Chapter 1: Operations

1.1 Role of operations management

This is concerned with managing the process that transforms inputs into outputs of goods and services. Operations refers to the activities of a business that acquire and combine inputs, changing them into finished goods and services.

1.1.1 Strategic role of operations management focuses on decisions and the plans for achieving long-term goals, for example, over the next ten years.

- **Cost leadership** is where a business has the lowest cost of operation compared to its competitors. A cost leader develops a competitive advantage over its rivals, gained by offering consumers greater value by means of lower prices, greater quality or by providing greater benefits and service at no extra cost.

Most businesses that aim to be cost leaders will offer products with a high standardisation which can be produced for a lower cost. Cost leaders need to keep their costs low by employing strategies such as developing an efficient scale of operations; using up-to-date technology in production; controlling production costs such as the costs of inputs and controlling the costs of research and development and selling costs.

- **Good/service differentiation** is the differences between products of competing businesses as perceived by consumers. It is based on features such as quality of service, price and product image. Three ways of aiming for cost leadership through differentiation are the physical appearance of goods; providing the customer with adequate levels of service at a minimum cost; and producing a good or service efficiently with a maximum of quality at a minimum of cost.

- **Physical appearance or styling of goods** focuses on product design, including product features. For a product to have a sustainable competitive advantage, operations managers must determine the product designs and features that customers demand.

- **Providing the customer with an adequate level of service** at a minimum cost, but offering higher costs for better levels of service, allows the customer to decide which level of service to select. Examples of customer services include delivery, installation, financing, customer training, warranties, and repairs.

1.1.2 Goods and/or services in different industries relates to how most businesses produce a combination of goods and services. Operations management manages the process of transforming inputs into outputs of goods and/or services. The inputs used to produce services will be different to the inputs needed to produce goods. With goods, outputs will often be physically transformed. The management strategies and logistical skills to produce manufactured goods can be quite different to the strategies and skills required for producing a service. The production of goods is less labour-intensive than the production of services. The manufacturing of goods has become automated with computer-aided design (CAD) and computer-aided manufacture (CAM).

Operations managers in service industries require people skills and areas such as HR management are particularly important because of the labour-intensive nature of these industries.

1.1.3 Interdependence with other key business functions relates to the key business functions of operations, HR management, marketing, and finance.

- **Operations** are the core key business function. Operations and management has direct links to all other key business functions.

- **HR management** contributes operations through the acquisition or hiring of employees, development of employees in various aspects of operations, the maintenance of employees via monetary and non-monetary benefits and separation of employees through voluntary or involuntary separation. Because most of the employment in any business will be in operations there will be a strong link between operations and HR management.

- **Marketing** connects operations directly with the customer. There is a strong link between operations and marketing when operations managers are making decisions about how much of a product to produce and for whom.

- **Finance function** is concerned with making decisions on how to raise finance so that production and distribution of the output of the business can take place. Financial managers will also carefully monitor the use of inputs and outputs by the operations function of the business through working capital management, where there are controls on current assets and liabilities.

1.2 Influences

Refers to factors outside the business that will have an impact on operations management and how the business performs in the marketplace.

1.2.1 Globalisation means that operations managers may be able to reduce the cost of operations by pursuing a global web strategy. Global web refers to the location of different parts of the production process in different geographical areas, including different countries. Cost advantages of a global web strategy include the abundance of raw materials; favourable movements in the exchange rate; a plentiful labour supply and low wage rates; government incentives in foreign countries; technology, skills and processes that do not exist in the home country; and relatively low transport costs.

1.2.2 Technology in the form of computer-aided design (CAD) and computer-aided manufacture (CAM) has an impact on operations in terms of reducing the number of employees. The computer is the main technological application for any business because of communication, research, design and information storage facilities as well as the ability to maintain, control and manage inventory. The use of all forms of technology also requires a

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Excel SYLLABUS SUMMARY NOTES
1.3 Operations processes

These make up the core business of an enterprise. The business acquires inputs and adds value to (or transforms) these inputs by transforming them into goods and services which become part of the output of the business.

1.3.1 Inputs

can be classified in two ways: transformed and transforming resources.

- **Transformed resources** (materials, information, customers) are those which will be changed into finished products by operations processes. In most businesses, transformed resources will include materials, information and customers. This transformation will add value to the resources undergoing transformation.

- **Transforming resources (human resources, facilities)** are those which will cause the change or transformation process in business operations. The main transforming resources are HR, which refers to the people who operate, maintain and manage the operation, and facilities, such as plant and equipment.

1.3.2 Transformation processes

In operations the ‘Four Vs’—volume, variety, variation in demand and visibility; sequencing and scheduling, including Gantt charts and critical path analysis; technology, task design and process layout; and monitoring, control and improvement. The four Vs are:

- **Volume** (refers to how many goods or services are produced by the operation).

- **Variety** (refers to how many different types of goods or services are produced by the business).

- **Variation in demand** (refers to how much the level of demand changes over time).

- **Visibility (customer contact)** (refers to how much of the operations process is actually experienced by the customer).

**Sequencing and scheduling** are important because of cost. A sequence is a plan which helps operations managers select the next task to be performed in an operation. Schedules are used to plan the timing and sequence of the use of both transformed and transforming resources. With careful sequencing and scheduling, the costs of operations can be kept to a minimum.

- **Gantt charts** provide a graphical illustration of a schedule that helps to plan, coordinate and track specific tasks in a project.

- **Critical path analysis (CPA)** lists all the key tasks in an operations process as a sequence, some of which can be performed simultaneously while others require other tasks to be performed first. Any delay of a task on the critical path will have a direct impact on the planned completion date.
Problem: A key benchmark in the airline industry is on-time arrival and departure. There are a number of essential tasks that must be performed to ‘turn around’ an aircraft that has just landed. Industry standards are less than 40 minutes. An aircraft has just landed from Sydney. What is the shortest time possible to turn the aircraft around for departure?

Numbers between tasks indicate minutes to complete task:

A. Disembark passengers
B. Unload luggage
C. Refuel aircraft
D. Clean aircraft
E. Perform visual safety check
F. Load luggage
G. Board passengers
H. Give safety briefing

A → C → E → G → H → J → K

The critical path is:

Technology, task design and process layout are related. Technology will influence task design and as a result, process layout.

- **Technology** has an impact on operations in a number of critical ways. The computer is the central application of technology in most businesses and even the mobile phone gives employees the opportunity to access computing facilities wherever they are. The use of computers in transformation processes can occur with CAD and CAM. These applications of technology have an impact on operations in terms of reducing the number of employees needed, especially in manufacturing.

- **Task design** is part of a series of steps that are designed to take inputs and transform them to produce a good or service. HR managers are responsible for analysing and designing the tasks employees have to perform.

- **Process layouts** are different to a production line or layout where equipment and activities are organised in a sequence. A process layout is more flexible because the equipment is general purpose and workers are skilled at working in their particular section. Process layout is used where it is important to group similar processes together.

**Monitoring, control and improvement** are related because having control systems allows collection of information. Analysis of this information allows improvements to be made.

- **Monitoring** is the systematic collection and analysis of information as a task progresses. It is aimed at improving the efficiency and effectiveness of an operations process. Monitoring is part of the planning process and its purpose is to see if resources have been allocated properly and are being used efficiently.

- **Control** is about assessing the performance of a business. Operations managers will carry out the control processes to compare the actual performance of the operations processes against the planned performance standards.

- **Improvement**, in terms of business, can involve a control system aimed at establishing a program of continuous improvement. A business aiming for continuous improvement is attempting to produce goods or services more efficiently by using fewer resources; using improved inputs and systems; using processes that reduce waste and costs and increase profits.

1.3.3 Outputs include everything that is generated as a result of business operations. Outputs include goods and services, waste, and customer service and warranties. Customer service and warranties are important outputs as they add value to the product. They are also important as outputs because they make the product more attractive to the customer.

- **Customer service** is a series of planned activities which are designed to increase the customer’s satisfaction with the product. Customer service adds value to the product and is essential to the ability of the business to generate revenue and profit. There are three main methods of customer service delivery: by telephone or Internet, in person and via written communication.

- **Warranties** are written guarantees that faulty products will be repaired or replaced under certain conditions of use. Warranties help give consumers protection and ensure producers maintain quality products. Warranties can either be an express (usually a written document which explains the warranty conditions) or implied (exists because of the nature of the transaction and what the buyer understands about the product) warranty.

1.4 Operations strategies

Operations strategy refers to the decisions which shape the long-term capabilities of any type of operations. Operations strategy is usually considered in terms of performance objectives such as quality, speed of response, dependability, flexibility, customisation and cost. The aim of operations strategies is to manage and use the resources of the business to achieve and maintain competitive advantages in the marketplace.

1.4.1 Performance objectives establish standards which can be used to evaluate the performance of operations. Their benefits are outlined in the table on the following page. It is not likely that a business will be able to achieve all of the performance objectives simultaneously, meaning that they need to establish priorities within the performance objectives.
1.4.2 New product or service design and development (NPD)
is used to describe the complete process of bringing a new
product or service to market. The development process involves
identifying a market opportunity, creating a product that will
appeal to that market and testing and modifying the product
until it is ready for production. This process is usually driven
by the need of the business to develop or maintain competitive
advantage in the marketplace.

The design and development process is illustrated in the
diagram below.

1. Idea generation
   - SWOT analysis (see Chapter 2)
   - Strengths, Weaknesses, Opportunities, Threats
   - Identify new product with focus
     - Groups—employees, suppliers, customers

2. Idea screening
   - Eliminate ideas that won’t work
   - Consider customer benefits, market growth,
     competition, manufacturing needs, profit expectations

3. Concept development
   - Develop marketing and engineering details
   - Identify target market
   - Specify features the product must have
   - Computer modelling for prototype design
   - Estimate production costs

4. Business analysis
   - Develop estimates for:
     - Selling price
     - Sales volume
     - Break-even point (sales revenue = production costs and profitability)

5. Market testing
   - Produce prototype of product
   - Test product in real use situations
   - Feedback from house groups
   - Refine prototype
   - Produce small quantity and test market

6. Technical implementation
   - Engineering operations planning
   - Identify suppliers
   - Plan logistics
   - Contingencies (what if) planning

7. Commercialisation
   - Product launch
   - Promote product—advertising
   - Initiate distribution channels (see Chapter 2)

8. New product pricing
   - Product costs (fixed and variable)
   - Forecast volumes, revenue and profit
   - Competition

1.4.3 Supply chain management (SCM) is a process used by a
business to ensure that its activities and organisation involved
in producing a good or service is efficient and cost effective.
SCM is the efficient control of raw materials, information,
and finance as they move in a process from supplier to manufacturer
to wholesaler to retailer to consumer. There are three goals of
supply chain management: to reduce inventory, to increase
the speed of transactions, and to increase revenue by satisfying
customer demands more efficiently.

Logistics is the management of the flow of the materials,
information and other resources between the point of supply
and the point of consumption by a business in order to meet
the requirements of customers. Logistics involves the integration
of information, transportation, inventory, warehousing,
materials handling and packaging.

E-commerce is business conducted on the Internet. It refers
to the electronic buying and selling of goods and services
where there is a binding commitment to exchange the goods
and services for an electronic transfer of funds. Advantages
include greater availability of information, speed (and time
saving), easier and cheaper access to global markets, easier
management of data, flexibility and the ability to create broad
networks. Disadvantages include privacy and security issues
and an increased risk of purchasing unsatisfactory or faulty
materials.

Global sourcing is an operations strategy where a business
acquires the inputs it needs for production across the borders of
a number of countries. Advantages include raw materials and
other inputs may be cheaper; the quality of input components
may be better; delivery may be quicker and delivery costs
less expensive; the inputs needed may not be available
domestically; global sourcing is an effective way to reduce
costs without the need for much investment; and exchange rate
changes may mean that global sourcing is now cheaper than
sourcing domestically.

1.4.4 Outsourcing occurs where other businesses provide the raw
materials and components, and also service inputs.

Advantages and disadvantages of outsourcing are outlined in
the following table.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Requires far less capital expenditure than vertical integration. Vertical integration involves the risks of the business having to invest in producing the supplies it needs (factories, research and development, raw materials).</td>
<td>The business is now dependent on other businesses to supply components or raw materials and production may disrupted if these are not delivered on time or if a competitor buys up available supplies.</td>
</tr>
<tr>
<td>The business is using the employees of other businesses to produce its inputs. The business does not have to maintain those employees by paying wages and other costs such as superannuation or annual, long-service or sick leave.</td>
<td>The business has little control over the quality of the inputs supplied by another business. If inferior quality inputs are supplied there will be a disruption to operations while another supplier is found.</td>
</tr>
<tr>
<td>May contribute speed to the operations in that the business does not need to become involved in producing those inputs it outsourced. If the business producing those inputs has a competitive advantage, the supply of inputs may be faster than if the business had produced them itself.</td>
<td>There is less control over the flow of inputs by managers. It is harder to manage suppliers of inputs than it is to manage your own employees.</td>
</tr>
</tbody>
</table>
1.4.5 Technology can be divided into two major categories: leading-edge and established technology.

- **Leading-edge technology** refers to the position of greatest advancement in the field of technology. This technology is so new that in many cases it is still being developed and modified for adoption into the world of business. The rewards for successful early adoption of new technologies can be substantial in terms of developing a competitive advantage in the marketplace. However, there is a downside if the use of leading-edge technology creates unforeseen problems such as choosing the wrong product or application.

- **Established technology** is a technological application where the cost, performance, and servicing of the technology is readily available. It has been established and used in business situations for a relatively long time. Advantages include the technology is ‘proven’, allows for electronic storage of data, and buying, selling and ordering is faster than manual transactions. Disadvantages include it can be expensive and is not always compatible with other systems.

1.4.6 Inventory management refers to systems and processes that identify the quantity of goods or materials to be ordered and the timing of the delivery of those goods or materials. The management process includes the stockpiling and storage of these goods so that the production process can be continued smoothly and customer demand satisfied.

### Advantages and disadvantages of holding stock

<table>
<thead>
<tr>
<th>Advantages of holding stock</th>
<th>Disadvantages of holding stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>An inventory management system that keeps a large amount of stock can be good because it will act as a buffer against high demand for inputs or complete products</td>
<td>Keeping a high level of finished products can increase storage costs as warehouses need to be built or leased and maintained.</td>
</tr>
<tr>
<td>Holding stock will ensure that customers can be served quickly and there is dependability of delivery</td>
<td>Keeping high levels of inventories adds to management costs.</td>
</tr>
<tr>
<td>Financial benefits in the form of a capital gain can be experienced by keeping levels of inventories high if prices are expected to rise in the future</td>
<td>The business can experience a capital loss by keeping high levels of inventory if prices for the product are expected to fall.</td>
</tr>
<tr>
<td>Some businesses maintain high levels of inventory in raw materials to take advantage of discounts that apply to bulk purchases of inputs.</td>
<td>There can be a problem with stockpiled goods passing their &quot;use-by&quot; or &quot;best before&quot; date if the goods are perishable.</td>
</tr>
<tr>
<td>If an unexpected order is received there is little danger of running down inventories if high levels are maintained.</td>
<td>Expanded inventory management can have costs associated with establishing a bureaucracy to manage the inventory as well as an expanded payroll.</td>
</tr>
<tr>
<td>High levels of inventory will ensure the production process runs smoothly.</td>
<td>High inventory levels places more layers of management between the customer and the product.</td>
</tr>
</tbody>
</table>

- **LIFO** stands for ‘last-in-first-out’. This means that relatively newer stock is displayed for sale before products purchased at an earlier date. One reason for doing this would be to ensure that up-to-date stock is on display for customers.
- **FIFO** stands for ‘first-in-first-out’. It is a queuing system whereby products that were purchased and stocked first will be displayed to be sold first. FIFO will be employed where perishable products have a ‘use-by’ or ‘best before’ date.
- **JIT** stands for ‘just-in-time’. As an inventory management system it means that products or materials that are required for operations processes are delivered to a business exactly when needed. The main objective for a JIT system is to eliminate inventories of inputs altogether from the supply chain.

1.4.7 Quality management involves setting performance objectives that clearly set quality as a foremost goal. Customers usually equate satisfaction with a business or product with quality. There are three main strands to quality management: quality control, quality assurance and quality improvement.

- **Quality control** (QC) is a feedback control and the process is undertaken to ensure that a minimum level of quality in a good or service has been achieved during operations. The process also checks that output is dependable.
• **Quality assurance (QA)** involves monitoring and evaluation of the various processes of a project, service or facility to ensure that minimum levels of quality are being achieved by the production process. Quality assurance monitoring will be undertaken by independent personnel from outside the operations area.

• **Quality improvement (QI)** is a process which aims to reduce the rate at which mistakes occur in the production process. It involves analysing what has happened and what actions will be taken to improve performance. One outcome of quality improvement may require significant changes to be made to a product.

1.4.8 **Overcoming resistance to change** is important in a business because change is inevitable. Without change there can be no improvement. In today's technological society the pace of change is rapid and businesses need to keep up with new processes, applications and ideas. If businesses do not do this there is a danger of losing competitive advantage in the marketplace. The way in which resistance to change can be overcome is to manage change effectively. The following figure shows reasons for resisting change.

### Internal environmental factors

- Purchasing new equipment
- Redundancy payouts
- Retraining
- Reorganisation of plant layout

### External environmental factors

- De-skilling
- New skills
- Loss of job prospects/promotional opportunities

1.4.9 **Global factors** can present cost-saving opportunities for management if they choose the most appropriate means of sourcing and if they consider the advantages offered by locating different parts of their operations in different countries.

• **Global sourcing** refers to the process of acquiring raw materials, services and various parts that are needed to manufacture goods or services. Sourcing examines whether a business should make or buy its inputs, or use a combination of these two options. The decision will be influenced by quality and price, size and scope of the market, nature of the product, and available technology and local resources.

• **Economies of scale** occur when the amount of production increases and as a result of this increased output there is a decrease in the cost of production per unit of output. Economies of scale can include lower cost of inputs because of bulk purchase discounts; spreading the cost of inputs such as research and development, marketing, skilled labour and machinery over a much larger output; cost savings in transportation; discounts in interest rates for debt borrowings as larger sums are borrowed; and better organisational skills in management due to the large scale of production and distribution.

• **Scanning and learning** involves monitoring a business's internal and external environment so that it can gather, analyse and use information for tactical or strategic purposes. Environmental scanning of the business environment will involve collecting both objective and subjective information. There are three ways of scanning the business environment: ad-hoc scanning, scheduled scanning and continuous scanning. This last type is sometimes called continuous learning. Scanning allows managers to learn from the environment which assists with problem-solving and strategic planning. The business environment is made up of all factors that can have a bearing on a business. The figure below summarises the influences that make up the internal and external environments of a business.

<table>
<thead>
<tr>
<th>Internal environmental factors</th>
<th>External environmental factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>This environment has a direct impact on a business and the business has some control over these factors</td>
<td>This environment has an indirect impact on a business and the business has very little control over these factors</td>
</tr>
<tr>
<td>Core business and production</td>
<td>Suppliers</td>
</tr>
<tr>
<td>Key business functions</td>
<td>Customers</td>
</tr>
<tr>
<td>Operations: inputs, processes and outputs</td>
<td>Competitors</td>
</tr>
<tr>
<td>Strategic, tactical and operational plans of the business</td>
<td>Creditors</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Environmental factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro environment: the elements of the micro environment have a direct bearing on the operations of the firm</td>
</tr>
<tr>
<td>Core business and production</td>
</tr>
<tr>
<td>Key business functions</td>
</tr>
<tr>
<td>Operations: inputs, processes and outputs</td>
</tr>
<tr>
<td>Strategic, tactical and operational plans of the business</td>
</tr>
<tr>
<td>Economic environment including the economic system, business cycles, economic policy</td>
</tr>
<tr>
<td>Social environment including the social make-up of a nation such as cultural attitudes and values</td>
</tr>
<tr>
<td>Political environment including the political organisations, system of government and political ideologies of political parties: the political environment of a country will have a great impact on business</td>
</tr>
<tr>
<td>Legal environment: includes flexibility and adaptability of law and other legal rules governing the business</td>
</tr>
<tr>
<td>Technical environment: influences the business in terms of investment in and application of technology</td>
</tr>
</tbody>
</table>
Chapter 2: Marketing

2.1 Role of marketing

2.1.1 The strategic role of marketing goods and services is as follows. Marketing involves the planning, pricing and promotion of the products of the business, as well as the distribution and servicing of the product. This contributes to satisfying the needs of present and potential customers. Marketing has a central strategic function within the business as it brings together the products of the business and the customers for those products.

2.1.2 Interdependence with other key business functions is as follows.
- Marketing and operations are linked because, as the sales of a product decline over time, there will be close consultations between operations management and marketing management to design and develop new products which can be marketed successfully.
- Marketing and HR management are linked because HR management hires and trains employees. As it is the function of marketing to bring the product to the customer this function will be performed successfully with the best HR.
- Marketing and finance are linked as one of the roles of the finance function is to provide the information to assist the marketing function with product design and development as well as the development of a marketing plan.

2.1.3 Production, selling, marketing approaches describes three types of marketing.
Production approach was based on the idea of attracting customers to an existing product. Mass production of a standardised product was aimed at increasing output and reducing production costs. This improved affordability for the customers. The customer’s wants were not considered.

The selling approach emphasised persuasive sales techniques such as door-to-door salesmen. There was little attempt to understand the customer’s wants and needs.

The marketing approach focuses on developing products based on the customer’s needs and wants. The marketing concept and customer orientation build on the marketing orientation developed in the 1980s.

2.1.4 Types of markets are:
- resource markets for raw materials such as land, labour, capital and enterprise for the production of goods and services, e.g. oil
- industrial markets for manufactured products, whether partly made products such as coffee beans or fully assembled items such as paper cups; these items may then be used for production of other goods, e.g. take-away coffee
- intermediate markets to provide the link between producers and the marketplaces where consumers make their purchase decisions, e.g. supermarket or large department store
- consumer markets that sell directly to the individual customer, e.g. the many shops in a large regional shopping centre
- mass markets for products that appeal to a large and relatively undifferentiated and homogeneous (similar) group, e.g. milk, bread, fruit
- niche markets for more specialised goods and services that only a few people are interested in or can afford, e.g. vintage wines, luxury motor yachts.

2.2 Influences on marketing

2.2.1 Factors influencing consumer choice are psychological, sociocultural, economic or government.

2.2.2 Consumer laws have had a considerable role in tackling unfair marketing practices. Consumers are protected by state (Sale of Goods Act 1923 (NSW), amended 1987, and Fair Trading Act 1987 (NSW), updated April 2008) and federal—Trade Practices Act 1974 (Cth), (renamed and amended as the Competition and Consumer Act 2010 Cth)—legislation. The Australian Competition and Consumer Commission (ACCC) has been set up by the federal government to make sure that businesses do not reduce competitiveness. In New South Wales there is an Office of Fair Trading within the Department of Commerce to assist consumers and businesses with their problems.

Deceptive and misleading advertising occurs when businesses are not truthful with their pricing claims, advertising and special offers. Advertising needs to be fair and not misleading. Deceptive and misleading advertising can be a major problem when it causes consumers to make choices based on incorrect or misleading information.

Price discrimination is the charging of different prices for identical products in different markets or among different groups of customers. It is illegal under the Trade Practices Act 1974 (Cth) (renamed and amended as the Competition and Consumer Act 2010 Cth). Sellers must generally offer the same product at the same price to everyone.

Implied conditions are part of every sale of goods. There are written terms and conditions to which customers may be referred and there are also certain unwritten conditions that are implied. These unwritten conditions guarantee that the product being offered for sale is suitable for its intended use and is of a reasonable standard. There is also the unwritten, or implied,
condition that the product offered for sale is of merchantable
good quality. This means that the good must be up to a standard for
the price that is charged.
Warranties are written guarantees that faulty products will be
repaired or replaced within a set period, under certain conditions
of use. Warranties help give consumers some protection and help
to ensure producers maintain quality products.

2.2.3 Ethical influences in marketing is where marketing
managers understand value systems and morality or what is
"right" or "wrong" with regard to the marketing of goods or
services.
• Truth, accuracy and good taste in advertising is established
by the Australian Marketing Institute's (AMI) code of conduct
which requires members to abide by Item 3: '...a duty to
maintain truth, accuracy and good taste in advertising, sales
promotion and all other aspects of marketing'. In addition, the
Australian Competition and Consumer Commission (ACCC)
administers laws that apply to advertising. Consumers have a
right to accurate and truthful information from businesses
about their purchases. This is required by the Competition and
• Products that may damage health—advertising smoking has
been banned in Australia and legislation has been passed
requiring health warnings to be displayed on cigarette
packets. There is a push to have similar warnings for products
containing alcohol and fast-food and junk-food products.
• Engaging in fair competition—the Australian Competition
and Consumer Commission (ACCC) is a federal government
independent authority that promotes competition and fair
trade in the marketplace to benefit consumers, businesses
and the community. Its main responsibility is to ensure that
individuals and businesses comply with competition, fair
trading and consumer protection laws. The law that underpins
fair competition is the Competition and Consumer Act 2010.
The Act deals with almost all aspects of the marketplace:
the relationships between suppliers, wholesalers, retailers,
competitors and customers.
• Suggesting (selling under the guise of research) is when
telemarketers give the impression that they are conducting
genuine market research but are, in fact, attempting to sell
a product. An unintended effect of this is to make people,
especially those who get caught up in such practices, sceptical
about all surveys. Privacy regulations have now restricted the
incidence of suggesting.

2.3 Marketing process

2.3.1 Situational analysis, including SWOT and product life cycle,
is the first stage in developing a marketing plan. It involves
researching and analysing the business's current position and any
new direction it may want to follow. It includes SWOT analysis,
product life cycle, market analysis and competitor analysis.

2.3.2 Market research involves three steps:
• Determining information needs by identifying and defining the
marketing problem, clarifying the objectives of the research,
planning the research tasks, and finally collating the data,
analysing and interpreting it, and reporting the conclusions of
the research.

2.3.3 Data collection (primary and secondary) can be summarised as:

• Observation
• Focus groups
• Surveys/ questionnaires
• Experiments

• Data analysis and interpretation is the final stage of market
research. The researchers interpret their findings, draw
conclusions about their usefulness and report them to
management. The conclusions of the report should be clear,
concise and recommend appropriate action to be taken.

2.3.4 Establishing marketing objectives is the second step in
developing a marketing plan. Marketing plan objectives are
derived from the business strategic plan but provide marketing
performance targets. They relate to product range, market share,
sales and profit. Effective objectives are SMART—specific,
measurable, achievable, realistic and timed.

2.3.5 Identifying the target market is the next step. The target
market for a product is the particular or specific segment of
the total market that the product is aimed at. Consumers can be
grouped into segments according to demographic, sociocultural,
geographic or psychographic factors.

2.3.6 Developing marketing strategies is the fourth step.
Marketing strategies are designed to meet marketing plan
objectives. The marketing mix of product, price, promotion and
place is at the centre of the business's marketing strategy.
• Product—positioning, branding, packaging
• Price—methods (cost, market or competition based) and tactics
(aiming, penetration, loss leader, price points)
• Promotion—personal selling, advertising, below-the-line
promotion, public relations
• Place—intermediaries, channel choice (intensive, selective,
exclusive), physical distribution (transport, warehousing,
inventory control).

2.3.7 Implementation, monitoring and controlling involves
three stages.

• Developing a financial forecast. This is the implementation of
the marketing plan—putting it into action—and will focus on
forecasting sales and staying within budgeted costs. This will
reflect the resources of the business, especially its staff, its
competitiveness and its financial strength.

• Comparing actual and planned results. This is the monitoring
which will involve comparing actual results with planned results.
This is done through controls that allow analysis of financial
and other data and enable the manager to stay informed about
such factors as market share, sales, customer feedback and
profitability. Decisions can then be made about the effectiveness
of the marketing.

Revising the marketing strategy. If necessary, the marketing plan
can then be revised and corrective action taken.

Excel HSC BUSINESS STUDIES
2.4 Marketing strategies

2.4.1 Market segmentation, product/service differentiation and positioning are integral parts of a marketing strategy. Market segmentation is the process of finding groups of customers, within the total market, who share similar characteristics. Market segmentation lets a business focus its marketing strategies on the target market, which is defined by geographic, demographic, psychographic or behavioural factors. Product/service differentiation occurs when consumers perceive a difference in a product compared to the competition products. The purpose is to create a competitive advantage for the product. The marketing mix at the centre of a business’s marketing strategies. It is sometimes known as the 'Four Ps':
- The product component focuses on the consumer being provided with benefits from the product.
- The price component focuses on setting a price that reflects the perceived value of the product for the consumer.
- The promotion component informs consumers that the product is capable of satisfying them.
- The place or distribution component focuses on getting the product to the right customer.

Positioning involves the development of an image for the product (in the mind of the consumer) in relation to other products in the market. Price, quality, perceived benefits and competition are key methods of positioning a product in the minds of customers.

- Positioning
- Branding
- Packaging
- Methods
- Tactics
- Price/quality/interaction
- Distribution channel
- Intermediaries
- Physical distribution
- Personal selling
- Advertising
- Below-the-line promotions
- Public relations

2.4.2 Products: goods and/or services are important when developing a market strategy. A product is a good or service that satisfies a customer's need or want. Every product is a combination of tangible and intangible benefits. Branding involves the development of names and symbols in the form of logos and trademarks for a product or service. This branding identifies the product and helps to differentiate it from its competitors. Packaging is the way a product is physically presented to the consumer and has become a highly influential strategy affecting consumer choice. Packaging protects and secures the product, but it has also become a specialist tactic for attracting the attention of new customers, making the product distinct and providing visual cues for repeat buyers.

2.4.3 Price is the selling price of anything offered for sale and includes discounts, credit terms and conditions. It is an important factor in influencing the buying decisions of potential customers. Pricing methods must be clearly set out. It is essential that managers understand the value of their product compared with those of their competition, that the buyer is aware of the value of the product and that the manager can link the marketing objectives to the price set. The price set by businesses needs to reflect the value to customers of the total package they are buying. It needs to be set so that production costs are covered in the long term, but at a level where the product will continue to be bought.

Prices may be cost-, market- and competition-based.
- Cost-based pricing is a system where the business adds a profit component to the cost of producing the product. A problem with cost-based pricing is that it ignores market demand. Using a percentage mark-up or a fixed profit amount, the business may have settle on a price that is too much for the market to bear. On the other hand, the final price may be far too low.
- Market-based pricing is a system where prices are set by demand from the market and supply of the product. If retailers set the price too high, then they are left with large quantities of the product in stock. Conversely, if retailers set the price too low, the product will be continually sold out.
- Competition-based pricing is a system where a business sets its prices based on its competitor's prices. Depending on the pricing, branding and relationship marketing of the product, some businesses will charge a higher price than their competitors while others will charge lower prices.

Pricing strategies/tactics include:
- Skimming involves setting a high price that provides a high margin and quick profits while demand for the product is still high and before competitors enter the market. This will occur in the introduction stage of the product life cycle.
- Penetration pricing involves setting the price of a new product lower than the prices of its competitors in the introduction stage of the product life cycle so that its competition will be undersold and it will become successful and gain market share.
- Loss leaders are products that are priced well below cost in order to attract customers. If the products are well known and are advertised extensively, customers will be expected to buy these products and to purchase other products, being sold at regular prices, at the same time.
- Price points are psychological pricing strategies that are based on a customer's perception of value for their money. Two types of price points are setting at a point such as $19.95 and developing a 'base level product' and pricing this product to attract customers' attention to the range on offer—the product range will have additional features at higher prices.

Price and quality interaction refers to the fact that many consumers believe that higher prices indicate higher quality. Clothes, expensive technology items, gemstones and wines are often positioned to reflect this price-quality association.

2.4.4 Promotion is a means of communicating with the market about a product. The objective of promotion is to create in the minds of consumers an image of the product that will generate sales. Elements of the promotion mix—the combination of promotion techniques used to inform and influence a target market—are personal selling, advertising, below-the-line promotions and public relations.

The communication process is the main role and aim of promotion. Promotion has to communicate with consumers about the unique qualities of a product, its value and benefits, thus
creating a demand and building long-term loyalty to the product. Effective communication is determined by the consumer's perception and interpretation of the information presented rather than the business intent and understanding of the information provided.

- **Opinion leaders** are people such as celebrities, sportspeople and experts in specialised fields (e.g. dentists) and organisations such as Choice (formerly the Australian Consumer Association), through its CHOICE magazine, whose opinions are respected by the community.

- **Word of mouth** occurs when customers who have used a product communicate their feelings about the product to potential customers, usually their friends and families. Word of mouth cannot be controlled directly by businesses wanting to promote their product but it is well recognised for directly influencing how people choose a product.

**2.4.5 Place/distribution**, in the marketing mix, refers to businesses making sure their product reaches the customers. The methods include selling directly to the public, to a warehouse or for redistribution, to various types and sizes of retail outlets and to another producer. The distribution method and channel choice determine the distribution strategy for the business.

- **Distribution channels** are the links between the producer and the customers of the product. They may be achieved through direct or indirect channels.

- **The reasons for intermediaries** are that in indirect distribution the product passes through independent intermediaries such as agents, brokers or retailers. In direct channels the manufacturer distributes the product directly to the customer.

**Channel choice**—the distribution channel intensity that the manager chooses—is critical to the success of the marketing plan. The channel choice will affect the type of customer, the perception of the product and the ease of access. There are three main types of distribution channels: intensive, selective and exclusive.

- **Intensive** channel distribution means that the product is made as widely available as possible, using most distribution channels. It is used for inexpensive, frequently bought, high volume products, such as bread and milk.

- **Selective** channel distribution is a situation where only a few channels are used, so that availability is limited. This method is usually used for infrequently purchased and more expensive durable goods for which consumers will travel some distance (e.g. to a regional centre where there are many retail outlets).

- **Exclusive** channel distribution is a situation where individual outlets are given exclusive distribution rights. It is usually chosen for expensive products such as motor vehicles or exclusive fashion.

**Physical distribution issues** include:

- **Transport** methods include road, rail, air and sea. The form chosen will depend on the type of product, the distance to be covered, the necessary speed of delivery and the cost.

- **Warehousing** involves the storing of products in a secure manner, with ready access so that they can be easily dispatched to retailers in smaller quantities when needed.

- **Inventory** control ensures products are available for sale when needed, without the costly problem of holding too much stock. Many businesses operate a JIT (just-in-time) inventory control system. This minimises the amount of stock a wholesaler or retailer needs to have on hand.

**2.4.6 People, processes and physical evidence** is as follows.

- **People** refers to the business having well-trained staff who can support the products of the business. This includes both selling and customer service.

- **Processes** refers to the procedures and policies that the business has developed in terms of the selling and customer service that applies.

- **Physical evidence** refers to the way that the product and even the business appears to the consumer. Physical evidence can also refer to the people in a business and how they appear to the customer.

**2.4.7 E-marketing** means marketing by means of the Internet such as advertising on popular sites like Google, as well as by email. There are a number of different approaches used with e-marketing, including:

- **one-to-one** approach where marketers target a user browsing the Internet so that the marketers' messages reach the user personally.

- **appeal to specific interests**, whereby marketers place an emphasis on appealing to a specific behaviour or interest rather than reaching out to a broadly defined demographic.

- **niche marketing** differs from traditional Internet marketing as it has a more specialised topic knowledge.

- **geo-targeting**, a method of determining the geographic location of a website visitor.

Advantages of e-marketing: it is easy to reach a large target audience for a relatively low outlay of funds, it is easy for the consumer to research the product, and it is easy for marketers to assess the success of the technique by measuring hits on the site compared to online purchases. Disadvantages include the customer cannot physically examine the product and the problem of having not only a secure payments system but a system that protects the consumer from identity theft.

**2.4.8 Global marketing** issues in managing a global business are as follows.

- **Global branding** is where a business uses the same brand (logo, name, trademark) in many different countries to make the brand more widely recognisable, thus helping to increase greater brand awareness and loyalty across the world. The most powerful brands (in 2008) included Google, Microsoft, Coca-Cola and GE (General Electric). Effective global branding is a key contributing factor in driving business growth.

- **Standardisation and differentiation** are important factors in global business. Standardisation is the selling of the same product in more than one country. For example, the PlayStation 3 is the same game console across the world. As the marketing and customer relationship develops to include increasing individualisation and customisation of products, differentiation of a product may be a better approach for certain products. Differentiation is when the same product is adjusted through its marketing mix to be more attractive to the target markets in specific countries.

- **Customisation** allows a business to target different markets segments either within a country or across borders by appealing to local or regional differences. As a business pursues the customisation strategy it has a better chance of maximising sales and acquiring better market share. Customisation is profitable, especially if it means that business increases its market share, but it is difficult to sustain if achieved through product differentiation, is vulnerable to being copied, and non-essential differentiation will be driven out of the market by lack of demand.

- **Global pricing** is influenced by impacts of tariffs and subsidies on the prices of goods and services, fluctuations in interest and exchange rates, methods of payment, price controls, anti-dumping laws, issues involving transfer pricing and exchange rate and credit risks.

- **Competitive positioning** is about creating a competitive advantage by developing an image of the product in the consumer's mind that makes it superior to those of competitors. An effective competitive positioning strategy includes starting with a market profile that includes features of the market (size of market and characteristics of a 'typical' customer);
developing a product or brand image that will appeal to these customers; defining the geographical location of customers; determining whether the product has been positioned to be local, national or global; identifying segments within the typical customer group based on age, gender, income, marital status, and so on, and determining the type of value that the product will deliver to the market. This is a key element of the positioning strategy. Differentiation is the key to positioning, as once potential customers see that what a business is offering is different to (and better than) what others are offering it is relatively easy to build market share.

3.1 Role of financial management

3.1.1 Strategic role of financial management is to provide the financial resources to allow the implementation of the business strategic plan. The strategic plan outlines the goals, objectives and future direction of a business. Financial management involves determining the financial resources available to implement the strategies necessary to achieve the goals and objectives of a business. The key to any business realising its objectives is to successfully finance its operations.

3.1.2 Objectives of financial management are as follows.
- Profitability is the ability to yield profit and refers to the fact that there is a relationship between the sales revenue of a business and the profit it makes. Business owners expect a profit over the long term as this is critical to a satisfactory return on investment. Investors expect that the business will be profitable.
- Growth is the increase in size and value of a business over time. Growth is often a key objective as greater economies of scale can be achieved in a larger operation. Growth also helps to consolidate the position of the business in the market in terms of its competitors. With careful cash flow management rapid growth can avoid serious liquidity and solvency concerns.
- Efficiency relates to achieving the greatest possible return or output from an input by using the lowest amount of resources or assets.
- Liquidity refers to the ease with which an asset can be converted into cash. Liquidity relates to the cash flow position of the business, and focuses on whether a business can pay debts as they fall due. The cash flow of a business is linked to its working capital:
  Working capital = current assets - current liabilities
The yearly management of cash flow is essential to even out fluctuations in the levels of cash inflows and outflows.
- Solvency refers to the extent to which the current assets of a business exceed its current liabilities. When solvency is viewed in this way, it is basically a short-term proposition and means that if current liabilities exceed current assets then the business is able to meet its short-term debt commitments and is described as solvent.
- Short-term financial objectives are mainly concerned with managing cash flow and ensuring that the balance between current assets and current liabilities is positive for the business. In this way the business is able to pay off its debt obligations when they fall due and therefore remain solvent.

3.2 Influences on financial management

3.2.1 Internal sources of finance are obtained from within the business. They include owners' equity, retained profits and sale of assets.
- Owners' equity is funds invested into the business by the owners. For sole traders or partnerships they will be the owners' personal savings while for companies they come from the issuing of shares.
- Retained profits are that part of the net profit of a business that is not paid out as dividends to shareholders. Instead, these funds are invested back into the business.
- Sales of assets such as buildings, plant and equipment is another way that funds from owners' equity can be used to finance business projects.

3.2.2 External sources of finance are funds that are borrowed or provided from outside the business.
- The two main examples of short-term borrowing are overdrafts and commercial bills. An overdraft is an arrangement between the business and its bank that allows the business to overdraft its account by an agreed amount. Interest is charged on the amount of funds that are overdrawn. A commercial bill is a written IOU order by the business to a bank to pay back an amount borrowed from the bank. The IOU will note the date and fixed amount to be repaid. The bill's face value will be higher (e.g. $100,000) than the actual amount borrowed (e.g. $94,000). The difference is the cost of the bill ($6000).
- Bank bills are usually for amounts of more than $50,000 and have terms of 90-180 days. A business will borrow short-term funds to finance temporary periods of lower cash inflows or higher cash outflows. These funds are repaid within a year.
- Factoring is the selling of a company's accounts receivable (money that is owed to the business) to a finance company for immediate cash.
• Forms of long-term borrowing are mortgages, debentures and unsecured notes. Mortgages are loans with a fixed schedule of payments and an asset is provided as security. The assets provided as security for long-term mortgages include property and for shorter-term mortgages equipment such as machinery. Debentures are fixed interest securities issued by a company that will pay a fixed interest rate on the money loaned to the company for a set time period. They are similar to a bank's fixed term deposits except they are issued by large businesses to raise capital. Long-term borrowing is for funds repaid over longer periods, usually three to twenty years. Unsecured notes are loans made by finance companies and are not secured by any assets. A higher interest rate usually applies.

• Leasing is another form of external medium- to long-term finance that allows a business to use an asset in return for payments over a set period. There are two main types of leases. A financial lease is for a set time and payments cover interest and the eventual purchase of the asset. It is similar to a loan. An operational lease is similar to a financial lease except that the business does not gain ownership of the asset at the end of the lease.

• Equity, as a means of raising finance, involves fewer risks than debt financing but has the disadvantage of increasing the number of owners, thus diluting the original owners' share of the business.

Ordinary shares are the usual way that an investor can buy part ownership of a public company (a business that is listed on the Australian Securities Exchange or ASX). New issues of ordinary shares are the usual way that a company would raise additional funds to use for expansion. New issues of shares are offered to existing shareholders and outside investors.

Rights issues involve the offer of additional shares to the existing shareholders of a company. Placements are the issuing of shares directly to an investor, usually an institution, rather than making a public offering. Share purchase plans (SPPs) allow companies to issue a maximum of $5000 in new shares to each existing shareholder without having to issue a prospectus.

• Private equity refers to securities that are held in companies that are not listed and not publicly traded on the Australian Securities Exchange. Strategies for raising finance through private equity include leveraged buyouts (LBO), venture capital and growth capital.

### 3.2.3 Financial institutions

<table>
<thead>
<tr>
<th>Participant</th>
<th>Example</th>
<th>Definition</th>
<th>Financial products</th>
</tr>
</thead>
</table>
| Banks       | Commonwealth, Westpac, NAB | Banks are the main providers of finance to businesses and consumers. Banks make available a wide range of financial products and services to business. The monies deposited for investment are used as loans for borrowers. The interest rate charged is the cost of borrowing these funds. | ▶ Deposit accounts (transaction, cheque, savings, fixed term)  
▶ Overdrafts  
▶ Credit cards  
▶ Short- and long-term loans  
▶ Mortgages  
▶ Leases  
▶ Services including advice, resources and online banking |
| Investment banks | Macquarie Bank, ABN AMRO Australia Ltd | Investment banks are banks that specialise in investment banking for medium to large corporations. Their main functions include private equity activities, international finance, funds management and advisory services, including advice related to mergers and acquisitions | ▶ Commercial bills (bills of exchange issued by investment banks)  
▶ Loans (secured and unsecured)  
▶ Private and project equity raising (underwriting new share issues)  
▶ Investment funds (managed funds, hedge funds)  
▶ Financial market trading (debt securities, foreign exchange, futures) |
| Finance companies | GE Finance, Esanda | Finance companies make loans to consumers and businesses. These loans usually have a higher interest rate and less strict criteria for loans than other creditors. The companies raise funds through debenture (company bond) issue. | ▶ Loans (short and long term)  
▶ Credit cards  
▶ Leasing  
▶ Factoring |
| Superannuation/ mutual funds | AEGST, CBUS | Superannuation is the financial contributions that individuals and their employers make to a fund for use in retirement. Mutual funds are not specifically for retirement but, like superannuation funds, pool a large amount of money to be invested in a wide range of securities, including shares, bonds and the money market. Superannuation is one of the fastest growing investment sectors in the finance industry. As at December 2007, the total estimated superannuation assets for Australia were $1.18 trillion. This provides a large amount of funds for investment in Australian and international capital and money markets. | ▶ Equity capital  
▶ Debt securities (long-term loans) |
<table>
<thead>
<tr>
<th>Classification</th>
<th>Examples</th>
<th>Definition</th>
<th>Financial/other attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance companies</td>
<td>NRMA (IAG), GIG, AAMI</td>
<td>Insurance companies cover various risks that people and businesses face, such as loss or damage to property and motor vehicles, as well as life insurance (providing compensation in the event of death or injury). To purchase insurance, customers pay a premium to an insurance company. These companies invest in other businesses as a method of spreading their exposure to risk.</td>
<td>Premiums, Equity capital</td>
</tr>
<tr>
<td>Unit trusts</td>
<td>Optical Investment Fund of Australia Unit Trust, MLC MasterKey Unit Trust</td>
<td>A unit trust is a fund that is managed by a trustee, which is usually a company. It raises funds from investors which it holds in trust for them and invests those funds in various investments. The advantage for investors is that they can pool their funds and earn a much larger return than if each investor had acted independently. Unit trusts can be fixed or non-fixed. With a fixed unit trust there is one group or class of unit holders with the same right to distributions of capital and income in proportion to the unit holdings of each unit holder. With a non-fixed trust, the fund is able to create two classes of unit holders: ordinary unit holders with similar rights to those in fixed trusts and income unit holders who may receive distributions of the income of the trust.</td>
<td>Mortgage funds, Cash management trusts, Share market funds such as equity growth funds, Property trusts</td>
</tr>
</tbody>
</table>

The role of the Australian Securities Exchange is essential in the financial market. The Australian Stock Exchange merged with the Sydney Futures Exchange to be renamed the Australian Securities Exchange (ASX) Group. The ASX provides a market for investors and companies to buy and sell shares. Investors (through stockbrokers) can provide funds by purchasing shares, bonds and derivatives (futures). This provides equity for a business to grow and expand, assisting its liquidity and long-term stability. The ASX has many roles, including:

- assisting companies to raise initial capital finance through the issue of shares (securities), whereby those buying the shares (investors) become part owners (primary market);
- providing a market for existing company shares to be traded (exchanged) between buyers and sellers (secondary market);
- providing a system for the transfer of share ownership, including the electronic trading systems known as the Integrated Trading System (ITS) and CHESS, which keeps a record of share ownership.

### 3.2.4 Influence of government

The Australian Securities and Investments Commission (ASIC) regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

ASIC licenses and regulates people and businesses engaging in consumer credit activities and assesses how effectively authorised financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. ASIC also licenses and monitors financial services businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, shares and company securities, derivatives and insurance.

The Australian government can have a substantial influence on financial management through the imposition of company taxation. For incorporated businesses (companies), the Australian company tax rate stood at 30 per cent of profits after deductions had been made in November 2010. The average company tax rate for countries at a similar level of economic development to Australia is 25 per cent.

### 3.2.5 Global market influences

The world experienced what has now been labelled as the Global Financial Crisis (GFC) which resulted from a credit crisis in the United States sub-prime market. In 2007, US commercial and investment banks were affected by the inability of borrowers to repay their bank loans.

- **Economic outlook**—the International Monetary Fund (IMF) expects global growth of 4.4 per cent in 2011, slightly higher than its October forecast, and 4.5 per cent in 2012. This is largely driven by better-than-expected activity in the second half of 2010 and new fiscal (taxation) policy initiatives in the United States.
- **Availability of funds**—there was a shortage of funds in the countries most affected by the global financial crisis (GFC), while countries least affected, such as Australia, found a flow of investor funds moving to the more secure investments there.
- **Interest rates**—the countries that were the most affected by the GFC are the countries with the lowest interest rates: the USA, Britain, Canada, the European Union and Japan. On the other hand, Australia (with high interest rates) weathered the GFC reasonably well.

### 3.3 Processes of financial management

### 3.3.1 Planning and Implementing

The elements in the planning cycle are:

- **determining financial needs** by means of a situational analysis of the current financial position. This is the basis for effective financial planning. Data-driven identification of current financial issues and trends will assist with the development of appropriate budgets, analysis, strategies and controls in the planning cycle. This data can be obtained from documents such as the revenue statement, cash flow statements and balance sheets.
- **developing budgets** to identify anticipated sources of revenue and expenses. A budget is a plan predicting the revenue (from sales and investments) and expenses of a business for a future time period. Budgets are derived from the overall strategic business plan.

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**Excel SYLLABUS SUMMARY NOTES 813**
Debt and equity financing—advantages and disadvantages is outlined in the following table.

<table>
<thead>
<tr>
<th>Debt financing</th>
<th>Equity financing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td></td>
</tr>
<tr>
<td>• ownership and control of the business is retained by the business</td>
<td>• the capital does not have to be repaid with interest, within a set time</td>
</tr>
<tr>
<td>• interest repayments are tax deductible</td>
<td>• owners receive returns through both dividend payments and increase in share value</td>
</tr>
<tr>
<td>• loan funds are often easier and quicker to obtain than equity funds</td>
<td>• there is flexibility in timing of dividend payments</td>
</tr>
<tr>
<td>• loans provide a business with the opportunity to grow</td>
<td>• there is greater potential for growth as owners have a vested interest in the success of the business</td>
</tr>
<tr>
<td>• profits are not shared with the lender of the loan</td>
<td>• the debt to equity ( gearing/leverage) ratio decreases, lowering the risk to the business</td>
</tr>
<tr>
<td><strong>Disadvantages—Costs</strong></td>
<td></td>
</tr>
<tr>
<td>• there are initial establishment costs and ongoing fees and charges</td>
<td>• increases the number of owners, reducing the level of control and increasing the sharing of profit and the time taken to make decisions</td>
</tr>
<tr>
<td>• interest has to be paid on the funds borrowed by the business</td>
<td>• in the longer term it is more expensive than debt—dividends are paid to shareholders and owners expect higher returns on capital investment</td>
</tr>
<tr>
<td>• interest rates can vary over the life of the loan, making the loan more expensive than originally planned</td>
<td>• equity is often hard to obtain and can take time to organise and, therefore, may limit growth</td>
</tr>
<tr>
<td>• repayments are often fixed and inflexible</td>
<td>• legal and administration costs are high</td>
</tr>
<tr>
<td>• amount must be repaid in a set period of time</td>
<td>• equity funding is not tax deductible</td>
</tr>
<tr>
<td><strong>Disadvantages—Risks</strong></td>
<td></td>
</tr>
<tr>
<td>• interest rates may increase, thus increasing the cost of the loan and repayments</td>
<td>• central control of ownership is reduced, causing a loss of control in decision-making</td>
</tr>
<tr>
<td>• cash flow difficulties may develop, causing the business to have difficulty repaying (servicing) the loan and this can lead to defaulting on the loan</td>
<td>• high demand for dividend payments to shareholders may reduce the level of retained profits</td>
</tr>
<tr>
<td>• if it is a secured loan, defaulting on the loan may lead to loss of the asset</td>
<td>• the business is more open to takeovers if another business buys a majority (51%) shareholding in the business</td>
</tr>
</tbody>
</table>

Gearing, or leverage, is the relationship between the level of debt to equity financing in a business. The gearing ratio or leverage of a business is important to its long-term stability.

Matching the terms and source of finance to business purpose—business managers who are effective in their financial decision-making will ensure that the terms and sources of the chosen finance match the business purpose:

• **Terms and purpose:** short-term assets should be funded by short-term finance.
• **Sources:** a business will need to consider the costs, benefits and risks associated with debt and equity finance and choose that which is most appropriate for the business.

3.3.2 Monitoring and controlling—cash flow statement, income statement, balance sheet is outlined below.

The accounting framework involves the collection, analysis and interpretation of financial information. Its essential role is to provide a control process for managers to assess their operations and take corrective actions where appropriate.

The three financial statements that students are required to analyse and interpret are the cash flow statement, income statement and the balance sheet.

Cash flow statements are important financial reports that forecast the monthly cash inflows and outflows of the business. This statement helps business managers meet their financial obligations and respond to periods of cash shortfalls and surpluses. There is an example of a cash flow statement on the following page.
The income statement, also referred to as the profit and loss statement or statement of financial performance, outlines the level of revenue (sales), costs of goods sold and operating expenses and calculates whether a business has made a profit or loss over a particular period of time, usually a year. Key terms and calculations needed to understand the income statement are:

- sales revenue—all goods sold
- cost of goods sold (COGS)—opening stock plus purchases and minus closing stock
- expenses—total operating costs of the business
- gross profit—sales revenue minus COGS
- net profit—gross profit minus expenses.

An income statement is shown below.

### Coco’s Coastal Cafe

#### Income statement for the year ending 30 June 2011

<table>
<thead>
<tr>
<th></th>
<th>$'000</th>
<th>$'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Less Cost of goods sold</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td>Less Operating expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling expenses</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>General expenses</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>120</td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td>280</td>
<td></td>
</tr>
<tr>
<td>Less Interest payment on loans</td>
<td>70</td>
<td></td>
</tr>
<tr>
<td>Net income before tax</td>
<td>210</td>
<td></td>
</tr>
<tr>
<td>Less Tax</td>
<td>63</td>
<td></td>
</tr>
<tr>
<td>Net income after tax</td>
<td>147</td>
<td></td>
</tr>
</tbody>
</table>

The balance sheet is a statement showing the financial position of a business at a particular point in time (usually 30 June). The balance sheet shows the short- and long-term assets (what the business owns), the short- and long-term liabilities (what the business owes) and the equity (capital provided by the owners). A balance sheet is essential in assessing the level of liquidity, gearing and solvency. It will influence financial managers’ decisions regarding appropriate sources of finance for the business. An example of a balance sheet is shown below.

### Coco’s Coastal Cafe

#### Balance sheet for the year ending 30 June 2011

<table>
<thead>
<tr>
<th></th>
<th>$'000</th>
<th>$'000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Non-current assets</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Equipment and furniture</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Motor vehicle</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Intangible assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>240</td>
<td></td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Mortgage</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td></td>
<td>240</td>
</tr>
</tbody>
</table>

**Key terms for understanding a balance sheet are:**

- **Current assets**: Short-term assets that can be changed into cash quickly—within the year—to help pay short-term debt.
- **Accounts receivables**: Amounts owed to the business by people. These people are in debt to the business.
- **Non-current assets**: Longer term assets that are used to assist business production and are used for more than one year.
- **Total assets**: Current assets + non-current assets.
- **Current liabilities**: Short-term debts of the business that must be repaid within the year.
- **Accounts payable**: Amounts the business owes to other people. The business has received trade credit from other businesses and must repay in the short term, usually 30–60 days.
- **Non-current liabilities**: Longer term debts to be repaid over periods greater than one year.
- **Total liabilities**: Current liabilities + non-current liabilities.
- **Owners’ equity**: The investment (capital) contributed by the owners of a business. It is the owners’ share of the total value of the business after debts have been paid. This capital is owed to the owners by the business.

The **accounting equation and relationships** are as follows:

- Total equity = total assets – total liabilities, or
- Total assets = total liabilities + total equity.

### 3.3 Financial ratios

Financial ratios are calculations that help managers examine the performance of the business and determine if the business is meeting its financial objectives. Ratios allow comparisons to be made over time, with the previous year’s performance, between business competitors and against industry averages and benchmarks.
The financial ratios required by the HSC syllabus are outlined in the table below.

<table>
<thead>
<tr>
<th>Ratio type</th>
<th>Financial ratio</th>
<th>Formula</th>
<th>Reasons for the use of this ratio</th>
<th>Suggested ratio level</th>
</tr>
</thead>
</table>
| Liquidity           | Current ratio   | \[
\frac{\text{Current assets}}{\text{Current liabilities}}\] | The ratio gives an indication of how well a business can meet its current liabilities from its current assets. | The generally preferred ratio level is 2:1. This means that for every $2 of current assets there is $1 of current liability. This means that the business is able to meet its short-term debts comfortably. |
| Gearing             | Debt to equity ratio | \[
\frac{\text{Total liabilities}}{\text{Total equity}} \times \frac{100}{1}\] | Gearing is the relationship between the level of debt of the business and the level of total equity. If a business is highly geared it faces the possibility of not being able to repay its debt and becoming insolvent. | The preferred ratio depends on the specific circumstances but for small business 60% is an acceptable level: for every 60 cents of liabilities there is $1 of total equity. The higher the % the greater the financial risk. Large companies may operate at over 100%. |
| Profitability       | Gross profit ratio | \[
\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}\] | This ratio measures what percentage of each dollar of sales is gross profit. It indicates the mark-up on the goods that are sold by the business. The ratio measures what percentage of each dollar of sales is net profit. It takes into account the operating expenses. This is one of the most important indicators as it shows how much the owner’s investment and risk in the business is earning. | The suggested ratio level depends on the type of industry. A gross profit figure of 30% indicates that every dollar of sales contributes 30¢ of gross profit to the business. Falling figures or a low figure compared to similar businesses would be a concern. A high or at least increasing % is preferred but it depends on the industry. The higher the return the better. Usually over 20% is a good return. |
|                     | Net profit ratio | \[
\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}\]   |                                                                                                   |                                                                                        |
|                     | Return on equity | \[
\frac{\text{Net profit}}{\text{Total equity}} \times \frac{100}{1}\] |                                                                                                   |                                                                                        |
| Efficiency          | Expense ratio   | \[
\frac{\text{Expenses}}{\text{Sales}} \times \frac{100}{1}\] | This shows the relationship between sales and the expenses that the business has made in making those sales. | This depends on the specific circumstances and strategies that the business may be undertaking. However, increasing expenses over time will need closer review. The standard time to repay credit is between fourteen and thirty days. If the accounts receivable rate is more than ten days above the standard payment time, then the business should be concerned. |
|                     | Accounts receivable turnover ratio | Two steps to calculation: \[
1. \frac{\text{Credit sales}}{\text{Accounts receivable}} = \text{Result} \]
\[
2. \frac{365}{\text{Result from step 1}} = \text{Days}\] | This ratio shows how long it takes for the business to receive cash for its credit sales from the debtors. |                                                                                        |

**Comparative ratio analysis** is made:
- **over different time periods**—comparing ratios for a business over various periods to identify trends and assist with interpretation of ratio results;
- **against common standards** such as industry averages and benchmarks to assist a manager’s interpretation and decision-making on the business’s performance;
- **with similar businesses**—comparing ratios from businesses in the same industry and of the same size will give further insight into the performance of a business.

**3.3.4 Limitations of financial reports** are outlined below.
- **Normalised earnings** are earnings on the balance sheet that are adjusted to remove unusual or ‘one-off’ events. An example would be a situation where an accounting business sold a block of land that it owned in the central business district of a large city. The proceeds of the sale would be quite substantial and might give an unrealistic picture of the profit for that business for that year.
- **To capitalise an expense** is to change the expense from a ‘one-off’ operating expense into a capital item which can then
be depreciated over time. If a business is able to capitalise an expense, it becomes an asset and is then recorded in the balance sheet of the business. This will have three immediate impacts: operating expenses will be reduced thus increasing the operating profit of the business; the assets of the business will increase and this will cause a change to the liabilities of the business.

- **Valuing assets**—the way in which the assets of a business are valued will have a significant impact on the balance sheet. Historical cost accounting values assets as equal to the cost of the asset at the time of purchase. It assumes the value of the dollar and inflation rate is the same for the whole accounting period. This is a limitation as assets can increase in value over time and inflation can raise the level of prices.

Intangible assets include goodwill, brand names, patents and copyrights. As these are not physical assets it is difficult to determine their real value, and various interpretations can be placed on their value as stated in the balance sheet. This limitation has largely been removed because of Australia’s adoption of International Accounting Standards.

- **Timing issues**—businesses find it convenient to prepare financial reports on a frequent basis. Managers usually require monthly reports and the Australian Tax Office requires businesses to report on their financial activities on a yearly basis. Usually the finance function of a business will prepare reports on the basis of a month, a quarter (three months), six months and one year.

- **Debt repayments**—debt transactions involve the borrower receiving an amount of money now. In return, the borrower agrees to repay the lender over a period of time. In this way the borrower provides the lender with an income stream. It is possible under some circumstances that the borrowing business may get into financial difficulties in repaying its interest and principal to the lending business. The lending business may be faced with the possibility that the borrowing business may go into receivership. Rather than allow this to happen, with the possibility of the loan never being repaid, the lender may make arrangements with the borrower to convert the debt into equity.

- **Notes to financial statements** are additional information provided in the financial statements of a business. Notes to financial statements explain the details and additional information that are left out of documents such as the income statement and balance sheet. This is done mainly to make the financial documents clearer. Information can include the explanation of individual items in the reports, the valuing system used for assets having value for an intangible asset was arrived at or even whether the accounting system that was used is cash- or accruals-based.

### 3.3.5 Ethical issues related to financial reports

**Audits** are used to check that businesses are not using illegal and unethical financial practices such as **inappropriate cut-off periods and misuse of funds**. An audit is an independent examination of financial information. Financial audits may be both internal and external. All public companies and many other organisations must have their accounts externally audited to make sure that the information provided is a true and proper record of their finances. Large businesses will also use their own internal auditors to check for irregularities. External auditors are independent and are employed on a fee for service basis.

**Other ethical issues** related to financial reports include:

- **Fictitious revenues**—revenues that do not exist and have been included to make the business look better than it really is.

- **Hidden liabilities and expenses**—these are often not included in balance sheets or income statements or are amalgamated with other liabilities or expenses to hide the true outgoing from owners, shareholders or other stakeholders.

- **Improper disclosures or omissions**—can obscure the real position of a business or imply that something actually exists when it does not.

- **Fraudulent asset valuations**—this can be a variation of historical value or reckless valuing of intangible assets such as goodwill.

### 3.4 Financial management strategies

Effective financial planning is essential to ensure an adequate cash flow, achieve financial objectives and avoid business closure. Two key aspects of effective financial planning are effective cash flow management and effective profitability management.

#### 3.4.1 Cash flow management

- **Cash flow** is the cyclical flow of cash in and out of the business. Cash inflows include sales, accounts receivable and commissions, while cash outflows include wages, payments to suppliers, insurance and loan repayments. Monitoring all cash inflows and outflows is essential for the effective management of the business. If there are more cash outflows than cash inflows, then there is a cash flow problem. Cash flow problems are one of the top ten reasons a business will fail. The three types of cash flows a business needs to monitor are operational flows which relate to producing and selling the output of the business; investment flows, which relate to buying and selling of the non-current assets such as property or new equipment; and financial flows, which relate to the flows of cash associated with debt and equity financing such as interest payments. For information on **cash flow statements**, refer to section 3.3.2 of this summary.

- **Management strategies** most often used to manage cash flow are distribution of payments and discounts for early payment. The money coming into the business will not evenly match payments due from the business. The business needs to understand the pattern of their cash inflows and cash outflows and link their payments to periods when they have higher cash inflows. For some businesses that receive regular cash inflows it is desirable to spread payments (cash outflows) evenly throughout the year. For other businesses it may be better to link lump sum payments to periods when they are receiving large cash inflows.

- **Discounts** are reductions in the price of the good or service if payment is made earlier. Businesses can offer discounts for cash and early payments. This encourages quick payment from customers (debtors), improving cash flow for the business. It can be a cheaper option than the use of an overdraft. The use of overdrafts and lines of credit will assist businesses in periods when cash outflows are greater than cash inflows. This is an expensive short-term solution.

- **Factoring** is the selling of a company’s accounts receivable (money that is owed to the business) to a finance company for immediate cash. It improves working capital by giving a business immediate access to cash from its credit sales.

#### 3.4.2 Working capital management

The **working capital ratio**, or current ratio, is the current assets divided by current liabilities. Working capital is the difference between current assets and current liabilities and can be expressed as an equation:

\[
WC = CA - CL
\]

Working capital is needed so that a business can extend credit to customers, buy stock and inventory and meet its current debts or financial commitments. Working capital needs to be managed for
a business to remain in operation. If there is too little working capital (CL > CA), then there will be liquidity difficulties. If there is too much working capital (CA > CL), then it limits the options for growth, profit and expansion.

Control of current assets (cash, receivables, inventories) is part of managing working capital.

- **Cash** is necessary to meet the operating costs of the business. Cash budgets are an effective method of helping to control cash as they help a business prepare for shortfalls and surpluses at different points of the year.
- **Accounts receivable** (or **receivables**) is the total amount of money that customers owe the business. A business needs to encourage these debtors to pay their accounts as quickly as possible. Some strategies to control receivables include discounts on cash and early payments, charges for late payment, sending out invoices and reminders more regularly (fortnightly rather than monthly), offering outside credit facilities such as payment by credit card, having a clear credit policy that includes details of credit checks and the collection process, and factoring.
- **Inventory control** requires a balance between too much and too little stock. Effectively controlling inventory allows a business to keep costs low. Strategies involved in the management of inventory include regular and ongoing stocktaking, control systems (e.g. perpetual inventory systems and just-in-time (JIT) inventory supply systems), use of sales to convert stock into cash etc.

Control of current liabilities (payables, loans, overdrafts) is critical to the business because a business must be able to meet these short-term debts in order to maintain effective liquidity. Businesses will need to control payables, loans and overdrafts.

- **Accounts payable** are the amounts that a business owes to other businesses and that need to be paid in a relatively short time. This is referred to as trade credit and different suppliers will have different terms and conditions. Some strategies include payment on time (to avoid late fee charges), taking advantage of early payment discounts and maintaining a good credit rating for continuing access to lines of credit provided by suppliers.
- **Interest and loan repayments** must be paid by the due date. The preparation of cash budgets and cash flow statements is vital for a business to control these effectively.
- **Overdrafts** can be very useful to a business in managing its working capital. When the cash budget indicates that there will be a shortage of cash, the business can use its overdraft to pay its accounts and other short-term debts.

**Strategies (leasing, sale and lease back)** are:

- **Leasing** is a financial arrangement that allows a business to use an asset in return for payments over a set time. By leasing assets the business maintains more working capital to invest in other assets and opportunities for expansion of the business.
- **Sale and lease back** involves the selling of assets such as buildings and equipment and leasing them back from the purchaser. This allows the business to raise finance without incurring new debt. The advantage of this to managing working capital is that the business has sold an asset and received cash. It will only have to pay a fraction of the value of the asset to lease it back from the purchaser.

### 3.4.3 Profitability management

Effective profitability management relies on cost control and revenue controls. Profitability is the ability to make a financial return from business activities. Profit can be calculated as the difference between revenue (such as sales) and expenses (costs related to the product/service). To maximise profits businesses need to keep expenses and costs under control and increase revenues.

**Cost control** is essential as poor cost control (costs are an outflow of cash from a business) means that profits will be reduced.

- **Fixed and variable costs.** Fixed costs such as insurance, interest payments and rent do not vary in relation to output. To minimise fixed costs it is essential to negotiate satisfactory arrangements initially or to take advantage of discounts for early payment. Variable costs such as those for raw materials, labour and delivery expenses such as petrol do vary according to output. Careful monitoring is needed to keep these costs under control.
- **Cost centres.** Businesses attempt to control costs by allocating a proportion of total costs to particular parts of the business. These cost centres are then responsible and held accountable for the costs that they incur.

**Expense minimisation.** Business managers understand the relationship between costs and expenses on the one hand and profits and competition on the other. Expense minimisation is reducing the costs and expenses in order to maximise the profits and gain a competitive advantage. Strategies include outsourcing, sales and lease back, replacing labour with technology, where appropriate, reducing inventory overheads (e.g. by implementing just-in-time inventory system) and improving budgeting and accountability.

**Revenue controls** are designed to ensure that there is income flowing into the business on a regular basis. Once this has been achieved, revenue controls aim to increase revenues and, therefore, improve profit levels. Three areas of revenue control are:

- **Sales objectives** are the link between the marketing plan and the financial plan. Sales targets are set to maximise sales, increase the turnover of stock and, ultimately, maximise revenues.
- **The sales mix** is the range of products and services sold by the business. Products with the greatest profit margins and that show high growth potential are developed, while slow moving and poor profit items are phased out.
- **A pricing policy** is necessary because setting prices is a complicated task and staff need to be aware of the business strategy for pricing. The main aim of a pricing policy is to balance sales with profits. Effective profitability management is outlined in the table below.

<table>
<thead>
<tr>
<th>Revenue controls</th>
<th>Cost and expense controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales objectives-set targets to generate maximum revenue</td>
<td>Fixed and variable costs—identify and account for expenses, alternative suppliers, bulk purchases, discounts on early payment</td>
</tr>
<tr>
<td>Sales mix—review each product's profit-margin contribution; have narrow or broad sales mix</td>
<td>Cost centres—make managers accountable for their business centre's expenses</td>
</tr>
<tr>
<td>Pricing policy—review price penetration, price skimming, price points, discounts</td>
<td>Expense minimisation—develop budgets to control use of technology, outsourcing, JIT system, casual employees</td>
</tr>
</tbody>
</table>

### 3.4.4 Global financial management

There are a number of elements of global financial management that have an impact on financial management strategies. They include exchange rates, interest rates, methods of international payment (payment in advance, letter of credit, clean payment, bill of exchange), hedging and derivatives.
• Exchange rates—currency fluctuations arise because of movements in the exchange rates of different currencies. An exchange rate is simply the price of one currency expressed in terms of another currency. Currency fluctuations can affect the prices paid and received for goods and services. Currency fluctuations will influence a business’s production and financial decisions and its international competitiveness. If the Australian dollar depreciates (goes down) compared to overseas currencies, Australian exports will be cheaper and imports more expensive, making Australian businesses more competitive in international markets. If the Australian dollar appreciates (goes up), Australian exports will be more expensive and imports will be cheaper, making Australian businesses less competitive in international markets.

• Interest rates can have an impact on the willingness and ability of businesses (domestically and overseas) to invest in business activities, and of customers (domestically and overseas) to purchase goods and services. Low interest rates reduce borrowing costs and encourage expansion, both at home and overseas. High interest rates increase borrowing costs and discourage expansion, both at home and overseas.

• Methods of international payment are outlined in the table below.

<table>
<thead>
<tr>
<th>Payment in advance (prepayment)</th>
<th>Payment is sent by the buyer before goods are sent</th>
<th>Most secure; least risk</th>
<th>Highest risk; least secure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Letters of credit (also termed documentary credit)</td>
<td>This is a bank-to-bank commitment where the buyer’s bank guarantees payment for the goods once the bank receives certain documents agreeing to the buyer’s terms of purchase</td>
<td>More secure as it reduces risk for exporter as the bank takes on payment risk</td>
<td>High risk; less secure if terms of documents not met</td>
</tr>
<tr>
<td>Clean payment</td>
<td>The clean payment method offers a relatively cheap and uncomplicated method of payment for both importers and exporters. All shipping documents, including title documents, are handled directly between the trading partners. The role of banks is limited to clearing amounts as required. There are basically two types of clean payments: 1. advance payment (see above) 2. open account—goods are sent to the buyer with a request for payment at a later date</td>
<td>Most secure; least risk</td>
<td>Least secure; most risk</td>
</tr>
<tr>
<td>Bills of exchange (also termed bills for collection)</td>
<td>Exporters will send documents from their bank to the buyer’s bank after goods have been sent. Exporter can specify that goods are released to buyer only after payment is received or an acceptance (bill of exchange) to pay at a future date is signed.</td>
<td>Less secure but risk reduced for exporter as they can communicate directly between their bank and the buyer’s bank</td>
<td>Most secure: this is the best option for cash flow</td>
</tr>
</tbody>
</table>

Chapter 4: Human resources

4.1 Role of human resource management

Human resource (HR) management refers to systems that have been developed to manage people within an organisation or a business.

4.1.1 Strategic role of human resources is to ensure that the productivity of a business or its output per person can achieve its fullest potential because the employees of the business are effective and efficient in the way they go about their tasks.

4.1.2 Interdependence with other key business functions is as follows

• HR and operations—HR management contributes to the core business function of operations through planning staff needs, acquiring employees, training and developing them, and through supervision, maintenance and conflict resolution.

• HR and marketing—the marketing function will be heavily involved with new product design and development. Marketing will also focus on customer satisfaction. A major part of the HR management function will be to hire and train employees of the business and this will be important in the marketing area. It will be the function of marketing to bring the product of the business to the customer.

Excel SYLLABUS SUMMARY NOTES 919
4.2 Key influences

4.2.1 Stakeholders in the employment relations process are as follows.

- **Employers** are individuals, companies, governments and non-profit organisations that seek and employ labour. Employers are vital as they provide employment opportunities and determine wages and working conditions.

- **Employees** are individuals engaged by employers to perform tasks for a reward. This may be on a full-time, temporary, part-time or casual basis. When an employee is hired to perform work, even if there has been no document signed, an employment contract has been established. This contract identifies the rights and responsibilities of both parties.

- **Employer associations** are support organisations for employers. Examples are the Business Council of Australia (BCA) and the Australian Chamber of Commerce and Industry (ACCI). These organisations represent the interests of employers in specific areas, such as negotiations with employees and unions, to develop policies and strategies for effective employment relations and to act as lobby groups to further the interests of their members.

- **Unions** are organisations that represent groups of employees on issues such as pay and conditions, health and safety, and job security. The role of the union is to support, advise and represent employees when making collective agreements and in wage negotiations and industrial conflicts, to advise them on their legal rights and responsibilities, and to act as a pressure group to highlight workers’ concerns. The peak union body is the Australian Council of Trade Unions (ACTU).

- **Government organisations**—the government develops the legal framework of employment and establishes independent organisations—such as the NSW Industrial Relations Commission and Fair Work Australia (FWA)—to support this legal framework. These organisations oversee, regulate and support HR to ensure compliance with the law.

- **Society**—a stakeholder is an individual or group with an interest in an organisation and its activities. As such, society as a whole has an interest in the outcomes of HR processes in businesses.

4.2.2 Legal influences are as follows.

- **The current legal framework**—the current Commonwealth legislation that governs most issues dealing with employment in Australia is the Fair Work Act 2009 (Cth) and the Fair Work Regulations 2009 which derived from the Act. The Fair Work Act and Regulations provide workplace laws that are fair to working Australians; are flexible for business; promote productivity and economic growth for our future economic prosperity; and take into account our international labour obligations.

- **Employment contracts** are agreements between employers and employees to ensure that responsibilities are performed and rights are protected. A contract usually has three parts: an offer, an acceptance and a consideration (something of value, usually skills, in exchange for payment). Written and verbal contracts are legally enforceable by courts. Contracts are either contracts of service (the standard employer-employee relationship) or contracts for service, where a ‘contractor’ such as a plumber or builder will perform a specific job for a set time.

- **Common law (rights and obligations of employers and employees)**—these are set out in the following table.

<table>
<thead>
<tr>
<th>Employer Responsibilities</th>
<th>Employee Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay correct wages</td>
<td>Follow lawful and reasonable instructions</td>
</tr>
<tr>
<td>Cover work-related expenses</td>
<td>Use due care in performance of duties</td>
</tr>
<tr>
<td>Provide safe working environment</td>
<td>Are accountable for all money and property (e.g. laptops and mobile phones) received while in employment</td>
</tr>
<tr>
<td>Forward PAYG tax to the Australian Tax Office</td>
<td>Are faithful to an employer’s interests (e.g. do not tell competitors about products or put down the products)</td>
</tr>
<tr>
<td>Make required superannuation contributions</td>
<td>Make available any product or process developed while in employment</td>
</tr>
<tr>
<td>Act in a way that will not affect an employee’s reputation, cause mental distress or damage the trust and confidence of the employment relationship</td>
<td></td>
</tr>
</tbody>
</table>

- **Statutes** are laws passed by parliaments and they take priority over common law. Statutes are often amended and changed to reflect changing workplace conditions and government policy. The current statute law that establishes employment contracts is the Fair Work Act 2009 (Cth). The Act also provides a safety net of enforceable minimum employment terms and conditions through the National Employment Standards (NES).

- **Minimum employment standards**—the Fair Work Act provides a safety net of enforceable minimum employment terms and conditions through the National Employment Standards (NES), which sets out ten minimum workplace entitlements which apply to all employers and employees in the national workplace relations system.

- **Minimum wage rates**—the minimum wages received by employees in the national workplace relations system are reviewed by Fair Work Australia annually, with any adjustments taking effect from the first pay period on or after 1 July each year. Employers and employees cannot agree to a rate of pay which is less than the applicable minimum wage. From 1 July 2010 the national minimum wage is $569.90 per week (before tax), or $15 per hour. This will be reviewed before July each year.
Awards are legally binding orders, usually made by a court or industrial tribunal, that define working conditions and set wage rates and other entitlements. Awards are usually industry-wide.

Enterprise agreements are made at an enterprise (workplace or industry) level between employers and employees about terms and conditions of employment. Fair Work Australia has the power to assist in the process of making such agreements, and also has the power to deal with disputes arising under the terms of agreements and assess and approve agreements.

An enterprise agreement is made between one or more employers and employees, and one or more relevant employee organisations (unions).

Other employment contracts are casual, part-time, and flexible contracts.

Casual workers are temporarily or irregularly employed and are paid by the hour. The hourly rate may be higher than for permanent workers but casual workers have no leave entitlements, superannuation or ongoing permanent employment. Casual workers have less security than part-time employees as they can be terminated quickly, usually immediately.

Part-time employment is employment for a number of hours less than the standard full-time hours in the relevant award or agreement. This is usually on a permanent basis. Employees are still entitled to holiday, sick and long-service leave on a pro rata basis.

Flexible employment can refer to people who are independent contractors or people employed in casual or part-time employment. Independent contractors have contracts for service and are employed for a specific task in a set time.

Permanent employment usually involves thirty-five to forty hours of work per week. Workers may be paid an hourly rate or a set annual salary with other conditions written-in to their employment contracts.

Occupational health and safety and workers' compensation is outlined below.

Occupational Health and Safety (OH&S) — Australia has nine jurisdictions that make OH&S laws. The body that administers Commonwealth-OH&S is Safe Work Australia (SWA). SWA was established by an Act of Parliament, with functions established by the Safe Work Australia Act 2008. Safe Work Australia's functions include developing national policy relating to OH&S and workers' compensation.

Workers' compensation legislation is designed to encourage safe work practices, provide financial assistance to workers who are injured in the workplace and assist workers to return to work. In NSW workers' compensation is administered by WorkCover New South Wales under two Acts of state parliament: the Workers Compensation Act 1987 (NSW) and the Workplace Injury Management and Workers Compensation Act 1998 (NSW).

Anti-discrimination — there are two main types of discrimination, direct and indirect.

Direct discrimination: when a person is treated less favourably than others solely on the grounds of sex, age, race, marital status or physical characteristics.

Indirect discrimination: in which a person who should be given special consideration is not and this results in an unfavourable outcome for that person.

Employers should ensure that neither direct or indirect discrimination takes place. The Anti-Discrimination Act 1977 (NSW) entitles employees to fair treatment while the major Commonwealth legislation in this area is the Australian Human Rights Commission Act 1986 (Cth) (formerly called the Human Rights and Equal Opportunity Commission Act 1986) which established the Australian Human Rights Commission (formerly called the Human Rights and Equal Opportunity Commission). This Commission has a role to enforce equal opportunity in the workplace at the federal level and ensure that other Commonwealth anti-discrimination laws are enforced.

Equal Employment Opportunity (EEO) means that employers prepare and implement specific equal employment opportunity management plans and programs designed to ensure that all employees get equal opportunity in the workplace. The Human Rights and Equal Opportunity Commission Act 1986 (Cth) mandates that employers ensure fairness in employment opportunities to all employees. The New South Wales law which makes equal employment opportunity mandatory is the Anti-Discrimination Act 1977 (NSW).

Unfair dismissal is when a worker has been dismissed or threatened with dismissal from their job and believes that this action is 'harsh, unjust and unreasonable'. Claims against unfair dismissal are supported by the Industrial Relations Act 1996 (NSW), and a worker can apply to the NSW Industrial Relations Commission for reinstatement or compensation.

4.2.3 Economic influences are as follows.

Economic cycle is the succession of booms and recessions that take place in an economy. Employment levels and the demand for labour and indirectly the relative bargaining power of labour will therefore fluctuate depending on the particular stage of the economic cycle at the time. In periods of strong economic growth labour will be in strong demand and wages and conditions should improve. In times of recession the opposite situation will exist.

Globalisation impacts on Australian businesses through greater competition, more foreign ownership of businesses with many Australians now working for overseas companies, and overseas relocation by many Australian businesses to reduce labour costs.

4.2.4 Technological influences impact on all aspects of HR. Technology has made significant changes to the recruitment process through online job searching and the ability for businesses to perform background checks on applicants. Technology has also led to employee self-service, whereby pay and tax information and leave applications can be accessed online. This reduces the need for employees to occupy the time of the HR employees.

4.2.5 Social influences include changing work patterns and living standards.

Changing work patterns include: greater participation by women, an increase in casual and part-time work, increases in outsourcing and contract work, an increase in service jobs such as retailing, a smaller proportion of workers needed in secondary industry and continual upgrading of skills to deal with technological change. Technical change in particular has greatly changed work patterns: employees have to be more flexible and willing to learn new skills and constantly retrain.

Living standards — standard of living can be defined as the level of material wellbeing as measured by the amount of goods and services that are available to an individual. This involves goods and services purchased directly and therefore dependant on the money income from all sources to which a person has access.

4.2.6 Ethics and corporate social responsibility are as follows.

Ethics — ethical responsibility in HR management is where managers understand value systems and morality or what is ‘right’ or ‘wrong’ with regard to processes of human resource management. These processes include acquisition, development, maintenance and separation of human resources.

Corporate social responsibility (CSR) is a commitment by a business to operate ethically and contribute to economic development while improving the quality of life of our
workforce and their families as well as the community at large. Many businesses operate a corporate social responsibility program and often this program becomes the responsibility of the human resources function.

4.3 Processes of human resource management

4.3.1 Acquisition is the obtaining of employees. In the acquisition phase, society is informed that a business needs employees, via advertisements in newspapers or journals, online, or electronic media such as radio and television and through word of mouth. Acquisition of HR is most concerned with:
- ensuring that there are stable workforce levels and that the business does not suffer because a position needs to be filled.
- preventing a high rate of turnover, especially with new employees. Turnover can be expensive in any organisation.
- succession planning and ensuring that key roles in the business are filled as soon as possible.
- acquiring employees within the budgets established by the finance function.

Some recruitment processes may involve written tests and medical examinations. HR personnel follow strict procedures and keep detailed records to avoid any challenge on the grounds of discrimination from an unsuccessful applicant.

4.3.2 Development is concerned with improving the performance of employees through educational programs. Development has four strands: induction, performance appraisal, training and development.
- Induction is the educational process of making a transition to a new workplace and even a new role. The main idea behind induction is to familiarise the new employee with the workplace so that their performance will be more effective.
- Performance appraisal is a process of evaluating the performance of employees, usually conducted by an employee's supervisor.
- Training involves educating an employee in the skills and processes of the job that they currently hold.
- Development involves selecting employees for educational programs that focus on roles that they may aspire to in the future. This usually applies to employees with managerial potential.

4.3.3 Maintenance has two strands, compensation and employee benefits.
- In terms of compensation, the business will need to observe any legal requirements such as enterprise agreements or contractual arrangements. The compensation system will be designed to offer incentives to employees to strive to achieve their best so as to maximise their output.
- In terms of employee benefits, the business will offer employees various benefits such as a superannuation scheme and various types of leave, including paid parental leave.

4.3.4 Separation is the process where employees leave the business. They will leave through retirement, resignation, redundancy or dismissal. This implies that separation can be voluntary or involuntary. Voluntary separation involves either retirement or resignation. There may also be the category of voluntary redundancy. Involuntary separation involves involuntary redundancy and dismissal.

Retirement can occur for a number of reasons, the most common being that the employee has reached retirement age and is eligible to receive a superannuation pension.

Resignation occurs when an employee decides to leave the organisation but has not reached the age of retirement.

Voluntary redundancy usually occurs when a business wants to reduce its labour force. Voluntary redundancy will often be offered to employees nearing retirement. The employee has the choice to take the redundancy package or to remain with the business.

Involuntary redundancy means that an employee is retrenched without wanting to be. It is usually not related to poor performance but because of economic cycles and the need of the business to reduce its workforce.

Dismissal occurs where an employer terminates an employee's position, usually because the employee has either performed poorly or for criminal acts against the employer. In other cases, the employer must give the employee a reason why he or she is at risk of being dismissed. The reason must be based on the employee's conduct or capacity to do the job.

4.4 Strategies in human resource management

4.4.1 The leadership style adopted by a manager will depend on the type of business, the manager's personality and the circumstances requiring leadership and decision making.

Autocratic leadership style is characterised by high levels of authority and obedience up the chain of command, limited amounts of flexibility, little participation by staff in decision-making and strict adherence to defined lines of command. There are situations where an autocratic leadership style may be appropriate.

The 'laissez-faire' manager exercises little control, leaving groups to sort out their roles and perform their work. This technique is usually only appropriate when a manager is leading a team of highly motivated and skilled people who have produced excellent work in the past.

Democratic or participative leadership style is one that encourages the leader and the employees to work together in the decision-making process so as to make informed decisions. Features of this style include: encouraging employee participation in decision-making, establishing effective two-way systems of communication (including feedback), and allowing for greater flexibility and negotiation of goals and tasks.

4.4.2 Job design—general or specific tasks

Job design is the process of describing and defining the general and specific tasks that need to be performed by an employee; it determines how work should be performed. The two main goals of job design are to satisfy the needs of the business in terms of greater productivity from employees and efficiency and quality in the operations key business functions, and to satisfy the workplace needs of employees.

- General tasks—an advantage of having general tasks as a principle of job design is that the employee is engaged in a variety of tasks which will help to overcome boredom. Moving from task to task can avoid health and safety issues.

- Specific tasks—the advantages of specific task design leading to specialisation are that a business would have increased performance. Employees would become skilled at performing a few tasks and their output would be of a much higher quality. A disadvantage of specific task design is that the specialised jobs become routine and boring.

4.4.3 Recruitment—internal or external, general or specific skills

Internal recruitment means that a business will try to fill a position from within the organisation. This may involve promotion or a change in role for the successful employee. Internal recruitment is good for filling job positions which need a knowledge of the organisation and its corporate culture.
4.4.4 Training and development—current or future skills
Training involves educating an employee in the skills and processes of the job that they currently hold. Training can be carried out in-house or via external, correspondence or online courses. Development involves selecting employees for educational programs that focus on future roles. If the goal of the business is to develop skills for current needs, training is the appropriate vehicle. If the business is looking to the future then development is appropriate.

4.4.5 Performance management—developmental or administrative
In the last two decades, performance management has embraced the ideas of talent management, management by objectives and constant monitoring and review. An effective performance management strategy focused on development of the employee establishes the groundwork for excellence by:
- linking individual employee objectives with the mission and strategic plans of the business;
- focusing on setting clear performance objectives and expectations through the use of results, actions and behaviours;
- defining clear development plans, and
- conducting regular discussions throughout the performance cycle.

4.4.6 Rewards—monetary and non monetary, individual or group, performance pay are the incentives that are provided to compensate and motivate people for their time, skills and effort in a job. Rewards are both monetary and non-monetary.
- Monetary rewards are the financial incentives provided to complete a job. These include pay, overtime payments, superannuation, bonuses, profit share, share issue, commission, performance-based pay, salary packaging and fringe benefits (e.g., laptops, mobiles, housing and cars).
- Non-monetary rewards include the personal satisfaction gained from caring for others and making a difference; job enrichment through interesting and challenging tasks; decision-making, leadership and education opportunities; and a positive work environment with effective management.
- Individual or group rewards involve a team of workers sharing monetary and/or non-monetary rewards for the performance of workplace tasks. Many businesses are looking at different systems of both monetary and non-monetary rewards that would apply to groups or teams of employees. There are many different schemes for group rewards but profit sharing, payment by result and bonuses seem to be the most popular.
- Performance pay is a system where employees may be rewarded either individually or as a group for work performed towards the achievement of specified goals. A portion of an employee’s pay is held over or not awarded unless certain results are achieved. The employee will be paid a base level of pay with performance pay on top, provided certain goals are met.

4.4.7 Global—costs, skills, supply
- Costs—labour costs vary from country to country depending on the size of the workforce and the skill level of available workers. Labour costs also depend on the demand for workers in particular industries or within a nation as a whole. As a comparison, between 1975 and 2007 in the United States, labour costs increased four-fold. Over the same period, labour costs in South Korea rose fifty-fold.
- Skills—India has become a preferred source of global labour because of its high literacy levels in English and technical skills. The South Korean workforce has developed technical skills but there is not the general proficiency in English. India's main advantage lies in information technology.
- Supply—the current world population is seven billion people. The labour force is declining in advanced industrial areas of the world such as Japan and Europe while the workforce is expanding in geographical areas such as Asia, Africa, Latin America and North America. Asia’s share of the global labour market will reach 65 per cent by 2025.

4.4.8 Workplace disputes are caused by wage demands, working conditions, management policy and political goals and social issues.
- Resolution of disputes should be swift for the benefit of all parties. Without a clear process, a grievance can lead to a serious dispute. The preferred method of resolving disputes has moved to an approach focused at the employee–employer level, using enterprise bargaining.
- Negotiation is the first step in any grievance procedure or dispute resolution strategy. It involves trying to identify the issues causing the disagreement or dissatisfaction, developing an understanding of reasons behind certain actions and discussing together strategies that will resolve the problem and improve the working relationship between the two parties.
- Mediation involves an independent third party appointed to try to help the disputing parties resolve their conflict. Mediation occurs only after negotiation fails. The mediator is a person who is mutually acceptable to both parties.
- Grievance procedures are an established set of steps written into workplace agreements for handling complaints by an individual or group of employees regarding the actions and policies of the employer or a problem between individual employees. A grievance procedure may incorporate informal negotiations between the parties, discussions with supervisors, the involvement of unions, and formal negotiations involving high-level management and union representatives. Many complaints are resolved with informal negotiations between the two aggrieved persons.
- Involvements of courts and tribunals— for most Australian employees, Fair Work Australia is the Industrial court that has the responsibility for resolving workplace disputes. Members of Fair Work Australia (FWA) are experienced in a wide range of alternative dispute resolution techniques including conciliation, mediation and arbitration. Depending on the circumstances, FWA can exercise statutory powers that enable disputes to be resolved on a final basis. This is the arbitration function of Fair Work Australia. The NSW Industrial Relations Commission handles workplace disputes involving NSW state and local government employees. All other employees on state awards were transferred to the jurisdiction of Fair Work Australia from 1 January 2010.
## 4.5 Effectiveness of human resource management

The indicators of effective HR management are outlined in the table below.

<table>
<thead>
<tr>
<th>Measure</th>
<th>Description</th>
<th>Costs/issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate culture</td>
<td>Corporate culture is a series of values, ideas and norms that are shared by the people involved in a business. It is similar to the personality of a business and in some ways becomes the “memory” of a business.</td>
<td>Low levels of success in meeting benchmark standards are often due to poor strategies in employment relations and will lead to low productivity, poor quality product and customer dissatisfaction.</td>
</tr>
<tr>
<td>Benchmarking</td>
<td>Benchmarking involves setting standards for measurements such as output per worker, level of faults and breakdowns, and levels of customer satisfaction.</td>
<td>Costs of high staff turnover include time and money spent on recruiting and orientation and training programs, periods of low productivity as new employees take time to adjust, and low levels of motivation in other staff.</td>
</tr>
<tr>
<td>Changes in staff turnover</td>
<td>If the number of employees leaving the business is above the normal level there would appear to be a high level of job dissatisfaction.</td>
<td>Costs of high staff turnover include time and money spent on recruiting and orientation and training programs, periods of low productivity as new employees take time to adjust, and low levels of motivation in other staff.</td>
</tr>
<tr>
<td>Absenteeism</td>
<td>Absenteeism is the failure of an employee to turn up to work. Managers will need to assess what level of absenteeism is valid and what is due to dissatisfaction, low staff morale, stress, and poor health and safety.</td>
<td>High levels of absenteeism disrupt work schedules, lower productivity and involve a cost in replacing the absent worker.</td>
</tr>
<tr>
<td>Accidents</td>
<td>Workplace accidents can be measured in terms of the number per period and various categories.</td>
<td>The costs of industrial disputes and action increase the number of working days lost and lower productivity and staff morale.</td>
</tr>
<tr>
<td>Disputation</td>
<td>Monitoring the frequency and severity of industrial disputes in the workplace will give an indication of the effectiveness of grievance procedures and dispute resolution processes.</td>
<td>The costs of industrial disputes and action increase the number of working days lost and lower productivity and staff morale.</td>
</tr>
<tr>
<td>Worker satisfaction</td>
<td>Businesses can measure worker satisfaction through a number of different surveys, opinion polls, suggestion boxes and group discussions. One indicator of success of worker satisfaction will be the number of grievances that have been reported during a specified period.</td>
<td>The costs of industrial disputes and action increase the number of working days lost and lower productivity and staff morale.</td>
</tr>
</tbody>
</table>