# ‘O’ LEVEL

# BUSINESS STUDIES

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**<u>Acknowledgements</u>**

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**S. Madzingira**

## PREFACE

The vision of the Study Pack project is to create a self-sufficient information base for the student. With this aim in mind this Study Pack provides all the necessary topical material in a simplified manner. The study pack gives a list and analysis of the skills that are pursued in the course. It also gives a good array of local examples that help to contextualise and conceptualise issues in business studies at this level. The module provides a variety of questions, ranging from revision exercises to typical examination questions at each chapter. Therefore, the book provides its proof for its user-friendliness.

# CHAPTER 1

**Syllabus Interpretation**

## Introduction

Business studies syllabus develops candidates' knowledge and understanding of the environment within which business, activity takes place. The study of Business studies helps the candidate to take note of the stakeholders of the business and how they affect the business activity. It is essential to study Business studies as one will develop business decision behaviour and will be able to work in the modern business world. Candidates are prepared for 'A' Level Business studies and later become business managers and entrepreneurs.

## Paper combinations

The Cambridge International examinations, IGCSE Business Studies syllabus, consist of two compulsory written papers- Paper 1 and 2 with course work as an optional extra.

However, the Zimbabwe school Examinations council (ZIMSEC) ‘O’ Level Business Studies (7116) syllabus, consists of two compulsory written papers only. The syllabus is divided into 6 sections which are:-

1. Business and its environment.
2. Business Finance and Accounting.
3. Managing Human Resources.
4. Marketing and production.
5. How and why government and community influence business activity.
6. Information Technology.

Business studies paper 1 (7116/1) is a 1hour 45 minutes structured paper which consists of “short answer questions.” The space for answering the questions is provided and it is assumed that the space should be enough for the answer expected. 7116/1 consists of 6 compulsory questions, for example, question 1 (a) up to (e) and 2(a) up to (f). Question one is set from the first section of the syllabus, and question two from section two and so on up to question six. The use of original examples is encouraged, especially those from your own country. The possible mark is 100 percent.

Business studies paper 2 (7116/2) is a 2 ¼ hrs paper. The paper is divided into two sections. Section A- case study and section B-Essays. In section A the candidates are expected to read the given passage first and then answer all the structured questions which follow. Section A adds up to 40 marks which covers all the six sections of the syllabus. Candidates are encouraged to refer to the passage when answering section A. Section B consists of 5 essay type questions which are taken from any five sections of the syllabus. The candidate is expected to answer any three essay type questions out of the five set. One essay carries 20 marks, i.e. 3 essays x 20 marks which is 60 marks All in all 7116/2 also adds up to 100. marks 7116/1 is 40%
7116/2 is 60% of the final mark

**Assessment Aims**

The aims of the syllabus are the same for all ‘O’ level Business studies syllabuses. The aims are:

1. To develop knowledge and understanding of the environment within which business activity takes place and of the way which changes in that environment influence business behaviour
2. Develop knowledge and understanding of business stakeholders and consider ways in which they are able to influence business objectives, decisions and activities.
3. Develop understanding of the roles and purposes of business activity in both, the public and the private sectors and of competition and monopoly.
4. Develop knowledge and understanding of how main types of business and commercial institutions are organised, financed and how their relations with the stakeholders are regulated

5. Develop knowledge and understanding of the language, concepts, techniques and decision-making behaviour.
6. To develop an awareness of the nature and significance of innovation and change within the context of business activities.
7. To prepare candidates for ‘A’ Level Business studies and any business related course.

**Assessment objectives**

1. To demonstrate knowledge and understanding of facts, terms, concepts and conventions to the syllabus
2. To differentiate evidence from opinion in a business context.
3. To demonstrate knowledge and understanding of theories, and techniques commonly used in businesses.
4. To use appropriate techniques in analysing and interpreting, information given in narrative, numerical and graphical forms.
5. To give reasoned explanations, develop arguments and understand implications.

**Interpretation of Key Words used by examiners**

1. **State, list or Outline**

The key words mean that you write down the points without explaining them.

2. Explain

- The candidate is expected to state a point and then give a reason. More detail is required than just listing or starting.

3. **Distinguish**

-the candidate is expected to give clear differences between the two given, terms. Note that defining the terms is not distinguishing.

4. **Analyse**

This expects the candidate to give an explained answer, showing the good part of the condition given and also the bad effects it might have.

5. **Discuss/ and to what extent**

The candidate is expected to look at both sides of the question. i.e advantages and disadvantages.

6. **Evaluate**

- The candidate is expected to show advanced skills, where he should list, explain, analyse the merits and demerits and then compare them to come up to the final recommendation. The candidate is expected to make judgements, recommendations and decisions.

NB: On key words like analyse, discuss, to what extent and evaluate, the candidate is expected to give a balanced argument, i.e look at both sides of the question. For one sided answers the maximum point is half of the total awarded.

# CHAPTER 2

## **Business and the environment in which it operates**

Chapter objectives:

After studying this chapter the student should be able to:

- Define the term ‘business’.
- Explain the aims of business.
- To define what is meant by business activity and economic problem.
- Distinguish wants from Needs.
- Explain specialisation and division of labour.
- Explain the factors of production and their rewards.
- To explain how to measure the size of a business.
- To explain the nature of business activity and key stakeholders.
- To explain how markets systems help solve the problem of scarcity.

### **Business Activity**

Business activity is a means of adding value and meeting customer needs.

Business activity is concerned with providing goods and services to satisfy human needs and wants.

**Needs** are goods and services which are essential for living e.g. food, shelter, clothes. We cannot survive without needs.

**Wants** are goods and services people would like to be able to buy and own but which are not necessary for living, e.g. phones, and jewelleries. Wants are limitless and contain many luxury items and needs are necessary for survival. Goods are physical objects that can be bought. Services are non-physical things that can be bought. Consumer durables are goods that can be used over and over again e.g. radio or motor van. Single use items are goods that can be used only once e.g. bread and are sometimes called perishables.

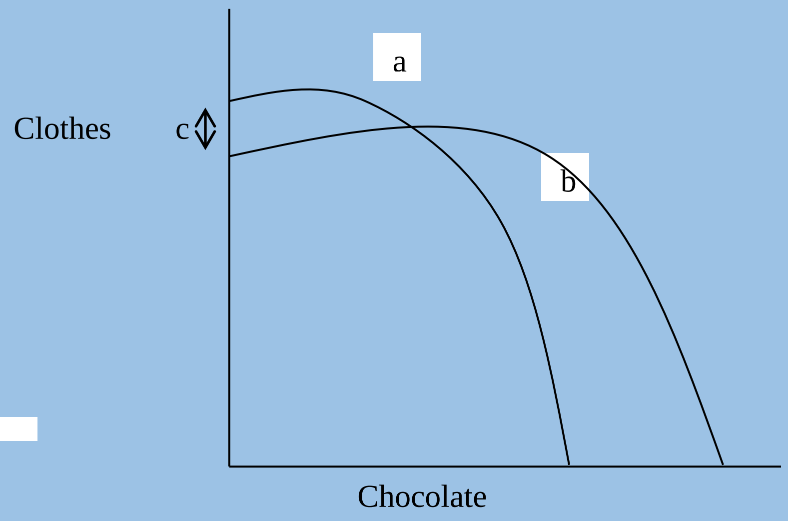
## Economic Problem

The economic problem culminates in the lack of resources to meet unlimited needs and wants. This gives rise to the concept of scarcity. Scarcity is a mismatch between needs and the resources that satisfy them. Because of scarcity, consumers are faced with making choices in order to satisfy their needs. When making choices the concept of opportunity cost comes into play. Opportunity cost is the best alternative forgone when making choices.

**Examples of opportunity cost**

- Should I do my hair or buy a business studies text book?
- Should I buy a lolly pop (sweet') or buy an H.B pencil?
  (All choices involve giving up something)
- Economic problem is caused by unlimited wants which lead to scarcity, heading to making choices which lead to opportunity cost

The concept can be shown through a production possibilities frontier.




In the diagram a shows the initial quantities of clothes and chocolates being produced and b shows more of chocolates being produced than clothes and c shows the opportunity cost forgone when making more chocolates.

**Exercise**

1. Define the term Business? [2]
2. List 3 examples of needs and 5 of your own personal wants [8]
3. What is Scarcity? [2]
4. What causes the economic problem? [2]
5. Giving an example, explain what is meant by opportunity cost [3]

**Factors of production and their rewards**

Too few factors of production cause shortage of goods and services
i.e. unlimited want + limited resources= Scarcity

**Land** - An area of land needed for making a good or a service. Raw materials are also natural products that come from the land. The reward is rent.

**Labour** - The mental and physical effort of the human beings. The reward is a wage or salary.

**Capital** -Equipment, machinery and reliable service needed to produce or supply a product or service. The reward is interest.

**Enterprise**- entrepreneur- refers to someone who takes the financial risk of starting and managing a new venture. Someone needed to show the ability to think of new plans and carry them out. This factor mobilizes other factors i.e. land, labour and capital to ensure that production is undertaken. The reward is profit.

Value added is the difference between the selling price of a product and the cost of the bought materials needed to make it e.g. if a firm sells a product for $18, but the materials that were brought in from other firms only cost $8, then the value added is $10. To increase value added, the marketing manager could keep the price the same but lower bought-in costs, cheaper materials could be bought. However, cheaper materials might lead to lower quality and actually reduced sails.

**Classifications of local and national firms into primary, secondary and tertiary sectors.**

The three types of business activity are:

a) Primary production – the extraction of the gifts of nature e.g. raw materials and natural resources from the land or sea. Primary production examples
Florist- producing flowers to sell to local markets.
Fishing- a small boat used to fish by an entrepreneur; oil extraction.

b) Secondary production – the turning of raw materials and natural resources into finished goods e.g. a car assembly, plant dressmaking, carpentry, construction.

c) Tertiary production or service sector- provides services e.g. teaching, hairdressing, car repairs, child minding, retailing, transport, insurance, tourism.

The three sectors are dependent upon each other. The secondary sector needs raw materials to complete its activities while the survival of the tertiary sector is also pivoted on the two prior sectors. In the formation of these sectors different stakeholder groups are involved in business activity.

## Business stakeholders

**A stakeholder is any person or group with a direct interest in the performance and activities of a business. These are as follows:**

Owners consumers

Workers **Stakeholders** Government

Managers the community

**Owners** They invest in the business are interested in the growth of business and take risks to make profit.

**Consumers** they buy the goods and services from the producer and need value for money.

**Government** Interested in the growth of the economy which creates pass laws to protect workers and consumers, employment, taxes and increasing national output.

**The Community** Wants products from firms might pollute the environment but at the same time get employment, products and services from the firms.

**Managers** Interested in the survival and expansion of the business for them to stand competition. They are also interested in Business profitability, growth, market share

**Workers** Interested in the continuity of the business for security of jobs and sustainability of families, also interested in disposable income and job satisfaction.

**Trade unions** they are willing to negotiate for the conditions of services.

**Suppliers** Suppliers are interested in variation and security of Orders, and the ability of the business to pay.

**Competitors** Fairness of the competition.

**Business growth and measurement of size**

Methods of comparing size are as follows:

- By capital employed-money injected into the business
- By the number of workers employed
- By sales/turnover
- By value of output
- By profit
- By the number of sales
- By the number of outlets
- By market share
- Geographic spread number of branches

Businesses come in all sizes. Some are small while others are large. Some businesses are capital intensive i.e. use machinery than employing more labour and others are labour intensive i.e. use workers than machinery. Goods produced from labour intensive firms are more expensive than those from capital intensive firms. Number of employee may not be a good measure of the size since the same business may purchase machinery and lay down the majority of the employees yet the premises have remained the same.

The size of a business is useful to

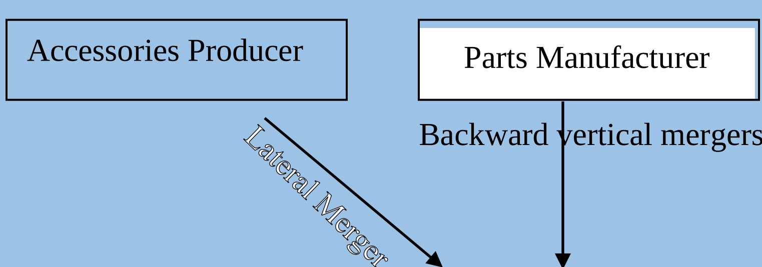
- Investors
- Government
- Banks
- Workers
- Competitors

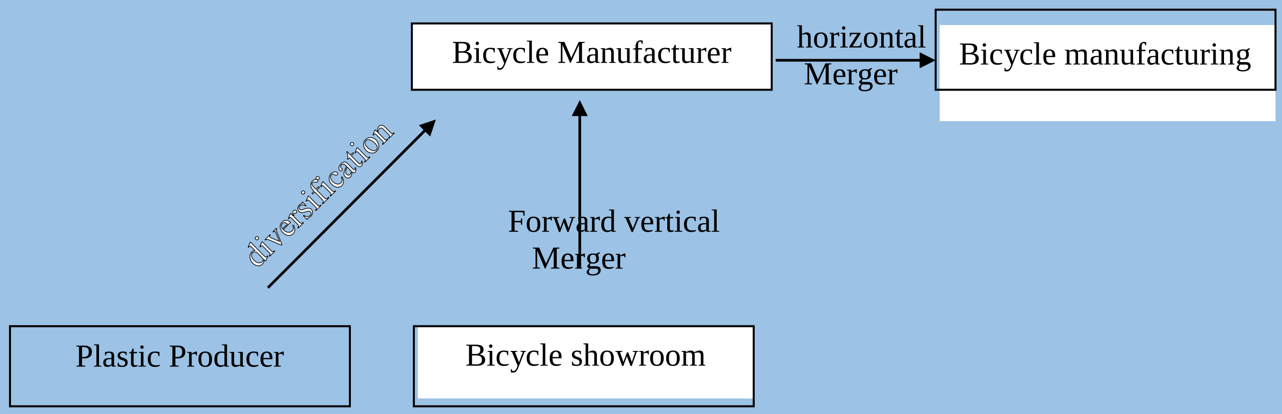
**Growth of firms**

Business can grow in two main ways

- By internal growth, opening more outlets facilitated through ploughing back profits
- A takeover is when two companies join together by mutual agreement
- By external growth, involving a takeover or a merger with another business.

**Types of mergers**






- * Vertical mergers occur between two companies engaged in different stages of production.
- * Backward vertical merger involves a prior stage of production being merged with while forward vertical merger involves joining a later stage of production. Supplier could be prevented from supplying by other manufacturers. The merger gives an assured supply of important components.
- * Horizontal mergers occur where two companies are engaged in the same stage of production of the same good.
- * Lateral mergers involve two companies producing related goods that do not compete directly with each other.
- * Diversifying or conglomerate mergers occur where the products of the companies involved are unrelated.

As business grow, their objectives change. Sometimes the different objectives of a business may conflict. Businesses have to be environmentally friendly. A local producing plant may decide to cut on pollution by using electricity or solar panels. Cement producing plants may enter into competition to cut down on pollution to get the latest ISO certificate. Governments may set fines for these industries disposing harmful substances into the rivers and other surroundings.

**Exercise:-**

1. Give examples of
   (a) Primary production [2]
   (b) Secondary production [2]
   (c) Tertiary production [2]
2. Give 4 stakeholders of a manufacturing business [4]
3. Explain the two main ways a business can grow[4]

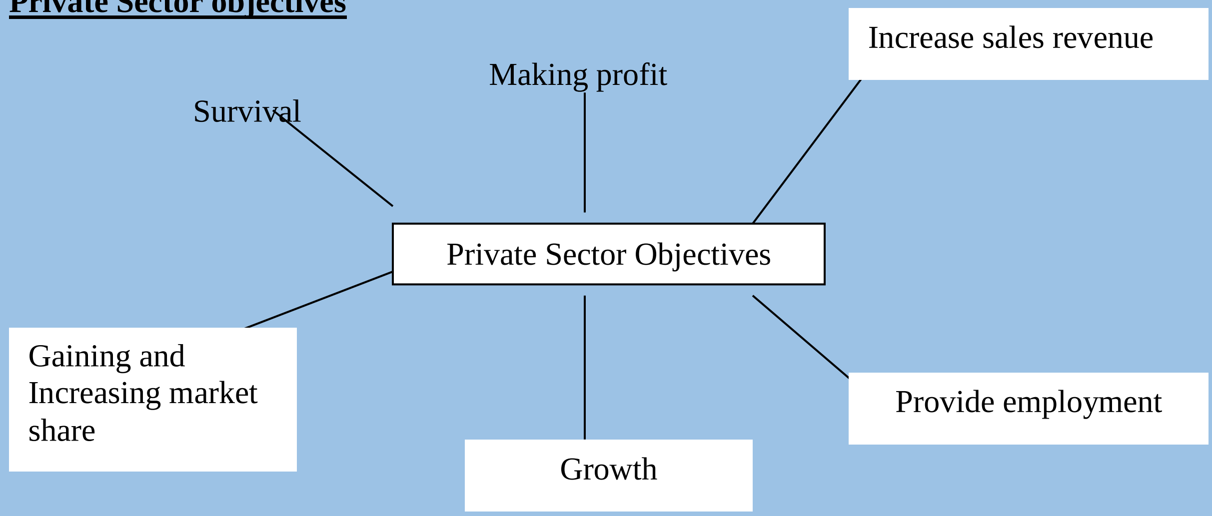
**Key features of national economy**

When businesses are set up there are negative and positive impacts that are brought about. External costs are costs paid by the rest of society, rather than the business, as a result of a business decisions. On the other hand social benefits also emanate. There are gains to society, resulting from a business activity. They are also known as external benefits. Examples of external costs could be destruction of an area of natural beauty, loss of homes for animals and destruction of environmental, incomes rise which creates spending in associated business. Government should control business activity.

**Business Objectives**

Objectives are goals or targets set by a business which they seek to achieve through activities of the business. Objectives largely depend on whether the business is a private enterprise established to make a profit for its owners, a non-profit making organisation, or a public enterprise set up to provide a service to the community. A private sector business is one that is set up, financed and managed by private individuals or groups of individuals. A public sector business is formed largely by the state and hence aims at achieving targets determined by the state. These might include providing an adequate level of service at affordable prices accessible to all people. Private sector businesses will aim to achieve the objectives of the owners including making profit.

**Private Sector objectives**



## Public enterprise objectives

A public service organization provides services such as education, national security and health. Other public services, such as national defence are provided to everybody in a society.

## Non profit making organizations

These provide services to its members, include charities and voluntary organisations. They are set up to fulfil specific social needs to a specific section of the community. These are charities which do not make a profit. They depend on donations, member subscriptions and ancillary activities.

## 3 Stages involved in production

### 1. Primary Production (Primary Sector)

This stage of production involves the extraction of raw materials from the land. These resources are provided by Mother Nature for example minerals, fish, forest etc. Industry in this sector is referred to as extractive which include, farming, fishing, forestry and mining

### 2. Secondary Production (Secondary Sector)

In this stage raw materials from primary production are transformed into finished goods. The industry activities are processing, construction and manufacturing

### 3. Tertiary Production (Tertiary Production)

Tertiary production is for service delivery systems where services are provided to corporate organisations and individuals. Activities in this sector involve banking, transport, Insurance, commission hotel etc

## Economic Environment

## Economic Systems

Due to the fact that resources are scarce, we have to make choices – we have to choose between various ways in which resources can be used. A choice implies that, there is sacrifice. This sacrifice is known as opportunity cost. In order to use resources for a specific purpose, the opportunity cost of that decision is the products we could have made if we had chosen to do something else. In any economic system there do some form of mechanism to allocate both scarce economic goods and the scarce resources used to make these Goods. All economics must solve the problems of

(i) What to produce?
(ii) How to produce it?
(iii) For whom to produce?

(iv) What price to charge?

All this is the responsibility of management and the central government or local authority.
There are three models or processes by which an economy can allocate its resources. There are:

**A. Free or market economies**

It is a market structure where there is no government control over factors of production (Land, capital, labour)
Example of a country- United States (though government controls)
This is the opposite of monopoly where a business which controls all the market for a product.
The price mechanism is needed to allocate scarce resource in a market economy. There is private ownership of resources, no government control. The profit motive spurs entrepreneurs as there is quick response to consumer change, only goods in demand are produced. The choice on offer is large. The price mechanism works out efficiently when it carries out its two formations namely:
(a) Signalling – stable or changing prices give signals to buyers and sellers conveying information which is acted upon by them
(b) Incentives – price increases or reduction should act as incentives. A great demand of product should encourage existing firms to employ more resources increasing their output, leading to economies of scale.

**<u>Advantages</u>**

1. Choice – people can spend their money how they want, choose to set up their own firm or they can choose for whom they want to work for.
2. A market economy can achieve great efficiency in production and in the allocation of resources. As a result there is productive efficiency and allocation efficiency.
3. Competition – through competition in efficient products are priced out of the market while more efficient producers supply their own products at lower prices for the consumers and use factors of production more efficiently
4. Consumer sovereignty- prices hence have to satisfy their clients in order to make a profit.

**<u>Disadvantages</u>**

1. Under use of resources – there should be full employment of resources in terms of labour and other resources, but employment still persists
2. Inappropriate use of resources – the price mechanism and profit motive can result in social judgments being ignored with the scarce resources not being allocated to socially beneficial projects because of the market factors. This results in non-profitable goods not being supplied without government interruption

3. Inequality – where the price mechanism is used as the basis for allocation, those who are priced out of the market cannot obtain many of the goods and services they require.
4. Public services – the price mechanism may not work efficiently where services need to be provided for the benefit of society as a whole such as defence and health services
5. Reduced competition – some products may have expensive advertising campaigns to sell their products which are basically the same as many other products currently on scale. This is wasted expenditure.

**B. Planned/State Economy**

The government owns the resources, is the central decision maker, sets objectives in line with government plans according to what it meant for people and the consumers are not consulted. There is no choice; public and merit goods are produced. Prices are low and subsidised while social costs are considered.

**Advantages**

1. Basic services – concentration on producing a range of goods and services for all the population
2. Large scale production – with mass production economies of scale are possible where costs decrease as products increase
3. Use of resources – can lead to use of all the resources of production and creating employment and using resources to their maximum.
4. Public services – monopolies are discouraged but the government can provide domestic power and defence efficiently throughout.

**Disadvantages of a Planned Economy.**

1) The state may not produce goods which people want
2) As the government fixes wages and private property is not allowed, there is less incentive to work.
3) There is low efficiency in firms due to lack of a profit motive

Example of a country- China (Now more changes to mixed).

**C. Mixed economy**

- Combines some features of both market economy and planned economy
- All countries have mixed economy
- Mixed economy includes Private sector and Public sector
- Important industries are controlled by government
- Water supply, education, healthy, defence, public transport, electricity supply.

**Privatisation**

Privatisation is a process where public enterprises (parastatals) are sold to private individuals. For example Zimbabwe Marketing Board was sold to Dairy Marketing Board Zimbabwe Limited which is a private limited company.

**Advantages of privatisation**

1. It reduces the government expenditure in the form of subsidies.
2. All private business pay tax to the government and by privatisation more revenue is collected by the government.
3. Privatisation improves efficiency as its main aim is to maximize profits
4. It leads to competition which enhances quality.
5. It increases the value of goods and services thereby contributing positively to the gross domestic product.

**Disadvantages of privatisation**

1. Privatisation may result in some good or services not provided for example public goods
2. In a bid to enhance efficiency, jobs may be lost resulting in an increase in unemployment.
3. Large firms may acquire potential rivals thereby creating a monopoly which may exploit the consumers by charging high prices.

**Examination type or standard Questions**

1. State three reasons why businesses set objectives [3]
2. Explain any two advantages of a free market[4]
3. Giving examples, distinguish between human needs and wants.
4. Explain 3 features of a command economy [3] (Zimsec 2009)
5. State the three levels of economic activity in which the economy is dividend [3]
   (Zimsec 2006).
6. Give three benefits to a business, of vertical integrating (forwards) with another business. [3]
7. What do you understand by the phrase "public sector" of the economy? [3] (Zimsec 2005)
8. State 3 disadvantages of privatization of industries such as electricity and gas supplies. [3]
9. Explain any two reasons why the government might want to control business activities in the Private sector [4] (Zimsec 2006)

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# CHAPTER 3

## Business communication

Chapter objectives:
After studying this chapter the student should be able to:

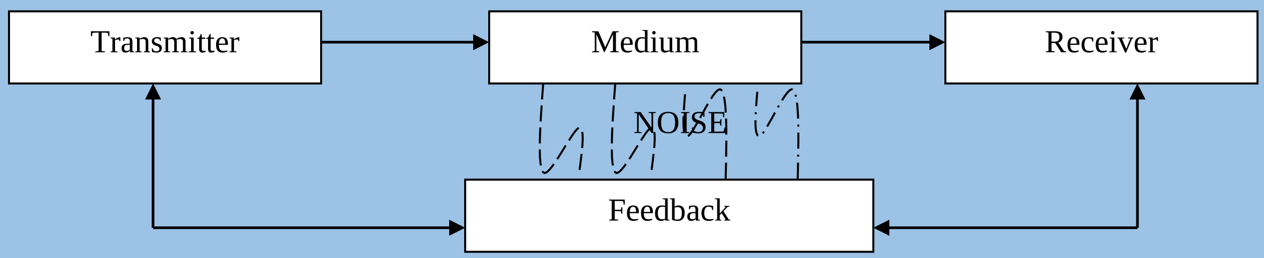
- Define communication.
- To outline the importance of effective communication.
- To describe how communication takes place.
- Distinguish between internal and external communication.
- Explain methods of communication.
- Explain communication nets.
- To explain why barriers to effective communication in business affect the Smooth flow of messages.

- Explain the need for formal and informal communication.

**Introduction**

Communication is a process of transmitting messages from one person or organisation to another. It is also a two way process in which messages sent pass from the sender to the receiver through a chosen channel producing a feed-back. It is the transmission of a message from the sender to the receiver, who understands the message.
Communication is effective if the message is accurately sent, properly received and a proper feedback received as intended by the sender.

**EFFECTIVE COMMUNICATION PROCESS**




**Transmitter (sender)**
A transmitter is a person who initiates the communication process. He or She starts off the process by sending the message to the receiver through a medium expecting a feedback. For example, a memo sent by a manager to the employees.

Medium (Channel)
Medium – method
Media – methods
A communication medium is a method used to transmit messages from sender to the receiver. This method can be in the form of telephone, cell-phone, letter e-mail or even a meeting.

**Receiver (recipient)**
A receiver is a person or organisation that receives the messages.

**Feedback**
Feedback is the process of responding to the message received by the recipient. A feedback is used to assess the effectiveness of the message sent; it must be in a manner intended.

**Noise**

It is anything that disturbs communication for example technical fault.

**Importance of effective communication**

1. It improves the quality of decisions as it is a two way system.
2. It encourages participation through group discussions and thus results in staff motivation.
3. Effective communication enhances co-ordination between departments.
4. The organisation can quickly adapt to the changes in the business environment.
5. The functions of management are inevitable without effective communication.

**Exercise 1**

A company (O.K stores) places an advert in newspaper (Chronicle) advertising about the new range of products to its customers.

1. Identify (in the case).
   a) The sender of the message. [1]
   b) The medium used. [1]
   c) The receiver of the message. [1]
2. Define the following terms.
   a) Transmitter. [2]
   b) Channel. [2]
   c) Receiver. [2]
   d) Feedback. [2]
   e) Noise . [2]

**One way and two-way communication.**

**One-way communication** refers to sending a message which does not call for a feedback. It also takes place when the receiver has no opportunity to reply or respond to the message.

**Two-way communication** occurs when the message is sent to the recipient and he responds.

**Examples of one-way communication**

Teacher's instruction: "Take these Business text books to the H.O.D Commercials."
"Keep this door closed at all times"

**Example of two-way communication**- "why didn't you write the Business studies homework?" The teacher asks a pupil.

**Advantages of two-way communication**

1. Both people are involved in the communication process. The receiver feels a part of the process
2. It motivates the receiver as she can make contribution to the topic being communicated.
3. It will be clear to the sender whether the message has been understood and acted upon by the receiver.

**Internal and external communication**

**Internal Communication - refers** to the exchange of messages within the organisation. Examples are, a sales clerk talking to the sales manager, finance manager, communicating with the production manager etc. It should be noted that the sender and the recipient must be of the same organisation.

**External communication**

It is the exchange of messages between one organisation with others from another organisation. For example, a buyer placing an order to a supplier, business selling goods to a customer, an accountant organizing a bank draft with a bank manager etc.

**The communication media**

**(A) Oral communication (verbal)**

It takes the form of one-to-one interviews, group meetings, team briefings, video conferencing and appraisals.

**Advantages of Oral Communication**

1. It permits two-way communication and proper feedback which motivates subordinates
2. It allows the sender to use body language which reinforce the message
3. It is available for probing, where the message is not clear.
4. It is a quick way of obtaining information which makes it appropriate in this turbulent environment.

**Disadvantages of oral communication**

1. There may be no written record of what was discussed
2. Body language may affect the message especially if the sender appeared bored.
3. When addressing many people, there is no way of telling whether everyone is listening or has understood the message
4 When feedback occurs, it can take long to use the vertical chain as there can be arguments on the topic.

**(B) Written Communication**

This can be through notice boards, letters, memos, reports and e-mails

**Advantages of written communication**

a. It allows transmission of complicated data via diagrams
b. It is available for future references especially where there are disagreements
c. It has a wide network spectrum especially electronic media
d. Electronic media is also cheap and instant feedback can be obtained.

**Disadvantages**

a. It eliminates supporting body language
b. There is no evidence that the message has been received or understood
c. It is not available for further probing or questioning to understand.

**Examples of written Communication**

**(1) Notices on board.**

(a) Cheap way of communication within the organization.
(b) Information can address a large number of people.
(c) Can be filled for reference.

**Disadvantages of a Notice board.**

(a) There is no certainty that they are read.
(b) No opportunity to reinforce the message by body language.

**(2) Letters**

**Advantages**

1) Avoid distortion of information.
2) Can be filed for reference.
3) Can be faxed, scanned or e-mailed.

**Disadvantages**

1) Written message might be long and ending up confusing the interest of the reader.
2) Two-way communication is difficulty.
3) Body language is absent for reinforcement of the message.

**3) Memorandum (memo)**

**Advantages-**

- Avoid distortion of information.
- Can be filed for reference.
- Can be faxed, scanned or e-mailed.
- Can be photocopied.
- Can be targeted to particular individuals.

**4. Reports**

Reports can be photocopied and sent to many people.

- Detailed information can be obtained.
- Complicated data like diagrams can be transmitted.
- There is hard evidence of the message which can be referred to in future.

**Disadvantages-**

- Written message might be long and ending up confusing the interest of the reader.

- Reports can be so detailed that they could not be understood by employees
- There is no further questioning to understand.

**(5) <u>Faxes, e-mail, Intranet and Internet.</u>**

**Advantages-**

- can be sent to many people within a short period.
- Printouts of messages can be obtained if a hard copy is required.
- It's a cheaper way to reach a large number of people.

**Disadvantage–**

- Direct feedback can lead to too many email messages, being created which causes information overload.
- Can be affected by power (electricity)

**(6) <u>Visual communication</u>**

Includes charts and diagrams, posters, films, videos and Power –Point displays
Business can get more customers as people are interested in looking at films, videos or posters than a letter.

**<u>Advantages</u>**

- Data can be simplified by presenting it in tables, charts, graphs and diagrams.
- This is usually used in training and marketing programmes as it makes messages clearer.
- It makes communication attractive and interesting as it is eye catching.

**<u>Disadvantages of visual communication</u>**

- Visual communication alone is not effective as it requires other communication media to reinforce the message.
- Charts and diagrams may be complicated to a lay man.
- There is no instant feedback

**<u>Exercise</u>**

**(1)** Explain any 2 examples of the following communication methods
  (a) Verbal [4]
  (b) Written [4]
  (c) Visual [4]

**(2)** Give 2 advantages of each of the communication methods above [6]

**<u>Factors influencing media choice</u>**

1. Cost, for example electronic media require expensive equipment
2. The time frame for the feedback, it instantly requires cell phones.
3. The longer and more detailed the message, the less likely that oral communication will be used.
4. The availability of the medium at the recipient's location, for example the lack of network coverage may make it difficult to use the cellular phone system.

## Formal and informal communication

Formal communication refers to the network of official communication channels in an organisation. This kind of communication is recognized by the organisation and has clear channels.

## Informal Communication

It is a form of communication that is not formally recognized by an organisation. It constitutes social relationships that develop as people interact with one another. These channels of communication are normally termed 'grapevine' and are used by managers who cannot effectively communicate.

## Informal communication

### Advantages

(1) Encourage members to achieve organizational objectives.
(2) Provides an extra channel of communication.
(3) Reflect what motivates workers.
(4) Social needs are catered for.
(5) Brings hidden issues to the surface.

### Disadvantages

(1) Can spread gossip and rumour which is unhelpful to managers.
(2) Can cause conflicts within the organization.
(3) Hatred can be created.

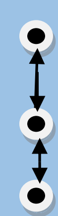
## COMMUNICATION NETS

Are the ways or, links in which people in a group communicate with each other.

## Examples of communication nets

**(1) Chain Net-work**

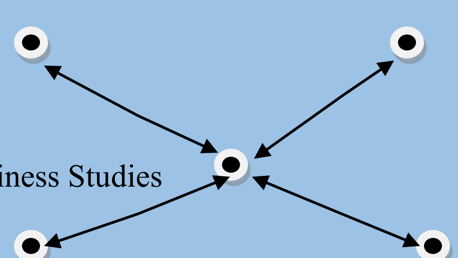
This net is used for company policy Communication



- Can be used to transmit information from top to lower levels
- There is one-way communication.
- The message becomes confused as it passes through several levels.

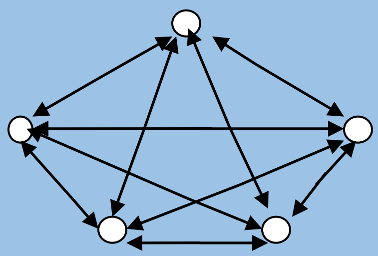
**(2) Wheel Network**

It is used by organisations to communicate to different branches or regions of the business



- Used to communicate with different branches, departments or region of a firm.
- Solutions can be communicated to other regions
- Communication directly between departments is not possible

(3) **<u>Connected Network</u>** (Group discussion)



- Two-way communication is the main feature.
- Suitable to discuss new ideas.
- Sender is not clear.
- Can be time consuming.

**<u>Exercise</u>**

1. Distinguish between formal and informal communication. [3]
2. Outline the disadvantages of informal communication.[4]
3. State one advantage and one disadvantage of the three Communication Networks. [6]

**<u>Barriers to effective communication</u>**

**(a) Problems with the sender**

- use of technical terms (jargon) which is difficult to understand
- message sent may be vague resulting in poor understanding
- too much information is sent, which complicates the communication process.
- Wrong message from sender to wrong receiver.

**(b) Problems with the medium**

- Medium chosen might be inappropriate, for example the use of detailed and technical diagrams, over the phone.
- When a wrong channel or medium is used, a technical fault arises
- Message might get lost.
- Breakdown of medium e.g. e-mail (computer).

**(c) Problems with the receiver**

- The receiver holds negative attitude(s) about sender.
- The receiver is not acting on the received message.
- Not paying attention.

**(d) Problems with the feed-back**

- lack of feedback
- Message may be distorted on the way

**(e) Physical reasons**

- Noisy factories are not suitable for communication
- geographical distance can limit communication

**<u>How to overcome communication barriers</u>**

- ensure that the message is clear, precise and adequately detailed
- avoid the use of technical terms
- Build a feedback into the communication process
- Ensure the channels of communication are known by all in the organisation
- Make sure the physical environments are appropriate for messages to be heard or received in other ways.
- Establish trust between senders and receivers

**<u>Examination standard questions</u>**

1. Define the term communication using the four basic elements. [2]
2. Distinguish between internal and external communication. [2]
3. Explain the uses of circulars in communicating business information [3]
4. Draft an appropriate format of a memorandum. [6]

5a) Explain two barriers to effective communication in an organization. [4]
  b) Describe how the above given barriers can be overcome. [2]

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# CHAPTER 4

## Business Organisations

Chapter objectives:
After studying this chapter the student should be able to:

- To explain the need for a business structure and the various forms in use.
- To explain the advantages and disadvantages of the forms of business organizations.
- To describe these forms of business organisation and their relevance to the Zimbabwean situation.
- Compare and contrast business forms.

**Business Organisations**

**Private Sector**
- Sole trader
- Partnership
- Limited companies
- Joint ventures
- Franchise
- Co-operates

**Public Sector**
- Public corporations
- Municipalities

## PRIVATE SECTOR

This sector comprises business which are owned and controlled by private individuals

### Examples of Private Sector

### A. Sole Trader

This form of business is owned by one person who is normally the manager. He is also known as a sole proprietor for he/she contributes capital alone. Example of a sole trader is Runganga General deader.

**Advantages of a Sole trader**

1. There are few legal requirements to set up a sole trader business.
2. The owner enjoys all the profits as he does not need to share them with anyone
3. There is independence in decision making that is the owner can make him/her decisions without consulting anyone
4. It offers an incentive to the owner to work and be efficient
5. The owner has personal contact with his customers
6. Secrecy- no published Accounts

**Disadvantages of a sole trader**

1. Poor decisions due to lack of consultation
2. Limited capital due to lack of collateral security
3. An unlimited liability, that is, if the owner fails to pay for the debts
4. Lack of specialist skills as the proprietor employees people who are unqualified.
5. Assumes all losses and bears all the risks.
6. The death of the owner terminates the legal existence of a sole trader.

### B. Partnership, Partnership Deeds

A partnership is a group of between two and twenty members who agree to make a business organisation for their joint benefit for example Deloitte and Touche (Accountancy). An exception is with lawyers and solicitors

**Deed of partnership**

There are a few legal requirements in forming a partnership business. The document which is required is a partnership agreement (deed of partnership) which spells out the following.

1. The amount to be contributed by each partner
2. How profits are to be shared amongst the partners (profit sharing ratios)
3. The amount of drawing by each partner
4. Interest on drawings
5. Interest on capital.
6. Duties of each partner

**N.B.** In the absence of the partnership agreement, the Partnership Act of 1890 applies. This document is referred to in the courts of law in case there are disputes among the partners.

**Advantages of partnership**

1 .More capital is raised due to partner's contribution.
2. Partners can share responsibilities of governing the business in the areas of specialisation.
3. The partners can take holiday as they can cover each other.
4. More profits can be generated as the partners use specialist skills.
5. The owners share unlimited liability.
6. It adds companionship to life in a small business enterprise.

**Disadvantages of partnership**

1. The partners have unlimited liability.
2. There may be disputes amongst the partners on corporate strategies or major decisions.
3. This business lacks continuity as the death of any partner will result in the dissolution of a partnership.
4. The partners share the profits of the business.
5. The decision made by the partner may bind all other partners and thus make them liable.
6. Partners fall short of one another's expectations.
7. Partnership does not have separate legal identity from the partners.

**Exercise**

1. What is the difference between Private sector and Public sector? [2]
2. Identify four forms of business in a Private sector. [4]
3. Explain 2 advantages of 2 of the forms mentioned above. [8]
4. List 3 items found in a partnership deed. [3]

**C. Limited Companies**

These are organisations with Limited liability that is separate legal entities. They are regarded as legal persona (person) as they can own property, employ people and indulge in any business activity that can be performed by a natural person.

The companies are owned by members who are known as shareholders because they bought shares (equities) from the company. Shareholders (owners) are entitled to a share of corporate profits known as dividend.

**The legality of limited Companies**

Two documents must be launched to the Register of Companies before a company is registered. These documents are the Articles of Association and the Memorandum of Association.

**Articles of Association**

This is a document of internal affairs of the company that is its rules and regulations It contains the following:

(a) rights and duties of the directors
(b) frequency of the annual General Meeting (AGM)
(c) rules regarding the election of board of members
(d) procedures when issuing shares.

**Memorandum of Association**

This is a document of external affairs of the company as it shows the relationship between the company and its external stakeholders. Its contents are as follows:

(a) Name of the company
(b) The company's physical location, members e-mail address, telephone numbers etc.
(d) The broad goals or objectives of the company must also be stated.
(e) The amount of authorized share capital (capital the company intend to raise)
(f) The number of shares to be bought by each member

These documents must be submitted to the Registrar of Companies for verification and if he/she issues a Certificate of Incorporation. This document entitles a private limited company to commence trading and a public limited company to issue a prospectus i.e. inviting prospective investors to buy shares.

**Differences between a private limited company and public limited company**

| Private Limited Company | Public Limited Companies |
|---|---|
| 1. It ends with Limited or Limited after the name<br>2. Shares are only sold privately to friends and relatives<br>3. Is not forced by law to publicise its financial statements<br>4. Can start operating after, receiving a Certificate of Incorporation | 1. It ends with public after the name<br>2. Shares are sold to the public through the stock exchange<br>3. It's obliged to publicise its financial statements by law<br>4. Certificate of incorporation and a trading certificate entitles the company to commence business |

| | |
|---|---|
| 5. Membership is limited to 50 | 5. Membership is at least 7 no limit |

**Advantages of a private Limited Company**

1. More capital can be raised through issuing shares to friends and relatives
2. Shareholders have limited liability, that is in the event of the business liquidating, owners lose only the capital invested, not personal assets
3. Issue of shares does not dilute equity as compared to public limited companies

**Disadvantages of private limited company**

1. Shares are not transferable without the consent of other shareholders
2. Financial statements must be sent to the Registrar of companies annually and this may divulge the company secret.
3. Since the public issue is not allowed by statute less capital is raised by a private limited company

**Disadvantages of a public limited company**

1. The company is forced by law to publish its final accounts. The information contained there on can be used by the rivals to enhance their competitive advantage.
2. There are a lot of legal requirements which are costly and time consuming
3. Registration on the stock exchange exposes the company to takeover bid.
4. Shares can be purchased by a lot of shareholders thereby diluting equity

**Exercise 2**

Draw a chart and show the differences between Private limited Company and Public limited Company. [10]

**Other forms of business organisations**

**D. Co-operatives**

A co-operative is a body which is formed by a group of people who pool their resources together. The rationale behind it is to encourage co-operation and to help the members with the shared expertise.

**Characteristics of Co-operatives**

1. Members benefit from bulk purchase thereby getting large trade discounts for example wholesale co-operatives which pool their resources to buy merchandise in large quantities
2. Retail prices are also set by a co-operative which is uniform. This reduces unnecessary competition which reduces prices.
3. Members can share the experience and skills which improves the co-operative performance.

4. Members are also encouraged to communicate through seminars of their rights and the obligation of others.

**Disadvantages of Co-operatives**

1. Members may disagree on issues of principal governance and decision making. This is normally true when, there are differences levels of understanding and education.
2. Some members may manipulate the system to serve their interests.

**E. The S- Corporation**

The subchapter corporation is derived from sub-chapter of the internal revenue code which permits a business to retain the limited liability features of a company (corporation) while being taxed as a partnership.

**Advantages**

(1) Limited liability
(2) There is separate legal entity
(3) Legal formalities are not many (founding statement required by registrar of Companies).

**Disadvantages**

(1) Not suitable for large organization as membership is limited.
(2) Decision making may take long as there is consultation of other members.
(3) Conflicts may arise after disagreement of certain business issues.

**F. Franchising**

Franchising is an arrangement in which one business (franchisor) allows another (franchisee) to use its trade name for a fee. Examples are Wimpy, McDonalds, KFC etc. A licence to operate is given to the franchisee by the franchisor after meeting all the requirements.

**Franchise** is the business
**Franchisor**: the owner of trade name
**Franchisee**: the business that uses the trade name

**Advantages of franchising (to the franchisee)**

1. Business failure less likely as well known brand name is used.
2. Franchisor carries out advertising for its members.
3. Suppliers may be obtained from the franchisor
4. Training of staff and owner can be undertaken by the franchisor
5. Banks are more willing to lend money to the franchisor due to low risk.

**Advantages to a franchisor**

1. The business expansion is rapid unlike when the franchisor finance all operations

2. Franchising lead to more business (increased sales) to the franchisor as all franchisers must buy goods from the franchisor
3. The franchisee benefits from fees payment especially to obtain the licence.
4. The management which is stressful is for franchisee.

**Disadvantages to the franchisee**

1. Annual fees are paid by franchisee which limit the profits available to the owner
2. The franchisee do not enjoy liberty in decision making as most decisions must be approved by the franchisor
3. It retards innovation as the franchisee is not allowed to produce and sell goods which are not on the list of the franchisor.
4. Can receive financial assistance from franchisor and delay payment.

**Disadvantages to the franchisor**

1. Profits made by franchisee are not remitted to the franchisor.
2. The image of the franchisor may be tarnished if any one of its franchisee has bad governance.

**G. Joint venture**

A joint venture is a contract entered into by two or more businesses to jointly work in a particular project.

Examples:
(1) Merger- two corporations come together and one absorbs the other.
(2) Consolidations- two or more corporations with separate existences cease and a new corporation with property of the old corporation come into being.
(3) Conglomerate- describes the relationship of a parent corporation to a subsidiary corporation engaged in diversified fields of activities unrelated to the field of activity of the parent corporation e.g. a manufacturing company that owns all the stocks of the drug manufacturing company.

Capital, expertise and profit are shared by members to a joint venture.

**Advantages of joint ventures**

1. Shared skills and experiences
2. Risk is spread on many people
3. The business can terminate after the competition of the project.

**Disadvantages of joint venture**

1. Problems in management.
2. Problems in decision making.
3. Difference in culture, thus running the firm differently.

**Exercise**

1. Explain two characteristics of a cooperative [4]
2. Give 2 advantages of franchising to:
   (a) Franchisor. [2]
   (b) Franchisee. [2]
3. How are S corporations formed? [3]
4. List three types of joint venture. [3]
5. What are the advantages of joint ventures? [3]

**Public Sector**

**It consists of businesses which are owned and managed by the government on behalf of people. Key services are normally nationalized, for example, water electricity, rail services and defence. The management of these nationalized businesses is entrusted into the hands of the Board of Directors (also known as the Board of Management) under a particular Ministry.**

**Examples include the Public corporations, municipal enterprises, public utilities etc.**

**Objectives of business in the public sector**

1. Provision of services to the public which is affordable
2. Create employment to the nationals
3. To achieve macro-economic objectives e.g. employments rate.

**Public corporations & Municipal Enterprises**

**Advantages of public corporations**

(1) Strategic industries like electricity, is controlled by government for the benefit of all.
(2) Natural monopolies are often owned by the government so that consumers are not taken advantage of by privately owned monopolists.
(3) They prevent unfair pricing of commodities.
(4) They reduce social costs.
(5) They prevent illegal employment practices.

**Disadvantages**

1. No hardworking as the profit motive will not be emphasised.
2. As there is no close competition in public corporations, there is lack of incentive to increase consumer choice and increase efficiency.
3. Government can use the corporation for political reasons.
4. Inefficiency in managers can be found as they will always think that government will chip in for help.

**Exercise**

1. Explain 2 benefits to society of the government controlling:-

(a) Water supply. [4]
(b) Television Services. [4]

2. Give two main types of business in the Public sector.

**Examination Standard Questions**

1. Explain how small firms (sole traders) survive competition from large scale firms [4]
2. Give four differences between a Private limited company and a Public Limited company [8]
3. Describe how a franchisee can benefit from franchising. [4]
4. What do you understand by the phrase public sector of the economy? [3]
5. Explain any three reasons why the state might want to control business activities in the private sector. [6]

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# CHAPTER 5

## INFORMATION TECHNOLOGY (COMPUTERS)

Chapter objectives:
After studying this chapter the student should be able to:

- To define computers.
- Give types of computers.
- Explain the need of computers.
- Give the advantages of Information technology/computers.
- Give the disadvantages of Information technology/computers.

**Information Technology**

This refers to the use of new technology i.e computers in homes and business operations.

**Examples of new technology**

1. Automation-: the equipment used in the factory is controlled by a computer e.g. Robots used to assemble cars.
2. Mechanisation: production is done by people- controlled machines.
3. Electronic point of sale-: a bar-code is checked for an individual item.
4. Computer aided design (CAD)- It is a computer software that draws items being designed more quickly and allows them to be rotated to see the item from all sides instead of having to draw several times.
5. Electronic fund transfer at point of sale-: Bank and point of sale computer connected. The money will be directly debited from the customer's account after they have signed for the debit to be made or entered through their Pin personal identification Number.

**Computer: Definitions**

1: This is an electronic device for storing and processing data.

2: An electronic device designed to accept data, perform prescribed mathematical and logical operations at a high speed.

**Types of computers**

1. Mainframe.
2. Portable computers.
3. Analogy computer.
4. Digital computer.
5. Micro computer.

NB: The type of computer for use depends on the size of the organisation and the intended use of such a computer.

**Exercise 1**

1. Explain the concerns of Information technology.
2. Describe 3 examples of new technology.
3. What is a computer.
4. Identify the 2 factors that influence the choice of a computer to use.

**Time and Cost requirement**

-Business deals are sealed within a short time as especially through internet.

-First transactions are made.

-The costs of travelling overseas for business deals are cut by use of internet.

**Exercises 2**

1. Explain the need for computers in the business.
2. Describe how computers increase the efficiency of the business.
3. Discuss the usefulness of computers.

**Why need computers**

-Keeping current on a competitor or industry.

-To catch technologies first-hand.

-Increase knowledge and share ideas.
-To foster local growth and developments.
-Local partnership and international merges can be obtained.
-Businesses can be helped to innovate and compete favourably.
-Critical mass is reached i.e more people are reached within a short time.

**Advantages of using computers**

1. There is increased market efficiency.
2. There is improved market information.
3. There is quicker communication and reduced paper work to increase profitability.
4. There is greater job satisfaction which stimulates workers as routine and boring jobs are now done by computers.
5. Better quality products are produced as new methods of production are introduced.
6. There is increased access to the market for both buyers and sellers.
7. Many routine managers are eliminated which leads to flat hierarchy.

**Problems of Information technology (Computers)**

1. Expensive-hardware and software installations
2. Need of a screen to show information.
3. Raises the number of unemployment as there is reduction of semi-skilled and unskilled jobs in both production and service areas.
4. High trained professionals are expensive to pay.
5. Redundancy costs among managers and workers might be high.
6. Maintenance and updating of the system regularly is costly.

**Barriers which were broken by the use of Internet**

**(a) Means of Payment**

-Business Accounts are now paid through international network.
-Money transfer is now easy for home and foreign trade.

(b) **Distance**

-Even if businesses are geographically spaced i.e some within the country and others abroad, distance is no longer a problem.
-Communication is made simple and fast.

c) **Language**

-Attitudinal problems are eliminated.

**Examination standard Questions**

1. What is a computer [2]
2. “Modern business cannot operate without computers” Discuss [10]
3. Why might an organisation experience a reduction in profitability following the introduction of information technology [6]
4. To what extent are computers important in a manufacturing industry [10]

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# CHAPTER 6

## Motivation

Chapter objectives:
After studying this chapter the student should be able to:

- To explain different motivation theories and how they can be applied at a work station.
- To outline different types of payment methods with their impact to the worker.
- To describe different leadership styles and their impact on production and motivation of the worker.
- To explain why motivation is essential to an organisation.

Motivation refers to anything that encourages the worker to want to work, that is, any factor which drives him to be effective and efficient.

## Factors that motive workers. (Why do people work)

Performance equation is the interaction of Ability, Motivation and Environment that is, Performance = Ability + Motivation + Environment

## Theories of motivation

### A. F.W Taylor (scientific management theory).

Scientific management as propounded by Taylor was based on the assumption that employees are motivated by financial factors to achieve personal gains. He tries to satisfy this need through increasing productivity. F.W Taylor ideas and findings published in 1911 and is a typical financial motivator theory. Example, "Money is the main motivator".

## Taylor's approach to increase productivity

1. He broke down each job into its simplest components
2. He selected workers to perform a task and observe them performing the task.
3. Recorded the time taken to do each part of the task
4. He identified the quickest method recorded
5 Trained employees in the quickest method
6. Pay the workers on their ability to produce the targeted output. Each was given a bonus for exceeding the expected output.

## Taylor's contributions

His ideas resulted in a big increase in production gains for the firms and income for the employees.

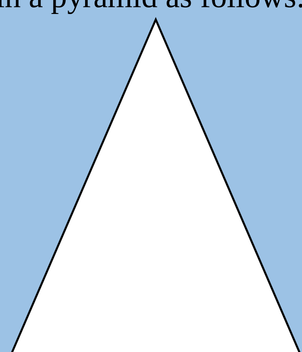
## Taylor's Criticism

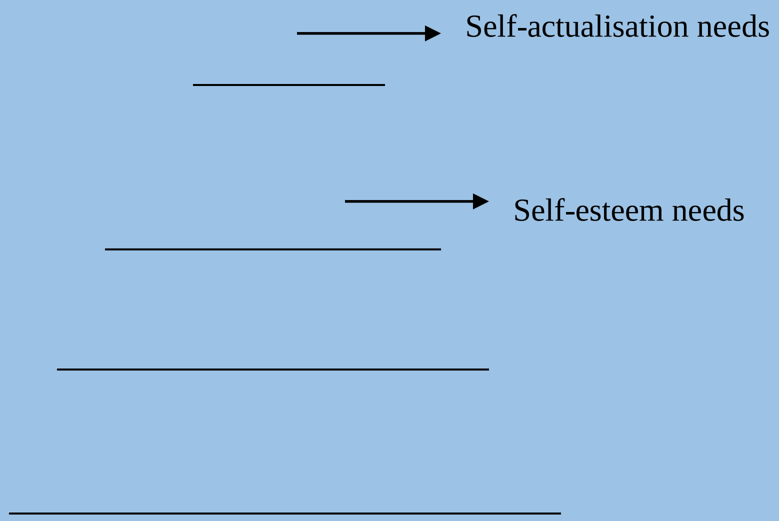
1. Taylor saw employees rather like tools to be used and was opposed by Trade Unions.
2. His theory was also criticized for its simplicity as it regarded money as the only motivating factors. In practice there are a lot of factors that motivate employers.
3. The theory was not practical for the jobs where output was difficult to measure for example in the police or defence.

### B. Abraham Maslow (Hierarchy of Needs)

Abraham Maslow **(behavioural science)** A hierarchy of needs is an example of financial and non- financial motivator. Maslow's formalised hierarchy of needs which individuals work to achieve.

These needs were put in a pyramid as follows:






1. **Physiological needs**
These are basic needs which are necessary for an individual for example, food, oxygen, water, shelter, clothes. They are normally catered by the salary. Physiological needs are fulfilled by payment (wages or salaries) high enough to meet daily needs like food and water bills.

2. **Safety needs (security)**
These needs focus on safety of the employees that is free from dangerous environment, dangerous equipment and safe working conditions. Offering a contract of employment provides job security, clear lines of authority and ensuring health and safety.

3. **Social needs.**
It refers to the need to interact with other employees at work. Work groups must be encouraged to ensure personal belonging, for example football clubs, or chess club.

4. **Esteem needs**
There are needs for status, recognition and achievements. The manager should offer recognition for work well done.

5. **Self-actualisation needs (self fulfilment)**

- This is the need to realize one's full potential and achieve challenging assignments. Opportunities to develop and apply new skills will increase potential. Achievement and recognition for esteem needs and challenging fulfilling work for self actualisation.

**Limitations of Maslow's theory**

1. He assumes that individual needs start on physiological level but some employees may desire to satisfy ego needs before basic needs.
2. Not everyone has the needs assumed by Maslow
3. Self-actualisation is never permanently achieved as suggested by Maslow
4. It's difficult to identify the level of needs one is trying to satisfy

**Exercise 1**

1. Explain F.W. Taylor's assumption on the employees' motivation. [2]
2. Give two jobs you could measure and find out how effective the employees are working and two jobs you cannot measure by output produced. [4]
3. State two criticisms of Taylor's approach. [2]
4. Draw Maslow's Hierarchy of needs. [5]
5. Explain two limitations of Maslow's Theory. [4]
6. Describe what Taylor did to increase productivity. [10]

**C. Frederick Herzberg (two factor theory/Hygiene' and 'Motivators')**

- Published in 1959
- Two factor theory i.e. basic animal needs- hygiene factors, human beings to grow psychologically.

  If managers want to motivate their employees to better performance, they must provide rewards that fill the higher order needs through such examples as advancement,

  Herzberg distinguished between motivators and hygiene factors. Motivators give satisfaction while hygiene factors do not cause job satisfaction but their absence de-motivates (cause dissatisfaction).

**Hygiene factors (maintenance factors)**

Job security
Good salary
Safe working conditions
Good company policy
Status security

**Motivators**

Achievements
Advancements
Personal growth
Recognition
Challenging

**D. McGregor (Theory X and Y) (1960)**

McGregor identified negative and positive attitudes towards the workers. His view is called: (Theory X) and (Theory Y) respectively.

**Theory x**

- The willingness to work is mainly influenced by methods of payment (high salaries & Wages) (External Factors).
- People are naturally lazy and have to be motivated and pushed to work.
- People need incentives and close supervision for them to work hard.
-

**Theory y**

- Motivation is basically an internal factor.
- People natural want to work but on favourable conditions.
- Providing satisfactory environment in which people can work freely will make them to have interest in their work.

| Theory X Managers | Theory Y managers |
|---|---|
| 1. Managers think that workers dislike work and will avoid it where possible | 1. The average person likes work as any effort at work is as natural as play or rest |
| 2. Workers should be controlled, directed and threatened with punishment to get the job done. | 2. Employers are able to direct and control themselves as long as there is recognition for effort |
| 3. An average worker does not want responsibility | 3. Employees accept and seek responsibility |
| 4. Employees have little ambitions | 4. Workers have a great deal of creativity and are geared, towards self-actualisation |

Supporters of Theory X advocate for an authoritarian leadership style and they centralize the decision making process.

Managers under Theory Y believe that motivation is an internal factor which is facilitated by a creation of a conducive environment.

**Exercise**

1. Describe F. Herzberg two factor theory. [3]
2. Identify 3 Hygiene factors and 3 motivators. [6]
3. Fill in the table below of McGregor 's Theory x & y

| **Theory X managers** | **Theory Y managers** |
|---|---|
| 1<br>2<br>3<br>4 | |

[8]

**Why do people work?**

1. **Security**-: Knowing that your job and pay are safe, no fears of losing the job in the near future.
2. **Money**-: so that one can buy basic needs and wants (luxuries)
3. **Job satisfaction**
   To offer a service i.e. enjoyment obtained from a feeling that one has done a good job.
4. **Social needs**
   One might admire to be just part of a certain group or organization. At work people make friends e.g. a school with high pass rate- one might want to be one of the teachers.
5. **Esteem needs (self important).**
   Feeling that the job you do is important.

**<u>Financial motivators (motivating workers using money)</u>**

**Financial rewards**

- Bonus- some call it a $13^{th}$ cheque as it is, a lump sum paid to workers at the end of the year, but it can be paid at intervals during the year.
- Motivated workers- increase or raise productivity.
- Always present at work or less days off.
- Fewer grievances.

**(1) Wages and Salaries**

A salary is a monthly payment awarded to the workers
A wage is any payment which is less than 30 days for example, weekly payment, fort-night payment or even daily wage.

**(2) Time rate**

Earnings are calculated by multiplying the hourly rate by the number of hours worked. The system provides workers with some security of payment despite unavoidable production bottlenecks. However, high overtime rates are common as employees delay the work so as to earn extra income.

**(3) Piece rate**

The piece rate system relates to output, that is the more the output the

more wage.
The advantage with this system is that it encourages greater output and a faster pace at work. On the other hand, piece rate may lead to reduced quality as employees rush to complete the task. Moreover, it discourages workers from accepting change at work as it might result in loss of pay.

**(4) Commission**

Commission is paid to the sales personnel for the goods sold. It may be straight commission where the worker is paid only on commission basis or basic salary plus commission

**(5) Performance related pay**

This method of pay applies to jobs whose output is difficult to measure, for example teachers, nurses etc. The superiors undertake an appraisal program to establish how one is performing her duties. Information obtained is used to assess the performance of the individual as well as to identify the needs for training

**(6) Profit sharing**

Profit sharing involves distribution of part of the company's profits to workers

**Advantages of profit sharing**

1. Workers become committed to organizations success and will be cost conscious
2. It reduces the conflict of interest between owners and employers

**Disadvantages of profit sharing**

1. The reward does not commensurate with the effort exerted by individuals.
2. It reduces profits available to owners and retained in business

**Financial Motivators.**

**7) Fringe benefits**

These are financial rewards which are offered to the employees over and above their salaries. Examples are:

- educational benefits to the employee's children
- company car
- payment for medical care
- share options
- free holiday trips

**<u>Non-Financial Motivators</u>**

**1) <u>Job satisfaction</u>**

This is the enjoyment which the employee gets from performing his/her job. It comes in the form of the level of authority, status, working conditions, prospects for promotion etc.

**2) Job rotation**

It is a system of moving employees from one task to the other to avoid boredom. Job rotation develops workers to be multi-skilled and values to be multi-skilled and makes them volatile. It makes production flow as it is not affected by absenteeism of any worker.

**3) Job enlargement (task of similar nature)**

Job enlargement is a process of adding more tasks to the job description of the holder. This is done in order to make the job challenging and thus resulting in motivation, through job satisfaction.

**4) Job enrichment (different tasks)**

Job enrichment involves adding extra task that requires more skills or responsibilities that calls for specialized expertise vertically.

**5) Team Work**

A piece of work is assigned to a group or team where the results are expected from the group contributions towards the work.

**<u>Exercise</u>**

1. Why do people work? [4]
2. What is meant by non-financial rewards? [2]
3. Give one advantage and one disadvantage of the following Financial rewards examples:-
   (a) Time rate. [2]
   (b) Piece rate .[2]
   (c) Commission. [2]
4. Explain how the following can increase motivation of employees.
   a) Job satisfaction. [2]
   b) Job rotation. [2]
   c) Job enlargement. [2]
   d) Job enrichment. [2]
   e) Team working. [2]

**<u>Leadership styles</u>**

It is the ability to influence followers towards accomplishment of worthwhile, meaningful and challenging goals.

**1) <u>Autocratic leadership (dictatorship)</u>**

Autocratic leaders make decisions on their own, without consultation. They set their own objectives which are passed to employees as instructions. Employees' motivation and morale will be very low which therefore calls for intensified supervision to get the job well done. Communication tends to be one way that is top bottom. Only this style is useful in armed forces and the police.

**Advantages of Autocratic leadership style**

1. Quick decision- making.
2. Enjoy leading the group.
3. Work is done fast.
4. Can eliminate uncertainties.
5. When present, rules are followed.

**Disadvantages**

1. Workers may resist orders as they are not included in decision- making.
2. Communication is poor as it is usually one way.
3. Leadership loses good opinions from workers.
4. Too much relaxation when the leader is absent.

**2) Democratic leadership**

Democratic leaders engage in group discussions before making a decision. Communication is two way, that is, for management to the employees a vice versa.

Full participation in decision making is encouraged. This may result in improved quality of decisions as employees share their experiences. For this style to be successful, the manager must be a very good communicator especially when explaining key issues and understanding employees responses. However, consultation with staff can be time consuming.

**Advantages of Democratic leadership style**

1. There is clear communication (from both ways)
2. There is room for discussions.
3. Can vary leadership style depending on situation.
4. Leader derives power.
5. Members feel part of group.
6. Team work is encouraged.
7. Firm's goals are met.
8. Delegation is possible.

**Disadvantages**

1. Time consuming because of consultation.
2. The leader can easily be replaced.

**3) Laissez-faire leadership (leave to do)**

Laissez faire leaders allow workers to carry out tasks and take decisions within very broad limits. The manager (leader) has little input into the work to be carried out by staff. It is applicable only in areas where workers are highly skilled and experienced. Communication in this type of organisation is very difficult as there are no clear lines of communication.

**Advantages of Laissez faire**

1. Group members are free to progress on their own.
2. Gives room for creativity when guided by own inspiration.

**Disadvantages of Laissez faire**

1. Leads to poor management.
2. Sense of direction is lost.
3. Goals may not be achieved.
4. Employees will also lose interest as the leader loses his.
5. Leads to chaos in organization as there will be no one to control anyone

**<u>Exercise</u>**

Give 3 advantages and 3 disadvantages of:-

(a) Autocratic leadership. [6]
(b) Democratic leadership. [6]
(c) Laissez faire. [6]

**<u>Examination Standard Questions</u>**

1. How important is motivation to the workforce of an organization [4] (Nov 2010 Zimsec)
2. Employees in a firm are paid by the hour. The employees argue that they need a method of payment which might increase their incentive to work. Assuming management agrees
   a) State and explain the method you would choose. [2]
   b) Discuss the strength and weakness of your chosen method. [4]
3. Name and describe any two benefits of working as a team. [4]
4. Explain the laissez-faire style of leadership. [4]
5. Discuss the Democratic leadership style. [6]

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# CHAPTER 7

## HUMAN RESOURCES MANAGEMENT

Chapter objectives:
After studying this chapter the student should be able to:

- To describe the responsible of the Human Resources department
- To discuss the importance of training
- To explain the role played by trade unions.
- To explain the need to know the laws related to employer-employee relationships. To explain the stages of the recruitment and selection processes.
- To explain redundancy and dismissal.
- Explain employer associations.
- Explain sources and solutions of conflicts.
- Explain types of Trade unions.

Human resources management is the process of recruitment, selection, placement development, motivation and retention of the employees. In an organizational set up, the human resources department is responsible for planning and managing the labour (worker) requirements. This is achieved through co-ordination with other functional areas like Accounting, Production, Marketing and Finance.

**The responsibilities of the Human Resources Departments**

1. **Recruitment**

Recruitment is a process of inviting prospective employees to apply for the job vacancy

2. **Selection**

It involves choosing the best candidate for the job who meets the organizational requirements

3. **Placement**

Placement is when the new employee is given a contract of employment and thus become part and parcel of the enterprise

4. **Training and development**

It is a process of enhancing skills and experience of the employees to improve their efficiency.

5. **Motivation**

Motivation is a process of encouraging employees to want to work i.e. factors which make them want to effectively work.

6. **Retention of staff**

Retention is a process whereby employees are motivated to remain with the company i.e. factors that reduce the staff turnover.

7. **Redundancy (retrenchment) and dismissal**

Redundancy occurs when employees are laid off due to underperforming or the changes in (negative) the size and composition of business e.g. economic recession

**Recruitment and selection**

Workers are recruited because of the following reasons:

1. Growth in the volume of sales and corporate size which calls for engagement of new employees.
2. Dismissal of the employee after failing to meet the required standards which creates a job vacancy.
3. Resignation of the worker because of greener pastures or poor working conditions.

4. Retirements when the employee reaches the age to retire which is 65 years in Zimbabwe

**Recruitment Process**

1. Vacancy arises.
2. **Job analysis** (first stage).
   It is for studying the tasks to be carried out by the new employee.
3. **Job description**
   Contents vary from organization to organization. It may contain:

- The job title: e.g. Sales Manager.
- Department which the person will work.
- Reporting to: e.g. managing director.
- Responsible for sales Representatives.
- Purpose of the Job.
- Main duties of the job.

4. **Job specification**
   Requirements mainly include

- The job title.
- Details of job.
- The level of educational qualification.
- The amount of experience and type of experience.
- Skills and knowledge.
- Personal characteristics.

5. **Job advertising**

- For internal recruitment, the vacancy may be advertised on a company notice board or a company Newspaper.
- For external recruitment, advertisement can be placed in a local newspaper, national Newspaper, specialist journals, job centre's (run by government)
  Information to be included:-

- Job tile
- Duties involved.
- Qualifications required.
- Salary and conditions of employment.
- Method of application
- Letter of application and Curriculum Vitae (C.V.) or application form to be submitted to who in the organisation.

6. **Application forms and short listing**

- Applicant may fill in a designed application form or
- Write a letter of application and attach a curriculum vitae
- The applicants who will closely match the job specification will be short-listed and called for an interview.

7. **Interviews and Selection**

- Interviews may be one-on-one, two-on-one or a panel of people to interview the applicant.

Purposes of interviews- are:-

- Asses the applicant's ability to do the job.
- Assess personal qualities that are advantage or disadvantages.
- Assess general character and personality of the applicant.

8. **Vacancy filing**

The most suitable person for the job is chosen and the vacant will be filled. Then, induction training is to be undertaken.

A recruitment process emanates from the job analysis which encompasses a study of the tasks and activities to be carried out by the new employee. Once this has been established, a job description is designed. A job description outlines the job title, its department, working conditions and duties and responsibilities of the prospective candidate. Having produced a job description, it is necessary for the firm to develop a document which is known as a job specification. This document spells out a profile of the ideal candidate, that is, the knowledge experience, physical traits qualification, skills and personality of the candidate sought.

**Types of Recruitment**

After the job description and the job specification development, the firm starts to invite the prospective candidates to apply for the job vacancy. This is done either internally or externally.

1. **Internal Recruitments**

Internal recruitment is an attempt by management to fill the job vacancy inside the organization that is by inviting the existing employees to fill vacancy in the same company.

**Advantages if internal recruitment**

1. It gives internal staff career hopes and real chances for promotion thereby creating a sense of belonging
2. The applicant is already aware of the organization and structure as well as operating systems
3. It saves time and money; it is cheaper than placing an advert on the mass media
4. Interviewer already know the applicant in terms of personal characteristics and charisma
5. It makes employees work hard in a bid to be promoted thus motivate them.

**Disadvantages of internal recruitment**

1. No new ideas may be brought into the organization
2. It reduces the pool of prospective employees thereby limiting talent

3. There may be resentment and rivalry amongst the existing staff

**2. External Recruitment**

External recruitment is when the prospective employee is invited from outside an organization e.g. by placing an advert on the newspapers, magazines, and journal or recruitment agencies. The advantages of internal recruitment and its disadvantages are advantages of internal recruitment and its disadvantages are advantages of the latter.

**Selection**

Selection involves picking a suitable candidate from several applicants. This is done through an interviewing process, written tests or practical tests. An offer letter is given to the successful candidate and regret to unsuccessful applicants.

**Exercise 1**

1. Explain four responsibilities of a human Resource Manager [8]
2. Explain why workers are recruited [4]
3. Design:-
(a) A job description of a job of your choice [6]
(b) A job specification of a same job as above [6]

4. Find and cut out an advertisement from a New paper, then state the main components [10]

**Types of Training**

1. **Induction Training**

Is a process of introducing the new employee to an organization and its internal control systems. It involves the following:

- Introduces new employees to colleagues
- Identifies the needs of the new employee
- Gives a guided tour of the company
- Explains the company history and its current structures
- Allow the new employee to meet with formal groups
- Explain clearly the safety and health issues relating to the new employee

2. **On-The -Job -Training (Internal Training)**

- This method allows employees to learn as they work by watching a more experienced officer doing the job.

**Advantages Of On-The-Job-Training**

- It is easy to organize.
- It does not disrupt production
- It is relatively in expensive
- Employees learn specific skills of a particular job not general expertise

**Disadvantages Of The On-The-Job Training**

- bad work practices are passed on the employee

- new ideas and methods are not introduced into the organization
- It develops a narrow scope of workers to the organization
- The trainer may not possess good training skills

3. **Off –The-Job-Training (The Job Training/External Training)**
   This method involves a course of instruction carried away from work. It can be done by a specialist –training department in an organization or by an agent outside the organisation.

**Advantages**

- a broad range of skills can be taught which makes employees to be versatile
- Specialised trainers are employed
- It does not interfere with production
- There will be increased productivity as the workers will be knowing what they will be doing- fast and efficient
- Improved customer service is guaranteed
- As technology changes fast, regular training will make employees to use new technology
- The quality of the output will be also improved
- If workers are multi-skilled, there is greater flexibility.

**Disadvantages**

- training is expensive
- It removes employees from work, therefore production suffers.
- It may lead to an increase in high labour turnover as well- qualified staff leaves the firm once they obtain improved qualifications.
- Training may be costly (expensive)
- Employees may leave organization and join other firms after training.
- The firm may lose output whilst training as those on the job training may be slow and make mistakes.
- Trainees may become better than trainer.

**Exercise**

1. What are the advantages of a trained workforce to the firm? [6]
2. What problems can be caused by untrained workforce? [6]
3. What is the purpose of induction training? [5]
4. Discuss the following types of training:
   (a) On- the-job training.
   (b) Off-the-job training. [10]

**Trade Unions**

- A trade union is an association of workers who join hands for their joint benefits. The aim of trade unions is to care for the welfare of the workforce and to assure them of optional working conditions, benefits and remuneration

**Trade Unions**
**Types**

1. General Union- It represents workers from a variety of industry and trade
2. Craft Union- a trade union which represents a particular type of skilled labour e.g. Zimbabwe Teachers, Association (ZIMTA)
3. Industrial Union- represents all types of workers in a particular industry e.g. A Trade Union for all civil servants.
4. White colour Union- it represents non- manual workers e.g. management, office workers and professional people.

**Advantages of a Trade Union**

- Employees can get advice if dismissed unfairly).
- There is strength in numbers.
- The union stands as a representation in grievances with management.
- There are improvement conditions of employment.

**Employer Associations**

- Like employees, employers or businesses join together to form their own associations.

**Benefits of joining an employers association**

1) Members are given advice on employment law, health and safety regulations and taxation laws.
2) The association represents members (employers), and negotiate with the trade unions on their behalf.
3) They put arguments to Government when changes are requested.
4) If not in direct competition, members share ideas on business operations.
5) The association can organize bulk buying for its members and therefore can obtain economies of scale.

**Industrial Action**

- Work to rule
  Is when workers strictly stick to rules and regulations laid down by the company so that work is slowed down.
- Non- cooperation- is when workers refuse to comply with new working practices. For example, changing of starting and knock off time.

**Disadvantages of Industrial Action**

1. Loss of wages to employees.
2. Employers might lose output and profits.
3. The employees may be dismissed after striking.
4. The company may lose customers to other firms.

5. The customers may experience shortages.
6. The economy’s exports may be lost.
7. Lower incomes means less tax for the government.
8. The company may end up with poor reputation.

**Exercise**

1. Explain the following terms:
(a) General Union. [2]
(b) Craft union.[2]
(c) Industrial union. [2]
2. Outline 5 advantages of joining a Trade union. [52]
3. Explain three benefits of joining an employer association. [6]

**Advantages to an employee of trade union membership**

- Higher wages through collective bargaining
- Improved job satisfaction by encouraging training
- Improved working conditions for example health and safety, noise heating etc.
- Social need – help workers to communicate effectively
- Job security – workers won’t be dismissed arbitrarily as each dismissal has to be justified in the eyes of the union

**Collective bargaining**

- It refers to the negotiation between one trade union and employer on pay and condition of employment.
- It may also be between more than one trade union and more employers or employer associations deliberating on issues of pay and conditions of employment
- Trade union advocate for pay rise due to inflationary pressure which reduces the purchasing power of the employee.

**Industrial Action**

- If is the trade union and the company fail to reach a consensus, the former undertakes an industrial action. This takes the following forms:

(a) **Strike**

It is a process where members of the trade union stop working and leave the work premises until their dispute is resolved

(b) **Go-slow**

Where employees deliberately take a longer time to complete their normal tasks or responsibilities. It culminates in frustration on the part of the customer and management thereby putting pressure on the company to resolve the outstanding issues.

(c) **Picketing (demonstration)**

Employees protest by staging a demonstration outside the work place (premises). This is done to attract the public attention to gain public pressure on the company to resolve the outstanding issues.

(d) **Overtime ban**

Overtime ban is when the trade union tells members to work only during the normal sessions and avoid working overtime. This results in the company failing to meet its orders or customer expectations thereby putting pressure on management to solve the labour issues.

**Exercise**

1. What is industrial action? [2]
2. Explain the following forms of industrial action:-

(a) Strike action [2]
(b) Go slow [2]
(c) Non- cooperation [2]
(d) Overtime ban [2]
(e) Work to rule [2]
(3) Give 2 possible harmful consequences of industrial action to each of the following:-
  (a) Employer [2]
  (b) Employee [2]
  (c) Customer [2]
  (d) The economy [2]

**Examination Standard Questions**

1. Training Workers is an important aspect to any business organization. Explain:
   (a) Any two benefits of training workers.[2]
   (b) Any two limitations of training workers.[2]
2. Explain 2 responsibilities of a Human Resources Department [4]
3. What are the purposes of:-
   (a) Job analysis [2]
   (b) Job description [2]
   (c) Job specification [2]
4. Suggest any three reasons why firms prefer to recruit internally [2]
5. Define induction training [2]
6. Explain any two advantages of on-the-job training [4]
7. Outline any four forms of Industrial action [4]
8. Explain any three benefits of Trade Unions [6]

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# CHAPTER 8

## BUSINESS ACCOUNTING

Chapter objectives:
After studying this chapter the student should be able to:

- To describe the major financial statement used in business
- State the roles played by stakeholders in Business activities
- To explain the need for financial statements and be able to prepare them.
- To interpret the financial statements and use ratios to analyse business performance.
- Explain why business needs to keep Business records.
- Methods of payment.

Accounts refer to financial records of a business transaction. A transaction is any activity that involves money or can be expressed in monetary terms e.g. buying goods for $ 1000. Accounting is the systematic recording, analysis, summarizing and interpretation of the financial statements to explain the status of a business and its performance at a given date.

**The major financial statements (final accounts)**

(a) Income statements /Trading and profit and loss account
(b) Balance sheet
(c) Cash flow

**Why financial Records**

1. To deter fraud. (Auditors can use them).
2. To keep record of what was bought from different suppliers.
3. To keep record of what was sold to different customers
4. To check if the business is operating at a profit or loss
5. To explain the status of a business at a given date
6. To be used when seeking a loan from the bank
7. Managers can use them for decision and control measures.

**Financial Documents**

(a) **Invoice**: - is a document that is used for credit transactions that is when either buying goods or selling goods on credit

(b) **Debit note: -** is used by the customer when retuning goods to the supplier. It is also used by the supplier to correct an overcharge on the customer's invoice.

(c) **Credit Note: -**A credit note is to correct an overcharge on the customer's invoice.

(e) **Receipt**: - A receipt is a document that is issued to a customer by the supplier after making a payment.

(e) Statements of account (statements)
This document is sent by the supplier to the customer at the end of the month to remind him to pay. It shows payments made, goods returned and the amount to be paid.

**Stakeholders**

These are people who have an interest in the affairs of the business that is people who use the financial statements.

**Examples of stakeholders**

1. **Shareholders** - these are owners of the company as they have invested in it. They are interested in the business growth and a share of its profits (dividend) at the end of the year.
2. **Creditors** - Creditors are people or companies that sell goods on credit to the business. Their stake is to see if the

business is secure and liquid enough to pay off its debts.

3. **Financial Institutions (financiers)**
These are organizations that lend business money. They decide whether to allow for increase in overdraft or loan facilities as well as to access the ability of the firm to pay back their funds (banks).

(4) **Managers**
There are workers who are entrusted with the responsibility of running the firm i.e. people who are charged with corporate governance. They are interested in meeting the performance of the business for planning and decision making.

(5) **Workers**
To decide whether the business is secure enough to pay wages and salaries

(6) **Government (tax authorities)**
It refers to a body which is responsible for assessing whether the business is operating within the law.

(7) **Customers:**
- are people, or businesses who buy goods from the business. They want to determine if they will be assured of future supplies of the goods

**Methods of making payment**

**1. Cash**
- It is used when paying small amounts.
- Petty cash is mostly used in large organizations.

2. **Cheque**
- Is a common form of payment used between businesses.
- Cheques are instructions to the bank to transfer a specific amount from the account to a named person.

3 **Credit card**
- Payment can be made over the counter by swiping the card and the amount added to the card holder's card bill.

**3. Debit card**
Same as, credit card, but no credit is allowed. If there is an insufficient balance in the cardholder's Account, the transaction is cancelled.

**Exercise 1**
1. Explain why a business needs to keep accounting records. [6]
2. Describe the following Accounting/financial documents
   a) Invoice. [2]

b) Debit note. [2]
c) Statement of account. [2]

3. Explain any two methods of payment a business can use. [4]
4. Why would the following stakeholders be interested in the affairs of the business:-
   (a) Workers. [2]
   (b) Creditors. [2]
   (c) Customers .[2]
   (d) Government. [2]

**Elements of Financial statements**

(a) **Income statements/trading and profit and loss Account**

It is a financial statement which shows the financial performance and position of the business

Income statements = Trading Account + Profit and Loss Account

**XYZ Limited**

**Income statement for the year ended 31 December 2009**

| | | |
|---|---|---|
| | $ | $ |
| Sales | | 10 000 |
| Less Sales returns | | 500 |
| Turnover | | 9 500 |
| | | |
| Less Cost of Sales | | |
| Opening inventory/stock | 4 000 | |
| Add Purchases | 6 000 | |
| Cost of goods available for sale | 10 000 | |
| Less Closing inventory/stock | 5 000 | 5 000 |
| Gross Profit | | 4 500 |
| Less Operating Expenses: | | |
| Wages and Salaries | 1 000 | |
| Rent and Rates | 400 | |
| Electricity | 200 | |
| Selling expenses | 300 | |
| General repairs | 300 | 2 200 |
| Net Profit | | 2 300 |

**Definition Of Terms**

Gross Profit = Sales – Cost of sales

Cost of sales = Opening inventory + Purchases - Closing inventory

Trading account shows the difference between sales revenue and cost of goods sold

Sales revenue is the income from the sale of goods and services

Net profit = Gross Profit – Operating expenses also defined as the profit earned by the business after paying operating costs

Operating expenses are costs incurred in day to day running of the business

The profit and Loss Account shows how the net profit (Loss) is calculated

(b) **Balance Sheet**

A Balance Sheet is a financial statement which shows the financial status (financial position) of the business that is its ability to pay its debts.

**Balance sheet as at 31 December 2009**

| | | | |
|---|---|---|---|
| | $ | $ | $ |
| **FIXED ASSETS** | Cost | Depn | NBV |
| Premises | 10 000 | - | 10 000 |
| Equipment | 80 000 | - | 80 000 |
| Furniture | 6 000 | - | 6 000 |
| | 24 000 | - | 24 000 |
| **CURRENT ASSETS** | | | |
| Stock | | 4 000 | |
| Debtors | | 6 000 | |
| Bank | | 3 000 | |
| Cash in hand | | 2 000 | |
| | | 15 000 | |
| **LESS CURRENT LIABILITIES** | | | |
| Creditors | 3 000 | | |
| Short term loan | 1 000 | 4 000 | |
| Working Capital | | | 11 000 |
| Net Assess | | | 35 000 |
| | | | |
| Financed by:- | | | |
| Capital | | | 42 700 |

| | |
|---|---|
| Retained profits | 2 300 |
| | 45 000 |
| Add long term loan | 10 000 |
| Capital employed | 35 000 |

**DEFINITION OF TERMS**

**Assets:**
These are resources which are owned by the business

**Non-Current Assets(fixed Assets)**
They are assets that are bought by the business to be used over a long period of time to generate revenue.

**Current Assets**
These are assets which are purchased to be converted into cash within 12 months i.e within a short period of time.
**Liabilities** are debts which the business owes to other business

**Long term liabilities.**
These are debts which are repayable over a very long period of time that is repay after I year.

**Current liabilities**
They are debts which are payable by the business within one year

**Working Capital**
is the difference between current assets and current liabilities
Working capital = current Assets – Current Liabilities

Net assets = working capital + fixed assets

**Retained profits**
- Are the profits that are ploughed back into the business for reinvestments

Is the net profit reinvested/ploughed back in to the company after deducting tax and payments of dividends.
**Capital** refers to money or any asset invested by the owner into the business or invested by the owner into the business.
**Capital employed** is the total capital invested into the business

**Deprecation**
-Is the fall in value of a fixed asset over the usage time?

**Ratio analysis**
Ratios are used to assess the performance of the business and its liquidity.

(1) **Profitability Ratios**

These ratios are used to assess the business performance for decision making
Examples of profitability ratios

(i) Cross Profit margin (%) $\frac{\text{Gross Profit x 100\%}}{\text{Sales}}$

Using information from XYZ Limited = $\frac{4\ 500}{10\ 000}$ x 100%

= <u>45%</u>

(2) Gross Profit mark-up = $\frac{\text{Gross Profit x 100\%}}{\text{Cost of Sales}}$

XYZ Limited = $\frac{4\ 500 \text{ x } 100\%}{5\ 000}$

= <u>90%</u>

(3) Net Profit margin (%) = $\frac{\text{Net Profit}}{\text{Sales}}$ x 100%

= $\frac{2\ 300 \text{ x } 100\%}{10\ 000}$

= <u>23%</u>

(4) Return on Capital employed = $\frac{\text{Net Profit x 100\%}}{\text{Capital Employed}}$

XYZ Limited = $\frac{2\ 300 \text{ x } 100\%}{35\ 000}$

= <u>6.57%</u>

(b) **<u>Liquidity ratios</u>**

These ratios are used to access the ability of the firm to meet its short-term financial obligations.

**<u>Examples of liquidity ratios</u>**

(1) Current ratio (working capital ratio) = $\frac{\text{Current assets}}{\text{Current Liabilities}}$

XYZ Limited = $\frac{15\ 000}{4\ 000}$

= <u>3,75:1</u>

(2) Acid test ratio (quick ratio) = <u>Current assets – Inventory</u>

Current liabilities

$$= \frac{15\,000 - 4\,000}{4\,000}$$

$$= \frac{11\,000}{4\,000}$$

$$= \underline{2{,}75:1}$$

**Importance of ratios**

1. Ratios are used to identify problems before they become acute
2. Information derived from ratios help users for decision making.
3. They show interrelationships between variables.
4. Ratios are also used for forecasting and planning.
5. They are also used to assess business performance and solving problems

**Limitations of Ratios**

1. Ratios are by nature historic and may be irrelevant today
2. Companies overtime are compounded by changes in the value of money
3. Ratios can be window-dressed to suit a particular purpose e.g. understanding profits to reduce corporate tax
4 Ratios do not show the qualitative information which is important for decision making e.g. the morale of the workers
5. Some ratios can be calculated using slightly different formulas which makes comparison very difficult.
6. Ratios are distorted by short-term fluctuations and their timing.

**Exercise:-**

**B. Moyo Trial Balance as at 30 June 2009**

| | DR | CR |
|---|---|---|
| Capital | | 48 970 |
| Bank | 270 | |
| Petty Cash | 40 | |
| Drawings | 10400 | |
| Stock at 31 May 2008 | 28740 | |
| Motor scooter | 4068 | |
| Furniture and fittings | 6100 | |
| Sales | | 70 156 |
| Purchases | 47 165 | |
| Salaries | 14 107 | |
| Rent Payable | 5 280 | |
| Advertising | 110 | |

| | | |
|---|---|---|
| Discount allowed | 190 | |
| Discount received | | 292 |
| Debtors | 1 820 | |
| Creditors | | 2 517 |
| Sundry expenses | 145 | |
| Delivery expenses | 3 500 | |
| | **121935** | **121 935** |

- Stock as at 30 June 2009 was valued at 26500

1. From the above Trial balance find
   a) Cost of goods sold
   b) Gross profit
   c) Net profit

2. Calculate the following
   a) Net assets
   b) Working Capital
   c) Capital employed

**Ratio Analysis**

**Exercise 2**

From the information of B Moyo Traders calculate the following ratios

1. Profitability Ratios
   a) Gross profit margin (%) [3]
   b) Net profit margin % [3]
   c) Return on capital employed [3]

2. Liquidity Ratios
   (a) Current ratio. [3]
   (b) Acid test ratio. [3]
   (c) Comment on the two ratios. [3]
3. Distinguish between liquidity and profitability. [2]
4. Give any two limitations of ratio analysis. [2]

**Examination standard questions**

1. State two groups that are interested in the Accounts of the firm. [2]
2. Distinguish between assets and liabilities.
3. Assess the usefulness and limitations of ratio analysis (20) (: Zimsec 2010)
4. What is depreciation? [2]
5. Find the missing figures:- sales 405 000
   Opening stock 135 000

| | |
|---|---|
| Purchases | (a)? |
| Closing stock | 108 000 |
| Cost of goods sold | (b)? |
| Gross profit | 108 000 |
| Less expenses | 72 000 |
| Net income | (c)? |

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# CHAPTER 9

## BUSINESS FINANCE

Key objectives

- To describe the need for finance.
- To explain internal sources and external sources of finance.
- To explain which sources of finance are short-term or long term and their suitability to an organisation?
- To explain the advantages and disadvantages of different sources of internal and external finance.

Finance refers to money that is used in business operations.

**The need for finance**

1. A business requires finance to provide for working capital requirements, that is day to day operations
2. The business will need finance to grow in size.
3. Finance is also required to set up a business
4. To finance export trade

**Capital and revenue expenditure**

- Capital expenditure is money that is used to finance the purchase of non-current assets (fixed assets). Such assets are used by the business over a long period of time to generate revenue.

- Revenue expenditure refers to money used in day-to day running of the business. It is thus spent on operating expenses of the business such as salaries, telephone, electricity etc.

**<u>Sources of finance</u>**

1. Internal sources: - money raised from within the business
2. External Sources: - money raised from sources outside the business

**<u>Examples of Internal Sources</u>**

**1. Sale of assets**

This is the sale of assets that are not fully utilized

**Advantages**

(i). It is a better use of capital tied up in assets
(ii) No interest charges are attached to this source finance.

**Disadvantages**

(i) This source of finance is only available to established businesses.
(ii) Assets sold may take a long time to realise cash
(iii) Assets sold may be used by rivals to enhance their competitive advantage

2. **<u>Retained Profits</u>**

This is profit that is ploughed back into the business after paying for corporate tax and dividends

**Advantages**

(i) Retained profits do not have interest payments unlike loan
(ii) It does not need to be repaid

**Disadvantages**

(i) It is only available to businesses that have been operating generating profit
(ii) It reduces the dividend payments to shareholders
(ii) Profits retained may not be enough to finance business expansion

3. **<u>Reduction in working capital</u>**

This refers to the reduction in stock levels and the amount of debtors

**Advantages**

(i) It reduces capital tied up in debtors and stock
(ii) Storage costs are also reduced which results in high profits

**Disadvantages**

(i) High purchase costs may be incurred due to low trade discounts which increases the operating expenses
(ii) The business may fail to meet the needs of its customers

4. **<u>Rights Issue</u>**
This is the sale of shares to existing shareholders on a pro-rata basis

**Advantages**
(i) It does result in the dilution of equity
(ii) It provides paramount capital as it does not need to be repaid

**Disadvantages**
(i) Shares will be sold at a price lower than what a public offer could fetch
(ii) Rights issue is only available to limited companies i.e. not available for sole trader and partnership businesses.

**5. <u>Owner's savings</u>**
Sole traders and partnerships can put money from their savings in the business. These firms are not separate from their businesses.

**Advantages**
(i) No interest is charged to this source of finance.
(2) It is available to the firm quickly.

**Disadvantages**
(i) Savings may not be enough to finance the business.
(ii) It increases the risk taken by the owners.

**<u>EXTERNAL SOURCES OF FINANCE</u>**
- is divided into short-term sources, medium term sources and long term sources.

**<u>Examples of External Sources of Finance</u>**

**<u>Short-term Sources of Finance</u>**

**(1) <u>Trade Credit</u>**
This involves delayed payment of bills for goods

**Advantages**
(i) The suppliers are providing goods without receiving immediate cash and this is as good as just lending money.
(ii) Goods are sold and profits earned before payment is made.
(iii) It does not require collateral security.

**Disadvantages**
(i) It is difficult to be obtained by enterprises which are over and above the money in the account.

2. **Bank overdraft**

This is an amount withdrawn from the bank which is over and above the money in the account

**Advantages**

(i) It is the most flexible of all the sources of finance
(ii) It is unsecured
(iii) Interest is only charged on the amount overdrawn

**Disadvantages**

(i) Bank overdrafts carry high interest rates
(ii) The bank can 'call in' the overdraft on short notices thereby forcing the company to pay it back.

3. **Debt factoring**

This involves the sell by a business of its debts (debtors) to a debt factor company. For example a debtor owing $ 10 000 is sold to a factor for $9 000 which is paid immediately to the seller. The factor will then collect the whole amount i.e. $ 10 000 from the debtor later and the $ 1000 ($10 000-$9000) represents the factor's profit.

**Advantages**

(i) It reduces the risk of bad debts to the business.
(ii) Immediate cash is obtained which can be used for the other purposes

**Disadvantages**

The firm does not receive the full amount from its debtors

**Medium-term Sources of finance**

This source of finance is available for between 3 and 10 years

1. **Hire Purchase**

A hire purchase is a payment for a non-current asset by instalments.

**Advantages**

(i) The hirer is allowed to use the assert while making payments
(ii) It accords an opportunity to small business to acquire expensive equipment

**Disadvantages**

(i) The finances remain the legal owner of the asset until the hirer pays the last installation.
(ii) The hirer is obliged to pay a deposit before the asset is collected
(iii) Interest payments are very high which makes the asset more expensive

compared to buying it out right.

**2. Leasing**

It involves a contract between a leasor (owner) and the lessee (tenant) to use the asset for monthly leasing premium (payments)

**Advantages**

(i) Lease payments are tax-deductible
(ii) There is no need for a deposit
(iii) Repairs and maintenance is carried out by the leaser

**Disadvantages**

(i) Payments will be greater in the long-run
(ii) The lease agreement may place restrictions on the use of certain products or materials
(iii) Leasing does not benefit from residential value

**3. Bank loan**

Bank loans are payable over a fixed period of time.

**Advantages**

(i) Can be of varying length of paying back period.
(ii) They are usually quick to arrange.
(iii)Low rates of interest can be offered to large firms.

**Disadvantages**

(i) It attracts interest when paying back.
(ii) Collateral is usually required.

**Long –term sources of finances**

This form of finance is used to purchase assets with a corresponding life and also to correct a persistent overdraft into bank loan. It is available for a period of more than ten years

**Examples of long term sources**

**(1) Mortgage**

Finance to purchase premises (land and property). It is obtained from commercial banks and building societies It has to be secured against the premises. However, the business should retain some liquidity to enable it to pay for interest charges.

**(2) Issue of shares (equity finance)**

This is the issue of shares to family and friends for private limited companies and to the general public for public limited companies

**Advantages**

(i) There are no interest payments

(ii) More capital can be raised where receipts are staggered for particular capital projects

(iii) Equity finance permanent capital which does not have to be paid

**Disadvantages**

(i) Divided is not tax deductible

(ii) Issue of shares result in the dilution of equity

**(3) Long-term loans (debt finance)**

Debt refers to borrowing or loan finance. There is a legal obligation to pay interest and to repay the capital amount when it is due. Debentures differ from long-term loans as they can be traded on the stock exchange.

**Advantages**

(i) Debt finance does not result in dilution of equity

(ii) Interest on loan is tax deductible

(iii) Lenders have no voting right at annual general meetings.

**Disadvantages**

(i) Debt finance is usually secured against specific assets and this reduces control over them

(ii) Debt finance increases the risk of insolvency. This is especially when a company is highly geared, that is, has a large proportion of capital in a form of debt than equity.

(iii) It reduces prospective creditor willingness to grant further loans

**(4) Debenture:**

These are long term loans which are tradable on the stock exchange.

**Advantages**

1. Can be used to raise huge sums of money payable after many years e.g. 20 years.
2. Interest on debentures is allowable as deduction for tax purposes.

**Disadvantage**

1. Interest is charged when repaying.
2. Debentures can be pledged against company assets thereby limiting their use and transfer.

**Exercise 2**

1. Explain 2 internal sources of finance. [4]
2. Give advantages and disadvantages of

(a) 2 external sources of finance (medium). [4]
(b) 2 external sources of finance (long-term). [4]

3. State whether the following are short-term, medium-term or long-term sources of finance
   i) 5- year bank loan
   ii) Selling debenture
   iii) Trade credit
   iv) Owner's savings
   v) Leasing [5]

**Factors influencing the choice of finance**

**1. Purpose**
What is the finance needed for e.g. for financing short-term cash flow problems or to buy fixed assets.

**2. Amount needed**
Use retained profits or get a bank loan for huge amounts.

**3. Risk and gearing**
Gearing measures the proportion of total capital raised from long-term loans.
Gearing = debt/ equity
The interest on loans is paid whether making profit or loss. So it is risky

**4** Legal structure and the desire of owners to retain control

**5** The time period for which finance is required

**6** Size and form of business.

**7** Interest rates

**8** Government policy

**Examination Standard questions**

1. Owners of a new business will definitely need finance, explain why .[4]
2. State two methods of raising funds for new firms. [2]
3. Distinguish between shares and Debentures. [6]
4. Explain any three factors influencing choice of finance. [6]
5. Explain any two medium- term sources of finance .[4]
6. What do you understand by the term gearing? (Zimsec 2010)

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# CHAPTER 10

## Operations Management

Chapter objectives:
After studying this chapter the student should be able to:

- To describe the elements of operations management
- To explain the difference between production and productivity
- To outline production methods used by different organizations
- To explain the advantages and disadvantages of the different production methods
- To explain lean production and how it relates to total quality management
- Explain examples of economies of scale.
- To outline the diseconomies of the scale.

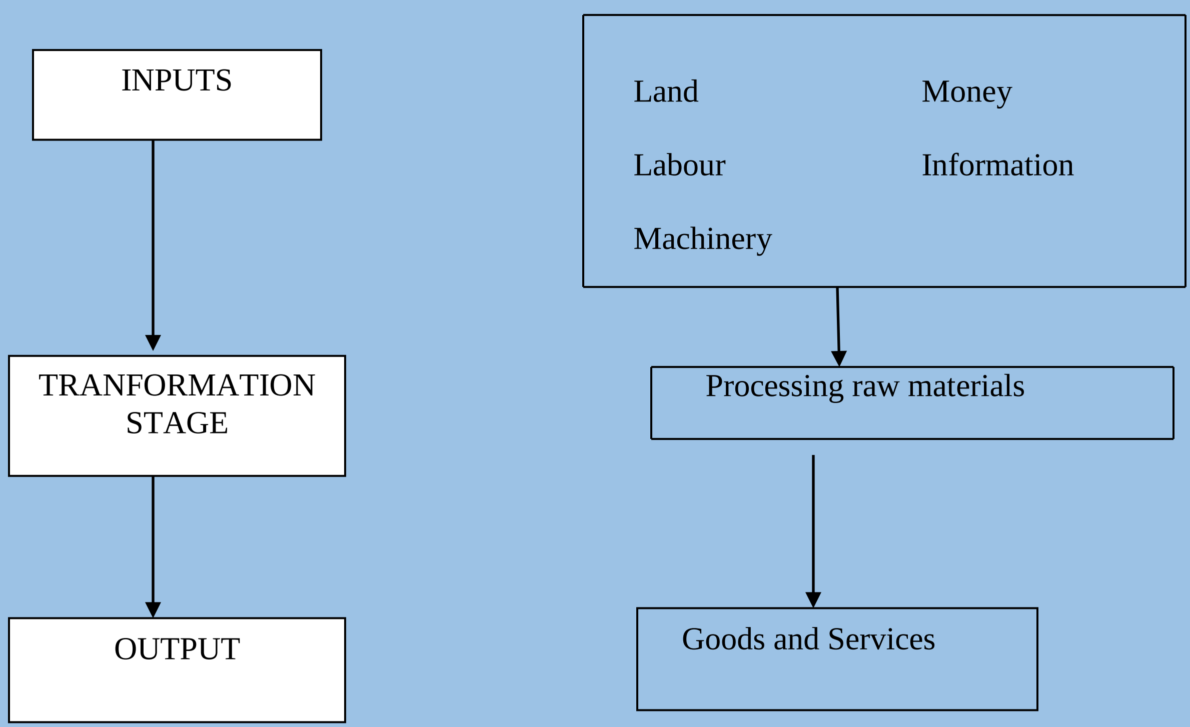
Operations management is concerned with the use of resources (factors of production) to provide goods and services that satisfy customers' demands.

**Elements of operations management**

1. efficiency of operations-keeping low prices
2. Quality services- quality means suitability for the intended purpose
3. Flexibility- adaptability of operations.

**Production process**

Production is the measured quality of output that a firm produces in a given period of time. Production process involves the conversion of input into output.




**Productivity and Efficiency**

Production is the provision of goods and services to satisfy, consumer needs and wants, while productivity is measuring output against the inputs used to create it. Productivity is the measure of a ratio of output to any of the firm's inputs usually labour and capital. Efficiency is the ability to do things right that is reducing efficiency or producing results with little waste of efforts

NB A firm that has become more productive is efficient since productivity is a measure of efficiency.

**Measure of Productivity**

1. Labour productivity = $\dfrac{\text{Total Output in a given period}}{\text{Quantity of labour employed}}$

   This is often referred to as the output per man.

2. Capital productivity = $\dfrac{\text{Total Output in a given time}}{\text{Quantity/Value of Capital employed}}$

**Ways of Raising Productivity**

1. Training of staff to raise skills level
2. Acquire latest technology
3. Improve employee motivation
4. Engage best management team
5. Division of labour

**Exercise**

a) Write down the production process [3]
b) Explain the above stages/ process in respect with the manufacturing of a chair. [5]

2a) Define efficiency [2]
b) Why is efficiency important in productivity? [2]

3. Firms strive to raise productivity, outline the ways of raising productivity? [4]

**Production methods**

There are three production methods. Job production, batch production and flow production.

(a) **Job Production**

- Job production is used to produce a single 'one off' product made to order.
- Jobs are frequently large and made to customers' specifications.
- Each order is different for each job.
- There is use of specialist machinery
- Examples of jobs are individual wedding cakes, individual tailor-made suits.

**Advantages of Job Production**

1. Products are tailor made to suit the requirements of the customer which encourage repeated orders.
2. It reduces monotony and thus motivating to the employees as each job is different from another.
3. The employees often do not carry out just one task. They have more varied jobs).

**Disadvantages of job production**

1. This type of production is costly
2. It often takes a long time to complete and is usually labour intensive.
3. It requires highly skilled manpower that is versatile

(b) **Batch Production**

- It involves the manufacture of different versions of the same basic product e.g. batches of bread baked in some designed houses.
- 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 stages.
- Every unit in the batch must go through an individual production stage before the batch as a whole moves to the next stage

**Advantages of Batch Production**

1. It permits the firm to do specialisation and thus can gain from economies of scale.
2. It is flexible as each batch specification is matched to the demand.
3. It gives more variety to workers' jobs.

**Disadvantages of Batch Production**

1. Batch production tends to have a high level of work in progress (stock that is partly processed).
2. The work may be monotonous and boring leading to staff de-motivation.
3. It is costly to warehouse the stocks of raw materials and components.

(d) **Flow production** (Mass Production)

- Flow production involves production of a single product on a continuous 24 hour basis.
- Dedicated plant will be used in the production process.
- Large volumes of standardized products are produced.
- Individual products move from one stage to the other as soon as they are ready.
- Example of products includes, liquids, cameras, DVDs which are normally produced in large quantities.

**Advantages of flow production**

1. Labour costs are low due to automation
2. Large quantities of output are produced resulting in economies of scale
3. Quality tends to be high and consistent
4. Low production costs means that prices are kept low.
5. Time is saved as there is no need to move goods from one part of the factory to another.
6. Unskilled workers can be used as less training is needed to operate machines.

**Disadvantages of flow production**

1. High initial set up costs (capital intensive)
2. The work tends to be repetitive, boring and de-motivating.
3. Flow of production e.g. packaged drinks, cars, cameras.
4. The whole production line is stopped if one machine breaks down.

**Exercise**

1. Define the following terms.

a) Batch production. [2]

b) Job production. [2]

c) Flow production. [2]

2. What method of production is used by each of the following types of business? Explain why.
   a) Mass produced packed foods company. [3]
   b) A construction firm building houses using the same design. [3]
   c) A Tailor, who has specific customers. [3]

**Inventory Management**

This is the process of controlling stock in such a way that holding costs and re-ordering are kept minimal.

Lead time is the margin of time between the date when stock is obtained and the date when it is sold on.

The business should observe the lead time so as to meet the needs of the production department.

**Forms of stock** (Inventory)

1. Raw materials- Unprocessed goods (materials) awaiting production.
2. Work-in-progress - Partially processed goods.
3. Finished goods - Completed goods awaiting sale or dispatch.

**Cost of a stock- out**

1. Sales may be lost to firms that hold higher stock levels.
2. Loss of goodwill
3. High costs associated with small order replenishment purchases.

**Costs of holding too much stock**

1. High stock levels mean that cash is tie up in an unproductive manner.
2. Goods need to be guarded.
3. Bulky goods require substantial floor space
4. Pilferage
5. Deterioration.

Management should keep the inventory level to strike the balance between cost of stock-out and costs of holding too much stock.

**Lean Production**

Lean production refers to various techniques used by management to increase efficiency by eliminating wastages. The objective is to eliminate waste of resources and time from original strike, ordering through to final customer service. The intention is to produce quality output with few resources.

**Methods of lean Production**

1. **Cell Production (cellular production)**
   - A form of flow production that is separated into a number of self-continued mini-production units (cells).
   - Each cell will have a team leader with a single level of hierarchy made up of workers who are multi-skilled
   - Performance of each cell is measured in terms of output levels, lead times and quality of service delivery system
   - Cell production leads to improvements in employee commitment and motivation resulting in high quality productivity.

2. **Just-in time (JIT)**

   It is a technique used to reduce the cost of holding inventory by producing goods that are ordered. Raw materials are scheduled to arrive exactly when they are needed for production thus reducing raw material stocks to zero.

   Work-in-progress and finished goods-stocks are minimized by matching production to demand. Production staff must be multi-skilled and prepared to change jobs at short notices. Equipment and machinery must be flexible and adaptable.

**Quality must be everyone's Priority**

There should be a strong relationship with the suppliers which will enable them to supply components with a short lead time.

3. **Kaizen**

Kaizen is a Japanese technique of continuous improvement by the employees without changing the level of technology. It employs quality circles where small groups of workers meets to discuss quality issues.

The overall aim is to investigate quality problems and to forward solutions to management or if the group is totally empowered to put the improvement into practice. This method results in employee motivation through participation and increased productivity. Quality is improved through joint discussions of ideas and solutions.

4. **Kanban**

- It operates by having two component bins, one on the production line and one being made ready.
- When the first is empty it is wheeled with its Kanban order card to the section of the factory that produces those components.

**Advantages**

It triggers production of components.

Everyone has to work together and efficiently so that production is not heaped up.

Kanban is used alongside JIT production.

**Exercise**

1. Give 2 advantages and 2 disadvantages of holding high levels of stock of finished products. [5]
2. Give 3 advantages and 2 disadvantages of holding low levels of components and raw materials stocks. [5]
3. Define lean production. [2]
4. Explain any 2 methods of lean production which a business can use [4]

**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.

Quality Control is a process of ensuring that the products meet the expected customer requirements. These products must be checked at every level of production to ensure conformity.

**Quality Assurance**

It involves setting quality standards and adopt them in the whole organisation. The prime objective is to ensure that customer satisfaction is achieved. The quality assurance department will focus on all areas of the business

The organisation should buy quality raw materials and achieve production quality through Total Quality Management. Goods produced should be delivered at the customer specification and after sale service should be offered to all customers.

**Total Quality Management (TQM)**

Total Quality Management is the commitment by all employees to quality where there is continual review and improvement. All aspects of an activity that have a bearing on the quality of its output and satisfaction of customers' requirements are improved.

TQM uses the concepts of internal customer where mediocre work by one department is rejected by the next department before reaching the customer (external customer). Each department is aiming to satisfy the next department by passing best quality products.
TQM aims to cut costs of faulty or defective production by encouraging all staff to get it right first time.

**Advantages of Producing Quality Goods/Services**

1. It creates customer loyalty.
2. A high price (premium) could be charged
3. Longer product life cycles.
4. Increased sales and profits
5. Less advertising will be necessary.
6. It saves on costs associated with customer complaints.
7. Scrap of finished goods can be reduced.

**Exercise**

1. Define quality. [2]
2. Why should a business use quality control system in their production? [4]
3. What does Total Quality management entail? [3]

**Economies of Scale**

Economies of scale refer to a situation where the costs of production decrease as output increase. It is also defined as the advantages gained by large firms.

**Examples of Economies of Scale**

1. **Financial economies**

Banks offer loans to big firms with proven track records at lower interest rates than small firms. The availability of collateral security regarding large firms enable them to access a large pool of financial resources (credits).

2. **Purchasing economies**

   It applies when a large firm buys goods or raw materials in large quantities from the suppliers. This will enable it to get large discounts thereby having a competitive advantage over the small firms.

3. **Managerial Economies**

   Large firms are able to engage highly skilled and experienced personnel who are efficient. If follows therefore that the average labour cost reduces.

4. **Marketing Economies**

   Marketing costs are spread over a large number of products which reduces the cost per unit. The firm can also market its own products which is not possible with small firms which rely on limited distribution channels.

5. **Technical economies**

   Big companies can afford to acquire advanced technology which it monitors by the computer system and operated by specialists. There is a tendency of using flow production which enhances quality at the least cost.

**Diseconomies of Scale**

These are disadvantages that accrue to an organisation as it grows in size. These challenges/problems are as follows:

1. It becomes more difficult to directly involve every worker and give them a sense of purpose and achievement in their work resulting in de-motivation,
2. Problems of co-ordination and control of all operations become an order of the day for management.
3. Long hierarchical level and wider chains of command create communication problems to the managers.

**Examination Standard Questions**

1. Distinguish between job and flow production [4]
2. Explain 3 ways a business can use to increase productivity [6]
3. Identify 3 techniques used by businesses to cut down on waste and therefore increase efficiency [3]
4. Holding low levels of components and raw materials is good for a business. Do you agree? [8]

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# CHAPTER 11

**BUSINESS COSTING**

**Costs, Revenue and Break- Even Analysis**

Chapter objectives:

After studying this chapter the student should be able to:

- Explain why businesses need to know the costs of running their businesses.
- Distinguish between fixed and variable costs.
- The need to compare costs and revenues.
- Calculate the breakeven sales, breakeven output and the margin of safety.
- Explain the uses of the breakeven analysis
- Describe the limitations of the breakeven analysis.

**Introduction**

Costs are expenses incurred by an organisation in its day-to-day running
Production costs are usually measured in monetary terms.

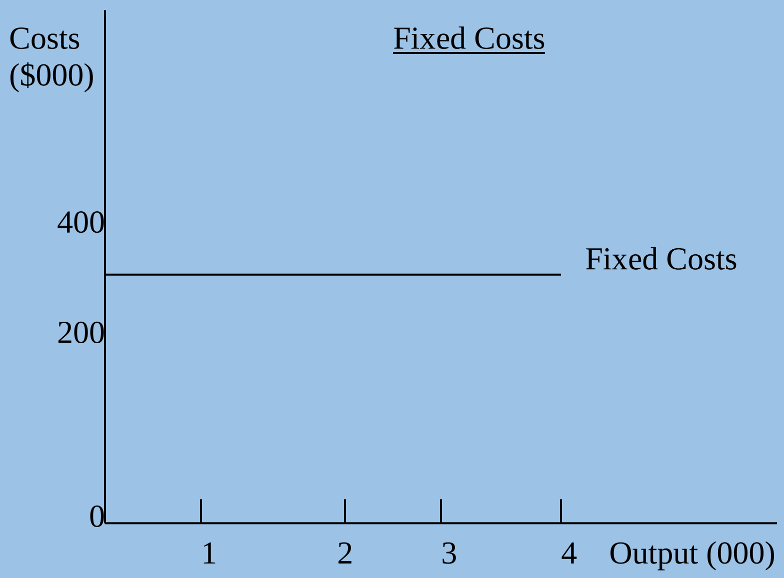
**Examples of Costs (expenses)**

1. Insurance
2. Telephone charges
3. Salaries and wages
4. Cost of raw materials
5. Rent and rates

**<u>Classification of Costs</u>**
Costs are classified into the following categories:
Direct costs, fixed costs, indirect costs, variable costs, marginal costs and semi-variable.

**a)** **<u>Fixed costs</u>**

- Are costs which do not vary (remain the same) in direct proportion to a firm's output e.g. rent, mortgage, interest payments, rates, heating, insurance etc.
- Are also known as indirect costs or overheads because they are not directly involved in the production of goods and services.
- Even if there is no output at all, a firm will still have fixed costs which it must meet.



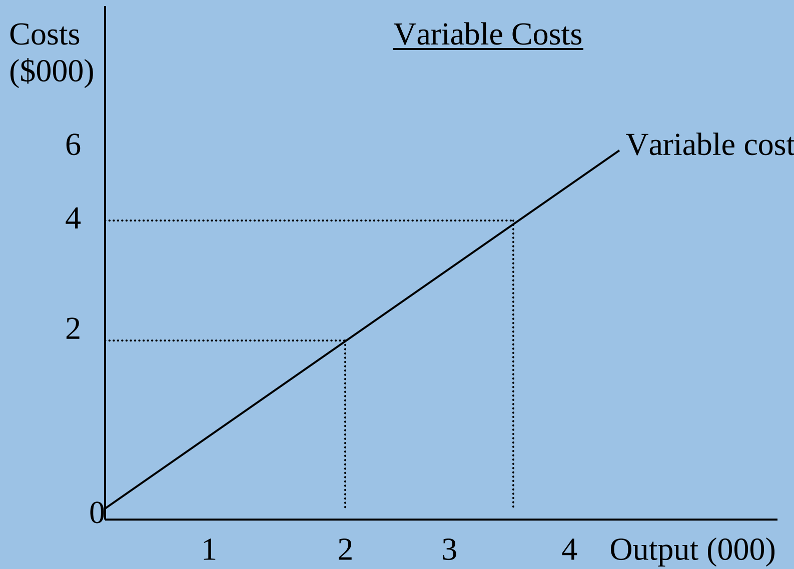

As shown by the diagram above, fixed costs are pegged at $300 000 which are not affected by an increase in production from 1 000 units to 4 000 units.

Examples of fixed costs include, rent, rates, insurance etc.

**b)** **<u>Variable Costs</u>**

- Are costs which change according to the level of production e.g. raw materials, overtime payments, wages etc.
- are directly related to output

- Are often direct costs, but this is not always the case




The diagram above shows variable costs. These costs are directly related to the production level that's why they are sometimes termed direct costs. If output is increased from 2 000 units to 35 00 units, variable costs increase from $2000 to $4000 as shown above.

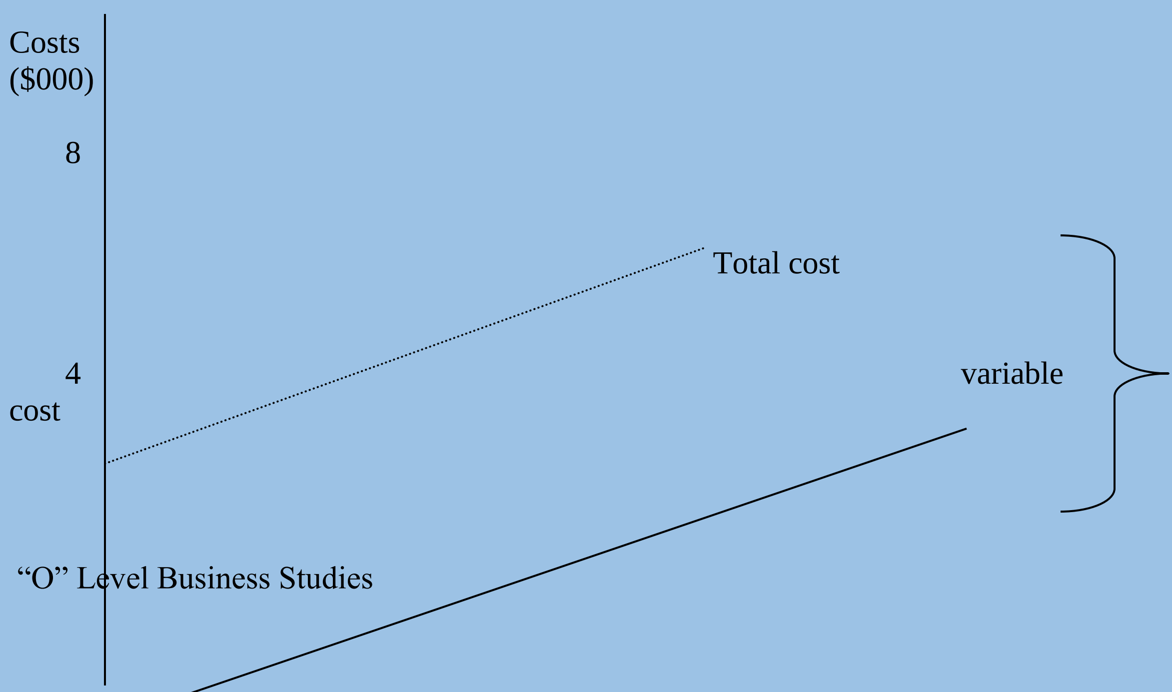
**c) <u>Semi- variable costs</u>**

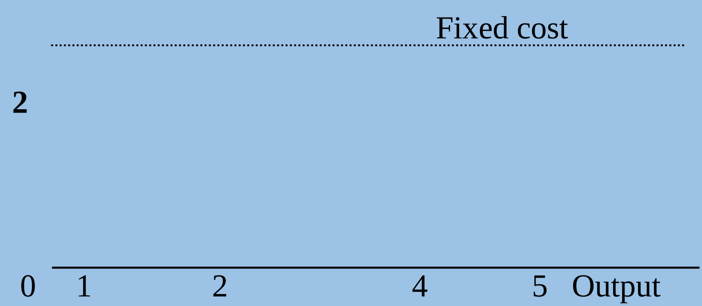
- Include both fixed and a variable element e.g. electricity- there is a fixed charge plus cost per unit used, or basic wage plus commission.

**d) <u>Total costs</u>**

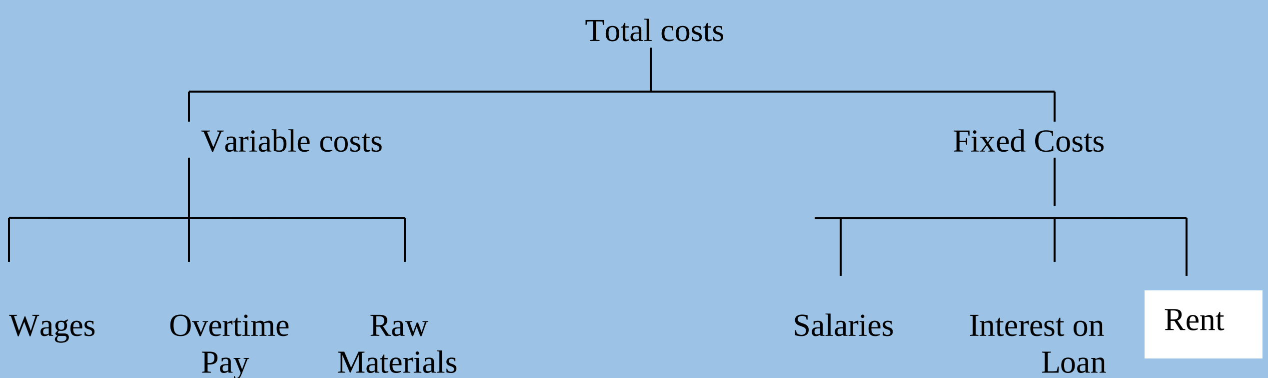
- are fixed and variable costs combined

N.B Total Costs = Total Fixed + Total Variable Costs






Total Costs are drawn parallel to the variable costs line and it emanates from the fixed cost line as show above.




e) **Direct Costs**

- Are those that can be directly related to or identified with a particular product or department e.g. salaries for the workers of a particular piece of machinery.

f) **<u>Indirect Costs</u>**

- Are those costs which cannot be directly related to a particular product.
- Remains the same as the output of the firm changes.
- Are associated with the fixed factors of production such as land and capital e.g. a firm pays the same rent and rates whether it produces 5 000 or 10 00 washing machines.

**g)** **<u>Marginal Costs</u>**

**-** are the additional costs of producing one more unit of output and will be the extra variable costs needed to market this extra unit.

**h) Average cost per unit**

- The total cost of production divided by total output.

i) **Revenue**

The income during a period of time from the sale of goods and services
Total revenue= quantity sold x price.

**Exercise**

1. Define the following terms:
   a) Fixed costs [2]
   b) Variable costs [2]
   c) Indirect costs [2]
   d) Marginal cost [2]
   e) Revenue [2]

2 a) Distinguish between fixed and variable costs [3]
  b) Give two examples of each [4]

**Break even charts**

Comparing costs with revenue

**Break even analysis**

- A firm breaks even when the total revenue it gets from selling its product just covers its total costs of production.
- Breakeven point is the level of sales at which total costs= total Revenue

Breakeven analysis can be undertaken in 2 ways

a) The graphical method
b) The equation method
- Break-even charts are graphs which show how costs and revenues of a business change with sales. They show the level of sales the business must make in order to break even.

**Fixed Costs**

Contribution per unit
Contribution per unit= selling price per unit - variable costs.
If fixed costs are \$200 000, and the contribution per unit of output is \$50, then the breakeven level of production is $\frac{200\ 000}{50}$ = 4, 000 units

a) Drawing a breakeven chart
   The following information is needed:
   - Quantity or units of output-are always shown on the horizontal axis
   - Revenue/cost is always shown on the vertical axis.

- Decide on a scale-look at the highest figures of revenue and total costs.
- Draw in the fixed cost line (FC). This line will be parallel to the horizontal axis, so plot this point. Draw a line between the two points plotted. Label this line TC (Total Costs).
- Use same method to plot revenue
  Revenue always starts at zero; if nothing is produced revenue cannot be achieved
- The break-even point is where the total cost line and total revenue line cross. To find the break-even quantity, follow this point down to the horizontal axis.
- Breakeven revenue is shown on the vertical axis

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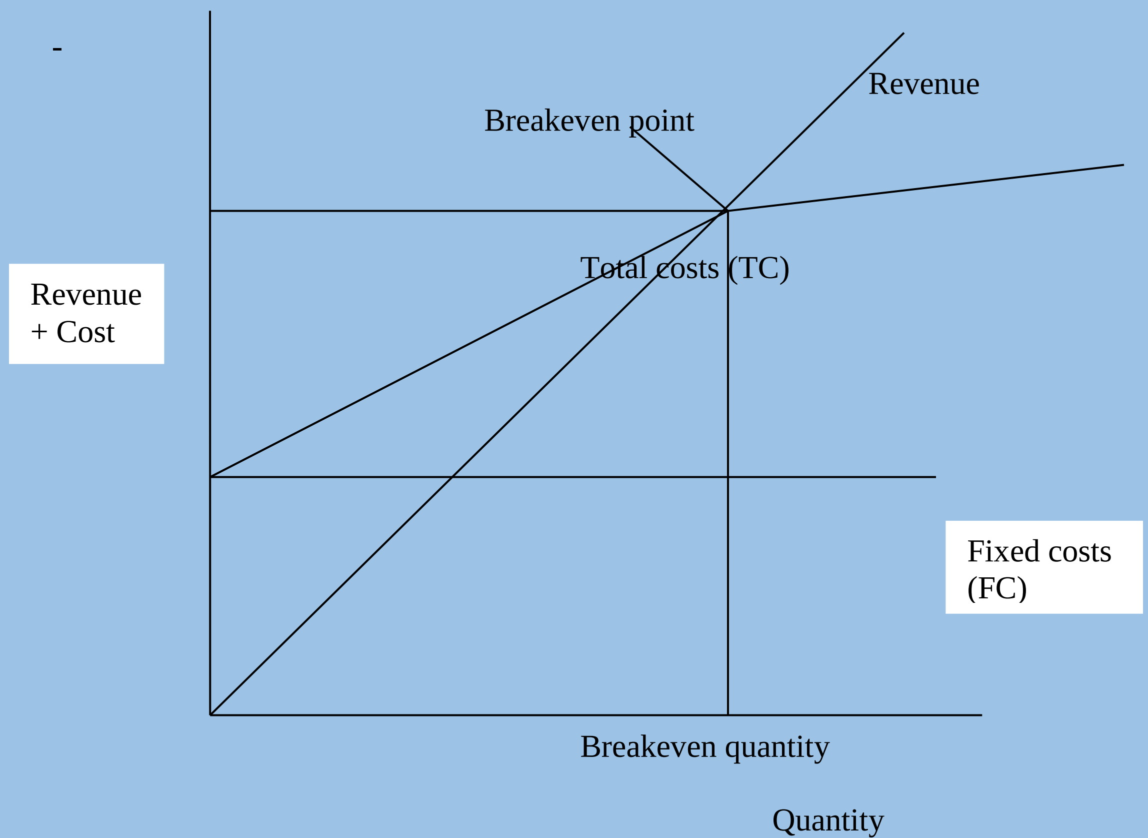



**Note**

- It is important for a business to know at what point the total costs are the same as the total revenue.
- A chart is drawn which shows how many units (outputs) have to be produced in order to break-even.
- When total Costs (TC) are greater than Total Revenue (TR) a loss is made
- When Total Cost (TC) are lower than revenue a profit is made
- Total Variable Costs (TVC) + Total Fixed Costs (TFC)= Total Costs (TC)
- Total Costs (TC) - Total Fixed Costs (TFC) = Total Variable Costs (TVC)

**<u>Margin of safety</u>**

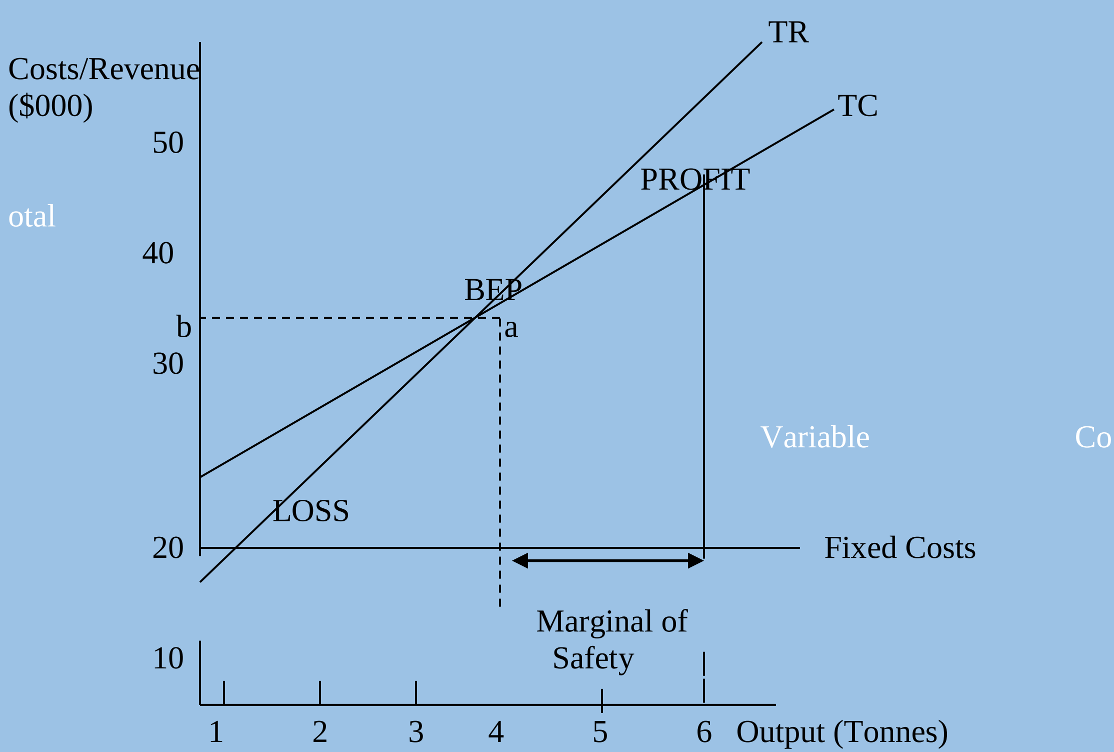
**-**The amount by which sales exceed the break-even point. This is a useful indication of how much sales could fall without the firm falling into loss e.g. when breakeven is at 400 units the margin of safety is 800-400 = 400 units i.e. it is the amount by which sales could fall. From the planned level before the organization ceases to make a profit.

**<u>Breakeven Analysis</u>**

This is a technique which shows the level of output that is required to generate a certain level of profit. It shows the relationship between costs and revenue

**<u>Breakeven Chart</u>**

Breakeven chart is a graphical presentation of the breakeven point.



**Explanation**

1. Loss is a region where Total Costs are more than Total Revenue showing that the business is incurring a loss.

2. Profit is a region where Total Revenue is more than Total Costs implying that a business in making profit

3. Margin of safety is the difference between planned out and break-even output. At this point the organisation is safe from most business risks since it is a region of profit.

4. **Breakeven point (a)**

   It is a point in production where the organisation is neither making profits nor realising losses. Total costs at this point is equal to total revenue any point after the breakeven is a region of profitability (margin of safety), while any point before the breakeven is a region of loss.

5. **Breakeven output (c)**
   This shows the output that should be produced by a firm to breakeven. If the output is below 4 tonnes therefore is incurring losses, as shown above.

6. **Breakeven Sales (Revenue) (b)**

   This is the value of goods to be sold for an organisation to breakeven

7. **Total Sales/Revenue**

   Revenue refers to the value of goods sold, that is units sold x price per unit.

**The Equation method**

Breakeven output and revenue can also be calculated using a formula. The following formulae can be used.

(a) Breakeven output = $\frac{\text{Fixed Costs}}{\text{Contribution per unit}}$

Contribution is the excess of sales over variable costs.

Contribution per unit = Selling Price per Unit-Variable Costs per Unit

(b) Break-even Sales = Fixed Costs x Selling price per Unit

Contribution per unit

(c) Margin of safety = Planned output- breakeven output

**Illustration**

ABC Ltd produces bread for the year ended 31 December 2009 the following information was obtained;

Fixed Costs R15 000

Planned level of output 8 000 units

Variable Costs per unit R4

Selling price per unit R7

**Required**

Calculate the following using the above information;

(a) Breakeven output
(b) Breakeven Sales
(c) Margin of safety

**Solution**

(a) Breakeven output = $\frac{\text{Fixed Costs}}{\text{Contribution per unit}}$

$= \frac{R15\,000}{R7-R4}$

$= \frac{R15\,000}{R3}$

= 5 000 Units

(b) Breakeven sales = $\frac{\text{Fixed Costs}}{\text{Contribution per Unit}}$ x Selling Price per Unit

$= \frac{R15\,000}{R7 - R4}$ x R7

$= \frac{R15\,000}{R3}$ x R7

= 5 000 x R7

= **R 35 000**

(c) Margin of safety = Planned output- Breakeven output

= 8000 units – 5 0000 units

= 3 000 units

**Uses of breakeven analysis**

1. It provides useful guidelines to management decision making regarding the output to be produced.
2. Comparisons can be made between different choices by constructing new charts to show changed situations.
3. it also shows the margin of safety which is a level of output to be targeted by the firm.

**Limitations of breakeven analysis**

1. It assumes that fixed costs remain constant throughout the whole year. This is not practical as these costs can increase at a certain level of output.
2. The chart shows a straight line relationship of costs and revenue. In practice discounts, overtime pay and special delivery charges result in non-linearity.
3. It assumes that costs can be easily classified into fixed and variable costs, yet some costs are semi- variable
4. The technique is appropriate for a single product firm.

**Examination standard questions**

1. A company manufactures a product and the following information is given

| | |
|---|---|
| Direct cost per unit | $60 |
| Overheads | $5 000 000 |
| Current Output | 100 000 units |
| Full capacity output | 150 000 units |
| Price | $140 |

**Calculate**

(i) Contribution per unit [2]

(ii) Breakeven output (in units) [2]

(iii) Margin of safety (in units) [2]
(iv) Profit at current output [3]

2. Explain the uses and limitations of breakeven analysis [10]

**REFERENCES**


1. Marcouse I. Understanding Industry, Third Edition, Holder & Stoughton, Great Britain, 2000.
2. Borington K. & Stimpson P., IGSCE Study Guide for Business, Murray University of Cambridge, UK, 2006.


# CHAPTER 12

**Cash Flow Forecast**

Chapter objectives:
After studying this chapter the student should be able to:

- To explain the nature and structure of cash flow forecast
- To explain the importance of cash flow to a business
- State the causes of cash flow problems
- Outline the ways of resolving the cash flow problems in business
- Construct a simple cash flow forecast for a business from information given
- Interpret a cash flow forecast.

**Definitions to learn**

(1) **Cash flow forecast**
-Is a financial statement which shows how much cash will be received (cash inflows) and paid (cash outflows) during an accounting period.

(2) **Cash inflows**
Are the sums of money received by a business during an accounting period.

(3) **Cash outflows**
Are the sums of money paid out by business during a financial period.

**Examples of cash inflows**

- Borrowing money from an external source- cash will flow into the business e.g. loan
- By the sale of goods for cash
- Payments from debtors
- Sale of assets of the business-old or unwanted property
- From shareholders-Putting more money into the business
- From Investors- those willing to invest into the business

**Cash outflows examples**

- Repaying loans
- Purchasing of fixed assets
- Purchasing goods or materials for cash
- Payment of wages, Salaries and other expenses in cash
- Payment to suppliers. (Creditors)

**Solving cash flow problems**

1. Obtain cheap supplies of materials and components
2. Reduce operating costs e.g. reduce promotion expenditure
3. Rent or lease equipment rather than buying it outright
4. Delay the payments of bills
5. Reduce the debtor's payment period
6. Encourage cash on delivery by offering cash discounts
7. Use a bank overdraft
8. Sell debtors to debt factors

**Exercise 1**

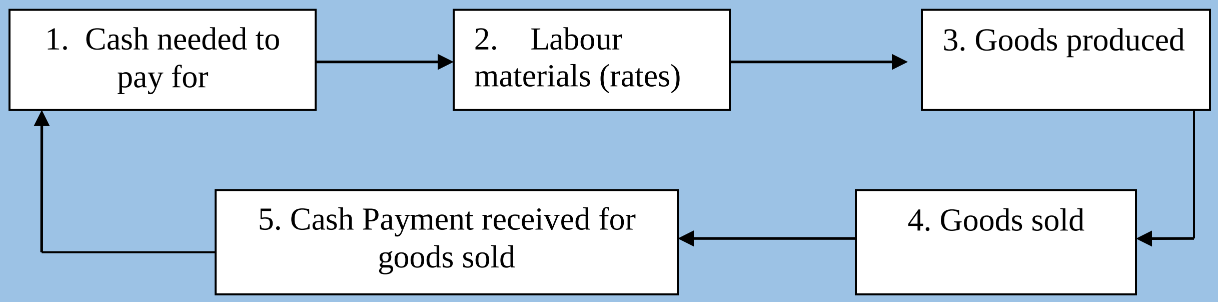
1. Define the following terms:
   (a) Cash flows forecast
   (b) Cash inflow
   (c) Cash outflow

2. Give 4 examples of
   (a) Cash inflows
   (b) Cash outflows

**Cash Flow Cycle**

-This shows the stages between paying out cash and receiving cash from the sale of goods
-It explains why cash paid out is not returned immediately to the business

Cash flow cycle can be presented in a diagram as below.




-The longer the time taken to complete these stages, the greater will be the firm's need for working capital and cash.
-The diagram also helps to understand the importance of planning for cash flows.

**Causes of cash flow problems**

- Purchasing too many fixed assets at once.
- allowing customers too long credit periods
- Owners withdraw profit in the form of cash
- Cash might be stolen
- Producing or purchasing too high stock levels,
- Cash used to repay loan

**Exercise 2**

1. Cash Flow Forecast for Bruce Taylor Co.
   May to August 2009
   Calculate a, b, c, d, e, f, g:

| | May | June | July | August |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Opening bank balance | 3 000 | c | 47 000 | 51 000 |
| **Cash Inflows:** | | | | |
| Cash Sales | 20 000 | 30 000 | 15 000 | 11 000 |
| Payments from Debtors | 10 000 | d | 1 000 | 1 000 |
| **Total Cash Inflow** | 30 000 | 45 000 | 16 000 | 12 000 |
| **Cash Outflow:** | | | | |
| Material and Wages | 5 000 | 5 000 | 4 000 | 10 000 |
| Rent expenses | a | 11 000 | e | 10 000 |
| Total Cash Outflow | 15 000 | 16 000 | 12 000 | 20 000 |
| Net Cash flow | 15 000 | e | 4 000 | f |
| Closing bank balance | b | 47 000 | 51 000 | g |

2. Suggest why materials and wages were high in August [2]
3. Explain the importance of cash flow forecast to the manager [4]

**Interpretation of the Cash of the Statement**

- Opening Bank balance is the amount of cash held by the business at the start of the month.
- Net cash flow is the difference between inflows and outflows
- Closing Bank balance- is the amount of cash held by the business at the end of each month. This becomes next month's opening cash balance

**Uses of cash flow forecasts**

- Stating up a business
- Managing cash flow
- Keeping the bank manager informed
- running an existing business

**Solving Cash flow problems**

- reducing debtors payment period
- encouraging cash sales
- cancelling capital spending plans
- disposal of redundant assets
- Issue of shares, debentures and other short term loans
- cash budgeting/planning
- delay payment to creditors
- sell debtors to debt factors
- use of a bank overdraft
- Rent or lease equipment rather than buying it outright.

**Examination standard questions**

1. Why might a profitable business face cash flow problems? [4]
2. Distinguish between cash inflow and cash outflow. [3]
3. State 3 forms of cash outflows from a business. [3]
4. Cash flow forecast for A.M. Garden Solution for 2010.

All figures in brackets are negative

| | January | February | March | April |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| **Cash Inflow** | | | | |
| Sales Revenue | 60 000 | 70 000 | 75 500 | 77 000 |
| **Cash Outflow** | | | | |
| Salaries | 35 000 | 35 000 | (iii) | 43 000 |
| Plant and trees purchases | 20 000 | 20 000 | 20 000 | 20 000 |
| Seed and Compost | 0 | 6 000 | 9 000 | 10 000 |
| Heating and Water | 1 000 | 1 000 | 1 000 | 1 000 |
| Lease Payment | 8 000 | 0 | 0 | 0 |
| Bank Interest | 990 | (ii) | 740 | 488 |
| **Total Cash outflow** | **64 900** | **63 800** | **73 790** | **(iv)** |

| | | | | |
|---|---|---|---|---|
| Opening bank balance | (5 000) | (9 990) | (3 790) | (2 530) |
| **Net Cash flow** | (i) | 6 200 | 1 260 | 2 512 |
| Closing bank balance | (9 990) | (3 790) | (2 530) | (18) |

a) Calculate the missing figures
i)
ii)
ii)
iv) [8]
b) Explain the importance of cash flow forecasting [4]

**REFERENCES**

(1) Borington K. & Stimpson P., IGSCE Study Guide for Business, Murray University of Cambridge, UK, 2006.
(2) Pyan J. & Richards J, Business Studies Today University of Cambridge, Britain 1996.

# CHAPTER 13

## BUDGETS

Chapter objectives:
After studying this chapter the student should be able to:

- Define budgets and forecasts
- Outline types of Budgets
- Explain purposes of Budgets
- Discuss the advantages and disadvantages of Budgets

**Budget Definitions**
1. Planning one's money in advance
2. Plans for the future containing numerical or financial targets
3. A financial expression of intentions or expectations
4. A financial or quantitative statement relating to the use of resources to achieve specific objectives or targets over a given period of time.
5. A financial plan or forecast of income and expenditure

N.B Forecasts' are predictions of the future, for example, likely changes in economic conditions.

**Preparation of a budget**

Information on current costs in and performance → Forecasts of future costs and performance → Set objectives → Budget agreed

**Types of Budgets**

1. Administration Budget
- Cost of administration
2. Capital Budget
Expenditure on capital items
3. Direct Labour Budget
- Quantity & Cost of direct labour
4. Marketing Budget
Expenses involved in marketing & the revenue from sales. This can be subdivided into specialist areas such as promotion, selling, distribution etc
5. Production Budget
Production budget translated into monetary cost
6. Purchases (direct materials costs) Budget quality and cost of direct materials
7. Sales budget
Volume of revenue from sales
8. Research and Development
- Expenditure on Research and development. Others zero budget, Cash budget,

Exercise

1. Define the terms
   a) Budget [2]
   b) Forecasts [2]
2. Elaborate how a budget is prepared
3. Explain the following types of budget
   a) Marketing Budget
   b) Sales Budget
   c) Purchases budget
   d) Production budget

**Purposes of Budgets**

1. To assist the planning process
2. To communicate plans
3. To coordinate activities and ensure harmony between different parts of an organization
4. To motivate staff
5. To control and evaluate performance

**Advantages of Budgets**

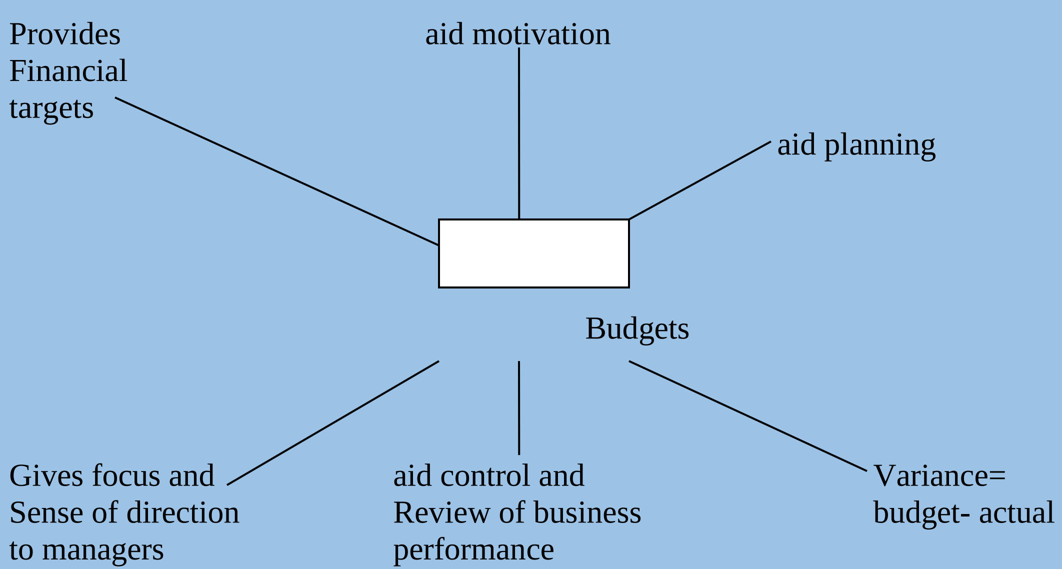
1. Facilitates co-ordination
2. Responsibilities are classified
3. Translates strategic plans into departmental action
4. Improves communication

5. Control expenditure
6. Scarce resources are used in the most efficient and profitable way
7. Performance can be measured against a quantitative target
8. Facilitates management by exception with deviations reported and investigated
9. By giving freedom within the budget' middle management can be motivated.

**Disadvantages of budgets**

1. More resources are used
2. Value depends upon the quality of information
3. Can be used mechanically and inflexibly
4. Demotivating if participation is not part of the process
5. Management becomes over-dependent upon the budget and neglects the process of management.

**In Summary**




**Examination standard questions**

1. State any two types of budgets (Nov 2009 Zimsec) [2]
2. Explain any two benefits of budgeting [4]
3. Assess the usefulness of Budget to a business organization [10]

**REFERENCES**

(1) Borington K. & Stimpson P., IGSCE Study Guide for Business, Murray University of Cambridge, UK, 2006.
(2) Pyan J. & Richards J, Business Studies Today University of Cambridge, Britain 1996.

# CHAPTER 14

## Introduction to Marketing

Chapter objectives:
After studying this chapter the student should be able to:

- To define marketing
- To explain market segmentation and the basis for segmenting markets
- To explain the need for market research
- To explain the need for environmental scanning and the tools used
- To explain the product life cycle and the marketing mix
- To discuss the forces of demand and Supply in determining price and production levels.

**Market**
A market is an interaction of sellers and buyers with an intention of exchanging goods or services for money. This applies that a market is not necessarily a place (location) but is a process of interaction of buyers and sellers to create a sale.

**Marketing**

-is the management function which organizes and directs all those business activities involved in assessing and converting customers' purchasing power into effective demand for a specific product and moving the product to the final consumer so as to achieve the profit.
-It can be simply defined as the social and managerial process by which people obtain what they need and want through creating, offering and exchanging products of value with others.

## Evolution of Marketing

Marketing develops from a series of stages which are also known as marketing approaches. This is because some of the approaches (or all) of them are still used by other organizations

Production oriented firms (production era)

↓

Product oriented firms (Product era)

↓

Sales oriented firms (Sales era)

↓

Marketing oriented firms (Marketing era)

↓

Societal marketing oriented firms

## Production oriented firms

These firms concentrate on producing efficient, low cost production methods and latest technology. The focus is on reducing the production cost per unit and not on customer preferences. Such a firm faces a major challenge of obsolescence that is change in technology and lack of customer appeal or satisfaction.

## Product oriented firms

From the production era, marketing develops product era where the firm focuses on the quality of the product. A lot of resources were committed in improving the quality, features appeal of the product itself. Customer needs were not considered (thereby resulting in their rejection of the product).

**Sales oriented firms**
These firms are concentrated on pushing a sale through aggressive advertising, they believe in a product that is well. This focus is demanded more by the customers. This focus is not the needs and preferences of the consumers but on the promotional mix.

**Marketing oriented firms**
Such firms start with undertaking market research to identify the needs of the consumers before producing any product. After a research program the product is produced which tailor is made to suit the requirements of the consumers such products are easy to market as the consumers are searching for them.

**Societal marketing oriented firms**
These firms don't only produce what is required by the consumers but also provide social responsibility to them. Its focus is on the consumer and the environment

**Objectives of marketing**
1. Undertake marketing research programs to establish current and future needs of the customers.
2. Product developments as well as improving the current ones.
3. Properly price the firm's product with a view to increase its sales and profits.
4. Enhance the distribution channels of an enterprise so as to increase the market share.
5. Create an awareness of the firm and its products.

**Division of Marketing**

Marketing is mainly divided into the following sub-divisions:

a) **The Research and Development function**
This department is responsible for producing new products and to improve the appeal of the existing products.

b) **The Sales Function**
Its objective is to ensure that products are sold to difficult customers. This is achieved through a network of sales representatives, telephone, cell phone as well as personal selling for highly technical products.

c) **The distribution function**
It refers to the function of moving goods from the company (manufacture) to its customers through a distribution network

(d) **The promotion function**
The department is responsible for creating an awareness of the company and its products. It involves advertising, personal selling, sales promotion, public relation and publicity.

**Market Segmentation**

Market segmentation is the division of the entire market into sub groups that have the same needs and preferences. These sub-groups (market segments) should respond in the same way to marketing stimuli (offering). For example company executives (market segment) may prefer suits that are expensive and exclusive.

**Bases of segmenting markets**

1. **Geographic differences:-** Different regions may have varying tastes for example people from Matabeleland region may prefer products that appeal to the Zulu Culture

2. **Gender (Sex)**
   These are products which are produced for a particular sex for example skirts for women.
3. **Income group**
   Some products target a group of customer for example Pierre Cardin shirts for high income earners.

4. **Age group**
   Different products appeal to different age groups, for examples, back out for young girls, pampers for babies etc.

5. **Product use**
   Big trucks, for example 30 tonnes, are purchased for industrial used not for domestic use.

6. **Lifestyle**
   The level of disposal income of consumers determines to a large extent the choice of goods and services. The social background also determines the individual lifestyle.

**The difference between mass and niche marketing.**

A Niche market is a group of a large number of consumers targeted by a business. Mass marketing is normally characterised by a large volume of sales targeting all customers.

**Niche market**

A niche market is a segment of the market which is small in terms of the number of product users and sales volume. This market is normally serviced by small firms for example dying of cloth. It tends to be specialized in nature.

**Exercise 1**

1. What is a market? [2]
2. Define the following terms.

a) Market oriented business. [2]
b) Product oriented business. [2]
c) Sales oriented firms. [2]

3. Explain 2 objectives of marketing. [2]
4. Explain 4 bases of segmenting a market. [8]

**Introduction to Marketing Mix**

Marketing mix is a combination of offerings made by the business to its customers. It is sometimes known as 4Ps of marketing in that it encompasses the Product, Price, Promotion, and Place. These will be discussed in detail in the next chapters.

**Types of Product**

1. Consumer goods: these are products that are meant for domestic use. They can be durable for example, stoves, kitchen unit, furniture and Television set or non-durable e.g. food, consumer services
   Consumer services are services which are provided to people e.g. haircut, entertainment, education etc.
2. Producer goods
   Producer goods are products which are produced for other businesses use. For example plant and equipment, machinery etc.
3. Producer services
   Producer services refer to offerings (service) which are provided to other business for example insurance, accounting, banking and communication.

**SWOT Analysis**

This is a management technique of evaluating the business offering relative to its competing firms (rivals).

S - Strengths

W - Weakness

O - Opportunities

T - Threats

**Strengths**

These are positive internal factors about the business and its products for example, a well recognised brand, strong finance resources, a highly skilled manpower etc.

**Weaknesses**

A weakness is a negative internal factor such as obsolete equipment, mediocre management etc.

**Opportunities**
These are external factors that have potential benefit for the business, for example availability of potential market.

**Threats**
These are external factors that have the potential to harm the business for example the entrance of a strong competitor.

**Product Development Stages**

(a) **Idea generation**
Idea generation is a brain storming stage where research and development is undertaken to scout for new product prospects. These ideas are generated internally from the employees and management or externally from customers, competitors, and public reports. A lot of possible product ideas should be generated.

(b) **Idea Screening**
Idea screening is the cost and benefit analysis of each idea in terms of its feasibility. Some ideas are abandoned which require resource which are not available in the company as well as those that are not in line with company objectives. The return on investments estimate is also undertaken as a screening process.

(c) **Idea evaluation**
This is the concept testing stage where the expected reaction of the customers is used as a basis to estimate sales and likely market share for each idea. Moreover, rough estimate of cost, profit, and sales is used to determine breakeven point.

(d) **Prototype Development**
Models (prototypes) are developed in this stage to establish the ability of the firm to manufacture the product. A model is a representative of the actual product to be developed.

(e) **Market testing**
Market testing is conducted where the product is sold to limited geographical areas to establish the reaction of the consumers before commercialization. Primary research is done at this stage to collect data relevant to the design of the product. Any information gathered is used to alter the product appeal to meet the requirement of the target market.

6. **Commercialisation**
Commercialisation is when the product is produced in large quantities and is sold through a wide distribution network.

**<u>Packaging</u>**

It is the designing of a wrapper or container for the product

**<u>The Role of Packaging in the marketing of a product.</u>**

1. Packaging aids promotion
2. Preserves the contents
3. Contains instructions on how to use the product
4. Can be used for other purposes after the product has been consumed
5. It helps self-service
6. It can attract customers
7. Helps to build brand loyalty that is the attachments of customers to a certain brand or company's products.
8. It makes it easy to handle the products especially with liquids.

**Branding**

A brand name is a unique name of a product that distinguishes it from other brands

**Advantages of branding**

- -Branded products are normally viewed of higher quality than unbranded products
- -Consumers are made confident in buying branded products
- -More products are realized as more sales are made.

**Brand loyalty**

Is when consumers keep buying the same brand again and again instead of choosing a competitor's brand.

**Brand image**

Is an image or identity given to a product which gives it a personality of its own and distinguishes it from its competitors' brands.

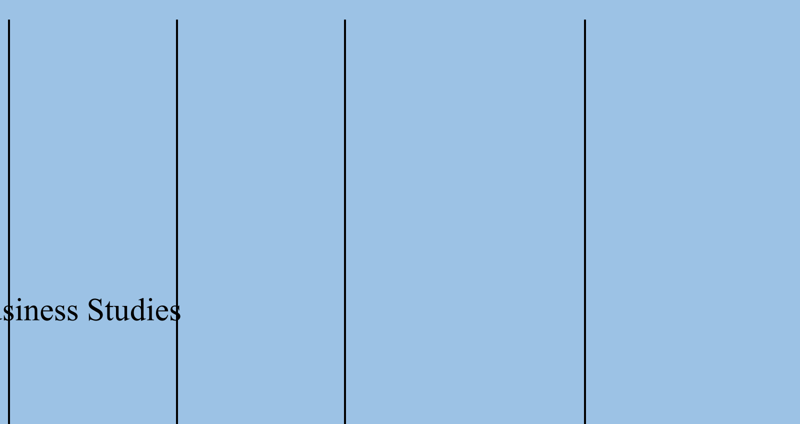
**<u>The product life cycle</u>**

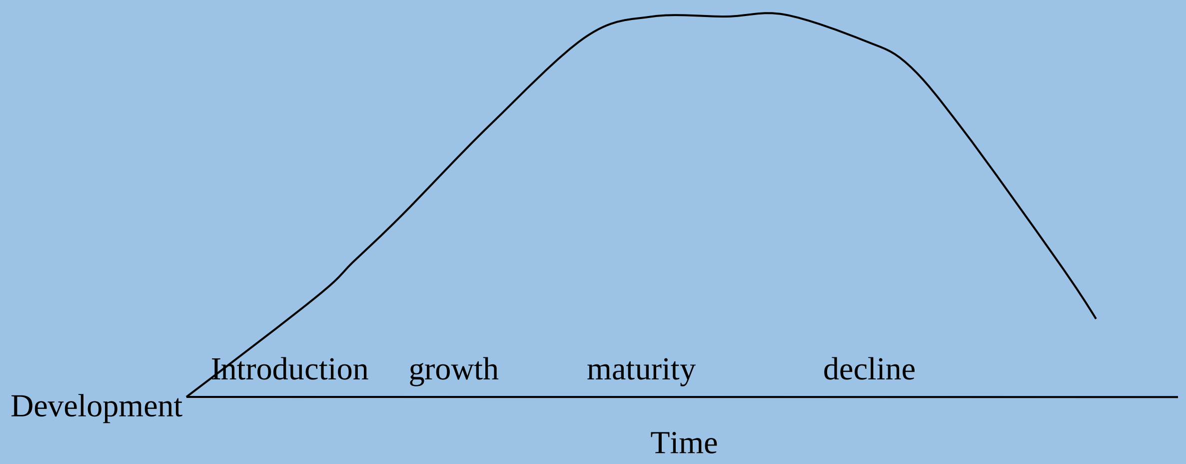
It is the path followed by a product in realization of sales and profits' from its inception to its demise. The following are stages of the product life cycle;

a) <u>Development</u>

Development stage involves market research where product models are tested. These prototypes can then be further developed in line with the needs of the customers.

Sales Volume
/Profits






(b) **<u>Introduction</u>**

This is the period when the product enters the market. Growth of the product is slow and thus sales are low. Promotion is focused on product awareness and persuading customers to try it. Distribution tends to be selective. Profits are very low or sometimes not realized as the firm tries to cover research and development costs. Price skimming is recommended for a firm to cover initial costs before competitors introduce their competitive products.

(c) **<u>Growth</u>**

Growth is a period when the product demand increases. Promotion tends to encourage brand loyalty. Prices are reduced due to entrance of competitors. Profits also grow as the firm fully covers the research and development costs.

(d) **<u>Maturity</u>**

Sales increase slowly or level up and profits are at their highest. Competition tends to be cut as rivals come up with better or improved products. The firm should intensify its distribution network in an attempt to increase or maintain the market share.

(e) **<u>Decline</u>**

Sales and profits decrease at this stage. The product is withdrawn from the market as the sales are not enough to cover the production costs.

**<u>Ways of avoiding the decline stage of the product life cycle.</u>**

1. Change the features of the product as well as its appeal.
2. Enter the new markets including the export markets.
3. Advertise the product by using new and improved campaign
4. Improve the production technique by acquiring the latest technology.
5. Research on other uses of the product.

6. Make the brand a house hold name.
7. Engage in social responsibility marketing through sponsoring social functions.

**Price**

Price relates to the amount of money that customers have to pay to obtain the product.

**Pricing strategies**

These are approaches to pricing decisions which are as follows:

(a) **Cost-plus pricing**

It involves the calculation of the full cost of production and adding a fixed percentage mark up for profit.

**Advantages**

1. It is easy to calculate
2. It guarantees that profit will be made

**Disadvantages**

1. It ignores demand
2. it ignores competition
3. It does not take into consideration fixed costs.

(b) **Penetration pricing**

It involves introducing the product at a lower price compared to competition. This is done to enable the customers to try the product and for the firm to penetrate (enter) the market.

This strategy creates brand recognition and loyalty in the long-run. On the other hand, it results in low profits due to low mark-up.

(c) **Price Skimming**

Involves charging a higher price compared to competing brands when introducing a new product. The strategy results in customers perceiving the product as high quality. However it limits sales as very few people can afford high prices.

(d) **Promotional Pricing**

Products can be sold at low prices for a short period of time for example, during a sales promotion (Easter promotion). After this period, the goods will be sold at normal prices.

(e) **Competitive 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 homogenous e.g. transport industry. It also involves charging a low price to destroy or weaken inefficient rivals (destroyer pricing).

(f) **Price discrimination**
This is charging of different prices to different segments of the market. For this to be possible, different markets should have varying elasticities e.g. price inelastic for a segment where high prices are charged.

(g) **Psychological pricing**
Prices are charged based on the perception of the consumers. For example $4,99, some consumers may perceive this to be $4 and others $5, so the approach will enable price sensitive customers to buy the product.

**Determination of Price in a free market**
In a free market economy, prices are determined by the interaction of demand and supply (market forces). Promotion as a part of marketing mix includes:
a) **advertising**

**TYPES OF ADVERTISING**

1. **Informative advertising**
This is designed to provide information which is useful to the public. The firm may inform the public about the availability of a new product.

2. **Persuasive advertising**
It is designed to persuade and convince consumers to buy more of a product.

3. **Generic advertising**
Generic advertising occurs when producers in one industry collectively advertise a product in general rather than their particular brands for example advertising on the importance of using detergents without mentioning any brand.

**The different forms of media**
Advertisements are normally placed on different media e.g. newspapers, TV, radio, billboards, magazines, internet etc.

**Newspapers**
A newspaper can be daily, weekly, monthly or quarterly e.g. the Herald, The Chronicles etc.

**Advantages of newspapers**
1. High coverage
2. Flexible
3. Relatively low cost

**Disadvantages of newspapers**

1. Short life
2. Problem of attracting attention
3. There are no movement or sound

**Television (TV)**

The use of ZTV, BTV, SABC1, DVDs etc.

**Advantages of Television**

1. There is sound, sight and motion
2. High coverage
3. Demonstrations can be done

**Disadvantages of Television**

1. High cost
2. Short life
3. Cannot refer back

**Radio**

**Advantages of a radio**

1. reaches a wider coverage
2. Different channels can be used to target specific segment of the market.

**Disadvantage of a radio**

1. The adverts tend to be short
2. No visual stimuli
3. Low attention.

**Magazines**

**Advantages of magazines advertisements**

1. Targets selected audience
2. Relatively long life

**Disadvantages of magazines**

1. High cost
2. Low flexibility
3. No sound or movement

**Internet**

**<u>Advantage of internet</u>**

1. Wide coverage
2. Instant feed back
3. Goods can be sold through the internet.

**<u>Disadvantages of internet</u>**

1. Lack of security
2. Is only accessible to customers who are online.

**<u>Bill boards</u>**

**<u>Advantages of bill boards</u>**

1. They are relatively cheaper
2. Adverts are permanent

**<u>Disadvantages of bill boards</u>**

1. Lack of detailed information
2. Can be missed by the customers as they pass by.

b) **<u>Sales promotion</u>**

- it is the use of a short- term incentive to boost or stimulate demand for a product. Sales promotion can be directed to the intermediaries or to the final consumer.

**<u>Types of Sales promotion</u>**

1. <u>Free Samples</u> where goods are given free of charge to consumers to try the product.
2. <u>Price reduction</u> – goods are sold at a price less than the normal selling price.
3. <u>Point of sale displays</u>

This is when goods are specially displayed in selected retail outlets. These displays have an advantage of attracting customers (eye catching).

4) **<u>After-sales service</u>**

It refers to an attempt by a company to make a follow-up of the goods sold. The intention is to gather information regarding the customer's satisfaction as well as to offer repairs and maintenance service. It is normally done to capital goods.

5) **<u>Competition</u>**

Entry forms may be placed on or inside the package which should be filled by the consumer and returned to the company for a prize.

**<u>Advantages of Sales promotion</u>**

1. it encourages customers to try the product
2. it creates brand loyalty

3. Non-users may be turned into constant customers.
4. Increased sales and profits.

(c) **Personal Selling**

Personal selling involves the effort of sales staff in pushing the product to the final consumer.

**Main Activities of Personal Selling**

1. Obtaining orders
2. Offering advice to consumers
3. Demonstrating the product
4. showing samples
5. Handling complaints
6. After sales services.

Personal selling mostly applies to highly specialized products such as electrical, machinery equipment etc. where the buyer lacks operational information.

(d) **Public relations**

Public relations refer to the establishment of a relationship between a company and its stakeholders. Its intention is to improve the image of the company. It is achieved through offering some donations or sponsorships to other organizations for example, charitable. The company is promoted through good news not advertisements.

**Place: Distributions as Part of Marketing Mix**

Distribution refers to the movement of goods and services from the producers to the final consumer.

**Distribution channels (Middlemen)**

These are intermediary firms that are involved in selling of the products. They link the manufacturer and the final consumer.

1. **Channel 1**

Producer — A producer is an entity that manufacturers the product.

↓

Wholesaler — Functions of (i) Breaking the bulk- buy goods from wholesalers in large quantities and sell in small lots.

2. Provide warehousing for retailers
3. Provision of advice to retailers
4. Offer transport to both producers and retailers

↓

Retailer — Retailers sell goods to the final consumers e.g. OK foods, TM Supermarket, Spar etc.

↓

Consumer — is a person who buys goods to use/consume.

2 **Channels 2**

Producer — This channel eliminates wholesalers from the normal channel of distribution because of:

a) The growth of large retailers that can buy in bulk and store in their large warehouses.

↓

Retailer — b) Sell of perishable goods (those that easily go bad)

↓

Consumer — Is a person who buys goods to use/consume.

Consumer

**Channel 3**

Producer — This channel eliminates both wholesalers and retailers from the first channel due to:

a) Sale of perishables.
b) The need for after- sales services.
c) Middle man fails to give support or attention to the firm's products

↓

Consumer

d) availability of internet services where goods are sold directly to the consumer.
e) Direct sales and mail order services.

**Channel 4**

Producer — Agents are middlemen who are not traders on their own. Thy act on behalf of someone else called the principal. Agents are common in export trade where the principal lacks trading information in the country the agent is based. In this respect, goods are sold through the agent to the wholesaler, retailer and to the final consumer. Agents are paid a commission for handling the producer's products

↓

Agent

↓

Wholesaler
↓
Retailer
↓
Consumer

**Intensive versus selective distribution**

Intensive distribution allows any possible stock of goods to distribute the producers' products i.e. goods are sold to all middle-man who can handle the product. This is done to increase market exposure, market share and sales revenue and profit.

Selective distribution is whereby the producer restricts the number of middlemen of the products. Selective distribution is used when customer requires after sales services, build a unique status of the product and where the market is small.

**Push Versus Pull strategy**

Push strategies are aimed at intermediaries. They include the use of discounts; point of sale displays trade exhibitions. Pull strategies are focused on the final customer and include cash discounts, customer competitions etc.

**Examination Standard Questions**

1. a) Moyo Ltd has just launched a new bicycle aimed at 18- 28 year olds, market segment. Apart from price, explain, other factors that the company should consider when deciding how to market this product [6]
   b) Moyo Ltd has developed this bicycle in response to the results of a market research. Is Moyo Ltd a market oriented business or a Product oriented business. Justify your answer [3]
2. The marketing manager said "Firms that are successful nowadays segment their markets."
   a) State any three factors used by firms to segment their markets [3]
   b) Discuss any two arguments for market segmentation [4]
   c) Explain any two arguments against market segmentation [4]
3. State any 4 elements of marketing mix [4]
4. Give 4 advantages of branding a product [4]
5. Give 2 advantages of using internet in the business world [2]

6. Explain 3 types of sales promotion [6]

**References**

1. Modern AR Elements of marketing 3rd Edition shepherds Bush Great London. 1994.
2. Geoffrey W Business Studies 2nd Edition Clap Ltd, Great Britain. 1994.
3. Naltal C Business Studies, Cambridge University Press UK. 2002.

# CHAPTER 15

## Market, research, demand and supply

Chapter objectives:
After studying this chapter the student should be able to:

- To explain the need for market research
- Describe Primary and secondary research
- Identify the different methods of primary and secondary research
- State the advantages and disadvantages of primary research and secondary research
- Give the sources of internal data and external data
- State the types of data
- To discuss the forces of demand and Supply in determining price and production levels.

**Market Research**

Market research is the systematic and objective collection, analysis, evaluation and presentation of information relating to markets and marketing. Market research concerns the demand of the product, and marketing research is also concerned with the effectiveness of a marketing strategy.

**Forms of research**

There are 2 forms of research which are primary research and secondary research

**Primary Research (Field research)**
It is the collection of data for the first time to solve a problem on hand. This data is original in the sense that it is not available in any form but is collected directly form the customers.

**Methods of primary research**

1. **Questionnaire**
   Information is collected using a list of prepared questions which are structured to obtain the customers' responses. Questionnaires have an advantage of obtaining qualitative information on the customers' opinions of the subject matter. However, it is time consuming and costly.

**Advantages of questionnaire**
- detailed qualitative information can be gathered about the product or service
- customers' opinions about the product or service can be obtained

**Disadvantages of questionnaire**
- Inaccurate answers can be given to questions which are not well thought
- It is costly (expensive in terms of money)
- It is also time consuming

2. **Interview**
   Is a form of face-to-face interaction between an interviewer (business) and the interviewee (customer).

**Advantages**
1. Responses are obtained instantly
2. It is available for probing i.e. for further explanation.

**Disadvantages**
1. Its success depends on the expertise of the interviewer that is, he/she can be biased
2. Traveling costs normally limit the interview to local people only.

3. **Observation**
   It involves watching the consumer in action to establish his/her buying behaviour.

**Advantages**
1. It is cheap to gather information using this method.
2. Consumers do not behave artificially.

**Disadvantages**
It does not provide reasoning behind consumer behaviour

4. **Experiment**

With this method, samples are given to consumers for tasting in the normal shopping areas. These consumers are then asked to comment on the performance of the product. The method is relatively easy to conduct. However, it limits the number of consumers to given shopping areas. Furthermore, customers may give biased responses in a bid not to offend the person conducting the experiment.

**Advantages of primary research**

1. The data is problem specific
2. The information collected is up- to date

**Disadvantages of primary research**

1. it is time consuming and thus delaying the decision making process.
2. It is expensive to collect information.

**Secondary research (desk research)**

It involves studying existing information, which was gathered for a certain different purpose. This means the information is available for use by other people.

**Sources of internal data**

(i) Sales records
(ii) Accounting records
(iii) Suggestion box
(iv) Quotation books
(v) Invoice books
(iv) Company reports

**Sources of external data**

(i) Newspaper
(ii) Central statistics office (CSO)
(iii) Banks
(iv) Trade associations
(v) Professional bodies
(vi) Chambers of Commerce

**Advantages of secondary research**

2. Information is gathered quickly
3. It is cheaper to gather the information

**Disadvantages of secondary research**

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

**Types of data**

1. **Quantitative data**
   This is raw information that can be put in numbers for example the number of customers supplied by the business.
   It answers questions about the quantity of something e.g. How many jerseys were sold in the month of June."?

2. **Qualitative data**
   This refers to opinions and judgments which cannot be put in numbers. For example consumer attitude and why consumers buy a given product.
   Answers questions like 'why do more teenagers than old people buy the company products."

**Exercise 2**

1. Define the term market research [2]
2. Distinguish between qualitative data and quantitative data [4]
3. Give two advantages of
   (a) Primary research
   (b) Secondary research

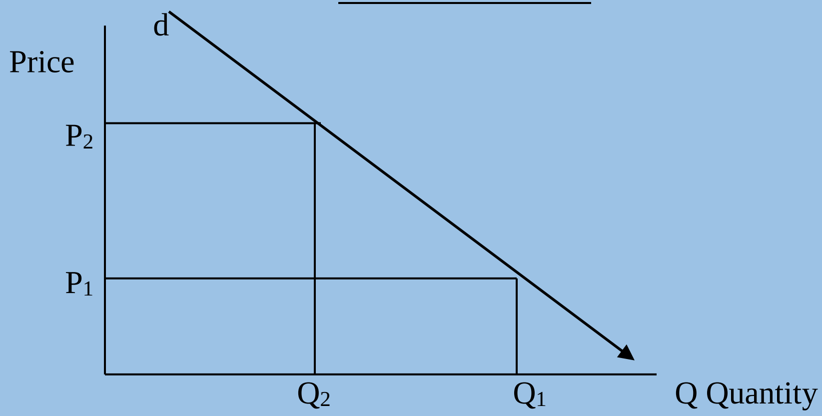
**Demand**

Demand refers to what consumers are prepared to and able to buy at a given price (ability + willingness)

**Law of demand**

It states that the more of a product is demanded the lower its price, that is there is an inverse relationship between quantity demanded and price, other things constant

The Demand Curve



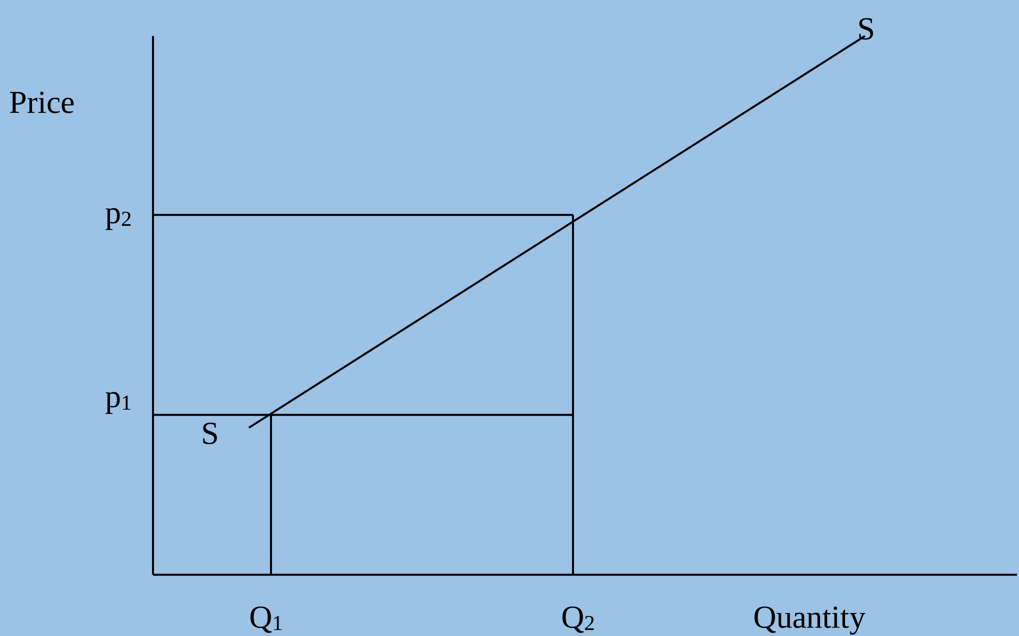
The demand curve is downwardly sloping from left to right hand side. This is explained by the use of the law of demand. If price is reduced from $P_2$ to $P_1$ quantity demanded increases from $Q_2$ to $Q_1$ as shown above

**Supply**

It refers to what suppliers are willing and able to offer for sale at a given price level at a given period.

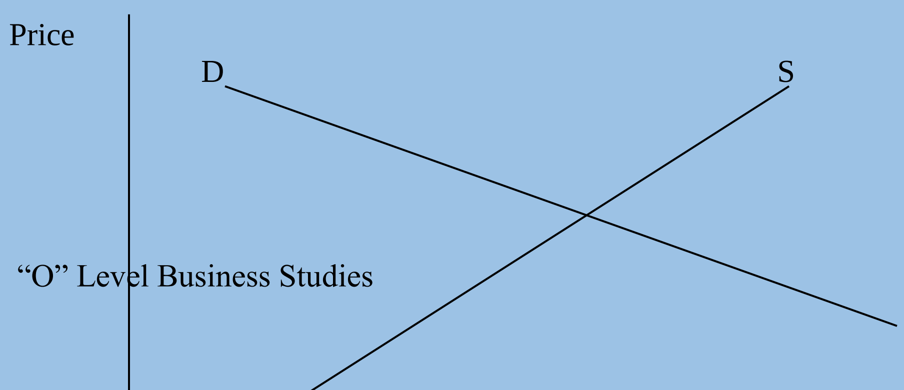
**Law of Supply**

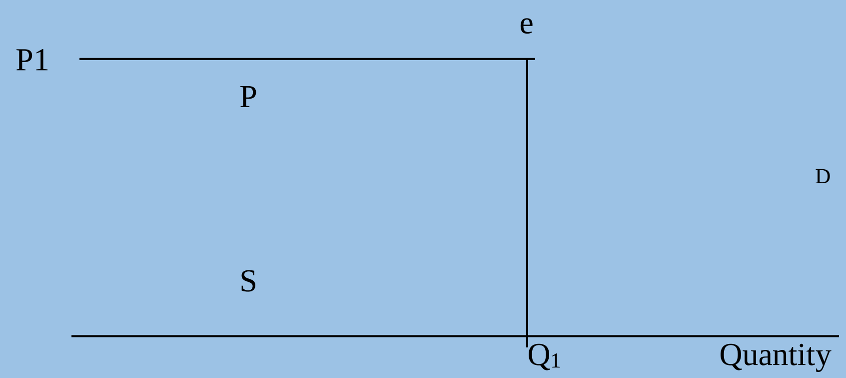
Suppliers are more willing to sell their goods at a higher price that illustrates a positive relation between quantity supplied and price.




The diagram above shows a positive correlation of quantity supplied and price. If price is increased from $P_1$ to $P_2$, quantity supplied also follow suit, 1Q increase from $Q_1$ to $Q_2$.

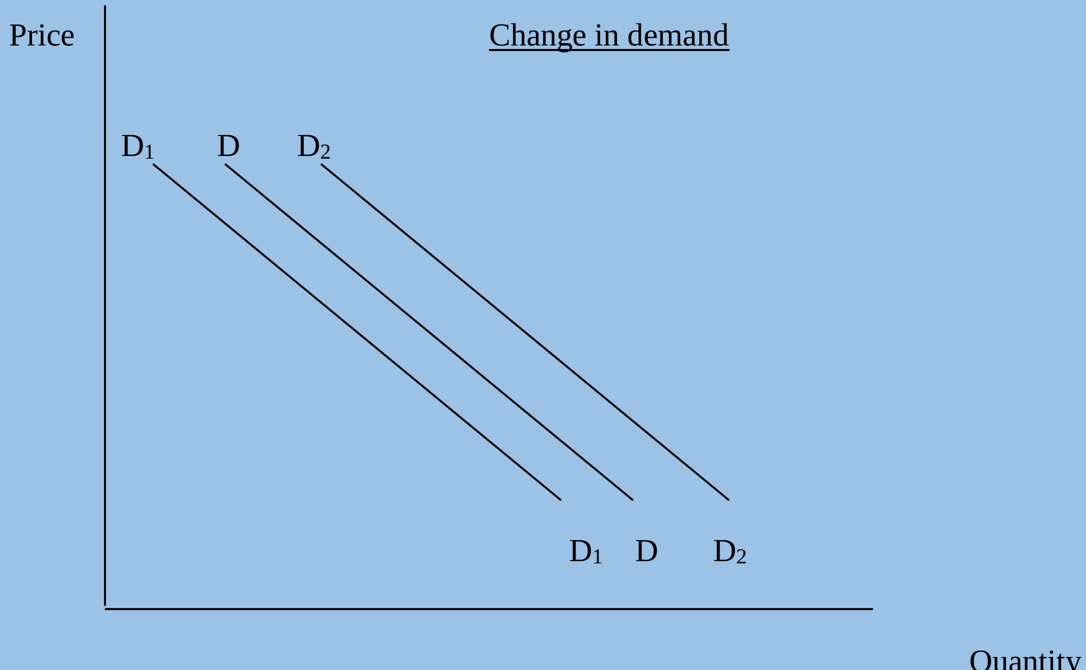
**The Market Price**






The market price as denoted by the above diagram. It is the interaction of demand and supply that is where demand and supply curves are at equilibrium. This means the market price is P and suppliers are prepared to offer Q1 quantity for sale. Any price above P means that supply is more that demand and prices will be forced to go down due to excess. On the other hand any price below P shows shortage as demand outweighs supply thereby forcing prices up.

**<u>Factors that influence demand</u>**




D is the original curve. A shift to the right, which is from D to D2, shows an increase in demand. A change from D to $D_1$ implies a decrease in demand.

1. **<u>Taste or fashion</u>**
   The fashionable a thing is, the more its quantity demanded, all factors being equal (ceteris peribus)

2. **<u>Availability of income</u>**

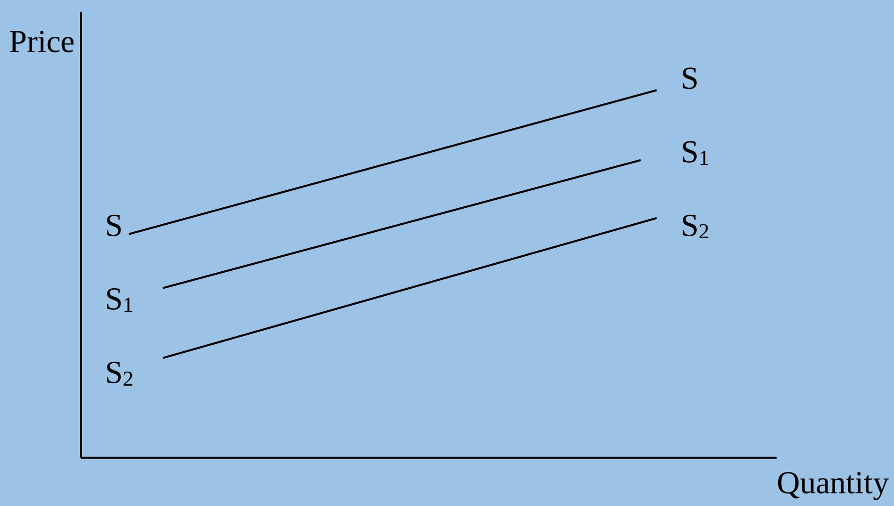
Some goods are more demanded the more the disposable income (money available for spending after tax payment), ceteris peribus. Less income means less demand for goods and services.
NB: The term <u>ceteris peribus</u> is Latin meaning "when other things are not changing"

3 **<u>Population</u>**
Any increase in population means as increase in quantity demanded for goods and services.

4. **<u>Availability of other products</u>**
If the price of substitutes (goods that can be used in place of another) is low, more goods will be demanded. For example if the price of margarine goes up while that of butter remains low customers will shift their demand from margarine to butter.

The price of complementary goods (goods which are jointly demanded affect each other). Complementary goods are products which one cannot use without the other.

**<u>Factors that influence supply</u>**




The diagram above shows the increase in supply from S to S2, which is a shift to the right hand side. Any shift to the left hand side from S to S1 shows a decreased demand.

1. **<u>Weather Conditions</u>**
This applies to agro-based economies such as Zimbabwe, where drought, famine and cyclones may affect the agricultural produce. It means affecting the agricultural produce. It means less will be supplied during these natural phenomena. Supply therefore shifts from S to S1 showing decreased supply.

2. **<u>Investment in technology</u>**

The acquisition of latest technology means that goods are produced in large quantities which reduce the cost per unit. More goods produced at least price means less price charged and hence increased affordability. Supply shifts from S to S2

3. **Government**

   Government can influence supply by offering a subsidy which reduces the prices thereby enhancing quantity demanded. On the other hand, more corporate tax means less supply as this reduces profits retained in business.

**Price elasticity of demand**

This is the responsiveness of consumers to a change in price of goods or services. If consumers are relatively sensitive to price changes, demand is inelastic. If they are relatively unresponsive to price changes demand is elastic.

**Price elasticity of supply**

It is the sensitivity of quantity supplied to changes in price of products. Supply is inelastic if the change in rice have a little bearing on the quantity supplied. Elastic supply means that a small change in price will greatly affect the quantity supplied.

**Examination Standard Questions**

1. Outline any two sources of external data.[2]
2. Identify any three factors that affect:
   a) Demand.[3]
   b) Supply.[3]

3. Explain any two advantages of using primary research to a company producing a new product.[4]
4. Distinguish between primary research and secondary research.[4]
5. Discuss the importance of the Research and development (RD) department to modern businesses.[10]

**References**


1. Modern AR Elements of marketing 3rd Edition shepherds Bush Great London. 1994.
2. Geoffrey W Business Studies 2nd Edition Clap Ltd, Great Britain. 1994.
3. Naltal C Business Studies, Cambridge University Press UK. 2002.

# CHAPTER 16

## GOVERNMENT AND ECONOMIC INFLUENCES ON BUSINESSES.

Chapter objectives:
After studying this chapter the student should be able to:

- To explain the role of a government on business activities
- To explain the business cycle and the measures that government can stabilize this cycle
- To explain the role of economic policies to portray an economy
- Explain the effect that uncontrolled business activity can have on society.
- Explain the economic objectives for the Government.

**Government macro-economic objectives are to:**

1. **Keep inflation at low levels**
   - Inflation is the increase in the average price level of goods and services over time

   **Problems of rapid inflation**
   - Businesses will be unlikely to expand
   - High unemployment- no jobs created
   - Prices of goods produced in the country will be higher than those in other countries
   - The standards of living are likely to fall.

2. **Keep unemployment at low level**
   - This happens when people who are willing and able to work cannot find a job.

**Problems**

- Total level of output will be lower than it could be as unemployed people do not produce any goods and services.
- Government has to pay for high level of unemployment.

**NB: Low unemployment will help to increase the output of a country and improve workers' living standards.**

3. **Achieve economic growth**

- Economic growth is when a country's Gross Domestic Product increases i.e. more goods and services are produced than in the previous year.
- The Gross domestic Product is the total value of output of goods and services in a country in one year.
- Economic growth leads to increase in the standard of living

**Problems of no economic growth.**

- No business expansion- People not having money to spend on the products they make
- The rate of unemployment increases
- The standard of living declines

4. **Balance of payments**

- This records the difference between a country's exports and imports
- Exports are goods and services sold from one country to other countries
- Imports are goods and services bought in by one country from other countries.

**N.B. If the balance of payment is negative (there is a deficit). This means that imports are more than exports.**

**Problems**

- The country could 'run out' of other countries' currencies and it may have to borrow from abroad.
- The exchange rate will be likely to fall (Exchange rate depreciation is the fall in the value of a currency compared with other currencies).

5. **Control of monopolies**

- A monopoly is when one firm controls or dominates the market for a good or service
- The governments attempt to control monopoly power e.g. by declaring them illegal and must be broken up into smaller firms.

**Disadvantages of monopoly**

- Monopolies are not efficient as there are no competitors.
- They fix high prices as they have no direct competitors.
- They can prevent new firms from setting up to compete with them.

**Exercise**

1. Explain three possible effects on the society if business activity was not controlled by Government.[6]
2. Explain the following economic objectives of government.
   a) Keeping unemployment at low level [3]
   b) Achieving economic growth [3]
   c) Maintaining a surplus balance of payments [3]
3. How Governments control business activity? [4]

**Fiscal policy** – government economic policies are based on public spending, taxation and borrowing.
Taxation is the main source of government revenue. Taxes take the following forms:

a) Direct Taxes = these are taxes on individual income and profits from firms
b) Indirect taxes – these are paid first by the purchaser to the supplier who then has to forward them to ZIMRA. Indirect taxes include VAT, customs duty
   If direct taxes are too high they,

1) Act as a disincentive to work as more of the income portion is taken as government revenue; the worker therefore remains with little money to spend. As a result the worker will not even have the passion to do overtime as taxes will be even higher
2) Acts as a disincentive to the productive industry as large sums of money are paid as corporate tax. Companies end up evading or avoiding to pay tax.

Eventually with decreased worker moral and reduction in production due to high taxes this leads to a decrease in Gross Domestic Product. Exports decline leading to an influx in exports thereby offsetting the Balance of payments. For economic growth to be achieved precisely the government has to cut down on taxes to encourage investment.

With government expenditure, it is paramount for the government to engage in capital expenditure where infrastructure development is facilitated to enhance building dams, construction of roads and government offices. This creates employment. Workers income is either saved or consumed.

Consumption creates demand which is met by investors who will borrow money saved by consumers in the banks. Again investors create jobs and enhance production. With production more food and services are available at prices determined by the forces of supply and demand. There is a chain of reaction and inflation is termed as long as the government cuts on taxes to increase consumer disposable income. On the other hand if the government channels funds to recurrent expenditure, i.e. on unproductive activities such as paying of civil servants, more production is thwarted further increasing tax and the standards of living reduce.

If the government relies more on borrowing funds, be it internal or external, there is interest to be paid. The interest is paid by the consumer through taxes. If the government borrows locally then investors fail to get money from the financial institutions for investors. On the other hand if it borrows from outside e.g. International Monetary Fund consumers will end up paying taxes to the government. This tarnishes the image of the country and affects other favours that might come from other financial institutions.

**<u>How governments control business activity</u>**

1) Governments can use controls to stop or limit business activities like production of dangerous explosives and drugs
2) Consumer protection through the following acts
    i) Weight Measurements Act
    ii) Consumer protection act
    iii) Sale of Goods Act
    iv) Consumer Credit Act
    v) Trade Discrimination Act
3) Competition policy through control of monopolies
4) Protecting employees
    i) Against unfair dismissal
    ii) Health and safety at work
    iii) Against unfair dismissal
    iv) On wage protection e.g. National Minimum Wage

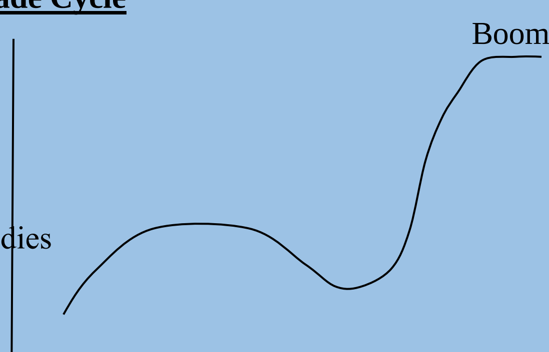
The government might want to achieve a lower rate of inflation in a country for the following reasons:

i) to encourage economic growth
ii) to increase people’s income
iii) to reduce inequality in society
iv) to discourage discontents and unrest caused by unemployment

The above objectives can be achieved through sound economic policies such as:

1. Fiscal policy
2. Monetary policy
3. Supply side policies
4 Trade policy
5 Exchange rate policy

**<u>The Business cycle/ Trade Cycle</u>**



growth

$

GPD Boom recession

Growth Slump

time

The regular savings in economic activity that occur in most economies vary from boom conditions to recessions, when total economic output declines.

1. Boom – a period of very fast economic growth can lead to inflation. As businesses and consumer confidence strengthens demand continues to increase. Business creates jobs, wages are increased to attract employees and investment is further enhanced. This high employment and demand for goods and services leads to inflation.

2. Recession – a period when a country's GDP is falling. Falling demand leads to cuts in output, this fuels unemployment. Most business will be making losses and eventually shut down. There is uncertainty in investments and only goods with price in elastic can survive the heat.

3. Growth/Recovery- demand begins to pick up. This is influenced by a sound government policy especially an expansionary fiscal policy to encourage investment.

4. Slump/down turn- there will be a price/wage spiral leading to lower profitability discouraging continued growth. There is absolutely no growth. Output decreases in response to falling demand. This leads to higher unemployment.

**<u>Undesirable effects which might be brought by business activity:</u>**

- Monopoly- businesses can merge so that they get more profits and leave consumers with less choice
- Pollution- some production methods lead to serious pollution e.g. air and water pollution
- Dangerous products can be made by the industry e.g. fast cars.
- Misleading advertisements- incorrect information can be given to persuade consumers to buy.
- Poor working conditions- due to managers who aim at lower costs

**NB: For all these reasons, the Government controls the businesses decision making.**

**Examination standard Questions**

1. Outline four economic objectives of the Governments [4]
2. Explain the following terms.
   a) Economic growth
   b) Gross Domestic Product
3. Explain why good environmental practices and ethical standards in decision making may be of advantage to a business [4]
4. Explain the 2 problems of a monopoly to consumers [4]

5. How do the government protect
   a) Consumers [4]
   b) Employees [4]
6. Explain two reasons why the central Government will intervene in the location of a business [4]

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# CHAPTER 17

## THE SURVIVAL OF SMALL FIRMS

Chapter objectives:
After studying this chapter the student should be able to:

1) Identify reasons for having small firms in the economy
ii) State advantages and disadvantages of small firms
iii) Explain the survival of small firms against large competitors.
iv) Discuss the forms of assistance available to small firms.
v) Explain why government help small firms.

**Why governments help businesses**

a) To encourage entrepreneurship by assisting small firms to set up and survive.
b) To develop poorer areas of the country.
c) To encourage firms to export, financial grants and subsidies can be used to attract new firms to areas of high unemployment.

**Reasons for having small firms in existence**

1. Demand for variety – for certain goods demand will be high, with customers wanting a wide variety of styles. Firms will need them to change methods of production quickly and easily, hence this can be done more easily if the firm is small.

2. Inability to obtain economies of scale – for the production of certain goods and services there will be little knowledge for obtaining economies of scale and so the firm will remain small.

3. Personal Services – certain services need personal attention, such as hair dressing and plumbing. Because they concentrate on small scale work and

hence remain small businesses as a whole, these tend to be owned by sole traders or partnerships where decisions are made quickly.

4. Luxury items – small firms may be able to fill the gaps in the market left by large firms. For instance, the large firm may be less interested in small production runs of high quality items and may, therefore not compete in providing such products

5. Ambition – owners may have limited ambition and may prefer a small family business so as to keep independent

6. Lack of finance – small firms may be unable to obtain finance in order to expand. A small firm may find it difficult in obtaining a loan as it might be considered a high risk by the bank.

**<u>The survival against large competitors.</u>**

A small firm can survive against large competitors by offering the customers the following:

i) Lower prices – reduce costs of all goods
ii) Customer Services- carry their shopping to their car.
iii) Cash discounts – those who buy over a certain amount can get a discount
iv) Free gifts – to customers who buy more than 3-4 items or more
v) Hire purchase- allow customer to pay a certain amount for a particular good they are interested in and want very much
vi) Credit cards to companies- allow big multinational companies to pay by credit cards.
vii) They do particularly well in industries where specialised labour and personal services are imported e.g. garages
viii) Production of goods and services which are manageable without large investment of capital.
ix) Niche markets.
x) Convenient location.

**<u>Some advantages of small firms</u>**

1) Limited Capital – Small business do not require a large sum of capital. Management is easy because it does not require experts to run the company
2) Self employment – many small firms are owned by sole traders and hence offer a mind for self employment
3) Serves as ancillary industry small firms are considered by large firms who do not manufacture all the components they may use in their products.
4) Flexibility-some small firms can change and adapt to changes with the society
5) Personalised Services – many firms cater for individual taste, they offer highly personalised services. This is one of the resources for survival against large firms.
6) Decreases unemployment as they can locate in rural areas

7) They provide choice and variety to consumers.

**Government encourages small firms to export for the following reasons:-**

1. To get more tax from successful business exporters.
2. To get foreign currency from exports
3. Rate of unemployment reduced as more people are employed to produce more goods and services.

**Problems faced by small firms**

1) Lack sufficient finance – the resources of small firms are merged. Many business opportunities are lost for want of sufficient finance.
2) Lack of technical managerial skills. Small firms fail because of the lack of technical and managerial skills. They are usually unable to find qualified staff because of their inability to pay high salaries and lack of promotional opportunities.
3) Lack of marketing knowledge – marketing is an important function in any business and it is the limiting factor of small firms. They do not have the knowledge of how to sell their products more profitable.
4) Location problem –another serious problem is the location of small firms. Good location with all facilities is not available to them because of the limited finance they have.

**What assistance is available to small firms?**

a) The financial assistance scheme – This is provided by the small industries finance scheme. It provides finance for the starting of an enterprise and its expansion, modernisation and diversification. The important point of this scheme is the low interest rate charged to these small firms.
b) The product development board- this encourages the development of new products hence will facilitate funds towards such.
c) Research and development assistance- these are mainly geared for technical consultation, product design, quality control and industrial research.
d) Subsidies- governments can provide stands at subsidized rates, grants and protection from large firms and internal pressure due to imports that will hinder the sales of similar products if they are cheaper
e) The skill development board- offers financial assistance to employers to train their employees. It offers assistance for the mechanization in the industry.
f) Organize trade fairs abroad to encourage foreign businesses to buy a country's exports.
g) Governments can guarantee for payment in case foreign customer refuse/fails to pay.
h) Governments offer subsidies or tax reduction to exporting businesses.

**Exercise 1**

1. What are the advantages of having small firms in the country [6]

2. State three problems faced by small firms [6]
3. Why governments encourage small firms to export [4]

**Examination Standard Questions**

1. State and explain three ways in which small businesses compete with larger ones [6]
2. Discuss the usefulness of small firms to the economy [10]
3. Give three reasons why Governments often provide assistance to small firms [6]
4. State three examples of assistance that is available to small firms [3]
5. Explain why governments encourage the expansion of small businesses in the economy [4]
6. Give 4 reasons for having small firms in existence [3]
7. State 2 forms of business which can be termed as small businesses and 3 as large firms [5]
8. Explain the following about small firms:
   (a) Customer service
   (b) Free gifts
   (c) Niche, markets
   (d) Hire purchase

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# CHAPTER 18

## FACTORS AFFECTING LOCATION OF BUSINESSES

Chapter objectives:
After studying this chapter the student should be able to:

- To explain why it is important to choose an appropriate site for a business
- To identify factors suitable to increase productivity of a business
- To list the effects on society of business activity
- To explain the need of laws and regulations governing business set-ups.

The government through the local authority can influence where businesses choose to locate. They have designated areas for particular business types.

**Factors affecting the location of different business**

**1. Retailing business**

a) Availability of suitable space
- There should be a vacant shop or premises for the business to locate in the area it wants.
- security

b) **Customer Parking**
- Customers need to park their vehicles nearby the shop. Lack of parking space may put off customers visiting the business. This will lead to low sales.

c) **Access to delivery**
Businesses which offer delivery vehicles, usually gain more customers.

d) **Shops nearby**
Locating nearby shops which are visited regularly like Banks and Post office is an advantage to a retailing firm. Customers will end up visiting the shop whilst they wanted to withdraw their money.

e) **Customers**
- The business should be located near its customers eg. If the goods are small gifts-type products, then locate in an area where tourists visit.

f) **Rent**
Businesses should be careful when choosing the sites. If the retail area is popular and at the central business district, it is usually entitled to high rent and tax.

g) **Access to suppliers**
- It is often cheap to locate a business near suppliers to cut down transport costs

**2.** **<u>Service Sector Business</u>**

a) Near to other businesses

Service businesses like banks need to be near busy areas for the convenience of customers.

- This means that they should be near retail shops that people visit regularly

b) **Availability of labour**

- Service business need to locate near to large cities or towns where employees may be found.
- However, if the business needs skilled labour, the skilled labour will move near to the business for work rather than the other way round.

c) **Technology**

- Some services are now conducted by computers e.g. internet. This indicates that some businesses do not need to be near to customers.

d) Climate- service businesses, like a Hotel, should locate themselves where climate is good in order to serve the need of their customers.

e) **Customers**

Service sector businesses should locate near its customers. Personal services like caterers, gardeners, builders, hairdressers need to be near their customers.

**3.** **<u>Manufacturing Businesses</u>**

a) Government influence the location of businesses and they even sponsor/ fund businesses to locate in certain areas.

- Government can give regulations and restrictions to locate in some areas e.g. because of the wastes produced (nuclear waste)

b) **Personal influence of the owner**

- The owner may have interest to stay in a particular place maybe because of its climate or may be originating from such an area.

c) **Power supply**

- Reliable power supply is important to a manufacturing firm so that no, disruptions will be experienced in the manufacturing process.

d) **Water supply**

- A reliable supply is needed for manufacturing processes. The cost should be reasonable

e) **Components and Raw materials**

It is wise to locate a manufacturing firm near raw materials and components.

- Perishable raw materials should be near where they should be processed
- Bulker raw materials also need to be near where they should be processed e.g. tarctim of minerals and where they should be processed.

f) **Availability of labour**

- For unskilled labour, an area where there is high unemployment is ideal. It is easy and cheaper to recruit locally.

g) **Transport and communication**

Locating near roads, railway or port or airport is ideal for easy transportation. Communication lines like telephone lines should be available for easy communication with suppliers and customers.

**4. <u>Business considering relocation</u>**

a) Government Grants

- Governments can give money to businesses so as to locate in their country so that they bring in foreign currency and create employment.

b) **Rent and taxes**

- Rent and taxes may become expensive, so business may decide to relocate in an area where it is cheap

**c) New markets**

If new markets are attractive, locating where they are, is more ideal so as to cut transport costs.

d) **No room for expansion of present site**

- Businesses may grow and produce more products which might need larger premises. If there is no room for expansion, it might relocate to a lager site

**Exercise**

1. Explain four factors that would affect the location of:
   a) Manufacturing business [4]
   b) Retailing firm [4]
   c) Service sector firm [4]
   d) Business considering relocation [4]

2. Distinguish between services sector business and manufacturing sector business factors affecting the location [4]
3. Identify 3 factors which are suitable to increase productivity of a business [3]
4. Why should some raw materials and components be near the manufacturing firm [4]

The government through the local authority enforces controls on location for the following reasons:

1. It is responsible to the natural environment to avoid the degradation of flora and fauna i.e. try to stop the destruction of area of natural beauty and the

habitat for wildlife. If this is not done eventually some animals would become extinct.

2. Prevention of pollution through noise and dust. Industries are normally located in one locality depending on the waste that they emit e.g. Firms producing cement are far away from the residential areas. Chemical industries also have their site away from rivers to avoid dumping poisonous chemicals into the rivers. To combat dumping into the rivers the governments imposes fines on those firms that violet or exceed the excess waste from what is considered as normal. Such fines are exorbitant and act as deterrents to such firms.

   The pollution of the environment will result in social costs to the residents.

   Business activities are harmful to the local residents if they cause pollution and degradation of the environment. However, it is not true that business activities are always harmful for the following resources.

1) There is provision for employment
2) Production of goods and services required by the residents
3) Improvement of infrastructure i.e. building of dams, construction of roads, improved communication networks
4) Social benefits to the community through donations.
5) Improved crime rate through provision of employment and improved social amenities

**<u>Effects on society of business activity not controlled</u>**

1. Dangerous products would be produced and sold
2. Firms could damage the environment
3. During production there could be no controls to prevent this
4. Monopolies could be created leading to high prices; workers might be exploited by being paid very low wages and salaries.

**<u>Ways government can control business activities that damage the environment</u>**

1. Preventive laws
2 Financial penalties
3. High taxes on pollution activity
4. Negative press

**Social cost could include the following**

1. Loss of farming land
2. Destruction of wild life habitat
3. Increased pollution

**<u>Social cost,</u>**

is the addition of the private and external costs of a business decision

- Private cost is the cost of the business decision actually paid for by the business e.g. firm expenses

- External costs are the costs paid by the rest of the community, other than business as a result of business decision e.g. pollution, smoke, relocation
- External benefits are the gains to the rest of the society, other than the business, resulting from a business decision e.g. important product to the community, job creation etc.
- Private benefits are financial gains made by a firm as a result of business decision.

**Examination standard questions**

1. Explain 2 ways government can control business activities. [4]
2. Why do you think Government often intervenes in business' location decisions? [6]
3. Outline the social costs and social benefits of building and operating a new airport. [4]
4. Identity 2 external costs and 2 external benefits of a business to society.
5. State two examples of pollution produced by a business. [2]
6. Explain the benefits of a business activity to the country. [6]

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# CHAPTER 19

## INTERNATIONAL ENVIRONMENT

Chapter objectives:
After studying this chapter the student should be able to:

- To explain ways in which businesses are affected by the international environment.
- To explain why governments encourage exports.
- To discuss the need for globalization and its impact on international markets.
- To explain the need for foreign currency within an economy.

Business is affected by the international environment in the following ways:

1. The international environmental provides export opportunities
2. Globalisation is fast spreading worldwide
3. Foreign producers pose a threat in the home market
4. Local firms are affected by the price of imported materials and components
5. The world economy impact upon local economy

**Export Opportunities**

It is desirable for countries to specialize in goods and services that they produce cheaper and more easily than other countries, thus enabling them to provide these to the international market comparatively cheaper or better. The degree of the impact on exporting firms will depend on the

1) extent to which the foreign market be open to imports or closed by various import controls.
2) Competitiveness of local firms
   Competitiveness is determined by the relative performance of the local firms and market in terms of:

1) Quality
2) Cost of materials
3) Cost of transport
4) Cost of energy
5) Reliability
6) Exchange rate
7) Cost of labour

**Threat to local market**

1) Local firms are unable to compete with imported goods, they will suffer and may eventually be forced to shut down. For this reason governments may impose import controls in order to protect the local firms. Barriers to trade can take the form of:
2) Tariffs – taxes on imported goods, making them more expensive
3) Quotas – planning a limit on the quantity of imports

4) Technical barriers – local product safety laws
5) Financial subsidies to home products-governments subsidies home products to compete against foreign rivals
6) Exchange controls – controlling excess of forex, making it difficult to pay for imports.
7) Embargo refers to a complete ban of a product.

**Reasons why governments encourage exports**

1) to increase economic growth
2) to lower unemployment
3) for stronger exchange rate
4) they improve the balance of payment

Encouraging exports is a way of generating a stronger exchange rate, the more export sales business in a country achieves, the higher the demand would be from abroad to buy that country's currency, and this would lead to an increase in the value of the local currency. A stronger exchange rate would make import less expensive and reduce inflation pressure.

**Factors to consider when declining to export**

1) Foreign competition
2) Size of overseas market
3) Quality standards abroad
4) Transport costs
5) Projected profits
6) Barriers to trade
7) Currency fluctuations
8) Risk of non payment
9) Government policies

The manager of a business needs to consider the size of the market to assess how profitable the export market will be to see if it is worthwhile exporting. The manager will have to assess whether the production department can cope with the additional output or different specifications of the products for the export market and assess if the raw materials will need to be purchased to manufacture goods for resale. The expenses have to be assessed.

**Monetary policy**

This refers to government policy based on controlling the amount of money in an economy

**Interest rates-** these are set by the Reserve Bank of Zimbabwe and they have a major influence on investment, growth and the economy in general.

The impact of a role in interest rate on

**a) the economy as a whole**

i) increases the cost of borrowing money
ii) decreases the level of investments

iii) decreases the discretionary income
iv) decreases consumer spending
v) decrease capital spending
vi) increases unemployment
vii) general downtone in the economy

**b) On a particular business**
i) decreases the volume of sales
ii) increases the cost of borrowing
iii) decreases the firm's investments plans
v) increase cost of working capital
vii) creates cash flow problems
viii) creates redundancies
(ix) it is more difficult to raise capital

**Balance of payments and exchange rates.**

A Balance of payment is the record of the movement of payment between countries i.e. balancing the payment out of the country and the receipts into the country. Governments have to ensure that the payments out are more than the receipts into the country otherwise there will be a balance of payment deficit i.e. a shortage of foreign currency and an increase of foreign loans.
A balance of payment deficit can be tackled through
a) Deflation – reducing the level of demand for imported goods and services
b) Devaluation of a country's currency decreasing the value of the currency.

**Exchange rates**

These are the rates at which a country's currency can be exchanged for another country's currency. This will determine price of the country's exports to another and the price of imports into the country. Changes in exchange rates will therefore have a big impact on the economy and to the businesses.

The impact of exchange rate charges:
**a) devaluation**
i) exports become cheaper
ii) imports become more expensive
iii) Balance of payment will improve if quantity changes sufficiently
iv) this harms firms that rely on imports and a boost to exports will provide stimulus to the economy
v) inflation consequences of dealer imports

**b) Appreciation**
i) Exports become more expensive
ii) Imports become cheaper
iii) Balance of payments will worsen quantities changes sufficiently
iv) Harms exporters and helps firms that rely on imports
v) Reduction in exports will depress the economy

vi) Deflationary consequences of cheaper imports

**Inflation**

It is when prices rise, and interest rates are the cost of borrowing money. Higher interest rates will affect a business in several ways

i) It will cost the business more to borrow
ii) This could mean that it decides not to expand
iii) Customers may not buy goods and services as they are now expensive
But if foodstuffs are sold, the business might not be affected as consumers will need to buy no matter how high interest rates are.

**Disadvantages to a country's economy arising from rapid inflation**

1) Balance of payments problems or depreciation of country's currency
2) Industrial conflicts as workers may press for wage increases to keep up with inflation
3) Job losses in industries whose cheaper products from aboard may be substituted
4) Reluctance of businesses to expand because of uncertainty about the future

**Business in the international community**

- Multinational Business
- Introduction
- Businesses cannot operate without affecting other businesses. The international environment can both control and help managers in running their businesses, so the international community has an impact on the success of one business.

**Exercise 1**

1. Describe how businesses are affected by the international environment [6]
2. Explain the following barriers to trade:-
   a) Tariffs [2]
   b) Quotas [2]
   c) Technical barriers [2]
3. Explain why governments encourage exports [4]
4. Explain the following terms
   a) Balance of payments
   b) Exchange rates

**Globalisation**

- Is the increased worldwide competition between businesses
- Some goods and services can be found in many countries now throughout the world.

**Advantages of globalisation**

a) It has provided a window to new technological advancement
b) Easy access to product information, potential competitors, their strength and weaknesses
c) It provides a wider market

d) It increases sales
e) Provides quality goods and services

**Weaknesses of globalisation**

a) There is distortion of culture
b) There is increased competition
c) It can destroy privacy
d) Some goods may be dumped into another country
e) There is also increased need for capital expenditure

**Multinational Businesses**

- Are businesses which operate in more than one countries e.g. Dunlop, BP,

**Reasons for becoming multinational business**

- To spread risks
- To avoid barriers to trade put up by countries to reduce the imports of goods
- To produce goods in countries with low costs e.g. low labour rate.
- To extract cheap raw materials.

**Advantages of Multinationals**

- New markets are obtained.
- Trade barriers are avoided.
- Labour costs are reduced.
- Spread of risks.
- Jobs are created.
- Taxes are paid to the government.
- There is more competition and more exports.

**Disadvantages**

- They use scarce resources of the country.
- Small existing firms are in danger.
- They often employ unskilled labour-(cheap labour) (exploitation).
- Profits are repatriated to home country.

**Exercise**

1. What is globalisation? [2]
2. What are the effects of globalization? [4]
3. Giving 2 examples, explain multinational Businesses. [4]
4. What are the reasons for becoming multinationals? [4]

**Examination standard Questions**

1. Evaluate the effects of Globalization on business activities [8]
2. Explain giving examples, three advantages you would expect a multinational firm to enjoy as a result of establishing a branch in your country [6]

3. What are the dangers of multinational firms to a developing country [6]

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