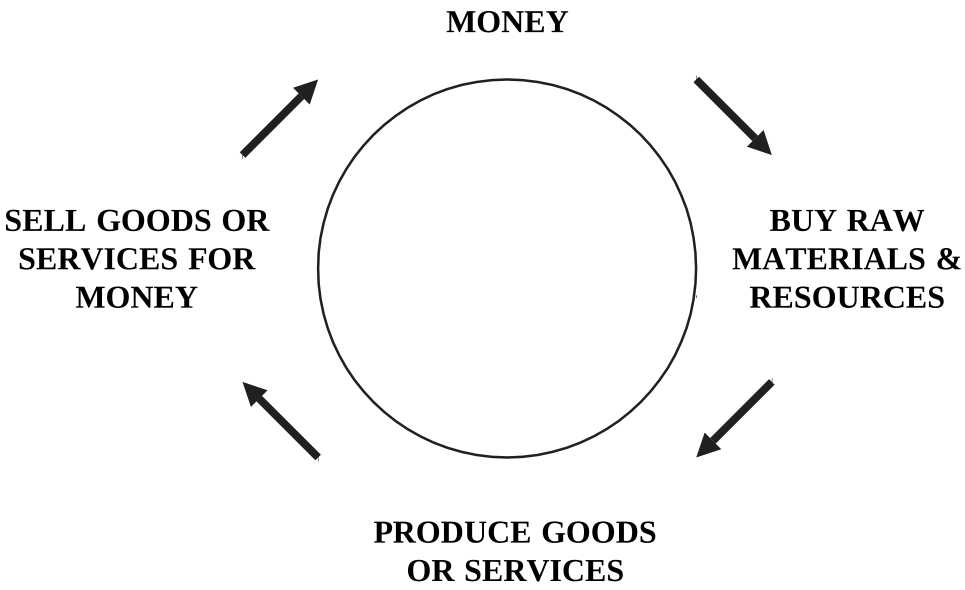
CONTENTS

BUSINESS STUDIES PACK 2

By Harry Jivenmukta

FINANCE - CASH FLOW

All businesses need money in order to survive. In most businesses the money is flowing smoothly and it is crucial that the money circulates efficiently in order that bills and wages can be paid and the company can buy new stock. The biggest single factor in bankruptcy is the failure of a business to maintain effective cash flow.



In the diagram above it is easy see the need for money to keep circulating. If, for example, the goods which are sold are paid for late, then the business cannot spend that money on buying new raw materials or resources, and therefore cannot produce new goods for sale. On average, businesses usually allow a maximum of 28 days for payment on the goods they sell. A recent government survey, (in 1997), found that in reality the average time taken for payment was 56 days. The impact on small businesses can be very serious because they may have to make other short term borrowing arrangements which also involve high percentage interest charges. It also means that the business may make payment to its suppliers late and therefore pass the problem of late payments by its customers 'down the line'.

EXERCISE

1. What is cash flow and why is it important to businesses?
2. Can you think of ways in which people can be encouraged to settle their bills more promptly?
3. What arrangements can businesses make to deal with late payments and which are the most cost efficient?

FINANCE - REVENUE AND CAPITAL EXPENDITURE

Businesses usually divide their expenses into two categories:

- **Revenue expenditure**. This includes things like heating expenses, rent on premises, and public transport costs.
- **Capital expenditure**. This includes buying equipment, vehicles, and buildings.

Capital expenditure is usually the largest expense and it is also fixed in the sense that if a business buys a building, in order to justify the expense it has to be used for many years. That is one reason why some businesses often have very outdated computer equipment. A Capital budget expense is a longer term investment and replacement usually cannot happen for a long time.

Revenue expenditure is related more to the everyday expenses which a business faces. An example of the difference between these two different types of expenditure is as follows:

If a business pays for its workers to travel on public transport then the expenses for this will be taken from the revenue account. If the business bought a minibus then it would be paid for out of the capital account. However, the petrol used by the van would still be paid out of the revenue account.

EXERCISE

Make a list of ten items which a business might utilise which are revenue items and ten which are capital items.

REVENUE ITEMS	CAPITAL ITEMS
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
10	10

FINANCE - SOURCES OF FINANCE

3

There are many ways in which businesses can fund their activities. Usually it is difficult for new businesses to fund all their activity from sales alone and so they have to borrow money. Established businesses may also have to borrow, usually because of expansion, but sometimes because of bad debts or bad cash flow. Sources of finance include:

Bank loans are usually taken out for one off, or large investments. A bank loan involves paying back the amount in a given amount of time, agreed at the outset, payable monthly, with a pre-arranged interest rate.

Bank Overdraft. An overdraft is used for short term borrowing. Businesses can arrange an overdraft level with the Bank and then use the money whenever it is needed. Interest is only payable for the time that the money is outstanding, and often prudent use of this facility helps businesses through difficult patches in the trading year.

Hire Purchase means that a business can buy the equipment it needs and pay the amount back in instalments. It is usually only used by small businesses and is an expensive way to borrow money.

Leasing is more like renting than buying. A business agrees a time-span and monthly, (or quarterly), charges with the leasing company for the equipment required. It is an easy way to acquire equipment and is especially useful when used for computer equipment. With computers and peripherals advancing in speed and effectiveness every few months, it is possible for companies to upgrade under their leasing agreement to obtain the latest equipment as it becomes available.

Selling Assets. Some businesses may be able to sell stocks and shares which they own to raise short term funds. They may, in desperation, sell their own vehicles or equipment to raise money. Usually, this sort of action is only undertaken as a last resort.

Mortgages. In small businesses the owners may re-mortgage their own homes to raise long-term finance, or take out a separate mortgage to pay for the purchase of buildings or offices.

EXERCISE

1. There are other ways in which businesses may finance their needs. Find out about these. Include; **Debt Factoring, Trade Credit, Shares, Government assistance**, etc.

2. Make a list of 5 short term and 5 long term finance options which are available to businesses.

SHORT TERM
1
2
3
4
5

LONG TERM
1
2
3
4
5

SHARES AND OWNERSHIP - OVERVIEW

4

The investing public is a major source of funds for new or expanding businesses. As companies grow, their need for funds grows, with the consequence that legal ownership of companies has become widely dispersed. Although large blocks of shares may be held by wealthy individuals or institutions, the total amount of stock in these companies is so large that even a very wealthy person is not likely to own more than a small fraction of it.

The chief effect of this stock dispersion has been to give effective control of the companies to their salaried managers. Although each company holds an annual meeting open to all shareholders, who may vote on company policy, these gatherings, in fact, tend to ratify ongoing policy. The only real recourse for dissatisfied shareholders is to sell their stock and invest in firms whose policies are more to their liking. It is in the managers' interest to keep the shareholders happy, for, if the company's shares are regarded as a good buy, then it is easy to raise capital through a new share issue.

If a company is performing well in terms of sales and earnings, its executives will have a relatively free hand. If a company gets into trouble, its usual course is to agree to be merged into another incorporated company or to borrow money. In the latter case, the lending institution may insist on a new chief executive of its own choosing. If a company undergoes bankruptcy and receivership, the court may appoint someone to head the operation. But managerial autonomy is the rule. The salaried executives typically have the discretion and authority to decide what products and services they will put on the market, where they will locate plants and offices, how they will deal with employees, and whether and in what directions they will expand their spheres of operation.

EXERCISE

1. How much power do shareholders have over the direction of the businesses they invest in?
2. Make a list of who you think has real power in large companies.

SHARES AND OWNERSHIP

Many companies have only one class of stock, often called common stock, or ordinary shares. This class of stock entitles the holder to interest in the earnings and assets of the company after limited claims are paid.

- Stockholders have the right to control the company through their voting rights, unless such rights are specifically withheld, as in special classes of 'nonvoting' shares.
- Dividends paid on common stock are usually unstable because they tend to vary with earnings; they are also usually less than earnings, the difference being used by management to expand the firm and allow the shareholders' equity to grow.
- The market price of common stock is often subject to wide fluctuations, because it depends largely upon investors' expectations of future earnings.

To appeal to investors who wish to be sure of receiving dividends regularly, many companies issue what is called preferred stock, or preference shares. This class of stock has a first claim to dividends paid by the company and, usually, to the assets of the company in the event of its dissolution.

- Dividends are usually set at a fixed annual rate that must be paid before dividends are distributed to the common stockholders.
- Preferred stock may be participating, meaning that its holders share with common stockholders in any company earnings over and above the stated dividends on the preferred stock.
- Preferred stock may be cumulative or noncumulative: if cumulative, dividends not paid in one year must be paid in addition to dividends earned in the following year, before any dividend payments are made on the common stock.

EXERCISE

1. Trace the rise of shareholding in the UK in the last 20 years.
2. What are the advantages of ordinary people holding shares rather than keeping their money in more traditional ways like building societies?
3. What is the difference between ordinary shares and preferred shares?
4. What sort of risk is there in shareholding? Are there any ways of having shares which are less risky?

ELEMENTS OF MARKETING - OVERVIEW

6

Many organizations and businesses assign responsibility for marketing functions to a particular group of individuals within the Company. In this respect, marketing is a unique and separate entity. Those who make up the marketing department may include:

brand and product managers

marketing researchers

sales representatives

advertising and promotion managers

pricing specialists

customer service personnel

As a managerial process, marketing is the way in which an organization determines its best opportunities in the marketplace, given its objectives and resources. The marketing process is divided into several parts:

- The strategic phase has three components;

segmentation

targeting

positioning

- The organization must distinguish among different groups of customers in the market **(segmentation),** choose which groups it can serve effectively **(targeting)**, and communicate the central benefit it offers to that group **(positioning)**.
- The marketing process includes designing and implementing various tactics, commonly referred to as the "marketing mix,":

product

price

place (or distribution)

promotion

- The marketing mix is followed by evaluating, controlling, and revising the marketing process to achieve the organization's objectives

ELEMENTS OF MARKETING-PRODUCT

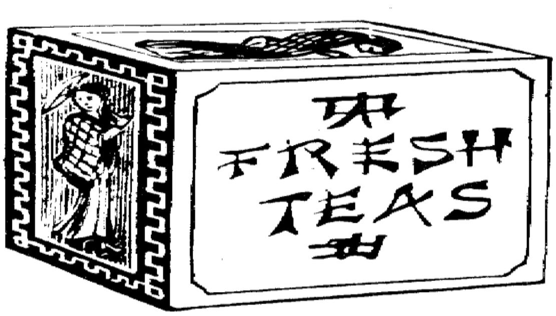
7

The first element is the product which will be made available to customers.

In the past the designers would make something they thought that people wanted and then ask the marketing department to try to sell as many as possible.	Today research is carried out to determine what the buying public want. Then a plan is put together of how the product can be made and its viability.

In traditional economies, the goods produced and consumed often remain the same from one generation to the next including food, clothing, and housing. As economies develop, the range of products available tends to expand, and the products themselves change. In modern developed economies products usually have a limited life - the product is new, established, declines, and is replaced.

Packaging and branding are also substantial components in the marketing of a product. In most industrialized countries, however, the packaging of merchandise has become a major part of the selling effort, as marketers now specify exactly the types of packaging that will be most appealing to prospective customers. The importance of packaging in the distribution of the product has increased with the spread of self-service purchases in wholesaling as well as in retailing.



The packaging of tea has come a long way since this early example.

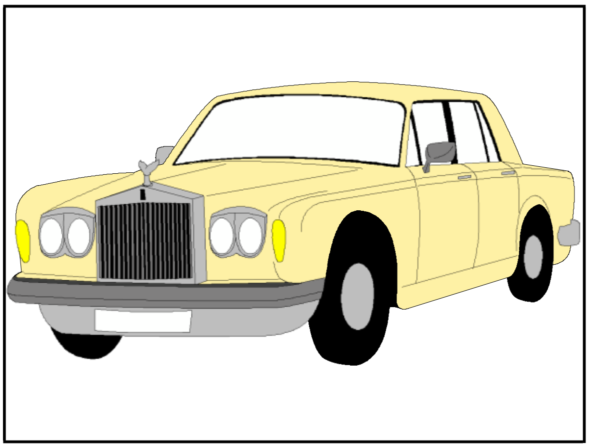
EXERCISE

1. How important is it to gauge public opinion before designing a product?

2. Are there some products which never change? Do producers still have to be careful about how the products are packaged?

3. Compare two or three packages of similar products and say why you prefer one more than others.

ELEMENTS OF MARKETING - PRICE



Companies usually determine a price by gauging the quality of the product and then selecting a price that reflects it. However, marketers also are aware that price can send a message to a customer about the product's presumed quality level. A Rolls Royce car is generally considered to be a high- quality vehicle, and it therefore can command a high price in the marketplace.

With some products even if the manufacturer could price its product competitively with economy ones, it might not do so, knowing that the lower price might imply lower quality. On the other hand, in order to gain market share, some companies have moved to "more for the same" or "the same for less" pricing, which means offering prices that are consistently lower than those of their competitors.

Many factors affect pricing policy including:

- Quality of the product
- Exclusivity of the product
- Competitors pricing policy
- Changing costs of materials
- Time of year, (seasonal products)
- Popularity of the product

EXERCISE

Selecting a product of your choice investigate how its price:

Compares with similar products

Varies seasonally, (if at all)

Is likely to change if the product is replaced or upgraded

ELEMENTS OF MARKETING - PLACE

9

Place, or where the product is made available, is the third element of the marketing mix and is most commonly referred to as distribution. When a product moves from producer to consumer, it is said to be following a channel of distribution. For example, the channel of distribution for many food products includes:

- food-processing plants
- warehouses
- wholesalers
- supermarkets

A food manufacturer makes its products easily accessible by ensuring that they are in stores that are frequented by those in the target market. However, each channel participant can handle only a certain number of products: space at supermarkets is limited. Because of this, some marketers may decide to skip steps in the channel and instead market directly to buyers through direct mail, tele-marketing, door-to-door selling, shopping via television (a growing trend in the late 20th century), or factory outlets.

Effective distribution is vital in order to:

- Quickly get the product to the consumer
- Get a return on sales over a shorter time span
- Provide a regular supply of goods which creates confidence in the consumer
- Compete effectively with other products

Often the production of an item is placed near to the market where it will sell. This improves distribution and keeps costs down. However, as products are designed which are more universal in appeal, the emphasis is more on effective distribution across a wide area.

EXERCISE

1. Make a list of products which need to be near their point of sale. This may be because the product is one which will quickly perish if it is not consumed quickly, or it is a specialist product which only has a limited appeal or appeals only in a particular area.

2. Find out how retailers distribute a large number of products effectively to stores across a large geographic area. What part does computerisation play in this?

3. How has technology improved the distribution process?

ELEMENTS OF MARKETING - PROMOTION 10

Promotion, the fourth marketing-mix element, consists of several methods of communicating with and influencing customers. The major tools are:

sales representatives, advertising, sales promotion, and public relations

Sales representatives are the most expensive means of promotion, because they require income and expenses. Their ability to personalise the promotion process makes sales people most effective at selling complex goods, big-ticket items, and highly personal goods (e.g., those related to religion or insurance). Sales people are trained to:

- Present the product to the customer
- Answer queries or explain complex details
- Convince customers to purchase the product
- Manage account growth

Some companies have successfully reduced their sales-force costs by replacing certain functions (for example, finding new customers) with less expensive methods (such as direct mail and tele-marketing).

Advertising includes all forms of promotion of products, services, or ideas. Advertising appears in such media as:

- Newspapers and magazines (a picture, a headline, information about the product, and sometimes a reply slip)
- On billboards, and leaflets
- Radio and television (an audio or video narrative that can range from short 15 second spots to longer ones known as infomercials, which generally last 30 minutes or more

EXERCISE

1. Write in your own words what you understand the job of a sales representative to be.
2. Why is it an expensive method of promotion to use sales representatives?
3. What is direct mailing or direct marketing?
4. Choose a product of your choice and find out all the different ways it is advertised. Why does the product appeal to you? How could the promotion of the product be improved?

ELEMENTS OF MARKETING - PROMOTION

11

Sales promotion offers a short-term incentive to purchase. Sales promotions often attract brand switchers (those who are not loyal to a specific brand) who are looking for low price and good value. Especially in markets where brands are similar, sales promotions can cause a short-term increase in sales but not usually a permanent gain in market share. The use of promotions has risen considerably in recent years. This is due to a number of factors including:

- Increased refinement in sales promotion techniques
- Greater pressure to increase sales
- A rise in the number of brands (especially similar ones)
- A decrease in the efficiency of traditional advertising

One of the key activities of **public relations** is to work with news and information outlets to ensure full coverage of the company's activities and products. Public relations specialists arrange press conferences, contests, meetings, and other events that will draw attention to a company's products or services.

Public relations does not always seek to increase sales or profitability directly, and is sometimes seen as serving a function that is separate from marketing. Increasingly, public relations is seen as a vital service which sets good businesses apart from the more profit motivated by offering a comprehensive service to customers.

EXERCISE

1. Make a list of 5 methods of sales promotion used by high street stores.

1
2
3
4
5

2. How important is a good public relations policy in building up consumer confidence in the products on offer?

3. Is a public relations department a luxury or a necessity in retail business?

ELEMENTS OF MARKETING - MARKETING IMPLEMENTATION

12

Companies sometimes hire different agencies to help in the development of advertising, sales promotion, and publicity. This sometimes results in a lack of coordination between elements of the promotion mix. When components of the mix are not all in harmony, a confusing message may be sent to consumers. When different parts of the promotion work badly together then the message of the product becomes confused.

On the other hand, by integrating the marketing elements, a company can more efficiently use its resources. Instead of individually managing four or five different promotion processes, the company manages only one. Also, promotion expenditures are likely to be better allocated, because differences among promotion tools become more clear. This reasoning has led to integrated marketing communications, in which all promotional tools are considered to be part of the same effort, and each tool receives full consideration in terms of its cost and effectiveness.

No marketing process, even the most carefully developed, is guaranteed to result in maximum benefit for a company. In addition, because every market is changing constantly, a strategy that is effective today may not be effective in the future. It is important to evaluate a marketing program periodically to be sure that it is achieving its objectives.

The elements in marketing implementation include:

- Designing an overall advertising strategy
- Finding key selling points and catch words
- Making full use of the advertising media - radio, television, newspapers, magazines, leaflets etc.
- Monitoring the success of advertising in increasing sales
- Evaluating and fine tuning the strategy

EXERCISE

1. Trace the rise of the advertising agency.
2. Why are advertising agencies so important? Why do some large companies have their own in house advertising and marketing departments?
3. Should marketing and advertising companies be used by:

    Political Parties

    Charities

    Public Services - (health services and education etc.?)
4. Is there anywhere that advertising cannot or should not be utilised?

ELEMENTS OF MARKETING - MARKETING CONTROL

13

There are four types of marketing control, each of which has a different purpose:

annual-plan control, profitability control, efficiency control, and strategic control

The basis of **annual-plan control** is specific goals, such as sales and profitability, that are established on a monthly or quarterly basis. Organizations use five tools to monitor this performance:

- **Sales analysis**, in which sales goals are compared with actual sales and differences are investigated, explained or accounted for
- **Market-share analysis**, which compares a company's sales with those of its competitors
- **Marketing expense to sales analysis** gauges how much a company spends to achieve its sales goals. This ratio varies throughout the year as often the company needs to spend more at some times and less at others, (e.g. Christmas and other holidays and festivals)
- **Financial analysis**. This includes a comparison of profits to sales (profit margin), sales to assets (asset turnover) and profits to assets (return on assets)
- **Customer satisfaction**. Analysis of this kind is generally less quantitative than those described above and may include complaint and suggestion systems, customer satisfaction surveys, and careful analysis of reasons why customers switch to a competitor's product

Profitability control and efficiency control allow a company to closely monitor its sales, profits, and expenditures. It demonstrates the relative profit-earning capacity of a company's products and consumer groups. Companies are sometimes surprised to find that a small percentage of their products and customers contribute to a large percentage of their profits. This knowledge helps a company allocate its resources more effectively.

EXERCISE

1. Why is it important for businesses to monitor sales and profits very carefully?
2. How do you think seasonal factors affect the way in which monitoring takes place?
3. How important is customer satisfaction monitoring?

ELEMENTS OF MARKETING - MARKETING CONTROL

14

Efficiency control involves micro-level analysis of the various elements of the marketing mix, including:

- Sales force
- Advertising
- Sales promotion
- Distribution

To understand the efficiency of its sales-force a company may:

- keep track of how many sales calls a representative makes each day
- how long each call lasts
- how much each call costs and generates in revenue

This type of analysis highlights areas in which companies can manage their marketing efforts in a more productive and cost-effective manner.

Strategic control allow managers to evaluate a company's marketing program from a long-term perspective. This involves a detailed and objective analysis of a company's organization and its ability to maximize its strengths and market opportunities. Companies can use two types of strategic control tools:

- In a marketing-effectiveness rating review a company examines its customer philosophy, the adequacy of its marketing information, and the efficiency of its marketing operations
- Closely evaluate the strength of its marketing strategy and its marketing tactics

EXERCISE

1. What do you understand 'efficiency control' to mean in terms of monitoring?
2. Can areas like public relations be measured in terms of efficiency? How?

ELEMENTS OF MARKETING - AUDIT

15

This is a periodic analysis that a company uses to examine its strengths in relation to its current and potential markets. Such an analysis is comprehensive because it covers all aspects of the marketing climate looking at:

- **macro-environment factors**;

demographic, with regard to density of population and capacity for expansion or decline

economic, relating to the production, distribution, and consumption of goods

ecological, the interrelationship with the environment

technological, improvements in technical processes that increase productivity

political, with regard to forthcoming legislation etc.

cultural, with respect to social structure, language, law, politics, religion, etc.

- **micro or task-environment factors**;

customers

competitors

distributors

dealers

suppliers

The audit includes analyses of the:

- marketing strategy
- marketing organization
- marketing systems
- marketing productivity

An audit must be systematic in order to provide concrete conclusions based on these analyses. To ensure objectivity, a marketing audit is best done by a person, department, or organization that is independent of the company or marketing program. Marketing audits should be done not only when the value of a company's current marketing plan is in question; they must be done periodically in order to isolate and solve problems before they arise.

EXERCISE

1. What is the difference between normal monitoring and an audit?
2. Why is it important to consider areas like: ecological and cultural?

A EUROPEAN PERSPECTIVE

The European Economic Community (EEC) was founded in 1957-58 to oversee the economic integration of the nations of western Europe.

In 1967 the EEC joined together with the European Coal and Steel Community and the European Atomic Energy Community to form the European Communities.

The success of liberal trade policies sponsored by the EEC (or EC) made its members more receptive to the greater integration of the EC. Efforts toward greater union of the EC's members led to the Treaty on European Union (Maastricht Treaty), concluded in December 1991. The treaty's enactment in 1993 created the European Union out of the European Community.

One of the main goals of the EC was the integration of its members' economies into a single frontierless market that would have a common currency and a common central bank. The measures the EC took in this regard were obtained by the unanimous consensus of its members. The EC oversaw the establishment of the European Monetary System (EMS) in 1978 to regulate currency exchange rates and aid monetary stability among its members. The EMS linked the currencies of the EC member countries (excepting those of the United Kingdom, Spain, and Portugal, who declined to participate). Restrictions on the movement of labour among the EC countries also were effectively removed.

In 1987 the EC member states adopted the Single European Act, by which they declared their eventual intention to create a unified, free-trade market in western Europe.

Measures implementing this declaration began in 1990 with the lifting of exchange controls and the elimination of barriers to Europe-wide banking, insurance, securities, and other financial services.

The economic agreements of the Maastricht Treaty further advanced this process by establishing the European Monetary Institute, effective from January 1st 1994 in Frankfurt, and by creating a vast free-trade zone.

EXERCISE

1. In your own words write a short summary of what the European Community is and what its aims and objectives are.

2. What are the main arguments for and against closer integration by the UK into the EC? Write five arguments for and five against.

5 ARGUMENTS FOR INTEGRATION
1
2
3
4
5

5 ARGUMENTS AGAINST INTEGRATION
1
2
3
4
5

A WORLD PERSPECTIVE - DEVELOPING COUNTRIES

Modern economic development started in Great Britain and spread in widening circles to other parts of the world, driven on by a series of technological innovations. In the 19th century the developed countries were limited to western Europe. By the late 19th century the circle had widened to include North America, Australia and New Zealand, and Japan. By the early 1970s about 34 percent of the total world population belonged to the developed countries, which among them had 87.5 percent of the total world Gross National Product (GNP).

The prospects of the still-to-develop countries of Asia, Latin America, and Africa joining this circle of economic development can be seen as problematic. On the negative side there are a number of factors that add to their difficulties:

- The level of per capita production, (for each person in the population), in the present-day developing countries is much lower than in the developed countries in their pre industrialization phase
- The present-day developing countries have large populations and have much faster rates of population growth
- They have generally a much weaker social and political framework to cope with the more explosive forces of discontent from internal economic disparities

On the positive side, the present-day developing countries can draw upon a greater store of scientific and technical knowledge from the developed countries. The potential opportunities to exploit the “technological gap” are not confined to manufacturing. Modern science and technology can make immense contributions to agriculture, as illustrated by the Green Revolution created by the introduction of improved seeds and fertilizers in some Asian and Latin-American countries. Modern methods of birth control can make a decisive contribution in the race for raising per capita incomes. In addition, as the circle of the developed countries widens, they are bound to exert an increasing upward pull on the developing countries.

EXERCISE

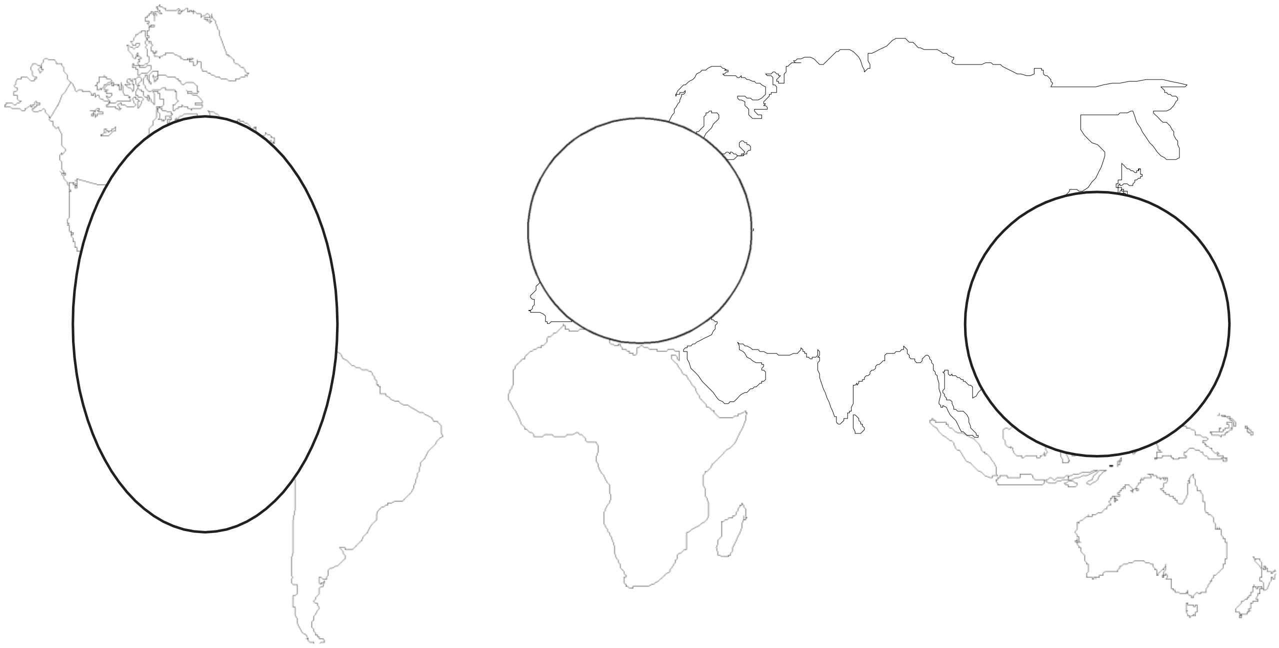
1. Trace the economic development of Western economies from 1800.
2. What difficulties do new developing countries face today?
3. What effect do developing countries have on established developed countries?

A WORLD PERSPECTIVE

The world can be divided into three main economic zones of influence. The USA leads the American continent zone and it has considerable influence on Canada, Mexico, and South American countries. The European Community (EC) is a second zone, and as the EC standardises itself in terms of a single currency and import and export regulations, it will have considerable influence on other non EC countries. The third zone is the Pacific rim countries dominated by Japan. Between them these three zones will influence what other countries produce and how they trade. With considerable power to dictate the economic future it is these three zones we must look to for the future of the planet.

Of course there will be competition between these three zones to influence the other countries which do not fall within their spheres of influence and it is here that the battle for economic supremacy will be fought. The massive natural resources of the African continent are obviously a target, as are the developing and emerging countries like China and the former Soviet Union countries.

It is possible to envisage one victor in twenty years time or so. Then we will really be able to point to a global market.



EXERCISE

1. Do you agree that the world can be divided into these three zones of influence?

2. What effect does seeing economics in terms of zones have on business?

3. If we accept the idea of economic zones, what effect do you think this has on countries which are not in any zone?

4. Can individual countries manage to survive adequately by being fully independent of other countries or economic zones?