appropriate form of remuneration.

Case study: Motivating employees at Fonda Mexican Restaurant

The word 'Fonda' is used in Mexico to describe a house with an open kitchen, where visitors are always welcome. The Fonda restaurant chain was founded in Melbourne by David Youl and Tim McDonald in 2011, and aims to carry on this tradition of a relaxed and welcoming dining experience. Although the restaurant now operates at seven different sites in Melbourne and one in Sydney, David and Tim have chosen not to make use of a franchise model, as they wish to maintain a consistent management culture across each of the restaurants. This culture encompasses the following features:

- Alignment between the business objectives and employee objectives is given highest priority. This means that employees have a direct interest in improving the profits of the business through a system of profit sharing.
- Each branch of the business is managed by a Restaurant Business Leader (RBL). This person is paid a base salary, which is augmented monthly by a 7 per cent share of the profit of that restaurant. The higher the profit, the larger the amount paid to the RBL. Base salaries are kept relatively low (and in line with legal minimums), but the share in the profits has meant that the actual take home pay is generally higher than the industry average.
- Assisting the RBL in each restaurant is a Senior Assistant Business Leader, who is paid 3 per cent of the profits, and two or three Assistant Business Leaders who are each paid 2 per cent. While base salaries for each of the members of the leadership team is also relatively low, their share of profit inevitably means they actually take home salaries that are higher than comparable employees in other restaurants.

SNAPSHOT



'Alignment between the business objectives and employee objectives is given highest priority.'

- The leadership teams meet together monthly with the business owners, when profit share payments are made and ideas for improving productivity are shared. Leaders are encouraged to learn from each other and to celebrate the achievement of business goals.
- Every three months, all staff meet for a 'Buzz Breakfast', at which a wide variety of staff achievements are reported and celebrated.
- An annual awards dinner is held each year for all employees, and this is seen as the company's equivalent to a Brownlow Medal celebration (the AFL best and fairest award).
- Each May, the leadership teams meet to set the objectives for the next financial year. These objectives are broken down into monthly, weekly and even daily goals, and these goals are made measurable and communicated to all staff. It is not unusual for customers in one of the restaurants to see staff stop for 20 seconds and break out into cheering and applause when a daily sales goal or a food preparation time goal has been achieved.
- Staff are known as 'Fondarians', and are encouraged to see themselves as important team members. Ideas and suggestions for improvement from all staff is strongly encouraged, acknowledged regularly and celebrated.

In 2015, Fonda was recognised by the *Business Review Weekly* as the 22nd fastest growing company in Australia, up from 39th the previous year. Aligning staff motivation with business objectives has proved a recipe for success for Fonda in the very crowded and competitive hospitality industry.

SNAPSHOT QUESTIONS

1. **How** do the owners of Fonda Mexican Restaurants make use of both monetary and non-monetary strategies to motivate staff?
2. In what ways are the business objectives of Fonda Mexican Restaurants aligned with the objectives of employees in those restaurants?
3. **Explain** why customers at a Fonda restaurant may occasionally see employees breaking out into cheers and applause, and congratulating each other.

Individual or group reward

Rewards are often related to individual performance; however, this can lead to conflict and rivalry if not managed effectively. All individuals are dependent on others and on efficient workplace systems to achieve high-quality performance. Increasing use of group- and team-based structures have increased the need for cooperation and made it difficult to distinguish performance of individuals within teams. **Gain-sharing plans** and group incentive schemes are often used to support a team-based culture.

BizWORD

A **gain-sharing plan** *involves the benefits of improvements and success, such as productivity improvements, cost savings and sales and profit increases, being reflected in rewards for teams, such as shares, cash bonuses or annual bonuses.*



FIGURE 16.9 A team-based reward system encourages cooperation between the employees in the business. However, it can result in the 'free-rider' phenomena: the team member who contributes little to overall performance but receives the reward nevertheless.

Many tools can be used by the human resource manager in developing a reward system. For example, a grid or matrix could be drawn up to assess the objectives of each reward and the overall effectiveness of the system (an example is shown in table 16.4).

TABLE 16.4 A rewards matrix for a business

Reward component	Reward objectives					
	Attract	Retain	Productivity	Individual contribution	Employee security	Company performance
Base salary	✓	✓				
Gain-sharing plan			✓			
Performance incentive		✓		✓		
Corporate profit share	✓					✓
Superannuation	✓	✓				
Other benefits		✓			✓	
Career planning		✓	✓		✓	

BizFACT

Around one-third of Australian employees never negotiate their pay.

Key issues to consider in designing a reward and benefits system in terms of the business include:

- business strategy
- economic conditions — supply and demand for labour and skills shortages
- organisational objectives of rewards
- rewards and benefits of competitors
- relevant awards and agreements, minimum employment standards
- union power
- profitability/viability of the business.

Key issues to consider in designing a reward and benefits system for individual employees are:

- **performance pay** — remuneration based on distributing rewards according to individual employee performance. In doing so it increases individual accountability and promotes employee development. Performance pay is often related to executive remuneration but is also received by approximately one-third of Australian workers.
- *performance related* — incentive plans for performance above standards or criteria, bonuses, piece rates, commissions, production-related incentives
- *job related* — role and level of responsibility, scope of supervision, base pay, interpersonal skills, knowledge and skills, experience, value to the company (e.g. links with key clients)
- *other individual considerations* — group incentives, the employee's values (e.g. job flexibility vs career planning), specific job conditions (e.g. requiring employees to live overseas) and their individual bargaining power.

BizWORD

Performance pay *refers to remuneration that is based on distributing rewards according to individual employee performance.*

Reward systems that are not clear or fair, or where employees believe there has been favouritism or bias, can lead to internal politicking and conflict, loss of trust and motivation, and higher levels of labour turnover.

The reward system should aim to motivate staff and be equitable, clearly communicated, defensible, relevant, cost effective and integrated with the corporate strategy. It must also be simple to understand and administer, and consistently applied to all employees.

BizFACT

Some argue that businesses may use performance incentive systems as a substitute for more important motivation strategies, such as improved job design, employee participation, and feedback to employees about their work.

SNAPSHOT



'People should get a bonus for outstanding performance.'

Red Star Fashions — the debate around bonuses

Maureen Brady, CEO of Red Star Fashions, pushed the thin pile of papers away and sighed. 'It seems that we have a serious problem. Employee productivity is in decline. We are losing our competitiveness. At this rate, we will make a financial loss by year end. Does anyone have anything to say?'

'Yes', snapped Carolyn Simon, Finance Director. 'The problem is our people are not motivated. Everyone gets paid the same irrespective of their performance. The best people became demotivated — everyone sinks to the lowest common denominator.'

'I agree', interjected Nick Dalmaris, Marketing Manager. 'We don't reward performance. We ignore it. It is no wonder that our people aren't motivated. Why should they be? What do they get for doing a good job? Nothing. This place has become a safe haven for non-performers. They get paid regardless and they know they can't or won't be sacked. It should come as no surprise that we are losing our competitiveness.'

'What do you suggest then?' asked Maureen.

'Pay people on the basis of their performance not on how long they have been with the company', replied Nick.

'Nick is right', Carolyn said enthusiastically. 'We need to get away from seniority and switch to a system of performance-based rewards. We need a bonus system. People should get a bonus for outstanding performance.'

'Stephanie, you have been silent so far, what are your thoughts?'

Stephanie Magolis, HR manager paused, then said, 'The culture of this company is built around teamwork — working together, sharing our knowledge and experiences. Individual performance rewards will destroy the collegiality that exists. Individual rewards promote competition. They will trash our cooperative culture. The present system is fair. Seniority-based rewards recognise loyalty and promote harmony. Individual performance payments do not. All that will happen is that people will spend all their time manoeuvring themselves to gain favour with their bosses. I am opposed to any change. I believe that the introduction of individual performance bonuses would have a most negative effect on the moral fibre of this company.'

'For heaven's sake, Stephanie, you must understand that if we wish to attract and retain talented people, we have to reward them appropriately. Why would a top performer come here?'

'We want a champion team, not a team of champions', Stephanie shot back. 'Performance pay is not about performance, it is about competition and the destruction of a cooperative corporate culture.'

SNAPSHOT QUESTIONS

1. **Outline** the opposing arguments. Who do you agree with? Why?
2. **Discuss** what effect a reward system might have on the culture of an organisation.
3. If you were the HR manager, **propose** the suggestions you would make to improve the productivity and competitiveness of Red Star Fashions.

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Syllabus area 4 | Topic 4 | Concept 6

Rewards
Summary screen and practice questions

SUMMARY

- Recruitment is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost.
- Most businesses use a mix of internal and external recruitment to maximise opportunities for new ideas and use of existing expertise in the business.
- Australia has long experienced a skills shortage, leading employers to increasingly recruit staff with general skills and upskilling internally.
- Many businesses recruit overseas and poach staff from other businesses to overcome shortages of skilled staff.
- Training aims to develop skills, knowledge and attitudes that lead to superior work performance.
- Development is focused on enhancing the skills of the employee to upgrade their skills in line with the changing and future needs of the business.

- Performance management is a systematic process of evaluating and managing employee performance in order to achieve the best outcomes for a business.
- Feedback from performance appraisal and management provides many benefits to the business and the individual.
- Rewards management is a system of monetary and non-monetary, and intrinsic and extrinsic rewards to attract, motivate and retain employees for their effort and performance.
- An effective reward system is equitable, clearly communicated, relevant, cost effective, simple to administer and aligned with the business's goals.

EXERCISE 16.3 REVISION

1. Beth Gaikwad, manager HRFirst, said: 'A poor recruitment and selection process has negative consequences for the business as well as the individual'. **Discuss**.
2. **Distinguish** between internal and external recruitment.
3. Using table 16.2 as a guide, **clarify** when it is appropriate for a business to use (a) internal recruitment and (b) external recruitment.
4. **Identify** the set of general skills employees need to possess.
5. **How** do human resource managers choose whether to recruit for general or specific skills?
6. 'Training improves current skills while development provides for future skills.' **Explain**.
7. **Outline** the purpose of performance management systems.
8. **Describe** the benefits to employers of using both developmental and administrative approaches to performance management.
9. **Describe** four benefits of an effective performance management system.
10. **Distinguish** between monetary and non-monetary rewards, and explain why a mix is best.
11. **Outline** the main features of a well-designed rewards system.

EXERCISE 16.3 EXTENSION

1. **Evaluate** the benefits of developing a training strategy which is focused on future skills in addition to current skills.
2. **Discuss** the benefits and costs of poaching staff from other businesses to overcome skills shortages.
3. In groups, **create** a rewards system either for staff in a university or for journalists at a large metropolitan newspaper. **Justify** your strategy.

16.8 Global strategies: costs, skills, supply

Globalisation of business, as well as technological developments in the internet, human resource applications and telecommunications, has significantly increased the competition faced by any business. These advances have also increased the complexity of managing human resources.

Issues such as high domestic labour costs, a skills shortage, especially apparent in some industries, and a relatively small labour pool have made businesses re-think the management of human resources.

The globalisation that has affected a number of Australian businesses has brought with it the need for change. Increasing competition, shareholder demands for higher returns, privatisation, outsourcing and restructuring have all forced businesses to analyse their strategic direction. Most of these strategic decisions have at their core matters relating to labour costs, skills and supply.

BizWORD

*A **subsidiary** is a company that is owned by another company (referred to as the parent) and it is often located in another country.*

Australia's higher living standards bring with it the expectation of better wages and salaries for workers. Employers are also faced with on-costs such as superannuation that add to the expense of remunerating local staff.

Some businesses have found that these higher labour costs reduce competitiveness and as a result have made the decision to restructure their workforce, including outsourcing some functions to lower labour cost countries. Others have established **subsidiaries** off-shore to take advantage of the opportunity to reduce production costs and gain access to new markets.

Countries such as China have factories able to produce goods at very competitive prices. This has attracted the attention of Australian businesses, which have moved production to China because it is cheaper, causing Australian factories to close.

For example, the Australian company Pacific Brands, known for its Bonds and Holeproof products (amongst others), relocated its manufacturing to China at a cost of some Australian 1800 jobs as it was no longer sustainable to keep its Australian factories open.

The airline Qantas also faced scrutiny for its ongoing restructuring of its domestic maintenance facilities that resulted in a loss of 1550 jobs since 2014. Much of the work previously done in regional centres such as Avalon, Victoria, was relocated to lower labour cost countries such as Singapore and Hong Kong.

Other activities such as basic accounting and legal work, including the processing of insurance policies, is being outsourced to countries such as India. It has a large pool of English-speaking, highly literate and tertiary educated workers able to provide the type of services desired by Australian businesses at a much lower rate than if the work was done in Australia.

The issue of labour force skills has also been significant for many Australian businesses. For some time now local managers have expressed their concern that there is a major issue relating to matching the skills possessed by Australian workers and those needed by business. It is a widely held belief by many of these managers that the Australian education system has not produced workers with the necessary numeracy and literacy skills.

Estimates are that Australian businesses will need in the vicinity of 2 million workers in the next few years and more than 5 million by the start of the next decade. Moreover, this shortage is seen as a major impediment to improving productivity in the workplace. This skills shortage is often blamed on the education system and on some employers who are more intent on importing cheaper labour, outsourcing or recruiting overseas. Australia will have a shortfall of 500 000 workers by the end of the decade and the skills shortage remains an issue as Australia continues to pursue opportunities for economic growth.

Short-term initiatives have been used to overcome the shortage of workers. The Temporary Skill Shortage (TSS) visa was introduced in March 2018. It replaced the temporary work (skilled) visa — the 457 visa. The TSS visa program comprises a short-term (up to two years) visa or a medium-term (up to four years) visa and will support businesses in addressing genuine skill shortages in their workforce. It aims to align with the skill needs of the Australian labour market and tightens eligibility requirements for employer sponsored permanent skilled visas.

Temporary visas serve the economy well in times of skills shortages in the short term, for example, in periods of economic growth. They are especially useful in attracting skilled workers to remote areas where Australian workers are reluctant to go especially in the medical services, engineering and skilled trades. A solid commitment to training Australia's workers is, however, the long-term solution.

The ongoing economic problems in Europe, with a number of long-term unemployed but highly skilled workers, is attracting the interest of some Australian businesses in search of workers. Europe, South Africa, United States and United Kingdom are also providing some Australian businesses with highly experienced senior management.

The supply of workers continues to be a problem for a country of 25 million people. China and India with their huge populations have an abundance of workers keen to find well-paid employment overseas. Australia is allowing skilled workers from these countries to migrate and work here, especially in difficult-to-fill occupations such as IT, and to replace the 100 000 workers Australia loses to business migration each year.

Businesses are sometimes attracted by the lower labour costs on offer in some countries; however, this needs to be more fully explored. Countries like China have a huge supply of labour but much of it is ageing and poorly qualified with low literacy levels. This is compounded by a shortage of younger workers and the limited availability of quality managers. Qualified staff tend to be concentrated in the major cities such as Beijing or Shanghai. Consequently, companies looking to China as a destination for expansion often face higher human resource costs and any benefits derived from such relocation decisions need to be considered in light of these factors.

It is often said that in China nothing is ever black and white — everything is negotiable. Worker rights are often ignored. The right to strike does not exist in law but there is no current law that expressly prohibits it. In addition, independent trade unions are not permitted (the government controls all unions via the All China Federation of Trade Unions) but instead are seen as an instrument of government policy where worker entitlements are secondary to the promotion of government interests.

Further, the change to a more market-based economy in China means there are inconsistencies in workplace laws that can appear to support unscrupulous management practices. This has given rise to criticism of some multinational businesses that have sought to benefit from this lack of structure and taken advantage of China's supply of low-cost labour in situations where the required skill level is relatively low.

High levels of corruption mean that government officials may also ignore health and safety hazards and other offences such as the employment of child labour. More recently, however, international organisations are putting pressure on the Chinese government and transnational organisations to take a more moderate view on the freedom of workers to belong to unions, as illustrated in the following Snapshot.

Case study: Foxconn's labour union elections put Chinese workers' rights under the spotlight

Apple's China-based contractor, Foxconn, is following a trend of increasing unionisation at transnational corporations in China by holding its first-ever democratic labour union elections.

As reported by the International Trade Union Confederation in 2012, branches of the All-China Federation of Trade Unions have been established for Chinese operations of Wal-Mart, Carrefour, Motorola and Samsung.

. . .

In 2012, the Fair Labor Association (FLA), an independent organisation which monitors labour standards on behalf of over thirty transnational corporations, found multiple violations of labor standards included in the FLA's Workplace Code of Conduct. One of the actions recommended by the FLA was to conduct more democratic union elections and eliminate management dominance from the union, strengthening workers' rights to freedom of association.

Under Chinese law, workers are not free to join the union of their choice, and unionisation is heavily regulated by the state. However, under the 2008 Rainbow Plan, the Chinese government has encouraged greater unionisation and collective bargaining, including in transnational corporations operating in China. The atmosphere is therefore more positive for unionisation. The FLA's 2012 report criticised Foxconn's practices as contrary to both Chinese and international law.

SNAPSHOT



‘Under Chinese law, workers are not free to join the union of their choice, and unionisation is heavily regulated by the state.’

Its recommendations on making Foxconn's unions more representative encourage the company to follow new, local regulations.

China remains an outsider to most of the international treaties, which guarantee freedom of association and union rights. It has signed the International Covenant on Economic, Social and Cultural Rights, but has declared that the right to form and join unions will be subject to the Chinese constitution and internal law. This reservation could effectively take away what the international treaty gives. China has been criticised within the United Nations for its failure to guarantee free unions, and several complaints against China have been brought to the International Labour Organisation (ILO)'s Freedom of Association Committee.

The FLA's Workplace Code of Conduct is based on ILO treaties, including those on freedom of association. Since China has not signed these treaties, it is understandable that the FLA grounded its criticism of Foxconn in Chinese as well as international law. This makes the recommendations more acceptable to Foxconn and to Chinese authorities, and therefore more likely to be followed. The recent announcement of democratic union elections demonstrates the success of the FLA's strategy of blurring the difference between the requirements of Chinese and international law.

Poor labour practices at Foxconn have placed Apple under pressure. NGOs such as China Labor Watch and Students and Scholars against Corporate Misbehaviour publicised allegations of abuse of Foxconn employees, with a focus on Apple, Foxconn's largest client. This publicity led Apple to appoint the FLA in early 2012 to audit Foxconn.

The FLA approach of linking international and Chinese law in its criticisms shifts the blame from the state to the company. The result, which could be repeated in other Chinese contractors to transnational corporations, is acceptance of stronger freedom of association standards. The method of maintaining commitment to international standards while masking them as internal law is a strategy worth adopting more widely. Even if China refuses to sign human rights treaties protecting freedom of association, a bit of creative thinking can make practical improvements to working conditions and access to union representation possible.

Source: Holly Cullen, 'Foxconn's labour union elections put Chinese workers' rights under the spotlight', *The Conversation*, 13 March 2013

SNAPSHOT QUESTIONS

1. **Identify** the companies that have supported increased unionisation in their China-based contractors/operations.
2. **What** factors gave rise to more democratic union elections?
3. **Outline** the purpose of the 2008 Rainbow Plan.
4. Who is the FLA? **Describe** its role in promoting democratic union elections in China factories.
5. **What** strategy does the author recommend to improve conditions in China's factories and also increase the likelihood of union membership for workers?

studyon

Syllabus area 4
Topic 4
Concept 7

Global context: costs, skills and supply
Summary screen and practice questions

16.9 Workplace disputes

Disputes are conflicts, disagreements or dissatisfaction between individuals and/or groups. Conflict between stakeholders is inevitable in workplaces. Stakeholders often have conflicting interests, particularly over the degree to which employees should share in the profits.

Workplace conflict can lead to problems such as higher levels of absenteeism, low productivity, legal claims and high staff turnover, which may be even more costly in the long run.

The Australian Bureau of Statistics (ABS) maintains statistics about official, or overt, disputes. An **industrial dispute** is a disagreement over an issue or group of issues between an employer and its employees, which results in employees ceasing work.

Strikes refer to situations in which workers withdraw their labour. They are the most overt form of industrial action and aim to attract publicity and support for the employees' case. Strike action is more common in public sector organisations and in the mining sector.

BizWORD

An **industrial dispute** *is a disagreement over an issue or group of issues between an employer and its employees, which results in employees ceasing work.*

Strikes *refer to situations in which workers withdraw their labour.*



FIGURE 16.10 Strikes can attract publicity and support for the employees' case.

Lockouts occur when employers close the entrance to a workplace and refuse admission to the workers. In some lockouts, management has been brought in by helicopter to avoid a **picket** line of workers. Lockouts have been used frequently in long disputes in manufacturing to promote concession bargaining, to push employees to sign individual agreements, and in response to strike action.

Each withdrawal or refusal is made to enforce a demand, to resist a demand or to express a grievance. Legal claims for matters such as discrimination, harassment and bullying are not included in these disputes.

The level of disputes varies within and between industries and businesses. Some employers seek to minimise conflict, others stifle it through tough tactics, while others manage more collaboratively through negotiation with staff and unions.

BizWORD

Lockouts *occur when employers close the entrance to a workplace and refuse admission to the workers.*

Pickets *are protests that take place outside the workplace, generally associated with a strike. Unionists stop the delivery of goods and try to stop the entry of non-union labour into the workplace.*



FIGURE 16.11 A picket line is formed by striking workers to prevent vehicles and non-striking workers from entering the workplace.

BizFACT

The types of strikes include the following:

- *Sympathy strikes are those called in support of a group of workers already on strike.*
- *Rolling strikes occur over a period of time, in between working periods.*
- *Rotating and revolving strikes occur where workers at different locations take turns to strike.*
- *Political strikes involve employees taking strike action over political issues, against government policy or actions.*
- *Wildcat strikes are those that take place without union approval.*
- *Lightning strikes occur without an employer being notified.*
- *General strikes involve a large number of workers in different industries going on strike simultaneously.*
- *Stop-work meetings involve employees stopping work to hold a meeting on an industrial issue during work time.*

BizFACT

Managerial policy is one of the most common causes of disputes. Disputes arising from managerial policy may be related to award restructuring, terms and conditions of employment, enterprise bargaining, production limits or quotas, promotion, discipline, personal disagreements and changing work practices.

The major causes of disputes recognised by the ABS are disputes relating to negotiation of awards and enterprise agreements. These issues typically include disputes about:

- remuneration. This includes matters such as wages, allowances, entitlements and superannuation.
- employment conditions. These include matters such as working hours, leave, benefits and other general employment conditions.
- job security issues. These include retrenchment of employees, downsizing, restructuring, use of contractors, outsourcing, re-classification of the workforce, and other industry-related matters (see the following Snapshot).

Matters outside agreements also cause disputes, for example:

- health and safety. These matters typically relate to physical working conditions, including safety matters, and workers' compensation provisions, protective clothing and equipment, uncomfortable working conditions, employee amenities, equipment condition, and overly strenuous physical tasks.
- managerial policy. These issues include decisions and policies of line managers, such as disciplinary matters, suspensions, discrimination, decisions that impact upon work and family issues, production limits or quotas, principles of promotion, and other work practices.
- union issues. These matters relate to employer approaches to the union, inter-union and intra-union disputes (e.g. demarcation disputes), sympathy stoppages in support of employees in another industry, and recognition of union activities.
- political or social protests.

SNAPSHOT



'. . . Hutchison Ports breached the enterprise agreement by failing to properly consult workers . . .'

Analysing the causes of two workplace disputes and the strategies used to resolve them

Case study: Workplace dispute 1 — Hutchinson Ports Australia and the Maritime Union of Australia

Hutchinson Ports Australia used an unusual procedure for advising nearly 100 workers in both its Sydney and Brisbane terminals that their services were no longer required.

In a text message and email sent to workers late at night they were informed that:

> . . . your position will not be retained. There are no redeployment opportunities. The intended last day of your employment will be Friday 14 August 2015. Accordingly you are [sic] will not be required to attend work effective immediately. We will of course pay you your normal salary to your last date of employment.

Disbelieving (and now sacked) workers were locked out of the business the next day and although they and 100 supporters formed on-site pickets in both Sydney and Brisbane, management was adamant that the workers would not be recalled. Workers across the sites responded with a four-hour stop work meeting to give them an opportunity to consider their next step in support of sacked colleagues.

The Maritime Union of Australia was called in on behalf of its members at the business and it immediately lodged the matter with the Fair Work Commission and the Federal Court of Australia, arguing Hutchison Ports breached the enterprise agreement by failing to properly consult workers and caring little about a dispute resolution clause before announcing the redundancies.

A court ordered injunction was issued to stop the dismissals and the on-site pickets were subsequently suspended. Management was able to meet with the union to articulate its concerns (believed to be about workplace inefficiencies) and a satisfactory settlement to the dispute sought.

The company eventually decided that it would accept voluntary redundancies in lieu of the sackings and about 25 per cent of the workers took this option. A further incentive for redundant employees came in the form of an additional payment of $20 000 above their legal entitlements.

In return the company would now be able to employ workers on a casual basis, however, the redundant workers could apply for these positions.

Workers had a slight increase in the length of the working week to 32 hours and they were also expected to offer some flexibility around rostering.

Hutchinson Ports Australia stated that it would benefit by being able to be more competitive through effective cost management and indicated that as the opportunity presented itself workers would be allowed to return to full-time work should they choose to do so.

SNAPSHOT QUESTIONS

1. **Identify** the parties to the dispute.
2. **What** was the cause/s of the dispute?
3. **Identify** the types of industrial action taken by both employees and their employer.
4. **Analyse** the strategies used to resolve the dispute.

Case study: Workplace dispute 2 — Bathurst Hospital and the Health Services Union

Some 150 workers supported by the Health Services Union (HSU) recently staged a four-hour strike to raise awareness of an alleged culture of bullying, harassment and intimidation at Bathurst Hospital. Catering, security, cleaners and other health professionals employed at the hospital intended their demonstration to be a two-hour stop work meeting but due to a perceived lack of interest by management it was extended. Further, if a satisfactory outcome was not achieved the HSU and its members were prepared to call a 24-hour strike if necessary.

The HSU called for an investigation into claims of a poor work culture at Bathurst Hospital, which they argued had developed over the previous seven years, rife with low morale, bullying and intimidation, unfavourable roster changes, health and safety concerns and pay rates.

As the stop work meeting entered its fourth hour a spokeswoman for Bathurst Hospital indicated that the workers' claims were being taken seriously and that an independent consultant would be employed to investigate the staff grievances.

At the same time Bathurst Hospital had to deal with a long running dispute over other staffing issues including unreasonable workloads. Claims that staffing numbers were inadequate and that this placed additional pressure on workers were made before the Industrial Relations Commission.

A spokesman on behalf of the hospital said that meaningful discussions were being had and that progress being made.

SNAPSHOT QUESTIONS

1. **Identify** the parties to the dispute.
2. **What** was the cause/s of the dispute?
3. **Identify** the types of industrial action taken by both the employees and their employer.
4. **Analyse** the strategies used to resolve the dispute.

> '. . . claims of a poor work culture . . . rife with low morale, bullying and intimidation, unfavourable roster changes, health and safety concerns and pay rates.'

16.9.1 Resolution of disputes

The key stakeholders involved in resolving disputes include employees, employers, governments, trade unions, employer associations, courts and industrial tribunals (see figure 16.12). The Fair Work Commission describes dispute resolution as the processes whereby disputes are brought to an end. The three processes are:

1. a negotiated outcome — the parties work out the solution for themselves
2. a mediated outcome — an independent mediator assists with the development of an agreement
3. an arbitrated/adjudicated agreement — an independent arbitrator or court determines how the matter will be resolved and makes a legally binding order.

BizFACT

Most workplaces have never experienced industrial disputes such as strikes or lockouts. Many firms now try to develop a work environment in which disputes are minimised through collaborative working relationships and by training staff in procedures, policies and guidelines for managing disputes. Effective human resources requires prompt and equitable settlement of disputes.

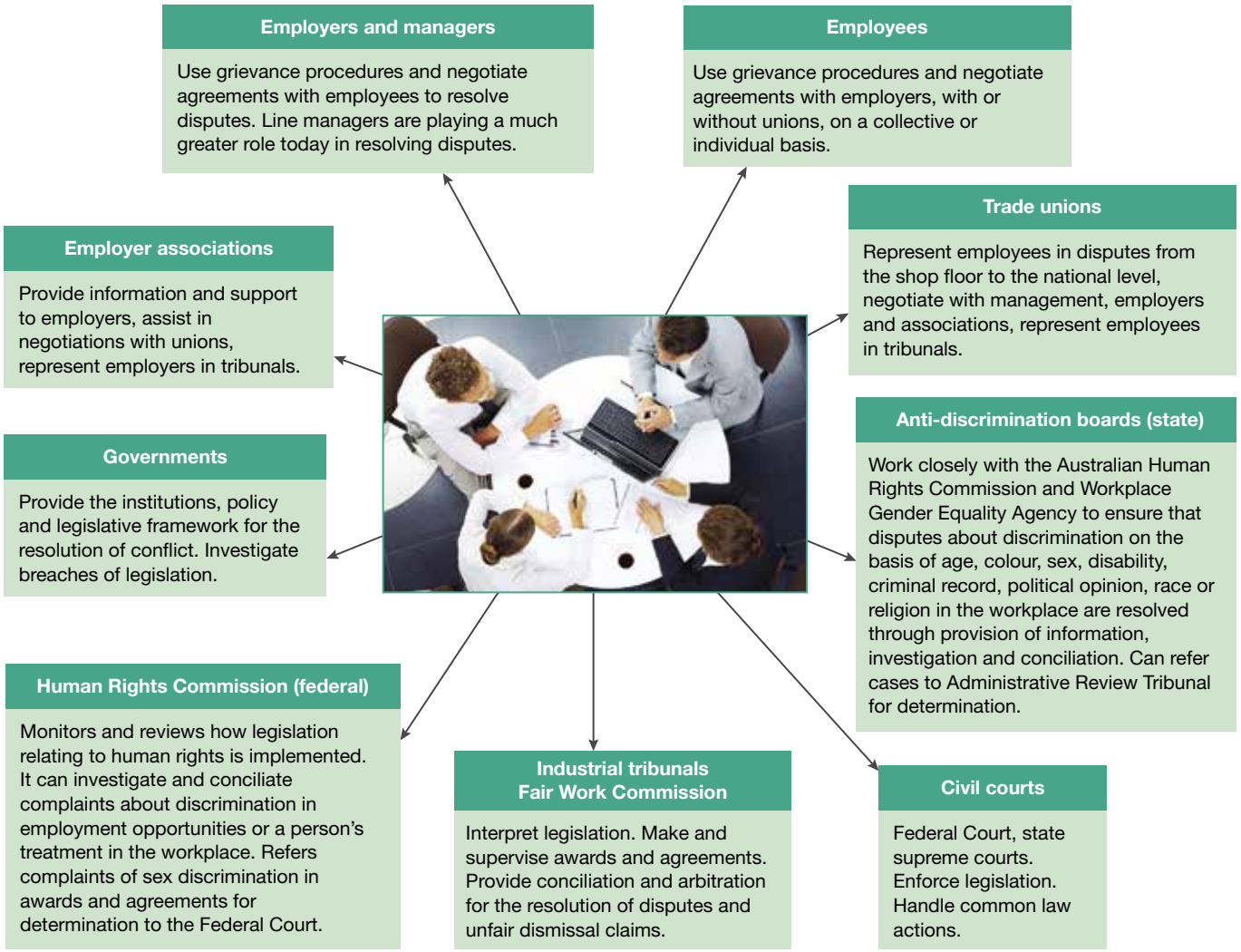


FIGURE 16.12 Key stakeholders and their role in resolving workplace disputes

BizWORD

In good faith *means the parties meet regularly with a willingness to reach an agreement.*

Before either party may take protected industrial action, there must also be proof that both parties have attempted to bargain **in good faith**. For cases where collective or enterprise bargaining does not resolve disputes in the workplace, conciliation is still available through the Fair Work Commission.

When disputes develop, a number of methods can be used to try to resolve them.

Negotiation

BizWORD

Negotiation *is a method of resolving disputes when discussions between the parties result in a compromise and a formal or informal agreement.*

Negotiation is a method of resolving disputes when discussions between the parties result in a compromise and a formal or informal agreement. This process can benefit the parties involved by increasing their knowledge of company policy, business's objectives, workers' concerns and issues involved in implementing change.

Most Australian industrial disputes are resolved by resumption of work, without negotiation, such as following a stopwork meeting. This may later lead to an agreement change. Most other disputes are resolved by negotiation without the intervention of a third party. In such cases, employees return to work following industrial action for a pre-determined period (such as after a 24-hour strike). Options available to the parties involved may be determined by the nature of the industrial agreement covering employees (federal/state) and the goals of the parties.

Mediation

Mediation is the confidential discussion of issues in a non-threatening environment, in the presence of a neutral, objective third party. The third party may be independent and agreed on by key parties in a dispute, or a representative from a business, tribunal or government agency, such as the Fair Work Commission, the Australian Human Rights Commission (AHRC) or the Anti-Discrimination Board (in New South Wales).

Mediation as an alternative dispute resolution technique is increasingly popular in Australia. It allows the parties to become empowered by resolving their own disputes, and it reduces the risk of disputes escalating and leading to expensive legal costs or industrial action. It is often required as the fist step in the resolution of a dispute.

BizWORD

Mediation *is the confidential discussion of issues in a non-threatening environment, in the presence of a neutral, objective third party.*

Grievance procedures

Grievance procedures are formal procedures, generally written into an award or agreement, that state agreed processes to resolve disputes in the workplace. Grievance procedures are useful in reducing the risk of an issue rapidly becoming a serious dispute. Most businesses have established a formal process, now required in modern awards and other agreements, by which issues can be handled. The steps in a typical grievance procedure are shown in figure 16.13.

BizWORD

Grievance procedures *are formal procedures, generally written into an award or agreement, that state agreed processes to resolve disputes in the workplace.*

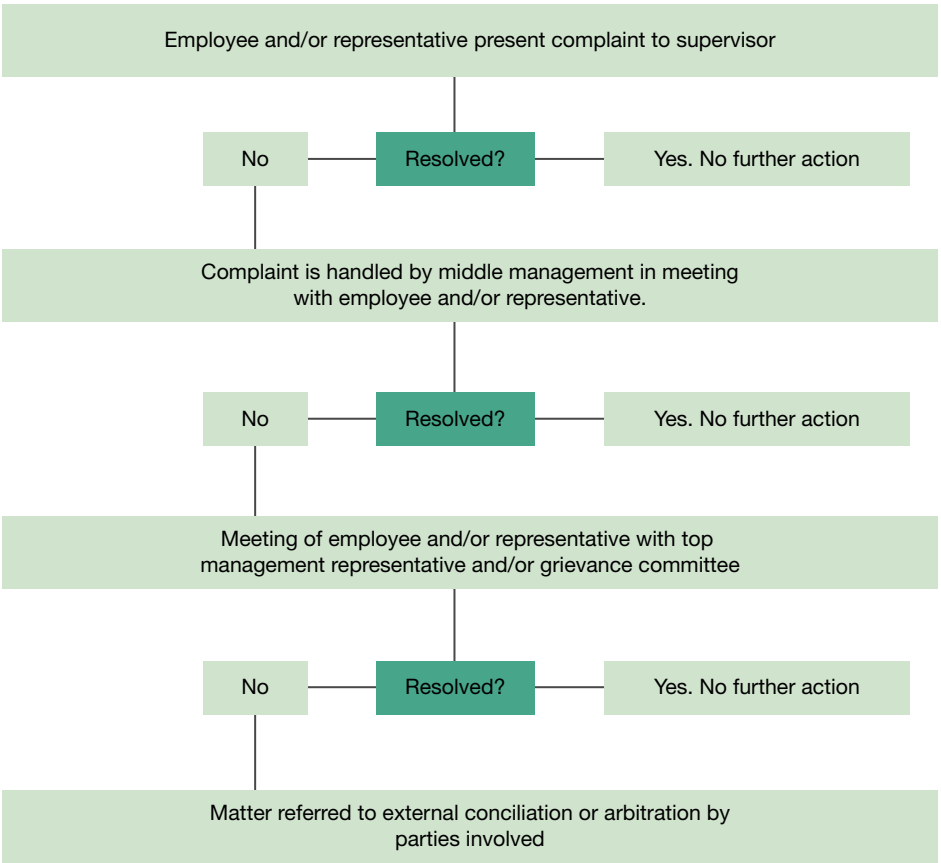


FIGURE 16.13 Steps in a typical grievance procedure. Complaints may be resolved at any of the stages indicated.

BizFACT

Around 70 per cent of managers are involved in grievance handling, and cite the most common issues as personality conflicts, allowances and pay, and discipline.

Effective grievance procedures require a full description of the complaint to be made by the employee(s) with the complaint. The person the grievance is made against should be given details of the allegation and an opportunity to provide their views. The process may deal with individual or collective issues, and matters such as changes being implemented in the workplace that will affect or cause

BizFACT

Conciliation usually means that the solution is owned by the parties to the dispute, whereas arbitration means that the decision is imposed upon the parties.

A conciliated outcome will mean that both parties are committed to making the decision successful, whereas an arbitrated result will more than likely mean a winner and a loser and some resentment.

conflict between staff. It is a useful strategy for resolving issues before they escalate. The Fair Work Commission recommends that issues be quickly resolved, handled sensitively and professionally, and in a manner that is fair, so that employees have confidence in the process.

Involvement of courts and tribunals

Industrial disputes that escalate to the level of courts and tribunals are most likely to occur when disputes have passed their nominal expiry date, bargaining has commenced towards a new agreement, and negotiations have failed. Employees and employers then enter a period where industrial action may be protected until a new agreement is developed.

Conciliation and arbitration

When a dispute has not been resolved through negotiation at the workplace, it may be referred to the Fair Work Commission (see the next Snapshot), who will appoint a conciliation member to hear both sides of the dispute. Conciliation is a process where a third party is involved in helping two other parties reach an agreement. The conciliation member calls a conference and attempts to help both sides reach an agreement. The member may require all parties to continue negotiations, reduce the ambit of the dispute or develop other strategies to resolve the dispute, then report back for another conference.

SNAPSHOT

'The aim of the act is to protect workplace rights.'

The Fair Work Commission — dispute resolution

When a dispute is not resolved in the workplace, it may be referred to a third party, such as the Fair Work Commission, to assist with the resolution. The role of the Fair Work Commission is to ensure that the parties play by the rules of the *Fair Work Act 2009*. Clear rules provide certainty and consistency for all stakeholders. The Fair Work Commission's role in resolving disputes includes:

- providing conciliation, mediation, recommendations and opinions to parties in disputes
- hearing and authorising applications for protected industrial action. For industrial action to be lawful it must be protected industrial action
- hearing, conciliating and making determinations on unfair dismissal claims (see section 16.9.1)
- suspension or termination of bargaining periods or protected action or unprotected action. This may occur where substantial harm may be done, or is imminent, to the parties involved or to a third party, the community or the economy. This is enforceable through orders in the courts.

The Fair Work Commission is empowered to deal with disputes relating to:

- disputes under the terms of an award or a collective or enterprise agreement
- bargaining disputes
- disputes arising under the general protections provisions.

Under the Fair Work Act, protection has been provided against adverse actions that may cause discrimination or disadvantage in the workplace. The aim of the act is to protect workplace rights, including the right to bargain freely and not to suffer from discrimination.

SNAPSHOT QUESTIONS

1. **Outline** the situations in which the Fair Work Commission assists in resolving issues.
2. **State** the roles the Fair Work Commission can play in resolving disputes.
3. **Identify** the possible outcomes of disputes that are referred to the Fair Work Commission.

If conciliation fails the matter may be referred to arbitration, if it is in the award or agreement, or if the parties agree. Arbitration is a process where a third party hears both sides of a dispute and makes a legally binding decision to resolve the dispute.

In this situation, a member or a panel of members hears both sides of the dispute in a more formal, court-like setting. A judgement, for example an **order**, is handed down based on the merits of the evidence that becomes legally binding on all parties. Orders may end a restrictive work practice or behaviour, such as a lockout, or require a secret ballot of union members if strike action is proposed. The Fair Work Commission may also order that staff be reinstated or that the parties return to the tribunal at a later date for further negotiations.

Common law action

Common law action is open to any party involved in or affected by industrial action. Parties may make direct claims for damages caused by the parties taking the action, or for breach of contract resulting from such action. An employer may ask a state or territory supreme court or the Federal Court for an injunction or stop order to prevent unlawful interference with the employer's trade or business, for example where a nuisance is created by a picket line. This option is not available if the action is a protected action during a bargaining period. Such action is costly and generally considered a 'last resort'. Common law action in civil courts is also available to those on individual common law contracts of employment disputing matters not covered in legislation or relevant awards.



FIGURE 16.14 One of the benefits of the successful resolution of industrial conflict is improved working relationships.

BizWORD

Orders *are decisions that require employees or employers to carry out a direction from the tribunal. They may be inserted in awards or agreements.*

BizFACT

The Fair Work Act 2009 *provides protections of rights, including:*

- *workplace rights*
- *the right to engage in industrial activities*
- *the right to be free from unlawful discrimination*
- *the right to be free from undue influence or pressure in negotiating individual arrangements.*

Industrial action will not be protected if it:

- *is taken while a bargaining period has been suspended*
- *relates significantly to a demarcation dispute*
- *is in support of claims for a multi-enterprise or greenfields agreement*
- *covers matters not considered lawful in the dispute*
- *contravenes any Fair Work Australia orders.*

SUMMARY

- Globalisation brings issues related to managing human resources. Access to sufficient numbers of skilled labour affects business decision making.
- The rapid growth of global outsourcing illustrates the potential for firms to develop creative strategies that access lower labour cost, while complying with regulations and pay scales in overseas countries.
- An industrial dispute is a disagreement over an issue or group of issues between an employer and its employees, which results in employees ceasing work.
- The level of disputes varies within and between industries and businesses. Some employers seek to minimise conflict, others stifle it through tough tactics,

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Syllabus area 4
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Concept 8
Workplace relations and disputes
Summary screen and practice questions

studyon

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Topic 4
Concept 9

Workplace dispute resolution
Summary screen and practice questions

while others manage more collaboratively through negotiation with staff and unions.

- The major causes of disputes recognised by the ABS are disputes relating to negotiation of awards and enterprise agreements. These issues typically include disputes about remuneration, employment conditions and job security issues.
- The key stakeholders involved in resolving disputes include employees, employers, governments, trade unions, employer associations, courts and industrial tribunals.
- Negotiation is a method of resolving disputes when discussions between the parties result in a compromise and a formal or informal agreement.
- Mediation is the confidential discussion of issues in a non-threatening environment, in the presence of a neutral, objective third party.
- Costs of industrial disputes include the cost of lost production and wages, loss of customer support, disruption to trade and social conflict.
- The Fair Work Commission has the power to resolve industrial disputes through conciliation or arbitration.
- Common law action is open to any party involved in or affected by industrial action.
- Benefits of industrial action include improvements in relationships and conditions.

EXERCISE 16.4 REVISION

1 **What** are the circumstances where a lockout or a picket would be used during an industrial dispute?
2 **Summarise** each of the methods available to resolve industrial disputes.
3 **Identify** the method used to describe the way the following disputes have been resolved.
   (a) Garth Enterprises makes an enterprise agreement with a majority of its employees, represented by the Australian Workers' Union.
   (b) Anna Baber and her employer PX Media ask the Australian Human Rights Commission to help them settle their dispute.
   (c) The Fair Work Commission orders Scali Ltd to reinstate 12 workers sacked last month.
   (d) Chow Machines finally reaches agreement with the CFMEU after regular meetings with the Fair Work Commission and the union.
   (e) Ramstine is fed up with his workmates playing practical jokes on him. He complains to Kevin Ly, his supervisor, who records the complaint and, as it is serious, takes it to the firm's group specifically established to help deal with such problems.
4 **Why** do many businesses not experience industrial disputes such as strikes?
5 **Identify** the criteria a party must prove to the Fair Work Commission before being permitted to take industrial action.
6 **Describe** how the focus on conflict resolution has changed over the last few years.
7 Recent legislation has forced employers and employees to increasingly resolve issues in the workplace. **Discuss** the advantages and disadvantages of this approach.
8 **Describe** common law action. **Explain** why it is generally considered a 'last resort'.
9 **Explain** how disputes can be costly to a business and the economy.

16.4 EXTENSION

1 **Analyse** the issues in the following situation and **propose** a solution for Marie. Use information available from the **Fair Work Online** website to assist you in considering this situation.

on Resources

Weblink: Fair Work Online

Marie's employer tells her she will not be paid for the next week because her employer intends to lock out Marie and three other workmates during a bargaining period leading up to the negotiation of a new enterprise agreement. He states that, if she does not agree to his new conditions after the lockout, she will be dismissed.

2 'Sometimes an open dispute in the workplace can be beneficial.' **Evaluate** this statement.

3 In groups, use newspapers and the internet to **investigate** a range of industrial disputes. **Create** a PowerPoint presentation or video clip to report to the class on the costs of the disputes.

Resources

Digital doc: Chapter summary (doc-24818)

Interactivity: Chapter crossword (int-7179)

Interactivity: Multiple choice quiz (int-7180)

studyon

Sit HSC exam

CHAPTER 17

Effectiveness of human resource management

OVERVIEW

17.1 Introduction
17.2 Indicators

17.1 Introduction

The role of the human resource manager, working with the management team, is to decide how the employment relationship will be best managed so that it is cost-effective, achieves the business's goals and contributes to the 'bottom line'. These are important considerations, with managers reporting that labour costs are around 60 per cent of operating costs, and that 'people management issues' take up most of their managerial time.

In best practice businesses, a strategic, holistic view is taken of the importance of building a workplace culture that attracts and retains the 'best' employees and fosters the success of the enterprise. The role of the human resource function is to effectively link individual performance with corporate strategy. The business can then modify processes and strategies, if they are not successful, through performance management. As previously explained, performance management is a strategic approach to improving organisational effectiveness and success, through improving the performance of the business, teams and individual employees.



FIGURE 17.1 Key elements of effective human resource management. These elements have been discussed in the preceding four chapters.

Once all these elements have been implemented, the final aspect of human resource management is to evaluate their effectiveness.

17.2 Indicators

Many businesses use a range of **indicators** to reflect on the effectiveness of the human resource functions. Indicators are performance measures used to evaluate the effectiveness of the business, team or individual, such as dollar sales achieved per employee per year.

Indicators can be compared to those of best practice businesses or internal divisions to determine strengths and weaknesses. This process is called **benchmarking**. Benchmarking is a process in which indicators (key variables) are used to compare business performance between internal sections of a business or between businesses. This is then used as a basis for improvement.

Indicators are gathered and collated in **human resource audits**. The major control tool is the annual strategic planning process, where performance is evaluated and strategies modified for further organisational development.

Typical indicators used to evaluate the effectiveness of the human resource function are shown in table 17.1.

BizWORD

Indicators *are performance measures that are used to evaluate organisational or individual effectiveness.*

Benchmarking *is a process in which indicators are used to compare business performance between internal sections of a business or between businesses.*

A **human resource audit** *is a diagnostic tool used to evaluate HR policies and practices in order to identify problems and develop solutions in an attempt to rectify problems.*

TABLE 17.1 Human resources effectiveness indicators

Functional area	Indicators (/ means 'as a proportion of')
Human resources planning	Number of staff/budgeted staff
Recruitment and selection	Applicant rejections Acceptance rates for job offers Recruitment costs Vacancies filled within target time
Training and development	Training days/hours per employee Training time/budgeted time Cost of training Test outcomes — changes in skills, quality accidents, output, productivity Succession planning rate Promotion rate
Employee rewards and benefits	Costs of rewards and benefits Labour turnover rates Absence rates/total hours worked Rewards and benefits compared with other businesses
Industrial relations	Grievance records Industrial disputes, work stoppages Time lost through disputes
Work health and safety	Accident rates Lost time injury incidence rates Workers' compensation costs/payroll
Performance appraisal	Appraisals undertaken Goals achieved/not achieved Disciplinary interviews/people employed Improvements in quality and productivity (turnover rate)
Separation/termination	Separation rate Dismissal rate Resignation rate Average retirement rate Unfair dismissal claims
General HRM effectiveness	Labour costs/sales and gross profit per employee Growth in market share

The most commonly used key performance indicators benchmarked for the effectiveness of human resource management are:

- financial indicators for each member of staff, including sales per employee
- contribution to production, for example, output per employee
- changes in staff turnover
- absenteeism
- accidents
- levels of disputation — workplace conflict and industrial disputes
- worker satisfaction, as seen in surveys, feedback and exit interviews.

Clearly, for indicators to be of value, results must be communicated and acted upon by management in improvement plans. The role of the human resource manager in using these indicators is focused on fostering continuous improvement by:

- communicating and educating employees about company vision, strategy and expectations at an operational level
- planning and setting goals for employees that are translated into meaningful tasks, and ensuring staff know how to achieve them
- developing employees effectively to improve performance
- evaluating performance, providing coaching and feedback in formal reviews
- linking rewards to performance measures
- providing organisational feedback for ongoing planning purposes.

17.2.1 Corporate culture

Reflect on either a part-time job you enjoyed doing, or a class you liked attending. What made these experiences so worthwhile? Your enjoyment was probably due to a combination of factors:

- You believed you were treated fairly and honestly, and were trusted.
- Your work was appreciated.
- Positive reinforcement, in the form of praise, was given for a job well done.
- Your involvement gave you a feeling of self-worth.
- Criticism, when given, was constructive.
- Conflicts, when they arose, were dealt with sensitively and appropriately.
- There was a harmonious atmosphere in the workplace/classroom, with positive work relationships between the staff.
- You felt part of a team working together to achieve a specific goal.



FIGURE 17.2 A cooperative workplace culture is common in the most popular workplaces. It is usually based around positive working relationships between employees.

When you think about it, a sporting or debating team, emergency workers at the scene of an accident, the crew of an aircraft or sales assistants serving at the checkout all have one thing in common: they are part of a team that requires the interaction of a large number of individuals to achieve a common objective.

Most businesses that are successful in the long term maintain a balance between concern for success (expansion or profit) and regard for their employees. Better work and employment relationships begin with an understanding of how to develop a positive **corporate culture**.

BizWORD

A **corporate culture** *refers to the values, ideas, expectations and beliefs shared by members of the business.*

People are a business's most valuable resource or asset. It makes sense, therefore, to develop a cooperative and effective corporate culture and positive working relationships. Without dedicated, trained and motivated employees, the best organised plans will never be achieved. In its broadest sense, human resources covers all types of interaction among people: conflicts, cooperative efforts, and interpersonal and group relationships.

The indicators that reveal a workplace has a poor corporate culture include:

- high staff turnover
- poor customer service
- high levels of absenteeism
- accidents
- disputes and internal conflict.

These problems are reflected in poor business performance, lower sales, lower profits than competitors and ultimately the 'bottom line'.

Effective workplace relationships depend heavily on the quality of a business's communications systems and participation of employees in decision making, as discussed in chapter 16. Strategies that focus on building trust and direct communication between people, and value their ideas are critical in building a positive workplace culture. Common features of the workplaces rated the best in Australia are shown in figure 17.3.

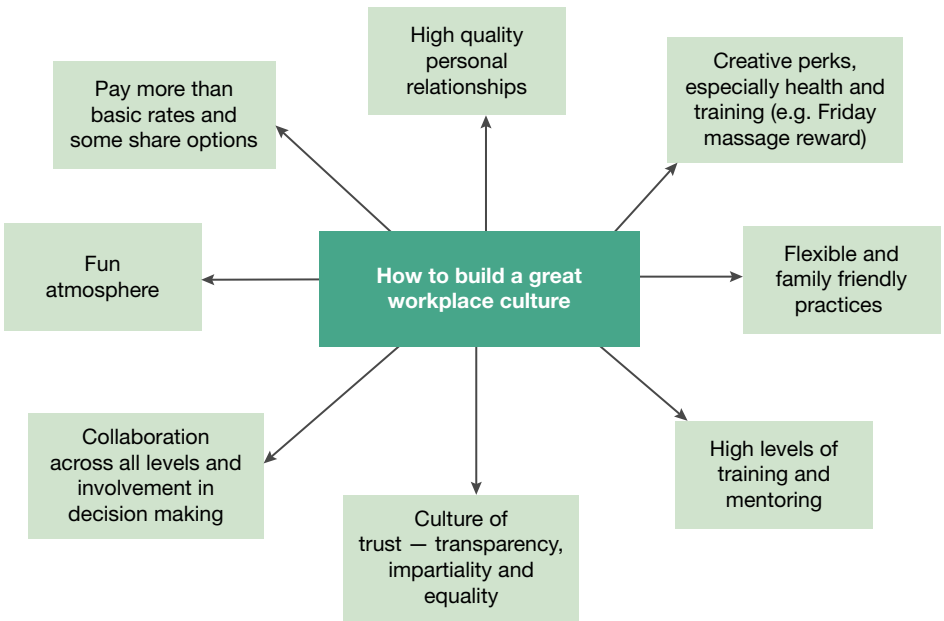


FIGURE 17.3 How to build a great workplace culture — features of workplaces rated the best in Australia

SNAPSHOT



'She includes staff unconditionally in the decision-making process … is considered to be a great leader …'

studyon

Syllabus area 4
Topic 5
Concept 1

Indicators: corporate culture
Summary screen and practice questions

Healthy management

City Health is a private healthcare provider serving a population of 500 000 people and operating with a budget of $500 million. It employs 3000 staff and has grown steadily over the last five years due to the merging of several major city hospitals. The chief executive of City Health, Dr Jan Dvorak, recently called a meeting of the executive team to discuss a strategic plan. These discussions explored the objectives of:

- developing a culture of quality and innovation
- working in partnership with all stakeholders to enhance the health of the community
- providing an environment that values and supports staff
- achieving a financially sustainable health service.

Up until now, Dr Dvorak has managed and guided City Health through its period of high growth. She has led the business to where it is today by listening to her employees, the hospital's patients and the community. She includes staff unconditionally in the decision-making process of the business. She is considered to be a great leader by her staff.

Dr Dvorak considers that the change to a new corporate culture will be her greatest challenge so far, but believes that the hospital is well on its way to achieving this goal.

SNAPSHOT QUESTIONS

1. **Outline** the recent changes at City Health.
2. **Summarise** the proposed City Health strategic plan.
3. Who is Dr Jan Dvorak? **Describe** her management style.
4. **Analyse** the changes at City Health and Dr Dvorak's approach to management in relation to their impact on the company's new corporate culture.

BizWORD

Informal benchmarking *includes any strategies such as networking through informal discussions with colleagues in other businesses, undertaking visits to other businesses, researching best practice online and attending conferences.*

Performance benchmarking *involves comparing the performance levels of a process/activity with other businesses.*

Best practice benchmarking *involves comparing performance levels with those of another best practice business in specific areas using a structured process to gain skills and knowledge and to modify organisational processes.*

Balanced scorecard benchmarking *is used for measuring whether the activities of a business are meeting its objectives established in the strategic plan. It benchmarks key performance variables with targets aligned with the strategic plan.*

17.2.2 Benchmarking key variables

Effectively performing benchmarking may involve coordination with line management, the human resource manager and even external specialist consultants. Each may share in evaluating the practices shown in figure 17.1. Benchmarking may follow a more comprehensive human resources audit or may be undertaken using basic indicators. The purpose is to compare a business's performance in specific areas against other similar businesses or divisions, or against 'best practice' businesses. The aim is then to initiate changes to foster improvement. Many businesses report they improve their process performance after undertaking benchmarking.

Benchmarking is commonly undertaken in a number of ways.

- **Informal benchmarking** includes any strategies such as networking through informal discussions with colleagues in other businesses, undertaking visits to other businesses, researching best practice online and attending conferences.
- **Performance benchmarking** involves comparing the performance levels of a process/activity with other businesses.
- **Best practice benchmarking** involves comparing performance levels with those of another best practice business in specific areas using a structured process to gain skills and knowledge, and to modify organisational processes.
- **Balanced scorecard benchmarking** is used for measuring whether the activities of a business are meeting its objectives established in the strategic plan. It benchmarks key performance variables with targets aligned with the strategic plan.

The approach used for benchmarking needs to be chosen for its suitability to the business's needs and resources as it can be a very costly and time-consuming process. Most businesses do not rely solely on quantitative variables or sales per employee, but also consider qualitative information such as feedback from staff and customers. The impact on the 'bottom line' (i.e. valued in terms of profits/costs) does nevertheless remain a major consideration, with the cost of human resources being the largest single contributor to most organisational costs.

Care needs to be taken in benchmarking. It may provide useful information about the business's human resources, but may focus excessively on costs rather than what is actually being achieved or may be achieved. The most important information is the long-term performance of those recruited and the development needs of talented staff with future potential in the business.

BizFACT

In 2017, the Workplace Gender Equality Agency *(WGEA) introduced benchmark data that allows a business to compare its performance both within the industry and with other organisations of the same size in other industries with respect to specific human resources issues such as gender composition of its workforce, remuneration, flexible work arrangements and sex-based harassment and discrimination.*

Case study: Westpac — key indicators and what they mean in human resource management

For the last four years Westpac has acknowledged more intently the role of people and culture within its organisation through a range of initiatives that are aimed at identifying, developing and retaining talented staff as a means of maintaining its point of difference with other financial institutions.

Westpac had identified a number of key indicators that it would monitor and where necessary act upon by implementing a variety of policies and practices to ensure the ongoing effectiveness of the management of its human resources.

These indicators for 2016 included:

1. total turnover rate — 11 per cent
2. voluntary turnover rate — 11 per cent
3. employees that use flexible work arrangements — 74 per cent
4. absenteeism — 7.32 per cent
5. lost time injury frequency rate (the number of work-related lost time injuries per million hours worked) — 0.8 per cent
6. women in leadership positions — 48 per cent.

Westpac's results across these indicators compare favourably from previous years and with other financial institutions when benchmarked, but nevertheless Westpac continues to seek ways to further improve upon these results. These initiatives include:

- a variety of leave options such as up to two years of parental leave, of which 13 weeks are paid (including superannuation), career breaks of between 3 and 12 months of unpaid leave to pursue personal interests and the option to buy back up to four weeks of leave (purchased leave)
- access to child care owned and operated by Westpac
- a *Flexible Work Options Guide* that can be viewed via the company's intranet and includes a program that allows people interested in job share arrangements to be matched with potential work partners
- a new induction program that encourage participants to engage in the consideration of stakeholder perspectives and ethical responsibility
- a remuneration program that is competitive and linked to performance management. It combines financial rewards such as wages and salary as well as access to cheaper insurance, loans and non-financial rewards such as cheaper IT and other electronic appliances.

The programs are monitored and evaluated and the success of such initiatives linked to indicators such as those listed above. Results show that Westpac's human resource management continues to meet its objectives and that its programs continue to make it a preferred employer.

Source: www.westpac.com.au

SNAPSHOT



'initiatives . . . aimed at identifying, developing and retaining talented staff'

SNAPSHOT QUESTIONS

1. **Why** has Westpac examined the role of its people and culture department more closely in recent years?
2. **Identify** the human resource indicators that have been the focus of Westpac's attention.
3. **Discuss** how Westpac has responded to its analysis of its human resource management indicators.

BizFACT

It is in the interests of businesses who wish to benchmark their human resource activities to share information. Businesses interested in benchmarking have joined together to form 'The Global Benchmarking Network'.

Human resource audits

A human resource audit can be used to systematically analyse and evaluate human resource activities and their effectiveness. This audit can be performed in a number of ways:

- Performance of one division or the business itself against another is benchmarked and compared to industry 'best practice' to determine areas of weakness and for improvement.
- An outside consultant conducts research to analyse problems and suggest solutions.
- Key performance variables are evaluated by management.
- A legal compliance analysis may be undertaken to determine areas of variance from laws and company policies. High levels of fines, workers' compensation claims and unfair dismissal claims would indicate this type of audit was required.
- A management by objectives (MBO) approach can be used to determine areas of poor performance against targets established.



FIGURE 17.4 Businesses should regularly evaluate human resource management strategies, the quality of workplace relationships and the corporate culture.

Quantitative measures

Quantitative measures to be analysed are shown in table 17.1 and in the following Snapshot. These should be able to demonstrate the actual effect of indicators in economic terms — that is, in terms of costs and profits. Key variables often include:

- variances in labour budgets. Significant increases in the size of labour budgets represent a major increase in the costs of business, and are most likely due to poor planning of staffing needs, higher unscheduled absenteeism, overtime or staff turnover rates, or increases in wage rates.
- time lost/costs of injuries and sickness. Rising costs are a clear indicator that health and safety requirements are being breached, perhaps due to poor training or a lack of training. Such costs also lead, in the longer run, to higher insurance premiums, and risks of fines and claims.
- performance appraisals completed compared with targets. This indicates the extent to which the appraisal of staff has been undertaken by managers, but does not provide detailed feedback on the effectiveness of these processes.

- percentage of goals achieved. Goals should be collaboratively determined by employees and managers. The return on human investment is a goal, which may be determined in many ways including dollar sales per employee. Rising sales per employee are often seen as an indicator of improved customer service and employee productivity.
- levels of labour turnover, particularly those initiated with employees. Higher levels can indicate workplace problems, ranging from a poor workplace culture and poor working relationships, to lack of clear job descriptions and opportunity for promotion or personal growth.

Benchmarking of such variables is undertaken frequently by businesses seeking to operate at world's best practice, or in accordance with standards in quality assurance programs.

Key human resource benchmarks (median) — a summary

	2013	2014	2015	2016	2017
Return on human investment ratio	$0.30	$0.38	$0.32	$0.19	$0.47
Managerial/professional male to female staffing rate	1.96	1.79	1.82	1.43	1.60
Unscheduled absence per employee (absenteeism)	7.03 days	7.25 days	7.74 days	7.87 days	8.22 days
Employee-initiated separation rate	8.39 per cent	8.29 per cent	7.36 per cent	7.61 per cent	7.26 per cent
Total separation rate	15.16 per cent	16.01 per cent	13.59 per cent	15.06 per cent	13.24 per cent
Training investment per employee*	$635	$817	$898	$1021	$1111

*excluding trainees' remuneration

SNAPSHOT QUESTIONS

You are the human resource manager of a major chain store. When you examine your key indicators for the last year, you find your return on human investment is $0.16, absenteeism is 12 days per employee, your total separation rate is 40 per cent and your training investment per employee is $483.

1. **Explain** how your business compares to the 2017 human resources benchmarks.
2. **Create** a report that **proposes** possible causes of, and solutions to, these differences.

SNAPSHOT



'. . . return on human investment is $0.16. . .'

Qualitative evaluation

Qualitative evaluation involves detailed feedback and research on key issues, which allows judgements to be made about changes in behaviour or quality of service provided. Major sources of such information may include feedback from middle management, surveys and focus groups about workplace culture, relationships at work, and the quality of customer service and leadership.

Benchmarking major variables is essential in planning for continuous improvement.

- High or increasing absenteeism and labour turnover rates are indicators of problems including boredom, poor relationships, and lack of training or opportunities to develop.

- Analysis of industrial disputes and the issues raised may provide useful feedback about issues such as health and safety, rewards and benefits, and relationships in the workplace.
- Feedback from performance appraisals provides information useful in evaluating and planning training, recruitment and selection, development, rewards, and separation processes.
- Feedback from supervisors, consultative committees, customers and employees in organisational surveys provides useful insight into worker satisfaction, empowerment and customer service.

Research by external businesses and institutions also provides valuable information for analysis and comparison. Businesses, therefore, need to consider domestic and international trends and management practices when planning strategies for improving the effectiveness of human resource management and business performance.

17.2.3 Changes in staff turnover

BizWORD

Staff turnover *refers to the loss of employees by a business who leave for a variety of reasons.*

Staff turnover refers to the separation of employees from an employer, both voluntary and involuntary, through dismissal or retrenchment. It is often shown as a percentage of total staff numbers. Staff turnover in Australia averages around 12–15 per cent per year, and fluctuates with the economic cycle, with around half being voluntary turnover due to resignation and retirement.

Turnover varies greatly between industries, with the hospitality and hotel industry commonly experiencing rates of 90 per cent per annum. In assessing the significance of turnover, it is therefore important for businesses to benchmark their turnover against that of other businesses in the industry; and to determine the type of staff leaving and their reasons. There are likely to be 'pull' factors outside the business or 'push' factors inside the business.

BizFACT

Exit interviews are used to find out why an employee is leaving the organisation. Surveys indicate that less than 5 per cent of employers actually make use of information gathered from exit interviews.

Staff may leave to seek new opportunities or promotion as a result of skills developed in a particular industry; this may not be a negative reflection on the workplace they are leaving. Others may leave due to a 'toxic' workplace riddled with internal politics.



FIGURE 17.5 The hospitality and hotel industry experiences high rates of staff turnover, as much as 90 per cent per annum.

The costs of high labour turnover are great, and involve high costs through pay-outs for entitlements, hiring, inducting and training new staff (see figure 17.6). Productivity and service quality (a major issue in the hospitality and hotel industry), corporate skills and knowledge are lost, particularly if there has been poor succession planning. This is often described as the biggest cost of high turnover rates. Lack of a focused workplace culture in such an environment reduces employee commitment and loyalty.

Some level of turnover is considered healthy in businesses, as new ideas are brought in and often stimulate innovation in work practices. However, a major change or a significant increase in turnover is a major warning sign.

Exit interviews		$1000
Administration		$100
Lost productivity		$15 000
(a) Costs of separation of employee from company	=	$16 100
Prepare job descriptions, review résumés and interviewing		$3000
Recruitment agency and advertising		$20 000
Pre-employment tasks and orientation		$1000
Lost productivity		$30 000
Training of new employees		$40 000
(b) Costs of replacement and training new employee	=	$94 000
Total turnover cost (a + b)	**=**	**$110 100**

FIGURE 17.6 Hypothetical total turnover costs for a middle manager in a large Australian business

BizFACT

Much employee turnover in Australia occurs in newly recruited staff with less than one year in the job. Unskilled employees with mundane or repetitive jobs, low pay and little participation in decision making are also more likely to resign.

High resignation rates are often linked with absenteeism rates as indicators of dissatisfaction in the workplace.

Case study: Managing employees at Nationwide Health

Nationwide Health is a national care organisation that employs 8000 people across Australia. While the business has performed well and management is pleased with this performance, there is concern about aspects of employment relations, in particular the high rate of staff turnover. Rates for this important human resource indicator appear to spike before and during school holidays and has become unsustainable. It appears that it is more of issue at Nationwide Health as it has a predominantly female workforce and anecdotally many of its staff were critical of the lack of interest being displayed in achieving work–family balance.

Management did eventually become aware of the issue and despite initial staff misgivings, it was keen to resolve the issue and stem the tide of staff separation. After a brief consultation period to hear concerns directly it introduced a more flexible work environment for staff that allows for job sharing, shorter night shifts, school holiday programs for children, negotiating with local childcare centres for cheaper rates, banked (accrued) leave and flexible rostering.

Since its introduction of its more flexible approach to workplace management, turnover has fallen to less than 2 per cent (much lower than the industry average) and the return to work rate for women following maternity leave increasing to 97 per cent.

SNAPSHOT QUESTIONS

1. **What** industry sector does Nationwide Health belong to?
2. **Identify** the human resource management issue faced by management at Nationwide Health.
3. **Why** was the issue most obvious during school holidays?
4. **How** did management address the issue it faced?
5. **Evaluate** the effectiveness of the strategies used by Nationwide Health's management to address the issue. Are there others you could suggest?

SNAPSHOT



'. . . many of its staff were critical of the lack of interest being displayed in achieving work–family balance.'

studyon

Syllabus area 4
Topic 5
Concept 2

Indicators: benchmarking key variables and changes in staff turnover
Summary screen and practice questions

SUMMARY

- Human resource indicators are used by many businesses to evaluate the effectiveness of the business, team or individual.
- The best way to maximise employee productivity and motivation is through a constructive corporate culture, where employees are trusted, collaborate, have strong personal relationships and are highly trained and mentored.
- Benchmarking is a process in which indicators are used to compare business performance between internal sections of a business or between businesses.
- Benchmarking may be undertaken using informal benchmarking, performance benchmarking, best practice benchmarking and balanced scorecard benchmarking.
- A human resource audit can be used to systematically analyse and evaluate human resource activities and their effectiveness.
- Quantitative measures should be able to demonstrate the actual effect of indicators in economic terms.
- Qualitative evaluation involves detailed feedback and research on key issues, which allows judgements to be made about change in behaviour or quality of service provided.
- Staff turnover refers to the separation of employees from an employer, both voluntary and involuntary, through dismissal or retrenchment.
- In assessing the significance of turnover, it is important for businesses to benchmark their turnover against that of other businesses in the industry; and to determine the type of staff leaving and their reasons.

EXERCISE 17.1 REVISION

1 **Clarify** the relationship between indicators, benchmarking and human resource audits.
2 Look at table 17.1 and draw a table listing one indicator from each functional area. Next to the indicator, **outline** how it can be used to evaluate the effectiveness of human resource management.
3 **Explain** how corporate culture can influence the success of a business.
4 Sonic Ltd has low staff turnover, low levels of absenteeism and very few accidents. **Deduce** what this reveals about Sonic's corporate culture. **Justify** your answer.
5 **Why** is benchmarking a useful tool for managers?
6 **What** are some of the most common methods of benchmarking used today?
7 **Discuss** some of the difficulties associated with benchmarking.
8 **Explain** why the effectiveness of human resource management in a business cannot be evaluated using a quantitative approach alone.
9 **Why** are staff turnover rates significant indicators of the effectiveness of human resource management in a workplace?

EXERCISE 17.1 EXTENSION

1 **Create** a logical, structured report on the following topic:
'A key aspect of effective human resource function is the monitoring, evaluation and modification of plans and performance.' Refer to business examples or case studies in your response.
2 **Assess** how benchmarking can assist in a strategic approach to human resource management in achieving the goals of the business.
3 The Australian Workplace and Industrial Relations Survey has revealed that most workplaces with more than 20 employees use these practices:
   - training for supervisors
   - equal employment opportunity and affirmative action policies
   - performance appraisal of non-managerial employees
   - productivity improvement systems, such as key indicators and benchmarking.

   Predict the possible benefits to be gained from the use of each of these practices.

17.2.4 Absenteeism

Absenteeism refers to a worker who neglects to turn up for work when they were scheduled to do so. High levels of absenteeism and/or lateness may indicate that workers are dissatisfied or that there is conflict within the workplace (see the following Snapshot).

BizWORD

Absenteeism *refers to a worker who neglects to turn up for work when they were scheduled to do so.*



FIGURE 17.7 Absenteeism may indicate dissatisfaction or conflict within a workplace.

Absenteeism — sickies cost!

Jordan, a kitchen manufacturer, is overheard complaining to Lloyd, a recording studio owner

Lloyd: When am I getting that kitchen delivered? The bands keep making a mess of my studio! I keep finding nuggets and chips on my equipment!

Jordan: Mate, I'm doing my best. I've got up to seven of my 95 staff absent at the moment. They're such bludgers! I'm going to sack them.

Lloyd: Have you thought about your workplace practices?

Jordan: I haven't got the time for that fuzzy stuff.

Lloyd: Does this happen a lot?

Jordan: Yeah, I lose 50 per cent of my staff every year.

Lloyd: You know, you should get some advice. I don't have a problem at all, but, as you know, I'm a good guy! My staff don't want to take time off because the work is great. I give them time off to look after their kids if they need it and get everyone to learn someone else's job, so they can take over when the others are off. I give them free CDs and concert tickets when they work hard. Even P. Diddy said he wouldn't mind working here when he came on a tour! What do you do for your staff?

Jordan: None of that. Work is work — not a play centre!

Lloyd: Mate, don't you do your key performance indicators? It's costing you probably $1500 every time your staff has more than a week's sick leave a year. Most people take off around 9 days a year, and I bet there are a few race days in that lot. Multiply that by seven staff, add 30 per cent for lost productivity, and you get the idea! And that's not counting all the make-up work. They reckon it costs you around $360 a day every time someone is off sick.

Jordan: Geez! My hip pocket is hurting. What should I do?

SNAPSHOT



'It's costing you probably $1500 every time your staff has more than a week's sick leave a year.'

Lloyd: Talk to my wife. She's a human resource manager for a big record company. She'll tell you to find out why they take time off, through meetings or a suggestion box.

Jordan: I can imagine the rude stuff I'd get in the box.

Lloyd: Try being a decent employer. Sit down and work out with them a clear policy for absences. You can reduce your absenteeism by 20 per cent by putting in a plan. If you give 'em rewards and fun staff activities, you'll get the benefit of having them there. You won't have all these upset customers because no one follows up on their calls properly, and you won't have to constantly reschedule things. Tell them how much it matters. Listen to your staff and then save money, mate.

SNAPSHOT QUESTIONS

1. **Outline** all the possible reasons for Jordan's high levels of absenteeism and labour turnover.
2. **Describe** the major costs of this level of absenteeism and turnover.
3. Draw up a table listing all of Lloyd's suggestions and **explain**, next to each suggestion, why it may be useful in resolving Jordan's problems.
4. Interview an adult about their opinions on absenteeism. **Discuss** their views with your class.

BizFACT

A recent study has indicated that a 2.5 per cent reduction in productivity occurs for each 1 per cent increase in absenteeism. In Australia that represents about $35 billion per year.

In terms of lost revenue, such unofficial expressions of conflict may be even more costly to firms than official forms of conflict. Firms need to have much higher staffing levels to cope with high absentee levels. Therefore, revenue is lost as work is disrupted and can lead to lower productivity and higher labour costs.

Job satisfaction is high on the list of reasons for absenteeism in the workplace. Poorly designed jobs and a lack of a strong employer–employee relationship contribute to workers being absent.

17.2.5 Accidents

BizFACT

Since a high in 2007 when there were 310 workplace deaths, figures have generally trended downwards. The 45–54 years age group is the most vulnerable, with 710 worker fatalities since 2003.

Around 5.3 per cent of Australia's 12 million employees experience a work-related injury or illness each year. According to Safe Work Australia, in 2015–16 there were 105 000 workers' compensation claims for serious work-related injuries or illnesses involving one week or more off work, a permanent incapacity or fatility. The median time lost for a serious claim between 2001 and 2015 increased by 33 per cent, with the highest rates being among labourers and machinery operators and drivers.

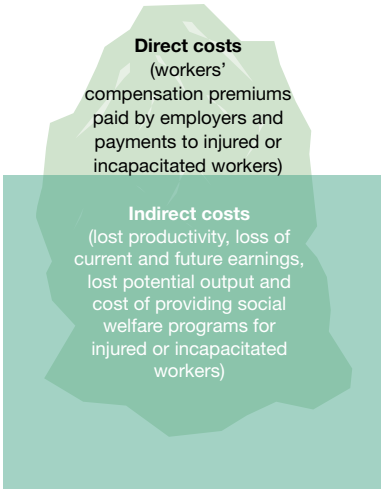


FIGURE 17.8 Financial costs of accidents and injuries in the workplace — the 'iceberg effect'

Professionals suffer few accidents. Women in the hospitality and health related services experience high rates of injury.

The most common types of workplace fatalities are associated with road crashes, particularly for tradesmen and transport workers; while injuries are associated with lifting, pushing and pulling objects, or being hit by an object.

All businesses need to adopt a systematic, legally compliant approach to managing work health and safety (WHS), as discussed in chapter 14.

WHS indicators are benchmarked internationally using a number of indicators, including:

- Lost Time Injury Frequency Rates (LTIFRs). A lost-time injury is an event that results in a fatality, permanent disability or time of one day/shift or more lost

on Resources

eLesson: Workplace accidents and Australia Post (eles-1047)

from work. The LTIFR is the number of lost-time injuries per million hours worked, calculated as follows.

$$\frac{\text{Number of lost-time injuries} \times 1\,000\,000}{\text{Total hours worked in accounting period}}$$

- Safe Work Australia rates based on accepted workers' compensation claims that involved the loss of one or more working weeks (termed serious claims). Claims for shorter periods are not counted in this rate.

Accidents in the workplace — 10 most common injuries and how to avoid them

Following is an overview of the 10 most common workplace injuries.

10. **Workplace violence:** Arguments in the workplace that lead to physical confrontation.
9. **Repetitive motion injuries:** These tend to be less obvious but are definitely harmful in the long run. Repetitive motions such as computer work that involves typing can strain muscles and tendons, causing back pain, vision problems and hand problems.
8. **Machine entanglement:** Occurs in factories where heavy equipment and machinery are used. Clothing, shoes, fingers and hair are all vulnerable when no precaution is taken.
7. **Vehicle accidents:** Employees who drive for business purposes are often injured in motor vehicle accidents, some of which can be fatal.
6. **Walking into injuries:** This occurs when a person accidentally runs into concrete objects such as walls, doors, cabinets, glass windows, table and/or chairs. Head, knee, neck and foot injuries are common results.
5. **Falling object injuries:** Objects that fall from shelves or are dropped by another person can cause very serious injuries. Head injuries are a common result of this type of accident.
4. **Reaction injuries:** These are injuries caused by slipping and tripping without falling. These incidents can cause muscle injuries, body trauma and a variety of other medical issues.
3. **Falling from heights:** This type of fall happens from an elevated area such as roofs, ladders and stairways. They can be caused by slip and fall accidents or due to faulty equipment.
2. **Slipping/tripping:** Falls on wet and slippery floors or trips over something lying on the floor.
1. **Overexertion injuries:** Injuries related to pulling, lifting, pushing, holding, carrying and throwing activities at work. Overexertion has not only consistently been the number one workplace injury but is also the most expensive.

Effective workplace management involves making the workplace safe for all staff. To avoid situations such as those outlined above, SafeWork NSW has identified a number of strategies to make the workplace safe. These include:

- inspecting the workplace for potential hazards
- prioritising work tasks according to the greatest risk of injury and ensuring that safe work procedures accompany it
- regularly reviewing safe work procedures to ensure currency
- consulting with staff about ways to eliminate or reduce risk arising from potential hazards
- providing induction, training and supervision for workers so that all work tasks are conducted safely.

SNAPSHOT QUESTIONS

1. **Outline** the 10 most common causes of workplace injuries.
2. Imagine you have been appointed to the role of a WHS manager. **Recommend** initiatives that you believe would be effective in reducing the occurrence of the listed common injuries.

BizFACT

Recent figures indicate that work-related injury and disease cost the Australian economy as much as $62 billion or 4 per cent of gross domestic product per year.

SNAPSHOT



'Effective workplace management involves making the workplace safe for all staff.'

Best practice businesses:

- have regular safety audits and comprehensive safety programs, and use data to improve
- build a culture of safety. They communicate effectively about health and safety using visible policy statements, safety signs and reminders.
- provide careful induction and regular ongoing training for staff to ensure they are aware of safety rules and prepared for emergencies
- consult employees and health and safety personnel on the implications of changes in the workplace.

Such businesses save on compensation claims, absenteeism, lost work time, replacement costs for damaged equipment, and loss of morale in the workplace. Customers appreciate the effort businesses make in producing a safer product or service; therefore, such businesses also improve their image to their customers.

17.2.6 Levels of disputation

Chapter 16 examined the causes of industrial disputes and examined the most common manifestations or types of industrial action — strikes and lockouts. There are however, many more, often costly, overt and covert manifestations of disputes that employers need to monitor and evaluate.

Indicators of industrial disputation

Although strikes and lockouts are officially recorded indicators of industrial disputes, a range of other forms are used in the workplace, as shown in figure 17.9.

- Work bans — a ban or boycott is a refusal to work overtime, handle a product, piece of equipment, process, or even a refusal to work with particular individuals. A green ban often refers to a refusal to carry out work that is considered harmful to the environment or natural resources such as forests.
- Work-to-rule — this action occurs when employees refuse to perform any duties additional to the work they normally are required to perform. This is most common as a form of industrial action in community services.
- Go slow — in this action, employees work at a slower rate than normal, causing customer complaints, and an expensive backlog of work to be caught up at a later date.
- Sabotage — vandalism, cyber attacks and internal theft are not uncommon, but are rarely discussed publicly by firms. They may involve employees taking action to harm or destroy the image of a firm, for example by contaminating food or disrupting production.

BizFACT

If teachers refused to do bus supervision or mark homework, this would be a work-to-rule action.

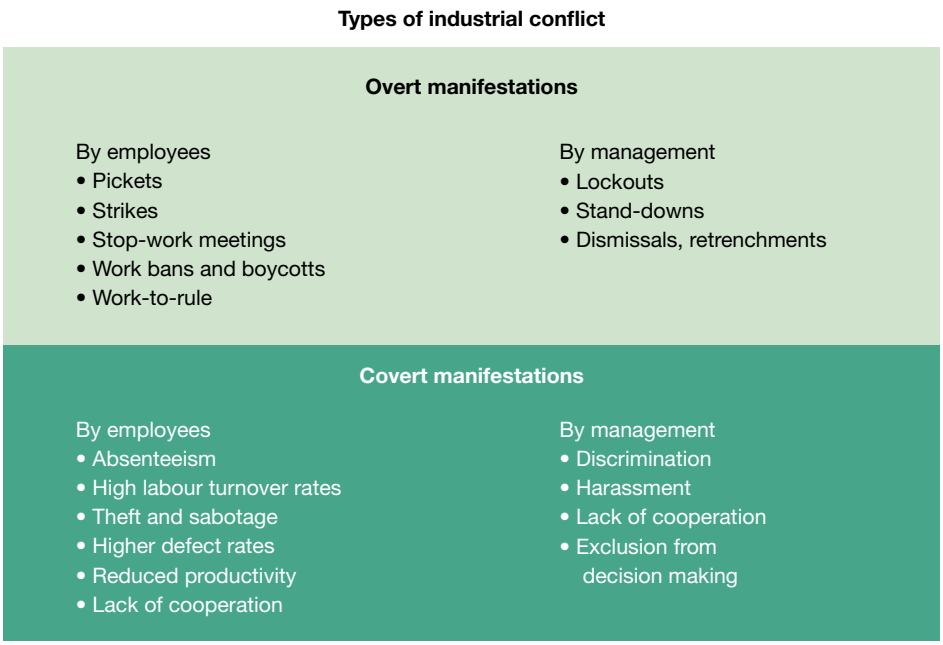


FIGURE 17.9 Types of overt and covert industrial conflict

Employers should be concerned if a number of formal grievances are reported, as they are an indicator of poor quality relationships in the workplace and can be very damaging if they attract media attention or move through the legal system. Careful investigation should indicate whether these issues relate to the policies and processes operating within the business, or to specific individuals who may need further training and development or formal counselling. Ongoing grievances are likely to be reflected in higher levels of staff turnover and/or industrial disputes.

As outlined in chapter 16, apart from negotiations related to the making of awards and agreements, managerial policy is one of the most common causes of disputes. Disputes arising from managerial policy may include the decisions and policies of line managers, organisational restructuring, discrimination, decisions that impact on work and family life, and changing work practices such as the use of outsourcing and contractors. Such disputes, when not reflected in strikes and lockouts, are more commonly reflected in grievances, fines, bans, accidents, poor customer service, declining productivity, and higher absenteeism and labour turnover.

BizFACT

The ABS publishes statistics on industrial disputation in Australia. Only disputes that amount to 10 or more working days lost are counted in ABS statistics. The ABS officially recognises a range of strike actions and lockouts by employers, but does not identify work-to-rule actions, go slows and bans (e.g. overtime bans), claims, fines or other indicators.



FIGURE 17.10 Job insecurity is often linked to worker demonstrations.

Disputes are more common in large businesses where relationships and communication between employees and management tend to be more impersonal, and the scope for mistrust and misunderstanding is greater. It should be noted that industrial action is not necessarily experienced in every workplace. In more than two-thirds of Australian workplaces, workers have never taken industrial action. More covert manifestations, however, such as high absenteeism or low productivity, are more common.

studyon

Syllabus area 4
Topic 5
Concept 3

Indicators: absenteeism, accidents and disputes
Summary screen and practice questions

17.2.7 Worker satisfaction

Employee satisfaction is a key factor in employee commitment, job performance and staff turnover. Employee satisfaction surveys are useful in helping employers measure and understand how their staff feel about their work, their management and the culture of an organisation. They can be undertaken using paper surveys,

online polls, focus groups or external consultants, and supplement data from performance feedback and exit interviews. Such surveys can be used to improve management style and processes, benefits and rewards systems, the physical working environment, employee relationships, and other employee needs.

Employee feedback needs to be confidential and analysed by professionals qualified to interpret such feedback. Managers need to track, communicate and act upon the results.

Although pay is an important factor in choosing a job, it is not that significant in employee satisfaction, unless there are significant pay differentials in the workplace.

In fact, employees who have good relationships with co-workers, enjoy their work activities, receive relevant training that allows them to do their job well, and gain opportunities to grow are more likely to be satisfied and stay with the business.



FIGURE 17.11 A recent survey showed that salary, proximity to home and job security are key motivators when looking for a job. It also showed that bad management, not feeling appreciated, wanting a new challenge and too much stress were the top reasons people sought alternative employment. Overall, the survey found that 6 out of 10 Australians were happy in their job.

BizFACT

In 2017, US travel technology firm Expedia recieved an award acknowledging its high levels of employee satisfaction. Reasons given by staff were its office layout, which includes table tennis tables, gaming consoles and a cocktail bar. But more importantly it was the culture and career opportunities that impressed both existing staff and those interviewed upon their separation from the business.

Effective leadership is one of the most important influences on employee satisfaction, particularly when employees feel recognised and encouraged, where management is transparent, promotion is merit based, and communication is honest and respectful. The quality of management is also a critical factor in employee satisfaction and retention, particularly with a widespread view in Australia that management is 'all talk and no action'.

Employee satisfaction is improved by matching the purpose of the business with the skills and cultural fit of the employee.

Employees who indicate emotional exhaustion with the job, particularly if it impacts on family life, are often less satisfied with work. Employees value a family-friendly culture, adequate breaks during the day, effective resourcing to do their job, rewards for effort and performance, opportunities for sabbaticals or 'leave' options, and workplace wellbeing strategies such as a gym.

Support for emerging leaders is also appreciated by employees. Ongoing training and mentoring or coaching is much more effective than pay differentials in fostering employee commitment.

It is the holistic approach to employees, which values and cares for them, that is the most effective in building commitment, satisfaction and retaining effective employees.



FIGURE 17.12 Employees are more satisfied and committed when given continuous 'on the job' training for competencies rather than offsite training.

Case study: Evaluating human resource effectiveness at Fine Wines

Michael, the human resources manager at Fine Wines concludes his presentation to the other managers in the business and comments, 'So, the major problem we have at the moment is this persistent absenteeism across the business'.

'That would appear to be the case Michael but how do we compare to our competitors? Is it an industry-wide issue or just a problem we have?' asks Lara the CEO of the organisation.

'Well in the finance section it's mostly the parents with young kids', offers Ryan.

'Not in my department', says Caroline, the marketing manager. 'The ones taking time off, especially on a Monday and a Friday are the graduates — they want to party all weekend and then have their recovery on a work day!'

The group finds this amusing.

'What about the operations department?' asks Lara.

'Well', replies Spiro, the operations manager, 'with us it's the young single blokes, the older blokes or those that are married seem to get it — you work and then you only have days off if necessary'.

'What about the women in your department?' asks Lara looking in Spiro's direction.

'No dramas there — in fact their attendance is excellent. Even if they don't feel well, they drag themselves into work. As a matter of fact during the winter just passed I had to tell a few of them they needed to go home and rest. It's not the high rates of absenteeism but more that they come to work when they shouldn't!' replies Spiro.

'In my department it tends to be the older permanent workers that are away the most. The contractors are never a problem', Jane, manager of IT, offers.

'So, across all the departments it seems that absenteeism exists among certain groups of workers. We don't seem to have dealt with the problem. I am curious about this, especially why it is happening. Michael, I recommend you get everyone in your department together, investigate the problem in greater depth and get back to us all at the next meeting', Lara instructs.

'All good, Lara I'll get onto it', Michael replies.

SNAPSHOT



'. . . across all the departments it seems that absenteeism exists among certain groups of workers.'

SNAPSHOT QUESTION

Organise groups and allocate a role to each as a member of Michael's HR team at Fine Wines. Each group should discuss the effectiveness of human resource management in the business with respect to the issues identified and recommend strategies that the HR team could present to the CEO to address the problem. Present the findings to the class.

studyon

Syllabus area 4
Topic 5
Concept 4

Indicators: worker satisfaction
Summary screen and practice questions

SUMMARY

- Absenteeism is measured as the average rate of employee absences on an average day, without sick leave or leave approved in advance.
- High levels of absenteeism and/or lateness may indicate that workers are dissatisfied or that there is conflict within the workplace.
- Around 5.3 per cent of Australia's 12 million employees experience a work-related injury or illness each year.
- A low level of accidents, as measured by the Lost Time Injury Frequency Rate (LTIFR), indicate effective human resource management strategies.
- Employers need to closely monitor both overt and covert manifestations of industrial disputes to evaluate relationships in the workplace.
- Employers should be concerned if a number of formal grievances are reported, as they are an indicator of poor quality relationships in the workplace and can be very damaging if they attract media attention or move through the legal system.
- Employee satisfaction is a key factor in employee commitment, job performance and staff turnover.
- Employees who have good relationships with co-workers, enjoy their work activities, receive relevant training that allows them to do their job well, and gain opportunities to grow are more likely to be satisfied and stay with the business.
- Employee satisfaction is improved by matching the purpose of the business with the skills and cultural fit of the employee.

EXERCISE 17.2 REVISION

1 The absenteeism rate at Extracus Minerals has increased by 78 per cent over the past 12 months. **Identify** the possible causes of the increase.

2 (a) In small groups, **discuss** whether it is acceptable for an employee to take a 'sickie':
(i) to care for a sick child or elderly parent
(ii) to farewell a friend about to leave for an overseas holiday
(iii) because they feel unappreciated at work.
(b) **Summarise** your responses and present them to the rest of the class.
(c) **Compare** your responses with those from other groups.
(d) **Analyse** the groups' responses.

3 **What** are the direct and indirect costs of accidents and injuries in the workplace?

4 **Propose** a practical strategy to ensure young employees apply work health and safety rules effectively.

5 **Account** for the use of covert types of industrial conflict by (a) employees and (b) management.

6 **Why** are industrial disputes more common in large businesses?

7 **Why** is the level of industrial disputes an important indicator for the effectiveness of a business's human resource management strategies?

8 **Identify** the major factors that lead to employee satisfaction in the workplace.

9 **Evaluate** the effectiveness of employee satisfaction surveys.

10 (a) **Discuss** the issues that should be considered in designing an employee satisfaction survey.
(b) **Construct** an employee satisfaction survey for a workplace that you are familiar with.

EXERCISE 17.2 EXTENSION

1 **Explain** how you would develop your own future workplace to maximise employee satisfaction, performance and retention in a cost-effective manner.

2 Jasmine manages a printing business, which is now merging with a large stationery business. The new business's location is half an hour's drive north of the current location, which is in an inner suburb of a large city, close to public transport. Jasmine and her new partner, Paul, will both reduce their workforce by one-third and merge their staff. The new structure will have several sections including printing, customer sales, accounting and finance, and warehouse and distribution. Significant change will occur.
(a) **Discuss** some of the human resources issues that may arise during the change.
(b) **Analyse** how the human resource managers may be involved in each step. **Determine** all the things that will need to change, such as production systems, and 'people management' issues involved in merging two workforces, such as teamwork, communication and resistance to change.
(c) **Recommend** a communication strategy for Jasmine in the merger and **identify** its benefits.

3 You operate a travel agency, Worldover, employing 50 staff in a flat management structure. You employ four managers, responsible for customer service and sales, administration, marketing, and finance and accounting. Staff turnover in sales and customer service is 45 per cent, in administration and marketing it is 10 per cent, while the accounting and clerical staff has remained largely intact over the past decade. Staff turnover is high during the first weeks of employment. Staff in customer service are frequently involved in disputes with administration and marketing staff. Although there has been no real decline in customers 'walking through the doors', sales have fallen 30 per cent in recent years. Feedback from customers indicates that frequent errors are made in bookings, and that service is not consistent.
(a) **Recommend** possible solutions for the business's problems.
(b) **How** could staffing needs be more effectively planned?
(c) **Create** a grid-based rewards system showing the short- and long-term financial and non-financial rewards that may help you improve customer service.

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Digital doc: Chapter Summary (doc-24819)
Interactivity: Chapter crossword (int-7181)
Interactivity: Multiple choice quiz (int-7182)

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Sit HSC exam

Human resources

MULTIPLE CHOICE QUESTIONS

1. An employer, for legal purposes, does which of the following?
   (a) Exercises control over employees
   (b) Determines the degree of supervision required for an employee
   (c) Has the responsibility of the payment of wages
   (d) All of the above
2. The four main elements of the human resource cycle/staffing process are which of the following?
   (a) Acquisition, development, managing diversity and separation
   (b) Acquisition, recruitment, motivation, maintenance and separation
   (c) Acquisition, development, maintenance and separation
   (d) Acquisition, development, maintenance and performance management
3. Which of the following would not be considered a potential advantage of outsourcing?
   (a) Lack of quality control
   (b) Access to experts
   (c) Cost savings
   (d) Expand capacity
4. Which of the following correctly describes awards?
   (a) Collective agreements that set out wages and conditions of employees
   (b) Legally enforceable formal agreements made by employer and employees at the industry level
   (c) Collective agreements made at a workplace level with an employer
   (d) Agreements made between an employee and an employer
5. Which of the following features are not part of an employment contract?
   (a) Duties
   (b) Location of the workplace
   (c) Bonuses
   (d) Trade union membership
6. Benefits employers gain from demonstrating corporate social responsibility in managing staff include which of the following?
   (a) Improved staff retention and reduced absenteeism as staff feel more valued
   (b) Business costs are reduced through reduced claims and fines
   (c) Reduced training and marketing costs
   (d) All of the above
7. Performance management includes which of the following?
   (a) Developing strategies to improve the way a business operates to improve efficiency
   (b) Systematically evaluating and managing employee performance in order to achieve the best outcome for the business
   (c) Planning for future human resource needs both at the managerial and non-managerial level
   (d) Designing a job and how it will interact with other jobs and employees in such a way as to motivate and retain an employee
8. Which of the following represents a non-monetary reward for employees?
   (a) Bonuses
   (b) Superannuation
   (c) Allowances
   (d) Challenging work
9. What is the term for an unresolved dispute that requires the Fair Work Commission to make a legally binding decision?
   (a) Conciliation
   (b) Grievance procedure
   (c) Negotiation
   (d) Arbitration

10. Which of the following are indicators used to evaluate the effectiveness of human resource management?
(a) Absenteeism, staff turnover, workplace injuries, industrial disputes
(b) Inventory turnover, sales per employee, industrial disputes, labour costs
(c) Workplace injuries, staff turnover, sales per employee, profit margins
(d) Industrial disputes, absenteeism, labour costs, marketing costs

SHORT RESPONSE QUESTIONS

1. (a) **Define** the term 'human resource management'. *2 marks*
(b) **What** is the role of human resource management in business? *4 marks*

2. (a) **Why** is work–life balance important for employees? *2 marks*
(b) **Propose** strategies for managing employees' work–life balance. *3 marks*
(c) An accountant is often late for work, his productivity has decreased and some clients have complained that he is slow to respond to their requests. As a human resource manager, **analyse** how you would handle this situation. *6 marks*

3. (a) **Outline** two ways in which governments influence human resource management. *2 marks*
(b) **Distinguish** between an enterprise agreement and an individual contract. *4 marks*
(c) **Explain** the workplace dispute resolution process. *6 marks*

4. (a) **List** three indicators of the effectiveness of human resource management. *3 marks*
(b) **Evaluate** strategies used to support more effective human resource management. *6 marks*

5. (a) **Describe** the process of human resource management. *2 marks*
(b) **Distinguish** between performance appraisal and performance management. *4 marks*
(c) **Propose** a set of guidelines an employer may use to eliminate discrimination in the workplace. *6 marks*

EXTENDED RESPONSE QUESTIONS

1. Cooper is the sales manager at Morgan's Cycles. At the weekly breakfast meeting he indicated there had been a substantial decrease in sales in the current financial year. He claimed the marketing staff were directly responsible for this decline and stated that consequently jobs may be lost. Many members of the sales team were disappointed with Cooper's comments and some were quite angry. The previous year's sales had exceeded the company's target but Cooper did not acknowledge it at the meeting.

Brian, the chief executive of the business, hears of the tension in the sales department and hires you to write a business report where you:
- **outline** the interdependence between marketing and human resources
- **recommend** strategies for more effective human resource management
- **evaluate** indicators of the effectiveness of human resource management.

2. David has been newly appointed as the human resource manager for a national golf club manufacturer. He meets with the managers of each of the key functional areas and notes that in particular there appears to be problems with the operations processes and that more generally workplace culture seems poor.

He has seen the outdated machinery in some parts of the factory and workers reported to him at the time that it produces equipment of low quality. Where newer machinery has been introduced there appears to be a mismatch between worker skills and the capacity to use the machines effectively. He has also heard there are often accidents in the factory. Workers appear dissatisfied and are threatening industrial action.

David contacts you to write a business report. In your report:
- **outline** the operations influences that may have affected the business
- **explain** how effective operations strategies will help the business sustain its competitive advantage
- **analyse** how understanding human resource processes can address the business's corporate culture.

3. **Assess** the advantages of a diverse, culturally competent workforce for a global business.

4. **Analyse** the causes of workplace disputes and the strategies used to resolve them.

on Resources

Digital doc: Sample HSC Business Report (doc-14150)

The role of human resources management

Kathmandu is an inspirational brand synonymous with adventure, innovation and passion. Its core purpose is to 'inspire and enable people to live their dreams of travel and adventure'. Kathmandu sees its team as integral to its business and endeavours to provide opportunities for its employees to develop skills and live the life they dream. This is the core of human resource management at the company.

The role of employees at Kathmandu, like many other service-based businesses, is important to its success. However, the people aspect of the organisation also extends beyond this, to its management. Key management have the authority and responsibility for planning, directing and controlling the company's activities.

The human resources team recognises the importance of bridging the gap between an individual employee and their team, department and the company's performance and achievement of goals through its strategic plan.

This strategic approach to the management of human resources seeks to establish an enduring connection between Kathmandu's purpose and objectives through its relationships with organisational teams. It aims to align policies, procedures, programs and services with its corporate goals. The company is currently in the middle of a three-year plan designed to:

> 'Enable future innovation and delivery of business performance through safe and engaged high performance teams.' This people plan is focused on three strategic pillars: safety, talent and capability.

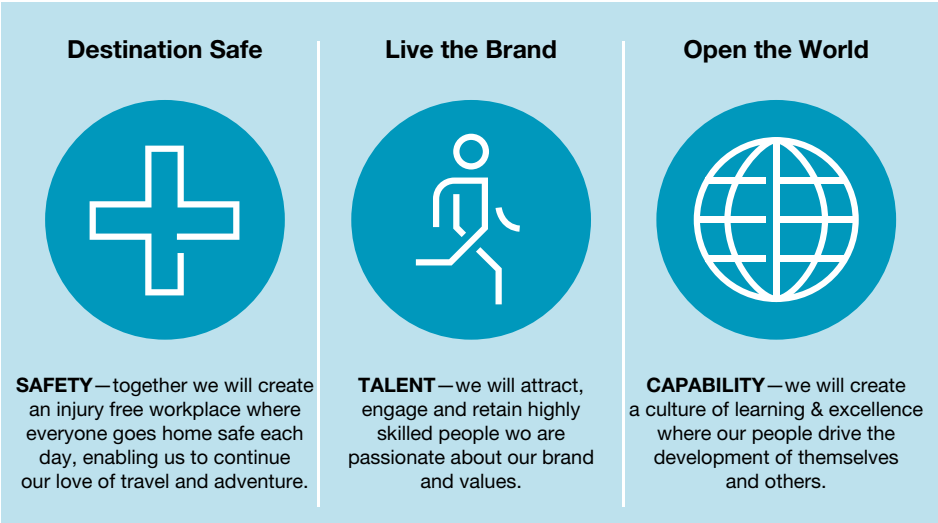


FIGURE 4.1 Three pillars of the Kathmandu People Plan

Interdependence with other business functions

As an integral component to Kathmandu's success, human resource management works cooperatively with the key functional areas to maintain the company's success. This extends to the employment of a general manager of human resources who sits along-side a general manager of retail stores and operations, supply chain management, marketing international and online, finance, product and merchandising. Each manager is responsible for ensuring that the strategic goals of the business are met and that their remuneration demands should be rewarded

according to their ability to 'influence the achievement of the Group's strategic objectives and business plans to enhance shareholder value for successful … performance outcomes and their contribution to these [goals]'.

The company also has a committee that seeks to ensure the remuneration program is consistent with the company's business plan and that it supports shareholder and customer value. In particular the committee oversees the development and application of the company's human resources strategy and that the remuneration framework ensures programs motivate high performance in all employees at all levels.

Outsourcing

As a company that outsources production globally to China, Vietnam and Taiwan, management has turned staffing difficulties into a competitive advantage. It is management's belief that human rights is its single most important priority as a brand because its people matter. While the decision to contract out production has assisted in achieving cost advantages, it has also presented some disadvantages including the concerns surrounding the exploitation of supply chain workers in the countries where its suppliers operate. Many of its stakeholders have supported the company's decisions to care for the people that make its products.

Kathmandu supports freedom of association and collective bargaining in China, where 85 per cent of production occurs. The concept of individual worker rights or independent unions has little influence in Chinese workplaces but is still important to Kathmandu's management. It has updated its Code of Conduct and Terms of Trade policies to have more emphasis on performance and partnership and less on policing and compliance. To this end the company has, through its corporate social responsibility team, shown that it is committed to protecting human rights and improving conditions for workers through its supply chain. This is facilitate by greater transparency and sustainable partnerships with its suppliers. It has also established closer relationships with its outdoor apparel competitors and has employed two workers whose full-time job is to ensure better working conditions within the supply chain.

Case study: Kathmandu and its competitors achieving better working conditions for vulnerable workers

Protecting vulnerable workers is a job that is bigger than any one single brand. To make progress, we have to work together. This year, we contacted some of our outdoor industry peers and engaged with them as supply chain partners. With one supplier, we worked with Columbia Sportswear, REI Co-op and MEC to do one audit instead of four. This is more cost efficient for each of us, but it also helps relieve 'audit fatigue' for the supplier, freeing them to spend more time solving the problems. We'll continue to look for ways to collaborate with brands to reduce the pressure of audits on our suppliers. We also worked with eight other international brands this year to help educate workers and managers about the importance of contributing to Social Insurance in China. It's a complex problem, exacerbated by migrant workers finding it difficult to contribute or access social insurance when they shift provinces. Workers on low wages are not motivated to invest part of their pay into this government scheme, but without contributions, they are not eligible for the benefits, like healthcare and retirement income. By sharing the costs with eight other brands we were able to implement an education programme that will help increase payments and protect more workers.

Source: Kathmandu *Sustainability Report 2017*, p. 21

Key influences on human resource management

Kathmandu's stakeholders have a significant role within the organisation. All range of stakeholders have been addressed and the company ensures it adheres to best practice policies. Its engagement with stakeholders is demonstrated in figure 4.2, which includes the mechanism for engagement, frequency and issues addressed.

STAKEHOLDER GROUP	ENGAGEMENT MECHANISM	FREQUENCY OF ENGAGEMENT	KEY ISSUES RAISED
Customers	–Social media –Customer insights –In our stores –Our website –Via our customer services team –Summit Club member communication	Ongoing	–Animal welfare –Waster management –Community investment opportunities and sponsorship –Human rights in our supply chain –Product care and repair –Microfibres
Staff	–Performance mechanisms –Questionnaire and surveys –Dream Team meetings –Other engagement committees	Ongoing	–Health and safety –Waste management –Training –Sustainability leadership
Suppliers	–Meetings –Site visits	Ongoing	–Fair and open procurement practices –Fair working conditions –Environmental impacts –Product quality and safety
Factories	–Meetings –Site visits –Audits	Ongoing	–Fair working conditions
Local communities	–In our stores and offices –Community events –Social media –Website	Ongoing	–Our impact on communities –Social investment and sponsorship
Government and regulators	–Meetings –Reports –Site visits	Quarterly and as required	–Economic performance –Environmental impacts –Community impacts
Shareholders	–Our annual reports –Annual General Meeting –ASX and NZX announcements –Website –Investor roadshows, briefing forums	Quarterly and as required	–Economic performance –All sustainability material issues
Industry associations	–Meetings –Reports –Workshops	Annually	–Environmental impacts –Community impacts –Human rights in our supply chain
Investment community	–ASX announcements –Website	Quarterly and as required	–ESG performance

FIGURE 4.2 Stakeholder engagement at Kathmandu

The board of Kathmandu has adopted a written charter that includes enhancing shareholder value through policies for the appointment of management, implementing a code of conduct and legal compliance, risk management, health and safety, diversity policy, and environmental and social responsibility.

Kathmandu's human resource team and management abides by Australia's current legal framework in respect to employment contracts, work health and safety, and equal employment.

There are 1955 employees globally, with 1241 in Australia. This consists of 898 full-time workers, 34 fixed-term full-time contracted workers, 39 fixed-term part-time and 270 casual workers. Further, there are three executive positions, 19 senior managers, 310 managers and 909 in employee non-management positions.

Health and safety and diversity are two areas of worker responsibility that the company is particularly keen to manage effectively.

Work health and safety

The company's management is aware of the need to cultivate a strong safety culture. It has adopted an integrated approach to safety and wellbeing that incorporates all aspects of worker wellbeing including mental health. In addition to health and safety being one of the company's '3 pillars', it has created a safety and wellbeing intranet site called 'Destination Safe'. This site contains a range of resources, tools and information that employees can access to assist in maintaining workplace safety including the reporting of incidents, emergency responses, and hazard and risk management.

Mental health is an increasing concern across society and the Kathmandu's human resource team has created individual plans to assist staff. This includes counselling services, leave and return-to-work plans that align with the existing treatment from a worker's health practitioner. Management has also launched a mental health awareness program, 'Make a mental note' which highlights that by being proactive and engaging with mental health issues its workers will improve their own understanding and wellbeing as well as that of those around them.

Other health initiatives include utilisation of the services of a dietician by management, which resulted in the introduction of Healthy Lunch seminars aimed at better nutrition choices. Staff were also encouraged to participate in a bike challenge — an initiative that was taken up by two-thirds of staff, who between them cycled 8000 kilometres.

Diversity

Kathmandu understands the importance of having a diverse and skilled workforce and has ensured this is reflected in a sustainable, inclusive and collaborative workplace culture. The true value of such an approach, according to the company is the innovative, responsive, productive and competitive workplace environment that benefits customers and shareholders. Further, this workplace culture where employee experiences, backgrounds and perspectives are diverse, provides for enhanced customer service and innovative products for an equally diverse community.

A diversity policy, the company's management believes, begins with staff acquisition but continues across the business through training and development, transfer and promotion, staff retention, company policy initiatives and procedures. To this end it has established a number of key metrics across gender, generation and culture profiles and is satisfied that it has made progress toward achieving its diversity goals.

Gender diversity is a key focus of the business and it recognises that it must monitor results in its initiatives in this area particularly if employee turnover influences

this and leads to an imbalance. Of the most recent permanent employees hired, 145 were male and 169 were female, 225 were younger than 30 years, 78 were aged 30–50 years and only 11 were over 50 years of age.

Pay equality between genders is also apparent in the business with no evidence of disparity between people fulfilling the same or similar roles. The economic influences on the company include the relatively slow retail environment faced by companies like Kathmandu. Despite this, there has been an increase of 888 new team members (3 per cent) in the total workforce mostly in the form of an increase in casual labour. It has, however, closed three underperforming stores, opened three new stores and relocated four stores, perhaps in recognition of the slow retail sales across the economy and in attempt to pre-empt the effects on its operations and staffing requirements of any further decline.

Changing work patterns are reflected in the business's approach to parental leave as indicated in figure 4.3.

A high proportion of males availing themselves of parental leave supports the positive attitude displayed by the company towards work–life balance. Further, evidence suggests that staff are supported in their commitment to their respective families especially with the arrival of new children. Parental leave is provided in accordance with legal requirements. In 2016, 61 team members took parental leave with a notable increase in the number of male workers accessing their parental leave entitlements.

42 % MALE

58 % FEMALE

57 % FEMALE MANAGEMENT

61 % EMPLOYEES TOOK PARANTAL LEAVE

---

405 % NEW HIRES MALE

483 % NEW HIRES FEMALE

FIGURE 4.3 Parental leave and staff acquisition at Kathmandu

Ethics and corporate social responsibility

From the outset the founders of Kathmandu have sought to be a business, which having established its long-term survival, would become a business that puts in more than it takes out of society. It has continued to focus on building a culture of sustainability that ensures all employees understand their impact and their role within the organisation — the *Sustain the Dream* strategy. Kathmandu aims to conduct its operations with a set of ethics that are closely aligned to customer values, its team and the wider community.



FIGURE 4.4 Kathmandu aims to protect workers in its supply chain.

Detailed factory assessments are conducted every two years to understand social and environmental impacts. This has resulted in closer relationships with suppliers and competitors on how best to address worker health and safety. For example, the company has been members of the Fair Labour Association since 2004 and this partnership has resulted in a joint effort in protecting worker rights in its supply chain.

Processes of human resource management

The acquisition and development of the best and most capable staff are a priority for Kathmandu as indicated by their prominence in two of the business's three strategic pillars: talent and capability.

Live the Brand aims to ensure the company continues to attract, engage and retain highly skilled people who are passionate about the brand and its values.

Open the World aims to demonstrate that the company strives to create a culture of learning and excellence where its people drive themselves and others.

In order to aid the development of its workers, the company supports the notion that they should be responsible for their own development and support others as well. The range of training program opportunities includes practical in-store, group and individual and detailed induction training.

The company also believes it is able to provide opportunities to employees to develop skills and maintain a healthy lifestyle.

It begins with the creation of an individual development plan (IDP) and management development plan (MDP) for all team members. The use of 360 degree feedback as a tool to identify development opportunities and target training programs to the wider business is considered highly valuable. Some example of its initiatives include:

- Kampfire Lunch Presentations. These are an opportunity for Kathmandu team members to share their knowledge and experience with a lunchtime presentation.
- Trekbud Mentoring Programme. Team members apply for the programme and are then matched with a mentor (TrekBud) who has the desired skills and experience to support their development objectives. Team members work with their mentors through coaching and other projects.
- Retail Talent Development. Resources and opportunities have been created to support retail employee development. Management has invested in the coaching skills of store managers with an external online training platform. This platform incorporates learning, practical activities and personal coaching.

Maintenance of employees is also a priority. Building capacity in staff is important and is seen as one strategy to retain workers. Stores consist of managers, assistant managers, 3ICs, key holders and sales advisors. The strengths identified in employees are encouraged with the longer term view of them taking on senior roles and building a career in retail.

Additional incentives come in the form of generous discounts across the entire range of Kathmandu products that are also available to extended family at certain times, for example, twice a year discounts are offered to family and friends.

Achievements are recognised including community support, outstanding customer service achievements and Store of the Year. Bonuses are available to managers and assistant managers upon reaching a certain target within the store.

Separation including the turnover of staff is in line with the seasonal nature of the business.

Strategies in human resource management

All indications are that management consults regularly with staff. It encourages the development of a strong team-based approach engaging with staff via performance management, questionnaires and surveys, team meetings and interviews to clearly articulate its strategic approach.

For example, the following position was advertised at one of Kathmandu's retail stores. The position was for a store manager at a city location.

The position requires specific skills in relation to the operation of the store, point of sale, stock control, cash handling, security and store presentation, but also more general skills in respect to customer experience and to develop passion in the store's team.

To be successful for this fantastic role we require you to:

- Deliver an exceptional customer experience
- Develop your team's passion to drive sales and provide world class service
- Bring to life our visual merchandising vision
- Have competence in all aspects of store operations; point of sale, stock control, cash handling, security and store presentation
- Demonstrate expert product knowledge
- Maximise sales and profit achievements through exceptional leadership
- Thrive in a busy environment with a genuine passion for our products
- Effectively recruit and drive succession planning within your store

FIGURE 4.5 Kathmandu job advertisement

The store relies on its digital media and window advertising to recruit staff, and offers prospective applicants the chance to filter options through the nature of employment, for example, full/part time, location (various states across Australia) and job category (management sales advisor).



FIGURE 4.6 One of the functions of human resources management is to get the right people for the job.

Successful candidates can then take advantage of Kathmandu's extensive training program and performance management strategies, rewards and in many cases carve out successful and fulfilling careers as reflected in the following employee profile.

> My experience at the Tower Junction store, managing a large team has enabled me to help others develop in their careers, which is pretty satisfying. My current role also gives me opportunities to motivate and support my team to

achieve as much as they can. It is challenging role, but I enjoy it because it allows me to develop my skills and improve my capabilities.

The transition in regional store management was very natural, and I'm fortunate that my team were receptive and respectful. I enjoy working at Kathmandu because I love my team, especially the culture we have created. I also like the diversity of my role, every day is different and I am never bored.

Kathmandu have always rewarded me with opportunities to develop my career. I feel very well supported in my role, and I have benefitted from positive interactions with my colleague at the support office. I would definitely recommend working at Kathmandu to anyone who enjoys a challenging, yet supportive environment.

For management the opportunity to have the success of the business reflected in their own remuneration package is consistent with that offered to executives in other public companies. Executive remuneration consists of three components: base salary and benefits, short-term incentives and long-term incentives.

Short-term financial incentive (cash) is paid to the CEO and all eligible executives for exceeding the company's financial performance target. In the most recent annual report this was 70 per cent cash for the CEO and 29 per cent cash/46 per cent equity for the executives. The additional 30 per cent was available should the CEO and executives achieve key performance indicators (KPIs). Executives were also eligible for long-term incentives in the form of equity (shares) should they remain employed throughout the year.

Kathmandu seeks to reward non-management employees both financially and non-financially. Success and performance is rewarded through generous staff discounts, competitive remuneration including bonuses and incentives and opportunities for career development.

Managers and assistant managers are eligible for bonuses provided that certain store targets are met. Bonuses are paid quarterly and are company and store based. Competitions between stores are also run and recreation budget incentives, regional manager star performer awards (which recognise outstanding contribution to the company, team or community), KPI challenges, annual and half-year awards are all on offer with prizes awarded to successful teams or employees. Employees also have the opportunity to participate in catalogue photo shoots where new products are promoted by the successful applicant in exotic locations such as Turkey or Africa.

The company seeks employees with requisite skills in both New Zealand and Australia. Its website provides information relating to the types of skills required in both the Australian support office (Melbourne) and New Zealand support office (Christchurch) in addition to the retail opportunities in various states of Australia and locations in New Zealand.



FIGURE 4.7 Employees also have the opportunity to participate in catalogue photo shoots in exotic locations.

Effectiveness of human resource management

Several key performance metrics are addressed by the firm when assessing its human resource management performance.

With respect to the wellbeing of staff, the Destination Safe initiative continues to be integrated in safe and healthy workplaces for all staff. In addition key metrics reported in all annual reports include injury rate, lost time due to injuries and recordable incidents. Kathmandu's recent performances, shown in figure 4.8, have seen improvements.

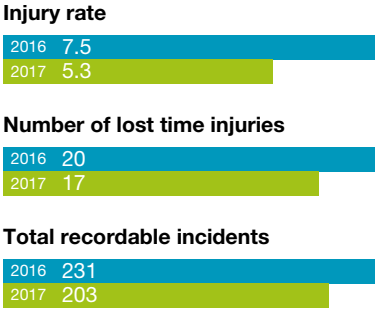


FIGURE 4.8 Injuries at Kathmandu

Manual handling injuries pose the greatest cause of injury for the business. A better understanding of the causes of these injuries has resulted in a reduction in them of 4 per cent.

Worker satisfaction appears high with low rates of staff turnover (approximately 4 per cent) and high retention rates for employees that return to work after parental leave (50 per cent male and 79 per cent female). This is indicative of its inclusive nature and encouragement of work–life balance. Approximately 83 per cent of all employees received performance review/appraisals in 2016 and the ongoing commitment by the company to engage with staff through such interviews and surveys appears to give valuable insight into the management of human resources.

Worker satisfaction is reflected in the story of Jamie Parker who has been with the company for 18 years. He started as a casual unpacking containers of product and today is a Senior Product Manager. It's the workplace culture that appeals most to him. Kathmandu is a huge part his life in other ways too.

> I didn't ever have a vision for my life so Kathmandu's given me a purpose — and an opportunity to grow. I have a lot of lifetime friends here. My partner works in the distribution centre. Kathmandu is a big part of me.



FIGURE 4.9 Worker satisfaction is high at Kathmandu, which contributes to the success of the brand.

CASE STUDY QUESTIONS

1. **Outline** the role of the three pillars of the Kathmandu People Plan in the strategic management of human resources.
2. **Explain** the interdependence between human resources and the other key business functions.
3. **Discuss** some of the advantages and disadvantages of outsourcing production to the global market.
4. **Outline** the key influences on human resource management.
5. **What** are the advantages of the diverse, culturally competent workforce?
6. **Explain** the role of the processes of human resource management.
7. **Evaluate** the effectiveness of strategies for more effective human resources management. Recommend alternative strategies.

APPENDIX: UNDERSTANDING KEY PROCESS VERBS

Assessment using key process verbs

The purpose of a key process verb in a question is to provide instructions on how to answer a question and how much to write. There is a direct relationship between the type of key process verb and the mark value allocated. The more thinking skills the key process verb requires, the higher the mark allocated.

Below is a colour coded list of the key process verbs that may be used for assessment. It is divided into three categories based on Bloom's Taxonomy. Each category represents the level of thinking skills required to complete a question. We have also included in the Key Process Verb list common exam terms such as 'Why', 'How', 'What' to help explain how to answer questions using these terms.

Mark allocation

The suggested marks used in these examples are specifically for short answer questions. Essay questions may also include a number of key process verbs.

Lower order thinking questions	**Clarify, define, describe, extract, identify, list, outline, recall, recount, state, summarise, what, when**	**1–3**
Middle order thinking questions	**Account, apply, calculate, classify, compare, construct, contrast, deduce, demonstrate, discuss, distinguish, examine, explain, how, interpret, investigate, justify, propose, recommend, to what extent, why, with reference to**	**3–6**
Higher order thinking questions	**Analyse, appreciate, assess, create, critically analyse/evaluate, detail, determine, evaluate, extrapolate, predict, synthesise**	**6–12**

Time allocation

In order to complete each question, time allocation is very important. If a student does not complete the examination in time, because they have not calculated the minutes/marks correctly, they will lose marks. A formula for calculating minutes/marks is as follows:

$$\textit{Marks/minute} = \frac{\textit{Total exam time in minutes}}{\textit{Total exam marks}} = \textit{minutes/mark}$$

$$\textit{Example: Marks/minute} = \frac{\textit{180 exam minutes (3hrs)}}{\textit{100 exam marks}} = \textit{1.8 minutes/mark}$$

In the above example, the student would need to allocate 1.8 minutes per mark in an examination. Therefore, a 4-mark question should be allocated 1.8 minutes × 4 = 7.2 minutes (or rounded to seven minutes). This ensures the allocation of an appropriate amount of time for each question.

Definitions and examples

LOWER ORDER THINKING key process verbs
Short answer questions using the lower order thinking key process verbs will typically have a mark value between 1 and 3.
Clarify — make clear or plain.
Define — state meaning and identify essential qualities.
Describe — provide characteristics and features.
Extract — choose relevant and/or appropriate details.
Identify — recognise and name.
List — make a list of.
Outline — sketch in general terms; indicate the main features of.
Recall — present remembered ideas, facts or experiences.
Recount — retell a series of events.
State — describe the main points clearly and specifically.
Summarise — express, concisely, the relevant details.
What — describe, provide characteristics or features.
When — indicate at what time or in what circumstances.

MIDDLE ORDER THINKING key process verbs
Short answer questions using the middle order thinking key process terms will typically have a mark value between 3 and 6.
Account — account for; state reasons for; report on. Give an account of; narrate a series of events or transactions.
Apply — use, utilise, employ in a particular situation.
Calculate — ascertain/determine from given facts, figures or information.
Classify — arrange or include in classes/categories.
Compare — show how things are similar or different.
Construct — make; build; put together items or arguments.
Contrast — show how things are different or opposite.
Deduce — draw conclusions.
Demonstrate — show by example.
Discuss — identify issues and provide points for and/or against.
Distinguish — recognise or note/indicate as being distinct or different from; note differences between.
Examine — inquire into.
Explain — relate cause and effect; make the relationships between things evident; provide why and/or how.
How — explain.
Interpret — draw meaning from.
Investigate — plan, inquire into and draw conclusions.
Justify — support an argument or conclusion.
Propose — put forward (for example a point of view, idea, argument, suggestion) for consideration or action.
Recommend — provide reasons in favour.
To what extent — show the impact, how broadly something is affected.
Why — explain the cause and effect relationship.
With reference to — in regards to, relating to.

LOWER ORDER examples
Clarify the reasons for…
Define the term…
Describe four roles…
Extract the issues that may arise…
Identify two effects of…
List the four components of…
Outline the roles of…
Recall the factors that…
Recount under what circumstances…
State how a business may address…
Summarise how the two issues affected the…
What are business plans…
When do business owners…

MIDDLE ORDER examples
Account for the improvements to…
Apply one of the processes relevant to…
Calculate which you believe to be the more…
Classify the following list of consumers into the…
Compare the problems experienced by…
Construct a SWOT analysis for the following small businesses…
Contrast a range of businesses with different legal structures…
Deduce what impact this had on the…
Demonstrate the opportunities a business can…
Discuss the role of…
Distinguish between internal and external growth…
Examine the reasons for…
Explain the processes undertaken…
How does Tracy track…
Interpret the reasons for the business owner deciding to…
Investigate three options available to the employees…
Justify your selection…
Propose a plan that may provide the business with…
Use the information provided to **recommend** a strategy…
To what extent does human resource management have an impact on...
Why is it important to...
With reference to a case study...

HIGHER ORDER THINKING key process verbs
Short answer questions using the higher order thinking key process verbs will typically have a mark value between 6 and 12.
Analyse — identify components and the relationship between them; draw out and relate implications.
Appreciate — make a judgement about the value of.
Assess — make a judgment of value, quality, outcomes, results or size.
Create — produce; design; invent; devise a new solution or plan.
Critically analyse/evaluate — add a degree or level of accuracy, depth, knowledge and understanding, logic, questioning, reflection or quality.
Detail — give specific information about it.
Determine — make a decision or work out an answer after appropriate thought and investigation.
Evaluate — make a judgement based on criteria; determine the value of.
Extrapolate — infer from what is known.
Predict — suggest what may happen based on available information.
Synthesise — put together various elements to make a whole.

HIGHER ORDER examples
Analyse the impact of changes to the…
Appreciate the importance of government bodies…
Assess the importance of…
Create a marketing strategy suitable to a business at this stage…
Critically analyse this statement…
Detail the four steps involved...
Determine whether the change required would…
Evaluate the processes…
Extrapolate the data found in…
Predict the outcome for a business if the following…
Consider a business's function and **synthesise** this information…

GLOSSARY

absenteeism: refers to a worker who neglects to turn up for work when they were scheduled to do so. p. 505

acceptable quality: means that products must be safe, lasting and with no faults, look acceptable and do all the things someone would normally expect them to do. p. 154

accounting equation: forms the basis of the accounting process, shows the relationship between assets, liabilities and owners' equity. p. 309

acquisition: is the process of attracting and recruiting the right staff for roles in a business. p. 438

advertising: is a paid, non-personal message communicated through a mass medium. p. 159

advertising media: refers to the many forms of communication used to reach an audience. p. 225

affirmative action: refers to measures taken to eliminate direct and indirect discrimination, and for implementing positive steps to overcome the current and historical causes of lack of equal employment opportunity for women. p. 422

ageing of the workforce: refers to the growth in the average age of the population, due to sustained low fertility and increasing life expectancy. As a result, there are proportionally fewer children under 15 in the population, and more people in older age groups. p. 428

analysis: involves working the financial information into significant and acceptable forms that make it more meaningful, and highlighting relationships between different aspects of a business. p. 314

appreciation: an appreciation is an upward movement of the Australian dollar (or any other currency) against another currency. p. 358

assets: are items of value owned by the business. p. 308

attitude: an attitude is a person's overall feeling about an object or activity. p. 144

audit: an audit is an independent check of the accuracy of financial records and accounting procedures. p. 333

Australian Securities Exchange (ASX): the primary stock exchange group in Australia. p. 284

availability of funds: refers to the ease with which a business can access funds (for borrowing) on the international financial markets. p. 289

award: refers to the legally enforceable minimum terms and conditions that apply to a business or industry. p. 392

award simplification: is the process of reducing the number of matters in each award and eliminating inefficient work practices. p. 392

B2B: refers to direct access from one business (the supplier) to another (the buyer), allowing the supplier to assess the needs of the buyer and meet them in a timely manner. p. 86

B2C: is the selling of goods and services to consumers over the internet, with payment usually by credit card. p. 86

bait and switch advertising: involves advertising a few products at reduced and, therefore, enticing prices to attract customers. When the advertised products quickly run out, customers are directed to higher priced items. p. 152

balance sheet: represents a business's assets and liabilities at a particular point in time, expressed in money terms, and represents the net worth of the business. p. 307

balanced scorecard benchmarking: is used for measuring whether the activities of a business are meeting its objectives established in the strategic plan. It benchmarks key performance variables with targets aligned with the strategic plan. p. 498

behavioural segmentation: is the process of dividing the total market according to the customers' relationship to the product. p. 204

benchmarking: is a process in which indicators are used to compare business performance between internal sections of a business or between businesses. p. 495

best practice: refers to business practices that are regarded as the best or of the highest standard in the industry. p. 431

best practice benchmarking: involves comparing performance levels with those of another best practice business in specific areas using a structured process to gain skills and knowledge and to modify organisational processes. p. 498

better off overall test (BOOT): requires that each of the employees to be covered by the agreement is better off overall than under the relevant modern award. p. 405

blog: a blog is an online journal that can be added to by readers. p. 247

bottleneck: a bottleneck is an aspect of the transformation process that slows down the overall processing speed or creates an impediment leading to a backlog of incompletely processed products. p. 68

brand: a brand is a name, term, symbol, design or any combination of these that identifies a specific product and distinguishes it from its competition. p. 211

brand loyalty: occurs when a favourable attitude towards a single brand results in repeat sales over time. p. 145

brand name: a brand name is that part of the brand that can be spoken. p. 211

brand symbol or **logo:** a brand symbol or logo is a graphic representation that identifies a business or product. p. 212

budgets: provide information in quantitative terms (facts and figures) about requirements to achieve a particular purpose. p. 293

bundle pricing: is where customers gain a 'package' of goods and services in addition to the tangible good they purchased. p. 220

capital-labour substitution: means that the machinery and technology displace people by doing the work they do. p. 46

carbon footprint: refers to the amount of carbon produced and entering the environment from operations processes. p. 35

cash flow: is the movement of cash in and out of a business over a period of time. p. 338

cash flow statement: a cash flow statement is a financial statement that indicates the movement of cash receipts and cash payments resulting from transactions over a period of time. p. 304

casual employees: are in employment that is short term, irregular and uncertain; they are not entitled to paid holiday or sick leave. p. 407

centralised industrial relations system: a centralised industrial relations system is a collectivist approach in which disputes are referred to industrial tribunals, such as the Fair Work Commission, for conciliation and arbitration. p. 396

change agent: a change agent is somebody who initiates change or facilitates the change process. p. 110

channel: a channel is any method used for carrying a message. p. 232

clean payment: a clean payment occurs when the exporter ships the goods directly to the importer before payment is received. p. 361

code of conduct: a code of conduct is a statement of acceptable and unacceptable behaviours in a business. p. 431

code of ethics: a code of ethics is a statement of a firm's values and principles. p. 431

code of practice: a code of practice is a statement of the principles used by a business in its operations. It generally refers to practices that are seen as ethical or socially responsible. p. 432

collective agreements: are made between a group of employees (or one or more unions representing employees) and an employer or group of employers. p. 405

commercial bills: are primarily short-term loans issued by financial institutions, for larger amounts (usually over $100 000) for a period of generally between 30 to 180 days. p. 273

common law: the common law is developed by courts and tribunals. p. 399

competition-based pricing: is where the price covers costs (cost of raw materials and the cost of operating the business) and is comparable to the competitor's price. p. 220

competitive positioning: relates to how a business will differentiate its products. p. 255

compliance costs: are the expenses associated with meeting the requirements of legal regulations, i.e. abiding by all laws. p. 34

computer-aided design (CAD): is a computerised design tool that allows businesses to create product possibilities from a series of input parameters. p. 61

computer-aided manufacturing (CAM): is software that controls manufacturing processes. p. 61

constitutional corporation: a constitutional corporation is one that falls under section 51(xx) of the Constitution of Australia — identified as foreign corporations and trading or financial corporations formed within the limits of the Commonwealth. p. 392

consumer guarantees: provide consumers with rights to certain remedies from retailers and manufacturers where goods purchased fail to comply with the consumer guarantee provisions in the ACL. p. 154

consumer markets: consist of individuals — that is, members of a household who plan to use or consume the products they buy. p. 137

continuous improvement: is an ongoing commitment to improving a business's goods or services. p. 105

contractor: a contractor is an external provider of services to a business. It may be an individual or a business. p. 377

control: occurs when KPIs are assessed against predetermined targets and corrective action is taken if required. p. 67

controlling: involves the comparison of planned performance against actual performance and taking corrective action to make sure the objectives are attained. p. 193

corporate culture: a corporate culture refers to the values, ideas, expectations and beliefs shared by members of the business. p. 497

corporate social responsibility (CSR): refers to open and accountable business actions based on respect for people, community/society and the broader environment. It involves businesses doing more than just complying with the laws and regulations. p. 36

cost: as a performance objective refers to the minimisation of expenses so that operations processes are conducted as cheaply as possible. p. 79

cost-based competition: is derived from determining breakeven point (the level at which the firm's total revenue is exactly equal to its total costs) and applying strategies to create cost advantages over competitors. p. 31

cost-based pricing: is a pricing method derived from the cost of producing or purchasing a product and then adding a mark-up. p.218

cost centres: are particular areas, departments or sections of a business to which costs can be directly attributed. pp.10, 353

cost leadership: involves aiming to have the lowest costs or to be the most price-competitive in the market. A key aspect to cost leadership is that although trading with the lowest cost, the overall business should still be profitable. p.10

cost of goods sold: the cost of goods sold is the value of stock that a business has sold to its customers. p.306

critical path analysis (CPA): is a scheduling method or technique that shows what tasks need to be done, how long they take and what order is necessary to complete those tasks. p.57

currency swap: a currency swap is an agreement to exchange currency in the spot market with an agreement to reverse the transaction in the future. p.363

current assets: are assets that a business can expect to convert into cash within 12 months. They usually include cash and accounts receivable. p.341

current liabilities: are liabilities that a business must repay within the short term. They usually include overdraft and accounts payable. p.341

customer choice (buying behaviour): refers to the decisions and actions of customers when they search for, evaluate, select and purchase goods and services. p.142

customer orientation: refers to the process of collecting information from customers and basing marketing decisions and practices on customers' wants and interests. p.132

customer relationship management (CRM): refers to the systems that businesses use to maintain customer contact. p.48

customer satisfaction: measures how goods and services supplied by a business meet or exceed customer expectation. p.133

customer service: refers to how well a business meets and exceeds the expectations of customers in all aspects of its operations. pp.71, 185

customisation: refers to creation of individualised products to meet the specific needs of the customers. p.78

customised goods: are those that are varied according to the needs of customers. These goods are produced with a market focus rather than a production focus. p.15

customised or **local approach:** a customised or local approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are different between countries. p.254

customised pricing: occurs whenever consumers in different countries are charged different prices for the same product. p.255

debentures: are issued by a company for a fixed rate of interest and for a fixed period of time. p.274

debt finance: relates to the short-term and long-term borrowing from external sources by a business. pp.271, 299

debt repayments: refer to either money owed to the business or by the business. p.330

decentralised industrial relations system: in a decentralised industrial relations system, employers and employees negotiate wages and working conditions in the individual workplace, through collective or individual bargaining and without the involvement of tribunals. p.396

demand: is the quantity of a product consumers are willing to purchase at a particular price. p.219

demographic segmentation: is the process of dividing the total market according to particular features of a population, including the size of the population, age, sex, income, cultural background and family size. p.203

dependability: as a performance objective, refers to how consistent and reliable a business's products are. p.77

derivatives: are simple financial instruments that may be used to lessen the exporting risks associated with currency fluctuations. p.363

development: refers to enhancing the skills of the employee in line with the changing and future needs of the organisation. pp.438, 472

discretionary income: refers to disposable income that is available for spending and saving after an individual has purchased the basic necessities of food, clothing and shelter. p.131

discrimination: occurs when a policy or a practice disadvantages a person or a group of people because of a personal characteristic that is irrelevant to the performance of the work. p.419

dishonest advertising: is when an advertisement uses words that are deceptive or claims that a product has some specific quality when it does not. p.152

distribution: refers to the ways of getting the goods or services to the customer. p.86

distribution channels or **marketing channels:** are the routes taken to get the product from the factory to the customer. p.236

dividend: a dividend is a distribution of a company's profits (either yearly or half-yearly) to shareholders and is calculated as a number of cents per share. p.277

drip pricing: means that a business advertises one price but in the process of a customer purchasing the service numerous additional charges and costs are added. The effect is that the final price can be much higher than the price advertised. Drip pricing has been an issue in

relation to airline ticketing and travel products sold online. p. 18

E-commerce: involves the buying and selling of goods and services via the internet. p. 85

E-marketing: (electronic marketing) is the practice of using the internet to perform marketing activities. p. 245

E-procurement: or the use of online systems to manage supply, allows suppliers direct access to the business's level of supplies. p. 85

economies of scale: refers to cost advantages that can be created as a result of an increase in scale of business operations. Typically the cost savings come from being able to purchase lower cost per unit of input and from efficiencies created through improved use of technology and machinery. p. 11

efficiency: is the ability of a business to minimise its costs and manage its assets so that maximum profit is achieved with the lowest possible level of assets. pp. 265, 321

employee: an employee is a worker under an employer's control. Control may involve:

- the location of the workplace
- the way in which the work is performed
- the degree of supervision involved. p. 372

employee poaching: is the practice of enticing employees to work for another business. p. 470

employee selection: involves gathering information about each applicant and using that information to choose the most appropriate applicant. p. 440

employees: are workers under the control of an employer. This control includes the workplace location, the way that the work is to be performed and the extent to which supervision will be exercised. p. 385

employer: an employer, for legal purposes:

- exercises control over employees
- has responsibility for payment of wages or salaries
- holds the power to dismiss employees. p. 372

employer associations: are organisations that represent and assist employer groups. They are usually respondents to the awards covering the employees of their members, and covering employers in the same or related industry. p. 386

employers: are those who exercise control over employees, have responsibility for the payment of wages and/or salaries and have the power to dismiss employees. p. 385

employment contract: an employment contract is a legally binding, formal agreement between employer and employee. p. 397

enterprise agreements: are collective agreements made at a workplace level between an employer and a group of employees about terms and conditions of employment. p. 405

environmental sustainability: (ecological sustainability) means that business operations should be shaped around practices that consume resources today without compromising access to those resources for future generations. p. 35

equal employment opportunity (EEO): refers to equitable policies and practices in recruitment, selection, training and promotion. p. 422

equity: as an external source of funds refers to the finance raised by a company through inviting new owners. p. 277

equity in the workplace: is the provision of equal opportunities for all employees to gain access to jobs, training and career paths. p. 399

equity finance: relates to the internal sources of finance in the business. p. 299

established technology: is technology that has been developed and widely used and is simply accepted without question. p. 97

ethical business practices: are those practices that are socially responsible, morally right, honourable and fair. p. 430

ethical consumerism: involves buying products that are not harmful to the environment, animals and society. p. 206

ethical sourcing: refers to business practices of sourcing from suppliers that engage in ethical conduct such as the payment of fair wages and the use of environmentally friendly practices. p. 7

expenses: are simply costs. Specifically, expenses are the costs incurred in the process of acquiring or manufacturing a good or service to sell and the costs (direct and indirect) associated with managing all aspects of the sales of that good or service. p. 306

explicit service: is also called the tangible aspect of the service being provided, such as the application of time, expertise, skill and effort. p. 82

extended marketing mix: the extended marketing mix refers to the combination of people, processes and physical evidence with the four main elements of the marketing mix. p. 200

external data: refers to published data from outside the business. p. 181

external finance: is the funds provided by sources outside the business, including banks, other financial institutions, government, suppliers or financial intermediaries. p. 271

external recruitment: involves filling job vacancies with people from outside the business. p. 466

facilities: refer to the plant (factory or office) and machinery used in the operations processes. p. 49

factoring: is the selling of accounts receivable for a discounted price to a finance or factoring company. p. 273

Fair Trade movement: is an alternative method of international trade that promotes environmentalism, fair wages, alleviation of global poverty and a fair price for farmers and workers. p.206

fiduciary: a fiduciary is a person in a position of financial trust with respect to others' money. p.38

FIFO (first-in-first-out): is a method of pricing inventory that assumes that the first goods purchased are also the first goods sold and therefore the cost of each unit sold is the first cost recorded. p.100

financial budgets: relate to financial data of a business and include the budgeted income statement, balance sheet and cash flows. p.294

financial controls: are the policies and procedures that ensure that the plans of a business will be achieved in the most efficient way. p.297

financial decision making: requires relevant information to be identified, collected and analysed to determine an appropriate course of action. p.271

financial forecast: is the business's predictions about the future. p.194

financial management: is the planning and monitoring of a business's financial resources to enable the business to achieve its financial objectives. p.262

financial resources: are those resources in a business that have a monetary or money value. p.263

financial risk: is the risk to a business of being unable to cover its financial obligations. p.296

fixed costs: are those that are not dependent on the level of operating activity in a business. Fixed costs do not change when the level of activity changes — they must be paid regardless of what happens in the business. pp.31, 352

fixed position layout: is an operational arrangement in which employees and equipment come to the product. p.64

flexibility: refers to how quickly operations processes can adjust to changes in the market. p.77

foreign exchange market: the foreign exchange (forex or fx) market determines the price of one currency relative to another. p.357

foreign exchange rate: the foreign exchange rate is the ratio of one currency to another; it tells how much a unit of one currency is worth in terms of another. p.357

forward exchange contract: a forward exchange contract is a contract to exchange one currency for another currency at an agreed exchange rate on a future date, usually after a period of 30, 90 or 180 days. p.363

frequency: the frequency of an advertisement measures the average number of times someone is exposed to the message. p.249

fringe benefits tax (FBT): is a tax employers must pay on certain benefits they provide to their employees or their employees' associates, such as a family member. It is based on the taxable value of the various fringe benefits provided. p.450

gain-sharing plan: a gain-sharing plan involves the benefits of improvements and success, such as productivity improvements, cost savings and sales and profit increases, being reflected in rewards for teams, such as shares, cash bonuses or annual bonuses. p.478

Gantt chart: is a type of bar chart that shows both the scheduled and completed work over a period of time. It is often used in planning and tracking a project. p.56

gearing: is the proportion of debt (external finance) and the proportion of equity (internal finance) that is used to finance the activities of a business. Gearing ratios determine the firm's solvency. pp.265, 316

general skills: include flexibility and versatility, social confidence, positive attitude, motivation, and the ability to work as a team and/or independently. p.468

generic brands: are products with no brand name at all. p.213

geographic segmentation: is the process of dividing the total market according to geographic locations. p.203

global branding: is the worldwide use of a name, term, symbol or logo to identify the seller's products p.253

global economic outlook: the global economic outlook refers specifically to the projected changes to the level of economic growth throughout the world. p.288

global pricing: is how businesses coordinate their pricing policy across different countries. p.254

global sourcing: is a broad term that refers to businesses purchasing supplies or services without being constrained by location. In the supply chain management activity, global sourcing means buying or sourcing from wherever the suppliers are that best meet the sourcing requirements. p.85

global web: refers to the network of suppliers a business has chosen on the basis of lowest overall cost, lowest risk and maximum certainty in quality and timing of supplies. p.27

globalisation: refers to the removal of barriers of trade between nations. Globalisation is characterised by an increasing integration between national economies and a high degree of transfer of capital (facilities and/or machinery), labour, intellectual capital and ideas, financial resources and technology. p.24

grievance procedures: are formal procedures, generally written into an award or agreement, that state agreed processes to resolve disputes in the workplace. p.489

gross profit: is that part of a business's profit that represents operating income minus cost of goods sold. p.306

growth: is the ability of the business to increase its size in the longer term. p.264

hedging: is the process of minimising the risk of currency fluctuations. p. 362

human resource audit: a human resource audit is a diagnostic tool used to evaluate HR policies and practices in order to identify problems and develop solutions in an attempt to rectify problems. p. 495

human resource management: refers to the management of the total relationship between an employer and employee. p. 372

implementation: is the process of putting the marketing strategies into operation. p. 193

implicit service: is based on a feeling and is therefore intangible. The implicit aspects of a service are the psychological wellbeing — the feeling of being looked after — that comes with the provision of the service. p. 82

implied conditions: are the unspoken and unwritten terms of a contract. p. 154

improvement: refers to systematic reduction of inefficiencies and wastage, poor work processes and the elimination of any bottlenecks. p. 68

in good faith: means the parties meet with a willingness to reach an agreement. p. 488

income statement: the income statement is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit. p. 306

independent contractors: often known as consultants or freelancers, undertake work for others; however, they do not have the same legal status as an employee. p. 407

indicators: are performance measures that are used to evaluate organisational or individual effectiveness. p. 495

individual contracts: exist when an employer and an individual employee negotiate a contract covering pay and conditions. p. 405

individual flexibility agreements (IFA): allow an employer and an employee to come to an agreement that varies the modern award or enterprise agreement to address their individual circumstances. p. 403

industrial dispute: an industrial dispute is a disagreement over an issue or group of issues between an employer and its employees, which results in employees ceasing work. p. 484

industrial market: the industrial market includes industries and businesses that purchase products to use in the production of other products or in their daily operations. p. 137

inertia: is a term that describes a psychological resistance to change. p. 109

informal benchmarking: includes any strategies such as networking through informal discussions with colleagues in other businesses, undertaking visits to other businesses, researching best practice online and attending conferences. p. 498

information: is the knowledge gained from research, investigation and instruction, which results in an increase in understanding. p. 47

inputs: are the resources used in the transformation (production) process. p. 45

insourcing: refers to delegating a job to someone within the business, as opposed to someone outside the business. p. 473

interdependence: refers to the mutual dependence that the key business functions have on one another. pp. 18, 128, 267, 373

interest rates: are the cost of borrowing money. p. 289

intermediate goods: are goods manufactured and used in further manufacturing or processing. p. 47

intermediate market: an intermediate market consists of wholesalers and retailers who purchase finished products and resell them to make a profit. p. 137

internal data: refers to information that has already been collected from inside the business. p. 181

internal finance: refers to funds generated from inside the business. For example, profits can be retained to finance expansion. p. 271

internal recruitment: involves filling job vacancies with people from within the business. p. 466

interpretation: is making judgements and decisions using the data gathered from analysis. p. 314

inventory control: is a system that maintains quantities and varieties of products appropriate for the target market. p. 239

inventory or stock: refers to the amount of raw materials, work-in-progress and finished goods that a business has on hand at any particular point in time. p. 98

job design: is the number, kind and variety of tasks that a worker is expected to carry out in the course of performing their job. p. 463

job enlargement: involves increasing the breadth of tasks in a job. p. 442

job enrichment: involves increasing the responsibilities of a staff member. p. 442

job rotation: involves moving staff from one task to another over a period of time in order to multiskill employees. p. 442

job sharing: occurs when two people share the same job. p. 442

judicial power: refers to the power of courts to interpret and apply laws. p. 393

just-in-time (JIT): is an inventory management approach which ensures that the exact amount of material inputs will arrive only as they are needed in the operation process. p. 101

kaizen: is Japanese for 'improvement'. It emphasises continuous improvement in all areas of a business, from the way the CEO manages to the way assembly line workers perform their jobs. p. 114

key performance indicators (KPIs): are specific criteria used to measure the efficiency and effectiveness of the business's performance. p. 48

label: a label is that part of the package that contains information. p. 216

labelling: is the presentation of information on a product or its package. p. 216

lead time: is the time it takes for an order to be fulfilled from the moment it is made. p. 52

leadership style: refers to ways that managers communicate with their employees to inspire and motivate them to work together to achieve an organisation's goals. p. 460

leading edge technology: is the technology that is the most advanced or innovative at any point in time. p. 96

lean production: aims to eliminate waste at every stage of production. It involves analysing each stage of the production process, detecting where inefficiencies are and correcting them. p. 6

learning: refers to changes in an individual's behaviour caused by information and experiences. p. 145

leasing: involves the payment of money for the use of equipment that is owned by another party. pp. 275, 348

letter of credit: a letter of credit is a document that a buyer can request from their bank that guarantees the payment of goods will be transferred to the seller. The letter of credit is issued by the importer's bank to the exporter promising to pay them a specified amount once certain conditions have been met. p. 361

liabilities: are claims by people other than owners against the assets (items of debt), and represent what is owed by the business. p. 308

LIFO (last-in-first-out): is a method of pricing inventory that assumes that the last goods purchased are also the first goods sold and therefore the cost of each unit sold is the last cost recorded. p. 100

liquidity: is the extent to which a business can meet its financial commitments in the short-term (less than 12 months). pp. 265, 314

lockouts: occur when employers close the entrance to a workplace and refuse admission to the workers. p. 485

log of claims: a log of claims is a list of demands made by workers (often through their union) against their employers. These demands cover specific wages and conditions. Employers may also serve a counter-log of claims on the union. p. 386

logistics: is a term broadly referring to distribution but includes transportation (including transportation modes), the use of storage, warehousing and distribution centres, materials handling and packaging. p. 86

loss leader: a loss leader is a product sold at or below cost price. p. 221

loyalty program: a loyalty program is a rewards-based program offered by a business to customers who frequently make purchases. p. 228

maintenance: is the process of managing the needs of staff for health and safety, industrial relations and legal responsibilities, including compensation and benefits, of all staff. p. 438

manufacturer's brand or national brands: are those owned by a manufacturer. p. 212

mark-up: is a predetermined amount (usually expressed as a percentage) that a business adds to the cost of a product to determine its basic price. p. 218

market: a market is a group of individuals, organisations or both that:

- need or want products (goods or services)
- have the money (purchasing power) to purchase the product
- are willing to spend their money to obtain the product
- are socially and legally authorised to purchase the product. p. 136

market-based pricing: is a method of setting prices according to the interaction between the levels of supply and demand — whatever the market is prepared to pay. p. 219

market-customised pricing: sets prices according to local market conditions p. 255

market coverage: refers to the number of outlets a firm chooses for its product. p. 238

market research: is the process of systematically collecting, recording and analysing information concerning a specific marketing problem. p. 177

market segmentation: occurs when the total market is subdivided into groups of people who share one or more common characteristics. p. 188

market segmentation: occurs when the total market is subdivided into groups of people who share one or more common characteristics. p. 201

market share: refers to the business's share of the total industry sales for a particular product. p. 184

marketing: is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives (American Marketing Association). A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers. p. 124

marketing approach: the marketing approach focuses on finding out what customers want — through market research — and then satisfying that need. p. 131

marketing concept: the marketing concept is a business philosophy that states that all sections of the business are involved in satisfying a customer's needs and wants while achieving the business's goals. p. 129

marketing data: refers to the information relevant to the defined marketing problem. p. 179

marketing mix: refers to the combination of the four elements of marketing, the four Ps — product, price, promotion and place — that make up the marketing strategy. p. 190

marketing objectives: are the realistic and measurable goals to be achieved through the marketing plan. p. 183

marketing plan: the marketing plan is a document that lists activities aimed at achieving particular marketing outcomes in relation to goods or services. The plan provides a template for future action aimed at reaching business goals, such as profit maximisation. p. 126

marketing profitability analysis: is a method in which the business breaks down the total marketing costs into specific marketing activities. p. 196

marketing strategies: are actions undertaken to achieve the business's marketing objectives through the marketing mix. p. 190

mass customisation: is a process that allows a standard, mass-produced item to be personally modified to specific customer requirements. p. 78

mass marketing approach: a mass marketing approach seeks a large range of customers. p. 188

mass markets: in mass markets, the seller mass-produces, mass-distributes and mass-promotes one product to all buyers. p. 138

materialism: is an individual's desire to constantly acquire possessions. p. 158

materials: are the basic elements used in the production process and consist of two types raw materials and intermediate goods. p. 47

mediation: is the confidential discussion of issues in a non-threatening environment, in the presence of a neutral, objective third party. p. 489

mix flexibility: is the mix of products made, or services delivered through the information process. p. 53

modern award: a modern award is an industry or occupation-based award that covers all private sector employers and employees who perform work that falls within their scope. They replace all existing national system awards (except those applying to a single enterprise). They do not cover employees earning higher incomes. p. 392

monetary rewards: are those reflected in pay or having financial value. p. 477

monitoring: is the process of measuring actual performance against planned performance. pp. 66, 193

mortgage: a mortgage is a loan secured by the property of the borrower (business). p. 274

motive: a motive is an individual's reason for doing something. p. 144

negotiation: is a method of resolving disputes when discussions between the parties result in a compromise and a formal or informal agreement. p. 488

net profit: is the difference between the gross profit and expenses. p. 306

net working capital: is the difference between current assets and current liabilities. It represents those funds that are needed for the day-to-day operations of a business to produce profits and provide cash for short-term liquidity. p. 341

niche market: a niche market, also known as a concentrated or micro market, is a narrowly selected target market segment. p. 138

noise: is any interference or distraction that affects any or all stages in the communication process. p. 232

non-monetary rewards: are those that do not have a financial value, such as social activities or retirement planning. p. 477

non-store retailing: is retailing activity conducted away from the traditional store. p. 237

offshore outsourcing: involves taking the activities to a provider in another country. p. 39

on-costs: are additional costs involved in hiring an employee, above the cost of their wages. These costs traditionally add around 25 per cent of the cost of the wage and include sick leave, holiday leave, leave loading, superannuation, retirement and redundancy payments, and other costs. p. 407

onshore outsourcing: involves the use of domestic businesses as the outsourcing provider. p. 39

operating budgets: relate to the main activities of a business and may include budgets relating to sales, production, raw materials, direct labour, expenses and cost of goods sold. p. 294

operations: refers to the business processes that involve transformation or, more generally, 'production'. p. 4

option: an option gives the buyer (option holder) the right, but not the obligation, to buy or sell foreign currency at some time in the future. p. 363

opinion leader: an opinion leader is a person who influences others. p. 232

orders: are decisions that require employees or employers to carry out a direction from the tribunal. They may be inserted in awards or agreements. p. 491

outputs: refer to the end result of the business efforts — the good or service that is provided or delivered to the customer. p. 70

outsourcing: or contracting out business functions involves the use of third-party specialist businesses, for example, recruitment firms. It aims to take advantage of the specialist skills provided by them and to achieve a reduction in labour costs. pp. 21, 39, 376

overdraft: with an overdraft, the bank allows a business or individual to overdraw their account up to an agreed limit and for a specified time, to help overcome a temporary cash shortfall. p. 273

owners' equity: is the funds contributed by the owner(s) and represents. p. 308

packaging: involves the development of a container and the graphic design for a product p. 213

participation rate: the participation rate refers to the percentage of a given group of individuals of working age who are employed or actively seeking work. p. 428

payables: are sums of money owed by the business to other businesses from whom it has purchased goods and services. Payables are recorded as accounts payable. p. 345

payment in advance: the payment in advance method allows the exporter to receive payment and then arrange for the goods to be sent. p. 360

people: the people element refers to the quality of interaction between the customer and those within the business who will deliver the service. p. 241

perception: is the process through which people select, organise and interpret information to create meaning. p. 144

performance appraisal: is a process of assessing the performance of an employee, generally against a set of criteria or standards. p. 444

performance benchmarking: involves comparing the performance levels of a process/activity with other businesses. p. 498

performance management: addresses both individual and business performance. Successful individual performance will often translate into the business's strategic objectives being met. p. 473

performance management (administrative): the performance management (administrative) model assesses the progress of the business in meeting its strategic goals and where necessary identifying the areas for improvement, such as establishing new goals or employee performance. p. 474

performance management (developmental): the performance management (developmental) model improves individual performance through establishing objectives such as reaching sales targets that are consistent with achieving the organisation's goals. p. 474

performance objectives: are goals that relate to particular aspects of the transformation processes. p. 75

performance pay: refers to remuneration that is based on distributing rewards according to individual employee performance. p. 479

personality: an individual's personality is the collection of all the behaviours and characteristics that make up that person. p. 144

personal selling: involves the activities of a sales representative directed to a customer in an attempt to make a sale. p. 227

physical distribution: is all those activities concerned with the efficient movement of the products from the producer to the customer. p. 238

physical evidence: refers to the environment in which the service will be delivered. It also includes the location of where the service is being provided and the materials needed to carry out the service such as signage, brochures, business cards, business logo and website. p. 242

pickets: are protests that take place outside the workplace, generally associated with a strike. Unionists stop the delivery of goods and try to stop the entry of non-union labour into the workplace. p. 485

place or **distribution:** are activities that make the products available to customers when and where they want to purchase them. p. 236

placement: involves locating the employee in a position that best utilises the skills of the individual to meet the needs of the business. p. 440

podcasting: involves the distribution of digital audio or video files over the internet. p. 247

precautionary principle: the precautionary principle requires that, where environmental impacts are uncertain, a business undertake actions that are most likely to cause least environmental impact. p. 35

premium: a premium is a gift that a business offers the customer in return for using the product. p. 229

prestige or **premium pricing:** is a pricing strategy where a high price is charged to give the product an aura of quality and status. p. 222

price: refers to the amount of money a customer is prepared to offer in exchange for a product. p. 218

price discrimination: is the setting of different prices for a product in separate markets. p. 152

price leader: a price leader is a major business in an industry whose pricing decisions heavily influence the pricing decisions of its competitors. p. 220

price penetration: occurs when a business charges the lowest price possible for a product or service so as to achieve a large market share. p. 221

price points: (or price lining) is selling products only at certain predetermined prices. p. 221

price skimming: occurs when a business charges the highest possible price for the product during the introduction stage of its life cycle. p. 220

primary data: are the facts and figures collected from original sources for the purpose of the specific research problem. p.179

primary markets: deal with the new issue of debt instruments by the borrower of funds. p.285

primary target market: the primary target market is the market segment at which most of the marketing resources are directed. p.187

private or house brand: a private or house brand is one that is owned by a retailer or wholesaler. p.213

process layout: the process layout is the arrangement of machines so that the machines and equipment are grouped together by the function (or process) they perform. p.63

process production: deals with high-variety, low-volume production. p.63

processes: refers to the flow of activities that a business will follow in its delivery of a service. p.242

product deletion: is the elimination of some lines of products. p.197

product differentiation: means distinguishing products (goods or services) in some way from those of competitors. p.13

product layout: is where the equipment arrangement relates to the sequence of tasks performed in manufacturing a product. p.64

product life cycle: the product life cycle consists of the stages a product passes through introduction, growth, maturity and decline. p.172

product mix: is the total range of products offered by a business. p.184

product placement: is the inclusion of advertising in entertainment. p.158

product production: (mass production) is characterised by the manufacturing of a high volume of constant quality goods. p.64

product utility: is defined as the usefulness and value that a product has from the consumer's point of view. p.82

product/service differentiation: in its broadest sense, is the process of developing and promoting differences between the business's products or services and those of its competitors. p.205

product/service positioning: refers to the technique in which marketers try to create an image or identity for a product compared with the image of competing products. p.207

production approach: the production approach focused businesses on the production of goods and services. p.130

products: are goods or services that can be offered in an exchange for the purpose of satisfying a need or want. p.210

profit centres: are those aspects of a business that directly derive revenue and profits. p.10

profit maximisation: occurs when there is maximum difference between the total revenue coming into the business and total costs being paid out. p.125

profitability: means the excess of revenue or income over expenses or costs. pp.20, 264

profitability management: involves the control of both the business's costs and its revenue. p.352

project budgets: relate to capital expenditure and research and development. p.294

project production: deals with layout requirements for large-scale, bulky activities such as the construction of bridges, ships, aircraft or buildings. p.64

promotion: describes the methods used by a business to inform, persuade and remind a target market about its products. p.224

promotion mix: is the various promotion methods a business uses in its promotional campaign. Methods include:

- advertising
- personal selling and relationship marketing
- sales promotions
- publicity and public relations. p.225

psychographic segmentation: is the process of dividing the total market according to personality characteristics, motives, opinions, socioeconomic group and lifestyles. p.203

psychological factors: are influences within an individual that affect his or her buying behaviour. p.143

public relations (PR): are those activities aimed at creating and maintaining favourable relations between a business and its customers. p.230

publicity: is any free news story about a business's products. p.230

puffery: is exaggerated praise or flattery, especially when used for promotional purposes that no reasonable person would take as factual. p.160

quality: may be understood to be a specific reference to how well designed, made and functional goods are, and the degree of competence with which services are organised and delivered. p.30

quality assurance (QA): involves the use of a system to ensure that set standards are achieved in production. p.104

quality control (QC): involves the use of inspections at various points in the production process to check for problems and defects. p.103

quality management: refers to those processes that a business undertakes to ensure consistency, reliability, safety and fitness of purpose of product. p.102

quality of conformance: is the focus on how well the product meets the standard of a prescribed design with certain specifications. p.76

raw materials: are the essential substances in their unprocessed state. p.47

reach: the reach of an advertisement measures the number of people exposed to the message. p. 249

receivables: are sums of money due to a business from customers to whom it has supplied goods or services. Receivables are recorded as accounts receivable. p. 344

record systems: are the mechanisms employed by a business to ensure that data are recorded and the information provided by record systems is accurate, reliable, efficient and accessible. p. 295

recruitment: is the process of locating and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies at the right cost. pp. 440, 465

redundancy and **retrenchment:** refers to employees losing their jobs, where the employees' job or work no longer needs to be done. It may be necessary due to a lack of work, as in the case of a fall in demand for a product or service, or the position may have been restructured or replaced by technology. pp. 108, 455

reference or **peer group:** a reference or peer group is a group of people with whom a person closely identifies, adopting their attitudes, values and beliefs. p. 146

relationship marketing: is the development of long-term and cost-effective relationships with individual customers. pp. 134, 228

remuneration: refers to both the financial (e.g. pay) and non-financial (e.g. career security) benefits that employees receive in return for their work effort. p. 477

resource market: consists of those individuals or groups that are engaged in all forms of primary production, including mining, agriculture, forestry and fishing. p. 137

robotics: are used in engineering and specialised areas of research, as well as on assembly lines where a programmable machine capable of doing several different tasks is required. p. 60

sale and lease-back: refers to the process of selling an owned asset to a lessor and then leasing the asset back through fixed payments for a specified period of time. p. 348

sales analysis: is the comparing of actual sales with forecast sales to determine the effectiveness of the marketing strategy. p. 195

sales approach: the sales approach emphasised selling because of increased competition. p. 131

sales promotion: is the use of activities or materials as direct inducements to customers. p. 229

scheduling: refers to the length of time activities take within the operations process. p. 56

secondary data: is information that has already been collected by some other person or organisation. p. 181

secondary markets: deal with the purchase and sale of existing securities. p. 285

secondary target market: a secondary target market is usually a smaller and less important market segment. p. 187

segmentation variable: a segmentation variable is the characteristics of individuals or groups that are used by marketing managers to divide a total market into segments. p. 202

self-image: an individual's self-image relates to how a person views himself or herself. p. 145

self-regulation: is a system by which a business or industry controls its own activities rather than being publicly regulated by an outside organisation such as the government. p. 166

self-service: means encouraging the customers to take the initiative to help themselves. p. 18

separation: is the process of employees leaving voluntarily or through dismissal or retrenchment processes. p. 438

sequencing: refers to the order in which activities in the operations process occur. p. 56

Six Sigma: is a quality management approach that seeks to identify and remove the causes of problems in the operations processes, achieving virtually defect-free production. p. 105

skills audit: is a formal process used to determine the present level of skilling and any skill shortfalls that need to be made up either through recruitment or training. p. 63

social class or **socioeconomic status:** refers to a person's relative rank in society, based on his or her education, income or occupation. p. 146

social justice: in the workplace involves businesses being responsible or behaving in a fair and ethical manner towards their employees, customers and the broader community. p. 395

social media advertising (SMA): is a form of online advertising using social media platforms such as Facebook, YouTube and Twitter to deliver targeted commercial messages to potential customers. p. 248

sociocultural influences: are forces exerted by other people and groups that affect an individual's buying behaviour. p. 145

solvency: is the extent to which the business can meet its financial commitments in the longer term (more than 12 months). pp. 265, 316

sourcing: refers to the purchasing of inputs for the transformation processes. p. 84

specific skills: are highly specialised and are required for some jobs within science, technology and engineering sectors. p. 469

speed: refers to the time it takes for the production and the operations process to respond to changes in market demand. p. 77

spot exchange rate: is the value of one currency in another currency on a particular day. p. 362

staff turnover: refers to the loss of employees by a business who leave for a variety of reasons. p.502

stakeholders: are any individual or group that has a common interest in or is affected by the actions of an organisation. p.384

standardisation: refers to the making of products that are homogeneous or identical. p.13

standardised approach: a standardised approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are the same the world over. p.253

standardised goods: are those that are mass produced, usually on an assembly line. Standardised goods are uniform in quality and meet a predetermined level of quality. These are generally produced with a production focus. p.15

standardised pricing: is the practice of charging customers the same price for a product anywhere in the world. p.255

statistical interpretation analysis: is the process of focusing on the data that represents average, typical or deviations from typical patterns. p.181

statutes: are laws made by federal and state parliaments; for example, laws relating to employment conditions. p.390

storage: involves finding a secure place to hold stock until it is required. p.87

strategic: refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of the business. pp.8, 125

strategic plan: encompasses the strategies that a business will use to achieve its long-term goals. p.263

strategies: are the actions that a business takes to achieve specific goals. p.122

strategy: refers to long-term, broad aims affecting all key business areas; that is, the strategic role of each key business function involves the managers of each function contributing to the strategic direction or strategic plan of the business. p.263

strikes: refer to situations in which workers withdraw their labour. p.484

structural change: refers to a change in the nature and pattern of production of goods and services within an economy. This includes a significant growth in the level of services in an economy compared to other sectors. p.426

subsidiary: a company that is owned by another company (referred to as the parent) and it is often located in another country. p.482

sugging: selling **u**nder the **g**uise of a **s**urvey, is a sales technique disguised as market research. p.166

superannuation: is a scheme set up by the federal government, which requires all employers to make a financial contribution to a fund which will provide benefits to an employee when they retire. p.282

supply: is the quantity of a product businesses are willing to offer for sale at a particular price. p.219

supply chain: refers to the range of suppliers a business has and the nature of its relationship with those suppliers. p.27

supply chain management (SCM): involves integrating and managing the flow of supplies throughout the inputs, transformation processes (throughput and value adding) and outputs in order to best meet the needs of customers. p.84

survey: conducting a survey means gathering data by asking or interviewing people. p.179

SWOT analysis: involves the identification and analysis of the internal strengths and weaknesses of the business, and the opportunities in, and threats from, the external environment. p.171

target market: is a group of present and potential customers to which a business intends to sell its product. p.187

tariff: is a tax on an imported product. p.255

task design: involves classifying job activities in ways that make it easy for an employee to successfully perform and complete the task. p.62

technology: may be defined as the design, construction and/or application of innovative devices, methods and machinery upon operations processes. p.28

telecommute: to 'commute', or travel to work, electronically. This means that home or another location becomes the worksite and work is delivered via email or the internet. p.59

total product concept: refers to the tangible and intangible benefits (attributes) a product possesses. p.210

total quality management (TQM): focuses on managing the total business to deliver quality to customers. p.106

trade unions: are organisations formed by employees in an industry, trade or occupation to represent them in efforts to improve wages and working conditions of their members. p.387

trademark: signifies that the brand name or symbol is registered and the business has exclusive right of use. p.212

training: aims to develop skills, knowledge and attitudes that lead to superior work performance. p.472

transformation: the conversion of inputs (resources) into outputs (goods and services). pp.4, 51

transformed resources: are those inputs that are changed or converted in the operations process. p.47

transforming resources: are those inputs that carry out the transformation process. p.48

transnational corporation (TNC): any business that has production facilities in two or more countries and that operates on a worldwide scale. p. 252

triple bottom line: refers to the financial profitability, social impact and the environmental impact of a business. p. 36

unconscionable conduct: any practice by a business that is not reasonable and often illegal. p. 150

unfair dismissal: occurs where an employee is dismissed by their employer and they believe the action is harsh, unreasonable or unjust. p. 457

unsecured note: an unsecured note is a loan from investors for a set period of time. Unsecured notes are not secured against the business's assets. p. 275

value adding: is the creation of extra or added value as inputs are transformed into outputs. p. 4

value for money: is the desire to obtain the best quality, features and performance for a given price of a product. p. 205

variable costs: are those that vary in direct relationship to the levels of operating activity or production in a business. Such costs include labour costs and costs of energy. pp. 31, 352

volume: refers to how much of a product is made. p. 52

warehousing: is defined as the use of warehouses for the storage, protection and, later, distribution of stock. p. 88

warranty: a warranty is a promise made by a business that they will correct any defects in the goods they produce or services they deliver. pp. 71, 155

word-of-mouth communication: occurs when people influence each other during conversations. p. 233

workers' compensation: provides a range of benefits to an employee suffering from an injury or disease related to their work. It is also provided to families of injured employees when the injury/disease was caused by, or related to, their work. p. 414

working capital: is the funds available for the short-term financial commitments of a business. p. 341

working capital management: is determining the best mix of current assets and current liabilities needed to achieve the objectives of the business. p. 342

workplace bullying: is a form of harassment involving unwelcome and uninvited behaviour that is offensive to 'reasonable' people. The more noticeable forms of workplace bullying are intimidation, humiliation, verbal abuse, pushing, touching, fondling or threatened and actual acts of violence. p. 453

workstations: are the desk areas required by office workers, usually fitted with access to a computer monitor, keyboard, telephone, mouse and mouse pad, storage, and close access to a printer and scanner. p. 65

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Note: Entries in **bold type** in this index indicate businesses featured in Snapshots throughout this book.

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