'A' LEVEL

MANAGEMENT OF BUSINESS

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STUDY PACK

THIRD EDITION

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S. Madzingira

Director

Introduction

The study pack was written to assist students of Management of Business (MOB). It follows the Zimbabwe Schools Examination Council (ZIMSEC) Syllabus. Students writing Cambridge Business Studies Examinations may also find the Study Pack useful. The book is a product of intensive research carried over a number of years by Turn-Up College. A lot of emphasis is put on local environment examples. This helps students understand and apply knowledge from their environment.

After studying this book students are expected to obtain the following skill levels:

LEVEL 1 – Knowledge and in depth understanding of the contents of the syllabus.

LEVEL II – Application of knowledge and critical understanding of problems and issues arising from both familiar and unfamiliar situations.

LEVEL III – Analysis of problems, issues and situations. The student should be able to:
- Distinguish between facts and opinions
- Explain patterns in data and the likely causes of them.

LEVEL IV – Evaluation and judgment. The students should be able to:
- Weigh up the reliability of data
- Judge the importance of main concepts and models
- Discriminate between alternative explanations
- Discuss issues and argue points that allow for a reasoned judgment to be reached.

These skills should be developed over the period one is studying for ‘A’ level Management of Business. Examiners use the levels as guidelines when marking examinations. This study pack provides essential support to enable students to excel in the subject. In addition, students are expected to update their knowledge through reading newspapers.

CHAPTER 1

THE BUSINESS AND ITS ENVIRONMENT.

Objectives

On completion of this chapter students should be able to:

1. Understand the nature of economic activity and the problem of choice
2. Classify industries into levels of economic activity i.e primary, secondary and tertiary
3. Understand the differences between the private and public sector in your own country
4. Identify the different forms of legal organisation of business and evaluate the most appropriate one or different businesses.
5. Evaluate the arguments for and against privatisation of state-owned industries

Introduction

The central purpose of this chapter is to discuss the inter-relationships between business, the environment in which they operate and the limits that this environment imposes on business activities. The chapter explains the reasons for and nature of business activity and the types of business units that exist in a modern economy. Business activity does not take place in isolation from what is going on around it. The very structure and health of the economy will have a great impact on how successful business activity is.

Business and its environment.

Businesses operate in an environment.

The term 'business' is used to describe all the commercial activities undertaken by the various organizations, which produce and supply goods and services (Danks: 1990). There are many types of business forms. Business can be classified by ownership, size, sector and level of production.

These businesses exist to satisfy needs, and wants.

a) **Needs** are basic necessities that people cannot live without e.g. food, clean water, and shelter e.t.c.

b) **Wants** are luxuries that people can live without e.g. TV, radio, entertainment, and cars e.t.c.

Businesses identify the needs of consumers or other firms. For example a National Foods produces flour which is used by Bakers Inn to make bread.

There are not enough resources to satisfy everyone's needs and wants. This is the problem of scarcity. Business activity attempts to provide for the human needs and wants but still there is a shortage. Since people cannot satisfy all what they need, they make choices on what to be met now and which to forego.

Scarcity and Choice

Resources in the world are scarce such that people are unable to obtain all they require in life. The poor fail to get the basic requirements like food, shelter and clothing even the rich people are not able to satisfy all of their wants for luxury goods and services.

It should be clear that unlimited wants and needs are to be satisfied by insufficient and limited goods and services. It is the purpose of the economic activity to provide for as many wants as possible. The shortage of products and the resources needed to make them lead to all people having to make choices. A scale of preference should be made, where people must choose which needs and wants to satisfy now, and which ones to forgo. If people are rational, they choose these things that give them the greatest benefit, leaving out those things of less value us. All economic units have to make choices, governments, business, workers, charities and many other groups.

Factors of Production

The scarce or limited resources which are used to produce commodities people want to consume, are collectively called the factors of production.

Each of the factors of production receives payment or reward, in return for the contribution it makes to production. Land receives rent, labour receives wages and salaries, capital receives interest, and entrepreneurship is rewarded with profit.

Factor of land

It includes not only land itself, but all natural resources found in the earth and sea. It includes geographical surface rivers, walks, minerals and chemicals. Land is fixed in supply. Quality of the soil may be improved by the use of fertilizers, drainage, land reclamation, containing and re-forestation. All economic activities involve the use of land since they are done on land.

Factor of Labour

It is man's physical and mental contribution to the creation of goods and services. It is the factor that converts resources into goods and services that people want. All production needs labour, even the automated factory requires workers to supervise machinery, to program computers, to operate equipment and to process paperwork. It is important that there is an adequate supply of labour, with the appropriate skills required.

Labour is often divided into three groups:

(i) Semi-skilled and unskilled-jobs, which require little or no special training, usually involve working with the hands e.g. drivers, cleaners, factory production line workers and watchmen.
(ii) Skilled workers are trained for technical skills e.g. engineers, mechanics, electricians, plumbers, computer operators and clerks
(iii) Managerial and professional workers e.g. teachers, doctors, nurses, pharmacist, senior supervisors and solicitors. Many businesses improve the quality of their labour force through education and training.

Factor of Capital

Capital is the money and all other assets which are employed in the process of production. Capital includes the buildings, machinery, equipment, stocks and many other capital goods used in making the items we consume. Capital takes two basic forms.

(i) Fixed Capital- with a long life which is used many times in the production of goods and creation of further wealth e.g. buildings, machinery and other assets
(ii) Working Capital- stocks of raw materials, cash, bank balances and other items required for the day to day operation of the business, and which are continually used.

Factor of entrepreneurship

This is the driving force, provided by risk- taking individuals that combine the other factors of production into a unit that is capable of producing goods and services. It provides a managing, decision making and coordinating role. The ability required to think of a business idea and manage the idea.

Opportunity Cost refers to the next best alternative forgone, when deciding to obtain one good; customers give up other goods as they cannot all be bought. The benefit that is given up by cost buying the best good is the "opportunity cost". For these need to be satisfied businesses require factors of production, which are:

1.1 The nature of business and environment.

The environment in which businesses operate will determine their successes or failure. Businesses must therefore take time to fully understand itself (internal environment), its immediate environment (operating environment) and the broader environment (external environment). All these environments are very important for the success of the business. By assessing the environment, the business is able to understand its strengths, that is internal factors which makes the business better than its competitors or what the business is good at. The firm will also be able to understand its weaknesses, that is what it lacks or what its competitors can do better than itself. Assessing the external environment enables the firm to understand its competitors, the economic factors which affect the business such as inflation, economic growth and interest rates. The firm will also be able to understand political factors which also affect business operations. From the external environment the firm will be able to identify opportunities and threats. Opportunities are those factors which a firm can take advantage of using its own strengths and grow its markets. Threats on the other hand are those factors which pose danger to the survival of the business.

The process of analyzing the environment to identify the firm's strengths, weaknesses, opportunities and threats is called a SWOT analysis.

The following shows examples of strengths, weaknesses, opportunities and threats

Strengths
- good managerial skills
- high level of worker
- good capital employed

Weaknesses
- lazy workers
- poor production methods
- Poor industrial relations.

Opportunities
- low inflation
- good infrastructure
- high levels of literacy rate
- Availability of Government incentives.

Threats

- high competition
- scarcity of resources
- Prohibitions of Government policies.
- declining levels of economic activities.

<u>Activity 1</u>. Identify one business in your locality and identify its strengths, weaknesses, opportunities and opportunities.
Explain how the firm can use its strengths to take advantage of the opportunities in its environment.

Businesses need to understand that strengths and weaknesses are internally generated. This means that businesses can control them, e.g. If the level of motivation of workers is low, managers can increase it by offering more financial and non-financial incentives. Businesses can benefit from their strengths by investing more in those things that strengthen them.

At the same time, businesses can deal with their weaknesses so as to improve their competitive edge. On the other hand, businesses are faced with opportunities and threats that are presented by the external environments. Businesses should take advantage of the opportunities, e.g. the availability infrastructure. Businesses should take advantage of this and open up more branches. If inflation is low, businesses should benefit by borrowing more and expanding their premises. However, the external environments can also pose some threats on businesses. Businesses should endeavor to fight the threats, e.g. if the general literacy rate is high firms should invest in training the workers, and if competition is high firms should adopt measures that will help fight competition e.g. improving quality of products, employ competitive pricing policies, e.t.c.

1.2. Environment Determinism

This term is used to emphasize the fact that the success or failure of a business is determined by the environment in which the business operates. It is therefore very important to understand the environment in which businesses operate.

Elements of business environments
These elements are divided into internal and external elements.

Internal elements

These are elements that are within a business' control. e.g.:

1. Workers –This would refer to the recruitment policies, the skills of the workers, their motivation and levels of experience.
2. Managers- The experience and leadership skills of a company's management is one of the strengths of the firm. A Company that has managers who have good vision and are able to come up with good objectives and how to achieve those objectives will do better than one whose management have no experience.
3. Capital- This refers to the owners of the company's financial resources which the company can use.
4. Technology- A company's technology would determine the quality of goods and how efficient those goods and services are produced.

External elements

These are elements of the environment which a firm cannot be able to control. A company has to find ways of responding to the external elements impact on its business.

1. Government policy- Governments put up laws which regulate the way businesses operate. Such laws include taxation, employment regulations etc.
2. Competition- These are firms which sell the same or substitute products. Such firms would compete on the basis of prices, channel of distributions and quality of goods. Examples of companies competing are Edgars, Topics Woolworth and Meikles.
3. Physical environments- These are natural factors which results from natural environment developments. Examples are earthquakes, Tsunamis, bad weather which affect the operations of a business.
4. Political environment- This relates to issues such as wars strikes and changes of government which would affect the way a business operates.
5. Technological environment- This environment deals with innovations and new ways of doing business. The company has to consider issues such as internet, communication, mechanization and all factors which simplify the way of doing business.
6. Legal environment- This refers to availability of rules and regulations within an environment. Government and Local Government should put up regulations which facilitates and safeguards the operations of businesses.
7. Social environment- This environment deals with social and cultural factors. The numbers of people in the community and their buying power, their health, issues of HIV Aids and availability of educated and skilled labour force.

1.3. Constraints

These are problems faced by firms in decision making. Constraints hinder firms from implementing their decisions.

Legal constraints

a. Law restricting mergers- These are laws which prohibit businesses from combining with one another to achieve economies of scale or to access resources which they may not have on their own.
b. Legal restrictions on financial structure- These are factors imposed on a firm regarding raising more capital or structuring its financing in desired manner.

Physical constraints

1. Accessibility- The ability of the rest of world to access the firm's products easily and quickly. Zimbabwe is a landlocked country, which makes transport costs expensive as most goods have to be transported by road from either Durban Port in South Africa or Maputo Port from Mozambique. .
2. Shortage of raw materials results in imports from other countries.
3. Persistent droughts lead to poor harvests and the need to import food and raw materials for those businesses which rely on agricultural products.

Ethical constraints

Ethics has been defined as what is good and evil, right and wrong, as well as unjust. There are several unethical practices faced or committed by organizations, these include: ill treatment of customers, pollution by waste material, cultural barriers, strike, testing employees for drug use and HIV/AIDS without their consent.

Pressure brought upon management in making management decisions e.g. employees surveillance of all kinds.

Social constraints

1. Level of education or literacy rate of the country- the more people there are who are educated, the more labour is available that can easily be trained and be efficient.
2. Level of diligence of the workforce.
3. Values and norms of the customers.
4. Rate at which workers go on strike (i.e. how militant the workers are, or how co – operative they are? This affects labour productivity and the costs of employment for businesses.

Economic constraints

1. Inflation- This defines the general increase in prices of goods and services in a country. A country with a sustained increase in price level causes an increase in the cost of living for people whose salaries are fixed or lag behind the increase

2. Rate of unemployment- This refers to the number of people who are looking for employment but cannot get the jobs. A country with high levels of unemployment means has less people who can buy goods and services provided by businesses.
3. Exchange rates- This defines the rate at which a currency is exchanged into other currencies. A currency that is expensive to exchange is said to be strong, while the one where you get more units of it for less of the other one is said to be weak. Citizens of a country with a weak currency, will find it difficult to buy good from a country that has a strong currency. For example Zimbabweans would need more Zimbabwean dollars to exchange into Rands to buy goods and services from South African Shops.
4. Balance of payments deficit- This refers to value of goods and services bought by Zimbabweans from the rest of the World compared to the value of goods bought by the rest of the World from Zimbabwe. A country is only able to buy goods from outside if it has enough foreign currency or money from other countries. Therefore if a country does not sell goods to other country (Exports) or get the money of other countries through loans or donations, it will not be able to buy goods from such countries (Imports).

1.4. Types of business activities

Primary Sector Business Activity: the extraction of raw materials from the earth. There is no conversion that takes place at this stage of production e.g. farming, fishing, and mining. Most less developed countries such as Zimbabwe has more businesses in the primary sector or extractive industries. Examples of businesses involved in primary levels are Hwange Colliery Mine, Saw Mills in Mutare and Nyanga, Farmers producing maize.

Secondary Sector Business Activity: Firms involved at this level of business activity are involved in the manufacturing of finished goods. Examples of companies at this level of production are Dairy Board Ltd, National Foods, Portland Cement etc. The second type of businesses at this level also includes construction e.g building of roads, bridges and houses etc.

Tertiary Sector Business Activity: these are firms which are involved in providing services to individuals and other businesses e.g Barclays Banks, ZIMNAT Life, Swift Transport, TM Supermarkets, CRESTA Hotels, Old Mutual, NSSA etc.

Changes in Business Activity

The importance of each sector in an economy changes overtime. **Industrialisation** is the term used to describe the growing importance of the secondary sector industries in developing countries. The relative importance of each sector is measured in terms of either employment levels or output levels as a proportion of the whole economy.

Benefits of Industrialization

1. It increases the total national output (Gross Domestic Product), of a country which raises the standard of living.
2. Employment is created through expanding manufacturing industries.
3. Increases foreign currency through exports.
4. The Country will be able to get more income from either value added tax or corporate tax paid by firms.

Problems of Industrialization

1. Most developing countries export low valued raw materials and import high valued finished components leading to increased demand for foreign currency. This will result in more import costs compared to the value of exports.
2. It encourages rural to urban migration due to chances of obtaining jobs in manufacturing industries located in towns. This leads to social problems such as theft, sanitation prostitution as people will be seeking means and ways of sustaining themselves in towns, where costs of living are quite high.
3. Growth of manufacturing industries is due to multi – national corporations, which might exploit natural resources, labour, or repatriate profits to home countries.

De-industrialisation

It is the general decline in the importance of secondary sector activity and an increase in the tertiary sector. This is common in developed economies.

Reasons for De-industrialisation

1. Rising incomes associated with higher standards have led consumers to spend much of their extra income on service rather than more goods. There has been substantial growth in tourism, hotels and restaurant services and financial services.
2. The rising imports of goods are taking market away from the domestic secondary sector firms.
3. In the developing world, there is an increase in the imports of goods at the expenses of domestic secondary industry products. Competition is too stiff globally and competitors are more efficient. These factors create a price competitive advantage.

1.5. Private and Public Sectors

Private sector of the economy - consists of those businesses that are owned by individuals or groups of individuals e.g. sole trader, partnership, Joint Stock Company, co – operative etc. Their common objective is profit.

1.6. Public Sector of the Economy

This refers to the state and local Government owned and controlled enterprises. State owned enterprises include ZBC (Zimbabwe Broadcasting Cooperation), ZESA (Zimbabwe Electricity Supply Authority), ZUPCO (Zimbabwe United Passenger Company), and NOCZIM. Local Government run enterprises include liquor undertakings such as Bulawayo City council's Ingwebu Breweries and Harare City Council's Rufaro Marketing.

It is argued that certain important goods and services are too significant to be under private ownership. These usually include defence, health, education, electricity, transport, law and order, energy, telecommunications etc.

1.7. Types of Business Organizations.

1.8. Sole proprietorship

Owned and controlled by one person. The owner provides permanent finance and has full control of the operations. He keeps all the profits. Sole traders can employ others. Sole traders suffer from unlimited liability i.e. the owner's personal possessions can be taken to pay off debts of the business, should it fail. Sole traders remain small due to their proprietors' interest in the wish to retain control and the limitations in raising additional finance. Most stores and grindings mills are owned by one person or one family with either the father or the mother being the owner. Immediate family members provide labour force for the business.

1.9. Sources of finance for sole traders

The sole trader finances the business from own savings, retained profits, leasing, hire purchase, debentures, bank loans, mortgages, friends and family.

Advantages of a Sole Trader

1. Keeps all the profits, that is all the money that the business makes is taken by the sole trade
2. Easy to set up, with few or no legal formalities .There are conditions set for individuals who want to start up business. There are no documentations required when one is setting a sole proprietor business.
3. Owner in full control- the owner is not answerable to anybody.
4. The owner is able to build close relations with staff and customers since he/she has direct contact with them.

Disadvantages of a Sole Trader.

1. Difficult to raise additional capital since he or she is the only one in the business.
2. Suffers all the losses alone and takes all the risks associated with businesses.
3. Lack of continuity: When the owner dies, as the business does not have legal status of its own, there is no continuity.
4. Faces stiff competition from bigger firms which have access to capital, more variety of goods and economies of scale which enable big businesses to reduce prices.
5. Owner is unable to specialize in all areas of the business. A business has several functions, such as finance, human resources, marketing stock control and accounting. It's not possible for the sole trader to fully understand all these areas.

1.10. Partnerships

It is when two or more people agree to do business together for the purpose of making profit. When planning to do partnership business, it is recommended to carefully choose partners as errors and poor decisions of one bind all the partners. Partnerships suffer from unlimited liability should the business fail. It is prudent for members to draw a Partnership deed, a document which spells out issues such as sharing of profits and losses, contributions by each partner, voting rights, management of roles and the authority to sign contracts. Partnerships address most of the disadvantages of the sole proprietor business. Partnerships are common in professions, such as law and accountancy

Advantages of Partnerships.

1. Partners may specialize in different fields e.g. marketing, accounting or production. Unlike sole trader partners are able to share responsibilities and specialize in their areas of specialization.
2. More capital is raised, as partners pool their resources together.
3. There is privacy, and few legal formalities.
4. Partners share decision making among themselves.
5. Business losses are shared by the business partners.

Disadvantages of Partnerships.

1. Unlimited liability for the partners, when the business has problems, partners private property is at risk of being taken to cover business debts.
2. Profits are shared among the partners in the ration of their ownership.
3. Partners are bound by one each other's decisions. In the event of a wrong decision being passed then by one partner it binds all the other partners.
4. Lack of continuity in the event of death or retirement of one of the partners. The partnership has to be dissolved and all the assts shared.

Sole proprietorships and Partnerships are unincorporated businesses and they differ from companies in the following ways:

(i) **Legal Personality:** a company is recognized at law as having a separate legal existence from its owners. This means the company can sue or be sued through the courts. However, owners and Directors can be legally responsible if they intentionally trade with a company they know is illiquid. They are required to act responsibly and legally.

(ii) **Limited liability**: this states that the shareholders can only suffer the loss of capital that they invested in the business. The debts of the business do not extend to their personal belongings. Thus their liability (potential loss) is limited to the shareholding. This is important because:

- Investors are encouraged to provide finance for business expansion.
- Greater risk of a company failing to pay debts is now transferred from investors to creditors. Creditors should ensure that the word "Limited" (abbreviated "Ltd") appears in the company's name and examine the financial accounts for any weaknesses.

(iii**) Continuity**: companies have continued existence even upon the death of the owners. Ownership is passed on through inheritance of shares.

<u>Legal Formalities in forming a Company</u>

All governments insist that certain legal stages are completed before a company may be established in order to protect investors and creditors.

1. **<u>Memorandum of Association</u>**

This states the name of the company, the address of the Head office through which it can be contacted, the maximum share capital for which the company seeks authorisation, and the declared aims of the business.

The document states the external relationships of the company. It consists of a number of clauses as follows:

(i) Object clause- it states the object for which the company is established e.g. to publish books or manufacture toys. Being aware of the company's aims means that shareholders can avoid business that may operate in business fields that they do not want to be associated with.

ii) Liability clause-state that the liability of shareholders is limited to the amount they have invested in the company.

iii) Capital clause- is a statement of the amount of capital with which the company is to be registered and the manner in which it is to be divided into shares e.g. $500 000 divided into 50 units shares or $1 each.

iv) Association clause- is a declaration implying that by signing the memorandum the members wish to form the company and that they are prepared to take up and pay for the number of shares shown on the form by their name.

v) Name clause- states the trading name of the company. The Registrar of companies ensures that no two companies are formed bearing the same name. The Memorandum has to state the status of the company. The public company indicates its status by the letters PLC or p/c at the end of its name whereas the private company ends its title with limited or Ltd.

2. **Articles of Association**

   Outlines the internal relationships of the company, that is, the broad way in which the internal organisation will operate.

Contents

1. The rights of shareholders
2. Methods of elections of directors
3. The manner in which meetings are to be conducted
4. Division of profit.

Certificate of Incorporation

When the memorandum and articles of association have been registered, the Registrar of Companies will issue a Certificate of Incorporation.

This enables a private company to commence trading. Public company needs to be issued with a Certificate of Trading after raising a certain amount of capital, stipulated by the Registrar of Companies.

GOING PUBLIC OR PRIVATE

Many private limited companies are converted to public limited company status or owners of public limited company may convert it back to private limited company status. A public company has access to capital as many people are able to buy shares from a public company. The company will sell its shares to the members of the public.

<u>Reasons for going public</u>

To raise additional finance through the sell of shares to the public in order to:-

1. Develop new products-This requires money to do research and also produce the product.
2. Acquire new capital equipment- The Company may not have sufficient money to acquire new technology or equipment which will make it competitive on the market.
3. Expand and modernise the production techniques- This is referred to as recapitalisation. Firms normally rely on bank finance for capitalisation. This form of financing is either expensive or not available to the company for a variety of reasons.

<u>Reasons for going private</u>

This refers to a process whereby firms buy back their shares from the public. This is done by majority shareholders who are normally the founders of the company. For fear of losing control of their companies they buy back their shares and turn the company back into the hands of private ownership. The main reasons for this reverse process are:

1. To regain control of the business- Majority shareholders or founders may want to regain control of their company.
2. To eliminate threat of takeover- When a company is public, anyone who has money can buy its shares and become a shareholder. This exposes the company to be owned and controlled by individuals who have money and may end up taking the company away from its founding or controlling shareholders.
3. To avoid administrative burden and costs associated with Stock Exchange listing. The Stock Exchange is where companies are bought and sold. Companies which want their shares to be listed on the Stock Market have to comply with Stock Market regulations which are expensive.
4. To pursue independent long-term strategy without worrying about the short-termism of investors. Owners have a long term view, while investors have a short term view as they want quick gains.

1.11. Private Limited Companies.

Private: The term private means that the activities of the company need not be disclosed to outsiders.

Limited Liability: The term limited means the financial obligations of the business do not extend to the possessions and financial obligations of its owners. Private limited companies cannot sell shares to the public. There is continuity in a private company irrespective of the existence of the directors. A company is recognized in Law as having a legal identity separate from that of its owners.

Advantages of private limited companies.

1. Shareholders have limited liability- Shareholders are not liable for the debts and obligations of the company.
2. Have a separate legal existence-The Company can sue and can be sued on its on through the Courts of Law.
3. Continuity of existence. In a company, the death of an owner or director does not lead to its break up or dissolution. Shares can easily be passed on to other people though inheritance or can be sold to other interested people.

4. Owner can still be in control- The owners of the business can either be managers or they can be Directors. The Board of Directors provides leadership for the company.

Disadvantages of Private Limited Companies.

1. Cannot issue shares to the public- The numbers of shareholders are limited by the Companies Act.
2. Many legal formalities when setting up the business- The company must be registered and comply with the requirements of Companies Act.
3. End of year financial results must be presented to the Registrar of Companies for inspection.
4. The Company should pay taxation if it makes a profit.

1.12. Public Limited Companies.

Public: A public company sells its shares to members of the public. There is distinct separation between ownership of the company and the control. The shareholders own the company, but appoint a Board of Directors who does management and decision making of the business.

All the advantages of Private limited companies apply.

1. In addition, Public limited companies can issue shares to the public and have them listed on the stock exchange. This allows these companies to raise large sums of capital by selling shares to the general public.
2. Existing shareholders may quickly sell their shares if they wish to. Flexible buying and selling of shares encourages the public to buy shares knowing that it will be easy to dispose of them if the need arises.

Another difference between private and public companies is the “divorce between ownership and control”. Private limited companies owners are still able to retain a majority of shares and continue to manage their firm. Public limited companies appoint Boards of Directors to manage the business. Conflict of interests may arise. Shareholders are usually concerned with short – term profits while managers may be interested in long term growth in order to increase their power and status.

Advantages of public limited companies.

1. Shareholders have limited liability- Shareholders are not liable for the debts and obligations of the company.
2. Have a separate legal existence-The Company can sue and can be sued in its own right through the Courts of Law.
3. Continuity of existence. In a company, the death of an owner or director does not lead to its break up or dissolution. Shares can easily be passed on to other people though inheritance or can be sold to other interested people.
4. Owner can still be in control- The owners of the business can either be managers or they can be Directors. The Board of Directors provides leadership for the company.
5. Substantial capital can be raised by selling shares to the public.

Disadvantages of Public Limited Companies.

Cannot issue shares to the public- The number of shareholders is limited by the Companies Act.

1. Many legal formalities when setting up the business- The company must be registered and comply with the requirements of Companies Act.
2. The Company should pay taxation if it makes a profit.
3. No secrecy as annual accounts are published as the financial statements will be published through the press so that the public who are the owners of the can be able access information about the companies they have invested in.

1.13. <u>Co-operatives</u>.

Features of Co-operatives.

1. All members have one vote at meetings.
2. Profits are shared equally among members.
3. All members can contribute to the day to day running of the business, sharing work and responsibilities.

a) **Producer Co-operatives or worker co-operatives** are involved in producing goods.
b) **Consumer co-operatives** – they sell goods and hence they are known as retail co-operatives.
c) **Agricultural Co-operatives**.
Members buy seeds and materials in bulk and benefit from economies of scale. Co-operatives can buy the produce of members and sell collectively at a higher price.

Advantages of co-operatives.

1. Members are motivated to work hard as they share profits.
2. Buying in bulk.
3. Working together in problem solving.

Disadvantages of Co-operatives.

1. Slow decision-making if all members are to be consulted.
2. Shortage of capital since no sale of shares to non- members is allowed.
3. Lack of managerial expertise unless professional managers are employed.

1.14. <u>Franchises.</u>

A franchise is a legal contract between two firms. It allows one firm (franchisee) to use the name, logo and marketing methods of the other e.g. Kentucky Fried Chicken in Bulawayo is an example of a franchise (franchiser) (KAC). McDonalds, Nandos, Coca-cola are examples of franchise. Franchises are rapidly expanding forms of business operation. This concept has allowed certain big companies, which are household names, to expand much more rapidly than they would have done by setting up their shops in various centers and countries.

Advantages to the Franchisee.

1. The Franchisee will receive technical training from the franchiser, this is much cheaper than investing in the technology required when one is setting a business.
2. Easy access to well known products, logos, and names for sale in a defined geographical area. The marketing, branding, product development and innovations are all done by the Franchisor.

Advantages of franchises to franchisor

1. It facilitates rapid expansion without incurring the high capital cost of direct ownership of all business within the chain. Coca-cola is found in most countries of world through franchising. Nandos is found in all the SADC countries through franchising.
2. The Franchisor will save on running costs since the franchisee will finance most of the capital and physical requirements for the franchise.
3. The franchiser will benefit from the efforts of committed enthusiastic franchisees.

Disadvantages to the franchisee.

1. The franchisee is required to pay for the use of the name, logo, and methods. These charges can be exorbitant.
2. May be restricted not to sell competing products in the same area. Also the franchisee is not allowed to sell in areas other than the areas specified in the contract.

Disadvantages of franchises to the franchisor

1. There may be costs in ensuring that they all adhere to the operational methods that are designed to achieve uniformity.
2. Failure by an individual franchisee will reflect badly on the whole franchise operation
3. Franchisee will have different objectives from those of the franchisor and in the long-run may begin to resent the control exercised by the franchisor.
4. The franchisee may under-declare sales to reduce franchise loyalty payment or engage in ancillary activities that are not regarded as compatible with the franchise.

Joint ventures

These occur when two businesses agree to work closely together on particular project and create a separate business division to do so. This is normally done when businesses are creating a new venture and want to share risks, or share the costs of financing the project. In Zimbabwe the country regulations stipulate that foreign companies must have joint ventures with locals to start businesses.

Reasons for joint ventures

1. Costs and risks of a new business venture are shared among the businesses going into partnership. This is important if the cost of developing new products is high.
2. Different companies might have different strengths and experiences and they therefore fit well together.
3. They might have their major markets in different countries and they could exploit these with the new products more effectively than if they both decided to go it alone.

Risks Involved

1. Styles of management and culture of the businesses forming the Joint Venture might be so different that the two teams do not blend well together causing the companies to fail to operate efficiently.
2. Errors and mistakes might lead to one blaming the other for mistakes.
3. The business failure of one of the partners would put the whole project at risk. If one of the companies sponsoring the joint venture fails, the joint venture company will also fail.

1.15. Public Sector Enterprises.

Public Sector enterprises are owned by the state and local Government. They aim to provide basic goods and services to the general public at affordable prices. Profit is not a major objective, but it may be secondary. The aim of these companies is to provide the public with services. Such services are essential and should be provided at a cost afforded by the general public. In Zimbabwe organizations such as ZUPCO, Zimbabwe National Water Authority (ZINWA), Zimbabwe National Road Authority and National Railways of Zimbabwe may get some grants from Government or they operate on a commercial basis with needs of the public at their forefront.

1.16. Advantages

1. They are managed with social objectives to afford essential goods and services to the general public.
2. Loss making services might still be offered.
3. Finance is raised from the Government.

Disadvantages.

1. Subsidies from the Government may encourage inefficiency and incompetent managers.
2. Lack of profit motive may result in inefficiency.
3. Government may interfere in business operations for political reasons.

1.17. <u>Revision Questions</u>

1**.** What is meant by business activity?
2. Explain the factors of production (resources) needed by a group planning to open a retail shop.
3. Explain three advantages to your own country from increased industrialisation.
4. What is the difference between private sector and public sector organisations?
5. State three differences between a sole trader and a private limited company.
6. Describe the roles of shareholders and directors in a public company.
7. Explain the extent to which shareholders are able to control large companies.
8. Why might the directors of a public limited company decide to convert the business back into a private limited company?
9. Explain how legal personality and continuity help businesses to operate effectively.
10. How does limited liability make it easy to raise finance?
11(a) Describe the contents of a memorandum and articles of association.
(b) Assess the significance of the objects clause.

12. Assess the advantages of (i) a partnership over a sole trader business (i) company status over partnership.
13. Why might a business stand a greater chance of success if it buys a franchise license than if it attempts to establish its own identity?
14. List some organisations in your country that are in the public sector.

ESSAYS

1a) .What are the advantages and disadvantages of a sole proprietorship? [10]
b).Compare and contrast the characteristics of the private and public sectors. [10]
2. When does a private limited company become a public company? Discuss the advantages and disadvantages of each type of company? [25]
3 a) Discuss the role of the small firm as;
(i) An independent organisation. [6]
(ii) Part of an Industry. [6]
b) Compare the problems of a small firm and those of a large one.

CHAPTER 2

BUSINESS AND ECONOMIC STRUCTURE

Objectives.

By the end of the chapter pupils should be able to:

1. Explain what is meant by an economic system
2. Examine the alternative economic systems to free market economies
3. Analyse the impact of multinational businesses on a countrywide economy
4. Understand the need for small firms, business growth and ways of growth in business
5. Explain the nature of and reasons for state interaction to assist and constraint business activity.

2.1. Economic systems.

Each country is involved in some form of business or other activity. In some economies or countries the government plays a more dominant and prominent role than private companies. Some economies are called planned economies where government runs all the sectors of the economy, with minimal participation by private firms and individuals. Some economies are called free market economies where firms and individuals supply most of the goods required by the country at economic prices. However in most country, the economic system is described as mixed, that is the operations of the free mixed economy are balanced with the role of government.

2.2. Functions of an economy

All countries are faced with the problem of scarcity and the need to make choices in terms of how to get the maximum benefits from the scarce resources. The economic system should make decisions in terms of the following questions;

1. What should be produced? – Choices should be made in terms of what the economy should produce using the scarce resources at its disposal. Should Zimbabwe build hospitals or buy luxurious cars.

2. How should the goods be produced? The country needs to choose between use of machines and high technology as opposed to the use of labour intensive.

3. For who is production produced? The general public or the few rich people in a country.

2.3. Free market economy / Laissez faire / capitalist/economy

The means of production in this economy are privately owned.

1. Firms operate to make profit- Resources are therefore channeled where companies would make more profit.
2. Resources are owned by individuals- There private ownership of means of productions.
3. There is free entry and exit of firms.
4. Prices are determined by the market mechanism of demand and supply.

There is limited Government intervention in the economy. Government role is limited to providing a good business environment through good regulations, providing defense, security, and guarding against unfair competition. Countries that are close to this economic system are Canada, U.S.A., and Japan.

2.4. Planned/ centrally planned / Command economy

1. There is Government ownership and control of resources.
2. Government sets the price.
3. Firms produce goods for the benefit of the public. Decisions on what to produce are made by Central Government.
4. Countries close to this economic system are Cuba and North Korea.

2.5. Mixed economy.

It is a combination of elements taken from a free economy and some from a controlled economy. Nearly all economic systems are in this category. However the strength of government intervention varies from country to the next. Zimbabwe is an example of a mixed economy with greater government role in terms of regulations and investment. In this type of economic system some resources and organisations are owned and controlled by the state and others by private individuals or group of individuals.

In mixed economies, the government may control the following:

1. Regulate prices of goods and services or inputs, by taxing or subsiding them or by direct price controls
2. Relative incomes by the use of income taxes, welfare payment or direct controls over ways and profits.
3. The pattern of production and consumption by use of legislation, direct provision of goods and services and nationalisation.
4. The macro-economic problems of unemployment, inflation, lack of growth and balance of payments deficits, by use of taxes and government expenditure, the control of bank lending and interests rates.
5. Most essential goods and services, which benefit society, are provided by both Government and private firms e.g. schools, hospitals and broadcasting.
6. Many products are provided by private firms e.g. cars, computers, clothing, and jewelry.
7. Finance for state - operated services is from the government through taxes.
8. Government controls pollution and restricts monopoly power by firms.
9. Examples of countries operating mixed economies are Zimbabwe, United Kingdom. e.t.c.

<u>Summary of economies.</u>

Economic System	Possible advantages	Possible disadvantages
Free market Prices – supply and demand Profit motive Private ownership.	- Profit encourages efficiency - Competition helps to keep prices low. - Increased customer choice.	- No Government control over pollution. - Emergency of monopolies. - Limited state support for the elderly and unemployed.
Planned/Command State ownership of economic resources.	- It prevents wasteful competition and duplication of goods. - Allows for long-term planning, usually 5 – year plan. - Production is based on needs of majority, not consumers' spending habits.	- No consumer choice. - No competition. - Very slow decision-making through bureaucracy.
Mixed. Mixture of state and private ownership of resources. Taxes collected to pay for public goods and services.	- Essential services for all, both rich and poor. - There is competition. - Consumer choice exists and work incentives too. -Inefficient business behavior is controlled or outlawed e.g. dangerous products or polluting factories. - Private sector is still encouraged to be successful and allowed to make profit.	- Taxes may be heavy to pay and this could reduce incentives to work hard or make profits. -State businesses are inefficient compared to private alternatives. - Excessive control can inhibit enterprises.

2.6. Stakeholders and their objectives

Are people, companies and systems which affect and are affected by the business or are able to influence the behaviour of business organisations?

Shareholders

These are the people who contribute capital into the business. Their main interests in the business are profitability, growth, dividends, stability/security and share value. They want to be assured that they get value for their capital investment.

<u>Directors</u>

These are elected by shareholders to run the company on their behalf. Directors' interest are mainly concerned with increasing their own power and status from business growth by retaining control and direct the strategy and major decisions.

Workforce

The workforce provides labour to the company. They expect to receive fair wage, good working conditions and to secure their jobs through the survival and expansion of business.

Customers

These are the most important stakeholder in the business, as the success of any business depends on the acceptability of its products by the customers. Customers are concerned about price, quality, after sales service, product variety and credit terms. They need to get good value for money from goods and services purchased.

Suppliers

These provide raw materials and other logistics for the business to be able to manufacture its good and services**:** Suppliers are concerned with ability to continue to sell profitability to the business, to be paid promptly and need security for orders.

Government

Government provides the regulatory environment. Companies pay taxes and comply with other laws as provided by the Companies Act. The Government provides the framework which guides the rest of the economy.

Competitors

To compare and contrast performance with other businesses, to compete by all lawful means and to differentiate its products from those of other businesses. Competitors take business from the firm and therefore affect the firm's pricing and quality of goods and services.

Conflict of Objectives

With the various stakeholders interested in the affair and performance of the business, there is a tendency for their objectives to come into conflict.

Examples of Conflicts

1. Government needs more people to be employed yet the firm need to cut on labour costs by employing less people and paying low wages.
2. Creditors expect early payment but the finance department needs to retain more cash for other purposes.
3. The directors want to retain profits and reinvest for future expansion but shareholders expert high dividends to be paid out to them.
4. Workers expect a high wage when the firm needs to see high productivity to justify the wage increase
5. Government and some pressure groups require a firm to be socially responsible when a firm needs to achieve profitability.

2.7. International Trade and Multinational Business

International trade is the buying and selling of goods and services between different countries of the world. Goods and services that citizens of one country buy from other countries are called imports and goods and services that one country sells to other countries are called exports. Visible trade refers to the import and export of visible goods for example foods machinery and vehicles. Invisible trade is the importing and exporting of services for example tourism, transport insurance and banking. Zimbabwe imports cars and machinery while it exports diamonds and tobacco.

2.8. Benefits to countries of international trade.

International trade provides a number of benefits

1. Creates specialization – countries will concentrate on providing those goods they are best at producing and importing those in which they are less efficient. This is called comparative advantage. Specialization leads to economies of scale, leading to low production costs. The firms can pass on these benefits to customers in the form of low prices. Living standards for all countries trading with each other are set to increase.
2. Low Prices – importing goods increases domestic competition leading to low prices and improved quality.
3. Greater choices – international trade offers consumers a wide selection of goods to choose from. This improves consumers' standards of living. Some products are not locally available but can be obtained from other countries.
4. Countries can improve political and social links with each other. International trade results in closer political and economic ties.
5. Economies of scale leads to production of low cost goods/services
6. Foreign currency is earned from selling overseas.

2.9. Difficulties faced by exporters

1. Language: the exporter needs to be conversant with the language of the country to which he intends to export his goods. Zimbabweans selling goods to China should be able to speak Mandarin or Chinese language.
2. Differences in measurements, weights and sizes also have to be taken into account by the exporter.
3. Suitability of products, regulations, safely and standards may differ in some foreign countries.
4. Import regulations- the exporter must observe and be familiar with the import regulations of other countries
5. Damage to goods during their long journey to the customer.
6. Packaging may need to be stronger than that used for home trade
7. Transport will be more difficult to organise than for home trade and the method chosen must be efficient and economic.
8. Documentation and payment arrangements can be complicated in overseas trade.
9. Agent is required to act on behalf of the exporter to make contracts for the sale of goods.
10. Payment defaults by overseas customers are more difficult to sort out than those in home trade.
11. Exchange rate fluctuations can adversely affect the market price of exports.

2.10. Problems of international Trade.

International trade creates problem for some countries:

Imported goods may land at a low price compared to locally produced goods. This will cause problems to local businesses. Local firms may find it difficult to compete with cheap imports. This may cause loss of jobs and closure of local businesses as local consumers will buy and consume cheap imports. When imports are cheaper and being of low quality compared to locally produced goods, such a process is called dumping. Infant firms may find it difficult to survive foreign competition.

2.11. Free trade

Free trade refers to the absence of barriers to facilitate the flow of goods across national boundaries. Countries put restrictions in order to protect their local firm's goods. Restrictions are done for social, economic and political reasons. Globalization: refers to the greater free movement of goods, capital and people around the world. Free trade and use of the Internet have reduced international distances.

2.12. Protectionism

Governments may restrict trade in order to protect local infant industries. The following restrictions can be used:

1. Tariffs: Taxes levied on imported goods. These do not stop the goods from entering a country but makes them expensive.
2. Quotas: this is a maximum limit on the physical quantity of goods that can be imported in country.
3. Financial Subsidies: some Governments give financial subsidies to local firms to help them meet production costs. This provides the firms with a price competitive advantage.
4. Voluntary exports limits: an exporting country may agree to limit the quantity of goods to be sold to another possibly to prevent tariffs and quotas being imposed.
5. Embargo: this is a ban on imports from certain countries.

2.13. Reasons for Protection

There are five reasons why a country may decide to impose barriers to trade

(1) To prevent dumping- this is when surplus foreign goods are brought in at a lower price than the locally produced goods..

(2) To provide for self sufficiency- a country might wish to protect industries in case of war.

(3) To protect infant industries- young industries may need protection from foreign competition to enable them to develop and grow and be able to compete.

(4) To reduce unemployment- imported goods might result in job losses in some industries

(5) To correct a balance of payments problem- a country may want to reduce imports in order to correct a trade deficit.

2.14. Globalisation

Refers to the new perspective or attitude about relationships with other people in other nations. It also refers to the unprecedented scope, shape, number and complexity of business relationships conducted across international boundaries. Globalisation has highlighted the role of governments in influencing competitiveness between nations. Global managers have to be patient with the evolution of global business relationship. This stems primarily from the fact that globalisation has brought together people whose cultures have been different for centuries

2.15. Multinational Business

A multinational company is one which owns and controls business operations outside the country in which it is based. They are in effect holding companies with shares in many individual overseas subsidiaries each of which is subject to the company law of the country in which it is located. Examples are Unilever, Ford, IBM, Phillips, Shell, Nethen, BP, Barclays, Standard Bank and Toyota

Characteristics of Multi National Corporation (MNC)

1. The headquarters is the international profit centre and each region operates as a profit centre within the MNC.
2. Finished products and components are often transferred between regions in an intercompany basis.
3. Headquarters provides other subsidiaries with technology information and communication systems.
4. There is coordination, so that duplication of function does not occur.
5. Each geographical region has a senior operating executive in charge, reporting to the managing director who is responsible for overall coordination.

Stages in the growth of a firm to a multination company

Stage 1: A firm engages in foreign trade that is exporting and importing from a foreign country through an agent.

Stage 2: A foreign branch or subsidiaries is established and the local agent is incorporated

Stage 3: Firm grows and sets up more local subsidiaries and the home office only coordinates the activities of its subsidiaries.

Stage 4: A regional autonomy is given if activities of the subsidiaries become more complex.

2.16. Reasons for overseas expansion by MNCs

Pull Factors

1. Availability of cheaper resources in foreign market.
2. Availability of low wage, high-skilled, trainable, non militant labour.
3. Availability of new markets.
4. Less government restriction on pollution and raw material exploitation.
5. Availability of cheaper resources of energy.

6. Provision of government incentives that help to reduce the cost of doing business.

Push factors

1. Stringent government controls in the developed world on pollution, the exploitation of natural resources and other business practices.
2. Persistent inflation and steady erosion of profits
3. High labour costs

2.17. Possible problems for MNCs.

1. There may be poor communication links with head office.
2. Cultural and language differences with local workers, customers and the Government.
3. Local labour force is likely to be unskilled resulting in high investment in training of employees.
4. Co-ordination with other plants elsewhere needs to be carefully planned to avoid producing competing products on world markets.

2.18. Benefits of MNCs to Host Nations.

1. The total national output of the country may increase [(GDP) Gross domestic Product.]
2. Management expertise in the community may improve if locals replace foreign supervisors after training.
3. Employment is created if the MNC engage local labour and training will improve the quality and efficiency of locals.
4. They bring foreign currency when setting up in the host country.
5. Advanced technology is also brought in.
6. Local firms can benefit from supplying raw materials and components to the new factory, creating jobs and generating incomes. Such supplying firms are forced to bring standards to international standards.
7. Tax revenue to the Government will increase.

2.19. Problems of MNCs to host nations.

1. Local business may be forced to close due to inferior equipment.
2. Exploitation of local natural resources. They have little incentive to conserve natural resources as they can relocate to other nations.
3. Distortion of local culture by the power of advertising and other promotions through semi-nude celebrities e.g. J – Lopez, Madonna.
4. Exploitation of local labour through low pay for long working hours. Some MNCs do not stick to health, labour and safety regulations.
5. Pollution may be at higher levels than is permitted in home countries. This could be due to relaxed rules or the MNC's economic muscle.
6. Some MNCs become involved in local politics and may sponsor rebels.
7. Profits are repatriated to their home countries

2.20. Problems faced by first time exporters.

Government's assistance for exporters.

1. Information and advice on international markets through ZIMTRADE.
2. Low interest loans – through Small Enterprises Development Corporation (S.E.D.C.O).
3. Tax exemption - firms involved in the export business are taxed at a lower rate for a certain level of exports. Government encourages banks to offer low interest loans to exporters.
4. Consular officials are based in several countries around the globe to promote foreign trade.
5. Trade exhibition e.g. Zimbabwe International Trade Fair – an annual trade exhibition to help firms access foreign customers.

2.21. Problems faced by a firm when exporting for the first time.

1. Insufficient commitment by top managers to overcome the initial difficulties and financial requirements of exporting.
2. Insufficient care in selecting foreign agents or distributors.
3. Failure to obtain qualified export counseling and do develop a master international marketing plan before starting an exporting business.
4. Neglecting export business when domestic market experiences a boom. This is a result of the firm viewing the export market as a residual market for extra output.
5. Failure to print warranty messages, names of products and instructions in locally understood languages.
6. Inability to engage an export management company to conduct the firm's foreign business when it is obvious its own personnel cannot undertake such activities.
7. Failure to modify products to meet regulation or cultural preferences of other countries. Nations exhibit diversified cultures that require firms to modify their products to meet local demand.
8. Failure to consider licensing or joint venture arrangements to enter those countries protected by import restrictions

2.22. Small Firm Sector

There is no universal definition of a small firm. However, the size of a firm can be measured in a number of ways:

a) The number of employees - a firm employing only a few people is small, but it should be remembered that some firms are capital intensive.

b) Sale turnover – this is useful when comparing firms in the same industry. The comparison is compromised as some firms sell high-value items while others sell low-value goods.

c) Capital base - this refers to the total value of long – term finance used in the business. The greater the business the higher the value of long – term finance. Most large firms are listed on the stock exchange.

d) Market share – firms serving less than 25% of the market share are generally referred to as small.

2.23. Government Assistance to Small Firms

1. Training programmes where local colleges provide training and government of funds the activity.
2. Government helps in economically deprived areas, by providing assistance to firms that agree to locate in these areas for example in small towns and growth points in Zimbabwe.
3. Assistance can be in form of grant for the building and equipment, low rent factories, low business taxes or areas that are completely free of business tax for a limited period.
4. Trade Exhibitions such as the Zimbabwe International Trade Fair and Agricultural shows help to promote exports and sales of upcoming businesses.
5. Government urges some commercial banks to provide low interest loans to small business e.g. Agribank and Standards Chartered Bank provides loans at favourable interest rates.
6. Government support can include an advice service based on information from embassies and government staff basis abroad or consider officials.
7. In Zimbabwe the Small to Medium Scale Enterprises are assisted through a scheme for loans, advice and management support.
8. Indigenisation policy empowers the locals to starts their own enterprises

2.24. **Government** Controls on Business Activity

Environmental Protection: pollution from companies' activities should be controlled, recycling of materials is encouraged and disposal of waste is restricted.

1. Monopolies: mergers and takeovers that create monopoly can be investigated and prevented
2. Consumer protection: goods should be safe and suited for purpose, sales must offer genuine reductions, and weight measures must be correct.
3. Anti-competitive practices are made illegal.
4. Employee protection-firms are made to pay at least minimum wage rate, must not exceed maximum work week.
5. Firms should ensure health and safety at work, no discrimination and employment protection
6. Location of industry is determined by government where it restricts new factory construction in crowded areas with planning regulations.

2.25. Importance of Small Firms to the Economy.

1. Employment is created. Each one of them will not employ many people but collectively they employ a significant proportion of the working population
2. They produce a wide variety of goods, increasing consumer choice.
3. Small firms create competition for the large ones leading to improved quality, efficiency and low prices.
4. Small firms widen the tax base for the Government.
5. Small firms contribute to national output (Gross Domestic Product).
6. Small firms also contribute to exports, bringing in the much-needed foreign currency.

2.26. Advantages of Small firms to owners

1. Flexibility of operations. This allows the owner to switch easily from one business to another.
2. Management and control is retained by the owner reducing possible conflicts common with large companies between managers and shareholders.
3. Personal contact of the owner with workers and customers.
4. Flexible working hours allow the owner to increase sales for the business.
5. Low capital is needed to set them up.

2.27. Problems Faced By Small Firms.

1. Problems in raising both short term and long - term finance due to lack of collateral security.
2. Lack of management expertise. Owner performs all functions e.g. accounting and marketing.
3. Difficulty in finding suitable and reasonably priced premises.
4. Marketing risks arising from a limited product range.
5. Do not enjoy economies of scale.

2.28. Survival of Small Firms.

Small firms survive despite competition from large firms. This is due to the following:

a) Joint Ventures: small firms may agree to do business jointly so as to enjoy the economics of scale
b) Supporting Role: small firms supply large ones with components and spare.
c) Specialist Services: services such as accountancy, legal advice and consultancy cannot be mass-produced. Small firms can supply such services.

d) Personalized Services: the need to give personal attention to customers who demand unique products best suit small firms. The market is too limited for large – scale operations. In addition the need to address individual tastes can only be served by small firms e.g. hair salons.

e) **Niche Marketing**: through market segmentation small firms might discover a gap that will be exploited to earn great profits. The size of the market may be too small for consideration by big firms. The small firm will then establish a known name and image.

<u>Revision Questions.</u>
1 a) Examine the ways in which the government in Zimbabwe:
(i) Controls business activity. (5)
(ii) Assist business activities [10]
b) Discuss whether business activity should be more firmly controlled by government. [15]
2. To what extent should the government of your country positively encourage multinational business to establish in your country? [20]

3 a) Examine three different ways in which business size may be compared. [10]
b) Evaluate the consequences for a business of deciding to integrate vertically in order to achieve expansion. [15]

2.29. Business Growth

Reasons for growth of business. Business growth is measured by a number of factors. Market dominance, economies of scale, diversification etc.

2.30. Growth of Firms

Business growth can be achieved in a number of ways. The different forms of growth can lead to various effects on stakeholder groups such as shareholders, customers, managers, workers and competitors. Firms can grow internally or externally.

2.31. Internal Growth

Expansion of the business by means of opening new branches or shops. This may involve selling shares to existing shareholders so as to recapitalize the company without diluting equity. This enables the business to increase output. Such growth can prevent the problem of excessive rapid growth with insufficient capital (over trading) and management problems associated with joining two firms with opposing cultures and attitudes.

2.32. External Growth.

A takeover is when one company acquires another company. The acquired company will lose its identity. A merger or integration occurs when two or more firms agree to join their operations into a single entity. Such growth may lead to management problems caused by different management style, for example:

Horizontal Integration – is the joining of firms in the same line of business and at the same stage of production, e.g. a bakery merging with another bakery.

Advantages

1. Reduced competition.
2. Economies of scale.
3. Increased power over suppliers on issues such as terms of payment, delivery and discounts.

Disadvantages.

1. May lead to the creation of a monopoly.
2. Rationalization may lead to bad publicity
.

Effects on Stakeholders.
1. Monopolies will charge high prices, inefficiency.

2. Workers may lose job security through rationalization.
3. High dividends to shareholders due to increased profits.
4. Increased accessibility to goods through mass production e.t.c.
5. Economies of scale lead to low prices

2.33. Vertical integration

This involves merging of two or more firms in the same industry but at different stages of production. It takes the form of: -

Forward merging – merging with a business at the next stage of production e.g. a manufacturing merging with the retail outlets.

Advantages of forward merging

1. Business is able to control the promotion and pricing of its own products
2. It secures outlets for its products – may now exclude competitor products.

Disadvantages of forward merging

3. The business might lack the necessary experience in this industry. A successfully manufacturer does not always make a good retailer.
4. The motive might be viewed by consumers as uncompetitive and they might react negatively.

Effects on workers
Workers may experience greater job security from the firm having secure outlets.
Increased career opportunities for workers.

Backward merging – Integrating with a supplier of the existing business, e.g. an oil refinery buying an oil field.

Advantages
1. The business will control the suppliers of raw materials.
2. It encourages joint research and development into the quality of supplies.
3. It gives control over quality, prices and delivery.

Disadvantages

1. Suppliers may become relaxed as a result of having a guaranteed customer.
2. The business may lack experience in managing a supplier.

Effect on stakeholders

1. Greater opportunities for career advancement for workers.
2. Customers may get improved quality products and innovative products.
3. Control of suppliers to competitors reduces competition and limits consumer choice

2.34. Conglomerate

Firms producing unrelated products merging. This is also known as diversification. The business is diversified away from its core business.

Advantage

Risk is spread over more products and markets.

Disadvantages

Lack of managerial experience in the acquired business
There could be lack of clear focus and direction since the business is spread across more than one business.

<u>Diversification</u>

1. The process of lateral integration is often termed diversification and firms which have such a diversification of interests are called conglomerates.
2. Diversification can be undertaken by internal growth but the costs of entry are often so high that it is cheaper to buy in established player in the market.
3. It enhances the firm's chances of survival where:

(i) Some of its products are reaching the end of their life cycle
(ii) The market is highly competitive
(iii) Product demand is highly variable

It is a means of avoiding monopoly and merger legislation by expanding outside traditional markets.

Impact on stakeholders

Greater opportunities for career advancement to workers.
Job security risk is spread across many industries.

2.35. Problems of Growth

1. Takeovers can be particularly expensive.
2. These factors may lead to negative cash flow and can increase in long-term borrowing.
3. The original owner or boss of the business may find it difficult to adapt or being leader and manager.
4. The original marketing strategy may no longer be appropriate for a larger organisation with a wider range of products.
5. Growth from national to international markets may not succeed if the marketing strategies are not suitably adapted.
6. There is less of control by original owners.
7. Too much dilution of profits leading to some shareholders selling off shares.
8. Expansion is expensive. Additional finance is required.
9. Management may fail to cope with a large business. Divorce between ownership and control becomes more pronounced. Co-coordinating a large and expanding business is difficult.

2.36. BUSINESS OBJECTIVES AND STRATEGIES

Topic Objectives
1. To understand the differences between mission statement, corporate objectives and business strategy.
2. To understand how business culture shapes and determines corporate objectives.
3. To understand the significance of objectives as the business for strategy.
4. Evaluate the impact of stakeholders on the firm's activities.
5. Explain the concept of management by objectives.

2.38 Business objectives.

A business objective is a broad statement of intent. It says what the business wants to achieve.

Importance of business objectives
1. They provide a guide to action.
2. Provide a framework for decision making.
3. Coordinate activities
4. Facilitate prioritisation and resolve some conflicts between departments.
5. Measures and control performance.
6. Motivate employees.
7. Provides a sense of direction and unity.
8. Encourages concentration on long term factors.

Businesses have a hierarchy of objectives and at the top is a mission statement.
a. This identifies the organisation's goals and it is a general statement e.g having quality services, good customer care and provide for the community at large.
b. The mission statement is not specific and does not show the performance measures.

Objectives should be seen as more specific and quantifiable and should help in the achievement of the mission statement.

Objectives should meet the SMART Criteria

S- Specific
M-Measurable
A-Agreed with all involved in achieving them.
R-Relevant and realistic to the needs of the organisation
T-Time framed i.e. to give a date for final completion.

Corporate Objectives

Are based on the central aim or mission statement of the business but they are expressed in terms that provide a much clearer guide for management action or strategy.

Examples

1. Maximising Profits

It is when a firm achieves the greatest difference between total revenue and costs which is positive. This is because entrepreneurs who invest capital expect a high net return for taking risk.

2. **Growth**

Growth is mainly measured in terms of market share and expansion of business activity. Larger firms are less likely to be taken over and benefit from economies of scale. A business that does not grow loses the competitive advantage and does not attract potential investors. However, too much growth can lead to cash flow problems and can be achieved at the expense of lower profit margins and experiences diseconomies of scale.

3. **Increasing Market share**

This involves selling a greater proportion of the total sales in the whole market. It indicates that the firm's marketing strategies are a success and there is a competitive advantage.
Retailers will be willing to stock and promote the bestselling brand.

4. Social, ethical and environmental considerations

1. It is the responsibility of firms to the community or the public at large. Increasingly pressure groups are forcing businesses to reconsider their approach to decision making and also legal changes have forced businesses to refrain from certain practices.
2. Firms have to consider their pricing, product quality, employment levels and the way they treat the environment.
3. This is reflected in the passing of laws requiring firms to provide equal employment opportunities, promotion prospects and compensation benefits to women, racial minorities and the handicapped.

5. **Survival**

i. Firms seek to cover only their costs by getting enough revenue to do so. This is an objective during times when the economic situation is bad and firms cannot make profits. Firms aimed survival so that they will not fail and go out of business.

6. **Maximising Shareholder Value**

A firm aims at increasing share prices and returns to shareholders. Potential shareholders will also seek to purchase shares.

7. **Increasing Sales revenue**

Firms aim to increase these as bonuses and salaries depend on sales revenue levels.

Strategy Analysis

2.37. Strategy is a long-term plan of action, aiming to achieve a specific objective.

ii. Strategic analysis is the process of reviewing existing plans and identifying new opportunities and risks associated them.

SWOT analysis

Identifies and analyses the main internal and external factors that will influence the future direction and success of a business.

It comprises:

S -Strengths

These are internal factors about a business that can be looked upon as advantages. An internal outlet of the firm shows its strength. Examples are loyal workforce, good product range and experienced management.

W -Weaknesses

These are the internal factors about the business that can be seen as negative factors. They include poorly trained workforce, limited production capacity and ageing equipment.

O -Opportunities

These are the potential areas for expansion of the business. An external audit of the market the firm operates in and its major competitors provides the opportunities. Examples are export markets expanding faster than domestic markets and lower rates of interest increasing consumer demand.

T- Threats

These are also external factors gained from an external audit. It analyses the business and economic environment, market conditions and the strength of competitors. Examples include new competitors entering the market, globalisation driving down prices, changes in the law regarding the sale of the firm's product and changes in government economic policy.

2.38. Organizational Culture

Culture is a code of behavior and attitudes that influence the decision making style of managers and subordinates in an organization. It is a way of doing things shared by all in a company. Cadbury Schweppes 1999 Annual Report stated, that "culture is about people, how they deliver, what they are accounted for, how aggressive they are in pursuit of objectives and how adaptable they are in the face of change".These are the norms, values, shared attitudes which determine the systems, structure and rules in an organisation and the way things are done.

Importance

- Culture influence patterns of behaviour, attitudes to change and the motivation, immoral and performance of employees
- It has an impact on business development and staff recruitment because the cultural reputation can attract people to or deter them away from an organisation.
- Culture is expressed in symbols, rituals and language

Types of Culture

1. Power Culture
   It emphasizes the risk taking attitude and low respect for established procedures. It is associated with small firms

2. **Role Culture**
   Has well defined procedures, conformity and emphasizes on rule bound behaviour. This form is bureaucratic in nature and found in public sector enterprises.

3. **Task Culture**
   Is made up of teamwork and problem solving behaviour in groups. The emphasis is on creativity and flexibility and is used in scientific research.

4. **Person oriented culture**
   Emphasis is on meeting the needs of clients and members of the organisation and it is commonly found in small consultancy type firms.

Business Culture will determine.
Individual worker behaviour, future attitudes and thoughts
1. The corporate image and long term achievement of objectives
2. The way in which objectives are expressed
3. Participation of workers in setting the objectives
4. The motivation of staff and the actions required to achieve objectives

2.39. Factors influencing culture.

1. Size of the organization. In small firms the personality of the owner will impact on the rest of the staff. An aggressive entrepreneur will quickly communicate to the organization, the necessary attitudes in decision-making situations.
2. Structure of the organization. A centralized and rigid organization structure will tend to make the business more resistant to change and less adaptable to market needs. Only senior managers make all decisions. A culture of fear is planted throughout the organization. Some business cultures are adaptive and open to change. This increases the chance of survival of the organization. Employees are encouraged to accept change, and be innovative, creative and to challenge each other.
3. The nature of business culture is determined by its focus. Some organizations place their focus on getting the job done, not the people doing the job. This is called a 'task culture'. Other organizations are people-focused with greater concern for the people doing the job and their extent of involvement in it. This is called a 'people culture'. Such an attitude leads to increased motivation for workers resulting in high productivity and team spirit.

Therefore business culture will affect:
- Business objectives.
- The way business objectives are expressed.
- Workers involvement in setting objectives.
- The action required to achieve objectives.
- The motivation of the workforce.

2.40. Management by objectives (M.B.O.)

It is an approach to motivate and co-ordinate employees by dividing the firm's overall aim into specific targets for each division, department and individual. It is undertaken after consultation with personnel at all levels of the organization.

2.41. Possible benefits of M.B.O

1. Each manager and subordinate will know exactly what is required of him/her. It assists in prioritizing time.
2. Since targets and objectives are discussed and agreed with managers and staff at all levels of the company, all will see the importance of their contributions to the success of the organization.

3. Objectives act as a control mechanism. Managers monitor everyone's performance using the set targets.
4. The use of corporate aims and objectives as the focal point for all departmental and individual targets ensures that all are working towards the same goals. This eliminates conflicts of interest.

Possible problems of M.B.O

1. Objectives can be outdated quickly.
2. Setting targets does not guarantee success. Other issues such availability of resources and staff training need to be considered if set targets are to be of any meaning or to be motivating.
3. The process of dividing the objectives into departmental, divisional and individual targets can be time-consuming since they are applied after full consultation with all those affected.

2.42. CONSTRAINTS ON BUSINESS OBJECTIVES

Topic Objectives

1. To understand how the economic objectives of unemployment, stability, balance of payments position affect business.
2. To analyse the impact of technology on business decisions.
3. To examine the ways in which legal changes may influence business behaviour, threats and opportunities it creates.
4. To explain how changes in society can impact on business strategy.
5. To assess the extent to which business behaviour should be directed or restrained by ethical considerations.

Introduction

A constraint is a factor that limits the decisions that the business can take. It limits the choice of action and or prevents the organisation from achieving its goals. External constraints are outside factors that limit the ability of the firm to achieve its objectives. The constraints will arise as a result of the change in state of economy or the policy actions of the government. Examples are economic, technological, political, social, ethical, environmental and social influence.

Economic Influences

Inflation

It is the increase in the average price level of goods and services. Inflation is measured by a number of indices of which the Retail Price Index is most widely known and quoted. It shows a weighted average of price rises over the past year.

2.43. Causes of inflation

Cost – push causes of inflation.

Businesses are faced with higher costs of production due to:

1. A lower exchange rate leading to rising prices of imported goods.
2. World demand for raw materials raises their prices.
3. High wage demands from employees.

Therefore businesses will attempt to maintain profit margins by raising selling prices. This is inflationary.

Demand – pull causes of inflation.

This is usually due to consumer demand rising due to economic boom. Companies will raise prices to earn high profit margins.Economists attribute inflation to the following causes:-

Impact of Inflation on business-Dangers

1. Customers experience a decline in their real incomes thus less purchasing power, which means less demand for goods and sales.
2. Profit margins are squeezed because of costs increases.
3. It makes business planning and assessment for future very difficult. Investment is made more complicated by uncertainty about future prices
4. Budgeting of future expenditure becomes difficult.
5. Provisions for replacement of business equipment as it wears out are more difficult when the replacement cost is higher than the initial cost.
6. Higher wage demands as people need to adjust their wages to the cost of living thus causing industrial disputes.
7. Consumers may no longer be loyal to brands but search for better bargains.
8. Inflation leads to high rates of interest and leads to high cost of borrowing, thus reducing investment.
9. Cash flow problems arise as firms have to find more money to pay the higher costs of materials.
10. Businesses lose competitiveness in overseas markets.
11. Credit transactions will make the firm lose to customer so credit sales fall.

Benefits

1. If it is demand full inflation it can lead to high profit margins as the selling price rises.
2. In case of stocks bought in advance and then sold later there is an increased margin from the effect of inflation.
3. Value of asset held by the firm increases, thus increasing the value of a business.
4. Inflation transfers purchasing power from creditors to debtors so the firm's real value of debts owed to other companies fall.
5. The firm can pass on price increases to consumers in form of high prices.

Deflation

1. Is the fall in the average price level of goods and services. This cannot benefit the firms as an anticipation that prices will further fall will make consumer delay purchases thus a fall in demand.
2. The value of debt that firms need to repay will have increase than the initial principal borrowed.
3. Future profitability of firms as prices fall is questionable so firms are unwilling to invest due to the uncertainty.

Exchange rates

Is the price of one currency in terms of another. It is influenced by demand and supply of currency.

Appreciation/Revaluation

1. It is when the value of currency rises in terms of another. Imports become cheaper relative to export price that rises.
2. Importers of raw materials get these at a low cost and increase their competitiveness
3. Lower import prices will help to reduce the rate of imported inflation.
4. However, exporters of goods and services experience fall in demand and become less competitive in their own market and consumers are prepared to switch to imported goods.

Depreciation/Devaluation

1. The value of the currency falls in terms of another.
2. Imports become expensive and imported raw materials become expensive.
3. Home based exporters sell at a lower price in overseas markets thus attracting high demand and leading to expansion of business.

However, to those who depend heavily on imported supplies of materials and components will reduce competitiveness.

Fiscal policy

1. Involves the deliberate decisions by government to change government expenditure, taxes and government borrowing. Taxes can be used to reduce business activity as they add to cost of production and reduce profits or act as an incentive to encourage more production by firms.
2. Government expenditure in form of subsidies, grants and other investment incentives encourage firms to produce. Other government expenditure provides income to the population leading to more demand for firms e.g government security benefits.

Monetary Policy

1. It involves government's decision on money supply and the rate of interest.
2. The government through the Reserve Bank of Zimbabwe influences the level of money supply (circulation) in the economy. If it increases, interest rates fall thus encouraging more investment and demand for goods and services. A fall in the supply of money increases interest rates this encouraging more investments by firms.

Technological Influences

Businesses must both use and adapt to technology because firms compete and the market is both global and highly sensitive for most of the major products and services.Technology affects the following areas, communication, product technology and costs of production, human resources and the market.

Effects of technology-Negative effects

1. Creates problems of isolation and computer stress.
2. Fixed costs of production increase which now needs a large market in order to spread these fixed costs and reduce unit costs.
3. High redundancy costs as technology replaces human labour.
4. High recruitment costs for those with computer and technology related skills.
5. De-skilling as some craft skills have been replaced by technology in areas such as printing and design.

6. More training costs as the workforce has to become more flexible in response to the need to work with technology.
7. The need for data protection and computerise protection funds, competitors gaining access to important business data.
8. The speed with which new developments are made the faster the systems become obsolete before they are installed so costs of updating are high.

Legal Influences

Fall into three categories i.e. law and employment practices, Consumer rights and business competition.

Law and Employment Practices

A written contract of employment must be signed so that the worker is fully aware of the pay, working conditions and disciplinary procedures to be followed. It is illegal to discriminate against people during recruitment and selection or whilst at work on grounds of race, colour or religion.

1. Termination of employment is also subject to legal constraints to avoid unfair dismissal.
2. The law requires firms to ensure a healthy and safe environment for workers i.e. to provide protection from dangerous machinery and materials, give breaks and maintain workplace temperatures and to equip factories with safety equipment.
3. The law ensures working hours are not too long and a minimum wage is set and minimum working age is not too low.
4. Legal constraints add on costs e.g supervisory costs to ensure safe premises, high wage costs if the minimum wage is paid, protective clothing & equipment to meet health and safety laws, employing more staff to avoid over long hours for existing workers.

2.44. CONSUMER RIGHTS

1. Costs of firms rise in order to meet the needs of consumer protection laws.
2. Products need redesigning and advertisements.
3. Improving quality control standards on accuracy of weights and measures
4. There might be a need to change the organisation strategy and culture to ensure consumer protection.

Law and Business Competition

1. Governments try to ensure fair competition between firms by passing laws which control monopolies and prevent mergers and limit uncompetitive practices between firms.
2. Government outlaws uncompetitive practices where firms act together or collude and act as one monopoly. They can use predatory pricing, refusal to supply a retailer and market sharing agreements.

Social Influences

The size, composition and characteristics of a country's population is the main component of social environment.

1. Growing population-benefits firms in increasing the size the total potential market and increasing the available supply of labour, thus slow growth is a constraint on the firm's activities.

2. **<u>Age Compositions</u>**

Trends in birth rate help firms like Mother Care and early learning centre. An ageing population or a growing number of retired people many of whom need a comfortable lifestyle provides an opportunity to some firms targeting the niche market.

3. **Changes in family life**

The one-person households give a challenge to firms as they need to produce small sized packets rather than the common large family sizes. A customer oriented firm will adapt to these changes and supply good in different sizes to cater for the needs of households.

4. Early retirement in developed nations lead to more leisure time and need for leisure related products and services, although it reduces supply of labour.
5. Women employment-has increased the supply of labour.
6. Multi-cultural economies- affect supply of labour and burden the needs of workers.

Environmental Constraints

The growing acceptance to corporate responsibility has led to businesses adopting ethical codes to influence the way that decisions are taken.

Ethics are the moral guidelines that determine decision making. Firms have to consider the ethical dimensions of their actions not just the impact they have on profits.

Firms' should consider the impact that their businesses have on the environment. Air and noise pollution from manufacturing processes, road congestion caused by heavy trucks, business expansion into country areas, emissions of gases that can lead to global warning and the use of scarce natural resources.

The growing power and influence of pressure groups at both national and an international level has made firms to incorporate the environment into their strategic thinking.

Pressure groups are organisations created by people with a common interest or aim who put pressure on businesses and governments to change policies so that the objective is reached. These groups require businesses to change policies so that less damage is caused to the environment.

Political Influences

The run up to the general elections may impact on business activity. The prospect of a change in government creates uncertainties especially if the opposition parties are promising major changes that will have a direct impact on businesses organisations. In Zimbabwe, political instability impacted on businesses as foreign firms had to relocate into neighbouring countries.

2.45. Impact of inflation on business.

Benefits for the business

Real value of debt owed by companies will fall. Since value of money is falling, a debt is repaid using with money less value than the original loan. In general the value of liabilities will fall.

1. Rising prices affect assets held by the business. The value of assets such as land and buildings rises.
2. Cost increases can be passed on to consumers in the form of increased prices.
3. Stocks bought in advance and sold later will result in increased margin.

Problems for business

1. Staff will experience a decline in the real value of their wages.
2. Consumers become price sensitive and look for bargains and not brand names.
3. Rapid inflation leads to high interest rats. Highly geared companies will be unable to raise cash for interest payments.
4. Cash problems arise and companies will be unable to raise money to pay for increased costs.
5. If inflation in one country is higher than is other countries, the local firms will lose their competitiveness. Businesses will be unwilling to extend credit to customers.

During periods of high inflation companies will:

1. Reduce investment spending.
2. Reduce labour costs.
3. Cut borrowing to levels at which the current interest rates are manageable.

Controlling inflation and its effects on business.

2.46. Exchange rate policy.

The exchange rate is the price of one currency in terms of another e.g. US $ 1 = $ ZWD 9500.00

A depreciation of the local currency.

The Zimbabwean dollar is said to have depreciated when one unit of it buys few units of other currencies.

The domestic companies that may gain from a depreciation of the Zimbabwe dollar are:
i) Home based exporters, who can now reduce their prices on foreign markets. This increases the value of their exports and leads to expansion of such business. This is why Zimbabwean exporters are asking the Reserve Bank to depreciate the dollar.
ii) Companies selling in the home market will experience less price competition from imported goods and services.
The domestic firm likely to suffer from depreciation of the Zimbabwe dollar is:
(i) Producers that rely on imported raw material components. These costs will rise and reduce price competitiveness.
(ii) Retailers that buy foreign currency supplies, especially if there are close substitutes. The prices of these substitutes will rise and retailers will be forced to find local suppliers.

2.47. The government and business.

Government policies include the interest rate policy, exchange rate policy and the fiscal policy.
Interest rate policy: is used by the Government to correct credit expansion in the economy. The Government influences interest rates through the – discount rate i.e. the rate at which the Reserve Bank of Zimbabwe lends to commercial banks. By raising the bank rates, the RBZ

forces the Commercial banks to raise the minimum lending rate i.e. the rate at which banks lend to private investors and individuals. When the rate of interest increases, borrowing becomes expensive forcing companies and individuals to cut down on their levels of borrowing. This in turn leads to a fall in investment and consumption.

2.48. Foreign trade policy.

The Government can use import duties or the exchange rate to influence foreign trade.
(a) **Import duties** are taxes levied on imported goods. By raising the tariffs, the Government can considerably reduce the volume of imports into the country. Tariffs do not prevent imported goods from entering into Zimbabwe, but make them expensive.
This in turn forces consumers to buy locally manufactured goods. Local battery manufacturers were protected from cheaper South African batteries using this method. Tariffs, however, can also cause problems for businesses. Many businesses in Zimbabwe depend on imported raw materials. By raising tariffs the government makes imported raw materials expensive, thereby increasing the cost to the business. This may lead to the collapse of import dependent firms.
(b) **Exchange rate policy.** The Government can devalue the currency. To businesses which rely on imports, devaluation is a disadvantage since it raises the price of imports.
This translates into an increase in the cost of production.
To exporting businesses, depreciation of the local currency has a positive effect. It causes the prices of exports to become cheaper. This leads to an increase in the demand for Zimbabwean exports. Business which can meet the increase in demand will earn high profits.

(c) **Fiscal policy**- deals with Government borrowing, expenditure and revenue. The Zimbabwe Government spends several trillions of dollars annually on public projects such as road construction, schools, and hospitals. It also spends on civil servants, salaries and social welfare. Much of the revenue to finance this expenditure comes from indirect and direct tax.
Direct taxes are levied directly on income, e.g. corporate tax and Pay as you earn (P.A.Y.E.). If the Government raises the rate of corporate tax, this erodes the profits of a business. This increases the impact on company profits. This means a decrease in the return on investments. It therefore affects investor confidence.
The Government also borrows from the financial market to fund its expenditure. When it borrows from banks it causes the rate of interest to go up. It also reduces the amount available for businesses and individuals to borrow. This is referred to as the “crowding out” effect.

Financial constraints. A business may be constrained by the unavailability of capital for expansion purposes. For example, it may be difficult for business to obtain long term loans and overdrafts from financial institutions. Even large firms may find it difficult to raise capital on the Zimbabwe stock exchange if the economy is depressed.

Economic Constraints include factors such as the economic system, availability of economic resources, and the foreign trade policy. If foreign trade is heavily protected, then it becomes difficult for a business to source inputs from and sells products to other countries.

Legal Constraints. Government affects business in a number of ways. For example in Zimbabwe, the Government allows existence of monopolies in the provision of services such as postal and railway services. The Government can either use legislation or policies to constrain a business. Other legislation includes the Companies Act, the Sale of Goods Act.

Economic policies include interest rates, and exchange rates; protectionism. The Government can raise the rate of interest so as to reduce the amount of spending in the economy. The government can also use the exchange rate to limit the amount of goods imported from abroad. For example it can devalue the local currency against major currencies. In 2005, the exchange rate was US$1 to ZWD$ 9 500.00. This has a negative impact on those businesses, which heavily depend on imported inputs. In addition government policy such as on industrial location can affect businesses.

Labour Laws require that there be a written contract of employment, stipulate minimum wages for employees, holiday and pension entitlements and more.

Physical constraints – the unavailability of labour (unskilled and skilled) raw materials appropriate methodology, technology and natural resources. Zimbabwe is usually affected by rainfall patterns given that it is an Agro – based economy. Also the shortage of raw materials such as minerals (diamond), chemicals can constrain a business.

Social influences on business. The structure of society changes over time. The following recent changes have been observed:

[a] **Changing role of women** – from child bearing to taking of positions of responsibility in industry.

[b] **An aging population** an older population affects the types of products firms should offer. Aged people demand more medical products and foodstuffs that have high nutrients, holiday travel package, and so on.

Older workers show loyalty to the business and will have extensive experience necessary to improve service to customer.

Revision Questions
1. Explain why some businesses benefit when an economy grows.
2. How are some businesses likely to be negatively affected by rapid rates of inflation?
3. Explain the negative effects on businesses that can result from significant fluctuations in the exchange rate of a currency.
4. Distinguish between currency appreciation and depreciation.
5. Explain the difference between fiscal policy and monetary policy.
6. How might a depreciation of Zimbabwe's currency have led to benefits or dangers for its industries
7. What do you understand by the term technological change?
8. Explain one way in which the adoption of new technology of a business might reduce the cost of making the product or providing the service.
9. Too much attention to health and safety has simply made business activity more difficult and expensive. Briefly discuss this statement.
10. What do you understand by' corporate responsibility."?
11. Give three examples of unfair competition.

12.	Give two examples of how laws in your country protect the interests of workers and consumers.
13.	Explain how an ageing population affects a fast food restaurant.

2.49. Privatization

Privatization is the transfer of ownership and responsibility from the state to individuals and firms that seek to make profit. It involves the sale of shares of public corporations to the public.

There are three main ways in which the government may attempt to reduce its involvement in business:

1. By converting public corporations into registered public limited companies. The government gives up part or all of its shares to private shareholders. The shares of these public companies are sold to the public on the open market.
2. By ensuring that services such as refuse collection and local transport are put out to tender. In most cases these services are provided by local authorities but because of high expenditure, the local authorities usually engage private firms to provide these services.

3. Deregulation involves the removal of controls or restrictions on the provision of goods and services. Prior to the Economic Structural Adjustment Programme (E.S.A.P.) 1990, the government fixed the prices for all basic commodities including transport. Deregulation has seen the government removing price controls and leaving the price to market forces.

2.50. Abolition of state monopolies

This is an ongoing process and the government intends in the long run to abolish all state monopolies. This would open up industry to competition for example the government abolished the urban transport monopoly by ZUPCO, this allowed private commuter omnibus operators to ply urban routes

The path to privatization in Zimbabwe

2.51. Commercialization

This involves the conversion of a public corporation into a commercial or profit - making enterprise. The government still retains 100% shares in the enterprise. It takes over all the outstanding debts of the public corporation and removes all grants and subsidies.

2.52. Privatization

When the government is satisfied that the commercialized enterprise can sustain itself, it then privatizes the business. This involves the disposal of all or some of the shares held by the government. Shares can be sold through a public share issue. The government appoints an issuing house, usually a merchant bank to underwrite the issue.

2.53. Indigenization

Involves the transfer of business ownership to locals. When the government privatized public corporations it reserved a certain percentage of the shares for black investors.

Arguments for privatization

1. To raise revenue through the sale of state enterprises.
2. To increase efficiency. It is argued that parastatals are inefficient and offer poor services because they face no competition. Privatization ensures that former public corporations operate at a profit. Profit and competition ensure that businesses are efficient leading to low costs, prices and better quality output.
3. To eradicate monopoly power. It has been alleged that previously the government used to raise prices to fund increases in public expenditure.
4. To empower people. People have been encouraged to buy shares and have ownership in private companies.

Arguments against privatization

1. Private monopolies exploit consumers. Privatization is argued to have created private sector monopolies that restrict output to force up prices.
2. It does not return ownership to the people. Instead shares of privatized industries are usually owned by large financial institutions such as banks and insurance companies.
3. The privatization of rail services raises fear that rail services to remote areas and off – peak services which do not offer profit may be discontinued. Thus the public's interests are no longer served.

2.55. Structured questions
1. Give three examples of :
2. Internal elements of the environment [3].
3. External elements of the environment [3].
4. Define the term 'ethical constraints' and briefly explain how these might affect the performance of a firm. [6]
5. Explain three reasons why partners may wish to incorporate. [6]
6. Examine two ways of measuring the size of a firm. [4]
7. Comment on the likely problem that exporters face. [5]
8. Explain why government would be interested in the activities of a multi-national company. [6]
9. Explain the following concepts and comment on their implications to business size and growth.
10. legal personality [2]
11. limited liability [2]
12. going public [2]
13. Explain, giving examples, the three levels of economic activity. [6]

14. Briefly discuss the problems that arise from the divorce between ownership and control in limited companies.[4]
15. Briefly explain how the free market economy deals with the problem of scarcity.[4]
16. State and explain the various ways that can be used to measure the size of a business. [4]
17. Outline the main advantages of cooperative enterprises. [6]
18. Examine any two reasons why public companies are obliged to publish their activities. [4]
19. Explain the principal categories into which decisions can be summarized. [3]
20. Distinguish between shareholders and stakeholders, giving an example of each. [5]
21. (a) Define the term 'multinational company'. [2]
22. (b) State and explain:

(i) Two reasons why a multinational might be supported by the host country. [4]

Two reasons why the host country might be suspicious of a multinational's wish to invest in it. [4]

State and explain any three recognised types of business enterprise in your country. [6]

2.54. Essay questions

1. Evaluate the role of industrialization in your country. [25]
2. Discuss the view that 'All firms aim at maximizing profits.'[25]
3. Critically examine the reasons why government control of organisations such as ZESA is important. [25]
4. 'The law exerts not only general influence on an organisation, it also forms part of the organisation's specific environment.' Discuss the various ways in law affects business. [25]

5. Outline the role of the government as a:

(i) Regulator

(ii) Promoter of businesses

(iii) Entrepreneur

(iv) Planner [25]

6. (a) Explain what is meant by the term 'de-industrialisation.' [5]

(b) Discuss the major causes of de-industrialisation. [20]

7. 'Company directors are ultimately responsible to one group of stakeholders- the shareholders.' Critically evaluate this statement. [25]

1. Case Study Good Hope Chemicals

Good Hope is a company that is based in Nigeria. The company produces chemicals that are used in cleaning factory machines and farm equipment. In addition to this, Good Hope also produces fertiliser and insecticides.

This company owns and controls a number of branches in various Sub-Saharan countries. Good Hope has experienced tremendous growth. This growth has been due to the fact that almost all the sub-Saharan countries that buy chemicals from this company have found them very relevant to their needs and thus have kept increasing their orders.

The directors of Good Hope have considered establishing a branch in Zimbabwe. Zimbabwe has been seen to be offering a lot of opportunities for this company. One of the directors has even highlighted that establishing a branch in Zimbabwe will help the company to avoid problems of trade protectionism and exchange rates that are associated with Zimbabwe. However the government of Zimbabwe has shown no interest in accepting Good Hope's offer to establishing a branch in the country. One government official has been quoted as saying, 'we are already overburdened with our own rates of environmental degradation, we cannot be seen taking any extra load.'

1. (a) What business term can be used to describe Good Hope. Give reasons for your answer. [3]

(ii) Why are companies like Good hope often viewed with suspicion by host governments. [7]

(b) Outline the various opportunities that make Zimbabwe a potential investment destination for Good Hope. [5]

(ii) Suggest any methods of trade protectionism that Zimbabwe might be using. [5]

(c) Evaluate the statement that if Good Hope establishes a branch in Zimbabwe environmental degradation will increase [10]

2. **Gukwa Pottery**

Gukwa Pottery is a one- man business that started operating in 1997. Bright Gukwa is the owner of the business who discovered he could make beautiful tea sets, casserole dishes, dinner plates and pottery vases using a special type of clay. Gukwa pottery sells its products in the domestic market and to tourists who visit the country, especially during special holidays like Easter.

Due to overwhelming demand, workers are forced to work overtime. Bright Gukwa has argued that he cannot employ a large number of workers because at times demand drops to below acceptable standards. As a result of overtime work, the level of motivation of workers is very low. Labour turnover is quite high. Bright Gukwa has expressed concern over the rate of labour turnover and has even argued that he has tried financial incentives to motivate the workers to no avail.

Sarah Gukwa, Bright's wife helps in the business by drawing up the books of the business. Lack of experience on her part has resulted in overstated profits that has caused further disharmony in the camp.

Leo Dube, Bright's friend, has advised the latter to convert his business to a private limited company. However Bright does not seem to understand how this move is going to help alleviate his problems.

1. (a) Explain how employing peripheral workers will help solve the problems faced by Gukwa Pottery. [10]

(b) Evaluate the benefits to Bright Gukwa of operating his business as a sole trader. [10]

(c) Explain to Bright Gukwa what it means to convert a business to a limited company. What advantages and disadvantages should Bright expect to face as result of such a move? [10]

CHAPTER 3

HUMAN RESOURCES MANAGEMENT.

Topic Objectives

1. To understand why organisations need a structure.
2. Analyse the different types of organisational structure that can be adopted.
3. Analyse the main features of an organisational chart.
4. Understand the difference between centralised and decentralised structures.
5. Evaluate the policy of delegation.
6. Examine the appropriateness of centralised and decentralised structures.
7. Understand the difference between authority, accountability and responsibility.
8. To understand the importance of the human resource to the productivity of a businesses.
9. Define motivation.
10. Recognise the contributions of motivational theorist and analyse the applicability of their views to different business situations.
11. Explain the importance of leadership and analyse the appropriateness of different leadership styles in the business.
12. Evaluate the contribution of informal leadership in the organisation.
13. Assess the role of non

3.1. Introduction

The main human resource management task is to recruit, train and utilise the organisation's personnel in the most productive manner to achieve company objectives.

Human resources management focuses on:

1. Planning the workforce needs of the business.
2. Recruiting and selecting appropriate staff.
3. Appraising, training and developing staff at all levels of the organisation.
4. Developing appropriate pay systems for different groups of workers.
5. Measuring and monitoring performance.
6. Involving all managers in the development of their departmental staff.

3.2. Human Resources Policy

It should be to staff the organisation with appropriately qualified people and to bring those people to contribute the best of their skills, talents and creative ability so that they achieve the objectives of the firm. To be effective the policy must include the following:-

- **Justice**-there must be a sense of fair play e.g procedure for punishment, judgement and discipline.

- **Dignity**- the work and working conditions must provide the worker with pride and a sense that what he is doing is important.

- **Compensation-** the package of benefits must come up to the market rate and give the worker the means to enjoy a reasonable standard of living.

- **Stability**- there must be a certain amount if stability of employment and working conditions

- **Discrimination**- no one must feel that he/she has been discriminated against by reason of race, language, religion or sex.

3.3. Manpower planning.

The human resources department must determine the organization's needs and the number of employees required in the future will depend on:

14. Future demand patterns of the firm's product.
15. The objects of the firm. If the firm plans to expand in the future, then employees will be required for the expanded business. Also a firm that desires to increase customer service sacrificing short – term profits will recruit more workers.
16. Productivity levels of staff. If productivity levels are estimated to increase, perhaps due to efficient machinery, then few employees will be required.
17. The predicted labour turn over and absenteeism rate. The higher these rates, then the greater will be the need to recruit replacement staff and ensure adequate numbers are available at all times.
18. Changes in law regarding workers' rights. The Government might set a minimum wage that is high causing firms to employ few workers and substitute them with machines where possible.
19. The skills of the staff required.

This depends on:

a) The complexity of machinery and production methods used. The advent of automation has replaced typists and clerks.
a) Need for flexible or multi skilled staff. Most firms need to recruit or train staff with more than one skill.

3.4. Stages in manpower Planning

1. An analysis of the existing situation that is the likely number of people to retire, resign, laid off and going on early retirement.
2. An analysis of future needs- the top management need to consider the number of people needed and the abilities needed in the organisation to remain in operation.
3. Planning for the recruitment and selection of personnel with skills needed.
4. Planning for development as an alternative, management may redeploy some of its staff by retraining them in new skills.

3.5. Advantages of Manpower planning

1. The correct number of staff are recruited for each level in the organisation
2. The staff requirements of various departments can be examined and plans made so that appropriate measures can be taken liken training, promotion and transfer.

3. The problem of high labour turnover can be highlighted for further study.

3.6. Types of Employment contracts
Part-time temporary or permanent?

Part time employment contracts. This is whereby a company offers employees short term contract either for specific periods or for specific jobs.

Advantages of part time contracts to the firm.

5. Staff may be required to work during busy periods and laid off during slack times. This reduces overhead costs. Farmers employ seasonal workers during planting and harvesting.
6. Staff can be assessed before they are offered full time employment.
7. More staff are available to be called upon should there be sickness or some form of absenteeism.

Advantages of part time contracts to the worker.

1. The contract could be suitable for certain people, for example students, parents with young children.
2. Ability to work two jobs with different firms, providing the worker with variety.

Disadvantages of part time contracts:

<u>To the firm.</u>

1. Low motivation since part time employees may feel less involved to the business. It will be difficult to establish a teamwork culture if staff do not meet each other.
2. There will be more staff to manage than if there were all full times.
3. Effective communication will be more difficult. Meeting with all staff at one time is difficult. The firm will be forced to rely heavily on written communication, for example memoranda.

Disadvantages of part time contracts to the part-time staff.

1. They will be earning less than full time staff.
2. May be paid. A lower rate than full – time staff.
3. Security of employment and other working conditions are usually inferior than to those of full- time employees.

Temporary contracts.

This can be full time or part time for fixed periods of time. Permanent contracts are terminated by a worker being fired, made redundant or resigning.

Differences between core and peripheral workers.

Peripheral

- Temporary
- Part time
- Self employed.

Core

- Full time
- Permanent.

Part time and temporary contracts give the firm an opportunity to have a small team of permanent staff known as core workers. This is further enhanced by the use of outside contractors to perform specific job.

3.7. Recruitment and selection.

This function ensures company objectives are met, and new ideas are brought into the organization through the appointment of qualified and experienced personnel.

Steps in the recruitment process.

a) Establish the precise nature of job vacancy
b) Draw up a job description, which includes:

Job title.
Details of the task to be performed.
Responsibilities involved.
Place in hierarchical structure, working conditions.
How the job will be assessed and performance measured.

The job description should attract the right type of people.

A job specification is a profile of the ideal candidate. It covers the knowledge, experience, physical characteristics, qualifications, age, and personality of the candidate sought.

A job description and job specification identify sources for recruitment. Sources outside the firm include:

1. Commercial employment agencies.
2. Schools and higher education contacts.
3. Electronic media.
4. Unsolicited letters and calls e.t.c.
5. Newspapers

Advantages of internal recruitment.

1. Applicants are already aware of the organization structure.
2. Those doing the selection already know the applicant.
3. It is faster than external recruitment.
4. It is cheaper than either external advertising or the use of agencies.
5. The applicant knows the organization well.
6. To give internal staff career hopes and real chances to progress. This can be motivating.

Disadvantages of internal recruitment.

1. No new ideas or practice may be brought into the organization.
2. There may be some resentment from those not offered the job.
3. The number of applicants will be lower than if the job was also external advertised.

3.8. Selection.

It involves the picking of a suitable candidate from several applicants. Whatever the selection method used it is important that it should be:

(i) Inexpensive relative to the importance of the job.
(ii) Non - discriminatory in terms of ability, personality, intelligence and other factors.

3.9. Training and development.

The purpose of training is to impart knowledge, skills and techniques to individuals to enable them to perform assigned tasks efficiently.

Two training - related functions are:

- Identifying individuals or groups training needs.
- Developing suitable training to meet the needs.

3.10. Types of training.

3.10.1 Induction training.

Induction training involves introducing the new employee and the organization to each other. The programme;

1. Use company history and current structures.
2. Gives a guided tour of the company.
3. Introduces new employees to colleagues.
4. Allow new employee to meet with formal groups.
5. Identifies the needs of the new employees.
6. Explains clearly health and safety issues to the new employees.

Internal training or on - the – job – training.

This method of training allows employees to learn as they work. The instructors are usually the current post holder, human resources managers or departmental training officers.

Advantages.

1. It is relatively inexpensive.
2. It is easy to organize.
3. It is specific to a job and not general.
4. It adds to production.
5. It is adaptable to meet the work needs of workers and the trainer.

Disadvantages of internal training.

1. It may disrupt work as supervisors spend time training other workers rather than doing work.

2. New ideas and methods are not introduced into the organization.
3. The trainer does not possess good training skills or may be a poor communicator.
4. Bad work practices are passed on to the employee/ trainee.

External training or off – the job training

This method of training involves a course of instruction away from the work place. The course could be done at a specialist-training center belonging to the firm or organised by an outside body such as the Ministry of Labour.

Advantages

1. Specialist trainers are employed.
2. Training takes place away from work-place disruptions.

Disadvantages.

1. It is isolated from the practicalities of the work.
2. It removes employees from work, therefore production suffers.
3. Training is expensive.
4. It can result in well-qualified staff leaving the firm once they obtain improved qualifications. However, lack of training leads to low production, less customer care, more accidents at work and poor quality products**.**

3.11. Recruitment

It provides a large group of suitable candidates from which the line manager can select the employee(s) needed to fill a vacancy.

3.12. Recruitment Process

It starts with the receipt of a staff requisition from each department. The request is accompanied by a job description for non-executive staff) or a position description (for managerial position)

3.13. Job description-

Is a document that outlines in broad terms the purpose, scope, duties and responsibilities of a job for which a person is hired. It gives the personnel department the following information:-

- The job title
- Location of the job on the organisation chart that is which section, under which managers.
- A complete summary of the work to be performed that is job analysis including the specific area of responsibility, the inherent authority and the working relationships with peers, subordinates and supervisors.
- The specific methods of work including the equipment to be used.

3.14. Job Specification

Is a description of the personal characteristics stating the skills, experience and special aptitudes required for performing a job and summarising the working conditions found in the job?

3.15. Selection

The objective of selection is to choose from the available candidates, the person whom the manager of the department where the vacancy arises, thinks is most suitable for the job.

3.16. Selection Process

Initial Screening-Candidates are required to fill out an application form so that they have some basic information to conduct the interview with. A smaller group of those with the necessary basic qualifications is selected.

Tests-They are to compare the skills that the candidate has with those required for the job and to gauge the potential of the candidate to learn on the job. At the end of this stage the manager will short list the suitable candidates for in-depth interviews.

In-depth interviews-They are conducted by a line manager or by a selection plan. The objectives of an in-depth interview are:-

- To find out more about the applicants, a person and whether he can fit in as member of the workgroups
- To assess the interpersonal skills of the applicant for the post
- To fill gaps is the candidate's application firm.

Physical Examination

- Are to ensure that the candidate is physically fit to perform his tasks.
- To eliminate candidate with contagious diseases.
- To protect the organisation against unjustified claims for medical compensation.

Job Offer

The terms of the contract of employment are explained to the successful candidate. The salary afford should be competitive with salaries for similar jobs offered by other organisations and compatible with the existing wage structure in the firm.

3.17. **Training**

A business may identify training needs for its employees. Some of these training needs may be identified by the employees.

1. Technological change which creates the need for new skills and updating existing skills.
2. Introduction of new equipment.
3. Where re-organisation occurs and people take on new or different roles.
4. Development of particular individuals in preparation for promotion into more senior posts.
5. Where competitive pressures create the need to make more efficient use of manpower in order to cut costs.
6. Where skill shortages exist
7. To further develop individuals employed for their particular skills.

3.18. Benefits from Training

To the employer

1. Improves quality and motivation of staff.
2. Brings in some ideas and skills that could improve efficiency, productivity and profitability.
3. Better health and safety helping to reduce accidents and raise standards
4. More effective use of staff, more quickly and less costly.

To employees

1. Feel valued by the organisation.
2. Opportunity to develop skills and knowledge.
3. May improve job satisfaction because they are more confident and competent to do their jobs.
4. Makes them better able to cope with change by increasing understanding of reasons for and providing the knowledge and skills to adjust.

Performance Appraisal

Is the process of evaluating a worker's job performance and potential for development.

1. It serves the following purposes;
2. Subordinates know how their performance is being currently rated.
3. It helps to pick out subordinates who observe increases in salary.
4. It helps to select subordinates who should be sent for special training.
5. It helps to select subordinates who should be promoted.

Advantages of appraisal

1. At every level of the organisation, people are aware of the organisation's objectives and the need to make improvements to achieve these objectives.
2. Appraisals make every member of the organisation more conscious of costs, profits and growth.

3.19. **Revision Questions**

1. What is motivation?
2. Why is an understanding of motivation important for the managers?
3. What does Maslow mean by "self actualization"?
4. What are the two factors in Herzebeg's theory?
5. What does the expectancy and equity theory state?
6. Define leadership.
7. Draw the managerial Grid of Blake and Mounto to show the five types of leadership behaviour.
8. Name three trait areas related to leadership successes.
9. What are the responsibilities of the personnel a manager?

10. What is involved in manpower planning?
11. What are the main sources of recruitment?
12. What items should a contract of employment include?
13. What items are at the core of an induction programme?
14. What are some weaknesses of management training programmes?
15. What are the purposes of performances appraisal?
16. What are the advantages of appraisal?
17. How is a firm's performance affected by a good industrial, health and safety's programme?
18. What is (a) job enlargement (b) job enrichment?

Essays
3. Organizational objectives are not the same as that of the individual employee. Hence managers must motivate their employees." Do you agree with this statement? [25]
4. "Money is the prime motivator of all human beings.' Discuss this statement in terms of employee motivation. [25]
5. What are Theory x and Theory y/? How has the application of these theorists helped to improve the work environment? (25)

3.20. Performance appraisal.

Performance is analysed against pre set and agreed targets. This seeks to improve the present performance levels and identifies employee potential for development and or promotion. It also helps to establish written performance records, which can be used in future, appraisal processes. Improvements in performance must be recognised and fed back to staff. Labour turn –over is the measure of the rate at which employees leave a company over a given time period.

Labour Turnover Rate = <u>Number of staff leaving in 1 year X 100</u>
Average Number of staff employed.

A firm employed an average of 380 staff last year and 38 left during the year. The labour turn over rate for year is 10%. If the rate is high or rising, this could indicate low morale, wrong recruitment policy and so on.

The costs of a high labour turnover to the organization includes:

(a) Additional recruitment and training costs.
(a) Disruption of production and poor customer services due to staff shortage.

3.21. Employee welfare.

Human resource departments may offer counseling and other services to staff who are facing family and other problems. These support services can reflect well on the business.

3.22. Compensation/ Remuneration.

Rate of pay. Should the firm base its rate at, above or below competitor rates?
Pay structure. Pay is related to the job, age, and length of service, or the results of a job evaluation exercise.
Merit rise. Pay may be increased given for additional qualifications
External influences A cost of living allowance may be paid.
Benefits - non- wage benefits such as number of days leave influence pay.
Differentials: between various grades of employees.
Annual pay rises. An automatic pay rise may be affected.

3.23. Pay systems.

Time rate

Earnings are calculated by multiplying the hourly time rate by the number of hours worked. The problem of this system is that pay is not related to output but merely to time spent on the job. This encourages time wasting, as employees may delay their work to obtain overtime pay.

Advantages.

1. Workers will do their work carefully, which will lead to high quality output.
2. Provides workers with some security of payment despite unavoidable production bottlenecks.
3. Suitable when output cannot be attributed to individuals.
4. Suitable in situations where employees have no control over the speed at which they operate.

Disadvantages.

High overtime rates are common as employees delay the work so that they earn extra income.

a. Too much time may be spent on one job, as there is no incentive to produce a higher output or work faster. Therefore supervision of work is required.
b. Wages still have to be paid if production is stopped, except for workers on a flexible-working contract.

Piece rate

The piece-rate system relates wages to output. It is useful where:
Output is standard and measurable. There is link between output and effort.
Works were output can be attributed to an individual so that each worker receives pay that is commensurate with effort.

Advantages.

a. It encourages greater output and a faster pace at work.
b. The labour cost of each unit is determined in advance and this helps in setting a price for the product.

Disadvantages.

a. May lead to reduced quality and safety levels due to a rush to complete units.
b. Provides little security over pay, for example in the event of a production break down.
c. Discourages workers from accepting change at work as it might result in loss of pay.
d. If each product is different then piece rate does not work.

3.24. Measured-day work.

It is a pay system that is fixed on a clear understanding that employees maintained performance levels specified in the contract. The greatest advantage is that there is stability in earnings. The disadvantage is less flexibility in output.

Advantages.

1. Provides status compared to piece-rate and time-rate systems.
2. Gives security of earnings.
3. Suitable for jobs where output is not measurable.
4. Suitable for a situation in which managers are expected to put extra time to complete a task.

Disadvantages.

1. Earnings are not related to productivity.
2. May lead to complacency of the salary earner.
3. Regular appraisal may be needed to measure whether the individual should move up the salary scale.

3.25. Further pay systems.

Commission is used for personal selling, where an individual is paid a commission on the sales made. Commission can also be paid in addition to a basic salary.

Performance-related pay to reward staff for above-average performance. A form of bonus paid in addition to a basic salary

Advantages.

a. Target setting can help to give purpose and direction to the work of an individual.
b. It also motivates staff to improve performance if they are seeking increases in financial rewards.

Disadvantages.

a. Team spirit can be damaged by rivalry caused by performance-related pay.
b. Allegations of favoritism can harm manager - subordinate relationships.
c. May lead to excessive control of staff by managers whose bonus is based on the performance of subordinates.

3.26. Profit sharing.

Profit sharing involves distributing part of the company's profits to workers. Staff becomes more committed to organizational success and will be cost conscious.

Advantages.

1. Reduces potential conflict between owners and employees since all are interested in high profits.
2. If successful in increasing motivation, then overall profitability of the company is increased.
3. The company is likely to attract better candidates as they seek the opportunity to share profits.
4. Increases employees' awareness of costs.

Disadvantages.

1. Reward offered is not closely related to individual effort as workers may benefit equally.
2. Small profits shared once annually may hardly motivate employees throughout the year.
3. Profit sharing reduces profits available to owners and retained in business.
4. Worker share ownership will dilute the value of existing share.

3.27. Fringe benefits.

Company cars, free or subsidized transport or meals, products at cost price, low interests on loans private health and education, and so on.

3.28. Job evaluation.

It is a systematic comparison of jobs, which aims to place them in rank order based upon the demand the job places on the individual. It is designed to produce a wage structure, which is fair and rational. It focuses on the job and not the post holder. The starting point in job evaluation is job analysis, which identifies and describes the nature of tasks involved in the job.

3.29. Techniques used in job evaluation.

- **Ranking is** a non-analytical, non-quantitative method, which determines the importance of each job by descriptive comparison with others. Grades and pay levels are determined after the rank orders.
- **Point – rating system entails the following:**

1. A detailed job analysis. To have accurate comparisons, it is necessary to have a clear picture of each job separately. Job analysis offers the following:
1. Description of main tasks.
1. Specific skills, competence and ability required by worker.

1. Value of assets for which the worker is responsible.
1. Working conditions and workers span of control.
1. Relevant job factors are then identified. These are specific features of the job used in making comparisons, level of responsibility, physical effort, working conditions and so on.
2. Point's allocation – each job is considered in turn with points being allocated, out of a maximum for each of job factor.
3. Total profits score is then summed. The total will determine the rank order of the jobs. For each pay purpose, it is possible to put ranked jobs into bands to avoid separate pay for each job.

Advantages of Job Evaluation.

1. Pay systems result from study of each job content and responsibility and not personal characteristics of the holder.
2. Rankings are updated to consider changes in work content or responsibility.
3. Pay disputes over differentials or equal pay claims can be solved by reference to evidence found in job evaluation.
4. The ranking system is based on objective and measurable criteria.
5. Participation is achieved through the involvement of manager and staff.

Disadvantages.

1. Job evaluation conclusions need constant updating to take into account changes in work content.
2. If workers are not involved then bad feelings can result from the findings.
3. The system still requires subjective judgments when comparing the degree of difficulty and skills needed for different jobs.
4. It does not consider individual performance in each post or the supply of people willing to undertake each job.

3.30. Health and safety.

Health and safety concerned with working conditions for all employees. It is broader than the obvious dangers of, say, excessive computer use. It also covers visitors to the organization.
In most countries it is controlled through legislation. Some employers and managers take steps beyond legal requirements to ensure staff safety.
It is observed that the company will enjoy increased output, as staff will give their best since the job will be safe.

Legislation usually covers the following under health and safety: -

1. Hygienic conditions
2. Strict limits on exposure to dangerous materials.
3. Protective clothing.
4. Protection from dangerous equipment.
5. Maintenance of reasonable workplace temperature.
6. Maximum working week.

3.31. Industrial relations.

Employee associations discuss with employers conditions of employment. They negotiate on pay, working conditions. e.t.c. in a process called collective bargaining. Other functions include provision of assistance to individual / members (grievances or disciplinary matters), acting as a channel of communication between employees and employers. Unionization of the workforce has led to a democratic or participative style of leadership.

3.32. Industrial disputes.

Failure in negotiations leads to disputes, which might result in one of the following forms of action: overtime bans, indefinite strikes, work - to - rule, go slow, lock outs and so on.

3.33. Forms of resolving disputes.

1. Mediation
2. Conciliation
3. Arbitration

To resolve a dispute one or the other party may seek the advice of an Advisory Conciliation and Arbitration Service (A.C.A.S). It offers advice on industrial relation matters such as grievance procedures and communication in an organisation.

Conciliation- A.C.A.S helps the two sides to reach a mutually acceptable settlement. The two sides are brought together to agree without imposing a settlement.

Arbitration – is a semi judicial ruling by a neutral; third party based on the justice of the case.

Mediation –is another service offered by A.C.A.S, which lies some way between conciliation and arbitration. A mediator will seek to guide the two sides towards a compromise agreement.

3.34. Managing human resources/ people in organization

Is a structured process in which persons interact for common objectives. It exists where two or more people agree to get together and coordinate their activities so as to achieve common goals

Organizing is concerned with:

1. Determining the specific activities that are necessary to achieve planned goals.
2. Grouping these activities into a logical pattern framework or structure
3. Assigning the activities to specific activities and people
4. Providing the means for coordinating the efforts of individuals and groups.

3.35. An organization structure

Is the internal and formal framework of a company that shows how management is coordinate lines of authority. An organisation chart shows the following:

a. The people with overall responsibility for decision-making.
b. The official relationship between different people and departments. Thus employees can identify their specific positions and their immediate superiors.
c. The number of subordinates reporting to each manager, known as the span of control.
d. The way in which authority is passed down, that is the chain of command.
e. Formal channels of communication. These can both be vertical or horizontal and enable communication problems to be identified.
f. The identity of superior – subordinate relationships.

3.36. Formal and informal organizational structure

The organization structure can be divided into formal and informal

The formal organization is defined as the network of official communication channels in the enterprise.

The informal organisation usually springs spontaneously from formal groups as employees interact during tea breaks, lunchtime or when going home. Informal groups constitute social relationships that develop as people interact with one another. Such relationships are not represented on an organization chart although management may unofficially recognize them.

The main differences between the formal and informal organization are shown in the table below:

FORMAL ORGANISATION	**INFORMAL ORGANISATION**
Well defined structure with clear authority. Reporting relationships, accountability and responsibility.	– defined structure with no clear authority, accountability, power, responsibility and reporting relationships.
Channel of communication	
Well-defined, consciously defined. Unambiguous and well known.	– defined, ever-changing and spontaneous e.g. grapevines
Position of members	
Clearly defined position of authority for each member.	– defined position of each member.
Objectives	
Hierarchy of objectives clearly stated.	Objectives are ambiguous and ever

	changing.
Benefits to members	
Tangible pay, packages are known.	Non – financial benefits, usually social & emotional.
Life span	
Durable & planned.	Spontaneous, may or may not be durable.
Flexibility	
Relatively inflexible due to emphasis on order.	Flexible and ever – changing.
Membership	
Gained openly and consciously.	May be gained secretly and unconscious or subconscious.
Graphical representation	
Convenient to be shown on a chart.	Ever – changing form renders it unsuitable for graphical representation.
Examples	
Business corporations and Government departments.	Social clubs, lunch groupings and tribal cliques.

Advantages of informal groups to organizations.

1. They help their members to communicate. They develop their own secondary channel of communication to the one established by management. Managers may use these unofficial channels [“grape vine”] to transmit messages secretly.
2. Informal groups perpetuate commonly held social and cultural values, as members are likely to share common norms and values.
3. Informal groups provide social satisfaction, status and security. Employees are given an opportunity to share jokes, eat meal and socialize after work. Human needs for support and help are thus satisfied. This sense of fulfillment reduces labour turnover, absenteeism and so on.
4. A sense of security is achieved by the feeling of “ strength in numbers” of the group and the psychological advantage of the knowledge that others are in the same situation.
5. Informal groups help members to solve personal problems. Concerns and problems of members can be addressed by the group. A business can benefit when lazy and careless employees are told to improve by fellow members or when a group assists a colleague

with personal problems which may be interfering with work. However new worker can be persuaded to reduce effort to the time – tested lower standards of the group.

Disadvantages of informal groups to organizations.

1. The "grape vine" dispenses both true and false messages. When employees are not well informed on matters that affect them, they may spread false information that undermines the morale of other employees.
2. Resistance to change.
3. Conformity – they act as reference points, encouraging conformity among members acting the same way, lacking creativity for fear of losing group's approval. Companies will suffer as employees lack creativity and innovation.
4. Conflicts. Providing social satisfaction can also conflict with management objectives. For example, a coffee break may increase productivity, but if members stretch it from 10 – 15 minutes daily then production is lost through socialisation.

3.37. Functional Organisation Structures

Advantages

There is a very clear task assignment and trained individuals find the job that they are interested in.

Staff members within a department can easily communicate and use one another's knowledge

Functional organisation structures provide a very suitable environment for new managers who must translate their academic knowledge into business action.

This form of organisation is easy to explain because the majority of employees understand the role of each unit

Functional structures make supervision easier

Disadvantages

1. 1 Staff may develop a narrow outlook and be unable to see business as a whole
2. It may be difficult to prepare managers for a wide range of functions, since there is specialisation.
3. Because functional managers have to report to central headquarters, it can be difficult to get quick decisions.
4. It is often harder to determine accountability and judge performance in functional structures, e.g. if a new product fails, who is to blame, Research and development, production or marketing?
5. Because members of each department may feel isolated from (or superior to) those in other department, they may have difficulty working with others in a unified way to achieve the organisation goals.

3.38. Departmentalisation

Departmentalisation splits the organization into different units, which can be based on

1. Function
2. Product
3. Customer

4. Geographical location
5. Matrix
6. Process

3.39. Departmentalisation

.

Is the method of grouping the elated tasks, activities or unit of an organisation.

3.40. By Process/Function

It brings together all those who are engaged in the same business processes or functions or several related functions. A business has its basic departments, Sales, Finance and Personnel.

Advantages

a. Professional expertise has the chance to build up.
b. There is little need for internal coordination within each department.
c. It facilitates centralised directing and control.
d. Economies of scale obtained after specialisation.

Disadvantages

a. Problems of communication and coordination amongst the departments.
b. Senior management needs wide experience but specialisation does not provide the necessary opportunities.

3.41. By Product

- Each department is responsible for a product or a group of related products. Each department takes the product(s) from the beginning stages to the market place.

Advantages

a. Each department can concentrate its efforts in its specialised area and products get full attention they need.
b. Departments are responsible for profit centres and ease burdens on top management
c. Product managers acquire broad experience through handling the range of business functions.
d. The method promotes product innovation.

Disadvantages

5. There is certain amount of duplication in areas like personnel and finance and these need centralisation.
6. Manager responds differently to environmental factors affecting the departments.

3.42. By region

As organisations' grow, branches or subsidiaries are established in other parts of the home country or in other countries. The organisation structure or each branch or subsidiary can be functional or product based.

Advantages
- Operating costs are lower as all the business functions are performed within each region.
- Local managers know their environment and make better decisions

Disadvantages
- Head Office may feel a loss of control since some activities need to be centralised
- Conflicts may arise between a regional division's activity and the overall organisation's goals.

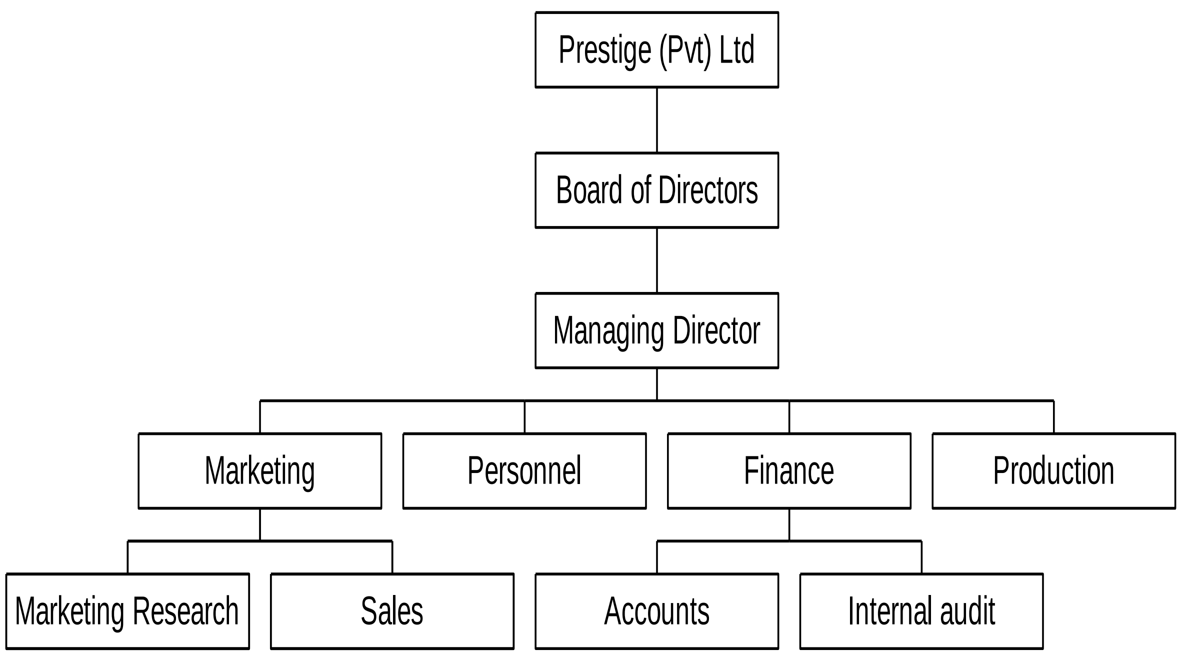
3.43. By Customer
If customers have different needs departments can be adopted

Advantages
Customers get the benefits of specialisation

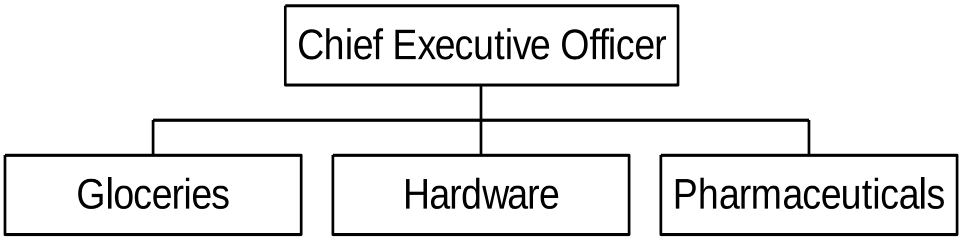
Disadvantages
- Top management needs to co-ordinate activities of the different departments to achieve organisational objectives
- Sometimes customers' needs cut across several department.

3.44. Organization chart

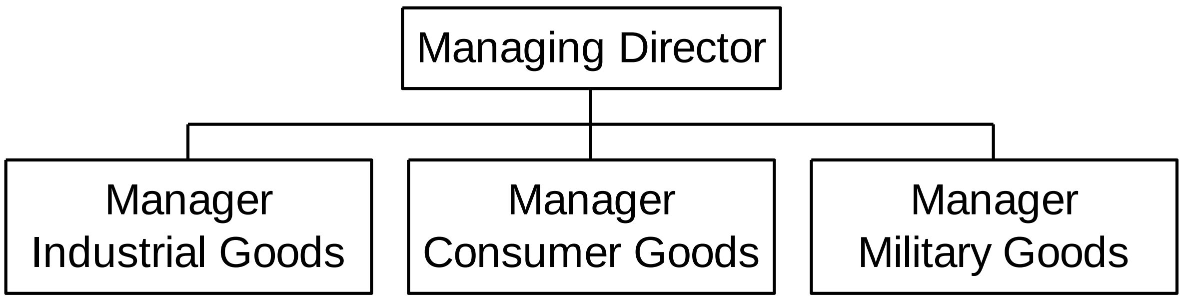
a model illustrating the way in which an organization is structured. It shows the chain of command and span of control.



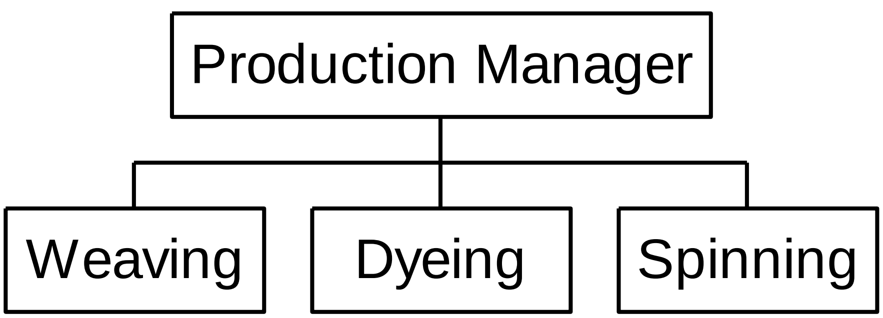
2) .**BY PRODUCT**



3.BY CUSTOMER



4.**By Process**



5.**MATRIX**

	Finance dept	Production dept	Marketing dept	Human resources	Research & Development
Project team X					
Project team					

Y					
Project team Z					

The matrix organisation cuts across department lines of a hierarchical chart and creates project teams made up of people from all departments.

It is task – or project – focused.

It gathers specialists with the aim of completing a task

Advantages of the matrix organisation

a. It allows total communication between departments and cuts across traditional boundaries.
b. Efforts are channeled towards what is good for the project or business instead of an individual or department.
c. As project teams can be created easily, the system responds quickly to changing market conditions.

Disadvantages

a. Less direct control from the top as teams may be empowered to undertake and complete projects.
b. The benefit of quick reaction to new situations is at the expense of reduced bureaucratic control. This trend may be resisted by some senior managers.
c. Team members may have two leaders if the business retains levels of hierarchy for departments but allows cross-departmental team to be created. This could cause conflict of interest.

3.45. Decentralization / Centralization.

As an organization grows in size, there is a tendency for management to subdivide the organization into components of more manageable sizes, components or divisions enjoying substantial autonomy in operational matters. This is what decentralization involves.
Decentralization refers to the dispersal or diffusion of decision - making authority.
It can also be defined as "Situations where ultimate authority to command and ultimate responsibility for the results are localized as far down the organization as efficiency permits." Decentralization is closely related to delegation.

Centralization refers to a relatively high degree of concentration of decision-making authority among very few top managers at the Head Office. Departmental stores exhibit this characteristic. There is centralized administration, human resources, finance, purchasing, and so on.

3.46. Variables affecting decentralisation

1. Size of the organisation – small organisations tend to be centralized while large organisations due to their complexity are decentralised.
2. Diversity of product lines. Single - product firms display a high degree of centralization, multiple product firms such as Unilever tend to be decentralised with managers responsible for particular products.
3. Geographical location of the business. If the business is distributed over distant markets, there is a tendency for the organisation to decentralise decision-making.
4. Communication frequency and facilities. The existence of communication facilities leads to a highly centralised organisations since Head Office is always in contact with its branches.
5. Type of organisation function. Personnel and Finance are usually centralised functions in most companies
6. Nature of growth. If growth is organic the organisation tends to be centralised while external growth leads to a highly decentralized organisation.
7. Philosophy of top managers. Some managers prefer to keep decision-making authority to themselves because they believe that their subordinates are incompetent.

Advantages of decentralisation

They are similar to delegation, that is relieving top managers of work overload so that they concentrate more on strategic decisions.

1. Quicker and better decision making taken at the scene of the action.
2. It offers training for junior managers and prepares them for more challenging roles.
3. Decisions in response to market changes become quick and flexible since head office will not have to be involved all the time.
4. Increases employee motivation through participation in decision-making.

Disadvantages
1. Coordination by top managers may become difficult.
2. Lack of control and ineffective communication may lead to inconsistencies relating to organizational policy.
3. Divisions may pursue their own objectives as the express of corporate goals.

3.47. Authority

Authority is the capacity of a superior derived from his or her formal position to make decisions that affect the behavior of subordinates.

Formal Authority is the type of legitimate power associated with organisation structure and management. Using his formal authority the manager has the right to:

(i) Make decisions within the scope of his / her authority.
(ii) Assign tasks to subordinates.
(iii) Expect and require satisfactory performance from subordinates.

- **Line authority** – this is the authority of those managers directly responsible throughout the organization's chain of command for achieving stated objectives. It is represented by the standard chain of command starting with the board of directors, extending down through various levels to the point where the basic activities are carried out.

<u>Chain of command</u>.

↓

Board of Directors

↓

Top management (General manager) (Managing Director)

↓

Middle Management

↓

Low-level Management

↓

Non-managerial employees

In the manufacturing firm line positions may include production, marketing while in a departmental store purchasing and sales are line activities.
Staff authority is the authority of those individuals who provide line managers with advice and services. The concept of staff includes all aspects of a business that are not classified as line. Staff can offer services such as legal and financial analysis. Staff authority does not expect line managers to use their advice and there is often conflict between the two.

Functional authority – this is the right to control activities of other departments as they relate to specific staff responsibility. It refers to the limited line authority vested with a manager, who allows him to issue instructions and seek compliance other than his own in respect of specific tasks only. For example a personnel manager has functional authority to instruct every employee in the organisation to sign the attendance register.

Responsibility is an obligation to use authority to see that duties are performed.

Accountability means that each person who is given authority and responsibility must recognize that the executive above him will measure the quality of his decisions. By accepting authority, the employee also accepts responsibility and accountability.

3.48. Chain of command

1. This is the plan that specifies who reports to whom in the organisation. It refers to the relationship of a superior and his subordinates shown by lines on an organization chart. The concept is supported by the following principles:

   Scalar principles. Someone in the organisation must have ultimate authority and a clear line of authority should be in existence at all parts of the enterprise. Lines of authority are shown by unbroken lines from top to bottom on an organization chart.

   The unity of command states that every employee should report to only one manager. Instructions from two or more superiors may conflict, which may work against organisational objectives.

3.49. Span of Control

Is the number of subordinates who report directly to a given manager. It is important in an organisation since it affects co-ordination. A manager with a broad span of control that is a large number of subordinates under his supervision may be over extending him/herself and face difficulties in coordinating their activities while a manager with a narrow span of control can give his subordinates closer supervision but he may be under utilised. A narrow span of control results in a tall organisation structure with many supervisory levels between top management and the lowest level. Tall organisations may suffer delays in decision making over supervision and high administrative costs. A wide span of control means fewer management levels and a flat organisation structure .An optimal span is one that is neither too broad nor too narrow and effective.

3.50. Factors influencing span of control

Manager is trained and capable.
Does not have non-supervising activities to perform.

a. Personally prefers a loose style of supervision.
b. People being supervised prefer loose supervisions.
c. People being supervised are well trained and able to handle a variety of work situations.
d. The work being done is repetitive and operations are stable and no unusual events to disrupt the routine.
e. The work subordinates is similar.
f. The methods of work have been formalized.
g. Subordinates work independently of one another.
h. The work of subordinates can easily be supervised.

3.51. Hierarchy.

The combination of span of control and chain of command results in a pattern of levels that is called a hierarchy. At the top of the organisation hierarchy are senior ranking officials commonly referred to as Directors. Other lower ranking managers are located down the various levels of the organisation.

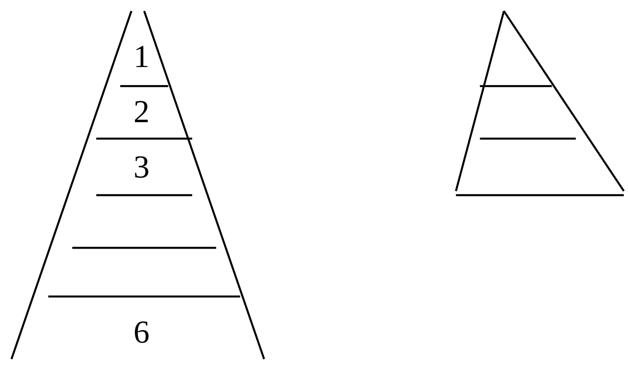
Choosing an appropriate span is important for two reasons:

The span may affect what happens to work relationships in a particular department. Too wide a span can mean that managers are over expanded and subordinates are receiving little control. Too narrow a span can mean under utilisation of management.

The span may affect the speed of decision making in situation where multiple levels in the hierarchy are involved. A narrow span of control creates tall hierarchies with many levels between the top and lowest managers. In such situations a long chain of command slows decision-making. Wide spans of control in contrast create flat structures with few managerial levels between the top and bottom.

Tall hierarchical **Flat hierarchical structure**

1
2
3
4
5
Narrow span of control



Consequences of Poor Organisational Structure

1. Poor communication.
2. Lack of coordination and control.
3. An inability to respond to changing condition.
4. Duplication of activities.
5. Failure to provide opportunities for the development of future managers.
6. Poor adherence to organisation objectives.
7. Low motivation and morale.
8. Ineffective decision making.

Tall Organisational Structures- Option

1. The problems associated with a tall structure have forced firms to opt for delayering. It is the process of removing whole layers of management to create shorter structures.
2. This has been assisted by improvements in information technology which enables senior managers to communicate with and monitor the performance of junior staff and widely dispersed departments, their reducing need for middle managers**.**

Advantages of delayering

1. Reduces business costs in form of manager's salaries and allowances.
2. Shortens the chain of command and improves communication in the organisation
3. Increases the span of control and opportunities for delegation.
4. Increases workforce motivation and greater chance of having more responsible work to perform

Disadvantages of Delayering

1. There could be one off costs of making managers redundant e.g redundancy payments
2. Increased workloads for managers who remain thus lead to overwork and stress
3. Redundancy reduce sense of security for the whole workforce

Revision Questions
1. Why do organisations need a forma structure?
2. Give three benefits of the hierarchical traditional structure.
3. Explain the benefits of a matrix structure.
4. What is meant by (i) long chain of command?
(ii) Wide span of control?
5. Explain why businesses have a centralised structure.
6. Explain how the organisational structure of a business might change as it expands
7. State two factors other than size of business that could influence the organisational structure.
8. Outline the importance of delegation to a business.
9. Distinguish between accountability, responsibility and authority.
10. Outline problems associated with narrow span of control and the degree of delegation exercised in a business.
11. Explain the link between the span of control and the degree of delegation exercised in a business.
12. Explain what is meant by delayering.
13. What possible reasons make the management of to firm wish a delayer the management structure?
14. Why might senior managers be unwilling to delegate?
Essays
1a) What factors in an organisation make centralisation suitable?
b) Draw an organisation chart to show a decentralised organisation [7]
c) What can be done to reduce the undesirable effects of bureaucracy? [8]
2a) Define "departmentation"? [5]
b) Describe the five common forms of departmentation used by firms [20]
3) Explain the term "Span of control"? What factors determine it? What is an appropriate span for an organisation?

3.52. Forms of span of control

Narrow span of control

Advantages
1. It offers tight control and supervision
2. There is a close relationship between the manager and subordinates due to frequent interaction.

Disadvantages
1. Subordinates may feel stifled due to excessive management involvement.
2. The task of coordination becomes difficult as the number of managerial levels increase.

Wide span of control

Advantages
1. Subordinates have greater freedom to exercise their initiatives
2. Subordinates are trained but they must make certain decisions by themselves.
3. There are reduced costs due to fewer managerial levels.
4. There is reduced coordination and communication due to fewer managerial levels.

Disadvantages
1. There is limited interaction between the manager and subordinates, which may lead to discontent and low morale.
2. Subordinates take long to be trained since managerial roles are shared by several The manager is unable to exercise direct control and supervision.
3. Subordinates may abuse their freedom arising from little managerial supervision.

How wide is the ideal span of control

It should be noted that there is no ideal span of control. Each manager in light of his/her own particular circumstances must evaluate the possible span of control and decide accordingly.

Factors affecting the span of control

1. The competency of the manager – a very competent manager might be able to supervise a large workforce.
2. The knowledge and experience of subordinates. Well-trained and experienced staff requires less supervision, and hence the span of control tends to be wide.
3. Complexity of work. The more complex the job, the narrow will be the span of control since close monitoring of each subordinate is required.
4. The degree of change in work content. Fast changing work leads to a narrow span whereas repetitive work allows a wide span due to specialization.
5. The cost of mistakes. The more expensive the mistakes the narrower will be the span of control because of high degree of accountability on the part of the supervisor.

3.53. Delegation

Delegation is the act of assigning formal authority and responsibility for the completion of specific activities to a subordinate. It is a process by which a manager transfers part of his legitimate power to subordinates without giving up his own responsibility to his superior. Delegation can be formally defined as follows:

"It is when an individual or group transfers to another individual or group the duty of carrying out some particular tasks and making some decisions."

The basic reason for delegation is that no manager can individually accomplish all the tasks for which he is responsible.

3.54. Reasons for delegation

1. The human limitations to which a manager is subjected will force him to assign at least some of the activities to his subordinates. However, the subordinates must have authority from the manager to perform these duties.
2. Through delegation, managers are relieved of less important, routine, and less immediate tasks in order to concentrate on more important issues.
3. Delegation also enables decisions to be taken where the action is.
4. It trains subordinates to make decisions and bear the consequences.
5. It provides flexibility by enabling decision making to be done at grassroots level.
6. It results in increased participation by subordinates thereby motivating them to identify themselves with the organization..

3.55. Effective delegation

1) For delegation to be effective, the superior should ensure that the delegated task is proportionate to the authority and responsibility given to the subordinates.
2) The superior should let workers choose methods and solutions different from the ones the manager would have used. There should be open communication between managers and subordinates.
3) The manager should be able to analyse the task requirements and match these with the employee's capability.

Tasks of effective delegation

1) Decide which tasks are to be delegated.
2) Decide who should be delegated the tasks.
3) Delegate the task
4) Be prepared to run interference if necessary
5) Establish feed - back facilities
6) Establish period check points

3.56. Barriers to effective delegation

1. The atmosphere of the organization. Some organisations are traditionally democratic in allowing decisions to be made for the organization others like military academies are bureaucratic.
2. Practical barriers in the work environment
3. A manager may be unwilling to delegate a task that he perceives or finds to be of great importance to the organization for example finance.
4. Delegation may be limited by the training and ability of subordinates.
5. The time limit on and importance of a particular project may make it necessary for management not to delegate such a project.

6. If the manager's own superiors expect him to personally perform the task, the manager will be reluctant to delegate since he is totally accountable for the completion of the task.

3.57. Psychological barriers

1. Some managers are of the habit of closely monitoring all work effort and hence find it difficulty to change the habit and delegating.
2. Particularly in small firms, managers who have a proprietary interest do not usually delegate.
3. Some managers are unwilling to give up the importance attached to the exercise of power.
4. Due to proficiency inadequancy, a manager may not delegate out of fear of losing his own standing to the efficient subordinates.
5. Power hungry managers want their subordinates to refer to them for consultation all the time.
6. Mistrust and suspicion about the ability and willingness of subordinates restricts some managers from delegating authority.

3.58. Motivation

Motivation refers to the way human needs and aspirations explain, control or direct behavior.

3.59. Effects of poor motivation.

Poor motivat**ion in a department, branch or the whole organisation will result in at least one of the following: low** productivity, high labour turnover, poor quality products, absenteeism, lateness, and sickness.

3.60. Overcoming poor motivation.

1. Changes in organization culture.
2. Introduction of suggestion schemes.
3. Improving conditions of work.
4. Improving the levels of pay relative to those offered by firms in the same industry.
5. Changing to a democratic style of management.
6. Offering fringe benefits e.g. transport, subsidized food, education facilities e.t.c.

3.61. <u>Theories of motivation</u>.

Non- Financial Methods of Motivation

Team working

1. Workers are laced into small teams of employees
2. Team working leads to more and better ideas from the workforce, improving the product and the manufacturing process. Workers can learn several skills and it helps to create a more flexible and adaptable workforce.
3. However, some workers may find it difficult to work closely with others and may not get in with other team workers.

Quality Circles

1. These are voluntary groups of workers who meet regularly to discuss work-related problems and issues.
2. Groups are informal and workers are encouraged to contribute to decisions.
3. Results of the quality circle meetings are presented to management and implemented across the whole organisations.
4. It allows participation of all staff and offers challenging tasks that require workers to accept responsibility.

Delegation and empowerment

Delegation involves passing down of authority to perform tasks to workers and empowerment goes further to allow workers some degree of control over how the task should be undertaken.

Target setting

- It is related to MBO, it enables direct feedback to workers on how their performance compares with agreed objectives.
- The idea behind is that people are more likely to do well when they are working towards a goal that they helped to establish.

3.62. Management Theory

<u>Classical Scientific Management</u>

- This came up as a consequence of the need to increase productivity. The demand of goods and services was increased but labour supply was limited and was in short supply.
- The emphasis of scientific management was to try and find the best way in production processes by examining how work was to be done.

3.63. Frederick W. Taylor

Proposed that scientific methods should be applied to factory problems and the proper use of human labour and time in carrying out some tasks. He introduced time studies to analyse workers' movements on the job. Taylor established how much workers should be able to do with the given materials and equipment. From this analysis it was easy to determine the quickest way to perform a task. He emphasized on job specialisation as seen in modern day assembly lines and the time and motion studies as the foundation for efficiency in work.

Scientific selection and training of workers was the basis for good staffing programmes

3.64. Classical Administrative Theory

This emphasized on the development of managerial principles rather than methods of operations like the classical scientific theory which focused on productivity.

3.65. Henri Fayol

Believed that management was not an in born behaviour or a personal talent but skill that could be learnt or taught. His main emphasis was on understanding the principles that under lie good management and on developing a general theory of management practice to serve as a guide to managers

He developed 14 principles and these are:

1. Division of work- specialisation, increases output by making employees more efficient.
2. Authority-managers must be able to give orders, authority gives them the right to give orders and authority brings responsibility.
3. Discipline- employees must obey and respect the rules that govern the organisation.
4. Unity of Command- every employee should receive orders from one superior.
5. Unity of direction- each group of organizational activities that have the same objective should be diversified by one manager using one plan.
6. Subordination of individual interests to the general interest. The interest of any one employee or group of employees should not take precedence over the interest of the organisation as a whole.
7. Remuneration- workers must be paid a fair wage for their services.
8. Centralization- refers to the degree to which subordinates are involved in decision making.
9. Scalar chain- the line of authority from top management to the lowest ranks is the scalar chain all communication flows.
10. Order-people and materials should be in the right place at the right time.
11. Equity managers should be kind and fair to all their subordinates.
12. Stability of tenure of personnel- high employee turnover inefficient.
13. Initiative-employees who are allowed to originate and carryout plans will exert high levels of effort.
14. Espirit de Corps- promoting team spirit will build harmony and unity in the organisations.

Max Weber-He described the type of organisation as bureaucracy with the following characteristics.

1) Impersonal relations- rules and controls are applied uniformly avoiding involvement with personalities and personal reference of employees.
2) Appointments based on rent-the only criterion used to appoint a person to fill a vacancy post merit. Merit is demonstrated by the kind of training and education acquired and the level of examination undertaken by an individual.
3) A prior specification of job authority- before people apply for any job the organisation or management must specify the job description.
4) Hierarchy/Authority-officers or positions are organised in a hierarchy each lower one being controlled and supervised by a higher one.
5) Formal rules and regulations- to ensure uniformity and to regulate the activities of employees, managers must depend heavily on formal organisational rules
6) Specifications- Jobs are broken down into simple, routine and well defined tasks.
7) Career orientation- managers are professional officials rather than owners of the units they manage. They work for fixed salaries and pursue their careers within the organisation.

3.66. FW Taylor (1856- 1917)

Taylor's aim was to reduce inefficiency that existed in US manufacturing firms. He wanted any productivity gains to be shared between employers and employees. The majority of workers were untrained and non- specialized. They were poorly led by supervisors and managers with little or no formal training in dealing with people. There was no formal selection and appraisal system of staff and the majority were recruited on a daily or weekly basis with no security of employment.

Taylor's approach to increase productivity.
Select workers to perform a task. Observe them performing the task and take note of the key elements of the task. Record the time taken to do each part of the task. Identify the quickest method recorded. Train workers in the quickest method and do not allow them to change it. Pay workers on the basis of results. Supervise workers so that the "best way" is carried out. His view was that man was driven by money alone and could stimulate further effort with chances of extra money. He introduced a piece-rate system which involves paying workers for each unit produced. To encourage increased output, a low rate per unit is set for the first units produced and a higher rate becomes payable if output targets are exceeded.

Taylor's Approach	Relevance to Industry.
1. Economic norm	Some managers still believe that money is the only motivating factor. However, workers have a wide range of needs that can be met in part, at least from work.
2. Select the right people	His contribution is still being rejected in the importance being given to capital selection of staff in all firms.
3. Observe and record the performance of staff.	Widely adopted and has become known as motion and time study. Regarded with suspicion by workers though as a way of making them work harder. But it is still applied with the co-operation and support of staff.
4. Establish the best method of doing a job – method study.	Still being applied as efficiency depends on the method being used. Taylor's approach of giving instructions without feedback is however, undesirable. Employee participation now applied.
5. Piece rate	Not widely used as quality may be jeopardized with employees aiming to earn more pay. Other payment systems such as time-rate are more prevalent.

3.67. Elton Mayo and the human Relations Approach.

Elton Mayo considered experiments undertaken at the Western Electric Company in Chicago. The experiments are known as the Hawthorne experiments.

His work investigated whether working conditions affects productivity. Workers were subjected to worsening working conditions but output still rose.

Mayo concluded that:

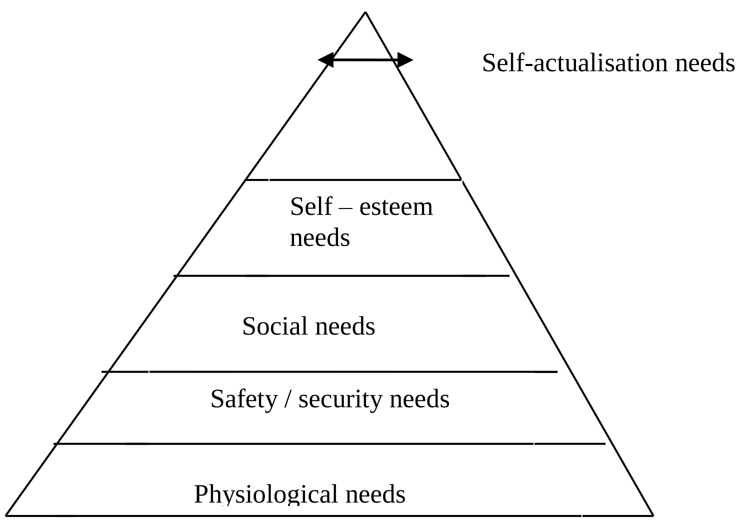
Changing in working conditions and financial rewards has little or no effect on productivity.

When management consults workers and takes an interest in their work, motivation is improved.
Working in teams and improving team spirit can improve productivity. Employees being observed had formed tightly knit groups. Employees who are allowed to control their working lives, such as deciding when to take breaks will feel motivated to work. Groups can establish their own targets or norms and this is greatly influenced by informal leaders.

3.68. Abraham Maslow's Hierarchy of needs.

Maslow formulated a hierarchy of needs, which can be interpreted as follows:

1. Individuals' needs start on the lowest level.
2. Once a lower need is satisfied, humans seek next order needs.
3. Self-actualization or self-fulfillment needs are the ultimate needs.
4. Once a need is satisfied it no longer motivates one to action, thus if material needs are satisfied then more money will not increase productivity.
5. Reversion is possible for example it is possible for satisfaction of one level to be withdrawn e.g. loss of job security, and for individuals to move down to the next level.



Importance of the Hierarchy of needs to business.

Physiological needs – Basic needs for survival e.g. the job, shelter, and clothes. Income from employment must be enough to meet these essentials.

Safety needs – Offering a contract of employment with some job security, a structured organisation with clear lines of authority reduces uncertainty. Ensuring health and safety are met.

Social needs – Working in-groups and teams and communicating effectively with the workers.

Esteem needs – Offer recognition for work done well. Status, advancement and responsibility will gain the respect of others.

Self – actualization – Offer challenging work that stretches the individual's mental capabilities. This will give the employee a sense of achievement. Opportunities to develop and apply new skills will also increase potential.

Limitations of Maslow's theory.

1. Not everyone has the same needs as assumed by Maslow.
2. In practice it is difficult to identify the degree to which each need has been satisfied and which need level the worker is on.
3. Self-actualization is never permanently achieved as was suggested by Maslow. Jobs must continually offer challenges and opportunities for fulfillment.

3.69. Herzberg's Two-Factor Theory.

Herzberg distinguished between motivation which gives positive satisfaction and what he called hygiene factors. Hygiene factors do not cause job satisfaction but their absence cause dissatisfaction.
These factors include pay, supervisors, work conditions, company policy and interpersonal relationships. These have to be satisfactory to get effort from workers but by themselves are not enough.

Motivational factors are intrinsic to the work and include achievement, recognition, advancement, promotion and the work itself. Herzberg's the theory led to the idea of job enrichment. He suggested that managers should provide motivation in the form of satisfactory jobs through job rotation, job enrichment schemes and at the same time ensuring that hygiene factors are present.

3.70. McGregor's Theory X and Y.

1. McGregor identified opposing attitudes towards the workers.
1. He referred to the negative attitudes as X and the positive Y.

Theory X management assumes	Theory Y management assumes:
Workers inherently dislike work and will try to avoid it where necessary.	Spending effort at work is as natural as play or rest and the average person likes work.
Because of this workers should be controlled, directed or threatened in order to get effort towards company goals.	Employees can exercise their own control, direction, and are rewarded through efforts towards achievement of organisational objectives.
The average person wants to be controlled and directed, has little ambition and seeks to avoid responsibility.	The average person learns to both accept and seek responsibility.

Supporters of Theory X advocate for an authoritarian organisational structure scientific management and centralized decision-making.

Advocates of Theory Y argue that the main limiting factor in an organisation is management's ability and willingness to develop employee potential.
Problems arise when employees who expect Theory Y approaches are subjected to Theory X approaches and vice versa.

3.71. Process Theories.
Process theories concern not the needs that have to be satisfied but the thought processes that influence behaviour. The theories analyse how employees make decisions and the thought processes behind these decisions.

3.72. Expectancy Theory.

Effort is linked not just to the desire for a particular outcome, but moderated by an understanding that if a particular course is followed, a certain outcome will be achieved.

The conclusions that can be reached are:
(i) Individuals will only act where they have a reasonable expectation that their actions will lead to a desired outcome.
(ii) Effort alone is insufficient. It has to be accompanied by ability and skill.
(iii) Job satisfaction will result from effective job performance.
(iv) Job design is therefore of great importance.

3.73. Equity Theory.

In return for an input (effort, skill, experience and training) workers receive an outcome (pay, status and fringe benefits).
Equity exists when the ratio of one's input and outcome equals those of others.
Inequity exists wherever the input and outcome ratios are not balanced. Workers feel a sense of injustice, if their efforts are not rewarded in a way that is commensurate with those of others.
Perceived inequality results in tension within an individual and effort to bring his input and outcome ratio in line with those of others.

3.74. Application of theories to work situations.

There is no best method. The main motivating factors are:

1. Pay rates as hygiene factors.
2. Security of livelihood.
3. Social groupings.
4. Style of leadership.
5. Nature of work and the work environment.
6. Sense of challenge in relation to the worker's ability.
7. Opportunities to participate in decision-making.
8. Desire for autonomy and responsibility.

Division of labour leads to increased output and efficiency. However, repetitive work is monotonous leading to a high labour turnover, low productivity and a general disinterest in work.

The application of motivational theories to the structure of work or job design will help to improve productivity and job satisfaction.

A well-designed job will:

1. Be reasonably challenging.
2. Be considered important by others.
3. Use the employee's skills and abilities to the full.
4. Provide some degree of autonomy and opportunities to work as a team.

3.75. Job design techniques.

Job rotation - the planned and systematic movement of workers from one job to another provides them with experience and variety.

Job enlargement - combines a series of tasks into a new broad job, which gives variety and challenge. However, job enlargement must not result in over - burdening of the worker.

Job enrichment is job design that includes achievement, recognition and other high-level motivators. It means complete job satisfaction through greater autonomy and participation in decision-making. Job enrichment is achieved through:
(i) Increasing the responsibility of individual workers.
(ii) Providing workers with more information.
(iii) Giving employees a complete unit of work, reducing specialization, enabling the employees to achieve the social, esteem and self-actualisation needs.

Autonomous group working - whereby an experienced group of workers in a given discretion to plan and make decisions. The manager sets the task but the worker decides how it should be done. This requires an experienced group of workers willing to accept responsibility and a manager who is willing to give up authority over the group.

3.76. **Changing work groups**

Leadership.

Leadership is the art of influencing people so that they perform assigned tasks willingly in an effective and efficient manner. It is essential to distinguish between managers and leaders. Managers must have leadership qualities. Managers who are not leaders will achieve some but not all of the objectives. Managers who are leaders will strive for total and enthusiastic cooperation from their subordinates.

Styles of leadership.
This refers to the way in which managers take decision and deal with their staff.

a) Autocratic leaders.

Autocratic leaders make decisions on their own without consultation. They set objectives themselves, issue instructions to workers and check to ensure that work is carried out. Workers can become so used to this style that they depend on the leader for all guidance and will show no initiative. Motivation of staff will be very low and supervision of workers become essential. Communication is one – way with no feedback. This style is useful in armed forces and police. It is also applicable in crisis such as an oil tanker disaster, or a railway accident. Leaders may have to take full control and issue orders in emergencies as there would be no time for consultation.

b) Democratic leaders.

Democratic leaders will engage in discussion with the staff before taking decisions. Communication is two way with every opportunity for staff to respond and initiate discussion.

(i) Managers must have good communication skills so that they are able to explain issues clearly and to understand responses from subordinates.
(ii) Full participation in decision-making is encouraged. This may lead to better final decisions as subordinates can offer valuable experience to new situations.
(iii) Consultation with staff is time-consuming, yet sometimes quick decisions will be required.

c) Laissez – faire management.

(i) Allow workers to carry out tasks and take decisions within very broad limits.
(ii) There will be very little input from management into the work to be carried out by staff.
(iii) It is effective in cases of research and design teams. In other cases such a style can be disastrous.

3.77. Approaches to leadership

Trait Approach

- Three main traits should occur-together for successful leadership that is intelligence, communication skills and ability to assess group goals.

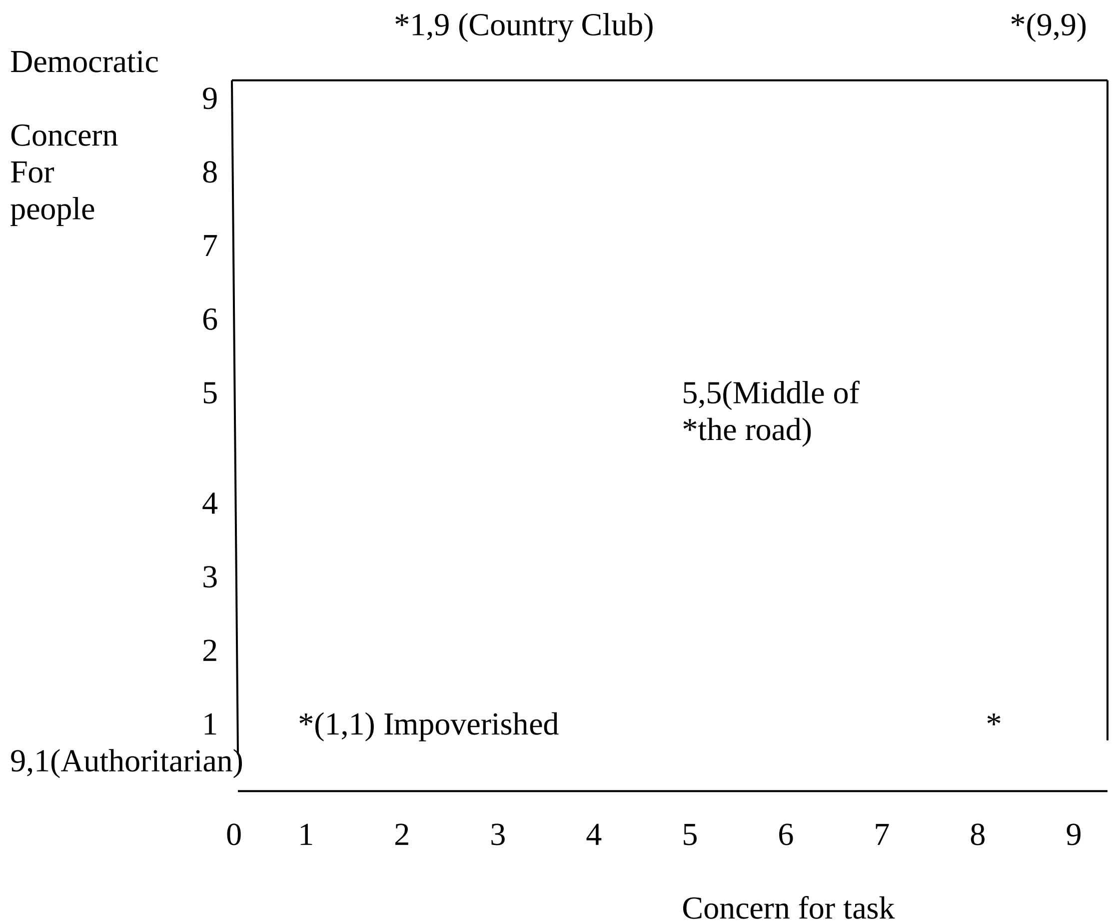
Behavioural Approach

- Researchers have identifies two leadership styles which reflect different behaviour patterns

1. Task-oriented managers-who monitor their subordinates closely to ensure that the task is completed to their standards
2. Employer-oriented managers- who try to motivate rather than control their subordinates, they encourage them to participate in decisions affect them and to develop friendly relationships among themselves.

3.78. Managerial Grid

Blake and Mouton booked at various combinations of task and people relationships and identified various management styles resulting from interaction between task oriented and employee oriented behaviour managers.



(1,1) Impoverished management- low concern for people and low concern for the task

(1,9) Country club management- High concern for people but low concern for the task

(1,9) Authoritarian management- low concern for people put high concern for the task.

(5,5) Middle of the road management- a balanced concern for the task and the people doing it.

(9,9) Democratic management- a high concern for the task and the people doing it.

Factors Influencing Choice of Leadership Style

1. The demands of the job- the task requirements influence the leadership style of a manager
2. Organisational climate- if the organisational climate is authoritarian then the manager is expected to control subordinates closely.
3. The expectations of superiors- the expectations and leadership style of a manager's superiors are very important in determining the style that he will adopt. Usually a manager copies the style of his superior.

4. The leader's past experience and expectations- a manager's values and background will affect his choice of leadership style. If he has had much success in an employee oriented approach?
5. Subordinate's characteristics, expectations and behaviour- the characteristics of a manager's subordinates will influence the leadership style that is chosen.
6. Peer expectations- the colleagues of a manager play an important role in influencing the leadership style. Whatever their own preferences, managers tend to adopt a style consistent with that of their peers.

3.79. Contingency Approach

1. The approach examines the work situation and then seeks a manager whose style is suitable for that situation.
2. The most important factors is the quality of leader- members relations.
3. If the members of the group respect the manager because of his experience, skill, personality or character, it will be much easier for the manager to influence them and he may not even have to use formal rank or authority
4. The task structure- when the task is highly structured that is step by step procedures or instructions for the task are available, the members of the work group know exactly what they have to do. When tasks are unstructured the roles of group members is ambiguous and members can easily disagree with or question a manager's instructions.
5. The leader's power position- the managing director of firm carriers a great deal of power and authority.

3.80. The best management style.

The style of management used depends on:

a. The training and experience of workers and the degree of responsibility they are prepared to take on.
b. The amount of time available for consultation and participation.
c. The attitude of managers or management culture.
d. The importance of issues under consideration.

3.81. Informal leadership.

In any group of people, at work or in a social context, it is common for informal leaders to be established. These people have the ability to lead without formal power, perhaps because of their experiences, personality or special knowledge. They may have more influence over the activities of the group than formal leaders. Managers should attempt to work with informal leaders to help achieve the aims of the business.

3.82. Management.

Management is a process of planning, organising, leading and controlling the work of organisational members, using all available organisational resources in order to achieve stated organisational goals.

Planning is the process of establishing goals and suitable course of action for achieving them. Plans provide guidelines by which:

The organisation gets and commits resources required to meet its objectives.

Employees carry on activities consistent with chosen objectives and procedures.

Progress towards objectives is monitored and measured so that corrective action can be taken.

Strategic Plans are long-range plans, which is includes survival, profitability and shave growth. Such plans relate to market share, solve revenue maximization, cash flow and productivity.

Tactical plans are short-term departmental performance targets, for example to attain 3% market share within three years or to increase sales revenue by 10% next year.

Organising is the process of engaging two or more people in working together in a structured way to achieve a specific goal or set of goals. Managers must match an organisation's structure to its goals and resources. This is a process called organisation design. Organising produces a structure of relationship against which future plans will be pursued. At times, organizing involves seeking new people to join the structure of relationship. The search is called staffing.

Leading is the process of directing and influencing the task related activities of group members or the entire organisation.
Managers lead so as to persuade others to join them in the pursuit of the future that emerges from the planning and organising steps.

Controlling is the process of ensuring that actual activities conform to planned activities. It involves:

1. Establishing standards of performance.
2. Measuring current performance.
3. Comparing this performance to the established standards.
4. Taking corrective action if deviations are detected through controlling, the managers keep the organisation on track.

3.83. Business communication

Communication is the transmission of coded both verbal and non-verbal message from one person or organization to another. It can be oral, visual, printed, electronic, diagrammatic and bodily.

Communication is effective if the message is accurately sent, properly received, and proper feedback sent. All businesses communicate externally with suppliers, customers, shareholders, and Government and internally between different people or groups within the organization.

Importance of effective communication in a business

1. Quality of decision-making: If all employees have good communication links, then better quality decisions will be made.
2. Staff motivation: If employees are encouraged to participate through group discussions, then effective communication will aid motivation leading to increased productivity.
3. Speed of reaction to changes in the market: Communication ensures the organization responds quickly to changes in consumer tastes: This enhances the organisation's competitiveness.

4. Coordination between departments will be enhanced by effective communication.
5. Effective communication results in improved problem solving by all staff that is consulted within the organisation.
6. Incorrect understanding of the message will lead to incorrect responses.
7. The management functions of planning, organizing, leading and controlling are inevitable without effective communication.
8. Communication ensures a business becomes open and interacts with all stakeholders.

3.84. Classification of communication

By media-The range of media used can be grouped as:

1. Oral communication takes the form of one-to-one interviews, group meetings, team briefings and appraisals.
2. It permits two-way communication and proper feedback, which motivates subordinates.
3. It allows the sender to use body language if necessary to reinforce the message.

However, there may be no written record of what was said, which is inappropriate for complicated and technical matters and can be time consuming. Body language may affect the message especially if the sender appears bored.

1. Written communication. This can be through notice boards, letters, and memos and diagrams, which provides a permanent record. Written communication allows transmission of complicated data via diagrams.
2. However, it eliminates supporting body language and does not allow for immediate feedback. In addition, there is no evidence that the message has been received or understood.

3.85. Electronic media

Electronic media has the benefit of being fast and is supported by written records. Messages are passed through faxes, the Internet, video conferencing and mobile cell phones. However, these media may require staff to be pre-trained. They also reduce human contact and therefore there is a sense of isolation. Information technology can also lead to information overload as a result of speed and low transmission cost. A large volume messages can take one, several hours to reply. Thus important messages may not be acted upon instantly. The equipment needed to facilitate communication is also costly.

3.86. Visual communication

This can be used to accompany oral, written or electronic message. Diagrams, charts, pictures and pages of computer images can be used. Visual communication is usually used in training and marketing programs.

3.87. Factors influencing media choice

1. Cost: Electronic media require expensive equipment but memos are relatively cheap.
2. Speed: Electronic media can be very fast but sometimes there will be need for allowing it to be aired.
3. The longer and more detailed the message, the less likely that oral communication will be used.

4. The importance of a written record of the message, for example a new employment contract.
5. Whether more than one method is used. For clarity, for example, a telephone message may be followed by a letter or order form.

By direction

1. <u>One-way communication</u> is when no facilities for feedback do exist. One-way communication includes safety notices, messages pinned on notice boards or written instructions which need to be acted on immediately. There is no assurance that the message has been received, understood and acted upon. It is remiscent of autocratic leadership style.

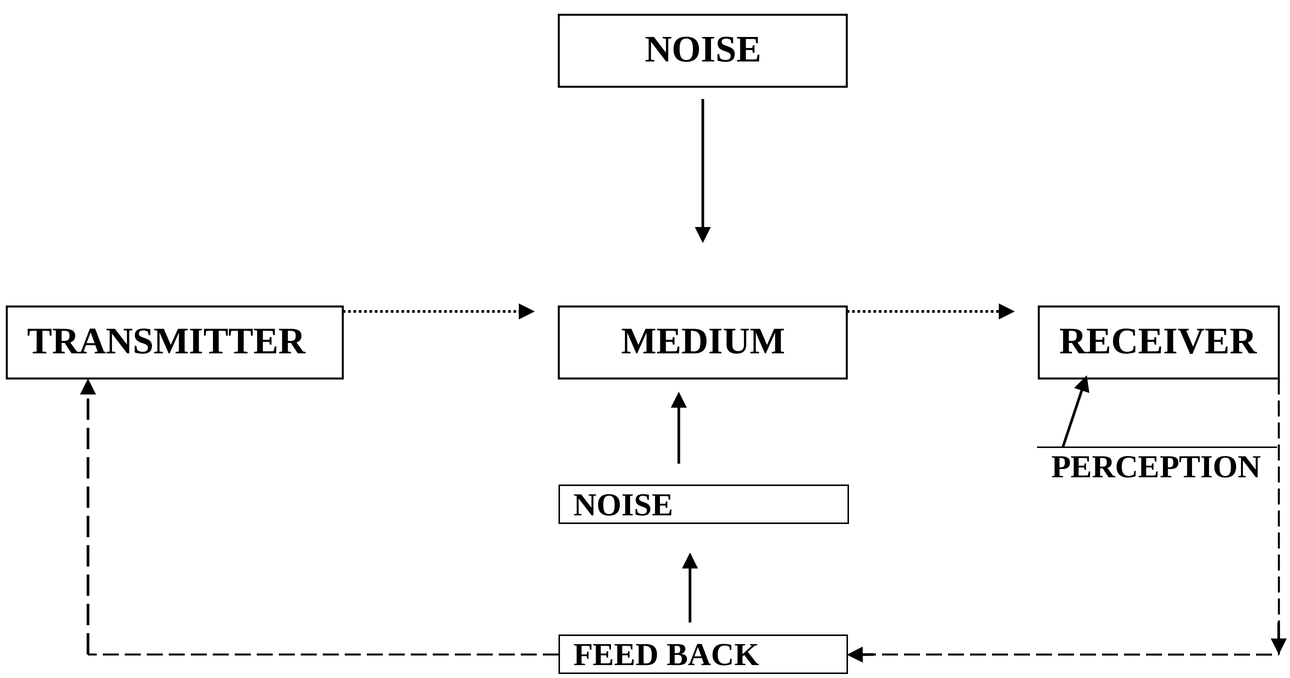
2. <u>Two-way communication</u> allows feedback. It is much more motivating since there is employee participation. It is essential for a democratic style of leadership. However, it is time consuming

By formality
Horizontal communication
It occurs along the organization chart between people who have approximately the same status but different areas of responsibility.

Formal communication channels are those that are officially, recognised by the organisation and follow the organization structure, for example from superior to shop floor workers.

Informal channels are not part of the organization structure but exist as people socialize at work. The “grape vine” can lead to rumors and exaggeration.

Model of communication



Noise is anything that disturbs communication e.g. bad handwriting

Perceptions are the ability to analyse the reactions of the sender and the receiver. Perception is a psychological process.

Influences of perception

1. Status: A top manager may be revered so much by his subordinates that all communication from him is accepted without reservation. Likewise the manager might look down on subordinates and dismiss what they say.
1. Background: People from despised background would tend to accept any communication from their superiors.
2. Gender: Perceptions held of women by male subordinates may affect communication from ladies.
3. Academic background: Usually people who are academically gifted understand more than those with lower education. Hence perceptions between the two groups may obviously be different.

3.88. Barriers to effective communication

1. Failure in any stage of the communication process
(a) The medium chosen might be inappropriate, for example detailed and technical diagram being explained over the phone.

a) A vague message would result in poor understanding.

c) Excessive use of technical language or "jargon".

d) Information overload – If there is too much information at the decoding of such information will take long and may be inaccurate.

2. **Poor attitudes of sender and or receivers**
a) If the receiver holds any negative attitude(s) about the sender, he might be unwilling to receive the message or act upon.

b) The sender may have a low opinion of the receiver and thus make no effort to ensure clarity of the message.

c) Intermediaries in the channel may deliberately sit on the message or change it in order to demotivate the receiver.

3. **Physical reasons**

a) Noisy factories are not suitable for communication.
b) Geographical distance can limit communication.

3.89. The use of computers in communication:

<u>The relationship between data and information</u>

The term data refers to raw unanalysed numbers and facts, while information refers to data that have been organised or analysed in some way. Increasingly, an organisation's information is seen as one of its most valuable assets

<u>Advantages</u>

1. They process the data far much faster than is possible with manual methods.
2. They are able to handle vast/huge quantities of data, which could otherwise be processed by a large number of clerks if done manually.
3. They are extremely accurate
4. They use the provision of financial and statistical information available, which would otherwise be too difficult or expensive to produce within the required time scale.
5. They enable exception reports (those that deal with adverse variances or these that don't confirm budget) to be produced easily thereby facilitating management by exception.
6. Reduces staff costs as fewer people needed to operate the computers are employed.

<u>Disadvantages</u>

1. Installation or set up costs are very high
2. Operating and user staff need training
3. Computers cannot think, so if they are fed with wrong information they will produce wrong information. Garbage In Garbage Out (GIGO).
4. Once a system has been designed and installed it may be difficult to change or modify it. With manual systems clerks can change immediately once they are received.

3.90. Typical examination questions

1. Explain how each of the following stakeholders will view a merger:
a. customers [8]
b. government [8]
c. workers [9]
2. Explain the following features of formal structures.
a. centralisation [3]
b. authority and responsibility [3]
c. span of control [3]
3. Distinguish between 'line' and 'staff' relationships as shown in an organisation chart.
4. Suggest two reasons why business might wish to engage in vertical backward integration. [4]
5. Distinguish between formal and informal communication in business. [5]
6. Explain the barriers to effective communication in a large company. [6]

Essay questions	
Question 1	
a. Explain the importance of induction training to an organisation. [10]	
b. Evaluate the role of training to a shoe manufacturer. [15]	
Question 2	
a. What is job evaluation [5]	
b. Outline the purposes of job evaluation. [20]	
Question 3	
Evaluate any three-payment systems a large manufacturing company can use. [25]	

Data response questions

Thuthukile Shoe Repairs

Thuthukile Shoe Repairs, a business entity that was formed in 1999, to produce and repair shoes. It is a one- man business that is owned by Tobias Dube. Dube is an export in making and repairing of leather bags and shoes. He has employed three employees and the morale among these workers is very low.

Dube believes in making all major decisions on his own. Communication between Dube and his employees is through the notice board. Dube has announced that he has decided to 'go public'. One of his reasons is that, he would like Thuthukile Shoe Repairs to enjoy limited liability so as to attract potential investors. His wife, who is his main advisor, has tried to discourage Dube from pursuing this move. However Dube seems to be too determined to go ahead with his plan.

1. Define the following terms as used in the passage:
   a. limited liability….line 17
   b. going public……line 15
   c. Identity the leadership style used by Dube and discuss its suitability to Thuthukile Shoe Repairs. [5]
   d. Discuss any two non-financial incentives Dube can use to motivate his workers. [4]
   e. Advise Dube if he should go ahead with the decision to 'go public'.

Jay and Jee Legal practitioners.

Jay and Jee are graduates of Law who graduated from the University of Zimbabwe in 1994. The two men were employed by a big legal firm from 1994 unit 2004 when they decided to form a partnership.

A lot of meetings were held between Jay and Jee to discuss issues pertaining to the partnership that was to be performed. The following proposals were put across and approved by the two Lawyers.
-Scientific management is applied to lower level routine and repetitive tasks.
-The partnership is organised by function.
- Employees be paid using the time rate system.
-Employees are trained in using computers.
-Both formal and informal communication is used to achieve effective communication.

The partnership was finally formed in December 2004. The initial number of employees was fifteen, comprising of the Marketing manager. Finance and Accounting manager and the Personnel manager and the auxiliary staff. The partnership has grown from strength to strength owing to the good reputation of the two Lawyers, Jay and Jee.

1. (a) Draw an organisation chart to illustrate Jay and Jee legal Practitioners' structure. [5]
(ii) Evaluate the strengths of functional organisational structures. [5]

2. Evaluate the advantages and disadvantages of scientific management theory. [10]
3. Evaluate the relevance of computers in present day management of business. [5]
4. Distinguish between formal and informal organisations. [5]

<u>Ngqwele Meat Producers Ltd</u>
Ngqwele Meat Producers is a big meat retail chain that has seen a very big expansion since its inception in 1991. The Shareholders of this company have attributed its growth to an efficient Personnel Department.

The Personnel Manager, Mr. Oxtail has been very efficient since his assumption of duty in 1992. His major strength has been his precise definition of jobs and clear outline of skills needed to perform duties efficiently. This he achieved by drawing up the following:
1. Job analysis
2. Job description
3. Job specification
4. Recruitment profile

However the General manager has attributed Mr. Oxtail's success on the latter's ability to motivate, train and remunerate fairly. Informal groups have existed in this company since its inception in 1991. The level of morale in the organisation is quite high.
(a) Distinguish between a job description and a job specification. [4]
(b) Give four ways in which a job analysis can be of help to Ngqwele Ltd. [8]
(c) Advise Ngqwele Ltd on why they should have a recruitment profile. [6]
(d) Evaluate the value of informal groups to Ngqwele Ltd. (6)

CHAPTER 4

MARKETING

Topic Objectives

1. To introduce the basic concepts of marketing.
2. Explain and analyse the role of marketing research.
3. To analyse the advantages and disadvantages of different methods of conducting marketing research.
4. To introduce the major techniques of forecasting.
5. To assesses the role of forecasting in marketing.
6. Analyze the techniques of positioning products.
7. To survey the role of packaging and branding in the marketing process.
8. Analyse the different techniques of promotion.
9. To understand the objectives for pricing policies.
10. To analyse the pricing policies available to firms and the circumstances in which each is appropriate.
11. To develop an understanding of the different channels of distribution and the principles of channel choice.
12. To analyse the different methods of entry into overseas markets and problems of engaging in international marketing.

4.0. Defining Marketing

Marketing is defined as the management process, which involves the exchange of goods and services in order to satisfy the requirements of customers in a profitable way. The aim of marketing is therefore to identify the needs of customers and then provide goods and services, which will satisfy the needs.

The definitions show the following components of marketing,

a. Process- it aims to develop ties and relationships, so it is not a single transaction.
b. Planning and execution in marketing is composed of the preparatory theoretical dimensions. Conception, pricing-explains the variety of marketing mix variables.
c. Exchanges- clarifies the need for mutual benefit.
d. Create-emphasizes the forward-looking approach in needs identification.
e. Satisfaction- emphasizes that customers don’t buy products but want satisfaction, value and benefits.

Marketing Approaches**-** Are philosophers that guide management in the way they do business.

4.1. <u>Roles of Marketing</u>

The role of marketing can be summarized as:

1. Marketing researches on the present and future needs of customers.

2. Product development and planning to develop products and services which will satisfy these needs.
3. Pricing determines what the organisation will get from its customers in return for the product offered.
4. Distribution ensures that the products are accessible to customers.
5. Promotion creates an awareness of the existence of products through advertising, selling, sales promotion, public relations and publicity.
6. Promotes trade and employment
7. Coordinates and directs the organisation resources and efforts to sell profitably.

4.2. Enlightened marketing Concept

1. It holds that a company's marketing should support the best long-term performance of the marketing system and it consists of five principles:
2. Consumer orientation.
3. Innovative marketing i.e. the firm is required to continuously seek real product and marketing improvements.
4. Value marketing- i.e resources are put in value building marketing investments.
5. Sense of mission i.e the mission should be broad in social terms rather than narrow product in terms
6. Societal marketing.

4.3. Marketing approaches

Not all firms start their marketing from the customer and his needs; there are other different approaches, which are used by firms:

a) **Production oriented firms** concentrate on production efficient, low cost methods of production expecting that the product will be sold as long as it is cheap. Such a firm does not respond to customers needs but concentrate on production costs.
b) **Product oriented firms** produce quality product from their points and not the customers point of view. They assume that customers do not know what is good until they see something, which has been designed. The firms risk producing products, which fail to satisfy consumer, needs.
c) **Sales oriented firms** produce whatever they can produce and try to sell it to the customers.
d) **The marketing - oriented firm**- starts with the customer and his needs. The aim of marketing is to identify and understand the customer's needs so that the product or service will be self-selling.
e) **Societal marketing oriented firms** do not only produce what customer needs but also what is good for the customer. Alcoholic products and cigarettes are wanted by customers but a societal oriented firm will not produce that because these are not good for customers. Profit-oriented firms do not normally use this approach.

Key Concepts

(i) Marketing – A business philosophy, which involves the identifying anticipating and exchanging goods and services to satisfy customers profitably.
(ii) Marketing approaches – The different marketing concepts used by firms

(iii) Promotion – All the marketing communication activities, which are aimed at creating awareness e.g. advertising, sales promotion, public relations, publicity, direct mail etc

4.4. The marketing concept

All efforts are aimed at satisfying customers at a profit. The marketing concept encompasses three elements namely: customer satisfaction, total company effort and profit as an objective.

4.5. The Selling concept

It focuses on the needs of the seller and holds that customers will not buy enough of the organisations products unless it undertakes a heavy promotional spending.

4.6. Difference between marketing and selling concept

Selling concept	**Marketing Concept**
1. Stresses needs of sellers	Stresses needs of buyers
Management is sales volume oriented	Management is profit- oriented
The emphasis is on the product	The emphasis is on customer wants
The company first makes the product and then works on how to sell it	The Company first determines the customer's wants.

Marketing Approaches Contrasted

Approach	**Starting Point**	**Focus**	**Means**	**Ends**
Production	Factory	Availability & Affordability of existing products	Production and distribution efficiency	Profits and Sales
Product	Factory	Performance of existing products	Product quality & Innovation	Profits and Sales
Sales	Factory	Existing products	Selling and promoting	Profits through Sales Volume
Financial	Investment	Financial objectives	High Sales Volume and Costs reduction	Maximum return
Marketing	Market	Customer Needs	Integrated marketing	Profits through customer satisfaction
Societal	Market	Customer Needs	Integrated Marketing	Profit through long term customer welfare and society well-being
Enlightened Marketing	Market	Customer Needs	Innovative and Value marketing	Long-run performance

4.7. Market

-Is defined as consisting of all those consumers who are wiling and able to buy goods and services and all those producers willing and able to supply them.

Consumer goods market: where goods and services for human consumption are excluded e.g cars, video recorders, hairdressing and window cleaning
Capital goods markets: where items such as machinery and vehicles are bought and sold by business origins.
Labour markets: where people are hired for their services.
Money market: where people and financial institutions borrow and lend money.

4.8. Market Location and Size

Identifying a market, its location and means to reach it is fundamental to a marketer's job. The marketer should be able to answer the following questions.
(i) What are the consumer's needs?
(ii) How important are these needs a) Locally b) Internationally?
(iii) Are these needs felt (a) regularly (b) occasionally?
(iv) Are the needs likely to last (a) for a long period (b) for the short terms?
(v) Are the needs felt by (a) all consumers (b) only selected groups of consumers?
A market for a good or service can be of any size and can cover any area. It can involve any number of consumers and producers anywhere in the world willing to use goods or service. Some newspapers are local while others are regional and national. Products like oil, sugar, video recorders and insurance have international or world markets. The marketer should estimate the size of the market although it changes over time either growing or declining depending on the changes in technology, fashions, tastes or government legislation. The importance to the firm in knowing the size of its market lies in:-

(i) The market potential which is the total amount of product that can be sold in a certain period of time
(ii) The sales potential or market share which is the portion of the market which the firm can get.
(iii) Size of the marketing organisation needed to tap this sales potential and then worked out how to satisfy those wants

4.9. Development of a new product

1. Idea generation: – ideas come from customers, users, marketing research, competitors, the sale force and middleman.
2. Screening: – strengths and weakness, fit with objectives, market trends and a rough return on investment estimate.
3. Idea evaluation, concept testing, reaction from customers, rough estimate of cost, sales and profit.
4. Development: – develop model or services prototype, conduct market tests and test marketing. Revive places needed. Return on investment estimate.
5. Commercialisation:– finalising product and marketing plan. Start production and estimate a final return on investment.

4.10. Product Portfolio Planning

Product planning is important to the continued survival of a firm because: new products are essential for growth, consumers are becoming more selective in their demand and it enables a better use of the firm's resources.

4.11. Product Development

Research and development function helps the firm keeping competitors at bay and pushing the company already in sales and profitability.

New products can be in three categories.

(i) Products that are really new and unheard.

(ii) Replacements for existing products that are significantly different, for example, ball point replaced fountain pen.

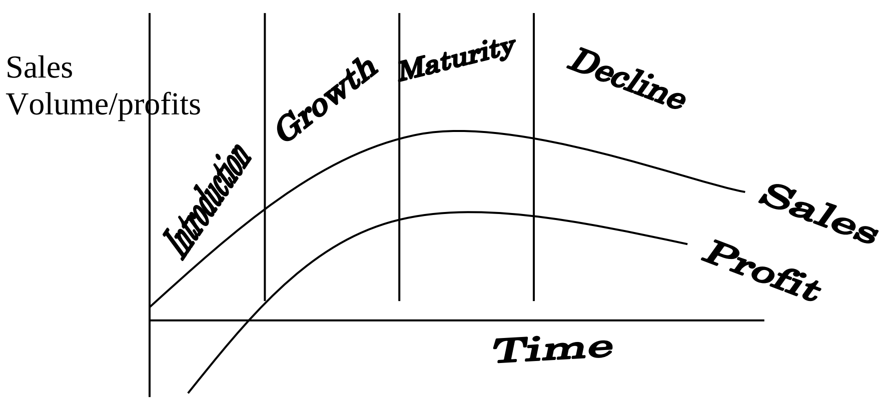
(iii) Imitative products that may be new to a particular company but not new in the market, for example, "me too" products to capture part of existing market.

Reasons for developing

1. Old products need to be replaced.
2. Market becomes saturated with the same product.
3. Consumers need new innovations.
4. Companies need to maintain balanced portfolio.
5. Companies need to increase customer benefits, products choice and meet new needs.

4.12. The product life cycle

It is the path followed by a product in realisation of sales and profit from its inception to its demise.



4.13. Importance Product Life Cycle

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1. It helps management to understand the stages through which products must pass that is products have a limited life.
2. It allows strategies to be developed that best suit each stage.
3. It assists when forecasts, actions and results can be reviewed as a basis for improvement of future action.
4. Enables marketers to understand that products require different marketing, financial, manufacturing and purchasing at each stage of their life.

4.14. Stages of the Product Life Cycle

<u>Stage 1. Introduction</u>
This is the period when the product enters the market. Growth is slow and whatever is realised cushions production costs. The main emphasis is research and engineering costs. As the product gets known by the public, sales increase and profit rise.

Strategies required:
1. An appropriate blend of public relations, heavy advertising, trade and sales promotions, introductory pricing and dedicated personal selling to develop the market and overcome consumer resistance. Use penetration or skimming pricing strategies.
2. Advertising should be informational to create awareness.

Stage 2. Growth stage
1. Strong advertising and sales promotions are needed to gain market share and possibly develop new market segments.
2. The firms can cut prices by offering discounts and other incentives.

Enter new market segments.

<u>Incentives</u>
Advertising is competitive

<u>Stage 3.Maturity</u>
1. Advertising and Sales promotions targeted at areas of special interest should be reduced due to brand loyalty created
2. Prices should be lowered
3. Product modification, for example, quality, feature and style improvement

<u>Stage 4. Decline Stage</u>
1. Promotional efforts and price reductions will have marginal effects at best. Price cutting may attract a few laggards.
2. Promotional and developmental budgets are slaved to maintain viability.
3. Product can be reintroduced/relaunched or harvested, that is, discontinued.
4. Explain strategies aim to rejuvenate the product to prolong its life and strategies include changes in;
5. The product
6. Its packaging
7. The way it is promoted
8. The channel of distribution

Patterns of sales over time vary producing different life cycle graphs, for example, the flop, the plateau, the gimmick, continuous growth, a false start and relaunch, or an extension.

4.15. <u>Why New Products Fail</u>

1. Inadequate market analysis:- thus inability to define consumer needs, buying motives and habits correctly.

2. Product deficiencies:- some products are poorly made or perform badly, others are too complicated for the consumers to use or offer no significant competitive product advantage over those already in the market.
3. Lack of an effective marketing effort:-lack of sufficient follow-through effort after the introductory launch and the failure to train marketing staff adequately to handle new products in the new markets.
4. Costs are not properly planned for:-costs incurred in the introductory stage are higher than anticipated, thus lead to lower sales volumes.
5. Under-estimating competitive strength or ability of competitors copy or to innovate:- as soon as the product is launched, competitors come up with an equally good product because the item is easy to copy.
6. Poor thing of product introduction:- the product could be introduced too late, similar items are already in the market, a product could be introduced too early and the market is not ready for it.
7. Technical or production problems:- demand is greater than anticipated and the inability to supply the product provides competitors a chance to get an unanticipated share of the market.

4.16. Value Analysis

1. Is to examine critically the function of a product with a view to fulfilling that function at the least cost consistent with reliability of the function.
2. It is concerned with identifying the relationship between costs, and reliability of function.

4.17. Stages of a Value Analysis

1. Select product to be studied.
2. Determine function, design and cost of product including components.
3. Develop alternative designs for production order to achieve same function at less cost i.e designs of higher value.
4. Evaluate the alternative designs.
5. Adopt optimum design i.e one is able to perform the required function reliably but at least cost
6. Implement design and review results.
7. The process is usually carried out by a multi-disciplinary team composed of the following- value analysts /engineers, product designer, cost accountant production representatives and purchasing manager.
8. Value analysis is applied most in mass production or assembly line production processes where large numbers of items are being produced, and where marginal cost savings can lead to substantial savings.

4.18. Benefits of Value Analysis

1. It encourages cost consciousness and the search for alternative designs and materials
2. Permits more competitive pricing.

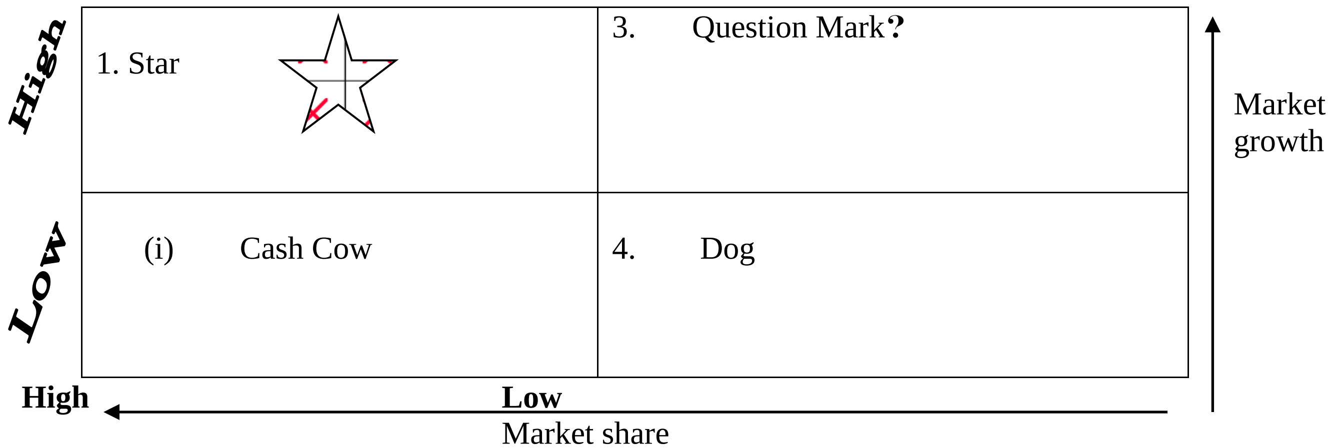
Critique

1. Duplicate work carried out at the design stage of a product.
2. Does require large scale production to show it off to the greatest advantage.

A product's life cycle has to be monitored and growth strategies enhanced. One way of monitoring the product is through the Boston Consulting Group's Share Matrix as shown below:

4.19. <u>The Boston Consulting Group's share matrix</u>

Relative market share



Boston Matrix

Is a portfolio planning method that evaluates a firm's strategic business units (SBUs) in terms of their market growth rate and relative market share.

The underlying principle is the generation and management of cash within a business. The relative market share is seen as the predictor of the product's capacity to generate cash and market growth is seen as a predictor of the product's need for cash.

Question marks

High growth and low market share.

1. Term is well chosen because the company has to think hard about whether to keep pouring money into the SBUs.
2. The management has to decide which ones to build unto stars and which to phase out
3. The products require a lot of support and commitment, therefore marketing activities must create awareness, encourage dealers to stock the product, encourage first purchase, gain market share, promote sales growth and make the product a market leader.
4. More funds must be allocated to keep up with the high market growth-rate and fight off competitor's attacks and to fund heavy media advertising and sales promotions.

Stars- are high growth and high market share products

1. They will have started to shine in their market segments by showing high profit potential
2. Management's primary concern should be sales growth, encouraging repeat purchases and making the product a market leader through heavy media advertising.
3. They usually need heavy investment to finance their rapid growth but eventually growth slows down and they turn unto cash cows.

<u>Cash Cows</u>

1. Products with high market share and low market growth
2. Like a cow which supplies milk, these products supply cash to pay company bills, to support stars, question marks and dogs which tend to be cash-hungry.
3. These are established and need less investment to hold market share.
4. Management should strategize to maintain market share, encourage repeat purchases and promote brand loyalty.
5. Management must be concerned with product improvement, research and development, product innovations and modifications, new packages.

<u>Dogs</u>

1. Are low growth and low market share, businesses/ products that generate enough cash to support themselves but do not promise to be large sources of cash.
2. They are in the decline stage.
3. The best strategy is to harvest and move out of the business.
4. For a little while they can be maintained while researching and developing alternative replacements.
5. The products can be sold as loss leaders

<u>Importance of the Boston Matrix</u>

1. A valuable tool for analysing a firm's product range and helps to identify strengths and weaknesses.
2. It can be adapted to forecast the position of the firm's products at some point in the future
3. Strategies can be developed for each product.

4.20. <u>Ansoff Matrix</u>

1. Is a planning framework used to identify market opportunities and strategies to follow. It is also referred to as the product/market expansion grid.
2. The Ansoff matrix identifies four courses of action open to a firm.

	Existing Products	**New Products**
Existing markets	(1) Market Penetration	Product development
New Markets	(2) Market Development	Diversification

4.21. Market Penetration

Takes the form of increasing sales of existing products in existing markets. As there is no change in either product or type of customers the additional sales are only possible by changes in market strategy (price, promotion channels of distribution). The aim is to increase usage among-existing customers or to encourage people to switch from other brands.

This strategy will be pursued when, the overall market is growing, the company is in a strong market position and the company is unable or unwilling to invest in new products or markets.

4.22. Product Development

Means selling new products to existing markets. It is a strategy that will be adopted if there is growth in the market, the company holds a high share of the market and enjoys a distinctive competitive advantage, the changing needs of customers demand new products and the company is strong in Research & development.

4.23. Market Extension/Development

Involves selling existing products to new markets such as a new segment or new markets in a geographical sense (new regions and new countries). This strategy will be adopted for the following reasons, the company's distinctive advantage lies with the products and it also has strong marketing competence, the company has identified new opportunities such as repositioning the product or developing new uses for it and the company's resources are structured to produce a particular product or product line and it would be very costly to switch technologies.

4.24. Diversification

Means developing new products for new markets. The reasons for pursuing this policy are, objectives can no longer be met without diversification, the company has large amount of cash in reserve, diversification promises to be profitable to avoid dependence on a single product to strengthen existing products by synergy, to compete on all points with a rival firm and to take advantage of downstream opportunities such as by products.

4.25. Marketing Plan

Is a plan which focuses on a particular product and or market and details the resources, strategies and programmes for achieving the products objectives in that market.

Strategies are broad statements of the action to be taken to achieve the objectives identified in the plan. Marketing strategies are all the methods used by an organisation to achieve its long term marketing objectives. They specify a target market (a group of customers to whom a company wishes to appeal) and marketing mix (the controllable variables the company puts together to satisfy this target group.

Marketing strategies are expressed in terms of the elements of the marketing mix.

1. Product- This item is deals with product range, quality, degree of standardisation, market positions, branding, packaging,
2. Price-This deals with skimming, penetration, differentiation, terms and conditions.
3. Promotions-This deals with how the company informs the market about its products advertising selling, sales promotion.
4. Place- This deal with how the company's products reach the market. channels of distribution, delivery, direct and indirect

The first component involves a diagnosis of the present situation in relation to the product, company and market which is a marketing audit. The audit is divided unto four components i.e. the general business environment, the market environment for the particular product, the competitive environment in relation to major competitors and an internal audit of the company and its marketing policies. The audit reveals strengths, weaknesses, threats and opportunities. The second component is a statement of the marketing objectives together with the overall corporate objectives which include market share, sales revenue, market penetration and contribution/profit. The third component is the heart of the plan as it details strategies and tactics for getting there. Strategies are the broad outlines of the methods' to achieve the aims and tactics are the specific programmes of action to be taken to make the plan work. The final part of the plan builds in a mechanism for evaluating progress towards the achievement of the marketing goals. The aim of these is to assess performance and where necessary take corrective action either by changing strategy or by revisiting the marketing objectives in the next planning cycle.

4.26. Product Strategy

The decision must be on how extensive the product line and mix will be. A product line example can be that of soap products marketed by Uniliver and cosmetic products by Kubi. A product mix is the sum total of the different product lines that are manufactured or marketed by an organisation.

4.27. Product line Strategies

(1) Product line breadth and depth

Breadth- refers to how many different products and how many variants of those products a firm attempts to market simultaneously.

A firm could achieve greater productive line breadth by marketing a large range of different types of products which can be designed for different demographic target markets e.g products for men, women and children.

Product line depth- pursued when a firm offers wide variety of choices of the same product type: Uniliver provides consumers a choice of different both aid wash soaps

Breadth and depth allow a firm penetrates different segments with similar products. Products in the live are designed with a slight difference to satisfy varying consumer needs and desires.

4.28. Product lines expansion and Contraction

It involves the addition or deletion of a product firm the company's line of offerings. Decisions to eliminate a product line is influenced by profitability, cost of production, changes in consumer tastes and demand and competitive pressures.

4.29. Product Positioning

-Is to identify a unique niche that a brand can occupy relative its competition. It is also defined as the act of establishing and communicating the product's key distinctive benefits in the market so that it fits an image or space in the consumer's mind relative to competing products.

4.30. Positioning Strategies

(1) Direct Competitive positioning

Identify a position for the company's product based on a assessment of competitor's products. Ideally a firm will be able to find a unique position within the competitive realm where the product is distinctive and clearly different from competing brands.

(2) Target market positioning- the target market and its preferences drive the decision making, demographics, life style factors or product use characteristics cans serve as basis for a target market positioning strategy. Through assessment of consumer choice criteria, consumer perceptions of brand features and preferences for brands currently marketed based on these features, firms can identify gaps in the market. The gaps represent areas of opportunity for new brands.

4.31. Product Differentiation

-Is creating in the minds of consumers a perceived difference between the firm's product or services and that of the competitors. The product can be differentiated through better performance, product size, ingredients, durability, reliability, warranty and price.

Differentiation gives a product an identity and helps to differentiate a firm's product in the minds of the consumer.

4.32. Classification of consumer goods

Consumer goods can be classified into convenience goods, shopping goods and speciality goods.

4.33. Convenience goods

<u>Characteristics</u>
1. These are consumer goods that customers purchase frequently.
2. They are lowly priced
3. Consumers exert minimum effort to purchase such goods.
4. there is a wide variety of such goods

Example: tobacco, soap, newspapers.

<u>Shopping goods</u>

<u>Characteristics</u>
1. Customers do a lot of shopping around (i.e. comparing prices) before they make a final purchase decision.
2. Customers' characterises on bases such as suitability, quality, price and style.
3. They are not frequently bought and hence customers exert a lot of effort to purchase such goods.

Examples; Furniture, clothing and major electrical appliances

4.34. Speciality goods

<u>Characteristics</u>
1. They are goods that are frequently bought
2. They have unique characteristics as brand identification for which a significant group of buyers are habitually to make a special purchase effort
3. Customers will not settle for a substitute product sought for is not available
4. These goods are extremely expensive to maintain on certain status in society.

Examples BMW cars, special photographic equipment, home computers

<u>Elements/Features of the marketing strategy</u>

a) Careful planning in terms of objectives
b) Sufficient resources to market the product successfully.
c) Good market research to define segments and locate them.
d) Good approaches to the state and to contact within the economy
e) Careful study of the competitors within the market
f) Honing the product to the specific needs of the market: culture etc
g) Pricing effectively
h) Promoting within the moves of the culture and the need of the defined segments
i) An effective distribution method appropriate to the market
j) A well-developed image in the market: customer care, after sales service, door to door delivery.

4.35. Market segmentation

Marketing Segmentation – is the division of the market into sub units, which respond in the same way to marketing offerings or which have similar needs. The similarity should have a marketing significance. For example if the buying behaviour of a group is distinctive this becomes important to a marketer.

For segmentation to be successful the market should have the following characteristics.

1. The subunit should portray the same behaviour.
2. The segment should be sustainable and profitable. For examples it would not be profitable for a company to target a segment of people who are left-handed because the market maybe too small and cannot sustain the organisation.
3. The organisation should have enough resources to meet the requirements of the targeted segment.

4.36. Bases of segmenting markets

1. Geographic difference.
2. Demographic difference.
3. Psychographic difference.
4. Behavioural segmentation.

4.37. Consumer markets.

The level of disposable income of a consumer determines to a large extent the choice of goods and services.
The consumer's socio-economic class, for example upper class, can also influence the consumer's buying behaviour. Demographic factors such as gender, income, age and occupation also influence the buying behaviour of consumers. Geographical factors – The place or area, in which the consumer stays can also shape the purchasing pattern and types of goods bought. People in rural areas portray different purchasing behaviour to those in urban areas though the income maybe the same.

4.38. Industrial markets

These are classified according to the following company behaviour.

1. Type of business of the organization-
2. Size of the organisation
3. Size of purchase
4. Service requirements
5. Location

4.39. Targeting segments

After segmenting the market the organisation should then decide on whether to target one segment, select a few segments or the whole market. Those are the three strategies faced by a company. The choice of strategy will depend on resources available and on the capacity of the company.

4.40. Targeting Segments

Target marketing is the process of selecting one or more segments to enter. It helps the producers to identify marketing opportunities better by developing the right and best offer for each target market instead of scattering the marketing effort.

4.41. Target Market Strategies

Mass marketing/Undifferentiated marketing
It ignores existence of segments and offers a single mix to the heterogeneous market. The failure to target is likely to result in disappointing level of sales, short gun approach with most of the shots going astray.

4.42. Differentiated Marketing

A separate mix is developed for each segment of the market. For example banks and building societies have developed different accounts to suit the needs of different types of customers.

<u>Concentrated/Focus or Single target Marketing</u>
A particular segment's targeted. The product cannot be available to people outside the target segment which targets a particular segments refers to the targeting of a narrow group of customers.

<u>Niche Marketing</u>
Is about concentrating on a narrow product range

<u>Competition within market</u>
Competition between firms can be on product, price or through new price competition e.g product image, quality, after sales services and promotion. Firms compete to supply a market to achieve the following;

1) To increase their customer base:- i.e to increase the number of customers buying their products.
2) To increase sales:- existing customers should buy more goods or services.
3) To expand market share:- its proportion of total sales on the market.
4) To achieve product superiority:- making a product that is clearly better than rival products for reasons of prestige and profit.
5) To enhance image:- customer's perception of an organisation is reflected in sales where a good image helps to expand sales and market share.

4.43. Types of Competition

Price Competition

Cutting price can expand consumer demand although it will reduce the margin between revenues and costs. If a firm is to be in a strong position to compete on prices it must try to reduce its costs by increasing the productivity of its resources. Penetration pricing- involves setting product price low to encourage sales.

<u>Destruction pricing</u>

Large firms when treated by new competition from smaller organisations try to destroy the sales of competitors by setting price very low even below costs and sustaining a loss for a short period of time, thus pushing out of the market, smaller firms.

<u>Non-price Competition</u>

Consumers do not only look for low price but for value for money in terms of the quality of the goods or service, its shape or size, colour, smell or taste. Consumers look for after sales care in case they leant to exchange a shoddy product. Promotion is important if consumers are to be tempted to buy one product rather than other e.g. free gifts, money off coupons, attractive in store displays and publicity in magazines can persuade consumers to buy.

<u>Market Structure</u>

Refers to the amount of competition among rival firms supplying a market Competition in a market affects an individual firm's ability to influence the market price for their products. The more competition a business faces from firms making similar products, the less scope it will have to influence prices.

<u>Types of Market Structures</u>

Monopolistic Competition

Producers try to differentiate their products so that they become monopolies in their own brands. It is achieved through brand-making differences in the design and packaging of products as well as the creation of different trade names and product images through advertising. Building consumer loyalty to a product reduces the effectiveness of price cuts & advertising as ways to lure customers away from rival firms.

<u>Oligopolistic competition</u>

1) Oligopoly exists if a small number of large firms dominate the supply of a particular good or service to a market.
2) Firms that dominate the market will tend to price their products in line with each other to avoid price wars.

3) Cartels which are formal agreements between firms to regulate prices/output are formed. There is price stability in oligopolistic markets so they tend to be used by aggressive non-price competition for consumers and market share. Oil suppliers, retailers and the communication, Industry in Zimbabwe are examples of oligopolistic markets.

<u>Monopoly</u>
1) A pure monopoly is a sole supplier of a good or service wanted by consumers. A monopoly can be any firm or group of firms acting together and supplying 25% or more of a market.
2) Monopoly faces little or no competition and is therefore able to keep profit levels high by setting a high price for its product.
3) Monopolies are prices makers since they can restrict on supply to a market to force up the market price, however, the monopoly must prevent new firms from entering the market.

4.44. Arguments in favour of segmentation

There is less waste as resources are used more efficiently. It gives the company a competitive advantage in a particular segment. It enables small firms to concentrate their effort on one segment. Products can be tailored to match the requirements of the market. Marketing strategies are targeted.

4.45. Arguments against segmentation

More resources are required to develop differentiated products.
Higher promotional and administrative costs.
The organisation may fail to segment the market properly.

4.46. Market Research

Marketing research involves the systematic and objective collection, analysis, evaluation and presentation of information relating to markets and marketing which helps management in making informed decisions.

The difference between marketing research and market research
Marketing research is concerned with the effectiveness of a marketing strategy, while market research concerns the demand for the product.

4.47. The elements of marketing research.

1. **Market research,**
   Market size
   Geography of the market
   Customer profile
   Future and potential markets
   Customer behaviour
   Market segments

2. **Product research**
   -Evaluation of strengths and weaknesses of existing products.

Investigation of new uses for existing products
Product variations
- Packaging research.
Sales potential of new products
Product development
Research into pricing policies

3. **Sales research**
   -Examination of selling activities by outlet, territory and agencies.
   Evaluation of sales methods
   -Measurement of the effectiveness of sales people.
   Planning of sales calls
   Analysis of distribution system
   - Identification of suitable outlets.

4. **Promotion research;**
   Analysis of the effectiveness of promotional activities
   Media research
   Copy research, formulation of advertising themes

5. **Business economics;**
   -Research into the macro and microeconomic environment.

6. **Export marketing research;**
   -Research for exports markets.

7. **Motivation research;**
   -Analysis of motives that condition customer responses.
   -Customer perception of value.

8. **Competitor research;**
   -Research into the activities of competitors.
   Market share
   Trends
   - Identification of unique selling points.

4.48. Marketing research methods

- **Secondary research** - involves studying existing information, which was gathered for a certain different purpose. Secondary data can be found within an organisation itself or outside the organisation.

Sources of internal data are:
Sales records
Accounting records
Customer complaints book.
Quotation books
Invoice books
Company reports

Previous researcher

Sources of external data are:

Newspapers
Central Statistics Office (CSO)
Banks
Trade associations
Professional bodies
Chambers of commerce

4.49. Advantages of secondary research

- Information is gathered quickly.
- It is cheaper to gather the information

4.50. Disadvantages of secondary research

- The information may not apply to the current problem since it was gathered for a different purpose.
- The information might be stale due to the ever-changing business environment.

4.51. Primary Research

This involves the collection of new information on the current problem facing the firm. The research uses questionnaires, consumer panels, discussion groups, opinion polls, test marketing, retail audits, observation, and motivational research.

4.52. Advantages of primary research

- The data is collected specifically for the current problem.
- The information collected is up- to- date.

4.53. Disadvantages of primary research

- It takes time to gather the information and thus delaying the decision making process is delayed.
- It is expensive to collect information

4.54. Types of data

- **Quantitative data** is data, which is quantified. For examples, how many consumers are in a particular market and how much they buy.
- **Quantitative research** is data, which cannot be quantified. For example, consumer attitude and why consumers buy a given product.

4.55. The research process

Definition of the problem: Research project should start with a statement of its objectives such as a hypothesis that is to be tested.

I. Analyzing secondary data: Before a business collects primary data it should review secondary data. This helps the company to have an insight to the problem and to design the questionnaire.

II. Selection of primary data collection methods: The research should select the most appropriate method of research. In making the choice, consideration should be given to relative costs, time available, type of information required, the type of people to be investigated and the degree of accuracy required. There are three basic techniques of field research namely survey, observation and experiments.

III. Decide on details of research techniques: In this stage the research should decide the sampling methods, the data collection method and the questionnaire design.

IV. Analysis, interpretation and evaluation of the data: After collecting data, conclusions must be drawn. The research should make use of statistical theories to analyses the data.

V. Conclusion and recommendations: The last part of the research is to pass recommendations on strategies to be implemented.

4.56. Methods of collecting primary data

1. Observation: This is the collecting of information without asking people but by simply watching their behaviour. Observers can be employed in and outside shops to see how they use the product after purchase.
2. Experiments: This technique is used to assess the response of consumers to changes in the marketing mix, e.g. adverting, packaging, price and distribution methods.
3. Focus groups: – This involves a group discussion in which people are encouraged to freely express views and opinions on a selected subject. This can be used to determine attitudes and motivations.
4. Surveys can be delivered in any of the following ways;
   Personal interviews
   Postal survey
   Telephone survey
   Panel survey
   Group interviews

4.57. Questionnaire design

The following principles should be taken into consideration when designing a questionnaire

-Clarity and purpose of the enquiry
- Devise clear, unambiguous questions
-Use language, which is simple to the respondent.
-Avoid leading questions
- Avoid difficult questions
- Avoid sensitive questions
- Ask only questions which are within the knowledge of the respondent.

4.58. Types of questions

- Closed questions: – Those questions give the respondent a guideline or the choice of words to use e.g. yes or no, high or low and so on
- Open questions: – The respondent is given room to answer in their own words influenced by guidelines. The main forms of open questions are:

"What do you think about DVDs?"
Word association:" What is the first word that comes into your mind when you think of DVDs?" Sentence completion: The main factor I take into account when buying a radio is.
Story completion.
Picture completion.

4.59. Sampling in marketing research

Sampling is the selection of the part of the population to be asked. If the population is small, the organisation can survey the whole population. A survey of the whole population is known as a census. Researchers sample the population for the following reasons:

1. To reduce costs
2. To save time
3. To conserve resources
4. Is more reliable as there is a concentration on fewer units

a) <u>Survey</u>

Objective of the survey

1. To ask the information required and whether a survey is the best method of obtaining it.
2. Precise definition of the problem is necessary so that the firm does not waste time, money and effort gathering irrelevant data.

4.60. Survey population

-Refers to the group of people who are included in the survey. It is normally too large for effective surveys to be carried out.

4.61. Sample size

- It is not possible to gather the information required from every member of the survey population so a sample or sub group is selected to represent the whole group.
- Large samples may produce reliable results but they are more expensive and may be impractical while a small simple will result in invalid results. A firm needs a balance between cost and reliability in deciding the sample size.

4.62. Forecasting

Is an attempt to predict the future behaviour of a variable and provides a basis for planning.

4.63. Qualitative Techniques

Depend on human judgement and experience and are used when data is scarce or unavailable e.g a newly introduced product, the time frame is so long that is of limited use.

4.64. Delphi Method

Involves a panel of experts responding to questionnaires and experts are asked independently and the response of each expert are presented anonymously to other panel members until a consensus emerges.

Panel consensus- a panel of experts discuss issues to arrive at a consensus forecast.
Market survey- in the absence of data, judgement is required in survey. Ask consumers about their present and future personal finances and their expectations about the economy.
Historical analogy- a model is used to understand likely trends in the demand of a product. The performance of one product provides an analogy of a product. The performance of one product provides an analogy to predict trends in a similar product. For example the product life cycle shows stages through which product pass in their life. A similar product's trend can be predicted as long as its stage of life is established.
Personal insight- forecasts are based on individual judgement.

4.65. Quantitative Methods

Time Series Analysis

A time series is set of data recorded over the uniform periods and show how a variable behaved over time. The data is decomposed to show a pattern which becomes the basis for predicting trends into future. If data is plotted on the graph an underlying trend is observed e.g upwards, constant or downwards and some fluctuations around the trend. The long term movement of a variable is known as a trend but around the trend there are fluctuations

- Seasonal fluctuations- are regularly repeated fluctuations associated with seasons of the year, days of the week or hours of the day.
- Cyclical fluctuations- these occur in a repetitive cycle but over a medium term period e.g business cycles of boom slump.
- Random Variations- these occur as a result of a major disturbance such as war. These are erratic rather than regular.

4.66. Moving Averages

1. Is one that is updated as new information is received
2. By calculating a moving average, it is possible to smooth out the data and isolate the trend from the fluctuations.
3. Moving averages can be calculated for periods with even number of periods or odd e.g 7 point moving average, 12 point moving average.
4. A period of one year can be divided into quarters and produce a four-period moving average based on the same data.
5. The greater the number of periods in the moving average the greater will be the smoothing effect.
6. The moving average is always centred, with even number of periods it should be placed in the centre of the year.
7. A centred moving average is also calculated by averaging the two moving averages shown at the boundary of each month. With odd number of periods the complications is not present.

4.67. Extrapolation

Having calculated the centred moving average for each month, we can depict the data on a graph and a trend line is identified. The trend line can be projected forward into the future in a process known as extrapolation. The validity of the technique is based on the assumption that the trend will continue.

4.68. Sampling methods

Sampling methods can be divided into two broad types
1. Probability or random sampling
2. Non probability or non random sampling

4.69. Probability sampling

In this method every member of the population has a known chance of being selected. There are three types of probability samples:
1. Simple random sample:- An example could be pulling names from a hat. In this sample each person or unit has an equal chance of being selected.
2. Systematic sample:- This involves choosing a starting point in a sample frame and then selecting every n^{th} item.
3. Stratified sample:- In this method the population is divided into subgroups and the sample reflect each subgroup in proportion to their representation in the population as a whole.

4.70. Non probability sampling

Non probability sampling involves human judgment. Examples of non probability-sampling techniques are:
1. Cluster sample: - This method is used when the population is widely dispersed and a full sample frame is not available.
2. Quota sample:- Involves dividing the population into subsets taking into consideration characteristics such as tax, income, occupation, and so on. This is also used when the sample frame is not available.
3. Multi – stage sample: - This involves taking a series of samples from successive stages such as region, town, and then suburb.

4.71. Developing the marketing mix

A marketing mix is the set of controllable tactical marketing tools, which encompasses product, price, place and promotion. A firm uses the mix to win the target markets to achieve high sales and profits.

4.72. Product

This refers to goods and services, which an enterprise offers to the target market. Variables to be considered are product variety, packaging, design, brand name and size. Product is anything that can be offered to a market for attention, acquisition, use or consumption to

satisfy a need. The benefits of the product are those characteristics consumers see as potentially meeting their needs. Examples are rest hopes peace of mind and convenience.
The actual product consists of fine characteristics namely quality level, features, design, brand name and packaging. The augmented product is intended to provide additional services and benefits and it included after sales services, warrants, delivery, credit and installations.

4.73. Packaging

1. Involves decisions regarding the design of the containers or wrappers for a product. Packaging can make a product more important, convenient to use or store. It prevents spoilage or damage.
2. Good packaging makes a product easy to identify and promotes the brand at the point of purchase and even in use.
3. Packaging has an effect on promotional strategy- it carries the brand name and communicates the name to the consumer.
4. Packaging plays a critical role of differentiating a manufacturer's product from competitors.
5. Providing packages of different sizes enables firms to serve the needs of different segments. E.g Victoria has different packages for mealie meal 50kg, 20kg, 10kg, 5kg, 2kg and1kg.
6. Packaging serves the basic purpose of protection for the product thus reducing the firm's liability for damaged goods.
    a. Customer dissatisfaction is also reduced from damaged or spoiled products.
7. Packaging creates a perception of value for the product with the package e.g perfume manufacturers often have greater packaging costs to ensure that the product projects the desired image.
8. Easy to handle packages reduces costs by speeding price marking, improving handling and display and saving space.
9. Resalable and no-spill packages prevent waste.
10. Some packages are re-usable –thus stimulate repeat purchase as the consumer attempts to acquire a set of the containers.

4.74. Criticisms of Packaging

1. It depletes our natural resources although this can be offset by some companies who are recycling materials.
2. It adds considerably to the total cost of the product.

The costs are passed on to consumers in the form of higher prices.

3. It poses health hazards.
4. Packaging can be deceptive when attractive pictures of how the product can be served are used.
5. Some packages conceal or downsize the product, giving consumers less for the money.

4.75. The roles of packaging in the marketing of a product.

1. -packaging reinforces the brand image
2. -aids promotion.
3. -preserves the contents.
4. -contains instructions on how to use the product.
5. -can be used later after the product has been consumed.

6. -makes it easy to handle the products
7. -aids self – service.
8. -can attract the customer.
9. -successful marketing of future products (family packaging)
10. -helps to build brand loyalty and fight competition.

4.76. Limitations of packaging in the successful marketing of a product.

1. -packaging is expensive and increases the prices of the final product.
2. -legislative prohibitions.
3. -Some types of packaging can be provocative and impact negative by on the successful launch of a product.

4.77. Labelling- related to branding and packaging

Is the wrapping on the product container that carries the brand name and important product use information. It provides instructions for using the product, nutritional information and method of communicating warranties. Use of hazards and warnings are also contained on the label.

4.78. Warranty Policies

1. Warranty explains what the seller promises about its products.
2. For use warranties improve the appeal of their marketing mix.
3. They design more quality into their goods/services and offer refunds or replacements if there is a problem.
4. Service guarantees reduces the perceived financial mix and thus effective in creating repeated purchases.

Price relates to the amount of money that customers have to pay to obtain the product. In pricing a product these factors should be considered: list price, discounts, payments, and period and credit terms.

Place involves the enterprises activities that make the product available to target consumers. Facts to be considered are: channels, locations, stock, transport and logistics.

Promotion relates to activities that communicate the merits of the product and persuade target consumers to buy the product. Facts to be considered are: advertising, personal selling, sales promotion and public relations.

4.79. Pricing strategy.

Approaches to pricing .

There are three broad approaches to pricing which a firm can use:

1. Cost – based pricing.
2. Customer – oriented pricing.
3. Competitor – oriented pricing.

4.80. Cost – based pricing.

This takes into consideration the cost of production or the cost of acquiring the goods, examples of cost – based pricing are:

(a) Cost - plus pricing, which involves the calculation of the full cost of production and adding a fixed percentage mark- up for profit.

4.81. Advantages of cost plus pricing.

1. It guarantees that profits will be made.
2. It is easy to calculate.`

Disadvantages.

1. It ignores demand.
2. It ignores competition.
3. It ignores capital requirements and the return on investment
4. It does not take account of costs, which may vary with volume of output.

Target pricing is whereby the firm determines the level of profit which it intends to get and then work out the price from there.

Marginal pricing- is similar to cost- plus pricing, the only difference being that marginal pricing is based on variable costs and ignores fixed costs. Marginal pricing is commonly used by service industries such as hotels, holiday firms and public transport.

4.82. Customer – oriented pricing.

This is similar to demand based price. It takes into consideration the customers' perceptions rather than the cost of production. Examples of customer oriented pricing are:

Perceived value pricing – this pricing strategy is based on how the firm wants its products to be perceived by the market. This pricing strategy is used to position a product in the market, a price which is consistent with the image of the product.

Price discrimination – this is charging of different prices to different segments of the market. For this to be possible the market should be separated and a higher price is charged in a segment where demand is price inelastic and a lower price is charged when demand is elastic. An example is a transport operator who charges a higher price during peak hours and charges a lower price during off peak hours.

Skimming pricing involves charging a higher price when the product is new to the market and later reduce the price when customers are used to the product.

Penetration pricing involves introducing the product at a low price to penetrate the market and increase the price as the sales volume of sales increase.

Competitor based pricing Prices are based on what other firms in the same industry are charging. This strategy is used in a perfectly competitive market where the product is homogeneous e.g. transport industry. Examples of competitor pricing systems are;

Going concern – charging the same price with competing firms.

Destroyer pricing- this involves charging a very low price to destroy or weaken smaller and less efficient rivals.

4.83. Pricing objectives.

Companies set prices to achieve one of the following objectives:

Profit maximization - To achieve this, the firm will adopt a pricing policy which will be able to cover all costs, fixed and variable.

Target level of profits - this is similar to the above, the only difference being that the firm seeks a certain level of profits rather than the maximum possible level.

To increase share- firms may seek to increase market share even to the extent of sacrificing short – term profits.

Sales revenue maximization- firms may choose to set prices to maximise current sales revenue.

Risk minimization - firms may set a price, which will keep it in harmony with competitors and customers.

Price and quality - it is not always the case that the customer evaluates the product and its quality and decide whether or not it is worth committing money to the purchase of the product. Customers frequently judge quality in terms of price, and assume that high price means high quality and low price means low quality.

Key concepts.

Cost based pricing - a price strategy, which takes into consideration only the cost of production or the cost of acquiring the product and then add a mark – up for profit.

Customer based pricing- a price strategy which is based on what the market thinks or how it market responds.

Competitor based pricing – a price strategy which is based on competitor behavior.

Demand based price - a price which is based on the demand for the product.

Price discrimination- charging different prices on the same product for reasons not associated with the cost of production.

Penetration- prices set low to increase market share.

Skimming- prices set high to maximise profits before competitors enter the industry.

4.84. Revision Questions

1.	What is the role of marketing in (a) business organisations (b) society as a whole?
2.	What is the purpose of market research? Describe some of the methods of market research.
3.	Describe how knowledge of a product's life cycle can help a marketing manager.
4.	How might costing methods be useful to the marketing manager when making pricing decisions?
5.	What is the difference between advertising and promotion?

4.85. Place

A channel of distribution for a product is the route taken by the product as it moves for the producer to the ultimate consumer.

A direct channel- takes the product directly from the producer to the ultimate consumer without the use of a middleman.

Indirect channel- involves one or more middlemen in getting the products from producer to consumer.

4.86. **Consumer of Distribution Channel**

Product Factors

- Perishability.
- Technical nature of the product.
- Unit Value-products with low mark-ups and high units costs need channels.

Market Factors

- Number of potential customers- industrial customers are therefore direct channels.
- Geographical concentration of markets.
- Order size.

Company factors

- Financial strength to maintain own sales force.
- Marketing ability of management.
- Desire for channel control- some producers feel they can achieve more aggressive. promotion, better control of the quality of the goods and better control of retail prices of their products than middlemen would do.

Middlemen factors

1. Middlemen policies- other middlemen will only carry a line of productions of exclusive distributorship.

2. Availability of suitable middlemen is limited- the experienced middlemen may already be carrying lines for competitors.
3. Services provided by middlemen e.g financing function.
4. Variety of products handled –needs a middleman who has extensive distribution coverage.

Physical distribution

- Consists of all activities involved in moving goods from where they are produced to where they are consumed. The physical distribution system is a combination of order processing, merchandise handling, inventory, storage and transportation.
- Good have to be transported to the final destination, at the least cost and have to arrive on their original shape.

4.87. Distribution strategy

Distribution refers to the movement of goods and services from the producer to the final consumer. Between these two ends it is likely that there are intermediary firms involved in the selling of the product.
There are three common intermediaries namely:

4.88. Agents, wholesalers and retailers.

Agents- these are middlemen who are not traders on their own. Unlike retailers and wholesalers, agents act on behalf of someone else called **the principal.** Agents are not common in domestic trade but in exporting. There are many types who act as intermediaries in the chain of distribution.

Brokers- these are agents who arrange deals on behalf of buyers and sellers. For example a Zimbabwean company which exports its products to Britain may employ an agent to do on its behalf.

Factor- factors can own the goods they deal in and can go into agreement in their own names unlike brokers who cannot trade using their names.

Wholesalers- these buy goods in bulk from producers and then sell to retailers or to the final consumers. The wholesaler provides services to both customers and producers. The services provided by wholesalers to customers are:

Breaking bulk - buying in bulk from producers and selling in smaller quantities to customers.
Provide variety- wholesalers buy goods from various producers giving customers a wide selection of goods under one roof.
Storage facilities- wholesalers offer storage facilities, which can help to even the irregular flow of goods.
Wholesalers can offer services such as transport, credit as well as information to customers.

The services provided by wholesalers to producers are:

Marketing - wholesalers help the producer to market his products by advertising, selling, promoting and even creating new markets such as an export market.
Information gathering- wholesalers are in direct contact with customers which this enables them to know the needs and complaints of customers, and the wholesalers can feed this information back to the manufacturer.
Stocking – some manufacturers do not have warehouses, therefore wholesalers often provide this facility to producers.

4.89. Retailers.

Retailers buy goods from suppliers (producers or wholesalers) and sell them to final consumers in shops and other retail outlets. The retailer provides services to both final consumers and suppliers. The services offered by retailers to final consumers are:

- Offer variety of products.
- Break bulk.
- Convincing in terms of location and opening hours.
- Information and advice to customers.
- Transport
- Credit to credit worthy customers.
- Packing.

Services offered by retailers to suppliers are:

-Promoting and advertising goods.
-Information gathering

4.90. Factors which determine the choice of channel.

Nature of products - industrial products are sold through shorter channels whilst consumer products use longer channels.

The market- geographically concentrated markets use shorter routes than dispersed markets with large number of customers.

The desire by the producers to exercise control- if the producer wishes to exercise control he will distribute through its own retail outlets or dealers.

Markets adopted by competitors- a firm can copy the methods used by a competitor or can come up with its own unique strategies.

Services are usually sold direct.

Intensive *Versus* selective distribution.
Intensive distribution allows any possible stocker of goods to distribute the producer's products. This is done for reasons such as to increase

- market exposure.

- market share
- sales revenue.

Selective distribution is whereby the producer restricts the number of stockists of the product. Selective distribution is used when:

- The customer requires after- sales service.
- To build a unique status of the product.
- The producer wishes to control intermediaries.
- The market is small
- Intensive distribution would result in conflict between intermediaries

4.91. Push vs. pull strategy.

To move goods through the channel one or two strategies can be used. Push strategies are aimed at intermediaries. Push strategies include the following:

- Discounts.
- Dealer completions
- Point of sale displays.
- Incentives for sales staff.
- Trade advertising.
- Trade exhibitions.

Pull strategies are focused on the final customer. They includes:

- Advertisements direct to customers.
- Customer competitions.
- Cash discounts.

4.92. Direct marketing

Direct marketing includes all methods in which producers approach customers directly rather than using the middleman. Examples of direct marketing are:

- Direct mail.
- Telemarketing.
- E- mail

4.93. Promotional strategies.

Promotion refers to any communication, which is aimed at creating or increasing the demand of a product. This includes advertising, personal selling, sales promotion, public relations and publicity.

4.94. Advertising.

Advertising involves the use of various media to pass a message about a product or a service. Advertising is non-personal and is directed to a number of people.

4.95. Types of advertising.

Informative advertising - this is designed to provide information, which is useful to the public. For example a firm may wish to inform the public about its change of address.

Persuasive advertising - this is deigned to persuade consumers to buy more of a product.

Generic advertising - this occurs when producers in one industry collectively advertise a product in general rather than their own particular brands.

4.96. The cause for advertising.

- Advertising is informative.
- It allows consumers to make a more informed choice.
- It acts as an aid to product identification.
- It is part of the competitive process.
- It helps to introduce new products.
- It helps to increase sales and profits of the firm.

4.97. Criticisms of advertising.

- Advertising raises costs and therefore prices also increase.
- It may mislead people to buy unnecessary products.
- It can be used by monopolies.
- Advertising exaggerates the performance of a product.

4.98. The different forms of media.

A media is where an advertisement is to be placed.

Newspapers.

A newspaper can be daily, weekly, monthly or quarterly. Examples of daily newspapers are: The Herald, The Chronicle, and The Daily Mirror.

Advantages of newspapers.

1. High coverage.
2. Flexible.
3. Relatively low cost.
4. Geographical selectivity.

Disadvantages of newspapers.

1. Short life.
2. No movement or sound.
3. Problem of attracting attention.

Television.

Advertisers can buy airtime on television.

Advantages of using television.

1. There is sound, sight and motion.
2. High coverage.
3. Demonstrations are possible.

Disadvantages of using television.

2. High cost.
3. Short life.
4. Cannot refer back.
5. Audiences can use remote controls to turn off adverts.

Radio.
Radio advertisements can take three forms:
- Short announcement.
- Sponsored advertising.
- special short - term flash announcement.

Advantages of radio advertisements.
a) Reaches a wider coverage.
b) Selectively, different channels can be used to target a specific segment of the market.

Disadvantages of radio advertisements.
(i) The adverts tend to be short.
(ii) No visual stimuli.
(iii) Low attention.

Magazines.
Magazines are the second type of print media.

Advantages of magazine advertisements.

- Targets selected audience.
- Relatively long life.
- High pass along rate.

Disadvantages of magazines.

- High cost.
- Low in flexibility.
- No sound or movement.

Other media types are:

Direct mail.
Outdoor media.
Cinema.

4.99. Factors which determine the choice of media.

The reach of the media - that is the proportion of the target audience which a media can reach.
Readership - this applies to point media and refers to the number of audience exposed to the advert.

Circulation - this also applies to print media and it refers to the number of copies sold out. This does not include pass along.

Selectivity of the media - the ability of the media to target a specific market.

Relative cost - the cost of a media per thousand of population.

Impact of the media - this is the extent to which the message is effectively taken.

4.100. Advertising agencies.

Some companies undertake their own advertising, while others use advertising agencies. Advertising agencies perform five main functions:

- They carry out research.
- They select and book the appropriate advertising media.
- They create advertisements, devising appropriate themes and messages.
- They produce the advertisements.
- They look after the client's advertising budget.

The benefits of using an agency.

- Access to the specialist expertise of the agency staff.
- Use of contacts of the agency.
- Expect advice.
- Low prices.

4.101. Sales Promotion

Is a bridge between advertising and personal selling which is used to coordinate and augment efforts in the two areas.

Sales promotions are short term incentives to;

- Encourage purchase, introduce new products, boost sales of products, challenge competition and communicate with customers as an alternative to media advertising
- Advertising offers reasons to buy and sales promotions offer reasons to buy now.

Advantages of Sales Promotion

- Bring the product closer to the customer.
- Encourage stocking by retailer as a result of newly created interest in the product that might have lost favour.
- Draw attention to new or modified products.
- Encourage customers to make first purchases especially brand switchers.
- Can induce impulse buying and creates good will for the company.

Disadvantages of sales promotions

- Encourage customers to be "Clerry pickers" that is only buy products with offers thereby leading to the erosion of brand images.
- Do not build long term preference and loyalty.
- Can demean product images if used carelessly.

4.102. Sales promotion tools

These depend on the market type, sales promotion objectives, level of competition, costs and effectiveness of each tool

Consumer tools	Trade tools	Sales contents
- Samples	- Discounts	- Trips
- Coupons	- Allowances	- Cash prices
- Cash refunds	- free goods	
- Price packs		
- Premiums		
- Contests		

4.103. Personal Selling

1. Is any form of personal communication and presentation between the seller and buyer
2. It is used for high technical products, unsought goods and services like insurance and new product introductions.
3. The personal contact allows for giving product details answering questions, demonstrating, concluding sales, image building, creative selling and delivery of the product like in the door to door sale of fresh milk.
4. Personal selling can be used as a research tool by encouraging sales people to provide feedback on customer attributes, changing needs, competitive activities and other environmental issues.
5. The main disadvantage of personal selling is that it is expensive. To get the best personal selling management has to make critical decisions on sales structure, size and compensation, recruitment and supervision, training and evaluating performance.
6. In terms of compensation, most firms use a mixture of salary and commission.

The activities of the sales staff:

i. Obtaining orders
ii. Offering advice.
iii. Demonstrating the product.
iv. Showing samples.

v. Handling complaints.
vi. Delivery.
vii. Presentations.
viii. After- sales services.

4.104. Public Relations/Publicity

1. Is a relations building tool between the firm and its various public to build, maintain and improve the firm's image.
2. Public Relations uses press relations, lobbying and counselling tools to achieve set objectives.
3. Good news about a firm can be picked by different media at no cost to the firm and is more credible than advertising.
4. The worthy news about a firm or its products for which the firm has not paid for is commonly known as publicity.
5. A firm can also suffer bad publicity, news reports about a firm mistreating its customers, damaging the environment or its management getting involved in shady deals can destroy the firm's reputation and image.

4.105. Typical examination questions

Structured questions

1. Demand for sugar is price inelastic. What is the significance of this for Zimbabwe Sugar Refinery when considering a change in the price of sugar? [3]

2. A bakery decided to increase the price of bread from $5 000 to $10 000. As a result, sales fell from 1200 to 900 per week. Calculate the price elasticity of demand for bread. [3]

3. Examine the factors, which might influence the demand for a product. [6]

4. Explain the following terms as used in the Ansoff matrix:
    a. Market penetration [3]
    b. Market development [3]
    c. Product development [3]
    d. Diversification [3]

5. What problems are faced by producers in developing new products? [6]

6. Outline the circumstances under which contribution pricing is most likely to be used. [6]

7. Examine any two factors that will influence the effectiveness of advertising.[6]

8. How would you justify the argument for the charging of different prices for different customers. [6]

9. Briefly explain the factors that will influence the choice of a distribution channel. [6]

10. Suggest and explain three factors that might influence the price charged for a product. [6]

4.106. Essays questions

11. Explain the factors, which should be considered when choosing an advertisement media? [15]
12. What do you understand by the term promotional mix? [10]
13. Discuss the defense and the criticisms of advertising? [15]
14. Evaluate the following pricing strategies:
    a. Contribution pricing

	b. Skimming pricing [25].
15. Footwear for Comfort is a foreign company that sells different types of footwear. This firm has shown interest in locating in your country. Advise the managers of Footwear for Comfort on the marketing strategy they should adopt to successfully sell shoes in your country. [25]	
16. How might market segmentation be used by:	
	a. A manufacturer of dresses
	b. A retailer of dresses [12]
17. Explain why the concept of segmentation may be of value to the marketing department of a large business producing dresses. [13]	
18. What is market research? [5]	
19. How might the findings of market research be used by the:	
	a. Marketing department
	b. Production department [20]

4.107. Data response questions

- **Zim-Chem Pvt. Ltd.**

Zim-Chem was formed in Zimbabwe by Dox and Cox, who are both science graduates from NUST. The company is registered and produces household detergents such as dishwashers, sta-soft, pine-gel and carpet cleaners. Zim-Chem's marketing strategy is based on mass marketing and the company has been successful in using the penetrative pricing policy. As competition intensifying, Dox, the marketing manager, has advised that mass marketing be changed to niche marketing. He has suggested that they target large-scale users of detergents like colleges, boarding schools and hospitals. However, Cox has rejected the proposal arguing that extensive market research might be necessary which will be very costly.

Dox has proposed that they issue shares to their friends to raise funds to finance market research. Cox however has suggested that they get a long –term loan from the bank. There have been rumous that the government will increase interest rates as a measure of dealing with inflation.

1. Define the following terms:

1.0. penetrative pricing [line 10] [3]

1.1. market research [line 19] [3]

2. Explain the difference between mass marketing and niche marketing [6]

3. Suggest any four possible techniques of collecting market research data Zim-Chem Pvt. Ltd. can use. [8]

4. Evaluate each of the options of raising finance that are mentioned in the passage. [10]

Khwezi Supermarket

Khwezi is an organisation that uses a market-oriented approach and thus focuses on the needs of its customers. Khwezi is a supermarket, which responds to the demands of marketing, and its philosophy is based on the belief that the customer forms the starting point for the development of the organisation's corporate strategy.

The success of Khwezi supermarket is based mainly on the right mix of factors to meet conditions in the target market at a particular time. Managers of Khwezi supermarket have realised that consumer's wants vary across the whole market and have thus segmented the market.
This has enabled them to develop various marketing mixes to meet the needs of the various market segments. Khwezi supermarket uses a cost plus pricing policy. The supermarket has implemented all the five promotional activities. However, advertising has shown to bring very good results in altering customer attitudes.

1.(a) Explain the term 'market- oriented' approach. [3]
2.Suggest the various ways Khwezi supermarket can use to segment its market. [5]
3.(i) What is a marketing mix? [3]
(ii) Suggest two elements under each 'P' of marketing. [5]
(b) Evaluate the pricing policy used by Khwezi supermarket. [8]
(ii) Outline the five promotional activities Khwezi might have used to promote its products. [5]
(c) What is advertising? Suggest three types of media that can be used for advertising. [6]

Guide Dube Pvt. Ltd

Guide Dube Pvt. Ltd is a company that was formed five years ago. The company produces stationery and the marketing strategy is based on mass marketing. Guide, the Marketing Director, has suggested that a niche market be found and targeted. He has explained that niche marketing will increase sales since a lot of private colleges are opening up around major cities of Zimbabwe.

The following information relates to the costs and revenue of Guide Dube Pvt Ltd.

	$
Direct Labour per unit	11
Variable Overheads per unit	3
Direct Materials per unit	6
Fixed Costs	200 000
Selling Price per unit	30

Market research has indicated potential sales for the coming period of 30 000 units at the current price, or 37 500 units if the selling price were lowered to $28 per unit.

Guide Dube is undecided on which strategy to adopt.
1.(a) Explain the terms: (i) niche marketing [2]
(ii) Mass marketing [2]
(iii) 'Break-even' [2]
(b) At the current production, calculate the Break-Even number of units to be sold. [4]
(c) Advise Guide Dube on whether he should reduce the price to $28 or maintain the price at $30. Show all the working. [10]
(d) Use the Ansoff matrix, to advise Guide Dube to increase sales of his stationery. [10]

CHAPTER 5

OPERATIONS MANAGEMENT.

Objectives

1. To understand the concept of production and added value
2. To understand the different types of production processes
3. To analyse the functions of stock control and contrast traditional stock control with Just In Time (JIT) methods.
4. To understand different approaches to quality control.

5.1. Operations Management Defined

Operations management is concerned with the use of resources (land, labour, and capital) to provide goods and services that satisfy customers' demands. Operations managers are concerned with:

a) Efficiency of operations - keeping costs as low as possible to give price competitive advantage.
b) Quality services - good quality service must be suitable for the intended purpose.
c) Flexibility - desire to adapt to new methods of working and new products.

5.2. The production process.

It involves the conversion of input into output.

INPUTS		**CONVERSION**		**OUTPUT.**
Land Labour. Machinery. Money. Information.	→	Production Process.	→	Goods and services.

The process applies to all manufacturing and services with the aim to add value to input bought by the firm so that the resulting output can be sold at a profit.

Value added- is defined as sales revenue less value of bought in components or materials. The degree of value added to inputs depends on:

1. The design of the product – it applies to economic manufacture whilst having quality features that enable a high price to be charged.
2. The efficiency with which inputs are combined and managed will increase the value added by production process.
3. The impact of promotional strategy and whether this convinces customers to pay more for the product than the cost of the input.

Reasons for adding value

1. To survive and grow which are basic objectives of any organisation.
2. Meet customer requirements which are essential if it is to be successful in the market place.
3. Meet competition which could come from home based or overseas organisations.
4. Improve profit levels which are more likely to happen if the business is operating more effectively and succeeding in meeting customer requirements and beating competition.

Ways of adding Value

1. More effective use of human resources.
2. Improved purchasing and stock control.
3. Value analysis.
4. Better marketing.
5. Improved working condition.
6. Reducing pollution and waste.
7. Investing an physical resources.
8. Investing in training.
9. Investing in research development.
10. Commitment total quality.
11. Raising productivity.

5.3. 5. Value analysis.

Value analysis is the process of analyzing whether a new product or new design can be made more efficiently without affecting its appeal to customers.
Three main features involved in designing a new product are:

Performance: does it have the features looked for by consumers and will it be reliable?
Appearance: is it appealing? Is the appearance of the product appropriate for the market it is aimed for?
Economy of manufacture: can it be made at a low cost level that will allow profits to be made?

Value analysis ensures that the three features are combined by working closely with all departments (marketing, production, and finance) and in particular arriving at the best combination of these.
The process may suggest ideas that allow the product to be made more cheaply and still appealing to customers. This involves suggestions of different types of material to be used in the product that cuts costs and not appearance or performance.
Successful value analysis involves team- work between departments. Comparison with competitors' best products in the market is also necessary.
Value analysis will be worthwhile if the final product turns out to be cheaper to produce than the original design but still offering customer good looks and value for money.

5.4. Production, productivity and efficiency.

Production- it is the measured quantity of output that a firm produces in a given period of time.

Productivity – is a measure of a ratio of output to any of the firm's inputs usually labour and capital. A firm that has become more productive is efficient since productivity is a measure of efficiency.

5.5. Measure of productivity

$$\textbf{Labour productivity} = \frac{\textbf{Total output in a given period of time.}}{\textbf{Quantity of labour employed.}}$$

i.e. output per man.

$$\textbf{Capital productivity} = \frac{\textbf{Total output in a given time / period}}{\textbf{Quantity / value of capital employed}}$$

i.e. output per capital input.

A Company increases productivity by employing fewer but more skilled workers and by using fewer but more technologically advanced machines. Improvements in productivity lead to low costs.

5.6. Raising productivity levels.

Training of staff to raise skills level: staff will be highly skilled and flexible. They should be more productive after training.
Purchase of more technologically advanced machines: modern machinery from office computers to robot-controlled machinery should result in increased output. Such costly investment is only worthwhile if high output levels are being maintained. However in addition to capital costs, staff may need to be retrained and a general fear among workers or loss of job or reduced job security.
Improved employee motivation through participation and fringe benefits.
More efficient management - more efficient operations and people management may go a long way to improve productivity levels. This involves purchasing correct materials e.t.c.
Division of labour.

5.7. Labour intensity vs. Capital intensity

a) Labour intensity: a firm uses a high level of labour input compared to capital.
b) Capital intensity: firm uses a high value of capital equipment compared to labour.

<u>Factors effecting the decision to be capital or labour intensive</u>

a) Financial resources: if a firm has a poor financial base it will rather employ labour intensive techniques, as it can be difficult to purchase machinery.
b) Need for training labour intensive methods will involve a cost of training costs.
c) Capital intensive method tend to more expensive than labour intensive.
d) Need to adjust to the ever changing technological world

5.8. Advantages of capital intensity.

Great opportunities for economies of scale and unit costs reduction offered by large – scale capital utilization.

5.9. Disadvantages.

1. Fixed costs tend to be high and the cost to the firm of financing the equipment can be beyond the reach of many firms.
2. Rapid pace of technological change renders the latest production equipment obsolete and inefficient.

5.10. Capital Utilisation

<u>Definition</u> : it is a process of forecasting demand and then deciding what resources will be needed to meet that demand.

Ways of increasing capacity and utilisation

Sub Contracting - This involves an enterprise increasing its capacity by contracting out other firms. Subcontracting results from the temporary inability of the firm to satisfy customer 's demand from the firm's own capacity. However a lack of faith in the supplier's ability to produce goods of a satisfactory quality will discourage the firm from subcontracting production to others
Scheduling overtime work
Shifting existing personnel from areas of low demand to areas of high demand
Adding or removing capacity by physical expansion (e g more equipment, more workers or contraction (e g fewer equipment, fewer workers)However this method can be very expensive.

NB The cost of each method of utilising capacity must weighed and be compared. The alternative with the lowest cost could turn out in lost sales and lost market share cost, risks and strategies effects must be thoroughly weighed by managers.

5.11. Production methods

Job production.
It is used to produce a single 'one off' product made to order. Jobs are frequently large and made to customers' specifications. Examples of jobs are individual wedding cakes and made – to - measure suits.
Each product has to be completed before the next production can be started.
Job production allows specialized products to be produced and tends to be motivating for workers because they produce the whole product and can take pride in it.
It involves production to order or specification for example Treger plastics produces for Dairiboard Ltd Zimbabwe packs for milk, sachets made to different specifications.

1. It is the system of costing used when non-standard products are made to customer's specifications.
2. When an inquiry is received from a customer the firm calculates the costs of products for that job, adds on a desired profit and quotes its price.
3. If the quotation is acceptable to the customers work begins on the job.
4. This type of production tends to be costly, often takes a long time to complete and is usually labour intensive.
5. The labour needs to be highly skilled and versatile.

Costs involved in a job are;

1. Direct material costs, direct labour costs, machine time costs, factory overheads, selling and distribution costs and administration costs.
2. When the job is completed, actual costs are compared with contract costs to determine if the profit objectives have been met.

Weakness

1. Job costing is expensive to operate as each order had to be worked out separately
2. If there are no standard rates, the form will have to estimate costs and use these as the basis for its quotation, firms which under-overestimate costs run the risk of losses and business failure.

5.12. Batch production

Batch production involves the manufacture of different versions of the same basic product.
Products are produced in separate batches where a product in a batch goes through the whole production process together.
The production process involves a number of separate/ distinct stages and every unit in the batch must go through an individual production stage before the batch as whole moves to the next stage.

Advantages.

1. Production permits the firm to use division of labour in the process and thus the firm can gain from economies of scale.
2. It is used in industries where demand is for batches e.g. different school uniforms.
3. It allows each individual batch to be specifically matched to the demand and the design and composition can be easily altered.
4. An example of batch products are paints and different types of bread (whole wheat, milk, brown bread)

Disadvantages.

1. Batch production tends to have a high level of work – in – progress stock at each level of the production process.
2. The work may be boring and demotivating to employees.

5.13. Flow production

Flow production involves production of a single product on a continuous 24-hr basis. Dedicated plant will be used in the production process.

The process is used where individual products move from one stage to the other as soon as they are ready, without having to wait for any other products.
The production system produces large quantities of output in a relatively short – time.
It is suitable in industries where demand for products is high and consistent as well as standardized products are produced, for example the production of liquids.
Flow production should be carefully planned to avoid disruptions.
Is used when a standard product is produced for sale to unknown customers, the firm has to decide on the price and quality of its product.
The product process can be divided into a number of distinct processes performed in a definite sequence and trace the costs incurred at each stage. (Conversion costs).

Advantages.
1. Labour costs are relatively low since much of the process uses machines with little physical handling of products.
2. Constant output rate should make the planning of output relatively simple and this leads to minimization of inputs stocks through the use of just – in – time systems (J.I.T)
3. Quality tends to be consistent and high and it is easy to check the quality of production at various points in the process.

Disadvantages.
1. High initial set- up costs, capital intensive, high- technology production lines cost a great deal of money.
2. The work tends to be boring, demotivating and repetitive.

Recent developments in production methods.

5.14. Mass customization.
It combines the latest technology with multi- skilled employees to use production lines to make a range of varied products. This permits the business to move away from mass marketing approaches. It uses focused / differentiated approaches.

5.15. Cell production (cellular production)

1. a form of flow production that is separated into a number of self - contained min – production units (cells)
2. It is said to create employee motivation.
3. Each cell will have a team leader with a single level of hierarchy made up of workers who are multi – skilled.
4. Performance of each cell is measured in terms of output levels, lead times, and quality and cash targets.
5. Cell production leads to improvements in employee commitment and motivation resulting in high productivity.
6. The choice of a production process depends on the financial resources of a company and the extent to which it seeks to produce a differentiated product.

5.16. Factors influencing choice of production methods.

Factors	job	batch	flow.
Size of order	small	⟷	big.
Volume of output	low	⟷	high
Product range	high	⟷	low
Capital investment	low	⟷	high
Make to order / stock	order	⟷	stock
Process time	long	⟷	short
Economies of scale	low	⟷	high.
Level of labour skill	high	⟷	monitoring.
Cost of set- ups	low	⟷	high.
Flexibility process	high	⟷	low

5.17. Size of market.

If the market is small, then job production is likely to be used. Flow production is used when the market for similar products is large and constant through out the year. If the market demands a large number of units but at different times of the year, then batch production will be the suitable method.

5.18. Amount of capital available.

A purpose – built production line is difficult and expensive to construct. Small companies are unlikely to afford this type of investment and are likely to use job production, since the costs of set up are low.

5.19. Availability of resources.

Large-scale flow production often requires a supply of relatively unskilled staff and a large flat area. Job production requires skilled workers. If any of the resources are not available or in short supply, then process has to be adapted to suit available resources. If a firm desires the cost advantages of high unskilled labour together with the ability to make slightly different products for different markets, then mass customization will be suitable.

5.20. Location of production

Location is key to business success and operations management decision.

Location decisions.

Locational decisions have an effect on profit i.e.

1. Fixed costs of different sites i.e. purchase or rent or value of land can vary greatly.
2. Variable costs i.e. labour rates, transport costs of raw materials will depend on location.
3. Revenue earned by a business will be influenced by location e.g. nearness to markets.

Quantitative factors influencing location.

Site costs: i.e. purchase or rent of land and property, conversion costs, and so on
Regional incentives: financial support from Government to business, which locate in growth point areas. In Zimbabwe, there is a tax reduction for investment in a growth point area.
Transport costs.
Labour costs.
Revenue generation - certain locations give business-increased sales.

Qualitative factors.

Infrastructure - quality of local infrastructure e.g. transport and communication links.

Environmental and planning considerations.
Management preferences- quality of life for example, some managers may prefer locating near a school for their children, sport facilities, and shops.
Clustering: - the benefits of businesses in the same industry located in the same area are quite high. Such benefits include nearness to existing and potential customers, suppliers and specialist staff.

State and public opinions for example Government may decide to divert business away from some areas and attracting them to others to ensure development takes place across the country.
Inertia: – exists when the original benefits of the location no longer exist but the inconvenience and costs of relocating could be preventive.

International location
-Is additional consideration by management when deciding on a foreign location.

1. Exchange rate risks – importing goods from another country rather than producing them locally will become less profitable if the exchange rate of the exporting country appreciates and vice versa.
2. Trade barriers - some firms have located in areas protected by economic trade barriers.
3. Political, legal and language differences – i.e. political instability, legal requirements such as product safety, and the cost of overcoming language barriers that may exist.
4. Cultural consideration

<u>Revision Questions</u>
1. What is production and added value?
2. Name and discuss the characteristics of the three main types of production.
3. What is the difference between research and development?
4. What is quality control and its benefit?
5. What is statistical quality control?
6. How is value engineering useful?
7. What are the policies, a purchasing department can adopt?
8. What are the advantages of centralised buying?
9. Why is sub-contracting of parts undertaken by large companies?
10. What is involved in stock control/?

11.	What factors affect the maximum and minimum stock levels?
12.	What is the relationship between the production and marketing departments of a company?
13.	Show the differences between (a) job production (b) mass production and (c) batch production?
14.	<u>**Essays**</u>
15.	1a) Why is research and development important to the continued survival of firms? [10]
c)	How can a firm organise its R & D activities? [15]
16.	2a) What are the benefits of quality control? [10]
b)	How does the Production Manager organise for quality control? [15]
17.	3a) What are quality control circles and how do they contribute to the firm's competitiveness? [10]
18.	b)How does value analysis help the production manage? [10]
19.	"Effective stock control makes a significant contribution to the success of a firm" Discuss [25]
20.	"Research and development adds nothing to the value of the products. It merely keeps the firm ahead of competition." Discuss
21.	6a) What are the essential differences between absorption costing and contribution costing?
22.	a. When is it necessary to use absorption costing?
23.	What are some of the limitations of contribution costing?

5.21. Costing.

Is the process of determining / ascertaining the costs of producing a product/ unit.

Reasons for costing.

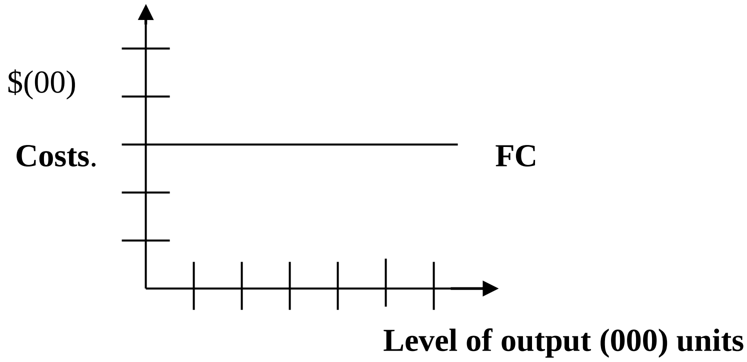
- To provide data for price – setting.
- To calculate the profitability of a product.
- To control expenditure by comparing actual with expected expenditure – budgeting.
- It helps to decide from alternative courses of action.

Cost statement

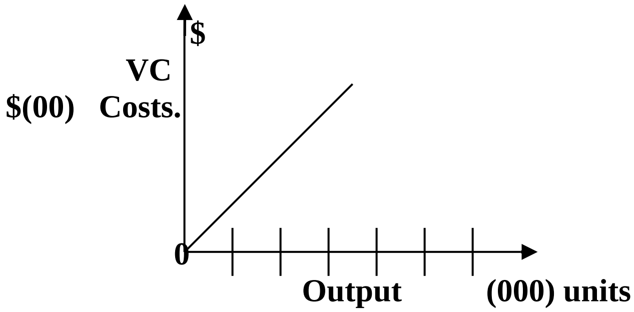
	$
Direct material	3
Direct labour	5
Direct other expenses	<u>2</u>
Prime cost	**10**
Add: overhead expenses / indirect costs	<u>3</u>
Production cost	**13**
Add: selling and administration costs	<u>2</u>
Total cost:	

Classification of costs.

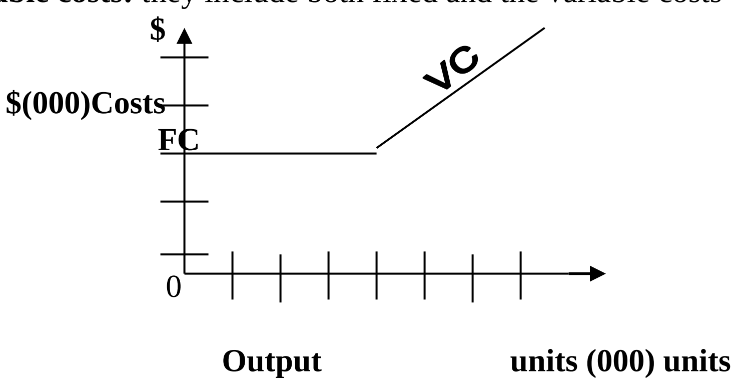
Fixed costs: they remain the same in the short – run irrespective of the level of output e.g. rent and interest. The costs remain the same whether output is high, low, or zero.



Variable costs: these vary as output changes, for example the cost of raw materials.



Semi – variable costs: they include both fixed and the variable costs electricity, water e.t.c.



Marginal costs: these are the additional costs of producing one more unit of output, and they are the extra variable cost needed to make this extra unit. Thus the marginal costs required to make one more wooden table are the additional material and labour costs incurred.

Direct costs: these are wholly and exclusively identified with a particular product e.g. raw materials, direct labour e.t.c.

Indirect costs: these costs cannot be directly identified with a particular unit because they are associated with performing a range of tasks or producing several products.

Break – even analysis
It shows the level of output required to generate a certain level of profit. It is a level of output at which total costs equal total revenue.

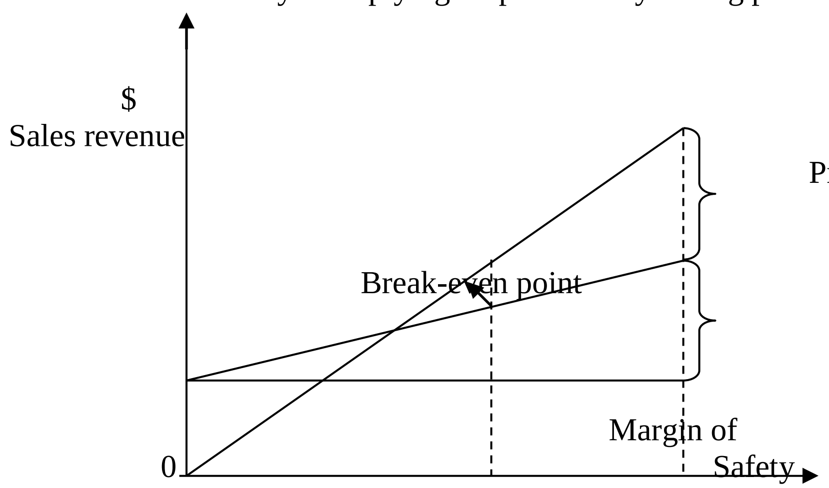
Total costs (TC) = Fixed Costs (FC) + Variable Costs (CV)

Total Revenue (TR) = Price per unit X units sold

1. If the TC >TR a loss is incurred
2. If the TR < TC a profit is made

At the beginning of production, as shown in the graph TR < TC
Sooner or later the TR has to start exceeding TC so the firm makes some profit
Where TR = TC is called the Break – even point

Graphical method.
a) Fixed costs will remain the same in the short – run.
b) Total costs, which are equal to fixed and plus variable costs.
4. Sales revenue is obtained by multiplying output level by selling price.



Profit full capacity

TC

Variable costs

FC

Level of output full capacity

Break – even output.

Where total sales is equal to total costs it is called the **break – even point,** the firm will make neither a profit nor a loss. If a firm fails to supply the breakeven output it suffers a loss and any level in excess of breakeven output makes a profit.

The equation method.
It is possible to calculate break – even output (B.E.O) without the graphs. The firm uses the concept of contribution i.e. the excess of selling price over variable costs (SP-VC)

$$\textbf{Break – even output} = \frac{\textbf{fixed costs}}{\textbf{Contribution per unit.}}$$

Assume fixed costs = $300 000
Planned level of output 100 000 units
Variable costs per unit $ 10
Selling price per unit $20

Calculate: (i) contribution per unit.
(ii) break even output
(iii) margin of safety.

Answer.

(i) SP – VC
$20 - $10 = **$10**

(ii) Fixed costs = $\frac{\$300\ 000}{\$10}$
Contribution/unit

= 30 000 units.

(iii) Margin of safety = 100 00 – 30 000 units *(Planned output – Break – even output)*
= 70 000 units.

Break – even sales revenue.

The basic technique can be modified to determine sales revenue to break – even.

$\frac{\text{Fixed costs}}{\text{Contribution/ unit}} \times \text{SP}$

Fixed costs = $200 000
Variable costs = $5
Selling price = $10

$= \$\frac{200\ 000}{5} \times \$10$

= $400 000

Target profit.

It identifies the level of output necessary to achieve a certain level of profit.

$\frac{\textbf{Fixed costs + target profit}}{\textbf{Contribution per unit.}}$

4.13 Break – even analysis – other uses.

Besides obtaining break – even levels of production and margin of safety, the technique can be used in important decisions. The charts can be redrawn to show a potentially new situation and this can be compared with a firm's current position.

Selecting between two locations for a new factory.

-An operations manager's decision, – the purchase of new equipment with lower variable costs.

-A marketing decision – the impact of a price increase.

Summary of uses.

1. Charts are relatively easy to construct and interpret.
2. The formula provides an exact break – even result.
3. It provides useful guidelines to management on break – even points, margin of safety and profit and loss at different levels of output.
4. Comparisons can be made between different choices by constructing new charts to show changed situations. Chart could be amended to show the possible impact on profit and break – even point of a change in price.

Limitations of break – even analysis.

1. It assumes that fixed costs will remain the same throughout the year. In reality fixed costs are likely to change at different levels of output. It would be more appropriate to represent fixed costs as a stepped line.
2. Neither variable costs nor selling prices are likely to be linear. Discounts, overtime pay and special delivery charges contribute to non- – linearity.
3. It assumes that costs can neatly be classified into fixed and variable costs only, yet some costs semi – variable.
4. The technique is appropriate for single product firm; multiple – product firms will be forced to draw several charts.

Should we make or buy?

The decision whether to take a particular item or to buy it can be helped by marginal cost information. Some important factors are:

(1) Plant capacity- if the business is expanding sub-contracting may help to ease the congestion in the factory when space capacity exist, a company would prefer to make the item so that the machines and the workforce can be kept busy.

(2) Profit maximisation

(3) Specialisation.

(4) Interdepartmental dependence.

Make or buy

Circumstances favouring making

1. Cheaper to make
2. Excess capacity in house
3. Low confidence in suppliers in terms of delivery time and quality.
4. Concern about collusion between suppliers to force up prices.
5. The component is strategic to the company- fear that design secrets will be disobeyed.
6. Where purchasing the component would eliminate specialist knowledge and undermine long term competitiveness.

Circumstances favouring buying in

1. Cheaper to buy in.
2. Confidence in supplier.
3. Lack of capacity in house.
4. Making would require additional investment.
5. Purchasing might improve cash flow.
6. The components are simple and producing it in-house would add very little value to the operation.

Should we expand capacity or buy?

1. When full capacity has been reached, managers are faced with the problem of expanding or buying from sub- contractors. If the business prospects for the industry look good they may prefer to expand capacity so that they will be in a position to further increase output when more orders comes in.
2. The buying decision will depend on the price permit that the outside contractor is quoting in relation to the cost of producing that same unit.

3. Based on the proposition that the time it takes to get a product from conception to the customer and provide good and service to the market can be the key to competitive advantage. The total time it takes to get the product through the supply chain is known as the throughout time.
4. Time Based Competition (TBC) eliminates the waste involved in unproductive time which can be found in preparation, waiting time, unnecessary movement overproduction, react, set up time, process waste, untidiness and bottlenecks.
5. Eliminating time wastages reduces costs, and improved the firm's responsiveness to customers thus increasing the firm's competitive advantage.

Benefits of TBC

1. By speeding new product development, firms can achieve a competitive advantage.
2. Speeding up the production process leads to savings in stocks and working capital.
3. Firms can behave opportunistically as new product ideas emerge and as new market segments appear.
4. It can increase customer satisfaction.
5. It leads to greater flexibility.

5.22. Costing concepts.

Cost center- is an area of responsibility such as a department in which costs can be charged.
Profit centers- a section of the business in which both costs and sales can be identified e.g. a branch in a chain of shops or department.

Importance of cost and profit centers to firms.

1. Management will have targets to work towards.
2. This target motivates and controls business divisions.
3. Individual performance of divisions and their management can be measured and compared.
4. Work can be monitored and future decisions made.

Unit cost also known as average cost.

<u>Total cost</u> = $ <u>56 000</u>
Output 400 000 units.

Each unit's cost = $0,14.

Marginal costing/ contribution costing.
Marginal cost is the addition to total costs resulting from the production of an extra unit of output. Marginal costing identifies contribution (sales revenue minus variable costs/ marginal costs). The calculations ignore fixed costs since they are not affected by the level of output. The costing technique is used in short-term decision-making, where costs can be identified as fixed and variable.

Marginal costing pro-forma statement.

	$	
Sales	xxx	
Less: direct materials:		xxx
Direct labour	xxx	
Variable manufacturing overheads	xxx	
Variable selling expenses	xxx	
Variable administrative expenses	<u>xxx</u>	
CONTRIBUTION	<u>xxx</u>	
<u>**Less:** fixed costs:</u>		
Manufacturing costs	xxx	
Selling expenses	xxx	
Administrative expenses	<u>xxx</u>	
Net profit	<u>xxx</u>	

Situations in which the marginal costing technique can be applied are as follows.

Acceptance or rejection of a special order.
This involves a decision on whether to accept or reject a special order where less than normal price is quoted:

<u>Example</u>
Mr. Tatenda manufactures and sells a juice for $ 20 000 per can. Current output is 400 000 units which represents 80% capacity. A local retail shop has approached Mr. Tatenda to purchase the product at $ 13 per can and has promised to sell as an own label. Total costs for last month was $560 000 of $160 000 was fixed costs. Should he accept the order or reject.

Solution.

Current solution.

$ (000)		
Sales 400 000 at 20	8000	
Less: marginal costs.	4000	
Contribution	4000	
Less fixed costs		1 600
Profit	2 400	

Special order.

$ (000)	
Sales 100 000 at 13	1300
Less, marginal costs 10/ unit	1100
Contribution	**200**

Acceptance of the order will result in an increase in profit by $200 000. The overall profit will now become $ 2600 000.

Should a firm stop producing a product?

A firm that produces more than one product might be faced with decision of whether to continue marketing a product that is making a loss or to drop it. If full costing is to be applied then the product will be dropped, even though it might still be making a positive contribution. Dropping such a product will reduce the overall profits of the business by the amount of contribution lost from the product dropped.

E.g. a company is making three products A, B, C the following information relates to the three products.

A	**B**	**C**	
Sales	32 000	36 000	39 000
Total costs	36 000	32 000	37 000
Profit / loss	**(4 000)**	**4 000**	**200**

The Directors have argued that A is making a loss and should be dropped. Total costs include 1/3 fixed cost and 2/3 variable costs.

Importance of contribution costing to decision-making.

1. Overhead costs are not apportioned to cost centers hence avoiding inaccuracies and arbitrary allocations.
2. Decisions about a product or department are made on the basis of contribution to overheads.
3. Spare capacity is more likely to be used.

Limitations of contribution costing.

1. Ignoring fixed costs until final calculations of profit and loss does not consider that some products may actually incur much high fixed cost than others.

2. Contribution may force managers to continue producing products just because they provide positive contribution.
3. Like in all situations of decision-making, qualitative factors such as goodwill must be considered. Products with low contribution may be part of a range of goods made by a firm, and just to stop making it would affect the appeal of the whole range.

Full-costing – all costs incurred by the firm are considered. Total overheads could be divided between products and cost centers depending on the basis of apportionment of each cost center uses.

Advantages.

1. Full costing is relatively easy to calculate and to understand.
2. The technique is particularly relevant for single - product firms.
3. All costs are allocated, which enables the calculation of profit / loss.
4. It is a good basis for making pricing decisions in single – product firms.

Limitations of full costing.

1. Arbitrary methods of overhead apportionment result in inconsistencies between departments and products. If the method is changed from a direct material basis to a direct labour basis, then the figures allocated will also change affecting the results.
2. There is no attempt to allocate each overhead cost to each cost center on this basis of actual expenditure incurred.
3. If full costing is used, it is important to allocate on the same basis overtime so that comparisons over-time can be meaningful.
4. Using this cost method for decision-making can be misleading.

5.23. Economies of scale.

Business expansion by using more of the factors of production is known as an increase in the **scale of operation.**

Economies of scale are the reductions in a company's unit costs (average costs) of production that result from an increase in the scale of production.

Examples:

Financial economies - financial institutions offer loans to big firms with proven track records at lower interest rates than small firms. Selling of shares to the public is relatively cheaper for large firms than small companies.

Purchasing economies - these take the form of bulk buying discounts. Only large firms will purchase in large quantities and negotiate for discounts.

Marketing economies - marketing costs such as for sales force, advertising and other promotions can be spread over a high level of output for a big firm and this offers substantial economies of scale.

Managerial economies - large firms can afford the services of specialist managers who operate effectively.

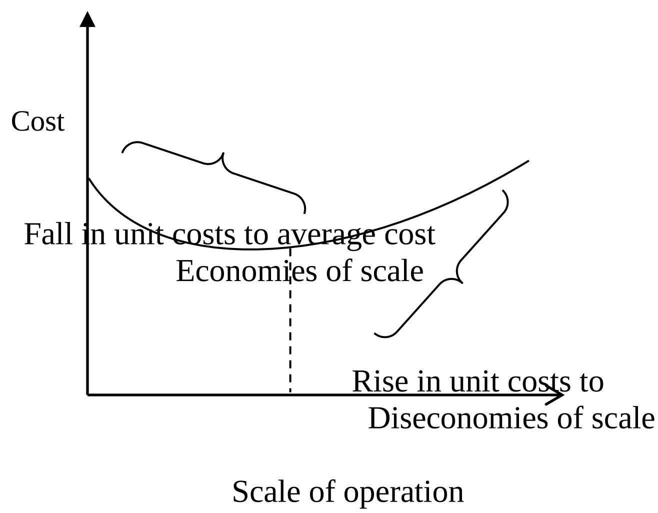
Technical economies - large firms can afford to purchase latest and technologically advanced machines.

5.24. Diseconomies of scale.

Factory unit costs increase as the firm's scale of operation increases beyond a certain size. They are related to management problems associated with trying to control and direct an organisation with thousands of workers, in separate divisions, often operating in several countries.

These problems could be due to:

1. Alienation of the employees for big companies: It becomes more difficult to directly involve every worker and give them a sense of purpose and achievement in their work. They may feel so insignificant to the overall business plan that they become demotivated and fail to make an effort.
2. Co-ordinating the firm: Business expansion is characterised by a growing number of departments, divisions and products. The problem for senior managers is to co – ordinate and control all of the operations.
3. Communication problems: Large-scale production leads to poor feedback to workers excessive use of non – personal media, communication overload, and distortions of messages resulting from long chains of command. These communication inefficiencies lead to poor decisions being made.



Economies and diseconomies of scale.

Approaches to overcoming the impact of diseconomies of scale.

Decentralization- it provides division autonomy and independence. They will now be operated like small business units and control will be left to managers close to the scene of action.

Management by objectives- it will avoid co – ordination problems by giving each division a department agreed objectives to work towards that are part of overall business aims.

Reduce diversification - businesses will concentrate on their core activities and reduce co – ordination and communication problems.

5.25. Stock control.

Stock is held so that there is continuity of operations while minimizing stock costs.

Forms of stock.

Raw materials- unprocessed goods awaiting production.

Work – in – progress - partially processed goods. The value of these goods depends on the length of time needed to complete production and also the type of production method used e.g. batch production tends to have a - high level of work – in – progress.

Finished goods - awaiting dispatch or sale.

Why do businesses hold stocks?
Raw materials (i) To allow for variations in supply.
(ii) To take advantage of bulk – buying discounts.
(iii) Anticipated price rise.

Work – in – progress.
To allow for greater flexibility and improved machine utilization.

Finished goods

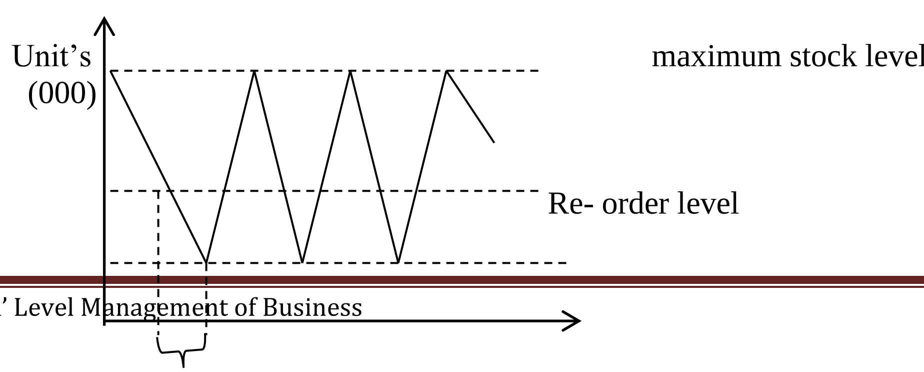
So that the firm can deal with variations in demand (seasonal goods).
To cope with sudden, unanticipated increases in demand and to satisfy customers without delay.

5.26. Stock management.

Effective stock management is important to avoid the following problems

1. Stock wastage, which might occur due to mishandling or inappropriate storage conditions.
2. There might be insufficient stocks to meet unforeseen changes in demand.
3. Expired stocks may be held if an inappropriate stock rotation system is not put to use.
4. Poor management of stock purchasing function can result in late deliveries, low discounts or too big a delivery for a warehouse to hold.
5. High stock levels lead to excessive storage costs and a high opportunity of cash unproductively tied up.
6. To control wastage and pilferage.
7. For valuation purposes.

5.27. Stock control charts.



Buffer stock level.

Time in weeks

Lead-time

Diagonal lines represent depletion through usage and sales. Rate of depletion is measured by the steepness of the curve. When stocks fall to re – record level, a new batch is ordered but due to a time gap between placing an order and receiving one, stock continue to fall. The time gap is known as **lead-time.** The longer this time gap, then the higher will be the re-order level.

Under conditions of certainly, there is no need to keep stocks in reserve. Stocks will fall to zero, knowing stock will arrive in time to avoid a stock- out or complete depletion of stock. Where depletion rates and lead times vary, it is important to carry a reserve called **buffer stock.**

5.28. Decisions on stock held.

1. The size of buffer stock.
2. The maximum stock level.
3. The size of batch to be re – ordered (re – order quantity)
4. The re – order level.

The buffer stock.
The lower the size of reserve the greater will be the likelihood of a stock- out.

Cost of a stock- out.
1. Sales may be lost to firms that hold higher stock levels. Contribution will therefore be lost.
2. Lost production.
3. Loss of goodwill.
4. Loss of bulk – buying discounts.
5. High costs associated with small order replenishment purchases.
6. Idle production resources.

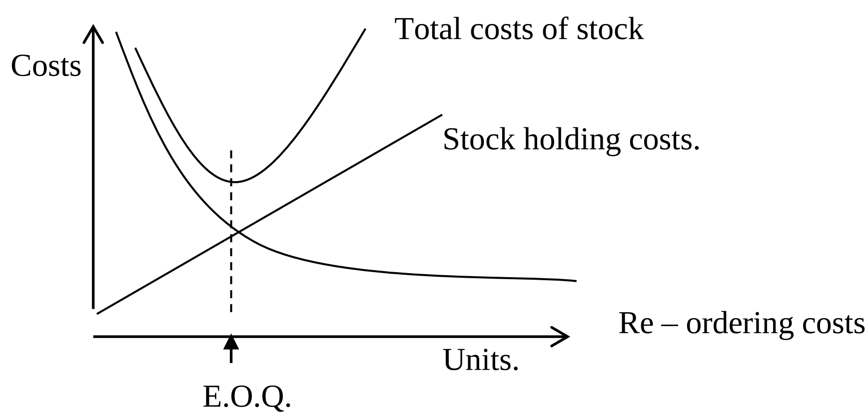
Where stock- outs are high, firms will be worried to hold stock levels.

Maximum stock level.
High stock levels mean that cash is tied up in an unproductive manner. Storage is costly if:
1. Goods are of high value and need to be guarded.
2. Temperature and moisture need to be maintained.
3. Goods are bulky and require substantial floor space.
4. Insurance.
5. Handling costs.
6. Pilferage.
7. Deterioration.
8. A change in demand.

Re – order quantity.
Managers will seek to establish a re – order quantity that minimizes the total stock costs that is the economic order quantity. The E.O.Q. is the ordering quantity that minimizes the balance between stock holding costs and re – ordering costs.

Stock holding costs.
1. Interest on capital
2. Insurance.
3. Handling costs.
4. Storage costs.
5. Security.
6. Costs in terms of wastage.

Re – ordering costs.
Transport.
Clerical costs.



Calculating E.O.Q.

E.O.Q. $\sqrt{\frac{2pd}{cc}}$

Where p = procurement cost per batch.
D = annual demand of the material.
CC = carrying costs per item per annum.

Re – order level.
This is the level of stock that will trigger a new order to be sent to the supplier. Practically computers are used to keep a record of every sale and every delivery of stock.

Just – in – time stock control.

Raw materials - are scheduled to arrive exactly when they are needed for production. Suppliers will also deliver materials at the exact moment required, thus reducing raw material stocks to zero.
Work – in – progress- is kept at a minimum, as goods are in the next stage of production.

Finished goods- stocks are minimized by matching production to demand.

Investment in working capital is reduced and space is freed from stock levels. For J.I.T management systems to be successfully introduced, the following requirements must be met.

Production staff must be multi – skilled and prepared to change jobs at short notice. Each worker must be able to switch to making different items at very short notice so that no excess suppliers of any one product are made.

Relationships with suppliers have to be reliable as they must always be prepared to supply the components as and when required with a very short lead time.

Accurate demand forecasts will make a J.I.T system a much more successful policy.

Equipment and machinery must be flexible. Modern computer- controlled equipment is much more flexible and adaptable – often able to be changed with no more than a different software programme.

1. Good employee - employer relationships are essential for just – in – time to operate smoothly. Staff motivation and co –operation is important.

-Quality must be everyone's priority.

-Dependable quality of raw materials are expected from suppliers so that there will be no returns.

-Short transit time between suppliers and customers.

-Long term contracts with a relatively few suppliers are important to ensure adequate supplies.

-Top management commitment is required when a firm is changing to the new system.

5.29. Lean production.

This is the term used to describe the management of production process more effectively with minimum resources. The objective is to eliminate waste of resources and time from original stock ordering through to final customer service.

The overall objective of this production method is to produce quality output with few resources.

Lean production cuts out anything in the production process that adds complexity, cost and time and does not add value to customers.

It brings together some of the practices of management such as J.I.T, quality circles, employee empowerment, time- based competition, cell working, T.Q.M, continuous improvements and so on Types of waste identified by Japanese proponents of lean production are:

1. **Processing waste –** processing methods inevitably produces some waste, but lean production demands that this be minimized.

2. **Inventory waste** – excessive stockholding increases handling costs.
3. **Waste in transport -** moving good from one part of the factory to another involves costs and yet does not add value to the output.
4. **Waste of over- production**- producing in excess of demand is clearly a waste of resources.
5. **Waste of waiting time -** work – in – progress that waits for the next stage of operation involves waste during the waiting time. Value is not being added to output. Lean production concentrates on the proportion of time used in value adding activities.
6. **Waste of motion -** movement does not necessarily mean that work is taking place. Movement that does not add value to the product should be minimized.
7. **Waste from product defects –** defective products necessitate reworking or scrapping. It also increases the cost of warranties and places future business at risk.

5.30. Quality control.

Quality refers to fitness for purpose. It is the totality of features and characteristics of a product /that bear on its ability to satisfy customers' stated and implied needs.

Two aspects of quality.

Quality of design - suitability of the product for the customer's purpose. After establishing customers' requirements (customers' perception of quality) it is considered in product design and specification.

Quality of conformance - consistency of the product. This is the extent to which the goods that are produced conform to laid down specifications

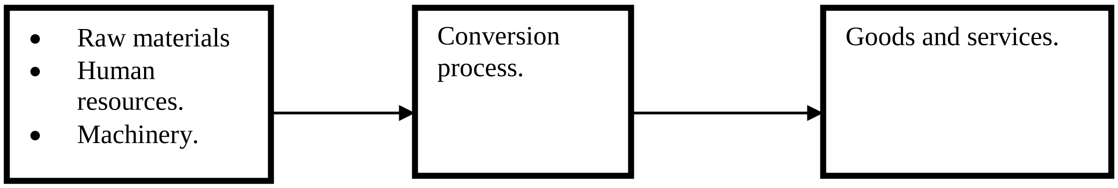
Quality procedures are produced so that the product meets customers' requirements and that there is no variation in the product as it comes off the production line.

Proactive and reactive approaches.
Quality control occurs before, during or after production.

Feed forward control - a pro – active approach in which control is focused on the inputs (human resources, raw materials, and machinery). By inspecting and controlling the variables that go into production, there will be greater consistency of finished goods with fewer defect.
Concurrent controls- monitoring of on – going activities to ensure consistency of the product as it is progressing. It is a pro - active approach.
Both the above methods are pro – active since they aim to prevent defective goods from being produced rather than detecting them.

Feedback control – (post – action control) – it focuses on output – it is reactive an is designed to detect defective goods rather than prevent them from being made in the first place.

INPUTS **PROCESS** **OUTPUT.**



Feed forward Q control e.g. Concurrent Q control e.g. Feedback e.g.
e.g. preventive methods. quality check points. final inspection.

Advantages of producing quality goods / services.

1. It saves on costs associated with customer complaints e.g. compensation, replacing defectives products, loss of customer goodwill and legal costs associated with product liability.
2. Easier to create customer loyalty (goodwill) due to consistency of the product.
3. Longer product life cycles due to repeat purchases.
4. Less advertising will be necessary, as the brand will establish a quality image through the performance of the product.
5. A high price - premium could be charged for such goods and services. Thus quality can be profitable.
6. Scrap of finished goods can be reduced or eliminated.

5.31. Quality assurance.

Quality control - is about checking to ensure that the products or services come up to an agreed standard.

Quality assurance- is setting and agreeing those standards through out the company and making sure that customer satisfaction is achieved. The quality assurance department will focus on all areas of the business.

Product design: will the product meet customers' specifications.
Quality of inputs; quality must not be compromised by bought in components.
Production quality: achieved through T.Q.M.
Delivered systems: customers expect goods to be delivered at times convenient to them.
Customer after sales service - continuous customer satisfaction depends on the quality of contacts with the customer after the sale.

5.32. Total quality management (T.Q.M.)

It commits the organisation and its employees to the continual review and improvements of all aspects of an activity that have a bearing on the quality of its output and satisfaction of customers' requirements.

The aim is to make all employees at all levels accept that the quality of their output is important. Employees should be empowered with the responsibility of checking this quality level before passing on their work to the next production process. T.Q.M uses the concept of internal customer. The internal customer is the next department in the production process. If work from previous department is below standard, then it will be rejected just as a customer will reject it. Each department is aiming to satisfy the next department by passing good best quality products. These departmental relationships are known as **quality chains.**
T.Q.M aims to cut costs of faulty or defective production by encouraging all staff to get it right first time. Under T.Q.M if quality is improved and guaranteed, then rejects costs should fall overtime as well as overtime costs.

However T.Q.M will only work effectively if everyone in the organisation is committed. It requires commitment from senior management to allow staff authority and empowerment, as the concept will not work well in a rigid or authoritarian structure.

5.33. Quality circles.

1. A Japanese technique in which small groups of workers meet to discuss quality issues.
2. It is based on staff involvement in improving quality, using groups of employees. Using team working and participation can result in quality improvements plus worker participation.
3. The overall aim is to investigate quality problems and to forward solutions to management or if the group is totally empowered, to put the improvements into practice.

Main benefits of quality circles.

1. They improve employee motivation through participation.
2. They improve quality through joint discussions of ideas and solutions.
3. They make full use of the knowledge and experience of staff leading to increased productivity.

Kaizen (Continuous Improvement)

1. Kaizen is the Japanese word for a continuous improvement and is important part of Total Quality Management (TQM).
2. Kaizen is customer focused in that quality begins with customers as customer views are continually changing and standard rising, so continuous improvement is required.
3. Kaizen involves small, graded but continuous changes.

Cell Working

1. A cell layout groups together a number of dissimilar machines or processes according to the design of the product being made or the operations required for its production.
2. The workers are in a team, workers in the cell are multi-skilled, operations sequence can be varied and each group enjoys considerable autonomy.

Cell working makes for simpler product control and is well suited to the demands of just in time product.

Benefits

1. Reduced material handling.
2. Reduced set- up time.
3. Reduces work in progress.
4. Reduced tooling costs.
5. Greater flexibility.
6. Benefits of team writing and facilitates quality circles.

Quality Control Measures

Zero defects

1. It has been recognised that human error can arise because of such factors as boredom. fatigue, indifference to a job and lack of vigilance. This is due to automation.
2. Many organisations have adopted a positive approach to such potential problems by introducing a zero-defects programme whereby workers are rewarded with financial and non- financial incentives if output of the desired quality is achieved.

Quality Standards

1. International Standards Organisation (ISO) works to promote the use of internationally agreed terms, definitions and standards. Products which reach the specifications laid down are awarded a symbol of quality, provided that the manufacturers agree to regular inspection and control.
2. In Zimbabwe the SAZ (standards association of Zimbabwe) is responsible to ensure that products made are of quality and products bear the symbol if they pass the test of quality.

Statistical Process Control

1. It involves spot checks to be made from time to time on a regular basis using statistical sampling techniques.
2. The best and surest clear of quality is of course 100% inspection/testing of products. This, however, would be very expensive and rather impractical or cost ineffective, unless where a product could represent a major health or safety risk.

Production Engineering

1. Specialist product engineers are hired to assist with the selecting planning and installation of such equipment.
2. They will be involved in drawing up specifications for machines and equipment which will include defining the standards of quality to be achieved.
3. They may also be used to monitor and evaluate manufacturing processes with a view to finding ways of improving them.

Work-study

It involves analysis of human work tasks so as to:

1. Determine the most efficient and effective way of carrying out a process – method study.
2. Measure the quantity of work – work measurement.

Method study.
It requires accurate observation, analysis and recording of existing work methods. These records are then analysed to devise improvements in methods such as:

1. Changes in the design of the product.
2. Changes in the sequence of operations.
3. A new method will emerge. After implementing a new method, it will be compare with performance under the old method to produce further improvements.

Work measurement. - It involves similar methods of observing, recording and analysing, but emphasis is quantitative and not qualitative. It is the technique to establish the time taken by a qualified worker to carry out a specific task at a defined level of performance. By measuring the time taken to complete tasks, it makes contribution to:

1. Costing.
2. Production planning.
3. Scheduling.
4. Recruitment and selection.

The analytical technique used will depend on the nature of the job, whether or not it is an existing one.

Synthetic timing. – The job is broken down into its components and a time calculated for each component.
Analytical estimating - it is an approximate based on the knowledge of operations and skills.
Pre - determined motion- time study – it is the synthesis of times for the basic human motions that build up into the job.

5.34. Bench marking

- The full title is <u>best practice benchmarking</u>.
It involves management identifying the best firm in the industry and then comparing the performance standards – including quality of the business and the firm's. The comparisons will determine areas of the firm that need to be improved to meet quality and product activity standards of best firms.

Stages in benchmarking

1. Identifies the aspects of the firm to be bench marked. This can be achieved by interviewing customers (reliability of the product, speed of delivery and after sales service).
2. Measure performance in these areas for example reliability records, delivery record and number of customer complaints.
3. Identify the firms in the industry that are considered to be best. This can be achieved through management consultants or bench marking schemes operated by Government or industry organisation.

4. Use comparative data from the best firms to establish the main weakness in the business. These data may be obtained from firm by mutual agreement, from published accounts, specialty industry publication, contact with customers and suppliers.
5. Set standards for performance. These may be standards set by best firms or could even be high to establish a competitive advantage.
6. Change processes to achieve the standards set.
7. Re- measurement changes to the process need to be checked to see if new, high standards are being reached.

Advantages of Benchmarking.

1. It is a speedy way of solving problems than for firms attempting to solve production and quality problems without external comparisons.
2. Process can help a business to increase global competitiveness.
3. If staff are involved in the exercise then their participation can lead to better ideas for improvements and increased motivation.
4. The areas of great importance to customers are identified and improved.

Disadvantages.

1. Simply copying the ideas and practices of other firms discourages initiative and originality.
2. The costs of the comparisons may not be recovered by the improvements obtained.
3. The process depends on obtaining relevant and up – to – date information. If this is difficult to obtain, then the process will fail.

Network analysis.

1. A rational and systematic way of planning a series of activities that combines into a large project e.g. a civil engineering project.
2. The purpose of the exercise, which is to identify the series of key activities, which determine the overall duration of the project.
3. It is possible to determine when components are needed to plan the deployment of resources to avoid idleness.

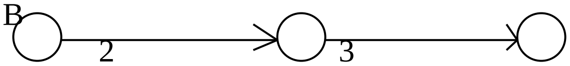
Net work diagrams.

Arrows represent activities that consume resources.

1. Circles are called nodes representing the starting and finishing of an activity.
2. Where an arrow into a node is followed by another out of the nodes, it means that the first task has to be completed before starting the second one. If two arrows enter into a node, both tasks have to be completed before the following one is started.
3. The dotted line is known as dummy activities – an imaginary activity that consumes neither resources nor time but is introduced if there are two starting and finishing points. It is a convention in network analysis that two separate activities cannot have the same starting and finishing node numbers.

Simple networks.
Activity A comes before B.

A
1

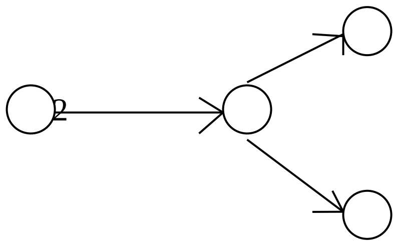


Activity A is done before B and C, which are concurrent activities.

B 3

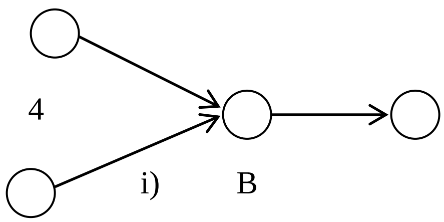
1

C
4



Activities A and B are independent activities and should be done before activity C.

1
A
3 C 4

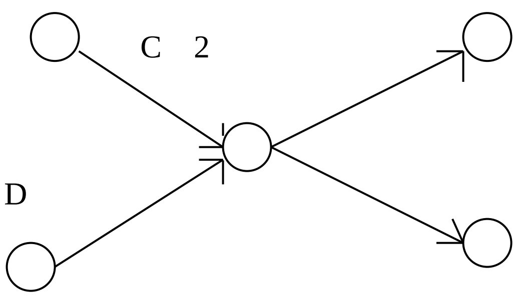


A and B are independent activities and are done before C and D which are simultaneous activities.

1 A

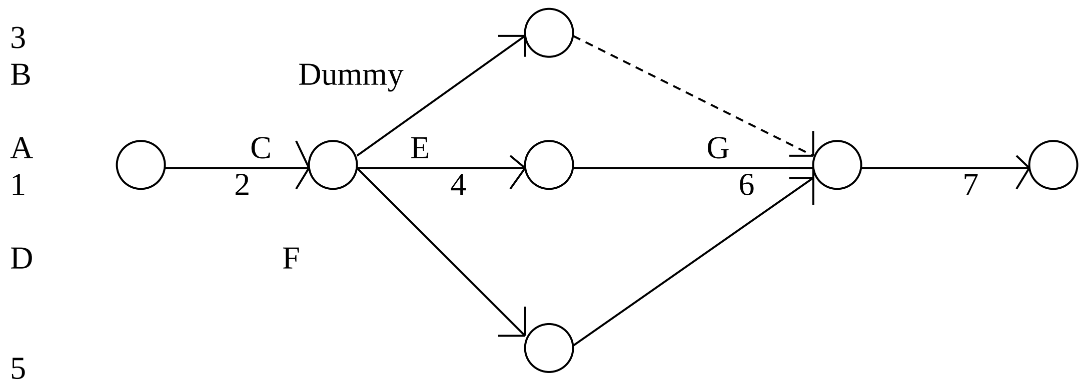
3
B

5
2



4
Question – In manufacturing a certain product, the following activities must be completed.
B,C, and D follow A
Activity E follows C
Activity F follows D
Activity G follows B, E and F.

Draw a network diagram of these activities.



Paths through the network.

A+B + Dummy + G = 18 days

A + C + E + G = 24 days / is the critical path.

A + D + F + G = 23 days.

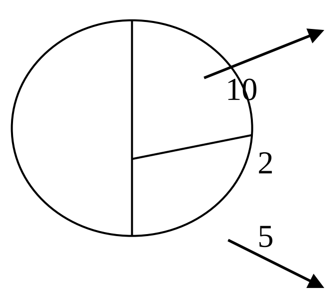
Times for each activity.

A = 6 days	D = 9 days	G = 4 days
B = 8 days	E = 2 days	C = 12 days
E = 2 days	F = 4 days.	

Critical path.
-The sequence of events that determine the minimum time in which the project as a whole can be completed. It is the longest path through the network.
-All activities on the critical path must be started as soon as proceeding one's are completed. They must be completed in time allowed if the whole project is to be completed on time.

Non - critical activities (those on the critical path) are completed in a shorter time than that necessary to keep the project on track. Spare time found in non- critical activities are known as float times.

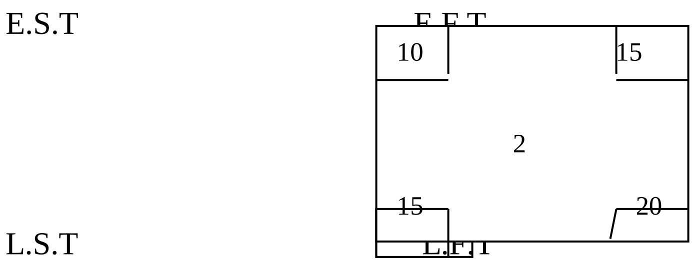
E.S.T of following activity



L.F.T proceeding activity.

2 is the node number and represents the node in the overall sequence.

Where E.S.T is the earliest possible since an activity can start. L.F.T is the latest possible time a proceeding activity can be finished if it is not to delay the overall project.



E.S.T = the earliest possible starting time for the following activity.
E.F.T = the earliest time an activity can be completed by.
L.S.T = latest time an activity can start without delaying the overall project.

An activity cannot start until day 10 but could be delayed until day 15. if delayed beyond day 15, then it will not be completed until after day 20 in which case, it will delay the start of the next activity and generally as the whole project.

Total float of an activity is the amount of time by which its start completion can be delayed without endangering the whole project which is LST minus EST. LST = LFT less duration of an activity.

Total float = L.F.T – duration – E>S.T

Example Activity B has an EST of 17 days, and a duration of 4 days. To avoid delay, the activity has to be completed by day 23.

Solution: 23 – 4 – 17
= 2 days.

Examination Question.

For a project to be completed, the following activities should be under taken in the order shown:
B, C follow A
E, F follow B
D follows C
G follows E
H follows F
I follows G and D

The project is completed when H and I are finished.

a) Draw a correctly labeled network diagram.
b) Using the activity times below, state the critical path.

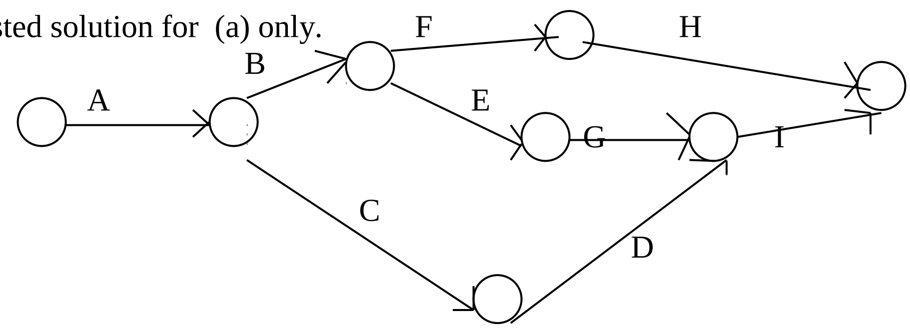
A = 4 days	B = 5 days	C = 6 days	D = 2 days
E = 7 days	F= 9 days	G = 2 days	H = 6 days.
I = 3 days.			

Suggested solution for (a) only.

B
A

I
C

D



NB: Please note that there is no answer provided for (b).

Aims of network analysis.

1. Facilitate planning and co – ordination of large projects.
2. Identify critical activities, which determine the overall duration of the project.
3. Identify activities, which cause or are likely to cause bottlenecks and delays.
4. Determine when resources and components are needed.
5. Plan the use of the resources to reduce and eliminate idleness.
6. Identify important linkages and sequential dependent relationships.
7. Reduce costs by eliminating waste.
8. Facilitate the taking of corrective action when performance falls below the special one in the plan.

Networks: an evaluation.
Networks minimizes.

1. **They minimize loss of time**, by ensuring that the transition from one activity to another takes place as soon as possible.
2. **Material wastage is reduced** by cutting down on the risk of spoilage and pilferage.
3. **Cash flow problems** are minimized by ensuring that materials are bought when they are needed and not too soon.
4. There is maximum utilization of stock.

Network analysis is a planning and controlling technique. It cannot solve production problems by itself. It requires skilled and motivated staff especially when attempting to make up for lost time in a critical activity. Experienced managers will need to identify the cheapest option for using and switching resources from non – critical activities.

Typical examination questions

Structured questions

i) Explain the factors that influence the location of a firm. [6]
ii) Discuss the factors that will influence the choice of rocking chairs production method. [8]
iii) Distinguish between fixed and variable costs in a clothing industry. [4]
iv) What do you understand by the term 'quality'? Explain how management might investigate the level of quality. [5]
v) What is 'buffer stock'? What factors might influence the level of buffer stock held? [5]
vi) Explain the term 'value analysis.'[3]
vii) Discuss the possible ways of increasing capacity utilisation. [6]
viii) What is lean production? Explain any two techniques of lean production.[6]
ix) Explain three ways in which production Department may be influenced by the activities of the Marketing department. [6]

Essays questions

Question 1

Evaluate the relevant of a work study program to a Catering Business.[25]

Question 2

Critically examine the role of accurate cost data in the efficient management of a business.

Question 3

a) How might a manufacturing company determine the level of stocks it should hold? [10]
b) Assess the importance of integrating stock control with sales, marketing and production strategies. [15]

Question 4

Evaluate the role of quality control to the overall success of a business. [25]

Data response

- **Flexible Chairs [Pvt] Ltd**

Flexible Chair is a furniture-manufacturing firm located in the Kelvin North industrial Area of Bulawayo. This company has been in operation since 1999 and is owned by Joyce and Joe. These two shareholders have revealed that flexible chairs' success is attributed mainly to its strategic location near Nkulumane Shopping Complex, United Refineries Pvt Ltd, Dairy Board Zimbabwe Ltd, Pelandaba Suburb and Sizane High School.

The business is considering two important issues which will have a big impact on the success of the business. The first issue is to introduce a flexible and comfortable range of chairs called, 'COMFY CHAIR.' The forecasted costs of this chair are as follows:

Variable Costs $500 000. Allocated annual overhead costs $150 000 000. It is expected that the selling price per chair will be $800 000. Joe has also proposed that they will change the payment system from the use of salaries to a piece rate system. He has argued that this will make workers produce more chairs as demand is expected to be very high.

The second issue concerns the purchase of a new delivery van. The following information relates to the net cash flows for the new van.

Year 0	$[6 000 000]
1	$3 000 000
2	$2 000 000
3	$2 000 000
4	$1 000 000

The delivery van is expected to have an expected useful life of four years. Depreciation on the van will be charged using straight-line method. The delivery van is expected to have no residual value at the end of its useful life.

You are required to:

a) Calculate the break-even level of output for the 'Comfy Chair'. [4]
b) Calculate the payback and average rate of return of the delivery van. Comment on your results. [8]
c) Explain the advantages of Kelvin North as a possible location for Flexible Chairs Pvt Ltd. [8]
d) Discuss the possible impact on the motivation of the workforce of changing the payment system. [10]

- **Zenzele Ltd**

Zenzele Ltd is a fast growing indigenous company that sells exclusive gents and ladies clothes. Despite the economy hitting a recession, this company has enjoyed increasing profits each year since its inception in 2002.

Zenzele has expanded so much so that apart from its main branch in Harare, it has opened two other branches in Bulawayo and Gweru. Ngoni is the General Manager who oversees the activities of all the three branches. He has argued that one of the strategies the company can adopt to cope with the expansion is to decentralize decision making.

However, Nyoni the Marketing Director has speculated that with more economic hardships facing the country, Zenzele Ltd will soon face problems. He has argued that one of the problems is the company's heavy reliance on internally generated funds. Shareholders have refused to authorize the use of externally generated funds in fear of dilution of control. Speculations are that the government might increase direct taxation has also been a cause for concern for Nyoni.

Market Research specialists who were employed to research on the prospects of Botswana markets have brought positive results. The Directors of Zenzele Ltd have studied the results and have unanimously agreed that they should consider relocating to Botswana before they are hard-hit by the economic problems.

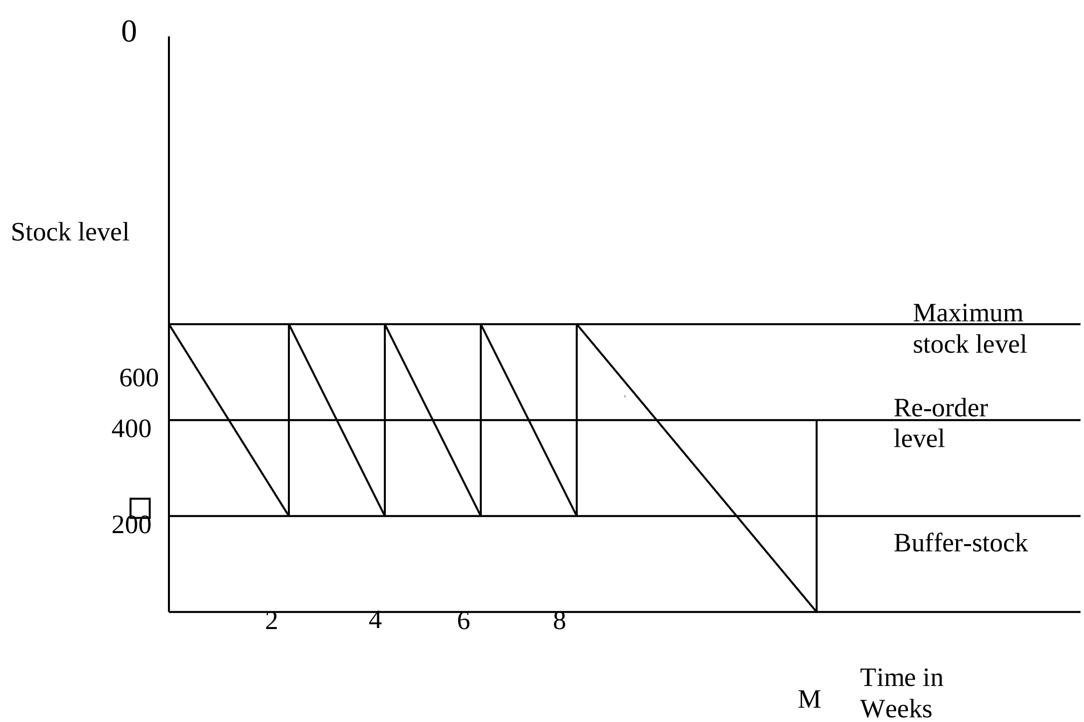
You are required to:

1. Define the following terms as used in the passage:
1. internally generated funds [2]
1. recession [2]
1. decentratised [2]
2. How might market research results help Zenzele Ltd to determine the viability of its business in the new location. [8]
3. Suggest possible reasons why the firm might need to relocate. [6]
4. Discuss the likely implications of increasing direct taxation for the company. Comment on the possible changes the company might make to its marketing strategic. [10]

3. Fresh Confectionery Bakery

Fresh Confectionery Bakery bakes and sells confectionery to school tuck shops and supermarkets._A decision was made to subcontract the baking and for the company to concentrate on marketing. This move is aimed at reducing costs of acquiring advanced baking equipment. However part of management is against the idea of subcontracting because they have argued that such a move can tarnish the relations with customers should there be delays in delivery.

The Production manager has provided information on the stock movement once subcontracting has begun. The stock control graph below shows how stock of confectionery will be managed.



5. Use the stock control chart in the passage to determine:

- The quantity of the product that is re-ordered each time. [2]
- The amount of the product that is normally required to be kept in stock all times. [2]

- Give two reasons to explain the change in the level of stock held between N and M. [4]

- State and explain two ways in which the company may seek to prevent customers canceling orders due to slow delivery. [4]

- Suggest three reasons why the subcontractor might find it difficult to expand his production meet the unanticipated demand. [6]
- How might Fresh Confectionery Ltd determine the level of stocks it should hold? [10]

- **MaMoyo's Meals On Wheels**

MaMoyo is in business to provide meals in a caravan to street vendors, commuter bus operations and the public at large. MaMoyo is a former civil servant who used to teach Food and Nutrition at Secondary School level. She resigned in 2000 to engage in the Catering business and used her retirement package to start her Meals On Wheels business. During her last five years her business has shown rapid growth and she ha engaged three extra caravans.

Gwebu, her financial advisor has advised her to consider renting some buildings to open up new restaurants. MaMoyo has expressed concern that with her limited managerial skill such an expansion may be disastrous. Gwebu has tried to explain the advantages of growing large and has even tried to highlight economies of scale resulting from growth.

MaMoyo has recently struck a deal with civil servants who occupy Mhlahlandlela Government Offices to supply them $1 000 000 worth of meals a day. The direct material costs are estimated at $200 000, the direct labour costs at $400 000 and general overhead costs apportioned to this job at $250 000. MaMoyo is working hard to fulfill this order.

- Suggest three possible sources of finance MaMoyo can use to financial the expansion of her business. [3]
- Calculate the contribution to fixed costs to be expected from accepting the Mhlahlandlela order.[3]
- Explain to MaMoyo the possible economies of scale she can enjoy if the expansion goes ahead. [6]
- Discuss how MaMoyo might motivate the staff to accept the heavier workload, if the restaurant expansion goes ahead. [8]
- What disadvantages might the expansion program bring to Meals on Wheels and its owner. [10]

CHAPTER 6

BUSINESS FINANCE

6.1. The need for finance.

Own savings – money for finance used to start up a business.
Investment finance – money used to purchase additional fixed assets e.g. machinery, motor vehicles or premises.

Why do business activities require finance.

(i) **Starting up -** getting up a business requires finance from the owners' savings.
(ii) **Expansion-** the business will need finance to grow in size.
(iii) **A business will need finance to provide for working capital requirements, that is** day – to – day operations.
(iv) To finance export trade.
(v) Special situations e.g. an extra – ordinary order from a customer.

Capital and revenue expenditure.

(a) Capital expenditure is expenditure for the purchase of assets that last for more than one year (fixed assets) such as machinery, motor vehicles and buildings.
(b) Revenue expenditure is spending on all costs and assets that will last less than one year such as wages, salaries, telephone and stock.

6.2. Working capital.

It is money used for the day – to – day operations of the business such as payment of wages and salaries and purchase of stock. It is the sum of current assets minus current liabilities. No business could survive without current assets.

Question. Where does the capital to purchase and hold these current assets come from?
Most businesses will obtain some of this finance in the form of current liabilities – overdraft and creditors.
Without sufficient working capital the business will be illiquid.

Cash + short term loans and overdrafts enable the firm to purchase stocks of raw materials. These are processed and transformed into work – in – progress and then finished goods.
Sale of goods will result either in immediate cash inflows or creation of debtors. Inflow of cash over a period should be in excess of cash outflow. This is because of the need to pay. (i) Interest (ii) for additional capital assets.

Over trading - is a situation of excessively rapid growth with insufficient working capital. A business, which is fundamentally sound, might have difficulties in raising sufficient funds to repay its debtors as they fall due

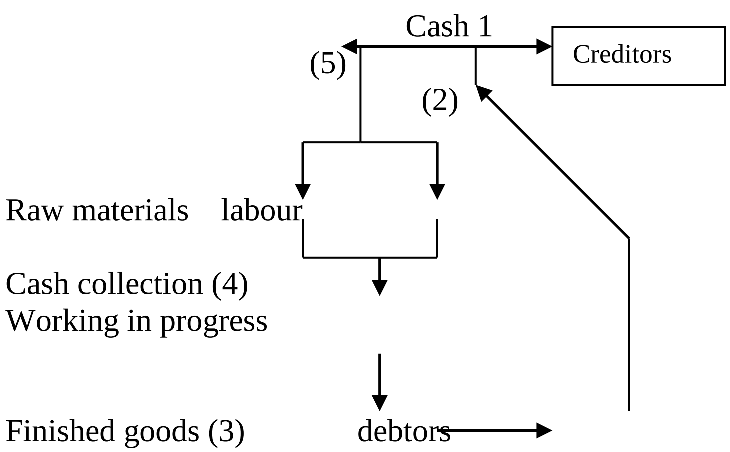
6.3. Working capital requirements.

Sufficient working capital is necessary to prevent a company from becoming illiquid .Too high in working capital creates an opportunity cost of too much working capital tied up in stocks, debtors, and idle cash.
Working capital requirements depend on the length of the working capital cycle.

6.4. Working capital cycle.

This refers to the time it takes for raw materials to be turned into finished goods and finally turned into cash sales.

1. Borrowing.
2. Purchases
3. Sale of goods.
4. Cash collection.
5. Repayment.



Credit purchases will lengthen the time before a sale is turned into cash.

1. Credit received by a business will lengthen the time before stock purchased has to be paid for.
2. To give more credit than is received is to increase the need for working capital.
3. To receive more credit than is given is to reduce the need for working capital.

Managing working capital.

1. Debtors.

a) Not extending credit to customers or extending for shorter time periods. However management must also consider the chances of losing customers to competitors.
b) Selling debtors to specialist financial institutions acting debt factors.
c) Being careful in assessing the credit worthiness of new customers.

6.5. Stock Management.

a) Keep small stock balances.
b) Use of computer system to record sales, stock levels and ordering when required.
c) Use of Just – in – time (J.I.T) system.

3) Management of Cash.

a) Use of cashflow forecasts.
b) Wise use or investment of excess cash.
c) Planning for too little cash and provision for overdraft made with the bank.

Management of creditors.

a) The firm can increase the range of goods or services brought on credit. This could be simple if the business has a good credit rating.
b) Extend the creditor payment period. Big firms enjoy favorable payment periods due to their sizes (financial economies of scale).

6.6. Sources of Finance.

a) **Internal sources-** money raised from the firm's own assets and retained profits.
b) **External sources- money** raised from sources outside the business.

Internal sources of finance.

a) A firm trading profitably will result in some of these profits being taken in tax to the Government, interest to financial institutions, payments of dividends to shareholders and the remainder will be **ploughed back (retained)** into the business for future use. This is only available to businesses that have been operating for more than one year generating a profit.

b) Sale of assets- well – established companies may discover that there are assets that are no longer fully utilized. These could be sold to raise cash. Some firms sell assets that they need to use but they do not intend to own. The assets are sold to specialist's financial institutions and are leased back by the company. The process is known as sale and lease back.

c) Reduction in working capital- when companies increase stock levels or sell goods on credit to customers, they use a source of finance when the current assets are reduced.

d) Sale of shares to existing shareholders- this is known as a rights issue. Shares will be sold at a price lower than what a public offer could fetch. However, it has the advantage that it does not result in the dilution of equity.

External sources of finance.

a) **Short term sources of finance:**

Trade credit: this involves delayed payment of bills for goods. The suppliers are providing goods without receiving immediate cash and this is as good as just lending money.

Bank overdraft: is the most flexible of all the sources of finance and also unsecured. The amount raised fluctuates daily depending on the particular needs of the company. Firms may need to increase bank overdrafts for short periods of time if customers do not pay as quickly as expected or if a large delivery of stock has to be paid for.
Bank overdrafts carry high interest rates. If a bank becomes concerned about the stability of one of its customers, it can "call in" the overdraft and force the companies to pay it back.

Debt factoring. - The business will sell its debts to a debt factoring company. In this case immediate cash is obtained.

6.7. Medium term sources of finance.

Hire purchase - payment of a fixed asset by installments. The financier remains the legal owner of the asset until the hirer pays the last installment – it avoids a large cash payment to buy the asset.

Leasing - involves a contract with a finance company to acquire the asset and not purchase it. Payments are made over the life of the asset but do not involve ownership.
It is payment for the use of an asset rather than its purchase.

Advantages of leasing.
1. Lease payments are tax –deductible.
2. There is no need for a deposit.

Disadvantages of leasing.
1. Payments will be greater in the long run.
2. Payments are out going.
3. The lease agreement may place restrictions on the use of certain products or materials.
4. Leasing does not benefit from residual value.

Medium term bank loan - this form of finance is used to purchase assets with a corresponding life and also to convert a persistent overdraft into bank loan.

Long – term finance - two main sources are debt and equity.
Debt finance- increases the liabilities of the business and can be offered at fixed rate of interest secured against specific assets and have fixed date of maturity.
Mortgage- finance to purchase land and property obtained from commercial banks and building societies. It has to be secured against the land or buildings. However the business should retain some liquidity to enable it to pay for interest charges.
Debentures - these are marketable securities that carry a fixed date of maturity. Just like shares they can be issued at a price different from the nominal value. It is secured against fixed assets.

Sale of shares- companies can issue shares to the public. The types of shares are preference shares and ordinary shares.

Permanent finance - takes the form of shares, which cannot be redeemed.
Long term loans – repayment after ten years.

Debt vs. equity.
Debt refers to loan finance. There is a legal obligation to pay interest and to repay the capital amount when it is due.
Debt finance is usually secured against specific assets and this reduces control over them. It carries a fixed rate of interest and has a fixed maturity date.

Equity represents ownership and there is no legal obligation to pay dividends, although shareholders need to be satisfied.

Debt finance increases the risk of insolvency. This is especially true when a large proportion of a company's capital is in a form of debt than equity. Such companies are said to be highly geared.

Advantages of high gearing.

1. No dilution of equity.
2. Interest on loans is an expense for tax purposes whereas individuals are paid after tax.
3. Lenders have no voting right at annual general meetings.
4. Loans will be repaid at last, so there is no permanent increase in the liabilities of the business.

Disadvantages of high gearing.

1. Increased risk for shareholders as they can lose their investment in the company during liquidation.
2. There is increased risk of the company failure due to high interest payments.
3. Most assets will be pledged thus reducing control over them.
4. It reduces prospective creditor willingness to grant further loans.

Finance for unincorporated business.

These are sole traders and partnerships. They cannot sell shares to investors and are unlikely to be successful in selling debentures since they are relatively unknown.
Owners will access bank overdrafts, loans and trade credit. They may borrow from friends and family members, use owners' savings and profits. Sole traders, can take on additional partners to influence more capital
The aspect of unlimited liability increases lender reluctance to lend to small businesses, unless the owners give personal guarantees, supported by their own assets. Grants are also available to small firms and newly established firms from Governments.

Factors influencing choice of finance.
Legal structure and the desire of owners to retain control – the original owner's will find it difficult if a public limited company is formed. Sole traders face the same dilemma when accepting partners into their businesses. Loans and retained profits may solve the problem.

Time period for which finance is required - It is not proper to pay for long term growth plans with short term financing e.g. overdrafts. Banks have the right to withdraw such funding at short notice.
Short term capital needs such as financing stock should not be paid for by issuing shares.

Amount required - very substantial amounts of money could be difficult to raise from only loans. Banks and other financial institutions may be cautious. Equity finance is likely to be needed.
Gearing ratios- companies that are already highly geared, have little chances of obtaining additional funds through loans. Share capital and retained profits will be the likely sources of finance for long term needs.
Risks ventures- the greater the risk associated with the project, the more likely it is that speculate funding such as venture capital or share capital will be used.
Size of business- small business will not be able to access equity finance.

Revision Questions
1. Why do firms require funds?
2. Why is it important to manage working capital?
3. Discuss the differences between debt and equity financing?
4. What is financial gearing? Explain the implications of high gearing to a firm.
5. What is factoring and what are the advantages of factoring?
6. Some firms are said to be "highly geared" what does this means? What are the effects of this on employees, shareholders and creditors?
7. What sources of (a) long term and (b) short term capital are available

6.8. Money market

This is the market for short-term securities. The instruments / securities traded mature in less than one year and include treasury bills (TBs), negotiable certificates of deposit (NCDs), and bankers acceptance.

Capital market - this is the market for long – term securities such as debentures, preference and ordinary shares. They mature after one year. Used to finance expansion of corporations.

6.9. Typical examination questions

1. What is meant by the term 'working capital'? [3]
2. Outline the possible benefits and problems to a company of introducing 'just- in- time' manufacturing. [10]
3. Explain the factors affecting the amount of finance required by a business. [5]
4. What is retained profit? [2]
1.2. Briefly explain the three ways into which profits are divided at the end of the financial period. [6]
2. Distinguish between internal and external finance giving an example of each type. [4]
3. What is the 'Stock Exchange' [3]
3.2. Explain two functions of a Stock Exchange. [6]
4. Examine four methods of financing a firm can use to install a new machine. [8]
5. Examine the implications to a private limited company of issuing shares to the public. [6]

6.	Outline three ways by which working capital can be:	
	i.	increased [3]
	ii.	reduced [3]
7.	What information might prove useful to a bank manager before approving a loan application? [6]	

6.10. Essay questions

1. Evaluate Leasing as a method of raising finance. Comment on the factors to be considered in deciding whether or not an asset should be acquired by lease or purchase. [25]
2. Evaluate the policies that might be used to ensure an adequate supply of working capital. [25]
3. Garai Ltd has a gearing of 30%. The company now wishes to raise additional $5 billion to finance the development of a new product. Evaluate the implications of the relevant alternative sources of finance. [25]
4. 'The use of information technology [IT] can improve the liquidity and profitability of a firm.' Discuss [25]

6.10.1. Case Study

Tom and Jerry Manufacturing

Tom and Jerry Manufacturing is a company that processes wheat to produce flour. The directors of the company have announced that the company is facing problems of working capital management.

The company has employed an accountant to address the directors on ways of tackling working capital problems. The accountant, Mr. Cooper, has explained that there are some external ways of increasing working capital. However even if one or other of the various external ways of increasing working capital are used he said that remains essential to monitor and control the key internal factors.

The accountant has also noted that Tom and Jerry Manufacturing is also suffering from over-trading. He has said that one of the objects of monitoring working capital and cash flow is to avoid over-trading and its consequences. Mr. Cooper has stressed that increasing sales is normally an excellent thing for Tom and Jerry Manufacturing but care must be taken that there is sufficient cash to support the inevitable increases in stock and debtors and to pay creditors on time.

1.(a) What is working capital? [5]
(ii) Analyse ways of managing debtors to reduce working capital problems. [5]
(b) Suggest and explain four:
(i) Internal
(ii) External key elements of increasing working capital. [10]
(c) Explain the term 'over-trading'. What are the main indicators of over-trading. [10]

1. Marula Preservation

Mbiko and Njobo graduated in 2000 at NUST with science degrees. The two graduates have come up with a brilliant idea of forming a company that will collect, preserve and store the wild fruit called Marula. This fruit is commonly found in the dry parts of Zimbabwe such as Matabeleland South. Mbiko and Njobo have argued that they have watched as the fruit goes to waste each year without any means of preserving it.

Mbiko and Njobo have approached a local commercial bank to negotiate loan conditions. However the bank manager has advised them to come up with a project proposal and a cash flow forecast.
The bank manager has also given them a loan application form to fill in. Mbiko and Njobo have been met with a lot of challenges.

1. (a) What challenges do you think will face Mbiko and Njobo in this project. [5]
(b) Explain the likely problems Mbiko and Njobo will face in drawing up a project proposal. [5]
(c) Draw a typical format for a cash forecast.
What are the benefits of a cash forecast to a company. [10]

(d) What information would the bank manager collect through the loan application form. [10]

Good Morning Start Ltd

Good Morning Ltd manufacturers a breakfast cereal which sells at $50 000 per packet. Current output is 200 000 packets per period which represents 80% of capacity. They have the opportunity to use the surplus capacity by selling their product at $30 000 per packet to a supermarket chain who will sell it as an ‘ own label’ product.

Total costs for last period were $70 ,000, 000 of which $20 000, 000, were fixed.
Good Morning Ltd is considering exporting its cereal to various countries. However speculation has been high that the Zimbabwean dollar is likely to gain value against other currencies. Previously the exchange rate has been to the company’s favour and due to an imminent increase in the value of the local currency directors of Good Morning start seem to be reluctant to sell to other countries.

1. (a) Calculate the total cost per packet for the last period. [4]
(b) Should the supermarket order be accepted even though the selling price is low? [7]
(c) Explain the term ‘own label’ and suggest the reasons why supermarkets prefer to sell goods under their ‘own label’.[7]
(d) Explain how the movements in the exchange rate will affect the activities of Good Morning start Ltd. [12]

CHAPTER 7

ACCOUNTING FUNCTION.

Accounting – it is a technique for collecting, recording, analysing and evaluation of financial data of a particular company so as to describe the present situation and to assist the process of decision making.

7.1. Types of accounting.

Financial accounting - that part of accounting which is concerned with external reporting to various stakeholders It refers to people and or organisations having interest in the financial state of the company.
Internal users- the workers and mangers.
External users - Government, shareholders and other stakeholders.

Differences between financial and management accounting

A Budgets
B Costing techniques such as Marginal costing, Absorbing costing and standard costing.

The main functions of management accounting

1. To classify and calculate costs of production. This is known as cost accounting.
2. To provides estimates of future Management accounting is concerned mainly with internal reporting to the managers of an enterprise while financial accounting is concerned mainly with external reporting to shareholders , government and other users of accounting information outside the enterprise
3. Management accountants seek to support management decision making by the provision of information and the analysis of financial performances while financial accounting acts as the steward of financial resources entrusted to it by the owners (e g shareholders)of the enterprise.
4. As the data is required for internal purpose the management accountant is not constrained by the need to comply with regulations on the format for presentation while in financial accounting there is need to comply with regulations as accounts are prepared for external reporting.
5. Management accounting emphasises the control and decisions making function while financial accounting relates to the stewardship function of management and also it is a means of ensuring the accountability of the controllers to the owners of the enterprise.

The major financial accounts

A Profit and loss account
B Balance sheet
C Cash flow

Major management accounts

1. expenses and revenues. This is known as budgeting.
2. To identify inefficiencies within the organisation.
3. To control costs and manage the flow of cash.
4. To seek opportunities, e g to identify tax breaks, possible cost savings and movements in foreign exchange rates which could be exploited by the firm.

Stakeholders of accounting data and reasons for their need of the data.

Business managers.

1. To measure the performance of the business.
2. To help them take decisions such as new investments closing departments and launching of new products.
3. To control the performance of each division in the Organisation.
4. To set targets / budgets for the future and compare these with actual performance.

Creditors.

1. To see if the business is secure and liquid enough to pay off its debts.
2. To decide whether the business is a good credit risk.
3. To decide whether to press for payment

Banks.

1. To decide whether to lend money to the firm.
2. To decide whether to allow for an increase in overdraft facilities.
3. To decide whether to continue with loans or overdraft facility.

Local community.

1. To see if the business is profitable and likely to expand operations.
2. To determine whether the business is making profits or losses as this could affect its future.
3. To decide if there is need to get involved and if so, how?

Workforce.

1. To decide whether the business is secure enough to pay wages and salaries.
2. To determine whether the business is likely to expand or to be reduced in size.
3. To decide whether jobs are secure.
4. To find out how the average wage in the business compared with salaries of directors.

Government and tax authorities.

1. To calculate how much tax is due from the company.
2. To determine whether the business is likely to expand and create more jobs.
3. To decide whether the business is in the danger of closing down, creating more economic problems.
4. To confirm that the business is operating within the law.

Investors – shareholders of the business.

1. To asses the value of the business and their investment in it.
2. To decide whether the firm is becoming more or less profitable.

3. To determine what share of the profits investors are receiving.
4. To decide whether the business has potential for growth.
5. If they are potential investors, to compare these details with those from other businesses before making a decision to buy shares in the firm.
6. If they are actual investors, to decide whether to consider selling all or part of their shareholding.

Customers.
1. To decide whether the business is secure.
2. To determine if they will be assured of future supplies of the goods they are buying.
3. To decide whether there will be security for spare parts and service facilities.

Limitations of published accounts.

1. Companies only publish the absolute minimum of the accounting information as laid down by the company law.
2. Other businesses do not have to disclose any information to the public but may be asked to bring their accounts to the banks and tax authorities.
3. Obtaining a copy of the published accounts of a public limited company will allow one to see the extent of disclosure required by the law.

Data that does not have to be published in annual reports and accounts include: -
1. Details of sales and profitability of each product or service.
2. Research and development plans of a business.
3. The exact future plans for the expansion of the business.
4. Performance of each department or division.
5. Evidence of company impact on environment and local community.
6. Future budgets or plans.
7. The dates published are all past and may not be valid today.

Management accounting.
It is concerned with internal reporting to the mangers of a company. It emphasizes the decision making and controlling of business.

Functions of management accounting.
1. To control expenditure by comparing actual with expected expenditure- budgeting control.
2. To classify and calculate the costs of production cost accounting.
3. To determine the profitability of each product or division.
4. To decide on alternative courses of action.

7.2. Accounting principles/ concepts/ conventions.

They enable the users to ensure that data are uniform.

Double entry.
All transactions are viewed from two angles e.g. expenditures of money and acquisition of assets. The accounts must balance each time a business engages in a transaction e.g. buying materials or selling goods.

1. Reduction in the store's stock of flour.
2. Increase in the owner's till receipts.

Transaction.	**Dual aspect for the transaction.**
Sale of goods for cash	- Goods have left the store. - Cash has been received by store.
Purchase of goods by cheque.	- Goods received by store. - Bank balance reduced.

Purchase of motor van by bank.

Motor van A/c

Dr	Cr
20 May 2005 Bank $50m	

Bank A/c

Dr	Cr.
20 May 2005 Motor Van	$50m.

Prudence concept / conservatism.

Final accounts always employ the least favorable position.**.** Thus losses are overstated and profits are understated.

[The principle states that managers must provide for and record losses as soon as they are anticipated. Profits should not be recorded until they have been realised. i.e. until it is certain that goods have been sold at a profit.]

The need for prudence is a result of managers being required to estimate when drawing up accounts. These include non- payment of debts by customers, accrued expenses and the amount by which assets will be depreciated over time.

7.3. Accruals concept / matching principle

Concerned with matching the revenue earned in an accounting period with expenditure incurred in earning the revenue. Hence, the income of a particular period is matched to the costs of the same time period.

It arises when services have been supplied but have not been paid for at the time accounts are drawn up. For example a firm pays a bill for one month after accounts are drawn up at end of accounting period, then it would have used one month's electricity without having paid for it. Without making adjustments, the results would be:

1. Profits in current period will be overstated as the one-month's electricity has not been charged to this accounting period.
2. Profits in the next year will be understated, it will include the last year's electricity bill.
3. As these costs have been incurred but not yet paid for, then they are added to current liabilities.

Accruals income results in high reported profits.
e g income received $3000 000
Accrued income $7000 000
In the trading profit and loss account the total revenue recorded will be $10 000 000. Therefore reported profits will be overstated.

Accrued expenses are added to the total expenses thus increasing the total expenses . this has an effect of reducing reported profits.

7.4. Realisation concept.

Sales revenue is recorded when the goods have been sold even though cash might not have been received. Purchases are included when goods are taken into stock whether or not they have been paid for.

Profit and loss account.

$	**$**	**$**		
Sales revenue			xxx	
Less: cost of gods sold				
Materials	xx			
Direct labour	xx			
Other direct expense		xx		
xx				
Add: production overhead	xx		xx	
Gross profit.			xx	
Less: selling expenses	xx			
Administration expenses	xx		xx	
Trading / operating profits			xx	
Add non-operating income			xx	
Profit before interest & tax			xx	
Less interest expense			xx	
profit before tax				xx
Less: taxation			xx	
profit after tax			xx	
Less: dividends			xx	
Retained profit for the year			xx	

Appropriation account.

Provides information on the way profits are dispersed. Part is taken in tax payments, and some is drawn from the business as dividends. The remainder is retained within the business for investment.

Uses of P/L accounts.

It can be used to measure and compare performance over/time or with other businesses.
Can be assessed in comparison with expected level of the business.
Bankers and lenders will need the information to decide whether to lend money to the firm.
Investors may judge the value of putting their money with business.

7.5. Balance sheet.

It is a statement showing a company's assets liabilities and owners equity at a specific date.
Books of Tatenda Eve Ltd.

Balance sheet as at 31 December 2005.

Cost	**accumulated depreciation**			**N.B.V**	
Fixed Assets.					
Motor vehicle		Xx		xx	xx
Land		Xx		-	xx
Xx	xx			xx	
Current assets.					
Stock		Xx			
Debtors		Xx			
Cash / bank		Xx		xx	
Less current liabilities.					
Creditors		Xx			
Dividends		Xx			
Provision for tax		Xx			
Overdraft		Xx		xx	
Working capital			xxx		
Net assets		xxx			
Less: long term liabilities		xxx			
Xxx					
Shareholders' funds.					
Share issues		xxx			
Share premium			xxx		
Reserves		xx		xxx	

Fixed assets take form of tangible and intangible assets.

Intangible assets

- these do not have a physical form.

They enable a business to access for funds on the open market. They affect the continued existence of the business. Examples are goodwill, development costs, trademarks and patents.

<u>Goodwill</u>

-is defined as the value of a business less the value of assets net of liabilities.

Purchase price:- Value of net assets= goodwill

1. It is included as an intangible fixed asset in the balance sheet.
2. An example, a business that has a net asset value of $120 million recorded in its Balance sheet is purchased for $150million. The purchaser has paid $30 million for goodwill because of the advantage of the business as a going concern.
3. These advantages include:
4. Existing customer base.
5. Reputation for quality.
6. Marketing skills.
7. Technical know- how.
8. Business connection.

9. Management ability and workforce.

Tangible assets – these are assets with a physical substance, and can be touched

7.6. Current assets.

Stock- goods that the firm possesses and expects to sell in the normal course of business. Three types of stock are raw materials, work – in – progress and finished goods.
Debtors- goods or services sold but not yet paid for. A certain proportion will become 'bad debts.
Cash - this is the liquid resource of the company e.g. cash on hand, cash at bank

Current liabilities.

Obligations or debts of a firm to be settled within the year. Expected tax payments are treated as a current liability.
Dividends declared but not yet paid are a current liability for which provision has been made.
Overdraft – banks can demand their money without notice.

Working capital.
This is the difference between current liabilities and current assets

7.7. Limitations of balance sheets

A balance sheet is prepared as at a certain date and it is, in a sense , a snapshot of the position at that date . It is possible that the position will change fundamentally within a short space of time
A balance sheet ignores items that cannot be expressed in monetary terms e g the level of motivation of workers
Various accounting concepts used in the preparation of Balance sheet will affect the figures shown in the balance sheet e g the net book value of fixed assets varies with the method of depreciation used , while the value of stock depends on the method used for valuing stock.
The balance sheet does not reveal the current value of assets unless property is revalued to show current value
The balance sheet is does not record the value of the business unless it includes the value of intangible assets especially goodwill.
The size of profit of a business is affected by the method used to calculate:
1. Depreciation of fixed assets.
2. Valuation of stock.

7.8. Depreciation of assets.

Depreciation is an expense, since it is deducted from the income, it results in low reported profits. However depreciation does not involve any cash movement. The diminishing balance method will result in reported profits that will increase, as the asset grows old, as it charges falling amounts with the asset's useful life.

The straight-line method results in steady reported profits as the same amount is charged to the profits, throughout the assets useful life.

The amount of depreciation each year depends on (i) cost of the asset. (ii) Residual value.

Straight-line method.
A constant amount of depreciation is subtracted from the value of the asset each year.
Historic cost – residual value.
Expected life in years.
The cost of a motor van is $33 000. It's expected life in years is 6 and will have a residual value of
$3 000. Its depreciation is therefore $5 000 per year.

It is unrealistic to assume that an asset will depreciate by an even amount each year.

Reducing balance method.

Sometimes known as the diminishing balance method. The method reduces the value of fixed assets by a constant percentage of the net book value. Thus if it is decided to depreciate fixed assets by 30% each year, then the amount of depreciation of an asset originally costing $1 000 000 will be as follows:

Cost	1000 000		
Depreciation in yr. 1 31/12/. 30% x 1 000000	300 000		
Balance @ start of yr. 11	700 000		
Depreciation at end of yr. 11 30% x 700000	210 000	– (210 000)	
Balance at beg of yr. 111	490 000		
Depreciation at end of yr. 111 30% x 490 000			147 000
		343 000	

Depreciation is greatest in early years but reduces with the asset's useful life.

7.9. Stock valuation.

Stock valuation is important for the final accounts of the business and for pricing issues from stores.
It is important to value stock because it enables one to calculate the cost of sales.

Net realisable value.
It is selling price minus costs incurred to put the goods into a saleable condition

7.10. First in, first out method (FIFO).

The oldest stock is issued out first. The price paid for the first batch is used for all issues until that particular batch is used up.
In period of rising pricess, FIFO undervalues issues.

Bharasa Ltd. had the following details for the month of September 2005.

Purchases		**Sales.**	
September 5	500 units @ $4	September 7	400 units @ $7
September 16	1300 units @ $6	September 18	1200 units @ $12
September 22	900 units @ $7	September 30	900 units @ $15

Opening stock 300 units @ $3.

Required.

a) Show the value of closing stock using F.I.F.O and L.I.F.O (last in first out).

b) Prepare the balance income statement for the month of September.

Date	**receipts**	**sales**	**balance**	**Value**
Sep. opening stock.			300 @ $3	900
5	500 at $4		300 at 3 500 at $4	2900
7		300 at $3 100 at $4	400 at $4	1600
16	1300 at $ 6		400 at 4 1300 at $6	9400
18		400 at $4 800 at $6	500 at $6	3000
22	900 at $7		500 at $6 900 at $7	9300
30		500 at $6 400 at $7	500 at $7	3 500

7.11. Last in first out method (LIFO).

The method prices issues from stock at the most recent purchase price. When that batch is finished, price of the previous batch is then used. Thus the last consignment received is issued/ sold first.

L.I.F.O last in first out.

Date	receipts	sales	balance	Value ($)
Sept: balance b/fwd.			300 at $3	900
5	500 at $4		300 art $3 500 at $4	2 900
7		400 at $4	300 at $3 100 at $4	1 200
16	1300 at $6		300 at $3 100 at $4 1300 at $6	9 000
18		1200 at $6	300 at $3 100 at $4	

			100 at $6	1 800
22	900 at $7		300 at $3 100 at $4 100 at $6 900 at $7	8 100
30		900 at $7	300 at $3 100 at $4 100 at $6	1 900

b) Prepare the income statements:
Stock valuation is for purposes of calculating the value of closing stock. Justify the statement that size of profit is affected by the method used to value stock.

Effects on reported profits of LIFO and FIFO

LIFO
Last in, Last out

1. This methods results in high cost of goods sold since it charges the latest costs of goods, thus it results in low reported profits.
2. However during falling prices, LIFO can result in overstated reported profits. During inflation LIFO results in low reported profits.

FIFO

1. First in, First out
2. This method results in low cost of goods sold as it charges outdated costs to the trading profit and loss account . This has a an effect of reporting high profits.
3. During falling price, FIFO can result in understated reported profits
4. During inflation FIFO results in high reported profits.

Ratio analysis – analysis of published accounts.

Ratios assess the profitability, solvency, and efficiency of the business.
Areas of concern are highlighted and decision making can be improved.

7.12. Profitability ratios.

They assess how successful managers of a business have been at earning profits from sales, and from assets employed.

a) Gross profit margin = gross profit x 100
Sales.

Bharasa	car sales	Dz. car sales.
2001 net profit	500m	50m
2001 turnover	3 200m	250m
Capital employed	5000m	400m
2002 gross profit	800m	125m
Sales	3200m	250m

2002 Bharasa car sales Dz car sales

Gross profit ratio <u>800</u> x 100 <u>125</u> x 100
3200 250

= 25% **= 50%**

Gross profit ratio shows the percentage profit available to pay overheads. Companies require a ratio of at least 20% if they are to pay their expenses. If the ratio is falling overtime, thus could be due to: -

1. Failure to pass on cost increases to customers.
2. Fraud.
3. Stock losses.
4. A difference in product prices with a move towards low margin goods

NB. Bharasa car sales could be adopting a low price strategy to increase sales. The company could increase its ratio by seeking a cheaper supplier or increase the price of the product by offering a better service.
Gross profit is a good indication of how effective managers have added value to the cost of production.

Net profit margin- compares net profit to sales turnover (net profit = earnings before interest and tax (E.B.I.T)

Bharasa car sales	Dz. car sales.
<u>Net profit</u> x 100	<u>net profit</u> x 100
Sales	sale
<u>500</u> x100	<u>50</u> x 100
3200	250 1
16%	**20%**

Dz. car sales has a relatively high overheads compared to sales when contrasted with Bharasa. Bharasa can further narrow the gap by further reduction in the expenses while maintaining sales. As with all ratios, comparison overtime will indicate whether the performance and profitability of the company were improving or not.

Return on capital employed (R.O.C.E) – compares profit with capital, which has been employed in the firm. Capital employed is equal to owners equity plus long- term debt.

Bharasa car sales	Dz. car sales.
R.O.C.E = **<u>net profit before interest & tax</u>** = **Capital employed**	**<u>net profit before interest and capital</u>** **capital employed**
<u>500</u> x 100 400	<u>50</u> x 100
10%	**13%**

The higher the value, the greater the return on capital invested in the firm. Making comparison overtime permits the establishment of the pattern of profitability of the company. R.O.C.E can be compared with return on interest accounts – could the capital be invested in a bank at a higher interest with no risk.

7.13. Liquidity ratios.

They assess the ability of the firm to meet short-term financial obligations i.e. the short-term financial health of the business. They are not concerned with profit but the working capital that the firm could be come illiquid and unable to meet short term debts.

Activity
State two liquid assets of a business. [2]
Why is liquidity important to any business? [4]

Current assets ratio = current assets
Current liabilities.

It should be between 1.5 and 2. If the ratio is low, it may be difficult for the company to repay loans. If greater than two, it suggests that money be tied unprofitably in excess current assets. This could be money tied up in bank accounts or too much stock levels. If a high proportion of current assets are in stock, then the business will be forced to sell stock at a discount to meet current liabilities.

Acid test ratio = Current asserts - stock
Current liabilities
Current liabilities.

	Current assets	Current liabilities	Current ratio
Dz. car sales	60	30	2:1
Bharasa car sales.	240	240	1:1

Very low current ratios are common for retail forms such as food outlets. They have regular inflow of cash that they can rely on to pay short-term debts.
The current assets ratio over 2 suggests that too many funds are tied up in stock, debtors and cash and would be better invested in profitable ventures. Too low a ratio leads to corrective management action to increase cash. Measures include: -

- Cancel capital spending plans.
- Sale of redundant assets.
- Share issues
- Taking out long term loans.

7.14. Liquidity vs Profitability

Can a profitable firm face liquidity problems?
Profitability is measured using the accruals concept. Accrued income is taken as income received while there is no cash received. This means that profitability is overstated by recording accrued income while liquidity is suffering as there is no cash received.

Debtors increase the revenue figure recorded in the profit and loss account while there is no cash received. This gives a picture of a profitable firm suffering from liquidity problems.

Prepaid expenses are deducted from the profit and loss resulting in an overstated profit figure, while cash will have been paid thus reducing liquidity.

1. Cash may be tied up in debtors for credit sales
2. Matching concept –profit calculation includes monies unreceived
3. Cash tied up in stock
4. Purchase of fixed assets includes large amounts of cash paid which are not shown in the calculations of profit

7.15. Efficiency ratios.

They assess how effective the resources or assets of a business are being used.

Rate of Stock turn = <u>cost of good sold</u>
Average stock

Where average stock=<u>Opening stock + closing stock</u>
2

The result is the number of times average stock is turned over in a period. A high stock turn suggests the business has been active and efficient in selling goods. The rate will vary from firm to firm. Firms that supply high value gods will turn over stock very slowly.

Debtor days = <u>average trade debtors x 365</u>
Total credit sales.

It measures how long on average it takes for the business to recover payments from customers who bought goods on credit. The shorter this time period the better management is at controlling its working capital.

Creditor days = <u>average trade creditors</u> x 365
Total credit purchases

Shows that the average length of time taken by a business to pay its debts. If this is rising it could suggest difficulties in finding sufficient cash to meet its obligations.

7.16. Shareholders ratios.

They are of particular interest to potential investors in a business. Buying shares have two types of return: -

Capital gain $\longrightarrow$ made by share price rising.
Dividends $\longrightarrow$ paid by companies annually unless profits are low or losses are made.

7.17. Dividend yield.

Measures the rate of return a shareholders get at the current share price.

	Dividend per ratio	Market share price	Dividend yields ratio
Bharasa car sales	15c	$3,00	15/300 x 100
Dz car sales	70c	$ 10,00	70/1000 x 100 = 7%

If the share price increases due to increased prospects of business, with unchanged dividend, the dividend yield will fall. If the directors propose an increased dividend, but the share price does not change – the yield will increase. This rate can be compared with bank rates and dividend yields from other companies.

N.B. a high yield may not indicate wise investment but could be due to a fall in share price. Therefore the results must be compared with previous years or other firms.

Dividend cover.

The number of times the ordinary shares dividend could be paid out of current profits. The higher this ratio, the more able also the company is to pay proposed dividends leaving a low figure indicate that the directors are retaining most of the profit.

Net profit after interest and tax =divided cover
Dividends (proposed and paid)

Return on equity
-Measures the return on shareholders investment (share capital + reserves).

Net profit after tax and interest and preferred dividends
Shareholders funds (equity)

Earnings per share
Measures the profit per ordinary share

Net profit after tax and interest
Number of ordinary shares.

This is likely to be lower than the dividend per share since some of the profits available for distribution are retained.

Price / earnings ratio.
Provides the measure of the profitability of the share both in terms of capital value and earnings.

Market price per share.

Earnings per share.

7.18. Gearing ratios.

Shows the balance between equity and loan finance.

<u>Fixed interest capital</u> x 100
Capital employed.

In a highly geared company, a high proportion of finance is loan finance and as a result there may be problems in meeting interest payments. The higher the gearing, the greater the dividend fluctuates.

7.19. Importance of ratios.

Ratios facilitate the evaluation of business performance. By taking comparison overtime or with similar firms, ratios can be used:

1. To identify problems before they become acute.
2. In forecasting and planning.
3. As data for decision making.
4. To assess performance.
5. To show interrelationships between variables.
6. To summarise data.

7.20. Limitations of ratios.

Inter- firm comparisons are only valid if the firms use the same practice in relation to depreciation and stock valuation.
Published accounts are by nature historic in that they relate to previous time periods. Thus ratios based on published accounts may not be valid today.
When ratios are used for inter- firm comparisons, we must bear in mind differences in product mixes of various firms, even if they appear to be in the same industry. It is possible that the figure of one of the firms is distorted by its interests in activities, which are not common to its competitors.
Comparisons overtime are made more difficult by changes in the value of money (inflation). A rise in profit ratios may result from gains from inflation rather than improved performance and efficiency. Changes in foreign exchange rates, interest rates, taxation might be reflected in apparently improved performance. However, this is not the result of greater efficiency but rather of events beyond management control.
Ratios are distorted by short – term fluctuations and their timing e.g. liquidity ratios are greatly affected by seasonality in sales.
Ratios highlight problems but they do not tell the whole story. The current health of the firm might not be accurately reflected in the ratios. Qualitative information should also be considered such as quality of workforce, goodwill, labour relations, research and development programmes.
Some ratios can be calculated using slightly different formulae. Care must thus be taken to only make comparisons which result from using the same ratio formula. E.g Return on capital employed.

7.21. Cash flow management and budgeting.

Why is cash flow important to business.

Many businesses fail due to lack of cash. Cashflow i.e. cash inflow and outflow is crucial due to the following problems facing companies. With insufficient cash the firm will be unable to pay creditors on time leading to loss of discounts. Some suppliers will insist on tight conditions such cash on delivery and in some case legal action will be taken in against the firm by creditors.

Tax bills will either be delayed or may not be paid and the Government will take legal action. Investment in fixed assets will be difficult. Wages and salaries may be delayed leading to a high labour turn over, absenteeism, and demotivation.

Is profit cash?

A profitable business may experience acute cash shortages while a company recording a loss may have a cash surplus. Profit or loss received by a firm in one time period may not be the same as its cash balance. This is due to:

Capital expenditure is recorded in the profit and loss by including depreciation as an expense. Depreciation does not involve a cash outflow.
A business may be selling more of its products on credit. Profit will be made as goods are recorded as sold, yet cash payment from customers will be done at a future date.

7.22. Cash flow management.

Effective management of cashflow requires that managers assess:

1. The size and time of payment (outflows). This is influenced by the period of credit offered by suppliers and costs to the business.
2. The size and time of receipts (inflows). This will depend on the time taken by debtors to pay.
3. If other sources of finance are present to cover periods of cash shortages.
4. Time is of crucial importance to cashflow management.

7.23. Cash flow forecasts.

1. They contain estimates of cash receipts and payments. An expected cash deficit can be made good by making an arrangement for an overdraft.
2. A cashflow forecast enables management to plan ahead to prevent future cash problems.
3. Bank Managers are prepared to assist with loans firms that have shown the ability to repay.
4. Substantial cash balances have an opportunity cost of interest.
5. Overdrafts due to cash shortages have great cost in terms of interest charges.

<u>Tatenda eve (Pvt.) Ltd.</u>

Cashflow forecast year 2006 ($000 000)

Month	**Jan**	**Feb**	**Mar**	**April**	**May**	**June**
Cash receipts						
Cash sale	400	420	420	400	400	440
Payments from debtors	200	280	260	300	210	300
Other(loan received)	Nil	Nil	Nil	Nil	200	40
Total cash received						
Total cash in	600	700	680	700	810	780
Cash payments						
Materials	200	200	210	300	120	400
Labour	100	180	180	200	200	200
Rent	200	200	220	250	300	300
Interest	Nil	Nil	Nil	Nil	20	Nil
Adverts	Nil	100	Nil	Nil	Nil	300
Purchase of fixed assets					80	
Total cash payments	**500**	**680**	**610**	**750**	**720**	**1 200**
Net cashflow	100	180	70	50	90	420
Opening cash balance	100	160	200	200	200	280
Closing cash balance	0	20	270	150	290	140

Solving cash flow problems

1. Obtain cheap supplies of materials and component.
2. Reducing or delaying expenditure – the firm might cut costs, such as reducing promotional expenditures or delay the purchase of machinery.
3. Rent or lease equipment rather than buying it outright.
4. Delay the payments of bills.

5. Collect cash in early from credit sales of goods. The firm could:

i. Sell book debts to a debt factor.
ii. Use a bank overdraft.
iii. Obtain a short – term loan.
iv. Reduce the debtor period.
v. Sell and lease back.

Cashflow statement
Is prepared after the event in order to record the flow of cash into and out of a business.
Section A- show the net cash flow from its normal trading operations

Section B- deals with income from investments in other enterprises, less dividends paid

Section C- Taxation paid to the government.

Section D- Records the acquisition and disposal of assets.

Section E-	Net cash flow before the firm resorts to financing by means of share issue and loans.
Section F-	Shows finances movement through share or repayment of loans.

FORMAT		**$**	**$**
A.	Net cashflow from operations/Operating activities		1 000
B.	Returns on investments less payments of dividends		(100)
C.	Taxation paid		(100)
D.	Investing Activities		
-	Payments to acquire fixed assets	(1 800)	
-	Receipts from sales of fixed assets	10	(1 700)
E	Net cashflow before financing		(900)
F	Financing		
	Share Issue	800	
	Repayment of loan	(50)	
	Net Cash Inflow from financing		750
	Change in Cash		150

The reconciliation of operating profit to net cash flow from operating activities cash be shown as follows $

Operating profit	xxx
Depreciation	xx
Increase/Decrease in stocks	(xx)/xx
Increase in debt or/Decrease	(xx)/xx
Increase creditors/Decrease	xx/(xx)
Net cash flow from operating activities	xxx

Business Plan

Purposes of a business plan

1. To clarify your own thoughts and objectives by writing them down.
2. To support an application for finance
3. To monitor performance and pleasure success by assessing progress against the plan
4. To set targets for sales and profit
5. To identify the resources which are needed & the costs involved
6. Business plan is presented in five key parts:

(i) Objectives
(ii) Sales and marketing
(iii) Production
(iv) Resource requirements
(v) Financial support data

7.24. Budgeting

A financial or quantitative statement prepared and approved prior to a defined period of time, to be implemented during that period for the purpose of achieving a given objective.

Advantages of setting budgets.

1. Planning – budgets translates the objectives of a firm into intentions to be achieved. They provide a sense of purpose to the employees.
2. Effective allocation of scarce resources.
3. They facilitate co –ordination of activities and harmony between the different parts of the organisation.
4. Improves communication in the business.
5. Responsibilities are clarified.
6. They motivate staff.

Purpose of budgeting.

Budgets are plans of actions expressed in quantitative terms. Key features are that they;

1. Are prepared and approved in advance.
2. Cover a specific time period.
3. Relate either to the whole firm or a department.
4. Are expressed either in real physical terms or financial terms.

Besides budgets for specific organisational functions (functional budgeting), cash budgets are prepared, a schedule of expected cash flow and outflow as a result of activities in the functions.

The master budget is a statement of the future profit / loss account and balance sheet resulting from operations on the plans. Budgets translate plans into financial terms that clarify and focus are imposed on business planning. Decision-makers can view the financial implications of their plans and activities co-ordinated.

People responsible for spending under the organisation's budget arrangements are known as **budget holders.** They are required to make effective use of the financial resources made available to them with expenditure being up to or below the budget limit.

Budgets also provide a means of control with evaluation of performance in relation to expected performance – budgetary control.

Cost, revenue and profit centers.

Budgeting involves responsibility accounting. It involves techniques concerned with the responsibility of middle managers for achieving targets set. They are accountable to top managers for performance of their sections, departments or divisions. A production manager is responsible for production targets and keeping production costs within the budgeted limit. The Production Department is therefore a **cost center**.

The Sales Department can be seen as a revenue center. Revenue targets are set and variance calculated. In divisionalised organizations, profits centers can be identified. This refers to sections of the organization for which costs and revenues can be calculated. It is responsible for contribution to the overall profitability of the organization.

Key factors of the organization.

A budget is not simply a forecast. Budgets are plans that an organization aims to achieve. A forecast is a prediction of what could happen in the future under certain conditions.

Budgets may be for any of the business as long as the outcome of its operation is quantifiable. There may be sales budget, capital expenditure budgets, labour cost budgets, and so on.

Co – ordination between departments when setting budgets is important. This avoids departments making conflicting plans. For example, while the marketing department may be aiming to increase sales through lower prices, the production department may be planning to reduce output and lower the direct labour cost budget.

Establishing budgets should be an exercise in participation. Decision about budgets should include those involved in putting the budgets into effect. This helps to motivate the department concerned to achieve targets set and also leads to the setting of realistic targets.

The budget will be used to review the performance of the department and the manager concerned and can be appraised on their effectiveness in reaching set targets.

7.25. Setting budgets.

Incremental budgeting.

The budgeting process uses past data. The status will be accepted with a percentage added on for the inevitable cost rises due to inflation. For businesses that operate in highly competitive markets, there may be plans to lower costs for departments each year, but to raise sales budgets. This exerts pressure on staff to achieve higher productivity. Incremental budgeting does not allow for unseen circumstances. The use of past data as a basis means that each department does not have to justify its whole budget for the coming year.

Zero based budgeting.

This involves a critical review of all activities before they are budgeted for. This requires all departments and budget holders to justify their whole budget each year. This is designed to create a questioning attitude and instill discipline on those who formulate and hold budgets. It produces better decisions but it is time-consuming. It also provides an added incentive for managers to defend the work of their departments. The changing situations can also be reflected in very different levels each year.

Fixed and flexible budgets.

Fixed budget - relates to a single level of activity. It is based on the assumption that the level of output remains the same. If the output level falls above or below the budget, then this could lead to wrong conclusions – they will not reflect real efficiency problems.

Fixed budget report

Fixed budget for October	**Actual results**		**Variance**
Output 100%	80%		20%
$ (000)	**$ (000)**	**$(000)**	**$ (000)**
Direct labour	80	70	10f
Direct materials	56	50	6f
Fixed overheads	10	10	-
Total	**146**	**130**	**16f**

This shows a favorable variance of $ 16 000 because costs are lower than budgeted for and profits are expected to increase. However it ignores the fact that output is 20% below.

Flexible budget.

	Fixed budgets	**price/ variable cost per unit**	**Flexible budget for unit sales of 12 000**	**14 000**
Sales in unit sales revenue	10 000 $(000) 100	$ 10	12 000 $(000) 120	14 000 $(000) 140
Variable costs				
Raw materials	20	2	24	28
Direct labour	20	2	24	
Factory supplies	10	1	12	14
Sales commission	**10**	**1**	**12**	**14**
Total	**60**	**6**	**72**	**84**
Contribution	40	4	48	56
Fixed costs	**30**		**30**	**30**
P/L	10		18	26

It is possible to predict what costs will be if, instead of operating at the expected level, the firm produced at a different level. A flexible budget produces valid data since it highlights changes in cost caused by changes in efficiency. Flexible budgets are motivating for middle - and lower - level managers as they will not be criticized for adverse variances that might occur just because output was lower than expected. The flexed targets that are given are realistic.

7.26. Budgetary control and variance analysis.

A comparison of actual performance with expected performance for a particular activity is carried out at the end of each year. The process is called variance analysis – the difference between actual and budgeted figures. This is important for a number of reasons:

1. It measures differences from the planned performance of each department.
2. It assists in analysing deviations from budget.

The reasons for the deviation from the planned levels can be used to change future budgets in order to make them more realistic.

This performance for each section can be appraised in an accurate and objective way.

If actual costs are less than forecasts, it is a favorable or positive budget. If they exceed budgeted costs, it is a negative or adverse budget.

Disadvantages of budgets.

1. They use resources.
2. Value depends upon the quality of information.
3. Demotivating if participation was not part of the process.
4. Management becomes over-dependent upon the budget and neglects the process of management.
5. Can be used mechanically and inflexibly.
6. Obscures inefficiencies not included in the budget.

7.27. Typical examination questions

7.28. Structured questions

1. Explain the term 'Balance Sheet'. What information do you expect to get from a Balance Sheet. [6]
2. Distinguish between tangible and intangible fixed assets. [5]
3. A business has $10 000 in stock at beginning of the year, $20 000 at the end, its cost of sales is $60 000.
4. Calculate the business rate of stock turn showing all the working. [4]
5. Evaluate the usefulness of a stock turn over ratio. [6]

6. Explain giving an example of each, the four groups of ratios. [8]

7. a. Explain the term 'depreciation'. [2]
   c. Why is depreciation a provision rather than an expense?[3]

8. State and explain three items, which might be shown as current assets in the balance sheet of a business.

9. A firm is deciding to acquire a new machine. The machine costs $600 000 and is expected to have no residual value at the end of its useful life. The firm uses a straight- line depreciation method. The following are the expected cash flows from the machine.

Year	**1**	300 000
	2	200 000
	3	200 000
	4	100 000

You are required to:

i. Calculate the amount of depreciation each year. [2]

ii. Calculate Payback
iii. Calculate Average Rate of Return [6]

10. Net profit divided by Capital X 100.
    i. What is the name of this ratio? [2]
    ii. What information can this ratio provide?[4]

11. Distinguish between a budget and budgetary control? [4]
    i. Evaluate the usefulness of budgets to a business. [6]

12. Briefly outline the Net Present Value method of appraising a project. [4]
    i. How useful is NPV in appraising a project? [6]

628. Essay questions

1. The average rate of return is given as:

   <u>Average Profits</u>*100
   Initial Investment

   a. Evaluate the role of the average rare of return when evaluating investment projects. [10]
   b. Examine two other investment appraisal methods that a firm can use. [15]

2. ‘Ratios extracted from a company’s accounts are virtually useless without additional information.’ To what extent is this statement accurate? [25]

3. To what extent do you think the:
   a. Method of depreciation used would affect a firm’s cash position. [10]
   b. Evaluate the importance of profit to a business. [15]

6.29 Data response questions

- **JH Construction**

JH Construction is a construction company that specialises in construction low – cost houses. The company started in 1999 by two ambitious building graduates John and Joe Hove. The Hove brothers started their business as a partnership and later converted it into a public limited company in 2001.

The balance sheet of the company for the year ended 31 December 2003 is given below:

Fixed assets	Cost	Dpcn.	NBV
Land & Buildings	120,000		120,000
Van	12,500	2,500	10,000
	132,500	2,500	130,000
Current assets			
Stock	85,000		
Debtors	8,000		
Cash	3,500	96,500	
Current liabilities			
Creditors	24,000		
Provision for tax	12,500	36,500	60,000
			190,000
Capital and Reserves			
Share Capital			100,000
Debentures			60,000
Reserves			30,000
			190,000

The directors of the company, Joe and John, have announced that they would want to increase their capital. A decision to issue new shares as compared to issuing debentures has been taken.

1. From the passage calculate;
   a. Current Asset ratio.
   b. Acid test ratio

2. Comment on the liquidity position of the firm. [6]
3. Explain the term gearing. [3]
   Calculate the gearing of JH construction. [4]

5. Critically examine the various methods JH Construction can use to issue new shares. [6]

6. Suggest two reasons why JH Construction might prefer to raise additional capital by means of debentures rather than by issuing more shares.

- **Quick Returns Shop**

Ben Ncube owns a business that produces and sells fast foods. He has revealed that his stock turnover is very high because fast foods are in demand especially by bachelors and spinsters who live around town and find that they rarely have time to cook. Quick Returns Shop is situated in the Bulawayo Center, in close proximity to many residential flats. The most popular dish is the traditional *sadza*, spinach and peanut butter [*dovi*] and *'mazondo'*. The popularity of this dish has been largely attributed to the health-consciousness of customers who believe that traditional dishes are healthy.

Ben Ncube has estimated that the total fixed costs for these popular dishes are $10 000 000, variable costs per order are $10 000, selling price per dish is $30 000. A prominent Bulawayo businessman, has approached Ben Ncube with a $500 billion offer to buy his Quick Returns Shop. Ben Ncube has instead argued that since Matshiya, is also in the fast foods retail business the would rather merger. While negotiations are going on, Ben Ncube has made the following information available from his business's balance sheet:

Fixed Assets	$480 000
Goodwill	$180 000
Stock	$120 000
Debtors	$ 90 000
Cash	$ 26 000
	$896 000

1. What is goodwill? [2]
2. Why should Strive Matshiya be prepared to pay for it? [4]
3. Suggest possible examples of variable costs incurred by Quick Returns Shop. [3]
4. Calculate the number of dishes Ben Ncube should sell to break-even. [4]
5. Ben Ncube has revealed that his stock turn over is high. Why would it be difficult to calculate his stock turnover ratio using the given information? [2]
6. Evaluate each of the options facing Ben Ncube concerning the future of his business. [10]

- **Pots and Pans Ltd**

Pots and Pans Ltd make sets of cooking utensils. They are currently making and selling 20 000 sets a year, 5 000 units below the maximum capacity of the plant. The plant capacity can be increased from 25 000 to 30 000 units per year but this will involve additional fixed overheads of $52 000 per year. Net assets will not rise because the company is considering leasing new equipment. The lease agreement would last for six years.

Pots and Pans had the following cost information for the year ended 31 Dec 2004:

1. Sales for the year 20 000 sets.
2. Direct costs per unit:
3. Materials $100
4. Labour $150
5. Fixed Costs $1 000 000.
6. Selling price per unit $500.

The marketing manager, Mr. Bonzo, has argued that contribution is more important than profit. Therefore as long as contribution is positive the firm is quite safe.

1. Distinguish between contribution and profit. [4]
2. Calculate the:

1. Contribution per unit from the cost information given. [4]
1. Profit at Current production. [4]

2. Suggest ways Pots and Pans Ltd can use to fully utilise extra capacity. [8]
3. Evaluate the benefits of leasing to Pots and Pans Ltd. [10].

CHAPTER 8

DECISION-MAKING

8.1 Central tendency

Mean, mode and median.

Mean - it is the sum of all individual values divided by the number of values.

Median- when data has been ranked, this is the middle item. It divides the data into equal parts. It is found by taking the middle item of data arranged by order of magnitude (if there is an odd number of item in the set) or by mean of two middle numbers (if there is an even number of items)

Mode - the most frequently occurring observation (i.e. the value with the highest frequency).

Example. Calculate the mean, mode and median.

10; 14 ; 12; 13; 18; 14; 15; 10; 10; 13; 10.

Solution. The mode is 10 because it is the value which occurs most frequently.
Median 10; 10; 10; 12; **13;** 14; 14; 15; 18

Mean = $\frac{129}{10}$ = **12,9**

8.2 Usefulness of central tendency

Mean
Uses.

When the range of data is small, the mean shows the likely sales per period of time. This could be used to determine the re – order levels. It is often used to make comparisons between sets of data e.g. attendance at football clubs.

Advantages.
It includes all the data in its calculation. Well recognised as the average and is widely used and is easily understood.

Disadvantages.
It is affected by one or two extreme cases e.g. in the wages of employees the highest paid executive will be earning a high figure against general hand. Therefore the mean is a distorted result.

Mode

Uses

As the highest frequently occurring, observation, it can be used in stock ordering purpose for shoes, the mode reflects the shoe size that should be overstocked instead of just an average size.

Advantages.

1. It is easily observed and requires no calculation.
2. It is easily understood and the result is a whole number.

Disadvantages.

-Does not consider all of the data.

Median.

-Could be used in wage negotiations **e**.g. half of our union members earn less than $2 million per month.
-Often used in products e.g. the reliability records show that our products are always in the best performing 50% of all products brands.

Advantages

1. It is less influenced by extreme figures.

Disadvantages.

1. When there is an even number of items, then it is estimated.
2. It cannot be used for further statistical analysis.

Range.

It is the difference between the highest and lowest observed values. The main problem with the measure is that it can be distorted by an extreme value.

8.3 Data presentation methods.

Data collected can be presented in a way, which communicates the information and enables conclusions to be drawn.

Tables – these are non- graphical ways of presenting a large quantity of data in labeled rows and columns. Data must be dated, with its sources and measurement units shown.

Uses.

Used when:
1. Wide range of results need to be recorded.

2. There is a lot of text to include with the results e.g. detailed headings for each column.
3. The results need to be analysed by statistical means and it is important to have the numbers themselves. It is commonly more accurate to take results from a table than a graph or chart.

Line graphs.
Uses.

1. Used when time is one of the variables.
2. When the trend and regular variation need to be identified.
3. When two or more sets of time series data need to be compared. For example when a competitor sales are compared with the company's own sales.

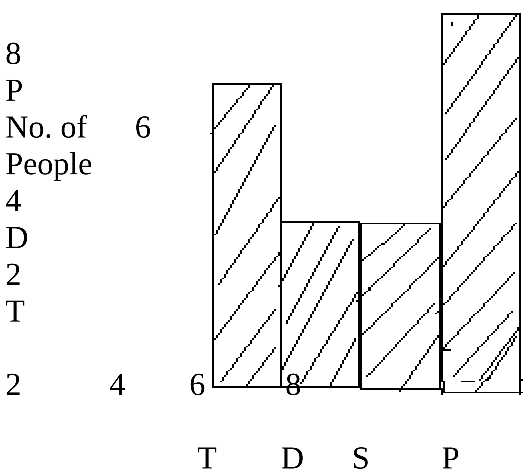
Bar charts.
Uses.

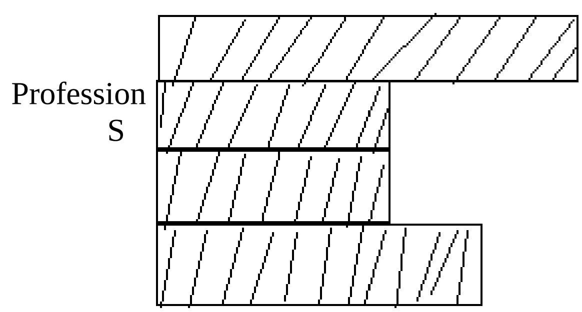
1. When the absolute size or magnitude of the results need to be presented and compared. Component and percentage component bar charts are used to show how the total figure is made of different sections.
2. Bar charts. Vertical or horizontal bars are used to represent data. The result is then called a vertical or horizontal bar chart respectively. The bars are the same width and the length of the bar is proportional to the size of the portion of the sample.

Consider the following professions: -

Teachers	6
Drivers	3
Secretaries	3
Policemen	8

Vertical bar – chart **Horizontal bar – chart**





Pie charts.

-Visually useful to show the relative importance of segments of the total. This can be usually compared with other time periods.

Pie charts

Consider the following sample: 40 fruits were packed in a pocket as follows

Oranges	11
Guavas	5
Apples	8
Paw – paws	5
Peaches	2
Grapes	9

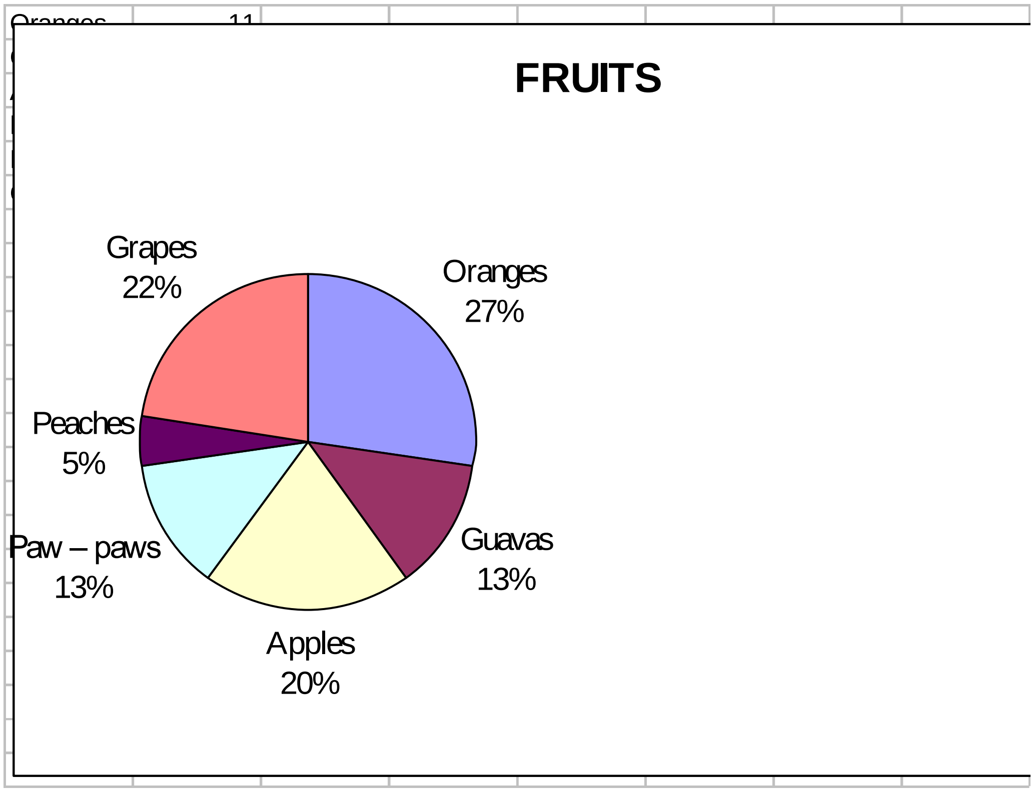
A pie – chart is made using a circle of any radius. The area of the circle will represent the whole packet of fruits and the sectors of the circle will represent types of the fruits.

Each sector is calculated as : $\frac{\text{No. of each fruit type}}{\text{Total No. of fruits}}$

e.g. oranges = $\frac{11}{40} \times 360$

= 99

Here is a pie – chart representing the above data



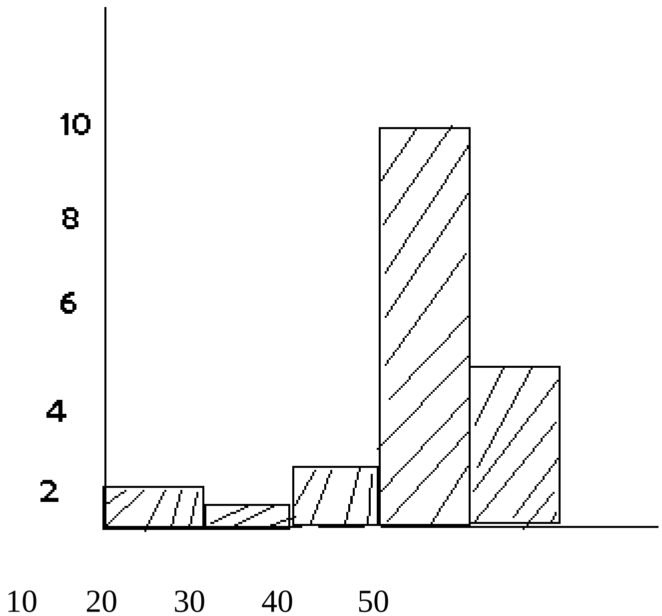
Histograms

A histogram is a bar graph where frequency is plotted against continuous data. A rectangle is drawn such that it is proportional to the frequency of the observations falling in the corresponding measurement. They can only be used for frequency data when the range of data has been broken into classes. The bars must be joined together.

Consider the following frequency distribution.

Height in cm	**Frequency**
10	2
20	1
30	3
40	10
50	8
60	5

Frequency



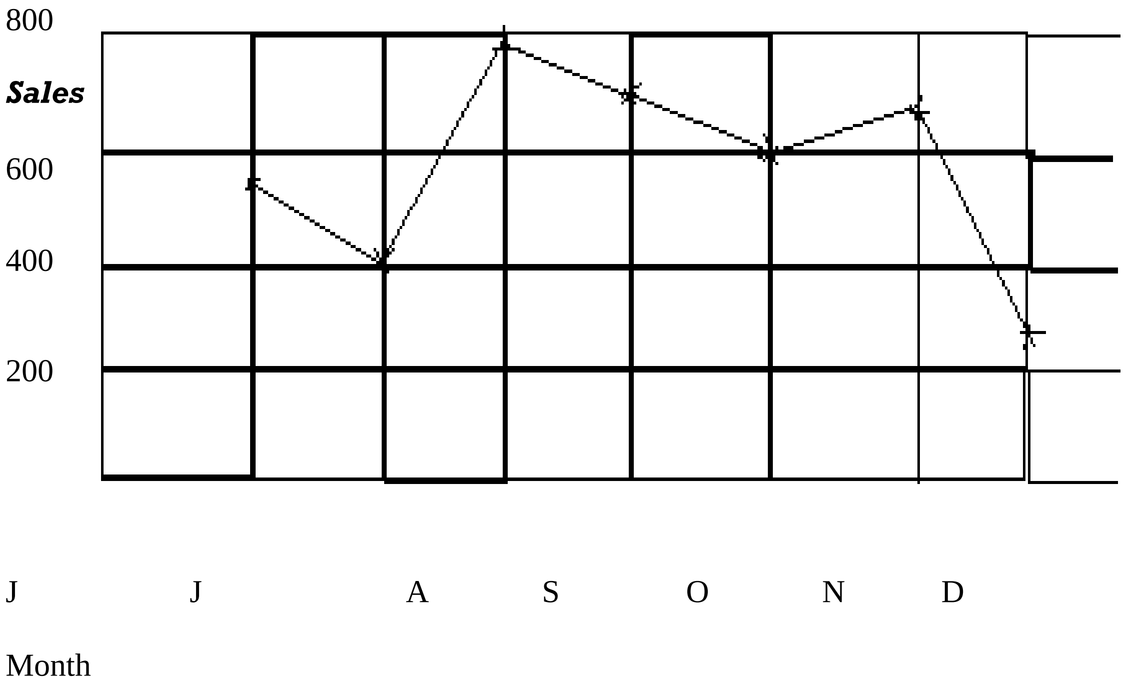
Pictograms.

-Used to attract the reader towards the data.
Line graphs

Consider the following data for the number of sales per month for a period of 7 months.

Month	June	July	August	September	October	November	December
Sales	520	400	800	750	600	655	300

When the points are plotted, the graph looks like this

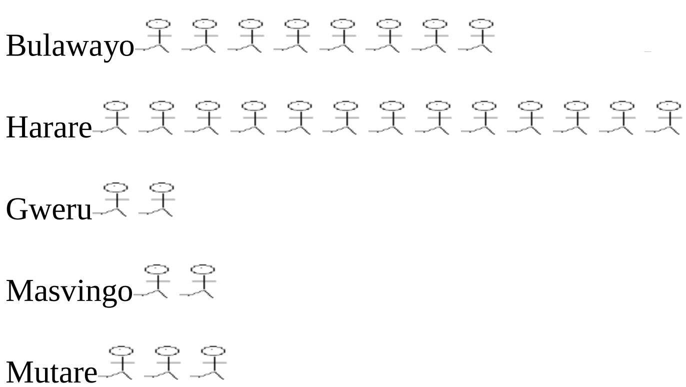


The graph is obtained by joining the plotted points by straight line segments

Data is summarized in picture form. Consider the following data for the approximate population of 5 cities forecasted

Bulawayo	4 million
Harare	6.5 million
Gweru	0.6 million
Masvingo	0.9 million
Mutare	1.4 million

Let the picture of a man  represented ½ million people.



9.4 Reasons why information may be presented in a misleading way.

1. So as to attract potential investors in this case, presenters tend to overstate profit figures so as to paint a bright picture about the firm and hence, win potential investors.
2. Insufficient knowledge on how data should be presented. This usually happens when firms do not have enough fund to hire experts in the field of data presentation.
3. Insufficient data.

Due to financial constraints, insufficient data can be collected leading to misleading results.

1. To mislead competitors
2. Firms usually present data in a misleading way to divert the attention of competitors from their core business.

8.5 Cost – benefit analysis (CBA).

Businesses are part of the community. Their decisions affect the general well-being of the community.

A business applying for planning permission to build a factory might argue that it is bringing employment, boosting the revenue of the local authority through payment of rates and improving the appearance of the landscape by building a modern factory with landscaped ground. Local residents might be concerned with congested roads, pollution or noise.

Local authorities are faced with a similar clash of interest when undertaking projects regarding the provision of service and improvements of infrastructure e.g. roads and clinics.

It is important to distinguish between private costs and social costs.

Private costs of a decision. The cost to the individual or company responsible for the decision which is usually reflected in the production cost of the business and therefore its price.

Social costs.

(externalities) borne by the community as a result of a social condition.

Cost benefit analysis is a collection of techniques which attempt to find an objective measure the utility of a proposal based on a range of people's values in a community and to measure these values on a common money scale.

Selection of site for dumping waste.

Costs	Benefits
- new roads - heavier traffic - Loss of amenity land. - Local ecology	- Increased employment. - Cleaner environment. - Revenue from dumping. - Landfill and reclamation.

8.6 Marginal costing.

Acceptance of special order.

Hotels often offer low rates to consumers during off – peak periods, arguing that it is better to earn a contribution from additional guests than to leave rooms empty.

If customers are gained or contracts accepted using prices below full cost, in some situations can be lead to an increase in total profits. There are dangers to this policy:

1. Existing customers may learn of lower prices and demand the same.
2. When high prices are used in establishing exclusively of a brand, then to offer some customers lower prices could destroy the brand image.
3. In some circumstances, lower priced goods may leak into the higher market.
4. Where there is no spare capacity, sales at contribution cost may be losing sales based on the full cost.

8.7 Investment appraisal.

Investment – this involves acquisition of capital equipment such as machinery, buildings, and motor vehicles e.t.c.

Reasons.

1. To increase productive capital to meet demand.
2. To replace equipment.
3. To provide facilities for new product development.

8.8 Methods of appraisal.

Payback period – it is usually a period expressed in years, which it takes for the project inflows from an investment to equal initial investment. The usual decision rule is to accept the project with the shortest payback period.

Initial cost $ 2 000 000
Income year 1. $ 400 000
2. $ 400 000
3.$ 600 000
4. $ 300 000
5.$ 700 000
6. $ 700 000
7.$ 1 000 000

Solution.

Year	Cashflow $ (000)	Cumulative cash flow $ (000)
0	- 2 000	- 2 000
1	400	- 1 600
2	400	- 1 200
3	600	- 600
4	300	- 300
5	700	+400
6	700	+1 100
7	1 000	+2 100

Payback = 4 and $\frac{3}{7}$ yrs.

Calculate the payback for each of the projects.

		A		B		C
Year	**Annual cash flow**	**Cumulative cash flow**	**ACF**	**CCF**	**ACF**	**CCF**
0	- 2 000	- 2 00	- 2000	-2000	-2000	-2000
1	+ 800	- 1 200	+ 500	-1500	+ 600	-1400
2	+ 700	- 500	+ 500	-800	+ 700	-700
3	+ 500	Nil	+ 700	Nil	+ 500	-200
4	-		+ 800		+ 200	Nil
5	-		-		+ 300	300
6	-		-		+ 500	800
		Pay back periods	project	A =	3 yrs	
			Project	B =	3 yrs	
			project	C =	4 yrs	

Advantages.

1. It is simple to understand and to calculate.
2. It is more objectively based because it uses project cashflow rather than accounting profits.
3. Favours quick return projects which produce faster growth for firms and enhance liquidity.

4. Choosing projects which payback quickest will minimise time-related risks. However, not all risks are related merely on time elapsed.

Disadvantages.

1. Payback is a rough measure of liquidity and not overall project worth – from the above example project c is ranked last even though it provides cash flows after payback (for 6 years).
2. Payback does not put timing into account, Projects A and B, above are ranked equally even though there are clear differences in the times of cash flows.
3. It ignores the life of the project.

Accounting rate of return.

It is the ratio of average profits, after depreciation, to the capital invested. This is a general definition and hence, several interpretations are:

(i) Profits may be before or after tax.
(ii) Capital invested may be the initial capital invested or the average capital invested.

<u>Initial investment</u>

(iii) Capital may or may not include working capital.

Exercise 11

A firm is considering three projects with an initial investment of $ 2 500 000.00 estimated profits are as follows;

After tax and depreciation profits.

Year	**Project X**	**Project Y**	**Project Z**
1	$ 000 250	$ 000 500	$ 000 100
2	250	450	100
3	250	100	100
4	250	100	450
5	250	100	500
	1 250	1 250	1 250

Required:

Calculate Accounting rate of return based on;
a) Initial capital invested.
b) Average capital invested.

Solution.

X **Y** **Z**

Average profits = $ <u>1250 000</u> <u>1 250 000</u> <u>1 250 000</u>

5 5 5

= $ 250 000 **$ 250 000** **$ 250 000 per annum** Therefore accounting rate of return based on

X **Y** **Z**

<u>250 0000</u> <u>2500 000</u> <u>2500 000</u>

25 0000 250000 250 000

= 10% **= 10%** **= 10%**

ARR.(based on average capital invested)

X	**Y**	**Z**
<u>250 000</u> 1250 000 **= 20%**	<u>250 000</u> 1250 000 **= 20%**	<u>250 000</u> 1 250 000 **= 20%.**

Advantages of ARR.

1. Simplicity of calculation and understanding.
2. It uses yields in all years.
3. The results can be easily assessed against predetermine criteria of the business.
4. It focuses on profitability, which is the central objective of many business decisions.

Disadvantages of ARR.

1. It ignores timing of inflows and outflows. The three projects are ranked equally even though there are clear differences in the timings involved.
2. There is no universal method of calculating ARR. Other names are return on capital employed ROCE) and return on investment [ROI].
3. It uses the rate of return the concepts of accountancy profit. Profit has subjective elements such as accounting conventions and is not as appropriate for decision making as the cashflows generated by the project

8.9 Discounted cashflows.

All discounted cashflow methods use cash flows and make little allowance for the time value of money.

Net present value.

It is the value in present day terms of the various cash flows from a project investment expected to arise at different periods in the future. In the net present value method, the initial cost of the project is shown as negative (an outflow) and as the cost is incurred today, it is not subject to discounting – the inward cashflow is shown as positive and subject to discounting.

NPV = sum of net inflows less cash outflow. If the sum of present values of inflows is greater than initial investment, then NPV is positive, the project is worth proceeding with, disregarding NPVs that are negative. Where there is a choice of projects the one with the highest positive NPV will be chosen

Example.
In appraising a $ 30 000 000 investment project, a firm uses a discount rate of 10%. The equipment will produce a return (net of operating expenses of $ 10 000 000 per year over a period. At the end of 5 years the firm expects to sell the equipment for $ 1000 0000.

Calculate the NPV. = 10%

Year	**Cash flow**	**Discount factor**	**Present value**
	($' 000)		($' 000)
0	- 30 000	1	-30 000
1	10 000	0,909	90 000
2	10 000	0,826	8 260
3	10 000	0,751	7 510
4	10 000	0,683	6830
5	10 000	0,621	6210
Residual value	1 000	0,621	621

Add up the present value total and deduct the initial investment. Residual value is positive since it is a cash inflow. However it is subject to discounting since it will be received after 5 years.

Why should a specific rate of discount be chosen?

The profitability of a project proposal depends on the discount rate used. The discount rate should reflect the current interest rates. This is important if the business has to borrow money to finance the project.
It is also important if the project is to be financed out of retained profits. The opportunity cost of the investment in capital equipment is the sacrifice of the interest in the financial market, the firm might otherwise have undertaken.

Internal rate of return (I.R.R)

The discount rate which equates the present value of the expected cash outflows from an investment with the present value of expected inflows. If IRR exceeds market rates of interest (which has to be paid to secure funds) then the project is worthwhile and vice versa. In other words, it is the discount rate, which gives an NPV of equal to zero.

Advantages of net present value
1. It considers both the timing of cash flows and the size of them in arriving at an appraisal.
2. The rate of discount can be varied to allow for different economic conditions. E.g. it can be increased if there is a general expectation that interest rates ere about to increase.

3. It considers the time value of time of value of money and takes the opportunity cost of money into account.

Disadvantages of NPV.

1. It is complex to calculate and to explain to non-numerate managers.
2. The final result depends on the expectation about interest rates, which may be inaccurate.
3. NPV can be compared with other projects only if the initial investments are the same. This is because the method does not provide a percentage rate of return on the investment.

Advantages of internal rate of return.

1. By giving a different percentage rate of return, different projects costing different amounts can be compared.
2. The IRR is easily compared to the rate of interest or the criterion rate of the business.
3. It avoids the need to choose the actual rate of discount.

Disadvantages.

1. Calculation is tiresome without a computer.
2. By giving an exact result, it can mislead business users into believing that the investment appraisal is a precise process without risks and uncertainty.

Decision tree analysis.

A decision tree analysis is a useful analytical tool for clarifying the range of alternative courses and their possible outcomes. It is a diagram with several possible outcomes and the potential for each course of action. Each alternative course of action is represented by a branch, which leads to further possible events. The decision tree sets out options clearly, encourages a quantitative approach showing the expected values of each option by multiplying probabilities by economic outcomes. At times it might be difficult to further meaningful data especially of the decisions are unlike previous ones and may ignore the qualitative factors as this does not take account the variability of the business environment.

The value of a decision tree is that its logical analysis of a problem enables a complete strategy to be drawn up to cover all before a business enterprise becomes connected to a project.

Sketching the diagram

The box indicates the point at which decisions have to be taken, and the branches emanating from it shows the available alternative courses of action. The circles indicate the point at which there are environmental changes that affect the results of prior decisions. Prestige College is considering whether to develop and market Management of Business textbooks. Development costs are considered at $ 2 000 000 and there is a 0,50 probability that the development will be successful and 0,25 probability that the development effort will be unsuccessful. If the development is successful, the product will be marketed throughout the country and it is estimated that:

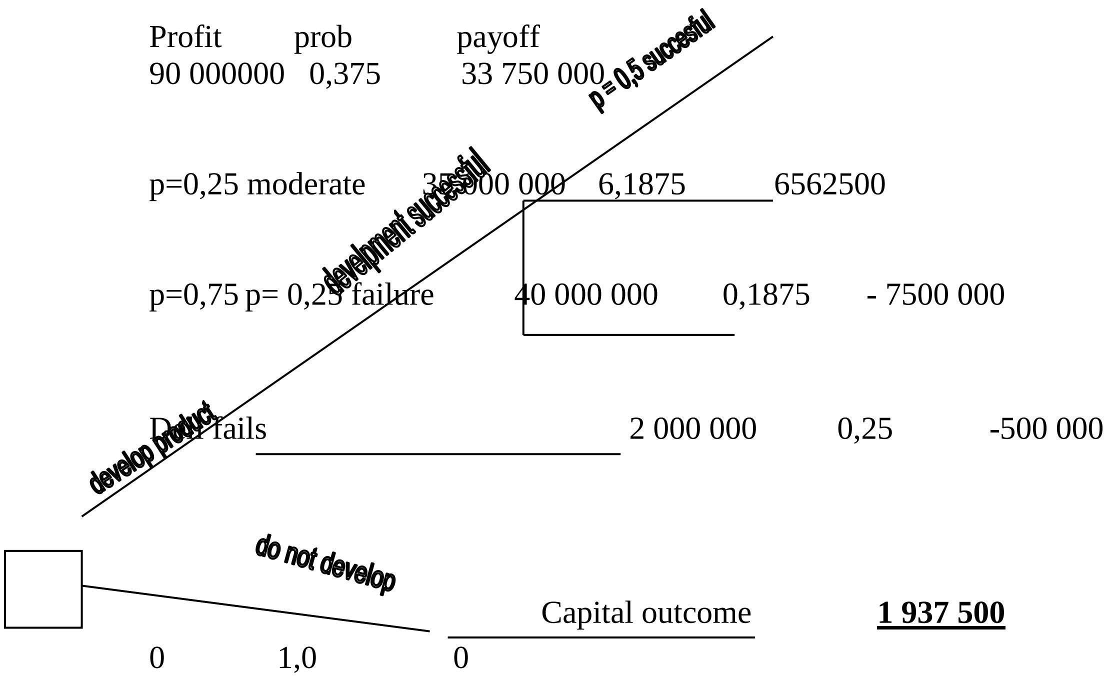
(i) if the product is very successful profits will be $ 90 000 000.00

(ii) If the product is moderately successful $ 35 000 000.00.
(iii) If the product is a failure there will be a loss of $ 40 000 000 .00. the estimated probabilities of each will be as follows:

(i) Very successful 0,5.
(ii) Moderately successful 0,25.
(iii) Failure 0,25.

What is the expected outcome of the project?

Solution.



Management may decide that project is too risky since there is nearly 0,5 probability of a loss occurring. The decision tree provides a convenient means of identifying all the possible alternative courses of action and their outcomes.

8.10 Limitations of decisions trees

1. It may be difficult to gather meaningful data especially if the decisions are unlike previous ones
2. Decision trees ignore qualitative factors, e g the nature of the economy and the effects on the decisions of the motivation of workers.
3. Decisions trees do not take into account the variability of the business environment.
4. Decision trees are based on subjective probability which is not always accurate, especially in a rapidly changing environment.

8.11 Linear programming

Linear programming is a technique which is used to solve practical problems concerning production. Through linear programming people in business, co-operatives, farmers and many others can determine how they should operate in order to increase production, but at the same time keeping running costs as low as possible.

The techniques of linear programming are applied when there are several limiting factors in decisions regarding application of production resources. Marginal costing is only used when there is one limiting factor. The maximum or minimum of a given function occurs at the intersection formed by the boundary lines. It is apparent to be able to plot a straight line graph in the form y = mx + c where:
m is the slope of the line
c is the fixed cost
y is the total cost.
It is further necessary to identify the limiting factors then compute contribution per limiting factor. The contribution per limiting factor then forms the constraint for maximising / minimising function. The next step is to formulate functions to be used in graphing the lines.

EXAMPLE

ABC Ltd manufactures two type of products. Information on cost is as follows:

X Y	X	Y
	$	$
Direct materials	19	16.3
Direct labour @ $16 per hr.	16	19.2
Variable overheads @ $10 per machine hr.	5	2.5
Variable cost per unit	40	38
Selling price per unit	46	47
Potential monthly sales in units	7 500	9 000

Available labour hours are 12 000 and 4 500 machine hours per month. Fixed cost is $55 000 per month.

Required: Determine the most economic production mix.

Solution	X	Y
$ $		
Selling price per unit	46	47
Less variable cost per unit	40	38
Contribution per unit	6	9

Maximising / minimizing function 6x + 9y. This is the function used to determine the most economic production mix.

Limiting factors

Required per month	X	Y	Available
Labour hrs	$16/$16 = 1	$19.20/$16 = 1.2	12 000
Machine hrs	$5/$10 = 0,5	$250/$10 = 0,25	4 500

<u>Equations / constraints from the limiting factors</u>
x + 1,2y = 12 000
0,5x + 0,25y = 4 500

The two equations can now be solved using any of the three methods below
The elimination
The substitution
The matrix.
For simplicity sake the elimination method will be used
x + 1,2y = 12 000 -------------------1
0,5x + 0,25y = 4 500----------------2

To eliminate x it is necessary to multiply 1 by 0,5 throughout such that 1 becomes
0,5x + 0,6y = 6 000.
Now that the coefficients of x are equally then elimination becomes possible for x by subtracting 2 from 1: 0,5x + 0,6y = 6 000
<u>-(0,5x + 0,25y = 4 500)</u>
0,35y = 1 500
$\therefore$ y = 4286
Now that y has been calculated it is appropriate to substitute for the value of y in any of the two equations above: 0,5x + 0,6y = 6 000
0,5x + 0,6(4286) = 6 000
0,5x = 6 000 – 2572

x = 6856

The solution is x = 6856, y = 4286

Any product mix falling within the lower left part of the graph can be produced with the available production factors. The maximum marginal income is however obtained at the intersections of the lines and this has to be ascertained through the constraint function 6x + 9y. Only three points of intersection A, B & C need to be considered as the other intersections will have less marginal income because products are not being manufactured.

Point	Function	Value
A (1 200: 9 000)	6 x 1 200 + 9x9 000	88 200
B (6856: 4286)	6 x 6856 + 9x4286	79713
C (7500: 3000)	6 x 7500 + 9x3000	72000

From the above computations it is evident that the maximum production mix is at point A where $88 200 is realised.

The Computer
The Central processing Unit (CPU) processes information according to instructions and at very high speed. To enter instructions and data, an input device is used and to display the results of computation on output a device is necessary.

INFORMATION TECHNOLOGY (IT)

The Electronic Office

With IT, managers and their staff are pushing for integrated information processing systems. This involves bringing together departments and activities traditionally operated separately. Tasks affected include;

-Telephone communication, mail distribution, meetings with co-workers and clients, originating of documents, processing of information, calculations of numbers in order to process them into information, producing copies of acceptable standards, copying of documents, storing of information and transition of information.

The objectives of Information Processing

1. Increased productivity of managers and their staff.
2. More support for operating and line managers in their planning, decision making and control.
3. More efficient output of paperwork.
4. Reduction of costs.
5. Communications among managers and between manager and their staff.
6. More effective use of time by everybody.

Applications of Information Processing

Databases- are a store of information which has been input into a computer so that it is ready to be processed and made available as required. It may be used for a wide variety of purposes and store vast amounts of data e.g names, address, receipts, payments and other records.

Spreadsheets- provide a matrix on which calculations can be performed. They show data in an easy to read format and can be used to answer ‘what if’ questions. Changes can be made to the data and the overall effects can be seen on the spreadsheet.

Desk top publishing

Packages allow text, computer added design and graphics to be merged together to produce high quality documents.

Accountancy packages

Which occupy other functions like book-keeping, invoicing customer accounts, VAT, Stock control, payroll and for producing final accounts.

Impact of Information Technology on businesses

Benefits to the Organisation

1. Increased efficiency and effectiveness
2. More stimulating and satisfying work for employees who can be freed from routine, less interesting tasks and develops new skills.
3. Increased autonomy irresponsibility and feedback for individuals.
4. Greater innovation and better customer care.
5. Increased flexibility and the ability to respond to change and market requirements.
6. The highlighting of poor areas of work or employee performance.
7. Improved communication and relationships
8. Access for people with disabilities
9. Better information and control over work flow and operations

Effect in Individuals

1. It can cause stress if information cannot be easily accessed or is lost instead of stored.
2. Burning to cope with change and developing the skills to use new equipment can also prove stressful or some people who may feel threatened as existing skills become redundant.
3. Visual Display Units (VDUs) are potentially harmful to health.

The Internet and Intranet

1. A computer network exists where two or more computers are connected together for the purpose of exchanging messages, screening data and system resources.
2. The Internet is a wide area network connecting thousands of separate computer networks on a world wide basis hence the World Wide Web (WWW) Internet is made with two or more computer networks are joined together and data is transferred between them.

Intranet- this is the application of internet technology within any organisation on a local area network.

Companies are scrambling to establish consumer to business services, re-inventing ways to create products, attract customers, accept payments and provide support in this new medium. Electronic catalogues, on-line advertisements, information services and virtual shopping malls are the new storefronts, network navigators are the new yellow pages.

Some businesses, however, have been worried about the internet because of the risk of unauthorised access to a firm's software and computer database and also the confidentiality of e-mail messages.

Questions

1. Give three advantages of Information Technology.
2. What organisational benefits should be expected from the implementation of IT?
3. Explain the differences between the Internet and Intranet.

8.12 Typical examination questions

8.13 Structured questions

1. Distinguish between data and information. [4]
2. Explain the factors that will influence the reliability and accuracy of information. [5]
3. Outline the principles to be considered in presenting information in an appropriate manner. [6]
4. For a building project to be completed, the following activities need to be completed.

A is the start of the project.
B and C follow A.
D follows B.
E and F follow C.
G follows D and E.
A takes 2 days, B 3 days, C 5 days, D 2 days, E 4 days, F 2 days, G 2 days.

You are required to:

1. Draw a network diagram to represent the activities above. [3]
2. Identity the critical path. [4]

5. A vegetable vendor sells cabbages and has provided the following information about the number of cabbages he sold per day for a seven-day week: 12, 15, 8, 25, 12, 32, 31.

You are required to calculate:

a) The mean [2]
b) The median [2]
c) The mode [2]

Evaluate the arithmetic mean and the mode as measures of central tendency. [4]

6. In a decision diagram, explain the significance of:
   1. The squares
   2. The circles
   3. The fractions on the lines.
   4. The numbers at the end of the lines.

7. Briefly describe the characteristics of a good questionnaire. [5]
8. Distinguish between primary and secondary data. Under what circumstances would you find that primary data is more applicable than secondary data? [6]
9. Evaluate the observation method of collecting data, explaining carefully where this method is likely to be relevant. [6]
10. 'Sampling reduces costs associated with a census'. Do you agree with this statement. Justify your answer. [6]

8.14 Essay questions

a) Evaluate the following methods of sampling:
   a) Convenience sampling
   b) Simple random sampling
   c) Stratified random sampling [25].

b) Outline the basic criteria on which a statistical report should be based. To what extent is it true that the presentation of data is as important as its accuracy. [25]

c) Using an example, explain what information can be presented in a pie chart. [10]

8.15 Data response

1. Builders Ltd

Builders Ltd is a small firm of builders which was formed in 2001. The company has received an order to develop five hundred houses in the new suburb of Cowdray Park in Bulawayo. Muvaki, the operations manager, has given the following information about the project:
A, B, C, are the start of the project.
D follows A.

E, G follows C.
F follows B and E.
H follows F and G

Activity	A B C D E F G H
Estimated Duration	4 7 8 5 4 4 11 4

To finance this project, the company has decided to issue ordinary shares and debentures to the public. This will result in the capital structure of the company to be like this:
50% debentures
45% Equity
5% Bank borrowing.
The project is expected to result in a significant increase in the level of employment for local people.

You are required to:

1. Define:
- debentures [2]
- ordinary shares [2]

2. Comment on the gearing of Builders Ltd. What implications does gearing have to Builders Ltd. [6]
3. Draw a network diagram using the information provided by Muvaki. [3]
4. Identify the critical path. [2]
5. Calculate the total floats for activity A and D. [4]
6. Present the information on the capital structure in a pie chart.
7. What are the advantages and disadvantages of presenting data using a pie chart? [6]

2. Mbizo Ltd

Mbizo Ltd is a small company that produces and sells carpets and rugs. The company is serving a large market that comprises of the fast emerging lodges around the major cities of Zimbabwe.

Newlin, the marketing manager has gathered information about the level of demand for clothes and clothing material. He has advised the production manager, Mr. Lowley, that the results of market research show that there are bright chances in the clothes and clothing industry. Mbizo Ltd is considering whether to continue producing its traditional range of carpets and rugs next year, or whether to produce the clothes and clothing range. To help in making this decision, Mbizo Ltd is considering spending $500 000 on a market research survey to assess the level of interest in this new line, which may be high, medium or low. Whichever range, Mbizo Ltd finally produces it believes that the sales will either be ‘successful or unsuccessful’. The researcher has held personal interviews with economists, customers and business people to obtain the following information.

	Probability	Cost	Payoff
Carpets and rugs	Success 0,5	100 000	3 million
	Failure 0,5		2 million
Clothes & Clothing	Success 0,6	200 000	2 million
Material	Failure 0,4		1 million

The production manager has been assigned the duty to analyse the data and present his conclusions to the Board meeting in a week's time.

You are required to:

1. Draw a decision tree to illustrate the information in the table. [3]
2. Advise Mbizo Ltd on which decision to take, showing all the workings. [6]
3. Evaluate the strengths and weaknesses of personal interviews as a method of collecting data. [6]
4. What are the limitations of relying too much on quantitative data? [10]

3. Teens and Tonns

Teens and Tonns is a toy manufacturing company. This company was formed five years ago by a couple, Tendai and Tony. Teens and Tonns produces two types of soft toys; rabby and rocky. The company produces for one big department store in the city of Bulawayo.

After completing orders for this well-known departmental store, Teens and Tonns has spare capacity in each of the three sections that are essential in the manufacturing of both toys.

Cutting section	1500 hours
Sewing and filling section	2400 hours
Packing section	2200 hours

The capacity in hours per 100 toys are:

<u>Rabby</u>	<u>Rocky</u>	
Cutting	3	1
Sewing	5	4
Packing	1	1

Gudu , the accountant, has advised Tendai and Tony to use linear programming to decide on the optimum mixture of the two toys.

1. (a) Set out the contrasts in the form of equations. [6]
   (b) Draw a graph to represent the problem. [10]
   (c) Explain why Linear programming is given the name 'Linear' programming. [4]
   (d) What is the optimum mixture if the contribution per Rabby is \$5 and per Rocky \$4. [10]

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