Cambridge International College

Professional British Study and Training for Successful Careers

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SPECIAL SOFTCOPY STUDY & TRAINING COURSE ON

MANAGEMENT & BUSINESS

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SPECIAL SOFTCOPY
STUDY & TRAINING COURSE ON

MANAGEMENT & BUSINESS

CONTENTS

Introduction

* The content of this Course is provided free of charge, with the compliments of Cambridge International College (CIC).

* The content of this Course on 'Management & Business' is provided in SOFTCOPY only, as a pdf document.

* This CIC Course contains 10 Modules. Each Module has been specially selected from one of CIC's most popular International Diploma Programs.

* This Course will provide valuable knowledge and understanding across a wide range of management and business specialisations.

* This Course is intended to encourage you to continue studies with CIC and gain one or more of CIC's professional Diplomas in the subject(s) which you are most interested in.

* Any of your friends, family, colleagues or others may study the content of this Course free of charge, and any of them may apply to CIC to sit an Examination to gain the Certificate (see section below).

Sitting an Exam & Gaining a Certificate

If you wish to gain the CIC Certificate on Management & Business, you will need to pass an Examination which will be set on the content of the 10 Modules.

The Examination will consist of: (i) a short question and (ii) some multiple choice questions, for each of the 10 Modules. (*It is NOT compulsory to sit an Exam.*)

The Exam arrangement depends on whether you are in 'Group 1' or 'Group 2' of the two Groups described below:-

* You are in 'Group 1' if you are already officially enrolled by CIC for the Management & Business Course *because* you were enrolled for the Course AT THE SAME TIME that you were enrolled for a CIC International Program.

  If you are in Group 1, then: your Examination Paper on Management & Business will be sent to your Invigilator/Supervisor at the same time that your Exam for the CIC International Program you were enrolled for is sent to your Exam Invigilator/Supervisor.

* You are in 'Group 2' if you were NOT officially enrolled/registered by CIC for the FREE Management & Business Course AT THE SAME TIME that you enrolled for a CIC International Program.

  If you are in Group 2, then: you will need to follow the instructions on pages 186 & 187 so that arrangements can be made for you to sit an Examination Paper to gain the Certificate on Management & Business.

Study & Training Advice

The Modules in this Course should be studied, Module by Module, exactly as explained in the following Steps.

Each Module has been designed and written by specialists who have wide experience of teaching people in countries all over the world to become managers, executives, administrators, supervisors, sales and accounting personnel, successful business-people, and professionals in many other fields.

By studying in the way that CIC's experts recommend, you should be able to learn easily and enjoyably, and master the contents in a relatively short period of time - and then be able to sit the Examination with confidence.

STEP 1	Once you have read this Study & Training Guide fully and carefully, proceed to Module One and start to read it at your normal reading pace, without trying to memorise every topic covered or fact stated, but trying to get "the feel" of what is dealt with in the Module as a whole.
STEP 2	Start reading the Module again from the beginning, this time reading more slowly, paragraph by paragraph and section by section. Make brief notes of any points, sentences, paragraphs or sections which you feel need your further study, consideration or thought. Try to absorb and memorise all the important topics covered in the Module.
STEP 3	Start reading the Module again from its start, this time paying particular attention to - and if necessary studying more thoroughly - those parts which were the subject of your earlier notes. It is best that you do **not** pass on to other parts or topics until you are **certain** you fully understand and remember those parts you earlier noted as requiring your special attention. Try to fix everything taught firmly in your mind. **Note:** You may not wish to, or be able to, carry out Steps 1, 2 and 3 one after the other. You could, for instance, carry out Steps 1 and 2 and then take Step 3 after a break. These steps may be carried out over several days, weeks or months.
STEP 4	When you feel that you have fully understood and learned everything taught in the whole Module (and if necessary after a further careful read through it) repeat all steps for each of the next 9 Modules. Continue to revise the Modules, and review any notes you have taken, right up until you attempt the Examination.

Final note: If you wish to gain the CIC Certificate on Management & Business you will need to pass a short Examination which you must attempt under true Examination conditions and without any access to the Study Materials or any notes. Therefore, it will be best if you do follow our study advice for studying the content of the 10 Modules.

Module One

STARTING A BUSINESS:
FACTORS TO CONSIDER WHEN STARTING A BUSINESS AND WHEN TAKING OVER A BUSINESS

This Module is one of the 12 Modules from the CIC Diploma Program on:

Business Management & Administration

Introduction: This Program provides expert business skills and knowledge for efficiency, competence and profitability in business, industry and commerce. A business manager or administrator must be proficient in management, finance, accounting, human resource, purchasing, marketing, inventory, computers, communication and more - all of which this Program covers.

This Program trains existing and future managers to run businesses successfully; it is for anyone seeking administrative or managerial posts, running businesses, or who is in a managerial position.

	Business Management & Administration - Modules Summary
Module	**Module Title**
1	Planning and Forecasting, the Modern Business World, the Board of Directors
2	Capital and Financing Businesses, Sole Proprietors, Partnerships, Companies
3	**Factors to Consider when Starting or Taking Over a Business, the Business Plan**
4	Business Organisation and Structure, Delegation, Communication in Management
5	Budgets and Budgeting, Sub-budgets and the Master Budget, Pricing Policy
6	Credit & Credit Control, Forms of Credit, Credit Risk, Types of Discounts
7	Human Resource Management, Recruitment, Induction, Personnel Policy
8	Stock and Inventory Control, Stocktaking, Principles of Purchasing, Suppliers
9	Sales Management, Marketing, Advertising and Publicity, Public Relations
10	Production Management, Production Methods, Industrial Administration
11	Financial Accounting, Bookkeeping, Final Accounts, Accounts Analysis
12	Office Organisation and Control, Computer Systems and Data Management

If you would like to study the complete Program and gain an international Diploma on **Business Management & Administration** you may do so by using the 'Special Offer' Enrolment Form on page 183

Henry Kramuel
wrote from **Vanuatu**:
"I thank CIC for the absolutely wonderful training on Business Management & Administration. CIC helped me a lot to achieve my goal as an officer in my country. I look forward to further CIC studies in management."

Daniel Musyoka Kavoi
wrote from **Kenya**:
"My CIC Diploma gained me entry to University in the UK, and thanks to CIC I gained a lot of experience in business and administration and I am now in charge of our transport division with 140 employees and 350 trucks across East Africa."

Module One

FACTORS TO BE CONSIDERED IN STARTING OR TAKING OVER A BUSINESS

The 'Business Plan'

The first matter to be decided upon when considering the establishment of a new business are its **objectives**: what it is going to do, and what it is hoped the new business will achieve. Once those objectives are clear, basic policies can be laid down to decide how those objectives will be achieved. It is important that adequate thought is given to objectives and basic policies and, if necessary, that full investigations and research are undertaken before final decisions are reached. If that is not done, the venture could be a costly one for the new businessman; furthermore, it might not be easy to change objectives or "direction" - or from one type of business to another - once operations have started.

Plans are considered as being the "routes to objectives", and it should be clear to you that plans have to be made in **advance** to show the best ways in which the objectives of a business will be achieved in practice, in the future. (Both **objectives** and **plans** are explained in more details in Module 1 of the Business Management & Administration Program). Plans are important in all aspects of business, and they are particularly important **before** a new business is established - and they should be set out in what is called a **'business plan'**.

Basically a business plan sets down in writing what a business should or will be, what it is intended to do and to achieve, and how it will go about achieving its objectives or "goals" in practice. Because a business plan is made in advance, it has to be based on **'forecasts'**: assessments of **future** events and factors, and how they might affect that particular business.

The modern business world is composed of a huge range of kinds and sizes of businesses, engaged in a very many different types of activities, and therefore there can be no set format for a business plan. However, these are general guidelines of what needs to be included:-

- What the **'objectives'** of the business will be:

  - Is it going to make or produce products - if so what?
  - Is it going to buy and sell products - if so what?
  - Is it going to provide a service - if so what?

  In other words, the very "nature" of the business has to be stated.

- What **'activities'** the business will be involved in to achieve its agreed objectives; what actions will have to be taken, and in what manner those activities will be carried out or performed. For example, if the business will be involved in distribution, the business plan will have to make clear how and from whom goods will be purchased, to whom and by what method(s) of selling the goods will be resold.

- Who will **'run'** or manage the business, and/or work in it. The owner of the business might work alone, or have family-members to assist, or might have to employ one or more employees, or work with a "partner" (discussed in Module 2 of the Business Management & Administration Program). The experience, training, knowledge and skills of the owners/ partners and/or employees should be listed.

- From where the business will operate - its **'location'** - and the premises it will require: for example, a shop or store, office, workshop or factory, or other.

- What **'market'** there is for the products the business is going to make, produce, buy and sell or provide. By this we mean, who its customers or clients will be, and how many there are likely to be who are willing and able (who can afford) to pay for its products.

- What **'competition'** will have to be faced; that is, what other businesses there are making or producing or buying and selling or providing the same or similar products, especially in the same area, or "locality" or "vicinity".

* A **'funds forecast'** dealing with financial matters. These include how much money (capital) will be needed to establish the business; to buy machinery and equipment; to buy stocks of goods or materials or components; to rent or buy premises; to pay expenses, to attract customers, and to keep the business "running" until it earns sufficient income from its activities. Also, how much, if any, money is already available, how much will have to be "raised" from other sources, and what those sources are likely to be.

* A **'profits forecast'**, that is, an indication of how much profit the business is expected to **gain**, year by year for, say, three years ahead. The owner(s) of the business will have to "estimate" (to calculate roughly, but as accurately as possible) the amounts of income they expect the business to receive and the amounts of expenditure to be paid out, year by year.

There are many other matters which might need to be included in a business plan, and we mention some of them at the appropriate stages. If you think carefully about the major ones, which we have described above, you will realise why producing a business plan in advance is so valuable. Without it, important matters might be overlooked, leading to problems and difficulties in the future. Without a plan, actions might be taken and decisions might be taken in a haphazard or badly thought-out way, which can easily result in disaster.

A business plan must be fair, honest and reasonable, stating the "plain" facts, without any adverse factors being "hidden", and with no exaggeration, so it is possible to gain a good idea of whether or not a proposed business is a **'viable proposition'**, that is, whether or not it stands a good chance of being successful, and profitable. Business people, full of enthusiasm for a new business venture, might be tempted to exaggerate the "plus" factors, and to overlook or ignore "minus" factors, or the "downside". It is important to avoid that happening, because an inaccurate business plan can be **harmful** - and even worse than not having a plan at all!

Other people whose help a business person might need - a bank manager or an official of a government agency, for example - will be able to **'study'** the business plan, and see whether the proposed business has the potential for success. Such people will be experienced in dealing with "new" - or "start-up" - businesses, and will spot any weaknesses, and anything in a business plan which does not "ring true". That could count against a "new" business person, when in fact professional support, guidance and advice could be very valuable; so it is essential that a business plan gives a "true picture".

It is not possible for us to know what type of business you already run or work in, or hope to run or work in. However, in this Module we discuss important matters which might need to be considered in reaching decisions on objectives and basic policies and, indeed, on whether or not to start a particular type of business, or to start it in a particular location. Not all factors will necessarily apply to all types of businesses, and other - rather more specialised - factors might apply to certain types of businesses. We look first at factors which might concern new businesses, and then turn our attention to the buying - or "taking over" - of existing businesses.

Dangers of NOT producing a Business Plan

Business people should never be tempted to neglect the preparation of a business plan; it is **not** a waste of time - it is a valuable guide and business "tool". Let us demonstrate why.

You might already be aware that in some countries most businesses were at one time run mainly by just one race or by just one section of the community. With the granting of independence and/or the raising of the general standards of living and education, however, came better opportunities for wider cross-sections of citizens to own and run businesses. Unfortunately, many people started or took over existing businesses without having gained the necessary "business" training or experience, and often without sufficient capital. As a result, many of these "new" business people faced unexpected difficulties and hardships; many businesses did badly, lost money and had to be closed or sold.

Another result of the lack of "business" knowledge and experience was that large numbers of people started or took over businesses of the same or similar type, often selling similar - or even the same - products; very often in the same streets or general areas. That applied in particular to businesses which required only modest capital and little, if any, knowledge about the products to be sold. A particular example relates to shops selling ready-to-wear garments; in some towns very many were started and/or taken over, often in very close proximity to one another, and often with a number in the same short street, all trying to sell virtually identical garments.

What the owners of those businesses - because of lack of training or experience - did not understand, is that an increase in the number of “outlets” selling the same or similar products does NOT mean that there will be an increase in the numbers of customers who want, need or can afford to buy those products. On the contrary, in a particular area there is usually only a **limited** number of potential customers for specific types of products.

Therefore, the numerous clothing shops very soon found themselves in fierce **competition** with one another to try to gain the limited numbers of customers for themselves. To try to do that, they were forced to reduce their prices, often to uneconomic or unviable levels, to try to attract customers. In the end, of course, those owners of shops who had limited capital - and no reserves, or sources from which to obtain additional capital - or which because of the lack of experience or training ran their businesses badly, were forced to sell (if they could find any buyers) their businesses or simply close them down, often losing all their savings. To make matters worse, other people did not “learn” from the misfortunes; some of the unprofitable shops were bought or taken over, and the new owners all too often also failed to make them “pay” (to be profitable) and eventually lost both the businesses and their capital.

The foregoing - tragic, but unfortunately true - example illustrates clearly the necessity for new business people to consider very carefully the following factors - set out logically and clearly in a business plan - **before** venturing into business:-

★ Capital needed, capital available, and a reserve of capital against unforeseen happenings.

★ The market potential in a particular area, that is, the numbers of likely customers in it for the products to be produced and/or sold.

★ The existing competition in the area concerned, and the likelihood of having to face competition in the foreseeable future; competition will reduce the market potential or, at the very least, reduce the profitability of a business.

★ The knowledge, experience, skills and abilities possessed or available to provide a sound basis for business success.

We now examine each of those factors in greater detail.

Capital

This factor is discussed in Module 2 of the Business Management & Administration Program, and we point out that capital is needed not only to acquire the fixed assets (machinery, equipment, etc) and the current assets (stocks of goods or materials, etc) necessary for business operations, but also to pay all the necessary expenses which will be incurred until such time as the business is earning sufficient revenue to cover them.

Initial Capital

The initial capital required might not, in some cases, be large or have to be entirely in the form of actual money. For example, a new business person might already own land or a building from which to operate the business, or stocks of goods or raw materials, or machinery or equipment. Nevertheless, whatever the type of business **some** money will be needed, and not necessarily only at the time at which the new business is started or formed - it might be weeks or months after that time before sufficient income or revenue is received to enable the business to “pay its way”.

Consider the example of a bookshop (covered fully in Module 1 of the Business Management & Administration Program) and think about all the planning, and the actual work, which would be necessary to get that shop ready to stock books for sale and to “open its doors” to customers. The shop would probably have to be redecorated and alterations might be necessary before it is suitable for its new role (for example, partitions might have to be removed, or erected - to make an office, for example.) Shelving would have to be obtained and erected, other furniture - display cabinets or counters, etc, would also have to be bought and positioned, perhaps the floors would have to be carpeted or otherwise covered, and so on. In addition, sales documents and stationery would have to be designed and printed, staff would have to be engaged and trained (and paid), books would have to be ordered, and so on.

All the foregoing take time - and **money**. And all would have to be spent well **before** even the first book could be sold to earn revenue! For example, rent would have to be paid for the shop even whilst it was being decorated or altered. It is very rare that a new business can be established and start earning money - let alone a profit - at once. Therefore, an accurate funds forecast is essential and once that has been agreed the new businessman must be **sure** that sufficient capital is - or will be - available when it is needed.

The Need for a 'Reserve' of Capital

As well as before start-up, money will probably be required for some time after the business has commenced operations. That applies not only because of foreseen or budgeted factors, but possibly also due to unexpected "external" factors over which the business person has no control.

We outline in Module 1 of the Business Management & Administration Program, the problems in accurately forecasting sales; clearly any factors which decrease sales will have an adverse affect on the financial position of a business. Some can be anticipated in advance, and planned for, but others cannot be, and the consequences for businesses which have no reserves of capital to "fall back upon" can be severe. Examples of such factors include:-

- **Poor health**: if the owner or a key employee of a business falls ill or is injured, the business might have to shut for a while, or its activities might be seriously reduced. This applies in particular to a one-man business.

- **Loss of key personnel**: there might be many reasons why such people might leave the employ of a business unexpectedly or at short notice; reasons might not necessarily be dissatisfaction with the business, but might be because of ill health or an accident, pregnancy, death in the family, transport problems in getting to work, and others.

- **Strikes** by workers in other industries, for instance, those which manufacture the products sold by the business, or transport, etc, which could result in the business running "out of stocks" of goods or raw materials, and thus being unable to satisfy its customers' needs.

- **Political** upheavals or **natural disasters** (such as floods, storms, hurricanes, fire, earthquakes, volcanic eruption, etc) which can cause considerable disruptions.

- **Tax increases,** the imposition of or tightening up of **exchange control restrictions**, or i**mport restrictions**, etc.

- Other **government actions**, such as the "fixing" or the "pegging" at short notice of the prices of certain basic commodities or staple products, at levels which permit little profit to be made by manufacturers, wholesalers or retailers; or, in order to control "credit buying", interest rates might be increased, or the minimum sizes of deposits for hire purchase sales might be increased.

- Unexpected **competition** might have to be faced; the matter of competition is dealt with later in this Module.

It must be appreciated that even during periods when events over which the owner/manager of a business has no control disrupt or reduce or prevent trade, there will still usually be many **'overhead'** expenses which **still** have to be met. Examples include rent and rates, standing charges for water, electricity, telephone, salaries and/or wages of employees, and of course the owner/manager's own salary.

We therefore emphasise that a **'reserve'** of funds must be maintained - not necessarily in actual cash, but its availability at fairly short notice should the need arise - to see the business through "difficult times" caused by unexpected events.

Capital and the Ownership of a Business

Frequently there is a necessary link between capital and the **ownership** of a business. For example, a person might have a good idea for a new business, and might be confident of making a success of it, but might lack sufficient initial and operating capital to get it "off the ground". If other sources (such as banks, which are often very conservative about "new" ideas) fail, then the only option left might be to seek a partner, either in forming a business partnership firm, or who is prepared to purchase a reasonable proportion of the shares in a limited company. Perhaps two or more such people will have to be found.

The person who initiated the idea of the new business will no doubt want to retain **'control'** of it and reap the full benefits of his idea and of his investment of work, time and money in it. However, the other person(s) who invested money in the business will want a "say" in what is done with the money and will, of course, want to share in any profits made as the return on the capital invested. (The same might apply to partners who "invest" their skill, knowledge or work in a business, a matter which is discussed later in this Module.) It must therefore be accepted that in many cases, capital - or an insufficiency of it - might prevent a person venturing into business from being his or her “own boss”.

Importance of ‘Retaining Control’

In a situation where lack of capital (and/or knowledge, skill, experience or the time to manage a business adequately, or a combination of two or more of those factors) makes it necessary to “bring in” one or more persons, thought **must** be given to the type of business unit to be established and to the ownership of it. Some of the advantages and disadvantages of business partnership firms were discussed in Module 1; in general, despite the additional cost of formation or incorporation, a limited company might be the best option for the new business person.

One advantage of that course is that it might not be necessary to **‘issue’** the entire amount of the share capital of the new company at once. For example, Mr A is anxious to form a company to make and market a product which he has invented:

1. His funds forecast indicates that eventually the company will need capital of $500,000, of which $320,000 will be needed initially.

2. He can raise only approximately $160,000 himself, but he has secured the “backing” of a Mr B who, although not interested in running the business, likes the product and is prepared to invest $160,000 in the new company by purchasing shares to that value in it.

3. They proceed to form the company with a total **‘share capital’** of $500,000, made up of 50,000 shares of $10 each. Mr A is to be managing director, and Mr B will be a non-executive director.

In this case, to start with it is necessary for only 32,000 of the shares to be issued: 16,000 to Mr A for his $160,000, and 16,000 to Mr B for his like sum. The **‘issued share capital’** of the company is therefore $320,000, whilst its **‘unissued share capital’** is $180,000 (a total of $500,000). At a later date, if the company does well and needs more issued capital for expansion, it might be possible to sell some of the 18,000 unissued shares - so increasing the issued share capital - to other people or organizations, although by then Mr A might himself be able to afford to buy more.

In order to retain **control** or the **‘controlling interest’** in the company, Mr A needs to hold <u>more than 50% of the shares in it which have been issued at any time</u>. Control gives many advantages, and so it should NOT be given up without thought.

4. From the initial issue of shares, it would be best for Mr A if he could buy and hold 16,320 (51% of 32,000 issued) and let Mr B have 15,680.

5. But Mr B, who is “putting up” (investing) a large sum of money, and who will not be involved in actually running the business, might insist on having the full 16,000 (50%) so that there is “parity” between them; that is, a “50-50 partnership”.

Of course, if the situation was different and Mr A could not raise his $160,000, he might be forced to hold fewer shares than Mr B, who would then have control.

This matter has been dealt with at some length because it **is important**, and can often be even more so when there are three or more people - or “parties” - involved.

‘Hidden Dangers’ of the Lack of Control

Say, for instance, that Mr A could raise only $110,000, whilst Mr B agrees only to “match” him by also putting up only $110,000. In order to raise the full sum needed initially, they secure the backing of a Mr C, who agrees to put in the balance of $100,000, but who wishes to take no part in the running of the business apart from being a non-executive director.

Mr A might feel that he is secure because there is still more or less parity between the three “parties”, but that might **not** remain the case. Although as managing director he is in charge of the day to day running of the business, if Mr B and Mr C do not like what he is doing in any respect, they could - quite legally - “vote” against him at board meetings. They have between them 21,000 shares against his 11,000, and so they could “out vote” him and force him to take a course of action or to direct the company in a way he does not like. Worse still, they could - if they wanted to - at a “general meeting” of shareholders (in this case just the three of them) vote to replace him as managing director and put someone else in his place; Mr A might have **no** recourse in law, and could even be voted off the board of directors entirely!

Such "hidden dangers" in losing control of a business through lack of capital (or for some other reason) must **never** be overlooked. There might, of course, be no alternative in some cases to "surrendering" giving up) control, but the business person concerned should think long and hard before taking a step which might be irreversible. In such situations, it can be well worthwhile seeking the advice of a lawyer who specialises in company matters, or a business consultant. A mutually acceptable agreement between the parties might be possible, for example to allow the businessman to buy some or all of the shares held by the backer(s) - probably at a premium - at some future time.

Partnerships

From the foregoing, it might be felt that a business partnership firm, run under a mutually acceptable partnership agreement in writing, might be a better solution, and in some cases it might well be - provided the partners get on well together, trust each other and all "pull their weight".

However, it is important to note that in many cases a partner might wish to sell his "share" in a firm, or withdraw the capital he invested in it. When a partner "withdraws" from a firm (or a new partner is "admitted") the original firm **ceases** to exist. A **new** firm might be formed immediately by the remaining partner(s) - with or without the admission of one or more new partners - but there might still be problems and complications, particularly with replacing the capital withdrawn by the exiting partner.

Where money (capital) and control of a business are concerned, there is always the possibility of conflict arising. Wherever possible, likely problems should be anticipated in advance, and a comprehensive ***'partnership agreement'*** should be drawn up by an experienced lawyer, to cover all eventualities, and should be signed by all parties involved. (Note that in most countries there is usually a legal statute to govern many matters concerning business partnerships in the absence of a formal partnership agreement.)

Market Potential

By **'market'** we mean the numbers of potential customers in a particular area (which might be an entire country) **who are able** and who are likely **to be willing to buy** the products of a particular business. In this context the word **'able'** refers to the people who can afford to buy the products concerned, whilst **'willing'** refers to the people who want or need the products, or who can be persuaded to buy them, for example, by skilful advertising and publicity.

Sometimes there is a **'ready made'** market. For example, people in a small town or village might not at present be able to obtain easily certain products which are readily available in larger towns or cities, although they are willing and able to buy those products. What the businessman then has to decide, is whether the number of potential customers warrants the expense of establishing a business, and that might depend on whether there is likely to be a continuing - and preferably increasing - demand for what he hopes to sell. For example, if the customers are likely to be "one off" as might be the case for, say, domestic or electrical appliances, he might do very well to start with but he might soon run out of customers!

In other cases a **'demand'** for products has to be **created**. Potential customers might not be aware of the benefits to them of possessing or using certain products; they might not be aware that a particular product even exists, or that it is superior in any way to similar products with which they are already familiar. A good example was the rise in popularity of compact discs (CDs). When they were first introduced "onto the market" few people bought them because they were sceptical about the superiority of the new products over the familiar record discs, the range of music available on the new discs was limited, and people were adverse to spending money on replacing their existing equipment with the new equipment necessary to play the compact discs. At that time, too, both the discs themselves and the players were expensive (in particular because of the high cost of research and development, and because relatively few of each type was being produced.)

However, skilful advertising and publicity, including frequent mention on radio programmes, together with a wider range of compact discs, gradually persuaded more and more people to buy the new discs and the equipment on which to play them. The increased demand in turn led to a reduction in the prices of both the compact discs and the players because:

(a) more manufacturers started producing them, some of whom did not have to "cover" the research and development costs involved, as they had been borne by the originators;

and
(b) because “mass production” techniques resulted in a lower cost per **‘unit’**.

The reductions in prices meant that more people could afford to buy the discs and players - particularly if credit terms, and especially hire purchase, were available on the latter - which in turn boosted sales, which in turn (coupled with increased competition) helped to reduce prices still further, which increased sales, and so on.

However, in the modern world of business things rarely “stand still”. Within a few years there were rapid technological developments which resulted in a new mp3 digital format for playing music. The mp3 digital format produces sound of an even higher quality than the sound produced from playing CDs. Through the mp3 digital media system, music can be purchased and downloaded directly from the Internet onto an mp3 player such as an iPod. An iPod is a portable hand-held device which allows the owner to listen to music stored on it, and which has the ability to store a huge number of music albums.

So the “marketing cycle” began again, with the manufacturers concerned needing to create - by skilful advertising and publicity - a **demand** for the latest equipment, and to persuade consumers to abandon their CD players in favour of the new products.

The high quality of the music available through mp3, the convenience of being able to purchase music tracks and albums online, and the simplicity and speed of the transfer of music over the Internet directly onto an iPod are all improvements on the music from CDs. These advantages, as well as the trendy “image” and the current “fashion” for having the latest electronic and musical products, are features “marketed” by the manufacturers and by the many shops and stores selling iPods keen to increase their sales income.

The examples given above are extremes, but they serve to illustrate the point that there is **no value** in making something or in trying to sell something for which there is little or no demand, or for which demand cannot be created.

Necessities and Luxuries

To a large extent, the demand for a product or a group of products might depend upon how it is regarded by potential customers, specifically whether it is looked upon by them as being: (a) a **necessity** or an **essential**, or (b) as a **luxury** or a **nonessential**.

Necessities

These are primarily products which consumers **need** to buy in order to keep themselves and their families alive and healthy - such products are **essential** to their lives and wellbeing. This group includes foodstuffs which form the “staple” diets of large proportions of the populations of various countries, for example rice in many countries in Asia, and yams and maize in different African countries; in other countries people consider reasonable quantities of meat, fish, salt, bread, sugar and various fruits and vegetables as necessary parts of their diets.

Reasonable clothing, appropriate to the climates of different countries, medical and dental services and education might also be classified as necessities or essentials.

Luxuries

Any products which consumers buy which are **not** strictly essential, but which add to the quality and comfort of life might by definition be classified as being nonessentials, and thus luxuries.

However, the demarcation line between necessities and luxuries is by no means a clear one, and varies considerably between community and community within countries, and also between different countries. Take for example a suit of clothes: to a peasant farmer it would be a luxury, but to a salesman in the same country a suit might be an essential as he could not perform his work successfully (and thus be able to afford to pay for necessities, and some luxuries) if he did not present a smart, well dressed appearance. Similarly, to the majority of housewives living in some countries electric cookers or refrigerators are considered great luxuries, whereas in other, more affluent or developed countries such items are regarded by the majority of housewives as being indispensable, and thus necessities.

As standards of living in a country rise, more and more products once regarded as luxuries become “accepted” as necessities by its population as a whole, or by sections of its population. From the point of view of a businessman, it can be said that a necessity is anything which a consumer buys in order to maintain himself and his family at the standard of living to which they have **become accustomed -** although that same product might be a luxury to other people. Whereas a luxury is anything that the **same** consumer buys which is designed to improve the quality of life and comfort still further (there are, of course, other motives for the purchase of luxuries by consumers.)

In general, necessities are products which people buy and use as a matter of course, and in the cases of real "basics" very little, if any, "salesmanship" is needed, because consumers know what they want and can afford, and simply ask a shop assistant for what they want or take it from the shelves of, say, a supermarket. When consumers have a **choice** of makes or brands of necessity items - and that is not always the case with all such products or in all countries - the selling task is for each manufacturer or producer (or the sales force employed) to persuade consumers to purchase **their** products rather than those of competitors.

Any product which a consumer does not need or have to buy but can afford to buy, must be regarded as a **luxury -** as far as that consumer is concerned. In general, demand has to be created for luxury products and people have to be persuaded to buy them. Therefore, it is with luxury products that the art and skill of salesmanship (see Module 9) are required, and indeed are vital.

When selling luxuries to consumers, it is important to remember that many potential customers have **limited incomes** and **budgets**. After they have spent or set aside sufficient money to pay for the necessities which they **must** have, they have only restricted sums of money "left over" with which to purchase products which - by them - are considered luxuries. Customers therefore frequently have to make a **choice** between the possibly wide range of products on which they can spend their limited resources.

Many people will have "priorities" and will know what they want or need to buy (although there might be competitive makes or brands for them to choose from) and it might require considerable selling skill to make them change their minds and buy different types of products. Other people might not have specific products in mind, but nevertheless will need considerable convincing of the benefits of products offered before they will part with hard-earned money. Yet other people might have decided to save what additional money they have, and again considerable persuasion might be necessary to get them to spend that money after all.

That very element of **choice** with luxuries (which might hardly exist, or not exist at all with necessities) is why skilful salesmen and salesmanship are vital. The managements of businesses selling products which are considered to be luxuries by some, if not all, of their prospects, must never forget that if they do not **satisfy** their prospects those prospects can choose not to buy from them, and can buy other products or similar products from competitive businesses.

(Note: We deal in detail with many topics related to Sales, Selling and Marketing in Module 9 of the Business Management & Administration Program.)

'Business Customers'

There is also a distinction between essential and nonessential products which are sold to enterprises (that is **'commercial customers'** or **'corporate customers'**) whether they are engaged in industrial, trading or service-providing activities. The demarcation line between essential and nonessential products is in some cases much clearer with such customers; for example, certain raw materials and components are essential for most manufacturers. Efficient services such as electricity, telecommunications, banking, transport, etc, are essential for the success of most enterprises, and adequate insurance cover is also essential if they are to be able to continue to operate in the event of losses due to fire, theft, flood, etc.

Although certain products might be essential to certain enterprises, there might be keen and fierce competition between those suppliers able to meet their requirements, and the larger the customer the larger the sizes of orders might be, calling for the greatest skills of experienced sales people.

Other products which might be sold to enterprises might not always be readily recognised as being essential or nonessential, and the classification will depend on the nature, activities and methods of operation of each enterprise. For example, a business which hopes to attract wealthy and discriminating clients and/or customers to its premises would find it essential to have those premises well appointed and furnished, possibly even luxuriously so. On the other hand, a business in a similar line but catering for less affluent clients/customers would find more utilitarian and everyday furnishings essential - as their clients or customers might feel ill at ease in luxurious surroundings with which they were not familiar.

Many types of modern office equipment, such as photocopiers, computer systems and printers, have become essentials in many enterprises, but there are still other enterprises which do not use them; either because they cannot afford the equipment or because their managements consider them nonessential to their operations.

Many of the factors explained in the foregoing paragraphs apply equally to both businesses and to the customers and prospective customers to whom they hope to sell the products with which they deal. A businessman, for example, might often be called upon to decide whether something offered to him by salesmen is essential or otherwise to the smooth and successful running of his business. Likewise, particularly when funds are in short supply, he will have to set priorities on what the business can spend its resources.

Market Research

To run a business without having reliable information about the market in which it is competing (or intends to compete in) could be compared to running in a hurdles race wearing a blindfold. It is therefore necessary to **'research'** the market before a new business is established, and at various times when circumstances, such as falling sales, dictate. Basically the process called **market research** seeks to provide answers to these kinds of questions:-

* How large is the market for the products of the business (or envisaged business) that is, what is the size of the demand for the products the business can supply?

* How does demand vary from area to area, and are there any common factors to account for the variations, for instance, are sales higher in towns than in country areas, or are the products purchased by higher income groups residing in suburban areas?

* What kinds of outlets are there in each area: are they mainly retail shops, department stores, offices, factories, builders' yards, etc?

* What "share" of the market has the business currently secured (or what share can it realistically hope to secure) and how does that compare with the shares of the largest competitors, and how can the business' share be increased in a profitable way?

Not all these questions apply to all businesses or to all types of products, and variations to the wording of "questions" might be necessary. But the answers obtained to the listed questions, and similar ones as appropriate, can provide very valuable - and often surprising - information for management, and can form the basis for planning and meaningful decision-making.

There are a number of methods which can be used to obtain the information required. The methods used, and the extent to which they will be used, depend largely on the type of a particular business (that is, whether it is involved in industrial, trading or service-providing activities), on its size or anticipated size, and on its range of activities. Some businesses might need to make use of one or both of the methods of research we now describe; established businesses might need to make use of other forms of market research, such as advertising research and test marketing.

Consumer Research

When a housewife goes shopping, she usually likes to compare the prices and qualities of the products she wants, or can afford to buy, in the shops/stores in her local shopping centre. If she is not satisfied with what she sees, and if there is no immediate need to buy what she has in mind, she might "put off" the purchase until a better selection is available. Or she might go to a larger shopping centre in the town, or even travel to a city where a far greater choice is available, sometimes at lower prices and, in some cases, of far better quality than she can buy locally.

The housewife is one of the millions of buyers classed under the name of ***'consumers'***. Consumers buy for a variety of reasons or **'motives'** (see Module 9 of the Business Management & Administration Program) and they will refrain from buying if the products are not up to their expectations in price or quality. Or, in the case of necessities, they might buy in reduced quantities until quality improves or prices become lower. A supplier must never forget: the consumer has a **choice**.

Consumer research is the part of market research which is applied to consumers. It is a systematic and careful investigation into the attitudes, actions and preferences of consumers. It might also include a specific question, the answer to which might greatly influence the future policy of the business. Differing opinions amongst directors of a company can lead to poor decisions being taken, but as a result of the replies given by consumers to the "key" question, a positive course of action might be indicated.

Marketing is concerned with the **creation of customers**, which means that a business has to make sales. To do that, its management must first find out **what buyers want.** But since buyers are people, their choices and preferences might vary to a certain degree, and for the sake of expediency a seller might decide to cater only for a certain section of the total market available; it might be more profitable to do so. In conducting consumer research, the researcher might have some or all of these “questions” on his or her questionnaire:-

Question	Seeking to discover
(1) Who uses the product?	Who buys the product. Their gender and marital status. Age group(s) - ‘demographics’. Whether for personal or family use. Their occupations and social classes. Places where it is sold: towns, villages.
(2) When is it used?	Time - morning, evening, anytime, etc.
(3) Why is the product purchased?	Comparison with competitors’ products in quality, style, design, size of pack and price.
(4) Where is the product bought?	Type of shop, small or large department store, supermarket, chemist, etc.

The questions must be skilfully prepared, and must be designed to attract the greatest volume of applicable information in the fewest number of words.

The people engaged in carrying out the research must be intelligent and businesslike in their approach. They must ensure that results are accurately recorded. Care must be taken to ensure that the survey covers a comprehensive cross-section of the community. The number of consumers interviewed can have a bearing on the reliability of the results obtained. If, for the sake of keeping costs to a minimum, only a small “sample” is taken, and a small area only is canvassed, the results could be misleading, and such an exercise would be a waste of time and money, and produce a mistrust of such methods of obtaining information in the future. On the other hand, the cost of interviewing an overlarge sample of consumers could outweigh the benefits the research is intended to provide.

Market Surveys

These seek **facts**: who sells the products (wholesalers, retailers, etc) and who buys them? A market survey is a systematic and careful **study of the buying and selling** done by wholesalers and/or retailers. The researcher in this case will attempt to find out total sales of similar products and the proportions sold of the various brands stocked, the levels of stocks carried of each brand, and the number of retailers who stock a particular brand as compared with other brands. It is also very useful to find out if a retailer “pushes” a particular brand in preference to any other and, if so, why. A careful analysis of the results of this survey, combined with the results of consumer research, could provide an insight into:-

- The size of the market.
- The strength of competitors and their relative positions and shares of the market.
- The structure of the market.
- Customers’ attitudes to the various brands available on the market.

The survey might also uncover marketing opportunities, both for existing products and for new products. By **‘marketing opportunity’** we mean a **consumer need** which is not at present being adequately met. To meet that “need” might require the modification of an existing product or the introduction of a new product which would provide a particular consumer benefit. This is another facet of market research of vital interest to marketing managers in particular. Once the opportunity is discovered, the “wheels of industry” can be set in motion to produce, package and promote sales of the new product. When the potential demand is great and the capability of competitors to make similar goods is also great, speed of decision and positive action are vital, because such competitors will strive to be first in the market.

Market research can be expensive to carry out, and unless the benefits derived from it are equal to, or greater than, the costs incurred, there would be little value in undertaking it. The increasing costs of running a business, together with greater competition, can lead to a serious fall in profits, and emphasises the need to make correct decisions, or to save the business from the worst affects of incorrect decisions already made. It is therefore of great importance that **as much information as possible** is gathered about the market, and about the needs of consumers.

Market research is needed because there are problems to be solved or questions to be answered. Having identified the problems or questions, management might have to decide whether the solutions or answers have to be found urgently, or very urgently, because in business all time is valuable. Management must then consider what is the probable cost of conducting the research, and whether the benefits arising from solving a particular problem or gaining a particular answer will increase profits, or whether the loss in profits that could be incurred by ignoring the problem or question would outweigh the cost of the research undertaken.

Let us remind you what the objectives are in any privately owned concern. The aim of shareholders or others who invest their money in a business is to gain a reasonable **'return'** on the amounts of money they invest. Shareholders appoint directors to make decisions and to formulate policies that will lead to attaining certain objectives, which are basically to ensure the efficient running of the business, and to ensure that it is run profitably. A manufacturing business will produce goods and strive to sell the maximum quantity possible at the minimum cost, to yield adequate profits and to satisfy buyers with price and quality. Because there might be many competitors with these same objectives, it is essential that the numbers, the needs, the preferences and the wishes of consumers and other potential customers are learned at a very early stage.

Similarly, businesses which buy the manufactured products for resale must be certain that they **can** sell them, relatively quickly, without too great expense and, of course, at a profit. The success of wholesalers and retailers in particular depends on their skill in buying the right products in the right quantities and at the right prices - and then being able to resell them quickly to their own customers. To be able to do that, they **must know** that there is a "market" for the products; not just some of those purchased, but **all** of them, because there is **no** profit in holding stocks of goods which cannot be sold or used.

That applies to every business, no matter how small it might be, and therefore some research, particularly **before** a new business is started, is essential. The information obtained from the research, however it is carried out, will form the basis for forecasting and planning. (At this stage you should read again the example of the manager of the footwear shop we gave in Module 1, noting the research, forecasting and planning that was undertaken.)

Competition

The potential market for the products or range of products a particular business hopes to manufacture and/or sell is very often limited or restricted by other - competitive - businesses making and/or selling the same or similar products. It is rare for a privately owned business to have a **'monopoly'**, that is, to be the only business able to supply particular products. Even if a business is the only one in, say, a small town or village selling a particular type of product, if customers are not satisfied with the brands (for example, with quality), prices or the service offered by the business, they might be able to buy the same or similar products in other towns or, increasingly in many countries, obtain them by mail-order or via the Internet; therefore, the business concerned still has **competition**.

It must be assumed that there is likely to be only a limited number of customers for certain types of products in a specific area. That number might be fairly "static", or might increase gradually as standards of living and incomes increase, or might decline due to economic factors, government intervention, etc. In other cases, in say a "tourist" area, the numbers of potential customers might fluctuate (go up and down) widely at different times or "seasons" of the year.

Whatever the situation, it can often be dangerous to start a new business in an area in which there are already a number of established businesses selling the same or similar products, or providing the same services. The new business would probably have to struggle hard to attract customers away from the established businesses, who have the advantage of "regular" customers. And the established businesses will fight hard to retain those customers, and to dissuade them from transferring their custom to the "new competition" (as the established businesses will consider the new one.)

In order to compete successfully with established businesses, the new one must be able to offer customers **something special or new**, or be able to give faster or more efficient service to customers, or be able to effect substantial savings for customers, such as by charging far lower prices. An obvious example, with which most people are familiar, is the supermarket or hypermarket. The range of products which a supermarket might sell is wide, and because it can buy in large quantities, has a rapid turnover and low operating costs, it can usually "undercut" the prices charged by smaller retail outlets.

The establishment of a supermarket in a small town can therefore seriously affect the profitability of established grocers, greengrocers, butchers, fishmongers, wines and spirit merchants, and other businesses in the town. Particularly if the new supermarket is a branch of a "chain" of such businesses, it might be prepared to operate deliberately at a loss to start with, by keeping prices artificially low, by making "special offers", etc, in order to attract customers quickly to it - and away from the established businesses in the town.

The "launch" of the new business might be supported by extensive advertising, publicity and sales promotion campaigns which are intended to attract the maximum number of customers to the new supermarket as quickly as possible. (Considerable market research would have been carried out to determine where to locate the store, what competition and "sales resistance", such as loyalty to particular shops, had to be overcome, what selling points to stress, for instance, dissatisfaction with existing high prices, lack of choice or variety, and so on.) The new business is therefore offering customers something new and different, and something beneficial to them.

Small wonder, then, that many small businesses buckle under the onslaught of such competition, and have to close or move to locations in which competition is not so severe. Of course, not all established businesses have to close; some can compete and survive by adapting their activities and by concentrating on providing "services" which the supermarket cannot, by its very nature, provide. Two particular areas are personal service and convenience.

Supermarkets (and other large chains of shops and stores) are "impersonal"; their staff cannot "get to know" their customers as can the staff of a small shop, cannot in the main cater for the personal likes and dislikes, preferences and circumstances of individuals;for example, have a chat, make special orders, make deliveries - and cannot always extend "credit" because they operate on a "cash and carry" basis. Furthermore, supermarkets are not always able to open at times to suit the convenience of some customers; a small shop, for example, might be able to open early in the mornings for the convenience of those on their way to work, and/or remain open late in the evenings for the convenience of customers returning from work; small businesses might also - depending on the trading laws of the country concerned - be able to open over the weekends.

Therefore, although many businesses have been put "out of business" by competition from larger - and usually more economically viable - enterprises, in many cases new businesses have actually been established to "fill the gap" left by the incursion of the larger enterprises and the disappearance of the former, more traditional businesses which previously served the customers. They can compete successfully, and prosper, because they, too, are offering customers something special and/or different.

The **'key'** factor, then, in the establishment of a new business is to try to find an "area" (not necessarily a physical one) in which there is market potential which is not adequately being catered for at present. That might mean the location of a business in a town, or a part of a town or city, in which there is little or no existing competition, or the manufacture (or import from another country) of a product or range of products for which a demand exists - or can be created - but which is not currently available to potential customers.

That might not be easy - successful business rarely is! - and might require considerable research to find the **right** area in which to concentrate, to give the best possible chance of success.

Future Competition

It is not only the size of existing competition which must be researched, but also what competition might be encountered **in the future**. For example, it could be disastrous to open up, say, a grocery shop in an area presently inadequately served, only to find out a few months later that a supermarket is opening in the vicinity.

Potential competition is not always as easy to assess as is existing competition, because if a business is obviously doing well in a particular area, other business people might try to follow suit; the very success of the original business can attract competitors. In some cases it might be possible to "sound out" the local business community about any other businesses intending to open in the area in the near future although, of course, some those business people might themselves be potential competitors, and so will not want to give away too much information. Visits to the local planning department or licencing authority might provide some information about future developments. It is always worth remembering, however, that if one person or organization has noted a good area in which to establish a business, others might have noted it too, and so there might often be an element of "risk".

Knowledge, Experience, Skills and Abilities

People have made a success of running businesses about which they have not had previous experience, but more often than not they fail, as in the true example given at the start of this Module. That is understandable, and really only to be expected, because every business or trade has its own peculiarities; the expression *"the tricks of the trade"* is very apt. If a person, or a group of people, has some prior knowledge or experience of a particular type of business, many of the "pitfalls" into which the inexperienced and unwary can fall (and in so doing incur losses) can be avoided.

Consider an example of a footwear or shoe shop (the full example is in Module 1 of the Business Management & Administration Program), and let us assume that a person without experience has decided to start such a business in an area which he considered to have good market potential. What problems is he likely to face because of his lack of experience, even if he has little competition? They are likely to include the following:-

(1) He might order too many or too few pairs of shoes, boots, sandals, etc, from manufacturers or wholesalers.

(2) What he does order might be of the wrong sizes, styles, colours or qualities.

(3) He might not place his orders at the right times to ensure deliveries of new stocks of the right footwear when they are needed.

(4) He would not know which manufacturers or wholesalers were the most reliable as regards deliveries; nor probably which offered the best trade and other discounts, and the best credit terms (explained fully in Module 6 of the Business Management & Administration Program).

Let us now look at those matters in greater detail:-

(1) If he orders too much stock - more than he can sell in a reasonable time - he will have money **'tied up'** in stock, money which he might need to finance the purchase of other items, or to meet the normal running expenses of the business. On the other hand, if he orders too small a stock he might lose customers and waste much of the money which he probably spent on advertising, etc, to attract them to the shop. It might be too late, or be difficult or to persuade them to return when he does eventually have sufficient stock.

(2) This is similar to the second point, above. He will lose customers if he does not have in stock what they want; they are likely to be annoyed that he does not have what they do want, and might go elsewhere for their requirements at once and in the future. Once a business gains a "bad reputation" (and "word soon gets about") it can be very difficult to restore a good image in the eyes of customers.

(3) If he places orders too late, stocks might not be available when they are needed; for instance, if he waited until the rainy/winter season started before he placed his orders for boots, etc, he would be too late to meet customers' needs. On the other hand, if he places orders too early, he will receive (and have to pay for) stock which he cannot yet sell (to recover what he paid) for some time; he might even have difficulty in storing the "excess" stock as well as the footwear which he needs at once - if he can afford to pay for both, that is.

(4) Obviously, if the suppliers he chooses are unreliable, he might run out of stock of needed footwear, or receive supplies after the demand for it has passed. If he does not get the most favourable terms, such as the highest discounts or the longest periods of credit, he might pay too much for stock, making his prices too high. He can lose sales because customers will not pay his prices and can buy the same or similar footwear elsewhere at lower prices.

No doubt in due course the owner will gain experience, but he might do so too late to prevent heavy losses, and by then he might not even be able to afford to keep the business going! Therefore, some experience of the type of business it is proposed to run is essential, whether by the owner of it or by other people who can be **relied** upon to provide sound advice and guidance, at least until the owner has gained sufficient experience for him/herself.

Clearly, if a person possesses skills, it would be best for him or her to establish a business in which those skills can be used and exploited. Such skills might be "practical" or "technical", cookery, painting & decorating, etc, or they might be skills in selling, administration, management, accounting, law, etc.

Alternatively, a person might have been able to gain knowledge, skill and experience from previous employment which allowed the opportunity to learn about the operations and peculiarities of certain types of businesses, and the manufacture and/or sale of certain types of products. Knowledge which might have been gained includes: from whom or from where to obtain supplies on the best terms; what types, sizes, qualities, etc, of products are in greatest demand; what prices customers are prepared or can afford to pay; what sizes of stocks must be held, when best to order them, and so on. Such knowledge can be vitally important when that person ventures into business, and could help him to avoid many pitfalls which can lose money.

If knowledge, experience, skills or abilities (or capital, of course) are lacking, it might be necessary for a person either:

(a) to seek a suitable partner or more than one; or (b) to employ skilled and/or experienced staff.

Let us consider both alternatives:

Partners

Why business partnerships are formed, and the possible advantages and disadvantages of them, were discussed in Module 1 and also earlier in this Module. A partner will, quite reasonably, expect a return from his investment of knowledge, or skill (and any capital invested, too) in the form of a share of any profits made by the business, in addition to being paid a salary. The business must therefore have the **potential**, eventually at least, to provide those benefits and make each partner's share of the profits worthwhile; the profit made by a business might be more than enough for just one person, but might be inadequate when divided between two or more partners.

Ideally, each new partner "introduced into" a business should be able to contribute sufficient to the success of the business so that the original partner(s), after the new distribution of profit, receives more than previously. Even with partners, it can be dangerous for a person to venture into a business about which he knows nothing at all; he should at least be able to run and control part of the business, and have a good idea what the other partner(s) is - or should be - doing.

'Key' Personnel

Problems can arise for a businessman who knows little or nothing at all about a business or what skilled and/or experienced personnel employed by it do - or should be doing. To rely too heavily on what are commonly called "key" personnel can be dangerous, because they could leave the employ of the business - for a variety of reasons, as explained earlier - at short notice, and it might be difficult to replace them. If the owner/manager cannot perform their work himself, or train others to do it, the business will suffer and might even collapse.

There is sometimes the possibility of hard working, skilled or experienced staff being "lured away" by competitors or potential competitors, which can be doubly serious for the business. Skilled and experienced staff often command high salaries, and those can seriously reduce a business' profits. Furthermore, if an employer does not have sufficient knowledge to be able to supervise his staff adequately, there is always a possibility that he will be cheated or defrauded; accounts of such happenings appear regularly in newspapers, etc.

The Location of Businesses

This is a matter which depends very much on the **type of business**, the **natures of the products** it is manufacturing and/or selling, the **type of market** in which it is hoped to compete, the **class of customers** which it is hoped to attract and what the owner(s) of a business can afford to spend. For those reasons no specific guidelines can be given; instead, we concentrate on "general" factors which **might** need to be considered. Factory location is looked at in Module 10 of the Business Management & Administration Program, and here we are concerned with trading, distributive and service-providing businesses.

* ***The Type of Business***

Many businesses depend for much of their trade on **'passers-by'** that is, people walking or driving past the premises from which the businesses operate; examples include shops and stores selling electrical appliances, clothing, footwear, books, jewellery, and many more. We say such businesses depend on **'passing-trade'**.

In order to attract the favourable attention of passers-by, such businesses need to have **attractive displays** of products for sale in their shop or showroom windows (a subject which is considered in Module 9 of the Business Management & Administration Program).) Such window displays are designed to appeal to the **eyes** of passers-by, to compel them to stop and look closer at items in the displays, to arouse their interest in those goods, and to encourage them to enter the shop, store or showroom and, hopefully, to buy. The majority of businesses which depend in full or in part on "passing-trade" need to be situated at ground level in busy streets or arcades or malls along which large numbers of people pass every day (where shopping centres or arcades or malls are constructed on more than one level, this type of business might be located on an upper level.) Businesses which depend on "passing-trade", would not be very successful if they were located, for example, in quiet "back streets".

Businesses which do **not** depend on "passing-trade" can often be located on upper storeys of buildings, or away from the hustle and bustle - and expense - of main thoroughfares or shopping precincts; there are, however, exceptions. Such businesses include those which provide **services** of one kind or another, such as insurance brokers, accountants, lawyers and other "professionals", artisans such as tailors, shoemakers, and hairdressers, and technicians such as those who repair electrical appliances, watches, radios and televisions, and so on. Provided they have built up good reputations, are not too inconveniently situated and, if necessary, carry out some advertising or publicity, their customers/clients will find them when the need arises for the products or services they provide. Exceptions include some travel agents and estate agents, banks and building societies which need to be centrally situated.

Wholesale businesses, which do not depend on passing trade (and which might not in any case be licensed to sell to the "general public") might be located in quieter areas. They do not generally need attractive - and expensive - shops or showrooms, but they probably need large areas of storage space, and good, uncongested access for vehicles delivering and collecting goods. Similarly, building merchants and timber merchants, for example, will often be located well away from the busy centres of towns where the large working areas they need are cheaper and easier of access (for road, rail or even water, as appropriate.) Businesses repairing and servicing motor vehicles might also be located on the outskirts of towns.

It is quite impossible to mention every type of business, but the examples we have given make it very clear that the type of business, and its range of activities, dictate the **general area** in which it needs to be located.

∗ *The Market*

In addition to existing or potential competition - which has already been discussed the "market" can be looked at from two aspects: (1) the **natures** of the products sold/services provided; (2) the **class** of customers/clients whom it is hoped to attract. Both aspects are closely related to the type of business, but they tend to "narrow down" the choice of location for a particular business. Let us consider each aspect.

(1) If, for example, a butchers shop or a greengrocers shop was to be established, it will need to be located in a busy place frequented by housewives; a market place or a busy shopping area with the least competition would be most suitable. There would be little value in locating such a business in an area frequented mainly by office workers or business people, no matter how busy that area might be, because such people would not be the most likely customers for the products of the business.

The types of businesses which could do better in such areas would be those which sold goods or provided services needed by people in them, that is **the market**; for example, businesses selling office equipment, stationery, printing, as well as travel agents, insurance agents, those providing business and professional, financial and secretarial services, employment or secretarial agencies, as well as cafés and restaurants and fast-food outlets, sandwich and coffee shops.

Clearly businesses such as newsagents, sandwich and burger bars, confectionaries, etc, whether large retail outlets or small kiosks, need to be located in the most busy places, frequented by people who want and will buy what is for sale; good examples are the foyers of large office blocks, cinemas, sports stadiums, etc, as appropriate to the types of products for sale.

When considering the **'nature'** of products, their qualities and prices (and whether they will be considered essentials or luxuries by potential customers) must be taken account of. That is because they relate directly to the class of customer to whom sales of those products, whether they are goods or services, are most likely to be made.

(2) The class - or financial status - of the majority of people who frequent an area should be carefully researched before deciding whether there is a market in that area for the types of products it is hoped to sell. For example, it would be unwise to locate businesses selling jewellery or expensive household appliances, furniture, televisions, DVD players, digital cameras, cosmetics and clothing (such as leather coats) in an area frequented mainly by people in low income brackets. Similarly, businesses selling inexpensive or second-hand clothing and other low-cost goods would have little or no markets in areas frequented by more affluent people.

In general - and there will be exceptions - businesses should be located in areas in which likely customers for their products live, work or otherwise frequent (for example, affluent women might frequent "fashionable" or exclusive shopping areas or stores rather than buying in their "local" shopping areas.) For instance, an office equipment business would stand the best chance of doing well if it was located in an office area, and would fare badly if located in a busy "general" shopping area; in this case, the correct location would enable potential customers, such as office and business managers, to visit the premises easily for demonstrations of equipment, and would ensure that salesmen and deliverymen paying calls on potential and existing customers, possibly carrying heavy pieces of equipment, would not have too far to go.

It must not be thought from the foregoing that it is always more profitable to sell expensive products than it is to sell lower cost products. In the first instance, the potential market might be quite small, although the profit on each "unit" sold might be quite high. In the second case the potential market might be much larger, but the "profit margin" per unit will probably be low. The profit made by a shop selling expensive, exclusive clothes might - taking into consideration the differences in their expenses - be very similar to one selling more modestly priced garments.

The exclusive shop, and other businesses and professionals hoping to attract wealthy customers/clients, will generally need to be located in better class (and expensive) buildings in "good" areas, and might need expensive, even luxurious, furnishings and decor, because that is what their customers/clients **expect**.

Less affluent people will not expect, or be able to afford, to visit businesses, doctors, lawyers, accountants, etc, in such buildings, and in fact they would probably feel very "out of place" and nervous in such surroundings; they usually prefer to visit places in which they feel "at home" or at ease, that is, places with which they are familiar. Businesses which are designed to "cater" for their needs might therefore be located in less expensive areas, and might require less costly, more utilitarian furnishings. (The rents of premises in main shopping areas are high, but that expenditure might be "spread" over large numbers of units of products sold.)

Special Facilities or Needs

Some businesses have special needs, or require special facilities, which might dictate the areas in which they have to be located, or limit the choice of areas. As already mentioned, some businesses rely on good access by road and/or rail for transport delivering or collecting their products. Others might need to be located near to an airport, or might have special fuel, power, water, electricity or communications requirements, and so on (the availability of labour, whether unskilled, semiskilled or skilled, in certain areas might have a bearing, particularly on manufacturing businesses.)

Some businesses might need parking facilities for customers; this factor might be important in attracting customers, or in deterring them if parking is not available. Space is often far too expensive in town areas to be allocated to parking, and so if a business cannot be located in the vicinity of a multistorey car park or a similar parking area, it might have to be located on the outskirts of the town, where land is available and is less expensive to buy or rent; hypermarkets, DIY and garden centres (see Module 1 of the Business Management & Administration Program) are good examples.

What Premises are Available, and the Cost to Rent or Buy

It might be fairly easy to reach a decision on where a particular business **should** be located for the best results, only to find that no suitable premises are available for sale or rent in the area selected. In addition, premises in the "best" or busiest areas are likely to be the most expensive to rent or buy. The combination of those two factors might necessitate the location of the business in a less suitable or desirable area; the cost of premises in it might be lower, but prospects for good and profitable business might be correspondingly lower.

You will, of course, be well aware that different types of businesses require different types of premises; examples include:-

★ Some businesses need shops or showrooms.
★ Some businesses need offices.
★ Some businesses need storehouses or stockyards, or warehouses or godowns.
★ Some businesses need factory sites.
★ Some businesses need a combination of two or more types of premises, for example a builders merchant might need a storehouse-cum-showroom, as well as a stockyard (for timber, building bricks, concrete products, etc) and also an office for management, clerical and sales staff.

Some businesses require premises at ground level, whilst others can be located on upper storeys of buildings. Some businesses need large premises; others might need only small areas, such as kiosks. There are many variations, but as far as is possible, within the limits of availability of premises and financial resources, the most suitable premises for a particular business should be selected.

However, it might very well be that the "new" business person might not be able to find exactly the right type and size of premises in the most suitable location, and at the right price. Very often a "compromise" has to be reached; that is, all the different factors have to be weighed up and set against each other in order of importance, and then a location selected that has as many of the "right" features as can be found or afforded, and with as few adverse or undesirable features as possible.

Business Models

A business model is a design for the successful operation of a business, identifying its revenue sources, its customer base, its products, and giving details of its financing. Typically a business model includes the business's purpose, its goals and its ongoing plans for achieving them. At its simplest, a business model is a specification describing how an enterprise fulfills its purpose. All business processes and policies are part of that model; the process of business model construction is part of *"business strategy".* A well designed business model should provide answers to the following questions:-

Who are our customers?

What do our customers value?

and

How do we deliver value at an appropriate cost?

A business model is similar to a business plan in its make-up and content. However, a *"business plan"* specifies only those elements which are necessary to demonstrate the feasibility of a prospective business to be established, whilst a *"business model"* demonstrates the elements that make an existing business work successfully.

A business model describes the rationale of how an enterprise creates, delivers, and captures value in economic, social, cultural or other contexts. The owner(s) of an existing business can create and use business models in assessing the current situation of the business and potential improvements which could be made to the business. However, business models are also valuable in assessing an existing business which is being considered for purchase and take-over, which is the subject of the remainder of this Module.

BUYING OR TAKING OVER AN EXISTING BUSINESS

There can be advantages in an individual, a group of people or an enterprise buying an **existing** business rather than starting a new one, and possibly having to compete with the existing one. There are many reasons why such action might be taken.

- One reason might be that the business is for sale just at the time a person or a group of people is considering establishing the same or similar type of business in the same general area.

- Another reason might be that an established business wants to "diversify" its activities - to broaden the range of its activities - either by venturing into a different type of activity (for example, you will recall in Module 1 we mentioned that a bookshop might also decide to sell or rent DVDs) or might want to use the business it is buying as a "branch" (see Module 4 of the Business Management & Administration Program).

- In other cases, the only way to secure the use of particular premises is to buy the business currently operating from it (whether the same type of business will continue to be run from those premises or whether they will be used for another purpose.)

You will no doubt be able to think of other reasons yourself.

The factors to be considered when deciding whether to buy or take over an existing business (and what type of business to buy or take over) include all those which have been discussed so far in this Module: capital, ownership, market potential, competition, experience and skills, etc, available whether an individual, a group of people or an enterprise is concerned with the purchase. We now look at additional factors which might have to be considered.

Why the Business is For Sale

There might be many different reasons why the owner(s) of a business wants, or needs, to sell it. Some reasons might be simple and straightforward, for example the owner(s) might be getting older and might want to retire and enjoy the fruits of their hard work in running the business, or they might be leaving the country or area of it, or might want a "change", and so on.

There might be other reasons, however, which the owner(s) of the business might not be too anxious to reveal because to do so might adversely affect the value of that business, that is, the amount for which it will be sold. It is essential for a potential purchaser to find out whether the reason(s) for sale given are genuine, or whether there is some "hidden" motive. For instance, the owner of the business might say that he wants to retire because he has done well out of the business but, in fact, the business might **not** have been doing as well as he claims. Alternatively, he might "know" something that he does not want to reveal, for instance that the establishment of a supermarket or some other large competitor in the area is planned.

No doubt the owner(s) will be able to produce ***'books of account'*** and other documentary evidence to support claims made about the volume of business being done and the profitability (or otherwise) of the business, including what are called ***'final accounts'*** covering one or more years. In Module 11 we look at the **'interpretation'**- or reading - of final accounts, but it is usually safer for inexperienced business people to consult an accountant for advice on whether those accounts give a true and accurate picture of the financial position of the business.

It should be remembered, too, that the final accounts give information about a **past** or **historical** position, and NOT the position as it is at the present time - in some cases the final accounts provided might be many months out of date. Even the bookkeeper or accountant for an enterprise considering the purchase of another business might not know exactly what to look for, and so management might still need to consult a firm of accountants (perhaps its auditors) which has experience in such matters.

It might be obvious that a business which is for sale has not been doing well. In such a case, it might be fairly inexpensive to buy; perhaps the owner(s) will accept a value which covers just the value of its stocks. Even then, unless there is some special reason (for instance if the premises are wanted rather than the business itself) for considering its purchase, it might be dangerous to buy it or take it over. The potential new owner(s) must be **certain** that they can "turn around" or reverse the trend of unprofitability and transform the business into a successful one.

Even a low purchase price will not compensate for the fact that the business is now unprofitable because, for instance, a supermarket has recently opened up nearby, or that a factory in the are has recently closed and customers are leaving the area. It must always be remembered that if there is **no market there will be no business** - unless a new market can be created.

The "vendor" (the person selling the business) might have knowledge which the potential purchasers might not have, for example, that competitors are moving into the area or because a nearby factory is closing, or that the authorities are planning developments in the area which might adversely affect trade. So they might want to sell the business before such events occur and result in a reduction in the value of the business.

Therefore, it is essential that prospective purchasers of businesses find out as much as possible about the area in which those businesses are situated, and about future events which might affect those businesses. A visit to the local chamber of commerce, trade office, or the town hall might provide valuable information, as might a talk with a local lawyer or business consultant. As much information as possible should be gathered about the "local scene" as it is currently, and as it might be in the foreseeable future, before serious consideration is given to the purchase of a business in that area.

The 'Asking Price' of the Business

The sum, or price, which the owner(s) of a business might initially ask is generally not the final sum which will be accepted for it; that will have to be arrived at, usually after negotiation. Obviously the vendor(s) of a business will want to be paid as much as possible; equally obviously the prospective purchaser(s) will want to pay as little as possible for it. It is therefore important to try to establish as closely as possible the **true value or worth** of a business, both to the current owner(s) and to the prospective purchaser(s). Generally the overall value of a particular business will be a combination of two main features:-

1. The agreed true value of its "unencumbered" assets (that is, assets which are not covered by HP or rental agreements or debentures, etc), less the value of its current liabilities.

2. Its particular ability to earn profits for its owner(s), and to keep on doing so.

The first feature is fairly straightforward, and the relevant values are likely to be calculated without too much difficulty, if detailed and accurate records of purchases (values and dates) and credit customers, etc, have been maintained. It should be agreed that the exact value of stocks will be ascertained at the date of sale by a detailed stocktaking and valuation (see Module 8) based on the **cost prices** of the various stock items, excluding any items which are obsolete or obsolescent and thus have little or no value.

Care might have to be taken in valuing plant, machinery, furniture and equipment, because their "book values" might be higher than their true "market values", perhaps because little or no charge against profits has been made for depreciation (see Module 2). In such cases an independent valuation of the assets concerned might be called for (in the same way as a person might go to an Automobile Association or a garage for assistance in deciding the value of a second-hand vehicle he is considering buying.)

The second feature might be more difficult to assess, and might arise from one or both of the following:-

(a) A business might possess special attributes which contribute in full or in part to its profitability, and which give it advantages over similar businesses. For example, it might own patents on certain inventions, or the copyright in certain publications, or it might have a concession or franchise (explained in Module 1) for the area. Or might have agreements or contracts with government or large customers, or might be the "sole agent" or "sole distributor" for certain products, whether manufactured within the country or imported from others.

Or, perhaps, a business might be located in a particularly advantageous position; to return to an earlier example, a bookshop located near a university or schools. The value placed on such special features might depend upon how long patents, copyrights, agreements, contracts, or even the lease on premises have to run, how far the special features have been exploited, what potential there is to exploit them further, and so on.

(b) A profitable business which has been established for some time has probably built up a good reputation, and probably has regular and satisfied customers - clientele - who will **continue** to deal with the business even when it is under new ownership. The new owner(s) should profit from the “ongoing” situation. The present owners of the business probably had to build up its reputation by hard work in providing satisfactory service, and might well have had to invest a good deal of money in advertising, etc, to attract and to retain customers - and their ***‘goodwill’***.

It is reasonable that a sum for the time, work and money invested in the business should be included in the “asking price” of the business, because the new owner(s) should gain the benefit of the goodwill created - provided that the same high standards are maintained. The difficulty is to decide just how much such an “intangible asset” is really worth. Various methods - based on the past performance of the business, as shown by its final accounts for 3 or 5 years or longer - can be used to arrive at a reasonable assessment of the value of the goodwill of a particular business. But as we have already stated, the value accepted by both the vendor(s) and the purchaser(s) might well be a compromise reached by negotiation.

In many cases the excess of the purchase price paid over the agreed total value of the assets of a business less its total liabilities is treated as **‘goodwill’**, however that excess is arrived at, and for whatever reason it is paid. Generally the matter of the valuation of goodwill does not arise until a business is to be sold or, in the case of a partnership, a partner leaves the firm or a new partner is admitted to it. If necessary, the advice of an accountant or a business consultant should be sought in deciding on a fair valuation of the goodwill (if any) of a particular business.

Other factors which might have a bearing on what price purchasers are prepared to pay for a particular business might include the following:-

1. How the price is to be paid. In some cases a vendor might insist on being paid the full price in one lump sum. In other cases, however, a vendor might be prepared to accept payment by “instalments”, perhaps over a number of months or even years; of course, a legal agreement would have to be entered into by all parties involved. In other cases, a vendor might accept a reasonable proportion of the purchase price at the time of sale, and enter into a legal agreement whereby a specified proportion of the profits made by the business during a certain number of future years will be paid “in lieu” (instead) of the balance of the agreed purchase price.

There are many other possibilities, particularly with a limited company, and they are often worth discussing with vendors by prospective purchasers whose finances are limited. Much will depend, of course, on how anxious a vendor is to sell his business, how badly he needs its full value at once, and what better offer he receives.

2. What assistance the vendor is prepared to offer the potential new owner(s). In some cases a vendor might be prepared to “stay on” with the business for a period - perhaps on a salary like a normal employee - to teach and guide the new owner(s) the running of the business. In the case of small companies, it is not uncommon for a former owner to agree to be employed - perhaps as a non-executive director - for a specified period as a “consultant” or an “adviser” to the new owner(s). Either situation can be an advantage to new owners who lack experience of running the type of business concerned.

The vendor is assured of an “income” for a certain period, so might be prepared to accept a lower price for the business; also, the salary or directors’ fees paid to him will be paid by the company (and charged against its profits) and so will not have to be paid by the new owner(s) personally. Whether a vendor will agree to such a proposal will depend on the same factors mentioned at the end of 1, above, and whether the vendor is willing, or able, to continue working.

3. Whether the vendor is prepared to enter into a legal agreement not to start or to be concerned with a competitive business in the same area (which might be a whole country) for a specified number of years after the sale of the business. This matter can be **very important** in some cases, and should **not** be overlooked. For example, a businessman might be well liked by his customers and if, after selling one business he starts another similar one (probably with the proceeds of the sale of the first one) in the same general area, his former customers might transfer their custom from his former business to the new one. Therefore, the new owners of the original one will have paid for goodwill which no longer exists! This does happen - so be warned!

For the foregoing reasons, and others, a formal **‘sale agreement’** should be drawn up by a lawyer. Usually the vendor’s lawyer draws up a “draft” agreement, and the prospective purchaser(s) should have it checked carefully by a different lawyer, who can advise on any matters not covered or inadequately covered, or which are against the best interests of his client. Negotiation between the lawyers, and a number of revised drafts, might be necessary before all parties are satisfied, and a final sale agreement is drawn up and signed by all parties involved. It is important that legal action can be taken if a party to the agreement is “in breach of” (breaks) any of the terms of the agreement.

Another matter which might need the attention of a lawyer is the **premises** from which a business operates. If the purchase price of the business includes the premises, a lawyer will be required to arrange the transfer of ownership of the building. But if a business operates from **'rented'** or **'leased'** premises, it is important that the **'lease'** - the agreement document which sets out the terms of the renting or leasing of the premises - is studied carefully, preferably by a lawyer. Particular points to which attention should be paid include:-

1. The ***'expiry date'*** of the lease - that is, the date on which it ends - and whether the ***'tenant'*** (the business renting the premises) has the right to renew the lease for a further period on its expiry and, if so, on what terms. The amount of the rent payable, and whether that rent has to be paid monthly, quarterly or longer in advance.

2. Whether the ***'landlord',*** that is, the owner of the building (or an appointed agent, such as an estate agent or a property manager) must give consent for a change of tenant and, if so, whether he will agree to the lease being transferred to the new owner(s) of the business; usually a lease states that such consent should "not be unreasonably withheld". (When the business is the tenant, a change of ownership of the business should not affect the lease, but it is best to check, and to inform the landlord of the change of ownership to avoid any later dispute.)

3. Whether there is provision for ***'rent reviews'*** or ***'rent revisions'*** at intervals during the ***'term'*** (the duration) of the lease and, if so, when they are due and on what they are based; such reviews usually involve increases in the rent that has to be paid. Rent reviews might be based on increases in the cost of living or on market value, or on some other generally accepted index, and in times of inflation and large rises in the cost of living, rent payable can jump substantially. It is therefore important to know when revisions are due and approximately by how much they will increase the rent payable, so that they can be planned for.

4. Whether the tenant has to pay anything **in addition** to the rent. In some countries there are separate municipal or other rates which have to be paid by tenants and by the owner of the building; it is not unknown for landlords to try to make tenants pay both types. In some cases landlords try to make tenants pay towards the cost of insuring the building concerned, which is not really the tenants' responsibility (tenants should, of course, insure their stocks, furniture, equipment, etc, housed in the building, against fire, theft and so on, and also against injury to their employees whilst on the premises, and against "public liability", that is, injury suffered by visitors to the premises rented.)

Another "hidden extra" in a lease might require a tenant to contribute towards the repainting or redecoration of the building which, like the other provisions mentioned, can greatly increase - sometimes unexpectedly - the cost of operating from particular premises, and can cut deeply into profits.

It is bound to be exciting for a new business person when getting close to securing his or her "first" business premises. However, it is always wise not to rush into signing a lease. A leasing agreement should not be accepted and signed unless everything in it is clearly understood by the intending tenant, and the cost implications have been considered. Once the leasing document has been signed, it might be too late to ask for clarification, and "hidden charges" can seriously hamper the establishment and development of a business.

People who are considering establishing new businesses - or relocating existing businesses to new premises - might also have to operate from rented premises, and therefore the matters we have discussed above relating to renting and leases apply equally to them. The wording of some leases can be vague (sometimes deliberately so) and therefore inexperienced business people, in particular, might find it well worth the little additional expense of consulting a lawyer before signing a lease or accepting the transfer of one.

A Warning on Renting

For many business people there is no alternative but to rent (or lease) premises. In all cases, however, it can be very **dangerous** to operate or run a business from rented premises **without having** a proper, legal lease. Premises might sometimes be offered for rent on a "monthly basis", which means that the landlord could legally give a tenant "one month's notice" (or less) to "vacate", to leave, the premises. If a landlord did that, and other suitable premises could not be found quickly, a business could be ruined.

Therefore, a business person should not rent or lease premises without having a proper signed leasing agreement which is legally binding on both (or all) parties, the terms and conditions of which are clearly understood.

Module Two

PRICE ELASTICITY OF DEMAND, CHANGES IN REVENUES, MARKET STRUCTURES, PRICING STRATEGY

This Module is one of the 12 Modules from the CIC Diploma Program on:

Business Economics & Commerce

Introduction: Economics explains about demand, consumer choice, supply, and factors affecting them; it covers production, prices and pricing strategy to help managers successfully guide their enterprises. Commerce focuses on how the business environment works: marketing, transport, distribution, import, export, banking, credit, insurance, profit, turnover, finance and more.

This unique Program is vital for business people and personnel who need to understand and analyse their business environment, and who want to develop profitable, successful organizations.

	Business Economics & Commerce - Modules Summary
Module	**Module Title**
1	Economic Systems and Activities; Needs, Utility, Factors of Production, Labour, Money
2	Demand & Supply, Curves, Markets, Equilibrium Price & Quantity, Factors Affecting Demand
3	Commerce, Goods, Services, Enterprise, Business Environment, Business Capital
4	**Price Elasticity of Demand, Changes in Revenues, Market Structures, Pricing Strategy**
5	Channels of Distribution, Wholesalers and Retailers; Credit in Business; Discounts
6	Commercial Documents: Types, Purposes, Information, Preparation
7	Consumer Choice, Budgets, Budget Lines, Indifference Curves, Cross Price Elasticity
8	Profit, Turnover, Capital, Entrepreneurship, Costs and Selling Prices, Distributions
9	Business Finance, Financial Statements, Overtrading, Business Performance
10	Production Management, Economies of Scale; Government Involvement in Commerce, Tax
11	Commercial Services, Banking, Bank Services, Lending, Interest, Insurance, Risk
12	Transport, Communications, Advertising, Sales Promotions, Import, Export, Currency

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Emmanuel James
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Module Two

PRICE, DEMAND AND ELASTICITY

The Price Elasticity of Demand

We use demand curves to show how the price charged for a product affects the quantity demanded of that product (explained in Module 2 of the Business Economics & Commerce Diploma Program).

Price elasticity of demand is a measurement of *how much* the quantity demanded *changes* in response to a small change in the price charged for a product.

The measurement - the calculation - of the price elasticity of demand (sometimes called the *own price elasticity of demand*) for a product is defined as:

✱ ***The percentage change in the quantity demanded divided by the corresponding percentage change in price.***

That is:

✱ Price Elasticity of Demand = $\dfrac{\text{change in quantity demanded (\%)}}{\text{change in price (\%)}}$

The price elasticity of demand can be a "key" piece of information in deciding what price to charge for a particular product or service. For example, let us say that certain suppliers of bags of tea at the moment supply at the price of $5 per bag, and find that they have excess (surplus) supplies of bags of tea left unsold.

In Fig.4/1 we see that at a price of $5 per bag, 10 thousand bags of tea are demanded. The suppliers concerned want to know if the current price should be kept as it is, or whether the price charged should be increased or decreased. The price elasticity of demand will help to answer that question.

Calculating the Price Elasticity of Demand

Read the definition of price elasticity of demand again, and then study carefully Fig.4/1. To measure the *responsiveness* of the quantity demanded to changes in the price charged for bags of tea we will look at price changes in units of $1 and calculate the price elasticity of demand *at each price*. Let us begin at the current price of $5 and consider the effect on quantity demanded of a price **cut** - or decrease - from $5 to $4, as shown in Fig.4/1.

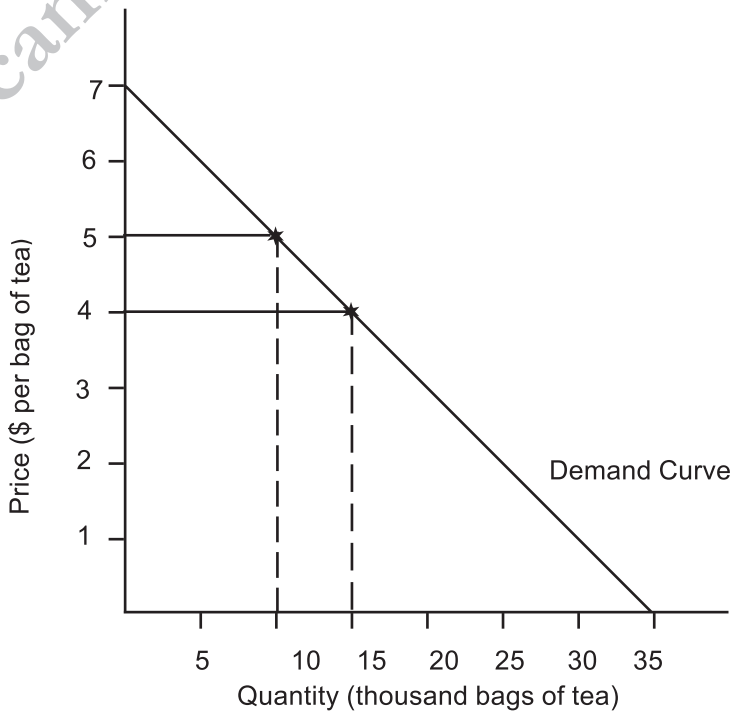


Fig.4/1. A Decrease in Price from $5 to $4 per bag of tea.

The "price cut" illustrated in Fig.4/1 results in:-

- a price *change* of minus one fifth, which is -20%, of the original price. That is calculated as follows: $5 less $4, divided by the original price of $5. Numerically that is: (5-4) ÷ 5, which comes to 1/5. As a percentage, 1/5 is 20%, and it will be **negative** because the price has **DE**creased;

and

- a corresponding change in quantity demanded from 10,000 to 15,000 bags of tea, which is an **IN**crease in demand of 50%.

The demand elasticity of a change from $5 to $4 per bag of tea is thus fifty percent (the **positive** change in quantity) divided by -20 per cent (the **negative** change in price). Numerically, that is (50/-20) = -2.5.

Work out for yourself what the price elasticity of demand for a *reduction* in the price from $6 to $5 would be. Then work out the price elasticity of demand for an *increase* in price from $2 to $3. Do your **own** calculations and then compare them with our workings below.

The price elasticity of demand is **always** a ***negative*** number. That is because either:

- A positive percentage change in quantity demanded (a quantity rise) is being divided by a negative percentage change in price (a price fall),

OR

- A negative percentage change in quantity (a fall in quantity demanded) is being divided by a positive percentage change in price (a price rise).

Workings

- To calculate the price elasticity of demand when the price is reduced from $6 to $5, we divide the change in quantity demanded of 100% (100% of 5,000 bags is 5,000 bags) by the change in price of -16.67% (-1/6 of original price). Thus the price elasticity of demand is 100% divided by -16.67%, which equals **-6**.

- To calculate the price elasticity of demand when the price is increased from $2 to $3 we divide the change in quantity demanded of -20% by the change in price of 50%. Therefore the price elasticity of demand is -20% divided by 50%, which equals **-0.4**.

When considering a certain change in price from the current price, the price elasticity of demand will be the **same** whether we reduce or increase the current price. For instance, calculate the price elasticity of demand for an upwards change in price from $5 to $6. Your answer should be the same as for a downwards change from $5 to $4.

Fig.4/2. A Table of Calculated Price Elasticity of Demand for Bags of Tea

Price ($) per bag	***Quantity demanded***	***Price elasticity of demand***
6	5,000	-6.00
5	10,000	-2.50
4	15,000	-1.32
3	20,000	-0.76
2	25,000	-0.40
1	30,000	-0.17

Characteristics of the Price Elasticity of Demand

The price elasticity of demand falls as we move 'down' the demand curve from higher prices to lower prices.

- When the price elasticity of demand is high (when it is a large number, such as -6 or -2.5) the *quantity demanded* of a product is very sensitive to changes in the price charged. As in our example, that is because at high prices $1 is a *relatively* small *percentage* change in price, but 5,000 bags is a *relatively* large *percentage* change in the quantity demanded.

- When the price elasticity of demand is low (a small number) the quantity demanded is relatively insensitive to changes in price, as at low prices $1 is a relatively large *percentage* change in price but 5,000 bags is a relatively smaller *percentage* change in the quantity demanded.

Elastic and Inelastic Demand

- Demand is said to be *elastic* if the price elasticity is more negative than -1 (such as -6 or -2.5).
- Demand is said to be *inelastic* if the price elasticity lies between -1 and 0.
- If the demand elasticity is exactly -1 then demand is *unit-elastic*.

Using Elasticity to Consider Changes in Price

There are some important implications to the concept of price elasticity of demand, which are to do with the revenue (income) that results from a price increase or decrease.

- A "cut" - or decrease - in prices **raises** revenue if demand is elastic, but lowers revenue if demand is inelastic.
- A "rise" - or increase - in prices **lowers** revenue if demand is elastic, but raises revenue if demand is inelastic.

Whether or not demand is elastic is a **key piece of information** required by business people in setting the price of goods, as we shall see further.

Price, Quantity Demanded and Total Income (sales revenue)

As long as other factors remain constant, the demand curve will show the quantity demanded at each possible price of the product. Therefore, the total amount spent by purchasers (that is, the income received by suppliers) can be calculated as:

- *The price of the product multiplied by the amount sold at that price.*

Let us look again at the market for bags of tea. We expect that a **de**crease in price from $6 to $5 will lead to an **in**crease in quantity demanded and an **in**crease in the **total** amount spent by purchasers (and thus increase the income received by suppliers). We expect this because that price decrease takes place in the price range where the price elasticity is more negative than -1 (calculated earlier, and shown in Fig.4/2).

Fig.4/3. tables the revenue earned by suppliers at various prices of bags of tea. At a price of $6 we see that total income was $30,000 ($6 x 5 thousand bags) but at a price of $5 the income or amount spent by consumers has increased to $50,000 ($5 x 10 thousand bags) - an overall increase in sales value of $20,000. This confirms that in the elastic price range, a small cut in prices is more than compensated for by the increase in the quantity demanded.

Fig.4/3. Relationship between Price Elasticity of Demand and Total Revenue

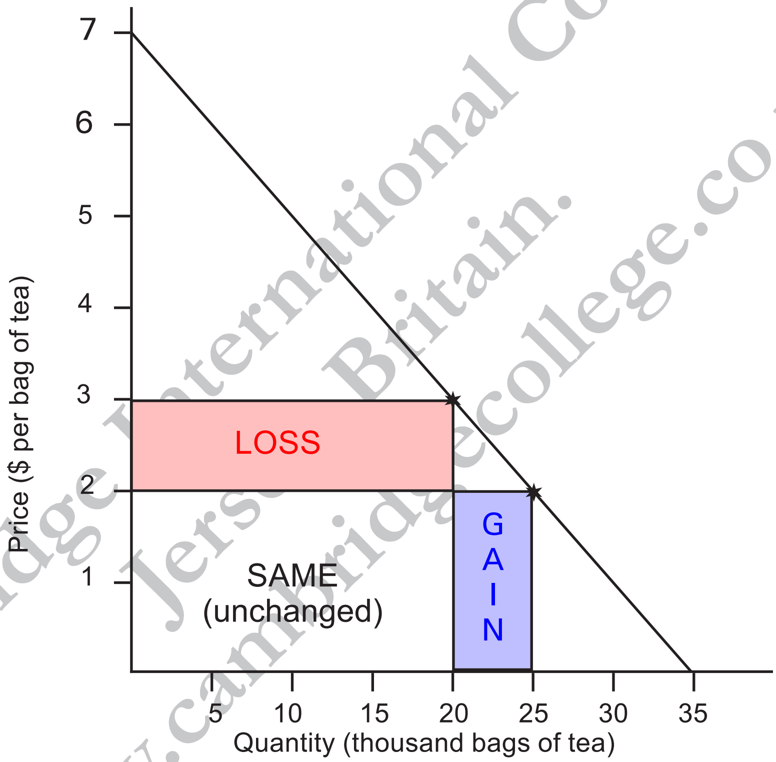
Price ($) per bag	*Quantity Demanded*	*Price Elasticity of Demand*	*Total Revenue($)*
6	5,000	-6.00	30,000
5	10,000	-2.50	50,000
4	15,000	-1.32	60,000
3.5	17,500	-1.00	61,250
3	20,000	-0.76	60,000
2	25,000	-0.40	50,000
1	30,000	-0.17	30,000

What would you expect the result to be if price was reduced from $3 to $2? The price elasticity of demand for that reduction in price is -0.76 (approximately), which we know is *inelastic*, and we would therefore expect income to **de**crease. Check this for yourself.

Fig.4/4. illustrates graphically what would happen to income if the price was decreased from $3 to $2. The boxed area marked SAME represents the income that will be earned whether the price is $2 or $3. The boxed area marked GAIN represents the income that will be *gained* by the price decrease, and the boxed area marked LOSS represents the income that will be *lost* due to the change in price. Here, the 'gain' is clearly a smaller amount than the 'loss', so revenue decreases, as we shall also confirm by calculation.

The total revenue for suppliers decreases by $10,000; at a price of $3 per bag 20,000 bags are bought, which is a total revenue of $60,000. But at a price of $2, we see that 25 thousand bags are purchased, a total revenue of $50,000. The price **de**crease has caused the quantity demanded to **in**crease but not by enough to increase *total* revenue for suppliers. This is what the calculation of the price elasticity of demand led us to expect.

Fig.4/4. Change in Revenue Caused by a Decrease in Price



Somewhere between $3 and $4 per bag is the price that will **maximise** sales revenue. Revenue is maximised when the price demand of elasticity is exactly -1, that is, *unit-elastic*, which is at a price of $3.5 per bag. (This has been shown in Fig.4/3.) That is the most important thing for the supplier(s) of bags of tea to know. So we have now calculated that by setting a price of $3.5, suppliers of bags of tea will be **maximising** their revenues. This highlights how important economic theory can be to business people in practical situations.

Factors Affecting Price and the Price Elasticity of Demand

We have seen that we can calculate the price elasticity of demand to help set the revenue-maximising price for a product, assuming that **other factors do not change**. However, there are a number of factors which might NOT remain constant and which will affect the price elasticity of demand of a product and the prices set for products. Some factors will be more influential than others depending on the product itself and on conditions in the market.

Substitute Products Available

One of the most important factors affecting demand in response to a change in the price of a product is the ease with which buyers can substitute another product/service that fulfils a similar need or provides a similar benefit. The more easily a product can be substituted, the higher its price elasticity of demand is likely to be. The higher the number of competing products, the more sensitive to small changes in price are customers likely to be.

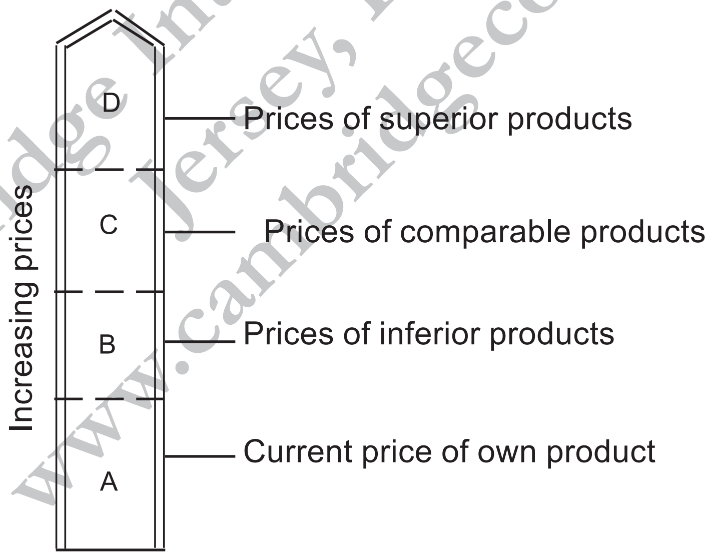
Suppose that at a fish market the price of **all** types of fish increases by 1%. The overall effect on the total demand for all fish is likely to be small. However, if the price of just **one** type of fish increased by a small but noticeable amount, there is likely to be a much larger response from buyers to the quantity now demanded of *that particular type* of fish. With so many other types of fish available at unchanged prices, buyers will switch away from the now relatively more expensive fish to other types of fish that fulfil the same function of food provision.

A general economic rule is that the more narrowly a product is defined, the larger the price elasticity of demand will be. That is, the price elasticity of demand will be larger for just one type of fish or one make of car or one kind of drink than it is for **all** types of fish or **all** makes of cars or **all** kinds of drinks.

Prices of Similar but Different Quality Products

The price of inferior, comparable and superior products will affect the price elasticity of demand. Look at Fig.4/5. Let us take for an example a restaurant owner who considers increasing the current prices (priced in sector A) of his restaurant's meals - meals which are moderately priced and of reasonable quality. At first, sales will not decline by much because purchasers will remain loyal to his moderately priced restaurant meals, which are better quality than the more expensive meals but inferior meals of many substitute restaurants (sector B), and demand will be relatively inelastic. However, if he continues to increase prices, demand for his meals will become more elastic, and as his meal prices rise into the range of similar and better quality restaurant meals (Sectors C and D), demand for his meals will become ever more elastic.

Fig.4/5. Prices in the Market for Restaurant Meals



Cross Price Elasticity of Demand

The demand for goods is affected by the price of related - substitute or complementary - goods. For instance, higher prices for bags of coffee or other drinks will increase the demand for bags of tea, as demonstrated in Fig.2/7.

The **cross price elasticity of demand** measures the sensitivity of the quantity demanded of one product to changes in the price of a related product. Cross price elasticity between two products is defined as:

The percentage change in the quantity demanded of one product
divided by
the percentage change in price of the related product.

Thus if a 2% rise in the price of coffee leads to a 1% rise in the quantity of bags of tea demanded, the cross price elasticity of tea to coffee would be 0.5. The cross price elasticity of demand can be a useful figure for measuring the competitiveness of other products and the effects of changes in their prices on your products or market - thus enabling a prediction to be made as whether or not price changes should be considered and made. Even so, the greatest influence on the demand for a product is virtually always its **own** price.

★ **Substitute products** will have cross price elasticities with positive signs, as a fall in the price of a substitute will lead to a decrease in the demand for the competitor product.

★ **Complementary products** will have negative cross price elasticities because a rise in price of a complementary product will tend to reduce demand for its complementary products.

Market Structure

In **competitive markets** there are many suppliers of similar substitute products and there are many consumers. Suppliers generally have limited control over the prices they can normally charge and each supplier generally has only a small market share.

For example, in a local marketplace such as a large town or city with many suppliers supplying a similar product at a similar price, what would happen if one particular supplier decided to try charging a lower price than other suppliers? Purchasers would be happy to purchase all the supplier could provide at the lower price. Possibly other suppliers in the same street or location might feel they may also need to reduce prices in order to make sales - retain their market share - and ensure steady revenues in the short-term.

However, because that one lower-priced supplier provides products to only a small overall proportion of the market - perhaps only 1% or 2% of the total market - the many suppliers who provide products to the other 98% or 99% of the market know there is no real need to reduce prices as there is still plenty of remaining demand. Sales therefore tend to be made at a price which is, or is very close to, the **going market price**; substitute products offered for sale above the market price will result in few or no sales of that product being made; sales made at below the going market price will generally increase turnover but will not necessarily maximise profits - as in the case of a supplier reducing the price for bags of tea from $3 to $2 in Fig. 4/3.

Such *competitive markets* are the opposite of **monopoly** where there is only ONE supplier - or just a very few suppliers acting together - of a product which fulfils a need or demand. The monopolist, unless there are governmental or legal constraints, can set the price where revenue and profits are maximised, which is often where price is high. The monopolist does not have to worry about competitive or market factors affecting the high price set. Examples of monopoly situations can include: a shipping port or airport which is the only one in an area or region, and which therefore can set its own high prices knowing that there are no other suppliers to satisfy the vital needs for its services. Another example is the provision of special medicines or medical treatments, which can be obtained from only one source, often at very high cost.

An **oligopoly** is where there are several suppliers/producers, each of which tends to have a relatively similar share of the market. In such markets the prices that suppliers charge depend largely on the prices charged and the actions of the other oligopolists. Unlike highly competitive markets, if one oligopolist reduces prices, that could have a substantial effect on the demand of other suppliers. Therefore it is vital to understand and predict how competitors might react to a price change; if all oligopolists reduced prices, there might be no extra overall market demand, and therefore overall total profit for each individual supplier would be decreased - which benefits none of the suppliers. To avoid this situation, many oligopolists also set prices close to the **going market price**. There might also be some formal or informal form of collusion in setting prices, which is considered in a following section.

Pricing Objectives and Strategic Pricing

So far we have concentrated on prices being set to *maximise revenue.* However, suppliers and producers might set product prices to satisfy other objectives. Some suppliers might aim to set prices in order to maximise sales or to set a price which deters or prevents potential new suppliers/producers being able to supply similar products or entering the market. The major pricing strategies are:

✱ A ***low-price strategy*** might be considered when demand is elastic and consumers can easily compare a range of different products of similar prices; in such a case it might be beneficial for suppliers to keep prices quite low to avoid losing sales to competitors and to maintain high market-share.

There are three other main reasons why a supplier might use a low-price strategy in the short-term. The three main types of low-price strategy are explained below:-

- ***Penetration pricing:*** this pricing strategy is used when demand is elastic and a low price is required to attract customers to the product. This is often used for new products to the market - a low price is the incentive used to encourage customers to try the product - to help a product gain market share and penetrate the market. Once that is achieved, and the market accepts the new product, its price might be slowly raised.

- ***Barrier to entry pricing:*** in order to maintain demand for the products they supply, suppliers might keep prices deliberately low to prevent new suppliers - who could not operate or supply goods except at higher prices - from entering the market. This *barrier to entry pricing* means that existing suppliers therefore protect their market share and avoid losing sales that might otherwise be made by potential new suppliers. Potential competition is not always as easy to assess as is existing competition. For instance, if a business is obviously doing well in a particular area, others try to follow suit; the very success of the original business can attract competitors, and that might be a reason to keep prices low.

- ***Promotional pricing:*** under this strategy, prices are reduced, often for just a short time, to "promote" - boost the sales of - a product and renew or create new interest in it or other related products. The ***loss leader*** concept is often used by supermarkets which price a product very low; that product will be sold at a loss, but the loss should be more than compensated by revenues from other products that a consumer will purchase whilst inside a supermarket after having been encouraged into it by the loss leader.

✱ A ***market-price strategy*** keeps prices at the *going market price* to avoid sales being lost at above-market prices, and to avoid causing competitors to lower their prices to match a below-market price.

✱ A ***high-price strategy*** could be used when a supplier is selling a high-quality product to a small, select market, and when the high price and 'exclusivity' itself is a "benefit" of the product, because the buyer wants to own a product or item which relatively few, if any, other people own. A Rolls Royce car/automobile is a good example, as are most exclusive and luxury products.

Alternatively, the high-price strategy might be used when there is a completely new product which it is difficult for anybody else to supply or produce. By charging high prices to start with, only those who can afford the high price will purchase the product. A short while later the supplier/producer reduces the price, and now another section of the market - which can afford the more moderate price - will buy the product. The supplier/producer will keep reducing the price by a certain amount over a period of time, ensuring that those who can afford to buy the product do so at each price. This is called **'skimming'** the market.

Collaboration and Collusion Between Suppliers

Suppliers might know that a certain price should bring maximum revenue for them. In our earlier example, such a price would be $3.5 for suppliers of bags of tea. If suppliers collaborated (colluded) they would agree to charge the *unit-elastic price*, which is the revenue maximising price for **all** suppliers *as a group*. In our example suppliers could, perhaps, agree between themselves to sell at a price of $3.5 per bag of tea.

However, a supplier with excess stocks might be tempted to "clear" his excess stocks by selling them at a lower price than agreed. That would cause other suppliers to reduce prices for fear they would not be able to make sales at the higher "agreed upon" price. In addition, many countries have legislation to prevent suppliers fixing or "rigging" prices or forming *cartels* who agree to control prices without letting "natural competition" influence prices charged).

If a purchaser offered to buy a number of bags of tea for, say, $3 from a particular supplier, that supplier might be unwilling to lose the opportunity to make the sale, and might accept a lower price, even though he had agreed with other suppliers to make sales only at the "set" price of $3.5. This could again have the effect of reducing prices to below the price agreed by the suppliers. The "bargaining power" of purchasers can thus also have an effect on prices (discussed further in Module 5 of the Business Economics & Commerce Diploma Program).

If suppliers then deliberately offered prices which were below revenue maximising price in an effort to secure sales, their rivals might also attempt to **'undercut'** the new price; all those suppliers would then be earning less than maximum revenue. The problem with collusion is that all suppliers must trust each other and be trustworthy; that situation, as demonstrated in the example above, very rarely occurs!

The Need and Necessity for a Product

The demand for general categories of basic commodities, such as fuel, food, medicines, and some household goods, is inelastic. Households have little opportunity to alter the broad pattern of their purchases. We cannot do without essential products which fulfil basic necessities; such products will have inelastic demands. Products which are considered to be luxury items will have a more elastic demand, as they are not items of prime importance in normal, everyday life.

Price Discrimination

We saw in Fig.4/4. that where only a single price can be set, suppliers will generally set the unit elastic price in order to maximise revenues. However, it may be possible in some instances and in different markets for suppliers to charge different prices to different customers, therefore potentially increasing total revenues.

Fig.4/6. Market Demand Curve for Holidays

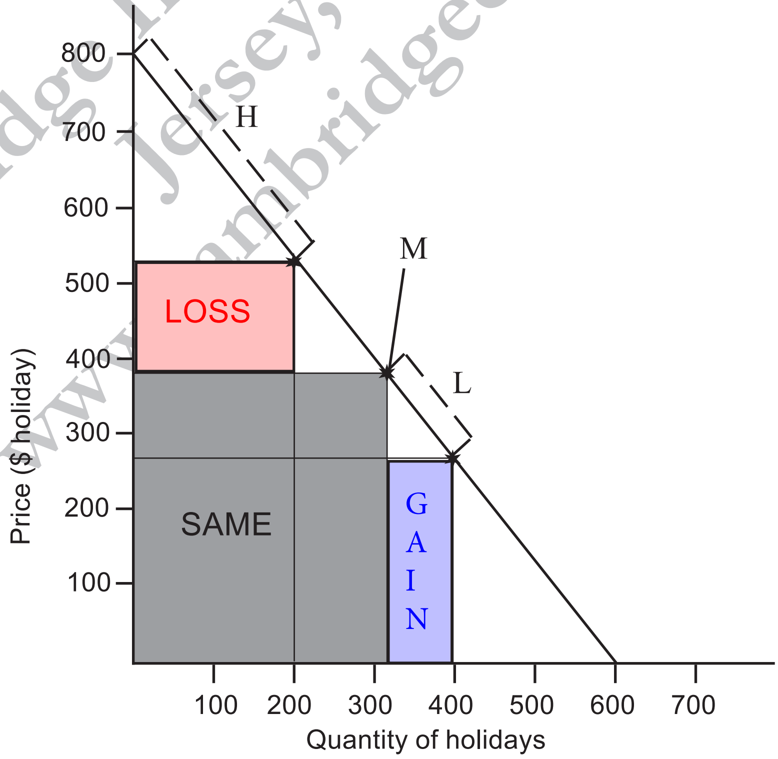


Fig.4/6. illustrates the market for a travel agency company. The price of $375 has been calculated as the revenue maximising price, leading to the sale of 325 holidays. The firm is profitable at that set price, but the managers/owners wish to know if it is possible to make the firm even more profitable. They know that:-

- ✶ some customers, those in region H of the demand curve, would pay **more** than $325 for a holiday, *but* that raising the price would mean a **reduction** in the number of overall customers and the selling of fewer holidays, thereby achieving smaller profits

- ✶ there are potential customers such as those in region L of the demand curve who will not pay as much as $375 for a holiday, but might still be willing to pay over $275 for a holiday. By lowering the price the firm could sell additional holidays to those potential customers, but in doing so the firm would earn less revenue from the existing customers who are willing to pay $375.

The *question* is: how can the travel agency company gain some of the potential extra revenues from region H, AND also profitably sell some holidays to potential customers in section L?

The *answer* is*:* charge *different prices* to different customers. This is the basis of **price discrimination** - charging different prices to different customers or consumers.

The *problem* is: identifying the different groups of customers who are able to pay different prices. There are various types of price discrimination which deal with this question, and those are now discussed.

Types of price discrimination

✲ First-degree price discrimination

The managers/owners of a firm would like to be able to charge each individual customer the maximum price which each customer would be willing to pay - that is termed the *reservation price*. Charging the reservation price is called first-degree price discrimination.

The firm can charge the reservation price - even to customers in region L below the original equilibrium price of $375 - as long as the extra profit from each sale is greater than the additional cost - the **marginal cost** - of providing that holiday.

The problems with first-degree price discrimination are that it is often impractical to charge every individual customer a different price, and it is hard to establish the reservation price of each customer. Often a firm can implement **imperfect price discrimination** by charging a **range** of different prices based upon estimates of customers' reservation prices.

The firms which use imperfect price discrimination are most often firms of 'professionals' such as doctors, accountants, lawyers or specialist consultants. They will know their customers - and their customers ability to pay - quite well. For example, an accountant with a wealthy client knows that a higher fee can be charged than for a less profitable or wealthy client.

Other examples of first-degree price discrimination include the provision of housing loans by government housing or welfare departments; here the government department might require information to be disclosed about personal income and savings in able to assess each applicant individually. Owners of commercial properties might require that a potential tenant shows the property owner a set of company accounts before agreeing to rent the premises to that company - and before confirming the final rental cost to be charged to the potential tenant. In both cases the information allows the supplier to use price discrimination.

Returning to the example of the travel agency firm, it is often the responsibility of good salespeople to judge the level of price discrimination they can apply; the salesperson needs to assess whether or not a client is happy to pay a certain high price, or whether a special reduction or discount or offer is needed to reach the customer's 'reservation price'.

✲ Second-degree price discrimination

This is a technique used when there is a diminishing marginal utility (refer back to Module One) for consumers, and when the consumer *reservation price* falls for each additional service, product or item. Second-degree price discrimination is: *the charging of different prices for varying quantities of the same good or service.*

Stepped or **'block' pricing** is a second-degree price discrimination technique whereby each extra 'block' purchased or used is charged at a lower price. For example, a mobile-phone company might charge callers at a rate of $1.50 per minute for the first 20 minutes of calls made in a week, then $1.25 per minute for the next 20 minutes of calls made (minutes 21 - 40), then $1.00 per minute for any further calls made that week; at the start of the next week the first 20 minutes of calls made would again be charged at $1.50 per minute.

Quantity discounts - dealt with more in Module Five - are also a form of second-degree price discrimination; for instance, offering a single light-bulb for $0.45 or a box of 5 light-bulbs for $1.75 (which comes to $0.35 each).

The supplier may continue to operate second-degree price discrimination as long as the extra profit from each sale or 'block' continues to be greater than the additional cost - the **marginal cost** - of providing the sale, and so long as the supplier is not overstretching the firm's resources.

✲ Third-degree price discrimination

Third-degree price discrimination is a pricing practice which enters the realms of marketing, especially of branding and the *identification of different consumer or customer groups.*

For example, a product such as a new model of CD player could be targeted at two different groups, each of which has a **different demand curve**:

✶ one consumer group might be 'young teenagers', for whom price is relatively inelastic, as the CD player is a "must-have" fashion item;

✶ the second group might be 'older adults', which is a more discerning consumer group for whom the price matters more - therefore the demand for this group is much more elastic.

Other examples of third-degree price discrimination include travel 'packages' - which may consist of an aeroplane flight, travel insurance and hotel accommodation. These may be targeted at the price elastic 'holiday market', and also at the less price-elastic 'business travel market'.

Offering the same or very similar products under different brands, such as food items and drinks at supermarkets, or services charged at different prices such as discounted bus fares to old age pensioners and students, are forms of third-degree discrimination.

In such cases suppliers must be aware that they are dealing with different demand curves for their product(s) or service(s) and therefore need to take care to handle each correctly, and to monitor all factors which affect the demand.

Market Skimming

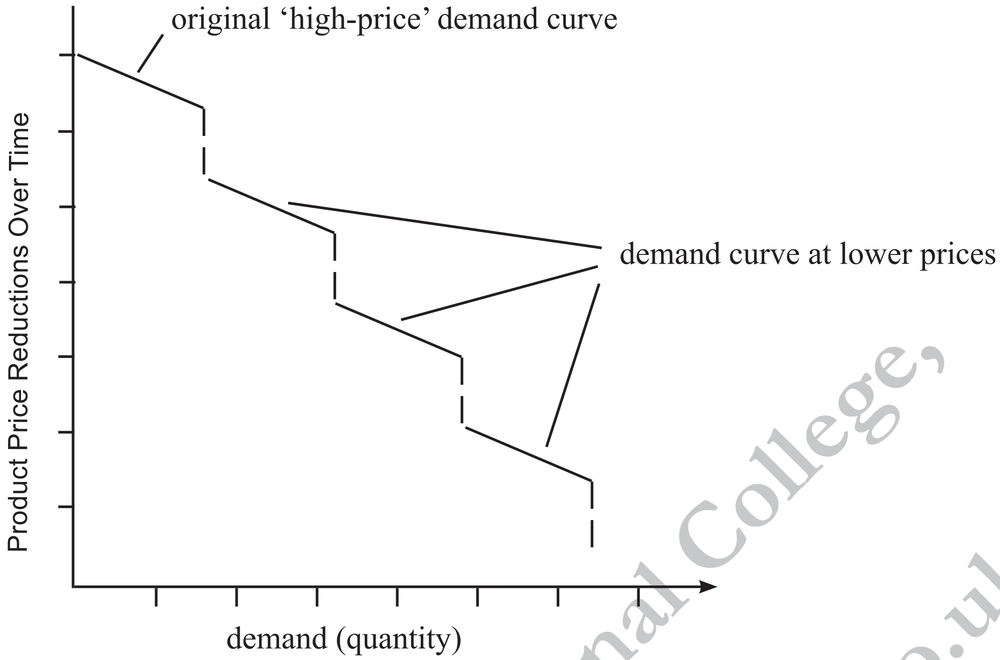
Market skimming is a pricing strategy which separates consumers into different groups by charging *different prices at different times* of the product life-cycle, generally by reducing prices at regular intervals.

Each consumer group is treated as if it has a different demand curve. For example, some consumers are willing to pay a very high or premium price for immediate possession or access to the very newest advanced computer equipment, mobile telephone set, or electronics products; the demand for this consumer group is inelastic.

At a later time, when this group of consumers has purchased the product, the price is reduced by the supplier, perhaps by 15% or 20% or any planned amount. This lower price now appeals to a new group of customers for whom immediate possession or access to the new product was not so important, and for whom demand was more elastic.

The price may be reduced several times until eventually the price is reduced to one which appeals to the mass market - thereby moving downwards through the 'reserve prices' of different groups. Fig. 4/7 demonstrates this market skimming technique.

Fig.4/7. Market Skimming



Peak-Time Pricing

This pricing strategy involves charging *different prices at different times of the day or week or year*. Examples include raising transport charges at peak-travel or rush-hour periods, or charging higher prices for cinema tickets, and charging higher telephone rates, at **peak times**, that is, times of highest demand.

Often this strategy is followed not simply to increase revenues at peak-times, but to try to improve **efficiency** by smoothing out the periods of highest demand. For instance, a railway service can more easily and efficiently deal with 1,000 commuters travelling between 7.30 am and 8.00 am, and 1,000 commuters travelling between 8.00 am and 8.30 am, and 1,000 commuters travelling between 8.30 am and 9.00 am, than 3,000 commuters all trying to travel between 8.00 am and 8.30 am. Here the train company might charge a higher fare between 8.00 am and 8.30 am to encourage commuters to travel either a little earlier or later.

Using premium or higher prices at peak-times can not only improve efficiency, but can sometimes **reduce costs**. For instance, in the case of the railway service, the railway might have to employ extra ticket collectors at peak times, thus increasing costs; whereas if demand was more evenly spread, the normal number of employees could do the job at any time without the need for extra assistance.

Bundling

This strategy is widely used by firms of all types. Let us refer to the example of the travel agency firm. Most holidays sold are a form of **pure bundling** because what is generally being sold is actually a bundle of separate items grouped together - in this case the aeroplane flight ticket, the hotel accommodation and the holiday insurance are all included in the cost of a 'holiday package'.

However, the travel agency might offer - or be requested to provide by a customer - just the aeroplane flight ticket (perhaps because he/she already has personal insurance and will be staying with a friend on arrival). This is **mixed bundling**, which is defined as the *selling of two or more goods/items either as a package or separately*.

Generally the prices of the individual components of a bundle, if brought separately, would be higher than the bundle itself. That is largely to do with costs, as a travel agency operator booking a full, pure bundle 'holiday package' might take just 30 minutes to arrange for the bundle to be sold. However, if just a flight ticket was purchased, the operator might still spend almost the same amount of time on the sale, but might make only one third of the "profit" - as only one component of the bundle is being purchased. Therefore, a higher price is charged for the single component to compensate for the relatively less profit earned for the 30 minutes of work.

Other examples of include buying a computer with various computer programmes - pure bundling - or buying them separately - mixed bundling. Buying a meal at a restaurant - either a 3-course ‘set menu’ - which is pure bundling, or buying a starter and a main course and a dessert separately which is mixed bundling.

Durability and Life-span of Products

Products which last for a fairly long period of time are called ***‘durable goods’*** or ***‘durables’***. Conversely, ***‘nondurable goods’*** do not last for long, and must quickly be used or consumed after purchase. The demand for durable goods is likely to be more elastic than for nondurable goods. For instance, once food is eaten it is a necessity that more food is soon purchased. However, durable products - such as motor vehicles or tables - might be used over a long period of time even when they are old and no longer in particularly good condition; there is not such an immediate necessity to buy durable products as there is to buy, for example, foodstuffs.

There is another category of products which falls between the two already described. They are often called ***‘fashion goods’*** because they can sell well - demand is high - whilst they are “in fashion” or are considered “trendy”. Items of clothing and footwear, particularly for women, are good examples. But peoples’ tastes and perceptions of what is “fashionable” can change very quickly, and so products which might be very popular can suddenly become less so, and sales quickly decline. Many such products, such as a pair of jeans for example, could last for a long time (and so are “durable”) but might simply not be worn any more because they have become - or are perceived to have become - “out of fashion” or “obsolete”.

Time Factors

Following an upwards price change, consumers might feel, in the short-term, that it is still necessary to buy the newly priced product. It might be some time before new products are “found” by purchasers, or are supplied or released for sale onto the market, which replace or act as substitutes for the original product. Until then, purchasers might have to put up with the price rises anyway, and for a while suppliers will find that demand is inelastic.

In the long-term - the period needed for consumers to be able to adjust their buying habits to fully take account of the price change - purchasers will normally be able to try new products and find alternative suppliers or find that benefits provided by alternative goods are actually satisfactory. Therefore, demand is more elastic in the long-term than in the short-term.

Proportion of Income Spent on a Product

When the prices of products on which a large proportion of a consumer’s income increase, such as housing or fuel or clothes or food, spending will simply have to be cut back on those products. However, products that are bought more rarely and are a relatively small amount of overall expenditure will not be so badly affected by a rise in price; demand is less elastic.

Changes in Income

A rise in the income of consumers will lead to an increase in **total** consumer spending, and the quantity demanded for most goods will increase. As incomes increase and people become more affluent, they can afford more of a product despite a higher price.

The ***income elasticity of demand*** for a product is:

✦ the *percentage* change in quantity demanded for it,

divided by

✦ the corresponding *percentage* change in consumers’ incomes.

Income elasticity of demand measures the effect on quantity demanded when incomes change but the price of products and substitutes stay the same.

Goods for which demand grows quickly as incomes rise will have better growth prospects in an expanding economy than goods for which demand increases more slowly with income. Businesses and business people will thus be very interested in differences in the income elasticity of demand for different products which they might currently supply or consider supplying in the future, especially if they need to invest and plan for future production/supply.

The Effect of Credit

The term ***'credit'*** means that customers do **not** have to pay at once all or part of the cost of products purchased; payment might be made at a **later date**. Businesses are said to "allow" or "extend" a ***'period of credit'*** to customers.

If suppliers extend credit to purchasers then in effect the income of the purchaser will increase in the short-term (explained in Module 5 of the Business Economics & Commerce Diploma Program). This will mean that consumers can buy more products, or the same products at higher prices; although, of course, they will **still** have to pay for those products!

Pricing for Shortages and Excesses of Demand

Price elasticities of demand are useful in calculating the price rise required to eliminate a shortage (excess demand) or the price fall required to eliminate a surplus (excess supply).

One important source of surpluses and shortages is shifts in the supply curve. For example, consider harvest failures and bumper crops, which are features of many agricultural markets.

- Because the demand elasticity for many agricultural products is very *low*, harvest failures produce very large increases in the prices of foodstuffs.
- Conversely, bumper crops cause very large decreases in food prices.

When demand is very inelastic, shifts in the supply curve lead to large fluctuations in price but have little effect on quantities demanded. Therefore, knowing the demand elasticity helps us to understand why some markets have very variable quantities demanded and stable prices, whilst others have stable quantities demanded and volatile or fluctuating prices.

When consumers fear that there will be a shortage of an article in the future, and no substitute product is available, they might be inclined to buy more than they actually need at once - and even to pay more because of its "scarcity value". They might tend to "hoard" or "stockpile" the products in anticipation of later shortages; that, of course, makes the situation worse.

Marketing and Advertising

Suppliers, whether they supply just a single product, a specific range of products or a whole variety of products, generally supply products of various qualities and sell them at various prices according to size or quality. As there might be many suppliers/producers producing similar products, there could be a large number of sizes, qualities, and prices for consumers to choose from.

Advertising and publicity stress the merits and benefits of products, and appeal in various ways to the consumers' motives for buying. An advertiser might claim that his product(s) are of a particular quality and fulfil certain needs better or more price-effectively than other, competitive, products. Another advertiser might not contest that claim but might claim an alternative benefit. Each supplier/producer will attract buyers for different reasons.

Some manufacturers market their products under **different *'brand names'***, that is, some under one name and others under a different name. Although all the products might be very similar in quality and size, the brand name or the packaging might establish one of them as the ***'brand leader'*** and enable it to be sold at a higher price than any of the competitive products.

Advertising, therefore, can have a large effect on the prices which suppliers/producers are able to charge and on the prices that consumers are willing to pay or on the quantity that consumers will demand of various products. This factor will therefore have a large influence on the price elasticity of demand for products.

Marketing and advertising are covered in more depth in the College's *"Sales Management & Marketing",* and *"Advertising and Public Relations"* Programs. Full information about them (and the Fees payable) will gladly be sent to you on request.

Consumer Tastes

We have already seen that consumer tastes and fashions can affect the demand curve, and they can also determine whether the price elasticity of demand for a product is high or low. For example, if it is considered socially essential to own a television, higher prices might have little effect on quantity demanded because people will pay highly to be seen as being socially acceptable. However, if televisions are considered an unnecessary luxury, the demand elasticity will be much higher.

Geographical Markets

Suppliers/producers often find that they can charge **different** prices in different regions or areas for the **same** product. That might be for a variety of reasons. For instance, in a low-income district a product might be considered a luxury, whereas in an affluent market the same product could be regarded as a necessity, and therefore the price elasticity of demand would vary between the two areas. It would be up to the supplier to set a price for each area which would maximise revenue (if that was the only pricing consideration).

It might be that only the wealthy market could maintain a *relatively* high price and still have a high demand. The less well-off area might only have a demand if the products were offered at lower prices; even though the products are offered at lower prices in the poorer region/ market, the supplier could still be able to supply products profitably in that region.

Immediate or Long-term Profit/Revenue

Based on the type of product supplied by, and the financial situation of, suppliers, prices might be set which lead to short-term immediate revenue, or to long-term revenue.

For nondurable products such as fruit or vegetables, or even with a service like a hotel room, the product **cannot** be stored and revenue must be attained quickly or the product will perish. (If a hotel room is empty for a night then there is no way the "lost" revenue can be recovered). That is why last-minute bookings of hotel bedrooms, or foodstuffs or other perishable goods might often be offered at "discounted" - reduced - prices. In this case, the supplier will need to set a price which ensures products generate revenue very quickly.

Suppliers of agricultural produce or livestock, like all suppliers, need revenue to cover costs and maintain operations. However, if they set prices that meant they sold all of their livestock - such as sheep or goats or cattle - they would be unlikely to generate revenue in future years. They need to keep some livestock from which to breed and rear new animals, so that revenues could be generated at a later date. They would need to set prices that guaranteed some current revenue but which also provided for future revenues. The same is true of manufactured durable goods.

Technological Improvements

As standards of living rise, people become accustomed to looking for improved products and technological advances that will provide greater utility. Often better products are produced within a relatively short period, and consumers will purchase them when they are available.

This, together with growing affluence of consumers, has led businesses to manufacture "durables" with a shorter "life span". The shortened "life span" of such durables might appear to be very good for trade, but there are certain disadvantages too. Previously the costs incurred in designing, manufacturing and promoting sales of the product would have been recovered from sales over a much longer period; and a steady volume of sales would have been anticipated to provide sufficient profits and to enable a "development fund" to be built up over many years to finance the designing and production of a new model some years in the future. Under those circumstances the price of the product could have remained fairly constant over a long period of time, and at a different level than it would have been had immediate profit - rather than long-term gain - been the objective.

However, prices must now be set which generate profits more quickly and allow more expenditure on research and development.

Generally, sales of the older durable products rose steadily for three or four years, levelled out, and gradually declined for several years. Sales of modern types of durables behave more like sales of fashion goods - rising rapidly to a maximum peak. Unlike fashion goods, modern durables could remain popular on the market for two or three more years before sales decline; but then like sales of fashion goods, the durable products could have to be sold off in “clearance sales” to make room for the new products that would take their places.

Business Survival and Cost Covering

For a business to survive, its revenue **must** exceed the total of its various costs. Short-term losses, especially when a new enterprise is established, or when activities are extended into a new area, might be accepted and might be “absorbed”. But such a situation must be contained, and must be remedied as soon as possible if the enterprise is to be able to stay “in business”.

Very often prices of products set are dictated by the costs which must be covered. Those might include costs involved in supply and production, distribution, storage, planning, research, design, labour, overhead expenses and many others. It is these costs which often determine what prices are normally charged by suppliers. One of the most recognised examples of costs being the basis for prices set is ‘**cost-plus pricing’**, where the costs involved in supply are calculated per product, service or item, and a percentage is added to arrive at a selling price. That percentage - such as 5%, 8% or 15% is often the “return rate” aimed at, but will be influenced by all of the other “pricing factors” already mentioned. See this example:

Fixed costs (such as rent and staff wages) per product/service:	$18
Variable costs (such as labour, materials, transport) per product/service:	$22
Total cost to supply/produce a product/service:	$40
Cost-plus percentage of 10% (10% of $40 = $4):	$ 4
Selling price:	$44

Government Intervention

As we explain in Module 1 of the Business Economics & Commerce Program, the extent of government intervention in a country’s economy can vary from country to country. Some actions taken that affect prices and demand include changes in bank interest rates, which affect the cost of borrowing and - as with credit - affect the relative wealth of, and money available to, consumers.

Increases in taxation or in customs duties or the tightening of import controls or foreign exchange controls can also lead to the raising of prices, and reduce demand. (These matters are dealt with in a later Module.)

Another course of action which governments can take can cause even more severe problems for trading/distributive businesses. Prices of some foodstuffs and other goods might be “fixed” or “pegged” at short notice at levels which permit little profit to be made by businesses, although prices are held steady or are reduced for consumers. When this type of government action is taken, it is usually on social grounds in times of high unemployment, or in times of scarcity of supplies of basic commodities - for example, bread, milk, maize, rice - depending on the “staple diet” of a country - in an attempt to stop “profiteering” and/or “hoarding” of supplies.

Conclusion on the Prices of Products

The prices at which the products of a business are sold obviously have a vital bearing on its potential and actual profitability. That being the case, we might have expected that there would be a standard ***set of rules*** for the setting or calculating of the prices at which products are sold. However, as we have seen in this Module, that is very definitely NOT the case!

This Module has explained basic economic theory and shown its practical usage in business. We have then considered other practical and commercial factors alongside business economics, and seen how - together - they can help business people to understand and react to the often complex business and economic surroundings in which they operate.

Module Three

THE NATURE AND CLASSIFICATIONS OF LAW, LEGAL SYSTEMS, PUBLIC AND PRIVATE LAW, THE LAW OF CONTRACTS

This Module is one of the 12 Modules from the CIC Diploma Program on:

Commercial Practice & Law

Introduction: It is essential that business people understand laws relating to commercial activity, especially the law of contract and the law of tort. Failure to comply with the law can lead to civil or criminal actions, fines, loss of business or personal possessions, and imprisonment. This Program covers vital topics on legal and ethical conduct and the practice of business.

This Program is for all business people, managers, owners and others who need to understand commerce and the commercial world, the essentials of business law, and their legal responsibilities.

	Commercial Practice & Law - Modules Summary
Module	**Module Title**
1	Commerce in the Modern World, Economics Systems, Commercial Law, Trade
2	**The Nature and Classifications of Law, Legal Systems, The Law of Contracts**
3	Credit Transactions, Credit Management, Business and Credit Documents
4	Legal Business Units, Ownership, Sole Traders, Partnership, Companies
5	Financing Companies, Shares, Law Relating to Company Directors and Officers
6	Law of Tort Relating to Physical Products, Types of Tort, Recovery, Defences
7	Tort Law Relating to Services, Damages, Losses, Negligence, Duty of Care
8	The Law of Agency, Types of Agent, Rights and Duties of Agency Parties
9	Employment or Labour Law, Employment Contracts, Duty of Care, Discrimination
10	Principles and Law of Insurance, Risk, Insurers, Types of Insurance Policies
11	Tort Liability for Premises, Occupiers, Visitors, Entrants, Liability Insurance
12	Intellectual Property Protection, Copyright, Patents, Rights, Data Security

If you would like to study the complete Program and gain an international Diploma on **Commercial Practice & Law** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Adzor Felix Kwasi
wrote from **Ghana**:
"Studying with CIC offers an unparalleled experience . The Study Materials are of such a high calibre they inspired me to succeed and it is very rewarding. The CIC course gives quality, employability and student satisfaction."

Marita Cremona
wrote from **Malta**:
"I took the Program even though I was a mother working full-time. However, with the professional course and guidance I was distinctly successful. The course helped my self-esteem and improved my performance at work."

Module Three

THE NATURE AND CLASSIFICATIONS OF LAW

Sources of Law

A ***'legal system'*** refers to the set of laws of a particular country and the ways in which they are interpreted and enforced; that is, how the laws work in that country. There are many different legal systems operating in countries around the world, but typically, a country's legal system consists of a combination of the following:-

1. a written or oral constitution;

2. primary legislation (statutes) enacted by the country's legislative body established by the constitution;

3. subsidiary legislation (bylaws) made by persons or bodies authorised by the primary legislation to do so;

4. customs or precedents applied by its courts on the basis of traditional practices; and

5. principles or practices of civil, common, Roman, or another code of law.

Over time, each country develops it own legal system which is modified to meet changing circumstances, and incorporates many other features which are considered necessary. This results in there being a variety of different legal systems in the world. At the global level, international law is of great importance, whether it is created by the practice of sovereign States, or by agreement among them in the form of treaties and other accords (types of agreements). Some trans-national entities - such as the European Union (EU) - have created their own legal structures. At the national level there are over 180 sovereign States in the United Nations Organization (UNO), and many of these are federal or confederal, and their constituent parts might enact their own laws.

There are many different sources of law in any society. Some laws will be written into the country's Constitution; others will be passed by its legislature (usually a parliament or congress); others will come from long social tradition. These are the major source of law:-

Constitution: Most countries have written Constitutions, covering such fundamental rights for its peoples/citizens as freedom of speech, freedom of religion, freedom of expression, etc. Typically a country's Constitution is the supreme law, taking "precedence" (priority claimed because of greater importance) over any other source of law, and no law can be enacted that contravenes the provisions of the Constitution. Unlike many other nations, the United Kingdom (UK) has no one single constitutional document; it has an uncodified or "unwritten" constitution, and much of the UK's constitution is embodied in written documents, within statutes, past court judgments, works of authority, and treaties.

Customary law: In many former "colonial countries" the Law is generally a mixture of law introduced by the former colonial power and of customary law which was practised before colonisation. That customary law often still takes priority in certain areas of life. Typically, customary law applies in those areas of life least affected by colonisation, such as land ownership, customary titles and family relationships. There might be special courts to deal with these matters, conducted according to tradition and presided over by a customary chief or group of elders.

Common law: This might also be called *"English Common Law"* and *"Anglo-American Law",* and is the body of customary law which is based upon judicial decisions and embodied in reports of previously decided cases, that has been administered by the common-law courts of England since the "Middle Ages" (circa 1066 to 1272 CE). From it has evolved the type of legal system which is now found also in the United States and in a majority of the member states of the Commonwealth (formerly the British Commonwealth of Nations).

Statutory or **Statute law** is the body of law consisting of written laws (as opposed to oral or customary law) adopted or enacted by a legislative body. Statute law is often contrasted with case law (see below) which originates from decisions of the courts; and with constitutional law, based on a country's written constitution.

A law passed by a lawful government which is different from common law will usually take precedence. For example, under the English common law principle of *"habeas corpus",* the police may not hold a person for longer than a certain period (typically 24 hours) without bringing them before a public court. Habeas corpus can be loosely translated from Latin to mean *"show us the person",* and it is meant to prevent the authorities holding people in secret without due legal process. However, in times of emergency such as war, many countries pass legislation suspending these provisions. In the so-called *"war on terror",* many countries have introduced anti-terrorism laws which override habeas corpus to allow authorities to hold people, often in secret, for much longer periods.

Case law is part of common law, and consists of judgments given by higher (appellate) courts in interpreting the statutes (or the provisions of a Constitution) applicable in cases brought before them. Called *"precedents",* they are binding on all courts (within the same jurisdiction) to be followed as the law in similar cases. Over time, these precedents are recognised, affirmed, and enforced by subsequent court decisions and continually expand the common law. They are sometimes called *"judge-made law",* because whilst legislatures pass laws, courts work out what those laws mean in practice; laws are interpreted and tested by a succession of trials, over a period of time, under a variety of circumstances.

Classification of Law

Although we may live in - and visit from time to time - different countries which have their own laws and legal systems, some of which might differ from those of other countries, we are all influenced by laws which affect every aspect of our daily lives. Laws govern our conduct from the cradle to the grave, and their influence even extends from before our birth to after our death.

We live in societies which have developed complex sets of rules to control the activities of the citizens of those societies. There are laws which cover personal relationships - such as marriage and divorce; laws which govern conditions in the workplace - for example, those which lay down minimum standards of health and safety; and laws which regulate leisure pursuits - such as banning alcohol from being taken into sporting events; and many others.

As we have explained, "the Law" is a set of rules which are enforceable by courts of law, and which regulate the government of the State, govern the relationship between the State and its citizens, and also govern relationships between one citizen and another. There are many reasons why we need laws: to regulate society; to protect people; to enforce rights, and to solve disputes and conflicts. Laws prevent or deter people from behaving in a manner which negatively affects the quality of life of other people: therefore, the consequences of breaking the law often "fit the crime". In some cases, such as action resulting in minor injury, *"compensation"* (the payment of money to rectify a situation) might suffice. Other infringements result in long or short-term imprisonment where the length of the term reflects the severity of the crime, and is intended to deter potential law-breakers from committing the same crime.

All laws are rules, but not all rules are laws. The difference between a rule and a law relates mainly to the scope of the rule; rules usually apply to specific groups or at specific times, whilst the Law applies to everyone, all the time. As individuals we are conditioned from childhood to abide by many "rules". Rules like getting to school or to work on time; rules of particular sports, such as the off-side rule in soccer or football, and the rules of a club or association to which we might belong. These types of rules are intended to bring "order" to a particular activity.

There are various ways in which the Law may be classified; the most important being into Public Law and Civil Law or Private Law. The simple difference between public law and private or civil law is in those which each affects; public law affects society as a whole, whilst civil or private law affects individuals, families, businesses, and small groups.

✱ ***Public Law*** is concerned with the relationship between the State and its citizens, and is composed of several specialist areas such as Constitutional Law, Administrative Law and Criminal Law:-

- ✦ *Constitutional law* is concerned with the workings of the Constitution of the State. It covers such matters as the position of the Head of State, the composition and procedures of the legislature or parliament, the functioning of central, devolved and local government, citizenship, and the civil liberties of individual citizens as a whole.

- ✦ *Administrative law* is the body of law which governs the activities of administrative agencies of government. Government agency action can include rule-making, adjudication, or the enforcement of a specific regulatory agenda. As a body of law, administrative law deals with the decision-making of administrative units of government (for example, tribunals, boards or commissions) which are part of a national regulatory scheme in such fields as police law, international trade, manufacturing, the environment, taxation, broadcasting, immigration and transport.

- ✦ *Criminal law.* Because certain kinds of wrongdoing pose such a serious threat to the good order of society, they are considered crimes against the whole community. Criminal law makes such anti-social behaviour an offence against the State, and offenders are liable to punishment. The State accepts responsibility for the detection, prosecution and punishment of offenders; such as by its police force, its public prosecution service and its law courts.

✱ ***Civil Law*** or ***Private Law*** is concerned primarily with the rights and duties of individuals towards each other, and exists to assist citizens involved in disputes which relate to private matters. The scope of civil or private law is more specific than public law, and covers:-

- ✦ *Contract law* (sometimes called *"law of obligations")* governs the rights and obligations of people and organizations who are entering into or who have entered into contracts. An *"agreement"* is any understanding or arrangement reached between two or more parties, but a *"contract"* is a specific type of agreement which, by its terms and elements, is legally binding and enforceable in a court of law.

- ✦ *Tort law* governs the rights, obligations and remedies provided to someone who has been wronged by another individual.

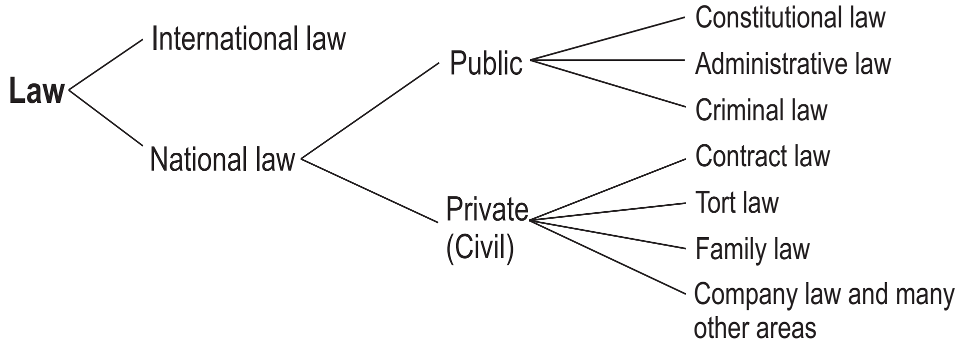
- ✦ *Property law* governs the various forms of ownership and tenancy in real property (land or real estate as distinct from personal or movable possessions) and in personal property, within the common law legal system.

- ✦ *Succession law* governs succession, *"estate"* (that is, the property of a deceased person), wills (testamentary law) and "probate" (which is the first step in the legal process of administering the estate of a deceased person, resolving all claims and distributing the deceased person's property between parties under a will.)

- ✦ *Family law* governs family-related and domestic-related issues, which include (but are not limited to) marriage, civil unions, divorce, spousal abuse, child custody and visitation, property, alimony, and child support awards, as well as child abuse issues, and adoption.

- ✦ *Law of Agency* is an area of commercial law which governs contractual, quasi-contractual and non-contractual *"fiduciary relationships"* which involve a person, called an *"agent",* who is authorised to act on behalf of another (called the *"principal")* to create legal relations with a third party. A *"fiduciary"* is someone who has undertaken to act for and on behalf of another in a particular matter, in circumstances which give rise to a relationship of trust and confidence.

Fig.2/1. classifications of law



The State's involvement in private law is confined to providing a civilised method of resolving a dispute which has arisen. Therefore, the legal process is begun by the aggrieved citizen and not by the State.

Some Definitions

As far as is possible, we try to keep our text free from *"lawyers' jargon".* However, there are a number of commonly used words and phrases of which you need to understand the meanings; they include:-

★ A ***'claim'*** is something that one party owes another; for example, one party might make a legal claim against another party for money or property.

★ An ***'action'*** is a *"case"* or *"lawsuit"* or *"proceedings",* and is a legal and formal demand for enforcement of one's rights against another party, asserted in a court of law. (Note, often the term '*lawsuit*' is abbreviated simply to '*suit*').

★ In law, a ***'trial'*** is a coming together of parties to a dispute, to present information (in the form of evidence) in a tribunal - such as a court - a formal setting with the authority to adjudicate claims or disputes.

★ A ***'claimant'*** or a ***'plaintiff'*** is the party who *"sues"* or brings a civil action or case against a defendant in a court of law.

★ A ***'defendant'*** is a person against whom or an organization against which criminal or civil proceedings are bought (or directed); in a criminal trial the defendant is called the *"accused"* and is being *"prosecuted".*

★ The ***'defence'*** consists of the legal representative(s) of the person being prosecuted.

★ A ***'legal remedy'*** (or *"judicial relief"* or *"judicial remedy")* is the means with which a court of law, usually in the exercise of civil law jurisdiction, enforces a right, imposes a penalty, or makes another court order to impose its will; measures include:-

  ★ *Damages,* which are *"monetary compensation"* for the plaintiff's losses, injury, and/or pain (see example in the next Section) or *"restitutionary measures"* which are intended to restore the plaintiff's status to what it was prior to the violation of his or her rights.

  ★ *Coercive remedies,* which require a party to do or to omit doing a specific act through injunctive relief or a court order of specific performance (such as when a court mandates that the party must fulfil its *"contractual obligations"* - see later Sections on "contracts").

Criminal and Civil Law

It is important for you to understand the nature of the division between criminal law and civil or private law, because there are fundamental differences in their purposes and procedures. Criminal law is concerned with forbidding certain forms of wrongful conduct, and punishing people who engage in prohibited acts. Criminal proceedings are normally brought in the name of the State and are called *"prosecutions",* which in some circumstances might also be undertaken by such bodies as the trading standards department of a local authority, and by private individuals, for example, a store detective who prosecutes a shoplifter. The consequences of being found guilty are so serious that the standard or *"burden"* of proof of wrongdoing is higher than in civil cases.

A business person might become in breach of criminal law by failing to comply with enactments, such as those which relate to business permits or licences, the registration and conduct of companies or corporations, consumer protection from unfair trading and faulty products, and health and safety at work regulations, tax evasion, foreign exchange or other financial irregularities, fraud, and others.

The purpose of an action under *civil law* is to remedy the wrong that has been suffered. Enforcement of the civil law is the responsibility of the individual who has been wronged; the State's role is to provide the procedure and the courts necessary to resolve the dispute.

Civil law sometimes allows the court to exercise discretionary powers, which are based not just on the legal rights of the parties, but on what will produce a just and moral solution. These discretionary rules are part of the "*Law of Equity,"* and they protect parties who are morally as well as legally entitled to a remedy. Equitable principles govern the issue of *"court orders"* such as injunctions and some contractual remedies (described in a later Module of the Commercial Practice & Law Diploma Program). They are the foundation of laws relating to mortgages and trusts, and they seek to protect vulnerable parties to a transaction from the abuse of power by lenders and trustees.

The distinction between criminal and civil law does not depend on the nature of the wrongful act, because the same act might give rise to both civil and criminal proceedings. A typical motor accident is a good example:

A woman (whom we will call Jane) is crossing a road at a designated crossing (like a "zebra crossing") when she is struck by an automobile driven by a man (whom we will call Bruce). Jane is taken by ambulance to a local hospital where she is found to have sustained a broken leg. The police arrive at the scene of the accident where they breathalyse Bruce and, finding that he is 'over the limit', charge him with the criminal offence of driving under the influence of alcohol. Later, in a magistrate's court, he is disqualified (banned) from driving for 12 months and is also fined a sum of money.

However, the fine is paid to the court, and does not go to compensate the victim, Jane in this case. She must pursue a separate civil action to remedy the personal wrong she has suffered. She sues Bruce in the tort of negligence, seeking "damages" for the injuries she sustained as the result of the automobile accident. Bruce is found liable (guilty), and is ordered to pay a sum of money to Jane in damages. Generally, the loser in a civil action also pays the winner's "costs" (such as the fees charged by advocates or lawyers) and therefore Bruce is also ordered to pay Jane's costs in 'bringing the action'.

Commercial Law or Business Law

Commercial law (also known as business law) - and which is our main focus in the remainder of this Module and the following ten Modules in this Program - is often considered to be a branch of civil law, and deals with issues of both private law and public law. Commercial law is the body of law that applies to the rights, relations, and conduct of persons and businesses engaged in commerce, merchandising, trade, sales, marketing and allied fields.

Commercial law provides the rules which merchants and other persons and organizations involved in commerce must follow in conducting their business amongst themselves and with consumers. It governs sales of goods and services; negotiable instruments; security interests; leases; principal and agent relationships; contracts of carriage by land, sea and air; guarantees; marine, fire, life, and accident insurance; bills of exchange; and partnerships. Commercial law also regulates employment practices, and the manufacture and sales of consumer goods, and related issues such as business bankruptcy and tax planning.

Commercial law encompasses all the laws which dictate and govern how businesses may be formed (established) and run, including all the laws which govern how to buy, manage and close or sell any type of business. The commercial law of a country establishes the rules that all businesses should follow, and provides the framework for standards of commercial conduct and practices within its borders. Various regulatory schemes and bodies control how commerce is conducted, particularly regarding employees and customers, and enforce privacy laws, safety laws (such as consumer protection, occupational health and safety, and food hygiene), trade licences or permits, import controls, and other commercial activities.

It will help you to understand the role of commercial law within a country's legal system if you view businesses as being "entities" which are *separate* from their owners, managements and employees. Just like individuals living together in society, business entities are subject to legal rules which are designed:-

- To ensure that all participants have equal opportunities in the marketplace.

- To protect people and organizations which sell to, buy from or have other contacts with businesses from loss or harm.

Commerce is at the core of any democratic country and, in order to be strong economically, the country must be attractive to "business". One way of doing this is to have a strong set of laws and regulations protecting businesses which enter into agreements with others, and which provide resolutions when things do not go according to plan.

An enforceable system of commercial laws not also benefits the economy of a country as a whole, but also provides for more efficient transactions. For example, a supplier who sells goods "on credit" (without receiving payment at once) can be confident that the buyer will be held to the agreed payment terms. As long as the contract between the two parties is written and executed in accordance with the commercial law of the jurisdiction in which it is transacted, the supplier knows that it will be possible to enforce the contract against the buyer if such action becomes necessary in the event of failure to pay.

Law of Contract

A ***'contract'*** is an agreement with specific terms made between two or more persons or entities in which there is a promise to do something in return for a valuable benefit known as *"consideration"*. The process leading to the agreement is said to be *"forming a contract".* The law of contract is at the heart of most business dealings, and it is one of the most significant areas of legal concern to business people.

It is easiest to think of a contract as being a legally binding agreement concerning an undertaking which is essentially commercial in its nature; for example, those which involve the sale or hire of commodities such as goods, services or land. Such contracts as those are known as *"simple contracts",* because they are usually enforceable even if they are not put in writing. A person is probably involved in literally hundreds of simple contracts every year without realising that he or she is "forming contracts"; for example, when doing everyday activities like shopping, getting a haircut, filling an automobile with fuel, or getting a piece of equipment repaired.

In such everyday activities as we have mentioned, the contracts are legally binding without the need for documents, signatures or witnesses. However, if the goods or services provided to a customer are defective, he or she has legal rights arising from the contract made with the *"vendor"* - the shop or store or any other type of seller. To enforce those rights, the customer will need to **prove** the existence of the contract; for example, a receipt or a cash register or till printout for the transaction would be handy evidence of that. If that is not available, other evidence - such as a credit card docket, or a cheque stub, or the word of a witness to the transaction - would be perfectly adequate.

Most business people enter into contracts more frequently than they might realise. In almost all business dealings, any time a business person agrees to take some action or make a payment in exchange for anything of value, a legal contract has been created. For example, most bills of sale, purchase orders, employment agreements, and other common business transactions are legally enforceable contracts.

Forming contracts in business dealings helps to ensure that agreements are acted on, because a “breach of contract” could result in a lawsuit or an out-of-court settlement and the payment of damages caused by the breach. Examples of situations in which business contracts are often formed include:-

★ buying or selling or providing materials, goods, services or intellectual property
★ leases and real estate sales or transfers
★ sales, transfers of ownership or amalgamations of businesses
★ for the creation of partnerships, joint ventures and franchises
★ hiring or being employed as an independent contractor
★ confidentiality agreements

A contract commonly involves paying for goods or services, etc, but non-monetary contracts are just as valid.

In this Module we now examine how business contracts are formed. In most countries they are still governed by common law principles, but statute also plays an increasingly important part. In later Modules we examine areas of contract law which are additionally regulated by statute: such as the sales of goods and services, employment law, and partnership firms.

The Essential Elements of a Contract

As we have stated, a contract is a legally enforceable agreement between two or more parties which creates an obligation to do or not do particular things. The term “party” can mean an individual person, a business or corporation or another legally constituted organization, central, local or federal government agency, etc. An agreement must contain four essential elements to be regarded as being a contract as we have defined it. If any one of these elements is missing, the agreement will not be legally binding:-

✦ an ***offer***

✦ an ***acceptance***

✦ ***intention to create legal relations***

✦ ***consideration*** (each party will contribute something of material value to the bargain)

The Offer

There must be a definite, clearly stated offer to do something. An offer should be a full and clear statement of terms on which the maker - the *“offeror”* - is prepared to do business with the person(s) to whom the offer - the *“offeree(s)”* - is communicated. Therefore, an offer is an expression of willingness to contract on a specific set of terms, made by the offeror with the intention that, if the offer is accepted, he or she will be bound by a contract to do or to provide what was offered. Examples include a “quotation” (see Module 3 of the Commercial Practice & Law Diploma Program) by a seller to a potential customer, or an offer by a landlord or agent to lease or rent premises.

What is called an *“invitation to treat”* is merely a declaration of willingness to enter into negotiations; it is **not** an offer, and cannot be accepted as such to form a binding contract. It is important to note that an agreement is not created if there is an acceptance of the invitation to treat. An invitation to treat is part of the preliminaries of negotiation, whereas an offer is legally binding once it is accepted, subject to compliance with the terms of the offer. Examples of invitations to treat are advertisements in newspapers and magazines, leaflets or flyers or circulars, website promotions, price lists, and catalogues.

In business, an offer is often stated to be valid only for acceptance within a stated period - for example *“quotation valid 30 days from date of issue”* - and it will lapse when the date for acceptance expires, or after a reasonable time in the circumstances (generally the greater the value of the potential contract, the longer the life of the offer.) Note that an offer can be modified, withdrawn or cancelled without penalty **before** it is accepted by the offeree and the offeree has been informed accordingly.

Acceptance

Only what is offered can be accepted. This means that the offer must be accepted exactly as it is offered without conditions, that is it must be *"unconditional".* It is important to understand that *"conditional acceptance"* is **not** binding; for example, an acceptance containing the words *"subject to contract"* is not generally accepted as a valid acceptance. If any new terms are suggested by either party prior to acceptance, they are considered part of *"negotiation"* and are regarded as being *"counteroffers",* which can be accepted or rejected. In some circumstances, during "negotiations", there could be a number of offers and counteroffers made before an agreement is reached.

It is not important which party makes the final offer, as the acceptance of that offer establishes the terms and conditions of the contract. Acceptance can be given *orally*, in *writing*, or may be *inferred by action* (such as shaking hands) which clearly indicates acceptance (performance of the contract). In any case, the acceptance must conform with the method prescribed by the offerer for it to be effective, and must be clearly "communicated" to the offeror, that is, the offeror must be told.

Intention of Legal Consequences

A business contract requires that the parties to it intend to enter into a legally binding agreement. This is called *"mutuality"* and means that the parties have had a *"meeting of minds";* that is, the parties entering into the contract must intend to create legal relations and must understand that the agreement can be enforced by law. In business, the intention to create legal relations is presumed - that is, it does not need proof - and therefore the contract does not have to expressly state that the parties understand and intend legal consequences to follow. If the parties to a contract decide not to be legally bound, this must be clearly stated in the contract for it not to be legally enforceable.

Consideration

For a contract to be legally binding, there must also be *"consideration"* or a price, as well as an offer and acceptance. In this context, consideration means that both parties must do something or promise to do something which they intend is to be legally binding. In contracts for materials, goods or services, this usually means that one party undertakes or promises to pay an agreed price, and the other party promises to supply specified materials, goods or services. Usually the consideration is the payment of money but it need **not** be; it can be anything of value, including the promise to do or not to do something, or to refrain from exercising some right.

Payment does not necessarily have to be made at the time the offer is accepted - that is, when the contract is made - but there must be an undertaking or promise to pay at an agreed later date (this is called "credit"). Consideration must be of material value, capable of being assessed in financial terms, and usually the financial nature of the consideration is obvious when goods, land or money are involved. However, the payment does not need to be a "fair" payment - usually the courts will not intervene where one party has made a "hard bargain" unless fraud, duress or *"unconscionable conduct"* - very unfair or overwhelmingly one-sided in favour of one party - is involved or is suspected.

Terms of a Contract

The ***'terms'*** of a contract are the statements which describe the rights and obligations of each party to the agreement. Terms are, in effect, all the matters which are agreed between the parties about what is to be done, how it is to be done, and under what circumstances. Exactly what those terms are must be determined by the parties to the agreement. Because terms are the elements of the contract, they are binding and carry legal consequences if they are broken or breached.

Even the simplest forms of contract will have terms; the main terms generally being the price paid or to be paid, and the *"subject matter*" of the contract, that is, the details of the goods or services or other property provided or to be provided. It is common for businesses to have standard written *"terms & conditions"* (T&C) which can be quite lengthy - see Fig.2/2. It is not a requirement that terms are written in simple contracts, although writing is required in certain types of contract, such as contracts for the sale of land, mortgages and consumer credit agreements.

Contract terms may be express or implied and they may be classed as either conditions, warranties or innominate terms. Where a contract is formed orally, it might be difficult to establish which statements made in negotiating the contract are treated as terms, and which statements are merely representations.

★ ***Express terms*** are terms which have been specifically - or "expressly" - mentioned, and agreed by both parties at the time the contract is made. Express terms can be either oral or in writing. For example, if a landlord presents a prospective tenant with a pre-printed lease for a house or apartment and the other party agrees to the terms contained in the document and signs it, then it is an express written contract.

★ An ***implied term*** is a term which was not specified in the contract, but might be implied into it by statute or common law. Sometimes a term might not have been mentioned by either party, but will nonetheless be "included" in the contract, often because the contract does not make commercial sense without that term or is clearly understood by all parties. For example, in a transaction within a home country - that is, all parties are in the same country - there is no need to define the unit of currency (pounds, dollars, rupees, or other) because that sum stated will be clearly understood by each party.

★ A ***'condition'*** is a major contractual term, which is crucial to the existence of the contract. Should a condition be breached, the innocent party may refuse further performance and may sue for *"breach of contract"*. Conditions are terms that go to the very root of a contract, and therefore a breach of any of these terms gives the innocent party the right to repudiate the contract, that is to "discharge" or end the contract.

★ A ***'warranty'*** is a minor contractual term, and a breach of one might entitle the innocent party to sue for damages. Because a warranty is less imperative than a condition, the contract will be valid even if there is a breach.

★ '***Innominate'*** refers to a term which is capable of giving rise to a variety of breaches of different degrees of seriousness. An innominate term might turn out to be either a condition (and therefore is integral to the contract) or a warranty (and therefore is incidental to the contract) depending on its effect on the injured or innocent party.

★ ***'Exclusion'*** or ***'exemption'*** clauses: the parties to a commercial agreement often try to manage their risk by inserting clauses into a contract stating that one or both of the parties' liability - in the case of a breach of contract - is limited or restricted in certain ways. Exclusion clauses often state that one party to the contract will not be responsible for certain happenings. For example, if a person joins a health club or gymnasium, the contract might state that the club or gym owner will not be responsible if a member is injured whilst exercising. The owners of a car park will often include in the contract a provision such as *"vehicles parked at owners' risk"* which means they will not be responsible for damage to a vehicle, or theft of goods from it, while it is in the car park.

An exclusion clause must be clearly shown to be incorporated into the contract using clear, unambiguous language. If there is any doubt or ambiguity in the clause, then the clause will be interpreted against the party relying on it - that is, the party seeking to limit its liability. Commonly, exclusion clauses are subject to legal controls to avoid abuses.

Before entering into a contract, various statements (orally or in writing) will often be made by one party in order to encourage or induce the other party to enter into the contract. A dispute might later arise as to which of the statements made should be considered a part - that is, a "term" - of the contract, and which should be taken as being merely pre-contract talk - which is often called *"sales puff"* - and which are therefore not a part or term of the contract. For example, if a vendor claims that a customer will be *"over the moon"* with the purchase, the claim cannot be taken literally, and so is not a "term" of the contract.

It is important to appreciate that the parties to a contract are bound **only** by its terms, and **not** by any "peripheral" statements which might have been made.

Every contract made will contain representations and warranties, which are basically the underlying matters or facts as they are being "presented" in terms of the contract. When selling something such as real estate (land or buildings) the seller represents himself to be the owner (or the owner's appointed agent) who has the legal authority to sell or negotiate the sale of the property. He warrants that the property is as he represents it to be.

When a customer buys, for example, an electrical, electronic or mechanical appliance from a shop or store or on the Internet, the customer enters into the process with certain basic suppositions. These include that:

- the vendor has the right to sell the appliance
- the appliance is what the vendor states it is in terms of manufacturer and model
- the appliance will do what it is advertised or claimed to be able to do
- the manufacturer/seller warrants that the product is free of defect for a specified period of time into the future

A ***'representation'*** is defined as an account or statement of facts, allegations, or arguments. Representations present everything from a product's past to its current status: a presentation of fact - either by words or by conduct - made to induce someone to act, especially to enter into a contract.

A ***'warranty'*** generally moves from the present to the future. The appliance the customer is buying is warranted as being free of defects, and the manufacturer and/or vendor agrees or "contracts" to repair any defects for a specified period of time into the future. Some products are advertised as having a *"lifetime warranty".* If, for example, the appliance has a lifetime warranty, then any and every time it malfunctions, the customer can send it back to the vendor or manufacturer to be repaired. The warranty obligates the manufacturer or vendor to the terms of the contract.

Statements made during the course of negotiations could amount to a contractual term or a representation. It is important to know whether a particular statement is a contractual term or if it is a representation because this will determine the appropriate course of action and remedy available. If the statement amounts to a term of the contract which is not fulfilled, the innocent party may sue for "breach" of contract, that is, take proceedings against the other party for having broken the contract. If the statement is merely a representation which turns out to be untrue, the innocent party may bring an action for *"misrepresentation",* and/or action will be taken by a government body, such as a trading standards agency, under a country's consumer protection laws.

Terms & Conditions of Trade (T&Cs)

Its *"terms and conditions of trade"* (which might alternatively be called *"terms and conditions of sale" - or more generally are referred to as just "terms and conditions" - T&Cs)* form the basis on which a business buys products (goods and services, etc) from suppliers and sells products to its customers. The T&Cs provide a seller with a measure of security for the recovery of payment due, following the supply of goods or services, should the buyer "default" - fail to pay as agreed. Equally, a commercial buyer (as opposed to a consumer) will usually have its own terms and conditions of doing business. Large retailers such as chains of supermarkets and hypermarkets, etc, and their central purchasing departments, might have their own general buying conditions, known as *"contract terms",* for approved suppliers.

What is essential is that both contracting parties (that is, the buyer and the seller) agree the terms and conditions of trade between them before entering into the contract or at the time that a contract is formed. This will set the "ground rules" between the contracting parties, and will mean that both parties know exactly what is expected of them, which can help to prevent unnecessary disputes.

Oral contracts are in theory just as enforceable as are written contracts, but the main problems with oral contracts concern evidence and certainty. Due to the passage of time, one of the parties might forget some of the terms which have been agreed, or there might be a dispute as to what was or was not actually agreed. Similarly, with exchanges of emails going backwards and forwards it can sometimes be difficult to work out exactly what was actually agreed.

It is much easier and less risky to have standard terms and conditions of trade or sale drafted, printed and readily available when needed. The T&Cs might be printed on the reverse of documents such as quotations, estimates, commercial orders and invoices (which we describe and illustrate in Module 3) and/or might be printed on separate sheets (or webpages) which can be attached to other documents, or issued as a "stand alone" document.

It is safest if the T&Cs have been drafted by an experienced commercial lawyer to ensure that they will clearly set out the position on all important matters, and will not overlook any matters which are less obvious. A business person will probably consider the more business-related terms - such as price, payment terms and delivery costs - but might not think about limiting liability, disclaiming liability for failure or delay caused by *"force majeure"* (an event which is a result of the elements of nature, as opposed to one caused by human behaviour - see below); the protection of intellectual property rights, and the passing of "title" (ownership) and risk.

A well-drafted set of terms and conditions should fully protect the position of the business. It is not always necessary for a business - especially a new or a small one - to have T&Cs "custom-written" for it, because "templates" of standard terms and conditions of sale, can be purchased as printed versions, or downloaded from websites (sometimes without payment). When necessary those can be modified to meet the exact needs of a particular business.

When a business has clear written terms and conditions covering all the necessary areas of its provision of goods or services, the chance of a legal dispute when things go wrong is minimised. That is because a lawyer will advise the other party that the terms and conditions are clear on the matter, and that they would have little chance of winning if the matter were to go to court. In consequence, the business is less likely to be taken to court.

Also, when a business has clear terms and conditions, it will be clear where a customer or supplier has *"breached"* or broken the contract. Written contracts are much easier to enforce should a business need - for example, in the case of non-payment - to take a customer to court, or if the customer needs - for example, in the case of the seller's poor or non-performance - to take the supplier or vendor to court.

Force Majeure

A *"force majeure clause"* (French for *"superior force")* is a provision in a contract that allows a party to it to suspend or terminate the performance of its obligations when certain circumstances beyond their control arise, making performance inadvisable, commercially impracticable, illegal, or impossible. The provision may state that the contract is temporarily suspended, or that it is terminated if the event of force majeure continues for a prescribed period of time - see clause 8 in Fig.2/2.

The list of events to be included is a matter of negotiation between the parties. A typical list of force majeure events might include war, riots, fire, flood, hurricane, typhoon, earthquake, lightning, explosion, strikes, lockouts, slowdowns, prolonged shortage of energy supplies, and acts of State or governmental action prohibiting or impeding any party from performing its respective obligations under the contract.

An example is if a hurricane occurred that forced the shutdown of a port; if there was force majeure provision in the contract, the seller who was intending to ship its goods through that port would not be liable for late delivery of the goods.

In the absence of a force majeure clause, parties to a contract are left to the mercy of the narrow common law contract doctrines of *"impracticability"* and *"frustration of purpose",* which rarely result in excuse of performance.

Voidable Contracts

A formal agreement between two parties that may be rendered unenforceable for a number of legal reasons is said to be *"voidable".* Reasons which can make a contract voidable include failure by one or both parties to disclose a *"material fact"* (something which might have caused the other party to decline to form the contract); a mistake, misrepresentation or fraud; undue influence or duress; one party's legal incapacity to enter a contract; one or more terms that are unconscionable; or a breach of contract. A voidable contract is said to have a *"defect",* and can be legally rejected by one party. If that party chooses not to reject the contract despite the defect, the contract becomes valid and enforceable.

Void Contracts

A void contract is a formal agreement which is illegitimate and unenforceable from the moment it is created. A void contract could be considered void for a number of reasons. Common causes of a void contract are contract terms that are illegal or become illegal due to changes in law; one party to the contract lacks the capacity to enter into a contract because he or she is a minor (too young to be considered an adult) or mentally incapacitated; or if it is legal but declared null by the courts because it violates a fundamental principle.

There is some overlap in the causes that can make a contract void and causes that can make it voidable. The fundamental difference between these two types of contracts is that a void contract is not legally valid or enforceable at any point in its existence, whilst a voidable contract can be legal and enforceable depending on how the contract defect is handled.

Fig.2/2. specimen terms and conditions of sale

TERMS AND CONDITIONS OF SALE

1. Definitions

Buyer: the person who buys or agrees to buy the goods from the Seller

Conditions: the terms and conditions of sale as set out in this document and any special terms and conditions agreed in writing by the Seller

Goods: the articles which the Buyer agrees to buy from the Seller

Price: the price for the Goods, excluding Sales Tax and any carriage, packaging and insurance costs

Seller: means (name) ______________________ of (address) ______________________________

2. Conditions

2.1 These Conditions shall form the basis of the contract between the Seller and the Buyer in relation to the sale of Goods, to the exclusion of all other terms and conditions including the Buyer's standard conditions of purchase or any other conditions which the Buyer may purport to apply under any purchase order or confirmation of order or any other document.
2.2 All orders for Goods shall be deemed to be an offer by the Buyer to purchase Goods from the Seller pursuant to these Conditions.
2.3 Acceptance of delivery of the Goods shall be deemed to be conclusive evidence of the Buyer's acceptance of these Conditions.
2.4 These Conditions may not be varied except by the written agreement of an authorised executive of the Seller.
2.5 These Conditions represent the whole of the agreement between the Seller and the Buyer. They supersede any other conditions previously issued.

3. Price

The Price shall be ____ (amount) or the price quoted on the Seller's confirmation of order. The Price is exclusive of Sales Tax which shall be due at the rate in force on the date of the Seller's invoice.

4. Payment and Interest

4.1 Payment of the Price and Sales Tax shall be due within 30 days of the date of the Seller's invoice.
4.2 Interest on overdue invoices shall accrue from the date when payment becomes due calculated on a daily basis until the date of payment at the rate of __% per annum above the bank base rate from time to time in force. Such interest shall accrue after as well as before any judgment.
4.3 The Buyer shall pay all accounts in full and not exercise any rights of set-off or counter-claim against invoices submitted by the Seller.

5. Goods

The quantity and description of the Goods shall be as set out in the Seller's confirmation of order.

6. Warranties

The Seller warrants that the Goods will at the time of delivery correspond to the description given by the Seller in the confirmation of order. Except where the Buyer is dealing as a consumer, all other warranties, conditions or terms relating to fitness for purpose, quality or condition of the Goods are excluded.

7. Delivery of the Goods

7.1 Delivery of the Goods shall be made to the Buyer's address. The Buyer shall make all arrangements necessary to take delivery of the Goods on the day notified by the Seller for delivery.
7.2 The Seller undertakes to use its reasonable endeavours to despatch the Goods on an agreed delivery date, but does not guarantee to do so. Time of delivery shall not be of the essence of the contract.
7.3 The Seller shall not be liable to the Buyer for any loss or damage whether arising directly or indirectly from the late delivery or short delivery of the Goods. If short delivery does take place, the Buyer undertakes not to reject the Goods but to accept the Goods delivered as part performance of the contract.
7.4 If the Buyer fails to take delivery of the Goods on the agreed delivery date or, if no specific delivery date has been agreed, when the Goods are ready for despatch, the Seller shall be entitled to store and insure the Goods and to charge the Buyer the reasonable costs of so doing.

8. Force Majeure

A party shall not be liable for any failure of or delay in the performance of a sale agreement for the period that such failure or delay is due to causes beyond its reasonable control, including but not limited to acts of God, war, strikes or labour disputes, embargoes, government orders or any other force majeure event.

9. Acceptance of the Goods

9.1 The Buyer shall be deemed to have accepted the Goods 48 hours after delivery to the Buyer.
9.2 The Buyer shall carry out a thorough inspection of the Goods within 48 hours of delivery and shall give written notification to the Seller within 5 working days of delivery of the Goods of any defects which a reasonable examination would have revealed.
9.3 Where the Buyer has accepted, or has been deemed to have accepted, the Goods the Buyer shall not be entitled to reject Goods which are not in accordance with the contract.

10. Title and risk

10.1 Risk shall pass on delivery of the Goods to the Buyer's address.
10.2 Notwithstanding the earlier passing of risk, title in the Goods shall remain with the Seller and shall not pass to the Buyer until the amount due under the invoice for them (including interest and costs) has been paid in full.
10.3 Until title passes the Buyer shall hold the Goods as bailee* for the Seller and shall store or mark them so that they can at all times be identified as the property of the Seller.
10.4 The Seller may at any time before title passes and without any liability to the Buyer:
10.4.1 repossess and dismantle and use or sell all or any of the Goods and by doing so terminate the Buyer's right to use, sell or otherwise deal in them; and
10.4.2 for that purpose (or determining what if any Goods are held by the Buyer and inspecting them) enter any premises of or occupied by the Buyer.
10.5 The Seller may maintain an action for the price of any Goods notwithstanding that title in them has not passed to the Buyer.

11. Carriage of Goods:

Carriage will be chargeable on all sales under ____ (amount) at the rate of ____ (amount)

Note: A *"bailee"* is an individual who is temporarily entrusted with the possession - but not ownership - of a good or other property by another individual known as the *"bailor".* This subject is enlarged upon in Module 8 of the Commercial Practice & Law Diploma Program.

Module Four

THE FUNCTIONS OF MANAGEMENT, POLICY & OBJECTIVES, PLANNING, ORGANISING, COORDINATING, COMMANDING, CONTROLLING

This Module is one of the 12 Modules from the CIC Diploma Program on:

Professional Management & Administration

Introduction: This Program explains how to become a professional modern manager with the ability to guide others: and how to plan, organise, direct, co-ordinate and control activities so that objectives are achieved efficiently and economically. It teaches how to manage and direct people, departments and organizations, and how to guide teams and provide positive leadership.

This Program provides men and women with the skills needed for good employment, advancement and development in careers which require managerial and administrative knowledge, skills and ability.

	Professional Management & Administration - Modules Summary
Module	**Module Title**
1	Modern Management & Leadership, Types of Businesses & Enterprises, Duties of Directors
2	Functions of Management: Planning, Organising, Coordinating, Commanding, Controlling
3	Authority, Responsibilities of Management to the Employer, Employees, the Community
4	The Delegation of Responsibility, Business Organisation, Structure & Expansion, Charts
5	Communication: Principles, Benefits, Channels, Barriers, Methods, Time Management
6	Internal & External Recruitment, Job Descriptions, Advertising, Selection, Appointment, Probation
7	Induction, Employee Relations, Training, Development, Remuneration, HR Policy, Team Building
8	Occupational Health & Safety, Duty of Care, Hazards, Accidents, Fire, Stress, Harassment
9	Employment Relations, Labour Law, Trade Unions, Disputes, Arbitration, Dismissal, Redundancy
10	Managers & Subordinates, Respect, Positive Behaviour & Attitude, Disciplinary Action, Counselling
11	Styles of Leadership, Scientific Management, Managers & Motivation, Job Content Factors
12	The Modern Manager, Qualities & Traits Needed, Empathy, Attitude, Preparing for Promotion

If you would like to study the complete Program and gain an international Diploma on **Professional Management & Administration** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Cyrus Sebit Hillary wrote from **South Sudan**:
"Many thanks to CIC for giving me great knowledge of management. After gaining the CIC Diploma I was appointed Manager in the Ministry of Finance and my salary was raised by 50%. CIC is the Master Key for a Better Life!"

Claudia Forbes from **St. Vincent & the Grenadines**:
"The theoretical and practical knowledge I learned helped me tremendously. Since I pursued the course I have been blessed with many business opportunities and accepted for a Bachelor in Management (USA)."

Module Four

THE FUNCTIONS OF MANAGEMENT

Introduction

What we described in Module 1 as being the "managerial" aspect of any manager's job or work, can be divided broadly into five ***functions*** - or five types or groupings of activities. In brief, they are:-

Planning This function entails deciding how the predetermined objectives of the enterprise, or the department or section or workgroup of it, should be achieved - in the most efficient and economical way - in accordance with the policy laid down by top management, such as the board of directors.

Organising This function involves putting the *"theory"* - the plans - into *"practice"*, by effectively arranging the work to be performed to ensure that the objectives will be achieved as laid down in the plans.

Co-ordinating This function is closely related to organising, and must ensure that although different personnel might perform different work, all their efforts will "mesh" smoothly together and that they are all directed towards achieving the common objectives.

Commanding This function involves providing *"leadership"* for subordinates, and also requires the ability to *"motivate"* them, that is, to encourage or inspire them to give of their best in achieving the objectives, by creating a good morale or working spirit amongst all persons employed by the enterprise.

Controlling This function comprises supervising the people employed, checking their work and the machinery and equipment used, to ensure that the *"end products"* are the desired objectives; it also includes recording performances - such as hours worked, materials utilised, production output, sales volumes - to provide a guide for further similar activities in the future.

Fig.2/1. the functions of management

We shall examine each of the five functions of management in greater detail later in this Module, and also see how they interrelate and what they entail in practice. However, as they are all concerned with achieving ***objectives***, let us first consider what those might be and who decides what they are to be.

The Objectives of Enterprises

Basically, objectives are the ***'goals'*** which an enterprise aims to achieve; in fact the attainment of the set objectives is the principal reason for the very existence of that enterprise!

Before any enterprise is started or established, a person or a group of people has to decide what that enterprise is going to do. These are some examples:-

✧ Is it going to manufacture something - if so what?

✧ Is it going to buy and sell - if so what?

✧ Is it going to provide a service - if so what?

In some cases the "answer" to the particular question raised is fairly straightforward. For example, a person might decide to open a bookshop, or an experienced painter/decorator might decide to set up on his own instead of working for others.

However, in other cases considerable thought as well as "research", might be necessary before deciding to produce or to provide:

❖ something which is not already available;

or

❖ something which is likely to be able to compete successfully with similar goods or services already available.

Numerous factors - such as finance and resources available or which can be made available, the market potential, facilities which will be required and so on - might have to be considered before a decision on viable objectives of an enterprise is finally reached.

The Profit Motive

In the private sector, the specific objectives of a business are combined with the objective of **profit**; by this we mean that the result of achieving the specific objectives of the business must be that its owners gain money.

It is important for you to understand what profit is and how it arises, because the performances of many managers are assessed by the profits earned by the businesses which they run or by which they are employed. A simple example will help to make the concept clear to you:-

Practical Example

A furniture-maker sells a table which he has made - produced. He spends the money he receives for the table to buy food or clothing or to buy materials or pay the rent of his workshop. What he has done is to **exchange** his materials and labour for the materials and labour of other people; and money is only the "medium" which makes the exchange easier.

In order to produce the table (and other items of furniture) the furniture-maker had to make use of three resources: **land**, **labour** and **capital**, which are called the ***'factors of production'***. Each resource is necessary in this instance (and in any other form of production, and in most other forms of endeavour) because:-

★ Without **land** there would be no place or workshop in which the furniture-maker could work to produce furniture.

★ Without the furniture-maker's **labour** no furniture would be made.

★ Without **capital** there would not be the money - the ***'finance'*** - the furniture-maker needs (a) to pay the rent of his workshop, to buy timber, tools, nails, screws, etc, from which to produce more items of furniture; and (b) with which to buy food and clothes for himself (and perhaps his family) until the next items of furniture are made and sold.

The furniture-maker needs to be sure in advance that his production will bring back the money he spends on materials, on labour, and on rent, and also bring a ***'return'*** on the capital employed; and it is this "return" which is called ***'profit'***. A return on capital in the form of profit **is** important. That is because in reality capital is nothing more than the result of previous production; if the furniture-maker works so well that he sells his products for more money than he needs immediately, he can either save that extra money against future needs, or use it as capital to finance more production.

Policies and Policymaking

Hand in hand with the decision on the objectives of an enterprise, is the necessity to decide in broad terms **how** and **where** those objectives are to be achieved, that is, to lay down the basic ***policies*** of the business.

To return to our earlier example of the intending bookseller, he (or she) must decide what type(s) of books the shop is going to sell; for example, will its objectives be to sell novels, paperbacks and less expensive publications, etc, or to sell text books, technical publications or expensive books, etc? Will the business sell only new books and/or buy and sell second-hand books? The owner must then decide **how** the business is going to sell the books: by wholesaling, retailing (over the counter sales), in bulk, by mail-order, through a website on the Internet, or by a combination of two or all methods.

Clearly the "where" is closely allied to the "how" and to the objectives, as customers might need easy "access" to a shop or store to make their purchases. If, in the case of a bookstore, it is going to sell novels and paperbacks it *"premises"* - that is, the building from which it operates - need to be located in a busy street area where its window displays will attract the attention of many passers-by, who will probably buy single copies of books for cash. On the other hand, if the store is going to sell mainly text books, it needs to be located in the vicinity of schools, colleges or a university, but it need not be in a busy thoroughfare.

In contrast, if sales will be made mainly or entirely by mail-order and/or via the Internet, the location of the premises used for the business might not need to be located in a busy thoroughfare, and could be in a quieter (and less costly) neighbourhood. However, the business needs to be located in an area with good communications facilities and despatch/ delivery services, and might need to incorporate a suitable storage area.

If the business will operate a bookstore which will sell single copies of books to students, those customers will probably pay for their purchases at once - what are called *"cash sales"*. But if the business is going to sell in bulk to schools, etc, space will be needed in which to hold large stocks, and the business will probably have to allow its customers a *"period of credit"*, that is, it will have to sell the books without receiving payment for them from customers at once.

The foregoing is, of course, a very simple - but clear - example of how objectives are need to be determined and how basic policies are laid down. In practical business situations - particularly with manufacturing businesses - the proceedings and decisions will be far lengthier and more complex. Besides decisions on the type and size of premises which will be required and their location, it must be decided whether to rent or purchase the premises or have them specially built, and how much can be spent on them; what methods of production are to be used, such as whether the latest technology and machinery are to be employed, or whether tried and tested methods and machinery will be used; what methods or "channels" for distributing the manufactured items will be used, and so on - the list is long.

Of course, objectives might have to be modified in the light of experience, market trends, commercial viability, etc, after a business has been established. A business (or indeed any enterprise) can only continue to exist for as long as there is a **need** for its products, or it can **create a need**.

Policies, being really the attitudes of the management of the enterprise towards achieving its objectives, are rather more flexible, and can be adjusted to deal with problems which might arise in attaining the objectives, or as required by the operating position of the enterprise at a particular time. Such modifications of objectives and adjustments to policy are made by the owner(s)/partners of a business, or by the board of directors if it is a company.

The Interpretation and Implementation of Policies

Once the initial objectives and the basic policies of an enterprise have been decided upon, the actual achievement of those objectives is the responsibility of the members of its management team. In other words, the various members of management have to set in motion the various activities which will **actually gain those objectives** IN PRACTICE.

That involves two important activities and decisions:-

★ Firstly the policies must be ***interpreted.*** This means that the policies must be examined carefully, and "broken down" to see clearly what activities and tasks will have to be undertaken to achieve the objects.

★ Secondly, once it is clearly understood what will be involved, it can be decided what steps must be taken to ***implement*** the policies - that is, what actions are necessary to put them into practice. In other words, the policies - the theory - have to be *'translated' into action.*

Unless an enterprise is very small, in addition to there being objectives for the enterprise as a whole, there should also be *"departmental objectives"* set by the board, with policies laid down for the attainment of them. Of course, the objectives of a particular department will be "narrower" in scope than those of the enterprise as a whole. Nevertheless, unless **each** department attains its set objectives, the overall objectives of the entire enterprise might not be achieved as intended.

A departmental manager (who as a "specialist" might be able to advise or influence the board on setting the department's objectives and in its policy making) will have to:-

★ **interpret** the policies laid down for his particular department;

and

★ **implement** those policies to achieve the department's set objectives.

In doing so, he will have to set objectives and lay down policies for their achievement for each of the sections which make up his department. The objectives of each section will inevitably be narrower in scope than those of the department as a whole; but each must attain its set objectives.

Each section manager - under the guidance of the departmental manager - will then have to interpret the policies for his section and implement them. That will require him, in turn, to set the even narrower objectives - and to lay down policies for their achievement - for each workteam or workgroup in the section, each of which will be under the control of a supervisor or foreman.

Finally, each supervisor or foreman will have to interpret the policies and implement them. He will do that by explaining clearly to each member of his team or workgroup - in clear and familiar terms - what he or she is to do, when, where and how.

So you can see that, stage by stage, the broad, overall objectives and the policies set by the board, are "broken down" into the possibly very narrow range of tasks and activities to be performed by each individual employee in the workforce. At each stage in the process, detailed, clear and easy to understand and assimilate information and instructions need to passed - “communicated” - to every one of the personnel concerned. (This important matter is covered in Module 5 of the Management & Administration Diploma Program).

The five functions of management are all concerned with the **interpretation** of policies and their **implementation** in order to achieve the set objectives. We must now turn our attention to a more in-depth study of them.

Planning and Plans

Planning is the activity concerned with making or formulating **plans**. Plans should be looked upon as being ***‘routes to objectives’.***

Once the objectives of an enterprise have been decided upon, planning is necessary to **work out how to achieve** those objectives within the framework of the policies formulated. Although we are concerned in this Program with planning as a managerial function, it must not be overlooked that planning is necessary in everyday living. Even a shopping expedition might need some planning - what route to follow to get to the shops; what form or forms of transport to take and when/where to change from one to another; the order in which to visit shops, for instance to avoid purchasing the heavy items first and then having to carry them around all the other shops to be visited; how to get back home with the parcels and bags of items bought, and so on.

In business, “top management”, such as the board of directors of a company, is involved mainly with “long-term planning” which is often called ***‘strategic planning’.*** That is concerned primarily with deciding what the objectives of the business should be in two, four, five or even ten years ahead, and the future policies of the business. Such planning is concerned mainly with the enterprise as a whole rather than with its individual departments or sections.

Senior management will be involved in ***‘tactical planning’***, that is, planning how the overall strategies are to be achieved. This often entails devising and operating short-term plans, for up to a year ahead.

Other levels of management, including supervisors and/or foremen, are involved mainly in very short-term ***‘activities planning’*** - sometimes called ***‘operational planning’.*** That involves planning the day to day running of departments or sections and individual assignments, for example planning how to meet a particular month’s production quota, or deciding what each member of a workgroup should be doing at any given time.

A good deal of the planning which managers are called upon to perform involves making **routine decisions**, and is concerned with everyday matters; for example planning the work of a team of office staff, which will be similar week after week.

However, plans must be **flexible** so that they can quickly and easily be modified in the light of events. For example, an office manager might have decided how his subordinates will cope whilst another member of staff is on holiday, and has planned the rearrangement of the work of the department. But the day after the implementation of the new plan, another member of staff falls ill so he must modify his plans, and determine how the work can be rescheduled with two subordinates away.

Much of such ***routine planning*** is an automatic process, requiring little conscious thought on the part of the manager, because his or her plans and decisions will be based largely on past experience with similar, or even with identical, problems. Other planning, of perhaps a business trip or a training course, for example, might require far more conscious thought, investigation and research before decisions are reached.

Planning in a Practical Business Situation

On the establishment of a new enterprise, branch or department or on the introduction of a new range of products, for sale or manufacture, considerable planning is necessary. Let us return to our example of the intended bookstore and see what planning and decision-making will be necessary by the owner-manager:-

* The layout of the premises secured will have to be planned so that there will be the correct amount of space allocated to each type or category of publication for sale (for example, different areas might be needed for different subjects: history, geography, science, etc, and some subjects might need more space than others.)

* Decisions will be needed on the types and sizes of racks and/or shelving to be used in the shop to contain the books for sale, and how they will be affixed to the walls or otherwise, as well as on what kinds and sizes of display cabinets, counters, etc, will be needed.

* The layout of the storage area - to hold "reserve" stocks of books - will have to be planned and decisions reached on the types and sizes of racks or shelving to be used. It is important to plan how new stocks can be supplied to the shop quickly to replace those books sold.

* The number of personnel needed to sell in the shop itself, plus any others who might be needed to maintain the stores or to be involved in reordering and/or accounts work, must be estimated. Decisions must be reached on the calibre of staff needed, how to recruit them and, if necessary, how to train them.

* If books are to be sold wholesale, in bulk, then a delivery van driver might have to be employed (and a van might have to be purchased.)

* It will have to be decided what equipment (such as cash registers, computer terminals) will be needed inside the selling area of the store, how much can be spent on them (can they be purchased second-hand for instance?) and/or what sales documents might have to be printed - and the layout of those items will have to be planned and designed, printers found, quotations asked for, prices compared, orders placed, proofs checked, and so on.

* Vital decisions will have to be made on the publishers and/or wholesalers from whom stocks of books will be ordered, as well as on the sizes of the orders. The latter might require a prior knowledge of, or research into, the likely requirements of potential customers, as well as forecasts of expected sales, and information on the publishers' prices, credit terms and discounts (that is, reductions in prices) offered.

* Plans will have to be made to combat possible "pilfering" - that is, stealing or shoplifting - and the necessary precautions will then have to be instituted.

* Decisions will have to be made on what advertising and/or publicity will be undertaken; for example signboards and/or signs on the building or in windows, advertising in local newspapers, circulars to potential customers, etc. It will be necessary to decide whether to have special paper bags or wrapping paper - bearing the name and address of the shop - printed and, if so, they will have to be designed, and their printing arranged.

* Allied with the previous point, it will have to be decided whether to offer special price reductions (or to employ some other form of "sales promotion") to attract customers to the new shop quickly.

* Many *"accessories"* and *"consumables",* such as adhesive tape, string, pencils, pens, pads, and so on, will have to be purchased - and be available for use when needed - and the suppliers of them must be decided upon.

Many other plans and decisions will, of course, have to be made, particularly once stocks of books actually start arriving and have to be housed in the store or displayed in the shop or in its windows. Arrangements for banking and for services, including utilities, needed - electricity, telephone, water - will all have to be made and, remember, **in advance** of business commencing.

The foregoing example is a relatively simple one, but shows you what is involved in planning, that is - in this case - in working out **how** the objective of selling books will be put into practice. Think how wide-ranging and complex will be the planning necessary to set up, for example, a factory to produce a range of tinned food products, or even a motor car or automobile.

The necessity for such planning can also arise **after** the establishment of an enterprise. For example, at a later date it might be decided (by the owner or board of directors) to ***'diversify'*** the bookshop so that in addition to books, it will sell or rent CDs and/or DVDs; plans will then have to be formulated on how that will be done, how the new section will operate with, or independently of, the existing organization, and so on.

The Activities of Organising and Organisation

Once the plans - the "theory" - have been formulated, a manager is involved in organising the physical resources at his disposal - the men and/or women, materials, components, machines and even the premises - to ensure that the objectives are achieved as planned.

Organising involves **much more** than simply instructing a given number of people to start work:-

★ There must be an adequate and competent workforce to perform all the work necessary.

★ Each person employed must know exactly what he or she is to do (and if necessary must be taught or trained to perform that work), how the work is to be done, when and where it is to be done, and so on.

★ All the materials to be used must be readily available when and where they are needed.

★ All services and utilities necessary: electricity, water, fuel, etc, must be provided.

★ The best machinery and equipment, within the financial resources of the enterprise, should be available for use, regularly maintained and in perfect working order, and - if necessary - training must be given to the employees who will operate it.

★ The premises, whether factory, shop/store or office, must be so laid out to provide the maximum efficiency and convenience, and to allow a smooth flow of work. For example, shelves, counters and cash desks (in a shop or store), desks, filing cabinets and office equipment and computers (in an office), machinery and tools (in a factory or workshop) must be positioned to utilise the available amount of space in the most effective layout, to avoid wasted effort, duplication and unnecessary movement.

It is clear, therefore, that the function of organising can be summarised as the managerial process of ensuring that:

The right personnel, the right materials and the right machines are in the right places at the right times and in the right quantities so that work will proceed in accordance with the formulated plans, without delays, hold ups or stoppages.

The Activities of Co-ordinating and Co-ordination

Organising and co-ordinating are very closely linked, and very frequently co-ordinating is an essential continuation of organising.

Co-ordinating involves:

Ensuring that all efforts move smoothly together in the same direction, that is, towards achieving the common objectives.

Co-ordination is as essential at top management level as it is at junior management and supervisory levels. For example, the managing director or general manager must ensure that the efforts and activities of all the various departments of an enterprise are in harmony, and in co-operation. There would be no point, for example, in the sales department endeavouring to sell items which are not yet in production! Good relations and communications between departmental managers must be developed and fostered so that they all work together in harmony.

At the other end of the scale, a junior manager, supervisor or foreman must co-ordinate the work of his subordinates in his workgroup so that although different people might be performing different tasks, work will, when necessary, flow smoothly and continuously from one person to the next.

Practical Example

Here is an example of what has just been discussed:-

In an office, one clerk might draft or dictate a letter, which then has to be passed to a typist or keyboard operator; after it has been typed, the letter has to be passed to another person for checking and signing, and the letter then has to find its way to the despatch department for franking, after which it will finally be despatched (by post, fax or email) to its addressee.

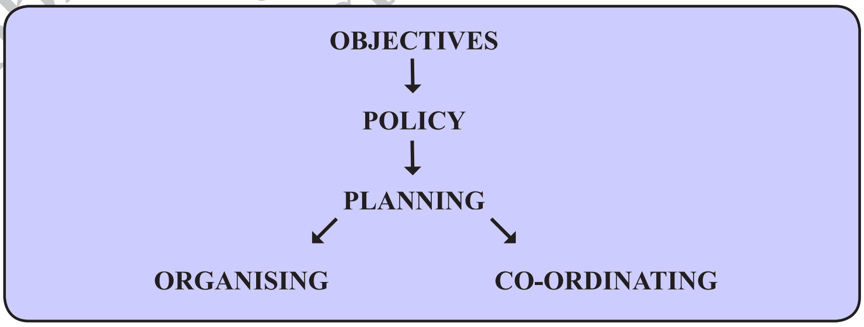
Furthermore, the copy of the letter and that to which it is in reply will have to be correctly filed for future reference.

Five or six or more people might be involved in this simple operation, but their different tasks must be so planned, organised and co-ordinated that the efforts of each mesh together like gearwheels.

Delays and backlogs would ensue if the clerk drafted or dictated fifty of sixty letters before passing any to the typist or keyboard operator - who might be sitting idle waiting for work, and so on down the line.

Co-ordination does **not** simply "happen" by itself - it has **to be planned**. The relationships between planning, organising and co-ordinating are shown in Fig. 2/2.

Fig.2/2. the relationship between planning, organising and co-ordinating



Activities Involved in Commanding

When we use the term *"commanding"* in this context, we do not mean simply "ordering" other people to do something. What we do mean is the performance of the important managerial responsibility of ***'leadership'.*** We can define *"leadership"* as being the ability of one person to exert a positive influence over the thoughts, behaviour and actions of one or more other persons, and then to direct their thoughts, behaviour and actions towards achieving a common goal or objective.

A manager must - by definition - be a **leader**; his or her managerial functions are concerned with planning, organising, co-ordinating, controlling and directing the activities of **other people** towards the achievement of an objective. To do that effectively a manager needs be able to ***'motivate'*** his or her subordinates; we refer to this activity as being ***'motivation';*** it is directly concerned with the people who work for a particular enterprise - rightly called jointly its *"human resource"* - and it involves:

Encouraging them to work well and willingly in the most economical manner in the best interests of the employing enterprise, as well as in their own best interests.

The objectives of any enterprise can be achieved ONLY through the efforts of people, human beings. It is "human nature" that people need ***'motives'*** - which the reasons people have for taking certain actions, or for acting in certain ways - and need to be ***'motivated';*** that is, they need to be induced, persuaded, prevailed upon (but **not** forced) - in a humane and understanding way - to give their best.

However, what motivates one person or group of people might not motivate another, and therefore for the best results a manager, supervisor or foreman should, as far as is feasible, get to know something about each of his (or her) subordinates.

- Mere financial reward is more of an incentive than a motivation to many people, although the end result - greater effort or better performance - might appear to be the same.

- Many people today are interested in gaining more from their employment than just money; they tend to look for what can be termed *"job satisfaction",* doing jobs which they enjoy, in which they feel that their skills/abilities are being utilised to the full, and of which the end products of the efforts are worthwhile and are appreciated.

- Many other people are interested in the likelihood of receiving training, or of working in a group, or in the prospects for promotion - in achieving positions of responsibility and authority or status (and so will be motivated to do their best to prove their suitability for promotion.)

- Other people might want jobs in which they can use initiative or can get away from being "desk bound" or from being tied to a routine or regular hours. (It must not be overlooked, however, that some employees are content with routine or repetitive work, and being allowed to remain on that type of work is in itself a form of motivation for them.)

- Other people are interested in "recognition" or in gaining various other "rewards".

So you can see that the range of motivations can be great and, of course, more than one - different - motivation might stimulate a particular person or group of people. However, a manager, supervisor or foreman must endeavour to get the best from **each** individual member of his or her team or workgroup, and that might require him to motivate different members in different ways, whilst still motivating *the team or group as a whole.*

The latter requires the building of a **good** *"working atmosphere"* based on a spirit of trust and co-operation between management and other employees. Good working conditions help in generating a good working relationship. And although a junior manager, foreman or supervisor might have little control over conditions - or say in the matter of salaries/wages, overtime, holidays, etc - subordinates must be able to trust their superior to put their case, when possible, to his immediate superior, and to trust that person to take action or to press the matter "upwards", and so on.

There must also be *"two-way communication"* within the enterprise, and all employees must be kept regularly informed about matters which affect their jobs and job security, and their livelihoods - and these important matters are considered in detail in Module 5.

What is called *"job security"* - or permanence of employment - is important in forming a good working atmosphere and encouraging employees to work well. Threats of dismissal or layoffs might sometimes induce better efforts in the short-term, but they are **not** to be recommended in modern management, and they are more likely to result in disgruntled workers and in disputes arising.

Subordinates want to know that they are looked upon **not** as mere *"working units"* or *"production units"* but as **human beings**, and that their manager(s) are genuinely interested in them as such. They require - and expect - an evenhanded, fair, unbiased approach from their managers, in addition to that essential quality called *"leadership".*

It is important for all people involved in management and supervision to appreciate that successful motivation by a good manager/supervisor produces a measure of self-discipline amongst his subordinates; they will have sufficient self-respect, and loyalty to their manager or supervisor, to work well and willingly. So proper motivation instils a good mental attitude towards work, which mere financial incentives cannot buy.

The Activity of Controlling

Controlling is the managerial and supervisory activity which primarily involves checking whether or not what was planned to happen **does actually happen** in practice. It also ensures that - in the event of any "deviation" or departure from the pre-planned course of action or standard expected - timely *"corrective action"* is taken to get back "on track" as quickly as possible.

Within this framework it can be seen that the work performed by all members of the workforce must be *supervised* and their work must be *checked* (and further instruction, guidance or training given when necessary.) In addition, all operations or processes must be *checked* and/or *inspected,* and *performances must be "measured"* against the targets set in the plans, and against set standards.

Standards

A *"standard"* in this context means:

A level to be aimed at, or a measure with which others must conform, or by which the accuracy of others can be judged.

A simple example is a business letter: certain standards will be laid down which it must meet: concerning the type, size and colour of paper on which it is to be typed or printed; the layout of the typed work, the position of the addressee's name and address, the date and reference (if any); whether paragraphs are to be indented; whether the signer's name and/or designation will be typed - and the typed letter will be expected to reach certain standards of neatness, to be free of spelling mistakes, and to be generally "attractive" to the eyes of the intended reader(s).

Of course, standards apply in everyday life, too: the laws of a country are the standards by which citizens have to abide; students are expected to attain certain standards of work and their examination work will be assessed against set standards or levels; to pass a driving test a certain level of proficiency must be possessed, and so on.

In management, standards are a measure of the performance of a process or a routine or of equipment, and they are used as a ***"comparison"*** to check that one item or process matches - in quantity or quality - that which is set as the standard. The standards set by the management of an enterprise might not necessarily represent perfection, but rather might represent the best method or item that can be produced at a given time within limits imposed by such factors as cost - or what consumers are prepared to pay - equipment available, quality and availability of materials and components, etc.

The management of an enterprise will establish its own standards for the various types of work performed, and for its end products; although in most countries there might be laws to ensure that various products meet certain quality or safety standards - and, of course, often consumers will indicate the standards which they expect. Standards apply in virtually all enterprises, whether they are industrial, trading, service-providing or State-owned. Even the customers of a one-man business will expect him to stock the type or quality of goods they want at prices they can afford to pay, that he serves them with efficiency and courtesy, and so on.

Standards must also be flexible so that they can be amended in the light of changing circumstances; for instance, changes can occur in consumer demand, there might be rising costs, better or newer technology might become available, and so on. An enterprise cannot become "static"; its operations and its personnel - both managerial and non-managerial - must adapt to changing circumstances and trading conditions.

Quantity Standards

These include specific *"targets"* which are set for sales, production, output per worker, output per machine, and many other such "quantifiables", which can be determined and/or measured fairly accurately, and which should be met within tolerable limits.

Quality Standards

These apply to the finished products or end results of processes or to various stages in the manufacturing process; production control and inspection are required to ensure that such standards are met.

The following types of standards can be used:-

Ideal or Strict Standards

These are set at the maximum level of efficiency; they are, in effect, standards of *"perfection"* and as such they can rarely be achieved, and then only for short periods. The setting of such standards can sometimes motivate employees to increase their output to the maximum. But if - despite their doing so - they still cannot attain the set standards, they are very likely to become discouraged and **de**motivated.

Attainable Standards

These are set at levels which it is considered are capable of being attained with reasonable effort. The problem for management is to decide what **really is** attainable; that is because - as we have already pointed out - each employee has his or her own character, and what motivates one person might not motivate another. Some people can be motivated to attain standards they are capable of, but they might not make much effort to exceed those standards; some people thrive on the challenge to exceed standards (but might become discouraged and **de**motivated if despite their best efforts they cannot do so); whilst other people attempt to set their "own" standards (which are usually lower than those which are set by management.)

Much depends on the types of work being performed in a particular workplace and on the skill and calibre of employees, on the work environment and the work climate, on management's attitude towards its workforce, and on the managerial skills of individual managers, supervisors and foremen. However, it is clear that reasonable, understanding and fair management is most likely to result in attainable standards actually being achieved on a regular basis.

Supervision

Controlling includes ensuring that employees perform the work which is allocated to them in the ways laid down, and with no wastage or duplication of time, effort or materials. That involves much more than simply instructing a given number of employees to perform work. All subordinates must be supervised and managed so that their combined efforts will achieve the desired results; and that requires, as we have already explained, that all personnel are motivated, checked, guided, taught, trained, encouraged and led to give of their best.

All employees of an enterprise - whatever their seniority or otherwise in that enterprise, and no matter whether they are categorised as being managerial or non-managerial - are human beings, with human failing. And therefore their efforts **cannot** simply be switched or off like a light bulb. All subordinates look towards, indeed depend upon, their respective managers or supervisors or foremen for direction, which requires leadership.

Maintaining Records

An important part of the function of controlling entails the maintaining of *"records of performance".* Such records, whether they are concerning sales, production, output, etc, are vital as a guide to future planning and in the setting of new or revised standards. Daily or weekly or monthly reports to higher management provide vital information which enables control to be exercised over all activities of the organization, and assists in the co-ordination of the efforts of the organization as a whole.

Forecasting

As we explained earlier in this Module, plans are the *predetermined routes* to the achievement of objectives, that is, they are the results of decisions which have been taken by the owner(s) or board of directors of an enterprise on how its agreed objectives are to be achieved in practice. Planning is concerned primarily with activities in the **future**. That might be the immediate future (for example, a few minutes ahead or a day's work) or the more distant future (which might be 2, 4 or more years ahead.)

Unless there is some guidance as to what might occur in the future, both short-term and long-term planning would be no more than mere guesswork. What is called **forecasting** is therefore essential to enable the management of an enterprise to carry out its planning function effectively.

In your everyday lives, you might come across the words *"forecast"* and *"forecasting"* mainly in connection with the weather. You might read *"weather forecasts"* in newspapers, hear them on the radio, and see them on television. They are concerned with what the weather **will be** - or is ***expected to be*** - in **the future**, usually the fairly near future. Such information is useful to different people in many different ways: from helping some people to decide what clothing to wear, such as for wet or dry weather; in helping some people to plan sporting fixtures and other "outdoor" activities; in guiding farmers when to sow their crops and when to harvest them; and so on.

So it is in business and management. The action of forecasting is intended to determine - as accurately as is possible - the *probable course of future events* which might AFFECT a particular enterprise and its activities.

In management, a ***'forecast'*** is an assessment of the *expected pattern of future events* and the way(s) in which they **might** have EFFECTS on the operations of the enterprise, or on sections of it. It is not possible to anticipate or to foresee the future exactly; but the more accurate is the forecasting:

* *the lower will be the degree of uncertainty about future events;*

and

* *the greater will be the possibilities of formulating reliable plans;*

and, in consequence:

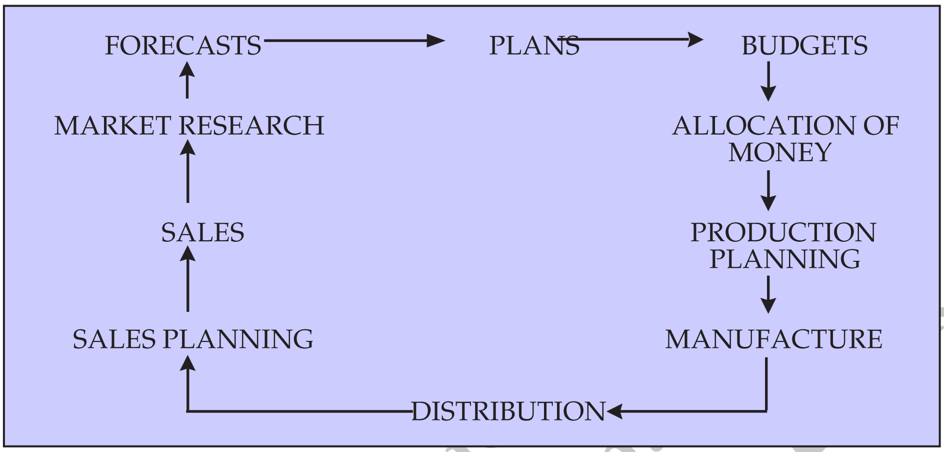
* *the greater will be the chances of achieving the enterprise's objectives.*

The Use of Forecasts in Practice

From what we have explained so far, you will appreciate that forecasting is an essential adjunct - or accompaniment - of planning by managers. Based on the forecast made, plans can be formulated to deal successfully with expected future events, and to take steps to deal with any problems which are anticipated will arise in the future - or even to avoid them before they arise. A good example of the importance of forecasting is in **anticipated sales**.

Sales are affected by many factors, which include the general economy, political trends, competition and manufacturing costs. The management team of a business must consider all those factors before it can be sure that the business can sell all it manufactures or has available for sale. Forecasts are also important in relation to the budgets (see next Section) of a business. Forecasts of sales are needed to indicate the extent of effort needed to satisfy the market and thereby indicate the amount of money required. Budgets of anticipated expenditure to be incurred in meeting the needs of the market can then be prepared and the money allocated.

Fig.2/3. a simple business cycle, indicating the places of forecasts, plans and budgets



Forecasting must be considered an art and not a science, because no person can predict the state of the economy, or the probable situation of an enterprise, in a few years time with any great degree of accuracy. Nevertheless, the best attempt possible must be made, and many different techniques can be used, depending on the type and size of a business and its range of products.

The accuracy of forecasts will often be influenced by certain considerations such as the extent of *"unknown" factors* as opposed to those factors which can fairly easily be predicted - because they are based on records of past performance, accounting records or statements, experience or published information. Also, it cannot always be assumed that *"known" factors* will remain constant; for instance, future sales of a product might not be the same as past sales of it, because external influences (some of which might not be predictable) might increase or decrease sales.

In general, the further ahead the forecast must cover, the less reliable it is likely to be, as there are greater chances of *"distorting" factors* arising. It is, of course, VITAL that:-

★ the data on which forecasts are made is as **accurate** or valid as possible;

★ the forecast contains only information **relevant** to the planning to be undertaken;

★ the forecast is **clear** to those who will use it on which to base plans, so that they WILL use it.

Planning and Forecasting in Practical Management

To illustrate the importance of planning and forecasting in practice, let us consider as an example the manager of a footwear shop.

He will know from past experience that certain types of footwear are in greater demand at certain times of the year than they are at other times. For instance, in the summer or dry season lightweight, open-toed shoes and sandals will be in demand, whilst in the winter or rainy season heavier, closed shoes and boots will be what customers want. Therefore, the manager must plan his orders to the various manufacturers or suppliers of different types of footwear well in advance, so that they will be available in the shop ready for the appropriate season in which they are most likely to be sold.

However, the manager must **not** simply order any footwear in any quantities or sizes. He must be certain that the shop will sell - and at a profit - the various types of footwear which will be ordered. It is essential that he *forecasts* what types, sizes, colours and styles of footwear, and how many of each, the shop *is likely* to be able to sell in the season concerned. To a certain extent his experience of past sales will guide him in his forecasts, as certain types are in demand year after year, and certain sizes are more popular than are other sizes.

Nevertheless, fashions - especially in women's footwear - do change, sometimes frequently, and colours or styles which are popular one year or even one month might be replaced in popularity the next. Therefore, our manager must *"research the market"* and keep abreast of fashions and trends; shoe trade magazines and manufacturers' catalogues might provide good guides as to likely future fashions and trends, and even as to what colours are likely to be "in mode" in two, three or more months time.

At the same time he must pay attention to what types or styles of footwear are being heavily advertised or publicised by their manufacturers, as either is likely to increase demand - a demand which his business **must** be able to fill if he is not to lose sales to his competitors.

There are other factors which might have to be taken into consideration by the manager in deciding what footwear to order:-

✧ If, for instance, the economic climate in the country, or the part of it in which his shop is located, is not good, he is less likely to be able to sell expensive footwear, and he will be well advised to order less expensive or moderately priced footwear.

✧ Competition might also have to be taken into account; it could be that a competitive shop nearby has recently closed, in which case his sales are likely to increase; whilst if the reverse has happened and another footwear shop has recently opened nearby, his sales are likely to decline.

✧ Changes in population might also change demand; for example, if a new housing development has recently been completed in the area, there might be an increased demand for more stylish footwear or for children's footwear. On the other hand, if younger people have been drifting away from the area, the demand might be for more conservative styles.

Having considered the factors relating to DEMAND for the items sold by his shop, he must now consider SUPPLY. The manufacturers of footwear must also *forecast* which types, styles, etc, of their products are likely to be in demand at different seasons of the year, and plan their production well in advance of the different seasons, frequently based on advance orders received.

Therefore the manager of the shop must place his orders sufficiently well in advance to ensure that they will be filled, and that the various items will be delivered - and available in the shop for sale - in good time. That is particularly important with popular types, styles and sizes of footwear, and those which have to be imported from other countries. Allowances might have to be made for possible delays in production or delivery, and even for a particular season starting earlier than usual - or going on for longer than usual. The reliability of different manufacturers or wholesalers - that is, whether they can be relied on to deliver the right products (quantities, qualities, etc) on time - might have a bearing, but again the manager's previous experience might provide a good guide for him.

Once decisions have been reached as to what types, styles, sizes, etc, of footwear are to be ordered, and in what quantities, the cost of them will have to be calculated. The manager, the owner of the shop or the board will have to decide whether that much can be spent, or whether the money will be available at the time payment will become due - or what plans can be made to ensure that it **is** available when required. In all probability, the amount which can be spent on new stocks, on advertising, etc, will have been estimated - or *"budgeted"* - and the manager will be expected to keep within the limits of the *"budget",* unless circumstances change; for example, if there is a likelihood of greatly increased sales.

Of course, the manager or the board of directors will have to decide on the **prices** at which different footwear is to be sold. There are two essential matters for them to consider in reaching their decision:-

★ The ***selling prices*** must be sufficiently high to cover not only the total cost prices of the different footwear, but also to cover all the varied expenses which have to be paid in order to run the shop and sell the goods - whilst still producing a profit.

★ However, if the prices are too high, potential customers will refuse to buy the footwear or will not be able to afford to do so, and sales might then be lost, including to competitors who are not charging so much.

In some cases retail prices are fixed, or recommended, by manufacturers - these are commonly called *"recommended retail prices"* or *"RRP"* - but in any case the shrewd manager, and/or his board of directors, will have previous experience and sales statistics/ information available to guide them on price setting.

The foregoing example is by no means exhaustive, but it highlights just some of the varied factors which might have to be taken into consideration by a manager or by the management of an enterprise **before** certain actions are taken. In this case, plans will still have to be made covering how to sell the footwear, and in addition the other functions of management must play their parts in ensuring that the objectives of the shop - to sell footwear, and at a profit - are achieved successfully.

Consider all the forecasting and planning which will have to go into the production of a new model of a motor vehicle!

Continuous or Ongoing Forecasting

It is most effective if forecasting is a continuing process, because that will ensure that forecasts will be available for appropriate members of the management team at regular intervals - such as monthly, quarterly, six-monthly or yearly, as circumstances require. That enables those members of management who are involved in planning to compare the latest forecasts with those on which their original plans were based, and allows them to determine whether any modifications to their plans need to be made in view of changed circumstances, recent current events, new information, and in the light of experience.

The Functions of Management in Practice

In practical everyday management, the five functions - which we separated so that you could examine them more easily - might not always be apparent or be recognisable as being distinct from one another. That is because together they form one continuous process, in which the individual functions blend, run into and interrelate with one another. That is as it should be; management should **not** be a job which a person has to force him/herself to perform, step by step, but a task which flows, without great conscious thought; stemming from his or her experience, training and an understanding of human nature. However, to illustrate that the five functions are distinct and how they work together in practice, let us look at a practical example.

Practical Example

A small building company has secured a contract to erect a brick wall between two adjoining properties.

<u>Planning</u>: The manager of the business together with a foreman visits the site and measures and marks out (with pegs and string) the line along which the wall is to be built, and they estimate the depth and width of the foundation trench necessary, the number of bricks which will be required, and the numbers of labourers and bricklayers who will need to be used (some of whom might already work for the company, or might need to be hired especially for the job to be done.) A "plan" of the site will be drawn on paper, showing clearly where the wall is to be erected.

Organising: The manager orders the quantity of bricks they have estimated will be needed (plus some extras for contingencies, such as breakages) as well as bags of cement, sand, etc, to be delivered to the site on a specified date and time. The foreman will arrange for the necessary numbers of workers (labourers or bricklayers) to be on site at the right times as and when they are needed, and ensure that they will have available all the necessary tools and equipment they will need to use.

Co-ordination: The foreman must make sure that the work proceeds in the correct sequence. For instance, the foundation trench must be dug by labourers in the right place and to the right depth before the bricklayers come on site. Similarly, he will make certain all materials have been delivered, and that the necessary tools and equipment (such as a cement mixer) are on site before the bricklayers arrive. It would be costly and wasteful in time and wages to have bricklayers waiting around for the labourers to finish digging the foundation trench, or waiting for supplies to arrive.

Commanding: The foreman must provide leadership for the workers, by explaining to them exactly what work is to be done, when and how; he will show them a copy of the "plan" to be followed, explain any particular details, and answer any queries, and leave them a copy of the plan for reference during the work. He must motivate the labourers to get the foundation trench dug as required in good time ready for the bricklayers to start work. Once the supplies, equipment, tools and the bricklayers (of which he might be one) are on site and are clear on what is to be done, he must encourage them - perhaps by setting a good example by the quality of his own work - to work accurately without wasting time, energy or materials.

Controlling: The foreman will either supervise the work himself, or *"delegate"* (that is pass on) that responsibility (see Module 4) to a senior bricklayer, to ensure the work proceeds smoothly as planned. He must ensure safety (covered in Module 8 of the Management & Administration Diploma Program) on the site, such as by checking that "hard hats" are worn by the workers. He will need to keep records of all the materials which are used, the hours worked by the different people, and ensure that no materials are wasted, and that no tools and equipment are lost.

The foregoing is a relatively simple example of *"management in action"* in a very practical situation; but it enables you to see quite clearly the five functions of management as separate and independent activities, and how they interrelate with one another. The example also enables you to see that the *"technical aspect"* - in this instance a knowledge of wall building and bricklaying - is quite separate from the *"managerial aspects"* of the work of both the manager and the foreman in the example.

Whenever you are in a situation in which management or supervision is being practised - whether by you or by another person - do try to identify the five functions, and what they involve in the given circumstances. Note also whether any of the functions has been omitted and, if that is the case, what effect that has had on the outcome. In that way you will learn to implement automatically all five functions in each and every managerial/supervisory situation, for the best results.

Note: Purely for simplicity, we often refer in our Modules to a manager as being male. Please read the word "he" as really being "he or she", and the word "his" as really being "his or hers". We imply no disrespect to the many, many good female managers and supervisors today working in all types and sizes of enterprises.

Module Five

RECRUITMENT STRATEGY & POLICY, THE SELECTION PROCESS, APPLICATIONS, INTERVIEWS, TESTS, APPOINTMENT

This Module is from the CIC Program on:

Human Resource Management

Introduction: This Program provides supervisors, managers, professionals and executives with the knowledge and training to provide effective leadership and build and manage teams. Having leadership skills is vital for business and career success; this Program covers these matters, as well as motivation, team behaviour and roles, power, development and culture.

This Program is for current and future managers and leaders aiming for successful careers in management, and aiming for promotion and to achieve the respect of colleagues and employers.

	Human Resource Management - Modules Summary
Module	**Module Title**
1	HR/Personnel Policy, HR Strategy and Management, HR Managers & Departments, Culture
2	Functions of Management, Organization & Job Structure, Corporate Objectives
3	Communication in Organizations: Internal, External, Oral, Written, Forms, Feedback
4	Manpower Planning, Job Analysis & Job Descriptions, Efficiency, Work Groups & Teams
5	Recruitment Strategy & Policy, Selection Process, Forms, Interviews, Tests, Appointment
6	Induction, Training Needs Analysis, Training Methods, Employee Development
7	Health, Hazards, Safety, Security & Welfare, Risk Assessment, Accident Prevention
8	Motivation, Theories & Theorists, Psychology, Counselling, Resignations, Retirement
9	Industrial Relations: Trade Unions, Collective Bargaining, Industrial Action, Negotiation
10	Job Evaluation, Job Ranking, Job Design & Redesign, Rotation, Enrichment, Rewards
11	Remuneration Packages, Systems and Benefits, Equal Opportunity Policy, Discrimination
12	Personnel Records & Statistics, HR Computer Systems & Data, Learning Organizations

If you would like to study the complete Program and gain an international Diploma on **Human Resource Management** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Walubuta Nyimba wrote from **Zambia**:

"I am delighted to be promoted to Senior Human Resources Officer. It is your institution which made me get this elevation and additional responsibilities and the admiration of my employers. CIC wins fame all over the world."

Lucy Klen Witne wrote from **Papua New Guinea**:

"I am now employed as a Staff Development Officer in a national hospital. My boss did my performance appraisal and commented that I am now ready for promotion in the Human Resource Department."

Module Five

RECRUITMENT AND SELECTION

Recruitment

The term **'recruitment'** refers to the first stages in the process leading to the filling of a **'vacancy'** - an employment post to be "filled", that is, a **'vacant post'** - which arises either:-

✦ due to the creation of a new post;
or
✦ because the present holder of it is leaving the employ of the organization or of a section or department of it.

In the latter case, consideration must first be given - by the head of the section or department concerned and the HR/personnel department - as to whether it is really necessary to replace the employee. For example, could his or her duties be spread amongst other personnel in the section who might not be fully occupied, perhaps due to a reduction in workload or efficiencies brought about by O & M or work studies. At the same time, the opportunity might be taken to change the scope of the post, to broaden or to reduce the range of duties, by "job enlargement" or by "job enrichment", etc, which we consider in Module 8.

In a large organization the recruitment of all personnel (except perhaps senior management) is the province of the HR/personnel department, and it will have various "sources" of possible new employees to be called upon as required by a particular vacancy.

Effective Recruitment

Effective and planned recruitment is vital in fulfilling departmental and corporate objectives, and particularly so in small, specialised commercial organizations. "Under-recruitment" creates excessive workloads and longer "learning curves". "Over-recruitment" generates idle time and dissatisfaction. Under-recruitment describes working situations in which there are too few and/or under-qualified personnel. Over-recruitment describes situations in which there are too many and/or over-qualified personnel.

Recruitment policy should never be driven by "at the moment" workload demands. It should be a strategic, consistent process, based on HR or manpower planning, which is seen to be fair to employees already within the organization.

In a small to medium-sized organization, some functions, for example HR/personnel, could perhaps be operated by a small team of multi-skilled and interchangeable personnel. However, that would be a simplistic view for a larger manufacturing enterprise, and might overlook the depth of skills needed for effective recruitment and to provide adequate technical training (this idea is discussed in Module 4 of the Human Resource Management Diploma Program.)

Recruitment Strategy and Policy

It is important that recruitment strategy and policy are always interpreted from corporate and organizational objectives, in conjunction with HR or manpower planning undertaken. They will, in turn, be "translated" into other key strategic elements within an overall business plan. New recruitment arises mainly for one or more of these reasons:-

✳ Growth or "expansion" (enlargement) of business operations.

✳ "Organisational development" (new or changed working roles) and human resources "wastage" (leavers or terminations).

✳ Perceived (by a departmental manager) rather than verifiable, workload demands. In such cases, the demand might be "artificial" and will at some stage lead to reductions in staffing levels (often called "down-sizing") and loss of motivation.

Recruitment Strategy

A general definition of "recruitment strategy" might be:

"To find and employ the needed human resource for an organization, having regard to the following related factors:-

- ✧ fulfilment of organisational and job needs;
- ✧ high probability of good performance in role;
- ✧ optimum induction learning curve;
- ✧ compatible remuneration acquisition cost;
- ✧ minimised risk to the corporate body".

The following recruitment policy criteria could be interpreted from the recruitment strategy given above, and then used as the basis for selection questionnaires or checklists:

- ✦ A high match with job skills and experience needs.
- ✦ Compatibility with organizational "ethos" and management style.
- ✦ Exemplary previous employment record and job stability.
- ✦ Absence of personal, legal or other restrictive complications.
- ✦ Verifiable prior employment and character references.
- ✦ Compatibility between personality and role/appointment.
- ✦ Salary or wage demands compatible with job grade and experience.
- ✦ Avoidance of conflict with existing employment conditions.

Internal Recruitment

This is the process of filling a vacancy by a person **already employed** by the organization. This process might involve the promoting of a person currently working in the section, or the transfer and/or promotion of a person working in another section or department or another branch.

Some organizations operate active policies of internal promotion, the advantages of which can include:-

✳ Personnel who are aware that promotion is the reward of hard work and loyalty are motivated to learn and do more, and that leads to greater job satisfaction and less inclination to leave the employ of the organization.

✳ The abilities and potential of "candidates" for transfer and/or promotion might be known to their respective managers personally, but if that is not the case, the HR/personnel department can call for reports from the candidates' supervisors, foremen, or other "seniors".

✳ Those personnel promoted or transferred will have knowledge about the organization and possibly about the work to be performed (especially if they have been given the opportunity - and trained - to prepare for promotion) and therefore the "induction" and "training" processes (covered Module 6 of the Human Resource Management Diploma Program) might be shorter than they would be likely to be for complete newcomers to the organization.

Emphasis is placed on providing the best possible career and promotional opportunities for personnel **already** employed, providing that they fulfil the required job needs and have histories of good conduct and performance. Only when the internal recruitment process is exhausted, would **'external recruitment'** begin. As stated, this is a commendable policy for motivating existing employees, but there are two weaknesses to be borne in mind when formulating such a recruitment policy:-

(1) There might be a tendency to bias recruitment in favour of under-qualified personnel, to avoid problems arising (say from workers' representatives) from rejecting all internal candidates for an appointment.

(2) Over a long period, the dynamic potential of the organization might be reduced, as well as its ability to respond or adapt to change, through lack of "new blood" brought in from outside, and entrenched "traditionalism". In practice, and especially at managerial levels, the organization might be deprived of the influx of new ideas brought in by new employees. This could be particularly noticeable in the areas of new technology, rapid developments in communications, computerisation, etc.

Recruitment Policy

Recruitment policy should aim to reflect an "enlightened" management attitude and create an environment in which employees are well-motivated. Fig.5/1 is a **'policy statement'** extracted from a typical "collective agreement" which has been made between management and employees' representatives:-

Fig.5/1. recruitment policy statement

- ✦ In making promotions or filling vacancies, management will consider specific job needs, giving due consideration to candidates' qualifications, educational background, skills, personal attributes, prior experience, current job grades, previous satisfactory service and job performance levels.
- ✦ When vacancies can be forecast, new appointments will be made in sufficient time to allow proper "hand-over" periods between outgoing and incoming personnel.
- ✦ Details of all vacant posts will be advertised on staff notice boards. These will be issued by the HR/personnel department at least ten working days prior to application closing dates. Personnel occupying jobs more than one grade below the vacant post might not be eligible candidates.
- ✦ All senior vacancies will be filled by personnel already employed by the company provided they meet the job requirements. Formal educational qualification requirements might be waived if candidates have equivalent practical experience.
- ✦ Selection boards are conducted in accordance with the procedures set out in standing instructions. Selection results will be notified personally to all internal applicants.
- ✦ Personnel whose applications were unsuccessful during the internal selection process, will not be eligible to apply for the same posts, where an external call for applications is made relating to the same vacancy.

Considerable care must be taken by staff of the HR/personnel department (promotion section) in dealing with internal recruitment, to avoid arousing any resentment or jealousy, or causing problems for those personnel who are promoted. Details of vacancies should be circulated to all those employees who might wish to apply; notices affixed to staff notice boards might be used for this purpose, as might "in-house" publications.

Decisions on promotions and transfers must always be made in a **fair** and **unbiased** manner - and seen to be so - based on **proven ability** and **past performance** and, if necessary, on **training** or **studies undertaken**.

To avoid jealousy and resentment, any personnel who were not selected for promotion should be told (tactfully) why that was, and should be given advice or counselling by HR/personnel department staff on how they could prepare for promotion in the future. A person promoted within the same workgroup, might face difficulties and obstruction because his or her former workmates might be reluctant to accept his or her "authority"; promotion and transfer to another work group can reduce problems caused by previous familiarity.

Another danger to be looked out for is the manager or supervisor who does not wish to "lose" his best man subordinate(s) and so will not recommend promotion or provide favourable reports. This can quickly cause resentment if it is allowed to go unchecked, and might lead to the organization losing a good employee's talents and abilities in any case - because he or she might seek promotion elsewhere.

'Introductions'

Most organizations pursue a policy of internal and external recruitment side by side, but it is important that candidates from both "sources" are treated **equally**. There is one source which is a mixture of both internal and external recruitment and that is the introduction by existing employees of friends or relatives. When this happens it tends to indicate that a good work climate exists in the organization, as it is unlikely that the introduction would be made if the friend or relation would be unhappy working for that organization.

Care must be taken to avoid bias in such recruitment, and of course problems can arise if the "introducee" is found to be unsuitable, or if one person's relative is selected instead of another's.

External Recruitment

This is from sources **outside** the organization itself, and the source or sources selected will depend on the particular post to be filled. Such sources include:-

✳ Local schools - particularly when beginners or juniors are required.

✳ Colleges/technical colleges and universities - when special aptitudes or knowledge are required or when potential managerial material is sought. The employment section of the HR/personnel department might establish good relations with both or either of these two sources, through careers counsellors, which might include end of academic year careers talks, visits to and tours of the organization's premises, and even a few days' "job orientation" or "work experience" at the premises of the organization towards the end of an academic year. It is usually advantageous to maintain contact with careers counsellors, who might be prepared to "sift" possible candidates, and so reduce the length of the selection process (see next Section).

✳ Local employment agencies - which might be government run or privately operated, secretarial agencies, staff or personnel agencies or bureaux, etc. Many of the privately owned businesses specialise in locating and selecting staff for specific posts or professions, as do some firms of management consultants.

✳ Advertisements in appropriate "media", such as national and/or local newspapers, either in classified "situations vacant" columns or using larger, more expensive display advertisements.

✳ Advertisements in the appropriate trade journals or the magazines of professional bodies; many of the latter maintain registers of members and/or students seeking positions within the professions concerned.

The Process of Recruitment and Selection

The following are three typical stages of the recruitment process. These are the processes which must be carried out, to enable selection:

(a) **Preparation:**

Prepare a job description and an employee specification.
Decide a target employment date.
Decide the appropriate remuneration (salary or wage) packet.
Prepare a "draft" of an advertisement.
Set an application closing date.
If necessary, obtain advertising budget approval.
Select the appropriate advertising media, e g newspapers.
Schedule interview date(s).

(b) **Recruitment Action:**

Publish advertisement(s) in selected media, e.g. newspapers, or the journals of trade or professional associations.
Collect advertisement responses.
Acknowledge advertisement responses and distribute employment application forms for completion and return.

(c) **Follow-up:**

Evaluate response levels from each source.
Assess quality of responses from possible candidates.
Move to candidate selection stage.

As we have already mentioned, initially the advertising "medium" used might simply be internal staff notice boards and only when internal procedure fails to find a suitable candidate, would "external media" be used. There might, however, be a case for comparing the performance of internal applicants against those available in the eternal 'market place', in order to identify a "benchmark" standard. The selection process for a key commercial vacancy such as a senior materials buyer, will almost certainly include the following five stages:-

(d) **Paper-sift:**

Review all application letters, completed application forms and CVs.
Use a classification system to rank each candidate.
Reject applications where there is a poor skills/experience match.
Prepare mini-summary report for each promising candidate.

(e) **Interview Preparation:**

Schedule interview dates and times
Send out invitations to attend interviews
Organise a suitable selection board/interviewer(s) and venue.
Prepare records in readiness for interview:
- letters of application and/or application forms and CVs
- job advertisement
- organisation chart
- job description(s)
- interview questions check list
- interview assessment form
- prepare a list of interview questions

(f) **Interviewing:**

Welcome the candidate and introduce interviewer(s)
Place a copy of the advertisement in front of the candidate
Show the position of the job in the organisation chart
Hand over the job description and allow time for "skim-reading"
Give a verbal "potted" summary of the organization's history
Ask the candidate:
- to outline his/her relevant career details
- what he/she knows about the organization
- why he/she wants the job

Ask the candidate specific (but appropriate to the position) interview questions, for example:-
- details of career background.
- particular technical/skill areas
- reasons for leaving earlier jobs
- future career aspirations
- about gaps in career history
- salary expectations
- availability to start if selected

Evaluate and record all the responses.
Begin to "close" the interview (after 20 to 40 minutes).
Ask the candidate for any final questions about the job and the organization.
State when a selection response will be given to the candidate.
Thank the candidate for attending and then "close" the interview.

(g) **Post Interview** (immediate)

Reconcile interview panel views and assessments.
Agree interview ratings for each candidate (and after all interviews).
Prepare summary report on each candidate.
Agree short-listed candidate(s) with selection panel members.
Recommend short-listed candidate(s) to final "decision maker".

(h) **Pre-Appointment:**

Recall final 2 or 3 candidates for "psychometric evaluation".*
Evaluate personality fit(s) with job profile(s).
Finalise selection choice with the "decision maker".**
Prepare/issue offer letter and contract of employment.

Notes: * Psychometric Evaluation is considered later in this Module.
** The decision maker is the person who is able to authorise an appointment (such as a director or function head).

Employment Application Forms

Generally speaking, advertisements are designed which clearly state the type(s) of person(s) required, the salary/wage range, and what the post holder(s) will be required to do, where they will be expected to work, and what other benefits and prospects can be expected, currently and in the future. Finally the name and address of the person, or the organization, to which applications must be forwarded, or an advertisement voucher, must be stated. Alternatively, a name and a telephone number might be given so that those interested might telephone for more information and, possibly, to arrange for an interview.

However, in many cases an **employment application form** is sent to each applicant for completion and return.

Application forms must be designed to ensure that not only is the essential information about applicants obtained (and it is important that appropriate size spaces are provided in which information can be written or typed) but that it is given by applicants in the best sequence to assist and speed up the selection process.

There might, of course, need to be different forms for different types of posts. In addition, it might be necessary to send out with the blank application forms sheets containing further information about the organization or about the job (such as a copy of the relevant job description) and, particularly if the vacancy is in a different town or even country, information about the locality in which the successful applicant will work.

As employment application forms are so important to an HR/personnel department they should be designed with care. Factors to be taken into consideration when designing such forms include:-

✷ The Information Required from Applicants

Much will depend on the post which is vacant, but the relevant employee specification will indicate what information should be sought. There is no value in asking applicants to give information which is not needed, for example. if it is immaterial whether a man is single or married. (It is accepted, of course, that when the same form is used for a variety of different posts, there will be some questions asked which do not apply in all cases.)

✷ The Arrangement

It must be easy for applicants to "complete" application forms quickly and accurately. To enable them to do so, explanations or guidance should be given (by "notes") where necessary, and information should be requested in a logical sequence or order; for example, all "personal" details (such as name, address, sex and age) should be grouped together, as should any physical particulars, such as height, weight, etc, if required. Next, applicants might be asked for details of schooling or other training, and then - apart from school-leavers or other beginners - for previous employment history. Other pertinent information can then be asked for if required.

The types of information asked for and/or provided should not be all jumbled up; that would waste applicants' time, and probably annoy them, and would also increase the time taken by HR/personnel department staff to "extract" essential information from the completed forms.

✷ **Their Completion**

Well-presented and produced forms, with guidance on their completion, should result in a reasonable proportion of neatly and clearly completed forms being returned. It is also essential that HR/personnel department staff know exactly how the forms they issue should be completed by applicants, so that they can give guidance to, and answer any queries raised by applicants, either by telephone call, letter or personal visit.

HR/personnel department staff might be forbidden to actually complete employment application forms on behalf of applicants, because the facility could be abused - in favour of, say, a friend or a relation - or alternatively, due to bias or prejudice, an applicant's chances of securing a post might be harmed

Application forms designed by HR/personnel departments for different organizations differ greatly, both as to content and as to design and layout and the order or sequence in which information is requested. However, let us now look more closely at the sections making up the form illustrated in Fig.5/2, which for convenience have been labelled (A) to (H):-

Fig.5/2. A specimen employment application form (comprising 4 pages)

(A)

POSITION APPLIED FOR:

DAVEREN ENTERPRISES LIMITED
APPLICATION FOR EMPLOYMENT

(ALL QUESTIONS SHOULD BE ANSWERED IN THE APPLICANT'S OWN HANDWRITING)

JOB REF NO.

SURNAME/FAMILY NAME	CHRISTIAN OR FORENAMES	MALE/ FEMALE	AGE
		MARITAL STATUS	DATE OF BIRTH

HOME ADDRESS TEL NO. E-MAIL ADDRESS (if available)	ADDRESS FOR COMMUNICATIONS (if different from home address) TEL NO. E-MAIL ADDRESS (if available)
PLACE OF BIRTH TOWN/COUNTRY	NATIONALITY

(B)

PHYSICAL

HEIGHT: cm WEIGHT kg.

GIVE DETAILS OF ANY PHYSICAL OR MENTAL DISABILITY, OR SERIOUS ILLNESS:

HAVE YOU LOST MORE THAN FIVE WORKING DAYS THROUGH ILLNESS IN THE LAST TWO YEARS? YES/NO
IF YES, GIVE BRIEF DETAILS

(1)

(C)

EDUCATION (from the age of 14 years)			
SCHOOL/COLLEGE/ UNIVERSITY	FROM	TO	EXAMINATIONS PASSED (with grades)
FURTHER/HIGHER EDUCATION, TRAINING COLLEGE	FROM	TO	TITLE OF COURSE
EXAMINATIONS PASSED	SUBJECTS AND GRADES		
1. DETAILS OF ANY OTHER TRAINING COURSE(S) UNDERTAKEN: IN-HOUSE, RESIDENTIAL, CORRESPONDENCE, etc. STATE NAME OF COURSE, DATES, SUBJECTS STUDIED.			
PROFESSIONAL QUALIFICATIONS OBTAINED (state if by examinations)			
(2)			

Section (A) This section contains mainly "standard" information which most HR/personnel departments will need to know about prospective employees: name, address, age, etc. Such information as place of birth and nationality might be required if there are, in the country concerned, restrictions (or special problems) concerned with recruiting non-citizens, or if the postholder will work in a different country. In some cases an application form will ask for information on number of children and even, perhaps, about other dependants.

Section (B) The type of information required by this section will only be asked for in certain circumstances; in some cases employing organizations might insist (and so state on the form) that successful candidates are required to be examined by the organization's doctor.

Section (C) HR/personnel staff will usually need to know the educational standards of prospective employees, and about any training they have undertaken, grades achieved, etc. For junior posts, the section will generally be shorter, and will concentrate mainly on secondary schooling and any examinations passed at the end of it. In some cases as much emphasis will be placed on "professional" or "career" training as on purely academic attainments.

(D)

EMPLOYMENT EXPERIENCE Please complete in chronological (date) order. Include any experience you may have had in armed forces and/or national service).				
FROM	TO	NAME AND ADDRESS OF EMPLOYER AND NATURE OF BUSINESS	POSITION(S) HELD	FINAL SALARY AND REASONS FOR LEAVING
Have you ever been dismissed or asked to resign? YES/NO. If yes, please state circumstances:				
Please describe your current or most recent post, indicating to whom you are/were responsible, and who is/was responsible to you. What are/were your 'main' duties and activities? (Continue on a blank sheet if necessary). (3)				

Section (D) Apart from vacancies for "school leavers" and beginners, HR/personnel staff will generally need to know what work-experience prospective employees have had, and what positions have been held, for how long and, of course, what reasons applicants have had for leaving.

Usually, unless otherwise stated, information is expected starting - at the top - from the earliest job occupied, working downwards to the most recent or current job. However, in some cases - to facilitate checking and sorting - information is asked for in the reverse order, that is, starting with the most recent or current job at the top, and working down to the earliest.

Section (E) The information in this section is not always asked for, but might be important to some employing organizations, for example for certain sales or senior management posts. Sometimes hobbies and interests might also indicate potential for training, etc.

Section (F) Not all employing organizations require or ask for references or recommendations, but they are necessary, in particular, for posts requiring the holders to have proven reliability, trustworthiness, honesty, etc. (For posts involving the handling of money, in a cashier's department or even at a cash till or register, the employer might require to take out what is called a "fidelity guarantee" to cover - by insurance - any loss due to the dishonesty of an employee, and the insurance company will certainly contact, or "take up", the references.)

(E) **HOBBIES AND INTERESTS**

Please give details of any hobbies or leisure interests you may have:

(F) **REFERENCES**

Give two references, both preferably from past employers, or college tutors or school headmaster:

Name:	Name: ....
Address:	Address: ....
....	....
Status:	Status: ....

(REFERENCES WILL ONLY BE TAKEN UP WITH YOUR PERMISSION)

(G) **SUPPLEMENTARY DETAILS**

Please use this space to record any other information which you consider relevant - languages spoken, special skills, overseas experience, etc. (continue on an additional sheet if necessary).

(H) I certify that the statements made on this application form are strictly accurate in every detail. I have not wittingly withheld any information which might be to my disadvantage in this application. I agree, if engaged, to accept all the rules and regulations of the company.

Signature .... Date ....

(4)

Section (G) Such a section is not always included in application forms, but some HR/personnel staff use this section as a "test", to check whether applicants really have read and understood the job description, etc, and whether the information given is really relevant to the job concerned.

Section (H) Most application forms have to be signed and dated. Some employing organizations require prospective employees to sign "declarations' similar to the one we have included (although the wording might differ and some might be longer or shorter); most employers require such a declaration after an applicant has been offered the post concerned.

✷ Presentation

Employment application forms should always be well produced and printed or photocopied, so that they give applicants and others a good impression about the organization by whom they are being invited to apply for a post. That is particularly important with skilled/experienced personnel whose services might well be in demand by a number of prospective employers; they are "competing" to engage such people - who thus have a choice of employer - and who therefore need to be attracted, and encouraged to apply for a vacant post.

Even with more junior posts, an attractively produced application form should encourage neatness and clarity in their completion by applicants, which will greatly assist HR/personnel department staff in "reading" them.

✷ **Codes or Reference Numbers**

The HR/personnel department should allocate a "job reference number" to each vacancy, and the relevant number should be written or typed on appropriate forms being sent to each potential applicant for the post concerned. The reference will help considerably when the completed forms are returned (see space for Job No. in Fig.5/2).

✷ **Filing**

Employment application forms (especially those of "successful" applicants) might have to be filed and retained for many years, and so (if not scanned and stored on computer) need to be produced on fairly strong paper.

Attachments to Application Forms

Any or all of the following documents might to attached or sent with an employment application forms to "support" the application concerned:-

- **Recommendations, References, Testimonials**

Typically these might include copies of letters from former employers, or other persons who know the applicant well and think highly enough of him to put information about him in writing. Many HR/personnel managers - often with good reason - are suspicious of "glowing" recommendations written by former employers; this is because in order to "get rid of" an employee, or to do so without trouble, some employers might provide much better references, etc, than are really warranted in the circumstances.

- **Certificates, Diplomas, School Reports, Transcripts, etc**

These can often be useful, as they indicate the standards or levels of education attained by candidates, and/or the extent and levels of "work" or "skills" training, if any, undertaken, and/or the standards and grades of any examinations passed. Knowledge of the foregoing can assist in the preliminary "screening" of applicants in the early stages of the selection process. If a candidate is still undertaking - or intends to undertake - studies or training, evidence of that - what is involved, the level to be attained or the examination(s) being prepared for - can also prove helpful to HR/personnel department staff.

- **Curriculum Vitae or CV**

This Latin term (which is often abbreviated to CV) refers to a brief account of a person's career. It generally contains much the same information (although often more) than is requested by an application form, but generally in a more summarised form. Such documents are prepared (and often printed or photocopied) by those with, perhaps, particularly good qualifications or those who have had "chequered careers" or wide and varied experience. They are often useful in enabling HR/personnel department staff (and others) to "scan" quickly through the main facts concerning a person and his/her career.

Preparation for Job Vacancy Announcements

The relevant job analysis, job description and employee specification should be available in the HR/personnel department, whenever possible, **before** a vacancy arises, so that steps can be taken to attract suitable applicants to fill it without delay (although, as we have already mentioned, the opportunity might be taken to make changes to the post in view of changed circumstances or in the light of experience.)

The emphasis should be on (a) attracting **suitable applicants** and (b) on **stimulating them to apply** for the vacant post; there is no value in wasting time and money dealing with numerous unsuitable applicants, whilst on the other hand if there are only a few applicants, there might be no real choice.

Whichever source(s) of recruitment are selected by the HR/personnel department, certain information - "extracted" largely from the job description and employee specification - will have to be presented, in a letter, poster, advertisement (or in some cases orally by telephone to, say, a school careers counsellor.) This is likely to need to include all or some of: -

* The organization's name, where it is located, and the nature of its activities.

* The job title and its objectives.

* Details of the most important tasks involved in the job.

* The most important "personal" qualities (qualifications, experience, age limits, etc, from the employee specification.)

* Information on remuneration: salary or wages, benefits, etc.

* Information on how to apply for the post and/or how to seek more details about it and the organization.

There might, however, be some occasions in which it is desirable **not** to state the organization's name and address in advertisements. It might be that management does not want to arouse speculation or alarm amongst the workforce, or to make an announcement until the "right" person has been found, or does not wish to alert a particular employee that a replacement for him or her is being sought, or does not wish to give prior warning to competitors that a sales drive or expansion is being planned, and so on. In such cases, it is common for advertisement "vouchers/box numbers" to be used.

Most newspapers offer such a service to advertisers who do not wish to disclose their names and addresses. Instead, those wishing to respond to an advertisement are invited to write to a Voucher or a Box Number at the newspaper. For example:

"Apply in own handwriting, giving details of age, education, etc, to:
Voucher No. X/426, The Standard."

Selection

The selection process "takes over" from the recruitment process once applications start being received, by telephone, letter or in completed application forms. The first step of the person or people responsible, is to compare the information provided by applicants with the personal characteristics detailed in the employee specification, and to select about six applicants considered to be probably and/or possibly suitable.

Each person selected will then be "invited" to attend an **'interview'**, which will be a face to face meeting between the applicant and "representatives" of the employing organization, for example a member of the HR/personnel department staff (perhaps even the HR/personnel manager himself) and the relevant department head or a senior subordinate.

Frequently communication is by telephone. That might be because an applicant telephoned in response to an advertisement (or learned about a vacancy in some other way) and asked to be sent an application form to complete or to arrange an interview. In the latter situation, the person in the HR/personnel department who handles such matters must be trained to give the caller a "fair hearing", but to make appointments for interviews only with callers who "sound" suitable from what information they provide, and who create a good impression on the listener.

Circumstances and procedures will, of course, vary but "notes" should be kept of information provided by applicants who have been invited to attend interviews.

Alternatively, a telephone call might be made to an applicant to arrange an interview because the information contained in a completed application form or letter makes him/her a "probably suitable" candidate to fill the vacant post; the call will probably be made by a member of the HR/personnel department. (With "internal" applicants, similar communications might be by intercom.) Situations might also arise in which it is necessary to inform an applicant (by telephone or intercom) that he or she is not to be called for an interview.

Such communications might sometimes be put in writing (and sent by hand, post or email, as appropriate) particularly when they concern vacancies at senior or managerial level. Examples are given in Specimen Letters 1 and 2.

Specimen Letter 1 inviting an applicant to attend an employment interview

MODERN FURNISHINGS LIMITED
33 High Street, Fielding SR1 3NN.
Telefax 2456/9. email: mod@rock.net

Our Ref. Emp/43/08
1 August 20..

Mr P T Thackery
18 Manor Close
Hailing SR 3 1PA

Dear Mr Thackery

I acknowledge receipt of your application for the vacant post of area sales manager, recently advertised.

Will you please call at our premises at 2.30 pm on Monday the 8th of August 20.. for a preliminary interview with our sales director, Mr Peter Barnes, and our HR/personnel director, Mr James Seawell. Should the date or time not be convenient for you, do not hesitate to telephone the undersigned.

Yours sincerely

K. Jackson (Miss)
Personnel Assistant

Note the final sentence in the second letter which follows; it might have been written out of politeness to reduce Wattling's disappointment, or it might be that his application was genuinely of interest - but not for the post currently vacant. It could save a great deal of time (and expense in advertising) in the future when another different vacancy occurs, if "interesting" applications - unsuitable for earlier vacancies - have been held on file, so that the applicants can be contacted if they now appear suitable. Of course, by then some of the applicants might have secured alternative employment, but nevertheless such a final sentence can often create "goodwill".

Specimen Letter 2 declining a request from an applicant for an interview

MODERN FURNISHINGS LIMITED
33 High Street, Fielding SR1 3NN.
Telefax 2456/9. email: mod@rock.net

Our Ref. Emp/43/11
1 August 20..

Mr Michael Wattling
Cherry Cottage
Deanholm

Dear Mr Wattling

I acknowledge with thanks receipt of your application for the vacant post of area sales manager, recently advertised.

The position calls for previous managerial experience in a similar field which you do not, from the information provided in your application form, appear to possess. I regret, therefore, that we cannot proceed further with your application. Rest assured, however, that should a suitable vacancy arise in the future within our organization, we shall contact you again.

Yours sincerely

K. Jackson (Miss)
Personnel Assistant

Employment Interviews

In this context an "interview" is a face to face meeting with an applicant - who might at this stage be called a "candidate" - for a vacant post. It is rare for new employees to be engaged without some form of interview first having been conducted. Depending on the number of "possible" applicants, interviews with them might be held all on one day, or might be spread over a number of days. The interviews might be held in "sessions" of two or three consecutively. Inevitably, employment interviews are time-consuming, repetitious, and sometimes even rather "boring" - although such an attitude should not be obvious to the candidates being interviewed!

Unless the post to be filled is a senior administrative position, an interview will most likely be conducted by a department or section head or a supervisor or foreman having practical knowledge of the work to be performed, together with a member of the HR/personnel department staff who will attend to the paperwork involved. Each person should have a list of relevant questions to be put to the applicant or candidate and they should between them agree on the order in which the questions will be asked.

Although the exchanges between candidate and interviewers must be conducted in a cordial atmosphere, the whole exercise has to be conducted with one objective in mind: to find out how nearly the applicant matches, in skill, in experience, in age, temperament and physical qualities the "ideal" postholder for such a job. However, no matter what the vacancy to be filled might be, no interview should ever be carried out in an offhanded or light-hearted manner.

All employment interviews are **important** and therefore proper attention must be paid to the prior **planning** and **conduct** of them. The aims of an employment interview are:-

* To enable the interviewers to confirm the information already provided by the candidate, to obtain further information and if necessary to read originals of documents (CVs, testimonials from former employers, certificates/diplomas, school reports, etc) particularly if copies of them were not sent with the application.

* To enable a candidate to obtain more information about the organization and the job and the "terms and conditions" of employment.

* To enable the interviewers to compare more accurately each candidate's personal characteristics with those detailed in the employee specification and thus to assess the degree of suitability of the candidate for the post.

* To enable the interviewers at the end of the session of interviews, to decide which is the most suitable candidate for the job and to encourage that candidate to join the organization.

A session of interviews might not achieve either or both of the objectives in the fourth paragraph. It is possible that none of the candidates is considered suitable, in which cases those applications previously rejected might have to be looked at again. On the other hand, two or more candidates might be considered similarly or equally suitable, in which cases they might be "short-listed" and be asked to attend a second interview. Finally, the candidate considered to be most suitable by the interviewers might decline - for one of any number of reasons - to accept the position when it is offered.

Interviewing Skills

Effective interviewing requires the exercise of a number of skills, and frequently HR/personnel department staff need to be trained in the acquisition, development and use of those skills, which include:-

* The ability to prepare adequately for each interview.

* The ability to listen, and to "pick up" points implied by candidates' answers.

* The ability to ask relevant and pertinent questions at the right times; "questioning skills".

* The ability to analyse the "picture" of a candidate which is emerging during an interview.

* The ability to summarise and make balanced notes about each candidate's performance.

* The ability to provide sufficient and relevant information to a candidate without boring him/her.

* The ability to establish a "rapport" with a candidate; to build and maintain an understanding.

* The ability to conduct - even control - each interview with tact, diplomacy, but firmness.

Conducting Employment Interviews

Circumstances might arise in which interviews might be conducted by just one person, but in general it is best for candidates - especially for supervisory or managerial posts - to be interviewed by two or three people, in order to reduce the possible effects of any personal biases, prejudices, likes or dislikes of individual interviewers. A "panel" composed of three or more interviewers can be somewhat intimidating for candidates, but might be necessary in interviewing candidates for senior managerial positions in an organization. In some cases candidates might be interviewed by a succession of people, each "sub-interview" perhaps being held in a different room or section of a room.

The proper planning of, and preparation for, interviews are essential for satisfactory and productive results. Firstly each interviewer should refresh his or her memory by reading the appropriate job description and employee specification. Then each application form and attachments, letter or notes of information provided, should be read through carefully, and notes made of specific questions that an interviewer might wish to ask a particular candidate (different interviewers might attach importance to different topics and so might want to ask different questions.)

As we have already indicated, a decision should be reached on the order or sequence in which topics will be covered and questions will be asked, not only to ensure that the interviews go smoothly, but also to ensure that all candidates receive equal and fair treatment. That is particularly important when both internal and external candidates are being interviewed for the same post in the same session. However, some flexibility must be catered for because the differing personalities of different candidates would make rigid adherence to a plan counterproductive.

Interviewers must appreciate that some candidates might be nervous or shy during an interview and, particularly if they have not attended an interview before, they might be apprehensive about the whole affair. Therefore, if an interviewer is to be able to assess the "true" candidate, he or she must be put "at ease" as soon as possible. For instance, if candidates have to wait before being interviewed, the room in which they will have to wait should be pleasant, quiet and friendly; and receptionists or other HR/personnel department staff who will meet them should be warned to expect them and should treat them in a welcoming and friendly fashion - certainly not disinterestedly or offhandedly.

The room in which an interview is conducted should be comfortable and quiet (away from telephones ringing or noisy computer printers.) An attempt should be made to "break down any barriers" as soon as the candidate enters the room; for example by the interviewers standing up, making a pleasant or friendly welcoming remark, and even by coming out from behind a desk, perhaps shaking hands, introducing any other interviewers by name and designation. Prior arrangements should have been made to ensure that there are no interruptions, such as intercoms ringing or callers entering the room.

If an interview is to achieve the aims listed earlier, the candidate **must** be encouraged to talk: that is, to give information about him/herself, his or her qualifications, abilities, experience, etc. Unless that is done, it will not be possible for the interviewers to assess the candidate's suitability or to gain an impression of his or her character (indications of which might be provided in the way that answers are given: hesitatingly, carelessly, enthusiastically, after consideration, excitedly, and so on.)

A common fault of interviewers is spending too much time talking and not enough time **listening** to the candidate; very little is learnt from or about a candidate whilst an interviewer is talking! Whenever possible, questions which require a simple "yes or no" answer should be avoided. Some general talk can help to relieve tension, but questions and answers should not be allowed to go off at "tangents"; also, interviewers must avoid becoming involved in disagreements with a candidate or criticising him or her in any way, and must avoid moralising and giving advice.

Fig.5/3. two interviews - one very formal and one less formal - both in tidy, well-planned settings

It is important for the candidate to be given the opportunity, and indeed to be encouraged, to ask reasonable questions about the organization, its activities and the job concerned. Quite often impressions of the character can be gained by the questions asked (e.g. is it a "penetrating" question, indicating that thought has been given to it; or is it a question which has already been answered, indicating lack of concentration or carelessness in reading the job description.) At the same time, the candidate needs not only to be sure that he or she understands what is involved in the job, but that it is the job for which he or she is looking, that the terms and conditions offered are acceptable, and that he or she is likely to be content in the employ of the organization.

During and/or immediately after an interview, notes should be made by interviewers of the answers to questions given by a candidate, about any interesting questions asked by the candidate, and about the impressions made by the candidate. After a number of interviews, possibly held over a few days, it is not always easy to remember an individual candidate (unless he/she made a particularly good, or bad, impression) and notes will refresh memories.

Interview Assessment Sheets and Records

The notes made by the interviewers of their observations and findings will prevent "judgement" errors which will almost certainly arise from "relying on memory". It is also beneficial for good "quality assurance", to follow a prescribed routine. The following is an extract from a general standard form used for recording observations during interviews for senior commercial staff. The example form in Fig.5/4 is most suited to evaluating "personal attributes". There would be another section for the evaluation of qualification, knowledge, skills and expertise levels.

Fig.5/4. selection Interview observation form

Rating Level	**1**	**2**	**3**
General Appearance:	Exceptionally well-groomed, clean & well-dressed	Above average appearance and correct clothing	Somewhat below expected standards of grooming/dress
Verbal Expression:	Very clear speech, extremely fluent & well-modulated	Above average communicator & good verbal range	Rather low verbal skills: difficulty in conveying meaning
Maturity & Worldliness:	Extremely mature person: exceptional sophistication	Above average maturity: worldly & self-possessed	Some signs of narrow perspective: slightly immature.
Mental Ability:	Apparently highly intelligent: rapid comprehension	Above average mental ability and grasps fine points	Below average grasp of fine points: some slowness of response

In practice, there might be four of five "rating" categories, and ten or more assessment factors. A useful technique is to "highlight" the phrases or "adjectives" which most nearly fit the candidate, and to "ring" the rating level judged to be appropriate.

Before an interview is brought to a close, the interviewer(s) should be certain that all necessary questions have been answered. If the information has not already been ascertained, the candidate should be asked when he or she would be available to take up the post if it was offered (bearing in mind that some people might have to give a period of “notice” to current employers, the answer to this question can be revealing - a candidate who is not bothered by leaving a current employer at short notice or without giving any notice, calls for caution as he could do the same to his new employer; on the other hand, a person who does not wish to leave his or her current employer “in the lurch” displays a sense of responsibility.) Finally, the candidate should be told when he can expect to learn the result of the interview, and he should leave the interview in a pleasant frame of mind.

Immediately following the completion of an interview, it is important to summarise the candidates’ results on another standard form which will allow quick comparison with the performances of other candidates. A typical standard form which could be used for this purpose is shown in Fig.5/5. That particular form has been designed specifically for interview summaries for senior purchasing staff. In practice, the “factor set” shown might be enlarged and five or more candidates’ results might be entered on the same sheet. There would also be a verbal performance summary given on the form for each candidate.

Fig.5/5. candidate assessment form

Post - Senior Purchasing Officer		**Candidate 1**	**Candidate 2**	**Candidate 3**
Factor	**Max**	**Score**	**Score**	**Score**
Professional qualification/s	(15)			
Relevant buying experience	(30)			
Commercial awareness	(20)			
Interpersonal skills	(15)			
Numeracy/computer literacy	(20)			
Totals:	(100)			

Finally, the interview panel would meet again to reach a “consensus” (a general agreement) on their findings, and report accordingly.

Psychometric Evaluation

This is the assessment of an individual’s “personality traits”, within the “norms” of a particular system. Particular reference is to the impact of these traits on job suitability and overall performance potential. Clearly a person who is naturally warm and friendly will be more suited to roles dealing with people. A person who is naturally inclined to be passive is unlikely to perform well in a selling or negotiating situation. Typically the traits under evaluation are within a score range of 0 - 10, on a framework of personality extremes. The framework in Fig.5/6. lists 6 “personality traits”, but there may be other “trait” comparisons, perhaps 10 or 15 or more factors, as appropriate:

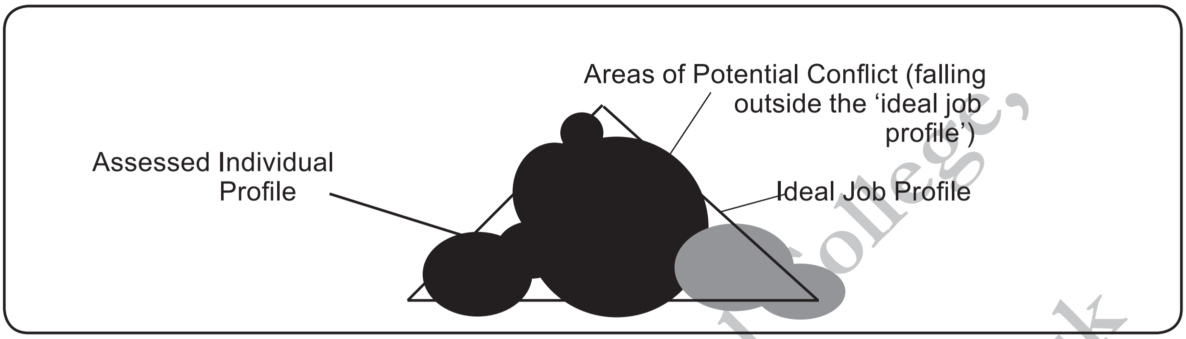
Fig.5/6. sample “personality traits” framework

	0 ⟷ 10	
Cool/Reserved	⟷	Warm/Friendly
Emotional	⟷	Calm/Stable
Passive/Mild	⟷	Assertive
Expedient	⟷	Conscientious
Practical	⟷	Imaginative
Group Dependent	⟷	Self-sufficient

These results are interpreted from answers given to a "multiple-choice" questionnaire completed under qualified supervision. Responses are required to be spontaneous rather than calculated. Clearly there are a number of implications, typically:-

1. Specific personality types will be more suited to certain jobs than others.
2. Conflicts might exist between employees' personalities and present roles.
3. Some conflicts can be compensated by training and development action.
4. Other personality/role conflicts might seriously limit performance levels.

Fig.5/7. representation of role/personality conflicts



The determination of employee profiles and the assessment of their implications in relation to potential job performance, are a matter for expert interpretation.

Selection Tests

As we have already mentioned, in some cases a second interview of "short-listed" candidates might be necessary before a final selection is made. For certain posts **selection tests** might be used to supplement - but not to replace - the selection interview. Some tests are fairly straightforward, such as work tests designed to check if a candidate is as skilful as claimed (such as a typist or a keyboard operator being given a piece of work to input, or a driver being requested to drive a vehicle); and aptitude tests designed to show manual dexterity in simple tasks. However, those which are designed to ascertain reasoning ability and the like (intelligence tests) and tests designed to indicate the possession or lack of certain character traits (personality tests) need to be carried out by qualified HR/personnel department staff.

Fig.5/8. skills tests to check candidates are as qualified as they claim:

mini-digger driving test - conducted and supervised in a safe and isolated area

machine-operating proficiency test conducted under the supervision of a factory foreman

left: a senior secretary observes and assesses the typing skills and input accuracy of a potential new secretary.

Notification of Appointment

The decision on final selection should not be delayed too long, particularly if at least one candidate appears to be very suitable to fill the post. Such a suitable candidate will probably have applied to other prospective employers as well, and is quite likely to have impressed their representatives, too. If a decision is delayed, by the time it is made the person concerned might already have accepted an offer of employment from another enterprise, and so will no longer be available.

That could be a serious disappointment, and might even apply to the second (and even third) choice as well, necessitating offering the post to one of the less suitable candidates or having to start interviewing the applicants not called in the first place - or even, in extreme cases, having to re-advertise the post, and starting all over again! The recruitment and selection processes are always time-consuming, and are often expensive as well.

Once a final selection has been made about the candidate whom it is considered will be most suitable, and who has indicated that he or she will accept the post if it is offered, that candidate should be informed or notified. In some cases he or she might first be informed by telephone (or by intercom or internal email, if already an employee), but even if that is done, the appointment should still be confirmed in writing.

The **'letter of appointment'** needs to state the date on which the successful candidate is to start work, and the time at which he should report and to whom. The letter might contain, or be accompanied by, particulars of the **'terms and conditions of employment'**, such as hours of work, starting salary or wage rates, holiday entitlement, etc, and perhaps even a copy of the relevant job description. A specimen of such a letter is given as Specimen Letter 3.

Specimen Letter 3 example of a letter of appointment

MODERN FURNISHINGS LIMITED
33 High Street, Fielding SR1 3NN.
Telefax 2456/9. email: mod@rock.net

Our Ref. Emp/43/04
17 August 20..

Mr L T Parker
11 Kennel Way
Rendell

Dear Mr Parker

Further to our meetings on the 8th and 12th, I am happy to be able to offer you the position of area sales manager of Preston, based at our new showrooms in Queensway.

I appreciate that you will not be able to join us until the first of October, but we feel that there will be adequate time for you to familiarise yourself with our methods and procedures here at Fielding before you take up the position in Preston in readiness for the “Grand Opening” planned for early December. You will also, of course, need time in which to participate in the final selection and training of your subordinate sales team members.

The terms and conditions of your employment, as agreed between us during our second meeting, are enclosed herewith. Please be kind enough to sign both copies and return one to me in due course; should you have any query, do not hesitate to contact me.

I look forward to welcoming you to our organization, and to a mutually satisfactory working relationship.

Yours sincerely

James Seawell
Managing Director

Unsuccessful candidates should also be informed as early as possible by tactfully worded letters, which ease disappointment and avoid upsetting the recipients. Although a candidate was not found the most suitable for a particular job, it might be that the person concerned could be suitable for a similar or another post. It is therefore useful to retain the notes, etc, about the people interviewed so that if possibly suitable vacancies arise in the future, the relevant people can be contacted at once. That could be helpful in filling a vacancy quickly without, perhaps, the necessity to advertise it or to conduct another session of interviews.

Quality Assurance in Recruitment

Quality assurance in recruitment is probably as important - if not more important - to the effective functioning of an organization than is product quality assurance. In recent years there has been an increasing tendency for "disaffected" employees to seek redress for their "grievances", through law courts and "industrial tribunals". In addition, increased levels of competitiveness in the market place require optimum performance levels from employees. Long learning curves caused by "under-recruitment" are unacceptable. Effective quality control at the "front end" of employment (recruitment) is therefore vital to minimise risk and to achieve good business performance.

The interviews and selection are not the end of the process as far as the successful candidate is concerned, and there is no way of being certain at that stage whether the most suitable or correct selection was made - only time will show that. Indeed, in some cases the person selected might not take up the post, and another selection might have to be made.

Module Six

WORKGROUPS AND TEAM BUILDING, SPECIALISATION AND DELEGATION, TEAM BEHAVIOUR AND GROUP NORMS, TEAM FORMATION AND VALUES

This Module is one of the 12 Modules from the CIC Diploma Program on:

Leadership & Team Management

Introduction: This Program provides supervisors, managers, professionals and executives with the knowledge and training to provide effective leadership and build and manage teams. Having leadership skills is vital for business and career success; this Program covers these matters, as well as motivation, team behaviour and roles, power, development and culture.

This Program is for current and future managers and leaders aiming for successful careers in management, and aiming for promotion and to achieve the respect of colleagues and employers.

	Leadership & Team Management - Modules Summary
Module	**Module Title**
1	Human, Financial & Material Resources, Management, Employers and Employees
2	Planning and Organising the Workforce, Management Roles, Training, Team Goals
3	Supervision and Control of Workgroups, Motivation and Building Work Relationships
4	The Responsibilities of Management to the Organization, Subordinates & the Community
5	Delegating Responsibility, the Delegation Process, Decision-Making, Initiative, Performance
6	**Workgroups, Team Building, Specialisation, Group Norms, Team Formation and Values**
7	Leadership Styles, Task & Relationship Orientation, Team Life Cycles, Conflict, Flexibility
8	Types of Team: Project, Operational, Cross-Functional, Self-Managed, Team Roles
9	Belbin & Team-Role Theory, Empowerment, Action-Centred Leadership, Accountability
10	Motivation Theories: Hierarchy of Needs, Acquired-Needs, Equity, Expectancy, Reinforcement
11	Communication in the Workplace, Vertical & Horizontal Lines, Feedback, Communication Skills
12	Coaching, Training and Development of Team Members, Induction, Discipline, Job Redesign

If you would like to study the complete Program and gain an international Diploma on **Leadership & Team Management** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Patrick Masikara
wrote from **Botswana**:
"CIC is the gateway to success! Training with CIC bought me knowledge, understanding, skills and many improvements. I now deliver to the best of my ability and lead my team and company to greater heights."

Ferdinand Maramag
wrote from **Malaysia**:
"Your institution is the breeding ground of professionals worldwide. Your teaching method and excellent Study Materials gave me a big edge to get my top job as a Senior Manager. My style of leadership is now effective and well-developed."

Module Six

WORKGROUP AND TEAM BUILDING

Introduction

Before management became a "profession", as it is today, many workers performed a variety of different tasks. In many cases that was time-wasting and inefficient. Some of the "pioneers" of modern, skilled management started re-organising the work to be performed by their employees, so that each worker performed a single task.

Those early skilled managers found that:-

* Workers soon became more proficient, and even expert, at performing the individual tasks allocated to them.

and

* The time taken by each worker to perform his or her given task was greatly reduced.

Gradually the process became known as the *"division of labour"* or the *"specialisation of labour".* That is because:-

Firstly: A complicated process or group of related tasks is "broken down" - or "divided" - into its component parts or individual tasks.

Secondly: Single workers, or groups of workers, are trained to *"specialise"* on performing the individual tasks.

Probably the most widely known use of this specialisation today is in the motor vehicle/automobile industry. In this sector, each worker has his or her individual, special task, which is generally very simple and repetitive. The various parts of motor vehicles (engines, bodies, chassis, doors, etc) are passed along an *"assembly line"* of workers. Each worker can perform his specific task on the part before it passes on to the next worker, who performs his specific task, and so on.

Today, the *"assembly line specialisation"* technique is used in various forms in the production of a wide variety of different products. In many cases the easier and more repetitive tasks have been, and are being, taken over and automatically performed by sophisticated machines or automated "robots".

Specialisation, today, is practised in virtually every organization. The larger it is, the greater is its need for specialisation within it. It is practised even in offices, where various clerks, computer operators, secretaries, etc, perform different tasks or groups of related tasks. For instance, there are accounts clerks, correspondence clerks, data entry clerks, telephone and computer operators, stenographers, and so on.

Specialisation and Delegation

"Specialisation" on various tasks is an important factor in delegation (covered in Module 5 of the Leadership & Team Management Program). A manager will delegate responsibility for certain tasks or groups of related tasks to a person or persons who will *"specialise"* on performing them. Let us take this matter further by returning to the example of the small retail trading business which is expanding, and whose owner needs help from other people.

As we explained, even to run such a small shop or store it is necessary to order stocks of goods, store them, pay for them, resell the goods, collect money from customers, pay that money into the bank account of the business, maintain a variety of records, and so on. Over a period, as the business expands, the owner-manager might need to delegate to other people responsibility for some or all of these activities:-

✦ Dealing with **stocks** or inventory of goods: ordering and reordering the goods to be sold, storing them and issuing them to the shop - or direct to customers - when required.

✦ **Sales** of the goods: running the shop, the layout of goods for sale in the shop, stocking shelves, preparing window displays, advertising, and related matters.

✦ **Accounts** or **financial matters**: such as handling and banking monies paid by the customers of the business, ensuring that those to whom goods are sold on credit pay for them when payment is due, paying for goods received from suppliers, paying salaries and other expenses, preparing financial accounts, etc.

In delegating the responsibility, the manager **must** observe and follow the 'rules of delegation' (covered in Module 5 of the Leadership & Team Management Program). If he fails to delegate fully or in the right manner, problems will be caused, and perhaps the business will not expand as quickly or as profitably as it should.

The owner - as leader and manager, remember - will retain **control** over the various activities - which can be grouped in "related" or similar activities (the ways in which that can be done are explained in Module 5 of the Leadership & Team Management Program). He must also ensure that there is **co-ordination** between the various people involved. For instance he must ensure that: the goods ordered are ones which he and the salesman forecast that customers will want or "demand", and not those for which there is little or no demand; and that those goods are bought from reliable suppliers and can be safely stored so that goods are available where and at the times customers want them; and that there is sufficient available finance to pay for the stocks purchased.

The Next Stages

Let us assume that our manager does delegate, and does so in the right manner. The business should continue to expand, as planned.

As that happens, each of the three persons (who were first made responsible for stocks, sales and accounts) or their successors, will probably need assistance. And so one or more subordinates will be employed to work with each person, who will now become a leader or supervisor.

Over a period of time, *"sections"* - containing groups of people engaged in related or similar work - will come into being. The sizes of the workgroups or sections will vary, according to the type and amount of work each performs. Even at this early stage they might be called *"departments",* although that would not strictly be a true description yet.

In our example, over a period of time, a *"stores section",* a *"sales section"* and an *"accounts section"* might develop. (The actual descriptive "names" of the sections might be different).

The people working in each section will be performing "related" tasks. However, it is likely that gradually different people or groups of people will "specialise" more and more on different activities, depending on their abilities and aptitudes, and the need for "specialisation" or the "division of labour" within a particular section.

Take, for instance, the stores section; in it:

✦ One person might specialise in "purchasing", that is, in keeping contact with suppliers, meeting their representatives, placing purchase orders for goods, etc.

✦ Another person might specialise in receiving incoming deliveries, and checking or inspecting them (to make sure the goods are correct in quantity and quality and are undamaged) and in storing or warehousing the goods correctly and safely.

Each of the persons will have been delegated responsibility for the activities in which they specialise, and they will be answerable to the section manager or supervisor. And if the business continues to expand, some or all of the "specialists" will need subordinates to assist them in their work.

If the business continues to expand from that stage, more personnel will need to be employed. Some, if not all, of the specialist subdivisions of sections will themselves have grown into sections. Each original small section will have grown into a "full" **department**, made up of a number of sections.

The stores department, for instance, might now have a purchasing section, a stock/inventory control section and an issues section, each with its own section head, leader or manager under the overall control of a departmental manager.

By this stage, the owner of the original small business might now be its managing director. Or perhaps he might have delegated managerial control to a salaried managing director or to a general manager or CEO. That executive would be responsible for the overall control and co-ordination of all the activities of what has now become a large business.

It is very important that the different sections and departments of the business are co-ordinated, so they work **together** to achieve the objective of the organization as a whole.

Workgroups

As we have seen, workgroups are formed as the result of growth and specialisation within an organization. As specialisation takes place, groups are formed to perform the various tasks - or groups of related tasks - which make up the different types of work, or *"functions"* carried out in an organization.

In different organizations a "workgroup" might be called a "team" or a "gang", or a "crew", or a "unit", or a "section", or a "department", or go by some other description. Sizes, too, differ; a workgroup might be anything in size from two members upwards. Whatever its name or size, a workgroup is basically:

"A collection of individuals, contributing to some common aim under the direction of a leader, and who share a sense of common identity".

A workgroup is **more** than an aimless crowd of people waiting at a bus stop, or on a railway station platform or in an airport lounge. A workgroup has a *"central purpose"* or objective, and the people it comprises must be aware of being in part of *"a group"* and being part of *"a team".*

However, it is important to appreciate that teams do not simply appear - they are *formed*. Merely getting together a group of people - even if they have shared interests and objectives - does not make a *"team".* What makes a *"team"* is that the people involved not only have common interests and shared objectives, but they are also bound together by a *"sense of belonging".* What is termed *"synergy"* in the workplace is the interaction or co-operation of two or more people to produce a combined effect which is greater than the sum of their individual and separate effects.

The term *"teamwork"* describes the functioning of a group of people who are closely knit around a common purpose, who work easily together, and who have positive working relationships. The functional meaning of teamwork is the ways people must work together and co-operate with one another in order to perform a task or to produce some product or service that cannot be produced by a single person.

In most work situations, the majority of tasks are undertaken by workgroups and teams, rather than by individuals. Groups are also widely used for solving problems, for creating new ideas, in making decisions and in co-ordinating tasks. Such *"group functions"* are what the organization itself needs to fulfil its purpose and to achieve its objectives. It has also been found that in practice many individual workers prefer to work in groups, and they gain encouragement, security and stimulus from being members of a "team" (why this is so is discussed in Module 10 of the Leadership & Team Management Program).

For many workers, teamwork provides a co-operative, enjoyable and friendly work environment. The team leader can also be helpful in responding to worker's problems and questions, thereby increasing the overall work efficiency of the team. One of the main benefits of a team environment is the ability to share ideas amongst the group. There is an old saying that *"two heads are better than one",* which is very apt because one person's knowledge and abilities are limited, and it can sometimes be hard for one individual to deal with or overcome difficult problems without the help of others.

At the same time, every individual is different and has unique qualities. Individuals with different experiences and backgrounds increase the creativity of individual team members and the workgroup as a whole. When group members apply different skills they are often able between them to jointly develop a more effective solution than might one person working alone on the same problem.

A *"project"* is an individual or collaborative enterprise which is carefully planned and designed to achieve a particular aim, and is often the basis for the formation of a team, whose members will work together to achieve the *"common"* aim or objective(s) of that project. Whilst accepting that there are some people who do not like or feel comfortable working in a group, let us examine in greater detail some of the possible advantages which can arise from group working with a proficient team leader:-

✳ Fosters creativity and learning. Creativity thrives when people work together on a team. What is called *"brainstorming"* involves holding a spontaneous group discussion, which will often produce an idea or a way of solving a problem. Discussing as a group often produces new *"input"* - ideas, views and suggestions - and prevents *"stale"* viewpoints which are often the result of working alone without any new input. Combining unique perspectives from each team member can create more effective solutions.

What one person has learned from his or her individual personal and work experiences might be entirely different from those of co-workers, and therefore teamwork maximises shared knowledge in the workplace, and helps others learn new skills to use. Collaborating on a project creates an enthusiasm for learning which solitary working usually lacks, and being able to share ideas with other team members can encourage and foster both individual and team knowledge.

✳ Blends complementary strengths. Working together helps one group member *"build"* on the talents of his or her teammates. For example, one person's strength might be creative thinking, whilst a co-worker might be good at planning and organising. Often a team works well together because team members rely on each other to bring individual talents to bear on the tasks to be performed. By observing the process behind these skills, a team leader can learn how to combine or inter-relate the various skills and talents of the individual members of the team and create a stronger team.

✳ Builds trust. Relying on other people builds trust, and teamwork establishes strong relationships with and between co-workers. Despite occasional disagreements, an effective team enjoys working together and shares a strong bond. When one group member puts his or her trust in a co-worker, the foundation of a relationship which can overcome minor conflicts is established. Having trust in workmates also provides a feeling of security which allows ideas to emerge. It helps team members to *"open up"* and encourage each other. Open communication - which we discuss in Module 7 - is important when working as a team, and produces effective solutions in difficult group projects.

Without trust, a team crumbles and cannot succeed on assigned projects. Good teams build each other up, and strengthen individual members to create a *"cohesive group",* that is unity, which we explain in detail in a later Section. By working together, members learn that wins and losses affect everyone on the team. Teamwork necessitates having confidence in each other's distinct abilities.

✳ <u>*Promotes a wider sense of "involvement"*</u>. Teamwork encourages workers to feel proud of their contributions. Tackling obstacles and creating notable work together makes team members feel fulfilled. Working toward achieving set goals and objectives encourages workers to feel *"connected"* to or *"belonging"* to the employing organisation. That in turn builds loyalty, leading to a higher level of job satisfaction amongst employees.

✳ <u>*Teaches conflict resolution skills*</u>. Conflicts inevitably happen when a group of unique people are put together. Workers come from varied backgrounds and have different work styles and habits. Whilst these unique viewpoints can create the most successful work, there can also be *"personality clashes"* (see below) as well as misunderstandings, differences of opinion and disagreements which can quickly turn into conflict. When conflict arises in teamwork situations, the team leader and team members are often able to resolve the conflicts themselves without having to turn to more senior management. Learning *"conflict resolution"* first-hand is a skill which the team leader and others in the group can use to become proficient managers in the future.

Personality clashes occur when two (or more) people find themselves in conflict not over a particular issue or incident, but due to a fundamental incompatibility in their personalities, their approaches to things, their style of life or personal philosophy. A personality clash might occur in work-related, in family-related, or in social situations - and might spill over from one to another. The unfortunate result is that the quality and enjoyment of peoples' work suffers, and their stress levels increase. In most situations when personality conflicts happen in the workplace, the entire team is disrupted as well. There are different types of personality conflicts:-

★ *Work style differences:* it is a reality in workplaces that people work in different ways. Some people work quickly, completing their tasks as soon as they are assigned, whilst others put it off and wait until the deadline is looming. Some people like to work on what appeals to them first, whilst other people prefer to work methodically down their checklist from step to step.

★ *Background differences:* gender, ethnicity, social and/or economic status, political views, and religious backgrounds can cause people to view situations from different perspectives. Each person's perception is in large part determined by his or her personal experiences and beliefs. These differences in perspective can have a major impact on how different people interact with one another.

★ *Attitude differences:* cynicism, arrogance, and irritability all contribute to an attitude of negativity. A *"negative attitude"* (such as always looking "down" on things and being unhappy) interferes with effective communication. Nobody wants to be around a very negative person. A naturally upbeat, optimistic type of person might have difficulty dealing with someone who has a negative attitude. Some people constantly complain, looking for flaws, whilst others look for the positive and focus on finding solutions. Such differences can make collaboration extremely difficult.

★ *Competitive versus co-operative differences:* some people feel the need to compete and compare constantly, whilst others seek to co-operate and work together, rather than against each other. It is very difficult to work with people who are condescending, petty, posturing, and aggressive. The constant attitude of undermining and *"one-upmanship"* can be very draining. When the competitive attitude is taken to extreme, it can result in intentional sabotage, which puts the other person in a perpetually defensive state.

Teamwork is not just helpful for employees - it can also benefit the employing organization in the long run as well. Employees who *"connect"* directly with their workplace are more likely to stay with their employer. Whilst employees leaving their jobs often cite poor pay or benefits, another common complaint is that their contributions *"do not seem to matter".* Teamwork allows people to *"engage"* with the organization and feel more committed.

Therefore, we can see that workgroups are important to enterprises as a whole, as well as being in the interests of individual members of those groups. The formation, leadership management or supervision, as well as the *behaviour* of its workgroups are therefore of particular concern and importance to the management team of any enterprise.

Behaviour of Workgroups

We have seen that in practice all supervisors and managers are *"team leaders".* A supervisor or manager needs to be able to build an effective team and *"lead"* its behaviour in a positive way to the achievement of the common goal which has been set for it. Briefly, the most important factors in the behaviour of workgroups are:-

- The size of the group. The members of a small group will all know each other, their duties and abilities, and might be easier to supervise (see the Section on *"spans of control"* in Module 3). A large group might be more "impersonal" and more difficult to control.

- Its leadership. We have discussed the importance of good leadership, and also the different styles of leadership and management which might be used, and we expand on these factors in later Modules.

- The nature(s) of the task(s). If the work to be performed is relatively simple and routine, and if most members of the group perform the same or similar work, a larger number can be supervised effectively. If the work is complicated or "complex", fewer people can be supervised effectively by one person.

- The working environment. Comfortable and safe working conditions tend to encourage a more contented workgroup; but the best environment is not always possible.

- Individual roles. Different members may have, or feel they have, certain or preferred roles and tasks within the group - and that others have specific tasks and roles as well.

- Experience and knowledge. More experienced workers are more likely to be able - and willing - to work without close or constant supervision. New and untrained workers typically need more supervision and assistance.

- The cohesiveness of the group. By this we mean the *"unity"* of the members of which it is composed; how well they get on together, and work together as a *"team".* We expand on this feature later in this Module.

- Methods of motivation. Various different or similar methods to motivate the group members, as individuals and as a team, might be used by the manager and/or supervisor.

- Group "norms". These are common standards of social and work behaviour which are expected from individuals in the group. Once such norms have been set, there are strong pressures on people to conform to (follow) them.

  Norms are influenced by organisational factors, such as management policies and style, rules and procedures. Norms might also be influenced by one or more employees, whose standards might or might not be the same as management's. For example, management might impose a *"no smoking"* rule in certain areas. But a "group norm" for a specific group of employees could be to follow a trend, or habit, of cigarette smoking. Their actions could be contrary to the "norm" concerning the health and safety of employees in the workplace. From management's point of view, the "ideal" situation is when the norms of the group are the same as the "official" norms of the organization as a whole. Part of the leadership role of any supervisor or manager is to bring about harmony within his or her own group. We consider group norms in greater detail later in the Module.

Steps to Building an Effective Team

A team leader or supervisor who possesses good team-building skills can *"unite"* subordinates to achieve the common goal set for the workgroup, which will then become more productive. Team building needs to be a continuous process, which helps the workgroup to become a united and *"cohesive unit".* The team members will then share group tasks and goals, and will come to trust, support and respect one another. It is important to make sure the team members know their respective roles and responsibilities in participating in the team, which should be covered in preparatory training.

To be able to lead a team effectively, the supervisor must first show or demonstrate his leadership qualities to each team member. The most effective team leaders build their relationships based on trust and loyalty, and not by fear, abuse or the power of their positions.

A supervisor should make it clear that he welcomes each subordinate's ideas as being valuable. A supervisor must set good examples for team members, and be "open" with them, and sensitive to their moods and feelings (including *"unspoken"* feelings or *"body language",* which we discuss in Module 7 of the Leadership & Team Management Program.) He must try to mediate and resolve minor disputes, so that team members will work together in harmony. He should encourage trust and co-operation amongst them, because good relationships between team members are just as important as his good relationships with them. He needs to pay close attention to the ways in which team members work together, and take steps to improve communication, co-operation, trust, and respect in their relationships.

A supervisor should be very clear when communicating and make sure that instructions and tasks are clear to all, and are fully understood. He should encourage team members to share information, and make sure they understand the importance of each worker's contribution, and how all their various tasks *"mesh together"* to achieve the team's goal. It is often appreciated if a supervisor delegates problem-solving tasks to the team, and lets the team members work on creative solutions together.

Good communication (which we discuss in Module 7 of Leadership & Team Management) is the single most important factor in successful teamwork. Good communication does not simply mean holding meetings all the time; rather it means setting an example by being *"open"* or *"receptive"* to suggestions and concerns, by asking questions and by offering help, and by avoiding confusion in one's own communications.

It is important for a team leader to establish *"team values and goals",* and to know how to evaluate team performance. Workplace and team values are the guiding principles which influence the way in which people work; they are often deeply held principles which help a person to choose between the right and wrong ways of working and in their dealings with other people, and they also help in making important decisions and career choices.

A team leader needs to talk with his team members about the progress they are making toward established goals, so they will get a sense both of their success and of the challenges that lie ahead. To do that, he needs to have a clear idea of what the team must accomplish, and what the standards for judging success are going to be. He must establish clear time-frames in which work is to be completed; and be sure that team members understand their duties and responsibilities.

It is always best if there is *"consensus",* that is, an idea or opinion is shared by the people in the workgroup. To create consensus, a supervisor needs to encourage discussion or debate. Shared ideas and consensus can inspire creativity and spur the team on to better results. Some team members might be afraid to disagree with others, and that can lead to the team making poor decisions; so *"open"* debate should be encouraged.

Some of the signs or signals of the need for team-building include:-

- decreased productivity
- conflicts or hostility amongst team members
- confusion about assignments and who should do what or when
- decisions misunderstood or not carried through properly

- apathy - that is, lack of interest, enthusiasm, or concern - and lack of involvement
- lack of initiation, imagination, innovation; for example, routine actions are taken for solving problems
- complaints of bias, discrimination or favouritism

Group and Team Norms

We introduced you briefly to *"norms"* earlier, and it is now time to consider them more fully. Essentially they are unspoken and often unwritten sets of "*informal rules"* or a *"code of conduct"* which govern individual behaviours in a workgroup. Group norms are common standards of social and work behaviour which develop between the members of a workgroup, and which are expected from the individuals who make up that group or team.

Group and team norms vary, because they are based on the particular group and the issues which are important to that group, on the team leader's attributes and attitudes, as well as rules and regulations laid down by management. Once such norms have been developed, there are strong pressures on people in the group to *conform* to them, that is, to follow them. Group and team norms can often:-

- Help the group as a whole to attain its objectives; its *"targets".* Because team members share the same code of conduct, the group's norms dictate the responsibilities and obligations of each member of that group. This combination of choices, decisions and behaviours generally *"fosters"* (encourages or promotes the development of) harmonious relations amongst the members of a group.
- Encourage bonds to develop between members of a group, which is called *"cohesion"* (which is explained further in the next Section.) Norms indicate what attitude team members should adopt in various circumstances. They might, for instance, help members to settle a conflict by providing them with possible resolutions to problems or misunderstandings. As a result, misunderstandings can be avoided and harmonious relationships amongst members can be maintained.
- Help members to gain a better understanding of their roles in the group. By suggesting or setting out acceptable and unacceptable attitudes or behaviours, as well as the roles and functions of each group member, norms enable members to better understand the behaviours of their co-workers. Norms also allow members to identify those who do not respect - or who *"deviate"* from - the rules established within the group.

Team leaders, supervisors and manager - and sometimes other individual group members - will have authority or "power" in a group or over a team if they possess one or more of the following attributes:-

- The ability to reward, or to punish "deviant" members.
- Knowledge valued by the group.
- A skill coveted by the group.
- Privileged information.
- Exemplary behaviour.
- Being seen by the group as a good advisor and/or teacher.
- Influence over other members' choices, decisions and behaviour.

It is important for team leaders and supervisors to appreciate that although several members of the team might occupy similar roles in the group, each person has a unique personality. The diversity of individual personalities has a significant impact on how a particular group will function.

These are some of the variations which might be found amongst members of a workgroup:-

- *Active or passive* attitude or behaviour in the group - not all members share the same level of involvement in the group. Some members play an *"active role"* and will express their opinions, whilst other members are more timid and are less vocal, especially during discussions; they are said to be *"passive".* In practice, the attitudes of individual members might fall anywhere in between the two "poles" of active and passive.

✦ *Positive or negative* attitude in the group - not all members of a group are congenial (pleasant or agreeable) and sociable. Some members appear to be congenial and warm, whilst others are indifferent or cold or uninterested. Some might constantly disagree with their co-members, whilst others are more friendly and open to new proposals. Therefore, what we call *"sociability"* might vary a great deal from one team member to another.

✦ *Attitude or personality* which causes the group to advance or to stagnate - different members *"invest"* time and effort differently in the activities of the group. Some members take their involvement seriously, whilst others are more focussed on their own needs rather than on the attainment of common objectives.

Some members, including team leaders, supervisors or foremen - and managers - help their respective groups to attain their objectives by:-

✦ Fostering co-operation amongst team members by their own behaviour.

✦ Responding positively to requests for information or advice made by members.

✦ Co-ordinating the actions of the members of the group.

✦ Motivating and stimulating the group and enabling it to progress.

Team leaders and supervisors - and often other members of a group - occupy roles which tend to maintain positive social interactions amongst members by:-

✦ Supporting and encouraging others, and praising the work or personalities of co-members.

✦ Maintaining harmony amongst members and minimising tensions and disagreements.

✦ Helping to reconcile diverging opinions and proposing new options.

Unfortunately, there are often also individuals in a group whose roles can become problematic for the team leader or supervisor or foreman of the group, and the pursuit of its common objectives. Some people might reject the ideas of co-members and thereby prevent the group's advancement; some might compete for prestige; or discourage discussion amongst members; or cause distractions by talking too much, or "taking over" co-workers.

Group or Team Cohesiveness

The term *"group cohesiveness"* refers to the ability of the members of a group or team to work together in unison, co-operation and harmony. It also applies to the ability of a workgroup to attract new members to it. Research has shown that cohesiveness develops over time; for example, a newly-formed workgroup has little cohesiveness; but cohesiveness develops as group members get to know and understand each other, their tasks, their skills, and their roles in the group, etc.

A very cohesive group will demonstrate strong loyalty to its individual members, and strong adherence to <u>its</u> established norms. Individuals who cannot or will not accept or who deviate from those norms are *"expelled"* from the group. An example is the *"punishment"* inflicted on an individual as a result of some dispute within the group known as *"being sent to Coventry";* the "culprit" is ignored - is not spoken to or listened to - by the other members of the group. This is an extreme situation which can cause many other problems within the group and reduce its performance, which an experience team leader will seek to avoid or to overcome, perhaps by mediating between the deviating member and the other members of the group.

Several factors - which we outlined briefly earlier - can encourage cohesiveness to develop within a workgroup, including:-

* The size of the group; a small group is generally more cohesive than a larger one; also the span of control of the team leader, manager or supervisor of a small group will be narrower, and is therefore likely to be more effective.

* Common social features, such as age, race, social status, education and training; the more similar the background interests, attitudes and values are, the more cohesive the group tends to be.

* The similarity of the work being performed by the group members.

* Where workers work in close proximity together, cohesiveness is generally increased.

* The structure of tasks and the work-flow system.

* The *"leadership style"* of the team leader, supervisor, foreman or manager.

* The prospect of "rewards" (such as performance bonuses) for the group; the more successful the team is the more cohesive it is likely to be.

* Threats - real or perceived - from outside the group; cohesiveness is often enhanced by members co-operating with each other when faced with a common external threat.

Other important influences on group cohesiveness include:-

- *Communication:* A manager or supervisor with strong inter-personal communication skills - and who is willing to solicit and respond to *"feedback"* (information or requests) from subordinates - has the best chances of building a cohesive group. In addition, communication and cohesion are linked to each other: as cohesion increases, team communication continues to grow and thrive. Communication in the workplace is so important that it is the topic of the whole of Module 7 of the Leadership & Team Management Program.

- *Trust:* As we explained earlier, group cohesion is not possible without trust, and trust is a trait which must be present amongst group members, and between group members and their manager or supervisor. Building trust takes a combination of personal characteristics, such as integrity and fairness, and work performance attributes such as skills, experience and knowledge.

- *Competition:* This can be an extremely effective method of bringing a group together. For example, there might be competition between sales teams for rewards, prestige or bonuses. However, competition might not provide such long-lasting results as do good communication and trust. Once the *"threat"* of, for example, being *"outdone"* or *"out performed"* by, say, another sales team has receded, cohesion might decline.

- *Prestige:* Members who have pride in their team are typically more cohesive than those who are less interested in their group. In addition, the harder a team is to join, the more its members will support the group. Managers can use prestige to build strong teams by recognising accomplishments of groups, or pointing out certain barriers to entry; for example, if the enterprise only recruits people with certain levels of education or training.

Cohesive groups do not necessarily produce higher output, but cohesive groups usually result in greater interaction between group members, mutual help and social satisfaction.

Stages in Group or Team Formation

In forming groups and work teams it must be appreciated that some people might not be familiar with or be experienced in working effectively and efficiently in and as part of a team. A well-recognised description of the typical stages through which a team progresses from its initial formation until it is a successfully functioning team are outlined briefly here:-

★ *<u>Forming</u>:* the early stages in which cohesiveness has not yet been achieved.

★ *<u>Storming</u>:* members are still learning their roles and might be somewhat confrontational at times.

★ *<u>Norming</u>:* members start to function as a team and work towards the goals of the team.

★ *<u>Performing</u>:* members have learned to work in the team and are familiar with its functioning - which might be called *"team dynamics"* - and are achieving the goals of the team, and operate together smoothly.

We discuss the four stages in greater detail later in the Program.

Fig.6/1. typical stages in group formation

There are a number of steps which management can take to help alleviate or reduce the early stages of team ineffectiveness. They include providing adequate training, assigning an experienced overseer - or "facilitator" - to offer advice and assistance, providing clear goals, making sure that middle management are supportive of their subordinates who have been *"empowered"* - that is, given the authority - and are willing to delegate responsibility and decision-making authority to team leaders and supervisors.

Fig.6/2. team cohesiveness

Team Values

Teamwork is often defined as being both a set of behaviours and as an attitude of mind. Understanding and managing these twin factors will help a team leader to encourage other people to work together effectively, and to become a team. The key to this is realising that:

"Attitudes come from what people value and are expressed in how they behave."

This requires a team leader to encourage high regard to such matters as *"team spirit"* - feelings of camaraderie amongst the members of a group, which enable them to co-operate and work well together - respect for others, and valuing their contributions. It also requires developing a sense that more can be achieved by working together than as individuals. And once these attitudes are ingrained, it is far more likely that team members will behave accordingly.

Team values are therefore a set of organisational values which everyone on the team believes in. Let us consider ways in which a team leader can behave and act in order to create and develop team values and team spirit:-

- *Integrity:* This is essentially the quality of being honest and having strong principles. It is the team leader's responsibility to encourage the development of an environment in which all team members feel valued and respected. In particular, it is necessary to develop an environment where their skills and abilities and personal values and beliefs contribute to their roles within the employing organization. This can be achieved through the recognition of individual and team productivity and professional achievements, as well as through the interpersonal behaviours displayed by the team leader and his or her team members.

  Being able to ensure that all those in the workgroup feel valued and respected relies heavily on the way in which the team leader interacts with team members and how team members interact with one another. A team leader enhances integrity by communicating with team members so that they are aware of all of the details of any impending changes which might impact on their roles and the workplace, on working conditions, or on them personally.

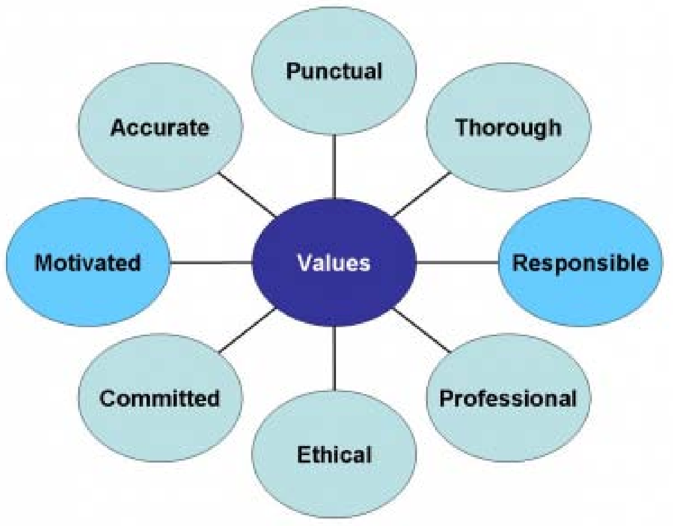
  From time to time a team leader might need to take actions or make decisions which team members might not agree with or favour. In these circumstances conflict can be minimised by explaining to team members the full facts about the situation and the options which had to be considered, and the team members should then better understand why the action had to be taken or the decision had to be made. If details are not communicated to the team, a culture of gossip and the *"grapevine"* (see Module 7) can be fostered, which can lead to an increase in stress and conflict, and a decrease in productivity.

- *Respect:* By respecting co-workers, a team leader demonstrates consideration for their wants, needs and feelings, and shows that their skills, abilities and knowledge are valued. Respect can be demonstrated by acknowledging the individual strengths of each of the team members, seeking their opinions on team-related issues, and - within the team leader's own sphere of authority - delegating responsibility to them in appropriate situations, and empowering them to make certain changes and decisions.

- *Empathy:* Basically, empathy is the ability to understand and share the feelings of another person; that is, trying to understand another person's situation and appreciating how they might be feeling (which might have a bearing on their actions, such as being distracted.)

  > Assume, for example, that a team member has telephoned to say that she will be away that day because she is unwell; this is the first sick day that she has requested. Letting the team member know - by what is said or the tone of voice used - how inconvenient this was for the team leader and the team as a whole, would **not** be displaying empathy. In contrast, the team leader should display empathy by asking the team member what the problem was, how she was feeling, determining whether she would be likely to be back at work on the following day, and wishing her well. This caring and understanding attitude would be appreciated not only by the sick team member, but also by the other members of the workgroup. (We discuss a more in-depth consideration of empathy in Module 7 of the Leadership & Team Management Program).

Fig.6/3. core values and norms



Core Values

Fig.6/3 shows some of the *"core values"* which typically make up the *"team values",* and expected group norms, although they might be adapted to, added to or replaced to meet the particular circumstances of a workgroup. If a list of core values for a group is set down in writing, it should be fairly short and compelling. It should not try to legislate every aspect of team behaviour, but must be sure that the really important expectations are laid out clearly.

Here are brief explanations of the core values illustrated:-

✳ *Punctuality:* each team member is expected to be prompt and to arrive at work on time every working day. Any absence should be approved in advance by the team leader or manager, or if that is not possible should be notified at the earliest time.

✳ *Thoroughness:* each team member is expected to complete their allocated tasks thoroughly and completely, so that the work does not have to be re-done by another member of the team. If a member does not know how to complete a task, or feels overwhelmed, or needs assistance, he or she should seek advice or assistance from the team leader in the first instance.

✳ *Accuracy:* each team member is expected to complete their work accurately and in a way that can be easily checked for accuracy by the team leader or manager. As appropriate, work is to be fully documented and easy to follow.

✳ *Ethical:* each team member is expected to give credit where credit is due, and to be honest and trustworthy in all their dealings with their work colleagues, and the employer.

✳ *Professional:* each team member must work diligently, sensibly and within laid-down and accepted guidelines, rules and laws, and must not bring the team into disrepute.

✳ *Committed:* each team member is expected to contribute an equal share to the achievement of the group's objectives, or to the success of the project.

✳ *Motivated:* all team members are expected to co-operate with one another and to be motivated to successfully achieve the set goals and objectives or the success of the particular project.

✳ *Responsible:* all team members will be expected to perform their assigned and allocated tasks to the best of their abilities, without taking undue risks, short-cuts or rash actions.

Module Seven

PROVIDING A SAFE PLACE TO WORK IN, THE WORK ENVIRONMENT, THE WORKPLACE LAYOUT, HOUSEKEEPING, ACCIDENT PREVENTION

This Module is one of the 12 Modules from the CIC Diploma Program on:

Health & Safety in the Workplace

Introduction: This Program explains how to avoid accidents and injuries which affect employees and employers, which can lead to reduced output, investigations and legal costs. It teaches how to identify and manage hazards and risks in many types of workplace, and teaches about accident prevention actions, risk assessment and implementation of health and safety measures.

This Program is for employers, management, supervisors, HR and personnel who need to ensure a safe environment, meet legal responsibility, and develop HR and safety skills for job advancement.

	Health & Safety in the Workplace - Modules Summary
Module	**Module Title**
1	Managing Health & Safety in the Workplace, Responsibility, Risk Assessment
2	**Providing a Safe Place to Work, Work Environment, Housekeeping, Accident Prevention**
3	General Fire Safety, Fire Risk Assessment, Eliminating Hazards, Fire Precautions
4	Working at Height, Causes of Falls, Preventing Falls, Ladders, Platforms, Roofing
5	Safe Use of Equipment in the Workplace, Hazards, Training, Rules, Maintenance
6	Transport in the Workplace, Route Planning, Vehicle Control, Materials Handling
7	Safe Use of Electricity in the Workplace, Noise and Vibrations in the Workplace
8	Hazardous Substances, Risk Control, Radiation, Flammable & Explosive Substances
9	Health & Safety in Kitchens and Eating Places, Food Preparation and Control
10	Psychological Health Hazards in the Workplace, Stress, Counselling, Job Design
11	Health and Safety in Educational Establishments, Danger Areas, School Security
12	Health Protection, First Aid Needs Assessment and Training, Equipment, Clothing

If you would like to study the complete Program and gain an international Diploma on **Health & Safety in the Workplace** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Egan Kakoma Sapato wrote from **Angola**:

"When I received my Diploma in Health & Safety my Supervisor and colleagues celebrated with me and I was honoured. I now conduct safety training for the company. I dedicate my achievement to the best learning institution, CIC!"

Brenda Murray wrote from **Scotland**:

"I very much enjoyed studying the Program, and with my Diploma I succeeded in gaining promotion from personal assistant to a managerial position with good benefits. Many thanks for your support and for my success!"

Module Seven

THE WORKPLACE:
PROVIDING A SAFE PLACE TO WORK IN

Introduction

The term ***'workplace'*** refers to any area in which work might be undertaken or performed. The variety of possible workplaces is huge, and ranges from offices and retail shops and stores to warehouses and stockyards, to factories and workshops, to building and construction sites, to mines and drilling sites and platforms, to agricultural and forestry land, to transportation (trucks, buses, trains, aeroplanes, etc) to kitchens, eating places, and many, many more, of all shapes and sizes. Some workplaces are "indoors", whilst others are "outdoors"; some might be a combination of both. And as we discussed in Module 1, each workplace presents its own inherent hazards and risks, some of which are more potentially serious than others.

Whatever its range of activities, and the place or places - and the same organization might have two or more, for example, a construction firm will have an office and one or more building sites - from which its work is performed, the management of every employing organization should strive to provide as safe and healthy a working environment as is possible in the circumstances for all its employees (whatever the types of work they perform, and the positions they hold).

Account must also be taken of employees' welfare needs with regard to - as is appropriate to the particular workplace and to the work being performed in it: adequate lighting, ventilation, temperature (heating and/or cooling), air extraction or circulation, hygienic toilets/WC and washing facilities, and a suitable place for making and/or consuming refreshments. As we mentioned in Module 1, a workforce might include some employees with disabilities or having "special needs" for whom special facilities - such as high-level or low-level toilets and wash basins, wheelchair ramps, handrails, wide doorways and aisles or gangways - might need to be provided.

Features in Creating a Safe Workplace

Because of the incredibly wide diversity of types and sizes of workplaces, and the activities which take place in them, we can in this Section provide you with no more than general guidelines, which you can equate to the particular workplaces which you work in, supervise or manage at different times during your career. Some features we describe are common to many workplaces, whilst others are more specific to certain categories of workplace.

Buildings

All buildings in or from which work is performed should be maintained in a good state of repair; any dangerous defects noticed should be put right immediately, before they cause accidents, damage or harm. Where appropriate, fencing or guardrails must be erected in order to prevent people falling from open edges, such as a landing or a mezzanine floor or level. Any "open" areas - such as a vehicle inspection pit - should be covered or fenced and their edges should be clearly marked (perhaps by yellow painting, or yellow and black diagonal stripes) or "signed" to avoid people falling into them and being severely injured.

Handrails or banisters must be provided in all stairwells, and must be securely fixed to the structure of the staircase or to adjoining walls. High-visibility and non-slip "nosing" (which is the very outward edge of a step) with a good colour contrast should be fitted to every step to help prevent slips and trips; ideally, the nosing should be square, because a curved nosing makes it more difficult for people to judge where the edge of the step is and where to place their feet.

A single step or multiple steps in "unexpected" places - such as at the junction of two levels - should be clearly marked and signed, for example, "watch the step".

Roofs or ceilings should be well maintained, not only to avoid injury occurring from falling tiles, slates or other debris, but also to prevent water-leakage. Damp working conditions can cause colds and other ailments, and damp patches on floors can cause slips.

Inside or outside, low ceilings or beams or joists or pipes, against which people could bang their heads, should be clearly marked and signed, for example: "low ceiling" or "mind your head".

Floors in all parts of a building in which a workplace is located need adequate attention and regular maintenance, and that applies whether the floors are made of concrete or wood or another material. Furthermore, whether the workplace is an office, a shop or store, a workshop, a factory, a kitchen, an eating place, a hospital, or any other, its floors need to be level, flat, even and smooth, without holes or broken boards. Where appropriate, floors should be covered with slip-proof surfaces - such as carpeting or tiles or a suitable synthetic material - to avoid the possibility of accidents and injury resulting from employees or other people tripping or slipping on uneven floors. Floor surfaces must be kept clean and dry, to avoid slips. A level floor also increases stability for any racking, shelving, machines and equipment.

In workplaces in which floor coverings are laid, they should be hard-wearing and should equate to the temperature ranges and to the types of work being performed. There is no value, for instance, in providing good quality carpeting in areas used for printing or cooking in which powder or liquid might be spilt or drip from machines; an easy-to-clean and dry vinyl floor covering would be more suitable in such areas.

In some workplaces, such as warehouses, floors not only have to bear the weight of the items held in stock - and the bins and racks, etc, in which or on which they are housed - but they must provide a suitable surface for wheeled vehicles, whether they are operated manually, mechanically or electrically, and also to reduce the energy expended in tractive effort. Those areas of floors on which power-driven vehicles start up and stop frequently need to be reinforced.

Doorways and openings into the building must be capable of being opened easily, and also of being secured against unauthorised access to the building, and should wherever possible be positioned to allow ease of access for people and, when appropriate, a smooth and uninterrupted flow of transport and materials and other items into, through and out of the building. Too many doorways or openings will increase security risks, whilst too few might reduce freedom of entry and exit; alternative "emergency" exits for use in the event of fire are important.

When installed, glass doors or partitions should be safely and firmly glazed and be made of thick or toughened glass, and should be clearly marked to avoid people walking into them. "Vision panels" should be fitted in swing doors (whether they are manually operated or powered "automatic" doors) to avoid people being hit. Where "crash-through doors" (see Fig.2/2 are used, one-way traffic must be ensured (and preferably a separate pedestrian doorway must be provided with a barrier dividing the two.)

Outside: Whenever practical, suitable weather protection should be provided for outdoor workplaces, and also "outdoor routes" should be safe, especially in adverse weather conditions; for example, salt and/or sand must be readily available for spreading during icy conditions. Suitable clothing should be provided for people who have to work outside in inclement weather or in high temperatures.

Outside working areas (such as stockyards, timber yards, building supply yards, recycling yards, quarries, mines and building and construction sites, etc) must be suitably fenced or walled. For permanent structures, wood or brick might be used, or galvanized or plastic-coated chain-link fencing, supported by steel or concrete posts sunk and usually cemented into the ground, is often found to be most suitable. Other methods - such as portable metal "linking" hurdles - might be used for "temporary" fencing. Walls or fences should be at least 2 metres high.

Other "deterrents" might be necessary to discourage trespassers from climbing over the tops of walls or fences. Particularly where an outside workplace is located in a very populated area, adequate perimeter walls or fencing will also discourage children from climbing over the walls or fences in order to play; although they might do little actual damage inside the work area or site, they could injure themselves whilst in it.

Fig.2/1. hazard warning signs

Fig.2/2. a “crash-through” door and a “bump though” swing door (note “vision panels”)

Lighting

Whenever possible, use should be made of “natural” lighting from windows or fanlights, although workers should not be so positioned that they face directly into light or are affected by draughts from open or leaky windows. Poor lighting can result in eyestrain and headaches, in mistakes and in accidents. Even in premises well served with natural light, artificial lighting might still be necessary because the intensity of the natural light might vary at different times of the working day or at different seasons or times of the year.

Fluorescent tubes (or strips) are frequently suitable for general lighting, but they tend to “flicker”, and so might need to be fitted with “diffusers” because some people find the glare uncomfortable to work by for long periods, and some people complain that fluorescent tubes or strips cause them to suffer headaches. In some areas - close to workstations, machinery, equipment, filing cabinets or in storage sections, for example - greater illumination might be necessary, and filament lamps, which can be switched on and off as required, might need to be installed. Stairwells, corridors and other passageways need to be well-lit at all times in order to reduce accidents such as trips and slips, which too commonly happen in such places if they are dark or if there are areas which are in shadow.

A matter which should not be overlooked is that older employees might require a greater intensity of illumination than might younger personnel.

It might be necessary to provide “emergency lighting” where failure of the normal lighting could give rise to danger, such as in areas with no natural lighting, or at night.

Ventilation

This is particularly important when “natural ventilation”, from open windows for example, is not available or when climatic conditions makes its use impractical. Ventilation and air circulation are also important when a large number of people work in one area, in an open-plan office for example. Poor ventilation or air circulation can cause unpleasantness or annoyance for people working in close proximity to one another, and can encourage the spread of infectious diseases such as colds and influenza.

Good ventilation and air circulation are also particularly important in workplaces in which heat processes (for example, using furnaces, or welding) are undertaken, and in those in which smoking is still permitted (and the practice is increasingly being banned in more and more countries) to reduce discomfort - and possible health hazards - for non-smokers.

Heating/Cooling

In many countries workplaces require some degree of heating, although that might vary from one time of the year to another. Conversely, workplaces in some countries might need cooling, at least at some times of the year. Extractor fans might need to be installed in such workplaces as kitchens; in other workplaces air needs to be kept circulating. Some machinery and equipment generate a good deal of heat, which can cause discomfort to people working in close proximity. Where financial resources permit, management should consider the installation of a complete air-conditioning system which allows for both temperature and humidity control. Heaters or coolers which release injurious or offensive fumes into the workplace, must be removed and replaced immediately.

Portable or movable heaters can be dangerous because they increase the risks of fires and accidents, particularly due to people tripping over them or their trailing leads or cables. Portable fans can also be dangerous, and can be a source of accidents. Heating or cooling units fitted on walls or suspended from the ceiling are frequently the most convenient and safe.

Layout

Every organization - regardless of its size or range of activities - will try to organise the layout of its available workplace(s) for the most efficient operations. The correct placement of machinery, plant and equipment, furniture, stocks of raw materials, components, products for sale, vehicles, or other materials and items as appropriate, is important to ensure the smooth flow of work from one workstation to the next, for supervision and control, and for the co-ordination of the different activities. The basic principles are the same, whether the workplace is one room or a number of rooms on one or more storeys of a building, or is in more than one building, or is a complex spread over a large area or site; they apply equally whether some or all work is performed inside buildings, or outside in stockyards or construction sites or farms or quarries, or other areas.

But whatever the type, shape or sizes of workplace(s) and however automated or labour-intensive or otherwise they might be, in most organizations work for them will be performed by its most valuable asset, its ‘human resource’, its employees or workforce. Due attention must be paid to providing a safe and healthy - and where possible comfortable - working environment for the workforce. As we explain in Module 1 of the Health & Safety Diploma Program, most organizations must also consider the health and safety of visitors to their workplaces, whatever the reasons for their visits.

Avoiding Overcrowding

Management must always appreciate that personnel cannot be expected to work efficiently and to maintain maximum output in overcrowded conditions. Not only will there be the distractions and annoyances of having people working and talking in close proximity, but interruptions and distractions might be caused, for example, by one person leaning in front of another or trying to squeeze through a narrow gap. There will also be delays and bottlenecks. Frustrations between workers might result in tempers flaring and in arguments, in carelessness and in accidents and injuries. An overcrowded workplace can be the cause of the spread of infectious diseases like colds and influenza (often abbreviated to “flu”.)

The laws of some countries lay down the minimum space which must be provided between each person in the workplace, and at the very least those laws must be complied with, although the “minimums” should be bettered whenever possible. In offices there should be adequate spaces between desks and around equipment; main aisles should not be less than 1.5 metres wide, and minor aisles should be at least one metre wide. In warehouses, factories, etc, main aisles or gangways must be wide enough for any transporting vehicles and materials handling equipment to manoeuvre, and also for pedestrians if separate routes (which are always preferable) cannot be provided; side aisles or gangways might be narrower, but must not restrict convenient movement.

Reducing Unnecessary Movement of People

Some organizations are more labour-intensive than are others, and the necessity for the movement of people within, into and out of their workplaces might vary considerably. Then, too, the need for people to move about their places of work will depend on the activities in which they are involved and their types of work, and the locations, sizes, shapes and layouts of the internal or external areas in which they work.

Unnecessary movement is not only inefficient and time-wasting from the point of view of productivity, but when engaged in unnecessary movement people are more susceptible to accidents; for example, people hurrying about the workplace have increased risks of tripping or slipping, and injuries can be compounded if they are lifting or carrying loads or pushing or pulling equipment at the time. Furthermore, they might bump into, knock over or trip other people. It might be safer to introduce the use of **'handling equipment'** - although that also has hazards (see Module 6 of the Workplace Health & Safety Diploma Program) - to reduce the number of people who need to move about whilst moving materials, etc, form one place to another.

Whenever practicable, personnel performing similar or related work should be grouped together to facilitate the quick and convenient interchange and flow of materials, components, tools, assemblies, information, documents, records, or other items as appropriate to their jobs; an example is an "open plan" office, in which a number of clerical and/or secretarial staff work together in the same large room. It is often easier for management to provide a clean and healthy working environment in such workplaces, with adequate heating and/or cooling as necessary, good ventilation and air circulation, and with sufficient and conveniently situated welfare facilities (toilets/WCs, restrooms, etc.)

Unnecessary movement can also be reduced when each member of the workforce has "close to hand" all the materials and "tools" (whether those are machines or pieces of equipment, hand-tools, raw materials, components, records, documents, or any other items) required for the performance of his or her work. Incidences of workers roaming around the workplace looking for materials or other items they need, interfering with or distracting colleagues, will be fewer. Modern internal communications (electronic mail or email, fax or telephone) can also help to reduce the number of people who need to move around a workplace to collect and/or to deliver information.

How unnecessary movement can best be reduced depends, of course, on the work being performed in a particular workplace, but this matter should not be overlooked by management. In some cases, in offices for example, it might be possible to position computer VDUs on the desks of those people who need to use them, or to locate shelves, filing cabinets or rotary filing equipment close to the staff working on their contents, or to have small cabinets or stationery holders on or near the desks of those personnel who need their contents.

Management must not overlook, however, that the movement of workers should **not** be restricted to such an extent that they are expected to remain at their workstations for long periods without break. Such a practice could cause fatigue and boredom, as well as leading to some physical problems, and output would be likely to decline. Where appropriate, suitable seating should be provided so that employees are not "on their feet" for long, uninterrupted sessions.

Noise Minimisation

Not only is noise a source of annoyance and distraction - which cause lack of attention, resulting in mistakes and accidents - but it can also cause distress to some employees and result in a decline in their physical and mental health. Particularly in open-plan layouts of workplaces (whether those are offices or factories or shops or stores, or woodworking or machine workshops, or others) some noise distractions might be unavoidable; for example, noise made by machinery or equipment, telephones ringing, computer printers, people talking. However, whenever practicable, noisy machines and equipment should be positioned well away from workers not actually operating them, and in particular well away from those people whose work requires concentration.

When practicable, noise should be reduced or stopped at its source(s), but where that is not possible, soundproofing materials might have to be affixed on walls, doors, ceilings and floors, and some doors and/or windows might have to be double-glazed, or even triple-glazed (for example, if a workplace is located on or near an airport.) Circumstances can and do vary considerably, and management should take the most suitable action necessary to ensure that employees can perform their work efficiently without disturbances.

In many cases a "balance" will have to be struck between the last two matters discussed. If, for example, in order to reduce noise distractions, machines are located some distance from those workers who need to use them, time and movement will be wasted by those people in getting to and from the machines.

Toilets (WCs) and Cloakrooms

The provision of adequate toilets (or WCs) and cloakrooms (in some countries called "bathrooms") is not a matter which should be ignored, either from the points of view of convenience and time or movement, or hygiene. The facilities should be easily accessible and in proximity to workplaces, and should be clearly signed and identified. They must be private, be well ventilated and lit, and be kept clean, disinfected and odour-free; that is, hygienic. The toilet area needs to contain - in or nearby - facilities for the thorough washing of hands and drying them; for example, warm air blowers, or paper towel or tissue dispensers with hygienic disposal units for any "used" paper towels and tissues, etc, might be fitted.

Toilet/WC cubicles should have locks on the inside of the doors, and be large enough to provide privacy, and toilet paper or tissue should be provided.

In workplaces in which both male and female workers are employed, separate and clean and hygienic - and private - facilities should be provided for each sex (which is a legal requirement in many countries) and must be clearly distinguished by signs (see Fig.2/3) or lettering. As we mentioned earlier, special toilet/WC and washing facilities might be have to be provided for workers with disabilities or special needs.

In some workplaces - such as kitchens, mines, and demolition sites - in addition to wash basins the provision of shower facilities (and when appropriate, separate units for males and females) might also be necessary; both should provide hot and cold running water, together with soap, and hygienic drying facilities, such as warm air blowers, or paper towel or tissue dispensers with hygienic disposal units for any "used" paper towels or tissues, etc.

A personal locker might also need to be provided for some or all workers, in which personal towels and other "personal" cleaning and hygiene items (for example, hair brush, tooth brush and toothpaste, deodorant or body spray, sanitary towels, etc) might be placed for safekeeping until needed. In workplaces where changes of clothing and/or footwear are necessary, ***changing rooms*** may be provided - separate ones for males and females in workplaces in which both sexes are employed - equipped with benches or other suitable seating, and storage facilities (which might also serve as their personal lockers.)

Housekeeping

This term refers to the general condition of the workplace. Where possible - and that is not always the case - workplaces, including their floors, ceilings and walls, their furniture and fittings, any machinery and equipment, etc, should be kept clean and dust-free. Floors must be washed, swept or vacuumed regularly. Walls should be washed and repainted at regular intervals. Rubbish must not be allowed to accumulate, because it can become a health risk or fire risk. Rubbish and waste should be placed in suitable containers; oil or solvent contaminated waste (such as oily rags) should be put into fireproof containers, such as metal dustbins with lids. Any spillages of water or other liquids should be mopped up immediately, if necessary using suitable detergents and absorbent materials.

Machinery and Equipment

It is important that all machinery, plant and equipment located in a workplace is regularly and professionally inspected and serviced or maintained to manufacturers' recommendations. Effective "guard" devices must be fitted on especially dangerous machinery or equipment, and those with moving parts, to protect operators and other people from injuries, such as cuts, abrasions, bruising, crushing, entanglement, contact with sharp edges, contact with hot surfaces or noxious chemicals (covered in Module 5 of the Workplace Health & Safety Program). Supervisors must ensure not only that the "guards" are effective, but also that they are being used by workers (and are not being removed or "bypassed" to save time or effort.)

The sensible positioning of machinery, equipment and furniture in the workplace and in individual workstations so that, for example, sharp corners or desk drawers do not stick out into aisles or gangways, can prevent many unnecessary accidents and injuries to those people working in the area, and also to people "passing through" it for any reason.

All electrical equipment, including plugs and sockets, wiring and cabling, light fittings, circuit-breakers, and any others, should be inspected - and, if necessary, serviced and/or replaced - regularly by qualified electricians (dealt with in Module 7 of the Workplace Health & Safety Program).

Accident Prevention

Accidents do not simply "happen" - they are caused, by shortcomings on the part of the employer, the employee or both. The results of an accident can be traumatic for both parties; in the way an injury can affect the employee, his or her family and their quality of life; for the employer through lost "man-hours", output or production, time spent on investigations and, in worst case scenarios, the cost of legal action and compensation.

What is termed ***'accident prevention'*** aims to reduce the chances of such an incident to the absolute minimum. Also, if "near misses" (accidents which are fortuitously avoided) or actual accidents do occur, immediate action must be taken to investigate how and why they occurred and measures implemented to prevent recurrence.

Many accidents which can - and do - occur in the workplace could be prevented with adequate planning and forethought by management, and the training of personnel in safety techniques. Not only can accidents be harmful to people and objects, but they can cause disruption to parts of or the whole of the workplace. Furthermore, accidents do not affect only those workers directly involved; they make good "topics of conversation", and are often as time-consuming as they are unnecessary.

As we have emphasised, every workplace has its own inherent hazards, risks and dangers, and those must be identified, assessed and then tackled by management in the most appropriate and effective ways to prevent, reduce or eliminate accidents, injuries, damage and other harm, such as ill health. We have already described some actions which should be taken to prevent accidents in certain types of workplaces, but we cannot cover each and every one because of the enormous variety of workplaces.

However, the following is just one example of the range of ***'accident preventive measures'*** which can be taken, in this case in an office-oriented workplace:-

* Planning and implementing the correct and safe siting of desks, chairs, machines and equipment, filing cabinets, cupboards, etc, with adequate room between or around them, and without sharp edges sticking out.

* Providing aisles of sufficient width so that people can pass without bumping into each other or into desks, machines, etc, and ensuring that aisles are kept clear; parcels, files and other items must not be left in the aisles or in other locations where they can be knocked against or tripped over.

* Making regular checks of floor and stair coverings for holes or worn patches or sections "lifting"; it is best that such coverings be of nonslip materials, particularly in areas which might become wet or damp from time to time.

* Ensuring that all filing cabinets, machines, equipment and cupboards are correctly balanced so they will not topple over if knocked against or banged into, or become top-heavy. Machines should be placed on even, solid bases.

* Providing effective "guard" devices for moving parts of machines and equipment, especially dangerous ones, such as paper guillotines. Regular checks should be made to ensure that personnel do not remove the guards, and adequate training should be given to personnel who will use the machinery and equipment. The machinery and equipment should be "serviced" regularly, whilst operators must not be allowed to become careless, or complacent or overconfident in using it.

* Arranging for regular inspections (and repair or replacement, when necessary) of electrical equipment, including plugs and sockets. All electric wiring or cabling (including computer network cabling) should be located under-floor, or when that is not possible, should be adequately covered to avoid people tripping over them.

* Prohibiting the storage of materials and other items in high and precarious positions; in cases in which use has to be made of high storage areas, suitable step ladders (see Module 4) should be provided so that personnel do not have to take the risk of standing on desks or chairs in order to reach those areas.

* Checking that cupboards and shelves are stacked neatly and scientifically, so they cannot topple over, and so that items cannot slide out or off of them (see Fig.2/6).

* Providing adequate and appropriate fire-fighting equipment, such as "fire extinguishers" - and ensuring that it is regularly checked and serviced, and is in working order. Staff must know where the equipment is positioned, and they must be taught how to use it properly should the necessity arise. They must also know what to do - and what not to do - in the event of a fire breaking out (covered in Module 3 of the Workplace Health & Safety Program).

* Introducing and enforcing a strict "no smoking" policy (whether or not smoking in the workplace is prohibited by law) in the office itself, and in corridors, in cloakrooms, and in other areas used by office personnel (and by visitors). Not only will this action reduce the risks of fire outbreaks, and of injury - such as burns - to people, and damage - such as scorching - to furniture and furnishings, but will also help to create a cleaner and more healthy atmosphere in which personnel can work.

All personnel should be trained to be "safety conscious". Instructions should be issued, if necessary in writing, about particular hazards and risks (whether they are only temporary or are permanent.) For example, safety precautions to be taken could be affixed to the wall above a particularly dangerous machine, and "no smoking" signs could be affixed to the outer doors or walls of areas in which flammable materials such as printing inks are stored.

Despite all precautions, accidents can and do still occur, very often as the result of the carelessness or silliness of personnel, for example from leaning out of windows or from "horseplay" or practical jokes during lunch or tea breaks. It is therefore important that a first aid kit should be readily available, and that it is checked from time to time to ensure that it is still adequately stocked with such items as antiseptic ointments, bandaging and sticking plasters, plus appropriate medicaments to combat headaches, eyestrain, and other common ailments, because the distractions which are caused by such ailments can easily lead to carelessness and accidents.

(We deal with many of the foregoing matters, such as fire prevention and action to be taken in the event of fire, first aid, etc, in greater detail in Module 3 and in the appropriate Sections of following Modules of the Workplace Health & Safety Program.)

Avoiding Slips and Trips

Statistics show that one third of all major injuries - such as broken bones, serious burns and loss of consciousness - are caused by people slipping or tripping. Slips and trips also account for half the injuries to members of the public in workplaces where there is “public access”, such as in retail shops or stores, restaurants, libraries and hospitals.

Slips and trips often cause other types of accidents, and in some situations the potential for serious injury is much greater. For example, people working in kitchens who trip or fall are at risk of being burned or scalded, people who work on high platforms who slip or trip could fall from height which increases the extent of injury, and slipping whilst carrying a load might cause a strained back. In addition, the sequence of events “triggered” by one person tripping or slipping might result in injury to another person (or more than one); for example, a slip by a person working in a commercial kitchen whilst carrying a frying pan or saucepan, might result in another person being scalded by hot oil or boiling water.

Floors

As we have already explained, defects in floors themselves or in floor coverings can be a major cause of slips and trips. Floors should not be uneven or sloping; floors or floor coverings should not have holes or worn patches or “lifted” sections; it is important also to watch out for floor tiles or mats which slide, or “curl up” at the edges. These matters apply not only to the workplace itself, but also to any corridors or passages, staircases - stairs need to have square high-visibility, slip-proof rubber “nose” strips fitted securely along their outer edges - escalators, etc, in or around the workplace, including outside paths, pavements or walkways.

People rarely slip on clean, dry floors. But if floors become “contaminated” with water or other liquids, mud, printing ink or powder, dirt, dust or any other extraneous materials, accidents can easily happen. If a floor has a smooth surface (such as vinyl) or a polished surface or ceramic tiles or metal, even a tiny amount of contamination can present a real slip problem. Floors with higher surface roughness usually provide better “slip resistance”.

Actions which can be taken to reduce accidents from slips include keeping floors:-

✱ **Clean** by regular washing, sweeping or vacuuming. A floor gets its “grip” from its surface roughness; poorly cleaned floors lose that roughness, and lose grip. Some floors can be treated with non-slip paint, etching, etc, to increase surface roughness and grip. Alternatively, stick-on or adhesive anti-slip strips might be used, but could present a trip hazard if they are not properly fitted or when they are old and frayed.

✱ **Dry**: where possible (and that is not always so in “outside” workplaces) there should be a “dry finish” to liquid-based (water alone or water plus detergent) cleaning. If floors have to be left “wet” after cleaning, people should be stopped - by barriers and/or “danger, wet floor” notices - from walking on them until they are completely dry. Any spillages must be cleaned or mopped up immediately. Foot mats may be provided inside entrances by which people might enter with wet feet (for example, if it is raining outside) so that they can wipe the soles of wet footwear. Umbrella bins might be provided by entrances from “outside” so people do not walk into the workplace carrying dripping umbrellas.

Obstructions - Tripping Hazards

Floors and walkways in workplaces (whether inside or outside), aisles, gangways, corridors and stairways must be kept free from obstructions and any other substances which might cause a person to slip, trip or fall. Many trip accidents are caused simply because objects are left where they should not be. Files of documents, packages, machines, etc, are too often put down on the floor in offices; materials delivered to warehouses might be left in aisles awaiting inspection or instead of being correctly housed on racks or shelves, especially when storage space is short; in workshops, hand-tools might be placed on the floor whilst not being used; on building and construction sites machinery or equipment might be left unattended. Too often all these hazards - and many others like them - arise from laziness or thoughtlessness, or at particularly busy times.

We have mentioned before that loose or trailing electric wiring or cabling, computer network cabling, telephone cables, or pipes are a major cause of trips, and therefore should be avoided. When that is not possible, “cable managers”, “cable ties” or suitable and effective floor cable coverings should be used to reduce or remove tripping hazards.

Particular accident “black spots” can be areas in which there is poor lighting, shadows or glare, because people are more likely to have accidents if they cannot see clearly where they are going or see any obstructions in their paths. Distractions - such as loud noises, chatting, telephones ringing - can also cause trips or slips whilst peoples’ attention is diverted. Too hurried movements, such as people rushing around whilst carrying loads, pushing or pulling equipment, can also cause trips, slips and other accidents.

Fig.2/3. toilet/WC signs and a changing room sign

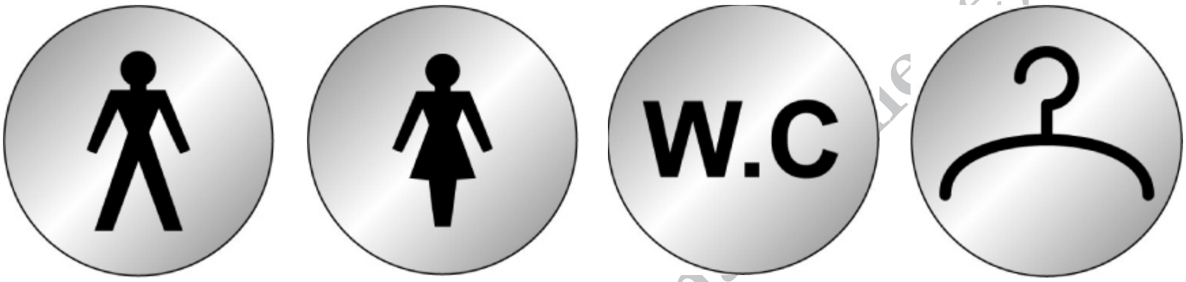


Fig.2/4. wet and slippery floor warning signs

Fig.2/5. trip hazard warning signs

Fig.2/6. a variety of hazard warning signs

Footwear

Both slips and trips result from some a kind of unintended or unexpected change in the contact between a person's feet and the ground or walking surface. Therefore, good housekeeping, good quality of walking surfaces (such as flooring), the selection of proper footwear, and an appropriate pace of walking are critical in preventing fall accidents. In workplaces where floors might become oily or wet, or where workers spend considerable time outdoors (particularly in inclement weather) the prevention of fall accidents should focus on selecting proper footwear, such as non-slip shoes or boots or steel-capped boots.

There are two major categories of work-related foot injuries. The first category includes foot injuries from punctures, crushing, sprains, and lacerations; they account for approximately 10% of all reported disabling injuries. The second group of injuries includes those resulting from slips, trips and falls; they account for approximately 15% of all reported disabling injuries. Slips and falls do not always result in a foot injury, but lack of attention to foot safety plays an important role in their occurrence.

Appropriate footwear should be chosen based on the hazards that are present in a workplace, which requires an assessment of the workplace itself and the work activities taking place in it, in relation to:-

- materials which are handled or used by particular workers
- the risk of objects falling onto or striking the feet
- any material or equipment that might roll over the feet
- any sharp or pointed objects that might cut the top of the feet
- objects that might penetrate the bottom or side of the foot
- possible exposure to corrosive or irritating substances

It might also be necessary to evaluate risks:

- to ankles from uneven walking surfaces or rough terrain
- of foot injury due to exposure to extreme hot or cold
- of slips and falls on slippery walking surfaces
- of exposure to water or other liquids that may penetrate the footwear causing damage to the foot and the footwear
- of exposure to rotating or abrasive machinery, such as chainsaws or grinders

Encouraging employees to wear suitable or "sensible" footwear in the workplace (such as by discouraging "high heeled" shoes) can also often prevent many slipping and tripping accidents. Another feature to consider is that properly fitting footwear increases comfort and prevents fatigue which, in turn, improves safety for the employee.

Module Eight

THE 'MARKET' AND MARKETING, THE '7 P'S' OF MARKETING, SEGMENTATION, PRICING AND COMPETITION

This Module is one of the 12 Modules from the CIC Diploma Program on:

Sales Management & Marketing

Introduction: This Program provides training for success in the vital fields of sales and marketing. It gives detailed, practical knowledge about selling and sales, markets, research, distribution, marketing strategies, advertising, publicity, pricing and more. It also covers sales and marketing management tasks of recruiting, motivating, planning, controlling and organising staff.

The Program is a route to good sales and marketing posts, and is essential for business people, entrepreneurs and managers, and anyone involved in sales, marketing or dealing with customers.

	Sales Management & Marketing - Modules Summary
Module	**Module Title**
1	The Importance of Selling in Commerce, Salesmanship, Products, Enterprises, Customers
2	Buyers, Motives, Selling, Sales Transactions, Sales Displays, Demonstrations, Related Sales
3	Travelling Sales Personnel, Finding Prospects, Research, Sales Journeys & Cycles, Follow-ups
4	The Principles of Management, Leadership, Recruiting & Training Sales Personnel
5	**The 'Market', Marketing, the '7 P's' of Marketing, Segmentation, Pricing, Competition**
6	Sales Forecasting & Planning, Product Life Cycle (PLC), Control of Sales Budgets
7	Channels of Distribution, Wholesale, Retail, Others, Internet Marketing, Websites
8	Credit & Credit Management, Methods of Credit, Discounts, Branding, Warranties
9	The Promotional Mix, Marketing Communication, Advertising, PR, Social Media
10	Sales Letters, Circulars and Sales Literature, the Sales Office, Records, Statistics
11	Developing a Sales Team, Regional Teams, Coordination, Salesforce Remuneration
12	International Marketing, Selling Overseas, Worldwide Trends, Marketing Concepts

If you would like to study the complete Program and gain an international Diploma on **Sales Management & Marketing** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Atef Hekmat Aref wrote from **Saudi Arabia**:
"Gaining my CIC Marketing Diploma was a great point in my life. Its distinguished reputation got me promoted to officer and my salary was doubled. Studying with CIC you get something of higher value than just money."

Danny Simfukwe wrote from the **Congo**:
"Due to my CIC studies I have been promoted and I am now in charge of six regions and our international market, and I have a new vehicle for me at Head Office. Imagine what awaits me when I finish even more training with CIC!"

Module Eight

THE 'MARKET' AND MARKETING

Sales and Marketing

Both sales and marketing are important activities for many organizations; they are both aimed at increasing revenue from the sales of products. But because they are so closely interlinked, the differences between sales and marketing are not always recognised or understood; indeed, in smaller businesses the same people might undertake or control both. But there **are** differences between sales and marketing, which can have significant bearings on many areas of an organization's operations, and in consequence on its success and prosperity. Larger organizations are more likely to recognise a clear distinction between marketing and sales activities, and to employ in-house or external specialist personnel to handle them separately, although to be fully effective their actions need to be co-ordinated.

Marketing activities include consumer research to identify the needs or demands (in terms of products) of customers, product development to design innovative products to meet existing or identified or latent needs, advertising to raise **awareness** of the products and to build the brand, brand marketing, public relations, direct mail, designing suitable distribution channels, and viral marketing. Typically, the aims of marketing are to generate interest in specific products and to create leads or prospects. In contrast, sales activities are focused on following up the leads, and converting prospects into actual paying customers. As a general rule, sales activities can be looked upon as involving interaction with prospects to persuade them to actually purchase particular products.

To put it simply, we can say that whilst marketing activities create the demand in the market, sales fulfils that demand.

Another distinction between the two functions is that marketing activities tend to focus on the general "buying public", or on a large swathe of people, whereas sales activities tend to focus more on individuals or on small groups of prospects. In general, marketing involves a long-term process of building a name for a brand and persuading customers to consider buying, even if they might not need products immediately. Whereas sales activities involve a shorter-term process of finding target consumers and actually selling products to them.

The Market

It is important for you to understand clearly the meaning of the term "the market" as used in the context of sales management and marketing.

In everyday usage, we might think of a "market" as being:-

- ✦ **Either** a *periodic "event"*, or a *"concourse" of people* for the buying and selling of products. Generally, vendors - who might be individuals, families or small businesses - display their "wares" (their products) which they might produce themselves or "buy in", and sell them from small "stalls", which might be moveable. Such markets might be held daily weekly, monthly or annually; some are held "outdoors", whilst others are held indoors.

- ✦ **Or** the *actual area* - which might be a building or a square or some other public place - where mainly relatively small businesses sell products on a regular basis, perhaps. 5 or 6 days a week, from "permanent" premises, such as small shops, kiosks and stalls.

Sales managers for many enterprises (such as wholesale businesses) might be concerned with selling products to businesses which operate from permanent premises in regular markets. Those buyers will, of course, buy in order to resell the products to their own customers.

However, when we refer to "the market" in the sales management and marketing context, we mean something **quite different**. We mean:-

*"The numbers of potential customers in a particular area (which might be an entire country) who are **able** and who are likely to be **willing** to buy the products of a particular business."*

Note in particular that in this definition:

* the word *"able"* refers to those people who can **afford** to buy the products concerned;

  and
* the word *"willing"* refers to those people who **want** or **need** the products, or those who can be **persuaded** to buy them, that is, by skilful advertising and salesmanship.

Ready Made Markets

Sometimes there is what is called a *"ready made" market.* For example, people in a small town or village might not at present be able to obtain easily certain products which are readily available in larger towns or cities, although they are *willing and able* to buy those products. The management of a business - in consultation with its sales/marketing manager - then has to decide whether the number of potential customers warrants the expense of establishing a new business or a branch of the existing one in that area. Their decision well might depend on whether there is likely to be a continuing - and preferably increasing - demand for what it is hoped to sell: for instance, if the customers are likely to be "one off" as might be the case for, say, electrical appliances, the business might do very well to start with but it might soon run out of customers!

Market Creation

In other cases, a demand - the market - for products *has to be created.* Potential customers might not be aware of the benefits to them of possessing or using certain products - they might not even be aware that a particular product exists, or that it is superior in any way to similar products with which they are already familiar. A good example was the rise in popularity of compact discs (CDs). When they were first introduced *"onto the market"* few people bought them because they were sceptical about the superiority of the new products over the familiar record discs, the range of music available on the new compact discs was limited, and people were averse to spending money on replacing their existing equipment with the new equipment necessary to play the compact discs. At that time, too, both the discs themselves and the players were very expensive (in particular because of the high cost of *research and development,* and because relatively few of each type was being produced.)

However, skilful advertising and publicity, including frequent mention on radio programmes, together with a wider range of compact discs, gradually persuaded more and more people to buy the new discs and the equipment on which to play them. The increased demand in turn led to a reduction in the prices of both the compact discs and the players because:-

★ more manufacturers started producing them, some of whom did not have to "cover" the research and development costs involved, as they had been borne by the originators;
  and
★ because "mass production" techniques resulted in a lower production cost per "unit".

The reductions in prices meant that more people could afford to buy the compact discs and CD players (particularly if credit terms, and especially hire purchase, were available on the latter), which in turn boosted sales, which in turn (coupled with increased competition) helped to reduce prices still further. That, in turn, increased sales, and so on.

However, in the modern world of business things rarely "stand still". Within a few years there were rapid technological developments which resulted in a new mp3 digital format for playing music. The mp3 digital format produces sound of an even higher quality than the sound produced from playing CDs. Through the mp3 digital media system, music can be purchased and downloaded directly from the Internet onto an mp3 player such as an iPod. An iPod is a portable hand-held device which allows the owner to listen to music stored on it, and which has the ability to store a huge number of music albums.

So the "marketing cycle" began again, with the manufacturers concerned needing to create - by skilful advertising and publicity - a **demand** for the latest equipment, and to persuade consumers to abandon their CD players in favour of the new products.

The high quality of the music available through mp3, the convenience of being able to purchase music tracks and albums online from the Internet, and the simplicity and speed of the transfer of music over the Internet directly onto an iPod are all improvements on the music from CDs. These advantages, as well as the trendy "image" and the current "fashion" for having the latest electronic and musical products, are features "marketed" by the manufacturers and by the many shops and stores selling iPods who are keen to increase their sales income.

The two examples given above are, of course, "extremes", but they serve to illustrate the point that there is **no value** in making something or in trying to sell something for which there is little or no demand, or for which demand cannot be created.

The Marketing Mix

There are many definitions of marketing but, in its purest form, marketing is all about identifying a customer "need" or "demand", producing a tangible product or a service to meet that need, and then providing that service or product to the ***'target audience',*** when and where it is needed and as efficiently and as economically as possible.

In this context, a ***'target audience'*** - or ***'target market'*** - is the primary group of people that some sales action, such as an advertisement or a message, is aimed at or is intended to appeal to; it is a group of prospective customers at which the management of an organization has decided to aim its marketing efforts - and to which it hopes ultimately to sell its products. A target audience can be people of a certain age group, gender, marital status, etc, and a well-defined target market is the first element in creating a marketing strategy.

Today, as competitive pressures increase, marketing is more and more the "key" to being successful in business. Good marketing plays a key role in many "business success" stories. Most small businesses carry out a great deal of marketing, but their managements do not always recognise it as being such, and do not always plan and utilise it to its fullest extent. They probably already know well what their customers want and expect; and they know that their businesses should continually be improving and extending their products. But marketing involves much **more** than just sales and advertising.

Successful marketing allows a business to identify, to anticipate and to satisfy customers' requirements profitably. If the management of a business gets its policies, strategies and plans "right", marketing will do much to ensure that the right goods or services reach customers at the right prices, in the right places, and at the right times. Successful marketing depends on addressing a number of key issues, including how an enterprise's products reach its customers, how the products are priced, and how its customers are told what is available, and where.

To effectively market a tangible product or service, there are four factors which an organization's management needs to get right: **Product**, **Price**, **Place** and **Promotion**. These four elements are collectively known as the ***'marketing mix'*** or the ***'4Ps'***. The four elements should be viewed as one unit and structured to support each other; if that is not done, the organization's marketing strategy will be confused and unco-ordinated. The marketing mix should be looked upon as being a **'business tool'** used in the marketing of products; it is often crucial in determining a product's or brand's unique selling point - that is, the unique quality which differentiates that brand or product from competitive brands or products - and is often synonymous with the 4Ps, which we now examine

✻ *Product*

The product aspects of marketing deal with the specifications of the actual goods or services, as well as how they relate to the needs and wants of end-users. As we have explained, a market must exist or be capable of being created for a product which it is intended to launch; there is no value in developing a tangible product or a service first and then hoping to find a market for it later. The market must be ***'researched'*** (see later Sections) before the product is launched to be sure that it meets the needs of customers, and that there are sufficient prospective customers who will be able and willing to buy it; in other words, that there is a "market" for the product.

Then a system must be put in place to check regularly that the product still meets customer demands and that, if and when necessary, the product is modified or replaced to meet changing customer demands, fashions, technology, expectations, safety standards, etc, as appropriate. As an adjunct to many products, it may be common to include "supporting elements" such as warranties or guarantees, and after-sales support.

✻ *Price*

This element refers to the process of setting a price for a product as well as, when appropriate, making decisions about any discounts or other terms (such as "credit") which might need to be offered as inducements to buy. It must never be overlooked that any product is worth only what customers are prepared to pay for it. The price set also needs to be **competitive**, which does not necessarily mean that it has to be the lowest or cheapest. A small business, for example, might be able to compete with larger rival organizations by adding "extra services" - such as "personal service" or a delivery service - that customers will feel provide better value for money.

In practice, price "positions" a product in the marketplace in comparison with competitors; the higher the price, the greater is the value or quality customers will **expect** for their money. Just as importantly, the pricing policy adopted must also cover the vendor's costs and provide a profit. The price is the only element of the marketing mix which generates **revenue** (income); everything else represents a cost (expenditure) - for this reason, we deal in detail with pricing considerations later in this Module.

✻ *Placement or Place*

The term ***'placement'*** refers to how the product gets to or reaches the buyer; the various ways are called ***'channels of distribution'*** (and we describe many of them in Module 7 of the Sales Management & Marketing Program), for example, from manufacturer to wholesale businesses to retail businesses to consumers.) This third 'P' may also be called ***'Place'***, to include not only how but also **where** a tangible product or a service is sold (such as through a retail outlet or online via a website or webstore) and in which geographic region or industry, to which target audience (such as young adults, families, business people). It might also consider, when relevant, how the surroundings in which the product is sold might influence sales.

The location - the "where" - a product if offered for sale or the provision of a service is offered, must be appropriate and convenient for customers. The product must be available in sufficient quantity to satisfy customer demands. At the same time, storage, inventory and distribution costs need to be kept down to acceptable levels. A "place" also means a way of displaying products to customers; this could be a shop or store window, or could be a mail order catalogue, or could be a website, or it could be an office or a workshop. The decision on "place" will depend on the nature of the product or service, and the methods by which sales of it are intended to be made; but in any case, it should always be designed to make what the business is offering accessible, available, appropriate and attractive to potential customers.

✻ *Promotion*

Promotion is the element of the marketing mix that most people readily recognise. In this context it refers to the way an organization communicates what it does and what it can offer customers. It includes such activities as branding, advertising, direct mail, website design and maintenance, public relations (PR), corporate identity, sales management, special offers, and exhibitions. Any form of promotion must gain attention, must be appealing, must tell a consistent message, and communicate the "benefits" - and not just the features - of the product and, above all, must give the customer a reason to choose **this** product rather than that of a competitor.

One aspect of promotion which is often not remembered or appreciated by management, is that of communicating effectively with its own sales personnel to ensure they are always well-trained, have full product knowledge, and can share expertise with their customers in the manner most likely to lead to sales taking place.

Because a service is not tangible, in recent times the marketing mix for a service has been expanded to ***'7Ps'*** by the inclusion of three additional elements: **People**, **Process** and **Physical Evidence**, which we will now examine.

✻ *People*

Every time an organization's employees come into contact with a prospect or customer an impression is made. It is essential to ensure that it is a **good** impression, by having properly trained, well-motivated sales personnel with a good attitude; in effect, the reputation of the organization rests in their hands. Providing after-sales support and advice is one way in which an organization can add value to what it offers, giving the business an important edge over competitors. Frequently, customers do not consciously "separate" the product or service from the staff member who sells or provides it, so "people" are a key element in the marketing mix.

∗ *Process*

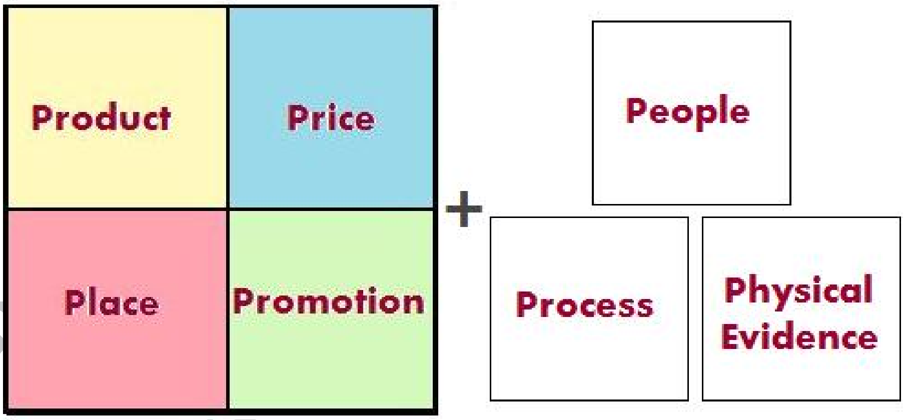
The provision of a service generally involves the performance of some type of work, and the process of providing a service - the manner in which it is given - is crucial for customer satisfaction. Such matters as response time, waiting and delivery times, the information given to customers and the interest, reliability, helpfulness and efficiency of staff, are vital in keeping customers happy. In general, customers are not interested in the "details" of how a business operates; but they **do** want and expect to receive a good level of service for their money. Well trained, courteous, responsive, efficient and helpful staff are vital in this element, and they should be looked upon as being "ambassadors" - in fact the "showcase" - for the business.

∗ *Physical Evidence*

Unlike goods, a service is intangible and therefore cannot be seen, tested or experienced in advance of its "delivery" or provision. Therefore, a customer choosing to use a service - whether it is a holiday, an insurance policy, or banking facilities, or a laundry, to take just a few examples - has to be sufficiently confident to buy "on trust", as it were.

A prospect's uncertainty can be reduced by helping the potential customer to "visualise" what he or she is buying. For example, an insurance salesman might be able to produce case studies and testimonials to provide evidence that the company keeps its promises. Websites for hotels - whose products include both tangible items and services - often offer a "virtual tour" of the hotel and its environs, as well as "reviews" posted by guests who have stayed at the hotel and experienced its facilities previously. In other situations, facilities such as a clean, tidy and well-decorated reception area can also help to reassure prospects.

In all cases, the physical evidence provided should be appropriate to the expectations of the customer or prospect. For example a financial services product will need to be delivered more formally than would a children's entertainer. This may be demonstrated in such aspects as the layout and furnishing of premises or in the way that staff - at least those who have contact with prospects and customers/clients - dress or are uniformed.



∗ *Planning*

In practice, there is an eighth ***'P'*** which pulls the other seven together and unites them, and that is **planning**.

Marketing Strategy and Planning

A marketing strategy defines objectives and describes the way in which an organization will go about satisfying customers in the chosen markets. The marketing strategy focuses on markets and customers, and is just one part of the overall business strategy, which takes a broader view which includes other business functions such as manufacturing and operations, finance, quality, purchasing and supply chain, and information and communication technology. For example, a business objective might be to increase sales; in turn, the marketing objectives to achieve that increase would be to reach new customers, to promote repeat-buying amongst existing customers, and to launch new products.

What is called ***'market segmentation'*** is a marketing strategy that involves dividing a broad target market into "subsets" of consumers who have common needs (and/or common desires) as well as common applications for the relevant goods and services being offered for sale.

Depending on the specific characteristics of a product, the subsets might be divided by criteria - often referred to as ***'demographics'*** - such as age and/or gender, or other distinctions, such as location or income. Marketing campaigns can then be designed and implemented to target these specific customer segments.

The marketing mix is an important part of the marketing strategy, because it consists of the marketing "tools" which can be made use of. But marketing strategy is more than the marketing mix. The marketing strategy sets the organization's marketing goals, defines its target markets and describes the actions which will be taken to "position" the business in the market to achieve advantage over its competitors. The marketing mix then follows on from the marketing strategy, making use of the "tools" to achieve in practice that "unique selling proposition" and to deliver benefits to customers.

Once the marketing strategy has been developed, it is usually incorporated into a broader marketing plan. The plan usually goes further than the strategy, by including such factors as the marketing budget allocated, and other relevant "detail". The marketing strategy might serve well for a number of years, but the detail - such as budgets allocations for various marketing activities - of the marketing plan might need to be updated and amended each financial year.

The key in constructing a successful marketing strategy is to understand and match the capabilities of the organization to the opportunities available in the market. To be able to do that, the sales or marketing manager will need a range of information, such as:-

Market data about the size and growth rate of the market, who potential customers are, what they buy, when they buy, from whom and through whom they buy, etc.

Competitive data on who direct competitors are, their products, prices, etc; such data also helps to identify indirect or potential competitors who might otherwise catch management "off guard", by introducing new products, or by mounting advertising or sales promotion campaigns, changes in discounts or credit terms, and so on, which could dramatically affect sales.

Internal data from within the business which will help to assess the strengths and weaknesses of the organization's products - whether those are goods or services, or a combination of both - and their core capabilities.

The "business judgement" of senior management, including the sales or marketing manager, will play a key part in deciding marketing objectives, target markets and suitable market positioning strategies. The constituent parts of a marketing strategy need to be based on a thorough and objective understanding of the current situation. They usually include:-

The scope of the business, such as the customer groups served, the benefits they are seeking and which the organization delivers, and the technology used. This might provide management with what some businesses call a "vision" or "mission statement"; that is, a set of words explaining what the business is about and where it is going (or intends to go).

Marketing objectives, such as market share, sales or market share growth, market entry, increasing customer awareness, and so on.

Target segments and positioning, such as the specific customer groups or segments to be targeted and the position of the business in those segments.

Marketing mix, that is, the product, price, placement or place (distribution) and promotion (plus people, process and physical evidence in the case of services) which the organization is or will be using as "marketing tools" to deliver benefits to its customers and to out-perform its competitors.

Implementation, which includes action plans, budgets, timescales and resources. The best marketing strategy will be of little value if it cannot be implemented - put into practice. Having finalised the marketing strategy, it is important for management to check that the organizational operational capacity and processes are capable of fulfilling the extra orders anticipated, delivering on time, and providing any extra services reliably and efficiently.

Market Research

As we explained in detail in Module 1, to a large extent, the demand for a product or a brand of products might depend upon how it is regarded by potential customers, specifically whether it is looked upon by them:

❖ as being a *necessity* or an *essential*
or
❖ as being a *luxury* or a *nonessential*

To run a business or the sales department of a business without having reliable information about the market in which it is competing (or intends to compete in) has been compared to *"running in a hurdles race wearing a blindfold!"* It is therefore necessary to ***research*** or to investigate the market before a new business or branch is established, or when considering "moving" or expanding into a new area (dealt with in Module 11 of the Sales Management & Marketing Program) and at various times when circumstances - for example failing sales - dictate.

Basically the process which is called **'market research'** seeks to provide answers to the following *types* of questions:-

✦ How **large** is the market for the products of the business - or envisaged business - that is, what is the size of the demand for the products which the business can or will supply?

✦ How does customer demand **vary** from area to area, and are there any common factors which account for the variations, for example, are sales higher in towns than in country areas?

✦ Are there any noticeable - and potentially profitable - **market segments** in the overall market which merit special attention? If so, do the market segments, whether composed of distinct groups of individuals and/or businesses, have specific identifiable characteristics? For example, are a significant number of products purchased by a high income group residing in suburban areas?

✦ What kinds of selling **outlets** are there in each area: are they mainly retail shops, department stores, offices, supermarkets, mini-markets, etc?

✦ What **share** of the market does the organization currently enjoy or what share can it realistically hope to secure); how does its share compare with the shares of the largest competitors; how can the business' **'market share'** be increased profitably; and how can its current share be protected and defended from other new or existing competitors?

Of course, not all such questions are applicable to all businesses or to all types or brands of products, or in all circumstances, and variations to the questions might be necessary. Nevertheless, the answers which are obtained to the listed questions, and similar ones, as appropriate, can provide very valuable - and often surprising - information for management, and can form the basis for planning and meaningful decision-making.

The **market orientation** and culture of a business will affect its approach to market research, and the types and depths of market research activities used. Some businesses are very *market oriented*, and continuously and pro-actively undertake market research in an effort to discover ways to better meet customer needs and wants than their competitors. As with all businesses, the resulting market research data and information must not only be *useful* and *relevant*, but must be *acted upon* to ensure that the research has been worthwhile.

There are a number of different methods which can be used to obtain the information required. Again, the methods adopted, and the extent to which they will be used, depend largely on the type of a particular business - that is, whether it is involved in industrial, trading or service-providing activities - on its size or anticipated size, and on its range of products and activities. Some businesses might need to make use of two or more of the methods of research which we now describe.

Consumer Research

When the average housewife goes shopping, she usually likes to compare the prices and qualities of the products she wants, or can afford to buy, in the shops and stores in her local shopping centre. If she is not satisfied with what she sees, and if there is no immediate need to buy what she has in mind, she will probably put off the purchase until a better selection is available. Or she might go to a larger shopping centre in the town, or even travel to a city where a far greater choice is always available, sometimes at lower prices and, in some cases, of better quality than she can buy locally. Alternatively, she might be able to order product(s) online from a website or webstore.

The housewife is one of the millions of buyers classed under the name of *"consumers".* Consumers buy for a variety of reasons or "motives" - many of which were described in Module

2 of the Sales Management & Marketing Program - and they will refrain from buying if the products are not up to their expectations in price or quality or, in the case of necessities, they might buy in reduced quantities until quality improves or prices become lower. A vendor must never forget: consumers have a CHOICE.

Consumer research is, then, as its name implies, that part of market research which is applied to the consumer. It is a systematic and careful investigation into the attitudes, actions and preferences of consumers. It might also include a specific question, the answer to which might greatly influence the future policy of the business. Divisions of opinion amongst executives of a business (including the sales or marketing manager) can lead to poor decisions being taken, but as a result of the replies given by consumers to the “key” question, a positive course of action might be indicated.

Marketing is concerned ***with the creation of customers***, because any business HAS TO MAKE SALES. To do that, its management must first find out ***what buyers want***. But since buyers are people, their choices and their preferences might vary to a certain degree, and for the sake of expediency a seller might decide to cater only for a certain section of the total market available; it might be more profitable to do so. In conducting consumer research, the researcher might use a questionnaire designed to obtain some or all of the types of information detailed in Fig.5/1.

The questions must be skilfully prepared, and must be designed to attract the greatest volume of applicable or useful information in the smallest number of words. Obviously questions to which sales or marketing managers will require answers will differ from product to product, as well as in differing circumstances, and the questions listed in Fig.5/1 are therefore no more than examples. There would be no need, for instance, to ask when breakfast cereals are eaten, or who buys baby foods!

On the other hand, it would be very important for the sales or marketing manager for a fruit drinks manufacturer to know exactly which are his main “outlets”, e.g. supermarkets, bars, restaurants, cafes, grocery shops, etc. Such information will:-

- Enable him to exploit those outlets to the fullest possible extent.

and

- Guide him on what action to take to get his products into types of outlets from which they are not currently being sold, or are not being sold in sufficient quantities.

Note: In Module 7 of the Sales Management & Marketing Program we consider channels of distribution, which are closely related to the results of market research.

Fig.5/1. types of information consumer research might seek to obtain

question	to discover
(1) Who uses the product?	Who buys the product. Their sex and marital status, age group(s), occupations, average incomes, and social classes; this might be called “demographic” information. Places where the product is sold: towns, villages.
(2) When is it used?	Time: morning, evening, any time, or other(s).
(3) Why is the product purchased?	Comparison with all competitors’ products in relation to quality, style, design, size of pack and price.
(4) Where is the product bought?	Type of shop/store, small or large department store, supermarket, chemist, etc.

The personnel engaged in carrying out market research must be intelligent and businesslike in their approach. They must ensure that answers given and results are accurately recorded. Care must be taken to ensure that the survey covers a comprehensive cross-section of the community so that it is a **representative *‘market sample’***.

The number of consumers interviewed can have a decisive bearing on the reliability of the results obtained. If, for the sake of keeping costs to a minimum, only a small sample is taken, and a small area only is canvassed, the results could prove to be misleading. Such an exercise would be a waste of time and money, and could produce a mistrust of such methods of obtaining information in the future. On the other hand, the cost of interviewing an over-large sample of consumers could outweigh the benefits that the research is intended to provide.

Effective and successful consumer research will result in the identification of the habits and actions, characteristics and attitudes, preferences and needs of consumers. That data can be utilised to create **consumer profiles** for its current and potential customers. Consumer profiles can be invaluable in the identification of *market segments* and potential *market niches* (discussed in the following sections).

Market Segmentation

As we explained briefly earlier, market segmentation is the identification by a business of specific groups or subsets of potential customers within the broader market for its products or services. By identifying market segments, businesses might be able to address the specific needs of those segments, if those specific needs are unique or different from the general market, and if it is profitable for the business to do so.

Tailoring a set of business activities to specified *target markets* enables the business to create a **competitive advantage**, that is, the provision of better value, quality or service to customers than its competitors are able to provide. Targeting a specific, clearly defined market segment is a method of creating a ***'niche market'***, which typically has low competition and which can frequently command premium prices.

Not all market segments which are identified need to have special marketing activities to "look after" them. For instance, in our earlier example of the introduction of mp3 players and iPods, the standard marketing activity for iPods might be equally effective for both the fashion-conscious teenage market segment as well as the maturer more discerning market segment which simply appreciates and wants the highest quality sound available when listening to music.

Market Surveys

Market surveys seek **facts**: who sells the products (wholesalers, retailers, etc) and who buys them? A market survey, then, is a systematic and careful ***study of the buying and selling*** done by wholesalers and/or retailers.

The researcher in this case will attempt to find out the total sales of similar products and the proportions sold of the various "brands" stocked, the levels of stocks carried of each brand, and the number of retailers who stock a particular brand as compared to other brands. It is also very useful to find out whether a retailer "pushes" sales of a particular brand in preference to any other and, if so, why. A careful analysis of the results of this survey, combined with the results of consumer research, could provide an insight into:-

- The size of the market.
- The strength of competitors, their relative positions and market shares.
- The structure of the market.
- Customers' attitudes to the various brands available on the market.

The survey might also uncover ***'marketing opportunities'***, both for existing products and for new products. By that term we mean a ***consumer need*** which is not at present being adequately met. To meet that "need" might require the modification of an existing product or the introduction of a new product which will provide a particular consumer benefit. This is another facet of market research of vital interest to marketing managers in particular. Once the opportunity is discovered, the wheels of industry can be set in motion to produce, package and promote sales of the new product. When the potential demand is great and the capability of competitors to make similar goods is also great, speed of decision-making and positive action are vital, because such competitors will strive to be first in the market.

Advertising Research

This is a specialised part of market research, and is really an extension of consumer research. It is a careful investigation into the **reactions of consumers** to all forms of advertising in relation to a particular product. Apart from extolling the benefits of that particular product, a systematic step-by-step approach is made to "imprint" the trade name of the company selling the product on the minds of the consumers. This might be done openly, or more subtly as necessary, so that the ***'brand name'*** appears to buyers in the same way as a hallmark on gold or silver, and as a guarantee of value.

To check the performance and effectiveness of advertising being undertaken, the sales or marketing manager needs to know:

* Does it deliver the brand selling message?
* What impression does that message create?
* Is it convincing and fully understood?
* How does performance rate against that of competitors?

(Advertising research is explored in Module 9 of the Sales Management & Marketing Program.)

Test Marketing

However confident and sanguine (optimistic) of success a sales or marketing manager might be, he might well find it prudent to "test" consumer reaction to a new product by releasing a small, initial quantity of the product on to the market.

It might perhaps be that an existing product has been modified, or that new packaging has given it a "new look". So that its "acceptance" - or otherwise - might be accurately measured, the product might be sold in one large store or chain of stores only; preferably that which sold the previous or similar model. Accurate results could be obtained and could determine whether (a) further modifications were necessary, or (b) full-scale marketing could be resumed.

The Need for and Cost of Market Research

Market research can be expensive to carry out, and unless the benefits derived from the operation are equal to, or greater than, the costs incurred, there would be little point in undertaking the exercise. The ever increasing costs of running a business, combined with greater competition, can lead to a serious fall in profits, and emphasises the need to make correct decisions, or to save the business from the worst effects of incorrect decisions already made. It is therefore of primary importance that as much information as possible is gathered about the market, and about the needs of consumers.

Market research is needed because there are problems to be solved or questions to be answered. Having identified the problems or questions, management might well have to decide whether the solutions or answers have to be found urgently or very urgently. Management must then consider what is the **probable cost** of conducting the research, and:

★ Whether the benefits arising from solving a particular problem or gaining a particular answer will increase profits.

or

★ Whether the loss in profits that could be incurred by ignoring the problem or question would outweigh the cost of the research undertaken.

If it is decided that the benefits are likely to exceed the costs, it then becomes necessary to ascertain whether the business has personnel who are sufficiently competent to carry out the research, or whether the services of a specialist *research agency* are required. If the latter, their report could solve the particular problem concerned and in addition could pinpoint other areas of the business' operations which could be improved. The sales/marketing manager of a business might have to change a member (or members) of his team, so that a new approach to perplexing problems can be made; and new policies formulated, to utilise the information provided by the research agency in the most advantageous way to achieve the objectives of the business.

Most market research - whether it is on-going research or research relating to a specific project or goal, can be broken down into a set of clear steps, tasks or stages:-

★ Clearly defining the aims of the research, or the market 'problem' to be investigated.

★ Specifying the research design, which determines whether the research is either:
  exploratory research: to generally gain greater knowledge and information; or
  descriptive research: to help predict demand or examine customer characteristics; or
  causal research: which looks at relationships and how variables affect each other.

★ Identifying the sources and types of data and information to be researched.

★ Designing the forms or templates with which to collect, record and save information.

★ Determining the sample or survey size and the method by which it will be sampled.

★ Actually conducting the survey and collecting the data.

★ Analysing and interpreting the data and editing it into a useful format.

★ Preparing the research report, and any conclusions and recommendations.

This research plan highlights the time and thought that must be expended prior to research even being approved, the resources that will need to be called upon to conduct the research, the control necessary for the research to proceed as planned, and the vital need to provide the findings in a format on which good business decisions can be based.

Let us emphasise what the objectives are in any privately owned concern. The aim of shareholders or other people who or organizations which invest their money in a business is to obtain a reasonable "return" on the amount of money they invest. Shareholders appoint directors to make decisions and to formulate policies which will lead to the attainment of certain objectives, which are basically to ensure the efficient running of the business, and to ensure that it is run profitably. A manufacturing business will produce goods and strive to sell the maximum quantity possible at the minimum cost, to yield adequate profits and to satisfy buyers as to price and quality. Since there might be many competitors with those same objectives, it becomes essential that the numbers, the needs, the preferences and the wishes of consumers and other potential customers are ascertained at a very early stage.

Similarly, customers who buy the manufactured products for resale must be certain that they **can** sell them - and relatively quickly - without too great expense and, of course, at a profit. The success of wholesaler and retailer businesses, in particular, depends on their skill in buying the right products in the right quantities and prices - and then reselling the products quickly to their own customers. They **must know** that there is a "market" for the products; not just some of those purchased, but **all** that they buy; there is **no** profit in holding goods in stock which cannot be sold or used. That applies to every business. Therefore, some research - particularly **before** a new business or branch of it is started, is essential. The information obtained from the research will form the basis for forecasting and planning - with which we deal in Module 6.

Competition

The potential market for the products or range of products which a particular business hopes to manufacture and/or sell, is very often limited or restricted by other - **'competitive'** - businesses making and/or selling the same or similar products. It is rare for a privately owned business to have a *"monopoly",* that is, to be the <u>only</u> business able to supply particular products.

Even if a business is the only one in, say, a small town selling a particular type of product, if customers are not satisfied with the brands (for example, with its quality) or prices or the service offered, they might be able to buy the same or similar products in other towns or, increasingly in many countries, obtain them by mail-order or through websites or webstores. Therefore, the business concerned **still** has competition.

It must always be assumed that there is likely to be only a **limited number** of customers for certain types of products in a specific area. That number might be fairly "static", or might increase gradually as standards of living and incomes increase, or might decline due to economic factors, government intervention, etc. In other cases - in, say, a "tourist" area - the numbers of potential customers might fluctuate widely at different times or seasons of the year.

Whatever the situation, it is usually dangerous to contemplate starting a new business or branch of a business in an area in which there are already a number of established businesses selling the same or similar goods, or providing the same services. The new business or branch will probably have to struggle hard to attract customers away from the established businesses, who have the advantage of "regular" customers. And, quite naturally, the established businesses will fight hard to retain those customers, and to dissuade them from transferring their custom to the new "competition" (as the established businesses will look upon the new one.)

To compete successfully with established businesses, the new one must:-

❋ be able to offer customers something special or new; or
❋ be able to give faster or more efficient service to customers; or
❋ be able to effect substantial savings for customers, such as by charging far lower prices.

Product 'differentiation' refers to the 'unique selling points' of the new business and/or its products - the special features such as quality, service, price, and so on, which set the products or the business itself apart from competitors. The sales/marketing manager must recognise the unique selling points of the products concerned and consider how to communicate them to customers in order to gain the best possible advantage. Product differentiation therefore *clearly* ***identifies****, positively* ***communicates****, and favourably* ***compares*** the unique selling points (USP) of the products to those of its competitors, in the most advantageous ways possible.

An example with which you are very likely to be familiar, is the supermarket or hypermarket. The establishment of a supermarket in a town or region can seriously affect the profitability of established grocers, greengrocers, butchers, fishmongers, wines and spirit merchants, and other businesses in the area.

The range of products which a supermarket usually sells is wide, and because it can buy goods for resale in large quantities, has a rapid turnover and low operating costs, it can usually "undercut" the prices charged by smaller shops. Particularly if the newly opened supermarket is a branch of a "chain" of such businesses, it might be prepared to operate deliberately at a loss to start with, by keeping prices artificially low, by making "special offers", etc, in order to attract customers quickly to it - and away from the established businesses.

The "launch" of the new business is likely be supported by extensive advertising, publicity and sales promotion campaigns, all of which are, of course, designed to attract the maximum number of customers to the new supermarket as soon as possible. Considerable market research would have been carried out to determine where best to locate the store; what competition and sales resistance, such as loyalty to particular shops, had to be overcome; what *unique selling points* to stress, particularly its own lower prices and wide choice of products in comparison with existing high prices or lack of choice or variety available. The new food-retail business (the supermarket) will therefore *differentiate* itself from competitors, by offering customers something new and different, and something beneficial to them.

Small wonder, then, that many small businesses "buckle" under the onslaught of such competition, and have to close or move to locations in which competition is not so severe. Of course, not all established businesses have to close; some can compete and survive by adapting their activities and by concentrating on providing "services" which the supermarket cannot provide. Two such areas are:-

personal service and ***convenience***

Supermarkets (and other large chains of shops and stores) are largely "impersonal"; their staff cannot "get to know" their customers as can the staff of a small shop, cannot in the main cater for the personal likes and dislikes, preferences and circumstances of individuals - like have a friendly chat, make special orders or make special deliveries - and cannot always extend "credit", as they work mainly on a "cash and carry" basis.

Furthermore, supermarkets are not always able to open at times to suit the convenience of some customers; a small shop, for example, might be able to open early in the mornings for the convenience of customers on their way to work, and/or remain open late in the evenings for the convenience of customers returning from work; smaller businesses might also - depending on the trading laws of the country concerned - be able to open during weekends.

Therefore, although many businesses have undoubtedly been "put out of business" by competition from larger - and usually more economically viable - enterprises, in many cases new businesses have actually been established to "fill the gap" left by the incursion of the larger enterprises and by the disappearance of the former, more traditional businesses which previously served the customers. They can compete successfully, and prosper, because they, too, are offering customers something special and/or different in their own *niche* or *target markets* - which we defined and discussed earlier. Additionally, smaller or specialist businesses are generally able to adapt more quickly to one-off events or circumstances.

The "**key**" factor, then, in the establishment of a new business or branch is to try to find an "area" (not necessarily a physical one) in which there is ***market potential*** which is not adequately being catered for at present. That might mean the location of a business in a town, or a part of a town or city, in which there is little or no existing competition, or the manufacture (or import from another country) of a product or range of products for which a demand exists - or can be created - but which is not currently available to potential customers.

That might not be easy - successful business (and that includes the selling function) rarely is - and might require considerable research to find the **right** area in which to concentrate, to give the best possible chance of success. And it will be a sales or marketing manager who is likely to be delegated the responsibility for carrying out or arranging for the research.

It is not only the size of existing competition which must be researched, but also what competition might be encountered **in the future**. For example, it could be disastrous to open a grocery shop in an area presently inadequately served, only to find out a few months later that a supermarket is opening in the vicinity! Potential competition is not always as easy to assess as is existing competition, because if a business is obviously doing well in a particular area, others try to follow suit; the very success of the original business can attract competitors.

PRICING CONSIDERATIONS

In the long-term (and often in the short-term, too) the revenue, or income from sales, of a business **must** exceed the total of its various costs if it is to prosper and, indeed, to survive. Short-term losses, especially when a new enterprise is established, or activities are extended into a new area, might be accepted and “absorbed”, but such a situation must be contained and remedied as soon as possible if the enterprise is to stay in business. (Here we exclude state or semi-state owned enterprises, which are frequently not or never - in some cases due to deliberate government policies - profitably run.)

The prices at which the products of a business are sold obviously have a vital bearing on its potential and actual profitability. That being the case, one would expect that there would be a definite ***set of rules*** laid down by a business for the fixing of the prices at which its products will be sold; and that the same or similar rules would be applied to price setting by all businesses. However, that is very definitely NOT the case!

There are many factors which might affect the prices of consumer goods, apart from the obvious need for manufacturers and distributors to obtain reasonable returns on their capital expenditure and enterprise. Even that basic requirement is subject to the various circumstances and ***‘market conditions’*** prevailing, and prices might be raised or reduced in different areas for a variety of reasons. For instance, a branch of a supermarket in one town might sell a product at a loss, whilst another branch of the same supermarket chain in a nearby town might sell the same size and the same brand of product above the normal selling price.

Some of the main factors which might influence the selling price of a “unit” of an article or a service at any particular time, can include:-

* The costs involved in its manufacture or production, and in its distribution to consumers.
* The nature of the product and the demand for it.
* The cost of storing or safeguarding the product.
* The prices charged by competitors selling similar products.
* The need for immediate profit or for profit in the future.
* Government intervention, buying and price restrictions.
* The psychological attitude of buyers.

Obviously not every “factor” will apply to every product, or in every case. Nevertheless, we now look more deeply at each of those factors in turn.

Manufacturers’ Costs

The costs incurred by the manufacturers/producers of products are made up of some or all of the following:-

1. Planning the making of the product, including the cost of research, design, machinery, etc.

2. The cost of raw materials and/or components.

3. The cost of direct labour involved in converting the raw materials and/or components into the finished article.

4. What are called “overhead expenses”, such as depreciation, power, rent, heating, lighting, office costs, and many others.

5. Administration expenses, such as interest paid on loans or bank overdrafts, legal fees, the fees of accountants, executives and directors.

6. Marketing expenses: advertising and sales publicity of all kinds, research, selling expenses, remuneration of sales personnel (salaries, commissions, bonuses, etc.)

7. Service expenses: delivery of goods to customers, after-sales service and repairs during a guarantee period, etc.

8. Discounts (reductions in prices - covered in Module 8 of the Sales Management & Marketing Program) such as trade discounts to wholesalers and retailers, quantity discounts for large orders, seasonal discounts on orders during slack seasons to keep personnel and machines working, and discounts for immediate or early payment.

The Product and the Demand for it

The nature of the product and whether it is considered a necessity or a luxury (see Module 1) to different classes of buyers has an important bearing. In a low-income district a product might be considered a luxury, whereas in an affluent market the same product could be regarded as a necessity. In the low-income district only products considered to be necessities will maintain high prices, and demand for luxury goods could be low even if they were offered for sale at relatively low prices. On the other hand, luxury goods in a wealthy market could maintain high prices and demand, and if they were offered at low prices, consumers might suspect their quality to be inferior and refuse to buy them.

Clearly in many countries whose citizens have varying degrees of wealth, some people might consider a particular item a necessity whilst others might consider it a luxury. However, there are cases in which the same product could be either a luxury or a necessity to the same buyer. Consider a businessman; to him a computer system in his office is a necessity - but if he buys a PC or a laptop for his own, or his family’s, “personal” use it is a luxury. Similarly, to a professional photographer a camera is a necessity because he cannot earn his livelihood without it; but if he buys another camera for non-business use it is not a necessity.

Many products are considered to be necessities; some form the “staple diets” in various countries, such as bread, rice, yams, potatoes, milk, eggs, salt, etc. These are always in demand, although increases in prices might reduce demand slightly. On the other hand, demand for luxuries depends on what people can afford to pay.

If the nature of an item is such that it can be mass produced, **increased demand** will lead usually to a **decrease in price**, and vice versa; electronic calculators, digital watches, laptop computers, and mobile telephones/cellphones are all good examples.

On the other hand, an increase in demand for an item such as a Rolls Royce motor car might lead its manufacturers to increase its price; conversely, a drop in demand might force a reduction in price. There are, however, other products, for example oil-based products such as petrol/gasoline, for which a drop in demand has led to higher prices. (To delve more deeply into such matters would carry us into the realm of Economics. If you want to learn more about this topic, we recommend that you study the College’s excellent *“Business Economics & Commerce”* Diploma Program.

Cost of Storing and Safeguarding Products and Cash

Storage costs have a definite bearing on selling costs. The expense of building or renting suitable storage premises can be high, and the cost of equipping and maintaining such buildings can also be great. A manufacturing business needs a large warehouse or godown in which to store its stocks of finished products awaiting sale and despatch. Its customers might be wholesalers who will also need storage facilities - possibly large warehouses or godowns - and the retailers to whom they resell must have adequate stock rooms or suitable containers in which to store the products which they buy.

Some products need dry, well ventilated storerooms; others need to be kept above freezing point (paints, liquids, etc), whilst others are required to be stored at sub-zero temperatures.

The costs incurred in heating or in refrigeration can be considerable. Frozen foods, for example, must remain at a constant low temperature from the time that they are prepared and packaged, until at the final retail points of sale they are handed to customers or selected by customers from refrigerated display cabinets. From producer to wholesaler to retailer, frozen foods are transported in specially refrigerated containers, so that the consumer receives the products in the same condition as when they left the producer.

All products must be safeguarded, as far as reasonably possible, against loss from fire, flood, pilfering and theft; but the safeguarding of some valuable products - for example, jewellery, precious metals, etc - and of cash (including bullion) can be very costly. Organised raids by criminals can result in heavy losses of valuables and cash. That leads to higher insurance premiums and to the employment of security companies which specialise in transporting cash and valuables in comparative safety, in making security rounds, and so on. The costs of such services must be covered in the prices charged for the valuables or added to the costs of the facilities provided, as indeed must be the costs of the protection required by any other product whilst in storage awaiting sale, or in transit.

***Prices of Competitors' Produc*ts**

Manufacturers seldom market only one product. They usually produce a **range** of products of various qualities and sell them at various prices according to size or quality. As there might be many manufacturers producing similar products, there could be a large number of sizes, qualities, and prices for consumers to choose from. Advertising and publicity material would extol the merits and benefits of each, and appeal in various ways to the consumers' motives for buying. To give you a simple illustration, an advertiser might claim: *"Brand 'A' Washing Powder washes Whiter".* Another advertiser is unlikely to contest that claim but might claim an alternative benefit: *"Brand 'B' removes stains that other washing powders leave behind".* Each brand will attract buyers for different reasons.

Some manufacturers market their products under **different** *"brand names"* - that is, some under one name and others under a different name - and might even *test market* their latest product in direct competition with their **own** existing brands, as well as with competitors' products. Although all those products might be very similar in quality and size, the brand name or the packaging might establish one of them as the *"brand leader"* and enable it to be sold at a higher price than any of the competitive products.

Prices can be affected by the availability of substitutes. Food products are subject to sudden fluctuations in price. For example, if a housewife who intended to buy beef found that its price had doubled due to a temporary shortage of supply, but that other meat products were cheaper, she could buy a substitute, perhaps veal or chicken. If the shortage of beef continued, it could cause the prices of veal and chicken to rise as demand for them increased.

The Need for Immediate or Long-term Profit

It is generally true to say that as standards of living rise, people become accustomed to looking for improved products and technological advances that not only look good but will provide greater utility of use. For example, the invention of the "microchip" has enabled the modern clothes washing machine to be programmed to perform a whole series of operations, resulting in clothes being washed, rinsed and dried without the housewife having to be in attendance. In spite of that, owners of those and other modern sophisticated appliances could be looking at even better products within a few years, with a view to replacing their existing machines with appliances having the latest refinements and providing even greater utility.

This growing affluence has led businesses to the manufacture of what are termed *"durables"* (described in Module 6 of the Sales Management & Marketing Program) with a shorter "life span", using lightweight materials such as plastics instead of heavier steel sheets to provide outer cases; and interior frames of steel strips which support electric motors, and hold together such "white goods", that is, appliances like freezers, washing machines and refrigerators. New plastics and alternatives are strong, colourful, heat resistant, and smooth, and they can be moulded with precision into whatever shapes are required. In addition to being lighter in weight than steel casings, plastics do not require to be enamelled, nor will they rust as older appliances did when enamelled surfaces were chipped.

Most durables are no longer built to 'last a lifetime', or as long as possible given their rate of usage; instead, they are frequently built to last until the next, more attractive, fashionable, up-dated or 'improved' model is available; and that applies generally to all products and especially electronic goods, such as computers and computer software, cameras and telephones.

The shortened “life span” of such durables - and their earlier and more frequent replacement by consumers - might appear to be very good for trade - but there are certain disadvantages too.

In the past, a manufacturer of, say, a cooker would expect the product to go on selling for up to fifteen years. The costs incurred in designing, tooling up, manufacturing and in promoting sales of the product would have been recovered from sales over a period of up to five years. From there on a steady volume of sales would have been anticipated to provide sufficient profits, to satisfy shareholders of the company, and to enable a *“development fund”* to be built up over the years to finance the designing and production of another, new model. When that became necessary, some years in the future, with that policy the price of the product could remain fairly constant over a long period of time, and at a lower level than it would have been had immediate profit - rather than long-term gain - been the objective.

With modern versions of similar products, manufacturers are faced with the prospects of continuous research to keep abreast of developments in every sphere and aspect of their products, and of financing the production of a new model every few years. That affects sales forecasting and determines sales objectives that will enable a level of profits which will not only (a) provide shareholders of a company a with reasonable return on their investment, but also (b) provide sufficient money to be retained in the company’s “development fund” to finance the next new project, just a few years - or even a few months - hence.

Generally, sales of the older durable products rose steadily for three or four years, then levelled out, and gradually declined for six years or more (this refers to the “Product Life Cycle” concept which is covered in Module 6 of the Sales Management & Marketing Program.) Sales of modern types of durables behave more like sales of fashion goods (also described in Module 6): for the first three years rising rapidly to a maximum peak. Unlike fashion goods, modern durables could remain popular on the market for two or three more years before sales decline; but then, like sales of fashion goods, the durable products could have to be sold off in “clearance sales” to make room for the new products that would take their places.

Government Intervention

The government of a country might wish to control the amount of hire purchase available at any one time, because the availability of credit might increase demand and contribute to inflation. In order to do that, it might increase the minimum amount of deposit which has to be paid, or increase the interest rate, or shorten the period of repayment. Any, or all, of those measures should discourage consumers from entering into hire purchase agreements, thus reducing demand and controlling output on the home market.

Increases in taxation or in customs duties or the imposition or tightening of import or foreign exchange controls can also raise prices, and curtail sales.

The foregoing factors are some of the unforeseen hazards (to which we refer in Module 6) which can upset the forecasts of sales and marketing managers and necessitate modifications to their aims or plans.

There is another course of action which governments can take which can pose even greater problems. Prices of some foodstuffs and other goods might be “fixed” or “pegged” at short notice at levels which - whilst reducing prices paid by consumers - permit little profit to be made by manufacturers, wholesalers or retailers. Such government action is usually taken on social grounds in times of high unemployment, or in times of scarcity of supplies of basic commodities, such as bread, sugar, milk, etc.

The Psychological Attitude of Buyers

When customers fear that there will be a shortage of an article in the future, and no substitute product is available, they might be inclined to buy more than they actually need and to pay more because of its “scarcity value”.

It often happens that certain products, such as clothes, footwear, fancy goods, etc, are sold at high prices, and at prices which yield high profit margins, because consumers believe that the quality of the products supplied equates to their cost. If such products were offered at lower prices they might be sold in a poorer market, but could lose the more lucrative, wealthy market of fashion-conscious consumers. If the buying motives of consumers are ignored, sales will fall. If buyers **expect** to pay a certain price for a product, manufacturers should try to comply, and if they are able to supply a large market and make large profits by so doing, then that is good business.

High profits can cushion the effects of **'inflation'** which, put simply, is a *"progressive increase in the general level of prices in a country or an area of a country",* and its effects are felt both in everyday lives and in business. As manufacturing costs increase, prices might be held down for a time, and then be increased only gradually as consumers become accustomed to the general rise in prices and the higher costs of necessities, which tend to increase immediately raw materials and expenses become dearer. Consumers raise many objections to paying a little more for basic items of foodstuffs. The same customers, however, when going out for a meal, might order a high-priced meal in a restaurant, pay a 10% service charge, tip the waiter, and return home well satisfied with a pleasant night out!

Similar satisfaction might be obtained by customers buying consumer goods from a certain prestigious store, or buying certain expensive brands of goods. The store has a certain *"image";* it has created an impression in the minds of the public and it has implanted appreciation for the products and services it sells; its customers *"are prepared"* to pay more for products in that store.

Certain brands of goods command loyalty from buyers for various reasons. The *"brand image"* might be created by any one or more of many reasons, and might appeal due to a combination of reasons and buying motives. Ultimately a reasonable standard of quality, a price that sufficient buyers can afford to pay, and good regular advertising might establish a good reputation and a brand image that will reflect reliability and give confidence to buyers, as well as producing the required profitability for the vendor.

The two foregoing paragraphs illustrate what is often referred to the **'perceived value'** of a product. By this we mean that some customers have a mental image or belief (which might have been created in their minds by skilful and subtle advertising and publicity) of the worth or value of a certain product - whether or not, in reality, it is the product's "true worth". Similarly, some customers might have the perception that a product is of better value or quality if it is purchased from a particular prestigious store whereas, in point of fact, the identical product might also be available - perhaps at lower cost - from other stores.

People's perceptions of the value and/or its quality (which we consider in Module 6 of the Sales Management & Marketing Program) of a product or the "prestige" of buying it or (buying it from a particular store) can therefore be powerful motives for buying.

Price Variations

Some retail businesses set their selling prices according to a standard 'formula'. From experience and accounting records, they can determine with a fair degree of accuracy what percentage of their "turnover" - income from sales - they will require to cover their trading expenses and overheads, and still leave a reasonable return or profit from their business activities. They might therefore add a percentage, e.g. 15% or 20% or another, to the actual cost price of each unit of an item they purchase for resale. In other cases, as indicated in the foregoing paragraphs, pricing is far more complex and might require detailed analyses of costs: in manufacturing businesses in particular, a process called 'cost accounting' or 'costing' enables businesses to calculate exactly how much a product 'unit' or service costs to provide and offer for sale, taking in to consideration *each and every* cost of the business; a selling price can therefore be set which covers the 'cost price' and provides a profit on the sale.

For more information about costing and cost analysis, please ask the College for information, and the Fee payable, for the College Programs on Business Accounting and Finance, and/or on Cost Accounting, or visit website: **www.cambridgecollege.co.uk**

A sales manager (unless he is also the owner or manager of a business) is unlikely to make decisions on what selling prices are set for specific products. Nevertheless, he is likely to be consulted, and be required to provide information and statistics, to members of management who are responsible for reaching reasonable decisions. After all, it is the sales/marketing manager who knows - or should know if he is doing his job properly - what prices the market can "bear"; i.e. what prices prospects would be willing or can be persuaded to pay. Of course, his advice must take into consideration many factors, not the least what competitors are charging for similar products, the costs involved in advertising and publicising the products, the salaries and commissions which must be paid to the salesforce, and so on.

From time to time it might be necessary for the prices of certain products to be **reduced** to give a boost to sales (see Module 9 of the Sales Management & Marketing Program) or for additional expenditure to be incurred in marketing those products; and the situation concerning one product being sold might be very different from another being sold by the same business. So a sales manager needs a very flexible mind and attitude, and needs to be able to weigh-up the various factors which affect each different product to be marketed. A sales and/or marketing manager's contribution to decisions reached concerning selling prices can therefore be **vitally** important, and should therefore never be given without adequate research and consideration.

If, once this course - or the Sales Management & Marketing Program or a Higher Programme of which the Sales Management & Marketing Program is a Core Subject - is completed, should you wish or need to study and explore marketing strategies and pricing strategy in more depth, ask the College for details of its 'Mastery of Management' Diploma on Marketing Strategy, or visit website: **www.cambridgecollege.co.uk**

Module Nine

LOGISTICS & SUPPLY CHAIN STRATEGY, DEMAND & SUPPLY, SUPPLY CHAIN COSTS, CUSTOMER SERVICE & SATISFACTION

This Module is one of the 12 Modules from the CIC Diploma Program on:

Logistics, Materials & Supply Chain Management

Introduction: This Program provides knowledge and understanding of logistics and supply chain management. It covers planning, organising and controlling logistics activities, competitive strategies and transport, explaining how to ensure that products are available at the right time and place, in the right condition - profitably, professionally and cost-effectively.

The Program is for anyone involved in logistics, or who desires a good job in logistics or related fields like supply, transport, distribution, materials management, procurement, warehousing and stores.

	Logistics, Materials & Supply Chain Management (& Transport) - Modules Summary
Module	**Module Title**
1	Manufacturing, Logistics & Supply Chains; Value Chains, Supply Chain Networks & Activities
2	**Logistics Strategy, Demand & Supply, Supply Chain Costs, Customer Service**
3	The Marketing and Logistics Relationship, the 4Ps, Order Cycles, Market-Driven Supply
4	Industrial and Consumer Products, the Product Life Cycle, Product Characteristics, Pricing
5	Sourcing & Procurement, Selecting Suppliers, Supply Factors, JIT and EOQ, Partnerships
6	Receipt and Storage of Stock/Inventory, Inbound Logistics, Warehouses, Materials Handling
7	Stock Control, Inventory Protection, Stock Levels, Order Processing, Issuing, Packing, Dispatches
8	Transport Methods, Features & Selection, Freight Forwarders, Containerisation, Bulk Freight
9	Operations Management, Product Design, Costs, Production Strategy, Quality Assurance
10	Lean Logistics, Avoiding Wastage, Agile Supply Chains, JIT Partnerships & Sourcing
11	Facility Location Factors, Distribution Centres, Reverse Logistics, Product Recalls & Defects
12	Project Management, Disaster Management, Emergency Planning, Humanitarian Aid & Relief

If you would like to study the complete Program and gain an international Diploma on **Logistics, Materials & Supply Chain Management (& Transport)** you may do so by using the 'Special Offer' Enrolment Form on page 183 and sending it, with the Fee payment, directly to the College in Britain.

Mohammed Morally
wrote from **Egypt**:
"Thank you for your support and encouragement through my Supply Chain studies. My qualification has enhanced my career and gained me better employment. I am continuing on to higher studies in this field with CIC."

Philemon Lelei
wrote from **United Arab Emirates**:
"With my Diploma in Logistics I was promoted to General Stores Superintendent. I thank CIC for the knowledge and skills which elevated my career. CIC offers high quality education that can change someone's career and entire life."

Module Nine

LOGISTICS STRATEGY FORMULATION

Introduction

Until the last century, the managements of the majority of businesses were not overly concerned with creating customer value. Up until the early 20th century, the guiding principle was that *"every supply (of products) creates its own demand (for those products)".* At that time demand was greater than supply, and whenever an entrepreneur or an enterprise was able to bring new or different goods or services to the market, there would likely be consumer demand for those products. During that same period, products were fairly standardised, and therefore price setting was dominated mainly by prevailing economic and market conditions.

For businesses involved in logistics this meant that offering capacity (such as trucking capacity and warehouse capacity) was the main *"driving force"* or *"driver"* for doing business. Clearly, businesses of all kinds and sizes needed such logistics activities to be able to deliver their products to their customers. In other words, the value created was very basic and without need of much consideration.

We all know that in the last few decades the business world has gone through dramatic changes - changes which continue today, and which continually gather pace. Nowadays there is severe - *"hyper"* - competition, from both home-based and international competitors, downward pressure on prices, and a high level of individualisation; that is, products and services increasingly require some level of *"customisation"* resulting in far less standardisation. In the contemporary business environment, enterprises can no longer rely on customers seeking their product simply because it is offered; businesses need to *differentiate* - that is, to find a *"competitive advantage"* - and offer superior value to become the supplier of choice.

Moreover, hyper competition together with the rapid changes in the environment - in terms of demographic, economic, social, technological, ecological and political developments - have led to a situation where *"change is the only constant".*

In this modern age, the primary "driver" in supply chains has shifted from *"supply push"* to *"demand pull"* - both of which we discuss in this Module. This dramatic change has had the effect of placing the customer *"in charge",* and therefore for businesses to remain profitable, business managers need to be constantly aware of the *"customer value"* they create. It is for this reason that the increasing importance of customer value is widely acknowledged in virtually all modern business strategy *"models"* (explained in a later Section).

Because logistics and the supply chain are important activities within any organization and between organizations and their customers, they are also expected to contribute to the creation of customer value, and we discuss in this Module the various ways in which that can be done.

Supply and Demand

'Supply and Demand' is one of the most fundamental concepts of economics, and it is the backbone of a *"market economy".* The description "market economy" refers to an economy in which decisions regarding business investment, production, and distribution are based on the relationship between supply and demand (see below) in the market; that relationship directly influences the prices of the goods and services available. In a market economy prices are not set or fixed or imposed by the State.

★ *Demand* refers to how much (the quantity) of a product or service is desired by buyers. The *"quantity demanded"* is the amount of a product people are willing to buy at a certain price; the relationship between price and quantity demanded at different prices is known as the *"demand relationship".*

★ *Supply* represents how much (the quantity) of a product or service the sellers/producers/ manufacturers for a market can or are willing to offer. The *"quantity supplied"* refers to the amount of a certain good which producers are willing to supply when receiving a certain specific price; as prices vary, then in general so will the amount of goods available for supply. The correlation between price and how much of a good or service is supplied to the market is known as the *"supply relationship".*

Price, therefore, is a reflection of supply and demand, and also affects supply and demand.

The *"law of demand"* states that *if all other factors remain equal* (meaning that there are no significant changes in the business environment) the higher the price of a good, the less people will demand that good. In other words, the higher the price, the lower will be the quantity demanded. The quantity of a good that buyers purchase at a higher price is lower, because as the price of a good goes up, so does the cost of buying that good. As a result, people will naturally avoid buying a product which will force them to forgo the consumption of something else they value more.

Like the law of demand, the *"law of supply"* demonstrates the quantities that will be offered for sale at various prices. But unlike the law of demand, the supply relationship shows an 'upward slope'. This means that the higher the price (ay which a good can be sold), the higher the quantity suppliers will want or try to supply. Producers are prepared to supply more at a higher price because selling a higher quantity at a higher price increases their revenue and profits.

Note: In this Module/Program we can give you only this very brief introduction to supply and demand. For more in-depth study, we recommend the College's excellent Program on *"Economics & Commerce".* Please ask the College for free information about the Program, or visit website **www.cambridgecollege.co.uk**

Business Models

A business model is a design for the (hopefully successful) operation of a business, identifying its revenue sources, its customer base, its products, and details of its financing. Typically a business model includes the business's purpose, its goals and its ongoing plans for achieving them. At its simplest, a business model is a "*specification*" describing how an organization fulfils its purpose. All business processes and policies are part of that model. A well designed business model should provide clear answers to the following questions:-

Who are our customers?
What do our customers value?
How do we deliver value at an appropriate cost?

A business model is similar to a business plan in its make-up and content. However, a *"business plan"* specifies only those elements which are necessary to demonstrate the feasibility of a <u>prospective</u> business, whilst a *"business model"* demonstrates the elements that make an <u>existing</u> business work successfully.

Traditionally, financial goals have been the main focus of such models, but *"business sustainability"* and *"corporate culture"* (both of which we explain later in this Module) have become increasingly integral to business strategy in recent years.

Strategies

Strategies affect the overall direction of a business and establish its future working environment. What is called *"corporate strategy"* defines the markets in which its management chooses to operate. In contrast, *"business strategy"* is a long term plan of action designed to achieve a particular goal or set of goals or objectives; it lays down the overall scope and direction of a business and the ways in which its various operations (such as production and sales and logistics) will work together to achieve the particular goals. Business strategy is management's *"game plan"* for strengthening the performance of the business, and sets out how commercial activities should be conducted to achieve the desired goals, and defines the basis on which the business will compete in the markets selected by its management. See also Fig.2/4.

Value-Added Functions of Supply Chains

Customers judge the value of products not only by their quality, but also by their availability, and efficient logistics can increase that value. Suppliers or distributors, for example, can offer their customers increased *"added value"* by taking over and providing certain logistics activities, such as providing free delivery to customers' premises. Such performance-oriented concepts improve customer satisfaction and create a *"competitive advantage",* that is, an advantage which a business has over its competitors, which allows it to generate greater sales and/or profit margins, and/or to retain more customers than its competitors.

Logistics activities are necessary if a customer is to be able to benefit fully from products purchased, and that necessitates a consideration of the *"utility value"* of merchandise. A *"good"* is something which satisfies human wants, and *"utility"* is a measure of the satisfaction achieved. Consumers will have a preference for particular products or sets of goods and services which, in comparison to other products or sets, provides them with most utility. The concept is an important one because it represents satisfaction experienced by the consumer of a good. Utility value can be increased by improving the characteristics of products (such as upgrades, modifications, greater quality control) and also by improving the availability of the merchandise when and where it is required - which is the very essence of logistics.

The effective, or actual, availability of different types of merchandise can be optimised in various ways, depending on a product's physical characteristics (size, shape, dimensions, weight, durability or fragility, perishability, value, etc) as well as its pricing structure, and how speedily and regularly deliveries are required, and so on. Methods include:-

✦ The management of a business which supplies or sells merchandise can improve its own logistics activities so that they become more effective and efficient.

✦ As mentioned above, a supplier or vendor of merchandise can take over and offer additional logistics activities for its customers and increase efficiency as a result; for example, a supplier could deliver goods directly to a customer's receiving department. The logistics service is effectively "sold" to the customer together with the merchandise, and provides added value to the supplier or vendor in the process. The supplier might also offer the customer a full range of logistics services, from shipment, acceptance, receiving and warehousing, to the provision of the items to the production line (called *"just-in-time"* or *"JIT"* (which we discuss in Module 10 of the Logistics & Supply Chain Program), and stock/inventory management.

However, it would make sense for a customer to *"outsource"* logistics activities in such a way only if this decision would lower logistics costs or if a higher level of customer service can be provided whilst logistics costs remain stable.

Differentiation of Supply Chains

As we have discussed, the purpose of supply chains is to *add value* to production and distribution. Depending upon the markets and the value chains which they are servicing, supply chains can be differentiated according to criteria such as costs, time, reliability and risk. Efficient logistics contributes to added-value in four major interrelated ways:-

∗ *Production costs:* Savings can arise from improved efficiency of manufacturing, together with appropriate shipment sizes, packaging and sensible stock/inventory holding levels. In this way, logistics contributes to the reduction of production costs by *"streamlining"* the supply chain.

∗ *Location:* Logistics can add value by taking greater advantage of various locations, such as well-positioned warehouses, good transportation links, closeness to suppliers or to customers, which might bring about access to new or expanding markets, resulting in an increase in customers and in lower distribution costs.

∗ *Time:* Added value can arise from having goods and services available precisely when and where they are required along the supply chain, and by setting shorter *"lead times",* and through improving stock/inventory and transportation management. Lead time is in essence the amount of time that elapses between when a process starts and when it is completed, such as the time between: (1) receipt of an order from a “user” or a customer; and (2) the production or delivery of those goods. Lead time is examined closely in manufacturing, supply chain management and project management, because businesses aim to reduce the length of time it takes to deliver products to their customers.

∗ *Control:* Added value can derive from controlling most, if not all, the stages along the supply chain, from production to distribution. By better synchronising *“lead times”* with deliveries, logistics enables a business to improve its marketing efforts and to react and respond more quickly to demands of its customers and markets; it allows more efficient anticipation of demand, and the ability to allocate distribution resources most effectively.

Cost Factors Affecting Supply Chains

A variety of factors jointly shape the *“configuration”* - that is, the relative and functional arrangement of the parts or elements or activities - of supply chains:-

Logistics costs

- The full range of costs involved in making products available to final consumers, including transport, warehousing and trans-shipment must be considered. Supply chain managers need to take into account the *stability of the cost structure* - that is, consistent costs. Volatility means liability to change rapidly and unpredictably Knowing with a high degree of confidence what expected costs are, allows better planning and makes forecasting easier.
- Routes suffering *“cost fluctuations”* (rises and falls) might be discarded in favour of routes which, although perhaps more costly, are less volatile. Typically the most reasonable (but not necessarily the cheapest) routing option is sought, so long as the cost structure remains stable - because supply chains are unlikely to be modified if a cost advantage is only temporary.
- The concept of cost is *“relative”* because its importance is in relation to the value of the cargo being carried. Cost considerations mostly tend to concern high-volume but low value goods, such as commodities - for example, paper - which are often containerised for transport, rather than high value goods such as electronics.

Transit time

- This factor - how long it actually takes to move the goods from the point of loading to the point of delivery - is increasingly being considered because it strongly influences stock/ inventory carrying costs and inventory cycle time (basically, how long stock items are held before being sold) in supply chain management.
- For example, for a consignment which has a higher value (such as fashionable or exclusive clothing) or is perishable (such as many foodstuffs) the routing option which is the fastest and/or shortest will be preferred. What are called *“reefers”* are refrigerated containers used in intermodal freight transport for the transportation of temperature-sensitive cargos (such as meat, vegetables and fruit) and routes selected will depend on where and how quickly reefers can be moved.

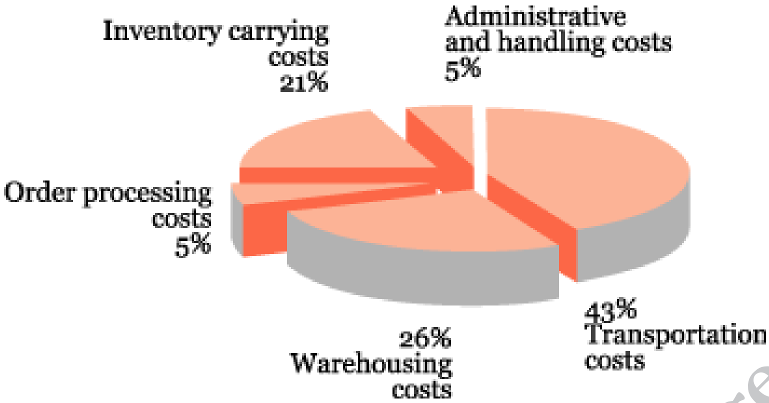
Reliability

- This relates to a factor which can be *“mitigated”* (alleviated or reduced) by contemporary supply chain management practices. For several supply chains, time can be a secondary factor so long as shipments arrive at the distribution center within an expected time frame.
- If shipments are regular and if reliability remains consistent, it is possible to organise supply chains accordingly; by having more inventory in transit rather than “sitting” in warehouses, there is less chance that customers will suffer non-deliveries and stock-outs, and levels of inventory will be at a more consistent level.

Supply chain risk

- This relates to a factor which is generally difficult or impossible to estimate or predict in advance, and which typically involves the level of confidence that the shipment will reach its final destination within anticipated costs, time and reliability considerations.
- Risk factors include unforeseen or potential blockages and disruptions in the supply chain, and in some cases can also involve potential cargo damage or theft. Low risks routes are obviously preferred over higher risk routes.

Fig.2/1. typical logistics costs



The foregoing and other relevant cost-related factors are considered in greater depth in later Modules of the Logistics & Supply Chain Management Program.

Cost reduction alone cannot be the only goal for an organization; the real source of its continuation and profitability is the creation of *"customer value"*. It is therefore crucial that logistics and supply chain professionals focus not only on efficiency, but also contribute to value creation and improved customer service, and thereby to the competitiveness of their respective organizations.

Customer Value

Products are purchased because people and organizations have "wants" or "needs" to be filled, and because they expect to receive or gain some *"benefit"* from what is bought. There are many different reasons or *"buying motives"* why products are purchased. Buying motives of *"consumers"* - who are the end-users of goods or receivers of services - are often very different from those of *"corporate buyers"* who buy on behalf or their respective organizations for reasons of trade or business.

Some consumer "*wants*" are basic in nature, such as food, drink, clothing, footwear, medicines, etc, which are called "necessities" or "essentials". In contrast, corporate buyers are interested in products which will enable their organizations to operate efficiently and to achieve their goals, which typically include making profits from their activities. The benefits of a particular product might include one or more of the following:-

- gaining or making profit
- increasing or adding to status
- saving of money or reducing expenditure
- making life more comfortable
- saving time
- saving of work (and/or effort or labour)
- enhancing appearance

.... and so on.

There are various interpretations of what is meant by "customer value". The term may mean low price, or receiving what is desired, or receiving quality for what is paid, or receiving something in return for what is given. However, a widely accepted definition of customer value is:

"A customer's perceived preference for and evaluation of the attributes of products, the actual performance of the attributes, and consequences arising from their use which facilitate (or block) the achievement of a customer's goals and purposes."

The definition suggests that there are two aspects to customer value:-

✦ *Desired value:* which refers to what customers desire, seek or want in or from a product prior to or before its purchase.

✦ *Perceived value:* which is the benefit which a customer believes was received from a product after it was purchased.

Customer value can be examined at different levels. At a low level, customer value can be viewed as the attributes of a product which a customer perceives he or she receives value from. At a higher level, customer value can be viewed as the *"emotional payoff"* received from the achievement of a goal or desire. When customers derive value from a product, they derive value from the attributes of the product as well as from the attributed performance and the consequence of achieving desired goals from the use of the product.

Therefore, put very simply *"customer value"* is essentially the difference between what *"benefits"* a customer expects to get from a product, and what he or she has to give or pay in order to get it (sometimes referred to as the *"sacrifice").* Every customer has a unique set of needs and resources, and therefore no two customers will place exactly the same customer value on the same good or service. The highest-quality good or service does not always provide the highest customer value, because the benefit of each item is measured against its cost. Some customers are willing to pay a high price for a high-quality product or for a high level of service, but other customers will make the decision that the same benefits (from high quality goods or services) are not worth the higher price or sacrifice.

It is one thing for management to understand what customer value is, but it might be another thing to know how to actually create customer value. Essentially, an organization *creates customer value* when it increases the perceived benefits of its products and/or reduces the customer's sacrifice better than can its competitors. This implies two factors:-

- Firstly, value creation is a dynamic activity; it is about "increasing" value on a <u>continuing</u> basis, and not merely as a "one off".

- Secondly, value creation is relative; it can only be seen, felt or measured when being compared to the customer's alternatives, such as competitors offering a similar product or organizations offering substitute products. In other words, the management of a business can only really understand how to create value by gaining an in-depth knowledge of customers' processes of perceiving value, and through awareness of alternative products.

Well organised logistics and supply chain management can create - and increase - an appropriate customer value by:-

- Providing exactly what products customers want, and when and where those customers want the products. By adding - within cost constraints - a better suited product/service, the overall benefits - as perceived by customers - will increase.

- Reducing delivery delays and any inconveniences caused to customers by delays or interruptions in supplies, such as stockouts, or errors in deliveries made, such as shortages, wrong quantities, wrong qualities, etc.

- Reducing maintenance costs, such as by regular "preventive" servicing of plant, machinery and equipment, which can reduce the necessity for costly repairs and reduce incidences of break-downs and stoppages.

- Reducing transaction costs, such as on excessive or unnecessary and time-consuming paperwork, such as by cutting down on the production and distribution of too many copies of documents - orders, invoices, statements, etc - and by replacing labour-intensive and time-consuming manual issue of documents by computerised production.

- Reducing disposal costs, such as for waste products, and the use of excessive packaging materials.

- Improving quality and delivery performance and reducing non-value adding activities, such as unnecessary documentation and paperwork, .

- Enhancing the multi-purpose use or utilisation of resources - such as water or materials - to avoid wastage; for example a waste or by-product of the brewing of beer is carbon dioxide, which might be used to aerate suitable water supplies (such as from natural springs), and turn it into "sparkling water" which can be bottled and sold.

★ Reducing unnecessary or excessive stock/inventory holding, to avoid finances being "tied up" when the money might be required for other purposes, and also because storage/warehouse space and administration are both limited and costly (these matters are considered further in Module 6 of the Logistics & Supply Chain Management Program).

Customer Service Strategy

The level or quality of *"customer service"* is an important element in building and maintaining a successful business. An enterprise might have a superb product, but without excellent customer service, the item might never be purchased. Customers interact with a business through a number of channels, and the level of service which is afforded (given to or invested in) those customers goes a long way to achieving customer satisfaction, and in turn to gaining more orders for the business.

Every enterprise has what is called a *"corporate culture".* Corporate culture evolves in many ways; for example, a corporate culture might be "steeped in tradition" and be based on tens or hundreds of years of behaving or thinking in certain ways; or the corporate culture of a new company such as a "technology start-up" might be to have a focused but casual approach. An enterprise's corporate culture defines how its business is conducted with its customers (and/or clients).

No matter what the corporate culture of an enterprise is, the focus must always be on the customer. As we stated earlier, increased competition and other factors have given customers *greater choice* between products and sellers, and so has placed them "in charge". For a business to prosper, it is essential today for it to provide good quality *"customer service"* - which is:

"The act of taking care of each customer's needs by providing and delivering professional, helpful, high quality service and assistance before, during, and after the customer's requirements are met."

Customer service involves meeting, as far as is possible or feasible, the needs and desires of each and every customer and potential or prospective customer.

It must not be thought that the provision of quality customer service is the responsibility only of sales personnel. Every section and department of a business has its part to play in making sure that customers are satisfied not only with the products they pay for, but with the way in which their orders and other contacts with the business have been handled. Logistics plays a vital role in ensuring that customers receive what they order, when and where they require those products, and therefore the logistics function is intimately involved in the level of customer service which is provided.

Some characteristics of good quality customer service include:-

★ <u>*Reliability:*</u> This can also be called *"dependability",* that is, ensuring that promises made concerning the delivery dates of products are kept; that is, customers should be able to depend on a seller making deliveries on time, where they are required, as agreed in advance. Sales personnel should not be permitted to make rash promises about product availability, or to give unrealistic delivery dates or times, which cannot be kept and which consequently damage customer satisfaction and retention. As far as is practicable, delays in deliveries and cancellations of orders should be avoided.

★ <u>*Politeness and courtesy:*</u> It often seems today that politeness is almost "a lost art". Saying *"hello", "good afternoon", "sir", "how can I help you"*, and *"thank you very much"* form an important part of good customer service. For any business, courtesy and good manners are appropriate whether the customer makes a purchase or not, and this policy must extend to warehouse personnel, deliverymen, maintenance and repair and service personnel, accounts and cashiering staff, and any other personnel who have contact with customers.

★ <u>*Professionalism:*</u> All customers should be treated professionally, which requires any person involved with the customer to display the competence or skill which is expected of a professional. Professionalism shows the customer that they and their interests are cared for. A positive attitude towards offering good quality customer service should be fostered (encouraged and demonstrated) by top management level, and be percolated downwards through all management and staff levels. The managements of different businesses might approach customer service in different ways, but it will be found that they will often adopt a *"customer service strategy"* which is usually made up of a number of elements, including good communication, offering convenience, and reliability.

★ Communication - Understandably, each customer wants to feel that they are an important - and possibly the most important customer - of the business, and therefore it is important to keep in contact with them so they will never need to contact the business because of a lack of information. For example, if a manufacturing business is producing and also shipping an item to a customer, that customer will want to know how far the item is along the manufacturing process, and once it is shipped, will require tracking information. A customer who is forced to telephone or email the manufacturer to obtain the information needed will be less satisfied; it is time-consuming and possibly costly for the customer to telephone and/or email - and it will cost the vendor money and/or other resources for a member of staff to spend time finding the information to relay to the customer.

With new technologies such as *"Customer Relationship Management"* (CRM) and social media websites, it is possible to communicate with customers electronically to inform them of new products, sales, or promotions which might interest them.

★ Convenience - For a customer, there is nothing worse than having to fit-in with the limitations of a supplier. For example, if a customer (such as a shop or store) is open from 7.00 am to 4.00 pm, that customer does not want to accept deliveries "after hours" because a vendor can only deliver after 5.00 pm. Good customer service dictates that the vendor should be available when it is convenient for the customer - not the other way around. If a customer wants, say, a delivery, or the services of an engineer or repairman to fix a piece of equipment before opening for business, it would be good customer service to arrange that, which will instil excellent customer satisfaction.

A supplier's website should also offer convenience for customers, not only for placing orders but also for tracking orders in transit. Many customers want to be able to review their orders, check shipping details and, if necessary, send a message to the vendor; they should be able to do that in one location or webpage, and not have to search through many pages to find the information required. Poorly designed websites can lead to frustration, to lower customer satisfaction, and to lost orders.

★ *Availability* - Customers expect the items which they need to purchase to be in stock or at least be readily available when and where they want them. Efficient logistics contributes to good customer service by ensuring that at least fast-moving items are always in stock; reliability also extends to other services, such as accurate ordering, accurate pricing, and genuine delivery dates. Dependability also relates to an enterprise's online presence; if its website is not updated regularly, or shows the wrong prices, has dead links, or fails to process orders correctly, a customer will simply move to the website of the next - and competitive - vendor whose systems are more dependable.

A good "*customer service strategy"* should ensure that management looks at all aspects of its business to enhance its reputation amongst customers for reliability and dependability. Social media are a particularly potent way by which a satisfied customer can recommend others to buy from the supplier - but equally social media make it easy for a dissatisfied customer to make any grievances known, which can discourage other potential customers.

Supply Chain Strategy

Long-term trends pose challenges for modern supply chain managers, and place increasing requirements on the strategic management expertise of businesses today. These trends include ongoing globalisation and the increasing intensity of competition, the growing demands of security, environmental protection concerns, and resource scarcity. And, last but not least, the need for reliable, flexible and cost-efficient business systems capable of supporting *“customer differentiation”,* that is, variations between individual customers. More than ever before, modern supply chain managers are confronted with dynamic and complex supply chains, and therefore with trends and developments which are hard to predict.

In years to come, supply chain management will therefore take on additional strategic tasks which extend beyond its current scope of activity which are largely operational. In order to respond to these changes and remain competitive, supply chain managers need to be able to identify and understand new *“sustainability”* issues in their enterprise and the business environment in which it operates.

Business sustainability is often defined as:

“Managing the process by which enterprises manage their financial, social, and environmental risks, obligations and opportunities”.

Typically, sustainable businesses are resilient, and they create economic value, healthy ecosystems and strong communities. These businesses are more able to survive external *“shocks”* (unexpected happenings which cause delays or interruptions in supply chains) because they are intimately connected to healthy economic, social and environmental systems.

Fig.2/2. considerations in sustainability

The term *“sustainable”* is a multifaceted word which can be applied to several aspects of supply chain operations. Most commonly, it is used to refer to a supply chain’s impact on the environment, and can be related to a number of questions such as:-

- Are businesses utilising raw materials in a sustainable manner?
- Can CO_2 (carbon dioxide) and other “green-house” (polluting) gas emissions be reduced through an optimised transportation strategy?
- Can a manufacturing plant be run on alternative energy sources?
- Is the packaging used environmentally friendly (for example, is it bio-degradable)?
- How can waste and unnecessary packaging be reduced or eliminated?

What is called *“fragmentation”* - which results in *“fragmented supply chains”* - is the use of different suppliers and component manufacturers in the production of a good. Fragmentation results in different enterprises producing component parts, rather than the finished good, with the components being assembled as a final product elsewhere. Suppliers do not have to be located in the same country or geographical region - see Fig.1/5.

Fragmentation brings with it the need for a *“unified”* and integrated approach to supply chain management, requiring open lines of communication and the establishment of common goals across all key supply chain functions, including purchasing, manufacturing, distribution and sales.

To achieve sustainability requires - especially in respect of global, international, and fragmented supply chains - not only highly efficient supply chain operations, but also good networking skills which must continuously adapt to sustainability demands so as to create sustainable, long-term customer-focused supply chains. It calls for the development of sustainable supply chain strategies which create a sustainable competitive advantage.

A business's supply chain strategy is a critical *"success factor"* for its sustainability. Having mentioned earlier the necessity for strategic management in today's supply chains, it is now necessary for us to consider:-

- ✦ What a competitive *corporate* strategy involves.

- ✦ What a supply chain strategy is in practice, that is, how it is linked to the organization's competitive strategy, and how it links to sustainability.

The word *"strategy"* derives from the ancient Greek *"strategos"* which in turn derives from two words: *"stratos"* (army) and *"ago"* (leading) - which brings us back to Alexander the Great's campaigns which we mentioned in Module 1, in connection with the evolution of logistics.

Today's definition of *"competitive strategy"* is that it is a *"holistic"* (all-encompassing) plan, so called because it is concerned with complete systems - the entire environment and all factors which impact on an organization's activities - rather than with the analysis of, treatment of or dissection of it into parts. Furthermore, it is a long-term plan for an enterprise to set out a distinctive way of competing in order to guarantee profitability over a specified time span, considering the development of its business environment.

A competitive strategy is specified by a "bundle" of aims and objectives to establish a *"competitive advantage"*, which allows one enterprise to out-perform other enterprises in the same industry or market. One indicator for this out-performing capability is an enterprise's profitability, compared to the industry average (the average profitability of its competitors).

There are two basic types of competitive advantage the management of a business might choose to pursue: <u>low cost</u>, or <u>differentiation</u>. Those are typically combined with the scope of activities which management seeks to pursue and derives from three generic strategies for achieving excellence and market success: *cost leadership*, *differentiation*, and *focus*.

The focus strategy has two variants, cost focus and differentiation focus:-

- ✷ With a *<u>cost focus</u>* or *<u>cost leadership strategy</u>* management aims for the business to become the lowest-cost producer in its industry. The sources of cost advantage vary between industries. Usually they include economies of scale (see below) proprietary technology, and preferential access to raw materials.

- ✷ With a *<u>differentiation strategy</u>* management seeks to develop products and services which are perceived as being unique in its industry, and which create a value advantage for its customers. This emphasises the importance of focusing on one or more attributes which customers perceive as being important. A differentiation strategy usually leads to higher cost levels, but customers of strongly differentiated businesses are usually very loyal to its services and goods, are less price-sensitive than other customers, and effectively reward the efforts made to differentiate products by paying premium prices.

Following markets and competition theory, in general we can distinguish three decisive factors which determine the business environment and, consequently, the strategy of an enterprise:-

<u>Demand</u>	that is, actual and potential customers, target groups, etc
<u>Supply</u>	that is, competitors, employees/workforce, suppliers, etc
<u>The general environment</u>	that is, regulations, society, natural resources, economics, technology, etc

In today's business environment all those three factors are becoming increasingly complex; they change over time, and together they determine the behaviour of *"market* *players"* - which are *all organizations involved in a particular market.* Hence a great challenge for strategists is to satisfy an enterprise's shareholders on the one hand, and on the other hand to satisfy the widely varied demands of more and more other "*stakeholders*"; especially with regard to sustainability, where certain stakeholders such as interest groups for environmental protection (for example, Greenpeace) have become influential.

An organization's supply chain now plays an important part in the three decisive factors listed, and therefore represents an essential *strategic resource* in the achievement of an organization's strategic goals. For example, customers increasingly recognise the value of supply chain service and quality, and are less likely to select products and services on price alone. It is now recognised that not only businesses but rather whole supply chains are in competition.

Both in theory and practice, we find two basic types of supply chain types, having the potential to assist competitive strategy in the achievement of both cost leadership and differentiation strategy:-

* Lean, cost-conscious, efficiency-driven supply chains	*and in contrast*	* Agile, fast, service-driven supply chains

* <u>*Lean supply chain strategy:*</u> this fits well with a cost focus or cost leadership strategy, and is particularly successful if total logistics costs represent a high proportion of the cost of merchandise sold, and if the supply chain offers sufficient possibilities for reducing and controlling those costs.

* <u>*Agile supply chain strategy:*</u> this fits well with a differentiation strategy, particularly if customer-oriented differentiation is essential, and supply chain solutions need to be segmented and diversified to meet the specific needs of different customers.

These matters are expanded upon in Module 10 of the Logistics & Supply Chain Program.

The managements of *"best-practice businesses"* do not concentrate on just one, fixed supply chain strategy. There is an increasing need - from which competitive advantage follows - to *"customise"* supply chains individually (with regard to different customers, countries, and products.) In consequence, it is often necessary to implement multiple supply chain strategies and solutions; especially where quite heterogeneous (diverse or varied) customer-product mixes (that is, a range of different categories of customers want a varied range goods or services) need to be supported within the same global supply chains.

The strategic challenge for a supply chain manager is to design, to *"configure"* (that is, arrange the elements in a particular form or combination, called a *"configuration")* and develop holistically all the multi-layered elements in a supply chain so that it is strongly aligned with the overall competitive and corporate strategies of the enterprise. The *"bridge"* between corporate and competitive strategy and an enterprise's supply chain is its *"supply chain strategy".*

The supply chain strategy formulated determines the goals and the configuration of the supply chain with regard to: supply chain partners; structures; processes; and systems:-

* Regarding *supply chain partners*: strategy affects the selection of partners, the configuration of "outsourcing models" and the associated "gain and cost sharing" models - how the benefits and costs will be "shared out" or be of benefit to the partners.

* Regarding *supply chain structures*: strategy affects the configuration of distribution or production network structures.

* Regarding *supply chain processes*: strategy affects the configuration of procurement, production, and distribution processes with regard to costs, reliability, speed, and flexibility.

* Regarding *supply chain systems*: strategy affects the configuration of leadership, information, reporting, controlling, and incentive systems.

In accordance with those decisive factors which determine the strategy of a business, the criteria involved in developing the “right” supply chain strategy are often - both in theory and practice - the “demand” or “supply” characteristics of the supply chain.

Today’s supply chain strategies concentrate more on “supply” and “demand” characteristics rather than on supply chain external conditions (such as social, technological, environmental, and political conditions.) And this is a main reason why the executives responsible for developing today’s supply chains frequently misjudge the relevance of sustainability in their strategies, although the link to sustainability is immense.

The type of supply chain and its strategic configuration determine the “volume” and the “quantities” of supply chain operations such as transport, warehousing, production, and recycling. For example, a European distribution network consisting of one central warehouse combined with air freight has a different operations volume from a network consisting of seven regional warehouses combined with rail and road freight. Therefore, the social, economic, and energy and resource consumption levels will distinctly differ, in turn influencing efficiency and cost aspects. Furthermore, differences will be seen in the CO_2 emissions of the trucks and planes, and/or in packaging waste in the warehouses.

The foregoing factors are important. The supply chain - as a key to competitive advantage for many businesses - significantly determines the social, economic and environmental impacts of the organization, which in turn influence more and more of its stakeholders and shareholders. It follows that a sustainable supply chain strategy represents one of the most important success factors for achieving sustainable development for the business, and needs to exhibit the following characteristics:-

* It should be aligned to the underlying corporate and competitive strategy.
* It should consider demand, supply, and any other particular or wider general conditions.
* It should incorporate environmental, social, and economic perspectives in all proposed actions.
* It should build increased shareholder and stakeholder value, and especially customer satisfaction.

Although a regular and consistent supply chain is the aim, in reality all supply chains will face constant changes and challenges of one type or another, and that will affect any logistics operation. To adapt to, and integrate, the needed flexibility of the supply chain, each business needs to *develop* and then *implement* a formal logistics strategy. This will allow a business to identify the impact of imminent and potential changes and then to make organizational or functional changes to ensure that customer service levels are not reduced.

When an organization creates a logistics strategy it is in effect defining the service levels at which its logistics operation will be at its most cost-effective. Because supply chains are constantly changing and evolving, a business might need to develop and implement a number of logistics strategies for specific product lines, countries, or specific customers.

Push and Pull Strategies

The business terms *“push”* and *“pull”* originated in logistics and supply chain management, but they are now also widely used in marketing and in the distributive industry (made up of large and small wholesalers and retailers.)

A manufacturing business’s supply chain stretches from the factory where its products are made, to the point at which its products are in the hands of customers (see Fig.1/4.). Supply chain strategy determines:

- when products should be fabricated, manufactured or assembled,
- when products should be delivered to distribution centres, and
- when products should be made available to the retail channel.

Under a *"pull supply chain"* it is actual customer demand which drives the process;

whereas,

Under a *"push strategy"* long-term projections and forecasts of customer demand drive the process.

Push and pull strategies both work within the supply chain. A typical supply chain has five different stages:-

- In the first stage, products start out as raw materials.
- In the second stage, the manufacturing processes take raw materials and turns them into products.
- The third stage occurs when the finished products are shipped to the distribution channels.
- In the fourth stage the distribution channels use the products to stock retail shops or stores or, in the case of an e-commerce Internet business, a fulfilment centre.
- In the fifth stage, the products are delivered to consumers.

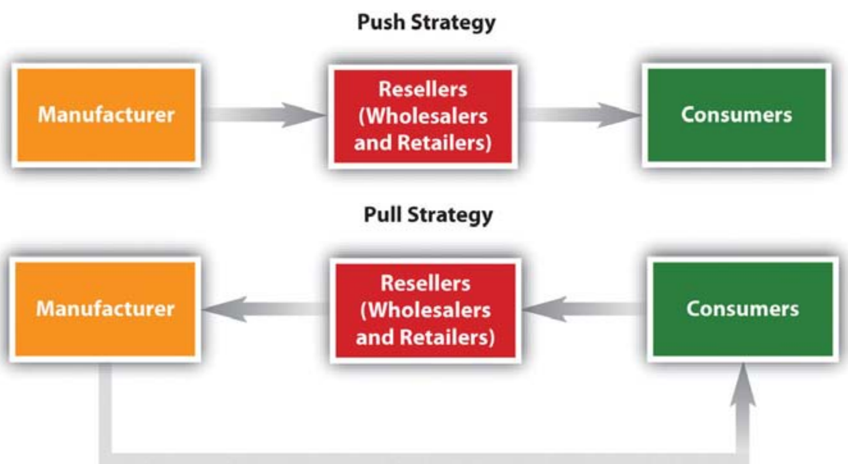
Push Strategies

A push-model supply chain is one in which projected demand determines what enters the supply process. For example, warm jackets are *"pushed"* to clothing retailers as the hot season or summer ends, and as the autumn or fall and winter or cold seasons start. Under a push system, businesses have predictability in their supply chains because their personnel know what will come when (such as the wet season after the dry season) - long before it actually arrives. That also allows their personnel to plan production to meet anticipated needs and sales, and gives them time to prepare or allocate warehouse space in which to store the stock/inventory as and when they receive it.

Pull Strategies

A pull strategy is related to *"just-in-time"* (JIT) methods (discussed in Module 10 of the Logistics & Supply Chain Management Program) under which the exact quantities of stocks are received only when they are actually needed; the object is to minimise or eliminate entirely *"stock in hand",* that is, stock/inventory holding. Under these strategies, products enter the supply chain when customer demand justifies that happening. One example of an industry which operates under this strategy is a direct-sales computer business, which waits until it receives an order to actually build a customised computer for the consumer. With a pull strategy, businesses avoid the cost of carrying inventory which might not be used or which might not sell. However, the risk is that these businesses might not have sufficient stock/inventory to meet demand if they cannot increase production quickly enough.

Fig.2/3. push and pull strategies



Push/Pull Strategies

Technically, every supply chain strategy is a *"hybrid"* or mix between the two. A fully-push based system still ends at the retail shop or store where the products wait for customers to *"pull"* the products off the shelves by buying them. However, a supply chain which is designed to be a hybrid converts from push to pull somewhere in the middle of the process. For example, the management of a business might choose to "stockpile" finished products at its distribution centres to wait for orders which "pull" them to shops and stores. Managements of manufacturing businesses might choose to build up stocks/inventories of raw materials and/or components - especially those which increase in price over time - knowing that they will be able to utilise the raw materials and/or components in future production (although care must be taken not to over.

Developing a Logistics Strategy

Management can start to develop an effective logistics strategy by looking at four distinct levels of their logistics operation:-

- *Strategic:* By examining the enterprise's objectives and strategic supply chain decisions, the logistics strategy should review how the logistics operation contributes to the high-level objectives, as set out in the corporate and business strategies.

- *Structural:* The logistics strategy should examine the structural issues of the logistics operation, such as the optimum number of warehouses and distribution centres, or what products should be produced at a specific manufacturing plant/factory.

- *Functional:* Any strategy should review how each separate process in the logistics operation is to achieve functional excellence.

- *Implementation:* The key to developing a successful logistics strategy is how it will be implemented across the organization. The plan for implementation will include development or configuration of an information system, the introduction of new policies and procedures, and the development of a revised management plan.

When examining the four levels of logistics operation, all components or processes of the operation should be examined to ascertain whether any potential cost benefits can be achieved. There are different component areas for each enterprise, but the list should include at least the following:-

- *Transportation:* Does the current transportation strategy help service levels?

- *Outsourcing:* What outsourcing is used in the logistics function? Would a partnership with a third party logistics company improve service levels?

- *Logistics systems:* Do the current logistics systems provide the level of data that is required to successfully implement a logistics strategy, or are new systems required?

- *Competitors:* Review what competitors offer. Do competitors offer something different, better or more efficiently - if so, could that be imitated or used as the basis for the organization's own improved customer "offering", and what lessons can be learned? Can changes to the business's customer service improve service levels?

- *Information:* Is the information which drives the logistics operation *"real-time"* (the actual time during which a process or event occurs) and is it accurate? If the data is inaccurate, the decisions taken which are based on it will also be inaccurate.

- *Strategy Review:* Are the objectives of the logistics operation in line with the enterprise's objectives and strategies? This question should be asked, and investigated, a minimum of once a year.

Fig.2/4. the different levels or stratas of strategy

A successfully implemented logistics strategy is important for businesses which are dedicated to keeping service levels at the highest levels possible, despite changes that might occur in the supply chain.

The goal of any formal logistics or supply chain strategy is to make sure that a business is delivering to its customers *what they want* - and delivering to them when and where they want it - whilst accomplishing all of that at the most reasonable cost possible. By following these guidelines, management can ensure that logistics are aligned with its customers' needs, with its inventory targets and with its cost reduction goals.

Management might need to review its logistics strategy from time to time, especially when supply chains and supply chain priorities change. For example, if an enterprise's supplier base had been primarily located in the United States and Mexico - and now, because of a change in a supply chain, the enterprise's suppliers are now primarily located in Asia - management clearly needs to review the existing logistics strategy. It might be, for instance, that the transportation and freight forwarding providers the business has previously been using might not be the right strategic partners for the new supply chain realignment.

Factoring Logistics Into Strategy

To employ logistics as an effective competitive "lever" and as a significant component of strategy, management must take two actions:-

✦ Firstly, it must adapt logistics programs to support ongoing corporate strategies in the short term.

✦ Secondly, it must *"factor"* logistics into the design of business operating strategies on a continuing long-term basis.

Note that the term *"factor into"* means to consider and include a particular item, amount or factor into a calculation or decision.

Steps necessary to ensure the foregoing include undertaking a *"logistics strategy audit",* a possible redesign of the logistics system, and establishing procedures to ensure continued attention to logistics as an integral element of corporate strategy.

Strategy Audit

A first step in achieving this objective can begin immediately in the form of an *"audit"* - a thorough examination - to explore strategic questions, the answers to which will guide management in planning and strategy formulation. Such questions include:-

❊ *What levels of service (a) do our customers expect? (b) do our competitors provide?*

Factors influencing the answers to these questions include:-

- the degree of loyalty that customers exhibit in the purchase of the enterprise's products and those of its competitors;
- how critical the enterprise's products are to customers;
- the influence of its customer service level on sales, and
- the costs of providing varying levels of customer service.

Customers' expectations and competitive levels of service might vary from product to product and from one geographic area to another.

The managements of wholesale and retail businesses must pose the same questions. Answers might lead to alterations in buying and stocking policies, as well as in warehouse and storehouse location. For traders and manufacturers alike, service goals will influence stock/inventory levels and locations, as well as transport decisions, and also the customer order processing methods which are employed (dealt with in Module 7 of the Logistics & Supply Chain Management Program).

❊ *Through how many outlets should we distribute our products? Of what type? Where?*

Retailers have long since identified *location* as a major element of service and sales in their businesses. The area from which a retail outlet "draws" its business depends on the type of products sold, the size of the shop or store, the degree to which competing shops or stores sell identical or comparable merchandise, and the importance associated with the purchase of its products by consumers. These factors determine the density of retail locations and the geographic intensity with which various types of retail goods are offered for sale.

The number and type of wholesale outlets for a product are determined by customer service needs. Such needs range from those associated with sales assistance, and after-sale service, product maintenance, etc, to product availability.

Amongst manufacturers, there has been a general reduction in the number of warehouses through which products of any one manufacturing business are distributed. This has probably resulted from a combination of factors, including increased attention to the costs of distributing through too many warehouses, improved methods of order processing and transportation, and improved main road/highway systems, which in many countries or areas of them has extended the "territory" which can be served from a warehouse's location.

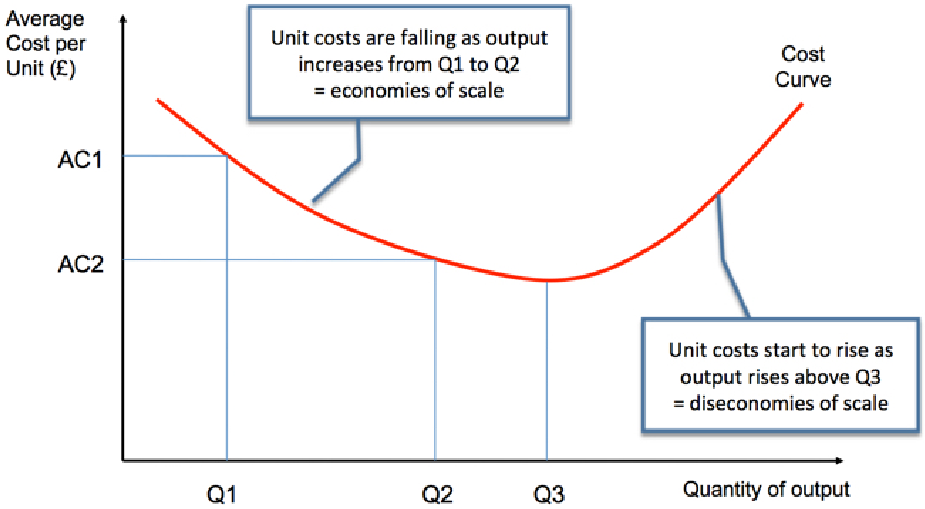
❊ *Are our plants located and focused properly to support corporate strategy?*

This question of location becomes even more important when an existing location does not fit in with an enterprise's logistical needs, and when economic savings from a move are more than enough to compensate for the economic and physical costs of the move.

Of greatest interest in the logistics strategy audit, however, is the extent to which the location of production facilities can provide the very core of a corporate strategy. Production processes which rely heavily on commonly located raw materials - such as water or coal or oil - will require market-oriented facilities. Those involving large weight reductions (for example, in the production of metal from ore) will logically be located near sources of raw materials. Those requiring large sources of inexpensive power (such as for the smelting of aluminium from alumina) might obtain competitive advantage by locating producing facilities near such power sources.

The degree to which plants are focused on the production of one or a limited number of products in a larger product line might be influenced by *"Economies of Scale"* - that is, the cost advantages which can arise due to size, output, or scale of operation, with the *cost per unit* of output generally decreasing with increasing scale of production, because fixed costs are "spread" over larger numbers of units of output, leading to a lower cost per unit.

Fig.2/5. economies of scale illustrated



Economies of scale is a simple concept that can be demonstrated through an example. A small business owner is considering ordering a marketing brochure from a printing company. The printer quotes a price of $5,000 for 500 brochures, and $10,000 for 2,500 copies. Whereas 500 brochures will cost the business $10 per brochure, 2,500 will only cost it $4 per brochure. In this case, the printer is *"passing on"* part of the cost advantage of printing a larger number of brochures to the customer. This cost advantage arises because the printer has the same initial 'set-up' cost regardless of whether the number of brochures printed is 500 or 2,500. Once those costs are covered, there is only a marginal (small) extra cost for printing each additional brochure.

Economies of scale can arise in several areas within a large enterprise. Whilst the benefits of this concept in areas such as production and purchasing and logistics are fairly obvious, economies of scale can also impact on other areas, such as finance and managerial/staffing costs.

❋ *Where is our organization in the logistics "life cycle" for all or a portion of our business?*

A manufacturing business might begin its life cycle by scheduling small quantities or batches of production at a single facility for local or regional distribution. What is called *"fulfilment"* is the process of supplying a finished, manufactured product directly from a manufacturing facility to a distributor or end user. The fulfilment cycle may include receiving customer orders and configuring the products to meet the requirements of the particular order, and shipping the products to distribution outlets or to the end users, plus invoicing (billing) the recipients of those products.

As sales volumes increase, more efficient production and shipment quantities are achieved (that is, economies of scale are achieved), reducing the costs of logistics in the *"cost profile"* (that is, the set of costs associated with a specific product, such as production, packaging, storage, handling, transportation and distribution) of the business. At this point, additional plants or production sites might be established, each of which might be focused on a specific portion of the product line. As sales territories are extended the logistics networks will become more complicated, often involving the operation of large numbers of market-oriented warehouses to minimise the cost of delivering small orders. Customer orders of increasing size might, at some point, permit the combining or consolidation of orders for shipping purposes, in cars, vans or lorries (by "carload" or "truckload") at locations intermediate to (in between) plants and markets, through the use of distribution centres, such as those established by supermarket chains.

With the continued growth of individual customer orders, it might once again become possible to ship products directly from plants to customers, as in the initial stage of the organization's life cycle. But this time the shipments might comprise single products moving in "vehicle-load" quantities.

Each stage of the logistics life cycle might require different manufacturing policies, different plant and different warehouse locations, and different transportation and order processing methods. Awareness of the logistics life cycle can reduce the time-lag between needs caused by changes in corporate strategy, and appropriate logistical responses to them.

Module Ten

INTERPRETING FINAL ACCOUNTS, CASH FLOWS, ACCOUNTING RATIOS, BREAK-EVEN ANALYSIS, PRICING POLICY, AUDITS

This Module is one of the 12 Modules from the CIC Diploma Program on:

Accounting & Finance in Business & Management

Introduction: This Program teaches how to record financial transactions, interpret accounting data, and prepare accounts; and how to manage costs, working capital, profits, finances and investments. It covers bookkeeping, cost accounting, budgeting, credit, bank accounts, and more; and how to guide colleagues and subordinates, and make wise financial decisions.

The Program is ideal for bookkeepers, accountants, finance and business people aiming for promotion and managerial posts, and for men and women seeking careers in the finance and accounting fields.

	Accounting & Finance in Business & Management - Modules Summary
Module	**Module Title**
1	The Need for Complete and Accurate Information, Functions of Accounting
2	Capital and Business Finance; Limited Liability, Working Capital, Revenue, Expenditure
3	Principles of Bookkeeping and The Books of Account; Bank Accounts
4	Final Accounts 1 - Accounting Concepts, Trading Accounts, Manufacturing Accounts
5	Final Accounts 2 - Profit & Loss Accounts, Balance Sheets, Net and Gross Profit
6	Principles of Costing: Terminology, Costing Systems, Overheads, Standards, Variances
7	Planning and Forecasting; Budgets and Budgeting, Budgetary Control, Limiting Factors
8	Stock Control and Inventory; Valuation, Stocking Factors, Stock Levels, Stocktaking
9	Credit and Credit Control; Benefits and Dangers, Bad Debts; Discounts, Types, Purpose
10	Partnership Accounts, Goodwill; Departmental, Branch and Hire Purchase Accounts
11	**Interpreting Final Accounts; Cash Flows, Ratios, Break-Even Analysis, Pricing, Audits**
12	Computerised Accounting Systems; IT Operations, Software, Databases, Security

If you would like to study the complete Program and gain an international Diploma on **Accounting & Finance in Business & Management** you may do so by using the 'Special Offer' Enrolment Form on page 183.

Stephan Chigondo wrote from **Zimbabwe**:
"When my bosses learnt I had studied with CIC, their respect for me increased tremendously, and I have been given promotion to operate the Accounting Department for my organisation at National Level."

Andrew Onyango wrote from **Uganda**:
"I am so happy to be a CIC Member. Since I completed my CIC Course in Accounting my salary has been increased by over 50% and I have been confirmed in a new position of Chief Cashier for the company. CIC studies are the key!"

Module Ten

INTERPRETATION OF FINAL ACCOUNTS

Introduction

In discussing various types of accounting statements in earlier Modules, we have described how - using the information provided in those statements as a basis - formulas can be used and calculations can be made to **'extract'** further needed facts and figures which enable management to make reasonable decisions and to take necessary actions to plan, co-ordinate and control the activities and operations of a business. That **'interpretation'** of accounting data is essential if a business is to be run efficiently and profitably.

In this Module we consider how the interpretation of the final accounts of a business can provide guidance about its financial position and financial soundness - or otherwise.

Who Needs the Information

Different people or groups of people might need to look at, and interpret, the final accounts of a business from somewhat different points of view. They are sometimes referred to as the "users", and they include:-

* Top management executives, such as the managing director or the sales or production managers, whose prime interest will be in what respects the business (or sections of it) is efficient or less efficient than it should be. The final accounts provide for them a **summary** of the mass of detailed accounting information which has already been provided to them in various formats.

* Creditors and potential creditors, such as banks, hire purchase/leasing companies and other financial organizations, are primarily interested in whether there is, or will be, an **adequate surplus of liquid assets** to enable the business to meet its present or potential liabilities when payment - or repayment, in the case of loans - falls due.

  The assets which attract the attention of creditors and potential creditors are those which will, in the ordinary course of trading, be converted into cash; examples are, of course, stocks and book debts, and people perusing the financial statements need to be able to assess the probable values of those assets. They also need to know what liabilities the business already has, and also the values of its current assets.

* Shareholders, or persons considering purchasing (personally or on behalf of organizations they represent) shares or otherwise investing in a limited company, are primarily interested in what **profits** the company has been making and, even more importantly, what profits it will be likely to make in the future - in which they will share in the form of dividends. That is particularly so of non-executive shareholders, that is, people who invest in a company by purchasing some of its shares, but take no active part in the day to day running of the business (the opposite is likely to be the case with the shareholders and/or directors of small companies.)

In general such "external" shareholders are interested in receiving, in the medium- or long-term, maximum or sufficiently high returns, in the form of dividends, from their investments; they are less interested in the values of the assets and liabilities of the company, provided of course that it remains solvent and has a sufficiency of liquid assets to pay dividends.

Working Capital

The working capital of businesses is covered at length in Module 2 of the Accounting & Finance Diploma Program, and we recommend you study or revise the subject, particularly with regard to the problems which are likely to be encountered by a business which has insufficient working capital.

When examining the working capital of a business, useful "indicators" include:-

- If there is a steady **increase** in the amount of its working capital, it is usually an indication of successful business operations.

- On the other hand, a **decrease** in its working capital over a period of time might indicate that losses will be incurred. However, the situation might be the result of an increase in business activity - necessitating expenditure on fixed assets without resort having been made to an additional share issue or to loans.

The computation of the amount of an enterprise's working capital is therefore a good test of its **solvency** and future prospects, because if the value of its current assets exceeds the value of its current liabilities by a reasonable amount, it should have no difficulty in meeting its debts when they fall due. However, the composition of the working capital of a business is as important as its size, and that fact should be taken into consideration when computing working capital - which is, you will remember, the total value of its current assets **less** the total value of its current liabilities - from the balance sheet of a business.

The date at which the balance sheet was drawn up and any changes of significance since that date should also be taken into consideration. As an example of the foregoing, consider the figures shown in Fig.11/1, which were extracted from the accounts of two companies.

Fig.11/1. comparison of the working capital of two companies

	company X $	**company Z** $
current assets:		
cash	5,000	8,000
stock	75,000	125,000
debtors	20,000	17,000
	100,000	150,000
current liabilities:		
creditors	75,000	125,000
working capital	$25,000	$25,000

Both companies have working capital of $25,000, and would therefore both seem to be in an equally sound position; but that is not necessarily the case. Should for any reason there be a drop in the prices at which the products of the two companies can be sold - due to a drop in demand, the economic climate of the country, or government intervention, or another reason - company X is actually in a sounder position to survive than is company Z.

That is because company X could cope with a one-third (33.33%) drop in prices before its working capital is eliminated, that is, 33.33% of $75,000 (the stock value) is $25,000. In contrast, company Z could bear only a 20% decrease in prices, because 20% of $125,000 is $25,000, before it could find itself in severe financial difficulties. Possibly the management of company Z has taken advantage of low cost prices or large quantity discounts to stock up, without thought to the future consequences of being overstocked.

Cash and Funds Flow

We discuss **‘cash budgeting’** in Module 7 of the Accounting & Finance Program, where an example is give illustrating the danger of **not** considering cash flow, and that Module illustrates how there is a continual “flow” of funds during the day to day operations of a business, which creates changes in its working capital.

Working capital is, in effect, being continually **‘turned over’** in an attempt to earn profits; such *profits* **increase** the amount of working capital of a business, whilst any *losses* **decrease** the amount of it.

A “flow” of funds is also created by any changes:

- In the values of fixed assets.
- In increases in share capital, that is, from an additional share issue.
- In loans made to or by the business.
- From the payment of dividends, and so on.

Some of the changes make additional funds available to the business, whilst other changes represent funds flowing out of the business.

Many changes which affect the flow of cash and funds circulating through a business are obvious. For example, an increase in the value of monies owed to trade creditors should be compensated for by increases in the values of stocks and/or cash from goods sold before payment is due to those creditors (or an increase in book debts for any of the purchases resold on credit.)

Some changes are not so obvious. Depreciation is “written off” fixed assets as a charge against profits, but it does not involve the actual payment of cash. But it is a **source** of funds because it represents a proportion of the profits made which are retained within the business. In the same way, the transfer of portions of profits to **‘reserves’** does not actually involve the payment of cash, but nevertheless the amounts involved are retained within the business.

Cash or Funds Flow Statements

It is often perplexing for management to see clearly what has happened to the profits which have been earned by a business during a financial period. It is therefore very helpful if a statement is prepared showing what monies have been received during the period, and how those monies have been spent in that period; that is, the sources and applications of funds. In effect a cash or funds flow statement is a summary of the enterprise’s cash book. Such a statement is valuable in that it can often draw attention to areas of overspending (and in some cases under-spending) and allow management the opportunity to take the remedial action deemed necessary or practicable in the circumstances.

Fig.11/2. A company’s comparative balance sheet for two consecutive years

BALANCE SHEET AS AT 31 DECEMBER 2017

	YEAR 1	YEAR 2		YEAR 1	YEAR 2
Issued capital	225,000	225,000	Land & buildings	110,250	108,045
Reserves	37,500	37,500	Machinery & equipment		
Net profit c/f	3,000	36,750	(depreciation:		
Debentures	37,500	33,000	Year 1 - £12,500		
Creditors	45,000	67,500	Year 2 - £16,500)	114,750	148,500
Bank overdraft	-	3,045	Work in progress	45,000	41,250
Proposed dividend	27,000	-	Stocks	26,250	33,750
			Debtors	56,250	71,250
			Cash at bank	22,500	-
	375,000	402,795		375,000	402,795

Note: The net profit made in Year 2 was $33,750; that is, $36,750 shown under that year, **less** $3,000 from Year 1 which was not distributed.

A question likely to be asked by the management of the company whose balance sheet is shown in Fig.11/2 is:

"if the bank balance of $22,500 at the start of the second year's operations has developed into an overdraft of $3,045 by the end of that year, where has the profit of $33,750 gone to?"

There is no one specific answer because, as we have explained, the profit is only one of a number of sources of funds. However, the cash/funds flow statement illustrated in Fig.11/3 shows the sources and applications of funds during the second year.

Fig.11/3. cash/funds flow statement

CASH/FUNDS FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2017		
Sources of funds:		
Net profit for year		33,750
Depreciation:		
Land & buildings	2,205	
Machinery & equipment	16,500	
		18,705
Increase in creditors		22,500
Decrease in value of work in progress		3,750
Depletion of bank balance plus overdraft		25,545
		103,500
Applications of funds:		
Debentures redeemed		4,500
Dividends paid		27,000
Purchases of machinery and equipment		50,250
Increase in value of stocks		7,500
Increase in debtors		15,000
		104,250

Fig.11/4. statement showing the value of working capital at ends of two consecutive years

WORKING CAPITAL AS AT 31 DECEMBER 2016 AND 2017		
	YEAR 1	YEAR 2
Current assets:		
Work in progress	45,000	41,250
Stocks	26,250	33,750
Debtors	56,250	71,250
Cash at bank	22,500	--
	150,000	146,250
Current Liabilities:		
Creditors	45,000	67,500
Bank overdraft	--	3,045
Proposed Dividend	27,000	–
	72,000	69,795
Working capital:	78,000	76,455
Decrease in working capital between the two years:		2,295
Made up of:		
(a) Increases in sources of funds:		
Net profit for year	33,750	
Depreciation charged against profit	18,705	
		52,455
(b) Decreases in sources of funds:		
Debentures redeemed	4,500	
Purchases of machinery and equipment	50,250	
		54,750
Excess of total decrease over total increase		2,295

The statement in Fig.11/3 shows clearly the funds which were received into the company during the second year, and how those funds were disposed of. The cash/funds flow statement is a summary of the differences - in cash terms - between the two balance sheets in Fig.11/2. As the totals of the two sides of each balance sheet agree, the differences must automatically also agree. This is made clear in Fig.11/4, which is a statement showing the changes - in *summarised form* - which took place in the company's working capital. It is useful to have such an additional statement accompanying a cash/funds flow statement.

Important Considerations by Management to Working Capital

There are two very important matters to which management must always pay attention when viewing an enterprise's working capital:-

✸ maintaining profitable business operations;
and
✸ maintaining a solvent financial position.

Naturally, profits are very important, but it is equally important for a business to be able to meet its debts when they fall due for payment. There is a situation which can arise, which is commonly called **'overtrading'**, in which an enterprise's business operations expand so rapidly that its financial solvency is endangered - because there are insufficient liquid assets available to finance the expansion and to meet its short term debts and commitments. In effect, its prosperity is threatened by its own success!

Overtrading can occur even when it is trading profitably, and so even profitable (in accounting terms) businesses may be forced to close. The practical example in Module 7 is an example of this. What if, for instance, the company paid rent on a monthly basis but, because of the cash deficit was not able to meet the rent for one, two or three or months? The landlord might evict the company, leaving it with no option but to close, even though sales figures indicated a profitable business.

Each of the major items which jointly contribute in one way or another to an enterprise's working capital availability at any time, should be strictly controlled by management to ensure that there is always a sufficiency available.

Cash

Most businesses will "hold" a certain amount of cash as part of the total value of their assets held at any particular point in time, and the necessity to ensure that sufficient cash is available to meet operational needs has already been considered. In this context "cash" does not simply refer to currency notes and coins; it refers to the ready availability of "liquid funds", such as money held in a current bank account or in a short-term deposit account (dealt wit in Module 3 of the Accounting & Finance Program) or the availability of bank overdraft facilities.

Besides the possibly high interest which might have to be paid for the overdraft facility, there is another danger in that the bank has the right to "call in" an overdraft at very short notice; it must always be remembered that an overdraft is **not** a loan for a fixed term. Such a happening could have serious consequences for a business which relies too heavily on its overdraft.

Cash budgeting (which we consider in Module 7 of the Accounting & Finance Program) is essential. However, the amount of cash held might vary considerably between businesses. According to contemporary economic theory, there are three motives for holding cash, which are:-

★ *The Transactionary Motive*

In order to meet its day to day commitments, a business requires a certain amount of cash. Payments in respect of salaries and/or wages, overheads (such as rent and payment of utility bills), trade purchases, and so on, must be made on the due dates. Cash has been described as the "lifeblood" of a business. Unless it circulates through the business and is available for the payment of maturing obligations, the survival of the business will be put at risk. We teach in Module 2 of the Accounting & Finance Program that assets and profitability alone are not enough; a business must have sufficient cash to pay its debts when they fall due.

★ ***The Precautionary Motive***

If future cash flows are uncertain for any reason, it would be prudent management for a business to hold a balance of cash. For example, a major customer owing a large sum to the business might be in financial difficulties. In such a difficult situation, the business would retain its capacity to meet its obligations if it was holding a cash balance. Similarly, if there is some uncertainty concerning future outlays, a cash balance will be required.

★ ***The Speculative Motive***

The management of a business might decide to hold cash in order to be in a position to exploit profitable opportunities as and when they arise. For example, by holding cash a business might be able to acquire the stock or other assets of a competitive business which has suddenly become insolvent; it might even be possible to buy and "take over" that competitive business at an attractive price.

Holding cash also has an "opportunity cost" for the business which must also be taken into account. Thus, when evaluating the potential returns from holding cash for speculative purposes, the cost of forgone investment opportunities must also be considered.

The Amount of Cash Held

If a business is able to borrow or use overdraft facilities quickly at a favourable rate if and when the need arises, then the amount of cash it needs to hold can be reduced considerably. Similarly, if the business holds assets which can easily be converted into cash (for example, marketable securities such as shares in listed companies and government bonds) the amount of cash it needs to hold can be reduced.

The decision on how much cash a particular business should hold is often a difficult one. The managements of different businesses will have different views and priorities as to the amount of cash which it is appropriate to hold from time to time. Factors which might influence the decision as to how much cash will be held are varied and can include:-

✶ **The nature of the business:** Some businesses, such as utilities (water, electricity and gas companies) might have cash flows which are both predictable and reasonably certain. This will enable them to hold lower cash balances. In some businesses, cash balances vary greatly according to the time of year. A seasonal business might accumulate cash during the "high" season to enable it to meet commitments during the "low" season.

✶ **The opportunity cost of holding cash:** In situations in which there are profitable opportunities, it might be wiser to invest in those opportunities rather than to hold a large cash balance.

✶ **The level of inflation:** The holding of cash during a period of rising prices will lead to a loss of purchasing power. The higher the level of inflation, the greater will be this loss.

✶ **The availability of near-liquid assets:** If a business has marketable securities or stocks which might easily be liquidated, then the amount of cash held may be reduced.

✶ **The availability of borrowing:** If a business can borrow or use overdraft facilities easily (and quickly) there is less need for it to hold cash.

✶ **The cost of borrowing:** When interest rates are high, the option of borrowing becomes less attractive.

✶ **Economic conditions:** When the economy of a country is in recession, businesses might prefer to hold on to cash in order to be well placed to invest when the economy improves. In addition, during a recession businesses might experience difficulties in collecting debts. They might, therefore, need to hold higher cash balances than usual in order to meet their own commitments.

✶ **Relationships with suppliers:** Too little cash might hinder the ability of the business to pay its suppliers promptly. This can lead to a loss of goodwill. It might also mean that opportunities to benefit from discounts offered are lost.

Debtors

The necessity for strict credit control is explained to you in detail in Module 9 of the Accounting & Finance Program. As we emphasised there, the unwise granting of credit can be very dangerous, and unplanned "extended credit" can be equally so, as was demonstrated in the example (relating to cash budgeting) given in Module 7 of the Accounting & Finance Program.

It is important that a constant check be made by the finance or accounts or credit manager of a business to ensure that debtors pay their accounts by the due dates. In times of high interest rates in particular, debtors might take every opportunity to delay the payment of "accounts due" for as long as possible. In some cases *prompt payment discounts* might be offered in order to encourage early settlement of accounts. Excessive pressure on debtors to pay early might, however, have the effect of making customers or clients place their business elsewhere.

Collection Policy

A business offering credit must ensure that amounts owing are collected as quickly as possible. An efficient collection policy requires an efficient accounting system. Invoices must be sent out promptly along with regular monthly statements of account. Reminders must also be despatched promptly when necessary.

Management should lay down an agreed procedure for dealing with customers who do not pay their debts when payment is due. The cost of any action to be taken against "delinquent" debtors must be weighed against the likely returns. For example, there is little point in pursuing a customer through the courts and incurring large legal expenses if there is evidence that the customer does not have the necessary resources to pay. When possible, the cost of bad debts should be taken into account when pricing products or services.

Management can monitor the effectiveness of collection policies in a number of ways. One method is to calculate the average settlement period for debtors. This ratio is calculated as follows:

$$\frac{\text{value of trade debtors}}{\text{average settlement period for debtors}} = \text{credit sales X 365 days}$$

Although this ratio can be useful, it is important to remember that it produces an **average** figure for the number of days during which debts are outstanding. But that average might be badly distorted by a few large customers who are also very "slow payers".

A more detailed and informative approach to monitoring debtors requires the production of regular **'ageing debtors'** schedules/reports. Debts are divided into categories according to the length of time each debt has been outstanding. An ageing debtors schedule can be produced for management on a regular basis to help make clear the "pattern" of outstanding debts. Fig.11/5. is an example of an ageing debtors schedule

Fig.11/5. ageing debtors report

Ageing Debtors

days outstanding

Customer	1 to 30 days	31 to 60 days	61 to 90 days	over 90 days	Total
A Ltd	20,000	10,000			30,000
B Ltd		24,000			24,000
C Ltd	12,000	13,000	14,000	18,000	57,000
Total	32,000	47,000	14,000	18,000	111,000

We can see from the schedule that A Ltd has 20,000 units of debt which is less than 30 days old, and 10,000 units which is between 31 and 60 days old. This information can be very useful for credit control purposes.

Many accounting software packages (covered in Module 12 of the Accounting & Finance Program) now include an ageing debtors schedule as one of the routine reports available to managers. Such packages often have the facility to put customers on "hold" when they reach their credit limit; for example, C Ltd might now be 'flagged' as not being allowed any further credit until the over-90-days balance is paid.

Another approach to exercising management control over debtors is to identify the pattern of receipts from credit sales which are made on a monthly basis. This involves monitoring the percentage of trade debtors which pays (and the percentage of debts which remain unpaid) in the month of sale and the percentage which pays in subsequent months. In order to do this, credit sales for each month must be examined separately.

To illustrate how a pattern of credit sales receipts is produced, let us consider a business which achieved credit sales of 250,000 units in June and which received 30% of the amount owing in the same month (June), 40% in July, 20% in August and 10% in September. The pattern of credit sales receipts and amounts owing is shown in the schedule in Fig.11/6.

Fig.11/6. pattern of credit sales receipts and amounts owing

Pattern of credit sales receipts				
Month	**Receipts from June credit sales**	**Percentage Received**	**Amount outstanding from June sales at month-end**	**Percentage Outstanding**
	units	%	units	%
June	75,000	30	175,000	70
July	100,000	40	75,000	30
August	50,000	20	25,000	10
September	25,000	10	0	0

The above schedule shows how income from sales made in June were received over time. This information can be used as a basis for control. The actual pattern of receipts can be compared with the expected (budgeted) pattern of receipts to determine whether there was any significant deviation). If this comparison shows that debtors are paying more slowly than expected, management might need to decide to take corrective action. That might include one or more of the following:-

- Offer prompt payment discount to encourage prompt payment.
- Alter the collection period.
- Improve the accounting system to ensure that customers are billed more promptly and that reminders are sent out promptly.
- Change the eligibility criteria for customers who require credit.

Stocks/Inventory

The adverse consequences to a business which holds excessive stocks (which are described in Module 8 of the Accounting & Finance Program) together with the need to maintain levels of stocks which are consistent with the operational needs of the business. Whilst few businesses can afford to have capital "tied up" in excess stocks, it is equally important that production and/or sales, and customers, are not lost because of shortages of stocks. Good stock control is vital.

Creditors

In general, suppliers' accounts should not be paid before the due dates. However, when funds permit, advantage should be taken of any *prompt payment discounts* offered. It should, however, be remembered that a business which gains a reputation for being a "late payer" might encounter reluctance amongst suppliers to extend credit.

Cash Flow and Future Capital Expenditure

The control and economical use of working capital flowing within a business, plus the “ploughing back” of proportions of profits, are two important means of building up funds with which to finance capital expenditure without resorting to possibly expensive sources of external financing, such as loans.

When finance is required for capital expenditure, the first step by management should be to ascertain whether all or part of it is already, or will be, available within the business itself. The “net cash flow” figure, that is, profits earned after taxation and dividends - but **before** charging depreciation - can be used to determine whether funds are available internally to pay for capital expenditure; or in the case of planned future capital expenditure, whether sufficient can be raised by ploughing back profits, and/or by an additional share issue - or whether some other source of financing will be necessary.

ACCOUNTING RATIOS

A **‘ratio’** is the relationship that one item bears to another; the latter is called the **‘base’** and it is divided by the former. For example, if it is desired to know the ratio of net profit ($3,000 in this case) to net sales ($20,000 in this case), $3,000 is divided by $20,000, which gives the ratio of 0.15. To express that ratio as a **percentage**, it is only necessary to multiply it by 100; thus in this example the ratio of net profit to net sales is 15%. (You will recall that such ratios were used in the trading and profit & loss accounts which were illustrated in Modules 4 and 5.)

There are very many - possibly hundreds - of useful accounting ratios. The usefulness of some of them will depend largely on the category of person(s), as described at the start of this Module, studying or interpreting the accounting statements of a particular business. Some of the most commonly computed ratios are described below, based on information contained in Figs.4/3, 5/2 and 5/5.

There are, broadly speaking, five categories of ratios:-

★ Profitability Ratios:	these help to assess whether a business has been successful in achieving profit and increasing the wealth of the owners.
★ Liquidity Ratios:	these help to assess whether a business has sufficient liquid resources to meet its debts and obligations, especially in the short-term
★ Efficiency Ratios:	these help to assess whether a business has been using its resources efficiently - they are also known as *activity* ratios.
★ Investment Ratios:	these help to assess the returns and share performance of a business from the shareholders point of view.
★ Financial Gearing Ratios:	these help to assess whether a business relies heavily on financing from its owners or from other sources such as through loans; this affects the level of risk associated with the business.

Different ratios will be useful to different groups of users, for instance, shareholders will be more interested in their returns and the risks of those returns, whereas trade creditors may be more interested in how well the business can cover and quickly repay its debts.

The persons undertaking a ratio analysis should consider exactly what information they want to obtain from the analysis and they can then choose suitable ratios to work with. Therefore, as different users may have slightly different aims or concerns, and different companies have different asset, liability and capital make-ups, it is quite acceptable and possible for certain ratios to be modified slightly to meet different needs; for example, those looking at the Return on Capital Employed ratio (a “profitability” ratio) may choose to use as one of the figures the net profit *before* tax, **or** they may choose to use net profit *after* tax.

Profitability Ratios:

✳ **The gross profit percentage ratio** is useful in determining the profitability of the business in its production and selling of goods, and so indicates what the net profit is likely to be - or should be - given the turnover (net sales) figure; what an equitable ratio should be depends to a very great extent on the nature of a business. However, it is computed on the following:-

$$\frac{\text{gross profit}}{\text{net sales}} \times 100 = \frac{\$39{,}650}{\$77{,}800} \times 100 = 50.96\%$$

The ratio helps to assess the operating performance of the business's main or core activities, that is, how well it is doing. The ratio percentage in the example shows that the business earns a gross profit of almost $51 for every $100 of net sales.

✳ **The net profit percentage ratio** should give a good indication of whether or not the expenditure incurred in running the business is reasonable in relation to the volume of business, and so is a measure of operational performance and efficiency in controlling costs. It is computed as follows:

$$\frac{\text{net profit (after tax)}}{\text{net sales}} \times 100 = \frac{\$10{,}184}{\$77{,}800} \times 100 = 13.09\%$$

The net profit percentage (or margin) ratio is one ratio where an alternative figure can be used; some analysts prefer to use the figure of net profit *before* tax. The net profit percentage ratio of a company may be compared - by managers, shareholders and potential investors - to that achieved by similar businesses or competitors, to assess its ability to produce a net profit from its turnover (net sales).

✳ **The return on capital employed percentage ratio** (often referred to as ROCE) gives a valuable indication as to the efficiency of the management of the business and the performance of the business. It measures input (capital employed - although some other base might be used such as long-term or fixed capital if appropriate) and output (profit). Generally the basis used is the market value of assets less the value of current liabilities (although other bases might be used in some cases). It is calculated as follows:

$$\frac{\text{net profit (after tax)}}{\text{value of assets - value of current liabilities}} \times 100$$

$$= \frac{\$10{,}184}{\$26{,}462 - \$6{,}278} \times 100 = \frac{\$10{,}184}{\$20{,}184} \times 100 = 50.46\%$$

To improve the return on capital employed (ROCE) the business and/or its managers generally need to either reduce production and/or selling costs; or increase selling prices; or increase turnover; or reduce the assets whilst maintaining its turnover level. ROCE is a ratio frequently used to compare businesses operating in the same or similar industry.

Liquidity Ratios:

✳ **The current ratio** is used to determine the strength of working capital and the degree of solvency of a business - and whether it is able to meet its debts as they fall due. It is based on the following:

$$\frac{\text{current assets}}{\text{current liabilities}} = \frac{\$21{,}664}{\$6{,}278} = 3.45 \text{ to } 1$$

✳ **The liquidity ratio** is used to measure the ability of a business to meet its current liabilities, and is often referred to as the "Acid Test Ratio". It is based on the following:

$$\frac{\text{liquid assets}}{\text{current liabilities}} = \frac{\$6{,}164}{\$6{,}278} = \text{approximately 1 to 1 (or 98\%)}$$

Both the current ratio and the liquidity ratio are important in helping to detect the potential problems of over-trading, previously discussed.

Efficiency Ratios:

✳ **The stock turnover ratio** was explained in Module 8, and shows the average period of time which all items are held in stock before being issued for sale or production; study again the relevant Section of the Module now. Only one of the two described methods of calculating the ratio is used here:

$$\frac{\text{net sales - gross profit}}{\text{average value of stock held}} = \frac{\$77{,}800 - \$39{,}650}{(\$13{,}250 + \$15{,}100) \div 2} = \frac{\$38{,}150}{\$14{,}175} = 2.7 \text{ times}$$

This ratio means that stock has been 'turned over' 2.7 times in the year to achieve its annual sales figure. Average stock holding period is therefore 365 (days) divided by 2.7 = 135 days. High stockholding periods may indicate slow moving or obsolete stock; low stock holding periods may indicate efficient stock control. In either case, the reasons for the figure needs to be investigated and compared to previous periods or other similar businesses. The shorter time that stock spends in the stores, the better for the business.

✳ **The average debtor payment period** looks at how quickly, on average, debtors pay the amounts they owe to a business; this affects cash flow and reflects on the credit policy of the business. It is calculated as:-

$$\frac{\text{trade debtors}}{\text{credit sale revenues}} \times 365 = \frac{\$2{,}685}{\$19{,}450} = 50.4 \text{ days}$$

(The above calculation assumes that 25% of total sales were credit sales). It should be noted that 50.4 days is an *average* figure, and all debtor figures should be reviewed in case there are one or two large customers who are particularly fast or slow to settle their debts, and also to help spot potential bad debts which may occur.

✳ **The average creditor payment period** looks at how quickly, on average, a business pays the amounts it owes to its creditors; this affects cash flow and possibly the goodwill of suppliers towards the business. It is calculated as:-

$$\frac{\text{trade creditors}}{\text{credit purchases}} \times 365 = \frac{\$6{,}131}{\$23{,}545} = 95 \text{ days}$$

(The above calculation assumes that 80% of total purchases were made on credit.) It should be noted that 95 days is an *average* figure, and there may be one or two large suppliers who, for whatever reasons, allow above-average credit terms.

Investment Ratios:

The following ratios relate to limited companies (and they are based on the information contained in Fig.5/7 of Module 5 of the Accounting & Finance Program), together with the following facts: -

1. A dividend payable is $0.15 per share ($60,000 ÷ 400,000 shares), that is 15%.
   and
2. The current "market" price of a $1 share is $2.

✳ **The dividend yield** is the actual dividend amount paid per share converted to its yield on the current market value, that is, it relates the annual dividend per share to its market value. The formula is:

$$\frac{\text{dividend per share}}{\text{market cost of a share}} \times 100 = \frac{\$0.15}{\$2.00} \times 100 = 7.5\%$$

This ratio is of particular interest to those who require an income from their shares (or the amount invested in the shares held). However, a high yield will make the shares more desirable, and so their market cost will rise as they are in demand, and vice versa, thereby making the yield fluctuate from period to period. The higher the yield ratio, the more return investors are receiving for their investment in the shares.

✳ **The earnings yield** is what a shareholder would have received if the **entire** profit after tax had been distributed to the shareholders. The *trend* in earnings per share helps to assess the potential future worth of a business's shares. The earnings yield (or earnings per share) is calculated as follows:

$$\frac{\text{profit (after tax)} \div \text{number of shares}}{\text{market value of a share}} \times 100$$

$$= \frac{\$64{,}316 \div 400{,}000}{\$2.00} \times 100 = \frac{\$0.16}{\$2.00} \times 100 = 8\%$$

✳ **The price-earnings ratio** relates the earning yield per share to the price of that share on the market. It is an important indication to management when considering a new issue of shares, and to potential investors, because it shows the earnings the market "expects" in relation to the current price per share. The formula is, in fact, the one for the earnings yield turned upside down:

$$\frac{\text{market value of a share}}{\text{profit (after tax)} \div \text{number of shares}} \times 100$$

$$= \frac{\$2.00}{\$64{,}316 \div 400{,}000} \times 100 = \frac{\$2.00}{\$0.16} \times 100 = \$0.12½ = 12.5\%$$

Financial Gearing Ratios:

✳ **The gearing ratio** helps assess risk by focusing on the commitments or requirements of a business to pay interest charges and to make capital repayments based upon its 'capital structure' - its 'debt to equity' ratio. The gearing ratio is calculated as:

$$\frac{\text{long-term debt}}{\text{shareholders funds + debt}} \times 100 = \frac{\$52{,}000}{\$556{,}638 + \$52{,}000} \times 100 = 8.5\%$$

The higher the gearing, that is, the higher the amount of borrowings and debt the business has, the more interest it has to pay from its earnings before it is able to make any payments to shareholders, thus making its shares a riskier investment for potential investors.

Special Matters to Examine in Final Accounts

You will by now appreciate that an in-depth examination of the accounts of a business can provide very valuable information about it, and will permit certain conclusions to be drawn from the "movements" in various figures when compared with the corresponding figures for the previous year, and indeed earlier years as well, which will allow a picture of any trends to emerge.

The value of comparative figures and percentages (which is demonstrated in Modules 4 and 5 of the Accounting & Finance Diploma Program) when considering their use in trading and profit & loss accounts; their value is increased further when used in conjunction with some or all of the accounting ratios described in this Module (and other ratios, as appropriate).

However, short-term movements in certain figures between one year and the next are sometimes capable of being misconstrued, and therefore, where possible, it is advisable to prepare an analysis, in **summarised** form, of the relevant figures from the final accounts covering three to five years. Particular attention should be paid to the following matters:-

❇ *Turnover*

Is it increasing, stable or declining? The reasons for any change(s) should be ascertained, together with any features which might affect the trend. Such information as whether the business has been producing and/or selling the same products during the period under review, or whether there has been a change in the range of products or in the volumes of sales of them, and what products it plans to produce and/or sell in the future, can be very useful.

❇ *Gross Profit*

How has the percentage changed during the years - favourably or unfavourably? The reasons for any changes should be ascertained in relation to changes in turnover and any changes in the products manufactured and/or sold during the years covered by the review.

❇ *Total Gross Profit*

Has it increased, remained stable or declined over the years? Again, the reasons should be ascertained, with reference to the turnover situation, discussed above. It should be remembered that:

★ a declining gross profit percentage will tend to reduce the net profit percentage ratio by an equal or similar amount, whilst
★ a declining gross profit total means that the effects of fixed overheads will become more severe.

The opposite is, of course, equally true and the significance of gross profit, explained in detail in Module 5 of the Accounting & Finance Diploma Program, should not be overlooked.

❇ *Selling and Distribution Costs*

Have they varied reasonably in proportion to changes in turnover? Because of fixed costs, such as the salary of the sales manager and sales offices costs, in general selling and distribution costs should rise slower than an increase in turnover, and fall more slowly than a decrease in turnover.

❇ *Net Profit*

Have the amounts been reasonable over the years in relation to (1) the values of turnover, and (2) the amounts of capital employed? If they have not, the reasons should be ascertained - there might well have been overspending in certain areas, which could be remedied by management.

Studying the Balance Sheet

Although the following matters have already been covered, this summary provides a valuable **'check list'** for the initial study of the balance sheet of a business:-

❇ ***Its Cash Position***: An insufficiency of liquid assets is frequently an indication that financial problems are being, or soon will be, encountered.

❇ ***Its Working Capital***: A shortage of working capital will mean that the business will have difficulty in meeting its debts when they fall due, necessitating the use of overdraft facilities or other financial assistance which are never inexpensive. Of course, as mentioned earlier in this Module, a drop in the amount of working capital might be due to the purchase of fixed assets, and so their comparative values should be looked at.

❇ ***Its Stock Value:*** An excessive value of stock might indicate poor stock control, or may be due to overtrading, both of which can have serious consequences. On the other hand, too low a stock value can be an indication that liquidity problems will result in lost or delayed production/ sales, customers and profits.

❇ ***Its Liabilities to its Creditors***: A large sum owing might indicate that because of a lack of liquid resources, the business has delayed paying its creditors when due, which could result in its creditworthiness being called into question; the loss of credit facilities could have catastrophic effects on its future.

A study of the final accounts of a business can also often give an accurate indication of the level of efficiency and effectiveness of its management, which is important whether those accounts are being studied by its own management or by outsiders.

Break-Even Analysis

The level of activity of a business is an essential factor to be considered when determining whether it is making a profit or a loss, and the size of that profit or loss. In discussing gross profit earlier, we pointed out that certain overheads of a business are "fixed" regardless of the level of activity of that business, for example rent of premises, whilst other overheads are "semi-fixed", such as repairs and renewals, and furthermore they also tend to be unaffected by the volume of turnover.

On the other hand, there are "variable" costs which are directly affected by, and are responsive to, the level of turnover, such as direct materials, direct labour costs, energy, etc. If, for example, a business has fixed and semi-fixed costs amounting to $150,000 but its total revenue is only $140,000, it is bound to make a loss no matter how much its variable costs are.

Obviously, then, a business must earn sufficient revenue to meet its fixed and/or semi-fixed costs **and** its variable costs before it can start to make a profit. It is therefore of major importance for the management of a business to know exactly *how much revenue* must be earned before a profit can be made:-

✦ If revenue is less than the total of fixed and/or semi-fixed costs, a loss will be made.

✦ If revenue is less than the total of fixed/semi-fixed costs plus the total of variable costs, a loss will still be incurred.

✦ But where revenue exceeds the total of all those costs, a profit will be made.

What management needs to know, therefore, is the point at which the business stops incurring a loss, and with the very next unit of revenue starts making a profit. The question is:

*"At what point is the business making neither a loss nor a profit, that is, what is its **'break-even'** point?"*

The relationship between turnover, costs and profit or loss at different levels of an enterprise's activities can be displayed diagrammatically, by drawing up what is called a **'break-even chart'**. From a well drawn up chart it is possible to see at a glance the approximate profits or losses which are likely to be made at specific levels of activity.

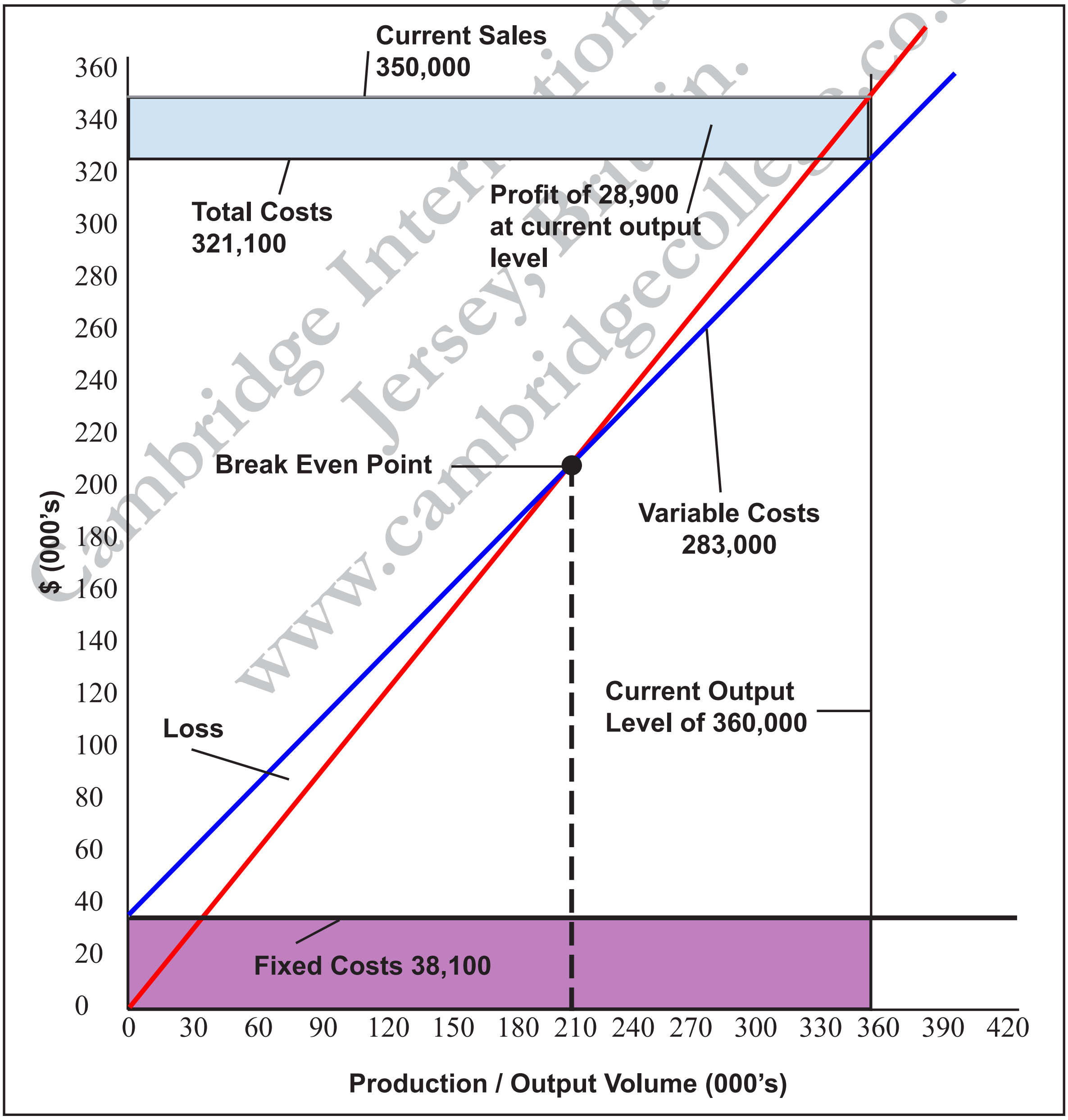
Fig.11/7 is drawn up from these figures:-

Fixed costs:	$		
Rent and rates	5,800		
Accounting fees	2,700		
HP interest charges	600		
Bank interest charges	1,000		
Insurance	1,500		
Leasing charges	1,500		
Office expenses	1,000		
Depreciation	6,000		
		$20,100	
Semi-fixed costs:	$		
Indirect labour	5,000		
Repairs and renewals	1,500		
Advertising	3,000		**total $38,100**
Telephone/Postage	1,500		
Sundries	1,500		
Pensions	4,000		
Travel & entertainment	1,500		
		$18,000	

Variable costs:	$	
Direct labour	60,000	
Direct materials	210,000	
Electricity	1,000	
Vehicle running costs	10,000	
Payments to subcontractors	2,000	
		$283,000
Volume of output activity:		360,000 units

The break-even chart (sometimes referred to as a **'break-even analysis chart'**) illustrated in Fig.11/5 shows the variable cost line starting at the point where the fixed/semi-fixed cost level has been established (see figures below). However, the sales income (revenue) line starts from zero. The point at which (a) the sales income line, and (b) the combined fixed/semi-fixed and variable cost line intersect, is the point at which the business can be said to be 'breaking even', that is, its total costs and its net income are equal - although at that point the business has **not** made any profit.

Fig.11/7. a break-even chart



At an output of 360,000 units, sales revenue is $350,000, whilst total costs are $321,100 giving a calculated net profit before tax of $28,900. The break-even chart indicates that the company can sustain a drop in volume of production/output of 42% (360,000 - 210,000, ÷ 360,000) before the break-even point is reached; that is its operational 'safety margin'.

The effects of changes on profits can easily be shown by including fresh lines on the chart indicating the changes, or intended changes, in the circumstances of the business. Such changes, which can bring about changes in profit, can include any one or more of:-

✶ An increase or decrease in the selling price of a product unit.
✶ An increase or decrease in fixed or semi-fixed costs.
✶ An increase or decrease in variable costs per unit.
✶ An increase or decrease in the volume of production and/or sales.

The limitation of manually produced break-even charts is that they are usually only able to show the effects of a change in only one of the four factors. However, there is very often a "knock on" effect; for example, an increase in unit price might well result in a drop in the number of units sold. The combined effects of changes in the various factors should therefore be considered, instead of considering just one change in isolation. The use of computerised accounting systems to produce break-even charts can overcome the manual method's limitations.

PRICING POLICY

As we have already made very clear to you, in the long-term (and often in the short-term, too) the revenue of a business **must** exceed the total of its various costs if it is to survive. Short-term losses, especially when a new business is established, might be accepted and "absorbed", but such a situation must be contained and remedied as soon as possible if the business is to stay "in business" (here we exclude state or semi-state owned businesses, which are frequently never - in some cases due to deliberate government policies - profitably run.)

The prices at which an enterprise's products are sold obviously have a vital bearing on its potential and actual profitability. That being the case, one would expect that there would be a definite set of rules laid down by a business for the fixing of the prices at which its products will be sold; and that the same or similar rules would be applied to price setting by all businesses. However, that is very definitely **not** the case.

There are many factors which might affect the prices at which consumer goods are sold - or are offered for sale - apart from the obvious need for manufacturers and distributors to obtain reasonable "returns" on their capital expenditure and business activities and investments.

Even that basic requirement is subject to the various circumstances and *"market conditions"* prevailing from time to time, and prices might be raised or reduced in different areas for a variety of reasons. For instance, a branch of a supermarket in one town might sell a product at cost, or even at a loss (as a loss-leader), whilst another branch of the same supermarket chain in a nearby town might sell the same size and the same brand of product above the normal selling price.

Some of the factors which determine the selling price of an article or a service at any particular time are:-

✶ The costs involved in its manufacture, and in its distribution to consumers.
✶ The nature of the product and the demand for it.
✶ The cost of storing or safeguarding the product.
✶ The prices charged by competitors selling similar products.
✶ The need for immediate profit or for profit in the future.
✶ Government intervention, buying and price restrictions.
✶ The psychological attitude of buyers.
✶ Other general or specific or strategic issues.

We shall now consider these factors in turn.

Manufacturers' Costs

These costs are made up of most or all of these:

- Planning the making, producing the product, including the cost of research and development - often abbreviated to "R & D" - design, machinery, etc.
- The cost of raw materials and components.
- The cost of direct labour to convert the raw materials into the finished article.
- Overhead expenses, such as depreciation, power, rent, heating, lighting, office costs, insurance, etc.
- Administration expenses such as interest on capital, legal fees, fees or salaries of accountants, executives and directors.
- Marketing expenses: advertising and sales publicity of all kinds, research, selling expenses, salesmens' remuneration, etc.
- Service expenses: transport and delivery of goods to the customer, after-sales service and repairs during a guarantee period, etc.
- Discounts, such as trade discounts to wholesalers and retailers, quantity discounts for large orders, seasonal discounts on orders during slack seasons to keep men and machines working, and discounts to secure immediate or early payment.

The Product and the Demand for It

The nature of the product and whether it is considered a necessity or a luxury to different classes of buyers has an important bearing. In a poor or low-income district a product might be considered a luxury, whereas in an affluent market the same product could be regarded as a necessity. In the low-income district only products considered to be necessities will maintain high prices, and demand for luxury goods could be low even if they were offered for sale at low prices. On the other hand, luxury goods in an affluent market could maintain high prices and demand, and if they were offered at low prices, consumers might suspect their quality to be inferior and refuse to buy them.

Clearly in many countries whose citizens have varying degrees of wealth, some of them might consider a particular item a necessity whilst others might consider it a luxury. However, there are cases in which the same product could be either a luxury or a necessity to the same buyer. Take a businessman; to him a computer in his office is a necessity - but if he buys a PC for his own, or his family's, home "personal" use, it is a luxury. Similarly, to a professional photographer a camera is a necessity because he cannot earn his livelihood without it; but if he buys another camera for nonbusiness use it is not a necessity.

Many products are considered to be necessities; some form the "staple diets" in various countries, such as bread, rice, yams, potatoes, milk, eggs, salt, etc. These are always in demand, although increases in prices might reduce demand slightly. On the other hand, demand for luxury products depends on what people can afford to pay.

If the nature of an item is such that it can be mass produced, increased demand will lead to a decrease in price, and vice versa; electronic calculators, digital watches, portable radios, mobile telephones, etc, are good examples. On the other hand, an increase in demand for an item such as a Rolls Royce motor car might lead its manufacturers to increase its price; conversely, a drop in demand might force a reduction in price. There are, however, other products (oil based products such as petrol/gasoline), for which a drop in demand has led to higher prices.

Costs of Storing and Safeguarding Products and Cash

Storage costs, as we explain in Module 8 of the Accounting & Finance Program) have a definite bearing on selling costs. The expense of building or renting suitable storage premises can be high, and the cost of equipping and maintaining such buildings can also be great.

A manufacturing business needs a large warehouse to store stocks of finished products awaiting sale and despatch. Its customers might be wholesalers who will also need storage facilities - possibly large warehouses or godowns - and when they resell to their retailers, they too must have adequate stock rooms or suitable containers in which to store the products which they buy.

Some products might need dry, well ventilated storerooms; other products might need to be kept above freezing point (paints, liquids, etc), whilst other products are required to be stored at subzero temperatures. The costs incurred in heating or in refrigeration can be considerable. Frozen foods, for example, must remain at a constant low temperature from the time that they are prepared and packaged, until they are handed at the final points of sale from refrigerated display cabinets by retailers to their customers. From producer to wholesaler to retailer, frozen foods are transported in specially refrigerated containers, so that the consumer receives the products in the same condition as when they left the producer.

All products must be safeguarded, as far as is reasonably possible, against loss from fire, flood, pilfering and theft, but the safeguarding of some valuable products, like furs, jewellery, etc, and of cash (including bullion) can be very costly. Organised raids by criminals have resulted in heavy losses of valuables and cash. That has led to higher insurance rates or "premiums", and to the employment of companies which specialise in transporting cash and valuables in comparative safety. The costs of such services must be included in the prices of the valuables, or added to the costs of the facilities provided, as indeed must the costs of the protection required by any other product whilst in storage awaiting sale, or in transit.

Competition and Competitors' Products

Manufacturers seldom market only one product. They usually produce a "range" of products of various qualities and sell them at various prices according to size or quality. As there might be many manufacturers producing similar products, there could be a large number of sizes, qualities, and prices for consumers to choose from.

✳ *Advertising and differentiation*

Advertising and publicity material would extol the merits and benefits of each, and appeal in various ways to the consumers' motives for buying. The aim would be to 'differentiate' the product - to make it stand out as different and special - and stress its 'unique' features. To give a simple illustration, an advertiser might claim:

"Brand 'A' Washing Powder softens and freshens."

Another advertiser is unlikely to contest that claim but might claim an alternative benefit:

"Brand 'B' removes stains that other washing powders leave behind".

Each brand will attract buyers for different reasons.

✳ *Brands*

Some manufacturers might market their products under different brand names, (that is, some under one name and others under a different name) and might "test market" their latest product in direct competition with their **own** existing brands, as well as with competitors' products. Although all the products might be very similar in quality and size, the brand name or the packaging might establish one of them as the "brand leader" and enable it to be sold at a higher price than any of the competitive products.

✳ *Alternative and Substitute Products*

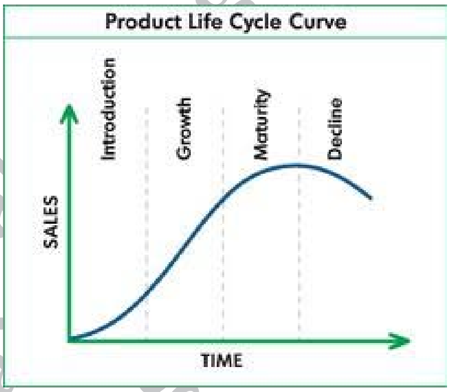
Prices can be affected by the availability of substitutes. Food products are subject to sudden fluctuations in price; for example, if a housewife who intended to buy turkey found that the price had doubled due to a temporary shortage of supply, but that other meat products were cheaper, she could buy a substitute and choose lamb or chicken. If the shortage of turkey continued, it could cause the prices of lamb and chicken to rise as demand for them increased.

The Need for Immediate or Long-Term Profit

There are many reasons why businesses might need to generate immediate short-term profits; these might include the need to finance current or on-going projects, or to counter liquidity problems, and so on; in such circumstances prices might be reduced for a limited period to give sales a boost or to sell off excess stocks.

Often, too, managers might concentrate unwisely only on achieving short-term gains, in an attempt to justify their positions and salaries, or to earn bonuses, BUT the focus should be on long-term gains; there is no benefit to the employees, investors, owners, managers or other stakeholders if after just one or two years of success the business collapses. Therefore, the focus must be on long-term, continued and sustainable success.

The Product Life-cycle



It is true to say that as standards of living rise, people become accustomed to looking for improved products and technological advances that not only look good but will provide greater utility of use. For example, the invention of the “micro chip” has enabled the modern washing machine to be programmed to perform a whole series of operations, resulting in clothes being washed, rinsed and dried without the housewife having to be in attendance. In spite of this, owners of these and other modern sophisticated appliances could be looking at even better products within five years, with a view to replacing their existing machines with appliances having the latest refinements and providing even greater utility.

This growing affluence has led businesses to manufacture “durables” with a shorter life, using lightweight materials such as plastics instead of heavier steel sheets to provide outer cases; and interior frames of steel strips which support electric motors, and hold together such appliances as freezers, washing machines and refrigerators. New plastics are strong, colourful, heat resistant, and smooth, and they can be moulded with precision into whatever shapes are required. In addition to being lighter in weight than steel casings, plastics do not require to be enamelled, nor will they rust as older appliances did when enamelled surfaces were chipped. The shortened life of such durables might appear to be very good for trade, but there are certain disadvantages too.

In earlier days, a business manufacturing a cooker would expect its product to go on selling for up to fifteen years. The costs incurred in designing, tooling up, manufacturing and promoting sales of the product would have been recovered from sales over a period of up to five years. From thereon a steady volume of sales would have been anticipated to provide sufficient profits, to satisfy shareholders of the company, and to enable a development fund to be built up over the years to finance the designing and production of another, new model. When that became necessary, some years in the future, with this policy the price of the product could remain fairly constant over a long period of time, and at a lower level than it would have been if immediate profit, rather than long-term gain, had been the objective.

With modern versions of similar products, manufacturers are faced with the prospects of continuous research to keep abreast of developments in every sphere and aspect of their products, and of financing the production of a new model more often than before, perhaps every two or five years. The **life-cycle** of the products, from entry to the market as new or modified or improved products, a period of high sales, through to the time of their obsolescence or replacement, has greatly shortened. That affects sales forecasting and determines sales objectives that will enable a level of profits which will not only give shareholders of a company a reasonable return on their investment, but also provide sufficient money to be retained in the company’s development fund to finance the next new project, a few years hence.

Generally, sales of the older durable products rose steadily for three or four years, levelled out, and gradually declined for six years or more. Sales of modern types of durables behave more like sales of fashion goods - for the first three two or years rising rapidly to a maximum peak. Unlike fashion goods, modern durables could remain popular on the market for two or three more years before sales decline but then like sales of fashion goods, the durable products could have to be sold off in clearance sales to make room for the new products that would take their places.

Government Intervention

The government of a country might wish to control the amount of hire purchase available at time, since credit might increase demand and contribute to inflation. In order to do that it might increase the minimum amount of deposit which has to be paid, increase the interest rate, or shorten the period of repayment. Any, or all, of those measures should discourage consumers from entering into hire purchase agreements, thus reducing demand and controlling output in the "home" market.

Prices rise and the curtailment of sales can also be caused by government action in such matters as:-

- Increases in taxation or in customs duties;
- The tightening of import controls, and/or the imposition of exchange controls.
- Changes in the rates of exchange between its own currency and those of major "trading parties".

The foregoing factors are some of the "unforeseen hazards" (to which we refer in Module 7 of the Accounting & Finance Program) which can upset the forecasts of management and necessitate modifications in their aims or plans. There is another course of action which governments can take which can pose even greater problems for businesses. Prices of some foodstuffs and other goods might be "fixed" or "pegged" at short notice at levels which permit little or no profit to be made by manufacturers, wholesalers or retailers, and reduce prices to consumers. Such government action is usually taken on social grounds in times of high unemployment, or in times of scarcity of supplies of basic commodities, such as bread, sugar, milk, etc.

Increasingly too, governments are taking actions to protect the "rights" of consumers by investigating price-fixing cartels or monopolies in order to avoid prices being unfairly "fixed" at high levels by the suppliers, and to encourage competition, which normally drives selling prices down.

The Psychological Attitude of Buyers

When customers fear that there will be a shortage of a product in the future, and no substitute product is available, they might be inclined to buy more of that product (and "hoard" it) than they actually need and to pay more because of its scarcity value. For example, in times of petrol/gasoline or diesel shortages - or expected price increases - drivers may flock to the petrol/gasoline/diesel filling stations to fill up their vehicles.

It often happens that certain products, such as clothes, footwear, fancy goods, etc, are sold at high prices, and at prices which yield high profit margins, because consumers believe that the quality of the products supplied equate to their cost. If such products were offered at lower prices they might be sold in a poorer market, but could lose the more lucrative wealthy market of fashion-conscious consumers. If the buying motives of consumers are ignored, sales will fall. If buyers "expect" to pay a certain price for a product, manufacturers should try to comply, and if they are able to supply a large market and make large profits by so doing, then that is good business.

High profits can cushion the effects of inflation. As manufacturing costs such as raw materials increase, prices might be held down for a time, and then be increased only gradually as consumers become accustomed to the general rise in incomes and the higher costs of necessities. Consumers will raise many objections to paying a little more for basic items of foodstuffs. The same customers, however, when going out to dine, might buy a high-priced meal in a restaurant, pay a 10% service charge, tip the waiter, and return home well satisfied with a pleasant night out!

Similar satisfaction might be obtained by customers buying consumer goods from a certain prestigious store, or buying certain expensive brands of goods. The store has a certain "image"; it has created an impression in the minds of the public and it has implanted appreciation for the products and services supplied. Certain brands of goods command loyalty from buyers for various reasons. The "brand image" might be created by any one or more of many reasons, and might appeal due to a combination of reasons and buying motives.

Ultimately a reasonable standard of quality, a price that sufficient buyers can afford to pay, and good regular advertising might establish a good reputation and a brand image that will reflect reliability and give confidence to buyers, as well as producing the required profitability for the vendor.

Strategic Pricing

Actual selling prices might be amended to take account of any one or more of the factors listed above, as well as for 'strategic' reasons. For instance, some suppliers/producers might offer their products at a slightly lower cost than others, in order to guarantee a good number of sales, or to increase market share. Other suppliers/producers might charge higher than average costs in order to be seen, or try to be seen, as offering an exclusive or rarer product.

Note: To delve more deeply into the factors which influence the selling prices of products would carry us into the realm of Economics, a subject which is beyond the scope of this Program. However, the study of the College's *"Business Economics & Commerce"* Program is highly recommended; please ask the College for information about (and the Fee for) that Program, or visit website **www.cambridgecollege.co.uk**

AUDITORS AND AUDITING

Some accounting personnel, and their managers, consider that auditors are a "necessary evil" and, at the very least, are "nosey" and intrusive. These are very unfair descriptions of people who have an important - and perhaps often undervalued job - to perform. An audit can also help to remind directors of what their duties and responsibilities are!

In general, auditors are qualified and professional accountants, whose training and experience can be valuable in many areas to organizations of all sizes. In many countries, the accounts produced by businesses - and especially by limited companies - must by law or statute be subjected to annual **'audit'** by "external" and independent firms of auditors. The purpose of an audit by external auditors is not only to confirm the accuracy of the accounts - and in particular the final accounts and balance sheet - produced by a business, but also to confirm that any statements or explanations contained in those accounts are substantially correct.

For example, a company's appointed auditors will be required to verify the physical existence and values of its assets (such as stocks of materials or goods) as stated in the balance sheet. Independent audit staff might be involved in stocktaking, and in valuing stocks. External auditors will also be required to check and verify the accuracy of the values of liabilities to the various creditors of an business, as claimed in its balance sheet. The inland revenue (tax) authorities of many countries will not accept the profit (or loss) disclosed by a business, unless its auditors "report" that both its profit & loss account and its balance sheet reflect a *"true and fair view"* of the information they are legally required to convey.

Most businesses will therefore use the services of "external" auditors, although not all its managers will necessarily have contact with staff of the audit firm; such contact might be limited only to those who duties involve accounts or stocks. There are also some businesses - usually larger ones - which also employ "internal" auditors; they will be members of staff, and might have contact with managers in any or all departments, as needed. We shall consider external and internal auditing separately.

External Audits

Generally the firm of "external" auditors whose services will be used by a company are "appointed" by the **shareholders** of that company, and **not** by its directors (although in small companies the directors might also be its shareholders, of course). The "duties" of the auditors are therefore performed on behalf of the shareholders, who are **remote** from the normal day to day operations of the business. The shareholders delegate control of the business to the directors, who then usually have total discretion over business strategy, investment and financing decisions.

In everyday life the need for an **'audit'** arises because a person (or a group of people) is doubtful or uncertain as to the quality, condition or status of some subject matter, and is personally unable to dispel the doubt or uncertainty. Therefore, another person (or group of people) is called upon or "commissioned" to examine the subject matter and to **'report'** to the originator on the quality, condition or status of the subject matter. For example, a person considering buying a second-hand, or "used", motor vehicle might request that it first be checked, inspected and examined by an automobile organization, which will provide a report on its condition, roadworthiness, value, and so on.

You can see that a shareholder in a company can be in a very similar situation. He or she will need to be assured of the accuracy and quality of the information in the financial statements provided about the company in which he or she has invested money, and from which "returns" are expected. There is no way that an individual shareholder in any company except a very small one - and not even always then - will have the opportunity to verify the contents of financial statements. The commissioning of an **'audit'** - by the shareholders collectively - would appear to be a solution to the dilemma.

What an Audit is - and What it is Not

A commonly accepted (but by no means the only) definition of an audit in regard to a business organization is:

"The independent examination of, and the expression of an opinion and the submission of a report on, certain financial statements covering transactions over a period of time and the financial position of an organization on a certain date by an appointed auditor in pursuance of that appointment and in compliance with any statutory obligations".

Points to note from the definition are that:-

- An auditor must be "independent" (of the management of the "client" business, and in the case of a company, of its directors).

- An auditor needs to collect "evidence" to support any opinion expressed.

- An auditor must produce an "objective report".

The responsibility for the preparation (by internal staff or by independent accountants) of the financial statements and for their content, accuracy, completeness and their presentation rests with the management of a business (and in the case of a company, with its directors) - and **not** with auditors. An auditor's responsibility is to **report** on the financial statements "presented" by management. To put it simply, there is first an examination, which is followed by a report. So the purpose of an audit is **not** to provide additional information; it is intended to enable users to rely more confidently on the information which has already been prepared by others.

It is often - wrongly - thought that the object of an audit is to detect and disclose irregularities or fraud. But that is **not** the case. The responsibility for the detection of irregularities and fraud rests with the management of a business (and in the case of a company, with its directors). Management must institute adequate systems of internal control.

An auditor's duties do **not** generally require that he or she specifically searches for fraud, unless the specific terms of engagement (or law) require that to be done. However, an auditor to should be able to recognise the signs of possible material irregularities or fraud which could - unless disclosed - distort the results or state of affairs shown by an organization's financial statements. The regular conducting of audits can in themselves often discourage irregularities or attempted fraud.

The objective of an audit of financial statements - prepared within a framework of recognised accounting principles, policies and concepts (taught in Module 4 of the Accounting & Finance Program) - is to enable the auditor to express an opinion on those financial statements; whether they are accurate and give a "true and fair" view of the state of the business. Whilst the auditor's opinion helps establish their credibility, a user should not assume that the opinion expressed is an assurance of the future viability of the organization. Nor does the auditor's opinion reflect the efficiency or effectiveness (or otherwise) of its management in conducting the affairs of the organization.

Comparison of Audit and Accountancy Work

In many cases, the final accounts and balance sheet are prepared by employees of an organization, and then submitted to the audit firm for examination. However, there are also many cases in which audit firms (which are run by one or more professional accountants, who might be "partners") prepare the final accounts and balance sheets - usually by computer - on behalf of their clients, based on the accounting information provided by those clients.

A clear distinction must therefore be made between the work performed in an accounting capacity, and that performed on actual auditing. Primarily an auditor's task is to audit the "completed" work, and although in preparing the accounts and balance sheet an auditor might carry out certain auditing work, such "preparatory work" is only carried out in his or her capacity as an accountant.

Frequently in the course of work, an auditor becomes aware of weaknesses and inefficiency in the working of an accounting system, and might bring such matters to the notice of the client organization. The auditor is again acting in the capacity as an accountant because, as we have explained, it is not the duty of an auditor to advocate any specific methods of working. Nevertheless, because of the skill and experience possessed, an auditor can be most helpful to those by whom he or she is engaged; but any accountancy work performed must always be considered apart from the work on the audit itself.

What an Audit Might Involve

Just as there is no one "typical" business or one "standard" accounting system, there can be no one "standard" audit. Much will depend on the type and size of an organization, its range of activities, its location(s), the accounting systems employed, and many other possible factors. In general, an audit must be "tailored" to the organization to be audited, and the most suitable audit pattern or system might be developed over a number of years. Then, too, although consistency might be preferable, different auditing firms might be appointed for the same organization at different times and, of course, staff of auditing firms also change.

In some cases just one employee of an audit firm might be involved; in other cases a "team" of auditors (of different levels of proficiency and experience, e.g. partners and juniors) might be used. In some cases the audit is undertaken on the premises of a client, whilst in other instances the relevant documents, books, etc, might be examined on the premises of the audit firm - there might also be combinations of the two situations.

In many cases, an audit will start from the "beginning", by checking statistically chosen samples of transactions (perhaps at random) from "source documents", through the "books", postings or input to the ledger accounts, trial balance preparation, and so on, through to the final accounts and balance sheet.

However, what is called the **'balance sheet audit'** has increased in popularity. Unlike the work entailed in the more "traditional" type of audit, it is necessary in this case to commence from the balance sheet, and to work "backwards", as it were, to the prime "book" entries and their source documentary evidence. It is essential however, that there is a reliable system of internal checks and control in operation; assuming that to be the case, the following broad scheme of operation might be suitable for the audit of a particular organization:-

* The auditor will first examine the "minutes" of directors and shareholders meetings of the organization, and make notes of any matters of importance affecting the final accounts and balance sheet items (e.g. reserves and provisions made, major changes in shareholding).

* The auditor will analytically review and compare the revenue account for the year of audit with that of the previous year, and attempt to ascertain the reasons for any material differences found.

* The auditor will compare any increase or decrease of variable expenses in conjunction with the variation in turnover. Unit quantities are important with regard to turnover, and adjustment and allowance will need to be made for price or other variations.

* The auditor will carefully investigate any changes in gross profit rates; and in conjunction with that, will examine stock values. The separation of various sales lines for investigation purposes will need to be made.

* The auditor will examine any items of a non-recurring nature, such as losses, or profits incurred on fixed assets. Depreciation charges will be carefully checked in conjunction with the assets concerned. The effect of these and variations in expenses mentioned above should render any change in net profit readily explainable.

* The auditor will consider and, if necessary, ask for explanations of the effect of the profit or loss for the period in changes to the balance sheet. Schedules, such as sources and applications of funds statements, may be usefully applied.

* The auditor will examine any variation in fixed asset holdings, by means of schedules showing movements since the last balance sheet date.

* The auditor will examine the variation in current assets as compared with the previous year. Accounting ratios may be most useful, together with credit control schedules.

* The auditor will scrutinise the lists of prepayments and accruals, and investigate any material alterations.

* The auditor will examine all remaining balance sheet items, such as share capital, taxation, etc, to ascertain that these are in order in line with prevailing audit requirements, e.g. taxation being fully provided for on current profits.

* The auditor will verify the values of all assets owned and liabilities owed.

* The auditor will ascertain whether any capital commitments exist, and that any items on which subsequent losses might arise have been provided for.

Note: We consider the audit of businesses with computerised accounting systems in Module 12.

Internal Auditors

Unlike external auditors - whose principal duties are to the shareholders of the client organization - internal auditors act in support of management. Internal auditors are employees of the organization, and might even be members of its management team. Internal audit is, to some extent, an extension of the system of internal controls, which might mean that the work done by internal auditors will be of some relevance to the external auditors.

A generally accepted definition of internal auditing is:

"An independent appraisal function established within an organization to examine a and evaluate its activities as a service to the organization, its objective being to assist members of the organization in the effective discharge of their responsibilities".

This definition is broad enough to encompass the many activities which are undertaken under the general heading of internal audit in both the private and the public sectors. There are, however, three distinguishing features of the internal audit function:-

* It involves the appraisal of activities.

* It is independent of the activities which are under investigation.

* It is intended to be a constructive service.

The internal audit function has, historically, been associated with the review of accounting information within the organization. Internal auditors are, however, becoming increasingly involved in the investigation of the overall efficiency of the organizations by which they are employed.

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Please enrol me for the CIC International Diploma Program which I have ticked:

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❑ Commercial Practice & Law
❑ Professional Management & Administration
❑ Human Resource Management
❑ Leadership & Team Management
❑ Health & Safety in the Workplace
❑ Sales Management & Marketing
❑ Logistics, Materials & Supply Chain Management
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PAYMENT DETAILS:

I enclose herewith the sum of: ______________ **being the FULL payment** for the Program(s) ticked.

Payment is in the form of (see page 184)**:**

❑ **Bank Transfer** (attach bank receipt); ❑ **Bank Draft/IMO;** ❑ **British Postal Orders;** ❑ **Credit Card**
❑ **Western Union 10-digit MTCN:** ______________________________ (attach Western Union receipt);
❑ **Currency Notes;** ❑ **PayPal;** ❑ **Other:** ______________________ (state details and attach receipt)

My details are (please write **clearly** in **capital letters -** with your surname or family name **last**):-

FULL NAME: Mr/Mrs/Miss/Ms ____
(write or type your full name **exactly** as you wish it to appear on your Diploma(s))

FULL ADDRESS: ____
(write or type the **full** and **exact** address to which we should send your Study & Training Materials)

Email address: ____

Telephone (include code): ____

Have you studied the subject(s) before? If so, give details: ______________________________

Practical experience of the subject(s), if any: ______________________________

Present employment / work experience: ______________________________

Qualifications held (certificates, diplomas, degrees - awarded on examination success - attach copies/transcripts if available): ______________________________

Special needs, if any: ______________________ Nationality: ______________ Age: ______

I agree to CIC's Terms and Conditions of Enrolment/Registration for Study & Training.

Signed: ______________________________________ Date: ______________

TERMS AND CONDITIONS OF ENROLMENT/REGISTRATION
for CIC International Diploma Programs

With Cambridge International College you can study in your country of residence; you do not need to come to the College premises in Britain. You may enrol on ANY DAY or DATE of the year.

By submitting an Enrolment/Registration Form you accept the following Terms & Conditions of Enrolment/Registration and agree to abide by all of the Rules and Regulations of Cambridge International College of Jersey, Britain.

1. On receipt of your completed Enrolment/Registration Form and Fee payment at the College Headquarters in Britain, you will be enrolled/registered as a Member of the College. If you give an email address, Module One for the Program(s) you have enrolled for can be emailed to you so you may commence Study & Training at once. You will be quickly sent by registered airmail post (or sometimes by courier) CIC Study & Training Materials with full Study & Training Instructions & Guidance and advice on how to learn and progress rapidly, with which you should comply, and which may contain Self-Assessment Tests, Recommended Answers, Practice Tests or Past Papers.

2. Your Study & Training Period (your 'Membership Period') commences on your enrolment/registration date. The Study & Training Period is 12 months for any one Diploma Program enrolled for (or 15 months for two Diploma Programs, or 18 months for three Diploma Programs enrolled for and studied together) - provided you have completed payment of the agreed Fee.

   However, with study by flexible distance-learning you can complete your Study & Training in a shorter period of time; alternatively - you may study and completed your Diploma Program(s) at the speed and pace which suits you; alternatively, arrangements with the College can be made to extend your Study & Training Period if required.

3. During your Study & Training Period you may receive a Mid-Training Progress Test and/or End-of-Training Progress Test, and/or a Past Paper, for your Diploma Program(s). You will have the option of submitting your Test Work/Answers for marking and assessment by qualified CIC Tutors at the College Headquarters in Britain, and receiving guidance, assistance and instruction from the Tutors on your Answers. If you choose to submit your Answers, there is an additional 'Tutorial Charge'; submitting Test answers is totally optional and is not a requirement of any course.

4. At the appropriate stage of your Study & Training, and when you are ready, you will be entitled to sit the appropriate Final Examination(s) under Approved Invigilation/Supervision in your own area. 'Approved Invigilation/Supervision' means you will sit your Final Examination(s) under 'true examination conditions' supervised by an 'Invigilator' ('Supervisor' or 'Proctor') appointed by the College - in your local area, wherever you are resident at the time you are ready to sit your Examination(s). Arrangements for you to sit your Final Examination(s) under Approved Invigilation/Supervision in your local area can only be made: (i) after you have been Enrolled/Registered as a Member of the College; and (ii) when you have studied sufficiently and made progress in your Study & Training (in accordance with the advice in the Study & Training Guide provided to you on enrolment.) Examination arrangements cannot be made before your enrolment. Full and clear details on sitting Examinations are provided with your Study & Training Materials and Study Guide.

5. On passing the set Examination(s), and as long as all fees are settled, you will be awarded and sent the appropriate CIC International Diploma(s) for the Study & Training successfully completed.

6. As soon as you are Enrolled/Registered with CIC you will be permitted to visit the College's special Member Services Website to see your personal Membership Details, Study Material Despatch Details, Examination Results, CIC Newsletters, Literature, FREE Study Modules, Study & Training Information, and more.

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Principal Dr Stephen Lawson and Vice Principal David Lawson lead the highly-experienced and professional College staff which is dedicated to ensuring YOUR study success and career advancement. Should you need any advice in choosing the right study and training for you, please contact our experienced Study, Training and Education Consultants.

ENROLLING AS A MEMBER FOR CIC STUDY & TRAINING

THE PROCESS IS SIMPLE AND STRAIGHTFORWARD - ALL THE COLLEGE REQUIRES IS YOUR ENROLMENT FORM (OR ENROLMENT DETAILS) AND A FEE PAYMENT

Complete the Enrolment/Registration Form fully and in CAPITAL LETTERS and then:

- **EITHER** send it by registered airmail post or courier, WITH your Fee payment or payment details to: **Cambridge International College, Attique House, St Brelade, Jersey JE3 8FP, Britain**
- **OR** scan and email the Enrolment Form WITH your payment details to: **learn@cambridgetraining.com**
- **OR** fax the Enrolment Form WITH your payment details to: + 44 1534 485485

YOU MAY SEND YOUR FEE PAYMENT TO CIC BY ANY OF THESE METHODS:

BY BANK TRANSFER: You can send your payment directly to one of our 'receive only' Bank Accounts:

Account Name: Services to Management (for Cambridge International College)

Bank Details: HSBC Bank plc, Jersey St Helier Branch, Britain

For transfers in British Pounds (GB£) send to:
Account Number: 32144670, Sort Code: 402534
Swift/BIC: MIDLGB22, IBAN: GB35 MIDL 4025 3432 1446 70

For transfers in US Dollars (US$) send to:
Account Number: 68294583, Sort Code: 400515
Swift/BIC: MIDLGB22, IBAN: GB59 MIDL 4005 1568 2945 83

For transfers in Euros (€) send to:
Account Number: 68343364, Sort Code: 400515
Swift/BIC: MIDLGB22, IBAN: GB38 MIDL 4005 1568 3433 64

BY ON-LINE BANKING: If you have a bank account which offers "on-line banking", you can make a transfer to one of the College's bank accounts - the details are stated above in the "By Bank Transfer" section.

For either Bank Transfer or On-line banking, post or email your Enrolment Form to the College in Britain with the bank receipt. Ensure you pay all charges and add £20 or US$40 or €30 to cover intermediary bank transfer charges; CIC can only credit you with the amount CIC actually receives.

BY WESTERN UNION: You can give your local Western Union Agent money in British Pounds (£), US Dollars (US$), Euros (€), or your local currency to transfer to CIC. CIC will receive your payment in British Pounds, US Dollars or Euros. You can transfer your payment through Western Union:-

by **'Quick Pay'** service (the best and quickest method to use to:
Account Name: **Services to Management**
Code City: **SMCOLLEGE,UK** Account No: **AUK040697**

or by **'Will Call'** service: to use this service you MUST first contact CIC for transfer and receiver details.

(Note, you should only try to use the "Will Call" service if the "Quick Pay" service is not available)

or by **'Global Pay for Students'** service:
Western Union will process your fee payment and send it quickly to CIC. See the CIC website 'How to Pay Fees' page or contact CIC by email for information.

Whichever Western Union method is used, send your Enrolment Form with the Western Union receipt to CIC in Jersey, Britain, stating clearly the 10-digit Money Transfer Control Number and the name of the "sender".

BY BANK DRAFT OR INTERNATIONAL MONEY ORDER: These must be payable to '**Cambridge International College**' and must be in **British Pounds** or **US Dollars**. A draft/IMO in British Pounds must be drawn on a bank in London (England); a draft/IMO in US Dollars must be drawn on a bank in New York (USA). US$ drafts/IMOs must be for at least US$200.

BY DAHABSHIIL MONEY TRANSFER: You can pay your Dahabshiil Agent in British Pounds, US Dollars, Euros or your local currency. Your Dahabshiil money transfer should be sent with these details:

Beneficiary: **David Simon Lawson** Destination: **Britain**
Contact details/telephone: 01534 485485

Scan and email, post or fax your Enrolment Form WITH the Dahabshiil receipt to the College in Britain, stating clearly the Money Transfer Control Number and the "sender name" exactly as it is stated on the receipt.

CURRENCY NOTES: You may send British Pounds (GB£), United States Dollars (US$), or Euros (€).

BY PAYPAL: You can pay your Fee via PayPal on the College website; click the "Add to Basket" button on the webpage of the chosen course(s) and follow the instructions.

PayPal also allows you to send your fee using your debit or credit card, bank payment or PayPal account to: **registrar@cambridgetraining.com**

BY CREDIT/DEBIT CARD: All payments will be in British Pounds. The best, fastest and safest way to pay using your credit or debit card is through the CIC website: you will need to click on the "Add to Basket" button on the page of the course(s) to be enrolled for, then follow the instructions.

Alternatively you can send to CIC a signed letter which states your credit/debit card number and expiry date, your name, postal and email address, and the amount to be paid, WITH a copy of the front and back of the card (the card MUST be signed on the signature strip) and it must be your own personal card.

MONEYGRAM: You may only send a fee by MoneyGram AFTER CIC has given you authorisation AND has confirmed the name of the person (the receiver) to whom the payment should be sent.

BRITISH POSTAL ORDERS: These may be purchased from British Post Offices. They must be made payable to 'Cambridge International College'. Only British Postal Orders can be accepted.

RELATIVES/FRIENDS/SPONSORS/EMPLOYERS:
Whether overseas or in your country, you may also arrange for your relatives, friends, sponsors or employers to send your completed Enrolment/Registration Form and your Fee payment to the College in Jersey, Britain.

ARRANGEMENT FOR THE SITTING & INVIGILATION OF AN EXAMINATION

✸ You are in 'Group 2' *(see page 3)* if you were NOT officially enrolled by CIC for the FREE Management & Business Course AT THE SAME TIME as being enrolled for a CIC International Program.

If you are in 'Group 2' and you now wish to attempt an Exam to gain the Management & Business Certificate
then you must ensure that both Section A and Section B are completed and returned to CIC together.

SECTION A: to be completed by the Invigilator/Supervisor

I confirm that I am a suitable person to Invigilate/Supervise an Exam as I am in one of these categories:

- An Officer at a CIC Affiliate or Associate Organization, a CIC Authorised Introducer or Approved Invigilator.
- An Official of the National Examinations Board, or Ministry of Education or the British Council.
- A senior official of an Embassy, High Commission, Consulate, United Nations mission, or similar.
- A Principal or Vice/Deputy Principal of a school, college or university.
- A qualified professionals, such as a lawyer, accountant, doctor; senior clergy of a religious order.
- A Director or Senior Manager of HR or Training Manager of an incorporated or government organization.

AGREEMENT TO INVIGILATE AN EXAMINATION

I certify that I agree to invigilate in due course the **2-hour** Examination of the candidate. A mutually convenient date for him/her to attempt the Exam will be arranged. I will be able to provide a quiet room, with a writing desk or table and chair. Invigilation will take place under **true Examination conditions**, in strict accordance with Instructions to be supplied by the College (sent with the Examination Paper). I understand that the Examination Documentation will be sent **DIRECTLY to me from the College under registered cover** (with a separate notification from the College that the packet has been despatched to me) and that I might be required to collect and sign for the registered item from my local post office. Inside the packet will be the Examination Booklet(s) - each in a sealed and unopened envelope - which I shall keep **securely** until the Examination time. I note that the College does not pay an Invigilation Fee.

My details are: (please complete all parts and requirements in capital letters):

FULL NAME: ______________________________

FULL POSTAL ADDRESS (including institution/organisation name to which the Exam should be dispatched):

____

____

Email: ______________________ Telephone: ______________________

Position in Organization: ______________________ Qualifications: ______________

Signature: ______________________ Date: ______________

***NOTE: AN OFFICIAL STAMP OR SEAL IS ESSENTIAL**

SECTION B is on the next page and is to be completed and returned to CIC by the candidate WITH this completed Agreement to Invigilate Form

Settlement Of An Exam Fee
TO SIT THE EXAM ON THE MANAGEMENT & BUSINESS COURSE

- I confirm that I wish to attempt an Exam to gain the Management & Business Certificate.
- My personal details and the details of how I am paying the Exam Fee are given below.

You must ensure that both Section A and Section B are completed and returned to CIC together.

SECTION B: to be completed by the person wishing to sit the Exam

I wish to attempt an Exam on the content of the FREE Management & Business Course so that I can gain the Management & Business Certificate:

My details are: (please complete all parts and requirements in capital letters):

FULL NAME (to appear on the Certificate): ______________________________

FULL POSTAL ADDRESS (to which the Certificate should be dispatched):

____

____

Email:______________________________ Telephone: ______________________________

Special Needs (if any): ______________________________

Age / date of birth (you must be at least 18): ____________________ Nationality: ____________________

I am sending / paying the Exam Fee of £50 or US$80 by: (please tick):
(details of how to send the payment are given on page 185)

❑ **Bank Transfer** (attach bank receipt); ❑ **Bank Draft/IMO;** ❑ **On-line Banking** (attach copy of transfer);
❑ **Western Union Quick Pay** (attach copy of Western Union receipt); ❑ **Currency Notes;** ❑ **PayPal;**
❑ **British Postal Orders;** ❑ **Credit Card;** ❑ **Dahabshiil Money Transfer** (attach copy of receipt);
❑ **Other:** ____________________ (state details and attach receipt)

Signature: ______________________________ Date:____________________

YOU NEED TO SEND THIS COMPLETED FORM

(*with the Agreement to Invigilate an Examination form***)**

BY EMAIL OR POST - TO:

THE EXAMINATIONS DIRECTOR,
CAMBRIDGE INTERNATIONAL COLLEGE,
Attique House, St Brelade, Jersey JE3 8FP, Britain.

Email: exams@cambridgetraining.com