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Welcome to the world of business! It is an exciting, challenging and rewarding world. It is also a world in which you have been involved — by buying goods and services to satisfy your many needs and wants, or working for an employer with the purpose of gaining income. Perhaps you have even operated your own ‘business’, such as a stall at a local market.

Whether as a consumer or employee, you rely daily on a diverse range of businesses — small, medium and large — for your economic survival. These businesses shape how people live, work and play. Life without them would be radically different. It is therefore important to understand how businesses function and to appreciate the crucial role they play in contemporary society.

Some of you will eventually decide to commence and operate your own business. The skills, knowledge and attitudes you bring to your business enterprise will largely determine the venture’s success. Operating your own business will provide you with personal satisfaction and financial rewards. The business will also play a crucial role in the Australian economy and contribute to the nation’s wellbeing.

In the past few years, we have seen an unprecedented number of changes in the social, technological, political and economic makeup of the business world. Businesses that survive and prosper in today’s rapidly changing world will be owned and managed by people who not only respond positively to change, but also initiate it. Such business owners will thrive on the opportunities these changes present.

During this Business Studies course, you will learn about the different areas that together form today’s business world, including management, finance and accounting, human resources, marketing, and operations. You’ll explore the types of tasks these different functions require and the many and varied jobs that are available. This knowledge will allow you to consider what kinds of jobs in business will interest you most.

Finally, as you progress through your Business Studies course, stop and reflect on what you have learned. Explore further the issues raised during the lessons. In this way, you will gain a deeper understanding of what is required for a business to succeed.
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HOW TO USE THIS BOOK

The following examples highlight the structure and main features of Business Studies in Action — Preliminary Course 3rd Edition. An electronic version of the textbook and a complementary set of targeted digital resources — the eBookPLUS — are also available online at the JacarandaPLUS web site (www.jacplus.com.au).

Each of the three topics has an opening double page that presents the focus area of the topic and lists the syllabus outcomes. A concept map allows students to visualise the key concepts in the topic. An engaging photograph and case study shows business in action.
HSC ‘key verbs’ are used consistently in all questions to prepare students for HSC study. Questions are graded according to low-, middle- or high-order thinking skills. The ‘key process verbs’ are listed and defined on the inside back cover and gatefold for ready reference. Weblinks are provided to key business bodies, updated data and statistics, and further resources.

1.3 Other functions of business

A business enterprise involves a number of specific activities, including:

- Operating a business
- Managing employees
- Managing the business's finances
- Allocating resources
- Controlling operations
- Communicating with stakeholders

1.3.1 Operating a business

Operating a business involves managing the day-to-day activities to ensure the business operates smoothly and efficiently. This includes:

- Overseeing the production process
- Managing inventory levels
- Handling customer service requests
- Coordinating with suppliers
- Ensuring compliance with regulations

1.3.2 Managing employees

Managing employees involves overseeing the work of employees and ensuring they are motivated and productive. This includes:

- Hiring and training employees
- Setting performance goals
- Providing feedback and recognition
- Resolving conflicts and disputes
- Providing opportunities for career development

1.3.3 Managing the business's finances

Managing the business's finances involves ensuring the business has the funds it needs to operate and grow. This includes:

- Creating and managing a budget
- Controlling cash flow
- Managing debt
- Investing in the business
- Preparing financial statements

1.3.4 Allocating resources

Allocating resources involves deciding how to best use the business's resources to achieve its goals. This includes:

- Prioritizing tasks and activities
- Making purchasing decisions
- Determining the best allocation of time and energy
- Balancing the needs of the business with the needs of customers

1.3.5 Controlling operations

Controlling operations involves monitoring the business's performance and making adjustments as needed. This includes:

- Setting performance goals
- Monitoring progress against goals
- Identifying areas for improvement
- Implementing changes to improve performance
- Evaluating the effectiveness of changes

1.3.6 Communicating with stakeholders

Communicating with stakeholders involves keeping all parties informed about the business's activities and performance. This includes:

- Communicating with customers
- Communicating with suppliers
- Communicating with employees
- Communicating with investors
- Communicating with the community

Summary

Businesses play a crucial role in the economy, largely determining our standard of living.

- Production of goods and services
- Employment of workers
- Allocation of resources
- Distribution of income

1.2 The nature of a business

Businesses are organized in a number of ways, depending on the industry and the specific needs of the business. This includes:

- Sole proprietorship
- Partnership
- Corporation
- Limited liability company

1.2.1 Sole proprietorship

A sole proprietorship is a business owned and operated by one person. This includes:

- Full control of the business
- Unlimited personal liability
- Personal funding for operations

1.2.2 Partnership

A partnership is a business owned and operated by two or more people. This includes:

- Shared control of the business
- Shared liability for debts
- Shared ownership of assets

1.2.3 Corporation

A corporation is a business owned by shareholders who are not involved in the day-to-day operations. This includes:

- Limited liability for shareholders
- Separation of ownership and management
- Easier to raise capital

1.2.4 Limited liability company

A limited liability company is a business owned and operated by two or more people, with limited liability for debts. This includes:

- Shared control of the business
- Shared liability for debts
- Shared ownership of assets

Extended response questions

These questions require a more detailed response, often involving critical thinking and analysis of the business environment. They may include:

- Case studies
- Scenario-based questions
- Discussion questions

Extended response questions

These questions require a more detailed response, often involving critical thinking and analysis of the business environment. They may include:

- Case studies
- Scenario-based questions
- Discussion questions

Sample HSC-style assessment tasks are provided for each topic, comprising multiple choice, short response and extended response questions with appropriate marks allocated.
About eBookPLUS

This book features eBookPLUS: an electronic version of the entire textbook and supporting multimedia resources. It is available for you online at the JacarandaPLUS website (www.jacplus.com.au).

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Step 1. Create a user account

The first time you use the JacarandaPLUS system, you will need to create a user account. Go to the JacarandaPLUS home page (www.jacplus.com.au) and follow the instructions on screen. An activation email will be sent to your nominated email address. Click on the link in this email and your activation will be complete. You can now use your nominated email address and password to log in to the JacarandaPLUS system.

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Minimum requirements

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• Adobe Flash Player 9
• Javascript must be enabled (most browsers are enabled by default).

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eBookPLUS gives instant access to an online electronic version of the textbook along with a wealth of targeted digital resources, making student learning more flexible and engaging.

The database of digital resources in this book includes video eLessons, projectsPLUS, digital documents, as well as weblinks to useful support material on the internet.

Your ICT activities are available through the student resources tab inside your Business Studies in Action — Preliminary Course eBookPLUS. Visit www.jacplus.com.au to locate your digital resources.

eLessons

Video clips with questions
These video case studies feature real businesses in action. eLessons are available in the areas of:
- Adapting to the external environment
- Business growth and expansion
- Business achievement
- Managing your business
- Responding positively to change
- Living with your business.

Worksheets targeted to the syllabus are included with each eLesson to enhance your understanding of the key concepts covered in your course.

ProjectsPLUS

ICT assessment task on creating a business plan
ProjectsPLUS is an exciting new research management system featuring media, weblinks, templates and a real-world video introduction to a unique ICT project. This has been specifically designed to inspire and engage students while providing quality assessment support for teachers.

Digital docs

Student worksheets
Digital documents apply and test the key concepts covered in your course. These include chapter crossword puzzles and chapter summaries to aid in revision. These student worksheets are created in Microsoft Word for easy customisation and editing.
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FOCUS AREA
The focus of this topic is the role and nature of business in a changing business environment.

OUTCOMES
Students should be able to:
• discuss the nature of business, its role in society and the types of business structures
• explain the internal and external influences on businesses
• analyse the responsibilities of business to internal and external stakeholders
• plan and conduct investigations into contemporary business issues
• evaluate information for actual and hypothetical business situations.
The world of business: it reads like a novel!

Every day thousands of Australian businesspeople are involved in making decisions about how best to plan and manage their businesses. Each one has their own story to tell in the world of business. Such stories often read like a best-selling novel. The ‘script’ of business includes:

• **Dreams and excitement** — for example, Chris Humphrey’s enthusiasm for animals saw him turn his dream into a reality when he created Wild Action Productions. This mobile educational zoo brings Australian wildlife such as snakes, insects and reptiles into classrooms and communities.

• **Originality** — for example, in 2004 Lara Solomon designed and produced Mocks: highly original mobile phone socks. Today Solomon’s company, LaRoo, offers 60 designs and has sold about 1.4 million Mocks around the world via the web and retailers.

• **Challenge** — for example, Amanda Young and Matt Braithwaite drew on their previous experience working for companies in the beverage industry to start Springleaf iced tea. With three small children, they wanted a better work–life balance. The learning curve has been steep, but they have succeeded in creating a profitable business as well as having more time for their children.

• **Passion, risks and commitment** — for example, Kristina Karlsson, founder and creator of kikki.K, had a passion for stationery. Start-up finance was difficult to obtain, which forced her to sell her house to fund the business development. Today she has more than 30 stores in Australia, four in New Zealand and more than 100 stockists throughout the world selling stationery products as designer accessories.

• **Social and ethical responsibility** — for example, Nick Savaidis, the founder of Etiko, believes that businesses should make a positive contribution to society. Consequently, from sales of its products, Etiko is able to help fund community development, micro-credit and healthcare programs around the world.

These are just a few of the thousands of individual stories behind every business. The world of business is most definitely an exciting and interesting one.
1.1 Introduction

Think of all the different businesses that operate in your local neighbourhood. Now imagine what the world would be like if they did not exist. Ultimately we would have to become self-sufficient: providing for our own needs and wants. Fortunately, in our society, businesses of all sizes play a crucial role in providing us with a vast array of goods and services. Businesses are at the very core of our economy, and our future wealth depends upon them.

Most people associate the word ‘business’ with large, transnational corporations, such as BHP Billiton, McDonalds, Apple and Westfield, operating in many countries, employing thousands of people and earning millions of dollars in profit. Although these types of businesses are well known, they are few in number. It is small to medium enterprises (SMEs) that make up about 98 per cent of all businesses in Australia. Take a look around your local area and you will see plenty of examples of businesses that are considered small or medium based on the number of people they employ.

The one common feature shared by both the largest and the smallest business is that they produce a product — goods or service — which is sold in a market where buyers and sellers meet. The Australian business world has approximately 1.98 million separate business enterprises that respond to the needs and wants of around 22 million Australian customers and millions of overseas customers.

Why learn about business?

Business Studies is a very important subject. It is concerned with activities that affect us on a day-to-day basis. You only have to listen to the news or read the
newspaper to find stories about business activity. Some of these stories will make you feel optimistic — for example, the developments of new products that have helped improve our standard of living. At other times, business activity may make us feel dejected and cynical — for example, when businesses have misled the public about safety standards or when companies have exploited weaker members of society. Therefore, when studying business, it is essential that you carefully examine business issues in order to make a balanced judgement.

Learning about business is both interesting and useful. It is also challenging and requires imagination.

In learning about business you will need to be creative and have a questioning mind. Business decisions are often open ended; there may be more than one way of going about things. Therefore, you will need to ask lots of questions and weigh up alternative ideas and proposals.

Business Studies is not a totally new subject to you. In one sense you have been ‘studying’ business ever since you made your first purchase many years ago — perhaps an ice-cream or lollies. That simple transaction launched you on life’s journey as a customer — and as an integral part of the business world. As a high school student, perhaps you have even operated your own ‘business’, mowing neighbours’ lawns, washing windows or setting up a stall at a local community market. You may be employed on a part-time basis and work in a local store or fast-food outlet — both examples of business enterprises.
Importance of business to you

Undertaking this Business Studies course will give you a better understanding of how businesses are established, organised and operated. As well, it will give you an insight into the different roles you will play throughout your life — as consumer, employee, business owner and/or investor. Each of these roles centres around a business as shown in figure 1.3.

**Successful business owner**
The technical skills and knowledge required to own and operate a successful business can be gained through learning about business.

**Informed consumer**
You will be able to make better informed decisions and use your money wisely. During your life you will make thousands of commercial transactions with hundreds of businesses.

**Productive employee**
Employers today require people to have a number of skills. These include technical skills, and the ability to cooperate with people and to have a working knowledge of business operations.

**Informed investor**
You may want to invest some money and become a shareholder in a company. To do this wisely requires an understanding of business operations and terminology.

**Business Studies**
It helps you throughout your life to perform these important roles better.

---

**Importance of business to the economy**

Business also fulfils a number of other important functions within the Australian economy, as displayed in figure 1.4.

**Exports products,**
which generates income for Australians and helps reduce our trade deficit

**Assists in the development and use of new technology**

**Provides employment and income for employees**

**Pays taxes to governments (company tax and payroll tax)**

**Undertakes investment, which leads to economic growth**

**Helps provide owners with challenges and rewards**

**Encourages research and development into new products (invention) and improved products (innovation)**

**Provides income for business owners**

**Encourages competition, which results in cheaper products**

**Creates value, which encourages economic growth**

**Provides a training ground for future business people (entrepreneurs)**

**Produces a wide range of products giving consumers greater choice**

**Improves our quality of life**

---

**FIGURE 1.3** Developing an understanding of the world of business will help you in so many ways.

Businesses, through the many products (goods and services) they make and sell, have an enormous impact on our lives every day. They influence how we live, work and play.

**FIGURE 1.4** The important functions of business within the Australian economy
Summary

- Businesses play a crucial role in our society, largely determining our standard of living.
- Small to medium enterprises (SMEs) make up over 98 per cent of all businesses in Australia.
- The one common feature shared by both the largest and the smallest business is that they produce a product — goods or service — which is sold in a market where buyers and sellers meet.
- Businesses have an enormous impact on our lives every day.
- Businesses play a crucial role within the Australian economy.

1.2 The nature of a business

There is one thing people have in common — they all have needs and wants. They need food to eat, clothes to wear and houses to live in. Most of us also want DVD players, iPods, mobile phones and cars — if only for the pleasure they give to us. To satisfy these never-ending wants is the role of business. A business can be defined as the organised effort of individuals to produce and sell, for a profit, the products (goods and services) that satisfy individuals’ needs and wants.

To satisfy the needs and wants of its customers, the business has to produce the products the customers demand. By producing these products for sale on the market, the business hopes to achieve a number of goals. Making a profit is perhaps the most basic of these.

Production — producing goods and services

When we go shopping we are choosing from a range of finished products — products that are ready for customers to buy and use. Rarely do we stop to think about all the operations that have occurred to transform raw materials into finished products ready for consumption. Business enterprises undertake many activities to provide the products demanded by customers, as shown in figure 1.6. However, by far the most important of all these activities is production. Production refers to those activities undertaken by the business that combine the resources to create products that satisfy customers’ needs and wants.
Forecasting sales, expenses and profit (e.g. café changes to a supplier providing cheaper coffee)

Planning finances, production and business needs (e.g. permission sought from local council to have tables on footpath)

Organising natural, capital and human resources (e.g. separate rosters are drawn up for the employees who work in the ‘Eats’ café and the antiques section)

Distributing goods and services (products) (e.g. the owner employs a delivery business to transport antiques to various customers at a cost)

Marketing products (e.g. online store established to show full range of antiques available)

Controlling production — quantity and quality (e.g. café manager seeks feedback from customers)

Management — coordinating the business’s limited resources to achieve specific goals (e.g. the owner buys a new machine that makes coffee faster and saves on labour)

Production — creating products (e.g. new reproduction furniture line is created featuring chairs with a ‘well worn’ look)

BizFACT

It is possible to calculate the value of production within an economy. The money value of all the finished products produced in Australia during one year is called the gross domestic product (GDP). This measurement is used as an indicator of Australia’s economic growth. Investigate the trend in Australia’s GDP over the past decade.

FIGURE 1.6 The main activities undertaken by this business, an antiques dealer with an on-site café, include more than selling furniture and serving coffee.

Summary

- The main role of a business is to produce and sell, for a profit, the products that satisfy individuals' needs and wants.
- Business enterprises undertake many activities to provide the products demanded by customers, with production being one of the most important.
- Production occurs when the business combines the resources to create products.

Revision

1 Identify the one common feature shared by all businesses.
2 Summarise how Business Studies can help you better perform the roles of consumer, employee, business owner and investor.
3 Refer to figure 1.4 (page 6). Select five functions and explain why each one is regarded as important to the Australian economy. (Such a diagram is called a concept map. Presenting information in this way is extremely helpful for it clearly shows the main points in a summarised format. During your Business Studies course you will be able to use this technique in your class notes, summary guides, assessable tasks and examination answers.)
4 Outline the role of business.
5 Define the term ‘business’.
6 Identify two goods and two services you recently purchased to satisfy a need or a want. Next to each one write the name of the business from which you bought the product.
7 Define the term ‘finished products’.
8 Explain why production is regarded as the most important business activity.
9 Gordon Su is the owner of a jewellery store specialising in handmade necklaces and bracelets. Read about his daily business activities (below) then complete the table to demonstrate each business activity Gordon undertakes to operate his business successfully. The first example has been completed for you.

<table>
<thead>
<tr>
<th>Activity undertaken by business</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production — creating products</td>
<td>Making necklaces and bracelets</td>
</tr>
<tr>
<td>Organising natural, capital and human resources</td>
<td></td>
</tr>
<tr>
<td>Marketing products</td>
<td></td>
</tr>
<tr>
<td>Controlling production — quantity and quality</td>
<td></td>
</tr>
<tr>
<td>Forecasting sales, expenses and profit</td>
<td></td>
</tr>
<tr>
<td>Distributing goods</td>
<td></td>
</tr>
</tbody>
</table>

10 Reflect on what you have learnt so far. State how this information would influence you if you were intending to start a business.

Extension

1 As a class, discuss the statement: ‘The one thing I’ve learnt about surviving in business is that it’s important to learn from past mistakes — and the more mistakes you make the more you learn.’ (Richard Branson, British entrepreneur, founder and CEO of Virgin Group)

2 Construct a clippings file of magazine and newspaper articles dealing with various aspects of business and its importance to the Australian economy. Select five articles and paste them onto a sheet of paper. Underneath each article prepare a 12–15 line summary.

3 Construct a series of flowcharts to show the interrelationship between producers and consumers.

4 The accepted measure of a country’s wealth is the gross domestic product (GDP). Investigate the present level of Australia’s GDP and then answer the following questions by going to the Australian Bureau of Statistics weblink in your eBookPLUS.
   (a) Outline how the GDP figure is calculated.
   (b) Construct a table showing Australia’s GDP growth over the past decade.
   (c) Examine the changes to the growth rate over this period.
   (d) Investigate the limitations of using GDP as a measure of quality of life.

1.3 Other functions of business

As outlined previously, Australian businesses provide employment for millions of people. As well, the products offered for sale provide consumers with a vast selection from which to choose. Therefore, the total output of all businesses adds considerably to the economic wealth and wellbeing of Australia. However, businesses also perform many other important roles as outlined in figure 1.7.
Innovation
Through research and development, existing products are improved and new products are created.

Employment
Businesses provide about 80 per cent of all private sector jobs.

Incomes
Businesses provide income to business owners/shareholders and employees.

Entrepreneurship
Businesses provide individuals with the opportunity to turn their ideas and passions into a livelihood.

Quality of life
Businesses offer a vast array of products that improve our standard of living.

Wealth creation
Business activity results in higher levels of economic growth and wealth.

Choice
Consumers have freedom of choice and the opportunity to purchase products at competitive prices.

Incomes
Businesses provide income to business owners/shareholders and employees.

Profit
This is the return, or reward, that business owners receive for producing products that consumers need and want.

Wealth creation
Business activity results in higher levels of economic growth and wealth.

Entrepreneurship
Businesses provide individuals with the opportunity to turn their ideas and passions into a livelihood.

Quality of life
Businesses offer a vast array of products that improve our standard of living.

Incomes
Businesses provide income to business owners/shareholders and employees.

Choice
Consumers have freedom of choice and the opportunity to purchase products at competitive prices.

FIGURE 1.7 The economic and social importance of business

Profit
The main activity of a business is to sell products to its customers. A business receives money (sales revenue) from its customers in exchange for products. It must also pay out money to cover the numerous expenses involved in operating the business. If the business's sales revenue is greater than its operating expenses, it has earned a profit. More specifically, profit is what remains after all business expenses have been deducted from the business's sales revenue (see figure 1.8).

BizWORD
Revenue is the money a business receives as payment for its products.

Operating expenses are all the costs of running the business except the cost of goods sold.

Profit is what remains after all business expenses have been deducted from sales revenue.

FIGURE 1.8 The relationship between sales revenue and profit
The business's profit becomes the property of its owners. For this reason, profit can be regarded as the return, or reward, that business owners receive for producing products that consumers want.

**Profits encourage risk taking**

Although our free enterprise economic system gives individuals the right to start a business, it does not guarantee the success of any enterprise. Individuals who go into business do so at their own risk. The owner of a new business cannot be certain that anyone will buy what he or she plans to sell. Even for the established business owner, there is always the possibility that consumers will change their preference and purchase a competitors' product.

If a business fails, its owner may lose all or part of the money he or she has put into it. If people are to take this risk, they must be encouraged by the hope of some reward for success. In our economic system, profit is the return (reward) or payment that business owners receive for assuming the considerable risks of ownership. One of these risks is the risk of not being paid. Everyone else — employees, suppliers, and lenders — must be paid before the owners. And if there is no profit, there can be no payment to owners. A second risk is that if the business fails, its owner may lose all or part of the money he or she has put into it.

**Employment**

Businesses have another important role to play. To be able to purchase products, consumers need money. They usually earn that money by working at jobs provided by businesses.

The number of employees hired by a business at any time will largely depend on the nature of the products and the number of customers who wish to purchase the products. Generally, the more that is sold the more employees a business will hire. Large businesses employ thousands of people within their organisations.

However, the SME sector is a major source of employment in Australia, accounting for about 50 per cent of all private (non-government) sector employment — approximately 5.3 million people. In fact, the SME sector has been the major generator of new jobs since the mid 1980s.
Incomes

Another important function of business is to provide income. For an individual, income is the amount of money received for providing his or her labour. A business's income is the amount it earns after covering all of its expenses: a return on its investments.

Many businesses require staff to conduct their operations. These employees provide their labour and in return receive either a:

- **wage**: money received by workers, usually on a weekly basis, for services they provide to an employer.
- **salary**: a fixed amount of money paid on a regular basis, usually fortnightly or monthly, to a permanent employee of a business.

This means that part of the money received from the sale of the business's products is divided among the workers who contributed to their production.

A business receives money from the sale of its products. As previously outlined, this is called sales revenue. From this revenue, all the expenses incurred in operating the business must be deducted. The amount that remains is the business's profit. This becomes the business owner's property and consequently their income.

If the business is a private or public company, it will have many owners referred to as shareholders. (A share is a part ownership of a company.) Usually, some or all of a company's profit is divided among shareholders. This type of income is called a dividend.

**BizWORD**

**Income** is money received by a person for providing his or her labour, or a business from a return on its investments.

A **wage** is money received by workers, usually on a weekly basis, for services they provide to an employer.

A **salary** is a fixed amount of money paid on a regular basis, usually fortnightly or monthly, to a permanent employee of a business.

**Shareholders** are people who are part owners of a company because they own a number of shares.

A **dividend** is part of a business's profit that is divided among shareholders.
The amount of income a business can generate as wages and salaries, profits or dividends, depends largely on how successful it is in selling its products. A business that is aware of what consumers desire and attempts to satisfy this demand will experience increasing sales. This provides the business with the opportunity to offer higher income payments to employees, business owners and shareholders.

**Choice**

*Choice* is the act of selecting among alternatives. For instance, you decide to purchase a new toothbrush. At the local supermarket you find a bewildering array of brands, designs, colours, shapes, textures, packaging, bristle arrangements, sizes and prices. A vast assortment of options — and all for the simple task of brushing your teeth.

In our society, consumers have freedom of choice and the opportunity to purchase a variety of products at competitive prices. An average supermarket will have on display approximately 20,000 product lines, with some hypermarkets carrying in excess of 40,000 lines. Freedom of choice exists when consumers can ‘shop around’ and select from a range of competitors’ products. The more competition there is, the greater the choice available to consumers. It is businesses, all competing with one another, that are responsible for the wide range of products in the shops. Every day thousands of businesses are producing products for specific sections of the overall market.

**Summary**

- Profit is what remains after all business expenses have been deducted from sales revenue.
- Profit is the reward that business owners receive for assuming the considerable risks of ownership.
- SMEs provide employment for about 64 per cent of all employees within the private sector.
- Businesses generate income for:
  - employees — wages and salaries
  - business owners — profits
  - shareholders — dividends.
- The amount of income a business can generate as wages, salaries, profits or dividends depends largely on how successful it is in selling its products.
- In our society, consumers have freedom of choice and the opportunity to purchase a variety of products at competitive prices.

**Innovation**

The development of new products, or improvements to existing products, is another important role of business. Many small business concepts are an innovation of an existing product. DVD recorders and digital cameras, for example, came into existence in the same way as light bulbs and car tyres — that is, through people making technical advances with established products. Sometimes, a person has an idea for a totally new product, an invention, which will satisfy a need that is not presently satisfied.

The way we listen to music has been the subject of innovation and invention over the last century or more. Prior to the invention of the first phonograph by Thomas Edison in 1877, the only way people had been able to listen to music...
was through live performance. Edison’s invention involved playing music that had been recorded on cylinders, but these were eventually superseded by discs in the 1920s. Tape recording was developed in the 1930s and 1940s, with the cassette tape appearing in 1964. Compact discs came onto the market in 1982. Since the 1990s digital recording techniques have allowed for music to be downloaded from the internet, stored on computer hard drives and on solid-state devices such as iPods and USB flash drives. New technological developments soon lead to new products, new markets and new business opportunities. In the same way, many SMEs undertaking research and development (R&D) have produced many new products that we take for granted.

SMEs generally display a consistently positive attitude towards innovation. They constantly research, develop and test new ideas and products. Many SMEs are built on product innovation (see the following Snapshot).

**PetMedics — a clever innovation**

What would you do if your pet was desperately sick and you had to get to a vet quickly? You could call a pet ambulance. Their passion for pets helped young entrepreneurs Nicole George and Gareth O’Connor turn PetMedics into a profitable business by making use of a gap in the market.

PetMedics is a 24-hour pet ambulance service staffed by experienced veterinary nurses. They pick up ill or injured pets from their homes, and the attending PetMedics will promptly and safely transport the pet to the appropriate veterinary hospital. The ambulance is fully equipped with medical oxygen and first aid supplies to ensure the patient receives any necessary care en route.

PetMedics came about when 24-year-old vet Nicole George was working the emergency shifts at North Shore Veterinary Specialist Hospital in Sydney. On any given shift she would receive a number of calls from distressed clients whose pets required urgent medical attention, but who were unable to transport their pets themselves. After speaking to friend Gareth O’Connor about the problem, the pair decided to start a 24-hour pet ambulance service to meet these clients’ needs.

From their experiences with the ambulance service they discovered that many pet owners have absolutely no idea what to do when their pet is ill or injured, and actually cause further injury or illness because they mistakenly assume human medication is safe for their pets (such as giving a cat paracetamol). To help prevent these mistakes, PetMedics has developed an Australian-specific canine first aid course for pet owners and people in the pet industry, and feline courses are currently being developed.

**Snapshot questions**

1. **Identify** PetMedics main strengths.
2. **Outline** what is meant by the phrase ‘gap in the market’.
3. **Assess** the role innovation played in the development of PetMedics.

Finding new and better ways of doing things has resulted in improved efficiency, and increased productivity. Studies confirm that the level of innovation among SMEs employees is much higher than among employees of larger businesses. This is perhaps because Australians have traditionally been a very innovative people, constantly recording the most number of new products per head of population.
Entrepreneurship and risk

Most of us have seen something advertised and thought, ‘That is just what I need’. Someone, somewhere, had the idea to provide this product. From this original idea a business was formed to develop, produce and market this product. People who transform their ideas into a new business are called entrepreneurs. They are prepared to take the risk of starting and operating a business venture; of turning their dreams and passions into a livelihood. Entrepreneurs have to take risks because usually they explore untapped markets with no track record of proven consumer demand or guaranteed returns. But for those whose ideas translate into a successful business venture, the profits are often huge.

Gordon Merchant, founder of Billabong — one of Australia’s most successful surfwear and surfboard businesses — is a classic example of an entrepreneur. He turned his ideas for selling surfboards and swimming gear from an operation run out of the back of his station wagon in 1973 into a worldwide operation. Today, the Billabong business venture sells its products in more than 8000 outlets in over 100 countries and is a publicly-listed company on the Australian Stock Exchange.

On a smaller scale, but just as successful, is soft tissue therapist Andrew Curry, owner of Miracle Massage, which operates in the country town of Goulburn. Andrew established the business in April 2001 when he was only 22 years of age. He operated the business while concurrently working part-time at the Australian Institute of Sport (AIS). Andrew’s experience of soft tissue therapy in private practice and in this elite sports environment, laid the foundation for the clinic’s unique treatment methods.

BizWORD
An entrepreneur is someone who starts, operates and assumes the risk of a business venture in the hope of making a profit.

BizFACT
Every new business starts with an idea. Describe a business idea that you could provide and that is, to your knowledge, not already available.

Weblink
Use the Billabong history weblink you your eBookPLUS to find out more about how Gordon Merchant started Billabong.
When Andrew started the business he had no idea that it would eventually:
• employ seven people
• undertake clinical research in spine, breathing and pelvic dysfunction
• offer Pilates and injury prevention training programs.

The principal reason for Miracle Massage’s success is Andrew’s passion, drive and commitment: his entrepreneurial skills (see the following Snapshot).

**SNAPSHOT**

**Interviewer:** What would you consider to be your main entrepreneurial skills?
**Andrew:** Being able to plan; confidence in my own ability, not because I’m arrogant but because I put a lot of time into developing my professional and business skills; highly motivated; honest and fair in all business dealings; work well with people; a competent communicator; a lateral thinker; prepared to take responsibility, especially for my employees; and highly organised.

**Interviewer:** Please outline the factors that prompted you to establish your own business.

**Andrew:** After completing my Associate Diploma course I approached a number of Canberra businesses for a position. I wanted to work for a business whose employees were all highly trained and that matched my level of training. At that time there was no standardisation for soft tissue training and consequently there was a wide variety of different skills sets across the businesses. Frustratingly, I was not able to find a business that matched my level of training or one that supported their treatment with sound theoretical knowledge. That may sound a bit pretentious, but it was the main factor that prompted me to start my own business. Two other factors that further prompted me included the identification of a business opportunity and a potential customer base.
Interviewer: How did you identify a business opportunity?
Andrew: During the job interviews I asked a lot of questions — in a sense, I undertook some market research — to identify the markets being serviced, the range of therapies they offered, their price structure and what strategies they used to achieve their business goals. The only business within Goulburn that offered a level of therapies and training that I desired was operating to maximum capacity. Therefore, I could see an opening for me to establish a business to satisfy unmet demand.

Interviewer: How did you identify a potential target market?
Andrew: While undertaking my course in Canberra, I worked part-time at the Goulburn Aquatic Centre as a lifeguard, and swimming and fitness instructor. I therefore had a good following: a market of active, health conscious people that I thought I could tap into.

Interviewer: Did you have a passion for establishing a business?
Andrew: It was more a strong desire to pursue my goals by meeting the needs of people. And the only way to achieve this was by setting up my own business.

Interviewer: As part of your course you were required to complete a business plan. How was this beneficial?
Andrew: It provided the basis on which I was able to develop my business. Without it I would not have been aware of all the requirements of establishing a business. It forced me to undertake research, evaluate different business ideas and identify some long-term goals. But most importantly, I discovered that the single main cause for small business failure is inadequate cash flow.

Interviewer: How did this influence the way in which you operated your business?
Andrew: I was determined to keep my cash flow positive. I did this by continuing with my work at the AIS, which provided an external source of funds. This minimised the risk of early failure.

Interviewer: You once said that as a businessperson/entrepreneur, you only take moderate risks rather than high risks. Please elaborate.
Andrew: All businesses involve some degree of risk; and I enjoy such challenges. A great quote I came across recently sums up my approach: ‘Growth demands a temporary surrender of security’. However, the more calculated you make the decision and the more you take emotion out of the decision-making process, the more moderate the risk becomes. You minimise a high-risk strategy by approaching it objectively and gathering as much information as possible. I don’t like to take high risks but I like to take high-risk situations and minimise the risks as much as possible. If this can’t be achieved then it is not worth following the idea. It is a ‘no-brainer’ to take a high risk with low benefit!

Interviewer: What must you do to be an ethical entrepreneur?
Andrew: Simply act honestly and fairly in all business dealings. For example, I have fantastic employees who are one of the main strengths of my business. I have a responsibility for their welfare at work, as well as their future development. All my employment processes, therefore, must meet rigorous criteria. This has the added benefit of treating fairly any employee who turns out to be unsuitable. Constantly monitoring and evaluating how I operate the business helps maintain my good reputation. One of my main business goals is for Miracle Massage to have a good reputation within the wider community; something I feel very proud about. Being a reputable business is good business. It results in a large number of repeat, loyal clients. Ultimately, I gain a great deal of satisfaction from seeing my clients recover from chronic pain.

Snapshot questions
1. Identify the main entrepreneurial characteristics exhibited by Andrew Curry.
2. Recall the factors that prompted Andrew to establish his own business.
3. Outline whether you agree with Andrew when he says that an entrepreneur should take only moderate risks rather than high risks.
4. Account for the success of Miracle Massage.
5. Discuss why it is important for Andrew to maintain an ethical business.
6. Predict what may happen to Andrew’s business over the next five years.
Entrepreneurial qualities, however, are not confined to adults. For example, at a recent swimming carnival, Yolanda Zurack, a Year 8 student, arranged to take along an Esky filled with cold drinks. To keep her costs down Yolanda bought the drinks through a local wholesaler. During the very hot day she sold all the drinks and made a reasonable profit.

Yolanda Zurack, Gordon Merchant and Andrew Curry are all entrepreneurs. They organised their business, undertook the necessary arrangements for it to operate, and were prepared to take a risk. The size of the profits may differ but they possess identical entrepreneurial qualities: courage, motivation, determination and energy. Without such entrepreneurs and their activities, many of the products we purchase would not exist.

**Wealth creation**

The more that is produced the more wealth is generated within the Australian economy. The thousands of individual businesses operating every day act as the ‘engine room’ of society, helping drive the economy forward to achieve greater levels of economic growth and wealth.

During normal operations, a business receives money from its customers in exchange for products. At the same time it must also pay out money to other businesses to cover operating expenses. Operating expenses are the costs involved in the day-to-day operation of the business. The difference between the two amounts, the value added, represents the wealth (profit) created by the business. This wealth is then redistributed to employees, governments, lenders, owners/shareholders and the business itself (see figure 1.13).

![Figure 1.13: The distribution of the wealth created by a business](image)

As previously outlined, businesses need to employ people to assist in the production process. These employees receive an income (wage or salary) that can be spent to satisfy their needs and wants. Both the money received and the products purchased add to the wealth of individuals and households. Imagine if all

**BizFACT**

An entrepreneur’s drive and motivation to establish and operate a business lies at the heart of our private enterprise economic system.
the businesses within your local community were to close down overnight. People would lose their jobs and source of income, fewer products would be available for purchase, and the flow of money would quickly contract. The end result would be an increase in the levels of poverty, the opposite of wealth creation.

The total output of the country’s diverse collection of businesses, ranging from large transnationals to the family-owned local corner store, makes a significant contribution to the wealth of the national economy.

Quality of life

In our society most people want more than the bare necessities; they want to achieve the highest standard of living possible. Overall, we have high expectations about what our economy should provide for us. However, we often want more than simply to have our material wants satisfied. We also desire a high degree of quality in our lives. Quality of life refers to the overall wellbeing of an individual, and is a combination of both material and non-material benefits.

For example, we desire to have leisure time for hobbies and recreation. Our quality of life is improved by having access to a number of non-material products such as fresh air and clean water, unpolluted earth, conservation of wildlife and protection from toxic sources. Consumers have become increasingly concerned about waste disposal, the greenhouse effect and the destruction of unique habitats.

Many businesses have responded to quality-of-life issues and are implementing environmentally friendly procedures, for example recycled materials, cleaner cars, less energy-consuming production and ‘green’ food products. Because business activities play a vital role in our lives, businesses have a responsibility to help provide what consumers want and to minimise what they do not want.

Summary

• Research and development (R&D) leads to the creation of new products (inventions) and the improvement of existing ones (innovations).
• A person who transforms their ideas into a new business is called an entrepreneur: someone who starts, operates and assumes the risk of a business venture in the hope of making a profit.
• An entrepreneur’s drive and motivation to establish and operate a business lie at the heart of our private economic system.
• Business is a major creator of wealth within the Australian economy.
• Businesses produce a vast range of products that enable us to satisfy many and varied wants, which results in a higher standard of living.
• Quality of life refers to the wellbeing of an individual, and is a combination of material and non-material benefits.

Revision

1 Recall the main activity of a business.
2 Describe the relationship between revenue, operating expenses and profit.
3 Calculate which of the following businesses has made a profit.
   (a) Sally’s Pet Shop has expenses of $2000 per week and revenue earned is $3500 per week.
   (b) Ben’s Gardening Supplies takes revenue of $6000 each week for a month, but has weekly expenses of $7000 the first week, $8000 the second and third week, and $3000 for the fourth week.
4 ‘Profit is the reward for risk taking’. Explain.
5 Describe the two main risks associated with operating a business.
6 Evaluate the significance of the SME sector’s contribution to total employment within the Australian economy.

7 Outline the three ways in which businesses provide income.

8 Recall the correct term and complete the table below.

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Income</td>
<td></td>
</tr>
<tr>
<td>B. Wage</td>
<td></td>
</tr>
<tr>
<td>C.</td>
<td>A fixed amount of money paid on a regular basis to a permanent employee of a business.</td>
</tr>
<tr>
<td>D. Shareholder</td>
<td>Part of a business’s profit that is divided among shareholders.</td>
</tr>
</tbody>
</table>

9 Define the term ‘choice’. Explain how businesses encourage freedom of choice.

10 Demonstrate the difference between an invention and an innovation.

11 Outline the role innovation plays within our economy.

12 Outline the role of the entrepreneur in our economic system.

13 Identify the entrepreneurial characteristics that Yolanda Zurack, Gordon Merchant and Andrew Curry have in common.

14 Assess your own entrepreneurial ability by completing the following questionnaire.

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Are you willing to take moderate risks?</td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>Are you easily motivated?</td>
<td></td>
</tr>
<tr>
<td>(c)</td>
<td>Do you get on well with people?</td>
<td></td>
</tr>
<tr>
<td>(d)</td>
<td>Is your health excellent?</td>
<td></td>
</tr>
<tr>
<td>(e)</td>
<td>Do you set realistic goals?</td>
<td></td>
</tr>
<tr>
<td>(f)</td>
<td>Are you prepared to accept responsibility?</td>
<td></td>
</tr>
<tr>
<td>(g)</td>
<td>Can you tolerate failure?</td>
<td></td>
</tr>
<tr>
<td>(h)</td>
<td>Do you have a positive self-image?</td>
<td></td>
</tr>
<tr>
<td>(i)</td>
<td>Are you well organised?</td>
<td></td>
</tr>
<tr>
<td>(j)</td>
<td>Are you a hard worker?</td>
<td></td>
</tr>
</tbody>
</table>

Someone with an entrepreneurial personality would answer ‘Yes’ to most of the questions. Write a self-evaluation report based on your answers. You may wish to use a word-processing package to prepare the report. Compare your response in class.

15 Clarify how businesses create wealth within the economy.

16 Identify the ways in which the wealth created by a business is redistributed.

17 Justify which is a more important contributor to a person’s quality of life — material or non-material benefits. Provide reasons for your answer.
Extension

1 A profitable business is one that returns to its owners more than they could earn by working for someone else. According to this definition, many businesses operating today would not be considered profitable. **Determine** why their owners continue to run them. Share your answer with the rest of the class.

2 **Construct** a three-minute presentation titled ‘How businesses contribute to our economic and social wellbeing’. Prepare some multimedia materials to supplement the oral presentation.

3 ‘The mother of invention/innovation is necessity.’ **Justify** this statement.

4 In small groups, **predict** the social consequences of an economy that is experiencing a large number of business failures. **Compare** your answer with other groups.

5 In small groups, **identify** someone who successfully runs a small business. **Critically analyse** the personal qualities this person possesses that contribute to the success of the business.

6 The Entrepreneur Network for Young Australians Ltd (ENYA) is a not-for-profit public company that ‘promotes the active participation of young people in enterprise, in an ethical and sustainable manner’. Use the **ENYA** weblink in your eBookPLUS and **examine** the main functions of this organisation.
2.1 Introduction

As explained in chapter 1, any organisation that sells goods and services to consumers in order to make a profit is a business.

Businesses may be organised in a variety of ways. Although no two businesses are identical, there are some common features that allow similar business types to be classified and grouped together. The four common methods used to classify businesses are:

• size
• geographical spread — local, national or global
• industry sector
• legal structure.

2.2 Classification by size

Like soft drinks, businesses come in three different sizes: small, medium and large (figure 2.1). Most people usually associate the term ‘business’ with large companies such as Woolworths, Commonwealth Bank and Westfield, which employ thousands of people across hundreds of locations. However, small to medium enterprises (SMEs) play an especially important role within the Australian economy. As consumers, we rely on a large number of SMEs to satisfy our wants and needs. These businesses also provide employment for about 5.3 million people.

In recent years, the SMEs in Australia have performed better than other sectors of the economy. They have created many new jobs, have become more innovative and are increasingly entering overseas markets (see chapter 10).
Although no universally accepted definition exists for a small, medium or large business, a number of measurements can be used to determine the size of a business, including:

- the number of employees — those who are hired to do work for the business
- the number of owners (of the business) — for example, a sole trader is a type of business that has one owner
- **market share** — the proportion of total market sales the business has compared to competitors
- the legal structure — for example, the business is set up as a sole trader, partnership or company.

Apart from quantitative measures, such as the number of employees, there are also qualitative descriptions that help us to determine the size of a business. These qualitative measures are based on personal observation about the business. From a qualitative viewpoint, a business may be classified as small or medium-sized if:

- the owner makes most management decisions, such as who to hire, what to produce and how to advertise a product
- the owner provides most of the capital (finance)
- the business has little control within the market. Smaller businesses do not usually have a large share of the total market sales and therefore have less control over such things as price.
- it is independently owned and operated (for example, the local hamburger shop is run by the owner, who does not answer to a larger organisation such as McDonald’s)
- the business is locally based. (This does not mean that it doesn’t export, because many SMEs do export. It just means that many SMEs are based in the one location and, unlike a transnational (multinational) corporation or company, do not have offices around the world.)

A comprehensive definition of small, medium and large business usually relies on a combination of both quantitative measurements and qualitative descriptions, as shown in table 2.1. This table also outlines the features of, and distinctions between, the different sized businesses.

**TABLE 2.1** Quantitative measurements and qualitative descriptions of small, medium and large businesses

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business type</strong></td>
<td>Corner store&lt;br&gt;Local mechanic&lt;br&gt;Hairdressing salon</td>
<td>Services club&lt;br&gt;Motel/hotel&lt;br&gt;Engineering factory</td>
<td>Woolworths&lt;br&gt;Qantas&lt;br&gt;National Australia Bank</td>
</tr>
<tr>
<td><strong>Number of employees according to the Australian Bureau of Statistics (ABS) business register definition</strong></td>
<td>Less than 20 employees</td>
<td>20–199 employees</td>
<td>200 or more employees</td>
</tr>
<tr>
<td><strong>Type of ownership</strong></td>
<td>Independently owned and operated by usually one or two people</td>
<td>Owned and operated by a few people and/or private shareholders</td>
<td>Owned usually by thousands of public shareholders</td>
</tr>
<tr>
<td><strong>Most common legal structure</strong></td>
<td>Sole trader&lt;br&gt;Partnership</td>
<td>Partnership&lt;br&gt;Private company</td>
<td>Public company (numerous)</td>
</tr>
</tbody>
</table>

(continued)
### TABLE 2.1 (continued)

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision making</td>
<td>Owner responsible for majority of decisions; simple and quick</td>
<td>Owner basically responsible for majority of decisions; more</td>
<td>Complex decision making, due to division of responsibilities</td>
</tr>
<tr>
<td></td>
<td>implementation of decisions</td>
<td>complicated decision making with slower implementation, due to</td>
<td>among directors, senior and middle management; possibly</td>
</tr>
<tr>
<td></td>
<td></td>
<td>influence of directors</td>
<td>slow implementation of decisions, due to the layers of management</td>
</tr>
<tr>
<td>Sources of finance</td>
<td>Owner (usually from own savings or a loan); difficulty in accessing</td>
<td>Owners'/partners' own savings or a loan and/or private shareholders;</td>
<td>Many sources, including cash reserves, retained profit, sale of</td>
</tr>
<tr>
<td></td>
<td>loans</td>
<td>easier accessibility to larger loans</td>
<td>shares, and loans from domestic and overseas institutions</td>
</tr>
<tr>
<td>Market share</td>
<td>Small, usually local area; not dominant in the industry</td>
<td>Medium, due to dominance within a geographic region; some market</td>
<td>Large, especially for multinational corporations that dominate the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>dominance</td>
<td>markets of many countries</td>
</tr>
</tbody>
</table>

### Micro businesses

Recent research undertaken by the Australian Bureau of Statistics (ABS) revealed that the majority of small businesses are not those that employ 10 to 20 people, but those that employ fewer than five people (including the owner). These businesses are referred to as **micro businesses**. Usually working from home (SOHO — small office home office), this group of businesses represents about 90 per cent of the
entire small-business population. As a result of the rapid expansion of these businesses over the past decade, this group is being referred to as the micro sector (as opposed to the small-business sector).

The main characteristics of micro businesses are that:

- they represent 82 per cent of all non-manufacturing small businesses
- 58 per cent are sole traders and partnerships
- they employ 31 per cent of all people employed in the private sector
- they are dominated by women, young people seeking self-employment and people who were retrenched from their previous employment
- 54 per cent have no employees.

2.3 Classification by geographical spread

Consider the suburb or town in which you live. This area can be classified as your local community or neighbourhood — that is, a group of people living and working in the same locality. The consolidation of all these local communities is what forms the nation of Australia. Now, broaden your scope even further. Australia is just one of the 195 independent nations that are part of the global network.

Businesses, too, can be classified as local, national or global according to their geographical spread: the presence of a business and the range of its products across a suburb, city, state or country or the globe.

Local

A local business, such as a newsagent, corner store, hairdresser, mechanic or pharmacy, has a very restricted geographical spread. It serves the surrounding area and is in no position to offer a range of products to another suburb or town. Local businesses such as these will frequently be used by consumers who live nearby. The majority of local businesses tend to be small to medium in size.
National

As a business grows, it increases its range of products and the area it serves. As it does this, it develops into a national business — one that operates within just one country. Coles, for example, commenced trading in 1914 as G.J. Coles variety store in Collingwood, Victoria. Started by George Coles and his brother Jim, it employed six people. Today, Coles is a leader in Australian food retailing, with more than 100,000 employees and over 11 million customer transactions a week.

Other well-known Australian businesses that serve the national market include:
- Australian Geographic — stores that specialise in Australiana, children’s games, gadgets, telescopes, travel and outdoor products. The Australian Geographic magazine was started in 1985 by Australian entrepreneur and adventurer Dick Smith. Today the magazine operates more than 70 stores across Australia.
- Sportsgirl — the boutique that became a major Australian fashion brand. The company offers a wide range of fashion and accessories, and has over 100 stores across Australia. Founded in Melbourne in 1948, Sportsgirl today holds a dominant place in Australia’s retail fashion market.
- David Jones — one of Australia’s oldest department stores. In 1838, just 50 years after the First Fleet arrived in Sydney Cove, Mr David Jones opened ‘large and commodious premises’ on the corner of George and Barrack streets, Sydney.
- Colorado Group — Australia’s leading national footwear and apparel retailer/wholesaler. With a history dating back 140 years, the group’s portfolio of leading brands includes Colorado, Mathers, Williams, Pairs, Jag and Diana Ferrari.

Global

A global business, commonly referred to as a transnational corporation (TNC), is a large business with a home base in one country that operates partially owned or wholly owned businesses in other countries. The TNC represents the...
highest level of involvement in global business. For such companies, national borders do not represent barriers to trade — they are merely lines on a map. Consequently, TNCs conduct a large percentage of their business outside their home country.

Transnational corporations come in many different forms and sizes. Coca-Cola, LG, McDonald’s, CSR, News Corporation, BHP Billiton, Toyota, Unilever, Westfield and Exxon are just a few of the well-known foreign and Australian TNCs. However, all TNCs have a number of features in common. In a fully developed TNC, finance, assets, technology, information, employees and goods and services all flow freely from one country to another (see the following Snapshot).

**Riding the wave: Billabong International Limited**

One example of an Australian TNC is Billabong International Limited. Established in Queensland in 1973 by Gordon Merchant, Billabong originally manufactured only boardshorts. Today, Billabong designs, produces and distributes a wide range of sportswear and accessories, including swimwear, backpacks, skateboards, sunglasses and jewellery. It is currently the leading surfwear apparel brand in Australia.

From its head office in Burleigh Heads, Queensland, the company controls its major brands: Billabong, Element, Von Zipper, Honolulu Surf Company, Kustom, Palmers Surf, Nixon, Xcel, DaKine, Sector 9 and Tigerlily. Billabong products are distributed in more than 100 countries and are available in approximately 10,000 outlets worldwide. Billabong employs about 4000 staff around the world, with most employees located in California’s Orange County, Australia’s Gold Coast and Hossegor in France.

Billabong’s products are manufactured by wholly owned operations in Australia, North America, Europe, Japan, New Zealand and Brazil. This requires a sophisticated system to monitor the production and delivery schedules. The company’s Hong Kong office manages the main international sourcing needs. Billabong is committed to ethical and responsible business practices and requires all suppliers to abide by its supplier code of conduct.

**Snapshot questions**
1. State Billabong’s main business activity.
2. Identify four major brands under Billabong’s control.
3. Recall where Billabong’s products are manufactured.
4. Outline the role of Billabong’s Hong Kong office.
5. Describe how Billabong fulfils its ethical responsibilities to the employees of its suppliers.
6. Use the Billabong weblink in your eBookPLUS.
   (a) Examine the purpose of the Social Accountability (SA) 8000 standard.
   (b) Explain why a global business should be aware of the labour laws of the country in which it operates.
7. Determine the advantages for Billabong of producing products in a number of countries.

**Reasons for business expansion**

Four interrelated forces lead businesses to serve a national or global market.

1. **Increase in sales.** As a business’s products become more widely known, sales increase. To satisfy this increase in consumer demand, a business will expand by establishing stores in new locations.
2. **Desire to increase profits.** Most business owners would like to increase their profits. One way to do this is to serve a wider market, because this normally results in further sales — growth leads to further growth. In the long term, this increases the business’s profits.

3. **Increase in market share.** At the start of a business’s growth period, it faces increased competition as new competitors enter the market. This begins the struggle for market share. Competitive conflict is expensive, and often the small, weak firms do not survive. Eventually, the remaining businesses start to reap the rewards of their investment.

4. **Global consumers.** There is increasing uniformity among consumers around the world. For example, the same television commercials are shown across the globe. Internationally, millions of people want to purchase a particular brand of soft drink, jeans, sunglasses, computer or car. Today’s consumers have access to the internet and are more likely to want to purchase foreign-made goods. Over the last decade, **e-commerce** (online shopping via the internet) has become the most commonly used method of purchasing products from overseas.

**Summary**

- Businesses can be classified as small, medium or large.
- Their classification will depend on such things as number of employees, market share, ownership and who makes the decisions.
- A micro business (usually a SOHO) employs fewer than five people (including the owner).
- Businesses can also be classified as local, national or global according to their geographical spread.
• A local business has a very restricted geographical spread; it serves its surrounding area.
• A national business operates in just one country.
• A global business — a transnational corporation (TNC) — is a large business with a home base in one country that operates partially owned or wholly owned businesses in other countries.
• The four main reasons businesses expand to serve national and global markets are:
  – increase in sales
  – desire to increase profits
  – increase in market share
  – global consumers.

Revision

1 Deduce whether the following businesses are small, medium or large, and explain the reason for your decision.
   (a) Qantas employs approximately 37,000 people.
   (b) National Australia Bank is an international financial services organisation that has customers in Australia, New Zealand, Asia, the United Kingdom and the United States.
   (c) Brookfarm is owned by Carolyn and Martin Brook. It produces gourmet macadamia nuts for domestic and export markets, and employs more than 20 staff.
   (d) Ripe Maternity Wear was started by two friends in 1996 to manufacture contemporary maternity clothes. It supplies clothes worldwide, employing no more than 20 staff.

2 Determine whether the following statements are true or false.
   (a) A micro business is a business that sells only miniature products.
   (b) SME stands for small to medium enterprise.
   (c) Small businesses do not usually have a large share of a particular market.
   (d) According to the Australian Bureau of Statistics, large businesses employ fewer than 200 people.
   (e) SMEs do not play an especially important role within the Australian economy.
   (f) An enterprise is just another name for a business.

3 Complete the following statements by determining the correct word from the choices given. Write the sentences in your notebook.
   (a) According to the ABS, a business with fewer than 200/300 employees is classified as a medium-sized business.
   (b) A common feature of all small businesses is that they are independently/interdependently owned and operated.
   (c) Small businesses have a complex/simple management structure with few/many rules and regulations.
   (d) The number of employees in a business is a quantitative/qualitative measure.
   (e) A small business has a large/small market share and usually serves the Australian/local market.
   (f) An example of a small business is Westfield Limited/Blue Hills Convenience Store.
   (g) Most small businesses are sole traders/public companies.

4 Compare a micro business with a small business.

5 Define the term ‘geographical spread’.

6 Distinguish between a local and national business. Provide two examples of each.

7 Recall another name for a global business.

8 Identify three examples of TNCs.

9 State what features all TNCs have in common.

10 Summarise the four main interrelated forces leading businesses to serve national and/or global markets.
### Extension

1. **Construct** a database of seven businesses that you have dealt with over the last few months. Copy and then complete the following table. The first one has been done for you.

<table>
<thead>
<tr>
<th>Business name</th>
<th>Business activity</th>
<th>Private or public enterprise</th>
<th>Size: small, medium, large</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Redback Café</td>
<td>Food and drink</td>
<td>Private</td>
<td>Small</td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(a) **Calculate** what percentage of the businesses are small.
(b) **Outline** the criteria you used to classify the size of each business.
(c) **Compare** the percentage with the figures for Australia.
(d) **Account** for the similarity/difference between the two figures.

2. **Critically analyse** the following statement: ‘Transnational corporations play a crucial role in our society. Without them, consumers would not have such a wide range of products to select from.’

3. Look for five internet or newspaper articles about SMEs that interest you. Start a file of news clippings or printouts and write an information page to attach to each article.
   On the information page:
   (a) **summarise** what the article is about
   (b) **examine** some background information about the business.

4. Reebok and Levi Strauss are two TNCs that place a great deal of importance on their corporate social responsibilities. Both companies have taken action against overseas suppliers over human rights issues and environmental codes of conduct. Use the [Reebok](https://www.reebok.com/) and [Levi Strauss](https://www.levistrauss.com/) weblinks in your eBookPLUS and **investigate** their commitment to their social and environmental obligations. Create either an oral or written report and present it to the rest of the class.

5. Arrange to inspect an annual report for one of Australia’s large transnational corporations. **Investigate** the company’s operations. To help you, use the [Transnational corporations](https://ebookplus.net/) weblink in your eBookPLUS.

### 2.4 Classification by industry sector

Another useful method used to classify businesses is based on the type of activity they undertake. When businesses are involved in similar types of production, they are grouped together in what is referred to as an **industry**. For example, the Australian car industry is made up of three major car firms: GMH, Ford and Toyota.

There are three main types of industry groupings or sectors: primary, secondary and tertiary. Due to the rapid growth in the tertiary industry over the last three decades, this sector has been subdivided into quaternary and quinary sectors (see figure 2.6).
FIGURE 2.6 The three main industry sectors

The relative size of each industry sector is shown in table 2.2. This table shows both the percentage of private sector firms and the employment in each industry sector.

TABLE 2.2 Industry size — percentage of firms and employment by industry sector, 2010

<table>
<thead>
<tr>
<th>Industry sector</th>
<th>Private sector percentage of all firms by industry</th>
<th>Percentage of total employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>9%</td>
<td>4%</td>
</tr>
<tr>
<td>Secondary</td>
<td>21%</td>
<td>19%</td>
</tr>
<tr>
<td>Tertiary</td>
<td>70%</td>
<td>77%</td>
</tr>
</tbody>
</table>

Primary industry

Primary industry includes all those businesses in which production is directly associated with natural resources. All production begins here. Examples of these businesses include all types of farming, mining, fishing, grazing and forestry. Even though this sector employs only 4 per cent of the labour force, its role is essential because it provides all of our food requirements. As well, approximately 60 per cent of all our exports come from these industries.

BizWORD

Primary industry includes all those businesses in which production is directly associated with natural resources.
Secondary industry

Secondary industry includes all those businesses that take the output of firms in the primary sector (raw materials) and process it into a finished or semi-finished product. For example, iron ore, coal and limestone are turned into steel — a semi-finished product that is then used to manufacture cars. Steel and car manufacturers are both examples of secondary industry businesses.

Tertiary industry

Businesses in the tertiary industry provide a service. Tertiary industry involves people performing a vast range of services for other people. Examples include retailers, dentists, solicitors, banks, museums and health workers.

Over the past 50 years, the number of businesses and people employed in this industry sector has grown rapidly, to a point whereby, today, about three out of every four employees, and two out of every three businesses are classified as tertiary. Due to this increase in numbers, the tertiary sector has been subdivided into two other sectors: quaternary and quinary.

Weblink

Use the Primary, Secondary and Tertiary Industries weblink in your eBookPLUS to discover more about these industries in the past compared to what they are today.
Quaternary industry

**Quaternary industry** includes services that involve the transfer and processing of information and knowledge. Examples include telecommunication, property, computing, finance and education. The quaternary sector is expected to undergo dramatic change over the next 20 years due to the rapid advances in telecommunications. Expansion in e-commerce and internet-based business activity will see an increase in the number of people employed in information processing and analysis.

---

Quinary industry

**Quinary industry** includes all services that have traditionally been performed in the home. Examples include hospitality, tourism, craft-based activities and childcare. It includes both paid and unpaid work. Due to social and lifestyle changes, as well as an increase in the number of two-income households, the demand for quinary-type services is estimated to expand rapidly during the next two decades. Many small businesses in particular have recently begun providing these services, filling a niche in the market.

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**Summary**

- An industry consists of businesses that are involved in similar types of production.
- Primary industry — production from natural resources.
- Secondary industry — production of finished or semi-finished goods.
- Tertiary industry — performing a service.
- Quaternary industry — services that involve the transfer and processing of information and knowledge.
- Quinary industry — services that have traditionally been performed in the home.
Revision

1 Demonstrate the difference between a firm and an industry.

2 Refer to table 2.2 (page 31). Propose reasons why the primary sector accounts for only 4 per cent of total employment whereas the tertiary sector accounts for 77 per cent of total employment. Discuss what this tells you about future employment prospects within the two sectors.

3 Construct a mind map summarising the five industry sectors. Provide examples for each sector. The concept map has already been started for you.

4 In your notebook construct a table with five columns. At the top of the columns put the headings Primary, Secondary, Tertiary, Quaternary and Quinary. From the list of businesses, determine the correct column for its particular industry group and write in its name. The first one has been done for you.

<table>
<thead>
<tr>
<th>Primary</th>
<th>Secondary</th>
<th>Tertiary</th>
<th>Quaternary</th>
<th>Quinary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tallong Orchards</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tallong Orchards</td>
<td></td>
<td></td>
<td>Data Transfer Computing</td>
<td></td>
</tr>
<tr>
<td>S. &amp; W. Legal Centre</td>
<td></td>
<td></td>
<td>National Australia Bank</td>
<td></td>
</tr>
<tr>
<td>Bowral Bricks</td>
<td></td>
<td></td>
<td>Tiggy Wiggles Child Care Centre</td>
<td></td>
</tr>
<tr>
<td>Clancy’s Restaurant</td>
<td></td>
<td></td>
<td>Hi Plains Merino Stud</td>
<td></td>
</tr>
<tr>
<td>Pollards Removalists</td>
<td></td>
<td></td>
<td>Southern Tablelands Towing</td>
<td></td>
</tr>
<tr>
<td>Moo Moo Pastures Dairy</td>
<td></td>
<td></td>
<td>Centretown Motel</td>
<td></td>
</tr>
<tr>
<td>Bald Hill Quarry</td>
<td></td>
<td></td>
<td>B. S. Plastics Manufacturers</td>
<td></td>
</tr>
<tr>
<td>Crookwell Real Estate</td>
<td></td>
<td></td>
<td>Country Furniture Constructions</td>
<td></td>
</tr>
<tr>
<td>Finlay’s Fine Furniture</td>
<td></td>
<td></td>
<td>Pioneer Water Tanks</td>
<td></td>
</tr>
<tr>
<td>Creative Hands Craft School</td>
<td></td>
<td></td>
<td>Access TV Productions</td>
<td></td>
</tr>
</tbody>
</table>

5 In small groups, use the brainstorm technique to propose reasons for the growth in the tertiary sector over the past 50 years.

Extension

1 (a) Construct a flowchart showing the industry sectors involved in the production of a car.

(b) Analyse the relationship between the various sectors.
2 (a) **Construct** a list of tertiary jobs that are essential for the production of a:

(i) television game show  
(ii) local newspaper  
(iii) hi-fi system, bought at an electronics store.

(b) Place the letters ‘Qt’ next to those jobs that would be classified as quaternary and the letters ‘Qn’ for those jobs in the quinary sector.

(c) **Deduce** what your list reveals.

3 **Investigate** why the quinary sector has included in it unpaid, voluntary jobs.

### 2.5 Classification by legal structure

There are a number of different legal structures to choose from when deciding how a business is to be owned and operated. The four main legal structures of privately owned businesses are shown in figure 2.12.

#### Incorporated and unincorporated business structures

As figure 2.12 shows, the four main legal structures of privately owned businesses can be further divided into:

- unincorporated businesses, in the case of sole traders and partnerships
- incorporated businesses, in the case of privately and publicly owned companies.

The term **incorporated** refers to the process companies go through to become a separate legal entity from the owner/s. This means the business exists in its own right, its own legal entity. Regardless of what happens to individual owners (shareholders) of the company, the business continues to operate. The business has taken on a life of its own.

An unincorporated business is a sole trader or partnership where the business entity and the owner are one and the same. When the owner dies then so too does the business entity.

The most common legal structure for a small business in Australia is the unincorporated business entity because this structure is the easiest and cheapest to establish.

**BizWORD**

*Incorporated* refers to the process companies go through to become a separate legal entity from the owner/s.
Selecting the appropriate business structure is one of the most important decisions a business owner has to make. Each of the different business structures is covered by different government regulations that must be followed and, as such, have an enormous effect on the overall running of the business.

**Sole trader businesses**

A *sole trader* is a business that is owned and operated by one person. The owner may employ other people to work in the business, but the owner or sole trader is the person who provides all the finance, makes all the decisions and takes all the responsibility for the operation of the business.

This type of business is easy to establish in terms of legal requirements. The only legal requirement specific to a sole trader is that the name of the business be registered if the name is different from that of the owner. For example, if Paul Jones operates a lawn-mowing service under the name of P. Jones or Paul Jones, then the name of his business does not need to be registered. If, however, he calls his business ‘Paul’s Lawn and Garden Service’, he would have to register the name. The name must be registered with the Department of Fair Trading if the owner lives in New South Wales.

A sole trader is not regarded as a separate legal entity; that is, the owner and the business are regarded as the same. This means that if the business is sued then the owner is sued, or if the business enters into a legal contract then the owner enters into the contract. If the business runs into financial difficulties, it is the owner or sole trader who has the financial problem and is solely responsible for the finances of the business. This responsibility may include selling personal assets, such as property or motor vehicles, to pay for the liabilities of the business. This is referred to as **unlimited liability**.
The advantages and disadvantages of being a sole trader are shown below.

**Advantages**
- Low cost of entry
- Simplest form
- Complete control
- Less costly to operate
- No partner disputes
- Owner’s right to keep all profits
- Less government regulation
- No tax on profits, only on personal income

**Disadvantages**
- Personal (unlimited) liability for business debts
- End of business when owner dies
- Difficult to operate if sick
- Need to carry all losses
- Burden of management
- Need to perform wide variety of tasks
- Difficulty in raising finance for expansion

**FIGURE 2.14** The advantages and disadvantages of being a sole trader

**Summary**
- Privately owned business structures can be either unincorporated or incorporated.
- A business that is incorporated becomes a separate legal entity from the owner/s.
- A sole trader — an unincorporated business entity — is a business that is owned and operated by one person and has unlimited liability.

**Partnerships**

A partnership is a legal business structure that is owned and operated by between two and 20 people. There are exceptions to this number, including medical practitioners and stockbrokers (allowed up to 50 partners); veterinarians, architects and chemists (allowed up to 100 partners); and solicitors and accountants (allowed up to 400 partners). A partnership is similar to a sole trader in that the owner and the business are regarded as the same; that is, there is no legal entity. Consequently, partnerships also have unlimited liability.

**BizWORD**

A partnership is a legal business structure that is owned and operated by between two and 20 people with the aim of making a profit.

**FIGURE 2.15** Partnerships are a common form of small business operation.
A partnership can be made verbally or in writing or by implication; that is, if two people set up a business together without a legally binding partnership agreement. A written partnership agreement is not compulsory, but it is certainly worthwhile in case disputes arise.

A partnership agreement usually has a standard set of contents (see the Biz Fact at left).

Limited partnerships were introduced to allow one or more partners to contribute financially to the business but take no part in the running of the partnership. The main reason for their investment is to add more capital or finance to an existing partnership.

There are a number of advantages and disadvantages of a partnership (see figure 2.16).

**Advantages**
- Low start-up costs
- Less costly to operate than a company
- Shared responsibility and workload
- Pooled funds and talent
- Minimal government regulation
- No taxes on business profits, only on personal income
- On death of one partner, business can keep going

**Disadvantages**
- Personal unlimited liability
- Liability for all debts, including partner’s debts, even before the partnership has begun
- Possibility of disputes
- Difficulty in finding a suitable partner
- Divided loyalty and authority

**FIGURE 2.16** The advantages and disadvantages of a partnership

**Summary**
- A partnership — an unincorporated business entity — is a business that is owned and operated by between two and 20 people and has unlimited liability.
- The partnership can be made verbally or in writing or by implication.

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**SNAPSHOT**

A partnership agreement contains many points, including:
- names and addresses of partners
- how long the partnership will exist
- the amount of money that each partner contributes
- how the profits and losses will be shared
- the duties of each partner
- limitations on the authority of the partners
- how the partnership may be dissolved
- arrangements regarding a partner wanting to leave and start up a business in competition.

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**Cut n curl hair studio: from partnership to sole trader**

An interview with Kristen Lowe, cut n curl hair studio:

*Interviewer:* Kristen, what made you want to own a salon?
*Kristen:* Ever since I was in Year 8 at school, I wanted to be a hairdresser. When I left school, the then owner of the salon offered me an apprenticeship and in my fifth year at the salon, the owner suggested that another hairdresser, Michelle, and I might like to buy the business. We were young and quite naive, so we both said ‘yes’ on the spot.

*Interviewer:* How did you finance the salon?
*Kristen:* We both had to borrow $5000, which we arranged through the bank, but because I was under 21 my father had to go guarantor [promise to repay money borrowed by someone else]. $4500 of the loan was to be used for the purchase of the salon with $500 each being put into what we called our ‘float’ — the money needed to keep the business running for a while.
Interviewer: Why did you decide to purchase an established business?
Kristen: We both wanted a business that had a good reputation and a viable customer base. As well, because we were working in the salon, we knew the customers, suppliers and how the business operated.
Interviewer: Did you have any business experience?
Kristen: Not a great deal. The previous owner had never shown any of her employees how to keep financial records. The one sensible thing we did do, though, was have prepared a written partnership agreement.
Interviewer: Did you realise at this stage the risks you were taking?
Kristen: No, not really. Michelle and I just thought the customers would keep on coming. Luckily they did! I think that was because Michelle and I had good reputations and over the years we had built up a large clientele of regular customers.
Interviewer: You started the business as a partnership but now operate it as a sole trader. How did this come about?
Kristen: Michelle wanted to begin a family, so when she became pregnant she wanted to leave the business. In our partnership agreement there was a section that dealt with how the business could be sold to one of the partners. We had our accountant value the business and I paid Michelle half that amount.
Interviewer: Was it difficult being a sole trader?
Kristen: Yes. At the beginning it was stressful without having someone to share the burden and talk things over with. However, as time went by, I found that I liked being solely in charge because I could make all the decisions, such as renovating the salon.
Interviewer: Would you like to take in another partner or even become a private company?
Kristen: Not at this stage. I like the freedom of being a sole trader. It is challenging but rewarding. As well, operating as a sole trader is quite inexpensive. The only fee I have to pay is the yearly business registration. Also, if the business became too big, I would worry that it could lose the friendly, personal culture I have tried to develop over the years. I have an excellent team and greatly enjoy running the business just as it is. Perhaps the most satisfying thing about operating as a sole trader is that the success of the business rests solely with yourself.
Interviewer: You have obviously learned a great deal about operating a business since you first started. What changes to the management of the business have been the most important?
Kristen: Over the last two years I started to organise the financial side of the business in a more comprehensive way. As well, I have begun a more orderly system of stock ordering and control. Above all else, I spend more time preparing and analysing the financial records. They are the only method of determining whether you are actually making any money. One strategy I have not changed over all the years is the belief that the customer must always be satisfied. They are the ones who determine the success or failure of my business.

Snapshot questions
1. State how Kristen and Michelle financed the purchase of the salon.
2. Identify the outside support services used by Kristen and Michelle.
3. Recall why Kristen and Michelle decided to purchase an established business.
4. Outline two new skills they might have had to learn to make the transition from employees to business owners.
5. Deduce why drawing up a partnership agreement was a sensible thing to do.
6. Explain the process by which the partnership was dissolved.
7. Describe the key advantages and disadvantages Kristen has discovered in becoming a sole trader.
8. Clarify why Kristen would have to register her business.
9. Evaluate whether being a sole trader is a suitable type of legal structure for Kristen.
Revision

1. Identify the four main legal structures of privately owned businesses.
2. Distinguish between an incorporated and unincorporated business.
3. Clarify why unincorporated businesses are the most common form of legal business structure.
4. (a) Identify three examples of businesses that might suitably operate as sole traders.
   (b) Explain why for each case.
5. Using a telephone directory, identify five examples of:
   (a) sole traders that would not have to register their name
   (b) businesses that would have to register their name.
6. Define the term ‘unlimited liability’.
7. ‘The advantages of being a sole trader outweigh the disadvantages’. Assess the accuracy of this statement.
8. Distinguish between a partnership and a sole trader.
9. Identify what you consider to be the two main advantages for a partnership. Justify your selection.
10. Outline the main purpose of a partnership agreement.
11. In pairs, imagine that you and your friend have decided to go into business together. Your business will specialise in designing home pages on the internet. Decide on a business name and then create a brief partnership agreement. Refer to the Biz Fact (page 38) for ideas.
12. The NSW Office of Fair Trading provides a range of regularly updated information about the legal requirements of business names. Use the NSW Office of Fair Trading weblink in your eBookPLUS and answer the following questions.
   (a) Outline the purpose of a business name.
   (b) Explain who owns a business name.
   (c) Describe the process involved in selecting a business name.

Extension

1. (a) Explain why limited partnerships were introduced into some states of Australia.
   (b) Examine the regulations that apply to limited partnerships.
2. Suppose you are a part-time employee working for a sole trader. The owner has offered you a 35 per cent partnership and you are going to accept. Create a list of questions you should ask the owner before you sign the partnership agreement.
3. Arrange to interview a partner of a local business. Investigate the following topics.
   (a) The number of people in the partnership
   (b) The advantages of the partnership
   (c) Contents of the partnership agreement
   (d) A brief history of the business.
4. ‘An effective partnership is one in which the partners always agree on all matters related to the business.’ Assess the accuracy of this statement.

2.6 Types of companies

All companies are incorporated enterprises or have gone through the process of incorporation. This means that the company has become a separate legal entity from its owners (shareholders). The idea of a separate legal entity is referred to as the ‘veil of incorporation’. This separate legal entity means that the company can sue and be sued; it can lease, sell or own property; and it has perpetual succession (this means it will continue to exist even when the owners change).

The process of incorporation is governed by the Commonwealth Corporations Act 2001, and is administered by the Australian Securities and Investments
Commission (ASIC). For a business to become incorporated, a company name must be registered with ASIC, who will issue a certificate of incorporation and an Australian Company Number (ACN). Directors must be appointed to run the company on behalf of the owners. Once incorporated, the company has a separate legal entity to its owners, who are known as shareholders (referred to in the Corporations Act as ‘members’). Incorporation also brings to the shareholders the benefits of limited liability.

**Limited liability**

The Limited Liability Act was passed by the British Parliament in 1855. This Act was necessary for the expansion of companies because it offered a degree of protection to shareholders.

In **limited liability** companies, the most money a shareholder can lose is the amount they paid for their shares. Therefore, if the company goes into liquidation, the shareholders cannot be forced to sell their personal assets to pay for the debts of the business. Over recent years this advantage has been gradually reduced through legislation (laws) penalising directors of companies who make false or misleading statements (see Biz Fact at right).

As well, financial institutions often ask directors to give personal guarantees for some business loans. Under some circumstances, therefore, directors can be forced to sell their personal assets to help pay for the debts of the business. To offset this risk, companies can insure against such an event.

The letters ‘Ltd’ signify that the business is a company that offers limited liability. A company can be organised as either a proprietary (private) or public company.

There are a number of advantages and disadvantages to the company form of business ownership as outlined in figure 2.17.

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**BizWORD**

*Limited liability* is a feature of corporate ownership that limits each owner’s financial liability to the amount of money he or she has paid for the business’s shares.

**BizFACT**

If directors make false and misleading statements or omissions in a prospectus, if they fail to appoint a company secretary or if they recklessly borrow money knowing that the debts probably will not be repaid, then the protection offered by the company in being a separate legal entity will not cover the directors. Directors accused of such unlawful behaviour may face common law suits and criminal charges.

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**FIGURE 2.17** The advantages and disadvantages of a company

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**Advantages**

- Easier to attract public finance
- Limited liability — separate legal entity
- Can transfer ownership easily
- Enjoys a long life — perpetual succession
- Experienced management — board of directors
- Greater spread of risk
- Company tax rate lower than personal income tax rate
- Growth potential
- Recent legislation allows a company to have only one shareholder and one director

**Disadvantages**

- Cost of formation
- Double taxation — company and personal
- Personal liability for business debts if directors knew at the time that the business was unable to pay loans
- Must publish a yearly annual report of audited accounts
- Public disclosure — reporting of certain information
- Becomes too large resulting in inefficiencies
Proprietary (private) companies

A proprietary (private) company is the most common type of company structure in Australia, and usually has between two and 50 private shareholders. Private companies often tend to be small to medium-sized, family-owned businesses.

Shares in a proprietary company are only offered to those people the business wishes to have as part-owners. Shareholders can only sell their shares to people approved of by the other directors. This is why such a company is called a ‘private’ company. It is not listed on, and its shares are not sold through a stock exchange.

A private company must have the words ‘proprietary limited’, abbreviated to ‘Pty Ltd’, after its name. The main advantage of a private company is that shareholders have limited liability protection.

Public companies

The shares for public companies are listed on the Australian Securities Exchange, and the general public may buy and sell shares in those companies.

Whereas private companies tend to be small or medium-sized businesses, most public companies are large in size and market a large range of products — for example, Woolworths, Telstra, BHP Billiton and Westfield.

A public company has:
- at least one shareholder, with no maximum number
- no restrictions on the transfer of shares or raising money from the public by offering shares
- to issue a prospectus when selling its shares for the first time
- a minimum requirement of three directors (two must live in Australia)
- the word ‘Limited’ or ‘Ltd’ in its name
- to publish its audited financial accounts each year, its annual report.

BizWORD

A proprietary (private) company is an incorporated business and usually has between two and 50 private shareholders.

FIGURE 2.18 A proprietary (private) company has an identity of its own — separate from its owners’ identity.

FIGURE 2.19 Most of Australia’s best known large businesses are public companies.

Weblink

Use the Australian Securities Exchange weblink in your eBookPLUS to browse the public companies listed on the ASX.
Government enterprises

**Government enterprises** are government-owned and operated. (They are also known as government business enterprises — GBEs.) Although only small in number — approximately 5000 — they are typically large, and include some of the largest employers of people in Australia. GBEs are owned and operated by all levels of government: federal, state and local. Examples include Railcorp (formerly State Rail Authority), Australia Post and Great Southern Energy. They are often referred to as public sector businesses and provide essential community services such as health, education, roads and welfare.

Beginning in the early 1980s, a wave of **privatisation** — the selling of government controlled businesses to private investors — began to take place in most industrialised economies. Australia followed this trend. During the 1990s, the federal government privatised a number of public sector businesses including:

- AUSSAT — domestic satellite operator (now called Optus)
- Qantas — international airline carrier
- Commonwealth Bank — financial services
- Telstra — telecommunications.

Due to the process of privatisation, these organisations changed their legal structure from GBE to public company. The rationale behind this practice is that economic efficiency is increased by transferring enterprises away from the public sector to the private sector. It is argued by some that privately owned and organised business enterprises will be more efficient and profitable than GBEs.

**Summary**

- All companies are incorporated enterprises.
- In limited liability companies, the most money a shareholder can lose is the amount they paid for their shares.
- A proprietary (private) company usually has fewer than 50 shareholders and must have the words ‘proprietary limited’ (Pty Ltd) after its name.
- The shares for a public company are listed on the Australian Securities Exchange.
- A public company must have the word ‘limited’ or ‘Ltd’ in its name.
- Government enterprises are government-owned and operated and provide essential community services.
- Due to privatisation some government enterprises have become public companies.

**Franchising — a popular form of business entity**

Under a **franchise** agreement a person buys the right to use the business name and distribute the goods or services of an existing business. The business that grants the right to others to use its name and products is known as a **franchisor**. The business that buys those rights is known as a **franchisee**. The franchisor supplies a known and advertised business name, the required training and staff development, a method of doing business, management skills, and materials. The franchisee supplies the start-up money and labour, operates the franchise business, and agrees to abide by the terms and conditions of the franchise agreement.

Franchising has a success rate of almost three times that of independent businesses, largely because it involves an established business name backed up by managerial expertise (see the following Snapshot). Franchising is the area of fastest business growth in Australia. Some well-known franchises include Bakers Delight, Tandy Electronics, McDonalds, Optus World, Wendy’s, Angus & Robertson, 7–Eleven and The Athlete’s Foot. Key considerations in setting up a franchise will be examined in more detail in chapter 11.
Gregg Hardie, franchisee at Bakers Delight, this career transition made perfect sense. Gregg had always had an interest in flying so he took to the skies and received his commercial pilot’s licence as soon as he completed high school.

‘I loved flying; studying to receive my commercial pilot’s licence and becoming a flying instructor was fulfilling a childhood dream,’ said Gregg.

‘However, I knew it wasn’t going to be my long-term future’.

So when Gregg’s mother came home with a local newspaper advertising the opportunity to pursue studies to work towards becoming a Bakers Delight franchisee, Gregg was inspired to take this up as his next challenge.

‘We’d always been Bakers Delight customers so I was familiar with the brand, the bread and the bakery environment. I embraced the training with the intent to one day own my own Bakers Delight business.

‘Training was extensive and included finance, baking skills, customer service management, marketing, people management and of course small business operations. Without the solid training behind me, I would not be where I am today,’ he said.

Gregg achieved his dream of purchasing his own bakery.

‘There was no way I could have started my own business at the age of 24 without Bakers Delight. I had some experience but I think what got me ahead was a lot of heart and determination to succeed.

‘I embraced the franchising concept and accepted all the support available to me from head office,’ he said.

‘They helped me with the paperwork, training staff through organised training sessions, facilitating networking with other franchises, as well as general motivation and encouragement.

‘I wanted to succeed and they wanted me to succeed, so it was a win-win situation . . . that’s the beauty of franchising.’


Snapshot questions
1. Identify the training Gregg received from the franchisor.
2. Appreciate the importance of such training.
3. ‘I wanted to succeed and they wanted me to succeed, so it was a win-win situation . . . that’s the beauty of franchising.’ Explain this statement.
There are a number of advantages and disadvantages attached to operating a franchise. These are shown in figure 2.21.

**FRANCHISOR**
- Fast and selective product distribution
- Avoids costs of construction
- Does not have to operate outlets
- Agreement ensures some control
- Motivated franchisees

**FRANCHISEE**
- Opportunity to start with limited finances
- Guaranteed customer base
- Established name
- Management back-up
- Proven methods of business

**Disadvantages**
- Unsuitable franchisee
- Disagreement over conditions and terms of contract
- Franchisor retains great deal of control
- Limited scope for individuality in business operations
- Disagreements over conditions and terms of contract
- If too successful, franchisor may open own outlet

**FIGURE 2.21** The advantages and disadvantages of a franchise arrangement

**Summary**
- A franchise means buying the rights to use the business name and distribute the goods or services of an existing business.
- The franchisor grants the rights and provides the business structure.
- The franchisee supplies the start-up money, labour and operates the franchise business.

**Revision**
1. **Explain** the legal steps that are required to incorporate a business.
2. **Outline** why you think companies need to have perpetual succession.
3. **Explain** why the *Limited Liability Act* of 1855 was important for company expansion.
4. **Recall** under what circumstances a director might be personally responsible for debts incurred by a company.
5. **Clarify** why new legislation was introduced to penalise company directors who made misleading statements about the business’s ability to repay its debts.
6. **Examine** figure 2.17 (page 41). **Identify** what you believe to be the three main advantages and the three main disadvantages of a company form of business ownership. **Explain** why you chose each one.
7. **Construct** a concept map highlighting the main features of a proprietary company form of business structure.
8. **Construct** another concept map highlighting the main features of a public company form of business structure.
Outline the ways a private company is ‘private’ and a public company is ‘public’.

Recall the main role of government enterprises.

Distinguish between a ‘franchisor’ and a ‘franchisee’.

Propose why businesses operating as franchises have a success rate three time that of independent businesses.

Evaluate the value of buying a franchise (refer to figure 2.21).

State (i) what the franchisor receives in a franchising agreement (ii) what the franchisee receives.

You are planning to establish the following types of businesses. Justify what form of business ownership you would prefer.
(a) a bicycle shop that will offer professional and personal advice
(b) a cattle stud specialising in a large-scale breeding program
(c) a travel agency that you wish to expand to 58 outlets within two years
(d) a national retailer that would require $467 million to establish.

Identify the most appropriate terms from the list to complete the following sentences.

A business entity with one owner is called a _____________. This person faces ____________ liability, which means the owner can be forced to sell his or her ____________ assets to pay for the debts of the business.

Partnerships normally consist of between two and ____________ partners. Partners ____________ the profits and losses and usually operate under a ____________ agreement. Partnerships have unlimited ____________.

There are two types of companies, private and ____________. A ____________ company usually has between two and 50 private shareholders. A private company has the words ____________, abbreviated to ____________, after its name. Public companies are listed on the ____________ and the general public may buy and sell ____________ in them. These companies must have a ____________ number of one shareholder and have the abbreviation ____________ in their names. Companies have ____________ liability.

In your notebook, draw up a table with six columns. At the top of each column put the headings Sole Trader, Partnership, Private Company and Public Company. From the list of businesses shown below, determine the correct column for its particular legal structure/entity. The first one has been completed for you.

<table>
<thead>
<tr>
<th>Sole trader</th>
<th>Partnership</th>
<th>Private company</th>
<th>Public company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jacinta’s Newsagency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fairfax Limited</td>
<td></td>
<td>Ozemail Limited</td>
<td>Jacinta’s Newsagency</td>
</tr>
<tr>
<td>M &amp; M Communications</td>
<td></td>
<td>David Tyler and Sons</td>
<td>Newcrest Mining Ltd</td>
</tr>
<tr>
<td>Tip Top Bakeries Pty Ltd</td>
<td></td>
<td>Con Chipprio Plumber</td>
<td>Southcorp Ltd</td>
</tr>
<tr>
<td>Paul Banwell Motors</td>
<td></td>
<td>Tynan Motors Pty Ltd</td>
<td>R &amp; R Cook Antiques Pty Ltd</td>
</tr>
</tbody>
</table>

Extension

Select a public company from the share page of a newspaper or the internet. Purchase a ‘virtual’ parcel of 5000 shares in this company and plot the price movements over a two-month period. Evaluate the performance of your share parcel over this period.
2.7 Factors influencing choice of legal structure

One of the most difficult decisions a business owner must make is what type of legal structure to select. This will depend on a number of particular circumstances influencing the business at certain times. These factors will change as the business expands. Therefore, the legal structure may need to be altered to reflect these changing circumstances.

Of all the factors that influence the business owner when deciding upon the most appropriate legal structure, the three most important are the:

1. size of the business
2. ownership structure
3. finances needed.

In reality, these three factors will all be interrelated and act together in influencing the choice made by the business owner.

Size of the business

As sales increase and the business operations grow to meet this higher level of customer demand, the business owner may need to select a more appropriate legal structure. Therefore, some broad generalisations can be made concerning the relationship between the size of a business and the most appropriate legal structure.

Most businesses begin their life as small or micro business enterprises. Therefore, the legal structure that is most suitable at this stage would be either a sole trader or partnership. If sales continue to increase, and the business keeps on growing, then further expansion will be needed and the business becomes a medium-sized one. The business will need to purchase new plant and equipment, which requires the injection of more money. Therefore, a partnership or private company may be formed with the new partners or private shareholders bringing with them extra funds.
finance, skills and expertise. If expansion is rapid, then the owners may wish to seek the protection of limited liability, in which case the private company legal structure will be chosen.

As the business continues to grow, it now becomes a large national or transnational corporation.

To finance this level of expansion, it will be necessary to draw from a large pool of available finances. The business will now decide to raise this money from a sharemarket float. A float is the raising of capital in a company through the sale of shares to the public.

A prospectus is issued (see figure 2.22), the business is listed on the Stock Exchange and shares are offered for sale. Also, an established public company can raise additional money from existing shareholders.

Of course, there is no rigid formula as to what legal structure best suits a particular size of business. Some businesses may establish themselves as public companies from the beginning, while others remain a private company even when the business has reached an international level. Each business owner will make a personal decision that best suits the conditions at the time, his or her own personal preferences and the overall business environment.

Ownership structure

If a business owner wishes to have complete control and ownership of a business, then becoming a sole trader is the only realistic option. On the other hand, if the owner wishes to share the ownership with other people, then a partnership is the ideal legal structure. Of course, a private company would also allow the owner to maintain a high degree of control and it would also offer the protection of limited liability. This is because a private company structure provides the owner with a large degree of control over who can become a shareholder of the business. As well, in most cases the maximum number of shareholders is restricted to 50.

Once a company floats and sells shares to the public, ownership will be divided among thousands of small, individual shareholders and a few institutional shareholders. The degree of ownership, then, is directly related to the number of shares owned: more shares, more ownership. Therefore, if the original owner/s wished to retain ownership and control of the business, they would need to hold more than 50 per cent of all the shares sold.

Finance

As mentioned earlier, when a business expands it will require injections of finance. This money will be used to purchase new equipment, undertake research and development, hire more staff, exploit new markets, and open new outlets.

Sole traders and partnerships, because of their exposure to risk (limited liability) with few business assets, can sometimes find it difficult to obtain adequate finance, especially for research and development. Traditional sources of finance, especially banks, perceive this type of finance request as high risk. One possible source of finance for R&D is venture capital. Venture capital is money that is invested in small and sometimes struggling businesses that have the potential to become very successful. The investors take an equity position in the business (own part of it) and provide supplementary finance.

To overcome the difficulty of raising finance from banks or financial institutions, the business owner may decide to sell shares in the business. Therefore, the
BizFACT
The need for injections of finance is crucial for the long-term success of any business.

BizWORD
Venture capital is money that is invested in small and sometimes struggling businesses that have the potential to become very successful.

Summary
• The most appropriate legal structure to select will depend on many variables including size, ownership and finance.
• As a business expands, it normally moves from an unincorporated structure to an incorporated structure.

Revision
1 Explain the general relationship between the size of a business and its legal structure.
2 Recall the purpose of a sharemarket float.
3 Define the term ‘prospectus’.
4 Outline the reasons a sole trader would be motivated to alter the legal structure to become either a partnership or public company.
5 Assume you wish to establish a landscaping business. Determine which legal structure/s you would choose if you wanted to:
   (a) retain complete control
   (b) share ownership with no more than 20 people
   (c) share ownership with no more than 50 people.
   Give reasons for your answers.
6 Recall the percentage of all the shares sold that a person needs to hold in order to own and control a company.
7 Outline how the legal structure will change as the business requires greater injections of finance.
8 Investigate the possible advantages and disadvantages of venture capital as a source of finance. Share your answer with the rest of the class.

Extension
1 ‘The majority of small individual shareholders have virtually no say in the running of a public company. The institutional shareholders have the game to themselves.’ Evaluate the accuracy of this statement.
2 Construct a list of 20 businesses that opened around two or three years ago in your local area.
   (a) Place a cross next to the name of each business that is no longer in operation.
   (b) In your opinion, propose some reasons these businesses failed.
   (c) Propose some reasons for the success of the other businesses.
   (d) Arrange to interview a person whose business succeeded. Have them explain to you the reasons for the business success.
   (e) Compare the reasons you gave with those provided by the business owner.
3.1 Introduction

Your school is part of your learning environment: the surrounding conditions in which you learn. You have some degree of control over the factors that make up part of your learning environment, such as the subjects you choose to study, extracurricular activities you participate in, and your interactions with teachers and other students. There are many other factors within your learning environment, however, over which you have little control but that have a direct influence on your learning. This includes such factors as the syllabus subject matter, the introduction of new technology and the changes in government education policies. As a student, you are part of an ever-changing and complex learning environment within which you must manage your education.

3.2 Business environment

No business — similar to students — operates in isolation. Businesses also have to deal with an ever-changing environment in which they operate. What happens in the larger business environment may have a direct influence on many other firms. If interest rates increase, for example, then some businesses may not be able to afford to purchase new equipment. Alternatively, reduced competition in the market may result in some businesses increasing their individual market share and profitability. All business decisions about how and what to produce are affected by the environment in which the business operates.

Successful business managers have a good understanding of the environment in which the business operates. This allows them to respond positively to changes that take place and prepare for the impact such changes will have on their business operations.
The **business environment** refers to the surrounding conditions in which the business operates, and can be divided into two broad categories: external and internal (see figure 3.2).

- The **external environment** includes those factors over which the business has little control, such as government policy, technology, economic conditions and social attitudes.
- The **internal environment** includes those factors over which the business has some degree of control, such as products, location, resources, management and business culture.

![](Influences in the business environment.png)

**FIGURE 3.2 Influences on business**

The factors that make up the business environment are not constant and certain. They are continually undergoing change, and a business must keep ‘in tune’ with the changes and adapt its operations accordingly.

### 3.3 External influences on business

Changes in the external environment make it necessary for managers to make adjustments to business operations. This may include the introduction of new government regulations that require the business to make adjustments; for example, a change in taxation laws or the economic effects of the global financial crisis in 2008–9. Figure 3.3 outlines the main external influences on a business.

![](External influences on business.png)

**FIGURE 3.3 External influences on business**

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**BizWORD**

*The business environment* refers to the surrounding conditions in which the business operates. It can be divided into two broad categories: internal and external.

The **external environment** includes those factors over which the business has very little control.

The **internal environment** includes those factors over which the business has some degree of control.

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**eLesson:** Adapting to the external environment

Michael and Anthony Dinte inherited the family’s foundry business, but when their father passed away there was no real plan as to how the company would develop.

**Searchlight:** ELES-0834
Economic influences

Imagine your local shopping centre to be a small-scale representation of the Australian economy. Now, imagine what would happen to the businesses within the shopping centre if all their customers decided to shop at another centre for a day. Economic disaster! If this situation continued for a month then the centre's businesses would close, employees would be laid off, and landlords and suppliers would not be paid. Eventually, as the ‘economy’ plunged into a recession, business owners would lose confidence in the economy’s future. However, at the rival shopping centre, new businesses would open, many new jobs would be created, landlords and suppliers would gain new customers, and the confidence of the local business owners would soar. The ‘economy’ of this shopping centre would boom.

Although such an extreme situation would not happen in reality, the Australian economy does experience economic cycles of ‘booms’ and ‘busts’. These periods of high and low economic activity are referred to as the business cycle (see figure 3.4). After a period of prosperity, business activity gradually slows until a recession or depression is reached. Eventually, business picks up again until prosperity is restored. This completes the cycle. These cycles are a basic feature of our economic system.

No economic system works perfectly all the time under all conditions, and the Australian economy is no exception (see the following Snapshot). The level of economic activity does not remain at a constant level; it fluctuates (moves up and down) over time. In other words, total production, incomes, spending and employment rise and fall.

**BizWORD**

Economic cycles (or business cycles) are the periods of growth (‘boom’) and recession (‘bust’) that occur as a result of fluctuations in the general level of economic activity.

![Figure 3.4 The economic or business cycle](image)

**Characteristics of a ‘boom’ period**

The following are some of the characteristics of ‘boom’ periods:

- **Higher levels of employment.** Employers may be willing to employ more people as they feel business sales and profits will remain stable or increase in the future.
- **Inflation may increase.** In periods of growth, some business owners feel that consumers are more willing to spend their income, so they may take the opportunity to increase their prices to achieve higher profit margins.
- **Wages increase** as employees seek to keep their wages rising at the same rate as inflation.
- **The level of spending by consumers increases** as they have more confidence in the economy and feel secure in their employment.
Characteristics of a recession period

A recessionary period in an economy is characterised as follows:

- **Unemployment levels** rise as many business owners experience a decrease in sales, which means they are unable to maintain their current number of employees.
- **Inflation may remain stable or fall** as consumer spending is reduced. A business must work harder to gain sales, so prices remain stable and in line with competitors.
- **Wages are less likely to rise** as employers are concerned about business costs and employees are concerned with job stability.
- **The level of spending usually decreases** as consumers who are concerned about job security are more inclined to save rather than spend any excess income.

### 2009 Global financial crisis

In September 2008 there was a massive loss of confidence in the US financial system. It was caused by the substantial increase in the number of US homeowners defaulting on their mortgage payments.

Like a house of cards, the system quickly started to collapse as the loan defaults spread throughout the entire US financial system. The long-established US global investment bank, Lehman Brothers, collapsed, filing the largest bankruptcy in American history. The US government was forced to step in and provide approximately US$700 billion (A$845 billion) to prop up other failing financial institutions. In the space of a few days, hundreds of billions of dollars in value had been wiped off the New York Stock Exchange.

The repercussions of this financial meltdown sent shockwaves through the world’s financial systems and stock markets. What started as a financial disaster quickly developed into an economic crisis. World stock markets collapsed and world economic growth and trade severely declined with a consequent increase in unemployment.

Expansionary economic policies were needed to act as a buffer against the deteriorating global conditions. Consequently, in early 2009, governments of the rich nations launched economic stimulus packages in order to pour millions of dollars into their economies. In Australia, for example, the Rudd government injected about $53 billion into the Australian economy through two budgetary measures. These packages contained a mixture of immediate stimulus to encourage consumer spending and longer term infrastructure projects. The government action shielded the Australian economy from the worst of the global recession.

### Snapshot question

1. **Outline** the main cause of the 2008–09 global economic crisis.
2. **Explain** why governments in rich nations introduced economic stimulus packages in early 2009.
3. **Predict** the likely impact of a severe recession on most businesses.

The state of the economy has a great impact on business. The policies implemented by the government are aimed at keeping the economy growing steadily, without putting pressure on inflation (prices) and wages. The economy is also affected by overseas trends — changes in trade, investment and currency levels all affect Australia’s level of economic activity. The continued growth and development of China’s economy has benefited Australian businesses in relation to exports. Many businesses are supplying not just raw materials such as coal, but finished products and, to a greater extent, quaternary services such as education and training.
When economic problems start to appear, we as consumers become more cautious with the way we spend our money, and our overall confidence begins to fall (see figure 3.5). The reduced spending has an impact on business owners — they find profits falling and cost cutting must occur if they are to survive. Unfortunately, this cost cutting can be in the form of retrenching workers; therefore, the economy falls further into recession. Alternatively, when there is evidence of a growing economy, confidence returns. The consumer is more willing to purchase consumer or luxury goods, which in turn sees spending levels rise and business profits improve.

One important factor to consider in terms of economic cycles is that not all businesses experience a downturn in revenue and sales during a recession; nor do they necessarily experience an upswing in trade during a ‘boom’ period. The businesses most susceptible to the ‘swings’ are those selling consumer or luxury goods, as consumers will cut back on these when they reduce overall spending. Some businesses fare very well during a recession, for example ‘bargain shops’ or other clearance outlets.
Demanding consumers and a tough market are forcing retailers to be creative, writes Nina Hendy. Retailing used to be fairly simple. If the shelves were well stocked and an A-board promoting your specials was out the front, you were in business. But the rules of the game are changing as a new breed of consumer demands more from retailers than ever before.

Exceptional service, tailored communications, a dazzling in-store experience and the ability to buy online are just the start. Not surprisingly, these new demands are stretching Australian retailers well outside their comfort zone.

The managing director of the Retail Doctor Group, Brian Walker, says global uncertainty on the political, financial and retail fronts is driving consumer change. ‘During good times, retailers can achieve growth with lazy practices but these days it’s imperative they get fit in all aspects of business,’ Walker says. ‘That includes getting rid of excessive merchandise, doing away with untargeted communication, managing staff better and reducing operational costs productively.

‘The bottom line is that if retailers aren’t doing this, they won’t be fit enough to survive.’

Overseas, retailers have been stepping up their efforts to meet the changing needs of consumers. But Australian retailers have been slower on the uptake. Walker says that once the economy improves, some retailers will be left behind.

‘Australian consumers are placing higher demands on their favourite retail brands to be sharper and more focused and based on overseas trends, consumer expectations are only set to increase,’ he says.

The program director for the Australian Centre for Retail Studies (ACRS), Stephen Ogden-Barnes, agrees: ‘Once upon a time, there might have been four bakeries in a strip of shops. But retailers struggle in a tougher economy and once things improve, only three might survive. Retailers have to ask themselves if they’re in the top three or the bottom two in their market.’ Retailers also need to get online. Time-poor consumers want to buy everything from fashion, groceries and face cream both in store and online. Walker says retailers operating in any category must have both an online and physical store presence.

Recent research conducted by the ACRS in conjunction with Google has also found that consumers use the internet as a research tool before hitting the shops. ‘We believe there’s a misconception among retailers that the internet is only used for selling but it’s also used by consumers to conduct research,’ Ogden-Barnes says.

‘For a retailer not to have a presence online would be foolhardy.’

Getting the online strategy right is paramount, especially given overseas retailers are entering the Australian market in growing numbers via online sales. These companies include British fashion chain Top Shop, which now offers global online sales. And a US jeweller selling online will deliver to Australia free.

‘Australian retailers need to understand that they’re not just competing against other retailers in their local area any more,’ Ogden-Barnes says.

‘One of the real wake-up calls is that retailers are increasingly competing on a global level.

‘Retailers should also be looking into the rise of social media like Twitter and Facebook to see how they can tap into this phenomenon to promote their offering.’

Value is also important to buyers. Bargain hunting as a pastime is increasingly popular, according to Sydney research and strategy firm, The Seed. Its managing director, Sean Adams, says: ‘Bargain hunting is a status symbol. Those looking for a bargain are just as likely to be high earners as battlers. Even at the low end of the market, good value should be at the core. Cheap doesn’t have to mean nasty.’

And environmentally conscious consumers will snub retailers not showing awareness of this issue. While getting rid of plastic bags is a good start, it’s the tip of the iceberg.

(continued)
According to the ACRS, consumers want greener products from retailers. But Adams warns retailers there’s a level of cynicism around green claims, with green beer, cars and even jeans flooding the market. He advises retailers to steer clear of ‘greenwashing’, which refers to green claims that mislead consumers.


**Snapshot questions**

1. Use the information in the article to outline the main issues for business during periods of:
   (a) strong economic growth (boom periods)
   (b) slowing economic growth (recessionary periods).

2. Outline how the internet is used by contemporary consumers. Explain the positive and negative effects on businesses.

3. In broad terms, explain what the article is stating by the headline ‘Survival of the fittest’. You should aim to identify three main points to support your explanation.

**Financial influences**

There have been enormous changes in global financial markets over the past thirty years.

*Deregulation* of Australia’s financial system began in 1983 and it continues to undergo change. This has resulted in a more flexible, market-oriented approach across the financial sector. A substantial number of new banking products have emerged, aimed at the business sector. The process of financial deregulation has resulted in the opening up of the financial industry to greater competition.

Due to globalisation of the world’s financial markets, it is no longer necessary for many large Australian businesses to use only domestic financial institutions for the raising of finance. For example, News Limited, the global media company, can access finance from worldwide sources.

Global financial markets themselves have undergone rapid change over the last decade. Developments in communications technology have enabled the phenomenon of global financial transactions. Global financial speculators may now easily make transactions spread across the globe.

**Geographical influences**

Two major factors that have an enormous impact on business activity are Australia’s geographic location within the Asia-Pacific region and the economic growth in a number of Asian nations, especially China. They provide challenging opportunities for business expansion, sales and profit.

Further changes that are likely to have a profound effect on business activity in Australia originate from changing demographic factors. Demography is the study of particular features of the population, including the size of the population, age, sex, income, cultural background and family size. Changes in any of these factors can lead to changes in demand levels and the nature of products and services.

A major demographic issue that has a considerable impact on businesses is changes in the age structure of our population. Commonly referred to as the ‘greying’ of the Australian population, baby-boomers — people born between 1946 and 1964 — are now reaching retirement age. This will cause some skill
shortages in the workforce as well as an increase in demand for age-related services such as health and aged-care. Any change in population growth will also have major implications for Australian businesses, as research shows there is a clear link between population levels and economic growth.

Globalisation

Another important geographical influence is that of globalisation. We live in a global world, rather than a world limited by national borders. Consider the news and entertainment we receive from around the planet, the clothing and footwear brands being sold worldwide, the rapid telecommunications access to all parts of the globe, and the large number of products Australia buys and sells on the world market. The Earth is a global community whose individual members are linked through the mechanism of international trade: the buying and selling of goods and services between nations.

BizFACT

Globalisation has not been welcomed by everyone. Critics argue that the process results in a ‘race to the bottom’ in wages and conditions. This inevitably leads to exploitation of workers, especially in developing countries, and the loss of jobs in developed countries.

FIGURE 3.7 Different age groups have distinctive spending patterns. Consequently, businesses need to market products that suit the tastes and preferences of their customers.

FIGURE 3.8 The current process of globalisation is remarkable for its phenomenal speed and reach, especially in relation to flows of finance and information. Figuratively speaking, the world is shrinking in many ways, with nations more closely linked than ever before. The world is becoming a very small place!
This process has been strengthened by the impact of **globalisation**: a process that sees people, goods, money and ideas moving around the world faster and more cheaply than before. Globalisation, assisted by the technological revolution in communications and computers, is radically altering the shape of world markets, as well as the nature of business and everyday life (see the following Snapshot).

Globalisation is not a new process. Trade, exploration, and the movement of people and ideas globally have been occurring for centuries. However, it is only since the 1950s and, in particular, the last 20 years that the world has experienced such rapid and widespread globalisation. Not only has the world economy been transformed, but new communications, information and transportation technology have redefined our concepts of distance and time.

**SNAPSHOT**

**The world is one big marketplace**

Businesses within countries will specialise in those goods and services that they can produce more efficiently. They then trade their surplus with other countries. International trade includes all those economic transactions that take place between consumers, businesses and governments in different countries.

Consumers rely on being able to purchase a wide range of goods and services, many of which come from overseas. Visit any department store, for example, and you will discover goods made in a number of different countries.

The world’s consumers are also linked via modern mass communication technologies, especially the internet. Consequently, consumers around the world will just as readily browse an internet shopping site as they would examine a catalogue. By using the internet, the global consumer can now shop in an international marketplace. Markets are no longer local and real, but instead they are global and virtual.

The rapid expansion of international trade and the process of globalisation have combined to create a world in which countries’ economies are connected with each other. Today, many goods and services are sold in other countries (exports) and imports are bought from foreign countries. Our economy is therefore linked to the world economy via export and import sales.

**Snapshot questions**

1. Describe what the term ‘international trade’ means.
2. Distinguish between an export and an import.
3. ‘Markets are no longer local and real, but instead they are global and virtual.’ Discuss this statement.
4. Predict what your life would be like if there was no international trade.

**Social influences**

Rapid identification and response to changes in tastes, fashions and culture can lead to sales and profit opportunities, and business growth. Failure to respond to social changes can threaten business stability and viability.

There are two social issues that are leading to significant change or have the potential to influence major change in business practices. The first concerns a growing awareness of our vulnerable environment. Over the past decade, Australians have become aware of a number of practices that lead to deterioration in the environment. The second social issue that is leading to significant change is a growing desire for family-friendly programs. Conflict between work and family responsibilities is a key factor causing women to leave businesses, and this high
turnover is expensive for business. Consequently, businesses have been under pressure to implement family-friendly workplace practices that assist employees and, at the same time, reduce the associated costs to employers.

Summary

- Business environment is influenced by both internal and external factors.
- External influences on business include: economic, financial, social, legal, political, institutional, technological, competitive situation and changes in the market.
- Economic influences on a business relate directly to their economic environment, which is dependent on changes in economic growth. These changes are characterised by boom and recessionary periods in the economic cycle.
- Changes in the global and domestic financial markets will influence the cost of borrowing money and therefore directly affect the level of investment by a business.
- Two major geographical factors that affect business activity are:
  - Australia's geographic location within the Asia-Pacific region
  - the process of globalisation.
- Demographic features such as the age, sex, income, cultural background and family have a profound effect on business activity.
- Social influences, such as changes to fashion and culture, have the capacity to affect business sales and profits.

Legal influences

Too much government interference! Too much red tape! Too many regulations! These are familiar cries from many business owners who face an increasing number of legal obligations in every aspect of their businesses. Today, small to medium businesses face levels of regulation similar to those facing large businesses. While most business owners are willing to comply with regulations, compliance is often time consuming and costly, and regulations can be confusing and contradictory.

Society expects business owners to abide by the laws of a country. Consequently, it is essential that they have a sound working knowledge of the laws that will affect their operations (so that they avoid penalties), and that they understand and accept the legal responsibilities they owe to all stakeholders. All levels of government impose legal responsibilities on businesses, and these laws govern every aspect of a business's life.
In the past two decades, a large number of new statutes were introduced, which will have a major impact on business conduct. This legislation includes laws on taxation, industrial relations, occupational health and safety, equal employment opportunity, anti-discrimination and protection of the environment.

An area of law that has significantly altered business conduct is the Trade Practices Act 1974 (Cwlth), which applies to virtually all businesses in Australia. It is administered by the Australian Competition and Consumer Commission (ACCC), which is an independent statutory authority. The ACCC operates nationally for the enforcement and administration of competition and consumer protection laws. A breach of any of the consumer protection provisions of the Trade Practices Act can result in the ACCC taking criminal proceedings against the business concerned. The Act allows the courts to impose penalties of up to $1.1 million for companies, and $220,000 for individuals who breach the Act.

Political influences

Government policies have a considerable impact on the business environment (see figure 3.11). Major political change can lead to business uncertainty or business confidence. As governments at all levels in Australia regularly face elections, there is an element of politics in most major issues that affect the business environment.

An example of a dominant political issue affecting Australian businesses was the introduction in July 2000 of a goods and services tax.
The goods and services tax (GST) is a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia. It was introduced in response to criticisms of Australia’s wholesale sales tax system. The GST had a major impact on many aspects of business operations because businesses became responsible for collecting the tax on behalf of the government.

Another significant political thrust that has led to widespread changes is the process of deregulation and privatisation. Deregulation is the removal of government regulation from industry, with the aim of increasing efficiency and improving competition. Privatisation is the process of transferring the ownership of a government business to the private sector. Examples of privatisation involve the sale or partial sale of the Commonwealth Bank, Telstra and Qantas.

### Institutional influences

There are three main institutional influences on business, including government, regulatory bodies and other groups such as trade unions and employer associations.

#### Government

Australia has three levels of government: federal, state and local. Each level of government imposes a range of regulations on businesses to standardise and protect their dealings with consumers and competitors.

**Federal government**

Federal government obligations include:
- payment of taxes for employees (earning above the minimum taxable income level) and for businesses with company tax and GST
- provision of employee superannuation
- observance of customs regulations
- abiding by relevant legislation that would affect business operations.

**State government**

State government obligations include:
- provision of employee entitlements, including workers compensation, occupational health and safety (OHS) requirements, award rates of pay and entitlements
- payment of payroll taxes
- abiding by relevant state legislation (e.g. health, trade practices, employment)
- abiding by pollution controls.

**Local government**

Local governments (city, municipal and shire councils) have control over the following business activities:
- approving new development and alteration (to an existing building) applications
- fire regulations
- parking regulations (e.g. provision of parking by new businesses)
- size, location and shape of business signs.

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**BizWORD**

The goods and services tax (GST) is a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia.

**BizWORD**

Regulations are rules, laws or orders that businesses must follow.

---

**FIGURE 3.12 Institutional influences on business**

**FIGURE 3.13 Some business laws relating to the levels of government**
Regulatory bodies

A regulatory body is one that is set up to monitor and review the actions of businesses and consumers in relation to certain issues (such as advertising) and the appropriate legislation. This is to ensure that businesses conduct themselves fairly in relation to the consumer, the community and other businesses. There are a number of regulatory bodies that operate in New South Wales and Australia. They include:

- the Department of Environment, Climate Change and Water
- the Office of Fair Trading
- the Australian Securities and Investments Commission
- the Australian Competition and Consumer Commission.

The roles of these regulatory bodies are summarised in table 3.1.

### TABLE 3.1 Major regulatory bodies in New South Wales and Australia

<table>
<thead>
<tr>
<th>Regulatory agency</th>
<th>Role</th>
</tr>
</thead>
</table>
| Department of Environment, Climate Change and Water (NSW) | • A NSW public sector organisation responsible for environmental protection  
• Is governed by the Protection of the Environment Administration Act 1991  
• The aim of this Act is to reduce risks to human health and prevent degradation to the environment by:  
  – promoting pollution prevention  
  – reducing harmful levels of discharge into the air, water and land  
  – regulating the transportation, collection, treatment, storage and disposal of waste.  
• All businesses are required to adhere to environmental guidelines in relation to pollution levels, waste disposal and storage of harmful waste.  
• There can be a dilemma for corporations that are obliged to maintain and increase profits, sometimes at the expense of the environment, e.g. Ok Tedi mine in Papua New Guinea, where extensive environmental damage is claimed to have occurred as a result of activities by BHP. |
| Office of Fair Trading (NSW) | • Is the NSW consumer protection agency  
• Provides information and assistance to all consumers and business owners on areas such as consumer information and business name registration  
• Services to business include:  
  – business licence information, e.g. real estate agents, builders, car dealers  
  – business name registration  
  – information for builders and tradespeople that covers their responsibilities and offers assistance in relation to disputes between themselves and clients/contractors  
  – product safety standards  
  – trade measurements relating to scales/scanners used to weigh and measure products. |
| Australian Securities and Investments Commission (ASIC) (federal) | • Monitors market integrity and provides consumer protection in areas such as payment systems and financial services such as investment advice.  
• Aims to ensure all businesses comply with the industry standards and codes of practice. |
| Australian Competition and Consumer Commission (ACCC) (federal) | • Is an independent statutory authority that administers the Trade Practices Act 1974 and the Prices Surveillance Act 1983. This includes monitoring of:  
  – anti-competitive and unfair market practices such as the misuse of market power (e.g. blocking competitors from entering the market), exclusive dealing and resale price maintenance  
  – mergers and acquisitions that could decrease the level of competition  
  – product safety and liability  
  – misleading and deceptive advertising.  
• It operates nationally for the enforcement and administration of competition and consumer protection laws. |
Other institutional influences

In addition to government bodies, other institutions affect how businesses operate in Australia. Some of these are shown in table 3.2.

**TABLE 3.2** Other institutional influences on businesses in Australia

<table>
<thead>
<tr>
<th>Employer, trade and industry associations</th>
<th>Employer associations</th>
</tr>
</thead>
</table>
| Employer associations | ● Developed in response to the growth of trade unions  
● Represent the interest of employers  
● Assist employers in the following ways:  
  - formulating policies in line with union activities  
  - acting on behalf of employers in negotiating enterprise or collective agreements  
  - promoting industry, trade and commerce  
  - providing submissions, advice and information to governments. |
| Trade and industry associations | ● National bodies that represent larger groups of employers (e.g. lobbying government on certain issues)  
● Examples include:  
  - Australian Chamber of Commerce and Industry  
  - National Farmers Federation  
  - Australian Industry Group. |

| Trade unions | ● Main aim was to improve working conditions and pay rates.  
● Union membership declined substantially in the past 20 years because of:  
  - new legislation that outlaws compulsory unionism  
  - changes to work patterns (increased part-time and casual work)  
  - workplace agreements  
  - privatisation and restructuring of union-dominated industries. |

| Australian Stock Exchange (ASX) | ● Operates a sharemarket where companies can raise funds by issuing shares in the company.  
● A business lists itself with the Australian Stock Exchange to become a public company. The main reason for this is to raise extra capital, usually for expansion and development. |

**Technological influences**

Global technological innovation has increased at a remarkable pace, revolutionising the workplace and every aspect of daily life. With appropriate technology, businesses can increase efficiency and productivity, create new products and improve the quality and range of products and services. The use of hi-tech robotics in many manufacturing industries is improving productivity, reducing operating costs and eliminating many boring and repetitious tasks. For example, at the General Motors Holden plant in Adelaide, a finished, fitted-out and painted Commodore comprising approximately 17,000 parts is produced in a single day. Rapid advances in information technology (IT) have reduced communications delays and allow suppliers and customers to interact over great distances.

New communications technologies allow information to be rapidly transmitted to an ever-increasing number of customers with a speed that now makes communication almost instantaneous. Since the introduction of fibre-optic cables and digital information transmission in the mid 1980s, the speed and capability of transferring communications data has allowed businesses to reorganise their structure and has fundamentally changed workplace practices.

A business that wants to be locally, nationally and/or globally competitive must adopt the appropriate technology. If slow to use and exploit technology, a business is likely to fail: the competition will strive to capture greater market share and develop a sustainable competitive advantage.
FIGURE 3.14 Robotics — a technological revolution

**BizWORD**

A *sustainable competitive advantage* refers to the ability of a business to develop strategies that will ensure it has an 'edge' over its competitors for a long period of time.

**Competitive situation influences**

Competition between firms to be the ‘market leader’ or to win customer loyalty can benefit the consumer *and* the business. It can provide the consumer with more choices, a range of qualities and a variety of prices. From the business point of view, competition can stimulate greater efficiency in production and usually results in a better quality product or service at the lowest cost to the business. Each business aims to achieve a *sustainable competitive advantage* over its competition in order to capture a larger portion of the market.

**FACTORS INFLUENCING A BUSINESS’S COMPETITIVENESS**

- Number of competitors
- Local and foreign competition
- Marketing strategies employed by competitors
- Ease of entry into a market for a new business

**NUMBER OF COMPETITORS**

The number of competitors refers to the size and number of firms that exist within an industry; it is also known as *market concentration*. There are four main types of market concentration (see table 3.3).
TABLE 3.3 Types of market concentration

<table>
<thead>
<tr>
<th>Types of market concentration</th>
<th>Features/characteristics</th>
<th>Example</th>
</tr>
</thead>
</table>
| Monopoly                     | • Complete concentration by one firm in the industry  
                                 • Firm has the ability to decide the price of the good or service because there are no competitors (i.e. the firm is the price maker)  
                                 • Customer has no influence over the price charged. i.e. the customer is the price taker. | Australia Post  
Railcorp |
| Oligopoly                    | • Consists of a small number of larger firms that dominate the market  
                                 • Are able to stay in control of the market because they spend large amounts of money on advertising and this enables them to restrict the entry of new competitors to the market. | Banks  
Oil companies  
Car manufacturers |
| Monopolistic competition     | • Most common type of market in Australia  
                                 • Large number of buyers and sellers  
                                 • The goods and services sold are differentiated from competitors using methods such as packaging, advertising, brand names and quality. | Clothing manufacturers  
Local retailing |
| Perfect competition          | • Large number of small businesses that sell products that are the same or similar  
                                 • Very little advertising is used to increase market share  
                                 • The only way to achieve market share is through price competition. | Fruit and vegetable growers |

BizWORD

Market concentration refers to the number of competitors in a particular market. There are four main types of market concentration:

• a monopoly — is complete concentration by one firm in the industry, e.g. Australia Post  
• an oligopoly — where a small number of larger firms have a greater control over a market, e.g. car manufacturers  
• monopolistic competition — where there is a large number of buyers and sellers in a particular market, e.g. local retailing shops  
• perfect competition — where there is a large number of small firms that sell similar products. They are unable to differentiate products from each other and so can only use price as a way of achieving market share, e.g. fruit and vegetable growers.

Ease of entry

Ease of entry refers to the ability of a person (or persons) to establish a business within a particular industry. The ease of entry will be determined by the type of market concentration. When there are many small firms (perfect competition and monopolistic competition), entry is not difficult as businesses are small and it is more affordable for the business owner to gain some part of the market. When there are a few firms dominating an industry (oligopolies), entry is difficult because the firms are larger and often more established. Potential competitors must have enough resources to gain some control in the market.

When there is only one firm (monopoly) that dominates an industry, no competitors are able to enter the market because the one firm has control over all resources that are being sold.

Local and foreign competitors

Local competitors are those who produce or sell a good or service in the same market. Local competitors must deal with the same variables as each other. These variables include:
• labour costs  
• transport costs  
• the economy  
• cost of stock/raw materials.

Foreign competitors are those businesses located overseas or offshore. They sell their goods or services in Australia and compete with local businesses.
Marketing strategies

A business will be influenced by the type of marketing measures taken by a competitor. For example, the business that uses television advertising extensively will have greater exposure to the market than a business that relies on flyers or word of mouth. Of course, the type and extent of marketing will depend on:

- the size of the market — the number of existing and potential customers
- the size of the business — the larger the business the more likely it is to invest in a range of marketing activities, especially more expensive forms of marketing such as television and newspapers. Smaller businesses may rely on simple marketing methods such as pamphlets, local paper advertisements and word of mouth (see the following Snapshot).
- number of competitors — usually the more competitors that there are in a market, the greater the need for marketing. This is necessary to maintain or increase market share.
- the nature of the product — this refers to the type of product and whether it requires extensive marketing. Some products, such as postage stamps, don’t need to be advertised in order to make sales.

**FIGURE 3.16** Advertising acts to persuade, remind and inform consumers about a business’s products.

**SNAPSHOT**

One of the crucial places to promote your brand is online, particularly given many consumers turn to the net to research their next purchase before hitting the shops.

The chief executive of Sydney media buying shop Aegis, Lee Stephens, says businesses should invest between 10 per cent and 15 per cent of profits back into marketing.

Online is a crucial first step, he says. ‘A business needs a good online search campaign so that a Google search in Sydney will put those businesses smart enough to invest in online at the top of the list.’
Ambient media — which refers to the new breed of outdoor advertising — can also be a good option. These include buying ad space around teller machines or placing an ad on the tabletops at the local shopping mall. These options can get your brand in front of a large audience.

‘Or you might be able to promote your business on the back of receipts in your local area,’ Stephens says.

‘Some of those sorts of options can be very effective.’

And while marketing experts say you need to invest significant dollars to get results, some brands manage to spruik their wares with virtually no marketing budget.

Tom Griffith co-founded bottled juice company Emma & Tom’s four years ago. The brand is stocked at more than 2000 independent retailers across the country.

‘We want the product to be seen in good spots and upmarket places rather than in mainstream places, which we think helps us to basically market the product for free,’ Griffith says. ‘The bottom line is that we just don’t have the cash to commit to big, expensive marketing campaigns.’

The brand counts product giveaways among its marketing mix as well as point-of-sale.

This involves giving stockists large stacks of branded counter cards, stickers, fridge strips or posters.

A small army of delivery vans painted with the company logo also spreads the word on the street for no ongoing cost. The approach obviously works. The company sells more than 60 000 bottles of juice every week and exports its products to New Zealand, Asia and France.

Niche marketing is the answer for garden tool manufacturer and supplier Fiskars. Its challenge is to get its brand in front of the serious gardening enthusiast. Fiskars marketing manager Nic Naes spreads his marketing dollars between key gardening magazines, a sprinkling of radio ads and online advertising. ‘We’re trying to communicate with serious gardening enthusiasts so we find that small, niche marketing campaigns work best for us,’ Naes says.

Mainstream media has proved more popular with home appliance brand Sunbeam. Marketing manager David Jackson says good deals are available on television and in print as media proprietors discount to meet budget in the slower market.

‘When you’re in marketing you’ve always got to make your dollars work hard for your brand,’ Jackson says. ‘We managed to secure good value on top-rating television shows for our recent ad campaign.’

Advertisers should also consider how to link their advertising from one medium to another so that print, television, radio and other advertising all tell a consistent message.

Newspaper advertising is successful at developing an affinity for a product or brand and encouraging readers to think differently about the brand, the report says. They can also raise important issues, provide information and remind readers of campaigns on other media.


### Snapshot questions

1. **Use the Snapshot to outline the marketing strategies used by the businesses.**

<table>
<thead>
<tr>
<th>Business name</th>
<th>Marketing strategies used by this business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emma &amp; Tom’s (juice company)</td>
<td></td>
</tr>
<tr>
<td>Fiskars (garden tools)</td>
<td></td>
</tr>
</tbody>
</table>

2. Using information from the Snapshot and your own knowledge, explain why the internet is such an important tool for marketing. Aim to identify 3–4 reasons.
Changes in markets

Changes in financial/capital markets

Finance (capital) is now more mobile and flows relatively easily between countries, especially since the 1970s when many countries phased out their controls on foreign exchange trading. As a result, international financial flows have expanded very rapidly over the last three decades. Consequently, the world capital market is now more integrated than ever before.

Capital flows to those countries where the investment opportunities and returns are favourable. It is now much easier for individuals and businesses to access overseas share markets and purchase equity in foreign companies.

However, the instability of financial markets was evident during the global financial crisis (GFC) in 2008–09. This was triggered by a series of loan defaults by US homeowners, which saw financial markets in the US collapse. This collapse sent shockwaves through the global financial and stock markets.

The GFC caused changes to be made within domestic and international financial markets, and will continue to influence future transaction procedures.

Changes in labour markets

The labour market has not been ‘freed up’ to the same degree as other markets. If anything, the labour market has become less global in the last 60 years. Due to political barriers, the flow of people between countries is now more restricted than it was from 1850 to 1900, when waves of migration occurred. This trend seems likely to continue, especially the restrictions placed on the movement of low or unskilled labour. For example, even within the European Union, which gives citizens of any member nation the right to work and live in any other, only a small proportion of workers travel across national borders.

BizFACT
The following stock market index measurements have become familiar segments in our news programs — a reflection of the free flow of capital. The Japanese Nikkei Index, Hong Kong Hang Seng Index, English FTSE (Financial Times Stock Exchange) Index and United States NASDAQ (National Association of Securities Dealers Automated Quotation System).
However, two trends in the labour market have resulted in the movement of workers. First, the movement of large numbers of temporary skilled migrant workers has been very important in Australia, Europe and Asia. For example, large numbers of unskilled Turkish and Filipino workers work in numerous countries. Second, the growing demand for highly trained employees means that such people are increasingly mobile.

During the mid 2000s and again following the GFC, Australia experienced an increased demand for skilled labour to support the expanding mining sector (driven by China’s demand for commodities). This increased demand could not be met domestically; therefore, the Australian government increased the number of temporary work visas to address this shortfall in skilled labour.

Changes in consumer markets

There has been phenomenal growth in the amount and value of world trade, especially since the end of World War II. For example, during the period from 1995 to 2005, global trade in goods and services increased by approximately 150 per cent. In 2008–09, however, the global financial crisis saw a fall in global output and trade, which was the first of its kind since the Great Depression during the 1920s and 1930s. After the sharpest decline in more than 70 years, global trade is set to rebound over the next few years and grow at 9.5 per cent. Countries are achieving cost savings by specialising in products they can produce efficiently. This results in cheaper prices on the world market and, in turn, generates increased sales in existing markets. New consumer markets also emerge, particularly in developing countries, like China and India.

Improved technologies and communications have also changed consumer markets. With the advent of the internet, innovative and visionary Australian businesses may reach much larger markets and take advantage of economies of scale. Consumers around the world will just as readily browse an online store as examine a catalogue delivered to their private letterboxes.

Summary

- Legal influences are the regulation (legal framework) within which a business must operate.
- Political influences are derived from both state and federal government policies and include taxation and the implementation of paid parental leave.
- Institutions that influence business include government, regulatory bodies and other groups such as trade unions and employer associations.
- Technological influences can increase business productivity and communication.
- Other external influences include competition and changes in the financial, labour and consumer markets.

Revision

1. Define the term ‘business environment’.
2. Distinguish between internal and external business environments.
3. In small groups, use the brainstorm technique to identify the elements that determine the environment of your Business Studies class. Choose a spokesperson to share the group’s comments with the rest of the class.
4. State what you understand by the ‘business cycle’.
5. Clarify why the level of economic activity fluctuates over time.
6. Outline the impact of globalisation.
7 Justify why businesses should offer family-friendly workplace practices.
8 Account for why the ACCC is so important to business in Australia.
9 Explain why it is important for a small business owner to comply with the consumer protection provisions of the Trade Practices Act.
10 Recall the legal penalties or remedies that might apply after a successful prosecution for breaches of the Act’s restrictive trade practices provisions.
11 Use the Department of Environment, Climate Change and Water (NSW), Office of Fair Trading (NSW), Australian Securities and Investments Commission, and Australian Competition and Consumer Commission weblinks in your eBookPLUS to investigate these government agencies and then complete the following questions. 
   (a) State their role.
   (b) Briefly outline their importance to Australian businesses.
12 Outline how information communication technology, especially the internet, has changed existing consumer shopping practices.
13 Define the term ‘sustainable competitive advantage’.
14 Describe what is meant by the term ‘market concentration’. Give examples.
15 Identify four types of market concentration.
16 Explain why the marketing strategies of a competitor will impact on a business’s competitive situation.
17 List five different products you use regularly, such as your computer, DVD player, shoes etc. and:
   (a) identify the brand name of the product
   (b) identify the company that made it
   (c) identify in which country it was made
   (d) determine why it was made there.
   Compare your list with other class members, noting similarities and differences.
   Propose a conclusion you can derive from this investigation about global consumerism.
18 Identify which external influence is affecting the small business in each of the following cases:
   (a) Julie runs a small busy restaurant. She recently introduced technology that allows waiting staff to electronically send orders to the kitchen. This means better service for the customer because the order is taken more efficiently and more time can be devoted to other tasks such as the prompt delivery of food and drinks.
   (b) John is the manager of a function centre that hosts large weddings and conferences. He makes sure to include an acknowledgement of the traditional owners of the land, the Wurundjeri people and their elders, in his opening remarks.
   (c) Mia has to design and print new labels for the foods sold in her deli. This is because changes to the food labelling laws require that all foods list the ingredients by particular portion size. This allows customers to more easily compare different food items. She thinks that this may affect which foods customers choose.
   (d) Michael, the owner of a local bottle shop, is no longer allowed to sell imported premixed alcoholic drinks because of a government ban on food and beverage imports from particular countries.
Extension

1 Explain the impact each of the external influences has on a business and how the business’s management responds. The first factor has been completed for you.

<table>
<thead>
<tr>
<th>Factor influencing the internal environment</th>
<th>Brief explanation</th>
<th>Management response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political influences</td>
<td>Elected governments at all levels in Australia regulate markets and have the power to make or change laws.</td>
<td>Must comply with the laws and regulations introduced by governments</td>
</tr>
</tbody>
</table>

2 Using an example, determine how the development of global consumers encouraged the process of globalisation.

3 (a) Demonstrate how technology has affected the way consumers can purchase goods and services.
   (b) Predict what will happen if an Australian business does not provide the opportunity for consumers to purchase online.

4 In small groups, examine and report on a social issue confronting businesses in your local area. You may wish to either prepare a PowerPoint presentation or use a word-processing package for your report.
   (a) Outline the issue.
   (b) State how the local businesses have reacted to the situation.
   (c) Determine what indicators you would use to decide the success or failure of a business’s response to the situation.

3.4 Internal influences on business

Internal influences relate to the specific factors within the business that will affect its operations. These factors can be identified and adjusted via feedback and evaluation processes that provide the business with information for change.
Product influences

Product influences affect a range of internal structures and operations within the business. The main product influences on a business are as follows.

1. The type of goods and services produced will affect the internal operations of a business. If the goods are physically large or require many raw material inputs, there will need to be structures in place to organise and monitor the processes involved in production. In contrast, a service may be delivered by a home-based business or a franchise business, such as Jim's Mowing, and will influence the internal structures or processes differently.

   The range of goods and services refers to the number produced by the business. The larger the number, the more internal impact it will have on the business as it will need to expand operations and internal structures to accommodate the changes. Companies such as Coca-Cola have continually expanded their product range over the last 20 years, and this has meant that internal changes to operations and management have been necessary to allow this expansion to occur.

2. Product influence will be reflected in the type of business (service, manufacturer or retailer). Internally, a service provider will be structured differently to a manufacturer or retailer, and the influences will vary. Some goods or services require extensive preparation, while others are merely deliverers. Consider the difference between the product influences of a clothing manufacturer and that of a clothing retailer.

3. The size of the business, as previously mentioned, will be based on the range and type of goods and services produced, the level of technology utilised, and the volume of goods and services produced. The larger the business the more goods and services being produced, which will in turn influence the internal structures and operations of the business. A café will operate at a different scale to a club bistro and therefore the influence on business functions will be relative.

Location influences

Location can make the difference between success and failure. A good location is an asset and will lead to high levels of sales and profits. A bad location is a liability that adversely affects sales and profits.

The choice of location is therefore important. This is particularly true for retail and service-oriented businesses, which need a constant flow of people walking past the store — the passing trade — and thus need to be located in a shopping centre, mall or main street.

The two most important considerations are customer convenience and visibility, which can be summarised in the following ‘equation’:

$$\text{Prime location} = \text{Customer convenience} + \text{Visibility}$$

If a business is not convenient and visible, customers may not make the effort to find the business, and optimum customer flow will not be achieved. It is normally best to avoid establishing a business in areas of low rental, because a bad business image may result. Locating next to complementary businesses may be beneficial because more customers may be attracted to a single site, as demonstrated by the clustering of retail outlets (see figure 3.20).
Each individual small business must satisfy its own criteria when deciding on the ‘best’ location. Figure 3.21 outlines the factors to consider when choosing a location.

![Diagram showing location factors: Visibility, Proximity to support services, Cost, Proximity to customers, Proximity to suppliers.]

**BizFACT**
To assist in selecting the best site, market research companies can be hired to prepare traffic and pedestrian flow measurements, an analysis of demographic data and an investigation of future trends. When selecting a suitable site to locate a new small business, it is crucial to remember real estate agents’ three important words: ‘location, location, location’.

**FIGURE 3.20** Locating next to complementary businesses may be beneficial.

**FIGURE 3.21** Factors to consider when choosing a location

The factors in figure 3.21 vary in importance from business to business, and depend on a business’s main activity. To understand each factor, it is necessary to consider the differences in a location decision for a retail business (such as a clothing store or café) and for a non-retail business (such as manufacturing or wholesaling).
For a retail business, location is extremely important to its overall success. The location must be convenient for potential customers and central to customers’ own location — that is, the business must have passing customer traffic.

Location for non-retail businesses such as manufacturers is about position and convenience. This means being close to transport facilities, which allow for shipping goods to customers and receiving supplies necessary for production. Many wholesalers and manufacturers locate in industrial estates or parks, which have been set up by local councils (see figure 3.22).

**Visibility**

A business wanting high visibility would locate in a prime shopping area such as a shopping centre or main street. Companies concerned with manufacturing would not consider this to be a crucial consideration, so may choose a low-visibility location ‘out of town’ and then advertise their location to appropriate customers.

**Cost**

Cost is another factor to consider when determining the location of a business. Leasing or purchasing a central location in a busy shopping centre will be far more expensive than in a location with lower levels of passing customer traffic. If the business relies on passing customer traffic and maximum exposure, then the cost factor is unavoidable. These types of businesses include coffee shops or cafés, fast food outlets and retail shops.

On the other hand, location may not be a key consideration if the business does not rely on passing customer traffic. Such businesses search for a low-cost site, especially if they are related to manufacturing and require large premises. These types of businesses include mechanics, car yards, equipment hire, and even solicitors and doctors.
Given the rapid changes in technology, many businesses do not consider their location as important at all. They are able to communicate with their customer base through computers, especially with the internet (which has become the fastest growing avenue for consumer sales). These types of businesses include telemarketers or businesses that wish to sell their products via the Web.

Proximity to suppliers

Proximity to suppliers is an important consideration for some businesses but not others. The main issue is the size and quantity of the raw materials needed for production, or the size of the finished goods to be supplied. A business that relies on bulky raw materials or finished goods — such as a logging company or steel manufacturer — has significant transport costs and will locate closer to the supplier in an attempt to reduce costs. However, for a business that does not transport bulky goods, proximity to suppliers is not a major consideration. These businesses include florists, bakeries and video hire shops.

Proximity to customers

The importance of proximity to customers depends on the type of business being established. A retail business must locate close to its customer base. A manufacturing or wholesaling business may decide it is more cost effective to transport the product to the customer, particularly if bulky raw materials are needed. Other location cost factors could include leasing costs in ‘prime shopping areas’, incentives offered by local councils, and general overheads such as rates or utilities.

Proximity to support services

Support services are the activities needed to assist the core operations or prime function of a business. They include accountants, solicitors and government agencies such as Austrade and the Business Enterprise Centre. Small businesses traditionally tend to use external services (mainly as a result of limited finance) whereas medium-sized and larger businesses often provide their own support services internally. But this trend is changing, with businesses now preferring to downsize their work force (in an attempt to reduce costs) and outsource many activities.

Today, proximity to support services is not the most important location factor, because advancements in technology have enabled all businesses (large or small) to access a range of support services through the use of computers (the internet and email), faxes, mobile phones, and phone and video conferences.

Resource influences

The four main resources available to a business are:

- **Human resources.** These are the employees of the business and are generally its most important asset.
- **Information resources.** These resources include the knowledge and data required by the business such as market research, sales reports, economic forecasts, technical material and legal advice.
- **Physical resources** include equipment, machinery, buildings and raw materials.
- **Financial resources** are the funds the business uses to meet its obligations to various creditors.

Although the quantity and quality of these resources varies amongst businesses, it is by combining them that all the goods and services demanded by consumers are produced.

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**BizFACT**

Grapinde Graphic Design has a customer base of 1300 small businesses, plus 15 000 signed-up members who can download sample graphic designs. This small business is located in a country town about 310 kilometres from Melbourne. Of Grapinde’s customers, 67 per cent come from the United States, England and New Zealand — all making contact via the internet.

**BizWORD**

**Support services** are the activities needed to assist the core operations or prime function of a business.

**BizWORD**

**Human resources** are the employees of the business and are generally its most important asset.

**Information resources** include the knowledge and data required by the business, such as market research, sales reports, economic forecasts, technical material and legal advice.

**Physical resources** include equipment, machinery, buildings and raw materials.

**Financial resources** are the funds the business uses to meet its obligations to various creditors.
FIGURE 3.23 Resources required to produce a school musical

It is important to realise that these are only general categories of resource. Within each category there may be hundreds of more specific resources from which the manager must choose. Gathering, selecting and coordinating the appropriate resources from a complex array requires knowledgeable and efficient managers. The skills and expertise of the management team in coordinating the business’s resources will largely determine whether the objectives of the business are achieved.

Management influences

Rapid advances in technology, coupled with the significant pressures on businesses from increased competition due to forces of globalisation, have resulted in businesses flattening their structures. This means that there are fewer levels of management. Such businesses can adapt quickly to meet changing consumer needs and market conditions because there are fewer managers who need to approve decisions.

BizFACT

If a business adopts a traditional hierarchical approach, management may allocate supervisors who have direct control and authority to ensure work processes are carried out. However, if a business adopts a flat management structure, it will emphasise teamwork and shared responsibility for achieving business goals. In today’s global environment, there is an ongoing emphasis on ‘virtual teams’. Such teams work without time, space or organisational boundaries by making use of sophisticated communications technology.

Traditional organisational structures

- Centralised
- Task/activity centred
- Division of labour: labour specialisation
- Rigid structure: hierarchical highly layered/multi-layered
- Autocratic, didactic management style
- Performance appraisal: ‘do it our way’

New and emerging organisational structures

- Decentralised
- People centred
- Multi-task, multi-skilled
- Flexible structure: flat, mono-layered
- Democratic and laissez-faire management styles
- Performance management: ‘do it the best way’

FIGURE 3.24 Pouring water on the sandcastle

- Power not shared (exclusive)
- Narrow span: workers controlled: dependent
- Communication: top–down
- Delegation: top–down
- Approach to employment relations: pluralist
- Traditional, conservative

- Equal power-sharing (inclusive)
- Wide span: workers autonomous: independent
- Communication: by consensus
- Delegation: by agreement
- Approach to employment relations: unitary
- Modern, forward thinking, contemporary
Businesses that adopt a flatter organisational structure reduce the number of levels of management, giving greater responsibility to individuals in the business. The trends and changes in organisational structures are summarised in figure 3.24. The characteristics listed on the left-hand side apply to the traditional structures, whereas those on the right apply to the most modern structures. Many businesses are in transition — they have adopted the traditional design and taken on elements of the newest designs.

**FIGURE 3.25** A ‘flatter’ management structure encourages a sense of ownership and innovation by managers. This emphasises teamwork and responsibility.

The characteristics of the two organisational structures (see page 76) reflect the important influence management has on business. Collaborative workplaces allow for a more cohesive and inclusive business culture. The management style that the business adopts will depend on its size and main activity — for example, retail, manufacturing or service (see the following Snapshot).

**The internal environment at Flight Centre**

The internal business environment consists of the management structure, business culture, management roles, styles and skills. It must be well managed so that businesses such as Flight Centre Limited can achieve their objectives. Flight Centre, one of Australia’s best-known travel agency groups, was started by Graham Turner in 1981 and it grew very quickly. It now opens a new shop or office almost every day and employs more than 13,000 staff in 10 countries.

Flight Centre has developed a strong business culture based on the working ethos of a family, village and tribe. Every staff member shares a commitment to valuing customers and other employees. Flight Centre’s structure is simple, lean and flat. It consists of only four to five layers, with business teams (made up of a minimum of three, up to a maximum of seven members) at the bottom. The hierarchy then progresses through area leadership (made up of 7 to 25 teams), national leadership, regional leadership and then the global board. All staff members have the opportunity to be involved in team, area and national leadership.

There is open communication in the workplace. Flight Centre believes that every individual should have the same privileges. Staff at Flight Centre do not have separate offices, receptionists or secretaries. A manager or leader does the same job as other staff: serves customers, cleans up and answers the phones. Promotion from within the business is a priority. The organisation believes that work should be challenging and fun for all staff.

**Snapshot question**

Describe Flight Centre’s internal environment.
Business culture

All businesses have their own business (corporate) culture — the values, ideas, expectations and beliefs shared by the staff and managers of the business. Each business develops its own particular way of doing things. The style or character of a business is consequently reflected in its culture.

Business culture can be revealed officially in the policies, goals or slogans of a business. It can also be seen in the unwritten or informal rules that guide how people in the business behave, such as the way staff dress, the language staff use and the way that staff treat each other and customers.

A manager must understand and assess all facets of a business’s unique culture as this is a powerful tool for achieving goals. Knowing and appreciating a business’s culture makes it easier to get things done faster or to initiate a change to routine or procedures. Competent, effective managers will use the business’s culture as a force for positive change. Research has shown that businesses with a healthy, well-developed and strong culture are more likely to be successful, because such a workplace is perceived by the employees to be more positive and personalised. Employees who have clear expectations feel better about their work — they develop a sense of belonging. A manager who does not understand a business’s culture may experience failure or disappointment.

Elements of a business culture

A business culture normally consists of four essential elements:

1. **Values.** These are the business’s basic beliefs, shared among its employees. Business values can include honesty, hard work, teamwork, quality customer service, employee participation and innovation.

2. **Symbols.** These consist of events or objects that are used to represent something the business believes to be important. It is a case of ‘actions speaking louder than words’. For some businesses, competitive sports are a key feature of the business’s culture. Other businesses have encouraged employee development and loyalty through the use of training and development programs.

3. **Rituals, rites and celebrations.** These are the routine behaviour patterns in a business’s everyday life. Regular social gatherings can be held to help develop
a sense of belonging among employees who normally work in small teams during the week.

4. Heroes. Heroes are the business’s successful employees who reflect its values and, therefore, act as an example for others.

Culture and organisational structures

The culture of a business is often evident in its organisational structure. Formal businesses with an emphasis on bureaucracy, line authority, hierarchical management structures, and defined job titles and areas of responsibility often have prevailing cultures that emphasise accountability, communication and cooperation. They also tend to conform to a culture of loyalty and respect for superiors (or, if not for superiors, at least for the positions they may hold). A culture that values and expects defined career pathways may be evident in formal organisations.

Less formal businesses with flatter management structures, less departmentalisation and fewer defined spans of control often exhibit highly flexible, innovative and risk-taking cultures. Apple Inc. is an example of a company that values innovation. Steve Jobs, the company’s co-founder, created the atmosphere of innovation that allowed the company to successfully introduce new products such as the Apple Mac, iPod, iPhone and iPad.

Management’s role in developing a business culture

Once a positive business culture is established, it needs to be kept alive. This is where management comes in. Management must ensure that staff members are given sufficient training to reflect the values of the business. For example, if treating customers respectfully is important in the business, then this might become part of customer service training.

For a change in business culture to be successful and sustainable, it is vital that senior management be role models for staff in those important values. Management must continually reinforce what the values are by communicating with staff, rewarding employees who display the appropriate values, and recruiting staff who already fit in with the values of the business (see the following Snapshot).

**SnAPShOt**

A leader who fails more than twice to meet the standards expected of them by employees will be sacked.

Semco — workplace democracy in action

The Semco Group, based in Brazil, South America, is a most unusual business as a result of its absolute commitment to workplace democracy. It has had a noteworthy history, managing to grow when whole industries collapsed, and an international reputation for its democratic employment relations practices. Today, Semco Group is a market leader in industrial equipment and solutions for postal and document management.

Semco actually began life in the 1950s as a company manufacturing centrifuges for the vegetable oil industry (a centrifuge is a piece of equipment where a compartment spins on a central axis to separate materials). Between the 1950s and the 1980s, Semco became a traditional hierarchical business, characterised by many layers. After running into trouble as a result of employee reaction to autocratic management, however, changes began in the mid 1980s that have continued to the present day.

Ricardo Semler, the founder’s son, took over as the CEO of Semco and fired 60 per cent of the top managers on his first day. In the 1980s, Semco was heavily involved in producing pumps, axles and other components for the naval industry. Semler believed that the company could be rescued by diversifying (moving into

(continued)
Semco introduced a matrix organisational structure, but this did not deliver the improvements that Semler was after. Semco then developed the idea of satellite units or strategic business units to develop new businesses and product lines. This provided greater freedom as well as more responsibility for managers and staff.

Semco is now completely based on the concept of employee ownership, full employee participation, flexibility and a focus on meeting customer needs. Employees design their workplace, set their own hours and share all information. At Semco, there are no managers. There are team leaders, but leadership depends on the leader passing an appraisal that subordinates conduct every six months. A leader who fails more than twice to meet the standards expected of them by employees will be sacked.

There is an emphasis on ownership and disclosure — all wages are tied to the performance of the business, and each person’s wage is published so team leaders are shown not to be earning unfairly high salaries. Staff set their own salaries, but need to be careful because there are no secrets. Staff are provided with information about how much they could make if they worked for another business using similar skills. Each employee has been trained in accounting so they can understand the business’s earnings and how their work affects the business.

The structure is an ‘octopus’ (see the diagram). This is a structure that Semco has created through its commitment to flexibility. This structure arose when recession hit and Semler wanted to avoid sacking people, even though the business could not afford to keep them. An arrangement was made whereby the business sold off parts of itself to employees, who would otherwise have been retrenched. Semco then purchased its supplies from these former employees who, now in their own businesses, were able to sell not only to Semco but also to Semco’s competitors.

Snapshot questions
1. Identify the features that make this workplace unique.
2. Discuss the effectiveness of employees accessing the work of managers.
3. Determine the benefits of employees having ownership of their work.

Weblink
Use the Semco Group history weblink in your eBookPLUS to discover more about the Semco Group.
Summary

• The internal influences on a business include product, location, resources, management and business culture.
• Product influences affect a range of internal structures and operations within the business.
• Location will have a direct impact on the sales and profits of some businesses.
• Factors to consider when choosing a location are:
  – visibility
  – cost
  – proximity to suppliers
  – proximity to customers
  – proximity to support services.
• The four main resources of a business are human, information, physical and financial.
• A flatter organisational structure reduces the number of levels of management.
• Business culture can be seen in the unwritten or informal rules that guide how people in the organisation behave.
• There are four essential elements of a business culture: values, symbols, rituals and heroes.

Revision

1. Summarise one way in which product influences affect a business.
2. Identify and outline three factors a business must consider when choosing a location.
3. Describe the four main resources available to a business. Choose one of these resources and explain how it will influence a business.
4. Distinguish between a traditional and flat organisational structure.
5. Define the term ‘business culture’.
6. Describe the culture of your school.
7. Explain how business culture can influence the success of a business.
8. Briefly explain how a manager can influence a business’s culture.
9. Summarise the four elements of a business culture.

Extension

1. Analyse the relationship between a business’s structure and its culture.
2. Determine how the choice of a good or service that a business sells will influence the business’s legal structure, size and operations.

3.5 Stakeholders

Businesses have many stakeholders: the people and groups that interact in some way with the business and have a vested interest in its activities. In this sense you are a stakeholder of your school.

Businesses are expected to be enterprising, to comply with the law, and be socially just and ecologically sustainable in their operations. They are expected to practise ethical management and do the ‘right’ thing in the interests of all stakeholders.

Many businesses are now extremely sensitive to public opinion and strive to be recognised as being good corporate citizens. Businesses recognise that they increase their chances of success when they pursue goals that align with the interests and expectations of their main stakeholders. All businesses, therefore, must attempt to fulfil certain responsibilities to their stakeholders as highlighted in figure 3.27.
Responsibilities to shareholders

Shareholders are the owners of the business. As such, the main responsibility of the business is to maximise the return on the shareholders’ investment in a sustainable way.

By investing in the business, shareholders are putting their money at risk; therefore, they are entitled to a reasonable rate of return. Not only must a business generate a profit for the investors in a socially responsible way, but it must also report profit levels in an ethical manner. For this reason, audited financial accounts are prepared and every shareholder has the right to receive the published Annual Report.

The business has other duties to its shareholders. Some of these are:
- to hold an annual general meeting to give the shareholders the opportunity to ask questions of the Board of Directors
- to allow shareholders to buy and sell their shares as they wish
- to divide surplus assets upon the company’s closure.

Responsibilities to managers

Managers must give an honest and accurate account of their management of the business’s resources. In return, the business has to support the actions of its management. Adequate resourcing levels, clear lines of communication and delegation of authority are necessary preconditions for successful management.

Executives in senior management, such as the Chief Executive Officer (CEO) and the Board of Directors, must commit time and money to allow the management team to fulfil its functions. Therefore, senior managers have a responsibility to provide the following to their managers:
- top-level commitment and support
- corporate policies that include references to ethical business practices
- a code of conduct
- extensive training and development
- effective auditing programs.

BizFACT
Presently, five million Australians own shares. These shareholders have instant access to vast amounts of information about companies and the market. The result has been the development of new shareholder groups, many of which focus their attention on environmental and ethical issues.

BizFACT
Every business must be aware of and take into account the needs of the stakeholders.
Responsibilities to employees

Businesses have a number of responsibilities they must fulfil for this important group. Employees need a safe and psychologically rewarding work environment. Such an environment would respect individual differences, be concerned for employees’ goals, aspirations and welfare. In this sense it is more than just providing a ‘pay packet’. Employees who are encouraged, trained and receive professional development become more valuable to themselves and the organisation. Reward and recognition, management development, leadership, teamwork, safety and equal opportunity in employment are important responsibilities.

One particular responsibility an employer has to his or her employees concerns the issue of privacy. In the business context, privacy rights refers to the protection of an employee’s personal life from intrusion. Employees believe that their political, social and religious beliefs, as well as personal lifestyle issues such as sexual preference, are private matters and should be safeguarded. Of course, exceptions may arise if an employee’s work performance is clearly suffering, but such issues often involve a number of ‘grey’ areas. For example, should a job applicant be expected to undergo a urine sample to check for drug usage or pregnancy?

Employees need to be treated ethically and fairly. Their legal rights must always be honoured and respected. Businesses also have other responsibilities towards their employees including:

- elimination of discrimination on the basis of gender, marital status and pregnancy
- promoting equality of men and women
- elimination of sexual or other harassment, intimidation and bullying (see the following Shapshot).
Bullying in the workplace

One in six students is bullied every week in Australian schools. Not much seems to change when we look at the workforce, with figures suggesting that 85 per cent of workers suffer or witness bullying in the workplace. It is a serious issue both for schools and workplaces. A survey of human resource officers at 325 companies also found that nearly 60 per cent of workers have taken (or know a workmate who has taken) sick leave as a result of bullying by bosses or other workers.

The more noticeable forms of workplace bullying are intimidation, humiliation, verbal abuse, slamming doors, pushing, touching or fondling, and threatened or actual violence against an employee — in short, any repeated actions likely to generate a risk to a person’s health and safety. Australian companies are paying dearly for bullying in the workplace. Recently, a company was ordered to pay $350,000 to an employee for his medical bills, loss of income, and pain and suffering. As a young apprentice he faced continual harassment, including being rolled around the factory inside a large drum, and having his genitals smeared with grease. The judge found the company instilled a ‘culture of intimidation’.

There are also subtle forms of bullying such as excluding or isolating employees, assigning meaningless tasks that are unrelated to the job, deliberately changing work rosters to inconvenience particular employees, and deliberately withholding information that is vital for effective workplace performance.

Snapshot questions
1. Identify the personal and business costs associated with workplace bullying.
2. Imagine that you are a person being bullied at school or in the workplace. Outline how it would affect your:
   (a) self-confidence
   (b) performance.
3. Demonstrate, within a school setting, a type of subtle bullying and another type of more noticeable bullying.
4. Construct a sentence using the following pairs of words:
   • bullying/workplace
   • company/responsibility.

Responsibilities to consumers

One of the largest groups that a business must satisfy is its customers. They are the life-blood for any business. Without a customer base a business will not be able to survive. Customer satisfaction should always be of prime concern for any business. Customers have certain rights created by legislation. The Commonwealth’s Trade Practices Act 1974 and the New South Wales Fair Trading Act 1996 protect customers from misleading and deceptive business behaviour. Businesses must comply with these laws.

Businesses that respect and satisfy their customers have a much greater chance of success. Those that exploit customers will suffer the same fate as those that exploit employees — they will lose customers to their competitors.

Today’s consumers are astute, better educated and better informed. They are increasingly prepared to seek compensation if they believe they have been either unfairly treated or have purchased a product that did not perform as promised. Consumer groups are also prepared to mount publicity campaigns aimed at embarrassing those businesses that do not act ethically or responsibly.
Responsibilities to society

As previously explained, businesses have a responsibility to the local community to be good corporate citizens. Society expects businesses to give back to the community something of what they take out in generating profits. Therefore, socially responsible businesses will participate in a range of community projects and activities. For example, The Body Shop organises for its employees to assist with a local charity of their choice. AGL Limited supports a range of educational, fundraising and social welfare programs.

Responsibilities to the environment

There is growing pressure for businesses to adopt ecologically sustainable operating practices. This is in response to concerns about climate change and the destruction of the natural environment. Concern for our environment operates at both the local level as well as on a global scale.

Over the last two decades, the business community has undertaken many initiatives to put the principle of sustainable development into practice. For example, the jeans manufacturer Levi Strauss and Co. has developed its own environmental philosophy and guiding principles. Levi Strauss will conduct business only with partners who share its commitment to the environment.

BizWORD

Ecological sustainability occurs when economic growth meets the needs of the present population without endangering the ability of future generations to meet their needs.
Businesses that have been successful in their environmental management have learned that new processes, procedures and strategies are often needed. For example, one particular organisational element that many proactive ‘green’ companies share is the development and implementation of an environmental policy.

Through communication and training, responsible businesses can ensure that all employees and contractors are environmentally aware.

**Summary**

- Businesses have many stakeholders with varying, and sometimes conflicting, interests.
- Shareholders are putting their money at risk; therefore, they expect a reasonable rate of return.
- Managers expect the confidence and support of senior executives.
- Employees expect a safe and psychologically rewarding work environment.
- Businesses that respect and satisfy their customers have a much greater chance of success.
- Society expects businesses to be good corporate citizens and give back something to the community.
- Society expects businesses to adopt ecologically sustainable operating practices.

**Revision**

1. **Define** the term ‘stakeholders’.
2. **Identify** the stakeholders of your school. **Compare** your answer with other class members.
3. **Summarise** the responsibilities your school has to each of the individual stakeholders.
4. Are a shareholder and a stakeholder the same thing? **Explain** your answer.
5. Briefly **outline** the responsibilities a business has to its managers.
6. ‘Employees are the most valuable resource of any business.’ **Discuss** the accuracy of this statement.
7. ‘Businesses that respect and satisfy their customers have a much greater chance of success.’ **Explain** why this is so.
8. **Define** the term ‘ecological sustainability’.
9. In small groups, use the brainstorm technique to **identify** reasons businesses should adopt ecologically sustainable operating practices. Share your answer with the rest of the class.
10. Use a table like the one below to **summarise** a business’s main stakeholders and their interest.

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Extension**

1. ‘The shareholder should take precedence over all the other stakeholders. They are the ones who have invested their money; they take the risks. Therefore, they should be rewarded with as high a return as possible.’ **Evaluate** this statement. **Compare** your answers with other members of the class.
2 Recently, consumer groups, some church organisations and trade unions have publicised the harsh conditions of outworkers in the clothing industry. Outworkers are usually women who work from home sewing garments on a contract basis. These workers have little or no protection regarding their working conditions. Evaluate the impact of such campaigns. To help you, use the Fair Wear Campaign weblink in your eBookPLUS.

3 What do you think motivates a business to engage in socially responsible business programs? Is it:
(a) altruism — an unselfish concern for others?
(b) enlightened self-interest?
(c) avoidance of government regulation?
(d) fear of being sued?
Justify why you chose the one you did. Share your answer with other class members.
4.1 Introduction

Businesses are similar to people in that:
- no two are identical
- each has its own identity
- they are referred to by name or brand
- they possess individual personalities and physical appearances
- they are confronted by life’s challenges
- they sometimes succeed and at other times fail
- they rely on each other for survival.

However, the most striking similarity is that, like people, a business will pass through a number of distinct stages as it develops. This is referred to as the business life cycle. The business life cycle is a model; that is, a simplified version of ‘real-life’ situations. Using a model makes it easier to understand the complexities of the business world. The four main stages in the life cycle of a business are shown in figure 4.1.

**BizWORD**

The business life cycle refers to the stages of growth and development a business can experience.

**Figure 4.1** The four stages of the business life cycle. The graph shows a smooth line with sales increasing up to the post-maturity stage. In reality, the growth in sales will usually show minor increases and decreases within each stage. The line we have drawn is the average sales changes.
In each stage of the cycle a business is confronted with new challenges — as well as being presented with different opportunities. The nature, operation and organisation of the business changes as the business progresses from one stage to the next. As this occurs, the business owners need to constantly develop strategies to deal with its expansion. To do this successfully, owners must continually assess the business’s position on the life cycle. This is important, otherwise inappropriate strategies will be put in place and jeopardise the ‘life’ of the business. However, the reality is that it can often be difficult for owners to determine their position on the life cycle because they fail to recognise the changes taking place.

The owner’s personal preferences can have an effect on the business life cycle. Many small business owners are often satisfied to keep their businesses the same from year to year. They have no desire to expand. These owners are content with their lifestyle and see further expansion as a cause of concern and worry. As long as enough income is being generated, they are happy to have the business stay the way it is.

There is one very important difference between the human and business life cycles — with the business life cycle, there is no set time limit for each of the stages. For example, some businesses can reach maturity in a short period of time, whereas another business may take decades to move beyond the establishment stage.

Some businesses are able to constantly renew themselves over a long period of time. As they do so, they continually grow and expand, often becoming dominant within their specific market.

Some Australian businesses have also expanded to become global businesses. Often these businesses are forced to compete with foreign suppliers as well as attempting to sell their products overseas. The Australian company PaperlinX Limited, the world’s leading global fine paper seller and retailer of the Reflex brand, is an example of how one business has responded to these influences. Its diverse range of businesses distribute paper, sign and display materials and provide graphics solutions and industrial packaging to a wide range of customers in Australia, New Zealand and Asia, Europe and North America. PaperlinX, with its global headquarters in Melbourne, also operates regional management teams in Amsterdam and Los Angeles. Cardboard and paper products are bought in bulk from paper mills around the world and sold in smaller quantities and custom sizes to customers. It has operations spanning five continents and 27 countries, and employs approximately 6500 people. PaperlinX is now truly ‘global’ in the distribution of its operations, and derives approximately 75 per cent of its sales revenue from foreign transactions.

Occasionally businesses run into financial difficulty and are forced to restructure. Some of Australia’s large businesses, such as Coles, have followed this pattern (see the following Snapshot).
The life of Coles — a constantly renewed business

Consider the variety of stores located in your local shopping complex. There will probably be a Coles or Bi-Lo supermarket, a Kmart or Target variety store, and perhaps a Liquorland outlet or Officeworks shop. All of these businesses were once part of the Coles Group.

Coles: early beginnings

For almost one hundred years, Coles has had a rich history in Australia. Coles, one of Australia’s largest retailers, traces its origins back to a small business retailer.

The first G. J. Coles variety store was opened in Collingwood, Victoria, in 1914 by Mr GJ Coles and his brother Mr JS Coles. It employed six staff. A particular feature of the store’s pricing policy was that no item on sale would cost more than one shilling (equivalent to ten cents). Over the ensuing years both businesses expanded and prospered.

By the mid 1920s Coles had opened its Bourke Street, Melbourne, store. The business developed successful marketing strategies and offered a wide range of products that satisfied the tastes and preferences of their customers.

During the Great Depression of the 1930s Coles continued to grow. Sales increased as their products were offered at affordable prices to a large range of customers. Its success reflected the philosophy of its managing director of the time, Sir AW Coles, who wrote, ‘A store has no right to succeed just because it is open for business and has a bright display. The goods must reflect the wishes of the community in which the store is located.’

Post–World War II growth

After World War II, Coles consolidated its position within the Australian retail industry by acquiring a number of department, chain and grocery stores in other states.

- In 1960 Coles opened Australia’s first supermarket.
- In 1969 Coles established Australia’s first discount store, Kmart.
- By 1975 Coles, with 559 stores and 36 000 staff, became the first Australian retailer to achieve more than $1 billion of sales in a single year.
- In 1978 Coles became the second largest private employer of labour in Australia, with more than 50 000 employees.
- In 1982 Coles developed the discount store concept further: it opened its first Super Kmart store.

Coles–Myer merger

In 1985 Coles and Myer — a major retailer that had started in Melbourne in 1900 — merged to form one company — Coles Myer Limited. After the merger the business continued to grow, introducing new retailing strategies such as EFTPOS and Fly Buys, and developing a number of concept stores such as Officeworks and Harris Technology.

At its peak, Coles Myer Limited was Australia’s biggest retailer with 1900 stores throughout Australia and New Zealand, and was Australia’s largest single employer with 165 000 employees.

During the late 1990s and early 2000s, Coles Myer Limited encountered trading difficulties and was underperforming due to senior management difficulties, IT and supply problems, and too much of an overlap between each division, resulting in them competing for the same market share. For example, Target and Kmart attracted a similar type of customer, as did Myers and Grace Bros. (Myer bought Grace Bros Holding Limited in 1983.)
Wesfarmers Limited takeover

In 2006 the Coles Myer Limited board finally accepted that the mega-merger had failed and sold the Myer chain to a consortium led by private equity firm Texas Pacific Group Capital, with Blum Capital and the Myer Family Company Pty Ltd.

Following the de-merger, the Coles group continued to struggle against its main rival, Woolworths Limited. Its financial performance deteriorated with a resultant fall in profits. It was ripe for a takeover (acquisition), which occurred in late 2007 when the Perth-based conglomerate Wesfarmers — one of Australia’s largest public companies — paid $22 billion to buy the Coles retail empire. At the time, this was the largest takeover in Australian history.

Over the past few years, Wesfarmers Limited has been successful in turning around the performance of the Coles division, largely due to improvements in the performance of Target and the Coles supermarket chain. It has streamlined the supermarket division by selling 45 Coles stores and eight Liquorland outlets to the independent grocer FoodWorks for $35 million. The sale was part of Wesfarmer’s five-year plan to improve its network of over 700 supermarkets and more than 600 Liquorland stores.

Today, Coles is a leader in Australian food retailing, with more than 100,000 employees and over 11 million customer transactions a week.

Snapshot questions

1. Identify the main reasons for the success of Coles up to the 1920s.
2. Many businesses failed during the 1930s Great Depression. Clarify why Coles was able to not only survive but prosper.
3. Describe the term ‘merger’.
4. (a) Outline what new (i) retail strategies and (ii) concept stores were introduced after the merger with Myer. (b) Propose the reasons for the introduction of these changes.
5. State the main reasons for the merged company’s underperformance.
6. Describe the term ‘takeover’ (acquisition).
7. Outline the strategies Wesfarmers Limited used to improve the performance of Coles.
8. Use the Wesfarmers Limited weblink in your eBookPLUS and access the Wesfarmers Limited group structure. Explain the benefit for Wesfarmers in having such a diversified range of business operations.

Summary

- The business life cycle refers to the stages of growth and development a business can experience.
- The stages are: establishment, growth, maturity and post-maturity.
- In each stage of the cycle, a business is confronted with new challenges and presented with different opportunities.

Revision

1. Examine figure 4.1 (page 88) and then answer the following questions. (a) Identify the four stages of the business life cycle. (b) Propose why the size of a business is directly related to the amount of sales.
2. Figure 4.1 is referred to as a model. Explain how using models can help our understanding of the real world.
3. State why it is important for business owners to assess the business’s position on the life cycle.
4. Explain why PaperlinX is considered a ‘global’ business.
Each stage of the business life cycle has its own special features and challenges. This section will examine the main features of each stage before considering the challenges experienced at each stage. This information will be presented in a table format to help you to compare and contrast the different stages. We will also follow the progression of Antonia Kirsner’s Kwik Print business and observe how her business changes as it travels along the business life cycle.

**Establishment stage**

The first stage in the life of a business is its birth — or establishment. Like human babies, recently established businesses are also vulnerable as their hold on ‘life’ is quite precarious. The overriding concern is to get the business on a solid foundation. This requires enough sales to be generated to bring in the much needed income, which will be used to pay expenses and to generate a positive cash flow.

Detailed planning undertaken when establishing the business can help greatly reduce the risk of failing and becoming just another business failure statistic. (Business planning will be examined in detail in later chapters.)

**TABLE 4.1 Establishment stage: main features and associated challenges**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative names</td>
<td>Start-up, birth, beginning, commencement</td>
</tr>
<tr>
<td>Goals</td>
<td>Survival, and setting a firm foundation for future growth</td>
</tr>
<tr>
<td>Sales</td>
<td>Normally begin slowly and are somewhat erratic</td>
</tr>
<tr>
<td>Marketing</td>
<td>Highlight product advantages by accentuating the product’s strengths. Undertake inexpensive promotion strategies</td>
</tr>
<tr>
<td>Profit</td>
<td>Usually slow to begin with, occasionally a loss. Sometimes all the profits are put back into the business to ensure its survival.</td>
</tr>
<tr>
<td>Feature</td>
<td>Challenges</td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Financial management</td>
<td>Greatest source of start-up capital is from the owner’s personal savings. This can be supplemented with a loan from a financial institution, although such finance is often difficult to obtain because of the high risks involved.</td>
</tr>
<tr>
<td>Cash flow</td>
<td>Sometimes erratic, with a period of constant cash outflow in the early stages.</td>
</tr>
<tr>
<td>Costs</td>
<td>Very high fixed costs. Major cost items include premises, equipment, raw materials and insurance.</td>
</tr>
<tr>
<td>Customers</td>
<td>Establishing a customer base large enough to sustain future viability is important. Need to develop a positive relationship with customers. Attempt to accurately forecast customers’ needs.</td>
</tr>
<tr>
<td>Management</td>
<td>Informal, with all decisions being made by just one or two people. Decisions are often made ‘on the run’.</td>
</tr>
<tr>
<td>Employees</td>
<td>Normally only a few. Owner establishing work routines and building up relationships</td>
</tr>
<tr>
<td>Failure rate</td>
<td>Very high, up to 33 per cent within the first year of trading.</td>
</tr>
<tr>
<td>Main problems</td>
<td>Lack of money with possible cash flow shortages</td>
</tr>
<tr>
<td>Risk level</td>
<td>Extremely high, especially within the first few months. High degree of uncertainty</td>
</tr>
<tr>
<td>Business entity</td>
<td>Usually sole trader or partnership</td>
</tr>
</tbody>
</table>

**Kirsner’s Kwik Print — establishment stage**

Antonia Kirsner had a good understanding of what was required to own and operate a small printing business. For the past 18 years she had been production manager at Goldtype Printing and Stamps. With 12 people to supervise and a yearly sales turnover of approximately $2 million, she enjoyed the responsibility and challenge of her job. It was this feeling that led her to contemplate establishing her own printing business.

After completing some market research and preparing a comprehensive business plan, Antonia was ready to start out on her own.

On Wednesday, 1 September, she opened Kirsner’s Kwik Print.

During her first 12 months of business as a sole trader, Antonia’s sales and profits steadily increased.

Her business soon began to acquire a reputation for excellent service, with high-quality printing at competitive prices.

Antonia liked operating as a sole trader. It meant she made all the decisions and kept any profit. However, the one aspect of being a sole trader that most excited her was that she had complete control over the business’s future direction. Antonia was aware though of the main danger facing her as a sole trader — unlimited liability. This meant she would be personally responsible for the debts of the business and could be forced to sell some of her personal assets to repay the business’s debts.

Over the next three years Antonia’s business gradually expanded. Five employees had been hired, the printing room had been extended and two new photocopiers purchased. Over the same period, the number of regular customers had increased by 57 per cent, sales rose by 32 per cent and, as a result, the gross profit was up 26 per cent.

Antonia’s skills and experiences had put the business on a firm foundation. She believed the business had succeeded because of the business plan that she originally developed and had modified over time.

(continued)
Summary

- The main challenge at the establishment stage is to get the business on a solid foundation by generating enough sales to create a positive cash flow.
- Detailed planning can help greatly reduce the risk of failing.
- Small businesses, such as a sole trader or partnership, have unlimited liability: when the business owner is personally responsible for all the debts of his or her business.

Growth stage

The second stage is a time of accelerating growth. Sales increase and the cash flow is normally positive. A customer base has been established with regular clients accounting for a large percentage of total sales. The business undertakes the development of new products to satisfy different market segments. More emphasis is placed on marketing and the use of complex computerised accounting procedures. In family-owned businesses, other members of the family usually take up specialised supervisory and management roles. The business has somewhere between 10 and 15 employees. Loyalty to the business is strong, with many of these businesses taking on the culture of an extended family. The business has a good reputation in the community, and owners develop a sense of pride in the products and personal service on which the business has built and flourished. However, with growth comes complexity, responsibility and the need for long-term planning.

The main features and associated challenges of the growth stage are outlined in table 4.2.

**TABLE 4.2 Growth stage: main features and associated challenges**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative names</td>
<td>Take-off, growth spurt</td>
</tr>
<tr>
<td>Goals</td>
<td>To constantly increase the average level of sales; to continue growing through mergers and takeovers; to diversify business activities</td>
</tr>
<tr>
<td>Sales</td>
<td>Rapid increase, especially in the early stages of the growth phase. New products introduced and some slow-selling products deleted</td>
</tr>
<tr>
<td>Marketing</td>
<td>Development of new products to satisfy market niches. Price discounts due to lower production costs. Extensive promotional activities and a widening distribution network. Desire to increase market share by using mass-marketing techniques</td>
</tr>
<tr>
<td>Profit</td>
<td>Should increase due to rising sales and falling production costs. As well, profits of other businesses acquired through acquisition (takeover) or merger are available for use.</td>
</tr>
</tbody>
</table>
eLesson:

Business growth and expansion

Carrie Felton's home-based business has become so big she shares it with her family and 17 employees — and it shows no signs of slowing.

Feature Challenges

Financial management Use of sophisticated, computerised accounting procedures and systems. Raising of finance tends to be easier. Main sources of finances are from financial institutions, the selling of shares or taking on more partners.

Cash flow Difficulties can be experienced if the growth is too rapid. Adequate cash flow must be maintained to continue expansion. A credit policy needs to be organised. Forecasting of sales and expenditures becomes more crucial.

Costs Production costs tend to decrease due to economies of scale — that is, cheaper unit costs due to larger production runs. Business becomes more efficient in areas of administration, finance and production.

Customers Concentration on satisfying existing customer base while at the same time tapping into new market, both domestic and overseas. Mass markets become a possibility.

Management Delegation of some responsibilities. Development of a formalised organisational structure. Introduction of line managers (supervisors). Clear lines of communication become essential. Specialist departments are established. Some functions may be outsourced.

Employees Increased specialisation of workforce requiring formal and informal training. Human resource strategies need to be implemented, especially in compiling job analyses and descriptions.

Failure rate Lessened, especially after successful mergers or takeovers, which result in increased diversification and reduced competition

Main problems Expanding too rapidly and therefore losing control of the business’s direction. Moving away from the core business activities — that is, what the business originally produced. Business may not have enough experience in the new areas. The need for finance to continue with the growth

Risk level Reduced, due to diversification and less competition. However, if borrowings increased too rapidly the business may leave itself exposed — that is, with liabilities far greater than its assets.

Business entity Usually some form of incorporated entity; private or public company

Kirsner and Bartlett: Kwik as a Flash Printing — growth stage

Antonia's business had continued on its growth path. Sales, turnover and profit had increased every year for the last five years. The business was performing above her expectations. However, Antonia's success soon attracted competition from two other printing businesses. Antonia considered this problem carefully. She came to the conclusion that she had two options: either buy out the competitors, which would require a great deal of money, or offer a service that was different from that of the other printers.

At this time she met an old friend, Guy Bartlett, who was a computer programmer. Antonia explained her problem to him and he agreed to help her by developing a computer-designed digital imaging system that could produce holograms on any (continued)
“One of the most challenging aspects of this growth had been the recruitment and selection of highly qualified managers...”

Mergers and acquisitions (takeovers)

During the growth stage the business must continually improve its competitive edge. Failure to do so will see competitors take away customers and the growth will stall. Owners tread a fine line in attempting to do this — a desire not to radically alter a successful formula while at the same time restructuring sufficiently to match what the competitors are doing.

Business growth and expansion can occur in a number of ways. One method frequently used is to integrate with other businesses through a merger or an acquisitions (takeover) (see figure 4.4).

![Diagram of business growth and expansion]

**FIGURE 4.4 Methods of business expansion: merger and acquisition (takeover)**
A **merger** occurs when the owners of two separate businesses agree to combine their resources and form a new organisation. An **acquisition** (takeover) occurs when one business takes control of another business by purchasing a controlling interest in it.

Sometimes a merger or acquisition is motivated by the desire for a business to continually expand its range of products. No product will last forever; eventually, it will become obsolete. A merger or acquisition is often an effective way a company can quickly increase its range of products. At other times, a merger or acquisition is undertaken to eliminate competition in the marketplace.

**Types of mergers and takeovers — integration and diversification**

There are several different types of mergers or acquisitions. Three types are described below.

- **Vertical integration** occurs when a business expands at different but related levels in the production and marketing of a product.
  
  When a business integrates with one of its suppliers this is referred to as backward vertical integration; for example, if a bakery acquires a wheat farm. Forward vertical integration is when a business integrates with a firm it sells to. For example, the bakery could merge with a supermarket chain that sells its bread (see figure 4.5).

![Diagram of Types of Integration](image.png)

**FIGURE 4.5** Types of integration: backward and forward vertical integration, horizontal integration and diversification

---

** BizWORD **

A **merger** occurs when the owners of two separate businesses agree to combine their resources and form a new organisation.

An **acquisition** (takeover) occurs when one business takes control of another business by purchasing a controlling interest in it.

** Vertical integration ** occurs when a business expands at different but related levels in the production and marketing of a product.
Horizontal integration occurs when a business acquires or merges with another firm that makes and sells similar products; for example, if a bakery merges with or is acquired by another bakery (see figure 4.4).

Diversification (or conglomerate integration) occurs when a business acquires or merges with a business in a completely unrelated industry. For example, diversification occurs if a bakery merges with a furniture manufacturer (see figure 4.4).

Summary

- During the growth stage the business has increased sales, a regular customer base, develops new products and improves its cash flow.
- With growth comes complexity and responsibility, which creates the need for long-term planning.
- Growth and expansion can occur either through a merger or acquisition (takeover).
- A merger occurs when the owners of two separate businesses agree to combine their resources and form a new organisation.
- An acquisition (takeover) occurs when one business takes control of another business by purchasing a controlling interest in it.
- Vertical integration occurs when a business expands at different but related levels in the production and marketing of a product.
- Horizontal integration occurs when a business acquires or merges with another firm that makes and sells similar products.
- Diversification (or conglomerate integration) occurs when a business acquires or merges with a business in a completely unrelated industry.

Revision

1. **Explain** why generating a positive cash flow is crucial for the survival of a business at the establishment stage.
2. **Examine** table 4.1 (page 92). **Construct** a mind map to show the main features of a business at the establishment stage.
3. One-third of all small businesses fail within the first year of operation. **Propose** why the failure rate is so high.
4. **Outline** three challenges that you believe to be the most serious for a business to confront while at the establishment stage. **Justify** your selection.
5. **Clarify** why the growth stage can be a difficult stage to manage effectively.
6. **Examine** table 4.2 (page 94). **Construct** a concept map to show the main features of a business at the growth stage.
7. **Outline** three challenges that you believe to be the most serious for a business to confront at the growth stage. **Justify** your selection.
8. **State** what often motivates businesses to merge or make acquisitions.
9. You are the owner of Elite Furniture, a business that makes specialty furniture. **Construct** a diagram to show how your business could expand using:
   (a) vertical (backward) integration
   (b) vertical (forward) integration
   (c) horizontal integration
   (d) diversification/conglomerate integration.

Extension

1. Arrange an interview with a local business owner. **Create** a two-page written or five-minute oral report. You might wish to develop your report under the following headings:
This third stage of the business life cycle presents unique challenges to the owner. It requires a great deal of rethinking about how the business should be operated to guarantee survival. At this time, the owner realises that the business could easily lose the energy, enthusiasm and vitality of its earlier times. A sense of complacency often envelops the business, affecting both management and staff. What is now required is a more formal, professional approach to planning.

With such a realisation may come the need to completely restructure and reorganise the business, which can sometimes be quite a painful experience. The business might lose its ‘family’ atmosphere and be replaced with a more clinical, professional culture. The size of the business dictates a more formal organisational structure. The difficulty is to introduce these changes without destroying the entrepreneurial spirit that laid the foundation for the business’s success.

However, as figure 4.1 reveals (page 88), sales are still increasing but at a slower rate. The growth stage has slowed down. This is an early warning signal of imminent danger — possible decline. The main features and associated challenges of the maturity stage are outlined in table 4.3.

**Maturity stage**

(Maturity stage: main features and associated challenges)

<table>
<thead>
<tr>
<th>Feature</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative names</td>
<td>Market saturation, market hardening</td>
</tr>
<tr>
<td>Goals</td>
<td>To maintain profits at pre-existing levels</td>
</tr>
<tr>
<td>Sales</td>
<td>Rate of growth slows and eventually flattens out; plateauing.</td>
</tr>
<tr>
<td>Marketing</td>
<td>Maintain customer and brand loyalty through extensive advertising. Due to increased competition, relative market share may decline. Need to improve quality of products</td>
</tr>
<tr>
<td>Profit</td>
<td>Rate of growth slows, eventually flattening out. Reflects what is happening to the level of sales</td>
</tr>
<tr>
<td>Financial management</td>
<td>All the correct procedures are in place, but their efficiency needs to be improved to protect the profit margin. Finances should be devoted to advertising and development of new products.</td>
</tr>
<tr>
<td>Cash flow</td>
<td>If costs are not able to be controlled, then the cash flow position starts to deteriorate.</td>
</tr>
<tr>
<td>Costs</td>
<td>Keeping costs under control is now essential. Need to improve efficiency to keep costs down, otherwise profits will start to fall even further</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>Feature</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Due to the size of the business, customers may sense a degree of impersonality. Business is in danger of losing the personalised service that gave the business success in previous stages.</td>
</tr>
<tr>
<td>Management</td>
<td>Leadership is crucial. Need to redefine the business’s objectives and vision. The organisation’s hierarchy becomes too entrenched and unable to quickly adapt to new conditions. Many new regulations and ‘red tape’ that will strangle any initiative</td>
</tr>
<tr>
<td>Employees</td>
<td>Introduce a work team approach, devolving responsibility to employees to avoid complacency. Introduce quality programs such as total quality management or quality circles.</td>
</tr>
<tr>
<td>Failure rate</td>
<td>Will increase the longer the business takes to react and reverse plateauing sales.</td>
</tr>
<tr>
<td>Main problems</td>
<td>Rate of increase in sales begins to falter, sometimes flattening out. Loss of initial enthusiasm. Air of complacency starts to dominate.</td>
</tr>
<tr>
<td>Risk level</td>
<td>If costs are not controlled and management becomes slow to respond to market demand, then cash flow falls and the level of risk increases.</td>
</tr>
<tr>
<td>Business entity</td>
<td>Normally, no change in the beginning although, if the situation deteriorates, parts of the business may be sold off. Program of downsizing and selling off non-core business activities</td>
</tr>
</tbody>
</table>

**Kwik Printing Pty Ltd — maturity stage**

Renamed Kwik Printing Pty Ltd, the company had undergone dramatic growth over the last eight years. It was now a diversified business with interests in printing, retail, tourism and financial services.

While Antonia and Guy were satisfied with the levels of sales, a disturbing trend had been noticeable for the last 15 months. The rate of increase in sales had been slowing, and in the last six months the level of sales had begun to plateau. Three of their main businesses had started losing some of their long-term customers. Talking to their suppliers, Antonia and Guy discovered their competitors had begun an aggressive marketing campaign to attract some of Kwik Printing’s established customers. As well, the market was reaching near saturation — gaining new customers would prove extremely difficult and expensive. Guy, because of his technical experience, was also aware their printing businesses had not kept up with new technological developments. This had led to some customers switching to their competitors.

These factors resulted in the cash flow deteriorating. Their finance manager advised them that the business had to adopt a plan to restructure some of the stock controls in order to decrease costs. To achieve this, the production of low turnover products was to be axed and more emphasis was to be placed on achieving greater efficiencies and cost savings. If these cost reductions could not be achieved within the next three months, the finance manager recommended that staff retrenchments would be necessary.

The marketing manager decided to redesign the business’s marketing strategies in order to identify new, untapped markets, while at the same time maintaining existing customer loyalty.
The market was reaching near saturation — gaining new customers would prove extremely difficult and expensive.

Summary

- The maturity stage requires a more professional approach to planning.
- The business introduces a more formal organisational structure.
- Sales increase at the maturity stage, but at a slower rate; an early warning sign of possible decline.

Post-maturity stage

Once a business reaches this, the final stage, it is faced with three possible outcomes, these being:

1. **Steady state** — to keep the business operating at the level it has been during the maturity phase
2. **Decline** — falling sales and profits ultimately resulting in business failure
3. **Renewal** — increasing sales and profits due to new growth areas.

The post-maturity stage represents many opportunities but also many threats. The decisions made by the owner will be crucial for the future survival of the business. By constantly monitoring the business environment, the business owner should be able to select the most appropriate path for the business to take.

Steady state

A business in a steady state is neither declining nor expanding. It is much like an aeroplane flying in a holding pattern. Such a business is satisfying customer demand and maintaining profit levels. It displays some of the characteristics of a business in the maturity stage. One significant difference, however, is that it does not continue expenditure on research and development. The owner is more content to produce what it has in the past and rely on marketing replacement products.

However, just as an aeroplane cannot maintain this position forever, neither can a business. Eventually the business environment will change and the business will be adversely affected. Perhaps customers’ tastes change or new competitors enter the market with superior products, or more efficient methods of production and cheaper products. Ultimately, this steady state becomes very unstable and the business stagnates. It eventually loses sales and its competitive edge. When this occurs, the business enters another stage of the business life cycle — decline.

Decline

As customers stop buying the business’s products the cash flow will be seriously affected. Eventually profits will also decline. This process of decline becomes difficult to reverse for the following reasons:
1. It becomes difficult to borrow money because financial institutions are reluctant to lend money to high-risk businesses.
2. Suppliers will restrict their credit facilities and may insist on cash payments.
3. Products become obsolete, leaving the business with unsold stock.
4. Well-qualified employees may begin to leave and seek better opportunities.

The longer the business attempts to ‘stagger on’, lurching from one crisis to the next, the greater the risk of failing and ceasing operations — cessation. We will examine the procedures involved in voluntary and involuntary cessation at the end of this chapter.

Renewal

Business decline can be avoided by carefully planned strategies that result in new markets being tapped and satisfying previously unmet demand. The business undergoes a revival. Sales, cash flow and profits all begin to increase once again. Even a business in decline can be turned around and placed on a path of renewal. It is very difficult to accomplish and takes an enormous effort by both owners and employees, but it is possible.

The key to achieving a long-term, sustainable recovery in sales is to focus production on what the customers are presently demanding — even if this means abandoning once-successful products. As well, an extensive market research program needs to be undertaken to assist in the forecasting of future consumer trends. The more successful the forecasting, the more able the business is to be proactive; that is, it can anticipate and plan for future changes. Businesses that tend to be reactive; that is, respond to changes after they have occurred, usually respond too late and lose valuable market share. Renewal is as much about planning and timing as it is about successful marketing strategies.

The main features and associated challenges of the post-maturity stage of renewal are outlined in table 4.4.

**TABLE 4.4** Post-maturity stage — renewal. Main features and associated challenges

<table>
<thead>
<tr>
<th>Feature</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative names</td>
<td>Regeneration, revival</td>
</tr>
<tr>
<td>Goals</td>
<td>To increase sales, cash flow and profits. Seek out and exploit previously unmet demand in new markets. Undertake further diversification and integration. Sell off any unprofitable non-core-related activities or assets.</td>
</tr>
<tr>
<td>Sales</td>
<td>Increase over time, especially as newer products are brought onto the market and new markets explored</td>
</tr>
<tr>
<td>Marketing</td>
<td>Conduct market research analysis to determine customers’ wants and identify any changes. Advertise in new market areas. Identify new market niches.</td>
</tr>
<tr>
<td>Profit</td>
<td>Will improve over the long term, reaching higher levels than previously achieved</td>
</tr>
<tr>
<td>Financial management</td>
<td>May need to issue new shares to raise finance to assist with research and development</td>
</tr>
<tr>
<td>Cash flow</td>
<td>May decline in the short term as money is spent on research and development of new products and markets</td>
</tr>
<tr>
<td>Costs</td>
<td>Research and development, marketing, integration, and restructuring costs will be high in the short term.</td>
</tr>
<tr>
<td>Feature</td>
<td>Challenges</td>
</tr>
<tr>
<td>---------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Customers</td>
<td>New markets exploited; explore possibility of exporting</td>
</tr>
<tr>
<td>Management</td>
<td>Implement an organisational development program to realign the objectives, vision statement and organisational structure so it fits in with the new environment.</td>
</tr>
<tr>
<td>Employees</td>
<td>Open and honest communication is essential. Employees need to be fully aware of where the business is headed, how the new goals are to be achieved and how individual jobs may be affected. Need to overcome possible resistance to change</td>
</tr>
<tr>
<td>Failure rate</td>
<td>Has been lessened compared to the maintaining or steady state phase</td>
</tr>
<tr>
<td>Main problems</td>
<td>Anticipated sales may not eventuate due to inaccurate forecasts, poor timing or inappropriate marketing strategies. Initial costs are high, with cash flow shortfalls in the short term. Employees may become disenchanted with the restructuring and having to adapt to constant change.</td>
</tr>
<tr>
<td>Risk level</td>
<td>Undertaking any new strategy involves some degree of risk. Risk minimisation techniques can help reduce the exposure to risk.</td>
</tr>
</tbody>
</table>

### Kwik Prints Limited: Post-maturity stage — renewal

Five years had passed since Antonia and Guy decided to float their business on the stock exchange to become a public company. They had decided to do this because the business’s growth had been held back due to the difficulties experienced in raising finance.

During the sixth annual general meeting of Kwik Prints Limited shareholders, Antonia, now chairperson of the board of directors, was asked why the company’s profits, though high, had been stagnant two years in a row. Antonia was well aware of the reason for the question. She knew that any business that became satisfied with a steady state mentality was on a course of stagnation and eventual decline. Antonia informed the shareholder that this was an issue she would raise at the next board meeting.

At the next meeting there was general agreement that the business needed to begin planning for renewal if profits were to increase in the future. Over the next six months, a number of strategies were formulated and evaluated. Eventually, the board had to choose from three main renewal plans:

1. the selling off, divesting, of low or unprofitable non-core business activities
2. investigating the possibility of entering previously untapped overseas markets and adopting an export-oriented workplace culture
3. a complete restructure of the company, both operations and staffing.

After four months, the board decided the most appropriate renewal strategy that would achieve the goal of increased profits would be to enter previously untapped overseas markets, concentrating on the United States of America, Indonesia, Thailand and Malaysia.

Kayako Sumi, the marketing manager, visited a number of potential customers and established a working relationship with them. On her return, Kayako informed the board that she had signed a total of eight sales agreements with the possibility of entering into a joint venture with the Unitech Graphics Company of America. These developments greatly pleased the board — if successful, sales, profits and shareholders’ dividends would all increase. The company would enter into a new phase of growth.

(continued)
There are three possible outcomes at the post-maturity stage: steady state, decline or renewal.

- Steady state: the business is neither declining nor expanding
- Decline: fall in sales, cash flow and eventual business failure
- Renewal: new products are developed and new markets are created, leading to increased sales and a positive cash flow.

**Snapshot question**

Create two case study stories detailing what could happen to the business over the next five years. The first case study will be based on the assumption that the business will succeed in its renewal program. The second story will assume that the renewal program will fail.

**Summary**

- There are three possible outcomes at the post-maturity stage: steady state, decline or renewal.
- Steady state: the business is neither declining nor expanding
- Decline: fall in sales, cash flow and eventual business failure
- Renewal: new products are developed and new markets are created, leading to increased sales and a positive cash flow.

**Revision**

1. Clarify why you think business owners and staff may become complacent in the maturity stage of the business life cycle.
2. Construct a concept map to show the main features of a business that is in the maturity stage.
3. Outline three challenges that you believe to be the most serious for a business to confront at the maturity stage. Justify your selection.
4. Explain why a business might need to restructure in the maturity stage.
5. Demonstrate how you could tell whether a business is in the:
   (a) steady state stage of the maturity stage
   (b) decline stage of the maturity stage.
6. Construct a concept map showing the main features of a business that is undergoing renewal.
7. Outline three challenges that you believe to be the most serious for a business to confront at the renewal stage. Justify your selection.
8. Recall the key to achieving a long-term, sustainable recovery in sales in the renewal stage.
9. Calculate at which stage of the business life cycle you think the business has to undergo the most radical change. Provide reasons to support your answer. Compare your answer with other members of the class.
10. Use the NSW Government’s Small Business weblink in your eBookPLUS to answer the following questions.
    (a) Clarify why you think the government provides this information.
    (b) After viewing the introductory video, select an area that interests you and evaluate the information presented.
11. Complete this exercise by placing the appropriate letter in the space provided. Choose from the letters: A = Establishment, B = Growth, C = Maturity and D = Post-maturity. The first question has been done for you.
    (a) ____ A ____ Selecting a suitable location to commence trading
    (b) ____ B ____ Sales increase, but at a decreasing rate.
    (c) ____ C ____ Establishing a customer base
    (d) ____ D ____ Renewal may involve a merger or takeover.
    (e) ____ E ____ It is sometimes difficult to keep up with the demand for the product.
    (f) ____ F ____ If there is no improvement in sales then voluntary cessation is an option.
    (g) ____ G ____ The business owner may become complacent.
    (h) ____ H ____ It is in this stage that many businesses fail.
Business decline (and possible) failure is not usually caused by just one single factor but rather a combination of several. Factors such as an ill-conceived business idea, failure to meet customers’ needs, producing a product that few people want, not preparing a business plan, ignorance of existing competition and lack of management skills could all contribute to a business’s failure.

However, two main causes of business decline, particularly of SMEs, are:

1. **Lack of management expertise.** When a business either fails to prepare a business plan or fails to keep on modifying an existing plan as the environment changes, the stage is set for imminent failure. It is this situation that gives rise to the often-quoted saying: ‘Businesses don’t plan to fail, they fail to plan.’

2. **Lack of sufficient money** — *undercapitalisation*. Many small businesses start out on a ‘shoestring’ budget. Without sufficient capital and a positive cash flow the business will not be able to purchase stock and materials. This inevitably results in lost sales and falling profits.

### 4.3 Factors that can contribute to business decline

Business decline (and possible) failure is not usually caused by just one single factor but rather a combination of several. Factors such as an ill-conceived business idea, failure to meet customers’ needs, producing a product that few people want, not preparing a business plan, ignorance of existing competition and lack of management skills could all contribute to a business’s failure.

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### Avoid business failure: manage the cash flow

Cash is the lifeblood of the business. If the cash flowing into a business is greater than the cash flowing out, then the business can continue to operate. But if the cash flowing out is greater than the cash flowing in, then the business will eventually run out of money and be forced to close. Even if the cash shortfall is only for a brief period, it can lead to business problems. SMEs are especially susceptible to cash flow difficulties because they usually do not have adequate cash in reserve.

One way a business can predict if it is able to meet its financial commitments, as and when they arise, is to monitor the cash flow.

In 2008, the world economy experienced a global financial crisis, which inevitably led to a reduction in consumer spending in the Australian economy. Smart small business owners, such as Kelly Baker, founder and managing director...
of Edible Blooms, learnt the importance of managing her cash flow during this difficult period.

Kelly put in place an operating system that linked orders to her accounting system. This allowed her to forecast her cash flow needs, especially during the busy Christmas period. Kelly recognised that the success of her business relies largely on her ability to monitor the cash flow needs in order to have adequate cash flowing through the business in both the good and the bad times. Kelly’s astute business practices were recognised when she won the 2009 MYOB Small Business of the Year as part of the Telstra Business Awards (see the following Snapshot).

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**Gifts retailer Edible Blooms wins 2009 MYOB Small Business of the Year**

Offering a twist on the usual flowers and gifts, the unique business specialises in edible bouquets made of chocolate, fresh fruit, cookies and even beer and champagne. It has seen extraordinary growth, expanding from one owner-operated location to a national production and delivery network, and one of the busiest flower and gift websites in Australia since opening in 2005.

Early challenges such as server crashes and technological investment paved the way for strong systems and a tight team mentality, which proved a great platform for expansion. Current plans include entry into European and Asian markets, with the company aiming to become a recognised employer of choice.

Founder and Managing Director of Edible Blooms, Kelly Baker, was ecstatic with the win. ‘We brought our whole team to Sydney and planned to celebrate no matter the outcome. But the win is just amazing. It will really help us take Edible Blooms to the next level’, she said.

Baker came up with the delicious concept in 2005, with a small starting gift range of nine fresh fruit bouquets, including Belgian chocolate dipped strawberries, but had her share of naysayers. ‘Banks didn’t want to finance the project and it was hard finding a landlord to take on our first premises’, Baker tells. Instead she invested her life savings in the business and now without the burden of debt is flying high amidst the global financial crisis.

Baker credits the company’s success to the loyalty customers have to the brand due to their stringent customer service, high-quality product offering and value for money. The company offers same day delivery to major capital cities, with over 100 ‘blooms’ currently available at www.edibleblooms.com.

**Snapshot questions**

1. **Identify** Edible Blooms’ main products.
2. **Outline** the challenges Edible Blooms’ faced in its establishment stage.
3. **Clarify** why these challenges ‘paved the way for strong systems and a tight team mentality’.
4. (a) **Explain** how Kelly financed her business in the establishment stage.
   (b) **Propose** why banks were reluctant to offer her finance to start the business.
5. **Summarise** why Kelly believes the company is successful.
6. **Calculate** what stage of the business life cycle Edible Blooms is currently in. Give reasons for your answer.
4.4 Voluntary and involuntary cessation

As mentioned in chapter 1, the world of business is one of activity, challenges, excitement, change and rewards. Many people are attracted to such a world. They have dreams, make plans, are enthusiastic and optimistic. Because the majority of businesses are classified as small, they often reflect the character, skills and personalities of their individual owners.

Whether a business succeeds or fails depends largely on the owner’s abilities, resources, enthusiasm, initiatives and level of management expertise.

A business may cease operating, either voluntarily or involuntarily. The difference between the two depends on who instigates the process (see figure 4.8 below).

**FIGURE 4.7** Whether a business succeeds or fails depends largely on the owner’s abilities, resources, enthusiasm, initiatives and level of management expertise.

**FIGURE 4.8** Cessation of business — voluntary or involuntary
A business may cease operations and voluntarily wind up its affairs. Any assets owned by the business are sold. The business stops operating because the owner may wish to retire, wants a change of lifestyle or, in the case of a sole trader, has died. However, most businesses cease to trade due to business failure. With debts increasing and a negative cash flow, a business owner will soon realise if their business is underperforming. To prevent this accumulation of debt, the owner will need to cease operating the business of their own accord; that is, undergo voluntary cessation.

Many businesses, however, finish involuntarily. The owner is forced to cease trading by the creditors of the business; that is, undergo involuntary cessation. Creditors are those people or businesses who are owed money.

Even though a business appears to be in financial difficulty, many owners continue operating in the hope that ‘things will get better’. In many cases they do not. As the business continues its decline, creditors become worried about the money they are owed and force the business owner into winding up the business.

Figure 4.9 displays the different methods available to wind up a business.

Voluntary cessation

Voluntary cessation occurs when the owner ceases to operate the business of their own accord.

Involuntary cessation

Involuntary cessation occurs when the owner is forced to cease trading by the creditors of the business.

Creditors are those people or businesses who are owed money.

Bankruptcy

Bankruptcy is a declaration that a business or person is unable to pay his or her debts.

Sole traders (businesses owned and operated by one person) and partnerships (businesses owned and operated by two to 20 people) may end up being declared bankrupt. Bankruptcy is a declaration that a business, or person, is unable to pay his or her debts.
Bankruptcy can be either voluntary or involuntary, with either the business owner or a creditor applying to a court for a bankruptcy order to be made. The court then appoints a representative to collect any money owed to the business. This money, along with money raised from the sale of any assets of the business (as well as some personal assets of the owner), is then divided between the creditors. The process of converting the assets of a business into cash is called realisation.

**Voluntary administration**
When a company is experiencing financial difficulties, it can be placed in voluntary administration.

Voluntary administration occurs when an independent administrator is appointed to operate the business in the hope of trading out of the present financial problems. The administrator usually has the combined experiences of a receiver, chartered accountant and investigator. The administrator's main tasks are to bring the business and its creditors together, and examine the financial affairs of the business.

Appointing a voluntary administrator is becoming an increasingly attractive alternative, especially to small business owners. If successful, the business may resume normal trading. If unsuccessful, the business goes into liquidation.

**Liquidation**
If a company is in financial difficulty, its shareholders, creditors or the court can put the company into liquidation. Liquidation, commonly referred to as winding up a company, occurs when an independent and suitably qualified person – the liquidator – is appointed to take control of the business with the intention of selling all the company’s assets in an orderly and fair way in order to pay the creditors. Once the creditors have been paid, any surplus cash is paid to the owners of the company.

A company in liquidation can also be in receivership. Receivership is where a business has a receiver appointed by creditors or the Courts to take charge of the affairs of the business. Unlike liquidation, though, the business may not necessarily be wound up.

**BizWORD**

Realisation is the process of converting the assets of a business into cash.

**BizWORD**

Voluntary administration occurs when an independent administrator is appointed to operate the business in the hope of trading out of the present financial problems.

**BizWORD**

Liquidation occurs when an independent and suitably qualified person – the liquidator – is appointed to take control of the business with the intention of selling all the company’s assets in an orderly and fair way in order to pay the creditors. Receivership is where a business has a receiver take charge of the affairs of the business. Unlike liquidation, the business may not necessarily be wound up.

**FIGURE 4.10** Up to 33 per cent of all small businesses fail within the first year of being established; this rises to an alarming 75 per cent after five years.
The main features of liquidation are that it:
• can be regarded as the equivalent of bankruptcy for a company (corporation)
• results in the life of a company coming to an end
• normally occurs because the company is unable to pay its debts as and when they fall due – it has become insolvent.

There are two types of insolvent liquidation:
1. Creditors’ (voluntary) liquidation. This is the most common type of liquidation process and can come about in one of two ways. The first method involves creditors voting for liquidation following a voluntary administration. The second method involves the company’s shareholders agreeing to liquidate the company and appoint a liquidator.
2. Court (involuntary) liquidation. In this situation a court appoints a liquidator to wind up the company, usually after an application has been made from either a creditor, a shareholder, a company director or, in some circumstances, the Australian Securities and Investments Commission (ASIC).

When a company is being liquidated because it is insolvent, the liquidator’s prime responsibility is to the company’s creditors. The liquidator’s main functions are to:
• take possession of and realise – convert into cash – the company’s assets
• investigate and report to creditors about the company’s financial and related business affairs
• determine debts owed by the company and pay the company’s creditors
• scrutinise the reasons for the company failure
• report possible offences by people involved with the company to ASIC
• finally, to deregister or dissolve the company.
A liquidator is not required to do any work unless there are enough assets to pay their costs.

Problems for stakeholders due to liquidation

Every year hundreds of Australian companies are placed into liquidation, hence creating a number of problems for the various stakeholders of the business. The full effect of a company being liquidated can be likened to the ripples on a pond; they radiate out, impacting on the wider community. Eventually the full impact of the liquidation is multiplied, involving many stakeholders. It is estimated, for example, that an average of 30 to 40 people are personally affected by one company insolvency. The main problems that arise for stakeholders are shown in table 4.5.

TABLE 4.5

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Main problems arising from company liquidation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company directors</td>
<td>• Possible loss of directorship position and/or disqualified as a director</td>
</tr>
<tr>
<td></td>
<td>• Could lose personal assets to pay for the company’s debts</td>
</tr>
<tr>
<td></td>
<td>• Possibility of a fine and/or imprisonment</td>
</tr>
<tr>
<td>Creditors (unsecured)</td>
<td>• May not recover any of the money owed</td>
</tr>
<tr>
<td></td>
<td>• If there are funds left over after the payment of the costs of the liquidation and payments to other priority</td>
</tr>
<tr>
<td></td>
<td>creditors such as employees, it may be possible to receive part payment for the money owed; for example, 5</td>
</tr>
<tr>
<td></td>
<td>cents for every dollar owed.</td>
</tr>
<tr>
<td>Employees</td>
<td>• Loss of jobs</td>
</tr>
<tr>
<td></td>
<td>• Have the right, if there are funds left over after payment of the liquidator’s fee, to be paid their</td>
</tr>
<tr>
<td></td>
<td>outstanding wages and superannuation.</td>
</tr>
</tbody>
</table>
The two main causes of business decline (and possible failure) are lack of management expertise or undercapitalisation.

The business’s cash flow position should be carefully monitored in order to have enough cash to keep operating.

Voluntary cessation occurs when the owner ceases to operate the business of their own accord.

Involuntary cessation occurs when the owner is forced to cease trading by the creditors of the business.

Sole traders and partnerships may voluntarily or involuntarily go into bankruptcy: a declaration that a business, or person, is unable to pay his or her debts.

A company has two options when facing financial difficulties:
(a) voluntary administration occurs when an independent administrator is appointed to operate the business in the hope of trading out of the present financial problems.
(b) voluntary or involuntary liquidation is the process of an appointed liquidator converting the business's assets into cash.

Liquidation normally occurs because the company is insolvent.

It is estimated that an average 30 to 40 people are personally affected by one company insolvency.

**Summary**

- The two main causes of business decline (and possible failure) are lack of management expertise or undercapitalisation.
- The business’s cash flow position should be carefully monitored in order to have enough cash to keep operating.
- Voluntary cessation occurs when the owner ceases to operate the business of their own accord.
- Involuntary cessation occurs when the owner is forced to cease trading by the creditors of the business.
- Sole traders and partnerships may voluntarily or involuntarily go into bankruptcy: a declaration that a business, or person, is unable to pay his or her debts.
- A company has two options when facing financial difficulties:
  (a) voluntary administration occurs when an independent administrator is appointed to operate the business in the hope of trading out of the present financial problems.
  (b) voluntary or involuntary liquidation is the process of an appointed liquidator converting the business’s assets into cash.
- Liquidation normally occurs because the company is insolvent.
- It is estimated that an average 30 to 40 people are personally affected by one company insolvency.

**Revision**

1. **Define** the term 'undercapitalisation'.
2. Apart from undercapitalisation, **state** three other causes of business failure.
3. As a class, using the brainstorm technique, **propose** the reasons why so many small businesses are undercapitalised.
4. **Explain** what is meant by the phrase, ‘Cash is the lifeblood of the business’.
5. **Identify** the reason why small businesses are especially susceptible to cash flow difficulties.
6. **State** how a business can predict if it is able to meet its financial commitments, as and when they arise.
7. **Distinguish** between voluntary and involuntary business cessation.
8. **Construct** a flowchart showing what happens when a business is declared bankrupt.
9. **Discuss** whether, in your opinion, there is a social stigma attached to bankruptcy today. Should there be? Share your answer with the rest of the class.
10. **Outline** the role of an administrator.
11. **State** the outcome if the process of voluntary administration is:
    (a) successful
    (b) unsuccessful.
12. (a) **Define** the term ‘liquidation’.
    (b) **Recall** the common term for liquidation.
13 **Identify** those who can put a company into liquidation.

14 **Distinguish** between ‘liquidation’ and ‘receivership’.

15 **Summarise** the two different types of liquidation.

16 Complete the statements in your notebook by **recalling** the correct word from the list below.

<table>
<thead>
<tr>
<th>Dissolve</th>
<th>Realise</th>
<th>Debts</th>
<th>Financial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Possession</td>
<td>Failure</td>
<td>Report</td>
<td>ASIC</td>
</tr>
<tr>
<td>Pay</td>
<td>Offences</td>
<td>Deregister</td>
<td>Cash</td>
</tr>
</tbody>
</table>

The liquidator’s main functions are to:

- take __________ of and __________ – convert into __________ – the company’s assets
- investigate and __________ to creditors about the company’s __________ and related business affairs
- determine __________ owed by the company and __________ the company’s creditors
- scrutinise the reasons for the company __________
- report possible __________ by people involved with the company to __________
- finally, to __________ or __________ the company.

17 **Demonstrate** the problems that arise for stakeholders when companies go into liquidation.

18 Use the **Insolvency Practitioners Association of Australia (IPAA)** website to **investigate** how a person who is made insolvent can avoid bankruptcy.

**Extension**

1 In small groups, **create** a list of success strategies for a business that:
   (a) has just been established  
   (b) is in the growth phase  
   (c) is experiencing a decline of its sales.

2 Assume the Minister for Small Business has established a committee to investigate the granting of business licences. **Propose** the recommendations you would make to the committee regarding the criteria to be used.

3 Most people who start a small business know of the high failure rate.
   (a) **Explain** why, in spite of this, they do not take steps to protect their business from failure.
   (b) **Determine** the steps you would recommend they take.

4 **Examine** the main reasons why people want to operate their own business. For more information, use the **NSW Government’s Small Business** weblink in your eBookPLUS and read an assortment of individual success stories. Present your findings as either a one-page report or a one-minute oral presentation.
**Multiple choice questions**

In the HSC examination you will be required to complete 20 multiple choice questions. Therefore, it is important that you become familiar with answering this type of question. For each question choose the best alternative:

1. A business is:
   - (a) any activity undertaken by people
   - (b) only motivated by maximising profit
   - (c) the organised effort of individuals to produce and sell, for a profit, goods and services
   - (d) none of the above.

2. The person who risks his or her time, energy and money to start a business is called:
   - (a) an employer
   - (b) an entrepreneur
   - (c) an innovator
   - (d) a financier.

3. An example of a secondary industry is:
   - (a) Plastics Manufacturing Ltd
   - (b) Zenon Mining
   - (c) Canberra Legal Centre
   - (d) Heritage Motel.

4. The most common type of business entity in Australia is a:
   - (a) partnership
   - (b) cooperative
   - (c) public company
   - (d) sole trader.

5. National Foods Limited would most likely be a:
   - (a) public company
   - (b) private company
   - (c) government business enterprise
   - (d) partnership.

6. Complacency amongst management normally occurs in the:
   - (a) establishment phase
   - (b) maturity phase
   - (c) post-maturity phase
   - (d) growth phase.

7. A business’s operating environment refers to:
   - (a) the nature of the workplace environment that businesses provide for their employees
   - (b) the specific external stakeholders with whom the business conducts its business
   - (c) those factors over which the business has some degree of control
   - (d) none of the above.

8. Businesses are important to the Australian economy because they:
   - (a) provide goods and services to satisfy consumers’ wants
   - (b) provide employment for millions of people
   - (c) contribute to Australia’s Gross Domestic Product
   - (d) all of the above.

9. An example of legislation designed to protect the interests of both consumers and business is:
   - (a) the Trade Practices Act
   - (b) the Broadcasting and Television Act
   - (c) the Consumer Affairs Act
   - (d) the Small Business Act.
10 Social and ethical responsibility of a business refers to:
(a) a business’s responsibility only to its shareholders
(b) a business’s responsibility only to its internal stakeholders
(c) a business’s responsibility to both its internal and external stakeholders
(d) a business’s responsibility only to its internal stakeholders.

Short response questions
In the HSC examination you will be asked a number of short response questions based on the HSC course.
A short response question generally contains a number of sections, starting with a low order activity and increasing in difficulty. How much you should write for each section is determined by how many marks it is worth. For example, a question that has a value of two marks will require double the amount of time and information than one with a value of one mark.

1 (a) State the main function of business. 2 marks
(b) Demonstrate the contribution businesses play within the Australian economy in terms of:
   (i) employment 4 marks
   (ii) incomes 4 marks
   (iii) choice 4 marks

2 (a) Define the term ‘entrepreneur’. 2 marks
(b) Evaluate the role entrepreneurship plays in determining business success. 10 marks

3 (a) Recall two quantitative measures and two qualitative measures used to determine the size of a business. 2 marks
(b) Distinguish between a small and a large business. 5 marks
(c) Determine why small businesses, such as the local hairdresser or restaurant, are able to compete with large, transnational corporations. 10 marks

4 (a) Identify two advantages and two disadvantages of each of the following types of business ownership:
   (i) sole trader 3 marks
   (ii) partnership 3 marks
   (iii) company 3 marks
(b) Distinguish between an incorporated and an unincorporated business entity. 6 marks

5 (a) Define the term ‘business environment’. 2 marks
(b) Distinguish between the internal environment and the external environment. 6 marks
(c) Factors within the internal and external environments can pressure businesses to change practices, policies or products. Referring to a business that you are familiar with, evaluate the accuracy of this statement. 12 marks

6 (a) Identify four external influences that can affect a business. 2 marks
(b) Demonstrate what impact the following internal influences can have on a business.
   (i) Product influences 4 marks
   (ii) Management influences 4 marks
(c) Assess the impact of technological influences on retail businesses. 10 marks

7 (a) Define the term ‘profit’. 2 marks
(b) Explain the relationship between sales revenue and profit. 6 marks
(c) Determine the role profit plays within our economic system. 11 marks

8 (a) ‘Wouldn’t every small business owner like his or her business to grow into a large firm?’ Discuss. 6 marks
(b) Determine whether the advantages of small business really are advantages. 12 marks
9 The business life cycle consists of four main stages.
   (a) **Identify** the four stages. 2 marks
   (b) **Propose** some strategies a business can implement to undergo renewal. 6 marks
   (c) **Assess** the importance of the business owner having an understanding of the business life cycle. 10 marks

10 Your brother is thinking about starting a family business. He has invited you to be a member of the business and has asked you for your advice.
   (a) **Clarify** two legal types of business structure that may be appropriate. 2 marks
   (b) **Discuss** the legal requirements for setting up each type of business. 6 marks
   (c) **Assess** the advantages and disadvantages of each type of business. 12 marks

11 Ezra and Jacinta are considering forming a partnership. They have worked for an architect for some time and now feel that they could do much better on their own. Imagine that Jacinta has approached you for advice.
   (a) **Define** the term ‘partnership’. 2 marks
   (b) **Discuss** the legal requirements for the formation of a partnership. 4 marks
   (c) **Determine** the legal rights and responsibilities of each partner in a partnership. 10 marks

12 (a) **Identify** the key to determining whether or not a business’s actions are socially responsible. 2 marks
   (b) **Outline** the main benefits to a business of conducting a sustainability report. 3 marks

13 (a) **Define** the term ‘stakeholder’. 2 marks
   (b) **Explain** why some of these responsibilities are incompatible whereas others are compatible. 5 marks
   (c) ‘Shareholders’ expectations should take precedence over the desires of other stakeholders’. **Evaluate**. 8 marks
   (d) **Determine** the responsibilities a business has to each of its stakeholders. 12 marks

14 (a) **State** why it is sometimes difficult for a business to satisfy the expectations of all its stakeholders. 3 marks
   (b) **Propose** a number of strategies a business can use to reconcile the conflicting interests of its stakeholders. 5 marks
   (c) **Evaluate** the effectiveness of each of these strategies. 10 marks

15 (a) **Define** the term ‘undercapitalisation’. 2 marks
   (b) **Distinguish** between voluntary administration and liquidation. 6 marks
   (c) **Demonstrate** the main problems that arise for stakeholders when companies go into liquidation. 10 marks

**Extended response questions**

In the HSC examination you will be asked a number of extended response questions based on the HSC course.

One of the extended response questions will require a report style format, a style of writing used extensively in business. Report writing will require you to disregard much of what you have previously been taught when writing traditional essay style answers. Report answers use:
• short statements
• lists of main points followed with explanations when appropriate
• short paragraphs
• headings and subheadings
• diagrams, tables and graphs
• condensed conclusions and/or recommendations when required.

Newspaper articles adopt a report writing style. Each paragraph is brief and to the point with short sentences. It is important that you become familiar with answering this type of question.

Your answer will be assessed on how well you:
• use your knowledge and the information provided
• communicate using relevant business terminology and concepts
• present a logical, well-structured answer to the question.
1 **Discuss** the importance of business to the Australian economy. In your answer refer to:
(a) creating value
(b) social and economic roles
(c) relevant stakeholders.

2 The internal environment refers to influences that come from within the business itself and can affect business performance. **Discuss.**

3 **Demonstrate** how businesses contribute to our social and economic wellbeing.

4 ‘Small business should not be taken for granted.’ **Evaluate** the accuracy of this statement. In your answer use some statistics to support your arguments.

5 ‘To be effective, business strategy must take into account the interests, needs, and expectations of all the business’s stakeholders. Companies should have a strategy that combines business goals and broad social interests’. **Discuss**, using examples, the accuracy of this statement.

6 Natureland Organics is a public company located 280 kilometres from Sydney. It relies on fresh, organically certified farm produce to supply its 3 Sydney outlets and employs 238 people from the local area. The business has a strong reputation for nutritional value, reliability and support for the environment. The business has recently started exporting to Singapore and Hong Kong. This will require a new production facility to be built. The CEO has identified two areas of concern for future growth:
- Local residents are complaining that a new plant will cause environmental damage, especially pollution of a nearby river.
- Shareholders are complaining about the cost of the new plant needed for the extra production.
(a) Prepare a report that could be given to Natureland Organic’s management team. In your report, you should:
  (i) **Identify** Natureland Organic’s stakeholders.
  (ii) **Outline** three pressures affecting Natureland Organics.
(b) Natureland Organics contributes in many ways to the Australian economy. **Demonstrate** two economic contributions that would be lost if Natureland Organics was forced to close.

7 **Discuss** three challenges that you believe to be the most significant in each of the four stages of the business life cycle.

8 **Outline** the main reasons for business failure. **Distinguish** between bankruptcy, voluntary administration and liquidation.

9 Both the quaternary (information processing) and quinary (household services) industry sectors are becoming major contributors to Australia’s Gross Domestic Product. **Determine** why you believe these two sectors are thriving.

10 Annika Schute and Gordon Wong, partners in Omega Home Renovations, have been operating their thriving business for five years. They now wish to expand, but cannot decide whether to become a private company or operate as a franchise of the highly successful Ultimate Home Makeover Pty Ltd. They have come to you for advice. Annika and Gordon wish to maintain control of their business; but like the idea that as a franchisee, they will have the full support of a successful business operation which will allow them to expand more quickly.
   As a business consultant, prepare a report that could be given to Annika and Gordon. In your report, you should:
   (a) **Describe** the main advantages and disadvantages of a private company and a franchise.
   (b) **Recommend** which of the two options is best suited to their long term goal.

11 You have been employed as a business reporter with the local newspaper. You are asked to **create** an article that examines the external environmental factors that affect business. A major focus within your article should be an analysis of the impact of each factor on specific businesses.
12 In 1980, brothers Roger and Lesley Gillespie, together with Gary Stephenson, opened their first bakery in Hawthorn, Melbourne. By 1988 they owned 15 bakeries. Confident with their business model and product, they began to franchise these bakeries, and by 1991 forty-three bakeries were in operation. Ten years later Bakers Delight had expanded to 200 bakeries and by 2003 to 600. Today there are 700 bakeries across three continents. **Investigate** what factors led to the success that Bakers Delight has experienced. **Explain** (i) why a business like Bakers Delight would sell franchises and (ii) why someone would purchase a Bakers Delight franchise.

13 ‘Improving a business’s ethical performance depends on the values of its managers and employees, and the business culture’. **Discuss.**

14 **Contrast** the stages of establishment, growth and maturity in the business life cycle.

15 When a business is wound up, there are usually negative consequences for the many stakeholders’. **Determine** the main problems arising from a company liquidation.
FOCUS AREA
The focus of this topic is the nature and responsibilities of management in the business environment.

OUTCOMES
Students should be able to:
- explain the internal and external influences on businesses
- assess the processes and interdependence of key business functions
- examine the application of management theories and strategies
- analyse the responsibilities of business to internal and external stakeholders
- plan and conduct investigations into contemporary business issues
- evaluate information for actual and hypothetical business situations
- communicate business information and issues in appropriate formats
- apply mathematical concepts appropriately in business situations.
What would you do?

As the general manager for Atlintis Pty Ltd, your day has been packed with one meeting after another. It’s getting late, you are tired, and you have already answered twenty emails and still more arrive. It seems as if the phone will not stop ringing; people either asking for your advice or alerting you to potential problems.

You would like to put your feet up and have a brief doze but you have too much on your mind. You just finished a meeting with Sarah Dawson, Atlintis’s marketing manager, where she forecast that sales for the next 12 months will decline by 20 per cent due to the increased competition from overseas manufacturers.

Atlintis is about to enter into a challenging trading period. To guide the business through this difficult period, you will need to draw upon all your management skills. Previously, when faced with a downturn in growth, you would develop a new strategy to boost sales. This time, however, you have a feeling that what may have been successful in the past will not work. Consequently, you believe major changes within the business will be needed to ensure its long-term survival.

You focus and turn on your laptop. The first words you type are ‘Back to basics’, and you begin to list the key questions that you must answer if you are to successfully manage the business. What should you, as general manager, be responsible for at Atlintis Pty Ltd? Given these responsibilities, what skills of management should you emphasise? What should your frontline managers and team leaders be doing, and how can you change the business to make sure they perform?

The one aspect of your job you enjoy the most is responding to and managing change. Instead of seeing change as a difficulty to overcome or a problem to avoid, you believe in your ability to manage change effectively. In the past you attempted to provide visionary leadership — a shared vision as to where the business was heading. You consider this skill to now be your most important responsibility, especially with the possibility of staff redundancies and the reform of past work practices. Providing positive leadership, coupled with effective communication, should help overcome some of the likely resistance to change. At the heart, your leadership style is to encourage, motivate, and guide your frontline managers and team leaders.

You type one more question: What is good management? If you were the general manager of Atlintis Pty Ltd, what would you do?
5.1 Introduction

Have you ever been shopping and spent all your money on the first few things you saw only to later be disappointed when you came across something you would have liked more? What about the assessable task you left until the last minute only to find all the information resources you needed had been borrowed from the library? Or the dental appointment for which you were half an hour late? In these cases you did not manage either your money, assessment requirements or time very well. These cases reveal that you have actually been practising the art of management for a number of years. Sometimes you have managed your affairs successfully; at other times you may have mismanaged them.

Managing is an essential skill that all people need to develop. How well you perform the task of management will often determine whether you achieve the goals you have set for yourself. In the world of business, just as in your personal life, management is a fundamental activity. It is what makes the business function. The general manager featured in the opening story of this topic highlights a number of important characteristics of management, including:

1. having the ability to analyse information, attend meetings and communicate with a wide range of people both inside and outside the business
2. possessing the skills to manage change effectively
3. having the vision to see how things could be, rather than just accepting things the way they are
4. providing leadership through the desire to encourage, motivate and guide employees
5. understanding your roles and responsibilities in order to achieve the goals of the business.

The traditional definition of management is the process of coordinating a business’s resources to achieve its goals. As outlined in chapter 3 the four main resources available to a business are:

- Human resources. These are the employees of the business and are generally its most important asset.
- Information resources. These include the knowledge and data required by the business, such as market research, sales reports, economic forecasts, technical material and legal advice.
- Physical resources. These include equipment, machinery, buildings and raw materials.
- Financial resources. These are the funds the business uses to meet its obligations to various creditors.
A manager, therefore, is someone who coordinates the business’s limited resources in order to achieve specific goals.

**BizWORD**
A manager is someone who coordinates the business’s limited resources in order to achieve specific goals.

**Contemporary definition**

The past few years have seen a subtle, but significant, modification of the meaning of the term ‘management’. More contemporary definitions emphasise that management is the process of working with and through other people to achieve the goals of the business in a rapidly changing environment, as shown in figure 5.3. Crucial to this process is the effective and efficient use of limited resources.

**BizWORD**
A more contemporary definition of management views management as the process of working with and through other people to achieve business goals in a changing environment. Crucial to this process is the effective and efficient use of limited resources.

**eBookplus**
Use the Modern business manager weblink in your eBookPLUS to read an article on how the role of a manager has changed in modern business.

**FIGURE 5.2** A skilful and experienced management team is an essential ingredient for achieving business success.

**FIGURE 5.3** Key aspects of the management process

**Achieving the goals of the business (effectiveness)**

**Getting the most from limited resources (efficiency)**

**Balancing efficiency and effectiveness**

**Coping with a rapidly changing environment**

**Working with and through others**
According to this definition, management requires:

- **Working with and through others.** Management is, above all else, a social process. Those managers who do not interact and communicate well with employees fail to achieve high levels of commitment from staff.
- **Achieving the goals of the business.** Without goals, the business would quickly lose direction. Employees would not understand the ultimate purpose of their work and managers would not be able to measure performance. **Effectiveness** measures the degree to which a goal has been achieved.
- **Getting the most from the limited resources.** All businesses face the problem of limited resources or scarcity. Consequently, managers need to coordinate the resources efficiently. **Efficiency** compares the resources needed to achieve a goal (the costs) against what was actually achieved (the benefits). The most efficient coordination of resources occurs when the benefits are greater than the costs.
- **Balancing efficiency and effectiveness.** Managers must usually balance both the efficiency and effectiveness of their decisions. A correct balance between efficiency and effectiveness is the key to achieving a competitive position in today’s challenging business environment.
- **Coping with a rapidly changing environment.** This is one of the most important tasks of all managers. Successful managers are those who anticipate and adjust to changing circumstances.

**Management within the business**

Management is a complex task. It is an exciting, challenging, sometimes frustrating but usually rewarding experience. All businesses must be managed; they do not operate automatically. For example, without managers how could 20,000 airline flights a day be achieved without an accident, tens of thousands of motor vehicles be manufactured, hundreds of thousands of students be educated, and hundreds of films and downloads be made available for our entertainment.

The manager’s role is similar to that of a musical conductor. It is the conductor who has to coordinate all the members of the orchestra so they stay in time, inspire and lead, encourage superior playing, develop the correct interpretation of the score, and have the orchestra playing as a whole rather than as a group of individuals just playing notes.

**Managerial ‘facts of life’**

Observations made of modern managers’ work patterns suggest that management is a difficult and demanding job. Most people, when asked to describe a manager, would probably use terms such as the following: power,privilege, status, authority and high income. This image of a manager is often reinforced through the media, especially through the stereotype of the ‘mogul’ or ‘tycoon’. The reality, however, is quite different.

These observations highlight the gap between the myths and realities of management (see table 5.1 on page 123). The hours are long, interruptions frequent, many conflicting interests have to be dealt with and each day follows a hectic schedule (see figure 5.5). It is predicted that future managers will confront an even more hectic pace of work. And yet, management can be a highly rewarding experience for those who develop their skills and strive for excellence.
Managers can sometimes feel as if they are caught in a never-ending cycle of meetings, interruptions, paperwork, emails and trivialities.

TABLE 5.1 The myths and realities of a manager’s job according to management researcher Henry Mintzberg

<table>
<thead>
<tr>
<th>Myth</th>
<th>Reality</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The effective manager is a methodical planner, reflects on what has been achieved, with time to systematically work through problems encountered throughout the day.</td>
<td>The typical manager is constantly interrupted, with no more than approximately 10 minutes spent on any one activity. The manager takes on a great deal and has little time for reflection.</td>
</tr>
<tr>
<td>2. The effective manager has no regular activities to carry out. It is all a matter of coordinating other people’s responsibilities and then sitting back to watch others do the work.</td>
<td>Although managers’ days are constantly interrupted by both trivialities and crises, they still have regular duties to perform. They must interpret and analyse information, attend meetings and communicate regularly with other parts of the business.</td>
</tr>
<tr>
<td>3. Management is a science and, as such, can be reduced to a formula and set of ‘laws’ that, if followed, result in goals being achieved.</td>
<td>The manager’s job is more art than science. Managers rely heavily on judgement, past experience, perception and intuition.</td>
</tr>
</tbody>
</table>

5.2 The features of effective management

Every business — whether it be profit or not-for-profit, small, medium or large — needs effective management to succeed.

Over the last century, there has been a shift in the way consumers satisfy their needs and wants. We no longer rely on a large range of small businesses for most goods and services but rather on a small range of large businesses. For example, the days of purchasing all your grocery needs from the corner store are long gone. Instead, consumers today rely on just a few national supermarket chains stocking...
items produced by large companies. We depend on some form of business for our housing, clothing, healthcare, transportation, recreation, entertainment and communication needs; in short, for the satisfaction of most of our individual needs. This makes the task of management crucial. Managers are necessary because society could not function without businesses, and businesses cannot function without managers.

The important role of effective management is to make sure the joint efforts of employees are directed towards achieving the goals of the business. Producing all the goods and services demanded by consumers involves the combined efforts of many people. This combined effort must be effectively coordinated so that the greatest amount of goods and services can be produced for the least cost — that is, efficiently. This coordination needs to be managed on many different levels; for example, within businesses, between businesses and on a national and international level. Businesses must do more than meet the needs of individuals; they must also meet the needs of all the stakeholders in general.

Above all else, what is important to any business is not the number of managers it employs, or the prestigious titles it gives them, but the ability of these managers to achieve the business’s goals. To do this effectively, a manager must possess a range of skills.

Summary
- Management is a fundamental activity that makes the business function.
- Management is the process of:
  (i) coordinating a business’s resources to achieve its goals
  (ii) working with and through other people to achieve business goals in a changing environment.
- Whether the goals of the business are achieved largely depends on the skills and expertise of the management team in coordinating the business’s resources.
- Every business needs effective management to succeed.
- The role of effective management is to make sure the joint efforts of employees are directed towards achieving the business’s goals.
- Effective management is usually the major factor influencing the success or failure of a business.

Revision
1. Read the story about Atlantis Pty Ltd at the beginning of this topic.
   (a) State the reason sales are forecast to decline.
   (b) Recall whether this is an internal or external influence on business. Account for your answer.
   (c) Identify the important management characteristics referred to in the story.
   (d) If you were the general manager of Atlantis Pty Ltd, propose what you would do.
2. Outline five specific characteristics the general manager displayed in the opening story.
3. State the main function of management according to the traditional definition.
4. Describe the four main resources available to a business.
5. Distinguish between the contemporary definition of management and the traditional definition.
6. Construct a concept map summarising the five key aspects of the management process according to the contemporary definition. The first one has been started for you.
7. Distinguish between efficiency and effectiveness.
The performance of managers is often evaluated according to two criteria: efficiency and effectiveness. Of the two, effectiveness is the most important. Discuss.

According to observations, contrast the ‘realities’ of a manager’s job from the ‘myths’.

Interview either a head teacher, deputy principal or principal at your school and compile a list of managerial activities they undertake in the course of a day. Calculate to what extent their experiences mirror the realities and myths of a manager’s job.

Recall the important role of effective management.

Explain why effective management is so important in our society.

‘How well you perform the task of management will often determine whether you achieve the goals you have set for yourself.’ Discuss.

**Extension**

1. Consider the following statement: ‘Management is often demanding, complex, stressful and exacting. Contributing to the complexity are globalisation, focus on quality, increasing competition, technological developments, and the rising demand for the ethical conduct of people and organisations. But at the same time, it can be personally rewarding.’ Examine the positive and negative aspects of being a manager.

2. Some people argue that middle-level managers have a more difficult job than top/senior or lower/frontline managers. This is because the work of a middle-level manager is more varied in managerial and non-managerial duties. Evaluate.

3. Determine which you think is the more difficult management task: getting employees to work in teams rather than independently, or getting employees to accept change in the workplace. Provide reasons for your answer.

4. ‘The main difference between employees and managers is that employees work and managers think.’ Assess to what extent this statement reflects conditions in today’s workplace. Compare your answers with other class members.

**5.3 Skills of management**

In every occupation, certain skills are needed for success. If you have a skill, it means that you have the ability to complete a task effectively. A surgeon must be decisive and have the technical abilities to perform complicated operations. A champion swimmer must have the combination of natural talent and skills that enable him or her to swim better than almost anyone else.

Not surprisingly, managers also need certain skills. The more successful managers appear to have more of these skills than the less successful managers. Not every manager requires the same amount of each skill; however, some skills are more important for some job types or workplaces than are others.

In general, effective managers are those who:

- possess a range of specific management skills (see figure 5.6)
- are able to use these skills in a number of different situations.

Normally, a manager is not required to use all these skills constantly. What is important is that these skills and abilities must be available when they are needed so that managers can organise and motivate staff to work effectively towards objectives. These skills take on added significance, given the two fundamental changes that have taken place in the structure of many businesses over the past decade:

1. the movement away from the ‘tall’ hierarchical structures of many traditional businesses, with their multiple layers of management, towards ‘flatter’ business structures
2. the development of self-managing work teams.

**BizWORD**

*Skill is the ability that comes from the knowledge, practice and talent to do something well.*
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In 2006, Innovation & Business Skills Australia (IBSA) commissioned the Boston Consulting Group (BCG) to undertake a study into how the role of Australia’s senior managers is likely to change between then and 2020. Their report, 2020 vision: The manager of the 21st century, reinforces the skills that will be needed to respond to these changes. The report says that the trend away from traditional ‘command and control’ forms of management towards team-based, consultative management styles will continue.

Managers require a range of skills to operate effectively now and into the future. These skills include:
- interpersonal (people)
- communication
- strategic thinking
- vision
- problem solving and decision making
- flexibility and adaptability to change
- reconciling the conflicting interests of stakeholders.

Summary
- In general, effective managers are those who:
  - possess a range of specific management skills
  - are able to use these skills in a number of different situations.
- All managers use their skills to achieve the business’s goals.
- Managers require a wide range of technical, conceptual (thinking) and people skills.
Interpersonal (people) skills

Do you know anyone who lacks interpersonal skills? These are the people who are insensitive to the needs and feelings of others; people who speak before thinking and consequently ‘put both feet in’; people who say the wrong thing at the wrong time or to the wrong person; people who rub others up the wrong way. Such people generally make very poor managers.

Managers get their work done with and through other people; therefore, interpersonal (people) skills are extremely important. Such skills mean a manager can work and communicate with other people and understand their needs. Interpersonal skills centre on the ability to relate to people, being aware of and appreciating their needs, and showing genuine understanding. People skills include the ability to communicate, motivate, lead and inspire (see the following Snapshot).

Healthy management

City Health is a public healthcare provider serving a population of 500,000 people and operating with a budget of $500 million. It employs 3000 staff and has grown steadily over the last five years due to the merging of several major city hospitals. The chief executive of City Health, Dr Jan Dvorak, recently called a meeting of the executive team to discuss a strategic plan. These discussions explored the objectives of:

• developing a culture of quality and innovation
• working in partnership with all stakeholders to enhance the health of the community
• providing an environment that values and supports staff
• achieving a financially sustainable health service.

Up until now, Dr Dvorak has managed and guided City Health through its period of high growth. She has led the organisation to where it is today by listening to her employees, the hospital’s patients and the community. She includes staff unconditionally in the decision-making process of the organisation. She has earned the respect of her staff because she displays an empathetic personality. One of her key interpersonal strengths is that she accepts that everyone is different, with different attitudes, values and ideas. This helps her understand and sympathise with ideas and attitudes different from her own. In turn, this helps her communicate effectively with others. She is considered to be a great leader by her staff.

Dr Dvorak considers that the change to a new corporate culture will be her greatest challenge so far, but believes that the hospital is well on its way to achieving this goal.

Snapshot questions

1. Identify and describe the interpersonal skills that Jan Dvorak possesses.
2. Explain why it is important for a manager to display good interpersonal skills if he or she wants to provide a workplace environment that values and supports staff.
3. Determine whether you would like to work for a manager similar to Dr Dvorak. Give a reason for your answer and share it with other class members.

A manager who lacks empathy, is arrogant, opinionated, unable to communicate or who has difficulty relating to people will not be able to develop positive relationships with employees. Employees may actually work more efficiently when such a manager is absent because the fear of intimidation or victimisation is reduced (see the following Snapshot).
Jack has been the general manager of Nars Chocolates for only six months. He had previously worked for a company with serious financial and staffing problems. From that experience he concluded that it is best to be very firm with staff in order to get results.

Jack’s recent behaviour has prompted staff to consider leaving. He shows very little interest in the needs of individuals, or their concerns. He severely criticised the work of the marketing manager at a planning meeting last week. ‘Carly, I just don’t think you have all the facts here,’ Jack said. ‘Firstly, from what I can see, you’ve done a poor job. And secondly, the rest of you people will need some clear guidelines or you will all be producing the sort of rubbish that Carly has presented.’

Some time later, two managers were discussing the deteriorating workplace conditions over a cup of coffee. ‘Can you believe the way that Jack treated Carly in the meeting last week?’ complained Josh. ‘Carly is a great manager, she listens to her staff and encourages her team to work with her to make decisions.’

‘And she was totally embarrassed by Jack’s comments because the new chocolate bar project her team is working on is still in its developmental stages,’ said Mai.

‘I heard him telling off Khalid last week for expressing an idea,’ said Josh. ‘He told him that he’s the boss, and if he wanted opinions, he certainly wouldn’t ask a subordinate for them. Mai, he’s treating us like we’re kids. But we’re experienced professionals.’

‘I agree,’ said Mai. ‘It won’t be long before I’m out of this place!’

**Snapshot questions**

1. Identify the negative interpersonal skills displayed by Jack.
2. Explain why Jack’s behaviour has prompted staff to consider leaving.
3. Assess whether you agree or disagree with Jack’s attitude ‘that it is best to be firm with staff in order to get results’. Give a reason for your answer and share it with other class members.

**Communication skills**

Communication is as vital as the air we breathe. As babies we learn to cry in order to satisfy our needs; it is a baby’s first attempt at communication. Communication becomes more complex, however, particularly in a modern global business environment. It’s not just about what you say, it’s about how you say it and what medium you choose to get your message across.

**Why is the communication skill important?**

One of the most difficult challenges for managers is getting employees to understand and want to achieve the business’s goals. Effective communication is at the heart of meeting this challenge. Without effective communication the most carefully detailed plans and brilliant strategies will most probably fail.

Communication is one of the easiest and, at the same time, most difficult of management skills. This is because of the complex nature of communication. Whether communicating with employees within the business or customers in the marketplace, effective communication is essential for the long-term survival of the business. Well-written letters, an inviting telephone manner, pleasant conversation, concise emails, and friendly smiles and gestures reinforce carefully planned business strategies and client networking.
Managers who are effective communicators and who are able to share their thoughts and plans will find it easy to influence others (see the following Snapshot).

The secrets of great communication

What is the secret to great communication? Brilliant communicators are often found at the head of highly successful and profitable businesses across the globe. Yet perceptions of what makes a great communicator are, like beauty, often in the eye of the beholder. Steve Jobs, the inspirational, charismatic Apple founder and CEO believes CEOs should exude a passion and a vision of the business’s future. Observers have studied Steve’s amazing success as a communicator and emphasised some of the strategies that he advises other business leaders and presenters to consider. Let us examine some of Steve’s communication techniques.

Firstly, when Steve prepares, he rehearses over and over, carefully taking into account the nature of the audience, the message and the ideas he wants people to take ‘onboard’. He uses his natural speaking voice in a friendly way — as if he is engaged in a normal conversation.

Steve’s presentations become events he wants the world to watch. He believes in creating a drama. For example, when introducing the new iPhone, he had fun with his audience while he acted on stage, pulling the new phone from the smallest pocket in his jeans. Visual ideas are important to Steve. He thinks audiences remember more of what they see than the words they hear. He always uses simple, dramatic, high-quality pictures, but does not over-use the visuals. What do you think great communication is?

Steve Jobs, a self-made millionaire, portrays himself as an individualistic, unconventional entrepreneur. Currently, his take-home pay is only $1. He started Apple in 1976 in California, making the first computer in his garage. Later he created the iPod and started Pixar animations. Today, the company operates 284 retail stores in ten countries and employs about 35 000 people worldwide.

Snapshot questions
1. Define the terms ‘inspirational’ and ‘charismatic’.
2. Outline Steve Jobs’ communication techniques.
3. Propose why speaking in a friendly way — ‘as if he is engaged in a normal conversation’ — is a smart communication strategy.
4. Determine what you think great communication is. Share your answer with other class members.
Miscommunication

Owing to the complex nature of achieving effective communication, mistakes, misunderstandings and unforeseen barriers sometimes lead to false messages or no message being received. Miscommunication can have disastrous consequences in a business (see the following Snapshot).

A solar eclipse

Can you remember a time when what you said was misinterpreted or you misinterpreted someone else’s communication. It happens in our personal lives and it happens in business too. The following information is from a number of telephone conversations between employees within a business. There is no feedback and none of the messages are written down. As you can see, effective communication does not occur.

Conversation 1: Managing director to the general manager
On Monday morning, at precisely 10.00 am, a total eclipse of the sun will occur — an event which takes place once in every 85 years. Please ask all employees to meet in the parking area outside the main entrance, wearing safety glasses, and I will explain this rare natural event. In case of rain, we will not be able to witness the event so have all employees meet in the auditorium and I will show them a video of the eclipse.

Conversation 2: General manager to department head
The managing director has ordered a total eclipse of the sun above the parking area outside the main entrance on Monday at 10.00 am. If clouds cover the event, instruct the employees to wear safety glasses, then proceed to the auditorium where this natural event will take place, something that occurs every 85 years.

Conversation 3: Department head to sectional manager
At 10.00 am on Monday, the managing director, who will be wearing safety glasses, has ordered a total eclipse of the sun in the auditorium. In case of clouds, assemble in the main entrance before going to the parking area, where the managing director will give another order, something that occurs only every 85 years.

Conversation 4: Sectional manager to senior supervisor
A rare event will occur on Monday at 10.00 am. The managing director will appear in the auditorium with his son, who will eclipse him now he is 85 years old. The managing director’s position has been under a cloud for some time. A presentation of rare safety goggles will be made to him in the parking area outside the main entrance, where all employees will be waiting.

Conversation 5: Senior supervisor to employees
On Monday 10, the rare 85-year-old managing director, accompanied by his son, Eclipse, will park in the main entrance before watching the clouds. After this, everyone will assemble in the auditorium, where safety goggles will be presented to all employees.

Snapshot questions
1. Explain why the original message became so confused.
2. Justify whose responsibility you think it is to make sure the message is correctly understood.
   (a) The sender
   (b) The receiver
   (c) Both the sender and the receiver
3. Propose some suggestions you would make to improve this communication process.
The importance of nonverbal communication

Communication is all about sending a message to another person. A message might be verbal, meaning words either written or spoken are used to convey the message. Alternatively, you may choose to convey a message using nonverbal methods as simple as a smile or an image to get your message across.

**Nonverbal communication** is any message that is not written or spoken. Nonverbal communication mainly consists of body language (posture, facial expressions, placement of limbs and proximity to others).

If you have ever gone to a party, then you are likely to be aware of how effective **body language** can be. A smile, a glance, a stare, the angle of a person’s head, a frown, a body movement or the invasion of someone’s personal space — they all communicate a message.

It is important for managers to be aware of the power of body language and the messages that can be secretly conveyed. Usually, body language conveys a more powerful message than spoken or written communication. This can result in contradictory messages being intentionally or unintentionally given. A manager who says she is free to talk to an employee about a work problem but then constantly glances at her watch is giving a message that it is not a convenient time to talk. Another example is a manager who expresses one emotion orally, such as confidence, but then has body language reading ‘I don’t trust you’. Such a contradiction often suggests that actions ‘speak louder’ (and more accurately) than words.

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**BizFACT**
Extreme care should be taken with body language communication because gestures can have different meanings in different cultures. For example, making a circle with the thumb and forefinger is a friendly gesture in Australia, but it means ‘you are worth nothing’ in France.

**BizWORD**

*Nonverbal communication* is any message that is not written or spoken.

*Body language* is the use of gestures, facial expressions and posture to communicate.

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**Strategic thinking skills**

Consider the following quotes:

‘Who in the hell wants to hear actors talk?’

Harry Warner, founder of Warner Bros Studios, 1927

‘I think there is a world market for about five computers.’

Thomas J. Watson, chairman IBM, 1943
‘There is no reason for any individual to have a computer in their home.’
Ken Olsen, president, Digital Equipment, 1977

‘Nothing has come along that can beat the horse and buggy.’
Chauncey De Pew, president of the New York Central Railroad, warning his nephew against investing in Henry Ford’s new company circa 1911

‘Everything that could be invented has now been invented.’
U.S. Patent Office circa 1900

With hindsight we laugh at these quotes. And yet, at the time, most people would have agreed with the speakers. It could be argued that their shortsightedness inhibited strategic thinking. Therefore, they were not able to perceive meaningful patterns in complex circumstances. Strategic thinking allows a manager to see the business as a whole — as a complex of parts that depend on and interact with each other, like the gears in a machine and to take the broad, long-term view.

The ability to think strategically lets the manager see the ‘big picture’. The manager may then:
• visualise how work teams and individuals interrelate
• understand the effect of any action on the business
• gain insights into an uncertain future
• see the business in the context of events and trends, and identify opportunities or threats.

Strategic thinking therefore involves thinking about a business’s future direction and what future goals the business wants to achieve. As a student, for example, you were thinking strategically when you made your senior course subject selections in Year 10. You had to imagine what the future job or study requirements would be when you left school, how the workplace may change over time, what future goals you wanted to achieve, and what would interest and motivate you in the future.

Many people assume that strategic thinking skills are the exclusive field of senior management, but that is simply not true. Managers at all levels need to exercise this skill. It will help the business maintain its competitive position within a constantly changing business environment. Although some people seem to have a special gift for being able to predict and comprehend the future, strategic thinking can be learned through practice.

**Summary**

• Interpersonal (people) skills are those skills needed to work and communicate with other people and to understand their needs.
• Interpersonal skills include the ability to communicate, motivate, lead and inspire.
• Effective communication of business goals and the strategies to achieve them are crucial to achieving business success.
• Managers who are effective communicators and who are able to share their thoughts and plans will find it easy to influence others.
• Miscommunication is to be avoided because it can lead to serious harm to the business.
• It is important for managers to be aware of the power of nonverbal communication, especially body language.
• Strategic management allows the manager to see the business as a whole and to take a broad, long-term view.
• Strategic thinking involves thinking about a business’s future direction and what future goals the business wants to achieve.
Revision

1 Define the term ‘skill’.
2 Recall two changes that have taken place in the structure of many businesses over the past decade that have resulted in the skills taking on added significance.
3 Examine figure 5.6 on page 126.
   (a) Identify some of the desired skills needed to perform this management position.
   (b) Clarify which skill you consider to be the most important. Justify your answer.
4 Define the term ‘interpersonal skills’.
5 Explain why it is important for a manager to possess good interpersonal skills.
6 ‘Interpersonal skills include the ability to communicate, motivate, lead and inspire.’
   Describe a situation, from personal experience, that demonstrates where two of these abilities were used effectively.
7 Discuss why managers should strive to improve their ability to communicate.
8 Not everyone is a great communicator, but we can all learn. Identify a poor communication habit you have and propose what you might do to improve your communication skills.
9 Examine how well you communicate as a class. Ask your teacher to make up a statement and then conduct your own game of ‘Silent whispers’, where each member must pass the message on to another person. At the end of the activity, have your teacher read out the original statement and compare it with the final verbal statement from the class member in the group who was told the statement last.
10 Describe how you might improve your own nonverbal communication skills with casual acquaintances. Refer to your use of eye contact, facial expression, gesture and voice-tone skills.
11 Define the term ‘strategic thinking’.
12 Explain why managers at all levels need to exercise strategic thinking skills.
13 Draw a table similar to the one following to summarise details of the management skills in this section. The first entry has been completed for you.

<table>
<thead>
<tr>
<th>Skill</th>
<th>Definition</th>
<th>Characteristics</th>
<th>Application to the workplace</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interpersonal skills</td>
<td>It is the ability to work and communicate with other people and to understand their needs.</td>
<td>Managers get their work done through other people. They need to display empathy.</td>
<td>Managers use interpersonal skills to communicate, motivate, lead and inspire.</td>
</tr>
</tbody>
</table>

Extension

1 In small groups, imagine you are board members of a medium-sized private company. The company manufactures electronic items for the domestic market. It has 284 employees and its current turnover is approximately $115 million. The company is well established in domestic markets but, due to increasing competition, sales and profits have been decreasing over the past few years.
   The board is preparing to hire a new chief executive officer to lead the company. In your group, create a profile of the business leader that you are seeking. Consider qualifications, experience, skills and personality factors.
   Conduct a class discussion on the similarities and differences of each group’s profile. Propose reasons for any differences.
2 From your knowledge of Steve Jobs, Apple founder and CEO, and his notions of great business leadership, determine four communication skills good managers should practise.
3 Use the Communication skills test weblink in your eBookPLUS to take the test. 
   (a) Analyse your results. 
   (b) Deduce whether you think this is accurate. 
   (c) Propose how you could improve your communication. 

4 ‘Being able to communicate effectively is the most important skill a manager can possess. Without this fundamental skill, all other attributes a manager may possess become less useful.’ Evaluate the accuracy of this statement. 

5 Construct a communication pie graph to illustrate the following information: spoken word = 7 per cent, nonverbal communication = 55 per cent and tone of voice = 38 per cent. Determine the important observation that can be made from these data. 

6 Create a PowerPoint presentation lasting no more than five minutes on one aspect of nonverbal communication that is of interest to you. Use the Nonverbal Communication weblink in your eBookPLUS to gather more information on this subject.

Vision skills

In his book Management: tasks, responsibilities, practices, Peter Drucker explains that it is ‘the first response of the manager . . . to give others vision and the ability to perform’. By vision, Drucker means the clear, shared sense of direction that allows people to attain a common goal.

Drucker argues that vision is the essential contribution of management, for without it there can be no sense of cooperation and commitment, which makes achieving goals impossible. Drucker explains that the most effective way for managers to share their vision for the business is through the organisation’s goals. Knowing where the business is headed and what it is trying to achieve helps employees understand where the manager wishes to take the business. A manager without a clear vision for the business is like a person who attempts to lead a bushwalk without any idea of where the group wants to go, without a compass or even a map. The walk would become aimless. The same thing happens in a business whose manager has not communicated clearly its vision. The business is without guidance.
Leadership

To share their vision and inspire others, managers will have to display effective leadership qualities. Leadership is the ability to influence people to set and achieve specific goals. A manager will use his or her leadership abilities to act as a bridge on which to support team members as they cross from the existing ideas into new and unfamiliar territory.

Being an effective leader is not an easy task; it is time consuming, especially if there are lots of people to lead. However, not displaying leadership qualities is inviting a greater possibility of failure. Leadership styles and the role of a manager as a leader are discussed in detail in chapter 7.

Problem-solving and decision-making skills

Problem-solving skills

When confronted with a problem, many of us search for an answer, jump at the first workable solution and move on. Management requires a more systematic problem-solving process when confronted with difficult and unfamiliar situations. Problem solving means finding and then implementing a course of action to correct an unworkable situation. Although managers have to deal with many problems in the course of a day, not all problems require such a systematic, formal process. One of the most important skills a manager can develop is the ability to decide which problem they should give their full attention.

There are six steps in a typical problem-solving process (see figure 5.10). The first step is to clearly identify what the problem is and what has caused it. The problem might be an industrial dispute or a need to develop a more socially responsible organisation. All of the facts and information that are relevant to the problem must be gathered. Some methods to use might be simply talking to people or completing questionnaires or surveys.

**FIGURE 5.10 A problem-solving process**

- Identify the problem and causes
- Gather relevant information
- Develop alternative solutions
- Analyse the alternatives
- Choose one alternative and implement it
- Evaluate the solution

**FIGURE 5.11** Problem solving involves finding and choosing a course of action to correct or improve a situation.
Management will need to develop alternative solutions so that the problem can be solved with an open mind. A list of possible solutions should be made, including the seemingly ridiculous ones. After analysing each of the alternatives for their advantages and disadvantages, the best option should be chosen. The solution to the problem will then be implemented and subsequently evaluated. If the solution does not work, the process would have to start again.

**Decision-making skills**

The task of solving problems will obviously require making some decisions. **Decision making** is the process of identifying the options available and then choosing a specific course of action to solve a specific problem.

Decision making can sometimes be dangerous. Not all management decisions are effective, as NASA discovered tragically in 1986, providing a case study of management decision making that shows dramatically the importance of the decision-making process (see the BizFact below).

Managers today are often confronted with complex, challenging and stressful decision-making demands. Accelerating change often makes it difficult to accurately predict the full effect of any decision. Therefore, managers need to develop an effective decision-making environment within the business. This can be accomplished by tapping into the creative potential of employees.

**Flexibility and adaptability to change skills**

Not since the Industrial Revolution over 200 years ago has business experienced so much change. Over the next 10 to 20 years, the Australian business environment will dramatically change. How managers perceive and react to these changes will have dramatic consequences for their businesses.

Regardless of their level of management, successful managers are those who anticipate and adjust to changing circumstances. They must be flexible, adaptable and proactive rather than reactive. Those who are unprepared or passive in the face of change will not succeed.

Businesses today are recruiting and selecting managers who can cope with unfamiliar and unexpected circumstances. For example, Arthur Hancock, former Senior Human Resources Manager for Global Equities Limited, said:

We are seeking managers who have learned how to learn and can adapt to changing situations. We do not want managers who are dogmatic and inflexible. Such a style of management may have been appropriate 50 years ago, but not for today's markets which are highly competitive, technologically driven and rapidly changing. We want to hire people who like surprises!

The topic of management and change will be examined in more detail in chapter 9.

**Summary**

- Managers must be able to provide a vision as to where the business is headed and what it is trying to achieve.
- To share their vision with others and inspire them, managers will have to display effective leadership qualities.
- Leadership is the ability to influence people to set and achieve specific goals.
- Managers must be able to solve problems — finding and then implementing a course of action to correct an unworkable situation.
- Managers must be able to make decisions — identifying the options available and then choosing a specific course of action to solve the specific problem.
- Managers must be flexible, adaptable and proactive rather than reactive.
Reconciling the conflicting interests of stakeholders

As outlined in chapter 3, there are a number of stakeholders in business. Stakeholders are groups and individuals who interact with the business and thus have a vested interest in its activities. Over the last four decades, there has been a significant philosophical shift in business conduct to meet society's expectations. Society increasingly expects businesses to accept responsibility and accountability toward all stakeholders for the promotion and management of change. Businesses are expected to be enterprising, to comply with the law, and be socially just and ecologically sustainable in their operations.

Most businesses are now extremely sensitive to public opinion and strive to be recognised as 'good corporate citizens'. Businesses recognise that they increase their chances of success when they pursue goals that align with the interests and expectations of all stakeholders.

All the stakeholders who interact with a business require something different; all place competing demands upon the business. Some of these expectations are compatible. For example, customers want quality for money. If the business meets this expectation then sales should increase, leading to greater profits. This in turn satisfies the business owners who are rewarded with higher dividends.

However, some expectations are incompatible; that is, they oppose each other. In this case, satisfying one set of stakeholders will most probably result in other stakeholders being dissatisfied. For example, employees require safe working conditions and reasonable wages while customers want reasonably priced products. Providing safer working conditions or a wage rise will cost money in the short term. If the business wished to retain a high dividend to satisfy the shareholders' expectations, then it may be forced to raise the prices of its products. This action will upset customers. On the other hand, the business may retain prices at the original level, reducing its profit. Doing this could cause disquiet among shareholders.

To maintain its profit, the management of a business may choose to cut costs, for example, and ignore some of its responsibilities. These types of decisions can endanger employees or society, or damage the environment through pollution, raising serious ethical and social responsibility considerations. Management might choose to reduce costs by sacking employees or by compromising on product quality or safety, which also raises other ethical and social responsibility considerations.

Reconciling these conflicting interests is not always easy. Senior management must assess constantly the actions of the business and attempt to satisfy as many stakeholder expectations as possible, while at the same time acting in a responsible manner.

FIGURE 5.12 In early 2010, millions of litres of radioactive water from the Ranger uranium mine flowed into the world renowned and World Heritage-listed wetlands in Kakadu National Park. Since its opening in 1981, the Rio Tinto-owned Energy Resources of Australia (ERA) mine, 250 kilometres south-west of Darwin, has experienced more than 150 spills, leaks and licence breaches. ERA has been warned repeatedly and fined by government regulators about various spills and other incidents.
Shareholders, society and the physical environment

Individuals and corporations purchase shares in companies for a variety of reasons, not least of which is to make a profit. Shares are sometimes purchased and held for only a short time. Such speculation is carried out with the intention of making a quick financial gain. Speculators are not normally concerned with the business’s long-term strategies, philosophies or business practices. They are motivated by a quick return on their investment.

However, other buyers purchase shares with the intention of holding onto them for a reasonable period of time. These non-speculative shareholders are more concerned with the long-term investment strategies of their companies. While these shareholders are still motivated by the desire to make a profit, they are able to adopt a long-term view. They appreciate the responsibility of a business to act as a responsible corporate citizen. They take into account the long-term impact of business decisions with particular regard to the environment and future generations.

The interests of society and future generations are very much reliant on the many decisions taken by businesses. Decisions concerning production processes, workplace practices, employment programs, product development and design, and business expansion will all have an impact on both present and future generations. Businesses have a responsibility to take into account the long-term effects of their current decisions.

One particular strategy that has been adopted by more enlightened businesses is to place greater emphasis on environmental practices. Adopting such a policy has benefits for both shareholders and society (see the following Snapshot).

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

Consequently, businesses are being asked to take increasing responsibility for the protection of the environment. The Earth is a fragile system, and needs high levels of support and informed intervention so that it may sustain itself. The social conscience of responsible business owners (and, increasingly, government legislation) has led them to adopt policies of conservation, recycling and restoration. The principle of ecological sustainability requires businesses to evaluate the full environmental effects of their operations.

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

In response to concerns about climate change, the community increasingly expects businesses to adopt greenhouse abatement measures and encourage the development of long-term sustainable strategies.

**Snapshot questions**

1. Define the term ‘ecological sustainability’.
2. Explain why businesses should be concerned with their ecological responsibility.
Many business analysts are now starting to refer to the ‘triple bottom line’ — economic, social and environmental performance — where shareholder value increases through the careful management of stakeholder value. More businesses are realising that reconciling conflicting interests and increasing stakeholder value ensures long-term growth and survival.

**Shareholder versus employee**

Employee share acquisition schemes are one strategy used to reconcile conflicting interests between shareholders and employees. Such schemes provide the opportunity for eligible employees to purchase shares in a business, often at a reduced price. This aligns the interests of both groups as a number of employees become shareholders.

Another widely used strategy is to offer training and professional development to employees. An educated and skilled workforce works more efficiently, reducing production costs. This results in rising profits, which pleases shareholders. Also, better trained staff produce a higher quality product, thus satisfying customer expectations.

The more successfully a management team achieves the business’s goals, the more it will be able to satisfy a greater number of stakeholders. Therefore, to succeed in reconciling the conflicting interests of stakeholders a business needs competent, informed, ethical and socially responsible managers.

**Stakeholder engagement**

In a desire to reconcile the conflicting interests of the various stakeholders, some businesses use a process of stakeholder engagement (see the following Snapshot). **Stakeholder engagement** refers to businesses sharing information with and seeking input from stakeholders, and involving them in decision making. Businesses anticipate that by engaging stakeholders they are more likely to act in an ethical or socially responsible manner.
Businesses also anticipate that a positive image of the business will be maintained if all stakeholders have their expectations satisfied, leading to increased sales as well as an improved reputation for corporate social responsibility.

**BHP Billiton**

With 41,000 employees working in 25 countries, BHP Billiton is the world's largest mining company. It was formed in 2001, following a merger between BHP and Billiton. BHP Billiton's major businesses include aluminium, coal, copper, manganese, iron ore, uranium, nickel, silver and titanium minerals, and it also has substantial interests in oil, gas, liquefied natural gas and diamonds. The headquarters for BHP Billiton Limited is located in Melbourne. BHP Billiton identifies its stakeholders on its web page, as well as explaining how it engages them.

**Stakeholder engagement at BHP Billiton**

BHP Billiton claims that it regularly consults employees and contractors, local and indigenous communities, shareholders and customers. It realises that other groups, such as the investment community, business partners, community organisations, unions, non-government organisations, suppliers, governments, media and industry associations have an influence on the business. Some of BHP Billiton's stakeholder engagement methods are described under the following headings.

**Community organisations**

Community organisations often represent local and indigenous communities near BHP Billiton's operations. Community organisations need to be assured that any potential environmental and social impacts associated with BHP Billiton's operations are kept to a minimum, and that opportunities arising from the operations are maximised. BHP Billiton says that individual sites work with their own host communities, using community consultation and engagement groups.

**Customers**

BHP Billiton's customers are mostly other large organisations. BHP Billiton says that they are usually interested in product quality, cost and delivery. The marketing area regularly communicates with customers. Technical support assists in the use and handling of products. Customers receive information about products and have the opportunity to visit BHP Billiton operations sites to learn more about its products.
Employees and contractors

Employees and contractors are very much concerned with their own health and safety as well as working conditions in general. Members of staff need to be provided with career and training opportunities to maintain employee satisfaction. BHP Billiton realises that an operation’s employees and contractors, who live locally, will also be concerned about such things as local employment, business creation and social infrastructure, schooling and health care. Quality of housing is also important to staff who live in remote communities. Processes need to be in place to enable employees and contractors to participate in performance improvement initiative, and to take part in performance reviews and employee surveys. Communication is vital.

Government

BHP Billiton respects the authority of government at country, state (or regional) and local levels. It attempts to work openly and constructively with the government of the country where it is operating.

Shareholders

BHP Billiton has shareholders in Australia, Europe and North America. Shareholders are interested in seeing suitable organisational performance and governance leading to profit, BHP Billiton communicates with shareholders at annual general meetings, through regular print and electronic communications, and through its website.

Suppliers

BHP Billiton’s suppliers include local businesses close to its operation as well as large international suppliers. Its suppliers are interested in supply agreements and payment processes as well as the standards that BHP Billiton requires of them. A single point of contact at BHP Billiton ensures that regular reporting and communications are maintained between the company and its suppliers. BHP Billiton attempts to use local suppliers and supports these suppliers in enhancing community development opportunities.

Snapshot questions

1. Describe the term ‘stakeholder engagement’.
2. Identify BHP Billiton’s stakeholders.
3. Complete the following table to demonstrate how BHP Billiton engages with its stakeholders. The first one has been completed for you.

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Explanation</th>
<th>Interests</th>
<th>Engagement method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community organisations</td>
<td>They often represent local and indigenous communities near BHP Billiton’s operations</td>
<td>They need to be assured that environmental and social impacts will be minimised and that opportunities are maximised</td>
<td>Individual sites work with communities, using community consultation and engagement groups</td>
</tr>
</tbody>
</table>

4. Outline some of the benefits of stakeholder engagement.
5. Explain how the management of conflicting stakeholder interests can lead to a business being viewed as socially responsible.
Summary

- Stakeholders are groups and individuals who interact with the business and thus have a vested interest in its activities.
- Society increasingly expects businesses to accept responsibility and accountability towards all stakeholders.
- Stakeholder expectations can be compatible or incompatible.
- Managers need to reconcile the conflicting interests of various stakeholders.
- Senior managers must attempt to satisfy as many stakeholder expectations as possible.
- Economic development must be accomplished sustainably.
- The triple bottom line refers to the economic, social and environmental performance of a business.
- Reconciling the conflicting interests of stakeholders requires competent, informed, ethical and socially responsible managers.
- Stakeholder engagement is a process that assists in reconciling the conflicting interests of stakeholders.

Revision

1. Draw a table similar to the one below and summarise details of the management skills discussed in this section.

<table>
<thead>
<tr>
<th>Skill</th>
<th>Definition</th>
<th>Characteristics</th>
<th>Application to the workplace</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Clarify why Peter Drucker argues that ‘vision is the essential contribution of management’.

3. Outline the relationship between ‘vision’ and ‘leadership’.

4. (a) Identify two or three people who you consider to be effective leaders. (b) Against each name, outline the personal qualities each person displays. (c) Determine what leadership qualities the individuals have in common. (d) Compare your answer with other class members.

5. Recall the six steps in a typical problem-solving process.

6. Explain the relationship between problem solving and decision making.

7. Discuss why it is important for managers to be proactive rather than reactive.

8. Define the term ‘stakeholder’.

9. Recall information to complete the following table. The first one has been completed for you.

<table>
<thead>
<tr>
<th>Major stakeholders</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers</td>
<td>Quality for money, reasonably priced products</td>
</tr>
<tr>
<td>Employees</td>
<td></td>
</tr>
<tr>
<td>Shareholders/owners</td>
<td></td>
</tr>
<tr>
<td>Society/physical environment</td>
<td></td>
</tr>
</tbody>
</table>

10. Looking at the information in your table, outline the ways in which the interests of stakeholders’ conflict.

11. Distinguish between compatible and incompatible expectations of stakeholders. Provide examples.

12. In small groups, recommend methods a business could use to reconcile the following conflicting interests.
(a) Consumers demanding cheaper products and employees wanting higher wages
(b) Shareholders desiring a higher return on their investment and society wanting a cleaner environment
(c) Managers being required to keep costs of production down and the government demanding improvements in occupational health and safety practices.

13 **Demonstrate** ways a business can show that it is acting in an ecologically sustainable manner.

14 **Explain** how stakeholder engagement can assist in reconciling the conflicting interests of stakeholders.

**Extension**

1 You have been asked to make a three-minute oral presentation at the local chamber of commerce meeting. The topic you have selected is ‘The essential skills of management’. **Investigate** the topic and present your report to the class. For each skill, include a definition of the skill, its characteristics and application to the workplace. You might like to use PowerPoint to present your lecture.

2 (a) **Identify** the major stakeholder groups often mentioned in relation to social responsibility.
   (b) **Analyse** to what extent these groups apply to your school.
   (c) **Determine** what other stakeholders you might add.

3 ‘To be effective, corporate strategy must take into account the interests, needs, and expectations of all the business’s stakeholders. Companies should have a strategy that combines business goals and broad social interests.’ **Evaluate** this statement.

4 Complete the following table. **Propose** any skills that you think could be used to achieve the business goals, and **explain** how they could be used. The first entry has been started for you.

<table>
<thead>
<tr>
<th>Business goals</th>
<th>Skills</th>
<th>How</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve the culture of a business</td>
<td>Communication</td>
<td>Explain to staff the changes that will take place.</td>
</tr>
<tr>
<td></td>
<td>Problem solving</td>
<td>Use the problem-solving steps to work out what problems are preventing the culture from improving.</td>
</tr>
<tr>
<td>Successfully merge with another company</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improve social responsibility</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improve staff satisfaction</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
6.1 Introduction: What are goals?

People start up a business because they want to achieve something; they have goals they want to attain. From an early age, you have been setting goals. A goal is a desired outcome (target) that an individual or business intends to achieve within a certain time frame. For example, when you were in primary school some goals you may have wanted to achieve could have included:

• learning to play a musical instrument
• becoming a member of a sporting team.

In secondary school, the goals will have changed and may now include:

• acquiring a part-time job
• improving your debating skills
• achieving the best possible results in Business Studies.

Success in achieving your goals is often determined by the amount of planning you undertake. Detailed planning increases the likelihood of successfully achieving your goals.

As with individuals, businesses:

• need to establish goals
• are required to undertake planning to successfully achieve specific goals.

The importance of goals

Carefully prepared goals — begin with the end in mind — benefit managers by:

1. Serving as targets. With goals, managers at all levels would find it easier to make coordinated decisions because they understand what the business is trying to achieve.
2. **Measuring sticks.** Specific goals act as a benchmark against which the business can measure its performance — that is, the actual outcome is compared with the planned goal.

3. **Motivation.** Good quality goals represent a challenge — something to aim for. They act as a motivating force. Employees will gain satisfaction when they successfully achieve a challenging goal. Goals also provide managers with a basis for rewarding performance, which in turn acts as a motivator.

4. **Commitment.** Getting an employee to agree to achieve a goal — or better still, having the employee participate in the goal-setting process — gives that employee a personal stake in the success of the business.

Goals for large businesses tend to be broader in scope, as evidenced by the company goals for Billabong International Limited (as outlined in its annual report):

Billabong International's values remain consistent with its foundation objectives, which include a commitment to brand protection and enhancement, the manufacture of design-relevant and functional products, marketing in the core boardsports channels, the professional development of staff, and ongoing customer service and relationships.

Goals for smaller businesses tend to be narrower in scope, as evidenced by the business goals for Yarrawollen Consulting (as outlined in its business plan):

Over the next two years, Yarrawollen Consulting will focus on achieving the following goals:

- maintenance of professional standards in all client contacts
- provision of up-to-date, relevant and practical business advice
- increase in customer base by 10 per cent
- improvement in profitability by 8 per cent.

### Setting goals

To influence employee behaviour and increase their commitment, goals need to be specific and challenging. For example, deciding to ‘increase sales this year’ will not direct and energise employees as much as deciding to ‘increase New South Wales sales by 5 per cent in the next 12 months.’ Similarly, choosing to ‘improve Business Studies results a bit’ will not motivate a student as much as deciding to ‘improve Business Studies results by 10 per cent during next term’. Specific and challenging goals provide a target to aim for.
Although setting goals is not a complicated process, the manager needs to set the right type of goals (see the following Snapshot).

**S.M.A.R.T. goals**

Using the **S.M.A.R.T.** technique — a common acronym in goal setting — is the best method for writing effective goals. Using this technique will help the business owner to define the goals more easily, and the details involved in achieving them. S.M.A.R.T. goals should be:

1. **Specific.** Goals should be straightforward and emphasise what the business wants to happen.
2. **Measurable.** Decide on goals whose progress can be measured so the business owner can see the change occur. This helps the business stay on track.
3. **Achievable.** Goals need to be challenging but not be too far out of the business’s reach, otherwise the business owner and employees will become unmotivated due to the lack of success.
4. **Realistic.** The goals must represent something that the business owner and employees are both willing and able to work towards.
5. **Timebound.** The goals must have deadlines and sub-deadlines attached to them otherwise the commitment is too vague.

As Nina Dravik, owner of Transcend Interiors says, ‘The first step in planning is to set goals. With easily understood and sensible goals, the business has direction and purpose. However, goal setting is a two-edged sword. If done correctly, goal setting results in a remarkable improvement in the business’s performance. If done badly, it results in poor performance results. Consequently, when setting goals for my business I use the S.M.A.R.T. technique because it produces clearly defined goals that provide employees with direction, focus and understanding.’

**Snapshot questions**
2. Explain what Nina Dravik means when she says that ‘The first step in planning is to set goals’.

**Summary**

- People start a business because they want to achieve something; they have goals they want to attain.
- A goal is a desired outcome (target) that an individual or business intends to achieve within a certain time frame.
- Success in achieving your goals is often determined by the amount of planning you undertake.
- Carefully prepared goals benefit managers by:
  - serving as targets
  - measuring sticks
  - motivation
  - commitment.
- The best method of writing effective goals is by using the S.M.A.R.T. technique.

**Revision**

1. Define the term ‘goal’.
2. Recall what often determines the success in achieving goals.
3 (a) Describe two personal goals.
   (b) Identify when you want to achieve them.
   (c) Outline what planning will be required to achieve these goals.
4 Discuss what is meant by the statement ‘begin with the end in mind’.
5 Summarise how carefully prepared goals will benefit managers.
6 Identify a benchmark you use to assess your achievement in Business Studies.
7 Read the following two statements. Decide and justify which one is a goal and which one is not.
   (a) ‘To improve customer service.’
   (b) ‘To respond to every customer enquiry courteously and completely within three hours.’

Extension
1 ‘We plan to expand our market into Asia, increasing worldwide market share by 2 per cent over the next three years.’ Determine whether this goal is more likely to belong to a large or small business. Give reasons for your answer.
2 Reflect on a goal you have recently achieved. Analyse the reasons why you were successful in achieving this goal.
3 Using the S.M.A.R.T. technique, create a suitable goal for the following businesses:
   (a) Blue Hills Corner Store
   (b) Evergreen Nursery
   (c) Banthai Restaurant.

6.2 Business goals — financial

In operating a business, the owner is generally striving to achieve four financial goals as shown in figure 6.3.

![Financial goals diagram]

**Maximise profits**

Have you ever saved enough money to purchase an expensive item? If so, you probably kept a record of all the money you received (revenue), the money you spent (expenses) and the resulting balance. These records provided you with information about your cash flow position. As you saved more and the balance increased, you were able to determine how close you were to achieving your financial goal. One of the most basic financial goals for businesses is to maximise profits.

As explained in chapter 1, profit is what is left after the costs of producing and supplying the product (expenses) have been deducted from money earned from sales (revenue). If the business is unable to consistently make a profit, it will fail. Only profitable businesses survive in the marketplace.

A major indicator of a business’s success is the size of its profit, so many businesses not only want to make a profit, they want to maximise their profit. Profit maximisation occurs when there is a maximum difference between the total

**BizFACT**

All businesses have financial goals as well as a system of financial record keeping. Financial records are also used to determine the business’s level of success.

**BizWORD**

Profit maximisation occurs when there is a maximum difference between the total revenue (that is, the number of sales made multiplied by the price) coming into the business and total costs being paid out.
revenue (that is, the number of sales made multiplied by the price) coming into the business and total costs being paid out (see figure 6.4). The goal of seeking to make as much profit as possible is probably pursued by a larger number of businesses than any other goal.

\[
\text{Total sales} \times \text{price} = \text{Total revenue (TR)} \\
\text{Total expenses incurred in operating the business} = \text{Total costs (TC)} \\
\text{Profit} = \text{TR} - \text{TC} \\
\text{Maximum profit} = \text{TR at maximum difference from TC}
\]

**FIGURE 6.4 Profit maximisation**

One way of maximising profits is to increase sales. This may be done by lowering the price so consumers purchase more. Alternatively, the business may seek to increase sales through a well-targeted marketing campaign or creating more innovative products or delivering better services.

The profit maximisation goal is likely to be more beneficial to a business if adopted over the long term. Ironically, this may require a business to accept either lower profits or losses in the short term. A business entering a new market or introducing a new product, for example, usually performs best by initially setting low prices to build a large customer base. This is a strategy that Virgin Airlines adopted when it entered the Australian market. It offered cut-price airfares to tempt passengers away from the established carriers. Virgin has as its long-term goal ‘the desire to maximise profits’, but they realised it would take a number of years to achieve.

**FIGURE 6.5** There are many ways businesses can maximise profit. Price may be lowered to increase the volume of sales or clever advertising may convince the consumer to buy a product.

**BizFACT**

Not all businesses aim for profit maximisation. Some, especially small businesses, aim for only satisfactory profits. They prefer returns that ensure the business’s survival and provide a comfortable lifestyle.

**BizWORD**

*Market share* refers to the business’s share of the total industry sales for a particular product.

**Increase market share**

*Market share* refers to the business’s share of the total industry sales for a particular product. In most industries, market share is usually a goal for only large businesses. Such businesses often develop an extensive product range, using many different brand names to gain an extra few percentage points of market share. ACP Magazines, for example, is Australia’s leading magazine publisher. It dominates the young women’s magazine market with a significant percentage of Australian women aged 14–18 years reading either *Dolly* or *Girlfriend*. In the motoring category, ACP Magazines has 87 per cent of the market share; the music category 79 per cent, with titles including *Rolling Stone* and *Limelight*; and in the women’s lifestyle category 75 per cent, with titles including *madison*, *marie claire* and *CLEO*. Overall, ACP captures about 52 per cent of total Australian magazine market share.
Increasing market share is an important goal for businesses that dominate the market, because small market gains often translate into large profits (see the following Snapshot).

**Market share battle: Coles v Woolworths**

The Australian grocery market is dominated by two large supermarket chains: Coles (owned by Wesfarmers) and Woolworths. According to most estimates, Coles and Woolworths account for approximately 80 per cent share of the packaged grocery market and about 55 per cent share of the fresh meat, and fruit and vegetable market. Between the two, they account for 25 cents out of every $1 spent in Australian retailers, with Woolworths taking about 13 cents and Coles about 12 cents.

Recently, the two supermarket giants have increased their dominance in the grocery market, poaching market share from the independent operators including Aldi, Franklins, Foodworks and Independent Grocers Alliance (IGA). Over the past few years, Coles has lost about 1.7 per cent of its market share to Woolworths. However, in a hotly fought battle, Coles intends to claw back this lost market share by undertaking store refurbishments to give them a new ‘look’, wider aisles that are broken mid-store, a larger range of products and wider checkout aisles.

While the percentage of market share lost by Coles may seem small, if Coles is successful in regaining this market share then sales will rise by around $1.3 billion, with almost half ($620 million) taken from Woolworths.

**Snapshot questions**

1. Recall the market share of Coles and Woolworths.
2. Explain why the two supermarket chains battle over their share of the total market.
3. Predict whether the changes introduced by Coles will be successful. Give reasons for your answer.

... sales will rise by around $1.3 billion, with almost half ($620 million) taken from Woolworths.
The market share of SMEs is usually restricted to the size of the business. A local corner store’s market share, for example, is limited to the number of customers living within its immediate area.

One of the most successful strategies used to increase market share is promotion. **Promotion** describes the methods used by a business to inform, persuade and remind a market about its products. Promotion can be used to convince new customers to try a product, while maintaining established customers’ product loyalty. Advertising that emphasises the product’s features also assures those who do use the product that they are making the right decision.

**Maximise growth**

Most businesses want to grow. They can achieve growth internally (organically) or externally. Internal growth could involve employing more people, increasing sales, introducing innovative products, purchasing new equipment or establishing more outlets. McDonald’s has pursued an ambitious growth program by selecting a large number of sites for future expansion.

External growth is achieved by merging with or acquiring other businesses. A merger occurs when two businesses join together to become one — for example, when the airline company Qantas joined with Jetset Travel. Expansion can also take place through acquisition. This means that one business purchases another business — for example, when Coca-Cola Amatil purchased Neverfail Springwater and Mount Franklin bottled water suppliers; SPC Ardmona, IXL and Taylor’s food products; and Goulburn Valley packaged ready-to-eat fruit merchandise.

**FIGURE 6.7** Coca-Cola Amatil has attempted to maximise its growth through the acquisition of a diverse range of sparkling, still and alcoholic beverages, and food products.

Maximising growth is not a goal that only large businesses can achieve. Many successful SMEs have followed similar strategies and in the process expanded to become large businesses. However, some small business owners are content to maintain the existing size of their business to:

- avoid the added pressures of expansion in a desire for a quiet life or a particular lifestyle
- keep control over the business’s operations
- maintain personal contact with the customers.
**Improve share price**

A share is a part ownership of a public company. Shareholders therefore are the real owners of companies. There are two reasons why a person will buy shares. Firstly, they may purchase shares in the hope of selling them for a higher price. Secondly, owning shares in a company entitles an investor to a part of the company’s profits, which is distributed in the form of dividends.

For companies that wish to be successful, they need to maximise the returns of their shareholders. This is achieved by keeping the share price rising — constantly improving the share price — and paying back healthy dividends. This is a goal that Coca-Cola Amatil has been able to achieve over the past decade (see figure 6.8).

![Share Price Movement](image)

**FIGURE 6.8** The 10-year share price movement for Coca-Cola Amatil

Of course, businesses must be aware that they operate within a wider community that expects corporations to act ethically. Unethical activities may temporarily improve a company’s share price but ultimately end up being detrimental to a business.

### 6.3 Business goals — non-financial

As well as achieving financial goals, many businesses also develop social, environmental and personal goals, and adopt strategies to achieve them.

**Social goals**

All businesses operate within a community and, like individuals, have certain social responsibilities. Many businesses develop social goals and adopt strategies that will benefit the community, while achieving financial goals. Among the main social goals are:

1. **Community service.** Business sponsorship of a wide range of community events, promotions and programs rapidly increased during the past decade. Many businesses financially support educational, cultural, sporting and welfare activities.

2. **Provision of employment.** Most large businesses do not regard employment of people as a main goal. Many small business owners, however, look at the continuity of their business, sometimes employing family members who otherwise might be unemployed.
3. **Social justice.** Everyone has the right to be treated fairly. A business may be concerned for **social justice** — that is, it adopts a set of policies to ensure employees and/or other community members are treated equally and fairly.

### Environmental goals

Imagine that the world is like a business. As owners of this business you would be concerned about its future prospects. Every year, more output is demanded and consequently its production lines work faster and faster. However, the raw materials used to produce the vast array of goods and services are shrinking at a frightening rate. In the effort to increase output, essential maintenance is sometimes ignored. The business’s water and power supplies are under increasing threat. To continue this way will be unsustainable and the business will eventually fail.
Does this sound unbelievable? Possibly. But in many ways this is what is happening to the world we live in. For quite a while people have treated the Earth just as they like, without giving much thought to the long-term consequences. However, the past is catching up with us. It is obvious that we cannot continue as we have; things will have to change. And the good news is that these changes are already occurring. There are signs that people and businesses are becoming more environmentally aware. Enlightened businesses are adopting practices of ‘recycle, renew and regenerate’, as well as adopting a ‘green’ attitude, and developing products and creating ideas that are environmentally friendly. These business practices reduce the impact on the planet’s health so that future generations are not disadvantaged.

**Sustainable development**

So far we have painted a somewhat bleak picture of the possible future. Fortunately, however, the world is moving away from many of its past practices. Economic growth must be achieved sustainably. Many in society now argue that economic growth should not occur at the expense of polluting and degrading the air, water and forests that are essential to support life on this planet. There needs to be a balance between economic and environmental concerns — in other words, **sustainable development**.

Businesses are starting to play their part in achieving sustainable development. Pressure to change has come from society’s increasing awareness of environmental issues. As well, governments are imposing stricter environmental regulations on business practices. This will provide many new business opportunities for environmental services and products (see the following Snapshot).

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**Clean Seas Aquaculture . . . is making sustainability its main goal.**

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**Sustainable and successful**

Australian businesses have responded to the worldwide increase in demand for environmentally sound products. Consequently, increasing numbers of businesses are putting some of their profits into environmental restoration and/or development of environmentally friendly products. For example:

1. **Ecotech Pty Ltd.** Ecotech specialises in the design, supply and maintenance of sophisticated air and water monitoring equipment and systems. Ecotech products have been installed for many water authorities, environmental protection bodies and a range of private industrial clients worldwide. Ecotech’s equipment and computer systems have been exported to New Zealand, India, Indonesia, Malaysia, Thailand, China, Mexico and Cyprus.

2. **Hagen Stehr — mulloway farmer.** Mr Stehr has been operating his tuna farm for a number of years. Recently he adapted his tuna-breeding skills to farm the almost extinct mulloway — otherwise known as jewfish or butterfish. Mr Stehr presently exports his product to the United States of America, France and England, where his ‘clean and green’ product has found a ready market. Clean Seas Aquaculture, a subsidiary of the Stehr Group, is making sustainability its main goal.

3. **Greenspan Technology.** Greenspan Technology, on Queensland’s Darling Downs, has grown to rapidly become one of the world’s leading water quality monitoring instrumentation companies. It makes a wide range of sensors and water quality analysers for the water and wastewater markets.

(continued)
4. Thistle Hill Vineyards. Situated just outside of Mudgee in central NSW, Thistle Hill Vineyards uses neither insecticides nor systematic fertiliser. It is one of a handful of Australian wineries producing organic premium quality table wines.

Snapshot question
Select one of the above businesses and:
(a) briefly outline the business’s operations
(b) summarise the business’s commitment to the environment
(c) determine the benefits of their products to the (i) business and (ii) environment.

Personal goals of owners and managers
Business owners normally have a number of personal goals. Often, the nature and operation of the business tend to reflect these personal goals, especially in small businesses. Personal goals of a higher income and improved financial security, for example, complement the business goals of growth and diversification.

Personal goals for business owners are not normally made public. However, this does not diminish their importance because they motivate the business owner and may underpin the viability of the business.

To use an example, Jordan Belfort (also known as the Wolf of Wall Street) was a 31-year-old multi-millionaire stockbroker in America whose greed for more material possessions eventually landed him in prison, charged with fraud (deceiving others). He says his personal goals were motivated by greed, and there was a time when he didn’t know the difference between right and wrong. He is now a motivational speaker and is working to pay back those investors who lost money because of him. He believes he is now channelling his energies into helping others.

FIGURE 6.11 Once known as the ‘Wolf of Wall Street’, Jordan Belfort is now paying back US$100 million to the shareholders he swindled.
6.4 Achieving a mix of business goals: Conflicting nature of goals

The preceding sections outlined the financial goals of a business, as well as the social, environmental and personal goals of the business owner. It is difficult for a business to achieve all its financial goals simultaneously because the links between the goals make some of them incompatible — that is, they conflict with each other. Such a situation will force a business owner into deciding to adopt a compromised position; a trade-off between conflicting goals. A business owner may face the dilemma of having to choose whether to maximise profits or increase market share. It is sometimes a difficult decision. You have probably faced a similar dilemma: for example, should you go to the movies or prepare for an exam? The two ‘goals’ are conflicting and, just like a business owner, you must make a decision.

Which financial goals may conflict? An increase in market share may only be achieved at the expense of maximising profit in the short term; it may require extensive advertising, which increases expenses and thus lowers profits until more products are sold. Such a strategy is based on the belief that profits will be maximised in the long term.

Maximising profits is often considered the business’s main goal. However, this goal may not be achievable, or it may be an inappropriate goal due to the following reasons.

• Present profit levels may be maximised by eliminating some expenses, but this may reduce long-term profits. For example, a decision to reduce the amount spent on advertising may reduce expenses (and therefore increase profits) in the current period, but it may reduce the level of sales in the long term, which ultimately may reduce profits.

• If profits are maximised due to higher prices rather than lower costs, managers may prefer lower profits to discourage potential competitors from entering the industry. In this case, a long-term price policy that is similar to the rest of the competitors will be more beneficial for the business than one that exploits current market conditions for instant profit.

• Managers may decide to limit profits by keeping prices down to maintain good customer relations. Consumers will often resent prices they consider to be unfair, which encourages them to buy their products from other businesses.

• Maximising profits, by charging high prices, may result in negative political and social outcomes for the business. For example, some consumers may argue exploitation by the business, resulting in government regulation.

• Businesses should be careful regarding how they go about achieving the goal of profit maximisation. Maximising profit should never involve short-term exploitation. Consumers, employees and the community who feel they have been taken advantage of may quickly lose their loyalty to a business. The result could well be a fall in profits in the long term.

• In large public companies, the shareholders do not usually decide how production is to be organised. The shareholders gain the profits, but it is the directors and managers who make the operational decisions. (This is referred to as the separation of ownership and control.) This may result in management pursuing other goals. For example, if a senior manager is offered a bonus that is tied to attaining a specific share price, to boost short-term profits, the manager may reduce expenses by decreasing the number of employees, which in turn could maintain a high share price. However, this may then conflict with
maximising profits in the long term. Alternatively, the manager may be driven by attaining as much power as possible and achieves this by placing a priority on the goal of maximising growth.

The ‘maximise profits’ question is complex, making it difficult to state unconditionally that businesses that operate in a competitive market do or do not seek to maximise profits. In reality, perhaps they prefer to achieve goals of satisfactory performance, such as a particular market share, or a definite growth rate, or a specific share price that generates a reasonable rate of return.

Occasionally, there may be conflict between the financial and social, environmental and personal goals of a business. A business’s desire to uphold its social justice commitments, for example, may require it to cease operations in a country that violates human rights. Such a closure would decrease profits. Some business owners may perceive ecologically sustainable practices as being too expensive, especially if the owners are driven by their bottom line, or profit.

Summary

- There are four main financial goals a business attempts to achieve:
  - maximise profits
  - increase market share
  - maximise growth
  - increase share price.
- Profit maximisation occurs when there is a maximum difference between total revenue (TR) and total costs (TC).
- Market share refers to the business’s share of the total industry sales for a particular product.
- A small change in a business’s market share can result in a large change to its profit.
- A business can maximise growth either internally (organically) or externally.
- Companies need to satisfy their shareholders by improving the share price and paying healthy dividends.
Many businesses develop social and environmental goals and adopt strategies that will benefit the community.

There are three main social goals a business attempts to achieve:
- community service
- provision of employment
- social justice.

Enlightened businesses are adopting sustainable development practices.

Managers often have to make a trade-off between conflicting goals.

Revision

1. **Construct** a concept map (started below) summarising the four main financial goals of business.

**Maximise profits**
- Occurs when there is a maximum difference between total revenue and total costs
- Is more beneficial if it’s a long-term goal
- Is the main goal for most businesses

**Increase market share**

**Maximise growth**

**Improve share price**

2. In the following examples, **identify** which financial goal the business is trying to achieve.
   
   (a) The business owner wishes to increase revenue so they conduct a large sale.
   (b) A board of directors announces that the company’s profits are forecast at 23 per cent over the next twelve months and the dividend will rise by 28 cents per share.
   (c) A manager decides to undertake an extensive promotional campaign in an attempt to attract new customers.
   (d) Senior executives knew there was only one way to expand the business and that was by buying the opposition.

3. ‘The main goal of a business is to maximise profits’.
   
   (a) **Define** the term ‘profit maximisation’.
   (b) **Recount** under what circumstances a manager may be prepared to accept reduced profits in the short term.
   (c) In your opinion, **discuss** whether maximising profits should be the only goal of a business.

4. **Describe** two strategies a manager can use to maximise profits.

5. **Explain** why profit maximisation is more suitable as a long-term goal.

6. Use the Coca-Cola Amatil weblink in your eBookPLUS to:
   
   (a) **Identify** the five products that have the greatest market share
   (b) **Discuss** why Coca-Cola Amatil wants to increase its market share for each of its products.
7 Recommend three strategies either Coles or Woolworths could use to increase their market share. Share your answer with other class members.

8 Distinguish between internal and external growth.

9 Recall why some small businesses are content to maintain their existing size.

10 Outline the relationship between a shareholder and a public company.

11 Define the term ‘share’.

12 Explain why some companies may not be able to constantly improve their share price.

13 Examine figure 6.8 on page 151 and then answer the following questions.
(a) State what this graph measures.
(b) Explain why a shareholder who purchased Coca-Cola Amatil shares in 2001 would most probably be satisfied.
(c) During 2008 the world suffered a global financial crisis. Deduce what impact this had on the Coca-Cola Amatil share price.

14 Summarise the three main social goals of a business.

15 Identify three examples that demonstrate businesses are becoming more environmentally aware.

16 Justify why businesses should adopt sustainable development practices.

17 Account for why profit maximisation may not always be an achievable or appropriate goal. Provide two reasons.

18 Explain how the separation of ownership and control can lead to conflicting goals.

Extension

1 Set up a class debate to critically analyse the following topic: ‘All businesses care about is making as much money as possible’. Share roles so that those not debating are involved either in assisting with research, or in running the debate and keeping notes on both sides’ arguments.

2 In small groups, arrange to interview a local small business owner to determine his or her main business goals. Compare and contrast them with what you have learnt from this topic. Present your findings to the rest of the class.

3 ‘A business’s financial goals sometimes conflict with each other’. Evaluate this statement.

6.5 Staff involvement

One important goal that all businesses should give a high priority to achieving is that of staff involvement. Sometimes referred to as employee empowerment or employee participation, staff involvement means involving employees in the decision-making process and giving them the necessary skills and rewards.

Employees are a business’s most important resource. It is important to recruit and select appropriate employees. It is then vital to provide a work environment that maximises employee involvement and satisfaction because this results in high levels of output. Therefore, managers should pursue workplace practices that increase labour productivity. Policies that recognise the involvement, knowledge, skills and creativity of the employees will lead to increased productivity and long-term business success.

Staff involvement is a type of decentralisation that involves allowing employees some authority to make decisions. Employees are encouraged to accept responsibility for their work. In businesses where true staff involvement occurs, employees gain confidence in their ability to perform their jobs and influence the business’s overall performance. One of the most influential results of staff involvement is that employees exhibit more determination and initiative in pursuing the business’s
goals. Overall, staff involvement provides two advantages: increased employee motivation and solutions to organisational problems. However, staff involvement will only be fully successful if a business provides employees with the necessary expertise as well as recognising the importance of:

- staff innovation
- mentoring
- motivation
- training.

**Staff innovation**

As we outlined in chapter 1, innovation occurs when a new idea is applied to improving an existing product or idea. With markets and competition becoming more global, Australian businesses are being forced to become more innovative. Often, a business can gain a competitive advantage if it innovates successfully. Therefore, all businesses should encourage an innovative business culture by recognising and encouraging one of the most important sources of innovative ideas: employees. For example, in 1968 Spencer Silver, a 3M technician, developed a ‘low-tack’ adhesive that would not stick — a glue that 3M considered a failure. The product was abandoned. However, in 1973, another innovative 3M technician, Art Fry, in a moment of insight, realised the full potential of a reusable bookmark and went on to invent the Post-it Note. It was through the innovative potential of these two employees that the humble Post-It Note has become an absolute necessity in the office. As the basic product evolved into an entire product line, Post-It Notes are to be found in most schools, laboratories, libraries, and in homes.

The innovative activities of staff are often referred to as the entrepreneurship within the business. More recently, employees who take on the entrepreneurial roles within businesses are called **intrapreneurs**. In some businesses, these creative people present some managers with a dilemma. Highly creative, innovative thinkers can be nonconformist in their behaviour and dress. Attempts to get creative employees to be conventional and follow the rules and regulations may actually suppress their creativity. However, if a business is to grow and to maintain its competitive advantage, then staff must be encouraged and given the opportunity to be innovative. The most important thing a business can do to achieve this successfully is to demonstrate that it values new ideas and solutions and it does this by taking them seriously. If a business just pays lip service to creativity then the employees quickly ‘get the message’ and stop coming up with original ideas. Other practices would include:

- rewards given to employees with innovative ideas that become profitable
- a trusting management that does not excessively control — micromanage — people

**BizWORD**

An **intrapreneur** is an individual who takes on the entrepreneurial roles within a business.
sufficient financial, management, human and time resources to achieve goals
not fearing the consequences of making a mistake
use techniques such as brainstorming to encourage ideas.

**Motivation**

Why do some employees work harder than others? Why can an employee with average skills regularly outperform someone with outstanding abilities? The difference between the two employees is most probably their level of motivation.

Motivating employees is one of the most important management functions because high levels of motivation result in increasing rates of productivity. **Motivation** refers to the individual, internal process that directs, energises and sustains a person’s behaviour.

Put another way, motivation is what drives a person to behave in a certain way, or to achieve a certain goal. For example, what motivated you to:

- return to Year 11 after completing Year 10?
- complete the latest Business Studies homework exercises?
- watch television instead of reading your English novel?

In a work setting, motivation makes people want to work, but what precisely is it that motivates people? This is a topic which is widely discussed, but often neglected in the workplace. This is mainly because it is an area of human behaviour which is difficult to understand given the conflicting answers provided by research.

For many years, managers have relied on the use of either rewards or punishments to motivate employees. An analogy is often used to try to explain what motivates people. It concerns a donkey and what is most likely to motivate it to move forward — that is, change its behaviour. According to the ‘story’ either a carrot can be dangled in front of the donkey (a reward) or it can be hit with a stick (a punishment). Either method may motivate the donkey. In the work environment, ‘rewards’ refer to increased pay and improved conditions, ‘punishment’ refers to fear of a reprimand, demotion or dismissal.

However, research over the last 70 years has revealed that motivation is much more complicated than just these two variables. Different theories have been formulated which lead to the conclusion that individual employees respond differently to various motivational techniques. Figure 6.14 outlines a number of motivational techniques that can be used. What they have in common is the need to develop a business culture that fosters employee welfare and involvement.

![TIPS FOR MOTIVATING (AND KEEPING) STAFF](image)

**FIGURE 6.14** Motivational techniques that consider the emotional and physical wellbeing of employees means high morale which in turn improves employee and business effectiveness.

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**BizWORD**

*Motivation* refers to the individual, internal process that directs, energises and sustains a person’s behaviour.

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**BizFACT**

Naomi Fraser, a well-respected management consultant, has concluded that ‘What motivates people is similar to how Winston Churchill viewed Russia... a riddle, wrapped in a mystery, inside an enigma’.

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**BizFACT**

Research reveals that intrinsic motivation — motivation that comes from inside an individual — is a more long-term and powerful motivating force than any external or outside rewards such as money, grades or promotions.
Is money the best motivator?

For generations managers have believed that money is the most powerful motivating force. However, recent research tends to suggest that employee motivation depends on a wide range of factors besides money. For example, imagine you are offered $100 for each assessable task you complete satisfactorily. You would almost certainly be motivated to complete all your tasks. However, after a while your level of motivation would decrease as the stimulus from the financial incentive diminished. Eventually, you would desire a larger incentive to remain highly motivated. It could be argued, from this simple analogy, that money can be a powerful motivator but only in the short term (see the following Snapshot).

As the writer Neil Simon expressed it, ‘Money brings some happiness. But, after a certain point, it just brings more money.’

‘Punished by Rewards’

One influential writer on the topic of motivation is Alfie Kohn. In his book *Punished by Rewards* he argues that money may actually be a demotivating force. Kohn acknowledges that everyone needs to earn a living but he quotes a variety of studies which suggest that factors other than money also play a powerful motivating role.

Kohn quotes research by Ken Kovach and Clifford Jurgensen, who studied more than 50,000 employees over a 30-year period and found that pay was ranked fifth or sixth most important out of 10 job satisfaction factors. ‘Several large scale national surveys,’ says Kohn, ‘have found that people who were unhappy with their jobs pointed to reasons like the lack of variety or challenge, conflicts with coworkers or the boss, and too much pressure’ as the major motivation issues in the workplace. Other concerns included the chance to learn new skills, full use of one’s talents and being part of the decision-making process.

Snapshot questions

1. State which three factors you regard as the most important in making people unhappy, and therefore unmotivated, with their job. Justify your selection.
2. Explain whether you agree or disagree with Alfie Kohn’s viewpoint. Compare your answer with those of other members of the class.

The reality is that people want to be involved in their working lives. The successful businesses today will need to give close attention to involving employees in the decision-making process. Good managers should, therefore, also be good motivators, encouraging employees and using positive reinforcement to influence behaviour. The overall success of the business largely depends on motivated and skilled employees who are committed to its goals — that is, everyone working towards a common purpose.

Mentoring

When talking with school students or employees about their school or work experiences, it is common to hear them refer to individuals who influenced them. Many schools and businesses have introduced formalised mentoring programs, especially for new students or employees, with the aim of providing advice, guidance and to help with their socialisation.

Mentoring is normally done by tutoring, coaching and modelling of acceptable behaviour. Most importantly, though, a mentor acts as a role model.

BizWORD

*Mentoring* is the process of developing another individual by offering tutoring, coaching and modelling acceptable behaviour.

*Socialisation* is the process a new employee undergoes in the first few weeks of employment through which he or she learns how to cope and succeed.
A mentor is someone — usually a more experienced employee — who helps develop a less experienced employee (the protégé). They act as a guide, teacher, counsellor, and coach. Such a practice is commonly referred to as taking someone under his or her ‘wing’. Ultimately, the protégé learns acceptable attitudes and behaviours. For example, CompuServe, a computer wholesaler, encourages its experienced sales representatives to take new employees on sales calls to the company’s largest customers. Teaching new employees what the business expects of them helps strengthen their dedication and commitment to the firm. It also helps to make sure that all employees are exposed to the values the business believes are important.

A formalised mentoring program is enormously beneficial because:
- it ensures access to mentors for all employees, regardless of levels of experience, backgrounds, gender or ethnicity.
- the participants in the mentoring relationship know what is expected of them. This is especially beneficial for new employees as it assists with their transition into the workplace.
- it assists with the training and development of all employees and passes on the skills and abilities of the more experienced staff members.
- it provides career and psychological support — a friend and counsellor — for inexperienced employees as well as allowing mentors to develop their interpersonal skills and provide a sense of satisfaction.
- it increases the possibility of skill transfer.

Training

As the nature of the workplace changes, especially due to the introduction of technology, existing employees must be trained and retrained. New employees also need some training, depending on their level of experience. **Employee training** generally refers to the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills. It may involve teaching them specific skills, and allows existing employees to continually upgrade their skills with the aim of developing multiskilled employees.

Multiskilled employees are better able to:
- adapt to a rapidly changing technological environment
- provide better customer service
- participate effectively in work teams — as outlined previously, increased participation improves the range of ideas available to businesses keen to innovate to maintain their competitive advantage
- gain promotion and therefore their commitment to the business is greater.

The goal of training is to improve employee productivity. Informal on-the-job training is one of the most common training methods used. Formal off-the-job training, consisting of classroom teaching and lectures, is often used for highly skilled, technical employees. Conferences and seminars have become an important format for training in recent years. Businesses should view training as an investment in the human capital of the business, rather than just another expense. Training is necessary for both personal and business growth, as will be examined in more detail in chapter 8.

Summary

- Staff involvement means involving employees in the decision-making process and giving them the necessary skills and rewards.
- A work environment that maximises employee involvement and satisfaction has high levels of labour productivity.
- Businesses should encourage an innovative business culture by recognising and encouraging one of the most important sources of innovative ideas: employees.
An intrapreneur is an innovative employee who takes on the entrepreneurial roles within a business.

Motivation refers to the individual, internal process that directs, energises and sustains a person’s behaviour.

Individual employees respond differently to various motivational techniques.

Good managers should also be good motivators, encouraging employees and using positive reinforcement to influence behaviour.

Mentoring is the process of developing another individual by offering tutoring, coaching and modelling acceptable behaviour.

Teaching new employees what the business expects of them helps strengthen their dedication and commitment to the business.

Employee training generally refers to the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills.

The goal of training is to improve employee productivity.

**Revision**

1. **Define** the term ‘staff involvement’.
2. Think of a situation where you were involved in the decision-making process.
   (a) **State** the decision that needed to be made.
   (b) **Describe** the decision-making process used.
   (c) **Outline** whether you were more committed to the final decision because of your involvement.
   (d) **Discuss** what implications this has for you if you were a manager.
3. Use the NSW Business Chamber weblink in your eBookPLUS to:
   (a) **outline** ‘The 5 minute rule’
   (b) select which of the ‘Checklist for a “committed” innovative workplace culture’ features you consider to be the most important. **Justify** your selection.
4. **Account** for the relationship between staff involvement and labour productivity.
5. **Recall** why businesses should encourage an innovative business culture.
6. **Discuss** the role an intrapreneur can play to assist a business maintain its competitive advantage.
7. **Determine** answers for the three questions on page 160 which analysed what motivated you to behave in a certain way.
8. **Calculate** which you believe to be the more powerful motivating force – rewards or punishment. **Justify** your answer.
9. **Outline** why it is important for businesses to mentor their employees.
10. **Explain** why spending on training should be considered as an investment and not just a business expense.

**Extension**

1. Suppose that you are the owner of a music store and you employ ten staff members. **Demonstrate** what staff involvement techniques you would use with these employees.
2. **Recall** a mentoring program you are familiar with.
   (a) **Investigate** the aim of the program.
   (b) **Evaluate** the effectiveness of the program.
   (c) **Recommend** changes you would make to improve the effectiveness of the program.
3. **Analyse** the system that is used in your school to motivate students. **Propose** how it could be improved.
4. **Investigate** the theories of motivation put forward by Abraham Maslow, Frederick Herzberg and Douglas McGregor. **Create** a written or oral report and present your findings.
7.1 Introduction

Management has been practised for thousands of years. The great pyramids of Giza in Egypt, for example, represent the combined efforts of more than 100 000 individuals who worked on the project over a 20-year period. This remarkable achievement was the result of well-coordinated management practices.

FIGURE 7.1 Effective management practices were applied to building the pyramids of Egypt.

The development of management as a body of knowledge and a subject in its own right is much more recent. The Industrial Revolution of the late 1700s, which encouraged the growth of factories, acted as a catalyst for developing management approaches (theories). As the number of factories increased, there was a need to coordinate the efforts of many people in the continual production of goods and services.

A number of people began thinking and writing about ways of running factories more efficiently. These individuals were the first to develop approaches to management and paved the way for the many management theorists who followed.

These approaches, or theories, outline the main functions of management including planning, organising, leading, motivating, communicating, negotiating,

BizFACT
Like today’s managers, the ancient Egyptian managers needed to:
• develop plans
• acquire human and physical resources
• arrange finance
• analyse information
• keep records and prepare progress reports
• monitor performance and coordinate activities
• take corrective action whenever required.
and controlling a group of individuals in an attempt to achieve specific goals. To a large extent, management approaches have tended to reflect the customs and traditions of the society at the time. Consequently, as social and economic conditions changed new approaches were developed. However, no single approach to management is universally accepted today. Rather, each approach offers something of value for today’s managers.

The management approach adopted by a business will have an enormous impact on all aspects of the business’s operation.

In particular, management approaches influence:
• the organisation and allocation of tasks to staff
• the organisational structure
• levels of management
• management styles.

Summary
• Knowledge about management today is the result of a long and continuing innovative process as ideas evolved over time.
• The business’s management approach will have an enormous impact on all aspects of the business’s operations.

7.2 Classical management approach

The Industrial Revolution began with the invention of reliable steam-powered machines. For the first time, businesses could mass-produce goods in factories that operated year-round. This posed challenges that earlier businesses had not previously faced. Problems arose in training employees, organising the managerial structure, scheduling complex manufacturing processes and dealing with worker dissatisfaction. Business owners now had to plan, organise, direct, control and staff many different types of operation.

In response to these many complex problems, managers developed and tested solutions with the focus on finding ‘one best way’ to perform and manage tasks. The evolution of modern management, called the classical approach, had begun.

As the Industrial Revolution continued, this approach generated two perspectives, each with a slightly different emphasis. First came the classical scientific approach, which focused on how best to organise workers and production methods on the factory floor. Then came the classical bureaucratic approach, which emphasised how businesses should be organised or structured.

Classical–scientific approach

One significant management approach that emerged during the nineteenth century was that of Frederick W Taylor (1856–1915). Taylor (figure 7.2) was an advocate of the production line method of manufacturing, which he viewed as the most efficient form of production. This production system was used in the industrialised countries of the world until the early 1970s and was based mainly on Taylor’s scientific management ideas.

Taylor, to assist his analysis, developed the principles of scientific management: an approach that studies a job in great detail to discover the best way to perform it.
Taylor’s four principles of scientific management are as follows:
1. Scientifically examine each part of a task to determine the most efficient method for performing the task.
2. Select suitable workers and train them to use the scientifically developed work methods.
3. Cooperate with workers to guarantee they use the scientific methods.
4. Divide work and responsibility so that management is responsible for planning, organising and controlling the scientific work methods, and workers are responsible for carrying out the work as planned.

To improve efficiency, Taylor attempted to systematise the way a job was done. He believed that a poorly skilled workforce could be trained to perform simple repetitive tasks effectively. He used time and motion studies to analyse the performance of a particular task, with the objective of reducing a task to an effective minimum standard. As well as reducing routine tasks into their most simple format, Taylor advocated the division of labour into function-related units; that is, tasks were divided into small, specialised activities.

Taylor also believed that employees follow their own self-interest and display a natural desire to avoid work. Such a situation, he argued, required tight control by supervisors and managers. He believed in the need for management to control workers and ensure they followed instructions by rigid rules and regulations based on a hierarchy of authority.

One notable student of classical–scientific theory was Henry Ford. Being familiar with Taylor’s work, Ford became an enthusiastic believer in scientific management and the use of machines. By combining these ideas, Ford developed his famous mechanised assembly line in 1913.

This approach to car assembly involved a chassis moving down an assembly line on a conveyor belt. A small team of workers would move with the car, fitting the various components that had been carefully set out along the production line. The end result was to reduce the hours spent on the assembly of a car from 728 hours to just 1.5!
McDonald’s is another business that uses Taylor’s scientific management approach in the preparation of its food. For example, a Big Mac is produced according to a set number of steps. The burger takes a predetermined number of seconds to cook, fixed amounts of lettuce, cheese and other ingredients are added precisely at the correct time and in exactly the same way. However, McDonald’s adopts other management approaches when dealing with its employees; approaches that emphasise the ‘human relations’ aspect.

Of course, the initial ideas of the classical–scientific theorists have been modified over time. However, modern managers realise that without motivated and committed employees, empowered to analyse their own work habits and take responsibility for what they do, productivity will not improve.

Classical–bureaucratic approach

The classical–bureaucratic approach was pioneered by Max Weber and Henri Fayol. According to Weber, a bureaucracy is the most efficient form of organisation and should have:

- a strict hierarchical organisational structure
- clear lines of communication and responsibility
- jobs broken down into simple tasks; specialisation
- rules and procedures
- impersonal evaluation of employee performance to avoid favouritism and bias.

Today, the term ‘bureaucracy’ is sometimes associated with controversy. People talk about bureaucracy as if it is self-serving and uncaring, but Weber described it positively. He believed that it contributed to a rational and more efficient organisation, because everyone knew their status and position in the organisation.

Fayol identified a number of management functions, including planning, organising and controlling (figure 7.4). His explanation of the functional approach to management provided a type of ‘job description’ for managers.

Fayol’s explanation of the functions of management was so concise and easy to understand that it formed the foundation of most management courses offered during the twentieth century. His explanation was often used as a definition of management itself.
FIGURE 7.4 The main functions of management, according to Henri Fayol

<table>
<thead>
<tr>
<th>Management function</th>
<th>Definition</th>
<th>Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Planning</td>
<td>The process of setting goals and deciding on the methods to achieve them</td>
<td>Planning the tasks that need to be performed</td>
</tr>
<tr>
<td>2. Organising</td>
<td>The process of arranging the resources of the business to achieve the goals</td>
<td>Organising the work and workplace in such a way as to maximise productivity and efficiency</td>
</tr>
<tr>
<td>3. Controlling</td>
<td>The process of evaluating and modifying tasks to ensure that the set goals are being achieved</td>
<td>Changing production procedures if goals are not being achieved</td>
</tr>
</tbody>
</table>

Fayol also developed a number of principles to assist managers, including:
- discipline as a feature of leadership
- the organisation’s goals should take precedence over an employee’s individual interests
- rewards for effort should be fair
- security of employment is essential
- teamwork should be encouraged.

In the nineteenth century, management models were based on a hierarchical system of authority similar to the layered and somewhat rigid organisational structure of the major churches, educational institutions and the army. Such techniques were viewed as appropriate for the production line because they ensured effective control of the workforce.

**Summary**

- A classical–scientific approach to management, pioneered by Frederick Taylor, studies a job in great detail to discover the best way to perform it.
- The classical–scientific approach led to the development of assembly line, mass-production techniques.
- A classical–bureaucratic approach to management, pioneered by Max Weber and Henri Fayol, advocated:
  - that a bureaucracy is the most efficient form of organisation
  - the main function of management is planning, organising and controlling.
- The main features of classical–scientific and classical–bureaucratic management approaches include:
  - time and motion studies used to reduce inefficiencies
  - production line methods
  - hierarchical organisational structure (bureaucracy)
  - clear lines of authority (chain of command)
  - discipline as a feature of leadership
  - autocratic leadership style
  - rules and procedures.
Revision

1. **Clarify** why the practice of management is not considered a recent invention.
2. **State** how the Industrial Revolution acted as a catalyst for developing management approaches.
3. **Recall** two challenges the Industrial Revolution posed for businesses.
4. **Outline** the impact the Industrial Revolution had on the development of management approaches.
5. **Define** the term ‘classical approach’ to management.
6. **Identify** the two perspectives of the classical approach to management.
7. **Summarise** Taylor’s principles of scientific management.
8. **State** the main purpose of time and motion studies.
9. **Demonstrate** the link between Ford cars and McDonald’s hamburgers.
10. **Identify** the main bureaucratic features Max Weber believed needed to exist in a business for it to operate efficiently.
11. **Apply** the correct definition to the terms underneath the grid.

<table>
<thead>
<tr>
<th></th>
<th>The process of evaluating and modifying tasks to ensure that the set goals are being achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The process of arranging the resources of the business to achieve the goals</td>
</tr>
<tr>
<td></td>
<td>The process of setting goals and deciding on the methods to achieve them</td>
</tr>
</tbody>
</table>

| planning | organising | controlling |

12. **Compare and contrast** Frederick Taylor’s ideas on how to improve productivity with the ideas of Henri Fayol. You might like to present your information in the form of a Venn diagram, as shown in figure 7.5.

**FIGURE 7.5** A Venn diagram is used to compare and contrast information. Points of difference are recorded in the outer parts of the circle and similarities are placed in the area where the two circles intersect.

Extension

1. In small groups, **create** a list of advantages and disadvantages of a modern business adopting a purely classical–scientific management approach. Share your research with the class as either a written or oral presentation.
2. **Examine** how the classical approach to management helped Henry Ford build the Ford Motor Company. **Evaluate** the criticisms that have been made of automated production line methods of manufacturing. Use the bio.true story weblink in your eBookPLUS to access a biography of Henry Ford and the working conditions in the early Ford factories.
3. **Determine** why supporters of the scientific management approach established bureaucracies within their businesses.
4. ‘Classical management thinkers looked for the best way to do everything. Their tools were time and motion study, and a scientific approach to studying work and workflow.’ **Discuss.**
Management as planning

Planning is often referred to as the primary management function. It provides the key to both the short-term and long-term success of a business. Effective planning provides a vision and goals for a business, strategies to achieve the vision and goals, and anticipation of future directions for change.

The ability of a manager to develop, implement and monitor plans will directly affect a business’s success.

Planning is the preparation of a predetermined course of action for a business. It involves showing how the business will achieve its stated mission and business goals.

Levels of planning — strategic, tactical and operational planning

Once the business goals have been determined, decisions have to be made about how they will be achieved. This requires detailed plans for activities at all levels of the business. There are three different types of plans.

1. **Strategic (long-term) planning** is planning for the following three to five years. This level of planning will assist in determining where in the market the business wants to be, and what the business wants to achieve in relation to its competitors.

2. **Tactical (medium-term) planning** is flexible, adaptable planning, usually over one to two years, that assists in implementing the strategic plan. Tactical planning allows the business to respond quickly to changes. The emphasis is on how the goals will be achieved through the allocation of resources.

3. **Operational (short-term) planning** provides specific details about the way in which the business will operate in the short term. Management controls the day-to-day operations that contribute to achieving short-term actions and goals. Examples of operational plans are daily and weekly production schedules.

**FIGURE 7.6** Planning is not a one-time practice, but a continuous function to be carried out throughout a business’s existence.
Management as organising

Organising is the next part of the process when management puts into practice the goals that were determined in the planning stage. Organising is determining what is to be done, who is to do it and how it is to be done. It is organising the financial, human and material resources to achieve the goals of the business.

Management has to coordinate activities to translate plans into reality — that is, to ensure that the goals of the strategic, tactical and operational plans are achieved.

The organisation process

The organisation process is the range of activities that translate the goals of a business into reality. These activities include the following three steps:

1. Determining the work activities. The work activities required to achieve management objectives must be determined. Work activities are then usually broken down into smaller steps.

2. Classifying and grouping activities. Once the work activities of a business have been broken down into smaller steps, similar activities can be grouped together. This improves efficiency by enabling the most appropriate allocation of resources. For example, it is common practice to group activities into departments or sections and allocate employees and supervisors to each section or department.

3. Assigning work and delegating authority. The next step in the organisation process is to determine who is to carry out the work, and who has the responsibility to ensure that the work is carried out. Delegation also involves ensuring that the person who has been given responsibility does carry out the processes.

Management as controlling

Controlling compares what was intended to happen with what has actually occurred. If there is a discrepancy between performance and goals, changes and improvements can be made.

Control processes

There are three steps in the control process (see figure 7.7).

BizWORD

Organising is the structuring of the organisation to translate plans and goals into action.

The organisation process is the range of activities that translate the goals of a business into reality.

BizFACT

The way that management views its employees will determine the level of responsibility and authority given to individuals for the purpose of achieving business goals.

BizWORD

Controlling compares what was intended to happen with what has actually occurred.

The control process involves establishing standards in line with the goals of the business, measuring the performance of the business against those standards or benchmarks, and making changes where necessary to ensure that the goals of the business have been met.

THE CONTROL PROCESS

1. Establish standards in line with the firm’s goals and influences from employees, management, industry and government.

2. Measure performance and determine how comparisons will be made against standards or benchmarks.

3. Take corrective action — changing activities, processes and personnel to ensure that the goals of the business have been met.

FIGURE 7.7 The three steps in the control process

Control methods

At the heart of any control measure is the need to monitor (check) the quality of the products being manufactured or provided. There are three different levels of controlling a business’s output quality.
1. **Quality control.** This traditional control management technique involves inspectors checking finished products, and detecting and removing any components or final products that do not meet the required standard. This method can involve considerable waste as sub-standard products have to be scrapped.

2. **Quality assurance.** Because quality assurance occurs both during and after production, and seeks to stop faults occurring in the first place, it is less wasteful than quality control. Quality assurance aims to make sure that products are produced to pre-set standards. It is the responsibility of the employees working in teams, rather than of the inspectors.

3. **Total quality management (TQM).** This is the most comprehensive form of control management. It is concerned with encouraging all employees in the workplace to think about quality in everything they do. Every employee sets out to satisfy customers, placing them at the centre of the production process.

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**BizFACT**

If a firm adopts total quality management (TQM) as its approach, it will emphasise teamwork and shared responsibility for achieving organisational goals. If a firm adopts a more traditional approach, management may allocate supervisors who have direct control and authority to ensure that work processes are carried out.

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**FIGURE 7.8** To ensure perfect buns, Tip Top Bakery uses a combination of quality control and quality assurance.

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**Hierarchical organisational structure**

Think of a business as a three-storey pyramid (figure 7.9). This type of management structure is found in many businesses, and is based on the traditional managerial hierarchy. **Management hierarchy** is the arrangement that provides increasing authority at higher levels of the hierarchy. This means that senior managers have greater accountability, responsibility and power compared to those at lower levels of the pyramid.
The primary characteristic of traditional hierarchical organisational structures has been the grouping of people according to the specialised functions they perform (see figure 7.10). These may include marketing, finance, human resources and operations. Even within each of these functional areas, tasks are further subdivided into specialised jobs. People within the operations division, for example, have specialised tasks to perform, such as warehouse manager, clerks, packers, process employees and storeperson. The same principle applies to sporting teams. For example, a hockey team has members who specialise in certain positions, such as coach, captain, winger, goalie or centre. The team is organised in this way to offer the best combination of people’s talents to achieve productivity. In this case, the team is performing its best.

Characteristics of the pyramid-shaped organisational structure include:
- rigid lines of communication
- numerous levels of management, from managing director to supervisors
- clearly distinguishable organisational positions, roles and responsibilities
- hierarchical, linear flows of information and direction, with a large amount of information directed downwards
- specialisation of labour resulting in tasks being divided into separate jobs
- a chain of command that shows who is responsible to whom.

**BizWORD**

Specialisation of labour refers to the degree to which tasks are divided into separate jobs.

A chain of command is a system that determines responsibility, supervision and accountability of members of the organisation.
Summary

- Management functions include:
  - **planning**: a predetermined course of action. This involves strategic, tactical and operational planning.
  - **organising**: a range of activities that translate goals into reality.
  - **controlling**: compares what was intended to happen with what has actually occurred.
- Management hierarchy is the arrangement that provides increasing authority at higher levels of the hierarchy.
- Senior managers have greater accountability, responsibility and power compared to lower-level managers of the organisation.
- The traditional hierarchical organisational structure has people grouped according to the specialised functions they perform.

Leadership styles

The important task faced by all managers is how best to achieve their business's goals. This task can be accomplished only by working with and through other people, so managers must select a leadership style appropriate to the environment in which they operate.

A manager’s **leadership style** is essentially their way of doing things — their behaviour and attitude. Leadership styles can be placed on a continuum (see figure 7.11) with the autocratic manager at one end through to the participative/democratic manager at the other.

An autocratic or authoritarian manager would be one who makes the decisions and tells employees what tasks to do and how to do them. A participative or democratic management style presents problems, asks for suggestions and works together to make a decision. The assumption is that all types of leaders would appear somewhere on that continuum.

Recent theories indicate that managers bring a range of styles to their leadership position that may change according to the situation. Most managers typically have a dominant style that they frequently adopt, and one or two ‘backup’ styles.

**BizWORD**

A manager’s leadership style is essentially their way of doing things — their behaviour and attitude.

**FIGURE 7.11** One theory of leadership style — the continuum
The two main types of leadership approaches and their characteristics are shown in Table 7.1.

### Table 7.1 Characteristics of the two main leadership styles

<table>
<thead>
<tr>
<th>Key feature</th>
<th>Autocratic or authoritarian manager</th>
<th>Participative or democratic manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision making</td>
<td>Makes all decisions and informs employees</td>
<td>Consults with employees, asks for suggestions then decides</td>
</tr>
<tr>
<td>Control</td>
<td>Centralised — controls all activities</td>
<td>Shares decision making with employees</td>
</tr>
<tr>
<td>Staff participation</td>
<td>Expects employees to follow orders</td>
<td>High level of employee empowerment</td>
</tr>
<tr>
<td>Communication</td>
<td>Top–down</td>
<td>Two-way</td>
</tr>
<tr>
<td>Motivation methods</td>
<td>External — rewards (carrot) and sanctions (stick)</td>
<td>Internal — sense of fulfilment, satisfaction</td>
</tr>
<tr>
<td>Workplace example</td>
<td>Military officer during wartime; time of crisis</td>
<td>Professional organisations — intellectual abilities of employees are similar or complementary</td>
</tr>
</tbody>
</table>

### Autocratic leadership style: ‘do it the way I tell you’

Managers who adopt a strict classical–scientific approach usually display an autocratic leadership style. A manager using an **autocratic leadership style** tends to make all the decisions, dictates work methods, limits worker knowledge about what needs to be done to the next step to be performed, frequently checks employee performance and sometimes gives punitive feedback.

The autocratic manager generally provides clear directives by telling employees what to do, without listening to or permitting any employee input. This style of manager controls the people in the business closely and motivates through threats and disciplinary action. Such managers expect compliance and obedience, and give more negative and personalised feedback.

**BizWORD**

A manager using an **autocratic leadership style** tends to make all the decisions, dictates work methods, limits worker knowledge about what needs to be done to the next step to be performed, frequently checks employee performance and sometimes gives feedback that is punitive.
The autocratic style of leading can be effective in a time of crisis when immediate compliance with rules or procedure is needed, or in meeting an unexpected deadline when speed is important. An army officer, for example, would adopt this management style during military exercises. This approach is also effective when individuals lack skills and knowledge. A McDonald’s crew trainer, for example, may adopt this style when supervising new employees. It is generally accepted, however, that this style does not encourage the best performance from employees.

The main advantages of the autocratic leadership style include the following.

• Directions and procedures are clearly defined and there is less chance of uncertainty.
• Employees’ roles and expectations are set out plainly, so management can monitor their performance.
• A hierarchical structure provides a stable and consistent environment in which the outcomes almost always match management objectives.
• Control is centralised at top-level management, so time is used efficiently and problems are dealt with quickly because there is no discussion or consultation.

The main disadvantages include the following.

• No employee input allowed, so ideas are not encouraged or shared. This means employees do not get the chance to develop their skills or to feel valued in the organisation.
• It ignores the importance of employee morale and motivation. When no responsibility is given to lower level staff, job satisfaction decreases, which ultimately affects issues such as absenteeism and staff turnover.
• Conflict, or potential for conflict, increases. Often workers are competing for the approval of managers, which can lead to tension between employees.
• An ‘us and them’ mentality may develop in the workplace as a result of the lack of employee input.

Summary

• The two main types of leadership style are:
  – autocratic or authoritarian — strong, centralised control
  – participative or democratic — authority and power are decentralised.
• Managers should bring a range of leadership styles to their positions that can change according to the situation.
• Most managers typically have a dominant style.

Revision

1 Define the term ‘planning’.
2 Explain why planning is considered to be the primary management function.
3 Complete the following table by identifying whether the planning activities are strategic, tactical or operational. The first one has been completed for you.

<table>
<thead>
<tr>
<th>Planning activity</th>
<th>Type of planning</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. An organisation plans to build a new warehouse.</td>
<td>Tactical</td>
</tr>
<tr>
<td>2. A supervisor wants to have regular weekly production meetings.</td>
<td></td>
</tr>
<tr>
<td>3. A marketing department is to relocate to a new site in another city.</td>
<td></td>
</tr>
<tr>
<td>4. A government department decides to undertake planning to fully privatise during the next four years.</td>
<td></td>
</tr>
</tbody>
</table>
Planning activity | Type of planning
--- | ---
5. A stocktake needs to be completed tomorrow. |  
6. A team leader decides to monitor the team’s performance over a two-month period. |  
7. A new computer system is to be installed. |  
8. A large-scale business operating in five countries decides to undertake an extensive restructure of its entire organisation. |  
9. A department sales manager requires the sales team to increase sales by 10 per cent over the next six months. |  
10. An engineering business wants to develop new production facilities in three countries. |

4. **Explain** why the organising function is important to a business.
5. **Summarise** the three steps involved in the organisation process.
6. **Define** the term ‘controlling’.
7. Examine figure 7.7 on page 171. **Identify** the correct terms to complete the following steps in the control process.

<table>
<thead>
<tr>
<th>Step</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>Establish standards</td>
</tr>
<tr>
<td>Step 2</td>
<td>Measure performance</td>
</tr>
<tr>
<td>Step 3</td>
<td>Take corrective action</td>
</tr>
</tbody>
</table>

8. **Discuss** why management controls are important.
9. **Distinguish** between quality control, quality assurance and total quality management (TQM).
10. **Define** the term ‘management hierarchy’.
11. **Identify** the three main levels of management.
12. (a) **Construct** an organisational chart of your school.
    (b) **Classify**, by highlighting in a different colour, the senior, middle and frontline management divisions.
    (c) **Deduce** why the school’s organisational chart is hierarchical.
13. **Contrast** an autocratic leadership style with a participative one.
14. **Identify** the leadership style of each of the following managers.
    (a) The manager sets high standards of performance and has little sympathy for those who do not meet the standards.
    (b) The manager takes care to explain why something must be done in a certain way.
    (c) The manager expects his or her orders to be unquestioningly followed.
    (d) The manager believes that developing close personal relationships with staff is the mark of a good manager.
    (e) The manager persuades the employees to do their best.
15. **Describe** a situation when an autocratic management style would be appropriate.
16. **Justify** whether you believe the advantages of the autocratic leadership style outweigh the disadvantages.

**Extension**

1. ‘The three levels of planning — strategic, tactical and operational — correspond to the three levels of management — top, middle and frontline.’ **Explain** the relationship between the level of planning and the level of management.
2. **Account** for the relationship between an organisational chart and an organisation’s chain of command. If you were new to a business, **explain** how an organisational chart would help you become oriented.
3 ‘Managers who adopt a strict autocratic management style normally organise their business along traditional hierarchical lines.’ **Evaluate.**

4 **Determine** how autocratic managers motivate their staff to get things done. **Assess** whether their style is successful.

5 Ask your teacher for permission to complete the following activity in class time. The aim of this activity is to put your theoretical understanding of business studies into practical use as you solve problems, plan and make management decisions.

**Materials required:** paper, tape measure, markers (such as flags or witches hats)

**Paper plane business — instructions**

You are about to embark on your latest venture . . . running a rather large paper plane business. Your team’s task is to construct the ultimate paper plane.

1 Arrange your class into groups of three or four. Each of these teams will become a business. Organise for some of the students in the class to be observers.

2 Your business has 30 minutes in which to produce the paper plane that travels the longest distance (you could also have a competition for the best looking plane or most innovative design).

3 As a team, determine what the goals for your business will be. Write down an action plan for your business (your strategies). List the key performance indicators (KPIs) that will show whether or not you have met your goals.

4 Establish your management structure (who is going to complete the various activities that need to occur for your business to achieve its objectives). Your teacher will explain the responsibility of each position. You would definitely need a managing director. Make sure each team member’s task is clear. Each team member should probably take responsibility for a particular goal.

5 Discuss a design for your plane and then produce it, making sure that you do your very best to meet all of your goals.

6 Find a safe place to test your planes. Use the tape measure to determine distance. Make sure you record these measurements.

7 The winner will be the group whose paper plane travelled furthest. Alternatively, the winner could also be the team with the best looking plane, the most innovative design etc.

8 The observers should next report to the class. What did they see happening as groups were planning, organising and controlling? Did any leaders emerge during the activity?

9 After finishing the paper plane activity, list your group’s goals. **Assess** how well you planned to achieve these goals. **Identify** the KPIs you planned to use to measure whether or not you met the goals.

10 **Outline** the role that you played in your business. For example, if you were the production manager, outline how you were involved in planning, organising and controlling your business.

11 Using the information from the observers, **discuss** whether anyone emerged as a leader in your group.

12 **Evaluate** how your group performed in terms of meeting its KPIs.

13 After finishing the paper plane activity, complete the following table to **summarise** the role of each member of your business. The first entry has been started for you.

<table>
<thead>
<tr>
<th>Manager</th>
<th>Planning</th>
<th>Organising</th>
<th>Controlling</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>Determined objectives for group</td>
<td>Delegated responsibilities to members of group</td>
<td>Compared planned performance with actual performance</td>
</tr>
<tr>
<td>GM</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

14 Benchmark your performance against other groups in your class (that is, compare the results to the other results). **Recommend** how you could improve.
7.3 Behavioural management approach

Scientific management principles did not always lead to increased productivity due to the repetitive and boring nature of many jobs and the dehumanising structure of the workplace. Approximately 50 years after the emergence of scientific management ideas, behavioural, or ‘human relations’, approaches surfaced. The behavioural school recognised that to make substantial productivity gains, worker participation in the production process was required. It acknowledged the workers’ contribution to output.

Advocates of the behavioural approach to management stress that people (employees) should be the main focus of the way the business is organised. They believe that successful management depends largely on the manager’s ability to understand and work with people who have a variety of diverse backgrounds, hopes, desires and expectations. The development of this humanistic approach has greatly influenced management theory and practice.

One major contributor to behavioural management theories was Elton Mayo (1880–1949). Mayo (see figure 7.13), is considered the founder of industrial psychology. Through his revolutionary experiments, conducted at the Western Electric Hawthorne Company in Chicago, he discovered what became known as the ‘Hawthorne effect’, which demonstrates that meeting people’s social needs has a significant impact on productivity (see the following Snapshot). Two significant results from the research were that:

• worker satisfaction to a large extent is non-economic; that is, workers have social needs in addition to economic needs
• being made to feel part of a team increases job satisfaction and output.

Elton Mayo — the Hawthorne studies (1927–1932)

The Western Electric Company’s Hawthorne factory manufactured a range of electrical components such as relay assemblies. Mayo wanted to find out what effect fatigue and monotony had on employee productivity. He selected six female employees from the assembly line, segregated them from the rest of the factory and placed them under the control of a supportive supervisor. The team was involved in assembling telephone relays. Mayo made frequent changes to their working conditions, always discussing and explaining the changes in advance.

To his amazement, Mayo realised that productivity had increased completely independent of any of the changes he made. The six individual employees had become a team and together eagerly participated in the experiment. They were happy knowing that they were working without coercion from senior managers or limitations from the workplace structure. They felt they were working under less pressure, not being pushed or bossed around by anyone. Under these conditions, they developed an increased sense of responsibility, with discipline coming from within the team.

Mayo’s findings were at odds with F W Taylor’s theory, which stated that workers are only motivated by self-interest. If Taylor was correct, the women’s productivity should have decreased when Mayo returned them to longer working hours. However, Mayo realised that the women had formed a harmonious team and felt happier at work, which raised their self-esteem. The women talked, joked and (continued)
began to meet socially outside of work. Mayo had discovered an elementary concept that seems obvious today: workplaces are social environments and employees are often motivated by much more than self-interest.

The section of the Hawthorne studies that examined the beneficial effects of positive and supportive supervision, and the impact of teamwork became known as the Hawthorne effect.

**Snapshot questions**

1. According to Elton Mayo’s research, explain why productivity increased even after the original working conditions were reintroduced.
2. Outline what is meant by the Hawthorne effect.
3. Imagine you are a manager for a small business. Discuss what impact Mayo’s research would have on:
   (a) how you organise your workplace
   (b) the management practices you would use.

A different value system emerged from the contributions of the behavioural theorists. Managers were now required to meet the social needs of their employees in addition to production efficiency. Skills in communication, social motivation and democratic leadership were quickly acquired.

**Summary**

- The behavioural approach to management, pioneered by Elton Mayo, stresses that people (employees) should be the main focus of the way in which the business is organised.
- The main features of behavioural management approach include:
  - humanistic approach: employees are the most important resource
  - economic and social needs of employees should be satisfied
  - employee participation in decision making
  - team-based structure
  - managers need good interpersonal skills
  - democratic leadership style emerging.
Management as leading

To act as a leader, a manager should display empathy and possess good listening skills. A leader will have high expectations of employees’ abilities to initiate and implement ideas. He or she will concentrate on the needs of their employees, building high-performance teams that attain their objectives. Less effective managers tend to focus on tasks and are more concerned with meeting deadlines — that is, they display the natural characteristics of a manager, not a leader. A leader, however, wants to empower (see the following Snapshot).

Managers control; leaders empower

Managers generally think in terms of controlling the elements of an organisation’s culture, strategy and all the other variables that fall within their domain. To control, they assume, is to maximise. When it comes to people, the manager assumes that people also need to be controlled. Control, managers feel, will help people attain the cooperation that the organisation requires. In the manager’s mind, if you can’t control it, you can’t manage it.

Leaders, in sharp contrast, would rather empower organisations and people. To their way of thinking, empowerment can unleash the energy necessary to take the organisation beyond its current position. Only by giving people the freedom and resources to act can you expect them to go above and beyond the call of duty. Leaders empower people, systems, structures, strategies, and other variables by opening the way for their expansion, enhancement and evolution. The leader’s soul says, ‘If you can’t empower, you can’t lead.’


Snapshot questions
1. According to Hickman, identify one of the main differences between a manager and a leader.
2. Propose reasons why a manager would want to ‘control’, whereas a leader wishes to ‘empower’. Share your answer with the rest of the class.

Added to these qualities, a successful leader is someone who:
• keeps an open mind, seeks out new ideas and freely shares information
• shows confidence in people, shares credit and recognition
• builds and communicates a clear vision
• sets an example and earns the respect of employees
• delegates tasks to suitable employees
• conveys the goals of the business to workers and motivates them
• demonstrates flexibility in dealing with situations
• understands the technical aspects of the industry or business.

Being an effective leader is not an easy task. There may be temporary setbacks, particularly during periods of negotiation. In the end, leadership may still fail. However, not displaying leadership is inviting a greater possibility of failure.

Numerous books have been written about what makes a good leader. Some people believe that good leaders are ‘born’ rather than ‘made’. They argue that the characteristics needed to be a good leader are part of an individual’s unique personality and cannot be learnt from textbooks. Other people, however, argue that with appropriate training and coaching, the skills of leadership can be learned. Whichever the case, managers who display ‘daring leadership’ are best able to inspire their employees.
Management as motivating

Some people work harder than others. An employee with outstanding abilities may constantly be outperformed by someone with average skills. The difference between the two employees is their level of motivation. Motivated workers will always perform at a higher level than unmotivated workers. To some extent, a high level of employee motivation is determined by management practices. Efficient managers need to put in place work practices that motivate their employees; they must be aware of the human factor involved in the business organisation.

Elton Mayo’s Hawthorne studies (see pages 179–80) highlighted the importance of the human factor in employee performance. Merely asking employees to participate in the research gave them a sense of involvement in their jobs. These employees — perhaps for the first time — felt as though they were of value and importance to the business. It was this sense of importance that acted as the motivating force that improved employee productivity.

As explained in chapter 6, motivation is the individual, internal process that energises, directs and sustains an individual’s behaviour. It is the personal force that causes a person to behave in a particular way.
The Hawthorne studies revealed that such human factors as recognition, self-worth and positive reinforcement are at least as important to motivation as external factors such as pay rates and working conditions. In some cases they may be more important. From this initial research came a flood of other behavioural management approaches focusing on the area of motivation. Overwhelmingly, the research highlights the fact that management would do best to provide a work environment that maximises employee satisfaction. Good managers, therefore, should also be good motivators, encouraging employees and using positive reinforcement to influence behaviour.

How then does a manager go about the task of motivating the business’s employees? This question is often asked and has resulted in a wide variety of answers. Numerous studies have identified such diverse factors as trust, respect for the individual, positive reinforcement, empowerment, enhancing self-esteem, employee participation, rewarding team performance, employee encouragement and so on. Managers can use a variety of techniques to improve employee motivation. However, what the majority of these motivation techniques have in common is the need to develop a workplace culture that fosters employee participation.

**Management as communicating**

As outlined in chapter 5, one of the most difficult challenges for managers is getting employees to understand and want to achieve the business’s goals. Effective communication is at the heart of meeting this challenge.

Communication is one of the easiest and, at the same time, most difficult of management activities. This is because of the complex nature of communication. Unless managers are effective communicators and able to share their thoughts and plans, they will find it difficult to influence others.

Effective communication is a crucial part of every manager's job. It encompasses every management function and role. Without effective communication, the most carefully detailed plans and brilliant strategies will most probably fail. Many studies have shown that the performance of both individuals and businesses improves when managerial communication is effective. This is especially so when open communication is used to motivate employees by providing them with information...
regarding the business’s goals, plans and overall financial results. Whenever a manager operates on the communication principle of ‘tell the employees only what they need to know and nothing else’, then the workers will not be motivated to achieve common goals because they do not know what the goals are.

**Summary**

- According to the behavioural management approach, the main management functions are:
  - **leading**: having a vision of where the business should be in the long and short term
  - **motivating**: energising and encouraging employees to achieve the business’s goals
  - **communicating**: exchanging information between people; the sending and receiving of messages.

**Revision**

1. Define the term ‘behavioural approach’ to management.
2. According to the behavioural management approach, identify what was required to improve worker productivity.
3. Recall the two significant results of Elton Mayo’s Hawthorne studies.
4. Identify five characteristics a manager should display in order to be a leader.
5. Calculate whether the following statements are true or false.
   
<table>
<thead>
<tr>
<th>Statement</th>
<th>True</th>
<th>False</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Leading and managing are much the same thing.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Good leaders are important for businesses.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) To be a good leader, you must be authoritarian.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d) Before you lead you must learn to follow.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e) Leaders should have only one concern: the task.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) To be an effective leader you must be a skilled communicator.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) A person’s leadership style should be fixed and unchangeable.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(h) Leadership skills can be learned.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
6. Recall the meaning of the term ‘motivation’.
7. State what the Hawthorne studies revealed about employee motivation.
8. Identify four factors a manager can use to motivate the business’s employees.
9. When talking about motivation, the carrot (reward) and stick (punishment) approach is sometimes mentioned. Explain why giving someone a reward or punishment might motivate them to act.
10. ‘For a business to succeed, effective communication is vital.’ Discuss.
11. Draw a table similar to the one following to summarise details of management skills in this section. The first one has been completed for you.

<table>
<thead>
<tr>
<th>Skill</th>
<th>Definition</th>
<th>Characteristics</th>
<th>Application to the workplace</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communicating</td>
<td>The ability to transfer information</td>
<td>Communication can be verbal (emails, meetings and face-to-face conversations) and non-verbal (body language, visual).</td>
<td>Managers use it to explain a vision, to instigate change, to answer questions and to listen.</td>
</tr>
<tr>
<td>Leading</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Motivating</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Extension

1 **Determine** why employees would favour the behavioural approach to management over the classical–scientific approach.
2 **Propose** why the development of behavioural management approaches would be called a significant turning point in the evolution of management approaches.
3 ‘Leaders know the best course of action, whereas managers only know the best way to follow it.’ **Evaluate** this statement.

Teams

A not-so-quiet revolution is rapidly transforming workplace cultures, practices, operations and productivity levels. Many businesses are starting to realise that a team approach can be the catalyst for superior performance. **Teamwork** involves people who interact regularly and coordinate their work towards a common goal.

Understanding how such teams function — that is, understanding the group dynamics of teams and teamwork, is vital for managers operating in the modern workplace. It is essential that managers foster a sense of cohesion between team members, otherwise the team is no more than a group of individuals all working separately. Such teams have no common purpose and therefore lack any sense of belonging to the organisation. In such cases, it is quite common for conflict to develop between team members. Ultimately, the team’s effectiveness will be diminished.

**BizWORD**

**Teamwork** involves people who interact regularly and coordinate their work towards a common goal.

**FIGURE 7.18** When teams work well, staff turnover and absenteeism decline, change is more readily accommodated, and productivity tends to rise.
These self-directed work teams alter some of the traditional roles of management. One obvious change is that managers have to work more closely with people over whom they have no apparent authority. They are required to adopt a team approach, negotiating consensus decisions rather than imposing demands.

Another significant impact of a team approach is the breaking down of the traditional pyramid-shaped hierarchical organisational structure. Hierarchical boundaries are disappearing as people and functions mix together to create much flatter organisational structures. Firms that adopt a flatter management structure reduce the number of levels of management, giving greater responsibility to individuals in the business (see figure 7.19).

The role of managers is therefore changing from controller to facilitator. Without being able to impose their authority, managers have to achieve their aims by balancing the needs of the team with those of the business. This can be accomplished by the manager attempting to understand the views of others, handling disagreements honestly and directly, and persuading others to adopt new ideas. Above all else, the manager must build a sense of trust, teamwork’s key ingredient, and develop a common goal (see the following Snapshot). To achieve this, it requires a move away from an autocratic leadership style to one that is more participative or democratic.

BizWORD
Flatter organisational structures have evolved due to a ‘de-layering’ of management structures resulting in the elimination of one or more management levels.

BizFACT
Now that teams are becoming the basic building block of many businesses, effective teamwork has the potential to empower employees and transform managers.

FIGURE 7.19 Flatter management structure — a typical organisation chart. The span of control is wider and management has more direct contact with employees.

FIGURE 7.20 To give purpose and direction to employees, managers require a good understanding of team/group dynamics.
What is a team?

In 1972 a group of rugby players, their friends and families left on a flight for Chile from Uruguay. The plane crashed into the snow-covered mountainside, killing 13 of the 45 passengers onboard the aircraft. The outside world thought that all 45 people onboard had disappeared.

Without any provisions, some of those left alive resorted to devouring the dead. Those who refused to eat the human flesh died of starvation. After 70 days in the mountains, 16 survivors were rescued and taken home. In the most gruesome manner, a group of people banded together as a team with a singular goal of survival.

What makes for a team when there is no sense of threat? Teams will form around a common goal that provides them individually and collectively, a challenge that they take responsibility for and that can give them increased self esteem. For example, assume your goal is to increase repeat business from 10% of turnover to 15% of turnover in six months, as you know the selling cost to repeat customers is one tenth the selling cost to new customers and the margin on repeat customers is 25% higher as they require fewer discounts. To have a higher probability of success, this clear and simple goal needs to connect with all staff so that they are motivated to achieve it.

The goals should tell a story of:

• the increased customer satisfaction that drives increased repeat sales
• the easier selling process with repeat customers
• the reduced need to deal with customer complaints, the increased security of employment, the increased ability for the organisation to grow and employ more people, the increased opportunities for promotion and more responsibility in a growing organisation
• the increased ability of the organisation to contribute to the local community and indirectly help the families who have people working in the company.

Explained this way, each single contribution to delivering the goal is seen as doing much more than reaching a corporate goal. Contributing as a team has a multiplier effect. The whole becomes clearly more than the sum of the parts.

Snapshot questions

1. Recall what causes teams to form.
2. Identify the common goal of the 1972 group of rugby players.
3. Explain why it is important to clearly communicate to employees the goals the business wants to achieve.
4. ‘Contributing as a team has a multiplier effect. The whole becomes clearly more than the sums of the parts.’ Evaluate the accuracy of this statement.

Summary

• Teamwork involves people who interact regularly and coordinate their work towards a common goal.
• Well functioning teams can produce superior performance.
• Managers require a good understanding of team/group dynamics.
• The development of work teams has resulted in flatter organisational structures.
• The role of managers is changing from controller to facilitator.
• Businesses are adopting flatter management structures which results in:
  – ‘de-layering’ of traditional hierarchical structure
  – establishment of market-focused work teams
  – each work team responsible for a wide range of production functions.
• Reducing the levels of management gives greater responsibility to individuals in the business.
Participative or democratic leadership style

A manager who implemented a classical–scientific approach would normally adopt an autocratic leadership style; a manager who practised a behavioural approach would tend to use a more participative or democratic leadership style (refer to figure 7.11 on page 174).

A participative or democratic leader is one who asks employees for their suggestions and then seriously considers those suggestions when making decisions. In this sense they share their decision-making authority with their subordinates. The degree of sharing can range from the manager outlining a solution, with the possibility of changes being suggested, to allowing the team to participate in the initial decision making.

Sometimes referred to as the ‘we’ approach, participative or democratic managers recognise the strengths and abilities of employees and actively involve them in the decision-making process. This style is frequently practised in those businesses that have flatter management structures and work teams, and is especially effective in situations where there are diverse groups to be coordinated. The contribution of employees is valued, and employees assist in the decision-making process through regular meetings. Employees have a commitment to the business’s goals because of their own input into the firm. This style of leadership is most effective when a business is operating in an environment undergoing rapid change. Individual employees accept responsibility and can implement changes themselves, making the business more responsive to change. Through activities such as brainstorming, a diverse range of opinions and ideas can be generated resulting in improved decision making.

The main advantages of the participative or democratic management style include the following:

• Communication is a two-way process.
• Employer/employee relations are positive and there is reduced likelihood of industrial disputes because employees are more likely to accept management decisions.
• Motivation and job satisfaction are optimal as employees feel they have played an active role in allocating tasks and implementing actions to meet objectives.
• Employees have a greater opportunity to acquire more skills.
• Power sharing encourages the development of work teams, and employees display high levels of commitment.
• There is a high level of trust, often resulting in improved employee performance. The main disadvantages include the following:
• Reaching decisions and introducing tasks can be time consuming with differing views having to be considered. The quality of decisions may also suffer because compromises are made rather than decisive, clear directions given.
• The role of management, and the control of the manager, may be weakened and undermined, with employees given too much power in some cases.
• Internal conflict can arise with so many views and opinions being shared. More involvement may actually bring about disagreement.
• The importance of the organisational structure may be minimised, leading to an informal system that could result in a complete collapse in management.
• Not all employees want to contribute.

There is no simple answer to the question: ‘What leadership style does a good manager possess?’ Management is an art, not a science. This means that no simple management formula can be applied to deal effectively with all workplace situations.

Summary
• A manager who adopts a behavioural approach will tend to use a participative or democratic leadership style.
• Participative or democratic leaders share their decision-making authority with their subordinates.
• This style of leadership is most effective when a business is operating in an environment undergoing rapid change.

7.4 Contingency management approach

While the classical and behavioural management approaches continue to provide important lessons for managers, other ideas have also emerged during the last couple of decades (see figure 7.22). These contemporary management approaches represent major innovations in ways of thinking about management and appropriate management practices. One of the most important contemporary viewpoints is the contingency approach to management. It stresses the need for flexibility and the adaptation of management practices and ideas to suit changing circumstances.

BizWORD
Contingency approach stresses the need for flexibility and adaptation of management practices and ideas to suit changing circumstances.

FIGURE 7.22 Timeline of management thought
Adopting to changing circumstances

Contingency theorists point out to managers that no two situations are absolutely identical. Each situation, therefore, requires its own unique solution. For example, you may have used a particular strategy to complete a task for assessment. Although this strategy may have been quite successful for that particular task, another assessable task may well require a completely different approach.

Contingency theorists stress that the traditional classical approach to management was not necessarily wrong, but is no longer adequate for our needs today. They also urge managers to borrow and blend from a wide range of management approaches and practices.

Above all, advocates of the contingency approach believe that managers need to be adaptable and flexible in their technique to solving problems. Because management is a discipline that is continually evolving, it frequently produces new ideas and theories, each with some relevance to practitioners.

The contingency approach, therefore, advocates that managers extract the most useful ideas and practices from a wide range to best suit their business’s present requirements. It stresses that an appropriate management response to one set of circumstances may be quite inappropriate to another. To adopt this approach, managers must sample all the past and present ideas on offer; some refer to this as the ‘smorgasbord’ approach.

A manager adopting this approach will obviously need to apply the ‘10 commandments for the modern manager’ (see figure 7.24).
THE 10 COMMANDMENTS FOR THE MODERN MANAGER

1. Share your vision with all relevant stakeholders.
2. Manage the relationships and the coalitions, not the employees.
3. Manage your own emotions and help others in the business to maintain an emotional balance.
4. Learn to thrive on diversity not conformity.
6. Cultivate the ability to adapt to changing circumstances.
7. Learn how to access and use appropriate information and manage this knowledge effectively.
8. Be aware of how developments in technology can improve your effectiveness and efficiency.
9. Recognise and use the experiences and expertise of all employees.
10. Encourage ethical behaviour in order to promote pride and commitment in employees.

FIGURE 7.24 The 10 commandments for the modern manager

Summary

- The contingency management approach stresses the need for flexibility and adaptation of management practices and ideas to suit a particular situation.
- Due to the unstable business environment, managers need to be flexible and borrow and blend from a wide range of management approaches.

7.5 Summary and comparison of management approaches

TABLE 7.2 Summary and comparison of management approaches

<table>
<thead>
<tr>
<th>Management theory</th>
<th>Organisation and allocation of tasks to staff</th>
<th>Organisational structure</th>
<th>Levels of management</th>
<th>Management styles</th>
</tr>
</thead>
</table>
| Classical approach | • Based on ‘scientific’ analysis of work processes  
• Highly programmed staff performing simple, repetitive tasks — single skilling, task specialisation  
• Time and motion studies used to reduce inefficiencies  
• Division of labour into function-related units, employees strictly controlled with tasks rigidly divided  
• Prescribed limits on individual discretion  
• Appraisal, reward and sanction of individuals based on achievement of production standards | • Hierarchical pyramid structure reflecting strata in church, army and school  
• Hierarchical, linear flow of information, with a large amount of communication directed downwards  
• Strict channels of responsibility from the top down and grouping into specialised activities based on function, product or process with considerable management and supervisory control at each level | • Many management and supervisory levels with clearly distinguishable and segmented organisational positions, responsibilities and roles  
• Course of action decided by management with little or no consultation with workforce  
• Bureaucratic management of authority believed to be the most effective means of controlling the workforce and ensuring that instructions are followed  
• Workers believed to be prone to laziness and self-interest, so tight control and external motivation necessary to achieve required organisational goals and objectives | • Autocratic |

(continued)
### TABLE 7.2 (continued)

<table>
<thead>
<tr>
<th>Management theory</th>
<th>Organisation and allocation of tasks to staff</th>
<th>Organisational structure</th>
<th>Levels of management</th>
<th>Management styles</th>
</tr>
</thead>
</table>
| Behavioural approach    | • Recognition that workers have social needs in addition to economic needs  
                          | • Teamwork and informal work groups important for productivity | • Hierarchical pyramid structure  
                          | • More consultation with workforce but still not full participative partnership | • Many management and supervisory levels  
                          | • Development of people management skills, particularly communication and social motivation skills | • More participative or democratic aspects emerging |
| Contingency approach    | • Flexibility and adaptation of a variety of ideas and principles from a range of theories mean that a range of options may be pursued to suit the business’s requirements | • May be pyramid, flat or decentralised organisational structure, depending on the business’s requirements | Depends on the business’s requirements; that is, the nature of the operation and abilities of employees | Depends on the requirements of the business |

### Revision

1. **State** why work teams are becoming more common in today’s businesses.
2. **State** what impact the development of work teams has on a business’s organisational structure.
3. Draw a hierarchical and a flat organisational structure. **Contrast** the two diagrams by listing their differences.
4. **Outline** in what ways self-directed work teams alter some of the traditional functions of management.
5. You have been appointed team leader of a new work group. **Describe** some of the strategies you could use to develop a sense of cohesion within the group.
6. **Outline** the main characteristics of the participative or democratic leadership style.
7. **Describe** a situation where the participative or democratic leadership style would be appropriate.
8. **Identify** what you consider to be the most important (i) advantage and (ii) disadvantage of the participative/democratic management style. **Justify** your answer.
9. **Deduce** the important lessons the contingency approach teaches managers.

### Extension

1. Reflect upon what you have learned from this chapter. **Determine** which leadership style you would prefer to adopt if you were a senior manager. **Determine** what style of leadership would best suit you as an employee. Present your answers as an oral report to the class.
2. ‘At TechVision Limited we do not rely on lists of rules and management authority. We believe our employees understand the link between productivity and profit, and act on it.’ Nadall Behling, Managing Director.
   (a) **Identify** what evidence there is that Nadall Behling adopts a participative or democratic leadership style.
   (b) **Predict** the likely outcome if either your sports coach or your school principal adopted this leadership style.
3 Discuss the meaning of ‘organisation’ within the management process. Construct a typical organisational structure based on the classical management approach. Construct another organisational structure, this time based on the behavioural approach. Determine the strengths and weaknesses of the two approaches.

4 ‘The contingency approach is centred on two basic questions: (1) What is the level of environmental uncertainty? (2) What type of organisational structure is most suitable?’ Predict how a business should best respond to these questions.
8.1 Introduction

So far in this topic we have discussed only the ‘what’ of management. We have examined:
• the nature of management: its importance and what skills are needed to be an effective manager
• achieving business goals: what the manager wants the business to achieve
• management approaches: ideas about different ways of performing the task of management.

However, we now come to the ‘how’ of management: how the task of management is actually done. Once a business has established a set of specific goals, the next step is to determine what needs to be done to achieve the goals. Strategies outline how the business will attempt to achieve its goals. Strategies are the series of actions undertaken to achieve an end result. This requires managers to make decisions about how best to administer and coordinate the four key business functional areas — operations, marketing, finance and human resources. This responsibility of management is often viewed as the ‘doing things right’ responsibility.

The focus of management’s strategies is to ensure that the key business functions are performing efficiently and effectively in order to support and implement the business’s overall intentions. Specialist managers in:
• operations focus on strategies to improve production processes and to create the ideal factory or office layout
• marketing determine the appropriate markets for the business’s products, and decide on pricing, product features, promotion and channels of distribution
• finance are responsible for the financial requirements, budget allocation and financial record keeping
• human resources are concerned with the recruiting, training, employment contracts and separation of the employees who are required to run the business successfully.

For example, imagine if one of Toyota’s goals is to increase its market share of hybrid motor vehicles. This would result in changes to the operations function — how the cars are manufactured. The marketing function would need to develop plans for pricing and promoting the new type of motor vehicles. Additional finance would be required to fund the extra resources needed. Finally, new employees with the necessary skills will need to be recruited and selected, or existing employees retrained.

In a small business, the key business functions are normally carried out by few employees. They are required to undertake numerous tasks that will often overlap (see figure 8.4 on page 197). Occasionally, a small business will decide to outsource one or more key business functions and concentrate on those functions in which it is most skilled. In large businesses, whole divisions or departments, such as the finance department or the marketing department staffed by many people, perform one specific function.

The key business functions are at the core of all businesses regardless of the business’s size, location, purpose or length of existence.
In most businesses, the key business functions are grouped to bring closely related tasks together. Thus, sales and marketing are grouped, finance and administration are grouped, and operations is grouped with research and development (R&D). Consequently, the range of functions is generally reduced to four main functions as is shown in figure 8.2.

**THE FOUR KEY BUSINESS FUNCTIONS**

- **OPERATIONS**
  - Incorporating:
    - manufacturing
    - provision of services
    - other value adding
    - may be domestic or global

- **MARKETING**
  - Incorporating:
    - sales and advertising
    - product design
    - marketing strategies

- **FINANCE**
  - Incorporating:
    - administration
    - financial management
    - financial planning
    - management and change

- **HUMAN RESOURCES**
  - Incorporating:
    - industrial relations (IR)
    - recruiting
    - training
    - employment contracts

These key functions are interdependent (i.e. they all overlap) and each relies on the other. In many businesses, they are separate functions. This is particularly true of large businesses. The word ‘synergy’ is often applied to describe the benefits of interdependence. Synergy means ‘the whole is greater than the sum of all the individual parts’.

**FIGURE 8.2 The four key business functions**

The importance of the key functional areas is highlighted by the fact that the High School Certificate Business Studies course is structured around — and examines in more detail — the four key functional areas.
Interdependence of key business functions

Though a business can separate the key business functions into departments that perform their distinct roles, the functions are interdependent — each relies on the others to perform effectively. **Interdependence** refers to the mutual dependence that the key functions have on one another. This means that the various business functions work best when they work together. A hockey team might have highly specialised players, for instance a brilliant left wing, a superb fullback and a dynamic goalkeeper. However, despite their individual brilliance, a side will usually win when all players contribute to the game, each working with the others in the team, passing, communicating and playing for the same victory. In the same way, each section of the business may perform its specialised function extremely competently — but if they together do not work as a ‘team’ and aim for the same business goals, then the business is not likely to achieve its objectives. Interdependence occurs when each key function area is committed to the same business goals as the other key areas, and they each work in a coordinated and collaborative way to achieve these goals. Interdependence is always preferred because it provides a unified approach by the business as it works to achieve its objectives.

8.2 Coordinating key business functions and resources

The coordination of key business functions depends on the broad goals of the business as well as its size. In large businesses the key business functions are often separated into different divisions or departments headed by separate managers. This is because the key functions require quite different skills and knowledge. Also, as businesses grow their needs become more complicated: they require many people to carry out each key function. This would mean that each division would have its own specialists. For example, in a large business the employment relations department would have specialists in salaries and pay, hiring of employees, staff training, occupational health and safety (OH&S), and so on.

**FIGURE 8.3** In large businesses the four key business functions are headed by managers who have responsibility for a specific, specialised business function and supervise many employees with expertise and training in that area.
The word **division** is often used by businesses to describe the separation of key functions. Division of a business along functional lines enables each part to specialise, but when the functions are separated, coordination between them becomes an important issue. In fact, the greater the divisional separation the more coordinated a business needs to be in order to run smoothly.

Most businesses are not in fact large but small. In the typical small business the work areas are not separated but often overlap. This is shown by the example of the hairdressing salon in figure 8.4.

**BizWORD**

**Division** refers to the separation of key business functions into specialised units or departments. The business is divided into functional areas.

---

**KLASSIKHAIR SALON (DUNDAS, NSW)**

**Owner**

Alain

**Part-time workers (all hairdressers)**

Nadine  Helen  Aliq

**Independent beautician**

Wei

- Senior hairdresser and manager (operations)
- All employment relations matters
- All finance and accounting (also uses an accountant)
- Some administration (shared role)
- All stock ordering and supply chain management (operations)
- All rostering and scheduling of maintenance
- Some bookings and reception (shared role)

- All involved in operations (hairdressing)
- In addition, all may manage the reception, update client files, take bookings and participate in stocktakes
- Main duties
  - Hair cutting
  - Hair colouring
  - Hair styling (e.g. for formals, weddings and so forth)

Operational and administrative functions overlap

**FIGURE 8.4 The overlapping of key functions as occurs in small business**

**Summary**

- Strategies are a series of actions undertaken to achieve specific goals.
- The four key business functions include:
  - operations
  - marketing
  - finance
  - human resources.
• The key business functions are interdependent — each relies on the other to perform effectively.
• All business functions should:
  – work towards the fulfilment of the business’s goals
  – be coordinated so that they have a common purpose.
• In large businesses the key business functions are often separated into divisions or departments.
• In small businesses the key business functions are not separated but often overlap.

Revision

1 Define the term ‘strategies’.
2 Recall the focus of the strategies developed by management.
3 Identify the four key business functions.
4 Examine figure 8.2 on page 195. Recall two activities involved in each of the four key business functions.
5 Clarify why in small businesses the key business functions are sometimes outsourced.
6 Recount what occurs when there is interdependence between the key business functions.
7 Explain why in large businesses the key business functions are often separated into different divisions or departments.
8 Demonstrate what is meant by the overlapping of key business functions.
9 Propose why the key business functions need to be coordinated in a business that has separate divisions.

Extension

1 Determine why it is impractical to expect small businesses to have distinct functional areas.
2 Predict what will happen to a business whose key business functions are not united in trying to achieve the business’s overall intention.

8.3 Operations management

Operations refers to the business processes that involve transformation or, more generally, ‘production’. It is a term that applies both to the manufacturing and the services sector. As explained in section 8.1, all businesses establish a set of goals. Next, the business implements strategies to achieve these goals. The core goal of all businesses is to maximise profits. This is often best achieved through the efficient production of a good or service. Operations management is the strategy used to achieve this goal. The HSC course investigates operations in greater depth, so this chapter will provide an elementary understanding of the main concepts.

Operations management consists of all the activities in which managers engage to produce a good or service. It is concerned with creating, operating and controlling a transformational process that takes inputs from a variety of resources, and produces outputs of goods and services that are needed by customers. When you buy a loaf of bread from the supermarket, for example, the bakery will have undertaken a number of processes from buying the ingredients, to mixing and blending them, baking, cooling then wrapping the finished loaves and, finally, delivering the loaves to the retail outlets.
FIGURE 8.5 Caroma recently spent $50 million to upgrade its facilities and technology, and robots now do the majority of the work. Production takes place 24 hours a day, seven days a week, allowing the company to compete on the global market.

Operations management, therefore, is at the heart of the success of all businesses. Production involves the skilful bringing together of a number of resources, such as finance, equipment, management, technology and people, to create finished goods and services through a series of operations (see the following Snapshot).

Toyota’s operations system

Operations is the part of the business that ‘gets the job done’ and at Toyota that means producing over 140,000 cars each year, half of which are exported. The process of producing the Camry at Toyota’s manufacturing plant in Altona, Victoria, is much the same as producing a cake — or any other product for that matter. You need inputs (resources used in the production process, such as labour and raw materials). The next step is to transform those raw materials into outputs (finished products). Many of the components used to build an engine, such as pistons and cylinder head covers, are produced in-house by Toyota and some parts are sourced from local suppliers. What else is needed to make a car? Lots of steel panels that are welded and painted and undergo a multitude of processes to then finally reach the 250-metre long assembly line.

Operations is not just about making products or producing services though. Many businesses strive to produce the best product or service on the market. Toyota uses the concept of continuous improvement to do this (referred to in Japanese as kaizen). This means that all company activities — from the assembly line to customer service — are continually scrutinised, then new and better ways of doing things are introduced if needed.

Just-in-time (JIT) production is also used at Toyota. This means that the right parts and materials are manufactured and provided in the exact amount they are needed, and at the time they are needed. The number of cars produced is directly related to customer demand.

Technology is used at Toyota to advantage. For example, the welding involved to make the shell of a car involves 250 processes and 526 parts. Robots do 105 of the welding jobs and the remainder are done by workers on night and day shift. Toyota says they are automated but ‘with a human touch’.

Snapshot questions

1. Clarify why operations is referred to as that part of the business that ‘gets the job done’.
2. Outline the process of producing the Camry at Toyota’s manufacturing plant in Altona.
3. Define the term ‘kaizen’.
4. State how Toyota implements the concept of continuous improvement.
5. Explain the just-in-time (JIT) production method.
6. Determine the advantages Toyota gains by using the ‘kaizen’ and ‘just-in-time’ processes.
The nature and type of operations vary considerably from one type of good or service to another. However, how the operations management function is carried out will directly affect a business’s competitive position because it will:

• establish the level of quality of the good or service
• influence the overall cost of production, given that the operations function is responsible for the largest part of a business’s capital and human expenses
• determine whether sufficient products are available to satisfy consumer demand.

The operations management function has a considerable influence on the quality, cost and availability of a business’s goods or services. These, in turn, have a direct bearing on whether the business achieves its other main goals — specifically, to maximise profits, to increase market share, to maximise growth or to provide a reasonable return for investors.

**Goods and/or services**

A manufacturer will transform inputs into goods: tangible products. **Tangibles** are physical products that can be handled and stored before they are sold to the consumer, such as bread, clothing or a car. The production process and consumption are not linked; that is, there is little customer involvement in production.

A service organisation will transform inputs into services. Services are **intangible**, which means that they cannot be touched. For example, if you attend a training course, you cannot physically touch it, but you hopefully benefit from gaining knowledge and learning new skills. Services cannot be stored and the customer may actually need to be present when the service is being delivered. For example, the customer must be present when receiving a haircut.

In reality, many businesses today produce a combination of both manufactured goods and services. Purchasing a product such as a car or electronic equipment will often come with a warranty and other services. When a customer enters a contract with an internet provider, for example, they will receive a service (their broadband connection), plus the modem and other goods necessary to enable the connection.
Summary

- Operations management is about producing goods and/or services based on business goals.
- The operations management function has considerable influence on the quality, cost and availability of a business's goods and/or services.
- Operations management is responsible for transforming inputs into outputs.
- The characteristics of operations management differ according to whether the business is a manufacturer of goods or a provider of services. Manufacturers produce tangible products (physical), while service organisations produce intangible products (services).
- Most modern businesses produce a combination of both manufactured goods and services.

Revision

1. Define the terms ‘operations’ and ‘operations management’.
2. State what operations management is concerned with.
3. ‘Operations management is the part of the business that actually gets the job done.’ Demonstrate this concept on a smaller scale by describing the materials you would need and the process you would undertake to bake a cake (your finished product).
4. Recall how the operations management function will directly affect a business's competitive advantage.
5. Distinguish between a good and a service.
6. Account for why modern large businesses combine goods and services.

Extension

1. One strategy to produce goods more quickly is to use better technology. For example, if you used a hand beater to bake a cake it may not have been as efficient as using an electric beater. Fill in the following table and determine some strategies that an operations manager might use to achieve the listed business goals. The first entry has been completed for you.

<table>
<thead>
<tr>
<th>Business goal</th>
<th>Operations management strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve the quality of service provided</td>
<td>Introduce quality management</td>
</tr>
<tr>
<td>Improve the quality of the product</td>
<td></td>
</tr>
<tr>
<td>Reduce production costs</td>
<td></td>
</tr>
<tr>
<td>Contribute to the protection of the natural environment</td>
<td></td>
</tr>
<tr>
<td>Increase profitability</td>
<td></td>
</tr>
<tr>
<td>Increase market share</td>
<td></td>
</tr>
</tbody>
</table>

2. Use the internet or look at the careers section of the newspaper to find a job advertisement for an operations manager (sometimes called a factory manager). The advertisement will most probably list responsibilities involved in the position. Classify these into the four management roles (planning, organising, leading and controlling).

3. Anita’s Cosmetic and Beauty therapy is a business specialising in a range of cosmetic and beauty enhancement treatments and products. Determine the range of operations activities offered in such a business.

4. Demonstrate how an operations manager of a manufacturing plant that produces confectionery might use the roles of planning, organising, leading and controlling in his or her daily job.
The production process

There are three key elements of the production process in any business: inputs, processes and outputs.

Inputs

Inputs are resources used in the process of production. Some resources are already owned by the business, while others come from suppliers. Inputs differ between manufacturing businesses and service businesses. There are six categories of inputs:

1. **Material inputs** are the raw materials consumed or converted by the transformation process. A manufacturing company producing building products will use, for example, water, steel and electricity. A service company such as a bank will consume computer software and paper.

2. **Capital equipment** includes the plant, machinery and property necessary to conduct operations. The manufacturing company producing building products will require factories, trucks, forklifts and tools. The bank will require security screens, computers, safes and office furniture.

3. **Labour** refers to people involved in the operations function. The building products manufacturer will require process workers, storepersons, drivers, machinery operators and labourers. The bank will need tellers, mobile lenders, managers and lawyers.

4. **Information from a variety of sources** contributes to the transformation process. Businesses do not always account for the value of this resource because it cannot be easily quantified as a business asset. The building products manufacturer may access new materials as a result of research conducted by universities; developments in computer technology may be adapted and transferred into production processes. The bank may use information provided by market research companies or communication services to assist in product design and delivery.

5. **Time** and its efficient use are critical to all businesses. Coordinating resources within appropriate time frames limits costs and wastage. Operational planning may involve achieving production tasks ranging in duration from one year to merely hours.

6. **Money** is generally considered to be the most flexible of all resources because it can easily be converted into any quantity or combination of materials, capital or labour.

Processes/transformation

The main concept of operations management is transformation, which is the conversion of inputs (resources) into outputs (goods or services). Sony, for example, takes plastic, metal, glass and electronic parts, and transforms them into numerous electronic products using an innovative approach and processes of design, manufacturing and assembly. Figure 8.8 illustrates this transformation process.

The term ‘transformation’ implies physical changes, but today it also includes the conversion of resources into services. Your school takes its main inputs — the students, the syllabus, the teaching and ancillary staff, and the buildings and other capital — and produces educated, employable graduates. What occurs in this educational setting is a transformation process. It is the task of the operations manager to create, operate and control the transformation process, and table 8.1 illustrates how this happens in a number of different businesses.
Owing to the vastly differing nature of business, the transformation process varies from business to business. It is often useful to look at the transformation process in a manufacturing business separately from the process in a service-based business because the transformation processes in manufacturing are far more visible and more easily quantified.

**Transformation process in manufacturing businesses**

The manufacturing process may involve different kinds of processing. One type takes the most basic resources and transforms them into the final goods for the use of consumers. Other types involve a step-like transformation across a range of processors and businesses. Some of these processors assemble components from manufacturers (who act as their suppliers), while other processors further manufacture the components into more **elaborately transformed manufactures (ETMs)** — products that are highly processed and valued (see figure 8.9).

---

**Table 8.1 The transformation process in a manufacturing and service business**

<table>
<thead>
<tr>
<th>Inputs supplied by existing resources or external supplier</th>
<th>Transformation process</th>
<th>Outputs — either goods or services</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Clothing factory</strong>&lt;br&gt;Pattern cutters, designers, drivers, machine operators, material, sewing machines, labourers</td>
<td>Computer-based designing, dyeing, hand and machine cutting, machining, branding, manual random checking</td>
<td>Dresses, shirts, suits, trousers etc.</td>
</tr>
<tr>
<td><strong>Private hospital</strong>&lt;br&gt;Nurses, doctors, operating theatre, computers, beds, drugs, laboratory, X-ray facilities</td>
<td>Consultation, diagnosis, assessment of alternatives, treatment (referral to specialist or done by a general practitioner, GP)</td>
<td>Patient returned to health</td>
</tr>
</tbody>
</table>

**BizWORD**

**Elaborately transformed manufactures (ETMs)** are manufactured goods that are highly processed and valued. They are complex because of the amount of processing they have undergone.
The process

Raw materials → Simple transformation → STMs → Increasing complexity and increased value adding → ETMs (complex and intricate products)

An example

Iron ore → Convert to steel and extrude → STMs → Steel bars → Grade and further process the steel. Fabricate parts and components. → ETMs → Customised wheelchairs (fully automated)

FIGURE 8.9 Complexity continuum of STMs to ETMs

Simply transformed manufactures (STMs) are characterised by their ability to be further processed in a wide range of processes. STMs are manufactured goods that are intermediate by nature. Due to the limited amount of transformation they have undergone, STMs have only a small amount of value added. An example of an STM is the manufacture of glass from silicon oxide (sand). This ‘rough’ glass is not yet saleable to consumers as consumers in retail markets want finished products such as windows and glassware. Different grades of glass are further processed, polished, cut and silvered to create products such as mirrors, car windscreen and so on.

Regardless of the type of manufacture, the operations process is similar and is summarised in figure 8.10.

BizWORD

Simply transformed manufactures (STMs) are characterised by their ability to be further processed in a wide range of processes. STMs are manufactured goods that are intermediate by nature. Due to the limited amount of transformation they have undergone, STMs have only a small amount of value added.

The value added is the creation of extra or added value as raw materials are transformed into intermediate or finished products through the various stages of production.

FIGURE 8.10 Operations in the manufacturing process
Transformation process in service businesses
Due to the intangible nature of services, the operations processes are less physical or visible. They take the form of knowledge, inputs, expertise and so on (see figure 8.11).

**FIGURE 8.11 Operations in service businesses**

Transformation processes adopted by service businesses differ from those in manufacturing businesses for two reasons:
1. Outputs of the service business cannot be physically held in stock. A bank, for example, cannot perform transactions on behalf of customers in advance and store these in anticipation of use at a future date.
2. Service businesses rely heavily on interaction with the customer in determining the output. Before an output is generated, the bank, in the example, needs the customer to indicate whether he or she requires a car loan, a deposit, a withdrawal or any other particular service.

**BizFACT**
As a result of the intangible nature of services, the operations processes are less physical or visible.
Table 8.2 highlights the main differences between manufacturing and service operations.

**TABLE 8.2 Highlighting the difference between manufacturing and service operations**

<table>
<thead>
<tr>
<th>Manufacturing operations</th>
<th>Service operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangible items are produced — they may be customised, but generally they are standardised and often mass produced.</td>
<td>Intangible and customised, or made to suit the individual’s requirements</td>
</tr>
<tr>
<td>Generally located close to supplies of raw materials or inputs (transport costs are of major concern)</td>
<td>Must be close to markets — location and proximity to users of services is vital</td>
</tr>
<tr>
<td>Zoning determines actual siting.</td>
<td>Zoning may allow for home-based flexibility.</td>
</tr>
<tr>
<td>High capital costs in operations but can achieve some economies of scale</td>
<td>High training/education costs but can operate with low capital costs</td>
</tr>
<tr>
<td>Employs unskilled or technically skilled people, so average cost of labour/workforce is low.</td>
<td>Focus is on skilled/experienced/semi-skilled and professional staff, so labour costs are relatively higher.</td>
</tr>
<tr>
<td>Quality of output is standardised and backed by warranty.</td>
<td>Quality varies depending on the strength of industry regulations, skill, experience, knowledge and honesty of practitioner. Backed by public liability insurance. Customer or client relations are ‘everything’.</td>
</tr>
<tr>
<td>Uses manufacturing technology</td>
<td>Uses office automation</td>
</tr>
<tr>
<td>Manufacturer generally makes the product and then awaits sale (thereby risking unsold stock).</td>
<td>The server only acts once the demand for a service is identified — hence less risk.</td>
</tr>
<tr>
<td>The goods last beyond the time over which they are paid for — they tend to be durable.</td>
<td>Services by their nature are inherently non-durable, though the actual work done may have lasting effects.</td>
</tr>
</tbody>
</table>

**Outputs**

Essentially, outputs refer to the end result of a business’s efforts — the good or service that is delivered or provided to the consumer (see figure 8.13 opposite). So far, a distinction has been drawn between service and manufacturing operations, but in many cases businesses carry out both types of operation. Ford Australia, for example, separates its vehicle manufacturing operation from its customer service operation, although both elements are critical to the business’s overall success. All businesses carry out many activities that can be isolated from direct involvement with the customer. Insurance companies employ mathematicians called actuaries who use formulas to determine risk and probability in setting the level of insurance premiums. Actuaries never deal directly with the public, but are instrumental in forming parameters or boundaries in which operations will occur.

The operations manager must be able to link transformation processes to the activities performed by other areas of the business. Output must always be responsive to customer demands. Issues of quality, efficiency and flexibility must be balanced against the resources and strategic plan of the business.
A car is an output that requires individual processes. There may be several thousand inputs, such as nuts and bolts, supplied by hundreds of businesses.

Summary

- The three key elements of the production process include inputs, the transformation process and outputs.
- Inputs are resources used in the production process and include raw materials, capital equipment, labour, information, time and money.
- The transformation process is the conversion of inputs into outputs.
- Elaborately transformed manufactures (ETMs) are manufactured goods that are highly processed and valued.
- Simply transformed manufactures (STMs) are goods that can be further processed in a wide range of processes.
- Transformation processes in service businesses are less physical and take the form of knowledge, inputs and expertise.
- Outputs are the finished goods or services.

Revision

1. Identify the three key elements of the production process.
2. Construct a concept map to summarise the six categories of inputs. The concept map has been started for you.
3 ‘The main concept of operations management is transformation’. With reference to an example, clarify the meaning of this statement.

4 Distinguish between ETMs and STMs.

5 State why the transformation processes adopted by service businesses differ from those in manufacturing businesses.

6 Using the process of completing homework, for example, construct a diagram that describes the operations component (that is, the transformation from no homework done to all homework completed).

7 Identify the inputs, processes and outputs of the following businesses:
   (a) Sanity music stores
   (b) Four ‘n’ Twenty pies.

   Present your answer in table form, as shown in table 8.1 on page 203.

8 Distinguish between ‘input’, ‘transformation’ and ‘output’.

9 The Rio Tinto Group is an international mining company. Rio Tinto finds, mines and processes mineral resources, which are then converted to products such as coal, copper, gold and silver. Use the Rio Tinto weblink in your eBookPLUS to identify the inputs, transformation processes and outputs that Rio Tinto use to produce its products.

10 Discuss the main differences between the operations function in a manufacturing business and a service-based business.

11 A popular online game is the McDonald’s game. This game allows you to manage some of the inputs that McDonald’s would use, from its suppliers through to its consumers. Use the McDonald’s game weblink in your eBookPLUS to play the game, then answer the following questions.
   (a) Identify the elements of this operations system.
   (b) State whether the business in this game offers a service or manufactures a product.
   (c) Propose which aspects of the game an operations manager would have responsibility for.
   (d) Explain what happened when you lost control of your materials or ran out of inputs. Outline what you needed to do to solve this problem.
   (e) Clarify how problems in your supply chain affected the profit trend.
   (f) Propose which operations management strategies you could use to improve productivity in the game. Share your answer with the rest of the class.
   (g) Outline some of the ethical issues that are raised within the game. Identify which of these apply to operations management.

Extension

1 Use the Biz/ed weblink in your eBookPLUS to find the Virtual Factory link. Go to ‘Factory floor’ and then to ‘Production’. Complete the following tasks.
   (a) State the stages of production involved in the manufacturing of hot-air balloons.
   (b) Identify the inputs, processes and outputs of the balloon factory.
   (c) Determine what type of layout is used at the Cameron Balloons plant. Give reasons for your answer. (Hint: Examine fixed position layout, product layout, process layout.)
   (d) Extrapolate why this type of layout would have been chosen.
   (e) Propose whether the production of balloons is capital intensive or labour intensive. Give reasons for your answer.

2 Contact a manufacturing business and survey its response to a range of questions that you, or a small group, have written and emailed regarding the operations function in their business. Synthesise your findings and present them to the class.

3 Contact a service-based business and survey its response to a range of questions that you, or a small group, have written and emailed regarding the operations function in their business. Synthesise your findings and present them to the class.
Quality management

Quality management is the strategy which a business uses to make sure that its product meets customer expectations. Three quality approaches are quality control, quality assurance and total quality management.

Quality is very important to Tip Top Bakeries, the bakery division of George Weston Foods Limited. To Tip Top, quality means understanding and exceeding customer expectations and making sure that products comply with regulations. A quality product should have a high degree of excellence and should achieve its stated purpose. A quality product should be reliable, easy to use, durable, well designed, delivered on time, include after-sales services, and have an agreeable appearance.

When managing quality, businesses will:
- minimise waste and defects
- strictly conform to standards
- reduce variance in final output.

Operations managers use a variety of approaches to maintain or improve quality. Tip Top uses quality control and quality assurance. Many businesses use an approach called total quality management.

Quality control

Tip Top bakeries uses quality control to optimise its production process. Quality control reduces problems and defects in the product using inspections at various points in the production process. Many businesses such as Tip Top have minimised errors and waste by ensuring that standards are met. Specifications or benchmarks are set before the physical checks are completed. Actual performance is then compared to the established criteria. If the established standards are met, it is likely that the business will be meeting customer expectations. Competitiveness increases as the costs associated with waste and faulty products are reduced.

In a service business, an inspection of employee performance can be used as a means of quality control. A bank might inspect teller accuracy, speed or courtesy. In a call centre calls might be monitored for quality assurance and control purposes.
FIGURE 8.15 Beneath the green grass of the MCG lies 5 kilometres of PVC drainage pipe that stops the surface from becoming waterlogged. This pipe is made by Vinidex Pty Limited, Australia’s leading manufacturer of thermoplastic pipe systems for the transportation of fluid, data and energy.

Vinidex uses meticulous quality control to maintain excellent customer service. New materials are carefully examined to make sure that Vinidex continues to achieve high standards in the pipes and fittings industry.

Quality assurance

Quality assurance is an integral part of Tip Top’s operations. A quality system is in place to ensure that set standards are achieved. Tip Top’s quality systems are certified to the ISO 9002 standard. The ISO 9000 series of quality certifications is a widely used international standard. ‘ISO’ stands for International Organization for Standardisation. Meeting these international standards is voluntary, but many businesses comply with their requirements to remain competitive locally and internationally. The ISO provides guidelines on how businesses should establish quality assurance systems by adopting specific procedures, controls, and recording and documentation measures. Tip Top’s quality system gives assurance to customers that it is able to provide safe and reliable products.

Total quality management

Total quality management (TQM) is a commitment to excellence that emphasises continuous improvement in all aspects of a business’s operation by sharing responsibility among all the members of the business (see the following Snapshot). Quality becomes both a commitment and the responsibility of every employee in the business. The aim of TQM is to create a defect-free production process, and maintain a customer focus in operations. The adoption of TQM can improve the price competitiveness of a business, but can also improve product quality, allowing the business to attain competitive advantage. To achieve TQM objectives a number of approaches may be used, such as employee empowerment, continuous improvement and improved customer focus.

BizFACT

Northrop, a US company involved in the production of B-2 aircraft, required each employee to sign a giant scroll which was then hung over the plant assembly line. The inscription read ‘Total quality control on the B-2 begins with me’.

BizWORD

Quality assurance involves the use of a system so that a business achieves set standards in production.

BizWORD

Total quality management is an ongoing, business-wide commitment to excellence that is applied to every aspect of the business’s operation.
Managers have been interested in the quality of their products since the Industrial Revolution. However, standards of quality tended to be an afterthought. This dramatically changed after World War II, due mainly to W Edwards Deming, an American quality expert. Today, quality is a driving force in businesses around the world. Hotels, hospitals, educational institutions and government departments are as interested as airlines, factories and retail establishments in improving product/service quality.

The ideas of Deming, who is known as the ‘founder of the quality movement’, were originally ridiculed in America, but the Japanese embraced his theories and modified them to help rebuild their companies into world leaders. Eventually, during the 1980s, American companies adopted Deming’s principles of statistical quality control.

Deming’s total quality management (TQM) concept focuses on managing the total organisation to deliver quality to customers. He advocated a shift away from an inspection-oriented approach to quality control towards an emphasis on employee involvement in the prevention of quality problems. Build the product right in the first place and you avoid the expense of inspection and the waste of rejected products, he insisted. Improving quality, said Deming, can also help organisations increase their market share (as a result of better quality and lower priced products), ensure their future and provide more jobs.

Deming’s approach instils quality values throughout every activity in a business, with frontline employees closely involved in the process. He rejected the traditional attitudes that defective products or poor service are due to employees’ sloppy work habits, stressing that most quality failures result from the production system. Committing to TQM means committing to change in a business’s culture, he argued. To achieve this change, four elements are needed: employee involvement, continuous improvement, benchmarking and a focus on the customer.

**Snapshot questions**

1. **Identify** the central focus of Deming’s TQM concept.
2. **Explain** how a business benefits from adopting a TQM program.
3. **Determine** why the successful implementation of a TQM program depends on commitment from everyone in the business.
4. **Analyse** the effectiveness of a focus of continuous improvement on work processes.

**Employee empowerment**

Deming believed that quality problems would be best solved with an emphasis on employee involvement. Many businesses use **quality circles** as a means of achieving employee empowerment. Under this approach, teams of up to 10 workers meet regularly to solve problems related to process, design or quality. The groups often make presentations to management with their ideas, in order to improve the performance of the business. Such programs have resulted in substantial cost savings for organisations — for example, at the Northrop Aircraft division that produces Boeing 747s, 55 individual quality circles halved the cost of parts within two years. At Chrysler, a quality circle discovered that heating rubber seals before installation could prevent car door leaks.

**Continuous improvement**

**Continuous improvement** is a process that involves a constant evaluation of, and improvement in, the way things are done. Higher and higher standards are set in the continual pursuit of improvement. **Kaizen** (Japanese for ‘improvement’)

**BizWORD**

**Quality circles** are groups of workers who meet to solve problems relating to quality.

**BizWORD**

**Continuous improvement** involves an ongoing commitment to achieving perfection.
emphasises continuous improvement in all facets of a business, from the way the CEO manages to the way assembly line workers perform their jobs. Although perfection is practically impossible to achieve, it is the ‘striving’ that is important to business culture.

Customer focus
Deming believed that quality should be the responsibility of every employee. The TQM approach considers one of the most important questions a business should ask: ‘What does the customer require?’ All teams need to realise that they are serving a customer. This is as true for the employees that deal directly with external customers as for those that simply pass work on to other employees inside the business.
Summary

- Quality management is the strategy that a business uses to make sure that its product meets customer expectations. Three quality approaches are quality control, quality assurance and total quality management.
- Quality control involves the use of inspections at various points in the production process to check for problems and defects. Performance is measured in relation to set standards or benchmarks.
- Quality assurance involves the use of a system where a business achieves set standards in production. A widely used international standard is the ISO 9000 series of quality certifications.
- Total quality management (TQM) is an ongoing, business-wide commitment to excellence that is applied to every aspect of the business’s operation. A number of approaches may be used, such as employee empowerment, continuous improvement and improved customer focus.

Revision

1. Outline the main features of quality management.
2. Explain why quality control is important to businesses.
3. Describe the ways a business can offer quality assurance to customers.
4. Explain what is meant by total quality management.
5. Summarise the three approaches that make up total quality management.
6. Read the following definitions. If a definition is false, propose a correct definition.
   - (a) Quality control involves the use of inspections at various points in the production process.
   - (b) Quality assurance involves the use of a system where a business achieves set standards in production.
   - (c) Total quality management is a commitment to quality that is applied to the business’s operations department.
   - (d) Continuous improvement involves an ongoing commitment to use of inspections.
7. Ganesh is the production manager for IBX technology, a manufacturer of Internet security software. Recently, the level of product defects has increased, although the production process has not changed.
   - (a) Propose to Ganesh strategies that he should use to determine the cause(s) of the defects.
   - (b) Explain to Ganesh the value of introducing a TQM approach.
8. The name ‘The Reject Shop’ suggests that it could not possibly sell quality products. Is this true? Use the weblink for The Reject Shop in your eBookPLUS to search the company’s website and see how many references to quality you can find. Explain how The Reject Shop ensures that it receives quality products from suppliers.

Extension

1. Use the Australian Quality Council weblink in your eBookPLUS to obtain information about the Australian Quality Standards. Assess the practical effects of such standards on industry.
2. Investigate W Edward Deming and his development of TQM. Justify whether you think he proposed anything extraordinary or he just made businesses more aware of their production methods.

8.4 Marketing management

Marketing is vital to the existence of the business. Just because someone invents a new product or improves an existing one does not guarantee customers will buy it. Without some form of marketing, customers may not even be aware of a product’s
existence regardless of how ‘record breaking’, ‘new and improved’ or ‘revolutionary’ it may be (see the following Snapshot). Statistics reveal that more than 70 per cent of new products launched on the market self-destruct in the first year of operation, mainly because of poor marketing. Businesses make few sales if they do not market their products successfully, eventually ending in failure.

Terry Markou’s AquaKerb

Have you watched the ABC television show called *The new inventors*? The show presents the inventions of men and women and demonstrates how these inventions can make someone’s life a little easier, safer or better.

Terry Markou hated seeing street trees die in droughts. His invention, the ‘AquaKerb’, was voted the most popular invention by viewers of the show on that night. Terry had developed a product for which there could be great future demand, especially in dry areas and those affected adversely by global warming.

As is the case for most contestants, that program was the first time Terry’s product was exposed and critically examined, rated and promoted in the public arena. The objective is not only to win the contest, but to gain support to manufacture the invention, and in its promotion and distribution to the domestic and overseas markets.

A great invention like Terry’s AquaKerb is of little value if it has not been effectively marketed — brought to the attention of the general public and targeted towards those who would be most interested in putting it to use.

Terry was about to take the important next step that would make or break the dream he had for his wonderful invention.

**Snapshot question**

Explain why Terry Markou must quickly develop a marketing plan for his AquaKerb invention.

At the same time, many products that would seem insignificant and unimportant have become best-selling ‘essential’ items as a result of a well-managed and professional marketing plan. Who would have ever thought that brown, sugary, fizzy water with addictive qualities would become the universal product it is today (see the following Snapshot)?

Marketing is a powerful business strategy available to all businesses. The HSC course investigates marketing in greater depth, so this chapter will provide an elementary understanding of the main concepts.

Coca-Cola — a successfully marketed product

Coca-Cola’s Coke soft drink was released on to the Australian market in 1938, 50 years after its release in the United States. The first distinctively shaped bottles — themselves part of Coca-Cola’s overall marketing strategy — were produced in that year by one of Sydney’s oldest soft drink factories. Australian consumption of soft drink was growing, but that did not guarantee the Coke product immediate success. Early sales representatives for Coca-Cola were lucky if a store owner bought a single bottle, let alone a case.

Coca-Cola largely owes its popularity to its successful marketing, especially its advertising. Advertisements for Coke were initially aimed at an older age group —
Marketing fundamentals

Marketing is not a new subject to you. Over the years you have probably been involved in some type of marketing activity. Consider the following examples:

• helping to organise a stall at a local fete
• setting up a raffle for a local sporting team
• persuading your parents to lend you some money to buy an iPod
• coordinating the publicity for the school musical.

Although all these activities are different, they have one thing in common: they involve a number of marketing activities. Some people may think that marketing is just a fancy name for selling, but there is much more involved than selling. Actually, the current view of marketing is such that it does not even have to involve the selling of a product — for example, not-for-profit organisations may want to inform the public of the services they provide.
What is marketing?

There are many definitions used to describe marketing. The most commonly accepted definition comes from the American Marketing Association: ‘Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives.’

A more simplified definition of marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers. At the heart of these activities is the most fundamental question all businesses should continually ask: ‘What do customers want to buy — now and in the future?’ This is the essence of marketing — finding out what the customers want then attempting to satisfy their needs.

Sometimes ‘selling’ and ‘marketing’ are used synonymously. However, the two words have different meanings. Selling is merely getting rid of existing stock, whereas marketing takes a much broader view. Successful marketing involves bringing the buyer and seller together and making a sale.

Small business and marketing

Some small business owners are excellent ‘technicians’ but dislike marketing and inadvertently turn away customers. Other small business owners are so convinced of the value of the good or service that they assume it will sell automatically. Unfortunately, this rarely occurs.

Many small business owners feel marketing is not for them. They happily place advertisements in local newspapers, display the name of the business on their cars and perhaps even advertise on a regional radio or television station. However, such advertising is just one part of marketing a good or service.

Small business owners often view marketing campaigns as something only large businesses do, and as too expensive, complicated or time consuming for themselves. What they do not often appreciate is that they can run a marketing campaign and that it can be simple and inexpensive (see the following Snapshot).

All businesses, regardless of size, need to undertake some form of marketing, otherwise customers will not be informed about the business’s products.

Total Solutions’ marketing campaign

Robert’s computer business ‘Total Solutions’ was approaching a milestone: its 10-year anniversary. To mark the occasion, Robert wanted to communicate to his customer base:

- the range of innovative products offered by the business
- that Total Solutions had recently received the ‘Excellence in Small Business Award’ for the third year in a row
- the new information technology courses he was about to launch
- his appreciation of continued customer loyalty and community support.

He decided that the anniversary should have a theme, so he chose the slogan: ‘Solutions — not a problem’. He then had to determine the appropriate marketing strategies. Eventually Robert decided on the following:

- a media release announcing the ‘Excellence in Small Business Award’. This release would be sent to the local newspaper, and regional television and radio stations.
- 1000 stick-on message note pads, featuring the theme slogan and a 10-year anniversary logo.
• an open day incorporating free lessons on digital photography and imaging
• a barbecue for customers and suppliers during the open day
• 150 helium-filled balloons featuring Total Solutions’ business details and the 10-year anniversary logo.

A budget of $4000 was allocated for the week-long activities. Robert and two other employees formed a committee to develop and implement the marketing campaign. Robert estimated the long-term benefits to the business's reputation generated by the campaign would more than offset the cost involved.

Snapshot questions
1. **Outline** the benefits Total Solutions will gain from the marketing campaign.
2. **Determine** which of the marketing strategies you think would have the greatest marketing potential. Give reasons for your answer.

**Role of marketing**

Marketing is much more than placing an advertisement in the local media. It is a way of thinking. Everything a business does should be directed towards putting the customer at the centre of its thinking. To do this successfully requires adopting a customer-oriented approach to marketing. Business owners need to view their business in terms of the needs and wants of their customers (see figure 8.19). As competition intensifies, it will be their marketing philosophy that will help their business face the competition and succeed.

1. Place your customers, not your products, at the centre of all you do.
2. Talk to your customers. Ask them what could be improved, what they like and dislike.
3. Think about ways to build loyalty with your customers.
4. Differentiate your product in ways that will make it special in the eyes of your customers.
5. Regularly communicate with your present and potential customers.
6. Develop a unique and recognisable brand or image that reflects the special qualities of your business.
7. Always deliver what you promise.

**FIGURE 8.19 Seven tips to becoming a marketing driven customer-oriented business**

For businesses that adopt a customer-oriented approach, the customer relationship does not end with the sale; it begins there. These businesses will continuously strive to not simply meet but exceed customer expectations. This means that, at every level of the business, employees should work towards customer satisfaction by establishing positive relationships with customers. To do this successfully a business should adopt the marketing concept approach.

**BizFACT**

All businesses should focus on satisfying the needs of their customers. All the activities of the business should be directed to the marketing of the good or service.
The marketing concept approach

During the 1950s, businesses began slowly to accept that they were not solely producers or sellers, but in the business of satisfying customers’ wants. This shift in focus to a customer-oriented approach brought about significant changes to marketing, especially the need to undertake market research and develop a marketing concept.

The marketing concept is a philosophy that all sections of the business are involved in satisfying a customer’s needs and wants while achieving the business’s goals. The business should direct all its policies, plans and operations towards achieving customer satisfaction. The marketing plan, therefore, needs to become integrated into all aspects of the business. For example, if the success of the marketing plan means having a product ready by a certain date, the production plan will need to be in place to make sure that happens. If the business makes Christmas puddings, it is no good delivering the puddings after 25 December! Financial planning must also ‘connect’ with the marketing plan. Marketing costs money and finances must be available if, for example, the business wishes to embark on an expensive advertising campaign. The marketing manager will also have to work with the human resource manager to ensure that the right staff are employed to create the product or service that is desirable to customers.

How can we best meet the needs of our customers?

Human resources plan

CEO
Sales Manager
Finance Manager
Technical Manager

Operations plan

Financial plan

Marketing plan
Customer-oriented

How can we best meet the needs of our customers?

Summary

• For a business to make a profit, it needs to create and market products that consumers will purchase.
• Marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers.
• Successful marketing involves bringing the buyer and seller together and making a sale.
• Businesses should continuously strive to not simply meet but exceed customer expectations.
• The marketing concept is that a customer’s needs and wants are met while achieving the business’s goals.

Revision

1 Outline the importance of marketing to a business.
2 Recall why most new products fail shortly after they are launched.
3 Identify some types of marketing activities you have been involved in.
4 Discuss how the ‘marketing’ definition provided in this chapter differs from your previous understanding of the term.
5 Distinguish between selling and marketing.
6 Recall why all businesses, regardless of size, need to undertake some form of marketing.
7 Justify why a business should adopt a customer-oriented approach to marketing.
8 Refer to figure 8.19 on page 217. Identify which of the ‘seven tips’ you think is the most important. Justify your answer and share it with other class members.
9 Recal the correct response to complete the following sentences.
   (a) The main emphasis in marketing today is the _________-oriented approach.
   (b) This means the business wants to ________ customers’ needs and wants rather than merely produce products.

10 The marketing concept is a business philosophy adopted by many modern businesses. Read the following two pairs of statements, choose the statement that best represents the business that has adopted the marketing concept approach and explain the reasons for your choice.
   (a) Business A: ‘We offer a means of transport, reliability and customer service.’
       Business B: ‘We make cars.’
   (b) Business A: ‘Our sales are falling. We will have to think about laying someone off.’
       Business B: ‘Our sales are falling. We will have to undertake some market research to find out why.’

Extension
1 Construct a PowerPoint presentation containing 10 dot points that reflect key features of your new understanding of marketing.
2 Use the Pepsi Cola and Coca-Cola weblinks in your eBookPLUS to investigate each business’s marketing strategies. Produce a one-page report that compares the marketing of Pepsi and that of its main rival, Coca-Cola.
3 ‘Marketing is not the sole responsibility of the marketing manager, but all managers.’ Determine the accuracy of this statement.
4 Predict what will happen to a business that neglects the importance of marketing.

Identification of the target market

Very few businesses can afford to market their products to all consumers or all businesses in Australia. At the same time, few businesses would want to because it is a very rare product that is suitable to all consumers. Until the end of the 1950s, Coca-Cola was such a product. But today Coca-Cola offers consumers a range of carbonated soft drinks based on its original cola formula including Coca-Cola Zero, Diet Coke and Vanilla Coke, as well as non-cola drinks such as Pump still water, PowerAde Isotonic and Fruitbox Juice Drink. Most businesses must select specific groups of customers on which to concentrate their marketing efforts: their target markets.

Three broad approaches can be adopted when selecting a target market: the mass marketing approach, the market segmentation approach or the niche market approach (see figure 8.21).

![Figure 8.21 Selecting a market to be the target market]
Mass marketing approach

Fifty years ago, marketers commonly spoke about 'mass market'. In other words, there was a large demand for a standard product. In a mass market, the seller mass-produces, mass-distributes and mass-promotes one product to all buyers. The Model T Ford, for example, was the first motor vehicle to be produced and sold to the mass market (see figure 8.22).

A mass marketing approach seeks a large range of customers. The business develops a single marketing mix and directs it at the entire market for the product. This means there is one type of product with little or no variation, one promotional program aimed at everyone, one price, and one distribution system used to reach all customers.

Few products today, apart from basic food items, water, gas and electricity, are marketed to the mass market. As a result of greater choice, higher personal incomes and customers seeking more individualised products, the mass market has been replaced by segmented or niche markets.

Market segmentation approach

Few businesses can sell their products to the entire market — the market is just too big. Therefore, a business will divide the market into distinct segments. A business that is marketing motor vehicles, for example, would not direct its marketing efforts towards every person in the total vehicle market. Some people might want only a sports car; others might want a four-wheel drive. The business would thus direct its efforts towards a particular segment of the total market for motor vehicles.

Market segmentation occurs when the total market is subdivided into groups of people who share one or more characteristics based on four elements or dimensions: demographic, geographic, lifestyle and behavioural, as shown in table 8.3.
<table>
<thead>
<tr>
<th>TABLE 8.3 Common elements or dimensions for segmenting customer markets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Demographic — population characteristics</strong></td>
</tr>
<tr>
<td>• Age</td>
</tr>
<tr>
<td>• Gender</td>
</tr>
<tr>
<td>• Education</td>
</tr>
<tr>
<td>• Family size</td>
</tr>
<tr>
<td>• Family life cycle</td>
</tr>
<tr>
<td>• Occupation</td>
</tr>
<tr>
<td>• Social class</td>
</tr>
<tr>
<td>• Religion</td>
</tr>
<tr>
<td>• Ethnicity</td>
</tr>
<tr>
<td>• Urban</td>
</tr>
<tr>
<td>• Suburban</td>
</tr>
<tr>
<td>• Rural</td>
</tr>
<tr>
<td>• Regional</td>
</tr>
<tr>
<td>• City size</td>
</tr>
<tr>
<td>• Climate</td>
</tr>
<tr>
<td>• Landforms</td>
</tr>
</tbody>
</table>

A business segments its market so it can better direct its marketing strategies to specific groups of customers, rather than the mass market. The ultimate aim of market segmentation is to increase sales and profits by better understanding and responding to the desires of the target customers.

**Target market**

Once the market has been segmented, the business selects one of these segments to become the target market (see figure 8.23). For example, a rural supplies business would normally aim its promotion strategies at male, 25 to 60-year-old, rural-based farmers with middle to high incomes. An exclusive women’s fashion boutique in central Sydney would have a target market of customers who are female, 25 to 45-year-old, city-based professionals with high incomes.

This approach allows the business to better satisfy the wants and needs of a targeted group, because the business can:
- use its marketing resources more efficiently
- better understand the consumer buying behaviour of the target market
- collect data more effectively and make comparisons within the target market over time
- refine marketing strategies used to influence consumer choice.

**BizWORD**

**Consumer buying behaviour** refers to the decisions and actions of consumers when they purchase goods and services for personal household use.
Sometimes, a business may be able to identify both a primary and secondary target market. Customer research conducted by Sportsgirl Fashion, for example, revealed a primary target market of 18 to 25-year-old females, as well as a secondary target market of 26 to 40-year-old females. The ability to choose the correct target market is an important marketing function because it will influence the entire marketing plan (see the following Snapshot).

**Beau’s Floral Studio — target market**

Beau Wilkes is owner–operator of a retail florist store called Beau’s Floral Studio. The business provides fresh and dried flowers, and associated product lines for all occasions. The business markets to a wide cross-section of the population within the surrounding suburbs, but particularly to females aged 15–65 years and males aged 15–25 years.

**Size of target market**

*Potential*
Beau’s potential target market consists of approximately 74 000 people who live in the surrounding suburbs.

*Actual*
Beau’s primary target market consists of females aged 35–65 years who decorate their homes with floral displays.

The two secondary markets consist of:
- females aged 15–65 years who purchase flowers for special occasions
- males aged 15–25 years who purchase flowers for their partners.

These target markets are important because they represent repeat customers who are essential for the business’s long-term survival. The primary target market consists of approximately 21 000 people. It can be further subdivided according to the benefits sought by the customer, as shown by the following table.

**Subdivision of target market**

<table>
<thead>
<tr>
<th>Benefits sought by customer</th>
<th>Customer characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comfort (sickness and sympathy)</td>
<td>Male and female, aged 15 years and above</td>
</tr>
<tr>
<td>Beauty (floral displays)</td>
<td>Predominantly female, aged 35–65 years</td>
</tr>
<tr>
<td>Happiness (weddings and parties)</td>
<td>Predominantly female, aged 15–50 years</td>
</tr>
<tr>
<td>Affection</td>
<td>Predominantly male, aged 15–45 years</td>
</tr>
</tbody>
</table>

**Target market dimensions**

*Geographic*
Beau’s Floral Studio targets the residents of the local area. Sales to customers from outside the surrounding suburbs are only occasional, not regular, and do not constitute an important segment for the purposes of her marketing plan.

*Demographic*
Customer research data collected over the past 12 months reveal that 67 per cent of customers were female and 33 per cent were male. Females aged 35–65 years were the most common type of customer, making up 83 per cent of the total female customer base. Males aged 15–25 years made up 78 per cent of the total male customer base.

*Purchase decision maker*
Predominantly, the purchase of fresh and dried flower arrangements is considered to be a gift purchase, for either the individual or another person. The experience...
A positive experience produces return business.

Income level

Beau’s Floral Studio caters for the middle to high income groups. These groups consist of individuals and households with high levels of disposable income. They do not perceive the buying of flowers as an infrequent luxury expenditure, but as a regular (weekly or fortnightly) purchase.

**Snapshot questions**

1. Identify the primary and secondary target markets for Beau’s Floral Studio.
2. Recall what four variables Beau Wilkes uses to segment the target markets.
3. Explain the importance of these target markets to Beau’s Floral Studio.
4. Analyse how segmenting the total market helps Beau Wilkes achieve her long-term business objectives.

**Niche markets**

An extension of the market segmentation approach is that of the *niche market*, which is a narrowly selected target market segment. In a sense, it is a segment within a segment, or a ‘micro market’ (see figure 8.24). For example, in any newsagency, you will see row upon row of magazines each appealing to a specific niche market — male, female, young, old, high-income, low-income, urban, rural, outdoor lifestyle, indoor lifestyle and so on.

**BizWORD**

*A niche market* is a narrowly selected target market segment.

**FIGURE 8.24** A magazine for every interest and every target market

**Summary**

- Three broad approaches can be adopted when selecting a target market: the mass marketing approach, the market segmentation approach or the niche market approach.
A mass marketing approach seeks a large range of customers.

A business segments its market so it can better direct its marketing strategies to specific groups of customers.

Market segmentation occurs when the total market is subdivided into groups of people who share one or more common characteristic.

A target market refers to the group of customers to which a business intends to sell its product.

Sometimes a business may be able to identify both a primary and a secondary target market.

A niche market is a narrowly selected target market segment.

**Revision**

1. **Distinguish** between mass, segmented and niche markets.
2. **Outline** the purpose of market segmentation.
3. **Recall** the different ways a market may be segmented.
4. **State** why market segmentation is the most common marketing approach used by businesses today.
5. **Explain** how market segmentation and target market are linked.
6. Use an ‘M’, ‘S’ or ‘N’ to determine whether the following products are sold in a mass market, segmented market or niche market.
   - (a) Electricity
   - (b) Ferrari cars
   - (c) Australian Financial Review
   - (d) Avon cosmetics
   - (e) Fruit and vegetables
7. **Determine** who is most likely to be the target market for each of the following small businesses. (You may think of more than one market for some businesses.)
   - (a) Convenience store
   - (b) Mechanic
   - (c) Accountant
   - (d) Nursing home
   - (e) Childcare centre

**Extension**

1. ‘Any business that neglects the role of marketing will almost certainly experience low levels of sales and reduced profit levels.’ **Evaluate** the accuracy of this statement.
2. In small groups, conduct a survey of 30 people to investigate what type of movies they watch at the cinema. Using a database, group the respondents by age and sex. Present your results in the form of graphs and charts.
3. In small groups, **create** a customer survey form for obtaining information on a business’s level of service, product range, business facilities and suggestions for improvement. **Compare** each group’s survey.

**The marketing mix — the four Ps**

Once the business owner has established the marketing goals (a statement of what the business expects to achieve through the marketing activities) and selected a target market, the next step of the marketing plan is to develop marketing strategies to achieve the goals. **Marketing strategies** are actions undertaken to achieve the business’s marketing goals through the marketing mix.

One of the most useful ways of understanding how to develop a marketing strategy is to examine each of the elements of the marketing mix. The **marketing mix** refers to the combination of the four Ps — product, price, promotion and place (distribution). The business has control over these elements and uses them to reach its target market. As well, the business has control over other organisational resources — such as information, finances and employees — that may also be used to achieve marketing goals.
Once the four Ps have been established, the business must then determine the emphasis it will place on each of the variables. This will largely be determined by where the product is positioned or its stage in the product life cycle. For example, a product that is being marketed with an image of exclusivity and prestige will require a marketing mix totally different from a no-frills, generic item. A different marketing mix will also be required for a product in its introductory stage than when it reaches the decline stage.

**Product**

This element of the marketing mix involves much more than just deciding which product (goods or service) to market. The business owner needs to determine the product's:

- quality
- design
- name
- warranty and guarantee.

The product is a combination of all these variables. Customers will buy products that not only satisfy their needs but also provide intangible benefits such as a feeling of security, prestige, satisfaction or influence.

One intangible benefit of utmost importance is customer service. A product may be superior in all aspects compared with its rivals. However, if the manufacturer is unable to deliver a high degree of customer service to complement the product, it will soon fail in the marketplace. Some businesses spend large amounts of money establishing a brand name, but their brand name advantage is quickly lost if they do not also focus on their relationship with the customer. Such a relationship is usually built around the level of customer service offered.

Businesses should also remember that customer service does not end with the sale. Ongoing service, especially for complex and expensive products, is crucial to maintaining strong customer relationships. A business needs to undertake much careful planning about after-sales service when developing the product.

**Product positioning**

Some brand names, such as Rolex, Ferrari and Longines, can immediately evoke an image of the product's quality. This image gives the product its position within the market. Product positioning refers to the development of a product image compared with the image of competing products (see figure 8.26).

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**BizFACT**

A business may vary its marketing mix when it wants to reach different target markets.

**BizWORD**

The product life cycle describes the life of a product over four stages: introduction, growth, maturity and decline.

**eBookplus**

Use The four Ps of marketing weblink in your eBookPLUS to discover more about the four Ps of marketing, and the strategy and implementation around these four elements.

**BizWORD**

Product positioning is the development of a product image compared with the image of competing products.
In highly competitive markets, sales may be difficult to gain. For this reason, a business will attempt to create an image that differentiates its product from the others. Many businesses invest considerable resources in the positioning of their product. Therefore, when customers purchase products, they buy both the tangible and intangible benefits (attributes) — a total product concept.

Product packaging
The packaging of a product is sometimes as important as the product itself to assist sales. Well-designed packaging will give a positive impression of the product and encourage first-time customers to purchase. Tasteful packaging can create an image of luxury, sensuality and exclusiveness, helping to promote the product. In addition, packaging helps preserve, inform, protect and promote the product.
With increasing community awareness of environmental pollution, businesses must also be sensitive to the problems caused by throw-away packaging. Approximately half of all household garbage consists of discarded packaging.

Product branding
An important part of the product development is the brand and associated brand logo. Combined, these can be a powerful marketing tool. For example, the three-pointed star of the Mercedes-Benz and Coca-Cola’s distinctive narrow-waisted bottle are famous brand names and symbols. Some businesses encourage the instant recognition of their brand symbol rather than their brand name. Perhaps the most famous example of this technique is the ‘golden arches’ symbol used by McDonalds. In some advertisements the brand name does not appear at all, only the brand symbol. This is a clever and subtle method used to reinforce the meaning of the symbol and associate it with a brand name.

Price
Many business owners have difficulty selecting the ‘correct’ price for their product. A price set too high could mean lost sales, unless superior customer service is offered. A price set too low may give customers the impression of a ‘cheap and nasty’ product. Therefore, correct pricing is important. Business owners normally choose one of four methods for calculating price.

1. Cost plus margin: calculating the total cost of production and adding a percentage (a margin) for profit.
2. Market price: pricing according to the interaction between the quantity that customers are willing to purchase and the quantity that producers are able to supply. If there is a shortage of the product, the market price will rise, whereas if there is a surplus, market price will fall.
3. Competitors’ price: choosing a price that is either below, equal to or above that of the competitors.
4. Discount price: reducing the price of stock that is not selling to stimulate demand.
Promotion

To sell more of its products, a business has to change customers’ behaviour through information or persuasion. This is achieved through promotion. The role of promotion is to inform, persuade and remind consumers about a business’s products, with the aim of:
• attracting new customers by raising awareness of a particular product
• increasing brand loyalty by reinforcing the image of the product
• encouraging existing customers to purchase more of the product.

Many people confuse promotion with advertising because of its visibility and frequency. However, advertising is just one of the four elements of the promotion mix. The main forms of promotion are as follows:
1. Personal selling: a sales assistant outlines the features of the good or service to the customer. The main advantage of this method is that the message can be modified to suit the individual customer’s needs. However, it is a time-consuming and expensive technique.
2. Sales promotion: activities and materials are used to attract interest and support for the good or service. Examples include free samples, coupons with cash refunds, and loyalty programs such as Fly Buys.
3. Publicity: the business sets up a free news story about its product. The main aim of publicity is to enhance the image of the product, highlight a business’s favourable features, and help reduce any negative image that may have been created.
4. Advertising: print or electronic mass media are used to communicate a message about the product. Advertising is used to attract potential customers, create a demand for the product and communicate essential information.

BizWORD

Promotion refers to the methods used by a business to inform, persuade and remind customers about its products.

BizFACT

E-commerce is a rapidly expanding form of promotion. Approximately one-third of small businesses in New South Wales expect to use e-commerce to sell goods and services within the next 12 months. Account for this trend.
Changes in technology, especially advances in information and communication technology (ICT), are having a significant impact on how businesses promote their products. The internet, for example, has become an effective advertising tool used by businesses to deliver specific messages to its target market. Internet newsgroups, ezines, chat rooms, social networking websites and online publications can all be used in an advertising campaign. The internet has also provided opportunities for many small businesses to undertake more of their own promotional activities (see the following Snapshot).

Outback Trekkers launch — live on the internet

Outback Trekkers was having trouble promoting itself. It experienced difficulty getting its story out to its target market. Based at an isolated cattle station in remote New South Wales, the business had very little success through normal media channels. The company decided to try a new approach. A live launch was scheduled on an internet site, to be followed by a carefully targeted email delivery to the most influential customers. Within the first month, the business had over 38 000 hits on its site, and 2159 follow-up emails from prospective customers. Taking the story live on the internet was a cost-effective way of generating awareness about the business and its products, as well as establishing a positive, progressive image. The internet provided five main benefits for Outback Trekkers.

1. The home page became the business’s window to the world; through it, potential customers could view what the business had to offer.
2. Many more people beyond the immediate geographic vicinity were reached.
3. The company reached potential customers who prefer electronic communications and with whom further communications were easy and cost effective.
4. Bookings and payment could be conducted online, reducing operating costs.
5. The home page could be updated regularly, incorporating graphics and customer endorsements.

Snapshot questions

1. Outline the advantage of a targeted follow-up email.
2. Identify the benefits of using the internet to promote a business and its products.
3. Predict what types of businesses would stand to benefit most from using the internet for their marketing campaigns.

Place

The fourth ‘P’ of the marketing mix is ‘place’ or **channels of distribution**. A distribution channel is a way of getting the product to the customer. This process usually involves a number of intermediaries or ‘go betweens’, such as the wholesaler or retailer. Apart from the retailer, the other intermediaries are often invisible; that is, the customer knows little about their role and operation. There are three main types of distribution channels:

1. **Producer to customer**. This is the simplest channel and involves no intermediaries. Virtually all services, from tax advice to car repairs, use this method.
2. **Producer to retailer to customer**. A retailer is an intermediary who buys from the producer and resells to customers. This channel is often used for bulky or perishable products such as furniture or fruit.
3. **Producer to wholesaler to retailer to customer.** This is the most common method used for the distribution of consumer goods. A wholesaler is an intermediary who buys in bulk from a producer, then sells in smaller quantities to retailers. Producers will use the services of a wholesaler when a large number of retailers sell the product and the producer finds it difficult to deal with them all.

**Summary**

- Marketing strategies are actions undertaken to achieve the business’s marketing goals through the marketing mix.
- A business controls four basic marketing strategies to reach its target market: product, price, promotion and place (the four Ps of the marketing mix).
- A product can be goods or service, and consists of both tangible and intangible features.
- Product positioning is the development of a product image compared with the image of the competing products.
- Packaging helps preserve, inform, protect and promote the product.
- Product branding is the brand and associated brand logo.
- A business must select the most appropriate pricing method suitable to its product and market conditions.
- Promotion refers to the methods used by a business to inform, persuade and remind customers about its products.
- Channels of distribution (place) is a way of getting the product to the customer.

**Revision**

1. **Recall** the four Ps of the marketing mix.
2. **Identify** four intangible benefits that products may provide.
3. **Clarify** the importance of customer service.
4. Think of a product you recently purchased. **Identify** the intangible benefits you gained from the product.
5. **Explain** why marketers prefer to use the term ‘total product concept’ rather than simply ‘product’.
6. Using examples, **explain** the importance of product positioning.
7. **Outline** the image the following products convey:
   (a) No Frills tomato sauce
   (b) Rolex watch
   (c) Dolly magazine
   (d) Sportsgirl clothing and accessories.
8. **Predict** what may happen to the level of sales if a product’s packaging does not match its position.
9. **Explain** the relationship between ‘brand’ and ‘brand logo’.
10. **Account** for why businesses spend so much money attempting to establish a brand name.
11. **Evaluate** each of the following brand names. Indicate the strong points of each name.
    (a) Nokia mobile phones
    (b) Apple computers
    (c) LG electronic products
12. **Summarise** the four major pricing methods.
13. As the manager of a show store, you have just received a delivery of new boots that cost you $50 a pair. Your usual mark-up is 60 per cent. However, you find out that yours is the only store in town that will be stocking this fashionable product. **Calculate** what price you will set for the boots. **Explain** your decision.
14. **Outline** the role of promotion.
15 Recall what promotion aims to achieve.
16 Construct a concept map summarising the four main forms of promotion. The first one has been started for you.

**Product Promotion Strategies (Promotion Mix)**

- **Personal selling**
  - involves sales assistant
- **Sales promotion**
- **Publicity**
- **Advertising**

17 Recommend a distribution channel for the sale of:
   (a) a daily newspaper
   (b) a washing machine
   (c) an imported motor vehicle.

**Extension**

1 When deciding on a brand name and brand logo, investigate some of the considerations that a marketer must take into account.
2 Determine how a business sets its price when it wants to achieve the objective of profit maximisation.
3 ‘Some people would argue that “marketing ethics” is a contradiction in terms’. Evaluate this statement.
4 Referring to a business you are familiar with, analyse and evaluate the promotion methods used for one of its goods or services.
5 Using magazines, newspapers and the internet, collect and paste into your notes five advertisements for small businesses.
   (a) Identify the good or service the business is selling.
   (b) State what unique features of the business are publicised.
   (c) Determine whether you think the advertisement fulfils its function of reminding, informing and persuading existing and potential customers. Give reasons for your answer.
   (d) Rank the advertisements in the order that they appeal to you, from the most appealing to the least appealing. Explain how you determined the ranking order.
   (f) Compare your ranking with other members of the class and discuss similarities and differences.

**8.5 Financial management**

A thorough understanding of accounting and finance is essential for business managers. Accounting is a management tool that is concerned with providing information on the financial affairs of a business, while finance is concerned with where the business sources its funding.

Management of business finance is a crucial aspect of business success. Management of finance starts with sourcing — where will the funding come from? Once a business has secured funding, it then needs to ensure that it is applied
appropriately. All financial managers would be aware of the need to manage the cash flow of the business. Cash flow is sometimes described as the ‘lifeblood’ of business. The management of cash flow involves anticipating cash expenditure and ensuring that enough of the income earned comes in the form of cash. A further challenge is to ensure that there is enough money saved in the event of unexpected challenges. Some money for contingencies needs to be put aside. Contingencies are unanticipated events that can lead to financial difficulty. For a business to be well managed, it needs to have saved money for such events because they can place the business under unexpected financial pressure.

A business that is well managed will have a good credit rating, which means that lenders will be prepared to lend the business money because they know that it is safe for them to do so. The credit rating is determined by financial organisations that assess the capacity of the business, both to repay debt and manage finances responsibly. If a business has a good credit rating, lenders will readily provide funds. The business can use borrowings to its advantage. Thus, if it wants to expand operations, update technology or open offices overseas, it probably will be able to get the money to do so.

In short, business leaders and managers need to have a good understanding of accounting and finance, and need to draw on this knowledge and skill when managing all aspects of the business.

The HSC course investigates finance in greater depth, so this chapter will provide an elementary understanding of the main concepts.

**Accounting — introduction and scope**

*Accounting* is a managerial and administrative tool that involves the recording of financial transactions, so that a clear summary of what has happened to the money coming in and going out can be traced over time. Every financial transaction, from the ordering of stock to the sale of an old stock item, is recorded. These records (which include delivery dockets, sales receipts, invoices, cash register records and e-payment transactions, to name a few) are entered into accounts that may be either computerised or manual (in the form of books). The information in these accounts is then summarised into financial reports and statements that provide very valuable information about the trading period (see table 8.4). The statements are set out in a standard format so that they are easy to read and understand. A well-trained manager can use these statements to get a very accurate picture of the financial status of the business.
The three main accounting/financial reports or statements are shown in table 8.4.

**TABLE 8.4 The main accounting/financial reports or statements**

<table>
<thead>
<tr>
<th>Name of statement/report</th>
<th>Content of the statement/report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow statements</td>
<td>Provide information about the liquidity of the business</td>
</tr>
<tr>
<td>Income statements (also called statement of financial performance, revenue statement or profit and loss (P&amp;L) statement)</td>
<td>Detail the income received and the expenses incurred by the business in the course of a period of trading</td>
</tr>
<tr>
<td>Balance sheets (also called statement of financial position)</td>
<td>Detail the financial stability of the business in terms of what it owes and what it owns</td>
</tr>
</tbody>
</table>

A business is an economic entity — it trades within society and has responsibility both to its internal and external stakeholders (i.e. the members of society who are directly and indirectly affected by the affairs of the business). Accounting provides information that is valuable to managers. It also provides information to employees, owners and shareholders (if it is a company), suppliers, lenders, customers, government (including regulators), competitors and the general public.

**BizFACT**
The main purpose of financial statements is to summarise information in a way that is useful for interested parties. Together the reports show accurately how the business is placed financially.

**FIGURE 8.30 The stakeholders interested in the accounting information given by business**

Accounting is useful, as it provides information in statements about each of the following as it relates to the business:
- financial status/position
- cash status/position
- financing or funding information
- cash flows
- profitability and return on investment
- trends in earnings, borrowings, sales and so on that together indicate the risks the business faces.
The main purpose of accounting then is to provide information that is useful and accurate, and presented in a clear and concise form. This information will encourage:

- judicious and prudent financial decision making
- planning that is purposeful
- confidence in the business’s management
- accountability, or stewardship, (see the following Snapshot).

**SNAPSHOT**

••• the decision makers (managers) are to act in accordance with what is best for the business.

**Stewardship — the heart of accountability**

Stewardship is an essential element of good management. A steward acts in the best financial interests of others. The heart of accountability is stewardship — that is, the managers acting on behalf of owners and in the owners’ best interest. This means that when the business is faced with financial decisions, the decision makers (managers) are to act in accordance with what is best for the business. This is hard to do, as there are some circumstances in which the manager may benefit from decisions made by the business. Consider the situation that arises if a business seeks a tender to supply some raw materials. What would happen if a manager’s brother ran a company wishing to tender for supply? Under these circumstances it might be hard for managers to act free of self-interest. Appropriate action, in this case, might be for the manager to declare the family connection and remove themselves from decision making.

**Snapshot questions**

1. Clarify the role of a steward.
2. Propose what you would do as a manager to avoid conflict of interest situations.
3. Explain why stewardship is an essential element of good management.

**Finance — introduction and scope**

Finance refers to how a business funds its activities — for instance, where it gets the money to trade, why it chooses to use certain lenders — as well as the costs, risks, terms and benefits of different types of borrowings. Financial knowledge requires an understanding of a range of financial instruments. Businesses, even very small ones, generally borrow money at some time — usually when they first set up.

It is vital for a business to be able to manage its borrowing and to use appropriate types of borrowing — namely types that match its earning stream and capital/asset structure. Borrowing represents a useful source of finance — but it is one that comes at a price. It is management of the cost and risk of finance that is the key to successful financial management.

Cost management is crucial because businesses tend to try to maximise profits. In today’s highly competitive markets, in Australia and globally, a business succeeds when it can minimise cost (while maintaining quality, reliability, high service levels and so on). Risk management is crucial because businesses can be uncertain regarding their chances of making financial losses. Astute financial management is therefore considered indispensable to business.

An understanding of both accounting and finance is absolutely necessary if business managers and owners are to make informed decisions. The ability to interpret financial information helps with the leadership task — which includes
planning for future activities; choosing between alternative courses of action when presented with business problems; organising the resources required to produce a product or service; and then effectively researching and marketing it; and controlling and monitoring spending in all aspects of the business.

**Summary**

- Businesses need to be led by managers with a good understanding of accounting and financial management.
- Accounting is a financial management tool that is involved with the recording and analysis of all the business’s financial transactions.
- The financial transactions are summarised into financial statements. The main ones are:
  - cash flow statement
  - income statement
  - balance sheet.
- Finance details how a business funds its activities.
- It is vital for a business to be able to manage its borrowings and to use appropriate types of borrowings.

**Revision**

1. **Distinguish** between accounting and finance.
2. **Recall** what the management of cash flow involves.
3. **Clarify** why some money for contingencies needs to be put aside.
4. **State** what a credit rating assesses.
5. **Explain** why a business would want to have a good credit rating.
6. **State** why accounting is necessary for business.
7. **Identify** the main accounting reports and statements.
8. **Discuss** the role of the internal and external stakeholders who would be interested in the financial situation of the business.
9. **Recall** five reasons why accounting is useful for business.
10. **Explain** the importance of accountability.
11. **Demonstrate** why astute financial management is considered indispensable to business.

**Extension**

1. Use the Australian Accounting Standards Board (AASB) weblink in your eBookPLUS to find out more about the organisation. **Investigate** how accounting standards are developed and implemented.
2. ‘Shrinkage’ refers to the loss of stock from a business. White-collar crime refers to the theft or embezzlement of money from a business. **Analyse** the proposition that: ‘if employees were paid higher wages, then there would be no need to audit as there would be no need for anyone to steal from businesses.
3. Use the Count weblink in your eBookPLUS to research an auditing firm. **Determine** the range of financial services the firm offers and present an advertisement for the business to the class.
4. **Assess** the effect of an economic downturn on a business’s financial management.
Financial statements

Introduction to financial statements

All business owners must be able to make judgements about the direction of the business at any given time. To help them achieve this, they need to prepare some financial statements — reports that summarise transactions over a period of time. (The main accounting reports and financial statements are listed in table 8.4 on page 233.) Business owners, for example, will need to be aware of whether the cash flow through the business is sufficient to allow the business to pay its debts on time, whether or not the business is trading profitably, and the financial status of the business.

The main kinds of financial reports are:

- **Cash flow statement.** This report shows the movement of cash receipts (inflows, such as money from sales) and cash payments.
- **Income statement.** This report is used to help the business to calculate how much profit it has made over a period of time by showing profits or losses, expenses and income.
- **Balance sheet.** This shows the value of assets, value of liabilities and owner’s equity (proprietorship) balances at a certain point in time. It is called a balance sheet because at that point in time assets are equal to liabilities and owner’s equity.

Cash flow statements

A cash flow statement shows the movement of cash receipts (inflows, such as money from sales) and cash payments. Cash flow statements are vital for the business to assess whether money inflows can match money outflows. The term ‘liquidity’ is often used to describe whether a business has a good or adequate cash flow. Figure 8.31 summarises the typical monetary inflows and outflows. A business...
is said to be liquid (or solvent) if it has the cash available to meet payments as they are due. Generally a business would prefer its sales to be in cash for precisely this reason — it has a need for cash to meet its own payments. Why do businesses allow credit sales when they prefer cash? This is because they need to match their desire for cash with the customer's ability to pay. By allowing customers to purchase on credit, the business will obtain sales it might otherwise lose.

Cash flow statements are closely related to budgets, which are estimates of anticipated future cash flows. Cash flow statements, however, are broader than budgets because they are also used to summarise past information. Cash flow statements are vital for the information they give on the timing of payments and receipt of income. A business will keep information on cash movements because this will help it predict future cash flows and hence make provision for payments. A typical cash flow statement can be seen in figure 8.32.

| Cash Flow Statement for Plant 1 (first quarter, 2011) |
|------------------|------------------|------------------|
|                  | January $        | February $       | March $          |
| Cash inflows     |                  |                  |                  |
| Sales:           |                  |                  |                  |
| retail           | 20 000           | 23 000           | 54 000           |
| public           | 33 000           | 36 500           | 123 000          |
| other manufacturers |                |                  |                  |
| A                | 1 000 500        | 2 560 000        | 2 600 000        |
| B                | 250 000          | 250 000          | 250 000          |
| C                | 3 400 000        | 3 200 000        | 2 800 000        |
| Total inflows    | 4 703 500        | 6 069 500        | 5 827 000        |
| Cash outflows    |                  |                  |                  |
| Raw materials    | 3 650 000        | 3 760 000        | 4 720 000        |
| Service costs    | 23 000           | 23 000           | 23 000           |
| Leases          |                  |                  |                  |
| forklifts       | 11 000           | 11 000           | 11 000           |
| equipment       | 125 000          | 125 000          | 125 000          |
| Wages           | 850 000          | 990 000          | 980 000          |
| Other           | 34 000           | 67 000           | 61 000           |
| Total outflows   | 4 693 000        | 4 976 000        | 5 920 000        |
| Cash surplus/(deficit) | 10 500          | 1 093 500        | (93 000)         |

**FIGURE 8.32 Typical cash flow statement**

A study of the cash flow statement (see figure 8.32) of a manufacturer shows that this business made a cash surplus for two of its first three months of trading for the year the report was made. You can see that the business made a small surplus in January and a large surplus in February. However, in March, this business experienced a cash deficit. It should be clear now why such statements are necessary. A business can track its inflows and outflows over a period of time. It can then use these statements to determine why the inflows and outflows are taking the pattern they are. For example, in January, sales to manufacturer A were down on the usual $2.5 million average. This may have been due to the normal business lull in January. The surplus for February is quite high and an astute manager would have ensured that a portion of this surplus was put aside in case it was needed in future months. As it turned out, the materials costs for March were very high and sales to manufacturer C continued to fall.

The business can see that it needs to take some remedial action. In the short term, if these trends continue, the business could cover cash deficits with the large
surplus it made in February. It would not, however, want the pattern of deficits to continue, so managers need to make some decisions. For example, they might ask where they can obtain a regular supply of cheaper raw materials. They could also look at diversifying their sales base.

By using cash flow statements in this way, a business is able to both control finances and plan strategies for financial benefit. Cash flow reporting can be used to plan and predict future cash flow inflows. Outflows tend to follow trends, with some variations over time.

**Cash flow statements for larger businesses**

While the cash flow statements previously shown are very detailed, they are more suited to small to medium sized businesses. The format of cash flow statements used by large businesses and public companies is shown in figure 8.33.

<table>
<thead>
<tr>
<th>Reflections Images Ltd</th>
<th>Cash Flow Statement for the year ended 30 June 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flows from operating activities</strong></td>
<td>$000</td>
</tr>
<tr>
<td>Sales</td>
<td>600</td>
</tr>
<tr>
<td>Payments for stock</td>
<td>(200)</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>(150)</td>
</tr>
<tr>
<td><strong>Net cash flow from operating activities</strong></td>
<td><strong>250</strong></td>
</tr>
<tr>
<td><strong>Cash flows from investing activities</strong></td>
<td></td>
</tr>
<tr>
<td>Sales of non-current assets</td>
<td>500</td>
</tr>
<tr>
<td>Purchase of non-current fixed assets</td>
<td>(200)</td>
</tr>
<tr>
<td><strong>Net cash flow from investing activities</strong></td>
<td><strong>300</strong></td>
</tr>
<tr>
<td><strong>Cash flows from financing activities</strong></td>
<td></td>
</tr>
<tr>
<td>New borrowing and currently raised debt</td>
<td>0</td>
</tr>
<tr>
<td>Changes in share capital</td>
<td>100</td>
</tr>
<tr>
<td><strong>Net cash flows from financing activities</strong></td>
<td><strong>100</strong></td>
</tr>
<tr>
<td><strong>Net cash increase/(decrease) from all activities</strong></td>
<td><strong>650</strong></td>
</tr>
<tr>
<td>Opening cash balance</td>
<td>(340)</td>
</tr>
<tr>
<td><strong>Closing cash balance</strong></td>
<td><strong>310</strong></td>
</tr>
</tbody>
</table>

**FIGURE 8.33** The format of cash flow statements for large businesses and public companies

It can be seen from figure 8.33 that there are various classifications of cash — that derived from operating, investing and financing activities. These terms are distinguished below:

- **Cash from operating activities** — these are cash flows related to the main trading operations and prime function.
- **Cash from investing activities** — these are cash flows related to the sale and purchases of assets such as land and buildings.
- **Cash from financing activities** — these are cash flows related to the acquisition of and repayment of both debt and equity finance.

**Summary**

- There are three main financial statements created by accounting processes: the cash flow statement, the income statement (also called revenue statement, profit and loss (P&L) statement or statement of financial performance), and the balance sheet (or statement of financial position).
- A cash flow statement shows the movement of cash receipts (inflows) and cash payments (outflows) over a period of time.
- Liquidity is used to describe whether a business has a good or adequate cash flow.
- Cash flow reports are vital for the information they give on the timing of payments and receipts of income.
- Cash flow statements are divided into three categories: cash flows from operating activities, those from investing activities and those from financing activities.

**Revision**

1. Briefly **outline** what a cash flow statement is used for.
2. **Define** the term ‘liquidity’.
3. **Recall** why businesses allow credit sales when they prefer cash.
4. **Explain** the effect (short-term and long-term) of a bank loan on a business’s cash flows.
5. **Classify** each of the following items as either a cash inflow or cash outflow, stating your reason for each item.
   (a) Credit sales
   (b) Purchases of stock
   (c) Payments of wages
   (d) Tax on income earned
   (e) Sales returned
   (f) Debtor payments
   (g) Creditor payments
6. **Examine** why a retailer may have a variable cash inflow, depending on the time of year.
7. **Explain** how a cash flow statement may be used to give a detailed insight into the financial situation facing a business.
8. **Distinguish** between the following cash flow items: those arising from operations, those arising from financing, and those arising from investing activities.
9. Juanita owns a craft shop. During July the business sold $8200 of craft goods and received $200 in bank interest. She paid her sales assistant a monthly wage of $1350. During this month, the business spent $2800 on craft equipment, $350 on rent, $750 on insurance and $150 on electricity.
   (a) **Construct** a cash flow statement for the month of July for Juanita’s business.
   (b) **Calculate** the business’s closing cash balance for July if the opening cash balance was $3500.

**Extension**

1. Cash is often referred to as the ‘life-blood’ of any business. **Analyse** the effects on a business of carrying too little cash, and outline the problems that could arise if a business carries too much cash.
2. Creditors, or accounts payable, are liabilities owed by the business that are due and payable. Debtors, or accounts receivable, are monies owed to the business by customers. **Assess** how delays in the receipt and payment of cash can have a large effect on a business’s cash flow.
3. Research the terms ‘liquidity’ and ‘profitability’. **Distinguish** between these terms and **explain** how sometimes a business will seek greater liquidity for lower profitability *(Hint: You might like to consider factoring, sale and leaseback, and inventory controls).*
The income statement has also been called the statement of financial performance. This alternative title makes the intent and the content of the statement clear. It has had other names including revenue statement, and profit and loss (P&L) statement.

The income statement is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.

Figure 8.34 is a simple income statement that enables you to see the general format. There are several important features to note. First, the statement must have a heading that states the period of time over which the business was operating for the purposes of the statement. Usually this is one year, but it may be half yearly, quarterly, or even every month or six weeks.

Second, there are only five main categories of items:
1. revenue or income
2. cost of goods sold (COGS)
3. gross profit
4. expenses
5. net profit.

Third, the income earned (or revenue) is always stated at the top of the report. If the business had absolutely no expenses then this would be the profit figure. This is not realistic. In truth, the business would have had costs that arose from selling. So, we then deduct the expenses that occurred while the income was being earned.

This is done in three steps:
1. List the sales for the period.
2. Calculate cost of goods sold (COGS) and calculate the gross profit.
3. Itemise all other expenses (which may be classified into administrative, selling and financial expenses) and calculate the net profit.

Net sales

Net sales are the amount of revenue a business has earned from sales when the effects of sales returns are deducted.

Revenue generally means income from sales. Sometimes the business will offer discounts to customers who pay outstanding amounts quickly. Such discounts reduce the business income and must be deducted from the calculation of profits.
Similarly, when customers return goods, the cost of those goods must be deducted from sales figures. This is the way to work out net sales in the revenue statement:

\[
\begin{array}{l}
\text{Sales} \quad 100\,000 \\
\text{Less discounts allowed to customers} \quad 2\,000 \\
\text{Less returns of sold items} \quad 3\,000 \\
\text{Net sales} \quad 95\,000
\end{array}
\]

**Gross profit and cost of goods sold (COGS)**

Gross profit is the term given to the sales less cost of goods sold (COGS) or, mathematically:

\[
\text{Gross profit} = \text{Sales} - \text{COGS}
\]

The gross profit calculation is important as, essentially, it tells the business how much its mark-up is on the cost price of the goods it has sold. This varies somewhat from business to business but is generally between 50 and 100 per cent. If the mark-up was enormous (say 800 or 1000 per cent), then it would attract other businesses to compete in the market.

The cost of goods sold is an expense to the business. However, it is not grouped with other expenses. This is because the mark-up (or ‘contribution margin’) on the cost of goods sold determines the level of overall income. In a service-based business, there is no stock and therefore no mark-up. Therefore, income and gross profit are the same. Cost of goods sold only affects businesses that on-sell items they have purchased.

The calculation for COGS is determined as shown below:

\[
\text{COGS} = \text{Opening stock} + \text{Purchases} - \text{Closing stock}
\]

**Opening stock** is the value of stock (or inventory) that the business has at the start of the financial year. **Closing stock** is the value of stock on hand at the end of the financial year. Here is an example showing how COGS is calculated:

\[
\begin{array}{l}
\text{Opening stock (stock at start of period)} \quad 2\,500 \\
\text{Purchases (during the period)} \quad 10\,250 \\
\text{Closing stock (stock at end of period)} \quad 3\,400 \\
\text{COGS} = \text{Opening stock ($2500)} + \text{Purchases ($10\,250)} - \text{Closing stock ($3400)} \\
\quad = 12\,750 - 3\,400 \\
\quad = 9\,350
\end{array}
\]

**Other expenses and separation of the expenses by type**

Expenses are simply costs. Specifically, expenses are the costs incurred in the process of acquiring or manufacturing a product or service to sell, and the costs (direct and indirect) associated with managing all aspects of the sales of that good or service. Expenses must always be subtracted from income to work out net profit. Although not always shown, it is very useful to separate the expenses by type because this helps users of the financial information to target problem areas quickly. In this part of the statement, all the expenses that do not form part of the cost of goods are listed.

The expenses are broken down specifically into three types. These are shown in figure 8.35.
### Expenses classified by type

<table>
<thead>
<tr>
<th>Selling Expenses*</th>
<th>Administrative Expenses</th>
<th>Financial Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission</td>
<td>Stationery</td>
<td>Interest payments</td>
</tr>
<tr>
<td>Salaries</td>
<td>Office salaries</td>
<td>Lease payments</td>
</tr>
<tr>
<td>Wages</td>
<td>Rent</td>
<td>Dividends</td>
</tr>
<tr>
<td>Advertising</td>
<td>Rates</td>
<td>Insurance payments</td>
</tr>
<tr>
<td>Delivery expenses</td>
<td>Telephone</td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>Depreciation on buildings</td>
<td></td>
</tr>
<tr>
<td>Depreciation on shop fittings</td>
<td>Audit fees</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accountant’s fees</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Insurances</td>
<td></td>
</tr>
<tr>
<td>Selling expenses:</td>
<td>These relate to the process of selling the good or service and can be directly traced to the need for sales.</td>
<td></td>
</tr>
<tr>
<td>Administration expenses:</td>
<td>Costs directly related to the general running of the business.</td>
<td></td>
</tr>
<tr>
<td>Finance expenses:</td>
<td>Costs associated with borrowing money from outside people or organisations and to minimising business risk.</td>
<td></td>
</tr>
</tbody>
</table>

* Costs of goods sold (COGS): this expense includes only the cost of stock sold and is shown separately in the income statement (or statement of financial performance).

**FIGURE 8.35** Income statement (or statement of financial performance) expense breakdown by type

### Expenses can also be classified as operating or non-operating

‘Operating’ means occurring in the normal course of trading and refers to predictable and recurring items. By contrast, ‘non-operating’ refers to unusual, unexpected and unpredictable items that affect income either favourably or unfavourably. Examples of operating activities include payment of wages, insurances and rates, whereas a non-operating expense might be loss due to a burglary.

### Net profit and expenses

The final step in the completion of the income statement is to determine the net profit. A net profit is the amount remaining when operating and non-operating expenses are deducted from gross profit.

Net profit is shown mathematically as:

\[
\text{Net profit} = \text{Gross profit} - \text{Expenses}
\]

If all this information is combined, we can draw a much more realistic income statement (see figure 8.36).

The income statement is always the first one to be compiled at the end of the accounting period. This is because the figures from it are used in the next statement — the balance sheet (or the statement of financial position).

When compiling the income statement, the manager should be mindful of several things — the proportion of gross and net profit to sales and also the level of expenses that accrue to selling, administration and finance. Because the reports collect and summarise a large amount of information, they also provide insight into how the business is both earning and spending. This insight is extremely valuable, especially when analysing the statements at the end of the accounting or operating period. The manager would also be aware that the ‘bottom line’, or net profit, figure, provides more important information than gross profit, which is really only a measure of the mark-up or contribution margin.
### U Win Pty Ltd income statement for year ended 30 June 2011

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>5 000 000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less COGS</td>
<td>3 200 000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td>1 800 000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Less expenses**

(a) Selling expenses
- advertising: 200 000
- sales salaries: 300 000
- depreciation on cars: 10 000
- delivery: 3 000
- telephone: 9 000

(b) Administration expenses
- office salaries: 400 000
- depreciation on fixtures: 5 500
- stationery: 1 500
- security: 12 000
- rent: 62 500
- insurances: 3 500

(c) Financial expenses
- interest: 125 000
- insurances: 6 000
- leases: 6 000

**Net profit** 656 000

---

**FIGURE 8.36** Typical income statement (or statement of financial performance) format (complex)

**FIGURE 8.37** Accurate income statements are vital, even for small businesses.

---

**Summary**

- The income statement is a summary of the income earned and the expenses incurred over a trading period.
- The main classification of items in the income statement are revenues, cost of goods sold (COGS) and expenses.
- \( \text{Gross profit} = \text{Sales} - \text{Cost of goods sold (COGS)} \)
- \( \text{COGS} = \text{Opening stock} + \text{Purchases} - \text{Closing stock} \)
- Expenses are simply costs and can be broken down into selling, administrative or financial. They can also be classified as operating or non-operating.
- \( \text{Net profit} = \text{Gross profit} - \text{Expenses} \)
Revision

1 **Identify** the different names given to the income statement.

2 **Define** each of the following terms and, where relevant, write down the mathematical equation that would help in calculating the figure.
   - Sales
   - Cost of goods sold
   - Gross profit
   - Net profit

3 **Calculate** the cost of goods sold (COGS), given the following information:

   \[
   \begin{align*}
   \text{Sales} & \quad \$700\,000 \\
   \text{Stock (opening)} & \quad \$100\,000 \\
   \text{Purchases of stock} & \quad \$400\,000 \\
   \text{Closing stock} & \quad \$50\,000
   \end{align*}
   \]

4 Using the figures from question 3 above, **calculate** gross profit.

5 Using your workings from questions 3 and 4, **calculate** the value of net profit (or loss) if expenses for the period totalled $80,000.

6 Anita Toparis owns and operates Petal’s Florist. Last year Anita had a sales revenue of $285,000. Her cost of goods sold totalled $115,000. Her operating expenses were: electricity $5,000, advertising $11,000, interest charges $5,000, salaries $62,000 and rent $25,000. **Construct** an income statement (statement of financial performance) for Anita and tell her whether she has made a net profit.

7 **Distinguish** between selling, administrative and financial expenses, giving examples for each.

8 **Explain** why it is useful to differentiate between operating and non-operating expenses in the income statement.

9 **Explain** how an income statement can provide useful information to a business and its stakeholders.

Extension

1 Research each of the following items that can be found in an income statement, **define** each, and **determine** where it would be found (under revenue, cost of goods sold, or expenses).
   (a) Cartage inwards
   (b) Cartage outwards/freight
   (c) Commissions
   (d) Bad debts
   (e) Depreciation
   (f) Interest
   (g) Security

2 Use the information below to **construct** an income statement (statement of financial performance) for Sathya’s Skatehouse:

   \[
   \begin{align*}
   \text{Revenue from cash sales} & \quad \$500\,000 \\
   \text{Revenue from credit sales} & \quad \$50,000 \\
   \text{Salesperson’s wages} & \quad \$80,000 \\
   \text{Insurance} & \quad \$2,000 \\
   \text{Opening stock} & \quad \$100,000 \\
   \text{Rent} & \quad \$20,000 \\
   \text{Advertising costs} & \quad \$10,000 \\
   \text{Interest costs} & \quad \$2,500 \\
   \text{Closing stock} & \quad \$20,000 \\
   \text{Telephone} & \quad \$15,000 \\
   \text{Rates} & \quad \$3,500 \\
   \text{Depreciation} & \quad \$4,000 \\
   \text{Electricity} & \quad \$2,100 \\
   \text{Water} & \quad \$3,500 \\
   \text{Lease costs (machinery)} & \quad \$5,500
   \end{align*}
   \]
Balance sheets, or statements of financial position

The balance sheet, sometimes called the statement of financial position, is used to help owners keep a watch on their debt and equity levels, compare their overall financial position with that of previous periods, and assist with the process of financial decision making. It is a report that shows the overall financial stability of the business. A typical balance sheet is shown in figure 8.38.

There are several things to note about the balance sheet. First, its heading denotes that it is a snapshot of the business’s financial position as at a particular point in time. Second, if a line is drawn between the two columns of figures, the sum of items on the left-hand side ‘assets’ is equal to, or balances, the sum of items on the right-hand side (liabilities and owner’s equity). This format for a balance sheet is called the ‘T-format’ because we can draw a line down the middle and separate the report into two halves by using the letter T. An alternative format, the narrative format, is explored in Year 12.

### Figure 8.38: Typical Balance Sheet for Real Quest P/L as at 30 June 2011

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
<th>Liabilities</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td><strong>Current liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>4 000</td>
<td>Accounts payable</td>
<td>550</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>6 000</td>
<td>Bank overdraft</td>
<td>1 200</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>6 000</td>
<td>Credit cards</td>
<td>6 200</td>
</tr>
<tr>
<td>Stock</td>
<td>10 000</td>
<td>Accrued expenses</td>
<td>550</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>26 000</td>
<td><strong>Total current liabilities</strong></td>
<td>8 500</td>
</tr>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td><strong>Non-current liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Land and buildings</td>
<td>50 000</td>
<td>Mortgage</td>
<td>65 000</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>10 000</td>
<td><strong>Total liabilities</strong></td>
<td>73 500</td>
</tr>
<tr>
<td>Intangibles</td>
<td>45 000</td>
<td><strong>Owner’s equity</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td>105 000</td>
<td>Owner’s capital</td>
<td>35 000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Retained profits</td>
<td>21 500</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>131 000</td>
<td><strong>Total owner’s equity</strong></td>
<td>56 500</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Total liabilities and owner’s equity</strong></td>
<td>130 000</td>
</tr>
</tbody>
</table>

### Balance sheet items

You will notice that the balance sheet is divided into two parts as shown in figure 8.38. On the left-hand side are recorded the assets — the things the business owns. On the right-hand side are recorded the liabilities and owner’s equity — the things the business owes.

**Assets**

**Assets** are items of value to the organisation that can be given a monetary value. Assets can be divided into several different types: current and non-current, tangible and intangible.
Current assets are items whose value is expected to be used up, or turned over, within 12 months. Examples include bank savings, cash on hand, accounts receivable (also called debtors), prepaid expenses, and inventories (stock).

Non-current assets are those items that have an expected life of three to five years or longer. These include large physical items such as buildings, land, machinery, technology, vehicles, furniture, fixtures and fittings.

Intangible items are also included here. Intangible items are things of worth that have no physical substance. Examples include goodwill, trademarks, designs, copyright and patents. A good name or reputation (‘goodwill’) or an easily identifiable logo obviously has worth — but how do you value in dollar terms something like good product design, a creative staff or reputation? Nevertheless, intangible assets are a resource that the firm owns and must be recorded in the accounts.

Liabilities

Liabilities are items of debt owed to outside parties and/or other organisations (like suppliers or the banks) and include loans, accounts due to be paid by the business, mortgages, credit card debt and accumulated expenses. The business will divide the liabilities into current and non-current items.

Current liabilities are those in which the debt is expected to be repaid in the short term (12 months or less) and include bank overdrafts, credit card debts, accounts payable (also called creditors) and accrued expenses.

Non-current liabilities are long-term debt items such as mortgages, leases, debentures and retirement benefit funds (money owed to employees upon their retirement from the business). Some of these non-current liabilities can last up to 30 years.

Owner’s equity

The owners give a business money for it to acquire resources and begin operating. This money is called owner’s equity (capital). As the business operates, it should start to earn an income to cover its costs and then later earn a profit. The business can hold or retain these profits to target money for a particular project or it may put money into ‘reserves’ for distribution later. The business could also choose to repay the owners who invested their money in the business at the outset.

Over time, a successful business will have its owner’s equity amount increase in value. This means that the owner’s claim on the business will also increase. This is the owner’s reward for risking their money — and is also the reason for people investing in the stockmarket long term.

Owner’s equity is considered to be a liability from the point of view of the business, because it is a type of debt the business carries. However, unlike liabilities, owner’s equity is a debt owed to owners because of the risk they took in investing in the business.

Summary

- The balance sheet shows the overall financial stability of the business.
- The main items in the balance sheet are assets, liabilities and owners’ equity.
- Assets are items of value to the business and can be either current or non-current.
- Liabilities are debts or business borrowing and can be either current or non-current.
- Owner’s equity items refers to the owners’ claims and is considered a liability from the point of view of the business.
Revision

1 Identify the alternative title used for a balance sheet.
2 Outline the purposes of a balance sheet.
3 Identify what is meant by the term ‘T-format’ used to describe the balance sheet.
4 Account for the fact that the balance sheet is called a ‘balance’ sheet with reference to both sides of the statement.
5 Define, with examples, what is meant by the term ‘assets’.
6 Distinguish between current and non-current assets, with examples of each.
7 Outline the intangible items of a balance sheet.
8 State what liabilities are, and distinguish between those that are current and those that are non-current.
9 Explain how the business owes owners both their investment and also a return for their investment.
10 The balance sheet below as at 30 September has been badly prepared. Construct the balance sheet correctly.

Balance sheet as at 30 September

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
<th>Liabilities</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>3 400</td>
<td>Motor vehicles</td>
<td>30 000</td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td>2 500</td>
<td>Debtors</td>
<td>2 000</td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>46 000</td>
<td>Stock of materials</td>
<td>1 600</td>
<td>33 600</td>
</tr>
<tr>
<td>Loan</td>
<td>10 000</td>
<td>Owner’s equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equipment</td>
<td>23 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>+ Drawings</td>
<td>4 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>27 000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>− Net profit</td>
<td>5 500</td>
<td>21 500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>61 900</td>
<td></td>
<td></td>
<td>55 100</td>
</tr>
</tbody>
</table>

Extension

1 Determine why increases in business wealth add to the owner’s equity amount and thereby increase the wealth of those investing in business.
2 Account for the fact that the income statement will always be drawn up before the balance sheet.
3 Intangibles are subjectively valued, whereas tangible assets are more easily objectively valued. Extrapolate why the value of intangibles — such as goodwill, trademarks, designs, copyright and patents — are very hard to value, while the value of buildings and vehicles can be easier to determine.
4 In accounting, the true value of assets — such as buildings and land (which may be revalued upwards), vehicles (which may be valued downwards) and goodwill — is reflected in accounts as ‘depreciation’, ‘amortisation’ or ‘revaluation reserves’. Research these terms and analyse how they are used to find a truer picture of the value of a business’s assets.
The balance sheet equation

The balance sheet is called the balance sheet for a good reason — it should always balance. This means that the sum of items on the left-hand side (the assets) must total the sum of items on the right-hand side (liabilities and owner’s equity). This is summarised in the balance sheet equation below.

\[ A = L + OE \]

**Assets = Liabilities + Owner’s equity**

You will immediately see that the balance sheet is set out in a way that mirrors the accounting equation, with assets on the left, and liabilities and owner’s equity on the right.

**Example 1**

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>145 000</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>110 000</td>
</tr>
<tr>
<td>Owner’s equity</td>
<td>?</td>
</tr>
</tbody>
</table>

Since \( A = L + OE \) then we can say \( $145 000 = $110 000 + OE \).

Therefore owner’s equity must be \( $35 000 \).

**Example 2**

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>12 000</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>65 000</td>
</tr>
<tr>
<td>Mortgage</td>
<td>250 000</td>
</tr>
<tr>
<td>Capital</td>
<td>230 000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>3 000</td>
</tr>
<tr>
<td>Visa Card debt</td>
<td>6 500</td>
</tr>
<tr>
<td>Land and buildings</td>
<td>?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/cs Pay</td>
<td>3 000</td>
</tr>
<tr>
<td>Visa Card debt</td>
<td>6 500</td>
</tr>
<tr>
<td>Mortgage</td>
<td>250 000</td>
</tr>
<tr>
<td>259 500</td>
<td>259 500</td>
</tr>
</tbody>
</table>

Step 1: Identify all assets, liabilities and owner’s equity items and group them as shown (into the format of the balance sheet).

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>12 000</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>65 000</td>
</tr>
<tr>
<td>Land and buildings</td>
<td>?</td>
</tr>
<tr>
<td>77 000</td>
<td>77 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A/cs Pay</td>
<td>3 000</td>
</tr>
<tr>
<td>Visa Card debt</td>
<td>6 500</td>
</tr>
<tr>
<td>Mortgage</td>
<td>250 000</td>
</tr>
<tr>
<td>259 500</td>
<td>259 500</td>
</tr>
</tbody>
</table>

| Owner’s equity             | 230 000 |

Step 2: Apply the equation and find the unknown quantity.

\[ A = L + OE \]

\[ $77 000 + ? = $259 500 + $230 000 \]

\[ $77 000 + ? = $489 500 \]

\[ ? = $489 500 - $77 000 = $412 500 \] (value of land and buildings)

By applying the equation we can find the missing item. In general, whenever you see a balance sheet, it is wise to quickly do this equation to satisfy yourself that it is correctly drawn.

**Summary**

- The balance sheet should always balance.
- This means the assets must equal the liabilities.
- The balance sheet equation is: Assets = Liabilities + Owner’s equity or \( A = L + OE \).
Revision

1 Calculate the missing figure for each of the following:
   (a) Assets = $245 000, Liabilities = $43 000, Owner’s equity = ?
   (b) Assets = $342 000, Owner’s equity = $152 000, Liabilities = ?
   (c) Assets = ?, Liabilities = $63 000, Owner’s equity = $212 500

2 Using the following balance sheet, calculate the value of the mortgage.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>Current liabilities</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>Creditors*</td>
</tr>
<tr>
<td>7 000</td>
<td>1 250</td>
</tr>
<tr>
<td>Debtors*</td>
<td>Bank overdraft</td>
</tr>
<tr>
<td>3 400</td>
<td>2 200</td>
</tr>
<tr>
<td>Stock</td>
<td>Credit cards</td>
</tr>
<tr>
<td>11 000</td>
<td>4 800</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>Non-current liabilities</td>
</tr>
<tr>
<td>Land and buildings</td>
<td>Mortgage</td>
</tr>
<tr>
<td>150 000</td>
<td>?</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>Owner's equity</td>
</tr>
<tr>
<td>12 300</td>
<td>Owner's capital</td>
</tr>
<tr>
<td></td>
<td>35 000</td>
</tr>
</tbody>
</table>

*Note: Debtors are accounts receivable; creditors are accounts payable.

3 Calculate the total value of assets, owner’s equity and liabilities from the balance sheet.

4 If retained profits and owner’s capital totalled $23 000, instead of $35 000, calculate the new value of the mortgage.

5 An artist, Candice Wahler, has asked you to help her construct a balance sheet.
   (a) Briefly explain to her how a balance sheet is set out.
   (b) Construct a balance sheet for her as at today’s date from the following information: cash at bank $1500, motor vehicle $10 000, accounts payable $6000, equipment $8200, accounts receivable $3 000, bank loan $13 500 and stock $3000.

Extension

1 Goodwill is sometimes determined by the following two methods:
   • method 1 — the difference between the total value of a business’s assets and the selling price of the business
   • method 2 — a proportion (e.g. 20 per cent) of the average of the past three years’ trading profits.

Application of method 1
A business is offered for sale for $250 000, but the valuation of the assets and stock at cost is $200 000. Thus, the goodwill is $50 000. This reflects the good trading reputation of the business, the stable client base and stable supplier contracts.

Application of method 2
A business records the following profits in the years 2010–2012. Calculate its goodwill if goodwill is set at 40 per cent of the average three-year trading profits.

<table>
<thead>
<tr>
<th>Net profit</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$45 000</td>
<td>$65 000</td>
<td>$50 000</td>
</tr>
</tbody>
</table>

Goodwill = ($45 000 + $65 000 + $50 000) × 0.40 = $160 000 × 0.40 = $64 000

Use the information below to determine the value of goodwill in the various scenarios provided:
(a) Ben’s Bowling is a business that is up for sale. The selling price is $150 000. The value of the assets totals $120 000.
(b) Leon’s Laser Toys has recorded annual profits for the last three years averaging $100,000. The goodwill calculation rate to apply is 33 per cent.

(c) Tina’s Video and Film Corporation has assets worth $40,000 in total. Profits are $3,000 annually on average, but she has put the business up for sale at $200,000. What should the goodwill be, assuming a goodwill calculation of 30 per cent of average profits over three years? What goodwill is Tina asking? Analyse the problems this raises for the valuation of intangible assets.

2 When a Qantas airline skidded off the end of the runway in Singapore, its perfect safety record was tarnished. No longer could it claim to be the ‘world’s safest airline’. Predict the effect this incident could have had on Qantas’s goodwill.

8.6 Human resource management

Do you have a favourite ice-cream flavour? Chocolate? Vanilla? Trampoline Gelato is a rapidly expanding business, with seven franchises now operating. While they pride themselves on the uniqueness of their ice-cream, and have even won international awards, success in business requires more than just a great product. Each store has an ice-cream maker who makes the ice-cream daily to a consistently high standard, and cheerful, helpful sales assistants who promptly scoop out customers’ favourite flavours. Richard Furphy, CEO of Trampoline Gelato, says, ‘Great staff help get the best out of the product’. Employees can make or break a business, so the management of staff has to be top priority for every business owner.

Human resource management (HRM), in its simplest terms, is defined as the effective management of the formal relationship between the employer and the employees.

Business owners recognise that they rely on the quality of their employees to achieve their goals of improved profit, growth and increased market share. For a business to make best use of its employees, it should:
• take care to hire the best people
• develop cooperative and effective working relationships
• motivate staff to do their best in the workplace
• provide employees with opportunities for training and development.

Also, when an employee turns out to be an excellent worker, retaining that employee may be crucial to ongoing business success. Without dedicated, trained and motivated employees, the best organised plans will never be achieved. The human factor is crucial in all businesses.

Most businesses that are successful in the long term maintain a balance between concern for success (expansion or profit) and regard for their employees. Better work and employment relationships, therefore, begin with the business recruiting and selecting appropriate staff members (see the following Snapshot).

Finding the right employees

Simply Rose Petals supplies dried rose petals in all sorts of colours, even black, for weddings all over Australia as well as overseas. Co-owners Sarah Benjamin and her mother, Jan Slater, were initially reluctant to hire staff because they wanted to be sure the business was sustainable, and didn’t want to have to put an employee off after only a short time if the business was unsuccessful. Once it was clear that the workload was too much for only two people, they hired their first employee, and have since gone on to hire a second staff member.

With such a small team, two staff management issues are apparent. As Sarah Benjamin points out, it is important that all employees are multiskilled and able to undertake a diverse range of roles and responsibilities. So identifying what exact skills are required can be very difficult. Staff teamwork is also vital when the business is so small.

Snapshot questions
1. Outline the two staff issues faced by Simply Rose Petals.
2. Explain why it is important for the employees to be multiskilled.
3. Describe the ethical concern Sarah and Jan faced prior to hiring their first employee.

The main functions of staffing are to attract and acquire, train and develop, reward, maintain, and separate the people — the human resource/employment cycle — needed to achieve the business’s goals. It is crucial for all businesses to select employees whose business approach complements that of the business. How well these functions are managed will largely determine the success of any business. Once a person is selected for a position they must be ‘maintained’ in the workplace. Training and development, as well as ongoing feedback on work performance, will assist both the employer and employee. Separation (termination) of employment is the final phase of the human resource cycle; it must be managed to ensure employees are treated fairly and within the law.

The dynamic nature of business means that staffing needs will change over time. As the business expands, or existing employees resign or retire, new positions will be created, so business owners need to constantly monitor their staffing needs. However, at the heart of staffing is the employee. Hiring the ‘right’ person for the ‘right’ position is of crucial importance to all businesses.

The HSC course investigates human resources in greater depth, so this chapter will provide an elementary understanding of the main concepts.
Human resource cycle — the staffing process

The human resource cycle involves a business determining its employment needs in line with its business strategy. As the name suggests, human resource management begins with acquisition — recruiting and selecting people to work for the business. Next, plans and procedures need to be put into place to train and develop these employees. As well, steps must be taken to keep — that is, maintain these valuable resources. Finally, there are times when employees will separate from the business, either voluntarily, through retirement or resignation, or involuntarily, through retrenchment or dismissal.

Figure 8.41 summarises the four main elements of the human resource cycle/staffing process: acquisition, development, maintenance and separation.
Each of these elements consists of related activities (see table 8.5 below) that are carried out by the human resource department. Each of the four elements complements the other, with the desired outcome being a productive and efficient workforce.

**TABLE 8.5 Elements of the human resource/staffing process and their related activities**

<table>
<thead>
<tr>
<th>Element</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stage one</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Acquisition</strong></td>
<td></td>
</tr>
<tr>
<td>• Hiring new employees</td>
<td></td>
</tr>
<tr>
<td>• Planning: identifying staffing needs; job analysis (determining the exact nature of the position to be filled)</td>
<td></td>
</tr>
<tr>
<td>• Recruitment: attracting people to apply for the position in the business; internal and external recruitment</td>
<td></td>
</tr>
<tr>
<td>• Selection: choosing and hiring the most qualified; testing and interviewing</td>
<td></td>
</tr>
<tr>
<td><strong>Stage two</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Development</strong></td>
<td></td>
</tr>
<tr>
<td>• Improving employees’ skills and abilities</td>
<td>Induction and training: teaching employees new skills; helping employees learn tasks associated with their jobs and to improve their skills</td>
</tr>
<tr>
<td>• Skills inventory: compile database of skills and experience of all current employees</td>
<td></td>
</tr>
<tr>
<td><strong>Stage three</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Maintenance</strong></td>
<td></td>
</tr>
<tr>
<td>• Motivating employees to remain with the business</td>
<td>Monetary benefits: rewarding employees’ efforts through financial compensation; pay rates</td>
</tr>
<tr>
<td>• Non-monetary benefits: rewards such as conditions; fringe benefits</td>
<td></td>
</tr>
<tr>
<td><strong>Stage four</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Separation</strong></td>
<td></td>
</tr>
<tr>
<td>• Employees leaving the business</td>
<td>Voluntary: employees leaving on own accord; retirement, resignation</td>
</tr>
<tr>
<td>• Involuntary: employees being asked to leave; retrenchment, dismissal</td>
<td></td>
</tr>
</tbody>
</table>

If handled correctly, ‘human resources’ can provide a business with a competitive advantage; if mishandled, this key area can generate many problems.

No longer can a business rely on a constant supply of homogeneous employees prepared to join a company for a lifetime. Businesses today must accommodate working parents with daycare needs, the middle-aged employee who has to care for an elderly parent or an increase in people from culturally diverse backgrounds.

Therefore, businesses today are taking their human resources function, especially the staffing process, more seriously than in the past.

**Summary**

- Employees are the most important resources for business success.
- Human resource management is the effective management of the formal relationship between the employer and the employee.
- Most successful businesses maintain a balance between concern for success and regard for their employees.
- The main functions of staffing are to attract and acquire, train and develop, reward, maintain, and separate the people needed to achieve the business’s goals.
Revision

1 ‘People are the business’s most valuable resource.’ **Outline** what is meant by this statement.
2 **Define** the term ‘human resource management’.
3 **Recall** what a business should do to make the best use of its employees.
4 **Identify** the main functions of staffing.
5 **Explain** why good staff management is vital to a business’s success.
6 **Identify** the main functions of the staffing process.
7 **Propose** why the staffing process is referred to as a ‘human resource cycle’.
8 **Construct** a concept map summarising the four main elements and the related activities of the staffing process/human resource cycle.
9 **Predict** what problems can arise if a business employs a person unsuited to a particular position. Share your answer with the rest of the class.

Extension

1 **Demonstrate** the relationship between the human resource cycle and business goals.
2 Traditional human resource management (HRM) practices were developed and administered by the business’s human resource department. A recent study of HRM practices revealed that line managers — people responsible for the management of staff contributing to the main function of the business — are playing a greater role in developing and implementing human resource (HR) practices. **Assess** the value a line manager can bring to developing and implementing HR practices.
3 ‘The future is unpredictable. The business environment changes so rapidly that it is impractical to make relevant plans for future staffing requirements. HR plans are therefore largely irrelevant.’ **Evaluate** the accuracy of this statement.

**Acquisition of human resources**

The first stage of the human resource cycle involves hiring suitable employees. Most people would associate this acquisition stage with the advertisement placed in the employment section of a newspaper or, increasingly, on an e-recruitment website. However, before any advertisement is published, a business must undertake a number of planning activities. In a sense, the advertisement represents the end of the first activity (identifying staff needs) and the beginning of the next activity (recruitment).

As table 8.5 demonstrates, there are three distinct activities involved in the acquisition stage of the human resource cycle. The first is planning; that is, identifying staffing needs.

**Identifying staffing needs — human resource planning**

All businesses have to plan for the positions that inevitably become vacant in their organisations. Employees retire, resign, or are promoted. New positions develop as the business expands. Therefore, for most businesses, determining staffing needs is an ongoing process.

**Human resource planning** includes the development of strategies to meet the business’s future staffing needs, forecasting the future demand for employees and estimating the supply available to meet that demand.

If a business fails to accurately identify staffing needs and rushes to place a job advertisement in the hope of quickly hiring someone, then the stage is set for major problems. Usually, this results in a person being hired who does not possess the skills or attitudes required for the position.
Therefore, it is crucial that all businesses undertake some human resource planning to accurately identify future staffing needs.

**Job analysis: specifying staffing needs**

Job analysis is the next step in forecasting a business’s staffing needs. There is no sense in hiring people unless the business is clear about what it is hiring them to do. In other words, the business must determine the exact nature of a job before it can recruit the right person to do it. **Job analysis** is a systematic study of each employee’s duties, tasks and work environment.

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**BizWORD**

*Job analysis* is a systematic study of each employee’s duties, tasks and work environment.

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**John Wiley & Sons Australia, Ltd**

**GRAPHIC DESIGNER (Artists)**

John Wiley & Sons Australia, Ltd, a leading educational publisher, wishes to appoint an experienced **Graphic Designer** for its busy Art studio in McDougall Street.

This full-time position involves creating flyers, brochures, posters, catalogues, advertising, stationery and web pages, along with book interior and cover designs.

The successful applicant will have excellent design skills and can format supplied text both quickly and accurately. A thorough knowledge of Adobe CS3 studio software package for the Macintosh is vital. GoLive, PowerPoint, or web site design experience, as well as good English skills, would be very advantageous.

Remuneration will be based upon experience. All applications should be sent in writing by **Monday, 5 October** to: Manager, Design, John Wiley & Sons Australia, Ltd, PO Box 1226, Milton QLD 4064. Work samples / copies would be appreciated.

We are also calling for expressions of interest from Mac artists with a thorough working knowledge of Illustrator to perform casual or freelance work for our Art Dept.

**John Wiley & Sons Australia, Ltd**

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**FIGURE 8.43** An example of a job description and a job specification
A job analysis examines:
• actual job activities
• equipment used on the job
• specific job behaviours required
• working conditions
• degree of supervision necessary.

The job analysis for a particular position typically consists of two parts:
1. **Job description**: a written statement describing the employee’s duties, tasks and responsibilities associated with the job (see figure 8.43).
2. **Job specification**: a list of the key qualifications needed to perform a particular job in terms of education, skills and experience (see figure 8.43).

**Recruitment and selection**

Once the job description and specification have been completed, it’s on to the process of recruitment and selection.

**Recruitment**

Recruitment involves finding and attracting the right people to apply for a job vacancy using advertisements, employment agencies and word of mouth. When an organisation decides to recruit staff, it may choose internal or external recruitment methods.

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**BizWORD**

A **job description** is a written statement describing the employee’s duties, tasks and responsibilities associated with the job.

A **job specification** is a list of the key qualifications needed to perform a particular job in terms of education, skills and experience.

**Recruitment** is the process of attracting qualified job applicants from which to select the most appropriate person for a specific job.

**Internal recruitment** involves filling job vacancies with present employees, rather than looking outside the business.

**External recruitment** involves filling job vacancies with people from outside the business.

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**Internal recruitment** occurs when a business decides to appoint someone already within the business to a vacancy. This often occurs when a person is promoted; it also provides a strong motivation for current employees. Internal recruitment is popular and involves less risk, because the employer already knows the person who will be filling the vacancy. Of course, the person recruited internally may then have to be replaced by external recruitment.

**External recruitment** involves finding suitable applicants from outside the business. A business will use external recruitment methods when it wants to bring in people with new or different ideas and attitudes.
The recruitment method chosen will depend on the size of the business, the type of position available and the nature of the labour force in the business’s particular area. The main sources of employees available to a business include:

- advertisements in the media
- private employment/recruitment agencies
- schools, TAFE colleges or universities
- public employment agencies — for example, Employment National
- internal searches.

Many businesses use private agencies or recruitment companies to source suitable applicants for a position. This is an expensive, but effective, method — the agency does the preliminary screening of candidates and presents potential employees who fit all the criteria of experience, education and training.

Many jobs are advertised online. Businesses, such as Seek Limited, provide an efficient way for job seekers to search online for jobs that meet their qualifications and expectations. Employers and recruiters use businesses like Seek to advertise positions online and therefore reach a wide audience, although some still choose the traditional method of advertising in the newspaper. Advertising in the general media means that a business has to screen applicants, and then proceed with interviews. This is often time consuming if the business receives a large number of applications; however, it does prove effective in many cases and small to medium-sized businesses often use this method.

Selection

Employee selection is the means by which the employer chooses the most suitable applicant for a vacancy. This involves identifying the skills, qualifications and experience of each applicant, and relating them to the skills, qualifications and experience listed in the job specification, to achieve the closest possible match (see the following Snapshot).
Michael Prevedello, Manager of Magnet Mart, a hardware store located in Goulburn, places a high priority on recruiting and selecting the most suitable applicant for positions within the business. Magnet Mart prides itself on its high level of customer service. At the core of the business are its employees. Therefore, it is crucial for the business to select employees whose business approach complements that of the business. In this interview, Michael outlines the recruitment and selection process he uses.

Interviewer: What skills do you use to avoid employing the wrong person?
Michael: It basically comes down to common sense. I like to meet the person first. If they do not present a good impression first up, I usually don’t take it any further. Whereas, if I like how they present and communicate, and use appropriate body language, then they progress to the next stage. As a former radio journalist, I believe a person’s communication skills are crucial, especially in our customer service positions.

Interviewer: What is the main difficulty when selecting an appropriate candidate?
Michael: When a person comes for a job, it can sometimes be difficult to detect their negative aspects. They may present extremely well in the interview but they may mask any deficiencies. I’m a fairly good judge of character, but occasionally I do make a mistake. Consequently, I have to live with that decision and try to work with the person I’ve hired.

Interviewer: Do you involve anyone else in the selection procedure?
Michael: Yes. All positions are coordinated with the company’s recruitment manager based in Canberra. She may or may not elect to have an input. Usually she leaves it up to me, but I still like to get her feedback.

Interviewer: What is the next stage in the process?
Michael: I get the applicant in for another meeting. If I still get a favourable impression, I then contact the nominated referees. However, you have got to watch that too. You don’t know if the applicant has worded the referee up to spin the truth a little. One of the advantages of living in a country town is that I know a lot of people, so I often know the referee. However, even then, I still listen very carefully. If they say things in a certain way, it warns me a little. Once the appropriate checks have been made, then I offer the person the position.

Interviewer: Is there a probationary period?
Michael: Yes. The person is placed on a three-month trial. I say to them that if during that time they don’t like the work, they are free to go without consequences. If we don’t think they are measuring up, then we can ask them to leave. This time allows both parties to assess the suitability of the work.

Interviewer: Do you screen at the written application and interview stages?
Michael: I screen all the way along, even during the three-month trial period. I have to. It’s a personal thing. If my recruitment manager is involved in the process, I involve her in the screening as well.

Interviewer: Apart from an applicant’s presentation and communication skills, what else do you look for?
Michael: Take, as an example, a cash register position. It’s reasonably tiring work. You are on your feet for about eight hours; customers coming at you all the time, coordinating their wishes and actions; and accurately using an electronically generated register. Therefore, the pressure is on. Consequently, a person needs to have the right emotional and physical characteristics to handle these requirements. It is not fair to put a person in a position where they can’t cope. It is important to always remember that you are dealing with human beings and these things need to be handled sensitively. However, at the same time, I have to balance that with the needs of the business.
Interviewer: Above all else, what do you want from an employee?
Michael: If you want to work in retail, you have got to be committed to serving customers. Our induction manual states that, ‘The customer is not an interruption to our work, they are the purpose of it’. Therefore, you have to empathise with the customer; have a desire to help them get what they want to satisfy their need. I want that attitude to be the workplace culture of this business. Consequently, selecting the right person to work for you is of the ultimate importance.

Snapshot questions
1. Identify the personal qualities Michael looks for when employing staff.
2. Describe the role of a nominated referee.
3. Discuss the advantages of a probationary period.
4. Propose what you consider to be the ‘right emotional and physical characteristics’ needed to adequately perform the job of a cash register operator.
5. Explain what you think is meant by the statement: ‘The customer is not an interruption to our work, they are the purpose of it.’
6. Analyse the relationship between Magnet Mart’s recruitment and selection practices and its workplace culture.

Selecting the most appropriate candidate can involve all or any of the following options:
• Written application. Some employers make use of a printed application form to be filled in by the applicant, requiring basic personal information, details of qualifications and experience, and names of referees. Alternatively, prospective employees may be able to submit a written application in any form they wish. This will usually include a curriculum vitae or résumé as well as any other relevant information. Applicants will often try to indicate how their own qualifications and experience match those included in the job specification. The employer usually shortlists a realistic number of suitable applicants.

BizWORD
A curriculum vitae or résumé is a summary of a person’s previous employment experience.
• Testing. Employers may apply a number of different tests to prospective employees. These can include psychological tests or personality tests, which attempt to measure an applicant’s personal characteristics; or aptitude tests, which attempt to measure the skills that might be relevant to the job description. Tests may be written, or may require the applicant to perform a number of different tasks.

• Interviews. The interview is perhaps the most important procedure in the selection process. Interviews should be well structured and cover a set of common questions to ensure consistency between applicants.

• Background checks. Referees can be contacted to verify the accuracy of an applicant’s previous experience, and to gain an assessment of their performance in a previous position.

After the successful applicant has been notified and has accepted the position, the other applicants are notified.

Summary

• Human resource planning involves developing strategies to meet the business’s future staffing needs.

• A job analysis is a systematic study of each employee’s duties, tasks and work environment. It comprises a job description and job specification.

• After the planning stage, the recruitment of staff commences to find the best person for the job.

• Recruitment involves finding and attracting the right people to apply for a job vacancy.

• A business can recruit from staff within the business or seek new applicants from outside sources.

• Once job applicants are found, the process of selecting the right applicant begins.

• Employee selection is the means by which the employer chooses the most suitable applicant for the vacancy.

Revision

1 Outline why determining staffing needs is an ongoing process.

2 In the following situations, explain whether staff planning has been adequate.
   (a) Anya runs a small café that mainly sells cake and coffee. She decides to offer a lunch menu. It turns out to be very popular, but many customers have to be turned away because Anya cannot meet the demand.
   (b) The restaurant is always busy over the Christmas period, so Jon decides to recruit some casual staff to ensure he is able to maintain an efficient service.
   (c) Gregory knew that his existing workers would not have the skills to operate the new equipment he had purchased for his motor mechanic business. He employed someone with computer skills, with the aim of training the other workers as well.

3 Explain the relationship between a job analysis, a job description and a job specification.

4 In each of the following cases, the employer did not plan appropriately. For each example, construct a job specification that would have prevented the problem.
   (a) Joanne wasn’t a qualified veterinary nurse, but the veterinary clinic employed her anyway because she loved animals. On most days, Joanne found difficulty doing simple bandaging and could not provide the advice expected of her.
   (b) Carrie was a waiter in a restaurant. When customers came in she would ignore them until she had finished what she was doing and always suggested that tipping was expected.
   (c) Janelle was employed as a florist but most of her bouquets fell apart when she handed them to the customer.

5 Undertake a job analysis for the position of ‘Year 11 Business Studies student’ at your school and identify the key elements for consideration.
6 Construct job advertisements for two of the following positions:
   (a) music store sales assistant
   (b) accountant
   (c) motor mechanic
   (d) motel receptionist.
Remember to include the job description and the job specification in your advertisement.

7 Summarise the two activities in the employment process: recruitment and selection.

8 Distinguish between internal recruiting and external recruiting.

9 In small groups, identify the advantages and disadvantages of external recruitment. Choose a spokesperson to share the group’s comments with the rest of the class.

10 In small groups, prepare a table of all the recruitment methods with which you are familiar. For each method, identify an associated strength and weakness. The first one has been completed for you in the table below.

<table>
<thead>
<tr>
<th>Recruitment method</th>
<th>Strength</th>
<th>Weakness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal advertising</td>
<td>Quick and inexpensive</td>
<td>Draws from existing employees only</td>
</tr>
</tbody>
</table>

11 Select three sources of employees available to a business and propose why each is an effective method of recruitment.

12 Describe two options that can be used in the selection process.

13 ‘In the current business environment it is crucial that small business owners recruit and maintain the right people for the job.’ In small groups, discuss the relationship between good staff and business success.

Extension

1 Predict the problems that may arise if a small business does not undertake human resource planning in some form. Give examples from small businesses with which you are familiar or that you have studied.

2 Determine how a business’s recruiting and selection practices may be affected by the type of position that has to be filled (i.e. a part-time sales assistant compared to a chief executive officer for a large transnational corporation).

3 You have recently been appointed as human resource manager for a national clothing company. The business has a history of high staff turnover and low morale. To correct these problems you have decided to improve the recruitment and selection procedures. Propose the steps you might take to identify capable employees.

   Determine how you would screen applicants.

4 Use the Job interview weblink in your eBookPLUS to examine effective interview techniques and then, working in small groups, conduct a job interview. One person adopts the role of a human resource manager, and another adopts the role of the candidate for a position. The third person acts as an observer to assess the interview on the following criteria:
   (a) Was the interview effective?
   (b) How could it be improved?
   (c) What standards/criteria would you apply?
   The student assessing the interview could award a score out of 20, giving a reason for the mark. All students should then swap roles.

Training and development

Training and development are aimed at improving employees’ skills and abilities — they are necessary for both personal and business growth. New employees may need some training and development, depending on their level of experience.
Existing employees also need training and development to continually upgrade their skills. **Training** is teaching staff to perform their job more efficiently and effectively by boosting their knowledge and skills. **Development** is the process of preparing employees to take on more responsibilities in the future through acquiring better knowledge and skills, and gaining more experience in a particular area. Developing staff often involves training. It is interesting to note that many employees expect their business to provide them with opportunities to grow and learn, and ultimately improve their employability.

The aim of training and development is to seek long-term change in employees’ skills, knowledge, attitudes and behaviour in order to improve work performance in the business. Many businesses do not, however, spend enough on staff training. According to the Australian Centre for Industrial Relations Research and Training, there is little evidence of a strong training culture within Australian workforces. This is unfortunate because a lack of training and development can have long-term implications for a business’s ongoing competitiveness, and could lead to higher turnover rates as staff seek development in other forms. Well-organised and well-presented training and development provides benefits for both the employee and the employer (see table 8.6 below).

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**BizWORD**

*Training* generally refers to the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills. **Development** refers to activities that prepare staff to take greater responsibility in the future.

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**BizFACT**

Ford Australia claims that employee training has led to halving absenteeism and reducing labour turnover. Can you account for this relationship?

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**FIGURE 8.47** Life is a continual learning curve and it just doesn’t stop when you’ve completed your HSC. You may start a full-time job or you might go to TAFE or university. In any case, you will receive training to help you gain knowledge and learn skills to work productively.

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**TABLE 8.6** Training and development provide benefits for both the employee and the employer

<table>
<thead>
<tr>
<th>Benefits for the employee</th>
<th>Benefits for the employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Opportunity for promotion and self-improvement</td>
<td>• Higher productivity through better job performance and more efficient use of human resources</td>
</tr>
<tr>
<td>• Improved job satisfaction through better job performance</td>
<td>• Goals and objectives more effectively met</td>
</tr>
<tr>
<td>• A challenge — the chance to learn new things</td>
<td>• Reduced costs due to less labour turnover, errors, accidents, absenteeism</td>
</tr>
<tr>
<td>• Adaptability — greater ability to adapt to and cope with changes</td>
<td>• A more capable, ‘mobile’ workforce</td>
</tr>
<tr>
<td>• Improved chances of future employability</td>
<td>• Existing staff more easily retained</td>
</tr>
<tr>
<td></td>
<td>• Less disruption in the event of staff turnover</td>
</tr>
<tr>
<td></td>
<td>• An ‘insurance policy’ — employees are able to cope better with business ‘crises’ (this is a benefit for employees as well)</td>
</tr>
</tbody>
</table>
An effective training and development program is planned and perceived as integral to the business’s strategy, as well as to maintaining or developing a business’s sustainable competitive advantage. Ongoing training for all employees is becoming critical due to rapid technological change and global competition — it is so critical that many businesses now promote the concept of a learning organisation. A learning organisation is aware of its actions and its environment and tries to improve its understanding of the relationship between the two. All employees are involved in developing knowledge and insights that allow the business to continually grow and improve.

Technology creates the need for ongoing training

It is the task of the human resource manager to plan for the effective introduction of new technology. Training needs must be identified well in advance of any proposed technological implementation. This will ensure change happens at a pace consistent with the capabilities and expectations of the workforce. It also means human resource managers must constantly consider the skills required by the workforce in the future. The existing workforce must be trained and, if very rapid technological change demands it, retrained within a short time. While training of employees is often expensive, it cannot be ignored.

Types of training

A number of training methods are available to businesses. The most common of these include:

• Formal off-the-job training — for example, classroom activities, simulations
• Informal on-the-job training — for example, coaching, job rotation
• Action learning: learning by experience solving real workplace problems — for example, NAB and IBM use this form of training
• Competency-based training: identifies skill strengths and areas where further training is required — for example, medical education uses this form of training.
• Corporate universities: businesses can also form partnerships with academic institutions to develop training — for example, Coles and Qantas have forged partnerships with academic institutions.

• Training technologies — for example, computer-based training (the computer becomes a vehicle for learning), multimedia training, web-based training (training via the internet).

Regardless of the type of training, business owners should view training and development as an investment in the human capital of the business, rather than just another expense (see the following Snapshot).

**Investment in training at Delta Industries**

Delta Industries spends about 5 per cent of its payroll for training its 2750 employees. It views this expenditure as an investment in the organisation’s long-term success. Delta Industries estimates that for every $1000 it invests in the training of its employees, it achieves a $25 000 improvement in performance — a 25:1 return on investment for employee training.

No matter how carefully job applicants at Delta Industries are screened, a gap typically remains between what employees *do know* and what they *should know*. Training is needed to fill this gap. Also, competent employees will not remain competent forever: their skills can deteriorate, technology may make their skills obsolete or the organisation may move into new areas, changing the types of jobs that exist and the skills necessary to do them. Delta Industries’ management perceives training as the essential management tool for ensuring employees acquire the attitudes, knowledge and skills they need to perform effectively and efficiently now and in the near future.

**Snapshot questions**

1. State the purpose of training at Delta Industries.
2. Outline why spending on training should be viewed as an investment.
3. Deduce the benefits to Delta Industries of its training program to:
   (a) the employee
   (b) the business.

**Summary**

• Training provides employees with the right knowledge and skills to perform their job effectively and efficiently.

• Development focuses on preparing the employee to take on more responsibilities within the business in the future.

• Ongoing training for all employees can be promoted by the business becoming a learning organisation.

• Training needs must be identified well in advance of any proposed technological implementation.

• Training should be viewed as an investment in the human capital of the business.

**Maintenance of human resources**

Once employees have been recruited, selected and trained, it is crucial for the business to provide working conditions that will encourage them to remain with the business. This is the **maintenance** element of the human resource cycle/management.

**BizWORD**

*Maintenance* is the provision of working conditions to encourage employees to remain with the business.
By retaining productive and efficient employees who are loyal and display a high degree of commitment to their work, a business is able to increase its productivity, achieve high levels of morale, lower the rate of absenteeism and reduce the costs of staff turnover. It is therefore in the best interests of the business for it to offer a type of compensation that is appropriate for the job being performed, and attractive enough to keep existing employees satisfied. To do this successfully, a business can offer its employees a range of monetary and non-monetary benefits as compensation. Compensation refers to the payment or benefits (or both) an employee receives in exchange for their labour.

Monetary and non-monetary benefits — remuneration package

The majority of employees in Australia are protected by legally enforceable minimum wage rates and conditions that are outlined in an award. The business owner may decide to give employees better conditions than those laid down in the award; that is, over-award payments. These are often provided when the owner wants to keep a productive staff member. Apart from the incentive of monetary benefits, business owners can provide incentives in the form of fringe benefits, such as a car, cheap housing loans and expense accounts. The combination of monetary and non-monetary benefits is referred to as the remuneration package.

Any business owner who neglects to manage staff effectively and does not practise skilful human relations will lose employees, and face declining staff morale and reduced productivity.

One very important non-monetary benefit of recent times is affordable daycare centres either within the business or subsidised by it. With changes to family lifestyles and work patterns, many businesses attempt to meet the personal needs of their employees (see figure 8.49).
Summary
• The maintenance element of the employment cycle is the provision of working conditions to encourage employees to remain with the business.
• A business can offer a range of monetary and non-monetary benefits as compensation for their labour.
• The remuneration package is the combination of monetary and non-monetary benefits.

Revision
1 Identify the overall aim of training and development.
2 Distinguish between training and development.
3 Propose reasons why you think ‘There is little evidence of a strong training culture within Australian workforces’. Share your answer with the rest of the class.
4 Outline how training and development can benefit both the employee and the employer.
5 Distinguish between informal on-the-job training and formal off-the-job training.
6 Explain why training and development expenses should be seen as an investment and not just a business expense.
7 State the main purpose of the maintenance element of the employment cycle.
8 Use an example to distinguish between monetary and non-monetary benefits.

Extension
1 Propose what actions you would take, as the human resource manager, if an experienced employee refused to undertake any training.
2 Arrange to interview your school principal or head teacher, and construct a report on the training and development policy of the school or faculty.
3 Evaluate the following statement: ‘When people say they want reward and recognition they really just want a pay increase and that’s all.’
4 You are the human resource manager in a large manufacturing company. You have become concerned about the performance of two valuable employees. Peter has worked in the business for many years and is on a high salary because of his experience and skill development. However, he seems to have lost some interest in his work, especially after being recently overlooked for promotion in the business. Veronica is a single mother with young children. She is scheduled to start work at 8.00 am, but is often late to arrive. She says she is unhappy with the poor pay she receives and is looking for a new job. She is a very good worker, who produces good results and is well liked in the business.
   (a) Using this information, determine what motivates each employee.
   (b) Propose the strategies you would adopt to motivate each employee.

Employment contracts
When a job applicant accepts an offer from an employer, a contract is established between the two parties. An employment contract is a legally binding, formal agreement between an employer and an employee.

There are three different types of employment contract:
• award
• enterprise agreement
• common law contract.

Award
All jobs have set minimum terms and conditions that make up the award covering that particular job. The award outlines the minimum conditions on such issues as pay rates; holidays; sick, long-service and maternity leave; overtime rates; allowances.
for tools or uniforms; and hours of work. Some businesses will provide above-award payments, especially if they wish to attract more workers to their firm or if they want to hold on to their existing staff. Awards have the following advantages:

- set a minimum for pay and conditions
- cover all employees performing a similar job.

Awards have the following disadvantages:

- can be inflexible and therefore may not suit all employees or businesses
- prevent recognition of individual initiative because all employees are guaranteed the minimum pay and conditions regardless of how productive they are.

**Enterprise agreement**

Imagine all the students in your Business Studies class sitting down with your teacher and negotiating a set of conditions for your class. Apart from the essential conditions, such as completing all the work and respecting each other’s opinions, you might negotiate a homework-free month in return for one extra assessment task. You have just entered into an enterprise agreement.

An enterprise agreement is a negotiated arrangement between an employer and a union or a group of employees. The agreement deals with the pay and conditions of people employed in that workplace.

Enterprise agreements:

- can either replace an award or act as an ‘add-on agreement’ to an award
- must comply with all NSW laws regarding employment rights and entitlements
- must be in writing and signed by each party
- are usually for a fixed term; however, they remain in force after that term until rescinded.

**BizWORD**

An enterprise agreement is a negotiated arrangement between an employer and a union or a group of employees.

**BizFACT**

A contract does not have to be written. It can be a verbal (or spoken) contract. It is generally safer to have a written contract, especially if one of the parties to the contract does not fulfil their side of the contract. There is an old saying, ‘verbal contracts are not worth the paper they’re written on!’.
Enterprise agreements have the following advantages:
• consultation with and involvement of employees, which, if conducted successfully, results in greater employee involvement and empowerment
• possibility of improved pay and conditions, which can be tied to workplace performance
• greater flexibility by agreeing on conditions that suit both the employer and employee.

Enterprise agreements have the following disadvantages:
• more time consuming due to the need to conduct agreement meetings at the individual workplace level
• administratively more onerous, especially as the agreement must comply with all existing laws regarding employee rights and entitlements.

Common law contract
Imagine if your Business Studies teacher and you came to an agreement about your conditions of work for this subject. These conditions would apply only to you. The new contract would do away with the classroom conditions agreed to in the award or enterprise agreement. For example, the new agreement may offer you a ‘classroom (employment) package’ that includes more homework in return for the right to attend only two Business Studies lessons each week. You have just entered into a common law contract.

Common law (employment) contracts cover those employees who are not under any award or enterprise agreements. They are more common among professional and managerial employees. Such contracts are signed individually and are secret; that is, not open to public scrutiny.

Common law contracts have the following advantages:
• flexibility to suit the varied needs of individuals and businesses
• individual initiative rewarded, which acts as a motivating force.

Common law contracts have the following disadvantages:
• an unfair bargaining position could exist, with one party being exploited
• expense of any court case if either party sues for compensation.

Rights and responsibilities
Every employee has a contract with an employer. The terms and conditions of the contract will vary between different jobs and different industries. However, all employment contracts establish legally binding rights and responsibilities for both parties.

Employers’ responsibilities
Employers’ responsibilities include the following:
• providing work and tasks for the employees to perform
• payment of income and expenses — employers are required to pay award or contract wages and salaries, and reimburse expenses incurred by the employee, as a result of performing their job
• to abide by and meet requirements of all industrial relations legislation, for example equal employment opportunity, unfair dismissal and affirmative action
• duty of care — employers are legally bound by the Occupational Health and Safety Acts to provide reasonable care for the health and safety of their employees.
Employees’ responsibilities

All employees are obliged to observe the following:
• Obey lawful and reasonable commands made by the employer.
• Use skill and care in carrying out their work activities.
• Act in good faith and in the interests of the employer.

National Employment Standards

Commencing January 1, 2010, employees are entitled to a set of minimum employment conditions, known as the National Employment Standards. A modern award must not exclude these standards. The standards are legislated by the federal government, and apply to all full-time and part-time employees, whether permanent or fixed term. They generally do not apply to casual employees. The 10 standards are:
• Hours of work — for full-time employees, this is generally set at between 35 and 38 hours per week. Employees cannot be required to work longer hours without special provision being made for penalty rates or other compensation.
• Parental leave — employees are entitled to 12 months’ unpaid parental leave in relation to the birth or adoption of a child.
• Flexible work for parents — an employee who is a parent of, or has caring responsibilities for, a child under school age will be entitled to request flexible working arrangements after having worked for the same employer for more than 12 months. These could include reduced hours, different start or finish times, or home-working arrangements.
• Annual leave — for most employees this is four weeks, with part-time employees entitled to a pro rata — in proportion to — amount. Casual employees have no entitlement to annual leave.
• Personal, carer’s and compassionate leave — full-time employees receive 10 days’ paid personal and carer’s leave for every year of service with the organisation, with part-time employees receiving a pro rata amount.

BizFACT
An employment contract creates obligations for both employer and employee, and all businesses operate within a legal framework of common law and statute law — that is, law passed by federal and state parliaments in Acts.

BizFACT
In June 2010, the paid parental leave scheme was passed into law by Parliament. The scheme provides parents who are the primary carers of a child born or adopted on or after 1 January 2011 with the Federal Minimum Wage for a maximum period of 18 weeks.

Weblink
Use the Fair Work Online weblink in your eBookPLUS to discover more about the latest National Employment Standards in Australia.

FIGURE 8.51 SES volunteers are entitled to take community service leave for emergency work.
• **Community service leave** — this includes jury service and emergency service duties, such as SES volunteer work. Employees are entitled to be absent from work for all periods necessary to provide the community service, including reasonable travelling time and rest time immediately after the activity. Usually this is unpaid leave, although employees on jury service leave can claim makeup pay.

• **Public holidays** — employees are not required to work on public holidays, but will still be paid for the hours they would have worked. If the employer requests the employee to work on a public holiday, the employee may be entitled to a penalty rate or other compensation.

• **Information in the workplace** — employers are required to supply all employees with a ‘Fair work information statement’ when they commence employment. This is a government document that contains information about the National Employment Standards and other employment-related issues.

• **Notice of termination and redundancy** — most employees are entitled to minimum periods of notice of termination of their employment (or pay in lieu of notice), based on their period of continuous service. Fixed-term and casual employees, and employees serving a probationary period of employment, are not included.

• **Long service leave** — permanent employees, whether full-time or part-time, are entitled to long service leave after a qualifying period. This period varies between different occupations and industries.

All employees, whether full-time, part-time or casual, have an entitlement to superannuation. Employers are required to make superannuation contributions for all employees aged between 18 and 69 who are paid more than $450 before tax in a calendar month. Employees under 18 years of age must work for 30 hours or more in a week to be entitled to have superannuation payments made by their employer.

### Changing employee expectations

The workforce today is well educated, and employees increasingly want challenging work, greater responsibility and autonomy. They are more aware of occupational health and safety issues and the effects of stress, often due to long working hours. There are more women in the workforce, so many employees are seeking increased equity in employment opportunities and trying to find a balance between work and family.

As outlined in chapter 6, employees are also demanding the right to be more involved in the decision-making process; they want to make decisions for themselves. This process of **workplace democracy** or empowerment breaks down the traditional ‘boss–worker’ relationship, placing new demands on human resource managers and resulting in the formation of autonomous work teams. It is called democracy or empowerment because employees are given the right to make decisions for themselves. The term acknowledges that employees can take responsibility for their own actions and can initiate tasks without being ordered to — a far cry from the conditions at a Dalgety’s office in the early 1850s (see the following Snapshot).


**Rules of the Dalgety office, 1850**

**Rules that applied to the Clerical Staff of Dalgety's (a Company dealing with wool farmers and livestock agents) in the early 1850s**

1. Godliness, cleanliness and punctuality are the necessities of a good business.
2. On the recommendation of the Governor of this Colony, this firm has reduced the hours of work and Clerical Staff will now only have to be present between the hours of 7 am and 6 pm on week days. The Sabbath is for Worship, but should any Man-of-War or other vessel require victualling, the Clerical Staff will work on the Sabbath.
3. Daily Prayers will be held each morning in the Main Office. The Clerical Staff will be present.
4. Clothing must be of sober nature. The Clerical Staff will not disport themselves in raiment of bright colours, nor will they wear hose unless in good repair.
5. Overshoes and top-coats may not be worn in the Office but neck scarves and headwear may be worn in inclement weather.
6. A stove is provided for the benefit of the Clerical Staff. Coal and wood must be kept in the locker. It is recommended that each member of the Clerical Staff bring four pounds of coal each day during cold weather.
7. No member of the Clerical Staff may leave the room without the permission of Mr Ryder. The calls of nature are permitted and the Clerical Staff may use the garden below the second gate. This area must be kept in good order.
8. No talk is allowed during business hours.
9. The craving for tobacco, wines or spirits is a human weakness and as such forbidden to all members of the Clerical Staff.
10. Now that the hours of business have been drastically reduced, the partaking of food is allowed between 11.30 am and noon, but work will not, on any account, cease.
11. Members of the Clerical Staff will provide their own pens. A new sharpener is available on application to Mr Ryder.
12. Mr Ryder will nominate a Senior Clerk to be responsible for the cleanliness of the Main Office and the Private Office, and all boys and juniors will report to him 40 minutes before Prayers, and will remain after closing for similar work. Brushes, brooms, scrubbers and soap will be provided by the owners.

*The owners hereby recognise the generosity of the new labour laws, but will expect a great rise in output of work to compensate for these near-Utopian conditions.*

**Snapshot questions**

1. **Identify** which rule you would find the hardest to obey if you were employed in this office. Give reasons for your answer.
2. **Explain** why you think the management insisted on rule 4.
3. **Calculate** approximately how many hours all boys and juniors work each day.
4. **Determine** if you think people would be prepared to accept these rules today. Provide reasons for your answer.

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**Fair Work Act 2009**

While the majority of small businesses are owner operated, many employ casual, part-time or permanent staff and, therefore, must comply with a variety of employment laws and regulations. One of the most important pieces of legislation relating to employment arrangements is the Australian government’s **Fair Work Act 2009**. This legislation covers the nature of employment contracts and agreements, unfair dismissal, dispute-settling methods, protection of human rights in employment, and employer responsibilities for tax payments on behalf
of employees. Businesses need to be aware of their legal responsibilities when employing staff, especially regarding discrimination and equal employment opportunities, and occupational health and safety.

**Equal employment opportunity (EEO) and anti-discrimination**

Discrimination occurs when a person is disadvantaged because of a personal characteristic such as their age or sex. For many years, discrimination in the workplace was widespread. Women found it difficult to gain promotion. They were often limited to clerical or sales assistant jobs. Comparable pay rates for females have been, and still are, below the pay rates for males. Older employees or married women were sometimes dismissed or forced to retire to be replaced by younger, lower-paid workers. Many migrants and Aboriginal Australians found it difficult to secure permanent employment.

Beginning in the late 1970s, several federal and state laws were passed aimed at ending these kinds of discrimination. Two of the most important pieces of legislation in this area are:

1. **Anti-Discrimination Act 1977** (NSW). This Act makes it unlawful to discriminate against an employee on the basis of race, sex, marital status, disability, sexuality or age.

2. **Affirmative Action (Equal Employment Opportunity for Women) Act 1986** (Cwlth). This federal government Act requires businesses to promote equal opportunity for women in their employment by establishing affirmative action programs.

Under these Acts, an employer may be held liable if any of the following people discriminate against or harass an employee: an employee or a group of employees, an agent, a contract worker, a partner, a director, a supervisor, a manager or a trade union representative. The employer can also be held liable if discrimination occurs in the workplace and the employer does not act on a complaint or take reasonable steps to prevent discrimination.

**FIGURE 8.53**  Female workers at the Warkworth Open Cut Mine in the Hunter Valley, New South Wales. What expectations might these workers have concerning what their employer will do or provide during the course of their employment?

**BizFACT**

Most sex discrimination happens at the recruitment stage, according to the Sex Discrimination Commissioner.
Occupational Health and Safety (OH&S)

Occupational health and safety (OH&S) refers to the responsibility the employer has to ensure the workplace is safe for employees and that steps are taken to minimise harm. Employees also expect they will be given appropriate training to ensure they know how to work safely. If OH&S issues arise, employees would expect that management communicates clearly and immediately to minimise any danger.

The following statistics reveal a serious workplace health and safety problem in Australia:

- More than 3000 employees die every year — 600 (12 per week) through accidents and 2500 (50 per week) through occupational illness.
- More than 650,000 employees suffer disease and injury at work each year.
- Ninety-seven per cent of work-related deaths can be prevented.
- One-sixth of all deaths involve employees under 25 years old.
- Ninety-three per cent of work-related deaths are male.
- The average male worker under 25 has a 50 per cent chance of being injured at work each year.

The workplace continues to be even more dangerous than the roads!

To try to reduce the number of workplace accidents and deaths, in 1983, the New South Wales Government passed the Occupational Health and Safety Act. This Act, which was amended in 2000, has four basic aims:

1. to ensure the health, safety and welfare of employees
2. to protect other people in the workplace such as visitors and subcontractors
3. to promote a working environment for employees that is adapted to their physical and psychological needs
4. to provide a simple framework for protection of employees.
Summary

• An employment contract is a legally binding, formal agreement between an employer and an employee.
• There are three different types of employment contract:
  – award — an employee’s minimum pay and conditions
  – enterprise agreement — a negotiated arrangement between an employer and a union or a group of employees
  – common law — exists when employers and employees have the right to sue for compensation if either party does not fulfil their part of the contract.
• The employment contract outlines the rights and responsibilities of the employer and the employee.
• The National Employment Standards are a set of minimum employment conditions employees are entitled to. A modern award must not exclude these standards.
• As the nature of work and the characteristics of the workforce change, employees are seeking more involvement in the decision-making process.
• One of the most important pieces of legislation relating to employment arrangements is the Australian government’s Fair Work Act 2009.
• Businesses need to be aware of their legal responsibilities when employing staff, especially concerning discrimination and equal employment opportunities, and occupational health and safety.

Revision

1 Define the term ‘employment contract’.
2 Identify the three different types of employment contracts.
3 Examine the BizFact on page 267. Explain what is meant by the saying ‘verbal contracts are not worth the paper they’re written on’.
4 Define the term ‘award’.
5 State four conditions outlined in an award.
6 Distinguish between an enterprise agreement and a common law contract.
7 Recall which NSW laws enterprise agreements must comply with.
8 Clarify what type of employee is usually covered by a common law contract.
9 Outline the right a party has if the conditions of a common law contract are not fulfilled.
10 Explain which employment contract you would prefer to:
    (a) accept as an employee
    (b) offer as an employer.
    Give reasons for your answer.
11 Recall the responsibilities of both employers and employees.
12 Identify which categories of employees are entitled to benefit from the 10 National Employment Standards.
13 Select what you consider to be the three most important standards from the 10 National Employment Standards. Justify your selection.
14 Identify two factors that are responsible for changing employee expectations.
15 State the areas covered by the Fair Work Act 2009.
16 (a) Describe the term ‘discrimination’.
    (b) Discuss why it is important that we have laws that attempt to prevent it.
18 State what the letters OH&S represent.
19 Identify which particular age and gender group faces the greatest risk of workplace death or injury. Propose reasons why accident numbers within this group are so high.

20 Examine figure 8.54 on page 273. Identify all the unsafe working practices shown in the drawing.

Extension

1 Use the Australian Council of Trade Unions weblink in your eBookPLUS and access the student section of the site. Go to ‘Job Union Match’ and select a job. Examine the award conditions for this particular job. Note such aspects as training required, starting wage, name of the award, hours worked and representative trade union.

2 Investigate workplace relations issues for young people by using the Young people at work and NSW Office of Industrial Relations weblinks in your eBookPLUS. Select a topic that interests you and create a brief report on what you learned.

3 Imagine you are the human resource manager at a medium-sized engineering factory. Predict the likely advantages and disadvantages workplace democracy would have on your workplace. Share your answer with the rest of the class.

4 Determine in which of the following recruitment processes discrimination has occurred. Give reasons for your answer.
   (a) Janine was told that it was very rare for a female to be able to cope with work down in the mine. Janine did not get the job.
   (b) Lai did not meet the qualifications required for the job and was sent a letter stating that she was unsuccessful in her job application.
   (c) Renaldo was excited about the interview and felt that he had a chance even though he was 60 years old. The interviewer was clearly surprised that such an elderly applicant would even consider applying for the job. A letter was sent outlining the reasons why Renaldo would not be considered for the next round of interviews and it stated that the company was only considering applicants in a younger age bracket.

5 Read about the following case and determine whether you agree or disagree with the decision made and why.

In the case Jordan v North Coast Area Health Service (No 2) [2005] NSWADT 258, a pregnant woman had requested that she be given light duties. Her employer did not concede to her request, saying that no alternative work was available and that a replacement worker could not be provided. It was suggested that the employee take leave. The employee claimed that she was discriminated against. It was found that the employer had indirectly discriminated against the pregnant employee. The NSW Administrative Decisions Tribunal said that the employer was required ‘to do more in the circumstances than to say, in effect, there is no policy [on how to deal with a move to light duties], there are no vacancies, there’s no money [for a replacement worker], and there’s no legal requirement’. Compensation of $7500 was awarded.

Separation of human resources

Gone are the days when a person would commence their full-time working life at the age of 16 or 17, work for approximately 45 years, and then retire. Work patterns and business operations have undergone radical change over the past two decades and this has dramatically altered the movement of people into and out of jobs. Due to increased international competition, many businesses — large, medium and small — have been forced to restructure. As a result, there has been a marked increase in the number of voluntary and involuntary redundancies being offered.

Separation is the ending of the employment relationship. There are many reasons why employees separate from a business. However, it is possible to classify the different types of separation into two broad categories: voluntary and involuntary (see figure 8.55).
Voluntary separation

**Voluntary separation** occurs when an employee chooses to leave the business of their own free will. There are three different forms of voluntary separation: retirement, resignation and redundancy.

**Retirement**

**Retirement** occurs when an employee decides to give up full-time or part-time work. Until the mid 1980s, it was common for men to retire once they reached 65 years of age and women 60. Since changes to legislation in the 1990s there is now no 'official' retirement age. People now have a choice at what age they would like to retire. A trend that has started to emerge in recent years is for people to retire ‘early’ — that is, in their mid to late fifties. How businesses have approached employee retirement has also changed. Today, many organisations provide advice and assistance to employees to help them prepare for retirement.

**Resignation**

**Resignation**, or ‘quitting’, is a voluntary ending of the employment relationship. People resign for a variety of reasons including:

- offer of a promotion with another business
- to start their own business
- boredom with their present job
- change of lifestyle.

Usually the employee needs to give the employer sufficient notice of his or her intention to resign. The length of notice varies from job to job, ranging from a few hours for casual employees to a month for some permanent employees.

Whenever a business wants to downsize, that is decrease the size of its operation, it will not fill vacancies that have come about due to retirements and resignations.
Redundancy — voluntary and involuntary

**Redundancy** is when a particular job a person is doing is no longer required to be performed, usually due to technological changes, a merger or acquisition. Therefore, unless the existing employee can be retrained for another job, they will be made redundant. Redundancy can be either voluntary or involuntary.

Voluntary redundancies occur when the business wishes to reduce either the size or nature of its workforce and decides how many employees should be ‘let go’. Employees are then informed of the situation and given the opportunity to nominate themselves for voluntary redundancy. Those who choose voluntary redundancy are offered a redundancy package: a payout of a sum of money. If not enough employees volunteer, then the business may be forced to decide which employees will be made redundant — involuntary redundancies.

**Involuntary separation**

**Involuntary separation** occurs when an employee is asked to leave the business against their will. Apart from involuntary redundancies, the two different types of involuntary separation are retrenchment and dismissal.

**Retrenchment**

**Retrenchment** is when a business dismisses an employee because there is not enough work to justify paying them. For example, when production levels are low, retrenchment notices will be given to selected employees.

**Dismissal**

There will be occasions when the behaviour of an employee is unacceptable and it then becomes necessary for a business to terminate the employment contract of an employee. This is called **dismissal**.

If an employee is not performing their job satisfactorily or they behave in an inappropriate manner, then the employer must provide counselling and explain clearly which actions are unacceptable and how to improve. There is no legal
requirement that an employer must give written warnings about poor performance or conduct. However, written warnings do carry added significance, especially if the employee decides to take his or her case to court and argue that the dismissal was unfair.

The most serious form of dismissal is summary dismissal — when an employee commits a serious breach of their employment contract. For example, an employee who is drunk at work or is found to have engaged in criminal activity may be summarily dismissed. If an employee is given a summary dismissal, no notice is required. Another form of dismissal, referred to as dismissal on notice, is when an employee is not performing the job satisfactorily. Poor performance may be identified during an appraisal or performance process. The amount of notice (or payment given in lieu of notice) will vary depending on a number of factors, such as whether the employee is governed by a particular award or contract, the age of the employee and how long they have worked for the employer on a continual basis.

Unfair dismissal occurs when an employer dismisses an employee for discriminatory reasons. This is an issue that both employers and human resource managers need to be aware of. Some examples of discrimination under Commonwealth workplace relations laws include dismissal because of:
- absence from work due to illness
- either belonging or not belonging to a trade union
- race, colour, sex, sexual preference, age, disability, marital status, family responsibilities, pregnancy, religion, political opinions held or ethnicity.

Whenever it is likely that an employee is to be dismissed, it is in the employer’s interests to follow the relevant legislative requirements. These include completing all the necessary paperwork, keeping the employee informed of the likely consequences of their actions, and providing some counselling and written warnings.

**Summary**
- The final stage in the employment cycle is the ‘separation stage’, in which employees leave the workplace on a voluntary or involuntary basis.
- This stage must be handled carefully and sensitively by the human resource manager.
- Voluntary separation occurs when an employee decides to give up full-time or part-time work and includes:
  - retirement
  - resignation
  - redundancy.
- Involuntary separation occurs when an employee is asked to leave the business against their will and includes:
  - retrenchment
  - dismissal
  - redundancy.
- Unfair dismissal occurs when an employer dismisses an employee for discriminatory reasons.

**BizWORD**

*Unfair dismissal* occurs when an employer dismisses an employee for discriminatory reasons, such as firing someone because they are pregnant.

**Revision**

1. **Distinguish** between voluntary and involuntary separation, giving examples of each.
2. **Construct** a concept map outlining the different types of voluntary and involuntary separation.
3 Recall some of the entitlements of employees who are made redundant.
4 Distinguish between summary dismissal and dismissal on notice.
5 Identify which of the following scenarios would most likely lead to summary dismissal.
   (a) Helen bribed another employee not to tell their manager that he had been accessing pornographic websites during office hours.
   (b) Roberto arrives for work entirely drunk. He has just been out to see a client, driving a company car. It’s the third time this week he has arrived in such a condition.
   (c) Jazmin’s not very good at her job. She frequently makes mistakes and doesn’t have the knowledge or skills to perform the job satisfactorily.
6 Many colloquialisms are used to describe involuntary termination. For example, ‘shown the door’; or ‘given the bullet’. Recall other expressions you are familiar with. Share your list with other class members and discuss why so many colloquialisms exist.
7 Recall three dismissal situations that would be classified as unfair.
8 In August 2008, workers at SPC Ardmona in the Goulburn Valley were informed that 60 redundancies were to occur, because the strong Australian dollar had meant a drop in exports and there was a fruit shortage due to the drought. The company employed 450 workers in three plants in the region. SPC Ardmona’s chief executive, Nigel Garrard, said that initially the redundancies would be voluntary and workers would be offered deployment to different sites.
   (a) Explain what Nigel Garrard meant when he said that initially redundancies would be voluntary.
   (b) Predict the possible impact on staff who volunteer for redundancy and those who remain. Share your answer with the rest of the class.
9 Use the Termination of employment weblink in your eBookPLUS to summarise the latest employee rights and rules that apply to termination of employment.

Extension
1 Compare voluntary and involuntary departures in terms of:
   (a) how difficult each is for the business
   (b) effects on the business
   (c) effects on staff leaving
   (d) effects on staff remaining.
2 Termination management is about managing the final phase of the employment cycle, when the employee leaves. Investigate the issues a HR manager must be aware of when dismissing an employee.
3 Read about the following case and then answer the questions.
   Natasha Frazer and Civic Printers

   I had been employed by Civic Printers for 12 years. One month ago, my new supervisor warned me that if my work did not improve I may be dismissed. Prior to this I had only received favourable work reports.
   One Friday afternoon I was told that someone else had complained about my performance and that I was being dismissed. I was not aware of any other complaint.
   I had never been given any written advice that my work was unsatisfactory. However, the supervisor’s decision was final and I was dismissed. I think it is unfair.
   (a) After reading the story have a class vote to determine whether Natasha’s dismissal was fair or unfair.
   (b) Now divide the class into small groups. Each group has to determine whether the termination of Natasha was fair or unfair, and then report back to the class. Discuss the different group responses.
   (c) Take another vote to see if the discussion has made any difference to class members’ views.
   (d) Synthesise what you learnt from this activity.
8.7 **Ethical and socially responsible business behaviour**

The words of William Arnott quoted in the Snapshot below are as true today as they were over 100 years ago. Obviously, businesses want to be regarded as responsible corporate citizens. Socially responsible businesses want to structure their production methods to fit in with increasingly strict environmental regulations. Such firms take seriously their environmental responsibilities in raw material usage, packaging, waste treatment and energy consumption. Most businesses also want to engage in ethical business practices; to act honestly and morally. These businesses will honour commitments, not engage in misleading or deceptive product descriptions and will provide a safe working environment for their employees.

**SNAPSHOT**

*Honesty is the best policy.*

The origin of the parrot as Arnott’s symbol is somewhat obscure. It is believed that about 100 years ago William Arnott, a Newcastle baker and biscuit maker, was given a parrot by a local sea captain. At the time, William Arnott had developed a successful small business supplying biscuits to the shipping industry. His daughter-in-law, Mrs Leslie Arnott, is believed to have made a coloured sketch of the parrot standing on its T-shaped perch eating a biscuit.

Someone seeing the parrot on its T-shaped perch is said to have remarked: ‘On his tee is the best pol I see!’ These words, of course, signify the phrase ‘Honesty is the best policy’.

*Source: Copyright Arnott’s Biscuits Limited. Reproduced with their permission.*

How true the story is, no one is absolutely sure, except it certainly tied in with William Arnott’s business philosophy: to be honest, ethical and socially responsible in all his business dealings. The parrot became the company’s logo and today is synonymous with the company.

**Snapshot questions**

2. Determine how a business would benefit from adopting such a business philosophy.

Not all businesses have adopted such an outlook. Some business owners still regard socially responsible and ethical business practices as a waste of money, the cost outweighing any benefits. They will often attempt to justify their behaviour as ‘smart business practice’ or ‘everyone does it, why shouldn’t I?’ And like most questions of ethical behaviour, not all the answers are a simple ‘black’ or ‘white’ response.
Some businesses have become involved in lengthy and very expensive court cases, which attempt to resolve particular situations that are often centred around a number of ethical issues or socially responsible actions. This frequently results in a deal of negative publicity and a deterioration in the business’s reputation.

The majority of business owners, however, regard the cost of ethically and socially responsible actions as a necessary expense — they make such a commitment an essential part of their business operation. They take a great deal of pride in the reputation their business has established and wish to protect its good name. These businesses want to be seen as responsible corporate citizens, conscious of the high standards expected of them by their customers and society at large.

Businesses that take their social and ethical responsibilities seriously are often ‘rewarded’ with improved business performance. Many businesses today are very much concerned with reporting on the triple bottom line. This means that they are no longer simply focused on making a profit at all costs; but rather, they recognise that environmental and social performance are also important.

A growing number of small businesses today, such as Etiko, exist purely for socially responsible and ethical reasons. Etiko is a small business based in Ferntree Gully, Victoria, with a strong commitment to ethics and the environment. Etiko sources products from international suppliers who produce Fairtrade certified items and/or are sweatshop free.

The founder of Etiko, Nick Savaidis, believes that ‘truly socially responsible businesses should not only minimise harm but actually make a positive contribution’. Beginning work as a secondary school teacher and then as an adult educator specialising in enterprise development in Northern Territory Aboriginal communities, Nick established ESP Pty Ltd (the company behind the Etiko brand) in 1996 to market ethically and environmentally sound products. While consumers purchase its products, Etiko is able to help fund community development, micro-credit and healthcare programs around the world. It is no coincidence that it has won many awards in the area of ethics and social responsibility.

BizWORD

**Triple bottom line** refers to the economic, environmental and social performance of a business.

**Fairtrade** is a trading partnership that seeks greater equity (fairness) in international trade. It promotes the rights of marginalised workers, especially in low-income countries.
Ethical business behaviour

Ethics are standards that define what is acceptable and unacceptable behaviour. Ethics involves the study of moral issues and choices. It is concerned not with legal obligations but with what is morally right or wrong — and all the shades of grey in between. In many decisions involving ethical questions, it is sometimes difficult to give a definitive answer as to what is ‘right’ and what is ‘wrong’. It often depends upon the individual circumstances surrounding the situation. Business ethics is the application of moral standards to business behaviour.

Like individuals, businesses are frequently confronted with ethical dilemmas. What does a business do:

• with a loyal, long-serving employee who cannot adapt to new technology?
• with confidential information about a competitor’s pricing policy that a disgruntled employee leaked?
• when it is asked for a cash payment to help hasten a decision about a tender contract?
• when a competitor engages in unethical business tactics that allows it to offer a cheaper product?
• when it outlines a promotion plan for an employee but later is unable to follow through with the plan?

These are just a few of the ethical challenges that confront business owners. How they respond to these situations will have long-lasting consequences to the image and reputation of the business, as well as the behaviour of employees. It is important for business owners to act ethically so employees perceive the importance of ethical considerations. Much of the evidence that ‘good ethics is good business’ is anecdotal. However, when James Burke, the former head of US company Johnson & Johnson, looked at the performance of a select group of companies committed to best ethical practice, he found that their stock value had increased by 11.3 per cent over a 40-year period. Over the same period, all other stocks increased in value by only 6.2 per cent on average.
Ethical issues

Within the business world, the following ethical issues regularly occur.

Fairness and honesty

Businesses must obviously obey all laws and regulations. As well, society expects businesspeople to tell the truth and avoid using misleading or deceptive information. Employees expect to be dealt with honestly and fairly. If, for example, a business promises a promotion to an employee, then the business should honour this commitment to the employee (except in exceptional circumstances). Customers and suppliers also expect to be treated honestly and fairly in all their business dealings. If, for example, a business arranges for a delivery of certain items and promises to pay within a set time, then the business should honour this commitment to the supplier.

Respect for people

If business owners treat their staff with respect, then you would also expect employees to act ethically.

Occasionally, a business may become aware of an unethical practice of an employee. This can place the business in a difficult position, especially if the employee is important to the successful operation of the business. At other times, an employee may be placed in a difficult ethical position by other employees — for example, when older employees decide to play a practical joke on a young apprentice. Sometimes, these practical jokes get out of hand and may develop into a serious harassment or negligence case. Other serious workplace ethical issues may involve a situation where confidential information is not kept secret, obligations are not fulfilled or subtle forms of discrimination occur.

BizFACT

Without the commitment of a business’s senior managers, including the board of directors, a program for ethical responsibility will fail. If senior management pay only lip service to the organisation’s code of conduct, then such behaviour ‘sets the tone’ (one of noncompliance) and will serve as a guide for other employees.
Conflict of interest

Conflict of interest occurs when a person takes advantage of a situation or piece of information for his or her own gain rather than for the employer's interest. Such conflicts can often occur when gifts or payments are offered. There is a fine line between what is regarded as a gift and what may become a bribe. Corruption undermines the integrity of the business and, if unchecked, infiltrates the workplace culture.

Once a pattern of corruption takes hold and is seen to be acceptable behaviour, it quickly becomes entrenched within the business. Changing the attitudes and practices of individuals within such a business is extremely difficult. What starts off as small incidents to which most people turn a blind eye may soon develop into corruption on a grand scale. When such corrupt practices are eventually exposed, the business’s image will be severely damaged.

Financial management

Businesses have ethical and legal responsibilities in relation to financial management. In recent years, unethical practices have been highlighted and increasingly questioned. There are growing calls for codes of behaviour to regulate the activities of businesses in relation to financial management.

It is generally accepted that financial management decisions must reflect the objectives of a business and the interests of shareholders. An area in which ethical considerations are important is the valuing of assets.

All financial records should be regularly audited. Internal and external audits assist in guarding against unnecessary waste, inefficient use of resources, misuse of funds, fraud and theft.

Truthful communication

Advertising can represent real ethical dilemmas. False or misleading advertising is not only unethical, it is also illegal. Terms such as ‘special’, ‘sale’, ‘low fat’ or ‘light’ can be misleading. For example, what precisely does the word ‘special’ mean when it is displayed above a product for sale? Most consumers would take this to mean the item is for sale at a cheaper than normal price; however, this may not necessarily be the case. The business owner may interpret the word ‘special’ to mean that the product has a distinct or particular character, that it can perform a particular function or it is different from what is ordinary or usual. The two interpretations can easily be confused. If the businessperson uses this word attempting to knowingly mislead customers, it would be classified as unethical behaviour. If the businessperson wants to advertise the fact that the product is available at a bargain price, then the words ‘on special’ would have a clearer meaning.

Encouraging ethical business behaviour

It is not always easy to maintain a consistently high degree of ethical behaviour in the real world. Employees who want to act ethically sometimes find it difficult to do so, especially if unethical practices are ingrained into the workplace culture.

One strategy that can be implemented to encourage ethical behaviour is to devise a Corporate Code of Conduct. This is a set of ethical standards for managers and employees to abide by.

Many businesses now document and distribute their codes of conduct or core values in order to provide internal stakeholders with ethical guidelines for workplace behaviour and practices.
Training may be given to employees to ensure they understand the values of the business. Most businesses also establish formal proceedings for reporting unethical behaviour in the workplace.

**St James Ethics Centre**

Due to the complexity of many business issues, determining how to act ethically can often be difficult. To assist, St James Ethics Centre was established in Sydney to support businesses with the development of their policies and procedures from an ethical perspective. This fully independent, not-for-profit organisation provides a non-judgemental forum for the promotion and exploration of ethics. It provides ethics training, ethics consulting, ethics counselling, leadership development and ethics advocacy.

**Summary**

- The majority of businesses want to be seen as responsible corporate citizens.
- The triple bottom line refers to the economic, environmental and social performance of a business.
- Ethics are standards that define what is acceptable and unacceptable behaviour.
- Business ethics is the application of moral standards to business behaviour such as:
  - fair and honest business practices
  - decent workplace relations
  - conflict of interest situations
  - accurate financial management
  - truthful communication.
- A corporate code of conduct encourages ethical business behaviour.

**Revision**

1. **State** the benefits of managing a business in an ethical and socially responsible manner.
2. **Explain** whether it is ethical for your school authorities to monitor student email usage on the school’s computer resources.
3. ‘Everyone cuts corners in business. It is the only way to survive.’ **Discuss** this statement.
4. **Identify** the three components that make up the triple bottom line.
5. **Outline** what Etiko does that makes it ethically and socially responsible.
6. Use the Etiko weblink in your eBookPLUS to **examine** Etiko’s business practices in detail.
7. **Distinguish** between ethical and unethical behaviour.
8. **Recall** what James Burke’s research revealed.
9. **Construct** a concept map outlining the five main ethical issues constantly faced by business.
10. **Discuss** what you believe to be the most ethical way to behave in the following situations and then **compare** your answers with other class members. Discuss any similarities or differences.
    (a) A customer is unaware that you have accidentally overcharged her. Do you inform the customer and give back the money or keep it yourself?
    (b) Your boss has told you not to record all the cash payments so as to reduce his taxation payments. Do you comply with these instructions? As an employee, what difficult position have you been placed in? How could you justify your decision?
    (c) A disgruntled employee from your main competitor offers to provide you with confidential information from that business’s marketing strategy. Would you accept such information? Give reasons for your answer.
(d) An employee is suspected of misusing the business’s internet facilities. However, the employee is the best salesperson in the business, generating thousands of dollars worth of sales each year. How should the employee be dealt with?

11  (a) Define the term ‘conflict of interest’.
    (b) In small groups, propose some possible strategies a business could use to minimise conflict of interest situations arising.

12  Explain how a code of conduct could help encourage ethical business behaviour.

13  Identify what is required for a code of conduct to work successfully.

14  Use the St James Ethics Centre weblink in your eBookPLUS to access the ‘Ethical dilemma of the month’ page. In small groups, answer the ethical questions raised with the dilemma. Discuss your answers with other groups.

Extension

1  Extrapolate how socially responsible and ethical business practices might increase a business’s sales and profit.

2  Create a list of five principles that could be included as part of the code of conduct for your school.

3  You have been contacted by Spencer Manufacturing Limited to assist in the development of a Corporate Code of Conduct. Create a series of guidelines that can be incorporated into a code of ethics for the business. Share your guidelines with other class members.

4  ‘Improving a business’s ethical performance depends on the values of its managers and employees, and the business’s culture.’ Analyse this statement.

5  ‘Ethical business practices do not just happen: they are carefully planned and implemented. Such practices filter through the business. In return, employees are more loyal, committed and proud to work at such a business.’ Assess the importance of business owners adopting ethical business practices.

6  Use the Fair Trade weblink in your eBookPLUS to examine the ways the movement is committed to ethical trade and production practices.

7  Use the St James Ethics Centre weblink in your eBookPLUS to investigate which laws protect confidentiality in Australia. The centre is based in Sydney, and monitors and promotes ethics in Australian businesses.

Socially responsible business behaviour

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

Social responsibility is good business — customers eventually find out which businesses are acting responsibly and which are not. Customers can react and stop buying a business’s product if they learn that the business is exploiting employees, accepting bribes or polluting the environment. At the same time, customers will reward socially responsible businesses by purchasing more of their products. Obviously, socially responsible business behaviour costs money in the short term but in the long run turns out to be to the company’s own interest (see the following Snapshot).
Late one evening in 2008, Harriet Michaels, owner of OzInteriors, a medium-size furniture store, was showing some overseas guests around her local town. As Harriet and her friends drove past the central park, they were stunned to see about five young homeless people sleeping at the back of the maintenance block.

Harriet was upset at what she had seen but also puzzled: why didn’t the young people want to go to a local welfare shelter? Over the next few days she went to investigate. Nothing she had seen or read prepared her for what she discovered. The welfare officer at the local hostel described how difficult it was to accommodate all those who needed shelter. The rooms were overcrowded, the bathroom facilities needed repair and the dining room was extremely basic. The hostel was severely underfunded.

Harriet soon realised that the living conditions in the hostel were draining the hope that the young people may have once had. She decided it was time to act and take some responsibility for what was happening in her town. She vowed that OzInteriors would do something to help. As a successful businessperson, she wanted to give something back to the community and so began the Welcome Home program. Harriet contributed both time and money — a portion of her business’s profits — to help with the refurbishment of the hostel. She also organised and funded a program that gave the hostel residents vital living skills.

Harriet is motivated by a desire to use the business to bring about a positive change within her community; to help create a more civil society. To date, the Welcome Home program has assisted 58 young homeless people complete their secondary education and move into employment.

OzInteriors is just one of the numerous businesses that have assumed greater corporate social responsibility in recent years. This is a trend which, over the past twenty years, has resulted in many businesspeople getting their firms more deeply involved in the social issues that confront their local communities. They wish to be regarded as ‘good corporate citizens’. Other examples include:

- National Australia Bank (NAB) supports the Alannah and Madeline Foundation’s Better Buddies Framework in Australia to help keep children safe from bullying in schools, NAB also supports a range of youth talent identification initiatives such as Lions Youth of the Year, and brought the elite level of The Australian Ballet to young dance students around Australia through Dance the Dream workshops.
- Wesfarmers supports communities through funding, sponsorships and in-kind support. Its community partnerships target four key categories: arts and innovation, indigenous communities, medical research, and education and community. Recently, Wesfarmers allocated 0.25 per cent of the group’s pre-tax profits to community projects and programs in these four key areas.
- Westfield shopping centres hold a variety of community events, such as displays, fashion parades and promotions, which are based around providing social and financial benefits to local communities and charities. At a corporate level, Westfield contributes to a range of worthy causes around the world, including the Sydney Children’s Hospital, the Peter Mac Cancer Foundation in Australia and the UCLA Jonsson Cancer Center in the United States.

A particular business’s corporate social responsibility will be influenced by its size, financial resources, the attitudes and values of owners and managers, and its past record in the area of social responsibility. However, above all else, the program must have total commitment or it will fail.

Snapshot questions

1. Identify the factors that motivated Harriet Michaels to establish the Welcome Home program.
2. Predict the ways that OzInterior might benefit from funding the Welcome Home program.
3. Identify one social responsibility program from the National Australia Bank, Wesfarmers and Westfield.
4. Reflect on what you have read. Discuss how this information would influence you if you were operating a small business.
Some disagree with the notion that business has a social responsibility. They argue that the business’s sole responsibility is to survive by making a legal profit. Business, they believe, has met all its legal obligations and this is all that is required. Milton Friedman, an influential economist, adopted such a point of view when he wrote in 1970: ‘there is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud’.

Today, due to changes in society’s attitudes towards business operations, many people would disagree with this proposition. They believe that because a business operates within a society it therefore has a responsibility to all those within that society; the business must be responsible for its actions. Today, society is more informed and better educated, resulting in higher expectations of business practices and a greater awareness of the social responsibility of business. Employees demand improved working conditions, consumers want reliable, safe products and conservationists desire careful consideration be given to our delicate natural environment. These groups demand that businesses be held accountable and responsible for their actions. In addition, government involvement in the economy has increased with legislation being passed, which directly influences business behaviour. Business owners must take into account all these competing interests. This has added to the pressures businesses already face, but those businesses who fail to meet such challenges will ultimately suffer.

There is also pressure from within the business for improved ethical behaviour. Business decisions are made within the business by individuals, owners, managers and boards of directors. Therefore, the social responsibility stance adopted by a business is a reflection of management attitudes and values. How these individuals deal with the vast range of ethical issues that confront them in their own personal lives will usually be reflected in how the business operates. For example, an individual who is quite prepared to distort the truth and lie to friends will most probably do the same within his or her business dealings. Maintaining a high ethical standard and adopting a socially responsive attitude is very closely tied to an individual’s beliefs and values.

### The sustainability report/social audit

How can a business assess its progress towards fulfilling its social responsibility to society? One method that many businesses use is to prepare a **sustainability report/social audit**. This is a report that details what a business has done, and is doing, concerning social issues that affect it. The sustainability report assesses how the business’s practices and operations affect society and the environment. Similar to the way a school report card indicates the academic progress of a student, the sustainability report measures the success or failure of the business with regard to fulfilling its social responsibilities.

**FIGURE 8.64** Sustainability is one of Wesfarmers Limited’s business ethics. Wesfarmers employees might work for Coles, Bunnings, Officeworks, Target, Kmart or one of Wesfarmers coal, energy, engineering, chemical or insurance interests. All employees are encouraged to adopt sustainable practices.
Summary

• Social responsibility refers to a business’s management of the social, environmental, political and human consequences of its actions.
• A socially responsible business tries to achieve two goals simultaneously:
  – expanding the business
  – providing for the greater good of society.
• Social responsibility is good business.
• Some businesses argue that making a legal profit is all that is required to act responsibly.
• Today’s society has high expectations of business practices and greater awareness of business’s social responsibility.
• A sustainability report/social audit is a report that details what a business has done, and is doing, concerning the social issues that affect it.

Revision

1 Identify the two goals a socially responsible business tries to achieve.
2 Clarify what the words ‘above and beyond making a profit’ suggest about a business’s commitment to socially responsible practices.
3 Outline why fulfilling social responsibilities could be good for a business.
4 Evaluate Milton Friedman’s view on corporate social responsibility.
5 Identify the main pressures influencing businesses to behave in a socially responsible way.
6 Demonstrate how the social responsibility stance adopted by a business is a reflection of management attitudes and values.
7 State what a sustainability report/social audit assesses.
8 Identify two businesses that you consider to be known for their socially responsible actions. Explain why you think they are socially responsible.
9 Use the Wesfarmers Limited weblink in your eBookPLUS to summarise Wesfarmers Limited’s sustainability principles.

Extension

1 Examine a social issue confronting businesses in your local community.
   (a) Outline the issue.
   (b) Discuss how local businesses reacted to the situation.
   (c) Explain what indicators you would use to determine the success or failure of businesses’ response to the situation.
2 ‘Social responsibility is merely a window dressing, public relations exercise. Such activities are undertaken to attract more customers and ultimately to increase profits.’ Evaluate the accuracy of this statement.
3 Justify why you agree or disagree with the following statements:
   (a) Social responsibilities are another unwelcome constraint on business.
   (b) Unethical behaviour of senior management soon becomes the standard adopted by all employees.
   (c) Providing jobs during times of high unemployment is a more important social responsibility than protecting the environment.
   (d) Enlightened businesses are keen to adopt social responsibilities for purely altruistic reasons.
   (e) It is not socially responsible for alcohol companies to sponsor sporting events.
   (f) Without a supportive business culture an individual’s ethical practices will not be sustainable.
4 Review recent issues of some newspaper or business magazines and identify a business that is currently involved in some form of legal action. Analyse how the business may have avoided this litigation if it had developed a sustainability report.
9.1 Introduction

It is difficult to imagine what people will be wearing in the near future because the world of fashion is constantly changing. So too is the world of business. Businesses only survive in today’s highly unpredictable business environment if they effectively manage change. Those who ride the crest of the wave of change will profit from it. Those who resist change will be left behind in its wake.

9.2 What is organisational change?

In Australia, over the past decade, there has been extensive and unprecedented change in the business environment. There is every indication that the pace of change will intensify during this decade. The prevailing attitude in business today can be summed up as follows: ‘There is only one constant in business and that is change.’
To help guarantee the long-term survival of the business, managers must respond to these changes. Hoping that the changes will either go away or have no impact on their business is a recipe for disaster. Managers also find it frustrating to learn that as soon as they adjust to one change in the business environment, they must readjust to accommodate another. Some managers are fearful of change, seeing it as a destructive force. Others perceive change as an opportunity for creativity and openly embrace it.

**Change** is any alteration in the business and work environment; for example, change in consumer tastes, change in production methods, change in markets or products sold, or change in how employees perform their tasks. It could also be a change to the way things are perceived, or new ways of dealing with problems.

The rapidly increasing pace of change threatens to overwhelm many businesses. Adapting to change forced by the external environment is never easy for a business.

While change may be the most daunting challenge confronting management, the rewards are great for those who are prepared to accept the challenge and not only react to change but also initiate and manage it (see the following Snapshot).

### Billabong rides the wave

One example of an Australian large-scale business that manages change successfully is the multi-country, multi-branded business Billabong International Limited, currently the leading surfwear apparel brand in Australia.

Billabong rides the wave of success, with its products distributed in more than 100 countries and available in approximately 8000 outlets worldwide.

To achieve consistent growth in sales, Billabong has to constantly devise and implement strategies to effectively manage the changing business environment in which it operates. The major issues Billabong faces include fluctuations in exchange rates, changing consumer tastes, a downturn in consumer spending in early 2009 due to the global recession, a strong commitment to ethical and socially responsible business practices, and increasing competition from other established, high-quality surfwear manufacturers.

Since its early days in 1973 — when Billabong founder Gordon Merchant designed board shorts at home and cut them out on the kitchen table — up to today, with sales of $1.35 billion worldwide, Billabong has always faced and responded positively to the challenge of change.

### Snapshot questions

1. **Recall** why Billabong has to effectively manage the changing business environment in which it operates.
2. **Identify** the major issues Billabong faces.
3. **Classify** the issues as either internal or external influences.

### Managing change

As profitable opportunities can arise from change, it must be considered a fundamental aspect of a business’s strategic planning. The ability to manage and, in many cases, embrace and adapt to change will increasingly determine a business’s competitive advantage and survival. Successful managers are the ones who anticipate and adjust to changing circumstances rather than being passively swept along or, worse still, being caught unprepared. Such people are proactive rather than reactive.
The crucial management issue is how to manage change to make it as productive as possible, using it to renew and strengthen the business. However, to be constructive, change must occur at a pace at which it can be absorbed and integrated by the business.

Also, all changes should be thoroughly evaluated to assess their overall impact. Poorly managed changes normally result in employee resistance, tension, anxiety, lost productivity and, ultimately, decreased profits. Managing change is especially difficult when the pace and nature of change is largely beyond the control of the manager.

Organisational change is the adoption of a business’s new idea or behaviour in response to internal or external influences. The ability to embrace, manage and adapt to change will increasingly determine a business’s competitive advantage. Successful managers are the ones who anticipate and adjust to changing circumstances.

**Summary**

- Organisational change is the adoption of a business’s new idea or behaviour in response to internal or external influences.
- The ability to embrace, manage and adapt to change will increasingly determine a business’s competitive advantage.
- Successful managers are the ones who anticipate and adjust to changing circumstances.

**Revision**

1. **Define** the term ‘change’.
2. **Explain** the meaning of the phrase, ‘There is only one constant in business and that is change’.
3. **Account** for why some managers are fearful of change, whereas others openly embrace it.
4. **Outline** the difference between proactive and reactive management.
5. **Examine** figure 9.2 above. **Explain** why change is compared to ripples on water.

**Extension**

1. Change is a continuous process, not an event. **Propose** an example from your own experience to illustrate the continuous cycle of change.
2. **Newspaper portfolio**
   - (a) Select four external influences that affect businesses. Over a 5- to 6-week period, collect four to five articles on each factor from newspapers, internet and journals.
   - (b) Paste the articles into a scrapbook under the four headings (influences). Ensure that you date and acknowledge the source of each article.
It is said that if you stop moving, you die! The same applies to businesses. Businesses must keep responding to the never-ending pressure for change. Whether the influences driving change come from outside (external) or within (internal) the business (refer to chapter 3), changes to the business will occur. Such changes can be either major (transformational) or minor (incremental).

When a business responds to the influences of change, businesses often undergo changes in their organisational structure, business culture, and human resource and operations functions.

Major (transformational) and minor (incremental) changes

Some businesses respond to the forces of change in a major way. The result is often a complete restructure of the business. Such a change is referred to as transformational change. A transformed business, after undergoing radical change, will have a different (usually flatter) organisational structure, new work systems and procedures, a changed employee structure, greater use of technology, and an altered corporate culture.

Other businesses may respond to forces of change in a smaller way. This may involve only a few employees at a time, undertaking new operational procedures. Such change is referred to as incremental change. For example, an office employee may change from using a fax to using email when sending information to customers.

Often, a business will implement both major and minor changes simultaneously. However, regardless of the extent of the change, recent studies conducted in a wide range of businesses revealed that all employees should be involved in the change process. This is because any change ultimately has an impact on every employee.

Impact of change on organisational structure

Businesses need to continually improve and develop if they are to survive change. As the business environment changes, businesses undergo structural change.

In recent years, the main structural changes introduced in Australian businesses have included:

- outsourcing
- flatter organisational structures
- work teams.

The aim of these changes has been to streamline business operations (including coordination and control), improve efficiency and empower employees to make their own decisions.
A trend rapidly gaining support throughout the corporate world and government establishments is outsourcing. Outsourcing has had a profound impact on businesses, particularly on the mix of employees. Many businesses have rearranged their workforces to employ a minimum full-time staff and use as many people from outside the business as possible — on a contract, casual or part-time rate. This keeps costs to the lowest possible level. Obviously, outsourcing has both positive and negative social, personal and economic effects, many of which are presently being debated.

Outsourcing

Recently, Qantas maintenance staff protested against management’s threat to outsource 3000 maintenance jobs to other countries.

Flat structures

Flatter management structures have become more common in recent times. As middle-management positions are abolished, greater levels of accountability and responsibility are transferred to frontline staff. Such businesses are characterised by fewer formal reporting controls, sharing of best practice methods, learning focused on the business’s needs, a supportive learning environment and a focus on continuous improvement. In the contemporary workplace, businesses are evolving from formal, hierarchical structures with many levels to less formal, looser structures.

Work teams

Coupled closely with the emergence of the flatter organisational structure is the development of work teams. Teamwork allows businesses to be more flexible and responsive. Teams also motivate employees to be more creative, to develop a broader view of goals, and to contribute across the entire business. The development of teams is transforming workplace cultures, practices, operations and productivity levels.

Impact of change on business culture

For a business to survive in the long term, changes within the external or internal environments should be reflected in its business culture. If the business culture fits the external environment, managers and employees have the attitude they need to compete successfully. For decades, Telstra enjoyed a monopoly on telecommunications services within Australia. With the deregulation of the

BizWORD

Outsourcing is the contracting of some organisational operations to outside suppliers.

BizFACT

Over the past few years Westpac has outsourced its human resource positions to GenPact in India; its credit card and merchant processing services to First Data Australia; its IT and telecommunications to numerous Indian organisations; and its mortgage processing to the American Electronic Data Systems (EDS) Corporation.
telecommunications industry (which resulted in increased competition), as well as the privatisation of Telstra, managers and employees were forced to adopt a different mindset to compete in the new environment. The existing business culture had to change because it did not fit the real-world requirements. The new external environment required a new way of thinking — a new business culture.

Students and teachers face similar challenges whenever the educational authorities modify the external examination requirements or implement new study designs. Such changes will influence the structure of a school, its operations and the school’s culture. Different attitudes, values and mindsets will eventually be adopted within the school to satisfy the new demands.

**Impact of change on human resource management**

Organisational change will ultimately have a profound impact on employees at all levels within a business. Consequently, adjustments to the human resource management function are necessary to improve the effectiveness of changes made in other business divisions, such as organisational structure and technology. Some of the main human resource management changes are:

- Recruitment and selection must be altered to reflect the need for individuals who possess the knowledge and skills required to handle the changing circumstances.
- If employees are to be made redundant then appropriate termination procedures must be put in place.
- Training must be offered to existing employees in the areas of teamwork, problem solving, decision making and change management.
- Performance appraisal and reward systems that reinforce the new behaviours must be put in place.
- More autonomous and empowered employees will require changes to the traditional roles and communication methods within the business.
- To attract and maintain skilled employees, flexible working arrangements will be needed.
- The bases of power will shift from title, seniority and authority to collaboration and contribution, and this must be communicated.
- A clear vision of where the business is headed and the benefits to employees will need to be developed and clearly communicated.

**FIGURE 9.4** Many businesses are starting to realise that a team approach can be a catalyst for superior performance.

**FIGURE 9.5** Considering that employees are a business’s most valuable asset, it is important to manage transformational changes sensitively and professionally.
For many businesses, reducing production costs has become the basis for gaining a competitive advantage in the marketplace. In response to changes in the environment, businesses are constantly seeking ways to speed up production time, shorten production development, streamline distribution and serve customers. Some of the main operations management changes are:

- businesses have refitted and reorganised their factories to take advantage of improvements in technology. They are also pursuing efficiencies in process design and materials management.
- New advances in production technology have been accompanied by changes in the way the production process is organised, including flexible manufacturing.
- Flexible manufacturing allows production plants to be smaller, more specialised, and closer to important markets.
- There is an emphasis on quality assurance — a business-wide system of procedures to ensure that the products satisfy consumers. This includes quality control, coupled with total quality management.
- Human relations are being improved so that employees will approach their work more intelligently. This includes such considerations as balancing workloads, using ergonomics, simplifying materials handling, changing operations sequences and training employees.

Changes in computer technology have revolutionised production and operations management. Changes can be major (transformational) or minor (incremental). When a business responds to the forces of change, the result will be a change to its:

- organisational structure, including outsourcing, flatter structures and work teams
- business culture; for a business to survive in the long term, changes should be reflected in its culture
- human resource management practices, including recruitment and selection, training, performance appraisal, and redundancy procedures
- operations management, including flexible manufacturing and quality assurance.

**Impact of change on operations management**

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- human resource management practices, including recruitment and selection, training, performance appraisal, and redundancy procedures
- operations management, including flexible manufacturing and quality assurance.

**Summary**

- Changes can be major (transformational) or minor (incremental).
- When a business responds to the forces of change, the result will be a change to its:
  - organisational structure, including outsourcing, flatter structures and work teams
  - business culture; for a business to survive in the long term, changes should be reflected in its culture
  - human resource management practices, including recruitment and selection, training, performance appraisal, and redundancy procedures
  - operations management, including flexible manufacturing and quality assurance.
Revision

1. **Distinguish** between transformational change and incremental change.
2. **Identify** three minor and three major changes that have occurred in your school over the last few years.
3. **Define** the term ‘structural change’.
4. **Examine** figure 9.3 on page 294. In small groups, **propose**:
   (a) reasons why Qantas maintenance workers protested against the possible outsourcing of jobs
   (b) the possible benefits to Qantas of outsourcing maintenance to other countries.
5. **Construct** a mind map to **summarise** the business’s three main structural responses to the changes in the environment. The mind map has been started for you.

   ![Mind Map]

   - **Outsourcing**
     - contracting to outside suppliers
     - impact on employees
   - **Flatter organisational structures**
   - **Work teams**

6. **Explain** why the business culture should be modified in response to changes in the external environment.
7. **Propose** why alterations to the human resource management function are necessary in response to changes in the external environment.
8. **Outline** what human resource management changes businesses have undertaken in response to environmental changes. Use the following headings in your response:
   (a) Recruitment and selection
   (b) Termination procedures
   (c) Training and development
   (d) Performance appraisal.
9. Select two operations management changes and **outline** how they assist the business in achieving a competitive advantage in the marketplace.
10. Consider the following situations and **determine** whether the change required would be major or minor. Give reasons for your answer.
    (a) A sales representative complains that he is unable to access the latest prices on some products quickly enough because price changes are mailed monthly to his office.
    (b) A distinct decline in the quality of manufactured items from the heavy metal section has been traced back to the high turnover of staff in this section over the past nine months.
    (c) The development of new technology in the paper manufacturing industry will require the chief executive officer and the board to completely reassess their present manufacturing operations.
    (d) The responsibilities of several key staff in the accounting department will need to change as a result of the new computerised accounting system.
Constant change has made the task of management more demanding and exciting than ever before. Change is the most daunting challenge confronting managers, as well as the most promising opportunity. Now well entrenched and likely to accelerate, change must be considered a fundamental aspect of a business's strategic planning.

BizFACT

In 2008, IBM conducted the ‘Making change work’ study, which revealed that about 60 per cent of business’s change programs failed to achieve their goals fully. The study showed that the most common goals for change programs were cost reduction, higher customer satisfaction and increasing revenue. The main reasons for success were senior management sponsorship, employee involvement, and honest and timely communication. The main resistance to implementing change centred on people’s mindsets and attitudes, and their business culture.

Extension

1. **Investigate** a business that is being restructured as a result of changes in its internal environment. Business magazines, journals or the internet are an excellent source of information and frequently report on organisational restructuring in a variety of industries or businesses. Some recent examples of changes you may wish to explore include:
   (a) e-commerce
   (b) organisational alliances
   (c) work-life balance.

2. Zoe could not understand why her team members were being so difficult. Couldn’t they see that the changes she had made to the work roster would be to everyone’s benefit? She thought they had all agreed to the changes when they were discussed at the last team meeting. She was not sure what to do next. Consider your own experience of the difficulties in trying to predict how something will turn out. **Determine** what managers can do to reduce these difficulties.

3. Flatter management structures often result in higher levels of responsibility and accountability for all employees. Consequently, any organisational restructure that involves removing a layer of management will be perceived by employees as a major change. Assume you are the manager in charge of a restructure that will result in a flat management structure. **Determine** the advantages you would put forward in support of the restructure.

4. Arrange to interview someone who has experienced a major change in his or her workplace. **Examine** and report on the impact of this change on the interviewee, his or her colleagues and the business’s culture. Critically **analyse** how the change was managed.

**9.4 Managing change effectively**

Constant change has made the task of management more demanding and exciting than ever before. Change is the most daunting challenge confronting managers, as well as the most promising opportunity. Now well entrenched and likely to accelerate, change must be considered a fundamental aspect of a business’s strategic planning.

**FIGURE 9.7** Qantas’s ability to manage and, in many cases, adapt to and embrace change will increasingly determine its competitive advantage.
Change is also inevitable. As a consequence, businesses must transform if they want to survive in today’s environment. For example, over the years Qantas has radically changed its operations, marketing, and organisational structure in response to external influences, including global terrorism, oil price increases, fluctuations in the value of the Australian dollar, increased competition from low-cost airlines, privatisation, and rapidly changing technology. The question for Qantas management is not whether to accept the challenge of change but how to manage change effectively, how to make the change as productive as possible and how to make it a process for revitalising and strengthening the business.

MicroForte Technologies is another example of a business that successfully managed the challenge of change (see the following Snapshot).

### The challenge of change

In 2005 MicroForte Technologies, an Australian manufacturer of specialised computer hardware, was facing increasing competition from cheap imports. Ultimately, the business was faced with two choices — scale back production and reduce the size of the business, or invest in new technology and training programs to improve productivity in order to reduce production costs. After much planning and evaluating of options, the business decided on the latter course of action.

MicroForte Technologies’ management created a more responsive business by working directly with frontline employees rather than through layers of management.

Russell McCulloch, Strategic Business Manager, had to create conditions and structures within the business so that the necessary changes were perceived as an opportunity and not as a threat. Past experience had shown that people will resist poorly implemented changes.

He put in place a number of change management teams, encouraged people to apply knowledge in new ways, involved all employees in some decision-making processes and communicated the reason for the changes. To some extent, the changes were stressful, and there was some initial resistance from frontline managers and employees. However, over time, MicroForte Technologies increased its market share by 12 per cent, productivity improved by 15 per cent and production costs went down by 10 per cent.

### Snapshot questions

1. **Outline** why change can be difficult to manage.
2. **Recall** how Russell McCulloch created a more responsive business.
3. **Outline** the conditions and structures that Russell McCulloch put in place so the changes would be perceived as an opportunity.
4. **Explain** how the changes were initially received and how they changed over time.
5. **Predict** what advantages can be gained by implementing well-managed change.

### Managing change effectively — low risk

There are a number of strategies a manager can use to manage change effectively, ranging from low risk to high risk. Low-risk strategies focus on keeping employees informed about why changes are necessary and involving them in the change process. These strategies rely on communication, involvement, support and negotiation.
An effective manager should always be scanning the environment, attempting to understand factors that will have an impact on the business. In this way, he or she may better identify current trends and predict future changes.

Achieving such a vision requires a holistic view of the outside world and awareness of the potential impact on the business of a variety of factors. Correctly anticipating these factors greatly assists the manager in identifying the need for change. This strengthens the business so it may take full advantage of opportunities that favour its long-term survival in an increasingly competitive world. Sharing the vision with employees encourages them to better understand why the change is necessary.

To better understand what changes need to occur, a manager needs access to accurate and up-to-date information.

**Business information systems**

As a student you rely on measurements — subject marks and school grades — to assess your progress. This information allows you to determine what changes, if any, need to be made to your study pattern. Information is also crucial for any business. Actually, much of a business’s success or failure to accurately identify what needs to be changed depends on its ability to collect, organise, process, and retrieve information quickly. For example:

- an operations manager of a manufacturing business must collect data about production costs and production schedules
- a marketing manager must gather data measuring sales, product development and customer satisfaction
- a finance manager must collect data about financial transactions and measure cash flows
- a human resource manager must record staff absences, training requirements and overtime payments.

Consequently, a successful business must be able to gather, store, combine, and analyse masses of data quickly and efficiently. Once processed and organised to be useful to an individual manager, this information becomes the raw material for decision making. Without it, a business would quickly lose its way because it could not accurately identify what needs to be changed.

Where do managers get the information they need? In most businesses the answer lies in a business information system. A **business information system (BIS)**, also referred to as a **management information system (MIS)**, gathers data, organises and summarises them, and then converts them into practical information.

Managers have to plan for the future, implement their plans in the present and evaluate the results against what has been accomplished in the past. Therefore, they need access to information that summarises future possibilities, the present situation and past performance. All this is part of a manager’s role in managing change effectively.

**Setting achievable goals**

A **vision statement** states the purpose of the business. It indicates what the firm does, and states its key goals. In conjunction with the vision statement, a business establishes specific company goals that are measurable (usually set on a yearly basis). Reassessment of the vision statement and business goals may be required if management detects changes in the external business environment that may
have a major impact on business activities. However, for change to be managed effectively it is essential that any new goals be achievable. This means goals that are attainable and realistic. Unachievable goals will only cause cynicism among employees and damage relationships between employees and supervisors.

On the other hand, achievable goals, devised after consultation with employees and communicated clearly by management, have a much greater chance of being realised (see the following Snapshot).

**Locke’s goal-setting theory**

Dr Edwin Locke did research on goal setting and motivation during the 1960s. He concluded that employees were motivated by clear goals and appropriate feedback regarding their achievement. Locke maintained that working towards a goal provided the motivation to reach that goal and this, therefore, improved performance. He found that specific and difficult goals led to better performance than vague goals or goals that were too easy to achieve.

That is, Locke found that in order to change people’s behaviour — to allow them the opportunity to embrace change — goals must be clear and specific, and provide a challenge for employees. The employee must also be committed to meet the challenge, and it helps if each employee receives constant feedback that provides clarification and adjustment of the goals, and recognition for their efforts. The goal or task should not become so overwhelming that a person loses motivation.

Locke’s theory is not new to us today because this approach to motivation and managing change has been used by individuals and businesses over the last 40 to 50 years. Goal setting is something that is accepted as necessary for our success.

**Snapshot questions**

1. **Summarise** the main points of Dr Edwin Locke’s research.
2. **Explain** how goal setting affects a person’s ability to cope with change.
3. **Propose** why setting goals that are easy to achieve might be counterproductive.

**Managing change effectively — high risk**

High-risk strategies are considered high risk because their failure may generate negative outcomes. They run the risk, for example, of generating ill feeling between employees and employers, which can permanently damage working relationships. Ultimately, any gains made may be outweighed by the instability within the business. However, if used intelligently and wisely, these strategies can result in lowered resistance to change.

**Manipulation**

If a business wishes to introduce new technology, it may inform its staff of the exciting new training and promotional opportunities that this change will provide. However, it may withhold the fact that the new technology will result in a number of forced redundancies. This is an example of **manipulation**. While some people regard manipulation as skilful or artful, others argue that it is deceptive and devious, and therefore an unethical practice.

Manipulation is normally used in situations where other tactics will not work or are too expensive.
The danger with manipulation is that this strategy can backfire if the person recognises what is being done and feels used.

A manager who will not or cannot invest the time and effort required for the other strategies may resort to the use of power to force change resistors to conform. This strategy usually involves some type of direct or indirect threat. Threats may involve loss of promotion, transfer, overtime or ultimately, termination. A business that faces competition from imported products, for example, may advise its staff of the need to change work practices and accept a reduction in entitlements in order to lower the costs of production — or alternatively, some staff positions will have to be terminated. For example, in 2006, Qantas flight engineers were given an ultimatum by senior management that job losses would occur if current work practices and manning levels were not changed. This threat ultimately resulted in prolonged industrial action, causing disruption to the organisation through numerous flight delays.
The danger with this strategy is that people may appear to be compliant on the surface but are resentful underneath. This can lead to an increase in resistance, possibly culminating in industrial sabotage, grievance complaints, compensation claims for stress and harassment, and industrial disputes. While the threat strategy may be used in some situations that require a speedy response, constantly relying on it as a ‘quick fix’ may obstruct future changes.

Summary
- To manage change effectively requires the change to be as productive as possible; to make it a process for revitalising and strengthening the business.
- Managers must develop strategies for managing change effectively.
- Identifying the need for change and setting achievable goals are two low-risk strategies for managing change.
- A business’s success or failure to accurately identify what needs to be changed depends on its ability to collect, organise, process and retrieve information quickly.
- Manipulation and threat are two high-risk strategies for managing change.

Revision
1. **Summarise** the information from the BizFact on page 298 by completing the table below. The first one has been started for you.

<table>
<thead>
<tr>
<th>IBM’s ‘Making change work’ study</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Common goals for change programs</td>
<td>• Cost reduction</td>
</tr>
<tr>
<td>2. Main reasons for success</td>
<td>•</td>
</tr>
<tr>
<td>3. Main resistors to change</td>
<td>•</td>
</tr>
</tbody>
</table>

2. **Recall** why an effective manager should continuously scan the business environment.
3. **State** why it is important for a manager to share the business’s vision with employees.
4. **State** the purpose of a business information system.
5. **Account** for the importance of current and up-to-date information for a manager attempting to manage change effectively.
6. **Outline** why setting achievable goals can help managers implement change effectively.
7. **Distinguish** between a low-risk strategy and high-risk strategy for managing changes.
8. **Explain** why manipulation and threat are high-risk strategies for effective change management.
9. **Propose** in what circumstances it may be appropriate for a manager to use manipulation or threat to overcome resistance to change.
10. **Deduce** some possible negative consequences of high-risk strategies to manage change.

Extension
1. **Determine** whether you regard (i) manipulation and (ii) threat as unethical business practices. Give reasons for your answer. Share your answer with the rest of the class.
2 **Extrapolate** whether an autocratic manager would tend to use low-risk or high-risk tactics to manage change. Give reasons for your answer.

3 Read the scenario below. In small groups, **create a plan to solve the problems and effectively manage a potentially difficult introduction to new technology. Present your plan to the rest of the class.**

**Scenario**

You are a divisional manager of 30 loyal, long-serving employees. Fierce competition is threatening the long-term viability of the business. Sales and profits are in the process of declining due to the lower prices of your competitor. The business could compete if it introduced new technology. (It has the finance to purchase and install the machinery.) The introduction of the new technology is going to mean changes to your division and the current product.

Twenty employees are required to work the new technology so 10 will become redundant.

Even though sales have declined, you have a number of very loyal customers who have expressed satisfaction with the format of the current product.

**Problems requiring solution and action:**
- (a) Retrenching of 10 employees — examine some of the criteria you might consider regarding who should stay and who should go:
- (b) Training the remaining employees to understand and use the new and more complex technology (quite a radical change from the technology currently in use)
- (c) Managing the change with sensitivity: maintaining positive workplace morale and exhibiting leadership
- (d) Communicating the change in the product format to the customers and convincing them to maintain their loyalty towards your company and its brand.

**Resistance to change**

At the same time as managers are undertaking — driving — change for the best of reasons, there will be restraining forces working against the change, creating resistance.
Psychology has shown how difficult it is for individuals to change their behaviour; how difficult it is to eat less, exercise more, stop smoking or be more patient. Resistance to change is strong because for most people personal change is:

- achieved only with considerable effort
- often emotionally stressful.

Businesses, like individuals, also find some changes difficult to cope with. When the pace of change is very rapid or coming from the external environment, then businesses may experience open resistance to the change. For example, consider where you sit in your Business Studies class. It is likely that you and other students sit in the same seats for each lesson. Imagine now that your Business Studies teacher changes the seating arrangement and tells you where to sit. This new seating arrangement will be permanent. No prior warning or explanation of these changes was given. You and your classmates may react with a mixture of annoyance, irritation, frustration, anger or delight. Perhaps you would be angry or upset at not being consulted or involved in the rearrangement process. You may have felt that you had no control over what you regard as your working conditions and organisational structure. Many of you may view the changes as a threat to the status quo.

What does this tell us about resistance to change? This reaction is common among managers and employees. As individuals become accustomed to doing certain things and doing them in certain ways, so too do businesses. As a result, businesses and employees sometimes vigorously resist change.

The most common reasons why change may be resisted include:

1. **Management.** Some managers may make hasty decisions that are poorly timed and unclear. Other managers may be indecisive and put off making a decision, creating uncertainty. Whichever of these circumstances applies, eventually employees will lose confidence in the management’s decision-making abilities.

2. **Fear of job loss.** Employees may become fearful of changes if such changes threaten their job status or security. They will, therefore, resist or disapprove of new processes because they feel the result will be forced redundancies and loss of control or power.

3. **Disruption to routine.** Employees may also resist change because they are worried that they cannot adapt to the new procedures that threaten established work routines. This is made worse if training is not provided.

4. **Time.** In some circumstances, not enough time is allowed for people to think about the change, accept it and then implement it. In other situations, the timing is poor.

5. **Fear of the unknown.** Change can have a major impact on people. Feelings of lack of control, fear of the unknown and uncertainty about the future can lead to anxiety. The situation is made even worse if there is poor leadership and management during times of change.

6. **Inertia.** *Inertia* refers to an unenthusiastic response to proposed changes. Some managers and employees resist change because it requires moving outside and away from their ‘comfort zones’. Many employees and managers of the typical business desire a safe and predictable status quo. Such an attitude is summed up in the phrase, ‘But we don’t do things that way here’.

7. **Cost.** A major reason for resistance to change is the financial cost of its implementation. Even with access to finance, a business contemplating change must weigh up the costs and benefits of the change. For example, David Jones’s recent successful upgrade of its network of stores cost $275 million to increase its floor space by over 20 per cent.
Driving and resisting forces

All businesses must deal with one constant reality of change: trying to balance the forces driving change with the forces resisting change. **Driving forces** are those forces that initiate, encourage and support the change. The main driving forces for organisational change are the changes in the internal and external environments, as outlined in chapter 3. **Restraining forces** are those that work against the change, creating resistance. The current conditions, or status quo, result from these two forces ‘pulling’ in opposite directions (see figure 9.11). Managers who are trying to implement a change must analyse the situation to identify and balance the driving and restraining forces.

**BizWORD**

*Driving forces* are those forces that support the change.

*Restraining forces* are those forces that work against the change.

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**FIGURE 9.11** Forces for change are constantly ‘pulling’ against the forces resisting change.

Businesses often fail to manage change well. The record tends to be poor because in the upheaval of a restructuring process the most crucial group of all, the employees, are often neglected. As well, existing communication channels are often inadequate when reporting progress. Such channels often break down in the highly emotional climate that surrounds a change program.

**Strategies for reducing resistance to change**

The first step in reducing resistance to change is to ensure that managers understand the main reasons why change is resisted. Once these factors have been identified, each manager can put in place strategies to reduce the resistance.

A great deal of research has been conducted on the most appropriate methods to reduce resistance to change. The majority of this research revealed that regardless of where or how a change originated, the workplace culture created by the manager and his or her leadership abilities can greatly affect employee acceptance. Figure 9.12 outlines several strategies for creating a positive environment for change. Two of the most effective are creating a culture of change and positive leadership.
Creating a culture of change

Adopting changes to work procedures or organisational structures requires a degree of risk taking by the participants. For employees and managers to be prepared to take such risks, the business culture needs to be supportive. One method to assist in this process is for the business to identify individuals who could act as supportive change agents. Such people fulfil a crucial role in helping to establish a positive and supportive workplace culture. Change agents may include members of the management team, employees of the business or outside consultants.

Effective teams have open communication channels that assist in the transfer of information; they also develop a strong sense of identity between team members and offer a supportive environment that reduces fear of change. When teams work well, staff turnover and absenteeism decline, change is more readily accommodated, and productivity tends to rise.

**BizWORD**

A change agent is a person or group of people who act as catalysts, assuming responsibility for managing the change process.
Positive leadership

How a manager treats his or her employees will largely determine their acceptance of or resistance to change. A manager who acts as a leader and has high expectations of employees’ abilities to initiate and implement a change process will generally be rewarded with people who are willing to embrace the change. There may still be some points of resistance, but this resistance can be productively dealt with because the employees believe they have the support and trust of their manager.

Employees are generally more prepared to accept the risks involved with change if they feel their manager is concerned with their welfare. Managers who concentrate on the needs of their employees are the most effective, building high-performance teams that attain their objectives. Less effective managers tend to focus on tasks and are more concerned with meeting deadlines — that is, they display the natural characteristics of a manager, not a leader.

Added to these qualities, a successful leader will need to:

• market and promote the change in a manner that will achieve cooperation and acceptance
• resolve conflicts, which often arise when change is implemented
• keep an open mind, seek out new ideas and freely share information
• cultivate a sense of stability, while at the same time push on with even more change
• show confidence in people, share credit and recognition
• build and communicate a clear vision.

Being an effective leader is not an easy task. There may be temporary setbacks, particularly during periods of negotiation. In the end, leadership may still fail. However, not displaying leadership is inviting a greater possibility of failure. Research constantly reveals that traditional management is not enough for businesses involved in continual transformation (see the following case study). Such businesses need charismatic, enthusiastic leaders who can inspire people to share their vision.

FIGURE 9.14 A leader who can ‘sell’ the need for change automatically reduces one of the main resistance points of ‘why do we need to change?’

BizFACT
A successful leader will market and promote the change in a manner that will achieve cooperation and acceptance.

Management consultants
As a student, if you have difficulty understanding some information within a subject, you will probably consult with someone who is an expert in that area. This could be another student, teacher or family member. This is similar to when you have a consultation with a doctor. You are seeking assistance from someone with specialised
knowledge. Businesses also seek advice from **management consultants** who specialise in a diverse range of business-related areas, including risk management, brand protection, business set-up, executive recruitment and sustainability. Businesses hire the services of management consultants because they provide:

- a wide range of business experiences
- specialised knowledge and skills
- an objective (external) viewpoint
- access to the latest research
- awareness of industry **best practices**.

The main role of management consultants is to help businesses improve their performance by investigating existing business problems and developing plans for improvement. Consultants can be especially helpful in providing **change management** advice: a methodical approach to dealing with change, both from the perspective of a business and on the individual level. They can provide strategies to smoothly manage the introduction of business changes by:

- undertaking change readiness reviews
- creating a supportive business culture
- actively involving all stakeholders in the change process
- gaining and recognising early achievements.

However, as in all aspects of life, the quality of advice from management consultants can vary. Therefore, it is best to hire those consultants who are members of the Institute of Management Consultants as their members have recognised standards of character, experience and education.

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**Magnatech Industries — managing change**

This case study of a real organisation is designed to provide insight into the management of change and the challenges that need to be addressed for long-term survival.

Magnatech Industries is a large, private company that manufactures rigid plastic injection mouldings for a range of whitegood manufacturers of refrigerators, freezers and washing machines. Injection moulding is a manufacturing process which involves heating plastic to a fluid state and inserting it into a mould. This process means that a variety of products once manufactured from heavier and more expensive materials can be produced from less expensive plastic materials.

Over the last decade, significant changes in this industry have meant changes to Magnatech’s strategic plans, resulting in operational and structural changes. Technical innovation in the external business environment is likely to result in further, wide-ranging change over the next five years.

**Business background**

<table>
<thead>
<tr>
<th>Name of business</th>
<th>Magnatech Industries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of ownership/legal structure</td>
<td>Proprietary company</td>
</tr>
<tr>
<td>Shareholders</td>
<td>100 per cent Australian owned</td>
</tr>
<tr>
<td>International division</td>
<td>Pro Tag International Thailand</td>
</tr>
<tr>
<td>Core business function</td>
<td>Plastic injection moulding servicing the whitegoods (refrigerators, freezers and washing machines) industry</td>
</tr>
<tr>
<td>Mission statement</td>
<td>To provide technical solutions through high engineering standards which meet the needs of our clients</td>
</tr>
<tr>
<td>Employees</td>
<td>115 in Australia, New Zealand and Thailand</td>
</tr>
</tbody>
</table>

(continued)
Magnatech faces both global and domestic competition.

Export markets are... a source of revenue that reduces the risk involved from domestic competitive pressures.

**Brief history**
The company has a history that stretches back to the 1950s, when a toolmaking business was established by the original owner. In 1972, the company began to make refrigerator, freezer and washing machine mouldings for three Australian manufacturers. In the 1990s, tariff reductions for electronic appliances had a significant impact on the business. Margins on whitegoods dropped by 40 per cent as the domestic suppliers reduced prices to compete with the cheaper imports.

While Magnatech faces both global and domestic competition, it continues to maintain a major share of the domestic market for plastic mouldings for whitegoods. International competition is increasing. Often, a partially loaded shipping container destined for Australia will be topped up with plastic mouldings, which will then be off-loaded on the domestic market at cost price.

There are currently five plants manufacturing refrigeration mouldings in Australia. Three of these are multinational companies that have chosen to make Australia their headquarters for production in the region, due to Australia’s political and economic stability. Magnatech’s manufacturing process is fully automated, resulting in lower per unit costs of production.

**The market**
Magnatech supplies mouldings to major customers in Australia (with a significant majority of the market share), with production facilities in Australia, New Zealand and Thailand. One of the characteristics of this industry is the increasing pressure to minimise inventories, reduce manufacturing costs, and reduce lead time (the time it takes to convert raw materials into a finished product) from one week to 48 hours.

Magnatech currently produces tinted trays and shelving for refrigerators and freezers in 10 different colours. While Magnatech maintains a stock of white internal mouldings, the coloured trays and shelves are made to order. With industry pressure to reduce lead times, Magnatech can generally produce orders for standard colour mouldings within 24 hours. A specialised colour may initially require a lead time of two weeks.
Changing direction of the business

While there has been a considerable amount of external change in the industry over the past decade, Magnatech's core business activity remains unchanged: injection moulding. However, the strategic plans for the organisation:

- reflect an awareness of the change in the industry
- acknowledge Magnatech's potential vulnerability in the face of change, particularly as its customer base for core products is a handful of major customers
- incorporate internal changes to ensure long-term survival.

Changes in the direction of the business include the following.

1 Development of new markets, especially export. Magnatech was initially reluctant to expand internationally because of the difficulties it believed it would face. However, the company soon learnt of the opportunities presented by such an expansion. While still in the developmental stage, Magnatech Industries' export markets are increasingly becoming another reliable source of revenue that reduces the risk involved from domestic competitive pressures.

2 Development of new products, using the skills developed within the core business. A recent major product development includes the manufacture of a range of security tag devices for clothing retailers. The product, ProTag, has been designed and developed by an associate company, ProTag International (100 per cent owned by Magnatech, including patents and trademarks). As a special releaser is required to extract the tag, products that are displayed are safe from theft. Unlike their core products, which are targeted towards whitegoods manufacturers, the customer base for ProTag is retailers.

The technology utilised in the production of the ProTag security system may also be adapted for other product areas. Security systems for aircraft luggage, for example, are currently under evaluation.

3 Site diversification with business expansion in Asia. Site diversification, particularly with the Thailand plant, has resulted in some significant cost savings and increased market share for the Magnatech Group. Magnatech Asia can take advantage of:

- access to resins (an input in the production process) at competitive prices
- the benefits offered by the Australia–Thailand Free Trade Agreement which reduced the barriers to trade between the two countries.

Management response to change — internal adjustments

1 Total quality management (TQM). All aspects of the business are continuously reviewed to ensure value is added and to maximise efficiency for the benefit of the customer. To achieve the TQM objectives, key performance indicators such as industry benchmarks are used. The company has successfully developed a workplace culture based on continuous improvement as it believes this will be the most cost effective in the long term.

2 Rationalisation. The company continues to audit all operations and processes and has recently decided to place some of the manual operations with subcontractors. Any part or product that cannot be fully automated (for example, clicking the parts together) is now outsourced. Subcontractor labour is more cost effective for labour-intensive work.

3 Training. The majority of the organisation’s employees are multiskilled and there are significant benefits in employee commitment to training. The company has an excellent team and values employee ideas.

If an employee has an idea about changes or refinements to production processes, the company is prepared to submit the idea to trial. Peter Townsend, the managing director, commented that this can sometimes be costly, but in the process of trialling new ideas, employees develop skills that can benefit other areas of the plant.

Over half of Magnatech's employees have at least 15 years of service. Through retirement, the company is likely to lose a substantial amount of experience and

(continued)
The company continues to audit all operations and processes.

expertise. Apprentices have been employed to gain knowledge and skills required for a smooth transition. Magnatech is now embarking on human resource policies that encourage individual expertise.

4 Ecologically sustainable production. Over the last five years Magnatech has implemented a ‘3R’ policy: reduce, reuse or recycle. This has benefited both the company, through reduced wastage and more efficient work practices, and the environment. Magnatech also adopted a triple bottom line approach in its financial and non-financial reporting processes.

Snapshot questions
1. **Identify** the stakeholders in Magnatech Industries.
2. **Identify** the sources of change in the internal and external environments that have had an impact on Magnatech Industries over the last decade.
3. **Describe** Magnatech Industries’ core business function.
4. (a) **Define** the terms ‘inventories’ and ‘lead time’. (b) **Explain** why Magnatech Industries wants to minimise inventories and reduce lead times.
5. **Outline** how Magnatech Industries’ strategic plan has been modified as a result of the changes in the business environment.
6. **Describe** what Magnatech Industries is doing to reduce the consequence of employee retirement.
7. **Construct** a mind map summarising the internal adjustments Magnatech Industries’ management has made in response to changes within the business environment. The first part of the mind map has been started for you.

**Total quality management**
- continual review to ensure value is added

**Ecologically sustainable production**

**TRAINING**

**RATIONALISATION**

**MANAGEMENT RESPONSE TO CHANGE — INTERNAL ADJUSTMENTS**
8. **Predict** the possible impact of each of the changes in direction of Magnatech Industries. Use the following headings to prepare your answer.
   - New markets
   - New products
   - Diversification.

9. (a) **Assess** the degree of control and influence Magnatech Industries has over factors in the external environment.
   (b) **Determine** what are some of the circumstances that will affect the degree of control.

10. **Determine** how the internal and external stakeholders are likely to benefit by Magnatech Industries promoting socially just and ecologically sustainable change. **Summarise** your ideas using a table like the following one.

<table>
<thead>
<tr>
<th>Benefits for internal stakeholders</th>
<th>Benefits for external stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>New and better products</td>
<td></td>
</tr>
<tr>
<td>New technology</td>
<td></td>
</tr>
<tr>
<td>Employee training programs</td>
<td></td>
</tr>
<tr>
<td>Improved working environment</td>
<td></td>
</tr>
</tbody>
</table>

**Summary**

- At the same time as managers are undertaking — driving — change for the best of reasons, there will be restraining forces working against the change, creating resistance.
- The main reasons for resistance to change include:
  - management (may make hasty decisions or be indecisive)
  - fear of job loss (fearful of changes that threaten job security or require new work routines)
  - disruption to routine (worried that they cannot adapt to the new procedures that threaten established work routines)
  - time (either poor timing, or lack of time)
  - fear of the unknown (feelings of lack of control and anxiety)
  - inertia (prefer to stay with the safe and predictable status quo)
  - cost (financial cost of implementing major changes can be substantial).
- Driving forces are those forces that initiate, encourage and support the change.
- Restraining forces are those that work against the change, creating resistance.
- Resistance to change is common among managers and employees.
- Two strategies for overcoming resistance to change include:
  - creating a culture of change (encouraging teamwork)
  - providing positive leadership (sharing the vision).
- The main role of management consultants is to help businesses improve their performance and assist with change management.

**Revision**

1. **Outline** why management and employees commonly resist change.
2. **Explain** how you would feel if your classroom was radically changed overnight without your knowledge.
3 **Distinguish** between ‘driving’ and ‘restraining’ forces.

4 Complete the sentences below by **identifying** the correct term from the following list:

- cost
- common
- fear
- effectively
- routines
- resistance
- analysing
- managers
- strategies
- security

When change is too rapid or when managers and employees feel they have no control over it, then ____________ to the change is to be expected. Resistance to change is ____________ among employees and organisations. The resistance needs to be managed ____________. Managers can fail to achieve change by not ____________ the situation properly. Employees may resist change because of the ____________ of the unknown, possible threat to job status or ____________; disruption to established work ____________. Inertia and ____________ are two main restraining forces. ____________ for reducing resistance to change need to be developed by ____________.

5 **Outline** how the following can be a restraining force:
(a) lack of time
(b) poor timing.

6 When the new chief executive officer for Bradley Southport Limited attempted to make some major changes, she encountered resistance among some senior level managers. **Explain** why these managers might have resisted the changes.

7 Based on the information from this section, **explain** why there was so much resistance by bank tellers when they were first required to use computers to process customer transactions.

8 **Examine** figure 9.12 on page 307. Select the two strategies you think are the most important. **Justify** your selection.

9 **Recall** the role of a change agent.

10 **Identify** the features found in a team that help others overcome resistance to change.

11 **Clarify** how positive leadership can help overcome resistance to change.

12 Select a major change in your life, such as moving house, changing schools or starting a new casual job, and complete the following:
(a) **State** the reasons you liked or disliked the change. Share your thoughts with other class members.
(b) **Identify** the reasons that were common among the group.
(c) **Interpret** what this tells you about the best strategy that a manager could use to help overcome resistance to change.

13 **Identify** the benefits of hiring a management consultant.

14 Use the **Institute of Management Consultants (IMC)** weblink in your eBookPLUS to **outline** the:
(a) role of the IMC
(b) purpose of the Certified Management Consultancy (CMC) designation.

**Extension**

1 **Evaluate** the accuracy of the following quotes concerning change:
(a) ‘Change for change’s sake is not progress.’
(b) ‘Change is life. Life is change.’
(c) ‘Change what you can change. Accept what you cannot change.’

2 Think about a situation in which you would like to make a change but face some resistance. The situations might involve improving your Business Studies results, changing the arrangement of your timetable or having greater use of the family car.
(a) **Summarise** the status quo.
(b) **Propose** the situation as you would like it to be if you could change it.
(c) **Identify** the main driving forces.
(d) **Identify** the main restraining forces.
(e) **Determine** strategies for reducing the impact of the restraining forces.

3 Because of recent changes to the Occupational Health and Safety Act you must implement some new safety procedures. You know that some of your employees are going to regard some of these changes as ridiculous. **Propose** what you might do to get the employees to accept the changes.

4 ‘... the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new.’ Machiavelli (*The Prince*, 1532). **Evaluate** the accuracy of this statement.
SUGGESTED ASSESSMENT TASKS:

Business management

Multiple choice questions

1 Which of the following would be a financial business goal?
   (a) Provision of parking spaces to all employees
   (b) Increasing market share over time
   (c) Instructing all managers to wear formal attire
   (d) Employing young people as casual labour

2 Which of the following states the process involved in planning?
   (a) Setting standards and targets
   (b) Analysing past performance
   (c) Reacting to daily business crises
   (d) Responding to last year’s financial collapse

3 Controlling involves which of the following?
   (a) Analysing the data from the business’s activities
   (b) Airing proposals for new product lines
   (c) Chastising employees for leaving the lights on overnight
   (d) Setting standards and targets

4 For what reason is it important to coordinate business functions?
   (a) To assist with achieving plans
   (b) To make the task of business organisation harder
   (c) To make employees feel valued
   (d) To give managers extra work to do

5 Maria has recently purchased a business from Tamara. The business has been losing sales for the past 12 months. It has been suggested that mismanagement is the cause. Maria should:
   (a) adopt better training practices for staff
   (b) restructure the administration staff
   (c) hire new managers
   (d) review the strategic plan and set new business goals.

6 In implementing strategic plans, organising involves:
   (a) improving staff employment strategies
   (b) determining and delegating work tasks
   (c) involving staff in decisions about changes in practices
   (d) reviewing the use of technology in business.

7 Planning for change that is proactive involves:
   (a) responding quickly to internal and external influences
   (b) only adopting strategies which match past trends
   (c) anticipating future trends and implementing strategies in advance
   (d) none of the above.

8 The contingency approach to management refers to:
   (a) seeking continuous improvement in employee performance and productivity levels
   (b) the need for flexibility and adaptation of management practices and ideas to suit changing circumstances
   (c) setting predetermined goals and formulating strategies to generate possible solutions
   (d) a situation where the main emphasis of management is to improve the interpersonal skills within the management teams.

9 Quality testing of raw materials upon entry into the business, by use of random sampling, is an example of which type of activity?
   (a) Quality insurance
   (b) Quality control
   (c) Quality differentiation
   (d) Quality production
10 Which of the following statements best defines the term ‘marketing’?
(a) Marketing is the distribution of goods and services from the wholesaler to the retailer so that they are available when the customer wants them.
(b) Marketing is a total system of interacting activities designed to plan, price, promote and distribute goods and services to present and potential customers.
(c) Marketing includes all those activities involved in the production and promotion of goods and services to the end customer.
(d) Marketing is any set of activities undertaken to produce and promote a range of goods and services to satisfy customers’ needs.

11 A market niche:
(a) is a broadly selected target market segment
(b) involves a business directing its marketing efforts to two or more target market segments
(c) is a narrowly selected target market segment
(d) involves a business directing its marketing efforts to an international target market.

12 For what can budgets best be used?
(a) Guiding the input of raw materials
(b) Determining the actual cost of labour
(c) Analysing the decision to save
(d) Ordering work and plant layout patterns

13 Budgets can best be described as which of these?
(a) Financial estimates of past sales
(b) Complete financial plans
(c) A source of equity finance
(d) A guide to allocation of resources, money and time

14 A business borrows money and pays an interest rate of 8 per cent. Over the following year this increases to 12 per cent. Where would this change be reflected?
(a) The revenue statement under cost of goods sold
(b) The revenue statement under expenses
(c) The balance sheet under assets
(d) The balance sheet under liabilities

15 Financial statements and reports are used for which three reasons?
(a) To assist with taxation, ensure liquidity and employment
(b) To assist with taxation, ensure some certainty and financial control
(c) To assist with financial planning, financial control and marketing strategies
(d) To assist with financial planning, financial control and employment relations

Short response questions

1 ‘To understand management today you must look at its history. Management approaches (theories) and schools of thought represent differing viewpoints and strategies for managing people, making decisions, organising workplaces and solving problems. Each offers something of value for today’s manager.’
(a) Identify three management approaches and summarise the main features of each. 3 marks
(b) Explain how these approaches could influence contemporary management practices. 6 marks
(c) Analyse the relationship between management approach and the types of business structure that a business could adopt. 12 marks

2 ‘Managers need a wide range of skills. The relative importance of these skills depends upon the manager’s level in the business.’
(a) Identify four management skills. 2 marks
(b) Explain how the quantity of the skills needed differs at each level of management. 5 marks
(c) Determine why it is important for a manager to acquire new skills. 10 marks
3 (a) Define the term ‘stakeholders’.  2 marks  
(b) Identify and describe two possible conflicts that could arise between various stakeholders.  4 marks  
(c) Propose possible strategies that managers could adopt to reconcile any likely conflicts of interest.  6 marks  

4 (a) Outline what is meant by the term ‘effective management’.  3 marks  
(b) Distinguish between ‘good’ and ‘poor’ management.  5 marks  
(c) Evaluate the importance of good management to the business’s overall success.  10 marks  

5 (a) Outline the role of managers when organising operations in a manufacturing-based business.  3 marks  
(b) Demonstrate how a business can ensure that quality of outputs is maintained.  6 marks  

6 (a) Define the term ‘marketing mix’.  2 marks  
(b) Outline the role and importance of brand, brand name and customer service in helping to achieve the marketing plan’s objectives.  3 marks  
(c) Explain how a business determines the emphasis within the marketing mix.  5 marks  

7 (a) State the main role of marketing.  2 marks  
(b) Explain the difference between a total market and market segmentation approach.  4 marks  
(c) Assess the importance of each of the four Ps of the marketing mix.  10 marks  

8 (a) Define the term ‘goal’.  2 marks  
(b) Identify the four main financial goals of a business.  3 marks  
(c) Distinguish between financial and non-financial goals.  5 marks  
(d) ‘A business should only focus on achieving its financial goals. Social, environment and personal goals are only for not-for-profit organisations.’ Evaluate the accuracy of this statement.  10 marks  

9 Construct an income statement and balance sheet in correct format using the following information. You will be required to determine profit and to use this figure to balance the balance sheet.  12 marks  

| Sales        | $400 000 | Owner’s equity    | $45 000  |
| Expenses     | $300 000 | Debtor’s          | $12 000  |
| COGS         | $50 000  | Mortgage          | $60 000  |
| Cash         | $20 000  | Land and buildings| $120 000 |
| Stock        | $10 000  | Goodwill          | $8 000   |
| Creditors    | $15 000  |                   |          |

10 (a) Define the term ‘human resource/cycle management’.  2 marks  
(b) Demonstrate the four main elements of the human resource cycle.  6 marks  

11 (a) Describe the steps to be followed by the human resource department so the most appropriate applicant will be chosen to fill a vacancy.  3 marks  
(b) Deduce what problems could arise for a business if an inappropriate candidate was selected to fill a job vacancy.  6 marks  

Extended response questions

1 In the following situation, identify and explain the management skills that could be used.  
A dispute has arisen between the IT department and the accounting department regarding the introduction of a new computer invoice system. The accountant wants the new system introduced by the beginning of the new financial year, but the IT manager believes that the staff will not be sufficiently trained by then to use it effectively. You are the human resource manager in charge of this project and must negotiate agreement without further delay.
2 Compare the classical, behavioural and contingency management approaches. Study a business and account for how management theory has influenced the business’s structure.

3 ‘The only constant in business is change. The pace of change is accelerating, with change coming from both internal and external sources. How a business responds to these changes will ultimately determine its future’. Critically evaluate the strategies used to manage change effectively in a business you have studied.

4 Choose a real-life example of a manufacturing-based business and a service-based business. For each example, outline the inputs, processes and outputs of their operations.

5 ‘An effective marketing mix is crucial if a business wants to increase its market share.’ Discuss.

6 ‘Marketing is a system of business activities designed to plan, price, promote and distribute something of value for the benefit of the customer at a profit.’ With reference to a business you have studied, discuss and expand on this statement.

7 ‘A thorough understanding of accounting and finance is essential for business managers’. Identify the three main financial statements and discuss their importance.

8 ‘If a business wants to be appropriately flexible and responsive to market needs, then it should train all employees to be good at everything. That is, they should be experts in all aspects of each key business function. Generalists, not specialists, are required.’ Is this a practical proposal? Justify this statement.

9 Imagine you are specialising in accounting services for a small business. Terry, one of your clients, runs a home maintenance business. He admits to you that he regularly offers a discount to customers who pay him in cash, so that he can keep his apparent profit as low as possible to avoid tax, and not have to declare every transaction on his BAS. Explain how you would try to convince him to maintain all his financial records in a socially responsible and ethical manner.

10 ‘There are only two ways in which to create and maintain outstanding business performance. First, take exceptional care of the customer and, second, develop new products. It is that simple.’ Determine how accurate this statement is. Give reasons for your answer.
FOCUS AREA
The processes of establishing and planning a small to medium enterprise

OUTCOMES
Students should be able to:
• discuss the nature of business, its role in society and the types of business structure
• describe the factors contributing to the success or failure of small to medium enterprises
• assess the processes and interdependence of key business functions
• analyse the responsibilities of business to internal and external stakeholders
• plan and conduct investigations into contemporary business issues
• evaluate information for actual and hypothetical business situations
• communicate business information and issues in appropriate formats
• apply mathematical concepts appropriately in business situations.
To climb to the top of a mountain requires thorough planning. The route needs to be carefully plotted, weather forecasts studied and essential equipment organised. It is the same in the world of business, as Joshua Meanjin readily acknowledges.

It was Joshua’s love of sailing that resulted in him establishing Plain Sailing Boat Designs Pty Ltd in 2006. After leaving school, Joshua worked as an apprentice with a local boat designer. The experience gave him a good understanding of the boat design market, especially the 125 sailing dinghy class. In August 2005, Joshua contacted Sven Jorgensen, his local Business Enterprise Centre manager, another sailing enthusiast. Over the next five months Sven helped Joshua prepare a business plan. The plan set out the desired goals and directions of Joshua’s business. Sven impressed the importance of planning on Joshua, especially its importance in obtaining finance.

Joshua’s business plan was professional in its presentation, detailing the legal, operational, financial, marketing and human resource aspects, and provided an overview of the business’s main activity. This gave financiers confidence in Joshua’s business abilities. Plain Sailing Boat Designs Pty Ltd was ‘launched’ in February 2006. Since then, Joshua has revised his business plan each year, using it to assess the business’s performance and also to set new goals.
10.1 Introduction

Small to medium enterprises (SMEs) are the ‘engine room’ of the Australian economy. Governments at all levels have recognised the importance of SMEs and have devised appropriate policies to build on the strengths and overcome the weaknesses of these businesses. These policies focus on areas like access to finance, networking, delivery of government programs, innovation and export programs.

The more adaptive and dynamic SMEs have responded to this environment through increased spending on research and development (R&D), new product developments, improved business practices, and an export-oriented business culture. In recent years the SMEs in Australia have performed better than other sectors of the economy, even during the 2008–09 economic downturn. SMEs have created many new jobs, become more innovative and are increasingly entering overseas markets.

10.2 Definition of SMEs

As outlined in chapter 2, establishing a clear-cut definition of a SME is no easy task. They are much easier to describe than define. Although there is no single universally accepted definition of a SME, a number of quantitative measurements (those based on statistical calculation) and qualitative measurements (those based on personal observations and a description of the business) can be used to determine whether a business is small or medium sized:

- number of employees
- type of ownership
- sources of finance
- legal structure
- market share
- management structure.
One of the most widely accepted quantitative measurements used to determine the size of a business is that devised by the Australian Bureau of Statistics (ABS). This measurement uses the number of employees as its benchmark (figure 10.2).

![Figure 10.2 Australian Bureau of Statistics classification of business size](image)

**Common characteristics of SMEs**

The definitions outlined above, and in chapter 2, have limitations. Studies have revealed the general public's narrow definition of the term 'small business'. The average person uses the term to refer to an owner-managed business that may employ a few people. It is best then to use a checklist of characteristics (both quantitative and qualitative), to determine the size of a business (see figure 10.3).

![Figure 10.3 Common characteristics of a SME](image)

Many SME owners want to stay small to avoid the pressures and difficulties often experienced in larger businesses. They are content with the size of their business, especially knowing they can offer personalised service to their customers.

One such small business that has adopted this philosophy is Barlett Precision Manufacturing (see the Snapshot overleaf).
Bartlett Precision Manufacturing: small, but big in its own way

Ever wondered what type of machine makes the plastic cards you have in your purse or wallet? Well, Troy Bartlett of Bartlett Precision Manufacturing is the person to ask, for his business makes the intricate dies that punch out the distinctive card shapes.

Ever since year nine, Troy wanted to be an engineer, and dreamt of one day owning and operating his own business. After leaving school, Troy gained an apprenticeship with Rheem Australia Pty Ltd and undertook four years of study at Meadowbank TAFE. Upon completion of his apprenticeship, Troy decided to start his own business, and Bartlett Precision Manufacturing began operation in 1999.

As with most small businesses, Troy experienced some start-up problems, especially when one major customer failed to pay their considerable account, but Troy thrived on the challenges. In the next few years, Troy consolidated his customer base and developed a network of reliable suppliers.

With the enthusiastic support of his wife Suzanna, who undertook a part-time accounting degree to assist with the business’s financial records, the business slowly developed and became recognised as one of the best in the industry. Troy invested in computerised numerically controlled (NC) equipment, which allowed him to specialise even further.

Although many small businesses are keen to expand, Troy wants his business to remain small. ‘I often wonder whether I should grow or not, but the more the business expands, the more I’ll lose control. I want to keep the personal contact with my customers’, he says thoughtfully. ‘When a customer comes in with a problem, I can design and manufacture to their specific requirements. This is my business’s main competitive advantage; I take a personal interest in the project from beginning to end. This means that I keep control of the whole process, so that the high levels of engineering are maintained’, he says.

Troy works long hours, especially when a customer imposes a tight deadline, but he does not want to lose what gives him most satisfaction from the business. ‘I like being on the machines. I’m very much a hands-on type of business owner. I get enormous satisfaction from working on a job from beginning to end’, he says caringly. Actually, it’s for that honest reason that he rejects so many suggestions for expanding his business to match the competition. ‘I just want to continue doing what I do. Bigger is not always better’, he quips.

Snapshot questions

1. Identify the strengths of Troy Bartlett’s business.
2. Outline what gives Troy his competitive advantage over his competitors.
3. Explain why Troy prefers to keep the business small.
4. Predict what might happen to Troy’s business over the next three years.

The number of SMEs

According to Australian Bureau of Statistics, (ABS) research, in 2010 SMEs accounted for approximately 98 per cent of all private sector business. However, it is difficult to provide an accurate count of the number of SMEs in Australia for two reasons. First, as was previously explained, there is no universally accepted definition of a SME. Second, the SME sector is extremely dynamic and changing daily. During a boom time in the economy, the number of SMEs increases rapidly. During a recession, business failures far outweigh business commencements.
Most figures quoted are merely estimates and range from a minimum of 1.5 million up to a maximum of 2.1 million small businesses in Australia in 2010. The ABS estimated that in 2010 there were approximately 78,000 medium businesses operating in the Australian economy.

**FIGURE 10.4** Think of the SME business sector as a pool of water. New businesses enter the pool and increase its size. Others have difficulty staying afloat. They sink to the bottom, leak out and decrease the size of the pool. This means the composition and size of the pool is constantly changing.

It is important to remember that even though medium-sized businesses represent only about two per cent of all SMEs, they play an important role because of the large number of people they employ.

### 10.3 The role of SMEs

By examining some of the main features of SMEs, their overall important role within the Australian economy can be seen. Australian small to medium enterprises:

- employ about 73 per cent of all the people working in the private sector (51 per cent in small businesses and 22 per cent in medium businesses)
- have created 80 per cent of Australia’s employment gains during the past ten years
- produce approximately 50 per cent of all the products produced each year
- generate an increasing amount of our total exports (see the following Snapshot)
- account for 20 per cent of all money spent on R&I
- provide a wide range of products used by large businesses
- earn more profits and pay more taxes than do large businesses.

Although the individual efforts of each SME may appear insignificant, their total impact is enormous.
SMEs — global customers via the internet

Over the past decade, the number of SMEs who are exporting has rapidly increased. Today, 97 per cent of Australian exporters are SMEs, and they earn almost 50 per cent of export revenue. The main cause of this (besides easier entry to many countries through trade agreements) is the rapid expansion in electronic business (e-business), which has largely been brought about by the development of the internet.

E-business has opened the door for many SMEs to sell direct to consumers across national borders. For example, Vetafarm, Australia’s leading innovator in companion animal health and welfare products, supplies its products worldwide via an extensive network of distributors and resellers. Based in Wagga Wagga in New South Wales, Vetafarm’s significant markets are the United States, Japan, the Middle East, the Philippines and Indonesia. Since commencing business in 1990, Vetafarm has designed and marketed over 450 products.

Slim Secrets, a private company owned and operated from home by Sharon Thurin, markets and distributes a healthy snack alternative. While involved with a health and wellness clinic, Sharon spotted a gap in the market for tasty, healthy snack products that are wheat free, high in protein and fibre, and have a low glycemic index (GI). With support and advice from Austrade (the Australian Trade Commission, the Australian Government’s trade and investment development agency), Sharon has turned this niche market product into a global success story. Originally Sharon intended to sell the product locally but now the business’s global markets include Singapore, New Zealand, the United States, Canada and China.

Research by Austrade has identified five trends for the next generation of exporters:
• many will be small in size
• they will be knowledge based, providing goods and services that use innovation and knowhow
• they will have been in business for only a few years
• they will be in small towns as well as capital cities
• they will use new ways of going global.

The strongest growth is likely to be among knowledge-based service exporters who work in areas such as film and video production, accounting services, and tourism.

Snapshot questions
1. Recall the factors responsible for the rapid growth in e-business.
2. Outline the effect the internet has had on Vetafarm and Slim Secrets.
3. Use the Austrade weblink in your eBookPLUS to examine the role and function of the Australian Trade Commission and answer the following questions.
   (a) State the role of Austrade.
   (b) Identify three specific Austrade programs designed to help business.

Owning and operating a SME can be challenging, rewarding and stimulating, as well as hard work. For those prepared to take the risk, and who finally make it, the sense of achievement and satisfaction is well worth the effort.

Summary
• Small to medium enterprises (SMEs) are the ‘engine room’ of the Australian economy.
• Australian Bureau of Statistics classification of business size:
  – Micro. Fewer than five employees (including the owner)
– **Small.** Between 5 and 19 employees
– **Medium.** Between 20 and 199 employees
– **Large.** 200 or more employees.

- A checklist of qualitative features can also be used to determine business size.
- The number of SMEs fluctuates over time according to the state of the economy.
- In recent years, SMEs have created many jobs, become more innovative and are increasingly entering overseas markets.

**Revision**

1. **Recall** what the letters SME represent.
2. **Distinguish** between quantitative and qualitative measurements used to determine the size of a business. Provide an example of each.
3. **Examine** figure 10.2 (page 323). Complete the following statements by identifying the correct word from the choices given. Write the sentences into your notebook.
   According to the ABS:
   (a) a business with fewer than 5/20 employees is classified as a small business
   (b) a micro business has fewer than five employees including/not including the owner
   (c) a medium business has between 20 and 199/100 and 199 employees
   (d) a business that has more than 100/200 employees is classified as a large business.
4. **Examine** figure 10.3 (page 323). Select the three characteristics you consider to be the most important and **justify** why you selected each one.
5. **Explain** why it is best to use a checklist of both quantitative and qualitative measurements to determine the size of a business.
6. **State** why many small business owners want to stay small.
7. **Outline** why it is difficult to provide an accurate number of SMEs operating in Australia.
8. **Discuss** why it is useful to think of the SME business sector as a pool of water.
9. **Explain** the relationship between the level of economic activity and the number of business commencements and failures.
10. **Identify** five important features that indicate the overall importance of the SME business sector to the Australian economy.
11. ‘SMEs are the “engine room” of the Australian economy.’ **Justify** this statement.

**Extension**

1. **Contrast** the various definitions of ‘small business’.
2. **Construct** a database of five small businesses in your local area. List the following:
   (a) the name of the business
   (b) whether the business is a manufacturing or non-manufacturing business
   (c) the number of employees
   (d) the turnover
   (e) the asset value.
3. **Evaluate** how useful these data are when attempting to define what a small or medium business is.

**10.4 Economic contribution of SMEs**

Before we can discuss SMEs’ contribution to the economy, we must first gain an understanding of what an economy is. An **economy** is a system or way of organising what goods and services are produced, how we produce these goods and services, and how these goods and services are distributed. It’s often easier to
think about this concept if we consider what would happen if a small group of people were stranded on a deserted island. An economic system or way of doing things would have to be devised for all members of the community to survive. What we produce would be dependent on the resources available, such as raw materials (for example fish from the sea), and how we produce would depend on our skills and available tools (for example, fishing rod and knowledge about how to best catch fish) to make that job easier. Perhaps, given there is a small group of people, goods and services produced (production) could be easily divided among all members of the community, therefore solving the question of who production will go to.

In real life, an economy must answer the three basic questions of:
• what to produce
• how to produce
• who will receive the goods and services produced.

Many different economic systems have been used, but the type of economic system we have in Australia is called a market capitalist economy. This means that most answers to the economic questions are provided by private buyers and sellers.

Now that we understand what an economy is, let’s consider how SMEs in Australia actually contribute to our economy.

**Contribution to gross domestic product**

Economic growth occurs when a nation increases the real value of goods and services over time. One common measure to check whether economic growth has occurred is to see whether our gross domestic product (GDP) has grown.

GDP is the total money value of all goods and services produced in Australia over a one-year period. The Australian Bureau of Statistics (ABS) estimates that SMEs contributed about 50 per cent of Australia’s GDP — approximately $560 billion. The total output of the country’s diverse collection of SMEs, ranging from highly specialised professional and technical firms to the local corner store, makes a significant contribution to the national economy.
Contribution to employment

Employment keeps the economy healthy. Employed Australians will use the wage they have earned to buy goods and services to satisfy their needs and wants, supporting business and opening up further opportunities for job creation. In 2009–10, SMEs employed about 7.5 million people, which represents about 73 per cent of total private sector employment. (Fifty one per cent are employed in small businesses and 22 per cent in medium businesses.) During the last 20 years, the SME sector has been the major generator of new jobs in the Australian economy. During times of economic downturn, as was experienced between 2008 and 2009, the SMEs were more likely to try to maintain their existing employees compared with the large businesses.

In addition to providing employment, SMEs contribute to the revenue raised through taxation. Not only do they pay tax, their employees also pay income tax. Taxation is used to provide goods and services that may benefit the whole community, such as a better education system.

Contribution to the balance of payments

One of the most dynamic changes to the Australian SME business culture is the increasing awareness of the need to service overseas markets. Evidence of this is the fact that the number of SME Australian exporters is growing faster than large exporters. SMEs in agribusiness, manufacturing and professional services are all experiencing rapid export growth. However, this growth is occurring from a very low base, as only four per cent of Australian SMEs export.

Exporting goods and services contributes to our balance of payments. The balance of payments (BOP) is a record of a country’s trade and financial transactions with the rest of the world over time, usually one year. One way of maintaining a favourable BOP, as well as encouraging economic growth, is to export more than is imported. This is another crucial role for SMEs as they are often more successful at exporting than large businesses (see the following Snapshot). Many agree that the adaptability and flexibility of SMEs make them more responsive to the needs of overseas markets. The federal government is keen to promote export growth within the small business sector and encourages this with programs operated by Austrade.

Extreme Solutions International — making big waves overseas

One example of a small business that is a skilful exporter, due to the success of ‘Spindek’— a rotating traction surface that can be attached to a surfboard, is the Western Australian company Extreme Solutions International.

Owned and operated by former IT managers Rod McKay and Chris Gray, Extreme Solutions International created ‘Spindek’, which allows the surfer to use their feet to give them more power and to turn more sharply without exerting as much physical effort. It took four years to perfect ‘Spindek’, but now the business has its own factory and sells to the world. What gives the business its major competitive advantage in overseas markets is that it can produce its deck grip products in one-tenth the time of its competitors.

It was their passion for surfing that motivated these young entrepreneurs to develop a range of high-quality surf-related products that they sell under the brand name Soggy.

(continued)
Prior to exporting, they obtained advice and assistance from the Western Australian Government’s Small Business Development Corporation (SBDC). The corporation’s TradeStart officer supported Rod and Chris and assisted them in realising their full export potential. Since these early beginnings, Rod and Chris now supply the largest range of deck grip options in the world.

Drawing upon their IT experience, Rod and Chris established a website for online sales. The site averages about 15,000 hits per month and online sales generate approximately 30 per cent of total revenue.

The two main target markets are Japan and the United States. Surprisingly, the Japanese are currently the world’s leading purchasers of surf-related products. TradeStart promoted their products in Japan, which resulted in a young, surfing-enthusiast entrepreneur agreeing to promote, distribute and retail their products. Japanese consumers are discerning consumers, particular about what they buy, but are prepared to pay a premium price for high-quality products. Extreme Solutions International aims to capture 1 per cent of the Japanese surf market within two years.

Encouraged by their initial export success, Rod and Chris are hoping to eventually export their full range of surf-related products to the United Kingdom, South Africa and Indonesia.

**Snapshot questions**

1. **Identify** Extreme Solutions International’s main competitive advantage.
2. **Outline** the support offered by the Western Australian Government.
3. **Discuss** the advantages and disadvantages of exporting as an expansion strategy for small business.
4. **Account** for the Western Australian Government wanting to provide such support.
5. **Predict** what might happen to Extreme Solutions International over the next three years.

---

**Contribution to invention and innovation**

Small to medium enterprises are the main source of most inventions and innovations in Australia. An invention is the development of something new. Innovation occurs when something already established is improved upon. Many successful businesses are built on these two forces (see the following Snapshot).

Invention and innovation are at the heart of our economy. Finding new ways to do things has resulted in improved efficiency and increased productivity. Over the past ten years, SME spending on research and development (R&D) has almost trebled in real terms. Research and development is a set of activities intended to develop new ideas and improvements in production.

Studies confirm that the level of innovation among SME employees is much higher than among employees of larger businesses. This is perhaps because Australians have traditionally been a very innovative people, constantly recording the highest number of inventions per head of population. This has resulted in more than half the major technological advances of the twentieth century originating with individual inventors and SMEs.

A persistent difficulty that SMEs face when undertaking R&D is obtaining adequate finance. Traditional sources of finance, especially banks, perceive this type of finance request as high risk. One possible source of finance for R&D is venture capital. The investors take an equity position in the business (own part of it) and provide supplementary finance.
Great Aussie inventions

How would you describe a country that has invented the following products? Victa lawn mower, Esky, Hills Hoist, Speedo swimwear, StumpCam, wine cask, surf life saving reel, insect repellent. You might describe it as a sports-loving nation that enjoys an outdoor lifestyle. Of course, it’s Australia! However, if we examine another list of inventions — penicillin, IVF freezing technique, the cochlear implant, ultrasound technology, flu vaccine — then Australia could be seen as a nation of scientists, not sports lovers.

What these two lists reveal is that Australians are very innovative. In fact, we have the highest number of inventors per head of population of all countries. Innovation and invention can lead to the establishment of a business based on the development of new or improved products or services. Converting an innovative idea into a successful business concept often requires the creativity and risk taking of an entrepreneur. Success is something the following Australian small business owners achieved.

1. Trevor Murphy and Ken Harrison from Coolum in Queensland have developed a shower timer called the Aqualim, which works on volume of water used, rather than time in the shower. The Aqualim measures out 40 litres of water for each shower. Near the end, the flow is reduced as a warning, and the person in the shower can then decide whether to reset the device to continue their shower or finish at the conclusion of 40 litres of usage. The inventors of the Aqualim have estimated that it can save up to 50 per cent of water usage in showers, contributing to considerable household water savings.

2. Entrepreneur John Parselle developed a system called Fingerscan, which allows people to make electronic transactions or gain access to high security areas by pressing a finger on a flat piece of glass. Everyone has a unique set of fingerprints, and Fingerscan can identify individual customers or employees.

3. About 15 years ago, Gary Leech started toying with the idea of producing hand-cooked potato chips. Using a domestic deep fryer, he experimented with varieties of potatoes, different oil temperatures and different slice thickness. From this humble beginning sprang the enormously successful Kettle Chips. When Gary Leech and his partners sold the business to Arnott’s Biscuits, Kettle Chips had a turnover of $18 million.

Snapshot questions

1. Identify what these three products have in common.
2. Explain why it often takes a long time from thinking of the original concept to having the final product ready for sale.

Summary

- The SME sector contributes:
  - approximately 50 per cent of gross domestic product (GDP)
  - approximately 73 per cent of total private sector employment
  - approximately 5 per cent of balance of payment, but growing rapidly
  - significantly to the level of R&D.

Revision

1. Define the term ‘economy’.
2. Recall the three basic questions that all economic systems must answer.
3. (a) Identify the type of economic system operating in Australia.
   (b) State how the economic questions are answered in this type of economic system.
4. Explain what happens when economic growth occurs.
5 Clarify how economic growth is measured.
6 Define the term ‘balance of payments’.
7 Describe how a country can maintain a favourable balance of payments.
8 Identify the missing words to complete the following sentence. The first letter of each word has been provided.
   SMEs contribute to the economy by boosting economic growth, as measured by
g________ d_________ p________ SMEs also contribute to taxation revenue
because they e________ approximately 7.5 million people. The e________ earnings
that SMEs generate through selling goods and services overseas are also significant.
9 Distinguish between an invention and an innovation.
10 Account for the fact that SMEs often face difficulties in obtaining finance for R&D.
11 Describe the role of a venture capitalist.
12 Summarise the economic contribution of SMEs by completing the following table.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic product</td>
<td></td>
</tr>
<tr>
<td>Employment</td>
<td></td>
</tr>
<tr>
<td>Balance of payments</td>
<td></td>
</tr>
<tr>
<td>Invention and innovation</td>
<td></td>
</tr>
</tbody>
</table>

Extension

1 Use the Small business export success weblink in your eBookPLUS to examine a
small business that has been successful in exporting its goods or services. Create a
short report using the following headings:
(a) Name of the business
(b) What the business does
(c) What the business exports
(d) Where the business exports its goods or services
(e) Reasons the business is successful.
2 You have been asked by the local newspaper to create an article evaluating the
importance of SMEs to the Australian economy. Your article will appear in a special
supplement dealing with small business. Prepare your article exactly as you would
like it published, using a desktop publishing program for layout if possible. Use your
imagination and choose a thought-provoking headline. After you have prepared your
first draft, confer with a partner to edit your article to publishing standard. Display the
articles around the room.
3 Determine why the level of innovation among small business employees is much
higher than among employees of larger businesses.
4 Reflect on what you have read and learned so far. Assess how this information would
influence you if you were intending to start a small business.

10.5 Success and/or failure of SMEs

Starting and operating a SME certainly is appealing, which is why so many
people dream of doing it. Many entrepreneurs are driven by the desire to be
their own boss, do what they want to do and turn passions into profit-making
businesses. While many people are successful in their business ventures, many
others unfortunately experience failure. In fact, of every ten SMEs started, about
seven go out of business within five years after opening their doors. The financial
risks of running a SME are very high, although some businesses are more risky
than others.
In addition to psychological and financial pressures, SME owners tend to be victims of physical stress. Often, they must not only be the owner but also the accountant, marketing manager, sales representative, stock clerk and receptionist. The hours can be long and vacations are rare. SME owners also face major challenges as they attempt to juggle home and work responsibilities.

However, thousands of people each year balance the risks and potential rewards and decide to become a business owner.

**Success of SMEs**

All SME owners start off optimistically, believing that their business venture will lead to financial success and security. They will probably have read a few of the many books that have been written about being successful in small business. These books often highlight five common ‘keys’ to SME success (see figure 10.7).

1. **Entrepreneurial abilities.** The people in SMEs are crucial to the success of the enterprise. Attitudes and personalities of owners will vary enormously. Some will have drive and enthusiasm, many will set targets, and some will take big risks. Some will thrive on the challenge of a potential failure, enjoying the process of solving the problem. The majority will be highly motivated and optimistic, as outlined in the Snapshot over the page.

2. **Access to information.** It is always difficult for a SME owner to choose relevant information and to gauge the quantity of information needed. As a bare minimum, the SME operator must have information regarding profitability, the quality of products and services, and the performance of employees. Accurate and up-to-date information will allow the SME owner to make better decisions.

**BizFACT**

Many capable people’s success or failure is not owing to their business idea but rather to how they manage their business once they start.

**BizFACT**

A common characteristic among the majority of small business owners is their optimism and initial hope for success.
3. **Flexibility.** The small size of the business allows the owner to adapt quickly to changes in the external environment. Because there are fewer levels of management, decisions can be made quickly. In addition, the close contact between owners and their customers allows the establishment of personal relationships, helping owners to respond quickly to clients’ changing tastes and preferences (see the following Snapshot).

4. **Focus on market niche.** Small businesses can concentrate their efforts on a few key customers or a specific segment of the market. This provides the opportunity for the SME to become more specialised and able to deliver a high level of service.

5. **Reputation.** Because the SME is servicing a narrow market niche, it can develop enviable reputations for quality and service.

---

**Alex Gillan — Stonker Boards**

‘The Stonker competition team gives me feedback — shorter, wider, more flexible — while I lead the construction. We are always trying new materials, new chemicals and new construction techniques. Work comes first. Then we go surfing,’ says Alex Gillan. Alex founded Stonker, an Australian manufacturer of kite boards and surfboards, in 1998.

Alex produced a board on his own in a garage in Port Melbourne, using the skills he already had in making surfboards. He made another one for a friend and put a website together. Then Stonker received an order from a French distributor for 50 boards. Alex was not in a position to match the order — he had managed to make fewer than 10 boards at that point.

He initially hoped to outsource the manufacture of boards locally. But the quality of the product locally was substandard, so he found a large Thai manufacturer who sold boards to retailers in the United States and Europe. Because Stonker was a small business, the orders did not receive a high priority and there was little opportunity to negotiate on price. The result was long lead times on orders, which created cash flow problems. The business was losing money.

After evaluating the performance of Stonker, Alex decided to produce his boards in Torquay. This became a sea change for him and his family. The decision to move enabled Alex to extend the Stonker brand. Stonker now has a retail shop (with a factory behind it) selling handmade boards, imported kite accessories and its own label of locally made and imported clothing and accessories.

Today, Stonker earns annual revenue of over $500,000, selling hundreds of boards (at about $750 each) and kites ($1000 to $2000) a year through local surf shops. Stonker employs four people and exports represent 50 per cent of sales. In the beginning, kite boarding was a new sport. Stonker now has many competitors, mostly from overseas. He must constantly evaluate the business’s performance and be innovative to remain competitive.

Alex believes that it is vital to keep up with the latest trends in graphic designs and board shapes. He takes careful note of customer tastes. Stonker put together a team-rider program that helps young people take part in kite boarder competitions. Alex is also planning to launch an online store, which will help Stonker achieve significant growth in the future.

**Snapshot questions**

1. **Outline** the challenges faced by Alex Gillan’s business.
2. **Identify** the personal qualities of Alex Gillan that help make his business a success.
3. **Explain** the meaning of the statement: ‘He must be constantly evaluating the business’s performance and being innovative to remain competitive.’
Failure of SMEs

Sometimes enthusiasm and optimism cloud the owner’s vision of reality and poor decisions are made. In the real world, success can be hard to achieve. Unfortunately, many SMEs end in failure. Although we do not want to dwell on the negative, it is important to acknowledge the experiences of many SME owners.

In a sense, it is perhaps too easy to establish a business: there are no interviews, no tests to pass and no previous experience required. All that is necessary is a payment of $152 to register a business name and even this is not required if the business owners trade under their own name. It is not surprising then that many businesses end in failure.

A SME is classified as a failure when it is:
(a) unincorporated and declared bankrupt — a legal process of distributing among the creditors the property of a business or person who cannot or will not pay their debts
(b) incorporated and either forced into liquidation or voluntarily closes down because it cannot pay its debts and faces a cash flow problem.

SMEs failure rates

Accurate figures are hard to obtain because not all business failures are reported. However, statistics collected by the Australian Bureau of Statistics point to an alarming trend: one in four businesses will fail within the first year of being established. This means that approximately 80 000 Australian small businesses fail each year — roughly 219 per day.

Table 10.1 shows the SME failure rates, which are calculated from various government surveys.

<table>
<thead>
<tr>
<th>Period from commencement</th>
<th>Cumulative total of approximate failure rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>After 1 year</td>
<td>25</td>
</tr>
<tr>
<td>2 years</td>
<td>42</td>
</tr>
<tr>
<td>3 years</td>
<td>54</td>
</tr>
<tr>
<td>4 years</td>
<td>64</td>
</tr>
<tr>
<td>5 years</td>
<td>71</td>
</tr>
</tbody>
</table>

Within the first five years of commencement, approximately seven out of every ten SMEs will fail. Female-owned businesses have a higher survival rate than those operated by men, and businesses jointly operated by both men and women have the highest survival rate of all. The figures in table 10.1 tell a sobering story for anyone contemplating establishing a SME: the chances of failure are high. Therefore, it is absolutely essential to undertake thorough planning so as to minimise the risk of business failure.

BizFACT

If a business owner decides to cease operating because of ill health, the loss of a partner or any other personal reason not associated with financial problems, then the business is not described as a ‘failure’.

Careful planning helps to minimise small business failure: ‘Small businesses don’t plan to fail, they fail to plan.’
Reasons for SME failure

Small to medium enterprises fail for many reasons (see figure 10.8). Small to medium enterprise failure is not usually caused by one single factor but rather a combination of several factors:

- failure to plan
- lack of information
- leadership crisis
- inaccurate record keeping
- failure to delegate
- complacency
- incorrect marketing strategy
- poor location
- lack of financial planning
- negative cash flow
- new competitors
- illness
- supplier problems

- poor use of external support services
- economic downturn
- new taxes
- change in government policy
- insufficient capital
- partnership problems
- lack of management experience
- incorrect pricing policy
- failure to seek advice
- not enough sales
- staff difficulties
- being under-insured.

FIGURE 10.8 Many SMEs have a short life.

Many SMEs start out on a ‘shoestring’ budget. Without sufficient capital — undercapitalisation — the business will not be able to purchase stock and materials. This inevitably results in lost sales. A business in this position faces disaster unless alternative finance can be arranged.

When a prospective SME operator fails to develop a business plan, the stage is set for imminent failure. Without a detailed business plan, the SME owner has no certain goals or directions; there is no blueprint for the business’s future growth.

The most common fault with many SMEs is their lack of adequate financial reporting and evaluation.

Summary

- While many people are successful in their business ventures, many others unfortunately experience failure.
The five common ‘keys’ to SME success are:
- flexibility
- reputation
- focus on market niche
- entrepreneurial abilities
- access to information.

A SME has failed when it is:
- unincorporated and declared bankrupt
- incorporated and either forced into liquidation or voluntary cessation.

SMEs have a high failure rate.

The most common causes of SME failure are managerial inexperience and incompetence, undercapitalisation, and lack of planning.

10.6 Future prospects of SMEs

What are the emerging growth areas for SMEs? Perhaps the most noticeable recent trend, and one that has the potential to revolutionise the small business sector, is the expansion of high technology. **High technology (hi-tech)** is a broad term used to describe new and innovative types of businesses that depend on advanced scientific and engineering knowledge. The prediction is that people with these specialised skills, who are also innovative and able to identify new market niches, will become a major segment of the SME sector.

The service sector is another growth area for small business. A survey conducted by *My Business* magazine concluded that successful businesses will be those whose ‘business owners are prepared to cater their services to the individual and make them as personally appealing as possible’. The survey identified the following four areas as likely to present future opportunities for those who are able to meet market expectations.

**BizWORD**

*High technology (hi-tech)* is a broad term used to describe new and innovative types of businesses that depend on advanced scientific and engineering knowledge.
Aged services
With the ageing of the population, there will be an increase in the demand for specialised services to cater for this group. Such services as home-delivered meals, house cleaning, garden maintenance and healthcare will be among those in most demand.

Small office home office (SOHO)
With the number of ‘small office home office’ (SOHO) or micro businesses rapidly expanding, services to support these businesses are destined to escalate. Currently these micro businesses, run by one or at the most two entrepreneurial people, make up 90 per cent of SMEs in Australia. Businesses that can provide support services, such as accounting, personal computers, telecommunication facilities and office equipment, will find a ready market.

Franchising
Franchising has become a popular form of operation, and Ernst and Young Entrepreneurial Services, based in Melbourne, believes franchising is ‘the key ongoing trend’. With busier lifestyles and time often at a premium, Ernst and Young predicts that the demands for gardening, catering, car and home maintenance, and house cleaning will rapidly increase. Franchising lends itself to these business areas and, with franchises presently increasing at a rate of 14 per cent per year, the industry should provide many business opportunities in the future.

Outsourcing
A trend rapidly gaining support throughout the corporate world and government establishments is outsourcing; that is, the contracting out of part of a business’s operations. Examples include graphic art, design, publicity, business documentation and other tasks that are not normally part of the organisation’s core business activities. Often the successful contractors are SMEs that have either an operating or overhead cost advantage. The future holds many opportunities for SME initiatives.

Summary
• Future growth areas for SMEs include:
  – aged services
  – small office home office (SOHO)
  – franchising
  – outsourcing.

Revision
1 Explain how a SME owner can maximise his or her chances of success by using the five ‘keys’ of business success (page 333).
2 Recall what needs to occur for a SME to be classified as a business failure.
3 Account for the high failure rate of small businesses in the first few years of operation.
4 Outline the two main reasons for small business failure.
5 Answer the following questions by identifying and then writing out the answer that you feel is most appropriate when considering the possible effects of small business failure. Share your answers with the rest of the class and discuss any differences.
   (a) Effect on the owners
      (i) Because most people who go into business know what they are letting themselves in for, there will be no adverse effects on the owners.
      (ii) There could possibly be some physical effects on the owners.

BizFACT
Australia is the most franchised nation per head of population in the world.
(b) Effects on staff
   (i) Most employees do not mind being retrenched.
   (ii) Being retrenched is never easy to accept and there is usually a certain amount of stress associated with finding new employment.

(c) Effects on creditors
   (i) The high number of SME failures is bound to cause financial hardship to creditors.
   (ii) Most creditors are large companies and can therefore afford for small businesses to go bankrupt without it being too much of a financial drain on them.

(d) Effects on consumers
   (i) When a SME fails, consumers are not inconvenienced at all because there are others to choose from.
   (ii) Often customers find themselves not only inconvenienced by SME failures but also feel left out in the cold when they attempt to receive some type of compensation for their loss.

6  (a) Refer to the list of reasons for SME failure on page 336. Prepare a table and classify each reason using the categories ‘internal business environment’ or ‘external business environment.’
   (b) Deduce what this table reveals about the reasons for SME failure.

7  ‘A business without a plan is doomed to fail’. Justify this statement.

8  Assume you have been employed by a newspaper to write an article on future growth areas for small business. Construct a mock newspaper page and include your article using an appropriate headline.

9  Use the Franchise Council of Australia weblink in your eBookPLUS and evaluate the information the Franchise Council’s site provides regarding buying a franchise.

Extension

1  In small groups, create a list of success strategies for SMEs.

2  Most people who start a SME know of the high failure rate and the reasons for it. Explain why they do not take steps to protect their business from failure. Recommend the steps they should take.

3  In small groups, create a list of the advantages and disadvantages of operating a home-based business. Share your list with other class members.

4  Assume the minister for small business establishes a committee to develop a poster highlighting the rules for success in small business. Create your poster and display it in the classroom.
11.1 Introduction

The thousands of SMEs in Australia today are owned and operated by all types of people. These businesses all had a beginning; they all had a person or small group of people who decided to ‘have a go’. When establishing their businesses, they needed to consider a range of influences that combine to determine the level of success achieved.

11.2 Personal qualities

All types of people own and operate the thousands of businesses in Australia today. Not everyone, however, is suited to the role of business owner as certain skills and personal qualities are required to succeed.

Starting a new business requires courage, determination and energy, and it demands a wide range of skills. It is important for people to recognise their strengths and weaknesses, decide if they have the right personal characteristics to be a business owner, and learn the skills they don’t presently have. It is best for business owners to select a business opportunity that suits their personality and builds on their strengths. If people have an honest understanding of their own personal qualities, then failure can be minimised: the ‘square peg in a round hole’ problem can be avoided.

There is no simple checklist of skills and personal characteristics that will guarantee business success. However, many studies have shown that certain personal characteristics are helpful in operating a business, and that the potential business owner should be prepared to honestly answer the questions asked in figure 11.1.

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>1</td>
<td>Am I self-motivated?</td>
</tr>
<tr>
<td>2</td>
<td>Do I have a desire to succeed?</td>
</tr>
<tr>
<td>3</td>
<td>Can I start and follow through long-term projects?</td>
</tr>
<tr>
<td>4</td>
<td>Do I have leadership qualities to assist in managing others?</td>
</tr>
<tr>
<td>5</td>
<td>Do I have sufficient organisational and administrative skills?</td>
</tr>
<tr>
<td>6</td>
<td>Am I self-disciplined?</td>
</tr>
<tr>
<td>7</td>
<td>Can I motivate others?</td>
</tr>
<tr>
<td>8</td>
<td>Am I willing to take managed risks?</td>
</tr>
<tr>
<td>9</td>
<td>Do I have the ability and willingness to learn new skills?</td>
</tr>
<tr>
<td>10</td>
<td>Am I able to listen to others’ advice?</td>
</tr>
<tr>
<td>11</td>
<td>Can I communicate my ideas to others?</td>
</tr>
<tr>
<td>12</td>
<td>Am I prepared to work long hours?</td>
</tr>
<tr>
<td>13</td>
<td>Am I prepared to receive lower financial returns in the early years than I would if I worked for someone else?</td>
</tr>
<tr>
<td>14</td>
<td>Do I understand the need for a business plan?</td>
</tr>
</tbody>
</table>

**FIGURE 11.1** Some questions to ask oneself to assess your entrepreneurial ability
Qualifications

Hundreds of thousands of people start a new business every year. Would you like to be one of them? You do not have to be an exceptional champion of legendary dimensions. Mainly, those who decide to ‘give it a go’ are ordinary people rather than sensational opportunists who desire adventure. Many start out with only a small amount of money, operating informally from home, at least in the beginning while they are getting established.

Exceptional grades and a dazzling history in business are not essential. What does appear to be important is the eagerness to work long hours. Recent research revealed that about 75 per cent of people who started their own SME spent at least 50 hours a week in the business; 25 per cent of them put in 65 hours or more.

Starting a SME knows no age limits. From the very young to the very old, people are starting new businesses at a rapid rate. Particularly encouraging is the large number of young people aged between 20 and 25 who are operating a SME. Older people are also involved in starting new SMEs; this type of business offers the most opportunities and flexibility to retirees.

For some types of SMEs, there are few or no formal academic requirements needed to commence operating. However, for those who want to gain academic qualifications in small business, there are many tertiary courses available. The Business Studies course you are studying is of enormous value should you decide to become a SME owner. Such courses give you knowledge and understanding of what is required to successfully own and operate a SME. Knowledge and understanding can also come from experience through working for other businesses. Your part-time job, for example, is providing you with experience in a business’s day-to-day operations, how to manage your time and other people, purchasing and pricing decisions, and a variety of other business functions.

SME owners are a varied group. It is extremely difficult to categorise them or the qualifications they possess that make their business a success. As well, a variety of personal factors encourage individuals to go into business. However, two factors that are often mentioned are motivation and the ‘entrepreneurial spirit’. They combine to form a powerful desire to create a new business.
Skills

Luck has little to do with business success. Skills are essential. These skills can be attained through experience, education and/or training.

Experience

If a person has been working the last few years as a dedicated employee, then during that time, they will have gained valuable experience. They probably also developed new skills as a result of training or exposure to various aspects of the business’s operations. Consequently, apart from well-developed management skills, a person with hands-on experience will have a greater chance of achieving business success.

The best time for a person to gain management experience is before establishing the business. This can be done by either completing a management training course or by undertaking a management role within a business. The best way a person can gain business experience is to work in the type of business in which he or she intends to become self-employed.

These experiences provide a platform from which to work. The experienced person will understand and be realistic about the demands, both financial and personal, that a business will place on them. Figure 11.3 outlines possible experiences, from working in other businesses, that could help someone establish their own business.

Education and/or training

Education and/or training is another way to gain skills. Universities, TAFE and business colleges offer courses in many business and industry fields. These courses may be broad in nature, such as a degree in business management, or specific, such as a degree or diploma in marketing, human resource management, computing or accounting. TAFE and business colleges also offer vocational courses and courses for establishing a SME. The main problem is that some courses are expensive and take years to complete. For this reason they are not always an option, especially for small business owners who may wish to gain the knowledge quickly.

Some government agencies provide opportunities to learn about starting a business. The Business Enterprise Centres in New South Wales are an example. The centres are run by business facilitators who have experience in establishing and operating a business. They offer a range of services, such as a business start-up kit that gives an overview of the requirements and regulations involved in starting a business, and of how to write a business plan.

**FIGURE 11.3** An individual’s range of experiences
All of these avenues for education allow the business owner to develop the essential skills necessary for establishing a business. These skills may include:

- accounting
- computer skills
- staff management
- business administration, including inventory control and rosters
- marketing.

**Motivation**

Motivation refers to your personal drive, determination and desire to achieve a goal or objective. The desire to be your own boss is a major reason for wanting to start your own business. Many people start on their own because they believe they can do better for themselves than if they remain with their present employer. Often they desire the freedom to choose when and where they work, with whom they work and whether to work from home. The underlying attraction is the desire to transform an idea into a successful product by capturing the attention of potential customers (see the following Snapshot).

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**Rachel Chippendale — Ruby’s Closet**

Ruby’s Closet is home to an amazing collection of uber-chic products created by designer Rachel Chippendale.

**How do you describe your business?**

My business is a combination of working with the things I love and the things I have skilled expertise about.

My launch product is a patent pending and registered design jewellery storage device that solves all problems people have complained about when storing their fashion jewellery. It’s unique, can be hung on the back of a door or in a wardrobe, keeps jewellery separated, easily accessible, and free from tangles and tarnish. I aim to have an online store that sells the most unique jewellery, accessories and gifts from all around the world.

**Did you always want to run your own business?**

Yes, I started ‘Trendy and Co.’ when I was seven years old, going door to door around the neighbourhood selling scrunchies and headbands that I sewed myself — I think I made a dollar here and there!

**How did the idea come about and what inspired you to get into action?**

When I returned from overseas, I came back with the most amazing samples of boots, jackets, jewellery and the like. But I knew the industry was very competitive and that I needed to differentiate myself first by inventing unique base products to develop my brand. I constantly noticed jewellery storage was a real problem for so many people — a lot of research, sketches, an engineer and prototypes later, my jewellery hanger is a reality.

**What are some of the things you enjoy most about running your own business?**

I love the challenges every day presents, seeing an idea come to life, receiving feedback from customers who love the product and the freedom. I am a country girl at heart, but I love to travel and want to live back in a capital city. So, having an online business that can be operated remotely gives me the freedom to do all these things and continue to source amazing products abroad. I also love the fact that you get out what you put in — rewards are only capped by your own efforts.

**What's the biggest challenge you've had to overcome to make your ideas a reality?**

Finding a reliable manufacturer that could bring my idea to life with the highest quality I envisaged, as well as marketing with limited start-up capital. It is incredibly frustrating having a great product that customers rave over and yet not being able to reach enough people to tell them about it yet.

(continued)
What advice can you share with other people trying to start a business?

Be prepared to work very hard and make sacrifices, believe in yourself and have a contingency plan for absolutely everything. Finding a market before you develop a product or service is a great idea. I found a problem and developed the solution, and solutions to problems are good business! Never give up — I have always been a firm believer that if you work hard and smart, and want something enough, eventually it will happen. But it takes time and determination. Most of all never lose sight of the big picture — success in life is not measured in dollar signs. You will only be good at what you do if you are happy with what you are doing.


**Snapshot questions**

1. Using the article, identify the characteristics shown by Rachel Chippendale that would categorise her as an entrepreneur.
2. Explain what protection Rachel receives by patenting her jewellery storage device.
3. Deduce why Rachel needed to undertake ‘a lot of research, sketches, an engineer and prototypes’ in the development of her product.
4. Recall some of the things Rachel enjoys most about running her own business.
5. Outline the benefits for Rachel of operating an online business.
6. Propose two strategies Rachel could use to overcome her main business challenges.
7. Summarise Rachel’s advice to people trying to start a business.
8. Determine why you think Rachel has been a success in business.

Most business owners are motivated by the rewards they believe can be gained from establishing a business, including both monetary and non-monetary rewards (see figure 11.4).
Entrepreneurship

As was outlined in chapter 1, an entrepreneur is someone who starts, operates and assumes the risk of a business venture in the hope of making a profit. The term can apply to any person — male or female, mature age or young — willing to establish a business in a bid for success. Not all entrepreneurs begin by setting up a business premises. An increasing number of people work from home, especially as computers have allowed greater access and communication with business markets. Entrepreneurship is not just an avenue to wealth, but a way of making a living and achieving job satisfaction.

Society is constantly changing and thus creating new opportunities for innovative products and services to be developed. The entrepreneur must have a range of personal characteristics that enable them to take advantage of, and be successful with, these opportunities (see figure 11.5).

First, entrepreneurs must be prepared to take a risk and incur the results of this risk, whether it is a success or a failure. They must be confident in decision making and willing to accept all responsibility for their decisions. Sometimes a decision requires ‘guts and determination’ and such times often lead to success. The entrepreneur must always have a will to succeed: they may not achieve the desired goal with the first venture, so they need drive, determination and an ability to recover from poor decisions or mistakes.

Flair and creativity are also essential for an entrepreneur. They allow the entrepreneur to create or seize new opportunities for business, new niche markets or new products and/or services. Success can sometimes depend on finding a new and more innovative way to sell a good or service. Rachel Chippendale — Ruby’s Closet, pages 343–4 — is an example of an entrepreneur who successfully developed a niche market. Finally, the most important quality for an entrepreneur is the ability to set goals and have a vision for the business’s future. Having achieved their goals, they must set new goals — continually adjusting to changing business, economic and customer markets (see the following Snapshot).

![General personal characteristics of a typical entrepreneur](https://example.com/characteristics.png)

**FIGURE 11.5** General personal characteristics of a typical entrepreneur

**Weblink**

Use the Young Entrepreneurs weblink in your eBookPLUS to explore the website of the Frank Team’s Young Entrepreneurs Network.
Yuan Wong — entrepreneur

At age 15, Yuan Wong was already turning a profit. In his spare time he designed brochures and posters for local rock bands and concert events. After completing his High School Certificate, Yuan’s creativity was rewarded when he won a scholarship to undertake a Graphic Design course at the local TAFE. Today, Yuan operates on a much larger scale.

Yuan is the driving force behind Eclipse Publishing & Design, a graphic design business specialising in advertising, brochures, digital photography, logos, publication design and stationery. Yuan started the business in 2005, and at the time he had no idea it would eventually employ 15 people and have 18 overseas clients. ‘The business is successful because we offer a diverse range of unique designs not available from many other graphic design businesses.’

In the beginning, cash flow was tight and Yuan had little experience in operating a business. However, he was highly motivated and keen to learn. ‘Creating an idea in my head and then seeing it actually appear out there in the world, that’s huge to me,’ Yuan says. ‘I get enormous satisfaction from creating products that delight my clients.’

‘If you want to go into business, then you have to realise there will be good days and bad days,’ he says. ‘I understood there would be risks but good entrepreneurs should take only moderate risks, which is what I did.’ In addition to Yuan’s self-confidence is his ability to identify business opportunities when they arise. ‘If I become aware of an opportunity that will be profitable and help grow the business, it is my responsibility to act. That’s the life of an entrepreneur.’

Yuan realised early on that the venture’s success would mainly depend on his level of business knowledge. Consequently, while completing his graphic design course, Yuan also completed some business management courses run by the local Business Enterprise Centre. ‘During this time I met with people in the graphic design industry and talked to potential clients. I knew that commencing a business would require hard work and long hours, but I was totally committed to the idea. I was determined to succeed. Ultimately, it comes down to self-belief. If you want it to work, you’ve got to believe it will.’

Yuan is now 29 years old. His venture into the business world has been financially and personally rewarding. He says, ‘Successful entrepreneurs are passionate about what they do and where they want to go’.

Snapshot questions
1. Identify the entrepreneurial characteristics exhibited by Yuan Wong.
2. Recall how Yuan differentiates his product from the competition.
4. Are you surprised that an entrepreneur should take only moderate rather than high risks? Explain why you think this might be the case.
5. ‘If I become aware of an opportunity that will be profitable and help grow the business, it is my responsibility to act. That’s the life of an entrepreneur.’ Evaluate the accuracy of this statement.

The benefits of entrepreneurship

A sense of freedom and independence are perhaps the best things about being a business owner. Often, a person will desire the freedom to choose when and where they work, with whom they work, and whether to work from home. The great attraction is the belief that owners will have more control over their own destiny.

Someone willing to work hard may believe that they can earn much more by working for themselves than they would by working for someone else. They would expect their extra effort to be rewarded through the profits from their own business.
These rewards may not come immediately — even the most successful businesses may lose money in their early start-up phase — but the hope is that eventually the business owner will earn more from being self-employed.

People who work for themselves also experience the satisfaction of guiding the business's growth. They enjoy the challenge of overcoming obstacles, setting and meeting new targets, and gaining a larger customer base. Whist it can sometimes be a hectic existence, most entrepreneurs seldom complain that running their own business is routine and boring. Ultimately, they take pride in having made it on their own.

The burdens of entrepreneurship

Small to medium enterprise owners must accept the responsibilities of entrepreneurship. Being in business requires a person’s full attention. The work hours for a business owner will invariably be longer than an employee’s work hours. As well, self-employed people find it difficult to leave their problems at work; they constantly ‘live and breathe’ the business’s problems. The anticipated freedom and flexibility may be illusive.

Even if the business succeeds, the owner still might have little money to spend apart from the salary the owner pays him or herself. Instead, the owner might have to reinvest the profits to generate long-term growth. Alternatively, there might be short-term accounts needing to be paid with cash. In some cases, the owner may not even be able to draw a salary until the business becomes more established. As one entrepreneur claims: ‘The commitment you have to make is enormous; entrepreneurs usually put everything on the line.’

Cultural background

A person’s cultural background can influence their reasons for establishing a business (see the following Snapshot). Cultural influence can arise from a community’s traditions and beliefs, such as the ‘work ethic’ — the willingness to work long and hard in an effort to be successful — which is strong in many European and Asian cultures. Many migrants come to Australia with few resources except a strong desire to improve their lives. Their determination often translates into business success. Cultural influence can also arise from centuries of experience in certain trades or services, enabling a person to use this knowledge to achieve business success. A person from a Thai cultural background, for example, may be able to succeed in a restaurant business that aims to provide quality, specialist Thai food.

Kath Fry and Eisha Saleh — The inspiration behind ‘baraka women’

After both Kath Fry and Eisha Saleh experienced the challenge of finding modest yet stylish clothing for women, the ‘baraka women’ decided to solve the fashion gap themselves. ‘Baraka’ translates to ‘blessing’ in Arabic.

Kath Fry and Eisha Saleh have a fledgling business designing and manufacturing modest clothes for stylish women. Although it’s currently a small business, there are big plans for the future. From a home base in Sydney’s Chester Hill, the duo aim to take the baraka brand global.

At present they sell through their website, at parades and through a number of boutiques. ‘We’re getting interest in our clothes from overseas,’ says Kath, ‘and are laying the foundation for sales in the US, Dubai, Saudi Arabia and especially the EU, which we see as a good market.’

(continued)
However, for Kath and Eisha, who met when Kath was studying to convert to Islam, it’s not just about sales. ‘We want to empower women through producing beautiful clothes for them to wear and also put money into charitable projects that support women. Five per cent of what baraka makes goes to charity.’ These charity projects promote the advancement of women through donations, upskilling and mentoring.

Clearly theirs is a different business path to most.

Another of their passions is having all their clothes made in Australia at a time when off-shore manufacturing is the norm. Kath says their customers are happy to pay for Australian-made quality.

Baraka received support from Industry & Investment NSW in the establishment phase. Kath and Eisha are now taking advantage of the opportunities provided by Industry & Investment NSW’s export programs.

Snapshot questions
1. Outline what motivated Kath Fry and Eisha Saleh to commence their business.
2. Recall the countries Kath and Eisha want to sell to.
3. Explain why having all their clothes made in Australia is a smart business strategy.
4. Use the baraka women weblink in your eBookPLUS to find out more about the charity projects sponsored by this business. Explain why ‘baraka women’ would want to assist such projects.

Gender

Governments of developed economies are realising that employment growth will not come from established large businesses but from the creation or expansion of the small business sector. Policies are being created specifically to assist small business in contributing to the national economy. In response to these policies, and to a general change in social attitudes, many women are setting up their own businesses (in particular in self-employment) at three times the rate of men (see the following Snapshot).

Trudy Croad — Events by Design

It takes courage, determination, persistence, self-confidence and a high level of motivation to achieve success with any business venture — qualities that Trudy Croad possesses. And at the heart of any successful enterprise will be the business plan.

‘I looked at the existing competitors and their activity, unique selling points, relationships within the industry, marketing techniques, and used this to create an exclusive offering with a unique look and feel,’ Trudy Croad says.

Croad decided to enter the wedding industry after working in events most of her life, including as the marketing director of Australia’s leading bridal magazine Bride to Be. Her sister’s wedding provided the inspiration to set up her company, Events by Design, which offers brides-to-be wedding planning, styling and fashion advice. But her experience in the market really drove her business plan.

She completed extensive market research prior to launching. However, she believes that her prior experience in creating annual business and marketing plans for new and established businesses has led to her success.
Croad started with an outlay of $20,000 and established a virtual office in Noosa. Her vision now involves the expansion of her business into key destinations including Noosa, Sydney and the Gold Coast. She recently diversified her business into reception décor as well as launching an Events by Design signature range, which has doubled her annual revenue.

**Snapshot questions**

1. Identify the personal qualities Trudy Croad possesses that equip her to be a SME owner.
2. Explain the importance of Trudy’s experience in determining the business’s success.
3. Clarify how Events by Design benefits from diversification.

“I looked at the existing competitors and their activity . . . and used this to create an exclusive offering with a unique look and feel.”

Research undertaken by both federal and state government departments has highlighted the following points regarding women in business:

1. Women own approximately one-third of all small businesses operating in Australia.
2. Over the past decade, there has been a rapid growth in the number of women who chose to be self-employed, growing by a rapid 33 per cent.
3. The major industries in which women own businesses are service oriented.
4. Women own almost half of all home-based businesses.
5. Women setting up businesses from home is the fastest growing sector of the Australian economy.
6. Women-owned businesses have less external debt, are more profitable and are profitable much earlier than those owned by men.
7. Women starting their own business generally:
   - are aged 26–45 years
   - have sole financial responsibility for the business
   - acquired skills used in their business from previous work experience
   - borrow very little money.
8. The main reasons for women establishing a business include the following:
   - desire to be their own boss
   - wanting greater flexibility in terms of family needs
   - personal challenge
   - an avenue to utilise their skills and talents
   - wanting to achieve financial security
   - experience of restrictions in terms of promotion within a previous career.

**FIGURE 11.6** The Women’s Network Australia is the nation’s leading networking organisation for women offering business information, online services, business education and networking events.
Summary

• Personal qualities, motivation, experience and entrepreneurship are the primary influences on an individual’s decision to establish a business.
• Business qualifications and skills can be attained through experience, education and/or training.
• These factors will affect planning decisions on issues such as the type and size of business, the business location, and the individual’s own role.
• An entrepreneur is someone who starts, operates and assumes the risk of a business venture in the hope of making a profit.
• An entrepreneur must have a range of skills and characteristics to own and operate a business successfully.
• There are other influences at work, including cultural background and gender.

Revision

1 Assess your own entrepreneurial ability by completing the questions shown in figure 11.1 on page 340. Someone with an entrepreneurial personality would answer ‘yes’ to most of the questions. Write a self-evaluation report based on your answer.
2 Choose a business you would like to own. Outline the personal qualities you think are needed to be successful in this business. Share your response with a classmate and discuss the main differences in your answers.
3 Divide a page into three columns as shown. In the first column, identify the skills that you presently possess and could bring to a small business. In the second column, identify other skills that you would need to develop. In the third column, outline how you would go about obtaining these new skills.

<table>
<thead>
<tr>
<th>Skills I presently possess</th>
<th>Skills I would need to develop</th>
<th>How I would obtain these new skills</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>

4 Refer to figure 11.4 on page 344 and classify the possible rewards of business ownership into monetary or non-monetary benefits. Interpret the results.
5 Describe the main characteristics of an entrepreneur.
6 Select the characteristic you regard as the most important and justify your choice.
7 Outline why an entrepreneur should continually set new goals.
8 Prepare a ‘T’ table format to summarise the benefits and burdens of entrepreneurship. The ‘T’ table has been started for you.

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Burdens</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sense of freedom and independence.</td>
<td></td>
</tr>
</tbody>
</table>

9 Determine which you consider to be more persuasive: the benefits or the burdens. Give reasons for your answer. Share your response with the rest of the class.
10 Propose what you consider to be the main reasons for women starting their own businesses.
11 In small groups, brainstorm the problems women face when they attempt to establish and operate a SME. Outline your problems to the rest of the class.
12 Using the Enterprise Network for Young Australians (ENYA) weblink in your eBookPLUS answer the following questions.
(a) Outline the role of ENYA.
(b) Identify the specific assistance ENYA offers potential entrepreneurs.

13 Use the Women’s Network Australia weblink in your eBookPLUS to select and read two stories of WomenPreneurs — ordinary women achieving extraordinary success. Compare the main factors that made each business a success.

Extension

1 ‘The entrepreneur has an important role in the Australian economy’. Assess the accuracy of this statement.

2 Investigate how the role of women in business changed over the past decade. Predict the importance of this role in the future.

3 Create a rap song explaining the meaning of ‘entrepreneur’ and describing the qualities needed to be a successful SME owner.

4 Write out the 14 questions asked in figure 11.1 (page 340) in order of importance, from most important to least important. Compare your list with the rest of the class, and be prepared to justify your rankings.

11.3 Sources of information

SME owners cannot be experts in all areas of their business. Further, they do not normally have the funds to employ a specialist or consultant to assist with management. They thus need to possess a variety of skills, including marketing, personnel, finance, administration and public relations skills. Obviously, this multifaceted role is not an easy task. However, the SME owner can receive assistance from a large number of government and private support agencies, examples of which are shown in figure 11.7.

![Sources of Advice](image-url)
Professional advisers

It is important for the business owner to have a good relationship with an accountant, solicitor and bank manager, and to keep in touch with them on a regular basis. Management consultants can also be used, especially when restructuring the business or changing its core business activity.

Business owners tend to be totally immersed in the day-to-day operations of their businesses, so they find it difficult to remain objective. However, the professional adviser is able to examine the business much more objectively and provide an independent analysis of the organisation. Professional advisers are also more aware of changes within the legal, economic and financial environment. It is advisable for business owners to make use of the information and advice from the following advisers:

1. **Accountants.** Accountants provide valuable advice on all financial management issues and taxation obligations. They have access to the latest changes to taxation and financial reporting requirements.

2. **Solicitors.** Solicitors provide information concerning business formation and structures, registration, contracts, leases, partnership agreements, patents and legislation. Solicitors are up to date with any changes to company law and can advise the small business owner on how best to deal with such changes.

3. **Bank managers.** The bank manager is another valuable contact who can provide information and advice on financial services, sources of finance and basic business management. The bank manager usually has a wide range of experience to draw on and is able to access the resources of the bank.

4. **Management consultants.** If a business management problem arises that the owner cannot deal with, then the advice of a management consultant may be necessary. Coming from outside the business, the consultant is able to be more objective and view problems in an unbiased manner. When outsourcing to management consultants, it is wise to check their credentials and experience.

Government agencies

**State governments**

All state governments have established agencies that provide support and advice to business owners. In New South Wales, the Ministry of State and Regional Development offers a number of programs designed to assist businesses. The main programs are described below.

**NSW Department of State and Regional Development — Small Business**

This New South Wales government department provides the following information and services to business:

- information and advice on starting a new business, buying a business, managing a small business and exporting
- information on current issues affecting business, such as technology and e-commerce
- workplace issues such as enterprise agreements and industrial relations
- other resources for business.

**Business Enterprise Centres (BEC) Australia**

BEC Australia is a not-for-profit network of business enterprise centres that provide support to SME owners. They provide advice on how to establish a business, examples of business plans and methods of identifying business opportunities.
The programs and advice offered by the BEC have special significance for rural-based small businesses because they can be easily accessed at offices in all the main regional centres of New South Wales.

**Federal government**

The federal government operates a website, www.business.gov.au, as a service to businesses of all sizes, offering access to all government departments, with advice on everything from fair trading to taxation. The Department of Innovation, Industry, Science and Research, through its program delivery division AusIndustry, provides specific advice on issues such as exporting overseas, research and development of new products, and grants and venture capital assistance.

![FIGURE 11.9](image)

The federal government website, business.gov.au, is a useful resource for someone establishing, managing or growing a business.

**Technological advice**

Establishing an online business presence, networking a number of computers within the business premises, or making maximum use of mobile devices can all improve business efficiency. Purchasing equipment from a dealer who offers advice and backup support, or establishing a relationship with an ICT consultant, is another important decision to be made by the prospective business owner. As a technological support service for small business, the federal government has established the *e-business guide*. This service provides free practical advice on how best to take advantage of the internet.

![FIGURE 11.10](image)

The *e-business guide* is designed for small business owners and staff. Its website is www.e-businessguide.gov.au.
Local government
This level of government is becoming more involved in encouraging business because it creates employment. Local councils offer advice on land zoning, assist with subsidised land and consider development applications.

Other sources
Chambers of commerce
Services provided by chambers of commerce include legal and financial help, economic and taxation advice, explanation of legislation, and industrial relations information. The chambers also organise training seminars, arrange industry conferences and liaise with government departments.

Small Business Association of Australia and New Zealand
This lobby group has a membership consisting of thousands of individual small business owners. The association provides a forum for exchanging news and views relating to small business matters. It also organises training days and promotes the role of small business and its importance in the total economy.

Trade associations
Trade associations offer specific industry information and assistance. Examples include:
- Metal Trades Industry Association
- Plastics and Chemicals Industries Association
- Stock Feed Manufacturers Association of New South Wales
- Australian Medical Association.

Each association is made up of organisations that are in the same line of business, so it can provide specific details about product development and industry trends.

Libraries and reference material
Libraries are a valuable source of information because they have access to vast amounts of reference material. Most libraries have online access to large databases with search facilities that help locate specific material. Librarians are highly trained and will undertake a search of the literature available. Most libraries also subscribe to trade and industry journals.

Australian Bureau of Statistics
The Australian Bureau of Statistics provides valuable data on social, economic and demographic trends. It also provides specialised data on business activities. Information useful to business owners can be obtained from the following:
- Census on Population and Housing
- Demographic Trends and Statistics
- Household Expenditure Surveys.

Having access to such information assists the business owner in analysing and understanding changes to the external environment.

11.4 The business idea
As well as determining whether or not they have the motivation and personal qualities to start a business, potential SME owners will have a clear idea of what they wish to sell. Sometimes it is an original idea for a good or service that is quite different from anything already on the market, or a distinct improvement
on something already available. Or it may be a realisation that particular goods or services are unavailable in a particular area. All the businesses in the world must have started from an initial idea and then grown according to their success within the market. Coke, for example, started as a medicinal tonic sold off the back of a travelling wagon. Now, Coca-Cola Amatil is an internationally successful business that dominates the soft drink market throughout the world.

The source of a business idea may come from a person’s own experiences, interests, abilities or imagination. Inspiration for ideas can be generated by:

• listening to people, particularly for ideas on the goods or services people want, but that may not be readily available
• reading magazines and books, and researching on the internet
• visiting displays and exhibitions in areas such as new technology or new products from overseas
• accessing government statistics and research information
• identifying a ‘gap’ in the market — that is, a demand not currently being satisfied
• determining improvements that could be made to an existing product.

The successful identification of a gap in the market is a key to establishing a lucrative business. It means that the new business provides something not already available. Breaking into a market that is already well served means that the new business has to do something exceptional to draw customers away from existing businesses. For example, if a shopping centre currently has three hairdressing salons, would a hairdresser be wise in setting up a fourth salon in the same centre? It is unlikely that a gap in the market exists unless the other three hairdressers are so heavily booked that locals find it difficult to make an appointment.

**Identifying business opportunities**

Identifying a business opportunity is not just about having an idea. An opportunity is something that a person can see as an avenue to success. It is often identified when a person feels they can provide goods or services in a better or different way from that already in the market. There are many ways of identifying an opportunity, for example:

1. Analysing and reviewing particular parts of the market to find an opening for particular goods or services. Sometimes, you can find the best opportunities by seeking those goods or services that larger businesses are unable or unwilling
to provide to their customers. Angela, for example, may want to open a plant nursery, but she is afraid that the larger nurseries will be able to undercut her prices in most products simply because they can buy in bulk. Angela could concentrate on the provision of services — maybe plant delivery services, landscaping, garden consultations, soil testing and more — which the larger nurseries tend to overlook.

2. Identifying whether many other people share a particular interest or hobby. This interest or hobby may become the main catalyst in identifying a business opportunity. An individual is not always driven by the motive to make a profit, but rather by a belief in the product itself. The most important issue is that such interest does not always equal success. There must be a large enough market to sustain sales of the product or service.

Once a business opportunity is identified, a number of areas need further investigation before the business opportunity becomes a reality. The most important of these is a consideration of the competition.

**Considering the competition**

**Competition** is rivalry among businesses that seek to satisfy a market. When identifying a business opportunity, the entrepreneur must decide on the type of market in which their goods or services will compete. This means deciding whether to target the goods or services at a broad market (mass market) or a more specialised market (niche market). Once this decision is made, the business owner is able to identify the level of competition and the main competitors.

The business owner must then decide how to make the business competitive or, more simply, how to develop a customer base or gain a market share from its competitors. Again, the type of market will influence the strategies used by a business. If the product is aimed at a niche market, for example, then there may be no competitors. On the other hand, a mass-market strategy will require extensive planning to create market share. There are two main ways of achieving competitiveness — cost of production and differentiation of the goods or services.

1. Cost will largely depend on production techniques. The business that can produce a good or service at the lowest possible cost and thus sell at the lowest price has the greatest ability to attract market share.
2. Differentiation is about making a product or service different, unique or better than its rivals — for example, selling a computer with extra service, lessons or added software. Competitive advantage is discussed in more detail in chapter 13.

Summary

• A variety of support services exist to provide assistance to a business owner who lacks experience. Some of them are free, and some are in the form of other businesses that charge for their services.
• A business idea describes the core activities of the business, and the specific features and value of the goods or services it provides.
• A business opportunity is something an entrepreneur can see as an avenue to success.
• Opportunities may arise due to either a ‘gap’ in the market, or an interest or hobby.
• Competition is rivalry among businesses that seek to satisfy a market.
• SME owners must decide how to make a business competitive. This can be done by either reducing the costs of production or providing something not already available.

Revision

1. (a) Recall the professional advisers a business owner should have a good relationship with.
   (b) State the information each one provides.
2. Use the business.gov.au weblink in your eBookPLUS to examine the range of information provided by this website.
3. Jamahl wishes to set up a hot bread shop in his local shopping centre. Identify five government agencies or organisations he could approach for support.
4. Use the BEC Australia weblink in your eBookPLUS to answer the following questions about Business Enterprise Centres (BEC) Australia.
   (a) State when and by whom this organisation was set up.
   (b) Summarise how the organisation has developed and grown following its initial establishment.
   (c) BEC Australia is a not-for-profit organisation. Outline how it funds its services.
   (d) Identify the key objectives of BEC Australia.
   (e) Identify five different services offered by BEC Australia, and explain how each operates.
5. There are many ways of coming up with an idea for a business. The following table provides some examples. In small groups, propose one suggestion of your own for each example given.

<table>
<thead>
<tr>
<th>Source of idea</th>
<th>Example</th>
<th>Your suggestion</th>
</tr>
</thead>
<tbody>
<tr>
<td>An inspiration</td>
<td>A self-filling printer cartridge</td>
<td></td>
</tr>
<tr>
<td>Listening to people</td>
<td>A skateboard facility</td>
<td></td>
</tr>
<tr>
<td>Noticing a gap in the market</td>
<td>A home gardening service</td>
<td></td>
</tr>
<tr>
<td>Own interests and abilities</td>
<td>A graphic design consultant</td>
<td></td>
</tr>
<tr>
<td>Improving an existing product</td>
<td>A better video store</td>
<td></td>
</tr>
<tr>
<td>New technology</td>
<td>A mobile HDTV screen</td>
<td></td>
</tr>
<tr>
<td>Developing a hobby</td>
<td>Making ceramic pottery</td>
<td></td>
</tr>
<tr>
<td>Combining two existing ideas</td>
<td>Antiques/coffee shop</td>
<td></td>
</tr>
<tr>
<td>Social trends</td>
<td>Home-cooked, prepared meals</td>
<td></td>
</tr>
<tr>
<td>‘Crazy’ ideas</td>
<td>A musical hair dryer</td>
<td></td>
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</tbody>
</table>
6 Define the term ‘business opportunity’.
7 Summarise two ways of identifying a business opportunity.
8 Choose a business — large, medium or small. Identify its main competitors.
9 Keeping ahead of the competition is essential for long-term business success. Recommend five strategies a café can use to keep ‘on top’ of its competitors.

Extension

1 Arrange for a representative of the local chamber of commerce, or the local traders association, or the local BEC to visit your class. Before the visit, prepare a number of questions to ask the representative on issues relevant to both informal and formal support services provided for local business owners. If possible, video record the session (obtain the visitor’s permission in advance). Create a 500-word report on what you learned from the visit.
2 ‘The business idea is the starting point for any new small business.’ Explain this statement.
3 When commencing a new small business, justify which of the following you think might be the most important.
   (a) the money required to commence the business
   (b) the development of the business idea
   (c) the skills of the people who will operate the business.
4 Choose a good or service you could provide/invent that is (to your knowledge) not already available.
   (a) Clarify why you chose this good/service.
   (b) Predict its chance of success.

11.5 Establishment options

There are two main ways of going into business:
1. setting up a new business from scratch, which may involve buying a franchise
2. purchasing an existing business.

Choosing between the two main options is sometimes quite difficult; each has advantages and disadvantages (see the Snapshot on page 362).

BizFACT
Seventy per cent of all new businesses start from scratch, while 26 per cent are purchasers of existing businesses. The remaining 4 per cent are businesses that have either been inherited from a family member, restarted from a previously failed business, or bought by the employees from the owners.

FIGURE 11.14 Many prospective small business owners find it difficult to select an establishment option. A wrong choice may place the owner in a vulnerable position.
Setting up a new business — starting from scratch

Sometimes conditions are more favourable for starting a new business than for buying an existing operation, for example:

• when a person has created something unique and starts a business to market their innovation or invention
• when a person recognises a gap in the market, where it is clear that customers’ needs are not satisfied by existing businesses
• when the market has grown and existing businesses cannot supply all customers.

If these conditions do not exist, then starting from scratch could be more difficult because existing SMEs will provide considerable competition.

Advantages and disadvantages

Starting from scratch has advantages and disadvantages (see table 11.1).

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The owner has the freedom to set up the business exactly as they wish.</td>
<td>• There is a high risk and a measure of uncertainty. Without a previous business reputation, it may prove difficult to secure finance.</td>
</tr>
<tr>
<td>• The owner is able to determine the pace of growth and change.</td>
<td>• Time is needed to develop a customer base, employ staff and develop lines of credit from suppliers.</td>
</tr>
<tr>
<td>• There is no goodwill for which the owner has to pay.</td>
<td>• If the start-up period is slow, then the business may not generate profits for some time.</td>
</tr>
<tr>
<td>• If funds are limited, it is possible to begin on a smaller scale.</td>
<td></td>
</tr>
</tbody>
</table>

FIGURE 11.15 Anna and Roberto Tonin started their business — Pasta Classica — from scratch to satisfy their passion for creating distinctive products. They maintain their focus on ‘uniqueness, personalised service, product range and quality’.

Buying an existing business

When an existing business is purchased, the business is already operating and everything associated with the business is included in the purchase — for example:

• stock and equipment
• premises
• existing customer base
• staff
• location
• reputation and goodwill.
When purchasing an existing business, it is essential for the potential purchaser to know why the business is for sale. If the business has been struggling, it may not be a very good purchase. It is also important to examine detailed accounts for at least the previous three years to determine the financial health of the business. The true value of goodwill is one aspect of the financial statements that is often hard to estimate. The seller of the business may overestimate the value of the business’s reputation; therefore, consultation with an accountant is important to confirm the accuracy of the value placed on goodwill by the seller.

Advantages and disadvantages

Buying an existing business has a number of advantages and disadvantages, as shown in Table 11.2.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Sales to existing customers will generate instant income.</td>
<td>• The existing image and policies of the business may be difficult to change, especially if the business had a poor reputation.</td>
</tr>
<tr>
<td>• A good business history increases the likelihood of business success.</td>
<td>• The success of the business may have been due to the previous owner’s personality and contacts, so may be lost when the business is sold.</td>
</tr>
<tr>
<td>• A proven track record makes it easier to obtain finance.</td>
<td>• It may be difficult to assess the value of goodwill, with the likelihood that the newcomer will pay more than it is worth.</td>
</tr>
<tr>
<td>• Stock has already been acquired and is ready for sale.</td>
<td>• If business premises are leased, the new owner may experience difficulties with the existing landlord.</td>
</tr>
<tr>
<td>• The seller may offer advice and training.</td>
<td>• Some employees may resent any change to the business operation.</td>
</tr>
<tr>
<td>• Equipment is available for immediate use.</td>
<td></td>
</tr>
<tr>
<td>• Existing employees can provide valuable assistance.</td>
<td></td>
</tr>
</tbody>
</table>
Buying a franchise

People choose to start a franchise in the hope of avoiding many of the problems associated with starting a new business. For a set fee, the small business owner receives the benefits of a successful business formula, a well-recognised name and established trademarks. Franchise operations, therefore, tend to have fewer teething problems. Franchise is the fastest growing area of small business with approximately 1300 franchisors in Australia.

Advantages and disadvantages

Buying a franchise has a number of advantages and disadvantages, as shown in table 11.3.

**TABLE 11.3 The advantages and disadvantages of buying a franchise**

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The franchisor often provides training.</td>
<td>• The franchisor controls the operations.</td>
</tr>
<tr>
<td>• The franchisee does not need to have previous business experience.</td>
<td>• The threat of franchise termination can be carried out in some circumstances.</td>
</tr>
<tr>
<td>• The investment risk may be lower.</td>
<td>• Profits must be shared with the franchisor.</td>
</tr>
<tr>
<td>• There is immediate benefit from the franchisor's goodwill.</td>
<td>• The franchisor often charges a service fee for advice.</td>
</tr>
<tr>
<td>• Equipment and premises design are usually established and operational.</td>
<td>• The franchisee is often required to purchase stock from the franchisor.</td>
</tr>
<tr>
<td>• Well-planned advertising often exists.</td>
<td>• Contracts may be biased in favour of the franchisor.</td>
</tr>
<tr>
<td>• Volume buying is possible, often resulting in cheaper stock.</td>
<td>• The goals of the franchisor may be incompatible with those of the franchisee.</td>
</tr>
<tr>
<td></td>
<td>• The franchisee may merely feel like an employee, but without the benefits and security.</td>
</tr>
<tr>
<td></td>
<td>• The franchisee must share any burden of the franchisor's business mistakes.</td>
</tr>
</tbody>
</table>

**FIGURE 11.17 A range of franchise business operations**

**BizFACT**

Australia’s largest franchise operation is L J Hooker Real Estate.
An interview with Madhu Gaikwad, owner of Madhu’s Restaurant

**Madhu, what made you want to own a restaurant?**

Ever since ninth grade at school, I wanted to be a chef and run my own restaurant. I was 15 years old when I started working as a kitchen hand in a friend’s restaurant. I worked on a casual basis. This experience gave me a good understanding of the restaurant scene and my passion for fine food.

**Do you enjoy your work? Why?**

Working as a chef involves hard work and long hours. You are always working quickly and nearly always under pressure. However, the creative satisfaction in producing great food that not only looks good, but tastes good too, makes it worthwhile.

**Would you prefer to work for yourself or be a salaried employee?**

I prefer working for myself. Not only does this allow me to be creative with my dishes, but it also allows me to generate my own income.

**Why did you establish a new business instead of purchasing an existing restaurant?**

In the beginning I weighed up the advantages and disadvantages of each option. The main advantages of setting up a new business are that I would have freedom of choice to set up the business just as I wish; there is no goodwill which has to be paid for; and importantly, because my funds were limited, I was able to begin on a smaller scale.

The main disadvantage is the high risk of failure because there is no previous business reputation or existing customer base to draw upon. This also makes it more difficult to obtain a loan.

**Did you consider purchasing an existing business?**

Yes, I almost bought a competitor’s restaurant. The asking price was low due to its poor reputation. Although it was poorly managed, it was in a great location. The main advantage of purchasing this business was that it was already operating and everything associated with the business was included in the purchase. However, the main disadvantage was that the existing image of the business would have been difficult to change. It was just too big a risk.

**Do you think you made the right decision?**

Yes. Even though it was hard in the beginning, with plenty of minor ‘dramas’, I would make the same decision again. It is immensely satisfying to know that I am creating something from nothing.

**Did you consider operating as a franchise?**

Not really. I did not want a franchisor to control how I operate my business. Nor did I want to share my profit or pay a fee to trade under their name. I wanted my independence. However, if I lacked experience I would have chosen this option because operating under a well-recognised brand and using a successful business formula would reduce the risk of failure.

**Finally, Madhu, how’s business so far?**

Well, as you know, I set up Madhu’s Restaurant in 2008. Since then, I have been pleased to see that there is a growing customer base. I am very satisfied with the profits so far. So, eat up and bon appétit!

**Snapshot questions**

1. According to Madhu, outline the benefits of being self-employed compared with being a salaried employee.
2. Recall why Madhu decided to establish a new business.
3. Identify one advantage of purchasing an existing business.
4. Explain under what circumstances Madhu would consider operating as a franchise.
5. Create a web page for Madhu’s restaurant. Provide a facility for ordering takeaway food online.
6. In pairs, predict what might happen to Madhu’s business over the next two years.
Summary
• Starting a completely new business — starting from scratch — or purchasing an existing business are the two main ways of going into business.
• When purchasing an existing business, it is essential for the potential purchaser to know why the business is for sale.
• Buying a franchise to make use of an existing brand name and reputation is also a popular way of going into business.
• There are advantages and disadvantages for each option.

Revision
1 Recall in what circumstances someone might choose to start a business from scratch.
2 Identify and explain what you consider to be the two most significant advantages and two most significant disadvantages of starting a business from scratch.
3 Identify and explain what you consider to be the two most significant advantages and two most significant disadvantages of purchasing an existing business.
4 (a) Assume you have decided to purchase an existing small business. Select one of the following advertisements and propose a list of questions that you should ask before making a purchase.
   (b) Justify which business offers the best prospects. Give reasons for your answer.

SOUND ESTABLISHED HAIRDRESSING SALON
Well equipped.
Established over 10 years.
Sound financial position.
Taking approx. $2500 p.w.
No goodwill required.
Pay only for premises, fittings and stock.
Excellent opportunity.

Phone 3856 2764

ATTENTION
Sack your boss.
Work from home instead.
Phone (03) 9856 2764
www.lastchance.com.au

SOUND INVESTMENT
Established Convenience Store – Beach Location
Once-in-a-lifetime opportunity to be your own boss.
Easily managed. Training provided.
Low rent only $770 per week.
Current turnover exceeds $5200 per week.
Increases in summer. Price includes fixtures and fittings, the shop plus 4 bedroom residence.
ASKING PRICE $915,000
Phone 0421 01516 7934 AM

5 Consider a small business that you would like to start. Recommend which of the three business options would be most appropriate. Give reasons for your answer.
6 Investigate why people choose to purchase an established business rather than start from scratch. Compare your answer with other class members.
7 Use the federal government’s business.gov.au weblink in your eBookPLUS to summarise the advice provided for buying an established business.
8 The Red Rooster restaurant franchise mission statement is ‘Be in business for yourself, but not by yourself’. Explain what is meant by this statement.
9 Clarify why businesses operating as a franchise have a success rate three times that of independent businesses.
10 Identify what the franchisor receives in a franchise agreement. Identify what the franchisee receives. Identify what each party provides.
11 Determine one main benefit of franchising for the:
   (a) franchisor
   (b) franchisee.
Extension

1 Read the following story and then answer the questions.

Bianca was bored working for someone else and decided to start her own business. She lives in a small New South Wales country town with a population of approximately 2500. The town has no major shopping centre and no established franchises. Bianca decided to open a café in the town. Her mother provided the funding for the business and gave her what little advice she could.

After only six months in business, Bianca realised that the business was not profitable. Her debts were increasing and she could see no way out of her problems. She wanted to sell the business but could not find a buyer.

(a) **Determine** whether it would have been wiser for Bianca to purchase an established business rather than commencing from scratch. Give reasons for your answer.
(b) If Bianca had conducted some basic market research, **predict** whether she would have opened a franchise instead of an independently owned business.
(c) **Propose** what Bianca should do. Share your answer with other class members.

2 From the ‘Businesses for sale’ section of a newspaper, find three advertisements for the sale of a corner store, newsagency or coffee shop. **Explain** all the terms used in the advertisements.

3 Select a small business that you patronise regularly and answer the following questions:
   (a) **Outline** why you use this particular business.
   (b) **Identify** the strengths and weaknesses of this business.
   (c) If this business were for sale, **determine** whether you would consider purchasing it. Give reasons for your answer.

4 Use the Franchise Council of Australia weblink in your eBookPLUS to **compare** three franchise operations that interest you and then answer the following questions:
   (a) **Summarise** the business’s concept.
   (b) **Identify** the training provided by the franchisor.
   (c) **Outline** the agreement terms.
   (d) **State** the level of investment required.
   (e) **Describe** the personal qualifications required.
   (f) **Assess** which franchise operation you consider to be the best business proposition. Give reasons for your answer.

5 **Create** an information brochure on franchises. Include useful facts, and useful organisations and websites that will assist a potential franchise.

11.6 Market considerations

Many business owners are so enthusiastic about starting that they often overlook these three crucial questions:

- Who will buy the goods or service?
- What is the most suitable price for the goods or service?
- What is the most appropriate location for the business?

More than anything else, the success of any business depends on the research and planning done to answer these three fundamental questions, because sales are the life-blood of a business and the source of its income.

**Good or service**

Many SME owners display such enthusiasm for their new goods or service that they often fail to consider whether any customers want to purchase it. Without customers, a good or service — even though revolutionary, efficient, record-breaking, exciting and so on — is useless. Businesses fail without a market (customers) for their goods or service; therefore, they must always undertake market analysis.
Market analysis involves collecting, summarising and analysing information about the state of the market, customers, the threats and opportunities that the market presents, and any advantages or disadvantages that the business is likely to have over its competitors.

Using a variety of methods, such as surveys, questionnaires and focus groups, market analysis can provide a wealth of information about customers' attitudes, perceptions and opinions. It presents a business owner with questions that focus on who will buy the product, for example:

- Who are our customers?
- What do we know about them?
- What is their age and gender?
- Why do they buy our product(s)?
- What do they see as our strengths and weaknesses?
- How can we gain more customers?
- Who are our competitors? How many do we have?
- What do our competitors offer that we do not?
- What are we really selling?
- To whom would we like to sell?

Price

One of the most crucial decisions that any business owner has to make is to determine the prices at which goods and services are provided to customers. This will have a major impact on the success of the business, as prices set too high may drive away potential customers, while prices set too low may make it difficult to achieve a profit. Four price-setting strategies can be used.

Percentage mark-ups

Percentage mark-ups are commonly used by retail stores. The cost price is increased by a fixed percentage to arrive at the selling price. Assume a sporting goods store has a mark-up of 100 per cent. A tennis racquet is bought for $200 and, with a 100 per cent mark-up, will have a selling price of $400.

The percentage price mark-up is usually calculated so that it will allow the business to cover costs as well as make a profit. For example, out of a 100 per cent mark-up, 80 per cent may be necessary to cover costs, leaving only 20 per cent as the net profit on the sale of the item.
Recommended retail price

Recommended retail price (RRP) is the price recommenced by either a wholesaler or the manufacturer of the goods being sold by a retail business. These prices are recommendations only, as it is illegal for any manufacturer or wholesaler to dictate the price at which any product can be sold to the public. However, the RRP can provide useful guidance to the retail business owner, particularly if they are starting a new business.

Price leadership and competition

To follow the prices set by another seller is to acknowledge that business as a price leader. For instance, in a shopping centre with a number of shops selling the same items, the prices set by the most competitive of the shops may be used as a guide by the other shops. All businesses need to adjust their prices from time to time to ensure their prices are competitive when compared with the prices charged by other suppliers in the same market. Failure to do so could result in a loss of market share. Special promotions or weekly specials are often used to improve the competitive position of a business.

What the market will bear

The most common example of this approach may be seen at an auction. Often it is difficult to place an exact value on a house, painting or racehorse, so an auction will be held and the people bidding for the item being auctioned determine its value. Not all businesses can sell their goods or services through an auction process, so determining prices based on what the market will bear often comes down to the experience and flexibility of the business owner. An ability to read and interpret consumer sentiment is an important entrepreneurial skill. Listening to customers, and observing industry trends and the direction taken by competitors will inform the business owner and assist in determining market reactions. The flexibility to respond quickly to market expectations can be the difference between success and failure in business.

The significance of location

Different types of businesses will be suited to different locations, and the business owner must consider a number of factors when determining the most appropriate location for their particular business. A suitable location might be a shopping centre or retail shopping strip, or the business owner may choose an online presence or prefer a home-based business.

Local government zoning determines where some types of businesses can operate. Zoning is designed to keep business activities separate from residential areas and prevent householders being disturbed by businesses operating late at night. The process sets aside commercial and industrial zones and it is in these areas that most SMEs will operate.

Shopping centre complex

The suburban shopping centre complex has been in existence in Australia for less than 50 years. Typical suburban shopping centre complexes have one or more supermarkets and a number of small specialist stores such as hairdressers, clothing stores, pharmacies, cafés, newsagents, and often a post office and bank branches. Larger regional shopping centres, such as Macquarie Centre, Centro Roselands, Westfield Bondi Junction and Warringah Mall often include major department stores and cinemas, as well as the full range of specialist retail outlets.
A well-established business in a busy shopping centre is an excellent option for a prospective SME owner wishing to purchase an existing business, although a new business in an established shopping centre is most likely to be successful if there are no existing competitors.

FIGURE 11.20 Shopping centres provide an ideal location for a wide variety of retail businesses.

Retail shopping strips
In metropolitan Sydney, shopping strips developed along major arterial roads during the second half of the 19th century. The busiest shopping strips were located near public transport, such as tram routes and suburban railway stations. Parramatta Road is an example of a major road in Sydney with extended shopping strips.

Many shopping strips in the metropolitan area have struggled to compete with the growth of shopping centre complexes offering off-street parking and an air-conditioned environment. Retail shopping strips offer the advantage of high visibility for passing traffic, but many shopping strips suffer from lack of parking, particularly those located on major arterial roads that are clearways during peak hours. Because many shopping centres close in the evenings, shopping strips have become popular locations for restaurants and ‘after hours’ entertainment. Norton Street in Leichardt is a good example of this.

Online presence
Given the rapid rise in technology, many businesses do not consider their location as important at all. Most SME owners have the use of a computer and access to the internet. This allows for the possibility of conducting business online, so the business is no longer limited to dealing with people who can physically visit its premises. Such online activities can include:

• using email to communicate with customers or suppliers
• using the internet to find information, such as prices, business contact details, and different products and market trends
• setting up a website to provide information about available products and services, or as a means by which customers can order goods online (see the following Snapshot)
• using the internet for online banking and payment of bills.
SNAPSHOT

Our key has been combining the traditional elements of service with the technology.

B2C sounds like a nickname for a robot but in fact it means business-to-consumer selling of retail goods and is sometimes referred to as e-retailing. Jacqueline Steedman’s small business — Eatfresh — is an example of a successful e-tailer selling fresh fruit and vegetables to consumers in Melbourne and Sydney. The business was set up in 1998 with the aim of catering for the needs of busy consumers who like fresh produce but don’t have time to go to the market. Customers place their order for fresh fruit and vegetables online and the software is in place to produce a report detailing orders, which is sent to a team of workers at the market and warehouse. This e-tailer is able to offer customers an efficient ordering system without leaving their workplace or home, and the business estimates that it has saved $300,000 by not having a physical shopfront. Steedman says: ‘Our key has been combining the traditional elements of service with the technology’. The challenge for Eatfresh in the beginning was locating a suitable web developer and this task was made easier by enlisting the services of Telstra. Eatfresh believe that traditional grocery and fresh produce businesses could improve their annual revenue if they also had an online shopfront.

Snapshot questions
1. Identify what the letters ‘B2C’ represent.
2. Define the meaning of ‘e-tailing’.
3. Describe Eatfresh’s primary target market.
4. Identify and explain two advantages of a business engaging in e-tailing.
5. Determine the issues that need to be considered when setting up an e-tailer.

Home-based businesses

Many tradespeople and other service providers have traditionally run their businesses from home. Plumbers, electricians, painters and various other service providers do not need a dedicated business location as they provide services in the customer’s own home or business premises. Increasingly, the development of information and communication technologies has allowed home-based businesses to use mobile phones, the internet and computer applications. Although home-based businesses have traditionally been service providers rather than goods retailers, online ordering and payment has allowed for the expansion of home-based retail businesses.

BizWORD

An e-tailer is an electronic retailer.

Weblink

Use the Micro business weblink in your eBookPLUS to discover more about home-based businesses.

FIGURE 11.21 Computers and the internet have increased the potential for home-based businesses.
Summary

• Businesses fail without a market (customers) for their goods or services, so they must always undertake a market analysis.
• A market analysis involves collecting, summarising and analysing information about the market.
• Price can be set by following a recommended retail price, using percentage mark-ups, price leadership or finding what the market will bear.
• One of the key decisions of a prospective small business owner is concerning the actual location of the business.
• Different types of business will be suited to different locations.

Revision

1 Clarify the purpose of a market analysis.
2 State the methods a SME owner could use to gather information about customers’ attitudes, perceptions and opinions.
3 From the following table, identify the appropriate number (event) and letter (price-setting method).

<table>
<thead>
<tr>
<th>Event</th>
<th>Method of setting prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A house is sold at auction.</td>
<td>(a) Mark-up</td>
</tr>
<tr>
<td>2. A percentage is added to the cost price of the goods.</td>
<td>(b) Recommended retail price</td>
</tr>
<tr>
<td>3. The butchers all copy the prices of Mighty Meats.</td>
<td>(c) What the market will bear</td>
</tr>
<tr>
<td>4. Milk is sold for a fixed price.</td>
<td>(d) Price leadership</td>
</tr>
</tbody>
</table>

4 Calculate the selling price for a computer using the mark-up supplied.

<table>
<thead>
<tr>
<th>Computer cost price</th>
<th>Mark-up</th>
<th>Selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$800</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>$1000</td>
<td>80%</td>
<td></td>
</tr>
<tr>
<td>$950</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

5 Clarify two factors to consider when setting a selling price for the item in each of the following cases:
(a) A small publishing business has developed an idea for a new fashion magazine for 16-year-olds.
(b) John wants to sell his car online.
(c) Troy has won a new mountain bike in a raffle but he doesn’t need it.
(d) Jemma wants to sell her handmade jewellery at markets and online.

6 Explain how local council decisions affect the location of different types of businesses.

7 Outline the advantages shopping centres have over traditional ‘main street’ shopping strips.

8 Summarise some of the main types of online activities SME operators undertake.

9 Demonstrate how an online presence can assist a business owner to operate from home.

10 Identify three types of businesses that can operate as home-based businesses, and explain why they are suited to this type of operation.
11 In small groups, propose what factors need to be considered when choosing a location for the following businesses:
(a) fast-food outlet
(b) dental surgery
(c) agricultural machinery supplier
(d) HSC coaching college
(e) hair salon
(f) panel beater.
Choose a spokesperson to share the group’s comments with the rest of the class.

12 Angela is considering purchasing an established sandwich bar that is located, on a main street, adjacent to a large industrial estate and near a parking area. Explain to Angela the importance of each of these factors. In terms of a favourable location, recommend whether Angela should purchase this business.

Extension

1 Copy and complete the following table. Propose three examples of items sold under each of the methods of setting prices. Use the internet for your research.

<table>
<thead>
<tr>
<th>Percentage mark-up</th>
<th>Recommended retail price</th>
<th>What the market will bear</th>
<th>Price leadership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example 1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Example 2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Example 3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2 ‘Location is a crucial factor for the success of some small businesses but not for others.’ Critically analyse this statement and provide relevant examples.

3 Visit the local shopping centre or mall. Identify the best located shops. Determine why they have the best locations. Arrange to interview the owners of some of these stores and question them about the reasons for their location.

4 Choose a small business that you are familiar with and explain the ways in which this business has advantages or disadvantages in relation to:
(a) visibility
(b) cost (in terms of likely premises expenses and transport costs)
(c) proximity to suppliers
(d) proximity to customers
(e) proximity to support services.

11.7 Finance

Finance refers to the funds required to carry out the activities of a business. It is a crucial issue when an entrepreneur is identifying a business opportunity, especially considering that it is often difficult to raise (see the following Snapshot).

Struggling to get financing

Kirsty Dunphey has always been entrepreneurial. She opened her first business at 15 and, in 2002, she was named the national winner of Telstra’s Young Business Woman of the Year Award. She started her own business, M&M Real Estate, in 2001 in Launceston, Tasmania. The business has now evolved into Harcourts Launceston after a joint venture with the real estate giant, Harcourts.

Dunphey says that she always ‘had goals for what I wanted my eventual, fabulous career to be. It had to be fun and exciting, it had to give me the potential to push...’
myself and be really successful, and it had to impact on people’s lives in a positive way.’ It wasn’t always easy though.

No bank would give her funding to open her real estate agency. She says that, ‘originally, trying to get funding for a real estate agency at 21 and to purchase investment properties at a similar age was challenging. I ended up financing my share of the business on a car loan and had to start small with investment properties.’ She began her business operating out of a two-bedroom apartment with her fellow director and no desks, no phone and no computers.

Despite Dunphey’s success, she says that early planning was ‘haphazard’. She doubts, however, that a business plan could have predicted the fast growth that her business experienced, but she still advocates having a business plan. She says, ‘even if it is on the back of an envelope or a full document it is good to have a reference point as you can get swept up in day-to-day stuff’.

**Snapshot questions**
1. **Explain** why it was initially difficult for Kirsty Dunphey to find funding for her small business.
2. **Outline** what she did to solve this problem.
3. Kirsty started her share of the business with a car loan. **State** the risks that might be associated with doing this.
4. **Recommend** other financing options available to Kirsty other than using a car loan. Share your answer with the rest of the class.

A number of preliminary factors need to be reviewed before any action can be taken. First, the entrepreneur must consider a series of questions as shown in figure 11.22. These questions allow the entrepreneur to consider the financial concerns of a business opportunity. Second, the entrepreneur needs to determine the most appropriate source of finance.

**FIGURE 11.22** Questions to consider when assessing finance for a business
**Sources of finance**

Finance can come from a variety of sources, but there are two main types of sources available to a business. The business owner can contribute their own funds (equity or capital), which is an internal source of funds. The business can also obtain loans (debt) from external sources (see figure 11.23). There are advantages and disadvantages associated with each source of finance.

**Debt finance**

Debt finance is money obtained through loans. The main advantage with debt financing is that the owner does not have to sell any ownership in the business. Also, debt financing has certain taxation advantages. For these two reasons, debt financing is the most popular source of finance used by businesspeople when starting a business.

Once the type of finance has been decided, the next step is to choose the appropriate term or length of time. There are three main terms for debt financing:

- short term — less than one year
- medium term — between one and five years
- long term — greater than five years.

**FIGURE 11.23** The two main sources of finance available to business owners

**Debt**

- Other people’s money from:
  - banks
  - finance companies
  - credit unions
  - building societies
  - solicitor’s trust accounts
  - trade credit

**Shareholders’ equity**

- Your own or a partner’s money

**BizWORD**

Debt finance is money obtained through loans.

**FIGURE 12.24** Financing a business is a little like picking a flavour of ice-cream — there are many options from which to choose. A SME needs to match the source of finance with the purpose for which the funds are needed.
Short-term finance is money needed to fund the day-to-day workings of the business. For this reason, it is commonly called working capital: current assets (receivables, inventories) less current liabilities (overdrafts, creditors). The main types of short-term finance are bank overdraft, bank bills and trade credit.

Medium-term finance covers loans with a term of between one and five years. For this reason, it is normally used when the business wishes to expand, purchase new equipment or develop new products. The main types of medium-term finance are term loans, personal loans and leasing.

Long-term loans, usually for a period of more than five years, are used to purchase buildings, land, plant and equipment. The main type of long-term finance is a mortgage, which is a loan secured on some type of asset such as land or a building.

Equity finance

Equity finance, also called equity capital, refers to the funds contributed by the business owner(s) to start and then expand the business. If the SME is a company, then this contribution is referred to as shareholder's equity. Equity has an advantage over other sources of finance because it does not have to be repaid unless the owners leave the business. It is cheaper than other sources of finance because there are no interest payments for the business. An owner who contributes the equity to a business retains control over how that finance is used. A disadvantage is that the owner may expect a good return on their investment, but the small amount of finance may only generate low profits and low returns.

Equity finance can also be raised in other ways — for example, by taking on a partner, or another partner, by seeking funds from another investor (who then becomes an owner or shareholder) or by selling off any unproductive asset.

Cost of finance

The cost of finance will depend on the following:

- the type of finance
- the source
- the term.

The type of finance used by a business will influence the cost of capital. Debt financing requires the use of money from an external source, such as a bank, building society or finance company, and the cost is the interest (cost of borrowing money) charged by the institution.

If capital is raised through equity finance, no interest is charged because the entrepreneur and/or partners and shareholders have invested the money. The cost of using this form of capital is the return paid at the end of the financial year if the business makes a profit. This return is called a dividend if the business is a company. The company does not pay a dividend if it does not return a profit.

The cost of equity finance can also be measured in terms of liability. Liability is unlimited if the business is operated as a sole trader or partnership. This means that creditors will sell all business and personal assets to recover the debt. However, liability of a company is limited to just the assets of the company and all funds put in by shareholders. The cost of capital will depend on the term and type of finance used by the business. Table 11.4 outlines examples of the types of loans available to businesses and the cost incurred for each type.
### TABLE 11.4 Some types of debt financing available to businesses

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Source</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading bank loans</td>
<td>Available for the purchase of land and buildings for a period of 3–10 years</td>
<td>Major trading banks — e.g. ANZ, Westpac</td>
<td>Standard interest rate cost for fixed period of time</td>
</tr>
<tr>
<td>Overdrafts</td>
<td>Used for short-term finance to assist in the daily operations of a business in times of need</td>
<td>Trading banks</td>
<td>Higher interest rate (not designed for long-term use)</td>
</tr>
<tr>
<td>Personal loans</td>
<td>Secured against the borrower’s own assets</td>
<td>Trading banks, building societies, finance companies</td>
<td>A general rate of interest with banks and building societies; finance companies usually charge a higher rate of interest than banks and building societies, due to the higher risk involved in lending.</td>
</tr>
<tr>
<td>Leasing finance</td>
<td>Allows use of an asset without actual purchase</td>
<td>Trading banks, finance companies</td>
<td>Interest rates that are above those for short- or medium-term loans, but benefit of tax-deductible finance repayments</td>
</tr>
<tr>
<td>Owner’s equity or shareholders’ equity</td>
<td>Money invested by owner/partner or shareholders. Risk of loss of the funds invested if the business fails, but share of profit if the business is successful</td>
<td>Owner of the business or a company shareholder</td>
<td>No interest on the use of these funds, but a return (dividend) on profits to be paid to shareholders</td>
</tr>
</tbody>
</table>

### Financial requirements

When starting a business, one crucial question the owner must answer is how much money will I need to establish and operate the business?

#### Establishment and operating costs

To answer this question, the business owner must begin by listing the main expenses in setting up the business — *establishment costs* (expenses). Items to consider include legal fees, furniture and equipment, phone and electricity connection, stock, and possibly rent in advance.

Next, the business owner needs to estimate the running costs for a full year’s operation — *operating costs* (expenses). These costs include wages, advertising, insurance, interest on any loans, telephone and electricity costs, stationery, rent, accountant’s fees, and motor vehicle running costs. These must be paid for the business to continue to trade.
Once these figures have been estimated, the business owner is in a position to calculate how much finance will be needed to commence and operate the business for the first year (see the following Snapshot). This is particularly important because research has found that the main reason SMEs fail is because of cash flow problems. This means that the business owner doesn’t have enough cash on hand to cover day-to-day expenses, such as paying suppliers or even the phone bill. Perhaps the business owner is waiting for customers to pay for goods and services already supplied, or perhaps there has been a slight downturn in business, which means that estimated income from sales is not what was planned for. Either way, cash — which is the lifeblood of a business — stops flowing and for some business owners it means they eventually have to close their doors.

### Financing a fashion store

Colleen Jacobson believed what Yves Saint Laurent said: ‘Fashions fade, style is eternal’. Colleen had always dreamt of opening her own fashion store, but this involves many expenses other than the cost of the clothes and accessories. This table shows a list of costs that Colleen has prepared for starting a fashion store.

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal fees</td>
<td>550</td>
</tr>
<tr>
<td>Advertising</td>
<td>870 per month</td>
</tr>
<tr>
<td>Wages</td>
<td>1800 per week</td>
</tr>
<tr>
<td>Electricity costs</td>
<td>1600 per three months</td>
</tr>
<tr>
<td>Phone connection</td>
<td>250</td>
</tr>
<tr>
<td>Insurance</td>
<td>2300 per year</td>
</tr>
<tr>
<td>Electricity connection</td>
<td>115</td>
</tr>
<tr>
<td>Initial purchase of stock</td>
<td>18 550</td>
</tr>
<tr>
<td>Telephone costs</td>
<td>75 per week</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>11 750</td>
</tr>
<tr>
<td>Interest on loan</td>
<td>315 per month</td>
</tr>
<tr>
<td>Motor vehicle purchase</td>
<td>28 000</td>
</tr>
<tr>
<td>Motor vehicle running costs</td>
<td>260 per month</td>
</tr>
<tr>
<td>Rent in advance</td>
<td>7200</td>
</tr>
<tr>
<td>Accountant’s fee</td>
<td>285 per month</td>
</tr>
<tr>
<td>Rent</td>
<td>3600 per month</td>
</tr>
<tr>
<td>Ongoing stock purchases</td>
<td>6000 per month</td>
</tr>
<tr>
<td>Stationery</td>
<td>55 per week</td>
</tr>
<tr>
<td>Computer</td>
<td>2870</td>
</tr>
</tbody>
</table>

### Snapshot questions

1. **Classify** each cost as either an establishment or an operating cost.
2. **Calculate** the total establishment cost.
3. **Calculate** the total operating cost for 12 months.
4. **Determine** how much revenue (income) Colleen Jacobson will need to generate to cover all her establishment and operating costs in the first 12 months.
5. **Recommend** an alternative method of reducing the establishment costs for items such as the motor vehicle and computer. Predict what impact this will have on other costs.
6. **Explain** the purpose of itemising the establishment and operating costs.
Summary

- A business cannot commence without finance to enable it to pursue its activities.
- SME owners must determine how their business will be financed throughout the life of the business.
- Businesses can obtain funds from either internal (equity) or external (debt) sources.
- Debt finance is money obtained through loans.
- The main forms of debt are a bank overdraft, personal loans, bank bills, leasing and a mortgage.
- Equity is the funds contributed by the owner(s) of a business to start and expand the business.
- The business owner must estimate the establishment costs (expenses that must be paid to commence the business) and operating costs (the running costs for a full years operation).

Revision

1 Account for the importance of finance in terms of establishing and operating a business.
2 Distinguish between equity and debt finance.
3 Prepare a table with two columns to identify the advantages and disadvantages of using debt to finance a business.
4 Prepare a table with two columns to identify the advantages and disadvantages of using equity to finance a business.
5 Compare the main forms of debt by completing the following table.

<table>
<thead>
<tr>
<th>Form of debt</th>
<th>Main features</th>
<th>Advantages/disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank overdraft</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal loan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leasing finance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6 Distinguish between establishment costs and operating costs. Provide examples of each.
7 Identify some of the establishment costs you would expect the following new businesses to have. The first entry has been completed for you.

<table>
<thead>
<tr>
<th>Business</th>
<th>Establishment costs</th>
</tr>
</thead>
</table>
| Florist             | • Refrigerated room  
                     | • Cash register and computer  
                     | • Telephone and installation  
                     | • Sign writing  
                     | • Business cards  
                     | • Advertising in the Yellow Pages  
                     | • Stock such as vases, ribbon, cellophane  
                     | • Delivery van                                                            |
| Window cleaning business |                                                                 |
| Surf shop           |                                                                                   |
| Bicycle shop        |                                                                                   |

8 Jordan has established that his operating costs will be $1000 each week when he opens his business. He estimates that revenue from sales each week will be $700.
(a) **Determine** whether he should go ahead with establishing the business. Give reasons for your answer.
(b) **Propose** two strategies Jordan could implement to make his business viable.

**Compare** your answer with other members of the class.

**Extension**

1. Contact a bank’s loan manager and request a summary of:
   (a) the different types of lending options for small businesses
   (b) methods of repayment on money borrowed.
   **Assess** the most suitable form of finance for a person wanting to establish a computer repair business that is operated from home.

2. In small groups, collect five advertisements offering different types of finance funding for small businesses. **Compare** the offers under the headings in the following table. Display your database in the classroom.

<table>
<thead>
<tr>
<th>Source</th>
<th>Interest rate</th>
<th>Borrowing limit</th>
<th>Terms</th>
<th>Main advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. **Analyse** why it is important to match the term of a loan to the life of the asset for which the finance was obtained.

### 11.8 Legal considerations

There are many licences, permits, approvals and authorities that must be taken into account by SME owners. All business owners have a legal obligation to observe the statutory regulations when commencing and operating a business. Fulfilling all legal obligations may be frustrating at times, particularly when more than one level of government is involved. However, businesses that do not obey the law risk losing customers and their reputation, being fined, or losing the right to continue trading.

The three levels of government (federal, state and local) all have regulations to which small business owners must adhere. The regulations are imposed primarily to promote fairness, protect consumers and encourage efficiency.

#### Business name registration

Under the New South Wales’ *Business Names Act 1962*, every business name must be registered, except when the name is that of the owner and then it is optional. But if something is added to a personal name, such as ‘Pty Ltd’, ‘Motors’, ‘and Associates’ or ‘and Co.’, then the business name must be registered. This is to prohibit anyone else from trading under a similar name. (If two traders want to register the same name, the first application for registration is accepted and the second trader must register a different name.)

Registration of a business name does not protect or establish any specific rights to that name. If the business name is a crucial part of the business’s operation, then it should also be registered as a trademark with the federal agency responsible for intellectual property (IP Australia), which administers the *Trade Marks Act 1995* (Cwlth).
Zoning

Local government controls zoning regulations. It ensures that activities that do not belong together, such as those associated with factories and residential areas, are kept separate. This function assists the local community in terms of planning.

When establishing a business, the owner must inquire with the local council to determine which zoning regulations will affect their business now and in the future. A manufacturing business that uses heavy equipment and wants to operate a 24-hour shift, for example, would need to locate where it is allowed to operate under zoning regulations. It would not be suitable close to a residential area, mainly because the noise is a problem.

Health regulations

Local government also imposes health regulations. Each local council supplies businesses (primarily those dealing with food, such as cafes, restaurants, butcher shops and bakeries) with the requirements and standards to meet in order to receive a licence to operate. Some requirements include:

• the temperature for food storage
• kitchen layout
• employee clothing requirements
• time for which food can be kept
• correct food handling.

A health inspector will assess premises regularly and often without warning to ensure the business owner/operator maintains standards. If problems occur, then the business is given a period of time to rectify the situation or they will be closed down.

FIGURE 11.26 Health inspectors check businesses regularly to ensure that they are meeting health standards, particularly food businesses.

BizWORD

The Trade Practices Act 1974 is a law that protects both consumers and businesses. It protects consumers from deceptive or misleading practices, and it regulates the trade practices of businesses.

Trade practices

The Trade Practices Act 1974 (Cwlth) has a function to protect both consumers and business, and applies to virtually all businesses in Australia, including the commercial activities of government. First, it is designed to protect consumers from deceptive practices such as misleading packaging or misrepresentation of the place of production. It also deals with product safety and the conditions and warranties
associated with products. Further, the act aims to regulate certain trade practices that may restrict competition (such as monopolistic power) because they can affect the price and quality of goods for the consumer. Table 11.5 outlines the Act’s role in consumer protection and regulation of restrictive trade practices.

TABLE 11.5 Role of the Trade Practices Act

<table>
<thead>
<tr>
<th>Consumer protection against:</th>
<th>Regulation of restrictive trade practices such as:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Misleading or deceptive conduct</td>
<td>Exclusive dealing, whereby a supplier imposes restriction on whom they may deal with</td>
</tr>
<tr>
<td>Unconscionable conduct</td>
<td>Price fixing, whereby a business agrees to fix, control or maintain the price of goods or services</td>
</tr>
<tr>
<td>False representation in terms of goods or services</td>
<td>Exclusionary provisions, whereby a contract, agreement or understanding contains a clause excluding someone</td>
</tr>
<tr>
<td>Offer of gifts or prizes (with sale of goods and services) that are never provided</td>
<td>Abuse of market power, whereby a corporation with substantial market power uses that power to damage or get rid of competitors, prevent anyone from competing in the market or prevent competitors from entering the market</td>
</tr>
<tr>
<td>Misleading conduct towards the public</td>
<td>Resale price maintenance, whereby suppliers state a minimum price at which a product is to be sold</td>
</tr>
<tr>
<td>Bait advertising — that is, enticing customers into the shop through the advertisement of a certain product, then telling the customer that the product is no longer in stock and offering a more expensive substitute</td>
<td>Price discrimination, whereby the company charges different prices for the same quality of product (i.e. different prices for different customers)</td>
</tr>
<tr>
<td>Referral selling — that is, offering a product or service to a customer if they refer other customers to the business</td>
<td>Mergers and acquisitions that may reduce competition</td>
</tr>
</tbody>
</table>

FIGURE 11.27 Consumers are now protected under the Trade Practices Act against misleading advertising or false representation on the part of the business.

Weblink
Breaches of any of these provisions may result in penalties of up to $10 million for companies and $500,000 for individuals. Other actions may include an injunction — that is, a restraint on a person — or the awarding of damages.

**Summary**
- All business owners have a legal obligation to observe the statutory regulations when commencing and operating a business.
- Of the many laws and regulations that small business owners need to comply with, some important ones are:
  - business name registration
  - land zoning
  - health regulations.
- The *Trade Practices Act 1974* (Cwlth) is a federal government statute that aims to:
  - promote fair trade and competition in the marketplace
  - protect both consumers and businesses from deceptive or misleading practices.

**Revision**
1. Recall the main objectives of imposing government regulations.
2. State when it is compulsory to register a business name.
3. Outline the purpose of land zoning.
4. Demonstrate how land zoning will influence where specific businesses can locate.
5. Identify the types of health regulations that local councils impose on businesses.
6. Read the section ‘Trade practices’ on page 378. Complete the paragraph below by recalling the correct word from the list that follows.

| deceptive | safety |
| price | Practices | regulate |
| consumers | misleading | competition |

The *Trade __________ Act 1974* (Cwlth) has a function to protect both __________ and business. First, it is designed to protect consumers from __________ practices such as __________ packaging or misrepresentation of the place of production. It also deals with product __________ and the conditions and __________ associated with products. Further, the act aims to __________ certain trade practices that may restrict __________ (such as monopolistic power) because they can affect the __________ and quality of goods for the consumer.

7. Refer to table 11.5 on page 379. Distinguish between:
   (a) bait advertising and referral selling
   (b) price fixing and resale price maintenance.
8. State the legal penalties or remedies that might apply after a successful prosecution for breaches of restrictive trade practices provisions of the Act.

**Extension**
1. Use the BLIS weblink in your eBookPLUS to find the NSW Business Licence Information Service’s start-up pack section. Record the types of licences the following businesses would need to begin and operate:
   (a) beauty salon
   (b) electrician
   (c) tour operator.
   Appreciate the importance of having a strict licence system in operation.
2 Imagine you are about to open a pizza restaurant. **Investigate** the government regulations you would need to satisfy.

3 **Evaluate** the role of the ACCC. To help you, use the Australian Competition and Consumer Commission weblink in your eBookPLUS.

4 ‘Government regulations are needed to create a fair marketplace for businesses and consumers.’ **Evaluate** the accuracy of this statement.

### 11.9 Human resources

As outlined in chapter 8, employees are the most valuable resource of any business. Hiring the ‘right’ people at the ‘right’ time, with the ‘right’ skills in the ‘right’ quantity is crucial for business success. Consequently, one of the most important influences in establishing a SME is staffing: the people side of the business.

In the establishment phase, the SME owner must answer one crucial staffing question: How many employees, if any, will be required to operate the business?

If a SME owner decides to hire staff, many sources are available. The source chosen will depend on the size of the business, the type of position available and the nature of the labour force in the business’s particular area. Figure 11.28 outlines the main sources of employees available to a business.

![Diagram of main sources of employees for a business](image)

**FIGURE 11.28 The main sources of employees for a business**

Once the business is operating and if people are employed, the SME owner must fulfil a number of important human resource requirements that deal with:

- staffing objectives
- specific duties to be performed
- the skill base of existing staff
- a forecast of future staff requirements and skills
- methods the business will use to recruit extra staff
- a form of the organisational chart
- administrative records to be kept to manage the employees.

Of all these requirements the most important are those that deal with the skill level of employees. Skilled employees are highly productive and result in creating wealth for the business.
Employee skills

A business owner should always remember that the overriding objective of recruiting is to attract a pool of qualified applicants — people with the most suitable skills — from which to choose the most appropriate person for a particular job. Skilled employees are more productive and create wealth for the business. This is the same principle that a sports coach uses when selecting a team. To improve the chance of winning, the coach wants those players who possess the highest level of skills.

The skill base of existing employees should also be detailed so that training needs can be identified. If the skills level of employees is not adequate enough for them to fulfil their jobs effectively, then the business owner has two options:
- provide training to improve the skills level of existing employees
- recruit people who have the required skills.

Employee costs — wage and non-wage

A business will only employ someone if the return is greater than the cost. The total cost of an employee is not solely the wage or salary paid. The employer is also responsible for other employee expenses, referred to as on-costs, which account for around 30–40 per cent of the total remuneration package (see the following Snapshot).
How much does an employee cost?

When employing new staff, there are many other costs that are not always taken into account. The following case study reveals that these hidden costs quickly add up.

<table>
<thead>
<tr>
<th>Cost breakdown</th>
<th>Amount $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Base salary</strong>. This is usually expressed excluding any on-costs such as superannuation.</td>
<td>50 000</td>
</tr>
<tr>
<td>2. <strong>Superannuation</strong>. The employer must pay 9 per cent superannuation of all employees earning more than $450 in a calendar month.</td>
<td>4 500</td>
</tr>
<tr>
<td>3. <strong>Annual leave</strong>. Normally 4 weeks per year. This means that the base salary is paid for 48 weeks work per year. Annual leave cost at 7.69 per cent (4 weeks/52 weeks).</td>
<td>3 846</td>
</tr>
<tr>
<td>4. <strong>Public holidays</strong>. There are about 10 public holidays in Australia each year. This is 3.85 per cent (2/52).</td>
<td>1 953</td>
</tr>
<tr>
<td>5. <strong>Sick leave</strong>. Most awards provide for 10 days each year. This is another 3.85 per cent.</td>
<td>1 953</td>
</tr>
<tr>
<td>6. <strong>Workers’ compensation insurance</strong>. The rate charged varies broadly depending on the risk of the industry. In some instances it can be 15 per cent. For this example a rate of 5 per cent will be used.</td>
<td>2 500</td>
</tr>
<tr>
<td>7. <strong>Payroll tax</strong>. This state government tax is levied once an employer’s annual payroll (including superannuation) exceeds a certain amount. In New South Wales the threshold is $658 000 and the rate is 5.5 per cent.</td>
<td>2 750</td>
</tr>
<tr>
<td>8. <strong>Recruitment</strong>. The average cost of recruiting the base-grade employee is about $5000. This includes the cost of recruiting, lost production and training of the new employee. For this example, assume the employee stays for 2 years.</td>
<td>2 500</td>
</tr>
</tbody>
</table>

| Total of on-costs                                  | 20 002   |

The total of the on-cost for this ‘average’ employee is $20 002. Businesses are responsible for these costs and must budget accordingly. Therefore, based on this case study, the total cost of employing someone on a base salary of $50 000 is $70 002.

The above table only deals with the most common on-costs for the ‘average’ employee. For some employees, especially senior executives, other specialised on-costs can include fringe benefit tax, car allowance, housing subsidy, travel and meal allowance, bonus fee and association membership fees.

**Snapshot questions**

1. **Calculate** the percentage on-costs represent of the base salary.
2. **Explain** why on-costs are sometimes referred to as ‘hidden costs’.

The main on-costs include:

- occupational health and safety requirements
- long service leave
- sick leave
- superannuation
- holiday pay
study leave
maternity and paternity leave
workers’ compensation
leave loading.

Two examples of these on-costs (non-wage costs) are superannuation and leave loading.

Superannuation

Under the federal Superannuation Guarantee scheme, all employers must make provision for employees’ superannuation. Superannuation (otherwise known as super) requires all employers to make a financial contribution to a fund that employees can access when they retire. The main aim of superannuation is to give employees a sum of money that can be used:

• for their retirement
• if they become an invalid
• by the beneficiaries upon a person’s death.

In some circumstances they can access the money if they leave a job, although tax disincentives apply. Employers are not required to provide for the superannuation of employees aged over 70 years, employees aged under 18 years and working 30 hours or fewer per week, employees paid less than $450 per month, and employees working outside Australia if they are not a resident or their employer is not a resident.

The employer’s main obligation is to make a financial contribution — presently 9 per cent of an employee’s earnings for their ordinary hours of work — to their employees’ superannuation account.

As with taxation, employers are required to keep records of all superannuation-related transactions, including payments contributed, payroll and employee records, and the level of entitlement of each employee. Employees are allowed access to all documentation, especially when leaving a workplace.

Annual leave loading

An extra amount — presently 17.5 per cent — is added to an employees’ holiday pay. The amount is calculated on the four weeks’ annual leave to which each fulltime, permanent employee is entitled. It was introduced at a time when workers’
wages were low and most worked more than a 40-hour week. Unions negotiated a percentage loading for workers so that the average family could afford to go away for a holiday (in addition to paying their regular rent or house repayments).

Summary

- One of the most important influences when establishing a SME is staffing.
- If a SME owner decides to hire staff, many sources are available.
- The overriding recruiting objective is to attract a pool of qualified applicants with the most suitable skills.
- Skilled employees are more productive and create wealth for a business.
- A business will only employ someone if the return is greater than the cost.
- On-costs are payments for non-wage benefits, including long service leave, workers’ compensation and annual leave loading.

Revision

1. Explain why hiring the ‘right’ employee is so important for a business.
2. Identify three sources of external employee recruitment.
3. ‘Skilled employees are more productive and create wealth for the business.’ Discuss.
4. Recall two options a business owner has if the skills level of employees is not adequate enough for them to fulfil their jobs effectively.
5. Unscramble the following on-costs and then construct a sentence to explain their meaning.
   (a) ypa dyohlia
   (b) eelav gaoldni
   (c) nnuepsnroiaau
6. Explain why on-costs are also referred to as non-wage costs.
7. Outline what the obligation of employers is towards employees in relation to superannuation.
8. Discuss the likely impact of abolishing leave loading from the perspective of (i) an employer and (ii) an employee.

Extension

1. Use the Smartmanager weblink in your eBookPLUS to construct a list of what you consider to be the three most important do’s and three most important don’ts for people conducting an interview. You could also enter ‘interviewing applicants’ in your search engine to find other websites that offer hints for employers when conducting an interview.
2. Competent employees are important for the success of any business. Imagine you need to employ a new staff member in your boutique store. You choose an inexperienced salesperson. Propose three strategies you could use to train the employee.

11.10 Taxation

**Taxation** is the compulsory payment of a proportion of earnings to the government. Taxation is an important issue when a person is considering all aspects of opening a business.

Federal and state taxes

Many different federal and state taxes apply to different businesses, and it is important that a person starting a business becomes familiar with all appropriate tax requirements. The main taxes that affect a business (see table 11.6) are imposed by the federal and state governments.
## TABLE 11.6 Major taxes that apply to businesses

<table>
<thead>
<tr>
<th>Tax</th>
<th>Levied by</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group tax — pay-as-you-go (PAYG)</strong></td>
<td>Federal government</td>
</tr>
<tr>
<td>• Imposed on the employee</td>
<td></td>
</tr>
<tr>
<td>• Taken from the employee’s salary or wage directly</td>
<td></td>
</tr>
<tr>
<td>• Lodged with the tax department by the business</td>
<td></td>
</tr>
<tr>
<td>• Detailed in a group certificate that the employee receives at the end of the financial year</td>
<td></td>
</tr>
<tr>
<td><strong>Fringe benefits tax (FBT)</strong></td>
<td>Federal government</td>
</tr>
<tr>
<td>• Tax on the provision of a benefit to an employee — such as cars for private use, low-interest loans, entertainment expenses, and housing and accommodation — in place of salary or wage</td>
<td></td>
</tr>
<tr>
<td>• Paid by the employer at a rate of 48.5 per cent</td>
<td></td>
</tr>
<tr>
<td><strong>Goods and services tax (GST)</strong></td>
<td>Federal government</td>
</tr>
<tr>
<td>• A broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia</td>
<td></td>
</tr>
<tr>
<td>• See pages 000–0 for a detailed explanation</td>
<td></td>
</tr>
<tr>
<td><strong>Company tax</strong></td>
<td>Federal government</td>
</tr>
<tr>
<td>• Paid on the earnings of a company and calculated on the company's taxable income (which is income left after allowable deductions are calculated)</td>
<td></td>
</tr>
<tr>
<td>• Currently calculated at 30 per cent of taxable income</td>
<td></td>
</tr>
<tr>
<td><strong>Capital gains tax</strong></td>
<td>Federal government</td>
</tr>
<tr>
<td>• Calculated on the profit made on the sale of assets acquired after 19 September 1985, including the sale of a business or properties bought and resold within 12 months</td>
<td></td>
</tr>
<tr>
<td><strong>Stamp duty</strong></td>
<td>New South Wales government</td>
</tr>
<tr>
<td>• Imposed on documents that give evidence to transactions, such as leases and mortgages, motor vehicle registration and transfer, and the transfer of property (e.g. businesses, real estate and shares)</td>
<td></td>
</tr>
<tr>
<td><strong>Land tax</strong></td>
<td>New South Wales government</td>
</tr>
<tr>
<td>• A tax on land owned by individuals or businesses over a certain value (in 2010 it was $376 000 or more)</td>
<td></td>
</tr>
<tr>
<td>• Land zoned as rural and used mainly for primary production or an individual’s residence are exempt from land tax</td>
<td></td>
</tr>
<tr>
<td><strong>Payroll tax</strong></td>
<td>New South Wales government</td>
</tr>
<tr>
<td>• Payable on wages paid by an employer to their employees on payrolls that exceed $638 000 at a rate of 5.5 per cent (2010)</td>
<td></td>
</tr>
</tbody>
</table>

All businesses must pay their taxes if they wish to continue to operate as a legitimate business. Small to medium enterprise owners should structure their records and finances in such a way that they have the necessary information and money to efficiently manage their taxation obligations. Apart from the moral and ethical considerations, tax avoidance normally results in an Australian Taxation Office (ATO) investigation and the possibility of a fine or prison sentence.

Different taxes apply to different businesses, so a person operating a SME must become familiar with all appropriate tax requirements (see the following Snapshot). Businesses pay taxes to their federal and state governments on the basis of what they earn, what they own, and even what they purchase. One of the most important tax obligations is the goods and services tax (GST).
Legal requirements

Under tax law, a person operating a business must keep records that record and explain all transactions. These records include any documents that are relevant for the purpose of working out the person’s income and expenditure. The person must keep his or her records in writing in the English language or, if not in a written form (for example, in an electronic form such as a computer system), in a form that is readily accessible and convertible into writing in English.

Any books of accounts, records or documents relating to the preparation of an income tax return must be retained for a period of at least five years.

Fringe benefit tax legislation requires records to be kept for five years. Other statutory provisions, such as corporate law, require a company to retain records for seven years after completion of the transaction to which they relate.

Snapshot questions
1. Describe what records a businessperson must keep.
2. Outline how these records must be kept.
3. State how long the records must be kept.

Goods and services tax (GST)

The goods and services tax (GST) is a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia. It was introduced in response to criticisms of Australia’s wholesale sales tax system. The GST had a major impact on many aspects of business operations because businesses became responsible for collecting the tax on behalf of the government.

The GST is paid at each step in the supply chain, with businesses charging GST as part of the price of the goods and services they supply. Any business with an annual turnover of $75,000 or more operating within Australia must register for the GST. The business is then entitled to claim input tax credits from the ATO for any GST included in the price of inputs that the business purchases. This means the consumer bears the cost of the GST, not the business providing the good or service. It is the responsibility of the business, however, to pay to the ATO the amount of GST collected from the consumer.

The GST requires all registered businesses to prepare a set of accounts — the business activity statement (BAS) — at regular reporting intervals, either monthly or quarterly. The key to successfully managing GST reporting and associated ‘paperwork’, therefore, is to be organised, especially in terms of the input tax credit. Failure to claim for these credits will result in them becoming a cost to the business.

BizWORD

The goods and services tax (GST) is a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia.

An input tax credit is an allowable tax deduction that a business can claim for any GST included in the price of business inputs.

The business activity statement (BAS) records a business’s claim for input tax credits and accounts for GST payable.
SNAPSHOT

How does the GST system work?

The example above shows how three businesses, each registered for GST, charge and pay the GST. The timber merchant sells timber to a furniture manufacturer for $110, including $10 GST. The manufacturer uses the timber to make a table, which he sells to a furniture retailer for $220, including $20 GST. The retailer then sells the table to a consumer for $330, including $30 GST.

The timber merchant pays $10 GST to the ATO. The furniture manufacturer, who is registered for GST, is entitled to an input tax credit for the $10 GST included in the price paid to the timber merchant. The manufacturer will offset that $10 against the $20 collected on the sale of the table to the furniture retailer, and pay $10 GST to the ATO.

The furniture retailer, who is registered for GST, is entitled to an input tax credit for the $20 GST included in the price paid to the furniture manufacturer. The retailer will offset that $20 against the $30 GST collected on the sale of the table to the consumer, and pay $10 GST to the ATO.

The consumer who buys the table pays the GST, because consumers cannot register for GST and cannot claim input tax credits.

Snapshot questions
1. State the total GST paid in this example.
2. Explain how this amount was calculated.
3. Identify who can claim an input tax credit.
4. Outline why the consumer pays the GST.

The Australian Business Number (ABN)

As part of the tax reforms and the GST in 2000, the Australian government introduced the Australian Business Number (ABN). The ABN is a single identifying number that a business uses when dealing with government departments and agencies. The ABN also allows the business to participate in the GST system, because input tax credits can be claimed only if a supplier has an ABN. If a business does not have an ABN, tax at the rate of 48.5 per cent can be withheld. This is known as withholding tax and can be avoided by quoting an ABN on invoices for the supply of a good or service.

BizWORD

The Australian Business Number (ABN) is a single identifying number that a business uses when dealing with government departments and agencies.
Local government rates and charges

Although they are often considered of lesser importance compared to the numerous state and federal taxes, local government rates and charges must be considered and budgeted for. Rates — a system of property taxation usually based on the value of land — is the main local government charge a business will face. The three main areas in which fees or charges are levied are:

- water and sewerage
- waste management services
- development and building approval fees.

The income generated from these taxes is used to provide better facilities for the local community. Sometimes a local council will offer exemptions or reductions in the rates and charges to encourage people to establish businesses within the council area.

Summary

- Taxation is the compulsory payment of a proportion of earnings to the government.
- Businesses are responsible for checking their obligations concerning group tax (PAYG), fringe benefits tax, goods and services tax, company tax, capital gains tax, stamp duty, land tax and payroll tax.
- Goods and services tax (GST) is a 10 per cent value added tax imposed on most goods and services.
- The customer pays GST when buying goods and services, which is passed on to the business that in turn passes it on to the Australian Taxation Office (ATO).
- GST collection and payments to the ATO are recorded on the business activity statement (BAS), which is also the means by which a business can claim input tax credits.
- The Australian Business Number (ABN) is a single identifying number that a business uses when dealing with government departments and agencies.
- Property rates is the main local government charge a business will face.

Revision

1 Distinguish between group tax — pay-as-you-go (PAYG) — and company tax.
2 Recall an employer’s obligations in relation to the stamp duty tax system.
3 Distinguish between fringe benefits tax and capital gains tax.
4 State the business owner’s requirements in relation to structuring financial records for taxation purposes.
5 Explain the operation of each of the following state taxes:
   (a) payroll tax
   (b) land tax.
6 Denise runs a real estate agency, which is registered as a proprietary company. She employs eight permanent staff and three casuals and paid a total of $870 000 in wages in the last financial year. The business provides five employees with a car each to assist them to visit properties as well as for their own personal use. Denise regularly uses her business contacts to buy cheap properties, renovate them, and sell at a profit. Her business owns its own premises, which are currently valued at over $1 million. Identify and explain each of the Commonwealth and state taxation obligations of Denise’s business.
7 State what the following acronyms represent.
   (a) GST
   (b) BAS
   (c) ABN
8 Define the term ‘goods and services tax (GST)’.
9 Explain the importance of a BAS.
10 Describe the effect of the system of input tax credits on businesses and consumers.
11 An electrical goods manufacturer sold a dozen refrigerators to an electrical retailer for $880 each, which included $80 GST per refrigerator. The electrical retailer then sold each of the refrigerators to its customers for $1320 each, including GST.
   (a) Calculate the amount of GST paid by each customer.
   (b) Identify who, in this example, can claim input tax credits.
   (c) Calculate the amount claimed as an input tax credit for each refrigerator by the electrical retailer.
   (d) Calculate how much GST the electrical manufacturer would be required to pay to the ATO.
   (e) Calculate how much GST the electrical retailer would be required to pay to the ATO.
12 Recall why it is important for a business to apply for an ABN.
13 Identify the main local government rates and charges.

Extension
1 In small groups, critically analyse the following statement: ‘In today’s commercial world, tax avoidance happens. The only problem is being caught.’ Choose a spokesperson to share the group’s comments with the rest of the class.
2 In small groups, arrange an interview with a local accountant. Create either a two-page written or five-minute oral report. Use a word-processing package for the written report or a multimedia application for the oral report. You might wish to develop your report under the following headings:
   (a) types and rates of tax payable by a small business
   (b) electronic recording systems for tax records
   (c) completion of the business activity statement
   (d) penalties for non-payment or avoidance.
12.1 Introduction

Businesses do not plan to fail, they fail to plan — this quotation is a sad reflection of reality. SME owners start keen, convinced their idea will succeed. They are full of optimism. However, while enthusiasm is an essential ingredient in the success of a business, it is not enough by itself. If prospective business owners neglect to undertake thorough planning, so they can put together a carefully researched business plan, the stage is set for business failure. Optimism will turn to despair as the small business owner faces the grim reality. All SME owners must have a good understanding of the:

- role of the business plan
- process of business planning.

The role of the business plan

A business plan is similar to a road map. You would not go on a year-long trip around Australia without first preparing a plan. You would need to decide which roads to take, where to stay and what sights to visit. During the trip, you would need to constantly refer to the map to make sure you were heading in the right direction. Also, on hearing about closed roads or experiencing mechanical problems, you would need to modify your travel plans to suit the new conditions.
It is amazing that many people put more planning into a holiday than they do into their business. Without planning, the business owner does not know where the business is heading. The business ‘journey’ will probably end in disaster, with the owner asking, ‘How did I end up here?’ Therefore, the essential role of the business plan is to act as a guide or map on which the business’s journey can be plotted. It is one of the most useful management tools a business owner can use. In all businesses, the best results come from effective management and detailed planning (see the following Snapshot).

**SNAPSHOT**

I really had to do my homework and develop a comprehensive business plan.

Kristina Karlsson, founder and creative director of kikki.K, started her business in 2001. She had a passion for stationery and opened her first kikki.K store in Melbourne Central. The store featured her stationery products as designer accessories. Karlsson says that ‘having limited financial resources to start and grow my business was probably the hardest challenge I faced in getting kikki.K off the ground. The banks certainly weren’t too supportive in our early years. They needed high levels of security, which we couldn’t give — so I ended up selling the house to fund business development. It meant that I really had to do my homework and develop a comprehensive business plan.’

A business plan should be a ‘living document’. It needs to change as the business changes. Kristina Karlsson believes that business plans must be flexible so that if something is not working, the business can adapt accordingly.

Today, kikki.K has more than 30 stores in Australia as well as four in New Zealand and more than 100 stockists throughout the world. The business has also grown its product range to include notebooks, greeting cards, pens and wrapping paper.

**Snapshot questions**

1. Recall how Kristina financed her business development.
2. State why the banks were not supportive in her early years of business.
3. Outline why it was important for Kristina to have a business plan.
4. Explain what Kristina means when she says that a business plan should be a ‘living document’.

However, preparing the business plan is only the first stage. Many SME owners realise the need to prepare a business plan before establishing a business, but they then make a fundamental mistake — they forget to constantly refer back to their plan. This would be similar to a student preparing a set of summary notes for a topic, and then never looking at them.

Even if a SME owner manages to avoid the mistake of not regularly consulting the business plan, there is still another trap. An inexperienced person may not be flexible enough to modify their business plan as the internal and external business environments change. Sticking too rigidly to a plan, and not adapting it to suit the changed conditions, can be as detrimental as not having a plan.

The business plan must always be seen as a working document. It is not a straightjacket restricting the business and preventing change. The unexpected can and often does happen. Unfavourable factors, such as a customer not paying an account or a new competitor moving into the market, will force the business owner/manager to modify their plan. Favourable conditions such as a new marketing opportunity will need to be seized and they will also require some modification to the plan.
What is a business plan?

A business plan is exactly what it says — a plan for a business. It is a written statement of the business’s goals and the steps to be taken to achieve them. In other words, it is a summary and an evaluation of a business idea in written form. The ‘writing’ is important because ideas tend to be no more than wishful thinking until transferred to paper. Thinking about something is not planning. A few ill-conceived ideas scribbled on the back of an envelope are likely to lead to business failure.

A comprehensive business plan will assist when arranging finance for the business. The plan provides information that lenders need to know and it also shows that the business is being properly organised and managed.

If a business plan is so important, why do some people attempt to establish a business without first preparing one? Figure 12.2 highlights some of the main reasons.

Reason 1 — Let’s get on with it straight away. These people believe planning is a waste of time and effort. This attitude often leads to impulsive actions and mistakes.

Reason 2 — Planning costs too much. Business planning does involve gathering and analysing information but it need not be expensive.

Reason 3 — You have to be an academic to plan. While some of the terms used may initially sound confusing, business planning is no more difficult than preparing a holiday.

Reason 4 — I’m only a small business owner. Businesses of all sizes need to set goals, prepare strategies and evaluate the outcome.

Reason 5 — What do they tell me that I don’t already know? Without a business plan it is impossible to shape the future, make projections and evaluate the business’s performance.

Reason 6 — I’ll do it later; I don’t need it at this stage. Just working hard is no longer a guarantee of business success. Planning and revising the plan need to be undertaken at all stages of the business’s life.

Planning is not always easy and it can be time consuming. However, the time invested in planning is never wasted in the long run, for, with it, the chances of success are greatly improved.

Types of business plans

Just as no two businesses are identical, neither are any two business plans. Each plan will be unique, containing information and strategies that apply to one particular business. A business plan for a transnational corporation, for example, will be detailed and comprehensive. It will add up to hundreds of pages, having taken

**FIGURE 12.2 The main reasons for business owners’ failure to plan**

**BizFACT**

A business plan is essential for those business owners who wish to thrive and not just survive.
much time, effort and money to prepare. Its presentation will be highly professional
and distributed to a large number of the company’s senior management. On the
other hand, a business plan for a SME may be only 10–15 pages in length, word
processed at home and circulated to only a few people.

Depending on variables such as the product, the market, the size of the business
and its location, each business will have a unique set of information in its business
plan. However, regardless of their type, length, appearance and distribution, all
business plans have a number of common elements, as shown in table 12.1.

**TABLE 12.1 The common elements of a business plan**

<table>
<thead>
<tr>
<th>Element</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Executive summary</td>
<td>A brief overview of the plan</td>
</tr>
<tr>
<td>2. Goals</td>
<td>What the business hopes to achieve</td>
</tr>
<tr>
<td>3. Strategies</td>
<td>An overview as to how the business will attempt to achieve the goals</td>
</tr>
<tr>
<td>4. Business description and outlook</td>
<td>An overview of the industry in which the business will operate, including a situational analysis</td>
</tr>
<tr>
<td>5. Management and ownership</td>
<td>The nature and type of organisational structure</td>
</tr>
<tr>
<td>6. Operational plans</td>
<td>Details the production process and the people required now and in the future</td>
</tr>
<tr>
<td>7. Marketing plans</td>
<td>The product, price, promotion and distribution details</td>
</tr>
<tr>
<td>8. Financial plans</td>
<td>A description of the business’s financial needs and methods for evaluating its performance</td>
</tr>
<tr>
<td>9. Human resource plans</td>
<td>Details both the present and future staff requirements</td>
</tr>
</tbody>
</table>
While all business plans contain similar information, a comprehensive and detailed business plan is most beneficial. A sketchy, quickly prepared business plan will not serve any lasting purpose. Some plans may only briefly refer to some of the areas, but all points need to be at least considered.

**Benefits of a business plan**

The planning process acts as a link or bridge between the business owner’s ideas and the actual operation of the business; it is a way of turning dreams into reality. The written plan becomes a useful reference point for the running of the business. Any small business with a plan has direction, which ultimately saves money, time and effort, and also increases the likelihood of success. Preparing a business plan is very similar to completing an assessment task. The result will reflect the amount of time, effort and research that goes into the plan and its final presentation.

**FIGURE 12.4 The benefits of developing a business plan**

### 12.2 Business planning process

Planning is a process, a series of actions to achieve a goal. If you decide to have a party next Saturday night, for example, this becomes your goal. Unless you undertake some planning you will be unable to achieve this goal. You will need to invite people, organise food and drinks, arrange music, and decide on a venue. These tasks are the ‘series of actions’ — an action plan — that you need to undertake to achieve the goal. Thus planning is the process of setting targets and deciding how to achieve them.

Planning is not always straightforward. However, a number of activities can be undertaken to make it easier (figure 12.5). A business plan is far more than just listing a few ideas. It is more than merely drawing up a marketing timetable or keeping financial records. The business plan needs to analyse the whole business by examining all parts of the operation. As a result, each part of the business can function effectively and achieve its goals, helping the overall success of the business.
<table>
<thead>
<tr>
<th>Party example</th>
<th>Activities — something you do</th>
<th>Terms — the names of what you will be doing</th>
</tr>
</thead>
<tbody>
<tr>
<td>I think my friends would like a party.</td>
<td>1. Predicting something in the future</td>
<td>Forecasting</td>
</tr>
<tr>
<td>I want it to be a successful party.</td>
<td>2. Determining what you wish to achieve</td>
<td>Setting goals</td>
</tr>
<tr>
<td>Anyone who becomes aggressive will be forced to leave.</td>
<td>3. Outlining how to cope with any current and future problems that stand in the way of achieving the goal</td>
<td>Formulating policies</td>
</tr>
<tr>
<td>I will:</td>
<td>4. Deciding on a course of action — that is, the tasks that will help achieve the goals</td>
<td>Programming</td>
</tr>
<tr>
<td>• invite people</td>
<td></td>
<td>Scheduling</td>
</tr>
<tr>
<td>• arrange a venue</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• organise food and music.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I’ll borrow $200 from Michelle.</td>
<td>5. Arranging the finances to satisfy the goals</td>
<td>Budgeting</td>
</tr>
<tr>
<td>PARTY!</td>
<td>6. Putting the plans into action</td>
<td>Implementing</td>
</tr>
<tr>
<td>I want everyone to enjoy the party.</td>
<td>7. Checking on the progress of the activity, evaluating and adjusting the plans if necessary</td>
<td>Monitoring</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Evaluating</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Modifying</td>
</tr>
</tbody>
</table>

**FIGURE 12.5** You need to consider a range of planning activities, whether your goal is a party or business success.

Government departments — such as the New South Wales Department of State and Regional Development or the federal government’s business.gov.au — provide free and comprehensive advice on a wide range of small business matters including how to write a business plan. As well, numerous small business magazines often contain articles examining business planning.
Summary

- It is vital that a SME owner completes a business plan. Businesses do not plan to fail, they fail to plan.
- A business plan is a written statement of the goals for the business, and the steps to be taken to achieve them. It is a summary and an evaluation of a business concept in written form.
- A business plan will also assist the SME owner when arranging finance for the business.
- A typical business plan may include, as a minimum, an executive summary, an operations plan, a marketing plan, a financial plan and a human resource plan.
- The planning process acts as a link or bridge between the business owner’s ideas and the actual operation of the business.
- Planning is the process of setting goals and deciding how to achieve them.

Revision

1. Define the term ‘business plan’.
2. Outline why it is important for a business owner to develop a business plan.
3. Recall why so many SMEs fail to prepare a business plan.
4. A friend has asked you to help her prepare a business plan for a new fitness centre she wants to open. Propose the elements she should include in the business plan.
5. ‘A plan is similar to a map — it plots the route the business will travel.’ Discuss.
6. Explain how the business plan acts as a link or bridge between the owner’s ideas and the actual operation of the business.
7. Identify the benefits of developing a business plan.
8. Explain why planning is a process.
9. Examine figure 12.5 (page 397), then create a plan for one of the following:
   (a) taking an overseas holiday
   (b) completing an assessable task
   (c) organising a hockey match.

For each plan briefly outline what is required for each activity.

Weblink

Use the Small business tool kit weblink in your eBookPLUS to explore the Small Business NSW’s tool kit and resources for small businesses.

FIGURE 12.6 The smallbiz website contains a wealth of information about how to write a business plan, including templates, video case studies and reference material.
Identify the most appropriate words from below to complete the following sentences.

plan  strengths
direction  fail
review  costs
link  loan
flexible  goals

(a) Businesses do not plan to ________, they fail to __________.
(b) Business plans should be ______________ — that is, modified as conditions change.
(c) A business owner should regularly ______________ the business plan and modify it when the business environment changes.
(d) Without a business plan the business lacks ____________.
(e) Many business owners do not prepare a plan because they think it __________ too much.
(f) When reviewing an application for a ____________, financial institutions will want to examine the business plan.
(g) ________ are what you want to achieve.
(h) A business plan helps identify the business's ____________ and weaknesses.
(i) The planning process is the ____________ between the owner's ideas and the actual operation of the business.

Use the Business plan weblinks in your eBookPLUS to find advice concerning the preparation of a business plan. Evaluate the benefit of these sites to someone wanting to start a small business.

Extension

1 ‘Businesses do not plan to fail, they fail to plan.’ Critically analyse this statement.
2 Interview a local small business owner to investigate the following aspects of the business:
   (a) the planning options that had to be considered when starting the business
   (b) the purpose of the business plan
   (c) the role of the business plan within the operation of the business
   (d) the importance of planning to the overall success of the business
   (e) the government departments and/or private organisations that offered assistance in developing a business plan.

Present your research as a business report. You may wish to present your report as a PowerPoint presentation.

3 ‘The process of planning is more important than the finished plan.’ Determine the benefits this process offers a SME owner.

4 Bruce Thurow, senior loans manager for a local bank, receives a lot of business plans from clients. He recalls one plan that arrived in three cardboard boxes as volumes of looseleaf notebooks. Overkill? ‘I knew I wasn’t going to read them. I just put them aside.’ In small groups, determine why such a detailed plan was inappropriate when all the small business owner was requesting was a small loan.

12.3 Sources of planning ideas

We have already examined how the business environment is divided into two categories:
1. the internal business environment. This covers the factors within the direct control of the owners. It represents what occurs within the business.
2. the external business environment. This is the larger environment within which the business operates. It consists of factors over which the business has little control, and represents what occurs on a larger scale outside the business.
Information is the essential ingredient needed to prepare a business plan. Having access to up-to-date, relevant and accurate information will allow the business owner to prepare a much superior business plan. Information for planning is obtained from different sources within and outside the business. The different levels of management and, in many cases, employees, may contribute ideas about how the business could achieve its goals. Research and development undertaken by a business may extensively contribute to planning (see the following Snapshot).

Mock heroics make for a triumphant cover story

It was a chance encounter six years ago that gave Lara Solomon the idea to start her business. The marketing manager was strolling the streets of Thailand when she came across stalls where women sold covers for mobile phones. ‘But they were all different sizes and qualities, there was no one branded product,’ she says.

When Solomon returned to Sydney, she decided to develop a higher-quality product with designs better suited to the Australian market.

After six months of research and with financial support from her family, she came up with Mocks, or mobile phone socks. Her original range included 12 designs sold through 17 shops in Sydney.

‘It was the only one that would stretch for all makes and models,’ she says. ‘I did a lot of marketing around the product and that immediately made it stand out because no one marketed their accessories, they’d market phones but not accessories.’

But Mocks’ originality made them a hard sell at first. ‘You had to explain it about five times and send a sample,’ she says. Solomon trawled through Yellow Pages, calling every mobile phone shop she could find. One chain’s trial in seven stores
proved so successful the owners decided to stock Mocks in every one of their 110 shops. Once the promotional campaign got into full swing, retailers began calling back to make orders.

Today Solomon’s company, LaRoo, sells dozens of designs and employs seven staff. At least 1.4 million Mocks have been sold around the world via the web and retailers. She pushes her niche to its limits, offering fluffy fabrics, diamantes and even a ‘couture’ tutu-inspired design. There are also wedding Mocks, flag Mocks and the ultimate in personalisation photo Mocks. ‘I really enjoy the fact the product is a small idea but very versatile and you can reach different niches by doing different things,’ she says. ‘You can personalise Mocks and add branding. It opens up opportunities and the only limit is your imagination.’

Solomon even uses designs to promote her brand, for example, by bringing out a horse-racing design in time for the Melbourne Cup. ‘We don’t just market the product, we use the product to market the brand.’

She has also expanded into earphone covers and Mocks for electronic items such as MP3 players and GPS devices.

Solomon believes Mocks’ quirkiness and practicality are the keys to their popularity. She stays ahead of local competition and cheap imports by building her range, quality, branding and customer loyalty. ‘Quite a lot of people know me as the Mocks lady,’ she says.

‘Mocks are now the generic name for mobile phone socks, so teens will say to their parents: “I want a Mock and make sure it’s a real one.” I’ve had a number of mums say: “I had to take this back and buy a proper one.”’


**Snapshot questions**

1. **Identify** the features of a Mock that differentiate it from that of other similar products on the market.
2. **Outline** the difficulties faced by Lara Solomon in the initial start-up phase of the business.
3. **Account** reasons for the success of Mocks and **identify** what strategies Lara adopted to expand her brand.

The external environment is also a source of ideas for planning. Economic, political, social, technological, geographic and legal factors have an impact on the business. The business must account for each factor during the planning stage, and gather information about each one. Specialists such as accountants, finance brokers, consultants, bank managers and solicitors all provide knowledge to assist a business in its planning.

**Situational (SWOT) analysis**

A situational **(SWOT) analysis** is an excellent technique for gathering information for use in the business plan. SWOT is an acronym for strengths, weaknesses, opportunities and threats (see figure 12.8). It is a powerful tool that can be used at all stages of the planning process. Analysis of the business’s strengths and weaknesses is an internal analysis. Given that the business has a degree of control over its internal environment, the analysis will provide information that can help place the business in a stronger financial position. From this position, the business can set new goals.

Analysis of the business’s opportunities and threats is an external analysis. Particularly important to the business plan is the identification of unmet or unsatisfied demand that the business can perhaps satisfy. At the same time, the business owner should attempt to convert threats into opportunities.
Internal assessment

What are our strengths?
• What is the business good at?
• Is our product popular?
• Are our customers loyal?
• Do we have a skilled and motivated workforce?
• Do we function efficiently?
• Are we in a solid financial position?
• Is our equipment state of the art?

What are our weaknesses?
• Do we have competent managers and staff?
• Is our computer system obsolete?
• Have we experienced past failures?
• Have we been upgrading our facilities to keep pace with others?

What are our opportunities?
• What will new technology bring for us?
• Is the national economy strong?
• Are interest rates low?
• What are our possible new markets?
• What other businesses can we acquire to expand the organisation?

What are our threats?
• What trends have been evident in our markets?
• Are there new laws regulating what we do?
• Are there new competitors?
• Are current competitors taking over our market share?

External assessment

What are our opportunities?
• What will new technology bring for us?
• Is the national economy strong?
• Are interest rates low?
• What are our possible new markets?
• What other businesses can we acquire to expand the organisation?

What are our threats?
• What trends have been evident in our markets?
• Are there new laws regulating what we do?
• Are there new competitors?
• Are current competitors taking over our market share?

FIGURE 12.8 A situational (SWOT) analysis

Summary
• The internal and external business environments are sources of planning ideas.
• Information is the essential ingredient needed to prepare a business plan.
• A situational (SWOT) analysis can be used at all stages of the planning process.

Revision
1 Distinguish between a business’s internal and external environments.
2 Identify two sources of information for planning (i) within, and (ii) outside the business.
3 Recall what the acronym SWOT represents.
4 Outline the benefits of a situational (SWOT) analysis as a planning tool.
5 Construct a situational (SWOT) analysis for either:
(a) a business that you deal with regularly
(b) your school.

Extension
1 ‘The most important aspect of the business planning is the process of examining the environment, one’s self, and the business opportunities the two represent’. Analyse the accuracy of this statement.
2 In small groups, use the brainstorm technique to determine the advantages of obtaining ideas from employees in the planning process.

12.4 Vision statement

The vision statement broadly states what the business aspires to become; its purpose and its function. The vision of the National Australia Bank, for example, is ‘we will be a leading international financial services company which is trusted by you and renowned for getting it right’.
Vision statements may relate to customers (using such phrases as ‘maximise customer satisfaction’, ‘remember that customers are our strength’, ‘never have a dissatisfied customer’) or employees (for example, ‘make the firm an enjoyable and rewarding place to work’, ‘offer opportunities for career advancement’, ‘remember that our employees are our strength’). A clear vision statement should be concise, creative, focused and realistic. It may contain any special features of the business, what it values and what it hopes to achieve.

**Purpose of the vision statement**

The main purpose of the vision statement is to guide and direct the business owners, managers and employees. It creates the culture within the business and acts as a benchmark against which to measure all the business’s decisions and operations.

### David Jones

**Vision**

David Jones will be the best, full line, differentiated department store. Our Company will be a combination of key capital city stores and key suburban locations. We will maximise shareholder return by focusing on delivering the core operating fundamentals of a department store.

### Bartlett Precision Manufacturing

**Vision**

Bartlett Precision Manufacturing is committed to:
- providing high-quality design and engineering services to our customers in accordance with best international practice
- the safety and wellbeing of our employees
- fulfilling the community’s demand for a safe and sustainable environment.

### Yarrawollen Designs

**Vision**

To be the region’s most respected architectural design company, providing innovative solutions and the best customer service experience.

**FIGURE 12.9** Vision statements from a range of businesses

### 12.5 Goals and/or objectives

Once the owner has formulated the vision statement for the business, they can determine specific goals. People start up a business because they want to achieve something; they have a goal they want to accomplish. As explained in chapter 6, a goal states what a business expects to achieve over a set time, which will assist in realising the business’s vision.

Goals for businesses could include the following:
- to become the largest business in the market
- to improve market share
- to provide a reasonable return for investors
- to contribute to the wellbeing of the community.

All these goals have one thing in common: they are the motivating force behind the business.

### Levels of goals and objectives

Once the goals have been established, a SME owner usually then decides how to achieve them. As outlined in section 12.2, this involves developing an effective and
worthwhile action plan. The action plan breaks down the goals into **objectives** — specific statements detailing what a business (or individual) needs to achieve in order to accomplish its vision. For example, you may have a goal of achieving a certain result in the Business Studies Trial HSC examination. Consequently, you will need to set some objectives, such as increasing by 60 minutes each week the time spent revising past papers, or weekly practice sessions answering 10 multiple choice questions.

In a business, senior management will normally set the **strategic goals**, which focus on long-term, broad aims and apply to the business as a whole. For example, the chief executive officer (CEO) may establish a strategic goal of ‘increasing market share’. This will involve the input of the four key business functional areas — operations, marketing, finance and human resources. Middle management set **tactical objectives**, which focus on mid-term, departmental issues and describe the course of action necessary to achieve the business’s strategic goals. To use the example of increasing market share, a marketing manager may set a tactical objective of researching consumer tastes and preferences in order to help achieve the strategic goal. Front-line managers or supervisors set **operational objectives**, which focus on short-term issues and describe the course of action necessary to achieve the business’s tactical objectives. For example, a marketing supervisor may set an objective of arranging for twenty customers to attend a focus group, research session to help achieve the tactical objective and strategic goal.

In practice, think of the levels of goals and objectives as pyramid-shaped as shown in figure 12.10.

**BizWORD**

An **objective** is a specific statement detailing what a business (or individual) needs to achieve in order to accomplish its vision.

**Strategic goals** focus on long-term, broad aims and apply to the business as a whole. **Tactical objectives** focus on mid-term, departmental issues and describe the course of action necessary to achieve the business’s strategic goals.

**Operational objectives** focus on short-term issues and describe the course of action necessary to achieve the business’s operational objectives.

**BizFACT**

The terms goal and objective are often used synonymously as both terms refer to something a business wants to accomplish. However, the people, timeframe and resources involved in achieving each goal and objective vary significantly.

**FIGURE 12.10** The objectives established at each layer of the business’s hierarchy are devised with the purpose of helping to achieve the strategic goal.

A business needs to have a clear idea of what it is trying to achieve; in other words, it needs clear goals and objectives. It is the interaction between the vision statement, goals and objectives that provide a process for a business to accomplish this (see table 12.2).
### Table 12.2 The relationship between a vision, goal and objective

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
<th>Personal example</th>
<th>Business example — Renewable energy company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vision</td>
<td>Broad statement of overall purpose</td>
<td>Be healthy</td>
<td>To be a company of choice in the alternate energy sector</td>
</tr>
<tr>
<td>Goal</td>
<td>More specific statement of what is intended to be achieved</td>
<td>Lose weight</td>
<td>To be the market leader in alternate energy sales</td>
</tr>
<tr>
<td>Objective</td>
<td>Very specific statement of how the goal is to be achieved</td>
<td>Lose two kilograms by 1 December</td>
<td>To increase sales by 10% each year</td>
</tr>
</tbody>
</table>

### Goals — what the business wants to achieve

In operating a business, the owner is always trying to achieve three broad goals: financial goals, social goals, and personal goals.

#### Financial goals

As outlined in chapter 6, all businesses have financial goals as well as a system of financial record keeping. Financial records are also used to determine a business’s level of success in achieving its financial goals. The four main financial goals are listed below.

1. **Profit**. Only profitable businesses survive in the marketplace. Profit is what remains after all the business expenses are deducted from the sales revenue. If the business is unable to consistently make a profit, it will fail. The size of the profit is a main indicator of a business’s success; it measures how productive the enterprise has been. Most businesses try to maximise the level of their profits.

2. **Market share**. Market share is a business’s share of the total industry sales for a particular product. The market share of SMEs is usually restricted to the size of the business. A local corner store’s market share, for example, is limited to the number of customers living within its immediate area.

3. **Growth and diversification**. Many businesses wish to grow and expand. Growth and diversification is not a goal that only large businesses can achieve. Many successful SMEs have followed similar strategies, as illustrated by Noel Carroll and Noel Roberts who, in 1988, founded Michel’s Patisserie. Their concept was simple: a central bakery bakes the product and distributes fresh daily to the retail outlets, which in turn display and sell to customers. Michel’s Patisserie is the largest franchising group of its kind in Australia, with over 340 stores throughout Australia, New Zealand and China.

4. **Share price**. Companies that wish to be successful need to maximise the returns of their shareholders. This is achieved by keeping the share price rising and paying back healthy dividends.

**BizFACT**

All businesses have financial goals as well as a system of financial record keeping. Financial records are also used to determine the business’s level of success.

**BizFACT**

In Australia, PepsiCo presently has about 10 per cent of the $1.8 billion carbonated soft-drink market, compared to Coca-Cola Amatil’s 60 per cent share.

**BizWORD**

The return is any profit that investors make from their investment.
Social goals

All businesses operate within a community and, like individuals, they have certain social responsibilities. Some businesses develop social goals and adopt strategies that will benefit the community while still achieving financial goals. The following are among the main social goals.

- **Community service.** Business sponsorship of community events, promotions and programs has increased rapidly during the past decade. Whether for genuine or altruistic reasons, many businesses financially support educational, cultural, sporting and welfare activities.

- **Provision of employment.** Many SME owners aim to continue their business in order to provide employment for family members.

- **Social justice.** Everyone has the right to be treated fairly. A business may be concerned about social justice; that is, it adopts a set of policies to ensure that employees or other community members are treated equitably and fairly. Federal government legislation (such as the Racial Discrimination Act 1975, the Sexual Discrimination Act 1984 and the Affirmative Action (Equal Employment Opportunity for Women) Act 1986) has forced businesses to adopt fair and non-discriminatory policies.

- **Ecological sustainability.** Businesses increasingly have to take responsibility for protecting the environment. The Earth is a fragile system that we need to take care of to ensure its long-term sustainability. The social conscience of responsible business owners has led them to adopt policies of conservation, recycling and restoration.

Personal goals of managers and owners

Business owners normally have a number of personal goals. Often the nature and operation of the business tend to reflect these personal goals, especially in SMEs. The personal goal of achieving higher income and greater financial security, for example, will complement the business goals of growth and diversification. Personal goals for business owners are not normally included in the business plan or mission statement. However, this does not diminish their importance, because they motivate the business owner and may underpin the viability of the SME.
Long-term growth

As outlined in chapter 6, an important aspect of profit maximisation is the business’s ability to maintain profits over time. To achieve this, a business must aim for long-term growth — the ability of a business to continually expand.

Long-term growth depends on a business’s ability to develop and use its asset structure to increase sales, profits and market share. It is an important goal of management as it ensures that the business is sustainable into the future. The department store retailer Myer, for example, recently put in place a number of strategies to increase profit maximisation to help guarantee its long-term growth. The strategies included:

- price discounting tactic to entice customers into its stores
- targeted promotional sales of exclusive brands that have high profit margins
- streamlining of its logistics systems
- concentrated effort to reduce shoplifting with the installation of security cameras.

Long-term growth does not happen accidently. Instead, it requires comprehensive, strategic planning. Consequently, for a business to not only survive competition but also prosper and grow, it must have a sustainable competitive advantage. This can be achieved by having a unique good or service, a consistent marketing plan and adopting a relationship marketing philosophy to encourage customer loyalty. Toyota’s global competitive advantage, for example, is based on a business philosophy known as the Toyota Production System (also referred to as lean manufacturing/production), aimed at the elimination of waste in seven critical areas: transportation, overproduction, defective units, over-processing, inventory, motion, waiting. This system very much depends on a human resources management approach that encourages employee creativity, involvement and loyalty, and a highly reliable network of parts suppliers. However, no manufacturing system is perfect. Recently, when some Toyota models suffered a serious defect with the braking system, which required a worldwide recall, Toyota had to undertake some strategic changes so as to protect and maintain its market share.

Some other strategies that successful businesses have used to achieve long-term growth include:

1. Customer feedback. Google, the internet’s number one search engine, continuously and rapidly upgrades its operating system by listening to its customers.

BizWORD

Long-term growth is the ability of a business to continually expand.

Logistics is the management of business operations, such as the purchasing, storage, transportation and delivery of goods along the supply chain.

BizWORD

Lean manufacturing/production is an operational strategy aimed at achieving the shortest possible production time by eliminating waste.
2. **Supplier and customer partnerships.** Bridgeport Manufacturing provides customers with the opportunity to develop products in consultation with the business’s designers.

3. **Product innovation.** Zentech Computers focuses on bringing three new products onto the market every six months by undertaking constant research and development.

4. **Sigma Six.** This business management approach, originally developed by Motorola and used extensively in all types of businesses, aims to improve business performance by improving quality, reducing costs and creating new opportunities. A sigma-six process is one in which 99.99 per cent of all manufactured products are defect free.

**Summary**

- The vision statement broadly states what the business aspires to become.
- Vision statements guide and direct the business owners, managers and employees.
- Once the goals have been established, a SME owner determines the objectives.
- Objectives are specific statements detailing what a business needs to do to accomplish its vision.
- Strategic goals, tactical and operational objectives are determined by different levels of management.
- Many businesses strive to achieve three broad goals:
  - financial — chiefly maximising profit
  - social — benefits for the community
  - personal — individual preferences.
- Longer term growth is the ability of a business to continually expand.
- Longer term growth depends on a business’s ability to develop and use its asset structure to increase sales, profits and market share.

**Revision**

1. Select a number of annual reports for public companies. **State** the vision (or mission) statements for each company. **Explain** how these relate to the business’s goals. To help you, use the **Business vision statements** weblink in your eBookPLUS for the following public companies:
   (a) Boral Limited
   (b) Westpac Limited
   (c) Origin Energy Limited
   (d) Woolworths Limited
   (e) David Jones Limited.

2. **Identify** which of the following are vision statements. Give reasons for your answers.
   (a) All breakages must be paid for.
   (b) Care for the customer is our number one priority.
   (c) Application of an integrated accounting system
   (d) A safe and healthy workplace
   (e) Commitment to excellence
   (f) To increase sales revenue by 5 per cent in the next six months

3. **Recall** three main goals of most businesses.

4. **Outline** the relationship between goals and objectives.

5. **Identify** three objectives you would need to set if you wanted to achieve the goal of improving your Business Studies results.

6. **Distinguish** between strategic goals, tactical objectives and operational objectives.

7. **Deduce** why a business needs clear goals and objectives.
8 Recall the correct level of management that determines the following goal or objective.

<table>
<thead>
<tr>
<th>Goal or objective</th>
<th>Level of management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic goal</td>
<td></td>
</tr>
<tr>
<td>Tactical objective</td>
<td></td>
</tr>
<tr>
<td>Operational objective</td>
<td></td>
</tr>
</tbody>
</table>

9 Explain the relationship between market share and growth.

10 Identify which of the social goals you consider to be the most important. Justify your selection.

11 Define the term ‘longer term growth’.

12 State three methods a business can use to achieve a competitive advantage.

13 Propose four strategies a business can use to achieve longer term growth.

**Extension**

1 ‘The main goal of a business is to maximise profits.’
   (a) Define the term ‘profit’.
   (b) Determine under what circumstances a business may be prepared to accept reduced profits in the short term.
   (c) In your opinion, assess whether profit should be the only goal of a business.

2 Arrange to interview a local business owner. Create a business profile by asking the following questions.
   (a) What motivated the owner to start the business?
   (b) Why is there a need for the business’s goods or services?
   (c) How has the business been funded?
   (d) Has the business been upgraded or expanded?
   (e) What are the future growth areas of the business?
   (f) What has been the business’s biggest problem or greatest mistake?
   (g) What external threats face the business?

3 Examine figure 12.9 (page 403), then answer the following questions.
   (a) Identify the common features of these vision statements.
   (b) Explain why it would be important for employees, managers and customers to be familiar with a business’s vision statement.
   (c) Determine under what circumstances the vision statement would need to be altered.

**12.6 Organising resources**

Once the SME owner has formulated the vision, goals and objectives, the next stage in the planning process requires organising the resources — human effort, time, money, equipment and materials — needed to fulfil the plan. As outlined in chapter 7, organising is determining:
- what is to be done
- who is to do it
- how it is to be done.

At this stage, the owner must determine all the activities that employees perform — from ordering stock through preparing financial reports to meeting with clients — and all the equipment, money and facilities that employees need to carry out those activities (see figure 12.13). This results in the creation of an **organisational structure**, which defines how tasks are divided (as shown by the organisation chart) and resources used.

**BizWORD**

An **organisational structure** is the framework in which the business defines how tasks are divided, resources are used, and departments are coordinated.
ZenTech Fashions
Our vision: To be the fashion company of choice within the Australian market

Step 1
Develop plans and establish goals

Step 2
Determine activities

Step 3
Group activities

Step 4
Assign work tasks and delegate authority

Step 5
Design a hierarchy of relationships

While driving the business towards its central purpose, as expressed in the vision statement, the benefits of a properly implemented organising process is that it:
• establishes a chain of command that results in an orderly way of communicating within the business
• creates a coordinated work environment by outlining sensible guidelines for who does what and who is responsible for various activities
• provides a sense of common purpose so that all employees are working towards a common vision, goal or objective
• organises resources in the most efficient manner so that all employees can perform their tasks.

Organising is a device that SME owners can use to gather resources for getting things done. Part of the organising process requires resource allocation, which refers to the efficient distribution of resources so as to successfully meet the goals that have been established. Resource allocation establishes what work will be performed by what person and/or machine, and under what conditions. The materials needed must be determined and ordered. The work tasks must be distributed to different departments. Human resource requirements must be calculated and time schedules set for each stage of the production process.

Each of the key business functions — operations, marketing, finance and human resources — require specific resources that need to be effectively organised.

Organising resources — operations

As outlined in chapter 8, the operations function of a business involves transforming different types of inputs (raw materials, labour, equipment and other resources) into finished or semi-finished goods or services. To produce either a good or service, therefore, a business needs to have essential equipment and knowledge. Consequently, to undertake successful production, the following questions will need to be asked.

• What type of equipment and raw materials are needed?
• Which suppliers will be used to purchase the equipment and raw materials?
• How much money needs to be allocated for the purchase of the raw materials and resources?
• What storage, warehouse and delivery systems are required?
• What level of technical expertise will employees need to achieve maximum production from the raw materials and equipment?

Researching the answers to these questions enables the SME owner to clarify what changes may need to be made to either the structure of the business or the production process. Bartlett Precision Manufacturing, for example, to manufacture highly-intricate components, needed to purchase computer aided design (CAD) and computer aided manufacture (CAM) resources (see figure 12.14). To arrange for the finance required to purchase the new machines, Troy Bartlett revised his business plan. Organising his operational resources in this way enabled Troy to gain a major contract thus guaranteeing the success of his business.

BizWORD
Resource allocation refers to the efficient distribution of resources so as to successfully meet the goals that have been established.

BizFACT
Strategy outlines what is to be achieved; organising explains how to achieve it.

BizWORD
Computer aided design (CAD) is a computerised design tool that allows the business to create product possibilities from a series of input data. Computer aided manufacture (CAM) is software that controls the manufacturing process.

FIGURE 12.14 The CAD software can be linked to the CAM software to allow instantaneous manufacture of designs that are requested by clients.
Organising resources — marketing

As outlined in chapter 8, a marketing plan will only succeed if all sections of the business are involved in satisfying a customer's needs and wants, while achieving the business's goals. This means that the marketing plan needs to become integrated into all aspects of the business. Adequate resources, therefore, must be devoted to the marketing plan. Where existing employees do not have the expertise or levels of skills required, additional training may be needed to bring them up to the levels needed. Additional funds may be needed to accomplish all the marketing objectives given to a specific department or team. The efforts of all employees in the marketing department must be coordinated and this is best achieved by adequate resourcing. For example, the sales consultants, advertising personnel, market research staff, distribution people and so on must be provided with the informational, financial and physical resources to perform their jobs.

Organising resources — finance

As outlined in chapters 8 and 11, new business ventures, even micro ones, require funds to operate. In organising the financial resources, one of the most important questions the SME owner needs to answer is ‘What will be the most appropriate source of financing?’ The most common sources are personal savings and/or loans from family, friends or banks. For example, Megan Pearce started her business ‘Megan's Marketplace’ with a $15,000 loan from the National Australia Bank and $12,000 borrowed from her sister.

Another important issue associated with organising finances is the amount of equity (ownership of the business) and potential control a SME owner must hand over to obtain the necessary financing. If the SME owner decides to fund the business by using equity capital, the investor will be given some form of ownership in the business. Frequently, SMEs that are aiming for relatively moderate growth use mainly debt capital with the owners retaining most or all of the equity.

Finally, when organising the financial resources, the SME owner must explore the wide range of federal and state government grants — any monetary or financial assistance that does not generally have to be repaid — and other funding programs. Generally, there are no grants for starting a business. Grants are usually provided for:
• expanding a business
• research and development
• innovation
• exporting.

Organising resources — human resources

Of course, new business ventures often require the help of others — employees — besides the entrepreneur or SME owner. In fact, since each employee in a SME represents a large percentage of the business's workforce, a specific individual's contribution can be especially important to the success of the business. This is why, as explained in chapter 8, employees are a SMEs most important resource. A great deal of care and thought, therefore, needs to be given to how best to organise this crucial resource.

SME owners need to use good recruitment and selection processes to find employees who will be invaluable assets as the business grows and expands. For example, when Danaye Stavropolous started her business, Gateway Information Systems Pty Ltd, she decided to employ people who had limited experience but

BizWORD
A grant is any monetary or financial assistance that does not generally have to be repaid.
displayed a keen desire to learn and an enthusiasm for the business idea. As the business grew, Danaye organised the business’s human resources in such a way as to ensure extensive training for all employees, which allowed her to generally recruit from within. As a result, her business has a skilled group of employees to support her expansion plans.

Another important aspect all SME owners need to consider when organising their human resource arrangements is the need to comply with legislation relating to anti-discrimination and equal employment opportunities. The retailer Myer, for example, was able to retain valuable employees when it introduced a policy of six weeks paid maternity leave for staff who had worked a minimum of 18 months.

Summary

- Once the SME owner has formulated the vision, goals and objectives, the next stage in the planning process requires organising the resources — human effort, time, money, equipment and materials — needed to fulfil the plan.
- Organising is a device that SME owners can use to gather resources for getting things done.
- Resource allocation refers to the efficient distribution of resources so as to successfully meet the goals that have been established.
- Each of the key business functions — operations, marketing, finance and human resources — require specific resources which need to be effectively organised.

Revision

1. Examine figure 12.13 on page 410. **State** the five steps of the organising process.
2. **Summarise** the benefits of a properly implemented organising process.
3. **Define** the term ‘resource allocation’.
4. Imagine you have been asked to make fifty family-size pizzas for a celebration lunch. You have five people to help with the task. In small groups:
   (a) **Identify** the resources you would need to make the pizzas.
   (b) **Classify** the resources as either (i) raw materials, (ii) equipment or (iii) knowledge.
   (c) **Demonstrate** how you would allocate the resources.
5 Recall five questions a SME owner needs to ask in order to undertake successful production.

6 Propose what may happen if a SME owner fails to organise adequate resources for the marketing plan. Give reasons for your answer.

7 Identify the two main sources of finance for a business.

8 Use the GrantsLINK website in your eBookPLUS to investigate the range of grants available for business and industry. Select two grants that interest you and briefly outline their purpose.

9 Use the brainstorm technique to deduce three advantages Gateway Information Systems Pty Ltd received by organising its human resources as it does.

**Extension**

1 Create an organisational chart for your school. Determine the advantages and disadvantages of this structure for you as a student.

2 ‘The purposes of organising are to give each employee a distinct task and to ensure these tasks are coordinated and adequately resourced so that the business achieves its goals.’ Evaluate the accuracy of this statement.

## 12.7 Forecasting

A business needs more than just information about present business conditions. It also needs information about possible future events. **Forecasts (or projections)** are the business’s predictions about the future.

Students sometimes forecast the results they hope to achieve in an assessable task. But just like weather forecasts, what is predicted and what actually happens may be quite different! Nevertheless, forecasts are needed to enable effective planning. An owner may need to forecast the availability of labour, raw materials, finance and building requirements. For this task, business owners rely on internal and external information sources.

One very useful set of data is the forecast for total revenue and total cost.

### Total revenue and total cost

When trying to determine whether a business will be financially successful, a SME owner can attempt to forecast the amount of money the business may receive as sales — its total revenue, and how much it has to pay for business expenses — its total costs.

#### Total revenue

**Total revenue (TR)** is the total amount received from the sales of a good or service.

It is possible to forecast total revenue by estimating how many units are expected to be sold. For example, if the price of each unit is $100 and 25 are expected to be sold, then the total revenue forecast will be $2500.

Estimates of future sales are determined by the demand for the business’s good or service and the amount of competition in the marketplace. Sales forecasting data:

- can be gathered by using market research techniques such as customer surveys
- are more precise if the business has some previous sales history to act as a guide.
Total cost

The costs involved in operating a business can be broadly classified as either fixed or variable costs (see the Biz Fact on page 416). **Fixed costs (FC)** are costs that do not vary regardless of how many units of a good or service are produced. **Variable costs (VC)** are costs that depend on the number of goods or services produced. Variable cost, therefore, will increase if more goods and services are produced and decrease when fewer goods and services are produced (see the Biz Fact on page 416).

The **total cost (TC)** of producing a certain number of goods or services is the sum of the fixed costs (FC) and variable costs (VC) for those units. This can be represented mathematically as:

$$FC + VC = TC$$

It is possible to forecast total cost by estimating the change in variable costs at different levels of production. Fixed cost, of course, will remain the same.

The forecast of total revenue and total cost make it possible to use the very useful forecasting technique referred to as the break-even analysis.

**Break-even analysis**

**Break-even analysis** determines the level of sales (total revenue) that needs to be generated to cover the total cost of production (see figure 12.17, page 416). Total cost of production includes fixed costs (costs that do not change regardless of how much is sold) and variable costs (costs that depend on the amount of sales — for example, materials). Sales above the break-even point will mean a profit; sales below the break-even point will mean a loss.

Break-even analysis is an important planning tool because management can determine the level of sales required to obtain a profit. It can also be used to determine the effect on profit if sales increase or decrease. This planning tool is used in the strategic planning stage, before budgets are prepared.

The break-even sales quantity can also be calculated by using the formula:

$$\text{Quantity (Q)} = \frac{\text{Total fixed costs}}{\text{Unit price} - \text{Variable costs per unit}}$$

**BizWORD**

- **Fixed costs (FC)** are costs that do not vary regardless of how many units of a good or service are produced.
- **Variable costs (VC)** are costs that depend on the number of goods or services produced.
- The **total cost (TC)** of producing a certain number of goods or services is the sum of the fixed and variable costs for those units.

**BizWORD**

**Break-even analysis** is used to determine the level of sales that needs to be generated to cover the total cost of production.

**FIGURE 12.16** Resorts such as this one incur high variable costs during the peak season and reduced variable costs during the off-peak season.
**Example: Break-even quantity**

Better Rackets produces different lines of tennis goods, including racquets, tennis balls and tennis bags. It plans to introduce a new style of tennis racquet and estimates that the new racquet should be priced at $200. Fixed costs are $600,000 and variable costs are $80 per racquet. The number of units that need to be produced to break even is:

\[
Q = \frac{600,000}{200 - 80} = \frac{600,000}{120} = 5000 \text{ units}
\]

Break-even is the point where sales equal costs (fixed and variable). That is, where at this point neither a profit nor a loss is made. In this case, 5000 units will need to be sold to break even.

**BizFACT**

Fixed costs do not change as sales increase or decrease. They include rent, insurance, salaries of management and office staff, rates, depreciation, interest on loans, and office expenses.

Variable costs increase as sales increase or decrease when sales go down. For example, for every $1 of sales, a business has estimated that 25c (or 25 per cent of sales) represents variable costs.

Examples of variable costs are direct labour and materials, commission on sales, delivery, freight, packaging.

Total costs are the sum of the fixed costs and the variable costs.

**BizWORD**

The cash flow projection shows the changes to the cash position brought about by the operating, investing and financial activities of the business.

**Cash flow projections**

The cash flow projection shows the changes to the cash position brought about by the operating, investing and financial activities of the business. It provides information concerning the business’s expected cash receipts (cash inflows) and cash payments (cash outflows) over an accounting period, usually 12 months.

Cash flow plans consist of a month-by-month projection of the flow of money into the business. Cash transactions recorded include cash sales, the collection of debts and the payments the business expects to make. From the information found in the cash flow projection, the SME owner should be able to estimate the business’s bank balance for each month and identify the extent and duration of possible cash outflows.
shortfalls. A positive cash flow occurs when the amount of money coming into the business is greater than the amount leaving it. Overall, this information will point out periods when business expenses are too high or times when a short-term investment is possible to deal with a cash surplus.

The cash flow projection is an important tool for cash flow management. It offers:
- the SME owner a clear indication of how much capital investment the business idea requires
- a bank loans officer evidence that the business is a good credit risk.

It is important to not confuse a cash flow projection with a cash flow statement. The cash flow statement indicates how cash has flowed into and out of the business in the past period of time. The cash flow projection shows the cash that is expected to be made or spent over a period of time into the future.

12.8 Monitoring and evaluating

Drivers constantly monitor and evaluate the road conditions, and make necessary changes to speed and direction as they receive updated information. A business also has to monitor and evaluate its environment and take corrective action — that is, it adjusts its business plan to avoid any problems.

Devising a business plan will not guarantee the achievement of the business’s goals. The plan must be constantly monitored and evaluated so the business can make accurate modifications as necessary (see figure 12.19 below).

**FIGURE 12.18** It is important to evaluate the performance of a business so that the business survives and does not become a dinosaur — resulting in extinction.

**FIGURE 12.19** The monitoring and evaluating process
Monitoring

Monitoring is the process of measuring actual performance against planned performance. This process involves constantly asking two questions about the business plan:

1. What does the business want to achieve — that is, what are its goals?
2. Are these goals being achieved?

This will indicate the business’s true achievements, rather than vague generalisations such as ‘things aren’t too bad’.

These questions should be asked at every stage of developing the business plan. Such monitoring involves two distinct steps:

1. establishing forecast performance standards
2. comparing actual performance with forecast performance.

The first step in the monitoring process requires the business to outline what it wants to accomplish — that is, to establish a performance standard. A performance standard is a forecast level of performance against which actual performance can be compared.

A performance standard could be, for example:

• a 5 per cent increase in monthly sales
• a production quota of 1000 units per week.

The second step in the monitoring process is to compare or evaluate actual performance against the performance standard. Budgets, sales statistics and cost analyses can be used to evaluate results. A business owner could compare each individual salesperson’s results, for example, with their sales quota. It is only by establishing performance standards and then comparing them with actual performance that a business owner can evaluate the effectiveness of the business plan.

Evaluating

SME owners evaluate their business’s performance to determine whether the goals have been achieved. They do this by constantly asking:

• how the business is performing in terms of profit etc.
• whether the business is performing as planned
• whether its performance has improved over time
• how its performance compares to that of similar businesses.

When a SME owner undertakes this task, he or she is engaged in evaluation — that is, the process of assessing whether or not the business has achieved its stated goals (see the following Snapshot).

Business mentor assists evaluation

Studio Latitude had run into some difficulty. Its owners, jewellery designer Melissa Voderberg and graphic designer and sculptor Louise McDonald, realised that something needed to be done when they found that they had too much stock, which was creating cash flow problems.

Studio Latitude produces art pieces for the tourism market. ‘We were growing quickly and needed assistance with strategic planning, pricing and cash flow,’ Melissa says. It was time to evaluate their business.

After identifying that things were going wrong, Studio Latitude’s owners asked a business mentor for help. Together, they improved their business plan and movement of stock. Melissa and Louise no longer sold their products exclusively to tourists, but began to concentrate on the expanding conference market. Following this change,
the number of new clients increased by 35 per cent. Sales and profits increased by 20 per cent and inquiries increased by 15 per cent.

**Snapshot questions**
1. Identify the indicators Melissa Voderberg and Louise McDonald used to evaluate their business’s performance.
2. Explain why Melissa and Louise need to have such information.

Once measurements have been collected, the SME owner can compare them with the planned goals. The SME owner needs to ask whether the business operations achieved the desired results and, if not, where and why he or she failed. If the business plan was successful, the SME owner should examine what strategies made it a success and re-use them. By evaluating a successful business plan, the SME owner may also identify weak spots that could be improved and modify the plan to fix them.

The three areas that need constant monitoring and evaluating are sales, budget and profit.

**Monitoring and evaluating sales**

Sales generate revenue for the business, so it is important that the sales management control function be regularly performed. Sales management control involves comparing budgeted sales against actual sales, and making changes where necessary. For example, if a new selling technique is introduced, the level of sales will need to be closely monitored to determine whether actual sales are above or below what was forecast. The new selling technique will be deemed a success if the sales are above what was forecast. If the figures are below what was forecast, the business will need to take some type of corrective action.

<table>
<thead>
<tr>
<th>Sales territory</th>
<th>Forecast sales $</th>
<th>Actual sales $</th>
<th>Difference $</th>
<th>% change ($ decrease + increase)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>25 000</td>
<td>29 000</td>
<td>4 000</td>
<td>+16.0</td>
</tr>
<tr>
<td>2</td>
<td>40 000</td>
<td>42 500</td>
<td>2 500</td>
<td>+6.3</td>
</tr>
<tr>
<td>3</td>
<td>35 000</td>
<td>33 500</td>
<td>−1 500</td>
<td>−4.3</td>
</tr>
<tr>
<td>4</td>
<td>32 500</td>
<td>36 000</td>
<td>3 500</td>
<td>+10.8</td>
</tr>
<tr>
<td>5</td>
<td>22 500</td>
<td>25 000</td>
<td>2 500</td>
<td>+11.1</td>
</tr>
<tr>
<td>Total sales revenue</td>
<td>155 000</td>
<td>166 000</td>
<td>11 000</td>
<td>+7.1</td>
</tr>
</tbody>
</table>

**FIGURE 12.20** Second quarter sales for DeltraWear Fashions Pty Ltd

Consider the sales figures for April, May and June — the second quarter of the year — for DeltraWear Fashions Pty Ltd (see figure 12.20). The figures reveal that total sales revenue increased by $11 000 or 7.1 per cent above what was forecast. DeltraWear would be pleased with this result. There would be some concern about the result in sales territory 3, which would require further investigation. However, all the other territories performed above expectations. This tells the business that the new selling technique is a success and should be continued.

**Monitoring and evaluating budgets**

No business should commence operating without having prepared a budget. A **budget** is the business’s financial plan for the future. It outlines how the business

*We were growing quickly and needed assistance…* 

---

**BizWORD**

A **budget** is the business’s financial plan for the future.
will use its resources to meet its goals. The budget contains projections of incomes and expenses over a set period of time.

Budgets enable constant monitoring of goals and whether they are being achieved. Budgets assist in emphasising the goals of the business and provide a basis for administrative control, direction of sales effort, production planning, control of stocks, price setting, financial requirements, control of expenses, and production cost control.

Budgets are used in both the planning and the monitoring aspects of a business; for example, the business owner can measure planned performance against actual performance and take corrective action as needed.

A budget is an important part of the planning process. Its preparation must account for various factors, such as:

• a review of past figures and trends, and estimates gathered from relevant departments in the business
• potential markets or market share, and trends and seasonal fluctuations in the market
• proposed expansion or discontinuation of projects
• proposals to alter price or quality of products
• current orders and plant capacity
• considerations from the external environment (for example, financial trends from the external environment, availability of materials and labour).

The budget should be regularly compared with actual revenue and expense amounts to detect any discrepancies. For example, once the owner has determined the goals, they can then estimate the business’s various costs and its revenue. A profit budget will establish the viability of the business by predicting how much profit is likely to be made from the expected sales. These figures are estimates, but the budget must be realistic. Figure 12.21 illustrates the information that should be included in a profit budget.

### Profit budget for 12 months ending ...

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Sales</td>
<td></td>
</tr>
<tr>
<td>Less cost of goods sold</td>
<td></td>
</tr>
<tr>
<td>(made up of)</td>
<td></td>
</tr>
<tr>
<td>Stock at beginning of year</td>
<td></td>
</tr>
<tr>
<td>+ Purchases</td>
<td></td>
</tr>
<tr>
<td>– Stock at end of year/</td>
<td></td>
</tr>
<tr>
<td>B. Cost of goods sold</td>
<td></td>
</tr>
<tr>
<td>C. Gross profit (A–B)</td>
<td></td>
</tr>
<tr>
<td>Less expenses</td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td></td>
</tr>
<tr>
<td>Rates</td>
<td></td>
</tr>
<tr>
<td>Stationery</td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
</tr>
<tr>
<td>Fax</td>
<td></td>
</tr>
<tr>
<td>Travel</td>
<td></td>
</tr>
<tr>
<td>Interest paid</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
</tr>
<tr>
<td>D. Total expenses</td>
<td></td>
</tr>
<tr>
<td>E. Operating profit before tax (C–D)</td>
<td></td>
</tr>
<tr>
<td>F. Stock estimate</td>
<td></td>
</tr>
<tr>
<td>G. Receivables</td>
<td></td>
</tr>
</tbody>
</table>

**FIGURE 12.21** Example of a profit budget
Once the budget has been completed, the business owner can determine the extent and timing of financial requirements. This profit budget should then be reviewed at least once per month, and the owner should compare the projected amounts and the actual amounts. Modifications must be implemented if there are any discrepancies.

The school dance

You have been appointed manager of a student group that operates the annual Year 11 school dance as a part of the Business Studies curriculum. This is a major event in the school calendar and your principal has stipulated that the school expected you to deliver a profit of $500. This will be donated to a charity of the students' choice. The school also wants its own costs covered from the evening. The key points to consider are:

- Between 300 and 400 people are expected, depending on the success of your promotion to other schools. Art students at your school will be designing and then distributing posters.
- The event is in the school hall.
- You are expected to provide food, drink, security and music.
- The costs for last year's dance are:
  - School costs. Printing of posters, plus electricity, water and gas on the night — $100
  - DJ Snoopy spins. Music and light show — $900 for 4 hours
  - Decorations. Supplied by local company Party Guys & Sons — $300
  - Finger food and drink. Party pies and soft drink — $500
  - Security. Two security guards from 'Crusher Securities' — $400 for 4 hours.

Snapshot questions

1. **Calculate** last year's costs for the school dance to work out its break-even point (They charged $10 per ticket).

2. (a) **As manager of the school dance**, **identify** what type of market you are seeking to target.
   (b) **Predict** what might happen if ticket prices and promotional material are not 'positioned' for this market.

3. **Working in small groups**, **discuss** ways in which you could reduce your costs for the school dance. For example, you might consider offering your suppliers (of catering, security, DJ and decorating services) the chance to promote their businesses on the night in exchange for reduction in their usual charge.

4. **As a group**, **construct** a cash budget for the dance. You must also explain your price structure in terms of the agreed cost of tickets.

5. **You sell 380 tickets at $15 each**.
   - The finger food and drink expense increased by $63, but you needed only one security guard.
   - You had to pay insurance of $689 at the last minute.
   All prices include GST. **Calculate** the profit or loss you made for this event. Remember to reduce all amounts by one-eleventh to remove the GST component.

Monitoring and evaluating profit

As the following headlines suggest, profit is at the centre of a business's activities and one of the most intensely watched financial indicators.

'**JB Hi-Fi hits the right note with 26 per cent lift in profit to $118 million**'.
'**Wesfarmers turns in a mixed profit performance of $1.6 billion**'.
'**Chairman quits as Downer EDI profits collapses by 98 per cent to $2.9 million**'.
'**Commonwealth Bank rings up a record $6.6 billion profit**'.
In a sense, a business's profit levels can be compared to a student's subject grades: they are an indication of performance. Such feedback is crucial to evaluate whether or not specific goals have been achieved and what, if any, changes need to be implemented.

There are five main reasons why a business's profit levels must be carefully monitored and evaluated.

1. **Profit as reward.** As outlined in chapter 1, profit is what remains after all business expenses have been deducted from the business’s sales revenue. Profit is regarded as the return, or reward, that business owners receive for taking the risks in operating a business that produces goods and services that consumers want.

2. **Profit maximisation.** In chapter 6, it was explained that one of the main goals of a business is to maximise its profits in the long term.

3. **Profit as a source of finance.** Chapter 11 outlined that one of the most important sources of finance for businesses is profits that have been ploughed back.

4. **Profit as a performance indicator.** The profit level also acts as the main indicator of a business’s performance. Changes to the level of profit act as a guide to how well the business is succeeding or failing.

5. **Profit as a dividend payment.** For incorporated businesses a proportion of the profit is allocated to shareholders as dividends.

Evaluating the profit levels will also reveal important information about a business's costs and revenues. These amounts must be accounted for and business owners need to be able to identify their source and quantity. For example, a fall in a business’s profit level may be a result of simply a rise in costs or a fall in revenue. Therefore, variations to the profit level act as a 'signal' alerting the business owner to a change in the business’s performance.

### 12.9 Taking corrective action — modification

Students are constantly involved in comparing planned performance with actual performance — for example, planning to score 70 per cent for an assessable task but receiving only 43 per cent. A mismatch between the planned and the actual performances means a student has to take some corrective actions and modify their behaviour: study more for the next assessable task, complete all the homework, drop out of the course or prepare a topic summary.

**Modifying** is the process of changing existing plans, using updated information to shape future plans. Sometimes the planned performance standards are unrealistic when they are first formulated. At other times, changes to the external environment make the standards unattainable. Whatever the case, the situation cannot continue and the business owner must undertake some corrective action/modification.

Corrective action may involve changes to the materials, products that are the firm’s output, the costs of turning raw materials into products, management practices, delivery of products to the market and so on. It may also involve changes to the organisation’s human resources, because each individual’s performance in the organisation is as important as the finished product.

### Summary

- Forecasts are the business’s predictions about the future.
- Total revenue is the total amount received from the sales of goods or services.
- The total cost of producing a certain number of goods or services is the sum of the fixed and variable costs for those units.
• Break-even analysis determines the level of sales that need to be generated to cover total production costs.
• The cash flow projection shows the changes to the cash position brought about by the operating, investing and financial activities of the business.
• SME owners need to monitor and evaluate the business’s performance by asking themselves:
  – Is my business performing as planned?
  – Has the performance of my business improved over time?
  – How does the performance of my business compare to that of similar businesses?
• Budgeted sales should be compared against actual sales.
• The budget should regularly be compared with actual revenue and expense amounts to detect any discrepancies.
• When using indicators, the main types of analysis are:
  – comparing figures within one financial year
  – comparing figures from different financial years.
• Profit levels are an indicator of a business’s performance and should be carefully monitored and evaluated.
• Modification is the process of changing existing plans, using updated information to shape future plans.

Revision

1 Define the term ‘forecasting’.
2 State how total revenue and total cost are calculated.
3 Distinguish between fixed costs and variable costs.
4 Identify three fixed costs and three variable costs your school incurs.
5 Outline why the break-even analysis is an important planning tool for businesses.
6 Explain how a house painter might make use of break-even analysis when providing a quote to a potential customer.
7 (a) Calculate the level of break-even sales, given fixed costs of $50 000, variable costs of $11 per unit and a selling price of $16 per unit.
(b) Calculate the level of break-even sales, given fixed costs of $600 000, variable costs of $500 per unit and a selling price of $2000 per unit.
(c) From the graph below, calculate amounts for (i) to (v).
   (i) the amount of fixed costs
   (ii) the break-even point
   (iii) the loss or profit if sales are $100 000
   (iv) the loss or profit if sales are $300 000
   (v) the amount of variable costs when sales are $250 000
8 **Outline** why the cash flow projection is an important tool for cash flow management.

9 **Distinguish** between a cash flow projection and a cash flow statement.

10 **Distinguish** between monitoring and evaluating. **Discuss** how the two processes are linked.

11 ‘Any business that fails to monitor its sales will not be able to evaluate the effectiveness of its selling techniques.’ **Discuss.**

12 **Identify** the data DeltraWear Fashions Pty Ltd (see page 419) needed to collect to monitor the new selling technique.

13 A business has a sales potential of $70 000 but achieves actual sales of only $32 000. **Interpret** what this signifies. **Recommend** what the business should do next.

14 You have just been appointed sales manager for Digital@Work Software. One of your first tasks is to conduct a sales management control using the following sales figures:

<table>
<thead>
<tr>
<th>Sales territory</th>
<th>Forecast sales $</th>
<th>Actual sales $</th>
<th>Difference $</th>
<th>% change (– decrease + increase)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>29 000</td>
<td>35 000</td>
<td>___________</td>
<td>___________</td>
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<tr>
<td>2</td>
<td>54 000</td>
<td>58 000</td>
<td>___________</td>
<td>___________</td>
</tr>
<tr>
<td>3</td>
<td>32 000</td>
<td>36 000</td>
<td>___________</td>
<td>___________</td>
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<tr>
<td>4</td>
<td>37 000</td>
<td>33 000</td>
<td>___________</td>
<td>___________</td>
</tr>
<tr>
<td>5</td>
<td>44 000</td>
<td>52 000</td>
<td>___________</td>
<td>___________</td>
</tr>
<tr>
<td><strong>Total sales revenue</strong></td>
<td><strong>_________</strong></td>
<td><strong>_________</strong></td>
<td><strong>_________</strong></td>
<td><strong>_________</strong></td>
</tr>
</tbody>
</table>

(a) Complete the table.
(b) **Examine** the forecast and actual sales. **Analyse** what these figures indicate.
(c) **Recommend** whether you would continue with the selling technique. **Explain** your reasons.

15 **Examine** the following market share results for Crystal Water:

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales revenue ($ million)</th>
<th>Market share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>28</td>
<td>18</td>
</tr>
<tr>
<td>2008</td>
<td>25</td>
<td>18</td>
</tr>
<tr>
<td>2009</td>
<td>33</td>
<td>14</td>
</tr>
</tbody>
</table>

(a) **Explain** how it is possible for sales revenue to decrease but market share to remain the same.
(b) If you were the owner of Crystal Water, **identify** which year’s result you would find most pleasing. Give a reason for your answer.

16 ‘No business should operate without monitoring and evaluating its profit levels’. **Discuss.**

17 **Explain** why the budget should be regularly compared with actual revenue and expense amounts.

18 A business’s profits have been declining over the past two years. **Recommend** two modifications the business could take to correct the situation. **Justify** your answer.

**Extension**

1 CCD Enterprises has been very successful producing and selling a range of sporting goods in the Australian market. It has decided that there is potential in the Asian market. **Describe** two planning tools that the company may have used in deciding to expand into the overseas market.
2 ‘The more accurate the predictions, the better the chances the business has of surviving.’ Evaluate this statement.

3 Read this case study, then answer the questions that follow.

Anna and Bill are technicians working in a relatively small electronics factory. They are trained and competent tradespeople, and live and work for new developments in the electronics field. At home, both have accumulated journals and papers on what’s new in the electronics field. They met by coincidence on an overseas trip and their mutual interests brought them together, eventually to work with the same company. Before joining the company, Bill worked with the government and Anna was in a sales position for a retail firm. This was a position that really came about by accident through personal contacts by her family. The sales position held no real interest and this led to a change in employment.

For some time they have been thinking about an idea that would mean leaving the company and setting up their own business. There are a number of electronic components currently imported from overseas that they believe they could manufacture locally for a reasonable price and perhaps launch into the export arena.

They have both talked with their spouses, immediate families and a number of friends about the possibility of branching out on their own. Together they believe they would have some $60 000 available through equity capital and loans. The amount of money required to establish a factory and various outlets is unknown at this stage, but they are assuming that individual funds would be available from banks or other sources.

(a) **Identify** what other personal factors Anna and Bill should consider before making the final decision.
(b) **Investigate** what factors may be important in the preparation of their business plan.
(c) If you were in their position, **determine** how you would go about analysing market prospects.

4 (a) **Determine** what is the most important aspect of preparing a business plan.
(b) **Explain** why a financial institution would require a business plan before approving a loan to the business.
(c) **Explain** why a business plan should be flexible and constantly revised.

5 **Recall** a situation in which you evaluated your performance. An example could be an assessment task, a part-time job or sports event.
(a) **Identify** your goal for this activity.
(b) **Assess** whether you achieved your goal. Give reasons for your answer.
(c) **Analyse** what corrective action, if any, you were required to take.
Critical issues in business success and failure

13.1 Introduction

When a business commences operation, the SME owner/manager is optimistic of success. Most businesspeople are aware of the general pitfalls, but all businesses — regardless of their size or function — must pay close attention to a number of critical issues. These issues include:

- having a business plan
- managing employees
- analysing trends
- identifying and sustaining competitive advantage
- avoiding overextension of financing and other resources
- using technology
- considering economic conditions.

While there are many reasons for business failure (see chapter 4), careful attention to the above factors will allow businesses to avoid failure and achieve success. These critical issues form the basis for discussion in this chapter.

13.2 Importance of a business plan

The vital point of the previous chapter was that all business owners must take time to develop a business plan (see figure 13.1). Chapter 12 also introduced you to the planning process and the activities to be undertaken to prepare the business plan. No two business plans will be identical but they should all contain some common information. Some plans will be structured and detailed; others will be less complex and more informal. However, regardless of its format, a plan must contain reliable and accurate information in enough detail to be valid.

The business plan should contain:

1. a clear, concise statement of the goals of the business — what the business wants to achieve
2. well-developed plans for achieving these goals — how the business is going to achieve the goals
3. reliable control standards for measuring performance — has the business achieved the goals; if not, what needs to be changed?

A comprehensive plan is essential for business success.

As outlined in chapter 12, the business plan is the ‘blueprint’ for future growth and development within a business. It sets out the desired goals and direction of the business. It is widely accepted that a business plan is essential to long-term success and necessary for all businesses regardless of their size or function. If prospective business owners neglect to develop a business plan or make profit projections, business failure is distinctly possible because there is no clear understanding of the business’s future.
Lack of planning can be as disastrous as a lack of capital. In all businesses, the best results come from effective management. This means that the manager uses the business plan and, more importantly, adjusts the plan when changes occur.

‘The business plan is a written summary and evaluation of all the research and thinking a SME owner has done in the development of a business idea. It is organised in such a way that all the factors necessary for the success of the business – operations, finance, marketing and human resources – have been adequately covered. A detailed business plan greatly increases the chance of success.’

An effective business plan contains a number of important elements that will make the plan an operating tool that assists in the management of the business.

**Business plan: presentation and preparation**

All business plans should be presented in a professional manner, because they may be read by bank managers, accountants, financial advisers, company directors, potential purchasers or interested partners; these people often have first contact with the details of the business via the business plan. Thus it is important that the plan reflects the skills and abilities of the business owner. A poorly presented plan will convey the impression that little thought has been given to the planning process. This will reflect poorly on the business owner and their capabilities of getting the business ‘up and running’. Sometimes it is a good idea to get professional help from an accountant, business adviser, solicitor or marketing consultant, particularly with plan elements such as the projected profit and loss statements, break-even analysis and market research.

Preparing a business plan is similar to completing an assessable task. The final result will reflect the amount of time, effort and research that goes into the plan and its final presentation. Any task that is completed quickly and at the last minute will probably lead to poor performance. But businesspeople who use the planning process effectively will end up with a valuable working document that will help guarantee a business’s success.

**BizFACT**

Accuracy and realistic expectations are crucial to an effective business plan. It is unethical to deceive investors and financiers, and it is unwise to deceive oneself.
As outlined in chapter 5, management can be traditionally described as being concerned with coordinating a business’s resources to achieve its goals. More contemporary descriptions highlight that management is the process of working with and through other people to achieve the goals of the business in a rapidly changing environment. What both these explanations have in common is that management:

• must make the best use of limited resources
• is responsible for the business achieving its goals.

Think of a manager’s role similar to that of a chef whose task is to efficiently combine the resources (ingredients) to effectively achieve a goal (a delicious meal). A skilled, competent chef could probably deliver an appetising meal even with limited resources; whereas an unskilled, incompetent chef would probably serve up an unappealing meal even if he or she had access to superb ingredients. The chef’s level of skill (ability) is the critical factor determining how well the goal is achieved.

It is the same for the management of a business. A manager’s skill is the most critical factor in determining a business’s success or failure. For example, a business may have the most up-to-date computer equipment, well-furnished offices, access to adequate sources of finance, a committed and motivated group of employees, an excellent location, and an outstanding range of goods or services backed up by a highly-expensive marketing campaign, but if it fails to have a competent manager(s), who can make effective and efficient use of these resources, then the business will not succeed.

Overall, the most important accomplishments a skilful manager will achieve for a business include the ability to:

• solve difficult problems
• set and help attain important goals
• develop attitudes of commitment and ownership
• create a positive business culture through their words and actions
• monitor the business’s external and internal environments
• plan and allocate resources
• coordinate teams and departments
• monitor the performance of teams and individuals
• successfully put workplace and business changes into action
• develop and implement schedules and operating plans.

Two important areas of business that a manager must pay special attention to are staffing and teamwork.

Staffing

If a SME owner wants the business to succeed, then it is essential to have employees who are satisfied and motivated (as was outlined in chapters 6 and 8), as they will be more productive. They also provide the business with a competitive advantage, especially if the business offers a service where the customers come into direct contact with the employees. Therefore, the management of the staffing function — the recruiting, selecting, maintaining, training and separating of employees — must be undertaken with care.

One mistake that some SME owners often make is not providing enough time or financial resources to satisfactorily carry out the recruitment process. Making hasty recruitment and selection decisions often ends in misfortune for both the SME owner and the employee. For this reason, many SME owners outsource this function and use an external recruitment agency.

External recruitment

It is time consuming to advertise, screen and interview potential employees. Many businesses use recruitment agencies as a way of decreasing the time involved in searching for a new employee. They pay an agency to interview candidates and recommend a shortlist of potential employees or an employee suitable for the available position. Outsourcing of staff recruitment is becoming popular with small businesses especially as the skill shortage worsens and owners see the advantage of using an expert to make sure they hire the best people.

Organisations may choose to employ the services of a recruitment agency to source the right applicants for the job. Vanessa Hall, former executive consultant at a boutique recruitment consultancy, talks about her role.

Recruitment consultancies usually aim to provide quality consulting services to corporate organisations. We assist clients to source and secure candidates by providing cost-effective and efficient recruitment strategies.

In my previous roles, I have been responsible for the recruitment and selection of human resource practitioners, and for sourcing and securing people who are an ideal fit for our clients. I also consulted with corporate clients on their recruitment needs.

On any given day, I might be creating advertisements, collating and screening response to advertisements, interviewing candidates or presenting candidates to clients.

If you are looking towards a career in business, I think you need to be open to opportunities and keep an open mind. It’s important to treat each contact or business dealing equally, as you never know where it will end.

**Snapshot question**

Outline the role of a recruitment agency.
A community employment agency such as Mission Australia Employment Solutions is one of the most common sources of employees for business. Mission Australia competes with other mainstream recruitment agencies for government contracts. Their recruitment service is provided at no change to businesses.

**Mission Australia Employment Solutions**

Mission Australia Employment Solutions will attract and screen candidates — including apprentices and traineeships — without the expense of using a private recruitment agency.

**Employee skills databases**

Once people have been employed, the next important staffing management function is to achieve the right mix and level of employees' skills. This is best accomplished by using a skills audit and skills inventory.

**Skills audit**

It is important for any business to detail the current skills base of the people involved in the business, as well as identifying any skills needed in the future. A personnel skills audit is used for this purpose. A **skills audit** is a process that establishes the current skills levels of employees and future skills requirements.

The aim of the audit is to identify:

- the skills that will give the business a competitive advantage
- weaknesses in the skills base which, unless overcome by training or recruitment, will threaten the business's survival.

Figure 13.4 provides an example of a skills audit form. One form should be completed for each employee. Once this information is collected, it can be used to produce a skills inventory — that is, a computerised database containing information on the skills and experiences of all present employees.

<table>
<thead>
<tr>
<th>EMPLOYEE SKILLS AUDIT FORM</th>
<th>Date ____________________________</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee</td>
<td>Personal experience</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**FIGURE 13.4** Skills audit form
Skills inventory

An employee database is an important tool used by business owners for recording personal and work details of their employees. This type of database should be regularly updated as new employees join the business and existing ones leave. One particular type of employee database is the skills inventory. A skills inventory is a database containing information on the skills, abilities and qualifications of existing staff. It is used to search for appropriate candidates to fill new positions within the business. For example, a business may be seeking a current employee with a commerce or business-related tertiary qualification, at least 10 years’ experience, fluency in Japanese, and with some knowledge of marketing. By accessing the skills inventory, a search can quickly identify employees who match these specifications.

Teams

As was outlined in chapter 7, many businesses are starting to realise that a team approach can be a catalyst for superior performance. Teams are replacing individuals as the basic building blocks of businesses of all sizes, especially in those businesses that are adopting flatter organisational structures.

Businesses are learning that teams:

- make more informed and creative decisions
- work without the need for close supervision
- create greater levels of employee cooperation
- provide improved customer service and/or production output.

How teams are managed, therefore, is another critical issue determining business success. However, it can sometimes be difficult for SME owners to have the time or expertise to develop highly functioning teams or improve the communication and efficiency of already established teams. Consequently, many SME owners are seeking professional help from training and coaching businesses. By investing time and money in the development and training of team leaders and team members, the business reaps the rewards of improved productivity (see the following Snapshot).

‘Teaming’ with ideas

Don Russell, owner of CompuWorks, has a favourite saying: ‘To build a great business, you must build great teams.’ However, Don was faced with a dilemma. ‘I wanted the four teams within the business to become more self-directing. Because I was so busy dealing with the daily problems that cropped up, I was not able to stand back and work out how to achieve this.’

Not being able to devote enough time to strategic planning is a problem faced by many SME owners. Don decided to hire the training company New Vision Pty Ltd to work with the teams. ‘As the owner of a medium-sized business, I feel the pressure to continually generate the entrepreneurial energy. What I wanted was for the teams to create ideas and explore different ways of solving problems. This would help lift productivity by reducing the number of production problems.’

Working with New Vision showed Don and the team leaders the importance of setting clear, realistic and attainable goals. Each team was given the responsibility for setting production targets and mutually beneficial outcomes for team members and the business.

‘One of the most important changes we introduced was regular, informal meetings where all team members are allowed to participate. We call these sessions “participate and review” sessions. At these meetings we acknowledge what teams have done well, how productivity might improve and set monthly goals.’ (continued)
Examine table 13.1 below. What do you notice about the business’s net profit results?

<table>
<thead>
<tr>
<th>Year</th>
<th>Net profit ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>62</td>
</tr>
<tr>
<td>2011</td>
<td>78</td>
</tr>
<tr>
<td>2012</td>
<td>85</td>
</tr>
<tr>
<td>2013</td>
<td>90</td>
</tr>
</tbody>
</table>

On a quick inspection, you would say that net profit is increasing over the four years. However, upon closer examination, you will detect that the rate of net profit growth is decreasing; that is, net profit is increasing but at a decreasing rate. This trend is best shown by graphing the net profit results (see figure 13.5). As a business owner, such a trend could be cause for alarm because it could mean that future net profit may fall.
Trend analysis is a process of investigating changes over time and looking for a pattern (trend) in order to predict the future. Trend analysis is based on the idea that what happened in the past provides an idea of what will happen in the future. For example, as a student you probably keep a record of your grades for each assessable task or test. You do this to determine whether your grades are generally rising, falling or stable. Analysing this information also allows you to predict what mark you will receive for a future assessable task or test. You will base your prediction on past performance. The more past grades you have to examine, the more accurate your prediction will be.

Trend analysis is a powerful tool which, when used properly, will assist SME owners to achieve business success by helping forecast such factors as:
- potential sales
- total revenue
- total operating costs
- gross and net profits
- availability of labour.

As was outlined in chapter 12, forecasts are needed to enable effective planning, and trend analysis helps make forecasting more accurate. Overall, trend analysis will provide more reliable information on which a SME owner can base decisions. If, for example, a retailer's trend analysis of past sales forecasts sales to decrease, then appropriate strategies — such as new products or a revamped marketing campaign — can be put in place to avoid the poor performance.

**Summary**

- Business plans are essential for owners/managers because:
  - they allow the owner to clearly define the goals, and future projections (e.g. finance)
  - they assist in the securing of finance from banking institutions or investors
  - they reflect the skills and abilities of the business owner.

- Management:
  - must make the best use of limited resources
  - is responsible for the business achieving its goals.

- A manager’s skill is the most critical factor in determining a business's success or failure.

- If a SME owner wants the business to succeed, then it is essential to have employees who are satisfied and motivated as they will be more productive.

- Outsourcing of staff recruitment is becoming popular with SME owners.

- Teams are replacing individuals as the basic building blocks of businesses of all sizes especially in those businesses that are adopting flatter organisational structures.

- How teams are managed is another critical issue determining business success.

- Trend analysis is a process of investigating changes over time and looking for a pattern (trend) in order to predict the future.

- Trend analysis is a powerful tool which assists SME owners achieve business success by helping with forecasts.

**Revision**

1. **Explain** the purpose of a business plan.
2. **Recall** why a business plan should be professionally presented.
3. **State** what the traditional and contemporary description of management have in common.
Business success and failure is linked (in the long term) to a business’s ability to develop a strategy that allows it to gain an advantage over other competitors in its market. A competitive advantage can be defined as the strategies used by a business to ensure it has an ‘edge’ over its competitors. A business cannot always sustain above-average performances in all areas for long periods. For this reason, it must choose a strategy (outlined below) that will allow it to use and develop its strengths as a business. This strategy can give the business a competitive advantage.

**Price/cost strategy**

The price/cost strategy requires the business to be serious in terms of wanting to be the leader within its industry. The business does not just compete with others, but leads the way by achieving the lowest production costs, which in turn allow it to reduce the product price. While the price is lower, it is important not to compromise the product’s quality in relation to that of competitors’ products. Figure 13.6 suggests the main ways in which to develop a cost advantage over competitors.

Efficiency of operation refers to the ability of a business to streamline the processes that occur within that business. A manufacturing business, for example, may use more machinery or perhaps specialise parts of the production line (where one operator completes one part of a process, such as placing finished products into boxes while someone else loads the boxes onto the transport).

Low-cost labour is an obvious way to gain a cost advantage over the competition. In Australia, labour is one of the most expensive components of the production process because minimum wages are set by the government. The union movement
Economies of scale can achieve a cost advantage for the firm. Simply, this concept relates to the level of outputs for a business and the cost of the inputs (for example, the cost of labour or raw material). To achieve economies of scale, the business tries to reduce the cost of inputs — perhaps by using more machinery, buying in bulk or increasing the specialisation of labour — and increase the level of outputs.

Many businesses attempt to reduce the cost of labour by decreasing the size of their workforce and using machinery where possible. Other companies choose to move their operations to countries where labour costs are low. Some countries, such as China, require employers to pay only small wages, so a firm in a labour-intensive industry (such as the clothing and textiles industry) may choose to relocate this part of its operations overseas.

The final way to develop a cost advantage over the competition is to use technology. Nearly all businesses today have found that technology — whether computerisation or the use of automation and robotics — has enabled them to improve efficiency and production. As a result, a business can reduce its overall costs. This is obvious in the car manufacturing industry where computers and machinery have gradually replaced labour.

The changes are more subtle, however, in a service industry: they may include, for instance, the computerisation of client information, or the use of advanced communication mediums such as the internet or email.
Differentiation strategy

The concept behind this strategy is to offer customers something that is not already offered by business rivals. The differentiation could be high product quality, innovative design, positive brand image or top-quality service. An example of differentiation is Westpac Bank’s ‘branch managers’ approach. In an attempt to increase market share, and to secure and build confidence in their existing market, Westpac has ‘brought back the branch manager’ in over 600 branches throughout Australia. The aim of this was to differentiate themselves from other financial institutions by focusing directly on their domestic customers (see the following Snapshot). This approach was also important because the global financial crisis (GFC) in 2008–09 left customers’ confidence levels low.

Westpac is bringing back the bank manager

Following a recent review of Westpac’s corporate strategy to put customers at the heart of everything it does — the strategy for the Westpac brand has also been reviewed and revitalised. The result: a sharper, customer centred positioning built on the bank’s reputation for foresight, vision, stability and doing the right thing.

‘In these uncertain times, Westpac is stepping forward with certainty and confidence. As a soundly performing bank we continue to grow, opening branches, business banking centres and hiring new Bank Managers as well as local business bankers,’ said Andrew Seager, Westpac Retail and Business Banking’s General Manager Marketing.

Westpac’s new advertising campaign, created by The Campaign Palace, re-introduces the phrase ‘We’re a bank you can bank on’, providing a subtle nod to Westpac’s heritage as the Bank of NSW and that sense of dependability and security while giving new meaning in today’s ever changing environment. The campaign also communicates the message of security, stability and thinking things through. The messages are expressed in a fresh but everyday way, leveraging Australian experiences and truisms, which are intended to evoke recognition and provoke thought in viewers.

‘The brand strategy is tightly aligned to the corporate strategy of delighting customers, and putting them at the centre of everything we do. One testament of the brand and corporate strategy is Westpac’s move to bring back the local bank manager, who knows and cares about their local communities, customers and their businesses, and understands what it takes to delight them.’

Snapshot questions

1. Describe the image or impression Westpac is attempting to convey to its customers with this new strategy.
2. Explain how this strategy is attempting to differentiate Westpac from its competitors.

Many businesses adopt a range of strategies to develop and enhance differences in their product. An example of this strategy is the use of celebrities to endorse and contribute to a product’s image, such as Delta Goodrem’s association with So Good soy milk and Proactive skin care range, and cricketer Michael Clarke’s endorsement of Slazenger.
Once a business achieves its product differentiation strategy, the challenge then is to sustain this competitive advantage, especially as competitors attempt to match this strategy.

**Ensuring long-term success**

Long-term success can be difficult to achieve if a business is unable to develop a competitive advantage. The business may succeed for a short period, but often only because other businesses in the same industry are not striving for any sort of advantage so they all exist at the same level.

Sustaining a competitive advantage is just as important as developing that advantage. Long-term success is assured if a business sustains its competitive edge. The business must be able to resist the actions of competitors who introduce new strategies, while also tracking changes within the industry (especially technological changes).

To limit the advances of competitors, a business must protect itself and reduce opportunities available to the competitors. This may be achieved through:

- research and development, which helps the business develop innovative products
- patents/copyrights, which protect against copying of inventions
- exclusive contracts with suppliers, which mean a supplier gives preference to the business
- lobbying government to limit foreign competition, which aims to restrict imported products.

Most importantly, for a business to sustain a competitive advantage, the actions of management must be dynamic. Staying in front of the competition requires constant action. All businesses operate in a constantly changing environment. The owner/manager must be constantly aware of issues that may affect their operation, market share and profit. If a business is not looking to the future and its impact, then its competitors will be. To sustain a competitive advantage, a manager must be able to predict changes and trends, and act on these predictions.

**Summary**

- Business success and failure is linked (in the long term) to a business’s ability to develop a strategy that allows it to gain a competitive advantage over other competitors in the market.
- A competitive advantage refers to a business’s ability to gain an ‘edge’ over its competitors.
- A competitive advantage is achieved through:
  - *price/cost strategy*. This is best accomplished by achieving the lowest production costs, which in turn allow it to reduce the product price.
  - *differentiation strategy*. The concept behind this strategy is to offer customers something that is not already offered by business rivals.
  - *ensuring long-term success*. This is assured if a business sustains its competitive edge by limiting the advances of competitors.
- A price/cost competitive advantage is best achieved by:
  - efficiency of operation
  - low-labour costs
  - economies of scale
  - technology.
- For a business to sustain a competitive advantage, the actions of management must be dynamic.
Ideally, those financing a business should start small and gradually expand. Unfortunately, some business owners overextend their capacity in the establishment or takeover stage, resulting in excess expenditure that is financed primarily by external sources such as banks. A business can overextend financially by:

- using hire purchase and/or leasing commitments made on:
  - cars
  - equipment
  - office furniture
  - plant and machinery
  - the premises.
- purchasing excess stock
- employing too many staff for the business's current needs.

These types of expenditures are fixed, which means the business has a lease contract that is valid for a certain period (such as one or two years). This can create a higher degree of business risk. If economic conditions weaken, for example, businesses that are highly geared (that is, they have a higher debt-to-equity ratio) come under greater financial pressure and are more susceptible to bankruptcy.

Another expenditure problem can arise if the business owner purchases the business premises. Leasing is an effective option, yet many owners decide to buy premises and may find themselves overborrowing. If the business cannot meet its capital and interest repayments, then its working capital will also be affected.

There are many tips for a business of any size and type to avoid overextending financially, including:

- business planning. This involves the completion of cash flow projections, preliminary establishment costs, personal financial budgets and financial statements of position, along with the setting of the business’s goals and objectives.
- avoiding an overdependence on debt financing. This helps avoid problems during weak economic periods when lenders or creditors are unwilling to wait for the business to overcome difficulties.

BizWORD
Leasing is a long-term source of borrowing for businesses. It involves the payment of money for the use of equipment that is owned by another party.
• *long-term financial planning.* This concerns not just the current financial aspects of the business, but anticipating future problems and planning the business’s direction in terms of growth and expansion.

• *a small start.* Many businesses ‘walk before they crawl’ and quickly find themselves in difficulty. It is important to start slowly and allow the market to determine the right times for expansion and growth.

**Overextension of other resources**

Finance is not the only area in which a business can overextend. A business can also overcommit to resources. Resources refer to the inputs necessary for a business to carry out its function. The following two factors have the potential for problems if they are not monitored by management.

**Stock**

A business that overextends in terms of stock has invested too much money in goods or raw materials. This may occur if the business anticipates customer demand incorrectly, or purchases a ‘bargain’ from a supplier (such as end-of-season stock) without establishing whether it is saleable among its own customers.

Stock is unrealised sales, and a business with too much stock not only ties up its own cash but potentially loses revenue. Many businesses avoid stockpiling, and prefer to keep only limited supplies and order regularly.

**Staff**

A business may find itself with too many staff. This may be due to over-optimism about sales levels, or just poor job allocations and hiring. Staff are costly, but there are options available for a business to decrease its dependence on this resource and reduce costs in the long term. These options include:

• outsourcing
• redefining current job descriptions
• using more equipment/machinery.

**13.7 Using technology**

Technology is having many effects on the business world. It is changing the machinery and equipment we work with, and changing the workplace environment. These changes have had a major impact on the internal and external business environments, and the extent and speed of change is likely to continue.

Advances in information technology include:

• iPhones
• BlackBerry smartphones
• Skype
• email

These have reduced communication time delays and improved distance communication between colleagues, suppliers and customers. But not just information technology has advanced: robotics, machinery and equipment for production processes have allowed for faster production times, higher productivity and greater flexibility, which in turn reduce overall costs.

There is little hope for a business that is not prepared to use some forms of technology. Figure 13.7 illustrates some of the technology available for all types of businesses.
Examples of the technology available to businesses

Over the past decade, there has been an explosion in electronic business, largely brought about by the development of the internet. The internet, a giant computer network connecting millions of computers around the world, has revolutionised the way in which small business owners both access information and do business — e-business and e-commerce.

One of the main advantages of accessing material electronically is that specific information can be located quickly, 24 hours a day, seven days a week. An electronic search is relatively inexpensive and fast. Such a search can also be designed to answer individual requests. These individual requests may include:

- legal requirements for starting a business or changing the formation of a business
- techniques for marketing a good or service
- changes to business administrative requirements, such as taxation changes
- current requirements for industrial relations, such as award conditions
- occupational health and safety requirements
- support from government agencies, such as Austrade or the Australian Taxation Office.

BizFACT

Many businesses are using social networking sites such as Twitter and Facebook to communicate with their customers.

BizFACT

The term ‘Web 2.0’ refers to the transformation of the World Wide Web into a more creative and interactive platform for information sharing, rather than just a means of retrieving information.

FIGURE 13.7 Examples of the technology available to business

Internet applications (e-business and e-commerce)

Over the past decade, there has been an explosion in electronic business, largely brought about by the development of the internet. The internet, a giant computer network connecting millions of computers around the world, has revolutionised the way in which small business owners both access information and do business — e-business and e-commerce.

Accessing electronic information services via the internet

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- techniques for marketing a good or service
- changes to business administrative requirements, such as taxation changes
- current requirements for industrial relations, such as award conditions
- occupational health and safety requirements
- support from government agencies, such as Austrade or the Australian Taxation Office.
However, there are some disadvantages, including:
- expense in terms of hardware, software and service provider charges
- slowness to display web pages
- corruption by a virus
- unwanted spam
- information overload.

E-business

E-business (electronic business) is using the internet to conduct business. It occurs when a business:
- uses the internet to find information — such as suppliers, prices and product details — and to keep track of delivery schedules
- uses email to communicate with customers and suppliers
- uses the internet for online working and paying of accounts
- uses the internet to research market conditions, industry trends and economic forecasts
- uses its website to market its goods and services
- uses the internet to lodge forms or apply for licences via a government department’s website.

E-commerce

The term e-commerce (electronic commerce) has a narrower meaning than that of e-business. It refers to the buying and selling of goods and services via the internet — it is a part of e-business. Today consumers expect a business to have an online presence. In response, more Australian small businesses are using the internet to cover all aspects of e-commerce.
Due to the perceived cost and complexity of e-commerce, some small business owners are tentative in their use of it. Apart from having an email facility and a website, they do not make full use of the technology and consequently do not realise its full potential.

**SNAPSHOT**

This veteran virtual shopper says the nirvana of online shopping is a store where you can get the three Cs: choice, convenience and of course, cheap prices.

Meet one e-shopper who buys everything from jeans to fireplaces online, writes Joanna Mather.

Beverley Uther is a veteran virtual shopper. She started buying music CDs and LPs online 15 years ago for ‘ridiculously cheap’ prices and has barely taken a breath since.

Over the years, she has expanded her repertoire to include everything from clothes and cosmetics to accommodation, car hire, homewares and last-minute birthday gifts such as flowers.

And now that she’s renovating a house, Uther is using the internet to uncover gems such as the cast-iron fireplace she picked up on eBay recently for 99¢.

‘It’s going to be the house that eBay renovated,’ she laughs.

She has also bought a pair of lights from an old coach to use as outdoor lamps, a second-hand dishwasher and an Edwardian-style mantelpiece.

Uther, a Sydney-based business analyst, says the nirvana of online shopping is a store where you get the three Cs — choice, convenience and cheap prices.

She buys jeans from the United States for $US19 ($21) and skin-care products at half the price they are in Australia. One of her favourites is Lands’ End in the US, which sells clothes, accessories, homewares and luggage.

‘Why is Lands’ End so good and why do I still use them 15 years later? Price. They’re cheap,’ Uther says.

‘They also serve a country of 300 million people so they have every size under the sun.’

But there are other, less obvious, factors that can make or break an online store for Uther.

One is sizing: unless a store’s sizes are consistent, it’s difficult to buy clothes without trying them on, she says.

Uther says one of the major pitfalls of shopping online is the dreaded credit card exchange rate fee.

This is a fee, typically detailed in the fine print of your contract, that banks and other institutions charge when you make a credit card purchase overseas.

Uther recently purchased a skin-care product with a price tag of $179.95 but it ended up costing more because she was charged $6.95 in exchange fees.

‘Ask your bank, but mine charges 3.3 per cent of the value of the transaction,’ she says.

‘There’s not much you can do to avoid the fees but it’s good to be aware of them so you don’t get a nasty shock.’

Another of Uther’s tips for ordering online from overseas stores is to buy several things at once, rather than pay to ship a single item.

‘And the other little joy? An Australian size 14 is a size 10 in the United States.’


**Snapshot questions**

1. According to this article, identify three advantages of shopping online.
2. Identify and describe one of the main problems of online stores.
3. Using the information in the article, which describes online shopping from a customer’s perspective, propose three strategies a business owner could adopt to make the process more efficient and customer friendly.
13.8 Economic conditions

As outlined in chapter 3, section 3.3, a nation’s economy will go through fluctuations; they experience good times — booms — and downturns — recessions. The economic conditions are an aspect of the external business environment in which the business has no control.

Changes in the economic conditions in the economy have the ability to impact dramatically on a business in regards to success and failure.

Economic conditions that promote business success

When an economy is in a boom, it will most likely mean that consumers are prepared to increase their spending because consumer confidence is high. Consumers are certain their jobs are secure and incomes are expected to increase; they have an optimistic outlook.

In periods of strong economic activity the economy will experience:

- high levels of consumer spending. This will mean businesses have a greater capacity to sell goods and services and therefore profits are maintained and improved. Businesses that sell more luxury type goods and services (such as brand clothing, jewellery and imported cars) will benefit in this type of economic condition because the consumer has a higher level of disposable income.
- falling unemployment. Unemployment is lower as businesses can afford to hire more employees when sales and profits are steady and growing. As well, to meet the increased demand for goods and services, businesses will be required to increase the size of their workforce.
- increased production. Businesses’ output will increase to meet buoyant trends that provide opportunities for future increased sales and profit.

Economic conditions that lead to business failure

When an economy is in a downturn, it will most likely mean that consumers are not spending as much. This is because consumer confidence is low. Consumers fear they may lose their job or their wages may not increase. Overall, reduced consumer spending translates to reduced profits for business. This will eventually lead businesses to reducing their production levels.

In periods of weak economic activity the economy will experience:

- lower levels of consumer spending. This will mean businesses have a reduced capacity to sell goods and services and therefore profits will decline. Businesses that sell more necessities and budget-type goods and services (such as groceries and cheaper clothing) will benefit in this type of economic condition. This is because consumers become more cost conscious and will seek out goods and services they consider to be value for money.
- rising unemployment. Unemployment is higher as businesses cannot support current employee numbers when sales and profits are decreasing or negative. As well, cutting back production levels may reduce inventories of goods and services that are potentially unsaleable. Consequently, existing employees may be made redundant.
- decreased production. Businesses’ output will decrease in response to the fall in consumer spending. As a result, profits will also decrease.
The Australian economy is currently experiencing steady economic growth after the government implemented stimulatory policies in response to the 2008–09 global financial crisis. As the Australian economy becomes more stable and reaches economic growth rates of 3 per cent, businesses are in the best position to maintain consistent and/or rising profits, and therefore have the capacity to expand in the domestic and global markets.

Summary

- A business can overextend financially by:
  - hire purchase or leasing overcommitments
  - purchasing excess stock
  - employing too many staff for the business's current needs.
- Overextending expenditure can create a high degree of business risk.
- To avoid overextending financially, a business should:
  - undertake thorough planning
  - avoid overdependence on debt financing
  - engage in long-term financial planning
  - grow at a sustainable rate.
- Overextension of stock ties up a business’s cash and can lose revenue.
- Overextension of staff results in employing too many staff.
- The integration of technology into the business is essential to succeed in contemporary society.
- E-business (electronic business) is using the internet to conduct business.
- E-commerce (electronic commerce) is the buying and selling of goods and services via the internet.
- A nation’s economy will experience periods of boom and recession.
- In periods of strong economic activity, consumer spending, sales of goods and services, production, and profits are rising.
- In periods of weak economic activity, consumer spending, sales of goods and services, production, and profits are falling.

Revision

1. Identify the main ways in which a business can overextend financially.
2. Outline how a business can protect against overextending its finances.
3. Explain why technology is so crucial in terms of business success and failure.
4. Distinguish between e-business and e-commerce. Provide two examples of each.
5. Select and explain two advantages and two disadvantages (for a business) of using the internet to access information.
6. Use the Yahoo! Australia, New Zealand Shopping Mall, Amazon and ninemsn Shopping weblinks in your eBookPLUS to investigate the operation of the large e-tailers. Evaluate the three sites, reporting on:
   (a) the ease of navigation
   (b) the layout of the home page
   (c) methods of payment
   (d) the ease of product selection
   (e) the return and refund policy.
7. Distinguish between an economic boom and a recession.
8. Explain the impact a period of (i) strong and (ii) weak economic growth will have upon most businesses.
Extension

1 **Analyse** the importance of financial planning for short-term and long-term success in business.
2 ‘Business expansion should be slow and steady.’ **Evaluate**.
3 ‘Technology has had a great impact on the internal and external business environment.’ **Discuss**.
4 **Determine** the advantages and disadvantages of the dynamic nature of technology in Australian business.
5 **Create** either an oral or ICT report about the internet. The following terms and phrases are a guide to the content you will need to research:
   - modem
   - security and authenticity of the website
   - 3D web technology
   - universal resource locator (URL)
   - hyperlink.
   - site domain name
   - internet service provider (ISP)
   - spamming privacy implications
   - What is the internet?
5 **Arrive** to interview a small business owner whose business has an online presence.
   **Investigate**:
   (a) the reasons for going online
   (b) the benefits of a web presence
   (c) the difficulties encountered in setting up the website.

You may wish to video the interview, then watch and discuss it in class.
Business planning

Multiple choice

1. The entrepreneur is:
   (a) an inventor
   (b) a risk taker
   (c) a factor of production
   (d) all of the above.

2. An example of legislation designed to protect both consumers and business is:
   (a) the Trade Practices Act
   (b) the Broadcasting and Television Act
   (c) the Consumer Affairs Act
   (d) the Small Business Act.

3. The main source of information available to potential investors in a SME is the:
   (a) statement of financial position
   (b) business plan
   (c) prospectus
   (d) articles of association.

4. Equity finance is:
   (a) money obtained through loans
   (b) money obtained from the owner’s personal funds
   (c) money obtained from a financial intermediary such as a bank
   (d) money obtained from a non-bank financial intermediary such as a venture capitalist.

5. The variable cost of producing yo-yos is $2 and management suggests that the selling price be $5. The business expects to sell 50 000 yo-yos in the next year. Fixed costs are $30 000. The break-even number of units of production of yo-yos required for next year will be:
   (a) 50 000
   (b) 10 000
   (c) 20 000
   (d) 30 000.

6. Just-in-time management includes:
   (a) keeping minimal stock and ordering supplies just prior to use
   (b) avoiding industrial action at the last minute by agreeing to union demands
   (c) maintaining a large inventory so that goods can be delivered on time
   (d) producing goods quickly in anticipation of increased demand.

7. A business plan:
   (a) is a statement of goals for the business and the steps taken to achieve them
   (b) is only prepared when a business is initially established
   (c) allows stakeholders to determine the viability and profitability of the business
   (d) both (a) and (c).

8. A competitive advantage is best described as the strategies used by a business to ensure it has an edge over its competitors. Which of the following may best be used to achieve a competitive advantage in terms of all goods and services?
   (a) Price, size and colour
   (b) Labels, management skills and colour
   (c) Price, weight and performance
   (d) Price, benefit and value

9. Franchising:
   (a) requires no government regulation
   (b) involves buying an established business
   (c) reduces the level of competition among businesses
   (d) involves the use of a registered name under licence.

10. A business charged customers $500 GST on credit sales, was charged $300 GST for goods bought on credit from suppliers, collected $900 GST from cash customers and paid $700 GST to cash suppliers. The overall effect is:
    (a) the business owes the ATO $400
    (b) the ATO owes the business $800
    (c) the business owes the ATO $200
    (d) the ATO owes the business $400.
Short response questions

1. When establishing a business, the entrepreneur risks capital and personal confidence.
   (a) **Describe** the personal qualities essential to all entrepreneurs.  
      3 marks
   (b) **Discuss** entrepreneurship and its importance in terms of the development of new 
      businesses.  
      6 marks

2. Referring to a business you have studied, answer the following questions:
   (a) **Identify** the three personal factors that should be taken into account before 
      establishing a new business.  
      3 marks
   (b) **Explain** what considerations are necessary when identifying business 
      opportunities.  
      6 marks
   (c) **Determine** how a business can achieve a competitive advantage in terms of its 
      chosen market.  
      12 marks

3. (a) **Define** the phrase ‘identifying a business opportunity’.  
      2 marks
   (b) **Explain** its importance.  
      4 marks
   (c) **Determine** what factors need to be considered before the business idea 
      can be developed.  
      8 marks

4. (a) **Define** the term ‘target market’  
      2 marks
   (b) **Demonstrate** why it is essential for a business to identify its target 
      market.  
      4 marks
   (c) Once a business has identified its target market, **recommend** three strategies the 
      business can use to achieve a competitive advantage.  
      6 marks

5. (a) **Outline** the two advantages and two disadvantages of buying an existing 
      business.  
      3 marks
   (b) **Explain** how a franchise operates.  
      4 marks
   (c) **Examine** the costs and benefits of buying a franchise.  
      4 marks
   (d) **Discuss** why franchises have become so popular in recent years.  
      5 marks

6. Location is considered crucial in terms of business success.
   (a) **Outline** the main factors that must be considered in terms of choosing a business 
      location.  
      3 marks
   (b) **Discuss** the differences in location choice for a manufacturing business and a retail 
      clothing store.  
      6 marks

7. ‘Government regulations are necessary for the business sector to function efficiently and 
   equitably.’
   (a) **Describe** two of the legal requirements to which businesses must 
      adhere.  
      3 marks
   (b) **Discuss** the accuracy of this statement and give reasons for your 
      answer.  
      5 marks

8. (a) **Define** the term ‘business plan’  
      2 marks
   (b) **Explain** the purpose of a business plan.  
      5 marks
   (c) **Evaluate** the importance of planning to the overall success of a 
      business.  
      10 marks

9. (a) **Outline** what motivates people to start their own business.  
      2 marks
   (b) **Identify** the personal skills required to successfully operate a small business.  
      3 marks

10. (a) **Define** the term ‘business concept’.  
      2 marks
   (b) **Explain** how a prospective business owner might devise a business 
      concept.  
      4 marks
   (c) **Analyse** the role of innovation and entrepreneurship in the establishment of new 
      businesses.  
      8 marks

11. **Identify** the range of support services that small business owners should 
    utilise.  
    3 marks

12. (a) **Identify** three advantages that the use of computers can bring to a small 
    business.  
    3 marks
   (b) **Select** three different examples of business hardware and **explain** the purpose of 
    each.  
    6 marks
   (c) **Analyse** how the use of information and communication technology can assist a small 
    business owner to make appropriate decisions.  
    10 marks
13 (a) **Outline** two business objectives that could be assisted by a business engaging in e-commerce.  
   2 marks  
   (b) **Distinguish** between e-business and e-commerce.  
       4 marks  
   (c) **Recommend** three strategies a small business could implement to increase revenue as a result of engaging in e-commerce  
       6 marks  

14 (a) **Distinguish** between debt and equity financing.  
   5 marks  
   (b) **Investigate** why funds should be borrowed for as long as it will take the increased profits to repay the loan.  
   6 marks  

15 Gerry has had an interest in antique and unusual children’s toys since he was a child, and has been collecting toys from the 1940s and 1950s for many years. He is interested in setting up a toy shop, incorporating a museum or similar display for his collection. His hope is that the display of antique toys will be a means of attracting customers.  
   (a) **Identify** the source of inspiration behind Gerry’s business concept.  
       1 mark  
   (b) **Outline** how he has sought to differentiate his business from those of possible competitors.  
       3 marks  
   (c) To assist Gerry in making a decision about whether to implement his business idea, **propose** a list of six questions that a market researcher might ask.  
       6 marks  
   (d) **Create** a step-by-step process that Gerry can undertake to determine whether or not there is sufficient demand for the type of business he is proposing.  
       12 marks  

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**Extended response questions**

1 Research reveals that women-owned small businesses are good prospects for financial institutions that lend money. Yet women still face discrimination when organising finance and often end up borrowing from family members. **Investigate** why this discrimination still occurs.  

2 **Discuss** the key considerations for an entrepreneur in terms of setting up a business. Use examples.  

3 Phillip and Janice worked in a bank, but had always wanted to run their own business. While on holiday in a small seaside town, they noticed that the local general store and takeaway food shop was up for sale. The business was the only one of its type in the town, but the town is very small and seems to have a reasonably large population only during summer and holiday periods, when the local camping and caravan park, and other holiday accommodation are all full. They are very interested in purchasing the store, but realise they have to make a number of important decisions before committing to making an actual offer on the store.  

As a business consultant, prepare a report that could be given to Phillip and Janice. In your report, you should:  
   (a) **Outline** the main personal qualities needed to successfully operate a small business.  
   (b) **Create** a list of 10 questions Phillip and Janice should consider before committing to making an actual offer.  

4 Referring to a business that you have studied, **determine** three critical issues that will influence the success or failure of the business.  

5 ‘Competitors can be a threat to a business but they can also ultimately lead to business success.’ **Explain** how competition may in fact be good for business.  

6 **Investigate** how the following act as the primary influences on an individual’s decision to establish a business:  
   (i) personal qualities  
   (ii) motivation  
   (iii) experience  
   (iv) expectations.  

7 ‘Choosing the right location was crucial because not everyone is interested in up-market garden accessories. We chose a location that had the right demographics — people took pride in their gardens and most of the people who live in the area are professional working people with cash to spend. It was also a big decision to set up our website where customers can order our garden accessories online.’ Sonya Mezups, proprietor, blooming nursery.
Explain how selecting the correct location can make the difference between success and failure.

8 Select a small business that you buy from regularly and identify its strengths and weaknesses. If this business were for sale, determine whether you would consider purchasing it. Give reasons for your answer.

9 Assess the relationship between key success factors and the competitive edge that a small business should seek.

10 You have been employed as a business reporter with the local newspaper. You are asked to prepare an article that examines the number of government and private support agencies that provide assistance to small business owners. A major focus within your article should be an evaluation of two government websites that assist small businesses.

11 A friend wishes to go into business for herself. She is not sure whether to purchase an existing business or set up a new business. She comes to you for advice. Outline for her the advantages and disadvantages of each option.

12 Jane has just set up a small business as a wedding planner. She hopes that couples planning a wedding will commission her to put together a ‘total wedding package’, for which she will charge a fee. To create the type of wedding packages her customers want, she has to deal with a number of different wedding service suppliers. These include reception venues, wedding car hire businesses, photographers and video businesses, florists, printers, dressmakers and formalwear hire businesses. Jane wants to make sure she fulfils all her legal responsibilities and she wants to have a reputation as an ethical business owner, because she knows that most of her business will come from personal recommendations and word of mouth.

Jane’s biggest concern is that she doesn’t know whether the other businesses she has to deal with share her principles. Imagine you are her solicitor, and she comes to you seeking advice. She wants to know how she can tell whether or not the wedding service suppliers she will be dealing with are acting legally and ethically, because any unlawful or inappropriate activities will reflect back on her and her business.

Construct a report for Jane that will help her identify whether or not her business is meeting its legal responsibilities to its customers, to other businesses and to the community. Your advice should include the following:

- how to tell whether a business is conforming to the federal Trade Practices Act
- how to tell whether a business is meeting the requirements of the New South Wales Fair Trading Act
- the responsibilities of food businesses, such as reception venues, in ensuring food safety
- what she can do to ensure she manages her legal responsibilities in an ethical and socially responsible manner.

13 Analyse why it is important for small business owners to have a detailed understanding of the market in which the business will be competing.

14 ‘A business plan won’t guarantee success but it does improve the chances of success.’

Assess the accuracy of this statement.

15 ‘Undertaking a break-even analysis in the early stages of the planning process is crucial. The information it provides determines how I advise the client to proceed.’ Nick Aquilano, small business consultant, BizVest Planning.

(a) Define the term ‘break-even analysis’.

(b) Explain why it is an important planning tool.

(c) Demonstrate how to calculate the break-even point.
Planning for Success
SEARCHLIGHT ID: PRO-0057

Scenario
The opportunity to put into practice what you have been learning in Business Studies is here. You have decided to start your own business and use this experience, not only to earn money, but to apply some of the knowledge that you have acquired so far.

Based on your knowledge, skills and feedback from your friends, you have narrowed your potential new business down to a T-shirt company based on your own designs or boutique pastries and cakes thanks to your grandma’s secret recipes.

Your Project Brief includes an interview with successful young entrepreneur Jamie Xuereb. Jamie gives insight into his experience in the different elements of starting and growing his small business of stickers, labels and printing.
Your task
To best prepare yourself for the challenge of starting and, more importantly, maintaining a new small business, you have decided to prepare a business plan to help plan all aspects of your new venture.

In order to complete your business plan you will need to:
• Research the different sections of a business plan and gather the information that you will require to complete it thoroughly.
• Investigate all the legal requirements (documentation) that you will need to complete in order to establish your business.
You must also attach completed templates of the legal documentation required to start a business such as ABN applications, Business Name Registration and Taxation forms.

Process
• Open the ProjectsPLUS application for this book in your eBookPLUS. Watch the introductory video lesson, click the ‘Start Project’ button and then set up your project group. You can complete this project individually or invite other members of your class to form a group. Save your settings and the project will be launched.
• Navigate to your Research Forum. Here you will find a series of pre-loaded topics which outline the main categories of your business plan. This will provide you with a framework for your research and investigation. You can view and comment on other group members’ articles and rate the information they have entered which provides a source of valuable feedback.
• Visit your Media Centre and download the Business Plan model, template and guide. In your business plan, you must address the following sections in relation to your proposed business:
  – Situational analysis
  – Operations plan
  – Marketing plan
  – Financial plan
  – Human resources plan
  – Executive summary.
• Research. Your business plan needs to be based on realistic data. In order to help with your research, your Media Centre contains a selection of images of your product, a series of weblinks which provide you with information and guidance on starting your own business as well as a guide to creating your business plan. The included SWOT analysis template may also be useful in supporting your data.
• You might like to use Microsoft Excel or alternative similar software to create graphs to display your research and figures in a visual manner. A Guide to Creating Graphs has been included in your Media Centre.
• As part of your project, you must also include completed templates of the legal documentation required to start a business. This might include ABN applications, Business Name Registration and Taxation forms. The weblinks in your Media Centre will help you locate these downloadable forms online.
• Once you have researched and responded to all sections of your project, print out your business plan and relevant forms from projectsPLUS and hand them in to your teacher with any supporting documents.

Your ProjectsPLUS application is available in this book’s Student Resources section inside your eBookPLUS. Visit www.jacplus.com.au to locate your digital resources.
**accountability**: when a business acts in the best and highest interests of its owners. Full and complete ‘disclosure’, which means to be open and not hide the truth, ensures that the books of account are kept accurately and that the information reflected in them, and which is summarised in reports, is based on the true and actual transactions. Another term for accountability is stewardship.  

**accounting**: a managerial and administrative tool for recording financial transactions, so that a summary of what has happened to business money can be traced.  

**acquisition**: (takeover) when one business takes control of another business by purchasing a controlling interest in it.  

**assets**: items of value to the business that can be given a monetary value.  

**audit**: an independent check of the accuracy of financial records and accounting procedures.  

**Australian Business Number (ABN)**: a single identifying number that a business uses when dealing with government departments and agencies.  

**autocratic leadership style**: the manager tends to make all the decisions, dictates work methods, limits worker knowledge about what needs to be done to the next step to be performed, frequently checks employee performance and sometimes gives feedback that is punitive.  

**award**: an employee’s minimum pay and conditions.  

**balance of payments (BOP)**: a record of a country’s trade and financial transactions with the rest of the world over time, usually one year.  

**balance sheet**: a statement of the business’s assets and liabilities (financial position) at a particular time using the heading ‘as at’ to pinpoint when it was created.  

**bank overdraft**: the bank allows a business to overdraw their account up to an agreed limit for a specified time, to overcome a temporary cash shortfall.  

**bankruptcy**: a declaration that a business or person is unable to pay his or her debts.  

**behavioural approach**: (to management) stresses that people (employees) should be the main focus of the way in which the business is organised.  

**benchmark**: a standard by which something can be measured or judged.  

**best practice**: business practices that are regarded as the best or of the highest standard in the industry.  

**body language**: the use of gestures, facial expressions and posture to communicate.  

**brand**: a name, term, symbol or design that identifies a specific product and distinguishes it from its competitors.  

**brand logo**: a graphic representation that identifies a business or product.  

**break-even analysis**: used to determine the level of sales that needs to be generated to cover the total cost of production.  

**budget**: the business’s financial plan for the future.  

**bureaucracy**: the set of rules and regulations that control a business.  

**business**: can be defined as the organised effort of individuals to produce and sell, for a profit, the products that satisfy individuals’ needs and wants.  

**business activity statement (BAS)**: records a business’s claim for input tax credits and accounts for GST payable.  

**business (corporate) culture**: the values, ideas, expectations and beliefs shared by members of the organisation.  

**business environment**: the surrounding conditions in which the business operates. It can be divided into two broad categories: internal and external.  

**business ethics**: the application of moral standards to business behaviour.
business information system (BIS): (also referred to as a management information system (MIS)) gathers data, organises and summarises them, and then converts them into practical information   p. 300

business life cycle: the stages of growth and development a business can experience   p. 88

business opportunity: can be described as something an entrepreneur can see as an avenue to success. It is often identified when a person believes they can provide a good or service in a better or different way from those already on the market.   p. 355

business plan: the ‘road map’ for future growth and development within a business. It sets out the desired goals and direction of the business.   p. 392

cash flow: the money coming into the business in the form of cash receipts, and the money leaving the business as cash payments   p. 92

cash flow projection: the changes to the cash position brought about by the operating, investing and financial activities of the business   p. 416

cash flow statement: shows the movement of cash receipts (inflows, such as money from sales) and cash payments   p. 236

chain of command: a system that determines responsibility, supervision and accountability of members of the organisation   p. 173

change: any alteration in the business and work environment   p. 291

change agent: a person or group of people who act as catalysts, assuming responsibility for managing the change process   p. 307

change management: a methodical approach to dealing with change, both from the perspective of a business and on the individual level   p. 309

channels of distribution: ways of getting the product to the customer   p. 229

choice: the act of selecting among alternatives   p. 13

classical approach: (to management) stresses how best to manage and organise workers so as to improve productivity (output)   p. 165

closing stock: the value of stock on hand at the end of the financial year   p. 241

common law (employment) contract: when employers and employees have the right to sue for compensation if either party does not fulfil their part of the contract   p. 268

communication: the exchange of information between people; the sending and receiving of messages   p. 128

compensation: the payment or benefits (or both) an employee receives in exchange for their labour   p. 265

competition: rivalry among businesses that seek to satisfy a market   p. 356

competitive advantage: the strategies used by a business to gain an ‘edge’ over its competitors   p. 434

complementary business: a business that sells a similar range of goods and services   p. 72

computer aided design (CAD): a computerised design tool that allows the business to create product possibilities from a series of input data   p. 411

computer aided manufacture (CAM): software that controls the manufacturing process   p. 411

conflict of interest: when a person takes advantage of a situation or piece of information for his or her own gain rather than for the employer's interest   p. 284

consumer buying behaviour: the decisions and actions of consumers when they purchase goods and services for personal household use   p. 221

contingencies: unanticipated events that can lead to financial difficulty. For a business to be well managed, it needs to have saved money for such events.   p. 232
**contingency approach:** the need for flexibility and adaptation of management practices and ideas to suit changing circumstances  p. 189

**continuous improvement:** an ongoing commitment to achieving perfection  p. 211

**control process:** establishing standards in line with the goals of the business, measuring the performance of the business against those standards or benchmarks, and making changes where necessary to ensure that the goals of the business have been met  p. 171

**controlling:** compares what was intended to happen with what has actually occurred  p. 171

**Corporate Code of Conduct:** a set of ethical standards for managers and employees to abide by  p. 284

**cost of goods sold (COGS):** the value of stock that a business has sold to its customers  p. 241

**creditors:** those people or businesses who are owed money  p. 108

**curriculum vitae** or résumé: a summary of a person’s previous employment experience  p. 259

**data:** unprocessed facts and figures such as sales figures and customer complaints  p. 300

**debt finance:** money obtained through loans  p. 372

**decision making:** the process of identifying the options available and then choosing a specific course of action to solve a specific problem  p. 136

**delegation:** the handing over of certain tasks or responsibilities to an employee who is suitably capable and qualified to carry them out  p. 181

**deregulation:** the removal of government regulation from industry, with the aim of increasing efficiency and improving competition  p. 56

**development:** activities that prepare staff to take greater responsibility in the future  p. 262

**dismissal:** when the behaviour of an employee is unacceptable and it then becomes necessary for a business to terminate the employee’s employment contract  p. 277

**diversification:** (or conglomerate integration) when a business acquires or merges with a business in a completely unrelated industry  p. 98

**dividend:** part of a business’s profit that is divided among shareholders  p. 12

**division:** the separation of key business functions into specialised units or departments. The business is divided into functional areas.  p. 197

**driving forces:** forces that support the change  p. 306

**e-business:** (electronic business) using the Internet to conduct business  p. 441

**ecological sustainability:** when economic growth meets the needs of the present population without endangering the ability of future generations to meet their needs  p. 85

**e-commerce:** the buying and selling of goods and services via the internet  pp. 28, 441

**economic cycles:** (or business cycles) periods of growth (‘boom’) and recession (‘bust’) that occur as a result of fluctuations in the general level of economic activity  p. 52

**economic growth:** when a nation increases the real value of goods and services over a period of time  p. 328

**economy:** a system used to determine what to produce, how to produce and to whom production will be distributed  p. 327

**effectiveness:** measures the degree to which a goal has been achieved  p. 122

**efficiency:** compares the resources needed to achieve a goal (the costs) against what was actually achieved (the benefits)  p. 122
elaborately transformed manufactures (ETMs): manufactured goods that are highly processed and valued. They are complex because of the amount of processing they have undergone.  p. 203
employee selection: gathering information about each applicant for a position, then using that information to choose the most appropriate applicant  p. 257
employee training: the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills  p. 162
employment contract: a legally binding, formal agreement between an employer and an employee  p. 266
enterprise agreement: a negotiated arrangement between an employer and a union or a group of employees  p. 267
entrepreneur: someone who starts, operates and assumes the risk of a business venture in the hope of making a profit  p. 15
equity finance: the funds contributed by the business owner(s) to start and then expand the business  p. 373
establishment costs: costs involved in setting up the business  p. 374
e-tailer: an electronic retailer  p. 368
evaluation: the process of assessing whether the business has achieved stated objectives  p. 418
expenses: costs. Specifically, expenses are the costs incurred in the process of acquiring or manufacturing a good or service to sell and the costs (direct and indirect) associated with managing all aspects of the sales of that good or service.  p. 241
external environment: factors over which the business has very little control  p. 51
external recruitment: filling job vacancies with people from outside the business  p. 256
Fairtrade: a trading partnership that seeks greater equity (fairness) in international trade. It promotes the rights of marginalised workers, especially in low-income countries.  p. 281
finance: how a business funds its activities — for instance, where it gets the money to trade, why it chooses to use certain lenders — as well as the costs, risks and benefits of different types of borrowings  p. 234
financial resources: funds the business uses to meet its obligations to various creditors  p. 75
financial statements: reports that summarise transactions over a period of time  p. 236
finished product: product that is ready for customers to buy and use  p. 7
fixed costs (FC): costs that do not vary regardless of how many units of a good or service are produced  p. 415
flatter organisational structures: evolved due to a ‘de-layering’ of management structures resulting in the elimination of one or more management levels  p. 186
flexible manufacturing: production by computer controlled machines that can adapt to various versions of the same operation  p. 296
float: the raising of capital in a company through the sale of shares to the public  p. 48
forecasts (or projections): the business’s predictions about the future  p. 414
franchise: buying the rights from another business to distribute its product under its name  p. 43
franchisee: an individual or business that purchases a franchise  p. 43
franchisor: an individual or business that grants a franchise  p. 43
geographical spread: the presence of a business and the range of its products across a suburb, city, state or country or the globe  p. 25
global business, or transnational corporation (TNC): a large business with a home base in one country that operates partially owned or wholly owned businesses in other countries  p. 26

globalisation: the process that sees people, goods, money and ideas moving around the world faster and more cheaply than before  p. 58

goal: a desired outcome (target) that an individual or business intends to achieve within a certain time frame  p. 144

goods: items that can be seen or touched  p. 7

goods and services tax (GST): a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia  pp. 61, 387

goodwill: the monetary value attached to the reputation of a particular business  p. 359

government enterprises: government-owned and operated businesses  p. 43

grant: any monetary or financial assistance that does not generally have to be repaid  p. 412

gross domestic product (GDP): the total money value of all goods and services produced in Australia over a one-year period  p. 328

gross profit: the term given to the sales less cost of goods sold (COGS)  p. 241

high technology (hi-tech): a broad term used to describe new and innovative types of businesses that depend on advanced scientific and engineering knowledge  p. 337

holistic: an approach that looks at the whole picture  p. 300

horizontal integration: when a business acquires or merges with another firm that makes and sells similar products  p. 98

human resource/employment cycle: covers all stages in the process of employing staff, from initial planning through to recruitment, selection, induction, training and development, performance management, and eventual separation of employment  p. 251

human resource management (HRM): in its simplest terms, defined as the effective management of the formal relationship between the employer and the employees  p. 250

human resource planning: the development of strategies to meet the business’s future staffing needs  p. 254

human resources: the employees of the business and are generally its most important asset  p. 75

income: money received by a person for providing his or her labour, or a business from a return on its investments  p. 12

income statement, or statement of financial performance: a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.  p. 240

incorporated: the process companies go through to become a separate legal entity from the owner/s  p. 35

incorporation: the process that companies go through to become incorporated, i.e. to become a registered company and a separate legal entity  p. 40

incremental change: results in minor changes, usually involving only a few employees  p. 293

industry: businesses that are involved in similar types of production  p. 30

inertia: an unenthusiastic response to proposed change  p. 305

information: processed data that have been deliberately selected and organised to be useful to an individual manager  p. 300
**information resources**: the knowledge and data required by the business, such as market research, sales reports, economic forecasts, technical material and legal advice  p. 75

**innovation**: an improvement on something already established  p. 13

**input tax credit**: an allowable tax deduction that a business can claim for any GST included in the price of business inputs  p. 387

**inputs**: resources used in the process of production  p. 202

**insolvent**: when a company is not able to pay its debts as and when they fall due  p. 110

**intangibles**: services that cannot be touched  p. 200

**interdependence**: the mutual dependence that the key functions have on one another. The key business functions work best when they overlap, and employees work towards common goals. For each function area to perform at capacity, it depends on the support of the others.  p. 196

**interest**: the cost of borrowing money  p. 373

**internal environment**: factors over which the business has some degree of control  p. 51

**internal recruitment**: filling job vacancies with present employees, rather than looking outside the business  p. 256

**interpersonal (people) skills**: those skills needed to work and communicate with other people and to understand their needs  p. 127

**intrapreneur**: an individual who takes on the entrepreneurial roles within a business  p. 159

**invention**: the development of something new  p. 13

**involuntary cessation**: when the owner is forced to cease trading by the creditors of the business  p. 108

**involuntary separation**: when an employee is asked to leave the business against their will  p. 277

**job analysis**: a systematic study of each employee’s duties, tasks and work environment  p. 255

**job description**: a written statement describing the employee’s duties, tasks and responsibilities associated with the job  p. 256

**job specification**: a list of the key qualifications needed to perform a particular job in terms of education, skills and experience  p. 256

**labour productivity**: how much an employee can produce in a set period of time  p. 158

**leadership**: the ability to influence people to set and achieve specific goals  p. 135

**leadership style**: a manager’s way of doing things — their behaviour and attitude  p. 174

**lean manufacturing/production**: an operational strategy aimed at achieving the shortest possible production time by eliminating waste  p. 407

**learning organisation**: monitors and interprets its environment, seeking to improve its understanding of the relationship between its actions and its environment  p. 263

**leasing**: a long-term source of borrowing for businesses. It involves the payment of money for the use of equipment that is owned by another party  p. 438

**liabilities**: items of debt owed to other organisations (e.g. suppliers, banks) and include loans, accounts to be paid by the business, mortgages, credit card debt and accumulated expenses  p. 246

**limited liability**: a feature of corporate ownership that limits each owner’s financial liability to the amount of money he or she has paid for the business’s shares  p. 41
**liquidation**: when an independent and suitably qualified person — the liquidator — is appointed to take control of the business with the intention of selling all the company's assets in an orderly and fair way in order to pay the creditors  

**liquidity**: the amount of cash a business has access to and how readily it can convert its assets into cash so that debt can be paid  

**local business**: has a very restricted geographical spread; it serves the surrounding area  

**logistics**: the management of business operations, such as the purchasing, storage, transportation and delivery of goods along the supply chain  

**long-term growth**: the ability of a business to continually expand  

**maintenance**: the provision of working conditions to encourage employees to remain with the business  

**management**: (contemporary definition) the process of working with and through other people to achieve business goals in a changing environment. Crucial to this process is the effective and efficient use of limited resources.  

**management consultant**: someone who has specialised knowledge and skills within an area of business  

**management hierarchy**: the arrangement that provides increasing authority at higher levels of the hierarchy  

**manager**: someone who coordinates the business's limited resources in order to achieve specific goals  

**manipulation**: the skilful or devious exertion of influence over someone to get them to do what you want  

**market analysis**: collecting, summarising and analysing information about the state of the market, customers, the threats and opportunities that the market presents, and any advantages or disadvantages that the business is likely to have over its competitors  

**market concentration**: the number of competitors in a particular market. There are four main types of market concentration.  

**market segmentation**: when the total market is subdivided into groups of people who share one or more common characteristic  

**market share**: the business's share of the total industry sales for a particular product  

**marketing**: the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives (American Marketing Association). A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers.  

**marketing concept**: a business philosophy that states that all sections of the business are involved in satisfying a customer's needs and wants while achieving the business's objectives  

**marketing mix**: the combination of the four elements of marketing, the four Ps — product, price, promotion and place — that make up the marketing strategy  

**marketing strategies**: actions undertaken to achieve the business's marketing goals  

**mass marketing**: seeks a large range of customers  

**mass production**: the process of manufacturing standardised goods on a huge scale by automation  

**mentor**: someone — usually a more experienced employee — who helps develop a less experienced employee (the protégé)
mentoring: the process of developing another individual by offering tutoring, coaching and modelling acceptable behaviour p. 161
merger: when the owners of two separate businesses agree to combine their resources and form a new organisation p. 97
micro business: employs fewer than five people (including the owner) p. 24
modifying: the process of changing existing plans, using updated information to shape future plans p. 422
monitoring: the process of measuring actual performance against planned performance p. 418
monopolistic competition: where there is a large number of buyers and sellers in a particular market, e.g. local retailing shops p. 65
monopoly: complete concentration by one firm in the industry, e.g. Australia Post p. 65
mortgage: a loan secured on some type of asset p. 373
motivation: the individual, internal process that directs, energises and sustains a person's behaviour p. 160
multiskilling: allows employees to develop skills in a wide range of tasks through ongoing training p. 162
national business: business that operates within just one country p. 26
net profit: the difference between the gross profit and operating and non-operating expenses p. 242
niche market: a narrowly selected target market segment p. 223
nonverbal communication: any message that is not written or spoken p. 131
objective: a specific statement detailing what a business (or individual) needs to achieve in order to accomplish its vision p. 404
occupational health and safety (OH&S): the responsibility the employer has to ensure the workplace is safe for employees and that steps are taken to minimise harm p. 273
oligopoly: where a small number of larger firms have a greater control over a market, e.g. car manufacturers p. 65
on-costs: payments for non-wage benefits p. 382
opening stock: the value of stock (or inventory) that the business has at the start of the financial year p. 241
operating costs: costs involved in the ordinary day-to-day running of the business p. 374
operating expenses: all the costs of running the business except the cost of goods sold p. 10
operational objectives: short-term issues and describe the course of action necessary to achieve the tactical objective and strategic goal p. 404
operational planning: specific details about the way in which the business will operate in the short term p. 170
operations: the business processes that involve transformation or, more generally, ‘production’ p. 198
operations management: all the activities in which managers engage to produce a good or service p. 198
organisation process: the range of activities that translate the goals of a business into reality p. 171
organisational structure: the framework in which the business defines how tasks are divided, resources are used, and departments are coordinated p. 409
organising: the structuring of the organisation to translate plans and goals into action p. 171
outputs: the end result of a business’s efforts — the service or product that is delivered or provided to the consumer  p. 206

outsourcing: the use of external sources or businesses to undertake business functions or activities for the business  pp. 194, 294

owner’s equity: the funds contributed by the owner(s) to establish and build the business. It is also called ‘capital’.  p. 246

packaging: the development of a container and the graphic design for a product  p. 226

participative or democratic leadership style: a style in which the manager consults with employees to ask their suggestions and then seriously considers those suggestions when making decisions  p. 188

partnership: a legal business structure that is owned and operated by between two and 20 people with the aim of making a profit  p. 37

percentage mark-ups: increase the cost price by a fixed percentage to give the selling price  p. 365

perfect competition: where there is a large number of small firms that sell similar products. They are unable to differentiate products from each other and so can only use price as a way of achieving market share, e.g. fruit and vegetable growers.  p. 65

performance standard: a forecast level of performance against which actual performance can be compared  p. 418

physical resources: resources including equipment, machinery, buildings and raw materials  p. 75

planning: the preparation of a predetermined course of action for a business; the process of setting targets and deciding how to achieve them  pp. 170, 396

primary industry: those businesses in which production is directly associated with natural resources  p. 31

primary target market: the market segment at which most of the marketing resources are directed  p. 222

privatisation: the process of transferring the ownership of a government business to the private sector  p. 43

proactive: a management style that incorporates dynamic action and forward planning to achieve particular objectives  p. 136

problem solving: a broad set of activities involved in searching for, identifying and then implementing a course of action to correct an unworkable situation  p. 135

product: a good or service that can be bought or sold  p. 7

product life cycle: the life of a product over four stages: introduction, growth, maturity and decline  p. 225

product positioning: the development of a product image compared with the image of competing products  p. 225

production: activities undertaken by the business that combine the resources to create products that satisfy customers’ needs and wants  p. 7

profit: what remains after all business expenses have been deducted from sales revenue  p. 10

profit maximisation: when there is a maximum difference between the total revenue (that is, the number of sales made multiplied by the price) coming into the business and total costs being paid out  p. 147

promotion: the methods used by a business to inform, persuade and remind a market about its products  pp. 150, 228

proprietary (private) company: an incorporated business and usually has between two and 50 private shareholders  p. 42
**prospectus:** a document giving details of a company and inviting the public to buy shares in it  
**quality:** the degree of excellence of a good or service and its fitness for a stated purpose  
**quality assurance:** the use of a system so that a business achieves set standards in production  
**quality circles:** groups of workers who meet to solve problems relating to quality  
**quality control:** the use of inspections at various points in the production process to check for problems and defects  
**quality management:** the strategy which a business uses to make sure that its products meet customer expectations  
**quality of life:** the overall wellbeing of an individual, and is a combination of both material and non-material benefits  
**quaternary industry:** industry involved in services that involve the transfer and processing of information and knowledge  
**quinary industry:** industry involved in all services that have traditionally been performed in the home  
**realisation:** the process of converting the assets of a business into cash  
**receivership:** where a business has a receiver take charge of the affairs of the business. Unlike liquidation, the business may not necessarily be wound up.  
**recruitment:** the process of attracting qualified job applicants from which to select the most appropriate person for a specific job  
**redundancy:** when a particular job a person is doing is no longer required to be performed, usually due to technological changes, a merger or takeover  
**regulations:** rules, laws or orders that businesses must follow  
**remuneration package:** the combination of monetary and non-monetary benefits  
**research and development (R&D):** a set of activities undertaken to improve existing products, create new products and improve production  
**resignation:** or ‘quitting’, a voluntary ending of the employment relationship  
**resource allocation:** the efficient distribution of resources so as to successfully meet the goals that have been established  
**restraining forces:** forces that work against the change  
**retirement:** when an employee decides to give up full-time or part-time work  
**retrenchment:** when a business dismisses an employee because there is not enough work to justify paying him or her  
**return:** any profit that investors make from their investment  
**revenue:** money a business receives as payment for its products  
**risk:** the possibility of loss  
**salary:** a fixed amount of money paid on a regular basis, usually fortnightly or monthly, to a permanent employee of a business  
**scientific management:** an approach that studies a job in great detail to discover the best way to perform it  
**secondary industry:** industry involved in taking a raw material and making it into a finished or semi-finished product  
**secondary target market:** usually a smaller and less important market segment  
**separation:** the ending of the employment relationship  
**services:** things done for you by others
share: a part ownership of a public company  p. 151
shareholders: people who are part owners of a company because they own a number of shares  p. 12
sigma-six: a process in which 99.99 per cent of all manufactured products are defect free  p. 408
simply transformed manufactures (STMs): characterised by their ability to be further processed in a wide range of processes. STMs are manufactured goods that are intermediate by nature. Due to the limited amount of transformation they have undergone, STMs have only a small amount of value added.  p. 204
skill: the ability that comes from the knowledge, practice and talent to do something well  p. 125
skills audit: a process that establishes the current skills levels of employees and future skills requirements  p. 430
skills inventory: a database containing information on the skills, abilities and qualifications of existing staff  p. 431
social justice: adopting a set of policies to ensure that employees or other community members are treated equally and fairly  pp. 152, 406
social responsibility: a business's management of the social, environmental, political and human consequences of its actions  p. 286
socialisation: the process a new employee undergoes in the first few weeks of employment through which he or she learns how to cope and succeed  p. 161
sole trader: a business that is owned and operated by only one person  p. 36
specialisation of labour: the degree to which tasks are divided into separate jobs  p. 173
staff involvement: involving employees in the decision-making process and giving them the necessary skills and rewards  p. 158
stakeholder: any group or individual who has an interest in or is affected by the activities of a business  p. 81
stakeholder engagement: businesses sharing information with and seeking input from stakeholders, and involving them in decision making  p. 139
strategic goals: long-term, broad aims and apply to the business as a whole  p. 404
strategic planning: planning for the following three to five years. This level of planning will assist in determining where in the market the business wants to be, and what the business wants to achieve in relation to its competitors.  p. 170
strategic thinking: allows a manager to see the business as a whole and to take the broad, long-term view  p. 132
strategies: the actions that a business takes to achieve specific goals  p. 194
structural change: changes in the business's structure — that is, the organisation chart  p. 293
superannuation: a scheme set up by the federal government. It requires all employers to make a financial contribution to a fund that employees can access when they leave or retire from a job.  p. 384
support services: the activities needed to assist the core operations or prime function of a business  p. 75
sustainability report/social audit: a report that details what a business has done, and is doing, concerning social issues that affect it  p. 288
sustainable competitive advantage: the ability of a business to develop strategies that will ensure it has an ‘edge’ over its competitors for a long period of time  p. 64
sustainable development: when the needs of the present population are met without endangering the ability of future generation to meet their own needs  p. 153
(SWOT) analysis: the identification and analysis of the internal strengths and weaknesses of the business, and the opportunities in, and threats from, the external environment  p. 401

tactical objectives: mid-term, departmental issues and describe the course of action necessary to achieve the business’s strategic goals  p. 404

tactical planning: flexible, adaptable planning, usually over one to two years, that assists in implementing the strategic plan  p. 170

tangibles: goods that can be touched  p. 200

target market: a group of customers with similar characteristics who presently, or who may in the future, purchase the product  p. 219

taxation: the compulsory payment of a proportion of earnings to the government  p. 385

teammwork: people who interact regularly and coordinate their work towards a common goal  p. 185

tertiary industry: industry involved in performing a service for other people  p. 32

time and motion study: a process of examining each of the steps in a production procedure and the time taken to perform them  p. 166

total cost (TC): cost of producing a certain number of goods or services; the sum of the fixed and variable costs for those units  p. 415

total quality management: an ongoing, business-wide commitment to excellence that is applied to every aspect of the business’s operation  p. 210

total revenue (TR): the total amount received from the sales of a good or service  p. 414

Trade Practices Act 1974: a law that protects both consumers and businesses. It protects consumers from deceptive or misleading practices, and it regulates the trade practices of businesses.  p. 378

traditional definition of management: the process of coordinating a business’s resources to achieve its goals  p. 120

training: the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills  p. 262

transformation: the conversion of inputs (resources) into outputs (goods or services)  p. 202

transformational change: often results in a complete restructure throughout the whole organisation  p. 293

transnational (multinational) corporation: a company that has branches in many different countries  p. 23

triple bottom line: the economic, environmental and social performance of a business  pp. 139, 281

undercapitalisation: when there is a lack of sufficient funds to operate a business normally  p. 105

unfair dismissal: when an employer dismisses an employee for discriminatory reasons, such as firing someone because they are pregnant  p. 278

unlimited liability: when the business owner is personally responsible for all the debts of his or her business  p. 36

value added: the creation of extra or added value as raw materials are transformed into intermediate or finished products through the various stages of production  p. 204

variable costs (VC): costs that depend on the number of goods or services produced  p. 415

venture capital: money that is invested in small and sometimes struggling businesses that have the potential to become very successful  p. 48
**vertical integration:** when a business expands at different but related levels in the production and marketing of a product  p. 97

**vision:** the clear, shared sense of direction that allows people to attain a common goal  p. 134

**vision statement:** states the purpose of the business; states what the business aspires to become; its purpose and its function  pp. 300, 402

**voluntary administration:** when an independent administrator is appointed to operate the business in the hope of trading out of the present financial problems  p. 109

**voluntary cessation:** when the owner ceases to operate the business of their own accord  p. 108

**voluntary separation:** when an employee chooses to leave the business of their own free will  p. 276

**wage:** money received by workers, usually on a weekly basis, for services they provide to an employer  p. 12

**workplace democracy:** (or empowerment) the move towards increasing the influence of employees in decisions affecting their organisation and their jobs  p. 270

**zoning:** a means by which local councils allocate land for different uses, such as residential, commercial, recreational and industrial  p. 366
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Assessment using key process verbs

The purpose of a key process verb in a question is to provide instructions on how to answer a question and how much to write. There is a direct relationship between the type of key process verb and the mark value allocated. The more thinking skills the key process verb requires, the higher the mark allocated.

On the right is a colour coded list of the key process verbs that may be used for assessment. It is divided into three categories based on Bloom’s Taxonomy. Each category represents the level of thinking skills required to complete a question.

Mark allocation

The suggested marks used in these examples are specifically for short answer questions. Essay questions may also include a number of key process verbs.

<table>
<thead>
<tr>
<th>Lower order thinking questions</th>
<th>Clarify, define, describe, extract, identify, outline, recall, recount, state, summarise</th>
<th>1–3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Middle order thinking questions</td>
<td>Account, apply, calculate, classify, compare, construct, contrast, deduce, demonstrate, discuss, distinguish, examine, explain, interpret, investigate, justify, propose, recommend</td>
<td>3–6</td>
</tr>
<tr>
<td>Higher order thinking questions</td>
<td>Analyse, appreciate, assess, create, critically analyse/evaluate, determine, evaluate, extrapolate, predict, synthesise</td>
<td>6–12</td>
</tr>
</tbody>
</table>

Time allocation

In order to complete each question, time allocation is very important. If a student does not complete the examination in time, because they have not calculated the minutes/marks correctly, they will lose marks. A formula for calculating minutes/marks is as follows:

\[
\text{Marks/minute} = \frac{\text{Total exam time in minutes}}{\text{Total exam marks}} = \frac{\text{minutes/mark}}{\text{Total exam marks}}
\]

Example: \(\text{Marks/minute} = \frac{180 \text{ exam minutes (3hrs)}}{100 \text{ exam marks}} = 1.8 \text{ minutes/mark}\)

In the above example, the student would need to allocate 1.8 minutes per mark in an examination. Therefore, a 4-mark question should be allocated 1.8 minutes x 4 = 7.2 minutes (or rounded to seven minutes). This ensures the allocation of an appropriate amount of time for each question.